wiiw

Forecast Report

SPRING 2021

Darkest Before the Dawn?

Economic Analysis and Outlook for Central, East and Southeast Europe

The Vienna Institute for International Economic Studies
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Darkest Before the Dawn?

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This report is dedicated to the memory of Peter Havlik who died in 2020. Peter was a former wiiw Deputy Director and a much missed colleague. He was the driving force behind the Forecast Report for many years, and an important mentor and tutor to many at wiiw. Peter always reminded us that economics is a social science, that there are rarely easy answers, and that we should strive to understand the full context of the economies we are analysing, including learning from other disciplines. We hope to continue to apply what he taught us and to honour his legacy.

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Executive summary

For the second year in a row, wiiw is publishing its Spring Forecast Report at a time of almost unprecedented global economic uncertainty. Governments around the world are racing to roll out vaccines to get ahead of new, more aggressive mutations of COVID-19. At the time of writing, there is significant divergence in terms of both public health and economic performance. China, the US and some other Western countries are performing well on public health, and are therefore seeing strong economic recovery. However, much of the developing world – including large parts of CESEE – are being buffeted by new mutations, with grave repercussions for economic activity. The euro area, and indeed most of Western Europe, is also currently coming under severe pressure.

In terms of timing and severity, our best guess is that – at least for the major global economies and the developed world generally – the worst is now over, even if a full return to normality will not occur this year. Acquired immunity and vaccines will bring the number of deaths down to a level that societies can tolerate. A ramping-up of vaccination efforts, plus better weather in the northern hemisphere, will allow a substantial easing of restrictions by late spring. In the developed world, a majority of the adult population may well have been vaccinated by the end of the summer. The euro area – CESEE's most important market and the source of foreign demand, tourists, remittances and investment – will recover, but will not boom. It will underperform the US significantly this year. Interest rates in the euro area will remain low, but those countries reliant on dollar funding will face higher borrowing costs. This policy divergence will weaken the euro against the dollar, increasing imported inflation in the euro area and those economies of CESEE that are linked to the single currency.

In economic terms, CESEE performed much better than Western Europe in 2020. On a weighted average basis, CESEE economies contracted by 2.3% last year. This was a milder downturn than the global economy (-3.4%, according to the OECD), and substantially better than the euro area (-6.8%). A large part of this strong performance was due to public health factors, with CESEE countries generally managing the first wave of the pandemic better than Western Europe.

One of the key drivers of differences between CESEE countries has been fiscal policy, reflecting both varying amounts of policy space and also different levels of willingness and capacity to use that space. Every country in CESEE in 2020 ran a fiscal deficit way above its average since 2004 – and for most countries, also considerably greater than in 2009, immediately following the global financial crisis. This reflected a response to the scale and type of emergency, but also a move away from the austerity that characterised the response to the last crisis. The size of the state may have permanently increased in CESEE as a result.

For CESEE as a whole, monetary policy has been less important as a strong crisis-fighting mechanism, given that many countries went into 2020 with low or negative real policy rates. Only in the CIS, Ukraine and Turkey (where the move has now largely been reversed) has there been substantial policy loosening. However, this does not mean that central banks in EU-CEE and the Western Balkans have not responded: rather, they have followed Western central banks in resorting to other monetary tools to stimulate the economy, such as quantitative easing.

Headline labour market data suggest a surprisingly limited impact from the pandemic so far, but the figures almost certainly do not tell the whole story. Many people who lost their jobs because of the pandemic have become inactive, rather than officially unemployed. Meanwhile, those in receipt of government support will rarely be getting their normal salaries, while those in the grey economy have certainly been badly affected. Cross-border seasonal workers from countries such as Ukraine have also been hit by the crisis. In many countries, the burden of the crisis seems to have fallen disproportionately on older workers. It may be the case that younger workers will not suffer as much as after 2008, given their better IT skills and the boost to the digital economy generated by the pandemic.

CESEE countries went into the current crisis with smaller external imbalances and longer maturities on foreign debt than in 2008. External liquidity has also remained plentiful, allowing foreign debt to be refinanced at historically low interest rates. The main exception to this fairly benign picture is Turkey, due to its combination of a large current account deficit, high inflation, lack of policy credibility and low foreign exchange reserves. Two parts of the external accounts that have taken a much more visible hit are tourism and foreign direct investment (FDI). Tourism was engulfed by a perfect storm in 2020, which combined heavy restrictions during most months of the year with heightened uncertainty and fear among many prospective tourists about travelling long distances. Meanwhile, announced greenfield FDI projects fell precipitously across CESEE last year, reflecting a sharp decline in investor sentiment owing to the pandemic.

Currently, CESEE is in the grip of a savage wave of the virus, which has pushed health systems to breaking point and necessitated a series of economically damaging new lockdowns. The region's strong public health performance during the pandemic's first wave has not been repeated in the second, with public health effectively sacrificed in an effort to keep the economy going. As of mid-March 2021, CESEE countries occupied most of the top places in the *Economist*'s global excess deaths tracker. It could take years for parts of the region to get back to truly 'normal' life, and during that time the economic, social and public health costs are likely to be considerable. Escaping the latest tight set of lockdowns will require an increase in the pace of vaccination, but this is proceeding at very different speeds across CESEE. While some countries can hope to reach herd immunity this year, others would appear to have no chance.

Our core scenario is that the region's economies will emerge gradually from the current wave during the spring. Those countries currently suffering badly will turn the tide via harsh lockdowns, and will gradually reopen as vaccination rates improve. A combination of vaccines and some limited restrictions will keep the health impact at a level that allows for solid economic growth during the rest of the year.

In 2021, CESEE overall is unlikely to continue to outperform the euro area. This reflects a combination of a higher base period (due to CESEE's relatively good performance last year) and the currently high rate of infections in the region, which has necessitated economically damaging lockdowns for many.

Across CESEE in 2021 and beyond, growth will be driven by a combination of exports of goods and services as the global economy recovers, the drawing-down of savings, better domestic sentiment as vaccination rates improve, and more (albeit less than last year) fiscal and monetary support. Private consumption will return as the main driver of growth almost everywhere in 2021 and across the forecast period; but in EU-CEE investment will also make a big contribution on the back of rising inflows of EU funds. Once the latest lockdowns are eased and sentiment picks up, consumer spending could rise sharply. In those countries for which comparable data are available, household

savings rates have increased substantially, and it would seem reasonable to expect at least a partial drawdown of these savings in H2.

Although the outlook for the summer tourist season is highly uncertain, our best guess is that it will be better than last year. Even though arrivals from abroad are likely to be well below pre-pandemic levels, the improvement on 2020 will generate considerable growth. By the time the core summer tourism months arrive, vaccination rates will be considerably higher than is currently the case; and like last year, the number of COVID-19 cases should decline with the warmer weather. There are still hopes that policy makers will do even more to help drive tourism flows around Europe over the summer.

The extent to which central banks are able to continue to engage in monetary stimulus will depend on inflation; there are signs that this will rise somewhat this year, but will remain low by historical standards. The recent sharp increase in global commodity prices is a particular issue for CESEE, given that in the region a larger share of the consumer price basket is weighted towards those items than is the case in Western Europe. However, demand-pull pressure on prices is currently extremely weak, and will not re-emerge strongly during the forecast period in our baseline scenario. Without more aggregate demand, firms will struggle to pass on higher input costs to consumers.

Rising US long-term interest rates will push up borrowing costs for those countries weighted towards dollar funding, which could cause external financing difficulties over the forecast period. However, most CESEE economies are in a better position to deal with any repeat of 2013's 'taper tantrum', when a more hawkish-sounding Fed caused a huge outflow of funds from emerging markets. Some countries, including Belarus, Ukraine, Albania and notably Turkey, would likely go into any new tightening of external financing conditions with substantially smaller current account deficits than in 2013. However, Montenegro, Moldova and Romania, in particular, have headline external balances that leave them more exposed to changing foreign investor sentiment than was the case in 2013.

Monetary and fiscal stimuli, supported by robust cross-border banking claims, provided sufficient liquidity in the CESEE region in 2020. However, in most countries this has not translated into strong credit growth. Much of the liquidity has been going into housing market, as signalled by a sharp rise in residential property prices. Risks of a correction in CESEE housing markets are mounting.

Once the acute phase of the crisis passes, attention will quickly turn to the other challenges and opportunities faced by the region – both those that already existed, and some that are new and result from the pandemic. Most of CESEE remains in the grip of the most serious negative demographic decline – excluding wars and famines – ever recorded. The dual shocks of automation and digitalisation, both of which are likely to be accelerated by the pandemic, create challenges, but also significant opportunities for a region that was struggling with a shortage of workers before the pandemic. There are reasons to think that over the medium term CESEE may gain from some 'near-shoring', as Western European firms move outsourced production closer to home. The independence of institutions was under strain long before the pandemic hit, but the unique challenges it has created have thrown up opportunities for unscrupulous leaders to further cement their influence in many parts of the region. Geopolitically, the region is facing a new era without the steadying hand of Angela Merkel in Germany, while the two most important divisions – the US versus China at the global level, and the EU versus Russia more locally – leave many CESEE countries caught in between, with negative implications for political stability and economic development.

COUNTRY SUMMARIES

ALBANIA

Recovery will be slower than expected, as the pandemic is still weighing on economic activity. Domestic demand will support growth, but still at below pre-pandemic levels. External demand has improved somewhat, but will remain weak, as demand in the services and tourism sectors depends heavily on immunisation not only at home, but also in the EU countries. We expect the economy to grow by 4.5% over the medium term.

BELARUS

Although Belarus experienced only a mild recession in 2020, the country is going through a period of political and economic turmoil. The disputed presidential election triggered mass protests and isolation from the international financial markets. Russia remains the only source of external funding; however, new lending may be conditional on tough political concessions. Given the growing financial constraints and the deep-seated structural problems, the economic outlook is rather bleak.

BOSNIA AND HERZEGOVINA

The COVID-19 pandemic caused the worst recession in Bosnia and Herzegovina since the Bosnian war, with an estimated GDP decline in 2020 of 5%. With the third wave of the pandemic, vaccine delays and the introduction of new restrictions, economic recovery will be delayed. Additional obstacles to growth include an inefficient fiscal structure and political disputes, which are preventing structural reform of the country and delaying its progress towards EU and NATO integration.

BULGARIA

After a year of protests and social turmoil, Bulgaria is entering a new electoral cycle with uncertain outcomes. The negative macroeconomic impact of the pandemic in 2020 was moderate. The shocks were partly mitigated by the policy support measures launched by the authorities. The post-COVID recovery is also expected to be moderate, with GDP growth of 2.5% in 2021 and slightly higher in the following two years.

CROATIA

After 2015, Croatia witnessed an economic recovery; however, the COVID-19 pandemic stopped it in its tracks. GDP contracted by 8.4% in 2020, due largely to the pandemic's devastating impact on the tourism sector, but also because the country was rocked by two earthquakes in March and December. EU aid will likely mitigate the earthquakes' adverse effects on Croatia's economic recovery, which is why we expect solid growth of 4.5% in 2021.

CZECHIA

GDP fell by 5.6% in 2020, a smaller decline than had been expected. Although the intensity of the recession was still evident in the fourth quarter of 2020, manufacturing is recovering. A moderate decline in employment is still under way. Czechia's economic fundamentals remain strong: the level of public debt is low, foreign-exchange reserves are very high and the trade balance is in surplus. Positive growth will return in 2021, although the rebound will not be particularly strong.

ESTONIA

The rebound in economic activity in the second half of 2020 suggested that the Estonian economy would bounce back once the virus was contained and restrictions were removed. However, an upswing of infections at the beginning of 2021 has turned out much worse than expected and is jeopardising economic recovery. We have downgraded our GDP growth forecast to 1.2% in 2021. The economy is expected to return to its pre-crisis path only in 2022, with a 3.8% growth rate, followed by 4.3% in 2023.

HUNGARY

Hungary's GDP dropped by 5% in 2020, due mostly to declining net exports, but also, to a smaller extent, to shrinking investment and household consumption. The key issues for a recovery are the early revitalisation of international value chains in the automotive industry, resilience of the small and medium-sized enterprise (SME) sector and restoration of the pre-crisis spending propensity of households. The political stakes are high in the wake of the government's growing confrontation with the EU and the approaching elections, scheduled for early 2022.

KAZAKHSTAN

After a relatively moderate real GDP decline of 2.6% in 2020 (thanks to a large anti-crisis fiscal package), economic recovery of 3.2% is expected for 2021. Although the high price of oil could suggest a more robust economic revival, the remaining pandemic-related restrictions on economic activity and the slow vaccination rate will impede a full recovery in consumption this year. Economic growth is likely to accelerate to above 4% in 2022-2023, driven by consumption, exports and investment.

KOSOVO

The economy contracted by 5% in 2020, but growth will return to 4.5% in the medium term, supported by domestic and external demand. However, the downside risks remain high, with the current pandemic still raging and vaccines far off on the horizon. The triumphant return of a Kurti government ('Kurti 2') represents a new opportunity for Kosovo to gain political stability. In March 2021, the European Parliament reaffirmed its call to the EU council to adopt visa liberalisation for Kosovo.

LATVIA

With GDP declining by 3.6% the Latvian economy has experienced a milder recession than expected; however, the subsequent revival of 2021 will be restrained. Last year household consumption slumped by more than 10%, while capital investments remained afloat. For this year we see a continuation of the revival in household consumption, but also external demand. Similarly, gross fixed capital investment will gain momentum, also boosted by public expenditures. In 2021 we expect GDP to increase by 2.8%; this will be followed by strong growth of 4.2% in 2022 and a somewhat slower upswing of 3.8% in 2023.

LITHUANIA

The Lithuanian economy experienced a short-lived recession in the second quarter of 2020, recovering quickly and experiencing just a small GDP decline of 0.8% for the full year 2020. Better-than-expected export performance and swiftly rebounding household consumption were coupled with a slump in imports. In 2021 the ongoing restrictions due to the second and third wave of infections will keep the economic revival subdued. The government continues to deliver substantial fiscal stimulus, and the announced public investments will support recovery over the next two years. For 2021 we expect real GDP to grow by 2.1%, followed by a faster upswing of 3.8% in 2022 and 3.1% in 2023.

MOLDOVA

The 7% drop in GDP in 2020 was mainly the result of contracting household demand and an extremely bad harvest. Official employment and unemployment both declined, as people were forced into irregular work. Economic growth will resume in 2021 (+4%), but slow progress in vaccination will delay a full recovery to the pre-crisis level. Surprisingly low inflation will not be sustainable once the economy starts growing.

MONTENEGRO

Montenegro suffered comfortable CESEE's deepest contraction in economic activity in 2020, with GDP shrinking by 15.2% on the back of a steep decline in tourism revenue and the country's limited fiscal cushion. In 2021, we expect economic recovery to be somewhat inhibited, with the government's COVID-19 restrictions from 2020 radiating well into 2021. We still expect GDP to grow by 6.5%, boosted by tourism and remittances.

NORTH MACEDONIA

After a large initial decline, North Macedonia's economy improved in the second half of 2020, ending the year with a minus of 4.5%. The improvement came as a result of government fiscal support. 2021 will be a year when the damage created by the pandemic will be slowly repaired, with real GDP growing by 4.1%. The pre-crisis level of activity will be reached at the beginning of 2022, and then, when ground zero is reached after two lost years, old structural challenges will come to the fore.

POLAND

The decline in GDP in 2020 turned out to be quite shallow. Trade made a positive contribution to growth, and industry is recovering. Inadequate demand remains the chief problem for the corporate sector, while shortages of labour have ceased to be a serious problem. During the forecast period, expansive monetary and fiscal policies are likely to continue, but the recovery in investment will be muted at best. Improvements in 2021 and beyond are possible, but not guaranteed.

ROMANIA

The Romanian economy weathered the 2020 COVID-19 storm better than many others in the EU. Restrictions were less severe than elsewhere during the winter, and so the full-year contraction of GDP remained below 4%. The recovery in 2021 will not be fast (+3.8%), owing to protracted lockdowns and austerity measures in the government budget. Huge inflows of EU funds could boost investment in the coming years.

RUSSIA

Few restrictions in response to the second wave of the pandemic have resulted in a sharp rise in infections and deaths, but have also mitigated the extent of economic downturn. GDP declined by only 3.1% last year, of which 1 pp was due to oil production cuts. In the baseline scenario, we project a recovery of 3.2% this year, while growth should gradually revert to the long-term average of around 2% in the years thereafter.

SERBIA

Serbia finished 2020 as one of the best-performing European economies, and started 2021 in a similar manner. Real GDP fell by just 1% in 2020, fuelled by strong public spending. Thanks to an excellent vaccine roll-out and growth in high-frequency indicators, we project 5% growth for 2021. The main risks lie with the ongoing pandemic wave, which might stall the economy for a while, and the announced fiscal consolidation, which could hamper growth if undertaken too soon.

SLOVAKIA

Slovakia's GDP dropped by 5.2% in 2020. This year the economy is expected to recover by 3.6%; in the following years the inflow of EU funds should foster gross fixed capital formation. However, the pandemic plus internal and external uncertainties pose several downside risks.

SLOVENIA

The economy remained robust during the strong second wave of the pandemic, which got under way in October. Exports, manufacturing and construction covered the losses in services and retail incurred by a prolonged lockdown. Government support measures continue to shield domestic firms and the labour market from shocks. In 2021 the ongoing pandemic will dampen the recovery and restrict the projected growth rate to 3.6%, underpinned by a strong current-account surplus and European recovery funds.

TURKEY

Uniquely in CESEE, the Turkish economy posted positive full-year economic growth in 2020, reflecting credit expansion in response to the pandemic. A period of higher nominal interest rates stabilised the lira, but is likely now at an end thanks to yet another change at the top of the central bank. Growth will be strong this year but slow by 2022, either due to high real interest rates to get inflation under control, or a lira collapse and balance of payments crisis.

UKRAINE

Ukraine's GDP contracted in 2020 by only 4%, largely because of favourable conditions in key export markets and resilient household incomes. In 2021 the economy will return to growth, supported by a rebound in private consumption and a revival in investment. Negative risks to the forecast have been growing, due to the suspension of the IMF loan programme and a slow vaccine roll-out.

Keywords: CESEE, economic forecast, Central and Eastern Europe, Southeast Europe, Western Balkans, EU, euro area, CIS, China, Japan, US, convergence, business cycle, coronavirus, Next Generation EU funds, private consumption, credit, investment, digitalisation, exports, FDI, labour markets, unemployment, short-time work schemes, exchange rates, monetary policy, fiscal policy

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

CONTENTS

Executive summary I

1. Global overview: Divergence, with Europe lagging behind 1

1.1. Public health backdrop: How do pandemics end? 1
1.2. US/Euro area divergence: growth and fiscal policy 3
1.3. US/Euro area divergence: Monetary policy 5
1.4. Should we be worried about inflation? 5
1.5. Main takeaways for CESEE 6
1.6. References 7

2. CESEE Overview: Darkest before the dawn? 8

2.1. CESEE has sacrificed public health to keep the economy going over the winter 8
2.2. GDP growth: Spluttering into life 13
2.3. Policy response: More options than after 2008 22
2.4. Labour markets: Hard to gauge the true impact 29
2.5. External accounts: So far (mostly) so good 30
2.6. Financial sector: Abundant liquidity, but limited investment options 34
2.7. Conclusions: After the pandemic 38
2.8. References 38

3. Convergence monitor 39

4. Country reports 41

Albania: Moderate recovery and mass vaccination against COVID-19 started 42
Belarus: Trapped in a shaky economic situation 47
Bosnia and Herzegovina: Vaccine delays and limited fiscal capacity slow down the recovery 52
Bulgaria: Moderate post-COVID recovery 56
Croatia: EU funds will support recovery 60
Czechia: Light at the end of the tunnel? 64
Estonia: The second wave has put the brakes on economic recovery 68
Hungary: Recovery with strong downside risks 73
Kazakhstan: Rapid recovery in doubt 77
Kosovo: Major future challenges and high expectations of new government 82
Latvia: Trying to overcome the economic spillover effects of the pandemic 86
Lithuania: Recession prevented, revival delayed 90
Moldova: Cumbersome recovery from deep recession 94
Montenegro: Tourism to drive recovery in 2021 98
North Macedonia: Healing COVID-19 Wounds 102
Poland: Not bad, in these circumstances 106
Romania: Modest slowdown, moderate recovery 110

Russia: Recession contained at the expense of health outcomes 114
Serbia: Setting an example for the region 119
Slovakia: Uncertainties prevail 123
Slovenia: Economic resilience in light of a disastrous second wave 127
Turkey: Back to boom and bust 131
Ukraine: Good luck can get you only so far 136

TABLES AND FIGURES

Table 1.1 / wiiw spring 2021 global assumptions 7
Table 2.1 / OVERVIEW 2019-2020 AND OUTLOOK 2021-2023....16
Table 2.2 / Real GDP growth forecasts and revisions....18
Table 3.1 / CESEE GDP per capita and gross wages per employee at PPS, 2020....40
Table 3.2 / CESEE GDP per capita and gross wages per employee at EUR, 2020 40
Table 4.1 / Albania: Selected economic indicators....46
Table 4.2 / Belarus: Selected economic indicators....51
Table 4.3 / Bosnia and Herzegovina: Selected economic indicators....55
Table 4.4 / Bulgaria: Selected economic indicators....59
Table 4.5 / Croatia: Selected economic indicators 63
Table 4.6 / Czechia: Selected economic indicators....67
Table 4.7 / Estonia: Selected economic indicators....72
Table 4.8 / Hungary: Selected economic indicators 76
Table 4.9 / Kazakhstan: Selected economic indicators 81
Table 4.10 / Kosovo: Selected economic indicators....85
Table 4.11 / Latvia: Selected economic indicators 89
Table 4.12 / Lithuania: Selected economic indicators 93
Table 4.13 / Moldova: Selected economic indicators 97
Table 4.14 / Montenegro: Selected economic indicators....101
Table 4.15 / North Macedonia: Selected economic indicators....105
Table 4.16 / Poland: Selected economic indicators....109
Table 4.17 / Romania: Selected economic indicators....113
Table 4.18 / Russia: Selected economic indicators....118
Table 4.19 / Serbia: Selected economic indicators....122
Table 4.20 / Slovakia: Selected economic indicators 126
Table 4.21 / Slovenia: Selected economic indicators....130
Table 4.22 / Turkey: Selected economic indicators....135
Table 4.23 / Ukraine: Selected economic indicators....139

Figure 1.1 / Survey of scientists on the future of SARS-CoV-2, % 1
Figure 1.2 / When will Germany report that 75m cumulative vaccine doses for COVID-19 have been given? 2
Figure 1.3 / Global Economic Policy Uncertainty Index....4
Figure 1.4 / Net saving rates of households and non-profit institutions serving households, %....4
Figure 1.5 / International Monetary Fund commodity price indices, 2016 = 100 6
Figure 2.1 / Workplace mobility versus baseline: 15 March - 15 May 2020 (left) and November 2020 - February 2021 (right), %....9
Figure 2.2 / Stringency index: 15 March – 15 May 2020 (left) and November 2020 - February 2021 (right) 9
Figure 2.3 / Deaths related to COVID-19 per 1m population, as of September 2020 (left) and March 2021 (right) 10
Figure 2.4 / Increase in total number of deaths in 2020 compared with 2015-2019 average, %....10
Figure 2.5 / Excess deaths from COVID-19 per 100,000 people, as of mid-March 2021....11

Figure 2.6 / Stringency index ... 11
Figure 2.7 / Years until 75% of population are vaccinated, based on current vaccination rates ... 12
Figure 2.8 / Relationship between real GDP performance and fiscal policy in 2020 ... 15
Figure 2.9 / GDP growth forecast for 2021-2023 ... 20
Figure 2.10 / Net saving rates of households and non-profit institutions serving households ... 21
Figure 2.11 / Budget balance, % of GDP ... 22
Figure 2.12 / Budget deficit ratio, % ... 23
Figure 2.13 / Effective interest rate on public debt, % ... 23
Figure 2.14 / General government expenditure as a percentage of GDP – 2020 versus long-term average and 2019, p.p. ... 24
Figure 2.15 / Estimated allocations under the NGEU programme, % of GNI ... 24
Figure 2.16 / Real policy rates, consumer price index adjusted, % ... 26
Figure 2.17 / Consumer price inflation sub-components, percentage change year on year ... 27
Figure 2.18 / Central bank nominal policy rates, end of year, % ... 28
Figure 2.19 / Real exchange rates against the euro, percentage change since December 2019 ... 29
Figure 2.20 / Change in LFS unemployment rate, p.p., Q3 2019 - Q3 2020 ... 29
Figure 2.21 / Employment, percentage change year on year ... 30
Figure 2.22 / Current account, % of GDP; 2007 versus 2019 ... 31
Figure 2.23 / Short-term gross external debt, % of total ... 31
Figure 2.24 / Current account, % of GDP; 2013 versus forecast period ... 32
Figure 2.25 / Travel services, credit (BOP), percentage change year on year, euro based ... 33
Figure 2.26 / Announced greenfield FDI projects, percentage change year on year ... 33
Figure 2.27 / Indices of cross-border consolidated bank claims on an ultimate risk basis by counterparty, nominal euro terms, Q3 2019=100 ... 34
Figure 2.28 / Real interest rate, CPI adjusted, % ... 35
Figure 2.29 / Credit growth among companies and households, % ... 36
Figure 2.30 / Index of real residential property prices, Q1 2017=100 ... 37
Figure 3.1 / GDP per capita at PPS convergence against Germany ... 39
Figure 4.1 / Albania: Main macroeconomic indicators ... 42
Figure 4.2 / Belarus: Main macroeconomic indicators ... 47
Figure 4.3 / Bosnia and Herzegovina: Main macroeconomic indicators ... 52
Figure 4.4 / Bulgaria: Main macroeconomic indicators ... 56
Figure 4.5 / Croatia: Main macroeconomic indicators ... 60
Figure 4.6 / Czechia: Main macroeconomic indicators ... 64
Figure 4.7 / Estonia: Main macroeconomic indicators ... 68
Figure 4.8 / Hungary: Main macroeconomic indicators ... 73
Figure 4.9 / Kazakhstan: Main macroeconomic indicators ... 77
Figure 4.10 / Kosovo: Main macroeconomic indicators ... 82
Figure 4.11 / Latvia: Main macroeconomic indicators ... 86
Figure 4.12 / Lithuania: Main macroeconomic indicators ... 90
Figure 4.13 / Moldova: Main macroeconomic indicators ... 94
Figure 4.14 / Montenegro: Main macroeconomic indicators ... 98
Figure 4.15 / North Macedonia: Main macroeconomic indicators ... 102
Figure 4.16 / Poland: Main macroeconomic indicators ... 106
Figure 4.17 / Romania: Main macroeconomic indicators ... 110
Figure 4.18 / Russia: Main macroeconomic indicators ... 114

Figure 4.19 / Serbia: Main macroeconomic indicators....119
Figure 4.20 / Slovakia: Main macroeconomic indicators....123
Figure 4.21 / Slovenia: Main macroeconomic indicators....127
Figure 4.22 / Turkey: Main macroeconomic indicators....131
Figure 4.23 / Ukraine: Main macroeconomic indicators....136

Box 2.1 / Business Cycle Index: Mostly not as bad as in 2009....13
Box 2.2 / The crisis in context for CESEE....19

Box Table 2.1 / wiiw Business Cycle Index, Q4 2020, full breakdown....14

Box Figure 2.1 / wiiw Business Cycle Index, Q4 2020, headline data....13
Box Figure 2.2 / Real GDP growth, percentage change per year....19
Box Figure 2.3 / Real GDP growth, %....19

Cut-off date for historical data and forecasts: 25 March 2021. Most data are taken from the wiiw Databases. Direct access is available at: http://data.wiiw.ac.at/.

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		

ABBREVIATIONS

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

BIS	Bank for International Settlements
BLS	Bank Lending Survey
BOP	balance of payments
CA	current account
CB	central bank
CE	Central Europe
CIS	Commonwealth of Independent States
CN	China
CPI	consumer price index
EA	euro area 19 countries
ECB	European Central Bank
EIB	European Investment Bank
ER	exchange rate
ESA 2010	European system of accounts, ESA 2010
EU	European Union
FDI	Foreign Direct Investment
FISIM	Financial Intermediation Services, Indirectly Measured
GDP	Gross Domestic Product
GFCF	Gross fixed capital formation
GVA	Gross Value Added
HH	households
HICP	Harmonised Index of Consumer Prices (EU wide inflation measurement)

ICT	Information Communication Technology
IL	Israel
IMF	International Monetary Fund
JP	Japan
LFS	Labour Force Survey
MFF	Multiannual Financial Framework
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne (Statistical classification of economic activities in the European Community)
NFC	non-financial corporations
NGEU	Next Generation European Union
NPL	non-performing loan
OECD	Organisation for Economic Co-operation and Development
OPEC	Organisation of the Petroleum Exporting Countries
PMI	purchasing managers' index
pp	percentage points
PPP	Purchasing Power Parity
PPS	purchasing power standard
RER	real exchange rate
RIR	real interest rate
RRF	Resilience and Recovery Fund
SME	small and medium-sized enterprise
SPE	Special Purpose Entity
UK	United Kingdom
US	United States
VAT	value added tax
WTO	World Trade Organization
wiiw	The Vienna Institute for International Economic Studies
.	not available (in tables)
bn	billion
m	million
p.a.	per annum
sa	seasonally adjusted
yoy	year-on-year

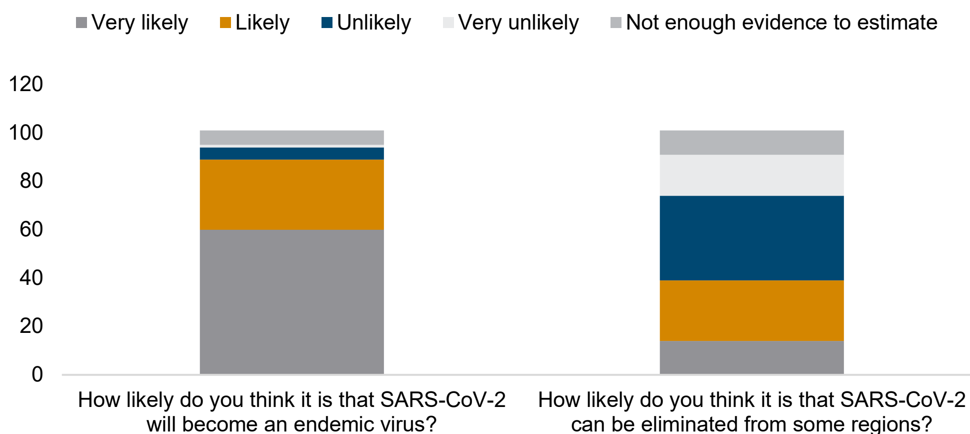
1. Global overview: Divergence, with Europe lagging behind

BY RICHARD GRIEVESON

1.1. PUBLIC HEALTH BACKDROP: HOW DO PANDEMICS END?

We will probably never reach zero COVID, but it will gradually become just another virus (Gross, 2021). In a survey of specialists conducted by the journal *Nature*, almost 90% of respondents said that they expected the virus to become endemic (Figure 1.1). The four coronaviruses that already exist, along with influenza, are all endemic and kill people every year.[1] However, acquired immunity and vaccines have brought the number of deaths down to a level that societies can tolerate (seasonal flu is estimated to kill 650,000 people per year). That is the most likely future for COVID-19 as well. It is highly unlikely that the pandemic will have a single end point; rather it will peter out differently, depending on age groups and regions of the world, and its ending will be a political and social decision, rather than a medical observation. A pandemic or epidemic ends when it becomes an ‘accepted, manageable part of normal life in a given society’ (Charters and Heitman, 2021).[2]

Figure 1.1 / Survey of scientists on the future of SARS-CoV-2, %



Note: Survey of 119 immunologists, infectious disease researchers and virologists from 23 countries.
Source: Nature survey.

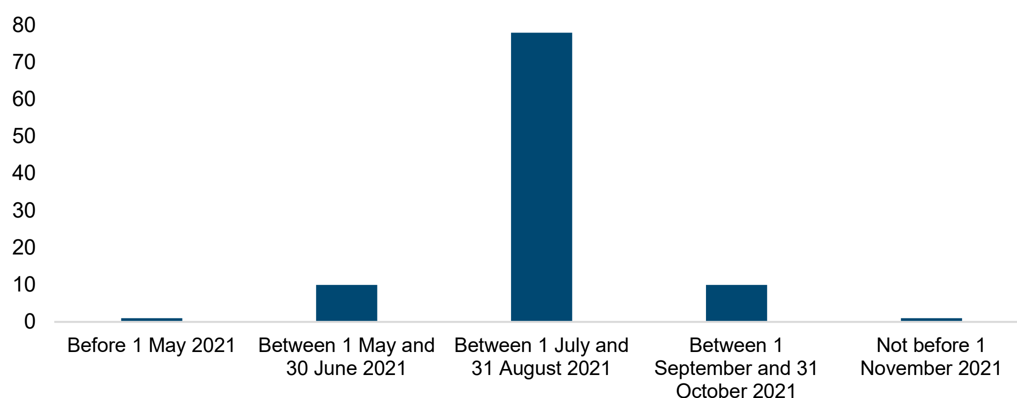
1 These are OC43, 229E, NL63 and HKU1. It is likely that at least three of these have been circulating among human populations for centuries. Children typically get these viruses before they are six, with mild symptoms. They do not then build up a life-long immunity, but re-encountering these coronaviruses in adulthood tends also to produce mild symptoms. It is too early to say if COVID-19 will behave in the same way. Studies suggest that for those who have had it, levels of neutralising antibodies start to decline after 6-8 months. However, cases of reinfection are so far rare. This apparent waning immunity would make the virus more likely to become endemic.

2 The Spanish flu was a pandemic from 1918-1920, but outbreaks continued until 1922 (historians disagree on whether that pandemic ended because the population reached herd immunity or because the virus mutated into a less deadly variant).

The key to returning to (something like) normal life as quickly as possible is vaccination, and here the signs are promising for 2021 – at least in the developed world. Studies from countries with advanced vaccination programmes, such as Israel and the UK, suggest that vaccinations dramatically reduce the number of people who get seriously ill from the virus (Reuters, 2021; *British Medical Journal*, 2021). One model produced by Imperial College London showed that vaccines with 90% effectiveness need to reach 55% of the population in order to achieve at least temporary herd immunity, so long as certain measures (wearing masks and working from home, for those who can) remain in place (Hogan et al., 2020). Although vaccine scepticism is widely reported in the media, a poll by Gallup showed that two thirds of people will take an available vaccine that has been deemed safe and effective (Gallup, 2021), while another survey in the US showed a similar two thirds for/one third against split (AP, 2021). It is reasonable to expect that, as vaccines continue to be rolled out, this number will rise (albeit missteps by both certain vaccine producers and politicians could continue to affect people's willingness to get vaccinated). That is a feasible scenario for much of the developed world by the summer; but clearly not for developing countries (or at any rate not for most of them).

Our best guess in terms of timing and severity is that – at least for the major global economies and the developed world in general – the worst is now over, even if a full return to normality will not happen this year. A ramping-up of vaccination efforts, plus better weather in the northern hemisphere, will allow a substantial easing of restrictions by late spring. In the developed world, a majority of the adult population may well have been vaccinated by the end of the summer. The Good Judgment Project attaches around a 90% probability that 75m doses will have been administered in Germany by the end of August (Figure 1.2). The EU did not tackle the initial phase of the vaccine roll-out well, but it now seems to be getting its act together. Mass vaccination alone does not mean normal life, but it does promise something much closer to normal life than we currently have. It should, for example, mean a better tourism season than last year. However, in much of the developing world, vaccination programmes have barely started. Travel restrictions between rich and poor countries may last for some time.

Figure 1.2 / When will Germany report that 75m cumulative vaccine doses for COVID-19 have been given?



Source: Good Judgment Project, accessed 19 March 2021.

There are risks to this outlook in both directions, but it is human nature to focus more on the downside. It is very unlikely that the current mutations will be the last (Osterholm and Olshaker, 2021). Each new strain may be more easily transmissible and more deadly than the last, and may be resistant to existing vaccines. We may never reach herd immunity, meaning that we will constantly need new vaccines that work against the latest mutation – a rather daunting process to repeat 1-2 times per year for the whole global population (Murray and Piot, 2021). One mathematical modelling exercise found that even very successful vaccination roll-outs will need to be accompanied by quite stringent restrictions on economic life (Moore et al., 2021).

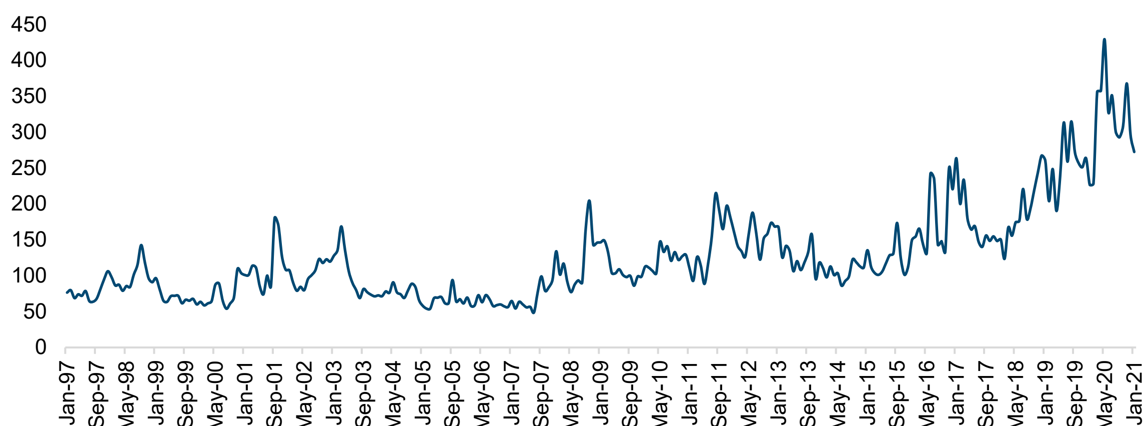
Some of the doom-mongering seems to be overdone, though. Initial trials suggest that existing vaccines can protect people from serious disease, and even against 501Y.V2 (the 'South African' variant; Ledford, 2021). Despite the B.1.1.7 strain (the 'British' variant) being widespread in the UK, vaccination there has had a dramatic impact on the number of cases. The human immune system is also capable of adapting to new variants (Phillips, 2021). Moreover, the early signs are that the new variants have common features, which will make it easier for scientists working on updated vaccines to react to them (*Economist*, 2021). A combination of partial immunity (from either having had the virus or having been vaccinated) and a shot of an updated vaccine each year will make SARS-CoV-2 into another virus that we live with. We will also probably have to get used to living with masks for some time. Those who decline the vaccine will naturally face a much bigger risk to their health.

1.2. US/EURO AREA DIVERGENCE: GROWTH AND FISCAL POLICY

The worst of the public health crisis may be over by the middle of this year in the world's major economies, but there is huge uncertainty about the shape and speed of the recovery. The pandemic has created unprecedented economic uncertainty, reflecting the range of possible outcomes and the extreme difficulty in attaching probabilistic estimates to each of them (Figure 1.3). Forecasters should all be especially humble in this environment. At the time of writing, it would seem that end-April or early-May is the most likely time for the major European economies to take the next step in reopening, with this date having been pushed back in many countries (including Germany, France and Italy) due to rising rates of infection in the early part of the year. All such projections, however, are hedged around with huge uncertainty.

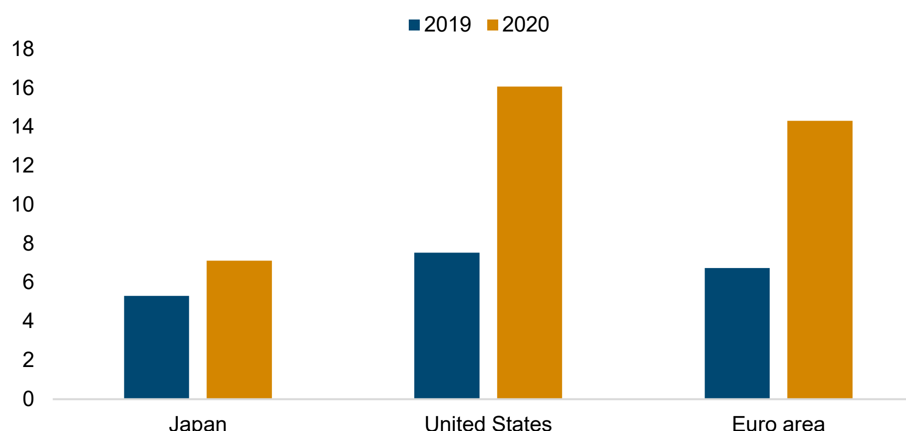
The prospects for the global economy as a whole are fairly positive, reflecting in particular the performance of the US and China. Based on the assumptions outlined above regarding public health and the timing of reopening, the global economy is likely to grow quite strongly this year. The Organisation for Economic Co-operation and Development (OECD) expects the global economy to grow by 5.6% in 2021, a strong recovery after last year's 3.4% downturn (OECD, 2021). The two big motors of the global economy –the US and China – both look to be in fairly robust health. According to the OECD, the US will grow by 6.5% and China by 7.8% in 2021, and the global economy overall will return to pre-pandemic levels by the middle of the year. Considering that the global economy has been hit by its biggest negative shock since the end of the Second World War, this is a very positive outlook. Household savings rates have risen markedly in many key global economies (Figure 1.4), which could unleash a tidal wave of spending as sentiment improves in 2021.

Figure 1.3 / Global Economic Policy Uncertainty Index



Source: Economic Policy Uncertainty; see also Davis (2016).

Figure 1.4 / Net saving rates of households and non-profit institutions serving households, %



Source: OECD.

Unfortunately, over much of the past 15 years the euro area has underperformed, and this is likely to continue during the forecast period – bad news for the countries of Central, Eastern and Southeastern Europe (CESEE). The OECD expects the single currency area to grow by 3.9% this year and by 3.8% in 2022. In contrast to the global and the US economy, the euro area will not get close to pre-crisis levels in 2021. This underperformance reflects a weaker and slower fiscal reaction and a disastrous start to the vaccine roll-out. The OECD has put total US fiscal support during the crisis at the equivalent of over 13% of GDP, while in the euro area the figure is around 7%. Although the fiscal reaction will come, and vaccination rates should pick up, it is unrealistic to wait for and expect the euro area to somehow perform like the US. However, while mobility in the euro area will certainly still be somewhat restricted during at least the second quarter, other factors will support growth, including spill-overs from the massive US fiscal stimulus and the uptick in world trade. Even as Europe's economy remains in a state of semi-lockdown, Germany's manufacturing Purchasing Managers' Index (PMI) is at one of its highest levels for decades. Moreover, people and businesses have adapted, and reduced

mobility is no longer having such a negative impact on GDP performance as during the first wave of the pandemic, in early 2020 (OECD, 2021).

1.3. US/EURO AREA DIVERGENCE: MONETARY POLICY

The very different fiscal and growth trajectories of the US and the euro area will also result in a continued divergence in monetary policy. In March, the US Federal Reserve said that it planned to keep rates on hold until 2024, and to continue buying USD 120bn of bonds per month to support the economy. However, given the size of the US fiscal stimulus and the expectation that the economy will grow by more than 6% this year, and with inflation currently above target, the bond market in particular has started to move. The yields on 10-year treasuries have regained their pre-pandemic levels, implying a tightening of monetary policy at the longer end of the curve. The market expects 'tapering' – a drawdown in the amount of bonds that the Fed buys each month – by the second half of the year.

The first important implication of developments in US interest rates is that pressure will increase on emerging markets reliant on dollar funding. All else being equal, as US rates rise, so emerging markets will also have to tighten policy, in order to continue to attract capital flows. Even if the Fed itself does not hike rates during the forecast period, tapering and market moves ahead of a rate hike will deliver effective tightening, at least at longer maturities. This matters, in particular, for Turkey, which is reliant on short-term dollar funding and has again recently changed the head of its central bank, causing further jitters on the market.

The second key implication of rising US rates is increased divergence from rates in the euro area, where weaker growth, a larger output gap and, consequently, a more dovish central bank will keep even longer-end rates much lower. While the market is betting on Fed tapering within months, the European Central Bank (ECB) announced in March that it is going in the opposite direction, increasing its monthly bond purchase to keep yields down. As a result, the euro has weakened recently, and we expect it to weaken further this year against the dollar. Growth and monetary policy divergence with the US will keep the euro weaker than it has been recently against the dollar throughout our forecast period.

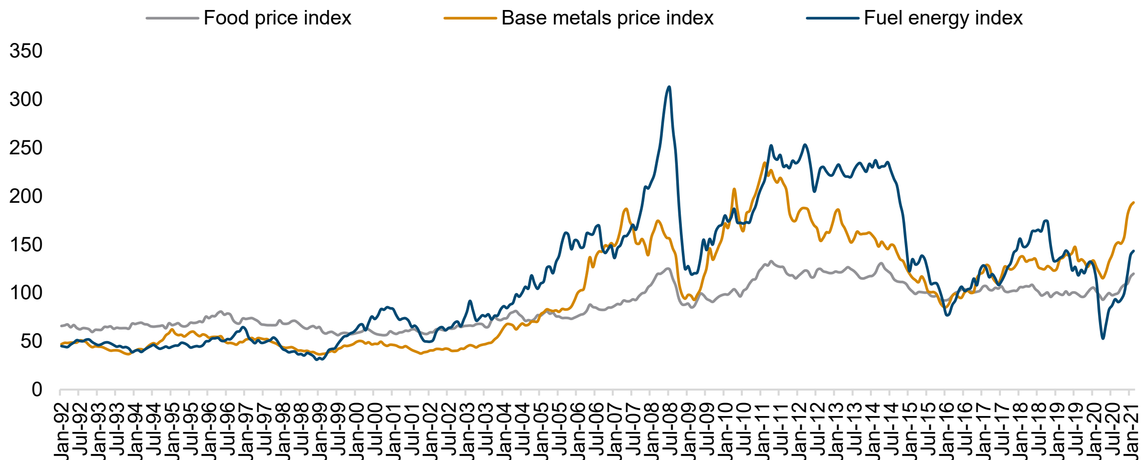
1.4. SHOULD WE BE WORRIED ABOUT INFLATION?

The pandemic has prompted a sharp increase in commodity prices on global markets. Food, energy and metals prices are going up (Figure 1.5). These increases appear to have been driven by supply bottlenecks related to the pandemic, as well as by increased demand owing to the global recovery. With many prices – not least of energy – having fallen off a cliff when the pandemic hit, the base period for commodities will be much lower from around March. As a result, a spike in headline inflation is quite likely for many economies in the coming months; but this will likely mean in the range of 2-3% for the US and major European economies, which is not especially high in historical terms.

Whether or not this lasts will depend on the country and the strength of demand-pull factors. Inflation in the US is already above target. However, it is much weaker in the euro area: the harmonised index of consumer prices (HICP) in February rose by 0.9% year on year in the euro area, less than half of the ECB's target. This relied, though, on a 1.7% decline in energy prices, which will reverse as lower base effects arrive from March. While this will bring higher headline inflation, we expect high commodity

prices in the euro area to lead also to a margin squeeze, with firms struggling to pass the full impact of higher input costs onto consumers amid fragile demand. Even by the end of the year, the euro area is still likely to have a sizeable output gap. Over the forecast period, we expect oil prices to fall back from their current levels, reflecting the effective cap on prices created by US shale.

Figure 1.5 / International Monetary Fund commodity price indices, 2016 = 100



Source: International Monetary Fund.

1.5. MAIN TAKEAWAYS FOR CESEE

Based on the above assumptions, the main takeaways for CESEE are as follows:

› The euro area – CESEE's most important market and the source of foreign demand, tourists, remittances and investment – will recover, but not boom. This will generate positive extra demand for CESEE economies. However, the euro area's recovery will be weaker than that of the US, and it will not recover to pre-pandemic levels of economic activity this year.

› Western Europe seems to have got over its bad start with vaccines, and a large share of the adult population will have been vaccinated by the end of the summer. This should help tourism inflows in the parts of CESEE that need them.

› The Fed may start to taper its asset purchases this year, while the ECB is going in the opposite direction. This will keep rates across Europe and much of CESEE low, but those reliant on dollar funding will face higher borrowing costs.

› This policy divergence will weaken the euro against the dollar, increasing imported inflation in the euro area and those economies of CESEE that are linked to the single currency.

› Global inflation will rise this year, especially as the much lower base period for commodity prices kicks in with the March data. However, large output gaps in the euro area mean that this is unlikely to generate permanently higher inflation.

Table 1.1 / wiiw spring 2021 global assumptions

	Spring 2021		Changes since autumn	
	2021	2022	2021	2022
Euro area real GDP growth, %	3.8	3.7	-2.0	1.2
USD/EUR exchange rate, average	1.15	1.15	0.00	0.00
USD per barrel Brent oil, US$, average	65.0	60.0	15.9	10.0

Source: forecasts by wiiw. Cut-off date: 25 March 2021.

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2. CESEE Overview: Darkest before the dawn?

BY RICHARD GRIEVESON AND OLGA PINDYUK[3]

2.1. CESEE HAS SACRIFICED PUBLIC HEALTH TO KEEP THE ECONOMY GOING OVER THE WINTER

CESEE economies will continue their recovery from the COVID-19-driven downturn this year, but at an uneven pace and with risks to the downside. The key determinant of the economic performance of CESEE economies this year will be a combination of the development of the virus and its various mutations, the speed at which vaccinations are rolled out, and the way in which governments and populations react to this. Our forecasts are being undertaken at a time of unprecedented uncertainty (Figure 1.3).

CESEE's strong public health performance during the pandemic's first wave has not been repeated in the second, reflecting the actions of both governments and citizens. Whereas during the first wave CESEE's good economic performance was partly *because of* good health management, in the second wave public health appears to have been sacrificed in an attempt to keep the economy going. During late winter and spring 2020, as the pandemic arrived in Europe, CESEE countries by and large got on top of it early. They generally imposed tough restrictions on economic life, despite low numbers of infections (especially compared with Western Europe) (Grieveson et al., 2020a). This limited the spread materially during the first wave, and meant that they could reopen their economies more quickly. However, the second wave has been quite different. Despite a sharp rise in cases in CESEE from October/November 2020, governments have mostly not reacted by imposing stiff restrictive measures, while CESEE residents have failed to adapt their behaviour as much as during the first wave.

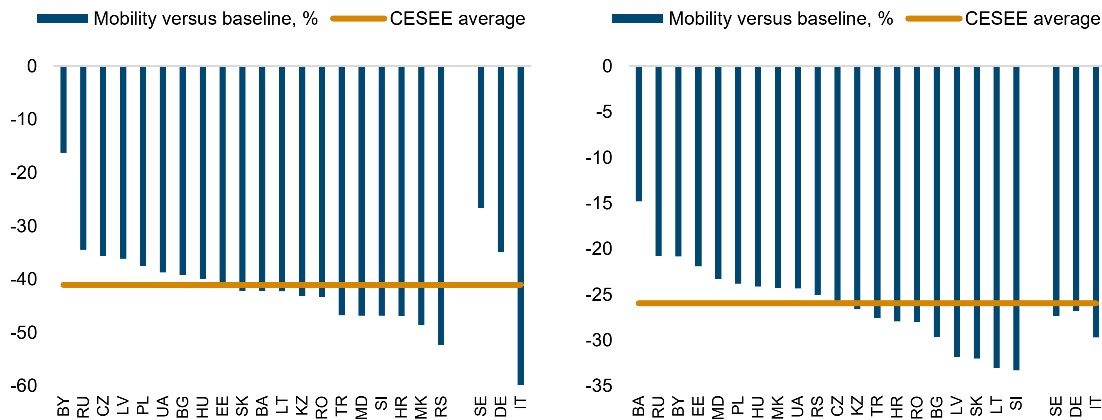
The data show significant differences in terms of both restrictions and mobility, compared with the first wave. Workplace mobility data, for example, show that during the first wave, CESEE residents recorded an average mobility decline of 41% (Figure 2.1, left-hand chart).[4] During the second wave, however, workplace mobility was down by only 26%.[5] It is also noticeable that during the first wave, almost all CESEE countries recorded a much more substantial decline in workplace mobility than Sweden (a country that famously took a looser approach) and Germany (a proxy for the Western European average). In the second wave, the CESEE average in terms of workplace mobility decline was less than in both of those countries. From the government side, the data on the extent of the restrictions tell a similar story (Figure 2.2). Whereas in the first wave, CESEE countries on average introduced much stiffer restrictions than European and global benchmarks, over the winter months measures have generally been much looser than in their developed country peers.

[3] The authors thank Vasily Astrov, Alexandra Bykova, Doris Hanzl-Weiss, Gabor Hunya and Branimir Jovanovic for useful edits, comments and suggestions.

[4] We use mid-March to mid-May 2020 to represent the first wave.

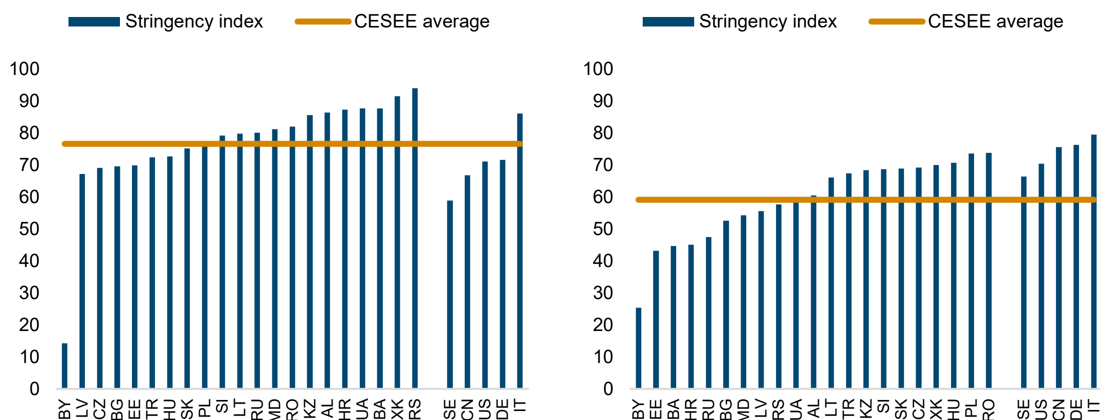
[5] We use November 2020 to February 2021 to represent the second wave.

Figure 2.1 / Workplace mobility versus baseline: 15 March - 15 May 2020 (left) and November 2020 - February 2021 (right), %



Source: Google.

Figure 2.2 / Stringency index: 15 March – 15 May 2020 (left) and November 2020 - February 2021 (right)



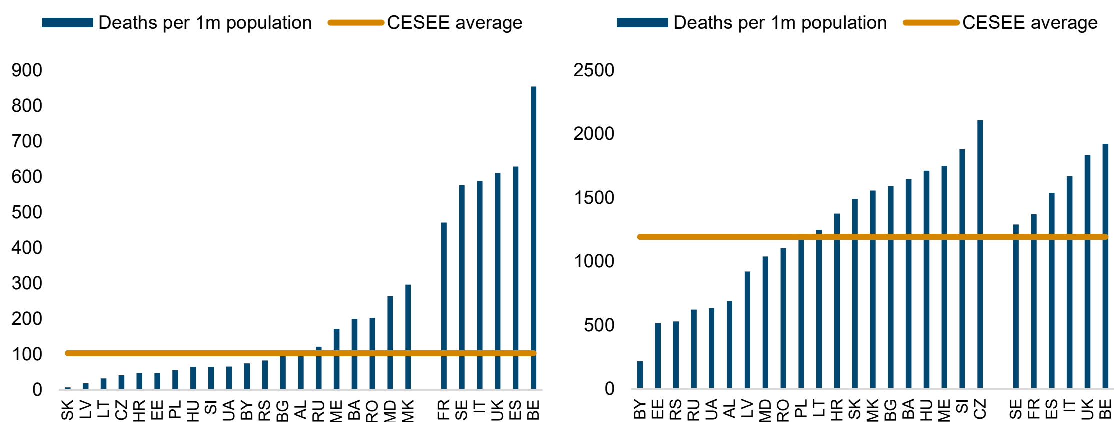
Note: 100 denotes the most restrictive measures; 0 denotes the least restrictive measures.
Source: Oxford Blavatnik School of Government.

The public health implications of this have been disastrous. Whereas during the first wave, CESEE death rates were well below those seen in Western Europe, as of March 2021 the death rates from COVID-19 in many CESEE countries have been worse than the hardest-hit countries of Western Europe (Figure 2.3). Data on 'excess deaths' provide perhaps the most accurate picture of the public health situation.[6] In 2020 as a whole, the number of deaths in many CESEE countries was over 10% higher than the 2015-2019 average (Figure 2.4), with particularly big increases in Kazakhstan and North Macedonia (both around 24%). In mid-March 2021, CESEE countries occupied most of the top places in the

[6] 'Excess deaths' are the difference between the number of deaths recorded in a specific period and those that would be expected to occur in the same period of time, based on historical averages. For COVID-19, a typical measure of excess deaths has been to compare total deaths in 2020 with the average number of deaths per year in 2015-2019.

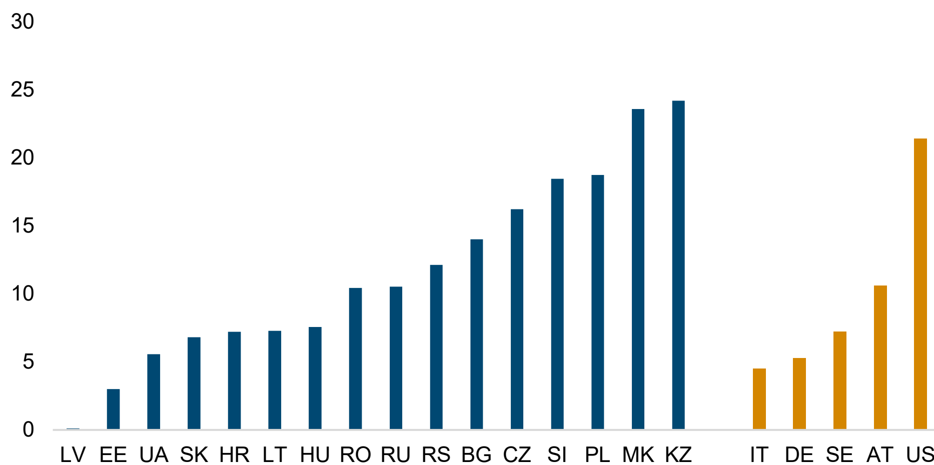
Economist's global excess deaths tracker.[7] Measured in terms of excess deaths per 100,000 population, Russia, North Macedonia, Bulgaria, Lithuania and Serbia occupied the top places in CESEE (Figure 2.5).

Figure 2.3 / Deaths related to COVID-19 per 1m population, as of September 2020 (left) and March 2021 (right)



Source: Worldometer.

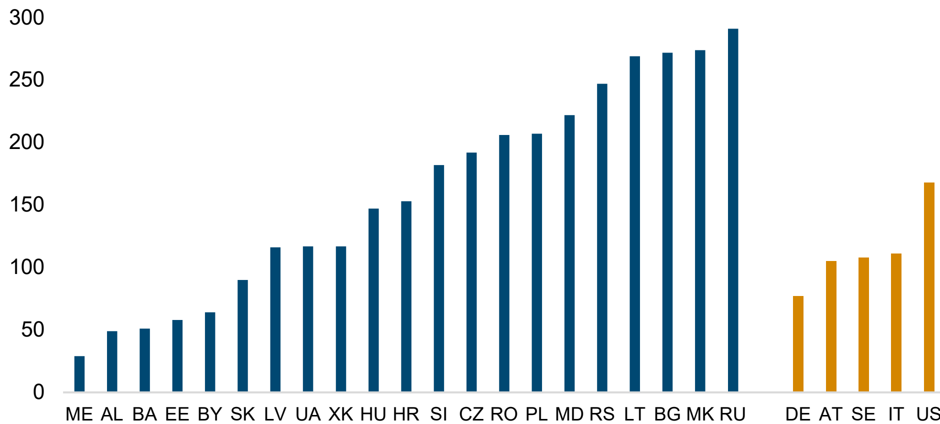
Figure 2.4 / Increase in total number of deaths in 2020 compared with 2015-2019 average, %



Source: Our World in Data, wiiw calculations.

[7] *The Economist*'s excess deaths tracker monitors excess deaths since the country's first 50 COVID-19 deaths, and adjusts for population size. As of 9 March (the most recent update at the time of writing), Russia, North Macedonia, Bulgaria, Lithuania, Serbia, Moldova, Poland, Romania and Czechia were all in the top 15 in the world. https://www.economist.com/graphic-detail/coronavirus-excess-deaths-tracker

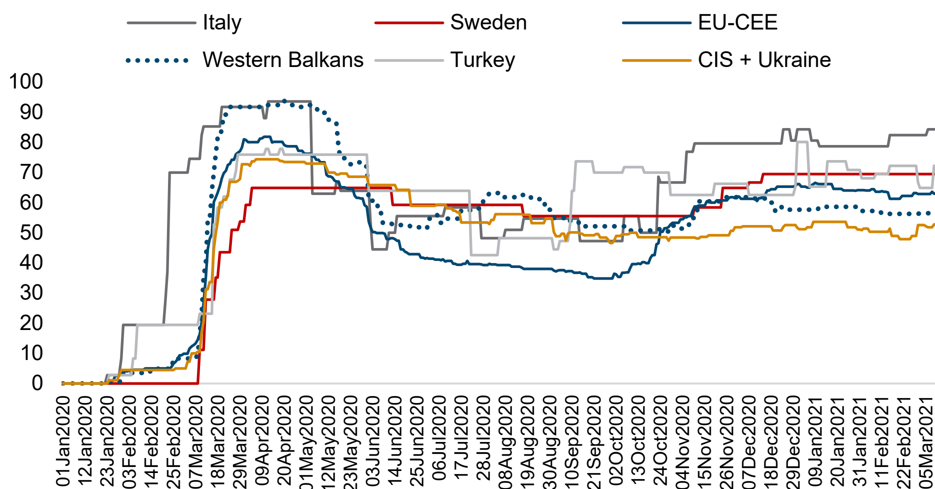
Figure 2.5 / Excess deaths from COVID-19 per 100,000 people, as of mid-March 2021



Source: *The Economist*.

This approach may have kept the economy going in the short term, but the public health implications could necessitate a longer period of restrictions in the spring, with repercussions for economic growth. As a result of the rapid spread of the virus, many CESEE countries are being forced to return to lockdown. In the first half of March, countries including Czechia, Estonia, Poland and Hungary significantly increased the restrictions on economic life. This tightening will certainly weigh on economic activity, even if the impact may not be as damaging to economic activity as during the first wave.

Figure 2.6 / Stringency index



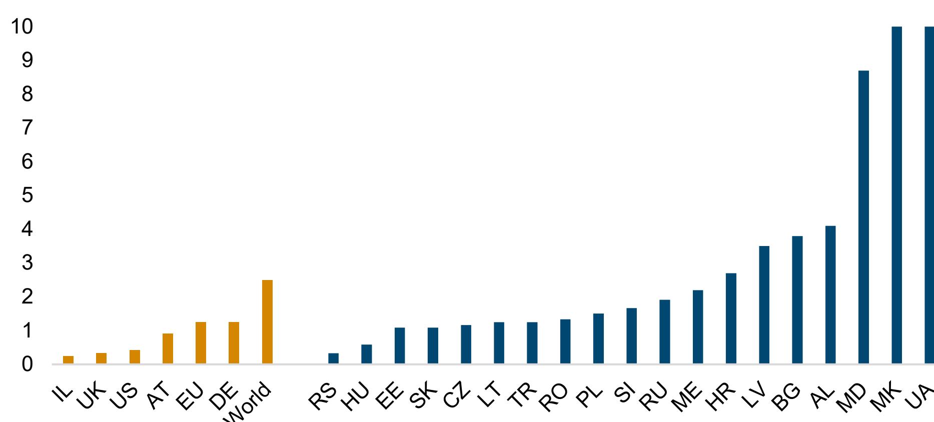
Note: Data are simple averages for each sub-region; 100 denotes the most stringent; 0 denotes the least stringent.
Source: Oxford Blavatnik School of Government, wiiw calculations.

So far, this renewed tightening of measures has largely been confined to the EU member states of CESEE, with economies in the Western Balkans, CIS and Ukraine apparently striving to avoid increased restrictions (Figure 2.6). At the time of writing, both the Western Balkans and the CIS + Ukraine have, on average, restrictions that are considerably looser than the famously relaxed Sweden

(Figure 2.6). There are various possible reasons for this. It may partly be because these are mainly CESEE's poorer countries, and so they do not have the resources to keep large swathes of the economy shut down, or to provide support for business and workers. Another factor could be the low level of trust in government and institutions, which makes it harder and more politically costly to implement and enforce further lockdowns. Whatever the reasons, the apparent general reluctance of non-EU CESEE countries to introduce further lockdowns may well not last, and these countries may have to increase restrictions during the spring to stop healthcare systems being overwhelmed.

Escaping the latest tight set of lockdowns will require an increase in the pace of vaccination, but this is proceeding at very different speeds across CESEE. While some countries can hope to reach herd immunity this year, others seem to have no chance, and this will affect economic performance. According to Bloomberg's COVID-19 data tracker (as of 26 March), it will take most CESEE countries several years to vaccinate 75% of their population at the current rates of progress (Figure 2.7). These data show that EU-CEE countries generally are in a better position, reflecting their involvement in EU-wide purchase programmes. Some – including Hungary, Czechia and Slovakia – have also turned to Russia. Serbia and Turkey are likewise making reasonable progress, in part owing to vaccines from Russia and China; this is thanks to the generally good relations that Serbia and Turkey have with those two countries. For others, especially Ukraine, North Macedonia and Moldova, unless vaccination rates speed up considerably, their governments will continue to face a choice between very harsh lockdowns and a dire public health situation. Those countries certainly need international help, above all from the World Health Organization's COVAX scheme, which so far has been inadequate. Even a rapid vaccination programme will not be enough; some restrictions on economic life will have to remain in place as well.

Figure 2.7 / Years until 75% of population are vaccinated, based on current vaccination rates



Source: Bloomberg COVID-19 data tracker.

It is likely that, for most CESEE countries, the lingering effects of the pandemic will be more severe than in Western Europe. CESEE will not see a definitive 'end' to the pandemic this year. And many CESEE countries look set to be struggling to vaccinate the necessary share of their populations even by next winter; as a result, looking beyond 2021, it would seem quite possible that the number of cases and deaths as a share of the population will be higher than in Western Europe.

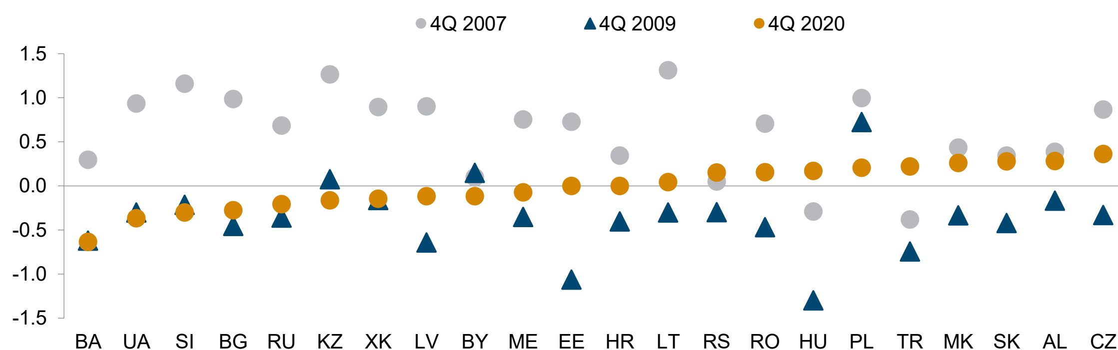
2.2. GDP GROWTH: SPLUTTERING INTO LIFE

In economic terms, CESEE performed much better than Western Europe in 2020. On a weighted average basis, the CESEE economies contracted by 2.3% last year (see Table 2.1). This was a milder downturn than was suffered by the global economy (-3.4% according to the OECD), and substantially better than the euro area (-6.8%). The top performers in the region were Turkey (the only economy in CESEE to grow, by 1.8%), Lithuania (-0.8%), Belarus (-0.9%) and Serbia (-1%). Easily the worst-affected country was Montenegro (-15.2%), followed by Croatia (-8.4%). It is not clear that any sub-region of CESEE was hit especially worse than any other. The weighted average decline in real GDP in CESEE in 2020 was 3.9% in EU-CEE, 3.5% in the Western Balkans and 3.1% in the CIS and Ukraine. However, the range of outcomes between the best and the worst performers in CESEE was the highest for over a decade, reflecting the huge differentiation in terms of impact. The difference between real GDP growth in Turkey and Montenegro was almost 17 percentage points (p.p.).

BOX 2.1 / BUSINESS CYCLE INDEX: MOSTLY NOT AS BAD AS IN 2009

The main story from our Business Cycle Index is that, for most countries, the situation is not as bad as in 2009 – at the nadir of the global financial crisis (Box Figure 2.1). Using a four-quarter trailing average of 11 indicators, we find that Bosnia, Ukraine, Slovenia, Bulgaria, Russia, Kazakhstan, Belarus and Montenegro are all at, or close to, the point they had reached at the end of 2009, at least on average; meanwhile, Poland is at a substantially lower point in the business cycle (Poland did not go into recession after the 2008 crisis). For all other CESEE countries, the average impact across the indicators considered is not as bad as in 2009, with the outperformance versus 2009 particularly strong in Estonia, Hungary and Turkey. The full breakdown (Box Table 2.1) shows that – relative to the historical average – GDP has taken an especially big hit, while fiscal policy is noticeably counter-cyclical almost everywhere. The other important point to note from the breakdown is that the unemployment situation is materially better than the historical average, indicating that – at least on the basis of official data – the labour market has not taken much of a hit so far (see section 2.4 for more analysis).

Box Figure 2.1 / wiiw Business Cycle Index, Q4 2020, headline data



Note: Number of standard deviations from historical mean, average of 11 indicators (see next figure for full list).
Sources: wiiw Monthly Database incorporating national statistics and Eurostat ; BIS; wiiw calculations.

Box Table 2.1 / wiiw Business Cycle Index, Q4 2020, full breakdown

	Domestic economy			External finance			Domestic finance				
	Real GDP	Unemployment	CPI	CA	RER	External debt	RIR	Private credit	Broad money	Fiscal balance	Property prices
BG	-2.59	1.20	-0.71	-0.64	0.55	-1.13	-0.39	-0.42	-0.56	1.70	-0.04
CZ	-2.90	1.63	0.78	-2.04	0.92	1.35	1.75	-0.58	0.64	1.50	0.96
EE	-1.27	0.56	-1.65	-0.52	1.16	0.06	-0.97	-0.45	0.15	3.04	-0.10
HR	-2.91	1.57	-1.34	-0.01	-0.81	-0.03	0.22	-0.06	0.08	1.70	1.60
HU	-2.56	1.21	-0.32	-0.53	-1.19	-0.59	1.92	0.85	1.42	1.81	-0.12
LT	-1.02	0.51	-0.52	-2.04	1.20	0.38	0.27	-0.61	0.90	1.24	0.18
LV	-1.19	0.78	-0.92	-1.09	0.86	0.28	-0.30	-0.54	-0.26	1.15	-0.06
PL	-3.47	1.33	0.59	-2.87	-0.76	0.14	2.07	-0.89	1.60	2.58	1.96
RO	-2.08	0.91	-0.61	-0.09	0.00	0.21	0.85	-0.53	-0.39	2.51	0.96
SI	-2.37	1.03	-1.23	-1.74	-0.63	0.45	-0.65	-0.28	0.47	1.14	0.52
SK	-2.65	1.55	-0.43	-1.13	0.84	2.20	0.84	-0.76	0.24	1.90	0.46
AL	-3.60	1.40	-0.90	-0.15	2.18	1.13	1.50	-0.46	0.06	1.66	
BA	-3.28	1.58	-1.29	-1.22	-2.16	0.47	-0.86	-0.93	-0.50	1.83	
ME	-4.42	0.78	-0.84	0.65	0.58	2.08	-0.20	-0.39	-0.73	1.80	
MK	-2.48	2.23	-0.37	-0.13	-0.67	1.69	0.99	-0.63	-0.61	2.84	0.03
RS	-1.45	1.89	-0.57	-0.59	0.94	0.39	-0.03	-0.26	-0.38	2.37	-0.61
XK	-3.84	1.40	-0.55	-0.67	0.47	1.05	0.84	-0.66	-0.29	0.78	
TR	-0.76	-1.62	-0.24	0.49	-2.38	1.98	0.67	0.11	0.95	0.42	2.83
BY	-1.25	1.55	-0.64	-1.17	-1.41	1.20	-0.27	-0.52	-0.77	2.12	
KZ	-2.32	0.87	-0.50	0.69	-1.27	0.97	-1.16	-0.41	-0.49	2.02	
RU	-1.66	0.55	-1.32	1.10	-0.49	-0.45	0.20	-0.57	-0.65	1.33	-0.29
UA	-1.03	-0.76	-0.94	-0.92	-0.39	0.33	-0.68	-0.84	0.14	1.43	

overheating: > 1 SD above historical average; underheating: > 1 SD below historical average

Notes: CPI: consumer price index; CA: current account; RER: real exchange rate (EUR) CPI deflated, values more than 100 means appreciation and vice versa; RIR: real interest rate CPI deflated. Data for unemployment, current account, real interest rate, fiscal balance are inverted (as for these indicators lower values would indicate overheating). Historical mean calculated for 4Q 2000 - 4Q 2020. Calculations are based on four-quarter trailing averages.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS; wiiw calculations.

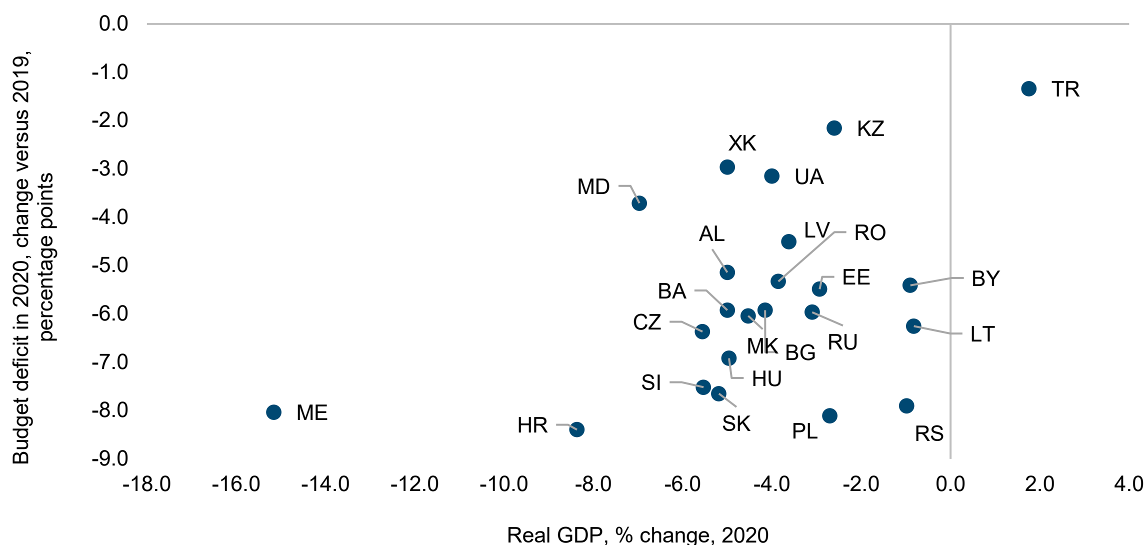
CESEE's overall quite robust performance relative to Western Europe owed a lot to better management of the pandemic during the first wave. As outlined above, most countries in CESEE reacted quickly and decisively, with restrictions on economic life already very high in mid-March 2020, even though at that time CESEE had very few confirmed cases (Grieveson et al., 2020a). As a result, CESEE countries could reopen their economies relatively quickly over the summer. From late May 2020, most countries in CESEE had restrictions on economic life similar to – or looser than – Sweden's, a country considered extremely loose by Western European standards (see Figure 2.6 above). During Q2 and Q3 last year, we find a strong positive correlation between health outcomes and economy performance (Jovanovic, 2021). The outperformance also reflected the generally lower share of services in GDP in CESEE, relative to Western Europe (Astrov et al., 2020).

On the expenditure side of GDP, on average across CESEE private consumption, investment and net exports all made a negative contribution to headline growth. Household consumption contributed negatively to growth in 2020 in all countries except Bulgaria, Kosovo, Turkey and Ukraine. This is hardly surprising, considering the hit to confidence, the supply constraints (i.e. shops and restaurants being closed for long periods) and the general uncertainty. Only Estonia, Romania, Turkey and Kazakhstan recorded positive contributions for gross fixed capital formation (this was especially strong in Estonia; see

country report). Meanwhile net exports were more mixed, adding to growth in 11 countries of CESEE and subtracting from it in the other 12. It seems that trade diversion may have played a part in supporting exports, while in some countries demand from outside the region (e.g. from China) was very supportive, even as core European markets recovered weakly. Net exports were also naturally boosted by the often much deeper decline in imports than exports, owing to weak domestic demand in CESEE and, in some cases, to currency depreciations. However, the biggest negative contributions for net exports came in countries with a particularly heavy reliance on tourism (Croatia and Montenegro) or with an especially large domestic demand (and consequently import) stimulus last year (Turkey). On the flipside, in all but five countries (Hungary, Slovakia, Montenegro, Belarus, Ukraine) government spending added to headline growth.

One of the key drivers of difference between the CESEE countries was fiscal policy, reflecting varying amounts of policy space, but also levels of willingness and capacity to use it. For many countries, sharp GDP contractions occurred in tandem with a hefty fiscal loosening, indicating how much worse it could have been in the absence of fiscal stimulus. For a few, especially Poland and Serbia, decisive fiscal loosening was accompanied by comparatively mild declines in real GDP, suggesting quite a successful counter-cyclical reaction to the downturn. Others (such as Croatia and Montenegro) posted huge fiscal deficits and a sharp decline in GDP. A further group of countries did not have the option to significantly loosen fiscal policy, either because of their inability to finance a large deficit, or because of the difficulty of implementing rapid large-scale emergency fiscal spending (e.g. Bosnia and Herzegovina and Kosovo).

Figure 2.8 / Relationship between real GDP performance and fiscal policy in 2020



Sources: Eurostat, national sources, wiiw estimates and calculations.

Table 2.1 / OVERVIEW 2019-2020 AND OUTLOOK 2021-2023

		GDP real change in % against prev. year					Consumer prices average change in % against prev. year				
				Forecast					Forecast		
		2019	2020	2021	2022	2023	2019	2020	2021	2022	2023
BG	Bulgaria	3.7	-4.2	2.5	3.1	3.4	2.5	1.2	1.5	1.5	2.0
CZ	Czechia	2.3	-5.6	2.9	3.2	3.9	2.6	3.3	2.1	2.0	2.0
EE	Estonia	5.0	-2.9	1.2	3.8	4.3	2.3	-0.6	1.3	1.7	2.0
HR	Croatia	2.9	-8.4	4.5	4.6	3.7	0.8	0.0	1.0	1.4	1.5
HU	Hungary	4.6	-5.0	3.9	4.5	4.0	3.4	3.4	3.9	3.5	3.5
LT	Lithuania	4.3	-0.8	2.1	3.8	3.5	2.2	1.1	1.8	2.7	3.3
LV	Latvia	2.0	-3.6	2.8	4.2	3.8	2.7	0.1	1.2	2.5	3.5
PL	Poland	4.5	-2.7	3.4	3.6	4.4	2.1	3.7	3.0	2.5	2.5
RO	Romania	4.1	-3.9	3.8	4.5	4.0	3.9	2.3	3.2	3.5	3.5
SI	Slovenia	3.2	-5.5	3.6	4.0	3.3	1.7	-0.3	1.3	1.7	1.6
SK	Slovakia	2.3	-5.2	3.6	4.4	3.5	2.8	2.0	1.4	2.0	2.0
	EU-CEE11 1)2)	*3.9*	*-3.9*	*3.4*	*3.9*	*4.0*	*2.6*	*2.7*	*2.6*	*2.6*	*2.6*
	EA19 3)	*1.3*	*-6.6*	*3.8*	*3.7*	*2.0*	*1.2*	*0.3*	*1.1*	*1.2*	*1.4*
	EU27 3)	*1.6*	*-6.2*	*4.2*	*4.1*	*2.4*	*1.4*	*0.7*	*1.3*	*1.4*	*1.6*
AL	Albania	2.2	-5.0	4.5	4.4	3.8	1.4	1.6	2.1	2.4	2.6
BA	Bosnia and Herzegovina	2.8	-5.0	2.5	2.9	3.3	0.6	-1.1	0.6	0.8	1.0
ME	Montenegro	4.1	-15.2	6.5	5.0	3.7	0.4	-0.3	0.9	1.5	1.5
MK	North Macedonia	3.2	-4.5	4.1	3.4	3.2	0.8	1.2	1.5	1.8	2.0
RS	Serbia	4.2	-1.0	5.0	4.4	4.2	1.7	1.6	2.0	2.4	2.2
XK	Kosovo	4.9	-5.0	4.8	4.6	3.9	2.7	0.2	1.5	1.7	2.0
	WB6 1)2)	*3.6*	*-3.5*	*4.4*	*4.0*	*3.8*	*1.4*	*0.9*	*1.6*	*2.0*	*2.0*
TR	Turkey	0.9	1.8	5.8	3.4	3.5	15.2	12.3	16.0	12.0	10.0
BY	Belarus	1.4	-0.9	1.5	1.9	2.2	5.6	5.5	6.5	6.0	6.0
KZ	Kazakhstan	4.5	-2.6	3.2	4.1	4.4	5.3	6.7	6.3	5.9	5.5
MD	Moldova	3.6	-7.0	4.0	4.5	3.5	4.8	3.8	4.0	4.5	5.0
RU	Russia	2.0	-3.1	3.2	2.7	2.3	4.5	3.4	5.0	3.5	3.2
UA	Ukraine	3.2	-4.0	3.5	3.2	3.0	7.9	2.7	7.0	6.0	5.0
	CIS4+UA 1)2)	*2.4*	*-3.1*	*3.2*	*2.8*	*2.6*	*5.0*	*3.7*	*5.4*	*4.1*	*3.7*
	V4 1)2)	*3.9*	*-3.8*	*3.4*	*3.7*	*4.2*	*2.4*	*3.4*	*2.8*	*2.5*	*2.5*
	BALT3 1)2)	*3.9*	*-2.1*	*2.1*	*3.9*	*3.8*	*2.4*	*0.4*	*1.5*	*2.4*	*3.1*
	SEE9 1)2)	*3.8*	*-4.3*	*3.9*	*4.2*	*3.8*	*2.8*	*1.6*	*2.4*	*2.6*	*2.7*
	CIS3+UA 1)2)	*3.5*	*-3.1*	*3.1*	*3.4*	*3.5*	*6.5*	*4.7*	*6.6*	*5.9*	*5.3*
	non-EU12 1)2)	*2.0*	*-1.7*	*4.0*	*3.0*	*2.9*	*7.8*	*6.2*	*8.4*	*6.3*	*5.5*
	CESEE23 1)2)	*2.6*	*-2.3*	*3.8*	*3.3*	*3.2*	*6.2*	*5.1*	*6.7*	*5.2*	*4.6*

Table 2.1 / (ctd.)

		Unemployment (LFS) rate in %, annual average					Current account in % of GDP				
				Forecast					Forecast		
		2019	2020	2021	2022	2023	2019	2020	2021	2022	2023
BG	Bulgaria	4.2	5.2	5.0	4.5	4.5	3.0	0.1	0.5	0.5	0.1
CZ	Czechia	2.0	2.6	3.1	3.2	2.9	-0.3	3.2	2.2	2.8	2.4
EE	Estonia	4.4	6.8	7.5	7.0	6.5	2.0	-0.9	-1.0	0.2	1.2
HR	Croatia	6.6	7.5	7.0	7.0	7.0	2.7	-4.1	0.2	1.0	1.5
HU	Hungary	3.4	4.3	4.2	4.3	4.3	-0.5	0.1	0.0	0.0	0.1
LT	Lithuania	6.3	8.5	8.0	7.0	6.5	3.3	8.0	5.1	4.4	4.0
LV	Latvia	6.3	8.1	8.0	6.8	6.5	-0.6	3.0	1.6	0.3	-1.2
PL	Poland	3.3	3.6	4.0	4.0	3.8	0.5	3.5	2.5	1.7	2.0
RO	Romania	3.9	5.5	5.5	4.5	4.0	-4.7	-5.0	-5.0	-4.6	-3.9
SI	Slovenia	4.5	5.1	5.5	4.6	4.3	5.6	7.3	6.2	5.8	5.4
SK	Slovakia	5.8	6.7	8.2	7.6	7.0	-2.7	-0.3	-0.2	-0.1	-0.5
	EU-CEE11 1)2)	*3.8*	*4.5*	*4.9*	*4.6*	*4.3*	*-0.2*	*1.4*	*0.9*	*0.7*	*0.8*
	EA19 3)	*7.6*	*8.0*	*8.9*	*8.4*	*8.1*	*3.0*	*3.0*	*3.0*	*3.0*	*3.0*
	EU27 3)	*6.7*	*7.3*	*8.2*	*7.7*	*7.4*	*2.9*	*2.9*	*2.9*	*2.9*	*2.9*
AL	Albania	11.5	11.7	11.4	11.2	11.0	-8.0	-8.9	-8.5	-7.2	-6.9
BA	Bosnia and Herzegovina	15.7	18.0	17.6	16.1	15.3	-3.1	-3.3	-4.5	-4.6	-4.6
ME	Montenegro	15.1	17.0	17.0	16.0	16.0	-15.0	-26.0	-20.9	-18.5	-16.1
MK	North Macedonia	17.3	16.4	16.0	15.5	15.0	-3.3	-3.5	-3.3	-3.7	-3.7
RS	Serbia	10.4	9.0	8.0	7.5	7.0	-6.9	-4.3	-5.6	-6.5	-7.3
XK	Kosovo	25.7	26.5	26.0	25.0	24.5	-5.6	-6.3	-6.9	-6.9	-5.7
	WB6 1)2)	*13.4*	*13.2*	*12.4*	*11.8*	*11.2*	*-6.3*	*-5.7*	*-6.3*	*-6.5*	*-6.7*
TR	Turkey	13.7	13.2	13.4	12.5	11.1	0.9	-5.1	-3.8	-3.6	-3.5
BY	Belarus	4.2	4.0	4.1	4.2	4.3	-1.9	-0.4	-0.4	-0.9	-1.1
KZ	Kazakhstan	4.8	4.9	4.9	4.8	4.8	-4.0	-3.5	-3.1	-1.9	-0.9
MD	Moldova	5.1	3.8	5.0	4.0	3.0	-9.3	-7.1	-9.0	-8.4	-7.0
RU	Russia	4.6	5.8	5.5	5.2	5.0	3.8	2.2	3.2	3.6	3.6
UA	Ukraine	8.2	9.5	9.0	8.0	8.0	-2.7	4.1	2.0	0.6	-0.2
	CIS4+UA 1)2)	*5.2*	*6.2*	*5.9*	*5.6*	*5.4*	*2.4*	*1.7*	*2.3*	*2.6*	*2.7*
	V4 1)2)	*3.3*	*3.8*	*4.2*	*4.2*	*4.0*	*-0.1*	*2.6*	*1.8*	*1.6*	*1.6*
	BALT3 1)2)	*5.9*	*8.0*	*7.9*	*6.9*	*6.5*	*1.9*	*4.3*	*2.6*	*2.2*	*1.8*
	SEE9 1)2)	*7.4*	*8.0*	*7.9*	*7.2*	*6.8*	*-3.1*	*-4.3*	*-3.9*	*-3.7*	*-3.4*
	CIS3+UA 1)2)	*6.6*	*7.2*	*7.0*	*6.4*	*6.4*	*-3.3*	*-0.1*	*-0.9*	*-1.0*	*-0.9*
	non-EU12 1)2)	*7.5*	*8.0*	*7.9*	*7.4*	*7.0*	*1.7*	*-0.4*	*0.3*	*0.5*	*0.6*
	CESEE23 1)2)	*6.6*	*7.2*	*7.2*	*6.7*	*6.3*	*1.0*	*0.3*	*0.5*	*0.6*	*0.7*

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: 25 March 2021.

Our core scenario is that the region's economies will emerge gradually from the current wave during the spring, with fairly robust rates of real GDP growth during the second and third quarters of the year. Those countries currently suffering badly will turn the tide via harsh lockdowns, and will gradually reopen as vaccination rates improve.

We expect the strongest growth in 2021 to be posted in Southeast Europe, including Turkey, Croatia and several Western Balkan countries (Table 2.2). Turkey has undergone its customary V-shaped recovery, and although there are increasing risks (see country report), the latest data suggest that a growth rate of close to 6% will be achievable this year. Serbia will also perform strongly, reflecting an advanced vaccination drive and strong policy support. Some of the other countries that we expect to perform best this year will benefit from extremely favourable base effects. These include especially Croatia and Montenegro. Although the outlook for the summer tourist season is highly uncertain, our best guess is that it will be better than last year. Even though arrivals from abroad are likely to be well down on pre-pandemic levels, the improvement over 2020 will generate considerable growth.

Table 2.2 / Real GDP growth forecasts and revisions

		Forecast, %		Revisions, pp	
		2021	2022	2021	2022
EU-CEE	BG	2.5	3.1	↑ 0.8	↑ 0.5
	CZ	2.9	3.2	↓ -1.0	↓ -0.3
	EE	1.2	3.8	↓ -2.7	↑ 0.8
	HR	4.5	4.6	↓ -0.5	↑ 0.6
	HU	3.9	4.5	↑ 0.9	↓ -0.1
	LT	2.1	3.8	↓ -2.4	↑ 0.6
	LV	2.8	4.2	↓ -1.6	↑ 1.4
	PL	3.4	3.6	↓ -0.1	↑ 0.2
	RO	3.8	4.5	↑ 0.1	→ 0.0
	SI	3.6	4.0	↓ -0.9	↑ 1.0
	SK	3.6	4.4	↓ -0.5	↑ 0.5
Western Balkans	AL	4.5	4.4	↓ -0.1	↑ 0.4
	BA	2.5	2.9	↓ -0.7	↓ -0.2
	ME	6.5	5.0	↑ 1.5	↑ 0.9
	MK	4.1	3.4	↓ -0.4	↓ -0.6
	RS	5.0	4.4	↑ 0.5	↑ 0.3
	XK	4.8	4.6	→ 0.0	↑ 0.3
Turkey	TR	5.8	3.4	↑ 1.7	↓ -1.2
CIS+UA	BY	1.5	1.9	↑ 2.7	↑ 0.6
	KZ	3.2	4.1	↑ 0.7	↑ 0.1
	MD	4.0	4.5	→ 0.0	↑ 0.5
	RU	3.2	2.7	↑ 0.7	↑ 0.6
	UA	3.5	3.2	↑ 1.5	↓ -0.4

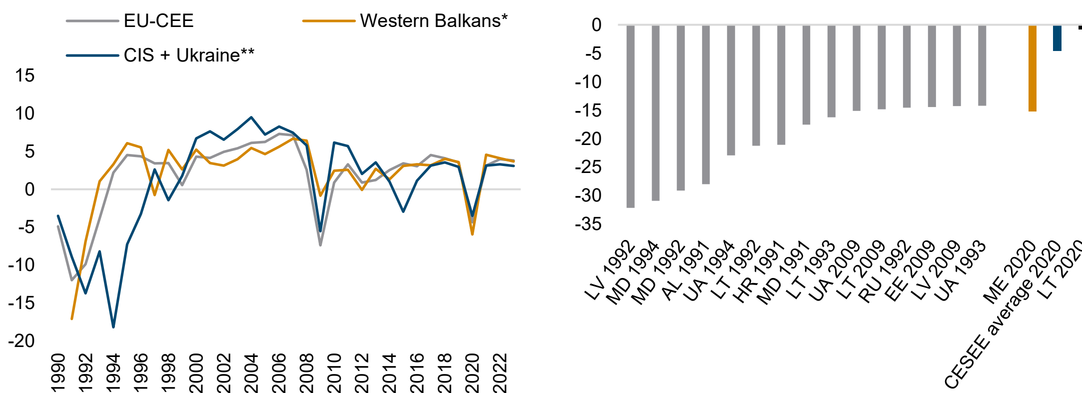
Note: Current forecast and revisions relative to the wiiw November forecast 2020. Colour scale variation from the minimum (red) to the maximum (green).
Source: wiiw.

BOX 2.2 / THE CRISIS IN CONTEXT FOR CESEE

While the current downturn is the worst for the global economy since the Second World War, CESEE has actually experienced much worse within living memory (Box Figure 2.2). Only Montenegro suffered a decline in real GDP in 2020 that was in any way comparable to the worst CESEE experiences faced during the early 1990s transition recessions or in the immediate aftermath of the 2008 global financial crisis. Using unweighted averages, we can see that the 2020 downturn was worse than in 2009 for both EU-CEE countries and (especially) the Western Balkans (Box Figure 2.3). However, for Turkey and the CIS and Ukraine, 2020 was a much better year than 2009. Given the weight of Turkey and Russia in the overall average, last year was substantially better for CESEE as a whole than 2009, on a weighted basis.

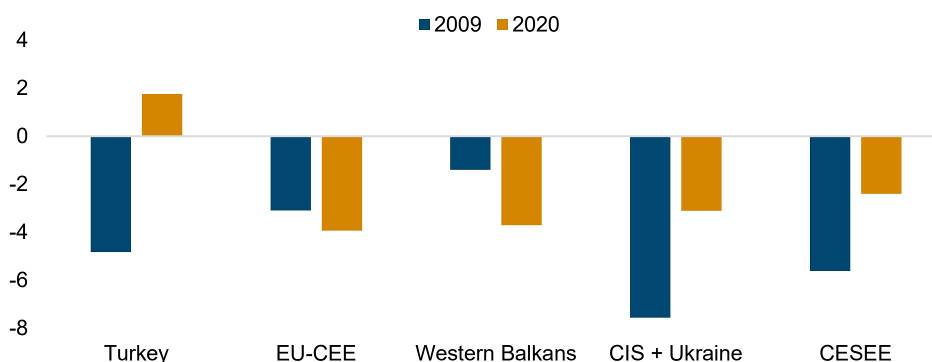
Box Figure 2.2 / Real GDP growth, percentage change per year

regional averages (left) and CESEE's 15 worst post-1989 years compared with the range of outcomes in 2020 (right)



Note: Left-hand chart shows simple averages. Turkey is excluded from these charts, as it did not experience the transition recessions of the early 1990s. *Average includes Albania and North Macedonia from 1991, Serbia from 1996, Bosnia and Herzegovina and Montenegro from 2000, and Kosovo from 2001. **Average includes Russia and Ukraine from 1990, and Belarus, Kazakhstan and Moldova from 1991.
Source: National sources, wiiw.

Box Figure 2.3 / Real GDP growth, %

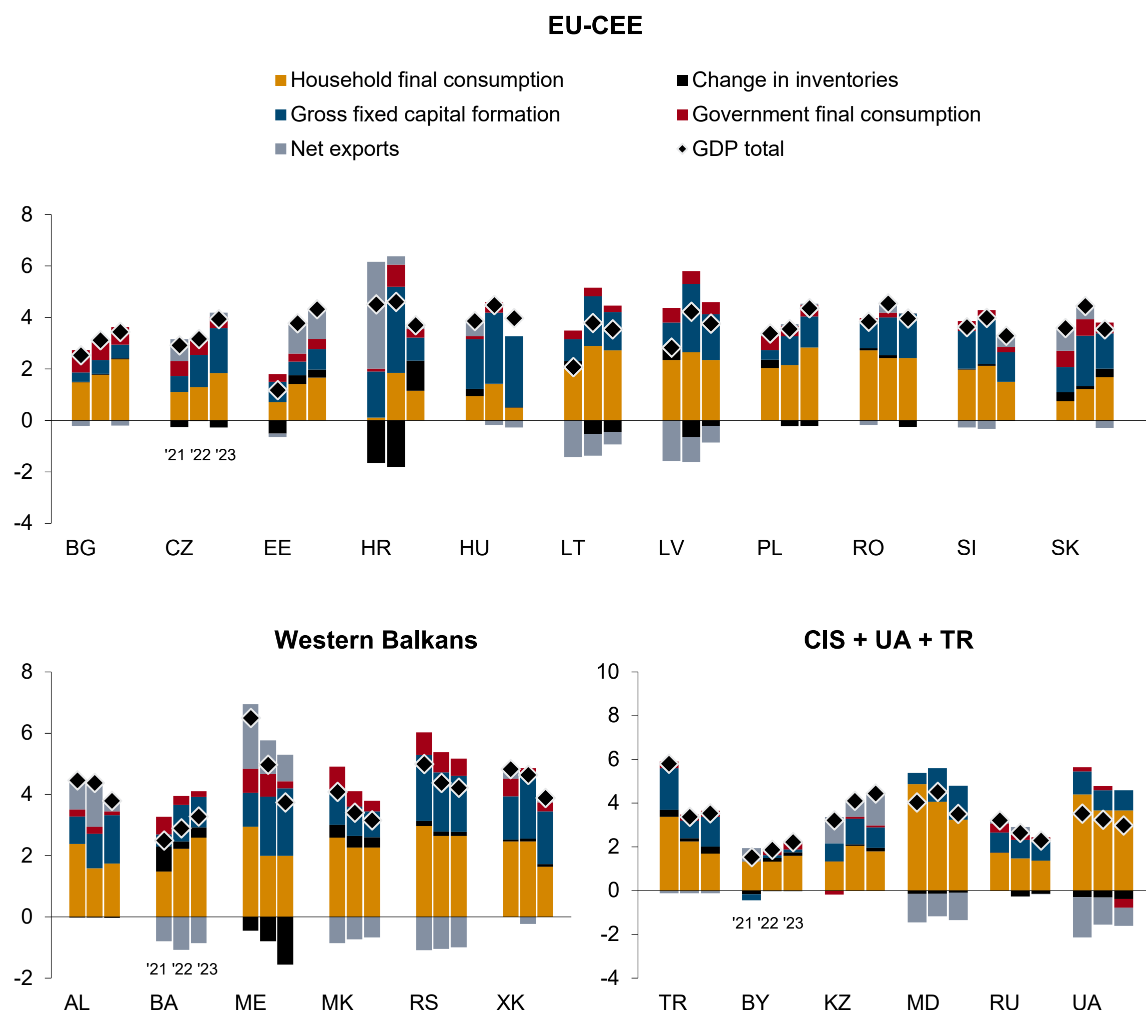


Note: Data are weighted averages.
Source: National sources, wiiw.

Given that last year was better than expected, we have made quite a few downward revisions for 2021, reflecting the combination of a higher base and the reimposition of lockdowns in much of the region (Table 2.2). We expect 2021 growth to be lower than previously forecast in eight EU-CEE and three Western Balkan countries. Our downward revisions are particularly large for the Baltic states, reflecting the fact that they provided among the most positive surprises last year, and will therefore have a higher base than we had previously anticipated. Our most notable upward revisions are for Belarus, Ukraine and Turkey. For Belarus, this reflects greater confidence about external funding coming from Russia, the resumption of oil and gas deliveries from Russia to Belarus, and the rise in oil prices. For Ukraine, our improved forecast reflects higher prices for commodity exports. In Turkey, the upgrade reflects very strong recent high-frequency data, the large credit impulse, robust industrial and export performance, and an expectation that monetary conditions will be loosened during the rest of the year.

Figure 2.9 / GDP growth forecast for 2021-2023

and contribution of individual demand components, in percentage points



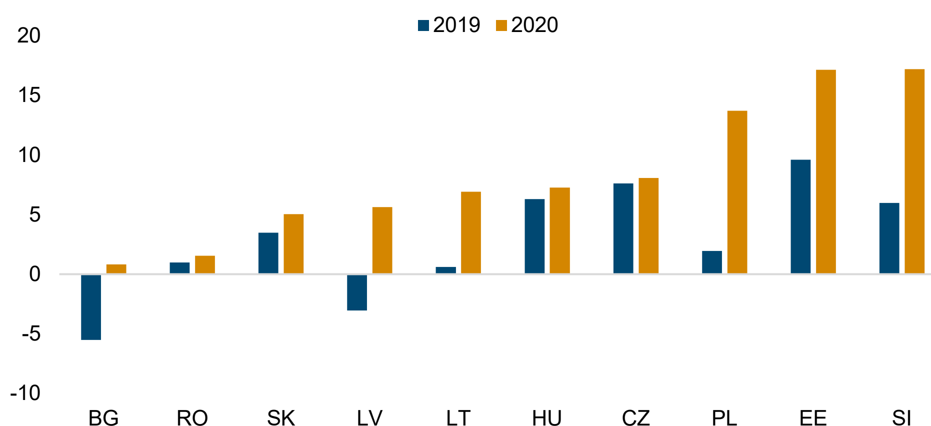
Source: Forecasts by wiiw.

In 2021, CESEE overall is unlikely to continue to outperform the euro area. We expect average (weighted) growth in CESEE in 2021 to be 3.8%, a very similar rate to that of the euro area as a whole. To a large extent, this reflects the fact that CESEE did so much better last year, and so therefore the base is higher relative to the euro area. However, the key reason for the less spectacular performance in 2021 will be the harsh second/third/fourth wave that has hit the region, and the consequent need to impose tighter lockdowns at the start of 2021 to get on top of things. We are also less optimistic than previously about the extent to which restrictions can be loosened this year. The main summer months may well again see very loose restrictions, as in 2020, but the extent to which the region can generate serious economic growth will depend on the much looser restrictions continuing for significantly longer than last year.

Across CESEE in 2021 and beyond, growth will be driven by a combination of exports of goods and services as the global economy recovers, the drawing-down of savings, better domestic sentiment as vaccination rates increase, and more (albeit less than last year) fiscal and monetary support. Private consumption will return as the main driver of growth almost everywhere in 2021 and across the forecast period; but in EU-CEE investment will also make a big contribution on the back of rising inflows of EU funds (Figure 2.9). In countries that were hardest hit by the tourism shock last year – Croatia, Montenegro and Albania – net exports should make a positive contribution this year.

Once the latest lockdowns are eased and sentiment picks up, consumer spending could rise strongly. In those countries for which comparable data are available, household savings rates increased substantially last year, especially in the Baltic states, Poland and Slovenia (Figure 2.10). It seems reasonable to expect at least a partial drawdown of these savings by the second half of the year, which would provide a sizeable boost for purchases of consumer durable goods and overall private consumption growth.

Figure 2.10 / Net saving rates of households and non-profit institutions serving households

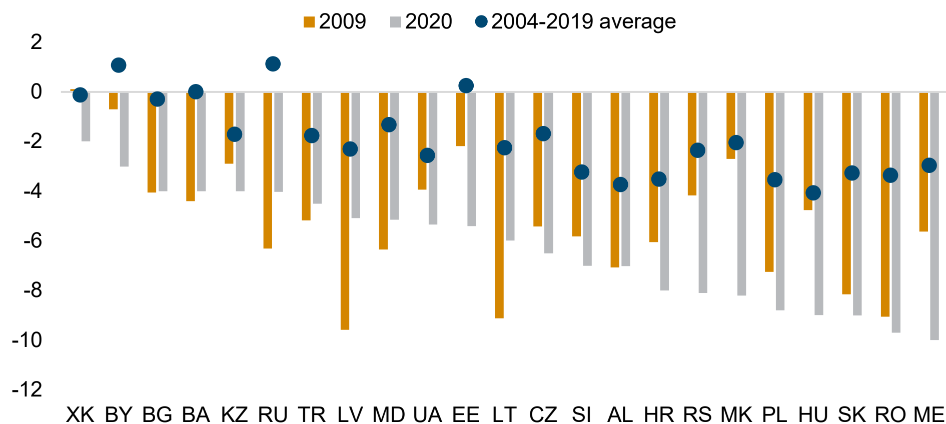


Source: OECD.

2.3. POLICY RESPONSE: MORE OPTIONS THAN AFTER 2008

The fiscal response to the current crisis in CESEE has been much more substantial than at any point in recent decades. Every country in CESEE in 2020 ran a fiscal deficit far above its average since 2004 – and for most, considerably bigger even than in 2009, immediately following the global financial crisis (Figure 2.11). Using the 'budget deficit ratio' – the budget deficit as a share of total government expenditure –we also identify an unusually big policy response in 2020 (Figure 2.12).[8] There are two main reasons for this. First, the scale and unusual nature of the pandemic, which forced governments to respond decisively in order to prevent what could have been a much more severe social fallout. Second, a lot of assumptions about fiscal policy have changed since 2009. Then, austerity was the dominant narrative, accompanied by fears of inflation and assumptions that both central banks and finance ministries faced very tight constraints on their actions. After more than a decade of massively increased money supply, with barely a hint of consumer price inflation (real estate and other asset markets are, of course, a different matter), many think differently. Thanks to the glut of global liquidity, the effective interest rate on public debt has collapsed in most countries of CESEE for which data have been available since 2009 (Figure 2.13). We do not know what a 'safe' level of public debt is as a share of GDP, but under current conditions it is substantially higher than it was in 2009. This has increased policy makers' confidence in acting more decisively with fiscal policy this time.

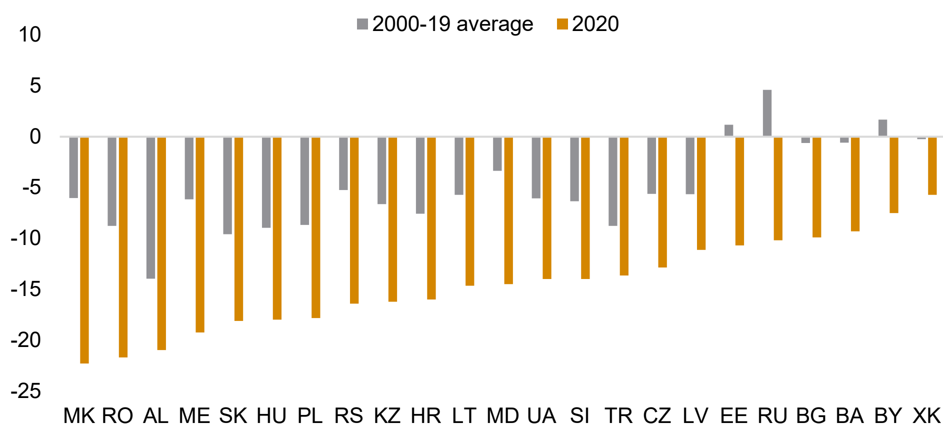
Figure 2.11 / Budget balance, % of GDP



Source: wiiw Annual Database incorporating national statistics and Eurostat.

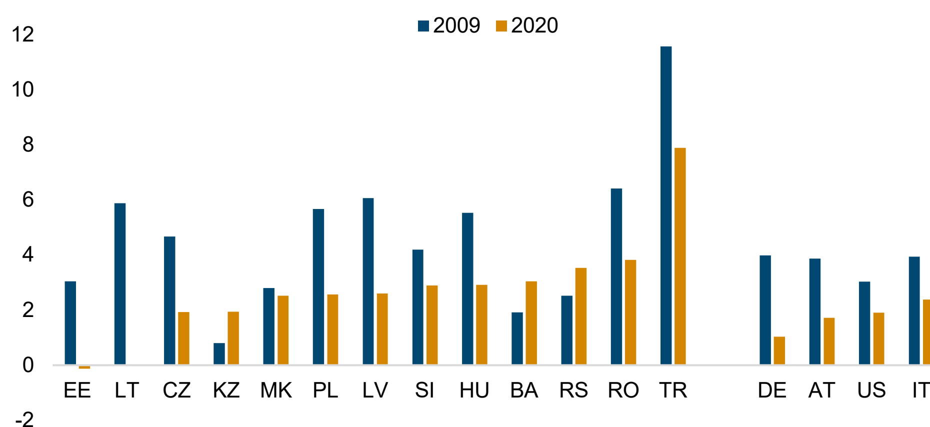
[8] The 'budget deficit ratio' is used by economic historians to understand previous periods of high inflation. Historically, a budget deficit ratio above 20% has been found to be an explanatory variable for subsequent periods of high inflation.

Figure 2.12 / Budget deficit ratio, %



Note: Budget deficit ratio = budget deficit divided by government expenditure.
Source: wiiw Annual Database incorporating national statistics and Eurostat, wiiw calculations.

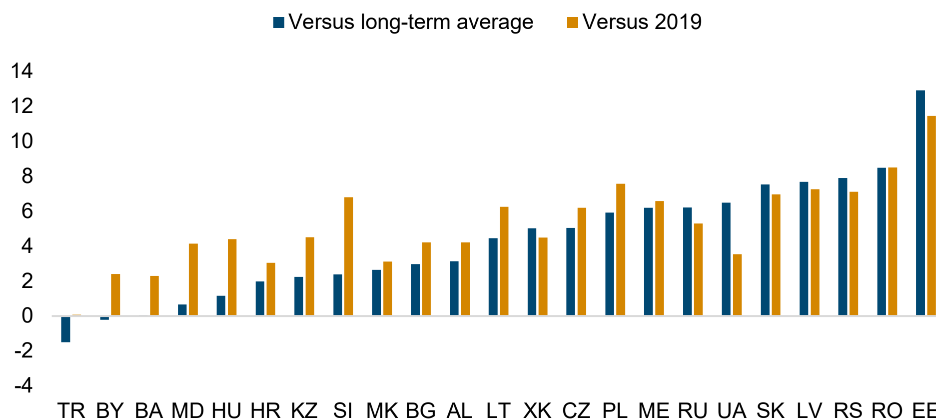
Figure 2.13 / Effective interest rate on public debt, %



Note: Effective interest rate on public debt calculated as interest payments (primary budget balance - overall budget balance) divided by net public debt.
Sources: IMF, wiiw calculations.

Fiscal policy will not be able to repeat its heroics of 2020 in most of the region, and the long road to fiscal consolidation will begin this year. However, the lingering effects of the pandemic, combined with the continued very favourable financing conditions, mean that in a lot of countries the pace of consolidation is likely to be very slow. Public expenditure as a share of GDP rose to multi-year highs last year (Figure 2.14). On average, general government outlays as a share of GDP were 4.1 p.p. higher than the long-term average (2000-2019) and 5 p.p. higher than in the previous year. In most cases, the fiscal deficit for 2021 should not be dramatically smaller than in 2020 (and even then, mostly on account of a cyclical increase in tax revenues, rather than a change in the fiscal policy stance), and we do not expect this to be fully unwound during the forecast period; the size of the state in CESEE may well have been increased permanently by this crisis.

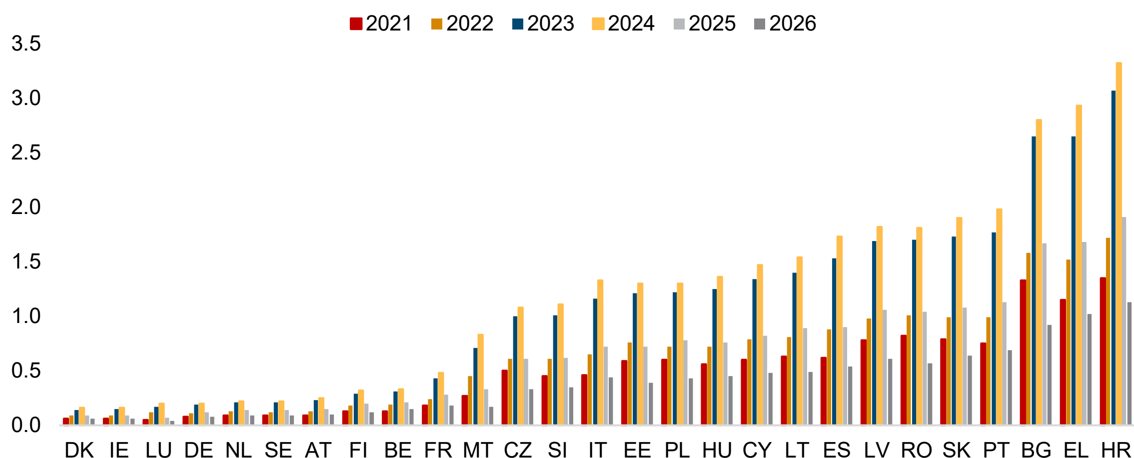
Figure 2.14 / General government expenditure as a percentage of GDP – 2020 versus long-term average and 2019, p.p.



Note: Long-term average = 2000-2019.
Source: wiiw Annual Database incorporating national statistics and Eurostat, wiiw calculations.

EU-CEE countries are going to get a lot of money from the EU to boost fiscal space in the coming years. The EU has been criticised for lacking a fiscal response comparable to that of the US or other developed countries; but the various funds are a huge step forward and potentially represent something of a game-changer for countries in EU-CEE. Funds include both the existing EU budget (Multiannual Financial Framework – MFF) from which EU-CEE countries have historically benefited (and continue to do so) and the Next Generation EU (NGEU) funds – a temporary instrument set up in response to the current pandemic. The NGEU has several components, but the most important is the Recovery and Resilience Facility (RRF). The MFF for 2021-2027 totals EUR 1.074trn, while the NGEU is worth an additional EUR 750bn. Together they therefore amount to around EUR 1.8trn. Importantly, around 70% of NGEU funds are planned for 2021-2022. Allocations to member states will be based on population size, wealth levels and the unemployment rate in recent years relative to the EU average.

Figure 2.15 / Estimated allocations under the NGEU programme, % of GNI



Source: Zsolt Darvas, Bruegel.

Much remains uncertain about the EU funds, but it seems that some of EU-CEE's hardest-hit countries are in line for fairly sizeable inflows. Estimates by Zsolt Darvas of the Bruegel think tank show that Croatia will be the single biggest recipient of NGEU loans and grants as a share of gross national income (GNI) in coming years (Figure 2.15). Both Croatia and Bulgaria are entitled to 1% of GNI this year, 2% in 2022 and 3% in 2023. Along with some Southern European countries, all the major recipients of NGEU funds will be EU-CEE countries.

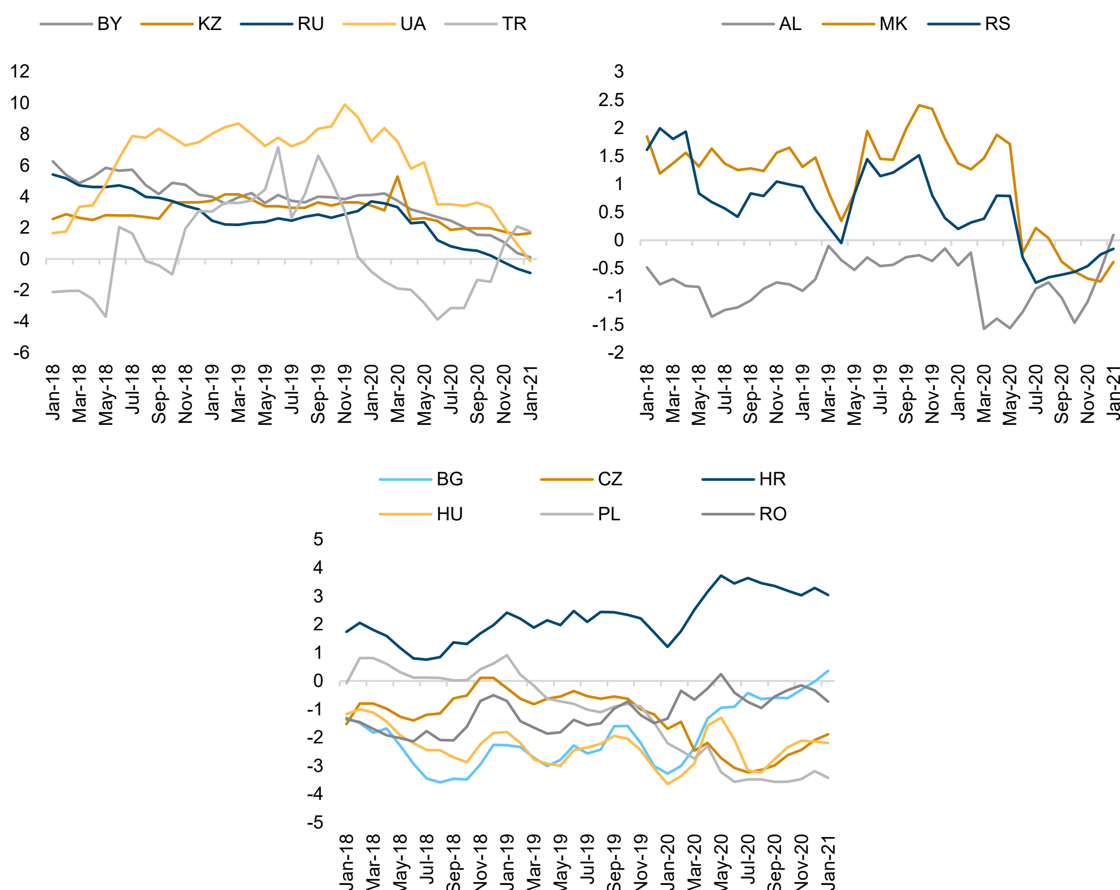
However, as the last 15 years in EU-CEE have shown, the challenges surrounding absorption capacity mean that entitlement to EU funding does not necessarily translate into actual receipt of it. It remains to be seen whether EU-CEE countries can convert these large allocations into concrete public investment and other productive forms of spending. Countries must also prepare plans and get approval from the Commission, and the deadline for submission of these plans is the end of April 2021. At least for 2021, we are quite cautious about the possible impact of NGEU plans on headline growth; however, we believe that from 2022 the impact could be more significant.

The second key question is the extent to which the EU will manage to concretely tie fund disbursement to rule-of-law abuses, and the extent to which this will limit allocations for at least some EU-CEE countries. The last decade or so seems to indicate that while Brussels is certainly upset about the undermining of institutional independence in parts of EU-CEE – especially, but not exclusively, Hungary – its ability to take concrete action is very limited. Over the past few years, Hungary has been among the largest recipients of EU funds as a share of its GDP. However, two things create the possibility that this time things could be different. First, the sheer size of the additional NGEU funds on top of the existing EU budget has raised the stakes. Such a disbursal of money has brought an increased desire in several northwestern EU member states to see that it is spent properly. Second, and linked to this, at the end of 2020 the EU – in the teeth of Hungarian and Polish opposition – did push through a mechanism to restrict EU funds to any member state where corruption in the use of such funds has been established (the Rule of Law Conditionality Mechanism). This may not yet affect the core issue of the undermining of independent institutions; but it could well be that a Rubicon has been crossed that will allow the EU to go much further than in the past in restricting EU funds for countries such as Hungary (see the Hungary country report for a further discussion of this). In a recent interview, Commission Vice President Věra Jourová used tough language in suggesting that the EU will not shy away from taking concrete steps as early as this year (Bodoni and Simon, 2021).

For the rest of CESEE, there will be much less outside help, and so fiscal policy is unlikely to be much of a growth driver. Some non-EU countries, such as Kazakhstan and Russia, certainly have policy space to use, should they so wish; but particularly the latter is likely to use only a fraction of what it could. The options for countries such as Belarus and Ukraine are much more limited. In the Western Balkans, some external financing options exist, but so far only Serbia has sought to maximise them. Its success in managing the downturn well using fiscal policy may inspire others to use currently favourable financing options to do the same this year (although this will be easier for some than for others). Bosnia and Herzegovina is a particularly difficult case: limited financing options and a complicated constitutional set-up that hampers effective policy implementation will prevent a major role for fiscal policy in managing the recovery. For the Western Balkans as a whole, more involvement in EU financing mechanisms would be a game-changer, while having barely any impact on the budget of the EU itself (Grieveson et al., 2020b). However, the chances of this happening seem close to zero.

For CESEE as a whole, monetary policy has been less important as a strong crisis-fighting mechanism, given that many countries went into 2020 with low or negative real policy rates. Only in the CIS, Ukraine and Turkey (where the move has now largely been reversed) has there been substantial policy loosening (measured as a decline in real interest rates) since the start of 2020 (Figure 2.16). On the same basis, there has only been much more moderate loosening in parts of the Western Balkans and EU-CEE. However, this does not mean that central banks in EU-CEE and the Western Balkans have not responded: rather, they have followed Western central banks in resorting to other monetary tools to stimulate the economy, such as quantitative easing. Central banks – including those of Hungary, Croatia, Poland, Romania, Turkey and Serbia – have bought government bonds since the pandemic started.

Figure 2.16 / Real policy rates, consumer price index adjusted, %



Source: wiiw Monthly Database incorporating national statistics and Eurostat.

The extent to which central banks are able to continue to engage in monetary stimulus will depend on inflation: there are signs that it will rise somewhat this year, but will remain low by historical standards. The recent sharp increase in global commodity prices (see chapter 1) is a particular issue for CESEE, given that in the region a larger share of the consumer price basket is weighted towards those items than is the case in Western Europe. Although, for much of CESEE, the effect of this has been absorbed somewhat by the stronger euro, cost-push pressure on inflation has certainly risen, as evidenced by recent Purchasing Managers' Index (PMI) surveys for the region's

bigger economies. However, this is offset by sizeable output gaps for most countries, which in most cases will be far from closed this year. As a result, demand-pull pressure on prices is currently extremely weak, and will not re-emerge strongly during the forecast period in our baseline scenario. This is hinted at by core inflation (excluding energy and unprocessed food), which has fallen in most countries since the start of the pandemic (Figure 2.17). Without more aggregate demand, firms will struggle to pass on higher input costs to consumers. So far, they certainly do seem to be struggling. Despite the rise in global energy and food prices, inflation in these categories in CESEE countries is very limited, if not actually negative (Figure 2.17). Although there is some inflation in the housing, water, gas, electricity and other fuels component of the consumer price index (CPI), this reflects domestic increases in electricity prices (see country reports for more details). Some change in these domestic price dynamics is very likely: global energy prices collapsed in the early months of the COVID-19 pandemic, and so this much lower base period will 'kick in' with the March inflation data. However, while CESEE is in partial lockdown, rising international commodity prices will probably lead to a squeezing of margins, while commodity prices will probably fall back over the medium term. It is, however, possible that when vaccination rates are higher and economies reopen, residents of CESEE will draw down their savings in a way that generates at least a few months of substantially higher inflation in the middle of this year.

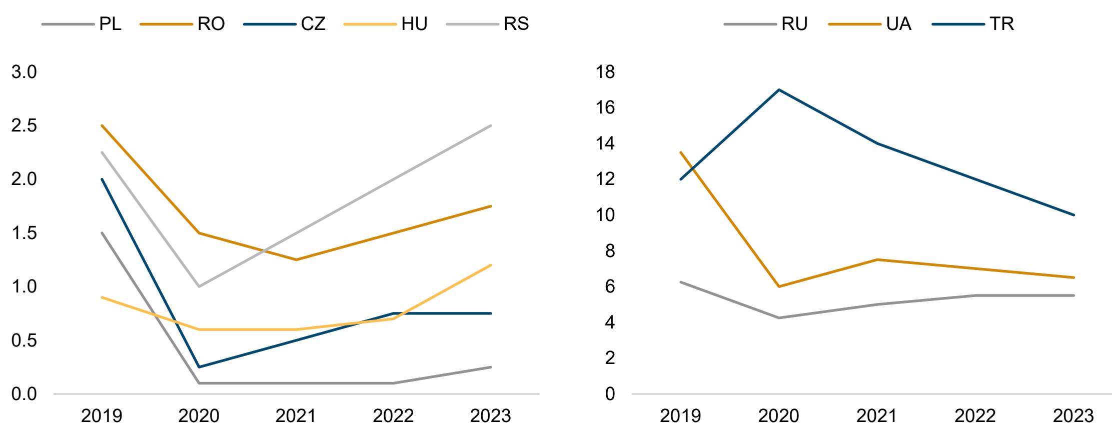
Figure 2.17 / Consumer price inflation sub-components, percentage change year on year

Core (top left); food and non-alcoholic beverages (top right); housing, water, gas, electricity and other fuels (bottom left); transport (bottom right)

Note: Core = headline minus energy and unprocessed food.
Source: National sources, Eurostat, wiiw.

Although the risks of sustained inflation seem quite limited, some of the region's central banks are keen to get ahead of the curve. Reflecting higher inflation, the Ukrainian and Russian central banks have already started to tighten policy: in March, the Russian Central Bank raised its benchmark rate by 25 basis points to 4.5%, and did not rule out further hikes in the coming months, citing rising inflation and geopolitical factors. Meanwhile, communication from the Czech National Bank in the same month suggested tightening will start from Q4, owing to higher price pressures and an expectation that the pandemic situation will be markedly better by then. We expect tightening in Czechia, Ukraine, Serbia and Russia this year (Figure 2.18). By contrast, following its March meeting, the Hungarian National Bank appeared willing to accept what it expects to be a temporary spell of inflation above its 2-4% target band in the coming months, despite further weakness in the forint. We expect the central banks in Romania and Poland also to remain on hold this year. Turkey looks almost certain to cut rates, however damaging that will be. Thereafter, we expect some moderate tightening in most of the region. Turkey is an exception, although there is a substantial risk that the central bank will have to reverse its course in order to react to inflation, a weakening lira and capital outflows.

Figure 2.18 / Central bank nominal policy rates, end of year, %



Source: wiiw Annual Database incorporating national statistics, forecasts by wiiw.

The impact of the pandemic on exchange rates across the region has been very diverse, but sharp real depreciations have been recorded in Turkey, the CIS, Ukraine and, to a lesser extent, Hungary (Figure 2.19). This reflects low or negative real policy rates in some cases (and weaker oil prices in the case of Russia and Kazakhstan), but more broadly the perceptions of risk at a time of heightened uncertainty and volatility on the financial markets. Although this will have knock-on effects on inflation, and has already prompted the central banks in Russia and Turkey to tighten policy, it has also delivered a potential competitiveness boost to those countries. In Turkey, the benefits of a weaker lira for exporters can be seen in the robust recovery of industrial output in H2 2020.

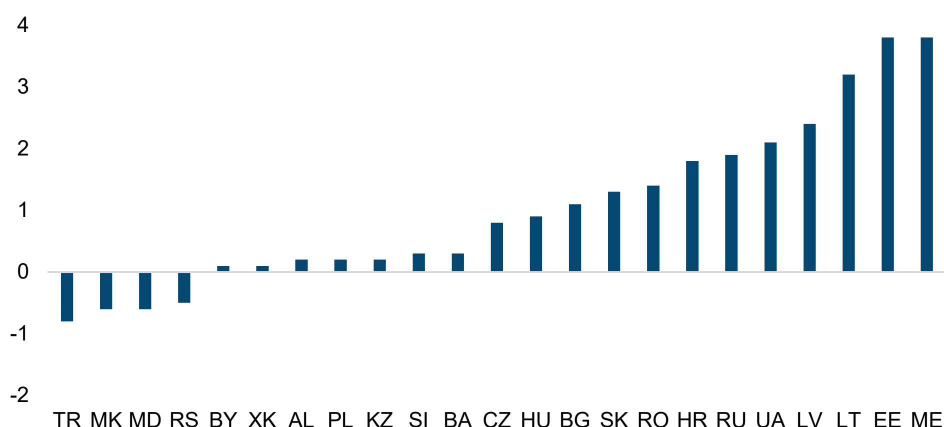
Figure 2.19 / Real exchange rates against the euro, percentage change since December 2019

Note: Data are as of January 2021 or latest available.
Source: wiiw Monthly Database incorporating national statistics and Eurostat, wiiw calculations.

2.4. LABOUR MARKETS: HARD TO GAUGE THE TRUE IMPACT

Headline labour market data suggest a surprisingly limited impact from the pandemic so far. Labour Force Survey (LFS) data show that most countries recorded a rise in the rate of unemployment between Q3 2019 and Q3 2020, but in most cases this was around 2 p.p. or less (Figure 2.20), which is relatively minor in the context of the global economy's worst recession for 75 years. Only Russia, Ukraine, the Baltic states, Croatia and Montenegro – the last two badly affected by the collapse in tourism – saw more significant hits to their labour market in the first year of the pandemic. Yet even for these countries, the early impact of the pandemic on the unemployment rate has been considerably smaller than that caused by the 2008 global financial crisis and its aftermath.

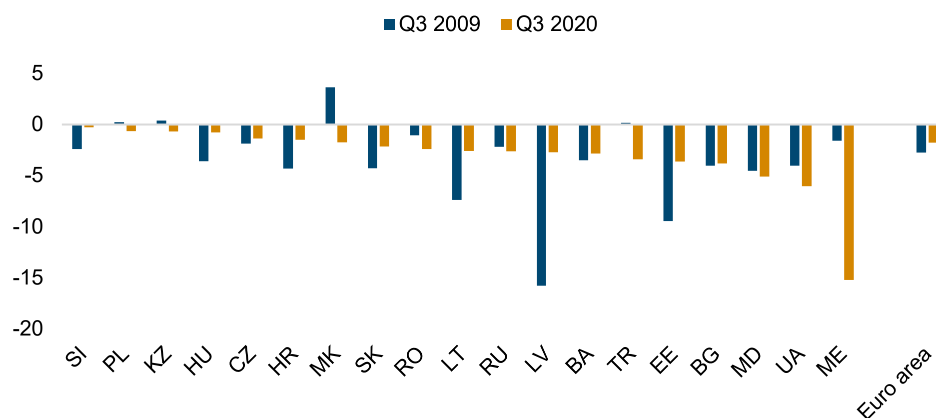
Figure 2.20 / Change in LFS unemployment rate, p.p., Q3 2019 - Q3 2020



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

Part of the key to this puzzlingly benign picture is the fact that people who lost their jobs because of the pandemic became inactive, rather than unemployed. In the third quarter of 2020, employment fell in year-on-year terms in every CESEE country, by an average of around 3% overall (Figure 2.21). Despite various short-time and furlough schemes designed to keep people in work, many countries recorded considerably larger drops in employment in Q3 2020 than in the same period of 2009, immediately after the global financial crisis. It is also likely that the headline figures fail to reflect a lot of the reality of this crisis, as experienced by many workers. Those receiving government support will rarely have been getting their normal salary, while those in the grey economy have certainly been badly affected. Cross-border seasonal workers from countries such as Ukraine have also been hit by the crisis. In many countries, the burden also seems to have fallen disproportionately on older workers. It may be the case that younger workers will not suffer as much as after 2008, given their better IT skills and the boost to the digital economy generated by the pandemic.

Figure 2.21 / Employment, percentage change year on year

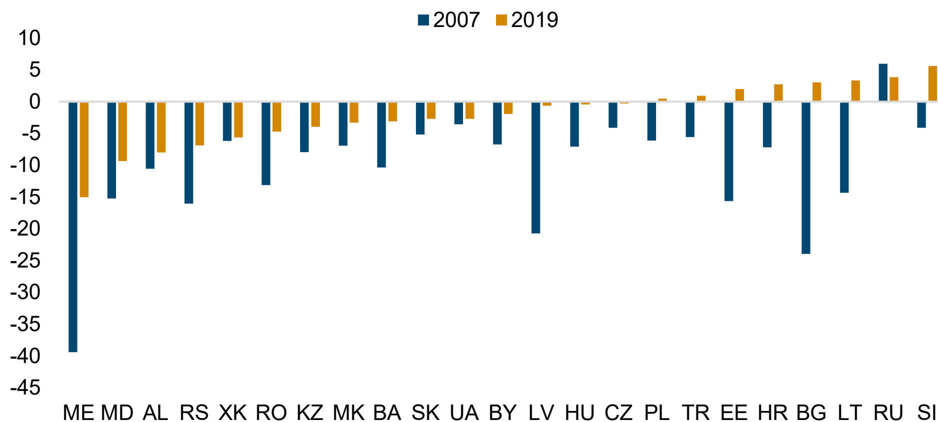


Source: wiiw Monthly Database incorporating national statistics and Eurostat, wiiw calculations.

2.5. EXTERNAL ACCOUNTS: SO FAR (MOSTLY) SO GOOD

External imbalances have not dominated the discussion around the region to anything like the extent they did after 2008. Then, the sudden halt to external financing created grave difficulties for many CESEE countries running large external deficits, and contributed to depression-like contractions in Ukraine and the Baltic states. Most countries in CESEE did not have big current account deficits coming into the current crisis. The average current account deficit in CESEE in 2007 was 10.6% of GDP, compared with just 2% in 2019 (Figure 2.22). Those countries that still do run big deficits often fund these with a large share of fairly stable financing from international organisations, with low interest rates and long repayment terms. Meanwhile, the extraordinarily loose policy of the major central banks has created a glut of global liquidity, which has been reinforced over the past 12 months (see global overview). In addition, for the poorest parts of the region, such as Kosovo, remittances last year acted as a counter-cyclical buffer to help finance the deficit, preventing a greater slowdown in economic activity. As a result, this time around the risk of external financing suddenly drying up and producing sharp economic contractions is greatly diminished.

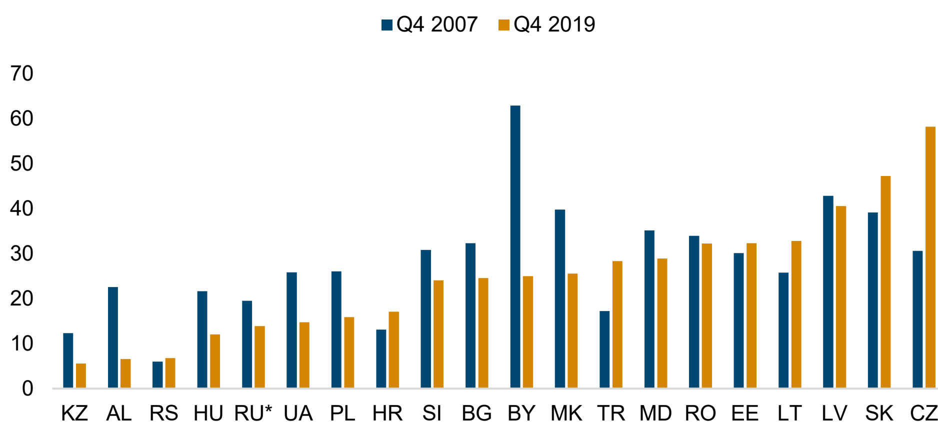
Figure 2.22 / Current account, % of GDP; 2007 versus 2019



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

A further factor of stability this time is that most CESEE countries went into the COVID crisis with much less short-term debt (maturing in the next 12 months) as a share of the total than was the case at the end of 2007 (Figure 2.23). This indicates that countries have sensibly used those years of very favourable financing conditions to extend the average maturity on their external debt. Mostly, the exceptions to this are euro area or 'euroised' countries with strong fundamentals and high credit ratings. However, they also include Turkey, where short-term external debt was almost 30% of the total at the end of 2019, compared with 17% at the end of 2007. We continue to see Turkey as something of outlier in CESEE, due to its combination of a large current account deficit, high inflation, lack of policy credibility and low foreign exchange reserves.

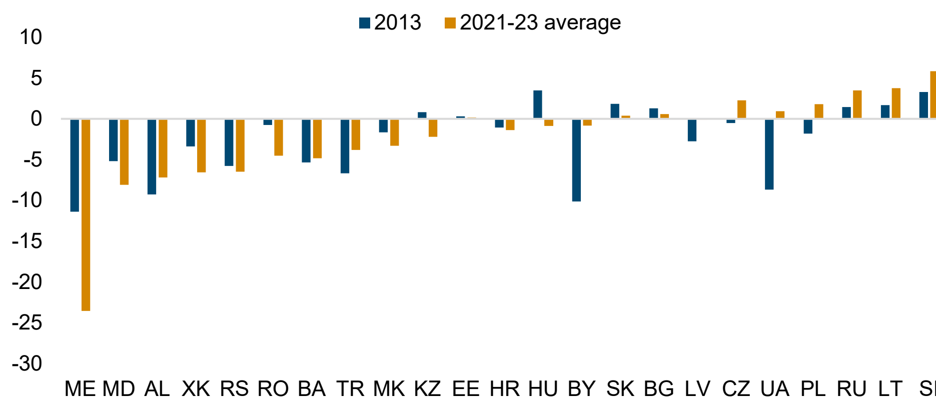
Figure 2.23 / Short-term gross external debt, % of total



Note: *Q4 2007 data for Russia unavailable; data shown are from Q1 2008.
Source: wiiw Annual Database incorporating national statistics, wiiw calculations.

Rising US long-term interest rates (see chapter 1) will push up borrowing costs for those countries weighted towards dollar funding, which could cause external financing difficulties over the forecast period. However, most CESEE economies are in a better position to deal with any repeat of the 2013 'taper tantrum', when a more hawkish-sounding Fed caused a huge outflow of funds from emerging markets. Some countries, including Belarus, Ukraine, Albania and notably Turkey, would likely go into any new tightening of external financing conditions with substantially smaller current accounts deficits than in 2013 (Figure 2.24). However, Montenegro, Moldova and Romania, in particular, have headline external balances that leave them more exposed to changing foreign investor sentiment than was the case in 2013.

Figure 2.24 / Current account, % of GDP; 2013 versus forecast period



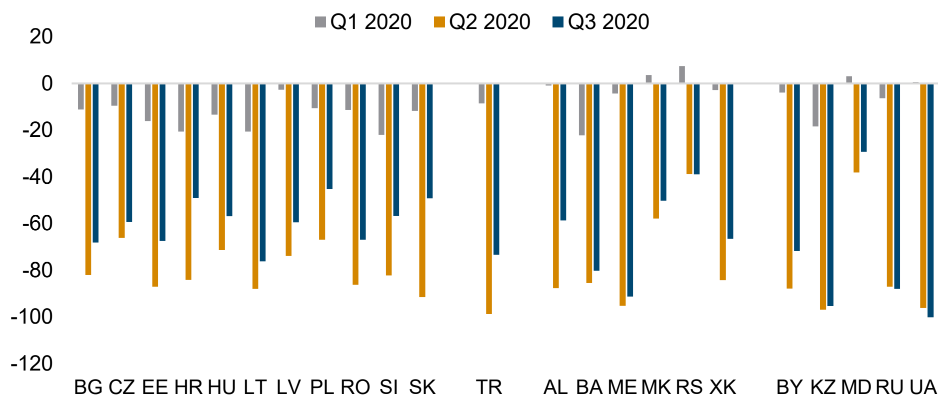
Source: wiiw Annual Database incorporating national statistics and Eurostat, forecasts by wiiw.

One key area of external vulnerability in this crisis has been tourism, and those countries that rely on it suffered badly in 2020. Tourism was hit by a perfect storm in 2020, combining heavy restrictions during most months of the year with heightened uncertainty and fear among many prospective tourists about travelling long distances. All countries suffered from this, with travel credit on the balance of payments (BOP) down by between 38% and 99% year on year in Q2 (Figure 2.25). Although declines were mostly not as bad in Q3 (since restrictions on international travel were eased), travel credits still fell by at least 23% year on year everywhere. Of those countries most reliant on tourism, Croatia suffered least in Q3 (-49%), reflecting a partial recovery as the lifting of restrictions allowed more arrivals from countries such as Germany. Montenegro, which is further away from big Western European tourism sources, suffered much more in Q2 (-91%).

The outlook for tourism this year is extremely uncertain, but it is likely that overall inflows for those CESEE countries most dependent on international arrivals will be up on 2020. The first reason for this is that the base is so low: especially in the second quarter of 2021, almost any amount of tourism will represent growth compared with last year. Meanwhile, by the time the core summer tourism months arrive, vaccination rates will be considerably higher than is currently the case; and like last year, the number of COVID cases should decline in the warmer weather. Croatia will continue to benefit from being a relatively easy car journey away from Germany, Austria and other core tourism sources. Meanwhile, Montenegro should benefit from the particularly high vaccination rates in Serbia, a big source of tourism. There are still hopes that policy makers will do even more to help drive tourism flows around Europe over the summer. Greece and other Southern EU countries have been pushing hard for

vaccination passports. On 17 March, Commission President Ursula von der Leyen announced proposals for a Digital Green Certificate, to include information on the holder's a) vaccination, b) tests and c) medical certificates in case of recovery from COVID-19. Margaritis Schinas, European Commission vice-president in charge of 'promoting our European way of life', has said that the passport scheme will be ready by 1 June.

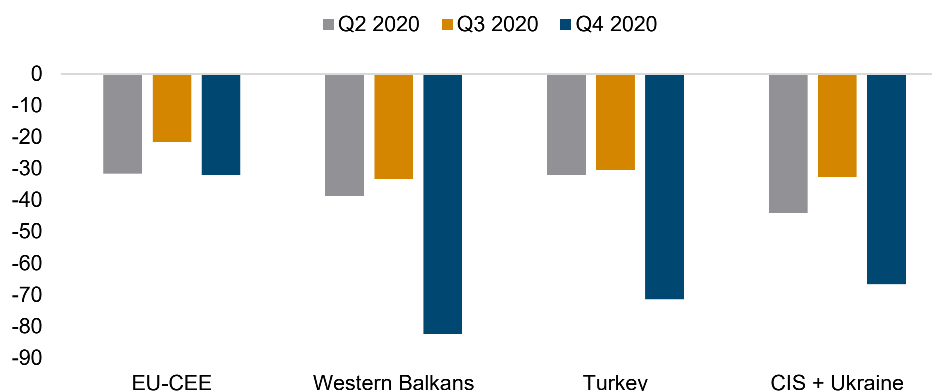
Figure 2.25 / Travel services, credit (BOP), percentage change year on year, euro based



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

Inflows of foreign direct investment (FDI) into CESEE dropped sharply last year, but this is a notoriously difficult indicator to read on a short-term basis, and the medium-term prospects for FDI in the region may not be negative. Announced greenfield FDI projects fell precipitously across CESEE last year (Figure 2.26), reflecting a sharp decline in investor sentiment owing to the pandemic. The number of projects announced fell in all sub-regions in Q2, Q3 and Q4, but the sharpest decline was clearly in Q4, especially for the Western Balkans, Turkey and the CIS and Ukraine. While this is patently bad news, and suggests that the worrying trend may continue in 2021, there are reasons to think that over the medium term CESEE may gain from some 'near-shoring', as Western European firms move outsourced production closer to home (Adarov and Hunya, 2020).

Figure 2.26 / Announced greenfield FDI projects, percentage change year on year

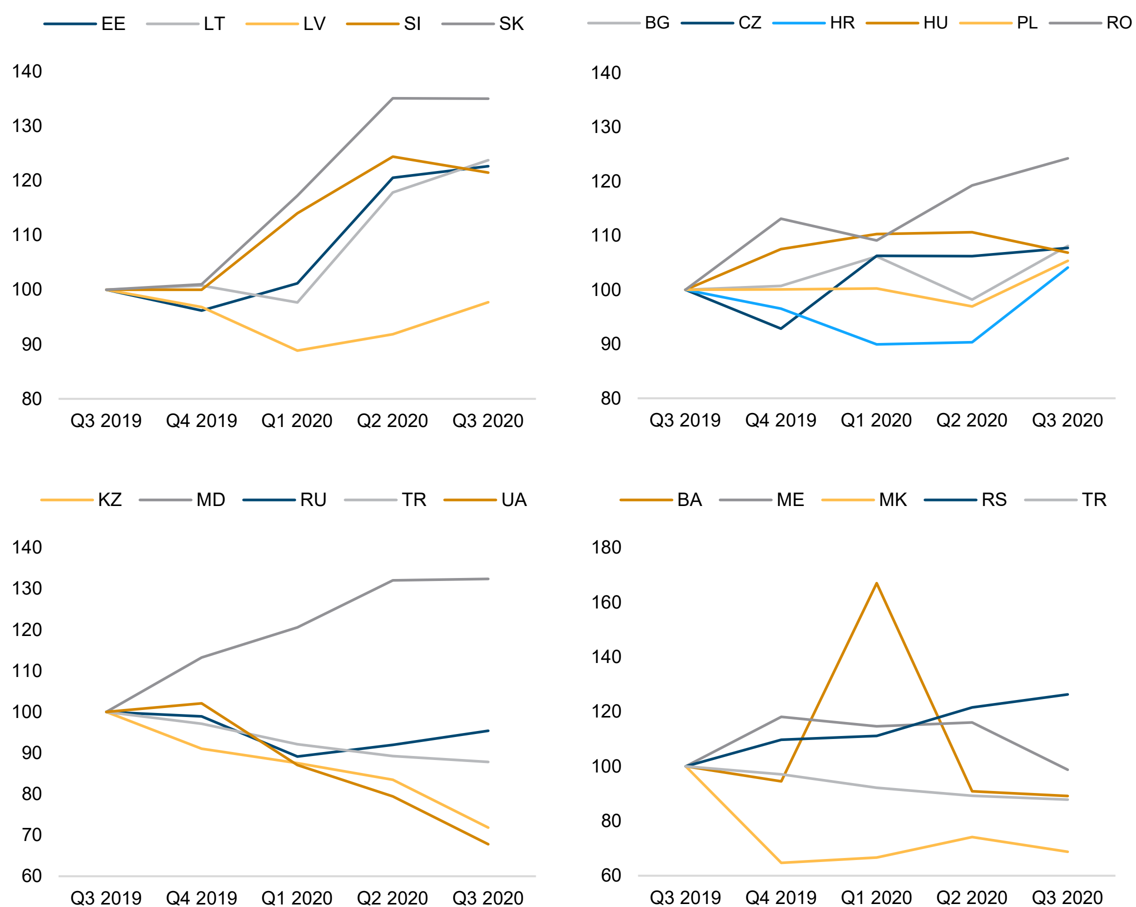


Source: fDi Markets, wiiw calculations.

2.6. FINANCIAL SECTOR: ABUNDANT LIQUIDITY, BUT LIMITED INVESTMENT OPTIONS

In 2020, central banks around the world responded to the pandemic with sweeping stimuli to provide relief to the disrupted economies. The latest European Investment Bank (EIB) Bank Lending Survey (BLS)[9] shows that the monetary and fiscal stimulus to offset the negative economic effects of the COVID-19 pandemic in the euro area kept the credit channel partially open in 2020, and the balance sheets of banks in Europe have surged. After a massive exodus from the emerging markets at the start of the coronavirus crisis, foreign investors embarked on a vigorous return to many of the CESEE countries' stocks and debt markets in the second half of 2020, further boosting the liquidity situation there.[10]

Figure 2.27 / Indices of cross-border consolidated bank claims on an ultimate risk basis by counterparty, USD terms, Q3 2019=100



Source: BIS.

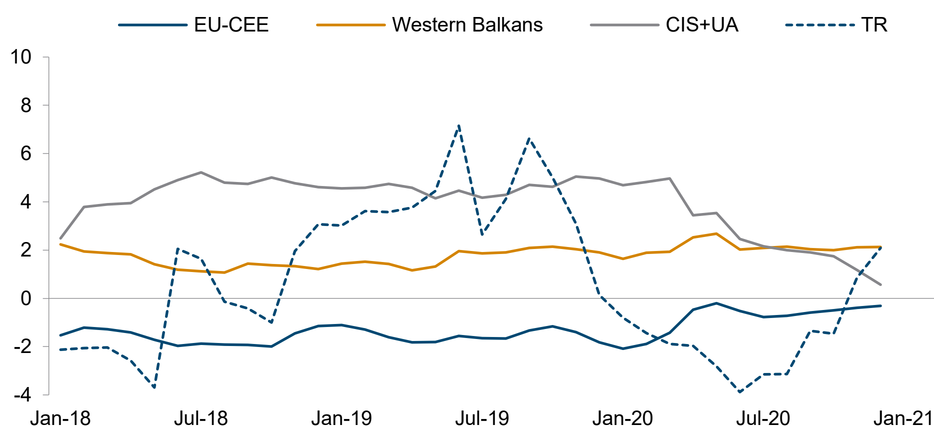
9 https://www.ecb.europa.eu/stats/ecb_surveys/bank_lending_survey/html/index.en.html

10 In our analysis, we use data from the Bank for International Settlements (BIS), and specifically its consolidated banking statistics on an ultimate risk basis and its real property prices time series. The consolidated banking statistics (CBS) measure international banking activity from a nationality perspective, focusing on the country where the banking group's parent is headquartered. The country of ultimate risk is defined as the country in which the guarantor of a financial claim resides or the country in which the head office of a legally dependent branch is located.

Cross-border bank claims in most of CESEE did not experience as dramatic a decline in 2020 as following the global financial crisis. According to the latest BLS, parent banks in the CESEE countries reported an overall positive approach in terms of their operations, commitment and profitability in the region. Around 60% of parent bank groups indicated their intention of maintaining the same level of operations, while 40% planned a selective expansion of operations in the region. Some 85% of groups expect the region to be profitable in the near future. Figure 2.27 shows that among EU member states in the region there was even an increase in cross-border bank claims in Q2-Q3 2020, most pronounced in the euroised countries. When it comes to the non-EU countries, the trends are quite different, especially in Ukraine, Kazakhstan and Turkey, where cross-border bank claims steadily declined throughout the period, largely due to depreciation of the local currencies. In the Western Balkans, Serbia appears to have outperformed the other countries in terms of positive cross-border bank claims.

Liquidity conditions were ample in the region in 2020, as reflected in the low real interest rates (Figure 2.28). In the second half of 2020 there was a slight monetary tightening in EU-CEE and – particularly – in Turkey; however, in EU-CEE the real policy interest rate remained negative on average. In CIS+UA, higher inflation and accommodative monetary policy shifted the real policy rate in the opposite direction, with Ukraine reducing its real policy rate in H2 2020 the most – by 2.5 points. Though many central banks in Western Balkans cut their policy rates, real interest rates stayed mostly unchanged, due to the low inflation, and oscillated around 2% throughout the year.

Figure 2.28 / Real interest rate, CPI adjusted, %

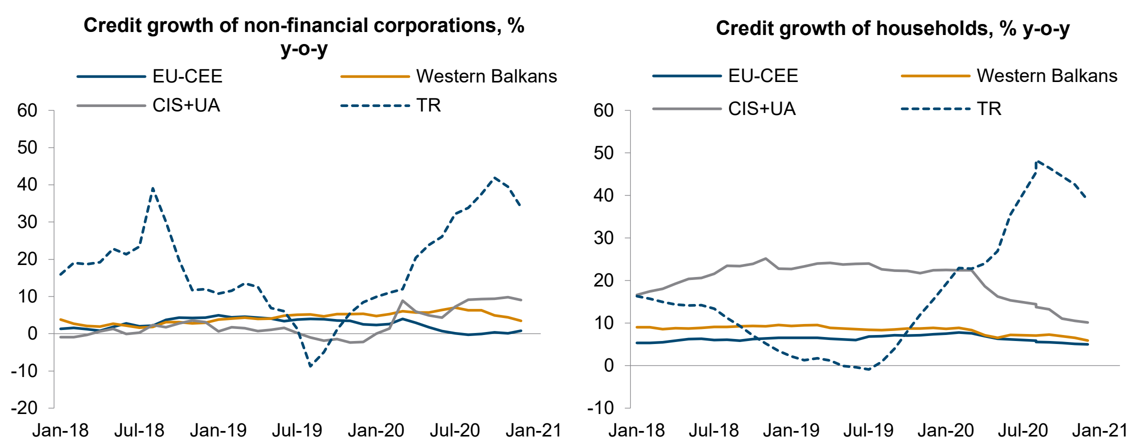


Note: Simple averages for country aggregates.
Source: wiiw Monthly Database incorporating national statistics.

Non-performing loans (NPLs) have been declining until now – partly owing to moratoria on bankruptcies introduced in many countries. However, banks expect them to rise in the near future, as many borrowers become insolvent. This is supported by a decline in the quality of loan applications in 2020 (BLS 2021). Moreover, the moratoria will serve to increase the future debt service, as they prolong the lending period over which interest is calculated. This implies a higher debt burden for households and firms, and may also contribute to higher default rates.

Credit activity has not reflected the favourable liquidity situation in CESEE: there has been some slowing in the growth of loans both to households and to the corporate sector (see Figure 2.29). In part, this is due to a tightening of the credit standards on loans, in line with the banks' heightened perception of risk and greater uncertainty about economic recovery. On the other hand, there has been a sharp fall in demand for loans by both firms and households (in the case of households, the fall in demand has mostly been for consumer loans) (BLS 2021). Loan rejection rates have also increased, particularly for consumer loans. A broad trend, evident since the global financial crisis, has been for the structure of banks' balance sheets to shift from credit to debt securities, fuelled by increased government borrowing.

Figure 2.29 / Credit growth among companies and households, %



Note: Simple averages for country aggregates.
Source: wiiw Monthly Database incorporating national statistics.

Demand for housing loans, by contrast, has been rising, **as have real residential property prices.**[11] This appears to be where much of the liquidity is (see Figure 2.30). In Q1-Q3 2020, real residential property prices increased most sharply in Turkey, Russia, Lithuania and Croatia.[12] In the countries of the euro area, this has been a continuous trend in recent years, but in 2020 growth accelerated – presumably because the European Central Bank (ECB) started boosting liquidity earlier than the central banks of CESEE countries. Net demand for housing loans has been growing, supported by the low general level of interest rates. Mortgage lending has also been facilitated by the fact that the reduced creditworthiness of borrowers is less important for housing loans than it is for consumer credit (BLS 2021).

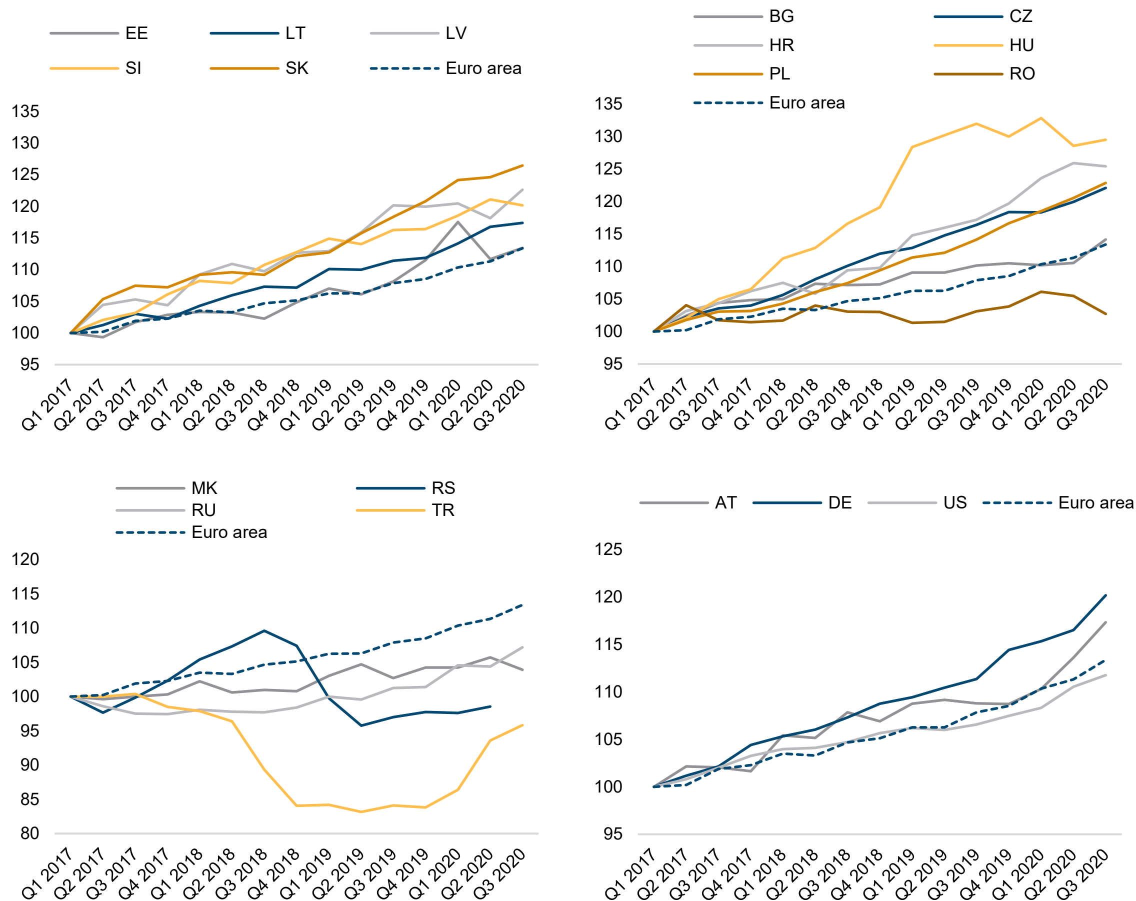
The recent developments point to an increased risk of correction on the housing markets of CESEE countries. Ample liquidity, a concentration of investment in the residential real estate sector and the rising risk of insolvency facing many firms and households create all but ideal conditions for the development of a financial crisis. That said, the banks are now arguably much better prepared for such an eventuality than they were on the eve of the global financial crisis (they have higher capital adequacy ratios). Low interest rates appear to be insufficient to revive business investment in the high-uncertainty

[11] Calculated by deflating the nominal residential property price series with the consumer price index.

[12] In Russia, the programme of subsidised mortgages was the decisive factor behind the rapid growth in residential property prices.

environment caused by the pandemic, which again indicates the need for increased public investment (as argued by Creel et al., 2020). Moreover, skyrocketing house prices have made homeownership increasingly unaffordable for a large section of households, while also driving up rents and causing gentrification in many cities.[13] This all requires government policy to promote affordable housing. Whether the housing bubble actually bursts will depend, to a large extent, on how far unemployment rises and how far future household income drops when support schemes are scaled back.[14] The likely tightening of mortgage lending standards by banks could also foster a slowdown in the housing cycle.

Figure 2.30 / Index of real residential property prices, Q1 2017=100



Source: BIS.

[13] https://eurocities.eu/latest/housing-affordability-a-european-crisis/

[14] https://www.ecb.europa.eu/pub/financial-stability/fsr/html/ecb.fsr202011~b7be9ae1f1.en.html#toc4

2.7. CONCLUSIONS: AFTER THE PANDEMIC

CESEE has clearly been hit hard by the pandemic and its fallout, and although the worst may be over, it is a long road back to normality. Truly normal life may take years to resume in parts of the region, and during that time the economic, social and public health costs are likely to be considerable. Nevertheless, after last year's negative shock and the renewed lockdowns of early 2021, the most likely scenario is that a combination of vaccines and some limited restrictions will keep the health impact at a level that allows for solid economic growth during the rest of the year.

Once the acute phase of the crisis passes, attention will quickly turn to the other challenges and opportunities faced by the region – both those that already existed, and some that are new and result from the pandemic. Most of CESEE remains in the grip of the most serious negative demographic decline – excluding wars and famines – ever recorded. The dual shocks of automation and digitalisation, both of which are likely to be accelerated by the pandemic, create challenges, but also significant opportunities for a region that was struggling with a shortage of workers before the pandemic. The independence of institutions was under strain long before the pandemic hit, but the unique challenges it has created have thrown up opportunities for unscrupulous leaders to further cement their influence in many parts of the region. Geopolitically, the region is facing a new era without the steadying hand of Angela Merkel in Germany, while the two most important divisions – the US versus China at the global level, and the EU versus Russia more locally – leave many CESEE countries caught in between, with negative implications for political stability and economic development.

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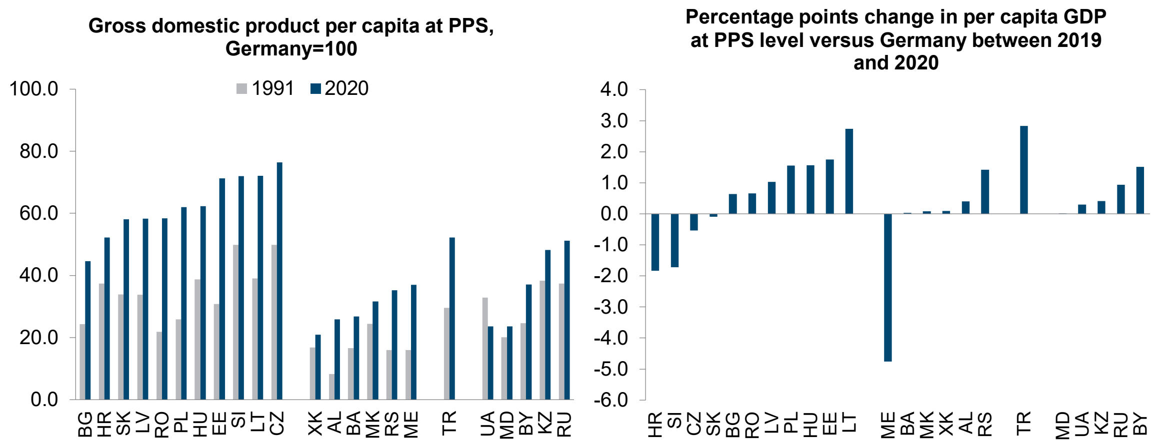
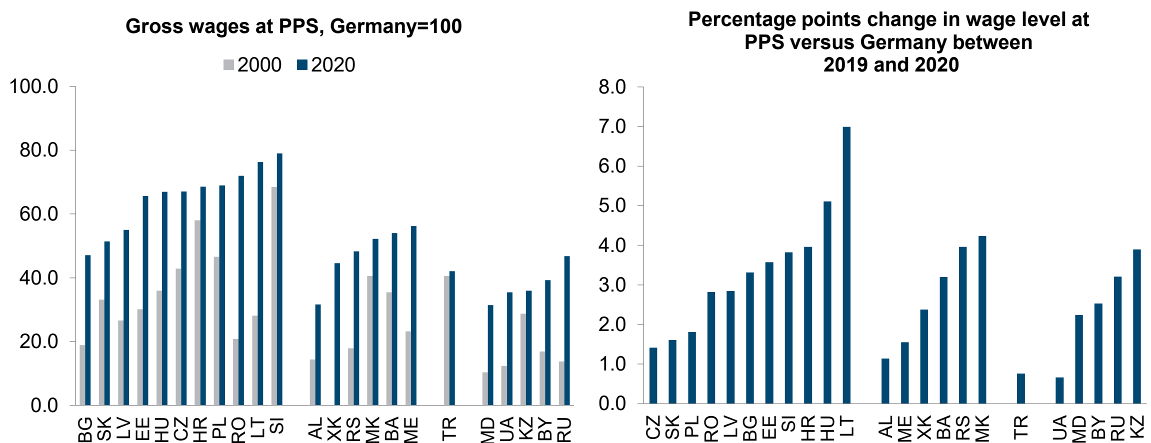
3. Convergence monitor

Figure 3.1 / GDP per capita at PPS convergence against Germany



Note: Data 1991 for BA and XK refer to 2000, for ME and RS to 1995.
Source: wiiw Annual Database incorporating national statistics and Eurostat.



Note: Gross wages are based on administrative data. From 2019 Lithuanian and Romanian wages include employers' social security contributions. In 2020 Croatian wages based on FTE employees. Turkey: data 2000 refer to 2003, wiiw estimate from 2019.
Source: wiiw Annual Database incorporating national statistics and Eurostat.

Table 3.1 / CESEE GDP per capita and gross wages per employee at PPS, 2020

	BG	CZ	EE	HR	HU	LT	LV	PL	RO	SI	SK	EU-CEE
GDP per capita	16,200	27,750	25,890	18,970	22,620	26,170	21,170	22,510	21,220	26,130	21,110	22,390
Gross wages	15,755	22,453	22,003	22,947	22,439	25,561	18,436	23,104	24,104	26,443	17,206	22,353

	AL	BA	BY	KZ	MD	ME	MK	RS	RU	TR	UA	XK	non-EU
GDP per capita	9,390	9,740	13,460	17,510	8,580	13,440	11,490	12,810	18,600	18,960	8,570	7,580	16,750
Gross wages	10,606	18,073	13,136	12,032	10,511	18,818	17,479	16,176	15,670	14,094	11,860	14,942	14,533

Note: Gross wages are based on administrative data. Lithuanian wages include employers' social security contributions. Turkey wages: wiiw estimate.
Source: wiiw Annual Database incorporating national statistics and Eurostat.

Table 3.2 / CESEE GDP per capita and gross wages per employee at EUR, 2020

	BG	CZ	EE	HR	HU	LT	LV	PL	RO	SI	SK	EU-CEE
GDP per capita	8,750	19,960	20,440	12,130	13,900	17,460	15,430	13,600	11,270	22,010	16,680	14,000
Gross wages	8,509	16,153	17,376	14,670	13,789	17,054	13,440	13,957	12,803	22,274	13,596	13,917

	AL	BA	BY	KZ	MD	ME	MK	RS	RU	TR	UA	XK	non-EU
GDP per capita	4,620	4,900	5,520	7,930	4,020	6,710	5,190	6,710	8,830	7,520	3,260	3,840	7,400
Gross wages	5,215	9,055	5,382	5,449	4,926	9,396	7,893	8,469	7,440	5,587	4,518	7,560	6,520

Note: Gross wages are based on administrative data. Lithuanian wages include employers' social security contributions. Turkey wages: wiiw estimate.
Source: wiiw Annual Database incorporating national statistics and Eurostat.

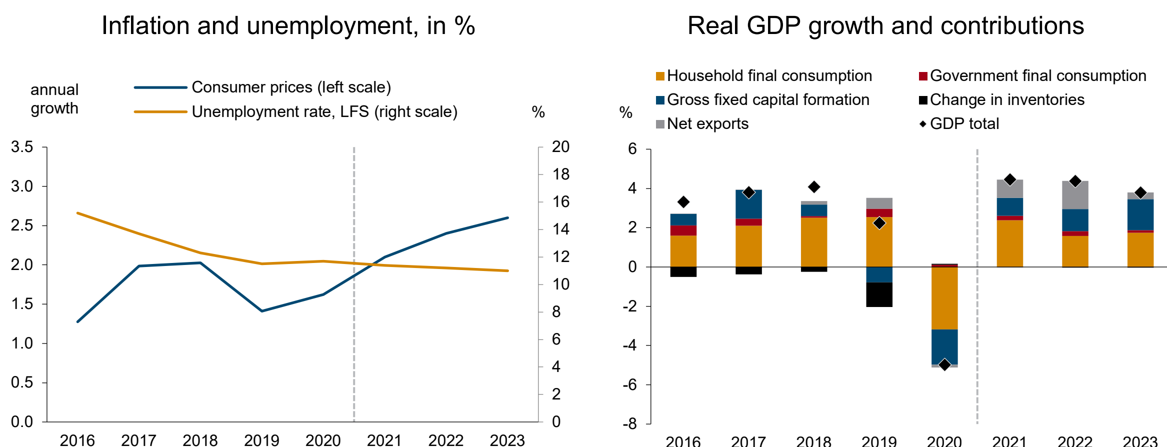
4. Country reports

ALBANIA: Moderate recovery and mass vaccination against COVID-19 started

ISILDA MARA

Recovery will be slower than expected, as the pandemic is still weighing on economic activity. Domestic demand will support growth, but still at below pre-pandemic levels. External demand has improved somewhat, but will remain weak, as demand in the services and tourism sectors depends heavily on immunisation not only at home, but also in the EU countries. We expect the economy to grow by 4.5% over the medium term.

Figure 4.1 / Albania: Main macroeconomic indicators



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

The economy is expected to recover moderately in 2021. The adverse effects of the pandemic on the economy were felt particularly during the lockdown (second quarter of 2020), when the economy contracted by 10.2%. For the first three quarters of 2020, the pandemic adversely affected domestic demand, which fell by 4%. External demand weakened, while the trade deficit widened: exports – of both goods and services – fell by 30% and imports by 20%. All sectors of the economy have been negatively affected, with the exception of construction and agriculture. The decline in activity has been particularly pronounced in the manufacturing, trade and services sectors. The easing of the restrictions in the second half of 2020 saw economic activity pick up (albeit at below 2019 levels), mainly in the construction, public administration and manufacturing sectors. The construction sector recovered in the second half of 2020 partly reflecting the reconstruction works following the earthquake of November 2019, a real-estate bubble in the capital, Tirana, and a handful of infrastructure projects. Signs of recovery were also evident in retail trade and services, especially in the last quarter of 2020. The recovery is expected to be moderate in 2021, as the negative effects of the pandemic have been only partially mitigated.

There have been proactive vaccination efforts, but tangible results take time. With the onset of the pandemic, public health was prioritised over economic activity; but this trend was reversed in the second half of 2020. A rapid government response in the first half of 2020 helped to keep the number of COVID-19 infections and deaths low. However, in the second half of 2020 (particularly between October and December) and in February 2021, the number of infections and deaths increased dramatically. In February 2021, the infection rate was up to 30% – almost 1,100 daily infections, with 20 deaths a day (total deaths by end of March 2021 reached almost 0.1% per million inhabitants). The government has been negotiating with the various providers of anti-COVID-19 vaccines (including the Chinese and Russian vaccines). It has been announced that 1 million doses of the Chinese Sinovac vaccine will be received by end May 2021, and a large consignment of the Russian Sputnik V vaccine is expected in the coming months. The massive vaccination programme has been launched on 28 March 2021. In the second half of March, the vaccination of 500 Kosovo health workers got under way in Albania as no vaccine was available to Kosovo until 28 March 2021.

The unprecedented rise in government debt has increased uncertainty. General government budget revenue contracted by 7.5% in 2020, while expenditure increased by 9%. Tax revenues were rather low in 2020: at 26.4%, their share of GDP was close to 2015 levels. Meanwhile, spending rose to 33.5% of GDP –similar to the 2009 level, when the negative effects of the international financial crisis in Albania were being felt. The budget deficit stood at 7% and general government debt to GDP rose to an unprecedented 80%. The ongoing pandemic indicates that additional fiscal stimulus will be needed to support the economy. It is also an election year, and there is usually some redistribution of resources towards less productive activities. In May 2020, the government issued a Eurobond worth EUR 650 million, to mature in seven years and with a yield of 3.5%. The risks to the economic outlook are also on the downside. As a result, there is high uncertainty about how to improve the fiscal position if economic growth remains sluggish and below its potential.

The banking sector is well capitalised and monetary policy has continued to be accommodative. During 2020, despite the pandemic, demand for credit increased by 6.5%. Demand from the private sector increased by 10%, despite tighter credit standards for firms. Those sectors that saw increased credit demand were mainly retail, manufacturing, accommodation and food services, but also information and communication (in fact, demand for credit tripled in that sector). A boost to credit demand also came in the form of the guarantee scheme launched by the government to support companies during the pandemic. However, the demand for loans was mainly driven by liquidity needs, rather than investment. Non-performing loans continued their downward trend in 2020; however, in early 2021 that was reversed with a slight increase from 8.1% in January to 8.2% in February, which may reflect deterioration in the financial situation due to the pandemic and a less optimistic economic outlook. Monetary policy has continued to be accommodative. The central bank has kept the interest rate unchanged at 0.5%. The exchange rate gained stability in the second half of 2020. Meanwhile, the inflation rate fluctuated considerably in 2020. The volatility of consumer prices has also been evident in the first quarter of 2021, mainly due to food prices, but also to medical costs. Inflation is expected to rise to 1.8% in 2021 – below the central bank target of 3% – as the recovery will be slower than expected.

Domestic demand is still weak, but the outlook could improve for the second half of 2021. Domestic demand dropped due to a 4% fall in private consumption and an 8% decline in gross fixed capital formation over the first three quarters of 2020. The effects were rather strong in the second quarter of 2020 – under the lockdown regime – when consumption and investment contracted by 8%

and 16%, respectively. However, the end of the confinement measures saw investment pick up by 4% in the third quarter of 2020, year on year, while consumption remained weak. Consumption is expected to recover and support growth by the second half of 2021. However, there are downside risks stemming from the pace of vaccination, the revival of the tourism sector and employment prospects.

The risk of poverty for certain segments of the population is likely to increase, as inactivity rises. The pandemic has had a negative impact on employment and has discouraged job searches. Unemployment rose to 11.8% in 2020 – an increase of 0.6 percentage points compared with 2019 – while employment fell by 22,000. Some 80% of those who lost their jobs moved to inactivity. The destabilising effects on employment were felt mainly among the older cohorts, with a strong shift in this category from employment to inactivity. Registered jobseekers receiving unemployment benefits more than doubled, while those receiving social assistance increased by 30%. Wages increased by 3%, while remittances, which are mainly destined for consumption, fell by 4% in 2020. The risk of poverty is likely to increase further, as a large segment of the population that works informally remains vulnerable and excluded from the social protection system.

The other side of the coin during the pandemic has been remote work. Remote work and online work platforms could offer better employment opportunities, especially among young people. The impact of the pandemic on youth employment – age cohorts 15-29 – seems to have been less severe. This could be explained by young people's greater flexibility and their better technical skills, allowing them to work remotely or adapt to teleworking. The share of workers using information and communication technologies in the workplace is increasing, although it is still smaller than in the EU: 25% of workers use computers in the workplace, compared to 55% in the EU. The pandemic has also boosted e-commerce: the proportion of businesses active in e-commerce has more than doubled, reaching 12.8%. For some other sectors, such as administration, support services, retail, and accommodation and food services, the expansion of e-commerce has been greater. Remote working and online work platforms have gained momentum – probably mainly among young people, given the technical skills required – and will continue to do so as the pandemic reshapes the world of work.

Demographic change in Albania has reached dramatic numbers and there is no short-term solution to the problem. The natural change in the Albanian population – the difference between the number of births and deaths – was unprecedented in 2020. Births exceeded deaths by only 470 – a net change which stands in sharp contrast to the figure of 10,345 in 2016. Of course, COVID-19 has contributed to the large number of deaths; but the main reason for the change is the low fertility rate joined with a high rate of emigration. Albania's population has fallen to the level of the early 1980s, but the picture is very different now: no longer does the country have either a buoyant fertility rate (3.4 in 1980, compared to 1.62 in 2015-2020) or zero emigration. The stock of Albanians abroad today corresponds to 57% of the current population. In the period 2011-2019 alone, it is estimated that 364,000 Albanians left the country (13% of the current population). New estimates also indicate that 39% of those who left between 2012 and 2019 have a high level of education. These demographic changes are affecting the structure of the population, but also human capital and labour market productivity.

External demand will return, but it might continue to be dampened. In 2019, exports of goods declined for all groups except food/beverage products. Exports from the textile and clothing industry fell by 14% and their share in exports declined to 37%, compared to 42% in 2016. The share of foodstuffs

and beverages in total exports is growing rapidly, and in 2020 was as important as that of minerals, fuels and electricity. The pandemic has severely affected exports of services and the tourism sector, but the effect has been less than expected. In 2019, the number of non-nationals entering Albania fell to 2.7 million – down from 6.4 million in 2019. Nights spent in tourist accommodation fell by 54% (65% among non-residents/foreigners and 28% among residents). With the lifting of mobility restrictions in the second half of 2020, the tourism sector returned to work, thanks both to domestic and neighbouring countries tourists, in particular Kosovo. This has generated some resilience in the sector, which is an important source of employment and exports of services. In 2021, the demand for tourism will depend on vaccine rollout. It is likely that this year, too, the sector will have to rely on tourist demand from Albanian nationals and their near neighbours. Therefore, further support from the government will be needed to strengthen the sector and bolster its recovery.

Foreign direct investment (FDI) has declined moderately, but the outlook is promising. In 2020, FDI inflows fell by 13%. It was announced in 2020 that the first solar power plant will be built by the French company Voltalia, in a project worth EUR 100 million. Preparatory work began in February 2021. Other important announcements also concern Vlora airport – in the southern coastal part of Albania: the Mabetex Group of Switzerland and the YDA Group of Turkey have won the tender and will invest EUR 104 million in construction of the airport over the next two years. In March 2021, the Albanian government and the United States signed a memorandum of understanding in the energy sector. This agreement provides for the conversion of the Vlora thermal power plant into a liquefied natural gas terminal. That will certainly increase US exporters' access to the European market and expand energy sources in Albania. However, it has already sparked some protests among ecologists, due to its environmental impact and its location in a coastal and tourist city.

The parliamentary elections scheduled for 25 April 2021 have been marked by the proactive engagement of civic movements. The start of the election campaign was marred by violent episodes. Few politicians that have dominated the scene for 30 years are also at the forefront of these elections. However, their leadership has stalled in the face of a high level of corruption, organised crime, the protracted EU integration process and the mass emigration of Albanians. The political manifestos in this election campaign are still based on past election commitments. EU integration is not high on the agenda in the campaign, given the very long prospects and the slowing of the process. The outstanding feature of these elections is the increased participation of civic movements: the Nisma Thurje civic movement is gaining in popularity, particularly among young people, and is being perceived as the Albanian equivalent of the Italian Five Star movement. Kosovo's Vetevendosje party has already opened a branch in Albania and has three candidates in the elections. Civic engagement and a bottom-up approach could be a game-changer in these parliamentary elections.

In a nutshell, the pace of recovery will be slower than expected, as the pandemic is still acting as a drag on economic activity. Domestic demand will support growth, but at below pre-pandemic levels. External demand will recover, but the downside risks remain high, as vaccination at home and abroad are progressing slowly. We forecast that the economy will expand at 4.5% over the medium term.

Table 4.1 / Albania: Selected economic indicators

	2017	2018	2019	2020 [1]	2021	2022	2023
						Forecast	
Population, th pers., average	2,873	2,866	2,854	2,800	2,790	2,780	2,760
Gross domestic product, ALL bn, nom.	1,551	1,636	1,678	1,600	1,700	1,800	1,900
annual change in % (real)	3.8	4.1	2.2	-5.0	4.5	4.4	3.8
GDP/capita (EUR at PPP)	8,770	9,180	9,550	9,390	.	.	.
Consumption of households, ALL bn, nom.	1,224	1,277	1,333	1,300	.	.	.
annual change in % (real)	2.6	3.2	3.3	-4.0	3.0	2.0	2.2
Gross fixed capital form., ALL bn, nom.	381	391	378	300	.	.	.
annual change in % (real)	6.0	2.4	-3.3	-8.0	4.0	5.0	7.0
Gross industrial production							
annual change in % (real)	-0.8	18.7	-1.1	-6.3	4.0	1.0	1.0
Gross agricultural production [2]							
annual change in % (real)	0.9	1.9	5.0	3.0	.	.	.
Construction output total							
annual change in % (real)	19.6	5.6	-2.5	9.5	.	.	.
Employed persons, LFS, th, average	1,195	1,231	1,266	1,243	1,250	1,270	1,290
annual change in %	3.3	3.0	2.8	-1.8	0.5	1.6	1.6
Unemployed persons, LFS, th, average	190	173	165	165	160	160	160
Unemployment rate, LFS, in %, average	13.7	12.3	11.5	11.7	11.4	11.2	11.0
Reg. unemployment rate, in %, eop	7.2	5.4	5.8	7.4	7.3	7.2	7.0
Average monthly gross wages, ALL	48,967	50,589	52,380	53,787	57,100	60,200	63,600
annual change in % (real, gross)	1.0	1.3	2.1	1.0	4.0	3.0	3.0
Consumer prices, % p.a.	2.0	2.0	1.4	1.6	2.1	2.4	2.6
Producer prices in industry, % p.a.	2.6	1.7	-0.8	-3.0	1.0	0.5	0.5
General governm.budget, nat.def., % of GDP							
Revenues	27.8	27.5	27.4	26.5	27.0	27.5	28.0
Expenditures	29.8	29.1	29.3	33.5	32.0	31.0	30.0
Deficit (-) / surplus (+)	-2.0	-1.6	-1.9	-7.0	-5.0	-3.5	-2.0
General gov.gross debt, nat.def., % of GDP	70.2	67.7	66.3	80.0	77.0	76.0	75.0
Stock of loans of non-fin.private sector, % p.a.	0.7	-3.6	6.6	6.9	.	.	.
Non-performing loans (NPL), in %, eop	13.2	11.1	8.4	8.1	.	.	.
Central bank policy rate, % p.a., eop [3]	1.25	1.00	1.00	0.50	0.5	0.5	0.5
Current account, EUR m	-866	-866	-1,089	-1,155	-1,170	-1,060	-1,070
Current account, % of GDP	-7.5	-6.8	-8.0	-8.9	-8.5	-7.2	-6.9
Exports of goods, BOP, EUR m	797	986	907	794	830	880	920
annual change in %	11.7	23.7	-8.1	-12.5	4.5	5.5	4.5
Imports of goods, BOP, EUR m	3,621	3,857	4,050	3,776	3,910	3,950	4,030
annual change in %	9.2	6.5	5.0	-6.8	3.5	1.0	2.0
Exports of services, BOP, EUR m	2,856	3,073	3,405	2,231	2,440	2,620	2,750
annual change in %	19.2	7.6	10.8	-34.5	9.5	7.5	5.0
Imports of services, BOP, EUR m	1,774	1,962	2,141	1,174	1,260	1,310	1,380
annual change in %	11.0	10.6	9.1	-45.2	7.0	4.0	5.0
FDI liabilities, EUR m	900	1,020	1,072	933	.	.	.
FDI assets, EUR m	-94	-3	36	43	.	.	.
Gross reserves of CB excl. gold, EUR m	2,941	3,342	3,240	3,806	.	.	.
Gross external debt, EUR m	7,949	8,353	8,246	8,554	8,800	9,400	9,300
Gross external debt, % of GDP	68.8	65.2	60.4	66.2	64.0	64.0	60.0
Average exchange rate ALL/EUR	134.15	127.59	123.01	123.77	123.0	122.5	122.0

1) Preliminary and wiiw estimates. - 2) Based on UN-FAO data, wiiw estimate from 2019. - 3) One-week repo rate.

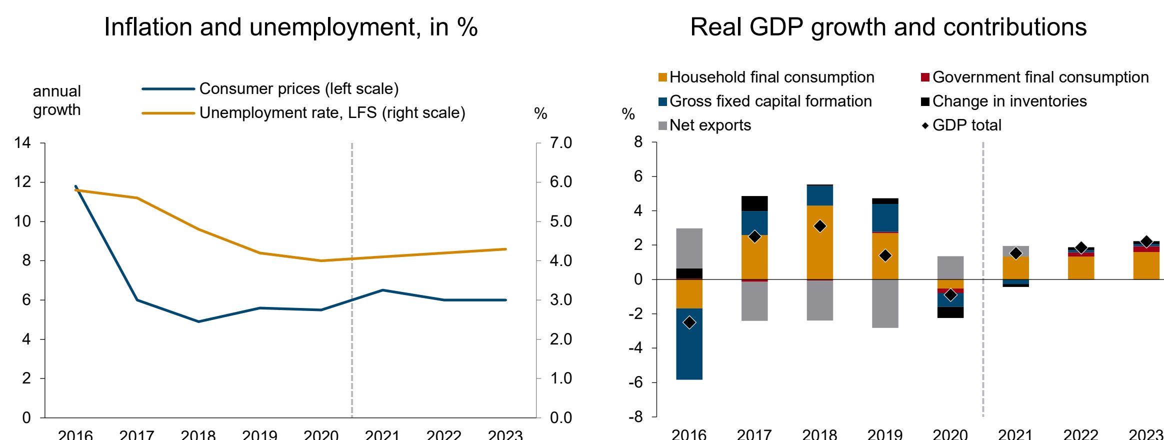
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

BELARUS: Trapped in a shaky economic situation

RUMEN DOBRINSKY

Although Belarus experienced only a mild recession in 2020, the country is going through a period of political and economic turmoil. The disputed presidential election triggered mass protests and isolation from the international financial markets. Russia remains the only source of external funding; however, new lending may be conditional on tough political concessions. Given the growing financial constraints and the deep-seated structural problems, the economic outlook is rather bleak.

Figure 4.2 / Belarus: Main macroeconomic indicators



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

Belarus is undergoing political and economic turmoil. The disputed presidential election in August 2020, in which the incumbent, Alexander Lukashenko, was officially declared the winner, undermined the country's international standing and provoked a lasting wave of mass protests**.** These developments also brought to the surface the fact that Belarusian society – which until then had appeared rather homogenous – was is fact radically polarised between opponents and supporters of Mr Lukashenko's regime. During the harsh winter months, the street protests subsided; however, none of the problems that triggered them was addressed in this period. It may therefore be only a matter of time before angry Belarusians rally again in the country's main cities.

Belarus experienced only a mild recession in 2020, with GDP dropping by a mere 0.9%. However, this was not a sign of economic strength, but the result of a combination of specific local factors, including policy decisions imposed by the authoritarian regime. Belarus is the only country in Europe that has not so far imposed a lockdown or any other containment measures during the coronavirus pandemic. The relatively limited COVID-related policy support was directed only towards the state-

owned sector of the economy. While all this enabled domestic activity to continue without major interruptions, it could not shield the country from negative indirect effects through the channels of international trade. In addition, in the early months of 2020 the Belarusian economy was hit by a reduction in oil supplies from Russia owing to a dispute over the price of imported gas.

The hospitality industry was among the worst affected by the pandemic. Although there was no formal lockdown – hotels and restaurants remained open – demand dropped sharply, owing to the standstill in international travel and the slump in foreign tourist arrivals. Domestic demand also plummeted, owing to self-imposed restraints by the population. As a result, a number of small hotels and restaurants were forced to close; some went out of business.

The manufacturing industry fared relatively well on average (gross industrial output fell by only 0.7% in 2020), but performance was uneven across sectors. At the beginning of 2020, the important petrochemical industry was dealt a blow by the suspension of Russian oil deliveries, with negative carryover effects throughout the year. By contrast, food processing and, in particular, the dairy industry reported positive output growth and increased profit for the year, largely because of increased demand from Russia.

According to the official statistics on COVID cases and mortality rates, Belarus did not fare worse than similar countries that introduced containment measures. However, the reliability of Belarusian COVID statistics has been repeatedly questioned. For example, the reported general mortality rate in the country rose significantly in 2020, which may suggest under-reporting of the number of COVID deaths. However, despite the lack of official restrictions, many Belarusians imposed restraints on themselves similar to the official restrictions enacted in other countries. It should be noted that during the course of the pandemic, so far there have not been reports of serious strains on the Belarusian healthcare system.

There were significant shifts in Belarus's external balances in 2020. In USD terms, the value of goods exports in 2020 fell by 13% from their 2019 level. The reduction in the exports of oil and petrochemicals (down by USD 2.8bn from 2019), which was reinforced by low oil prices, accounted for 70% of the overall decline in goods exports. The value of goods imports in 2020 fell even more steeply, by 17% from the previous year, on account of lower domestic demand and a depreciating exchange rate. The generally thriving Belarusian information technology industry fared well in 2020 as demand for online services grew rapidly. The Hi-Tech Park alone reported record export earnings amounting to USD 2.7bn, which mitigated to some extent the effect of the decline in exports of other services such as transportation and tourism. As a result of these developments, Belarus reported a notable reduction in its overall current-account deficit, from 2% of GDP in 2019 to 0.4% in 2020. Owing to the readjustment of foreign trade flows, net exports made a positive contribution to GDP growth for the year as a whole.

The widespread international condemnation of the brutal suppression of protests against the presidential election outcome resulted in a de facto isolation of Belarus from international financial markets. This caused a problem for the authorities, given Belarus's large external debt, most of which is public. Total debt service in 2020 amounted to around USD 3bn; before the election, Belarus had managed to raise only USD 1.4bn on international markets. Thereafter, Russia remained the only source of external funding. Following a high-level agreement on settling the dispute over prices of imported gas, Russia agreed to extend to Belarus emergency loans amounting to USD 1.5bn (including

USD 500m from the Eurasian Development Bank) and resumed regular oil deliveries. These measures provided a financial lifebelt that kept the Belarusian economy afloat in 2020.

The aftermath of the presidential election was marked by domestic financial turmoil, with runs on the currency and the banks. This triggered a depreciation of the Belarusian ruble and a reduction in the country's international foreign reserves, which fell by USD 2.6bn during 2020, to USD 4.4bn at year-end.

Faced with mass post-election protests, the authorities loosened their policy stance in an attempt to protect the large state-owned sector of the economy. There was a significant increase in directed lending to state-owned companies, a policy that the authorities had earlier committed to reduce and eventually abandon. So, although 2020 should have been the last year when directed lending would be applied, its volume increased by 3.2 times from what had been planned, to BYN 2.4bn (1.7% of GDP). According to recent policy statements, directed lending will be continued in 2021 (and probably also in the following years).

The fiscal position deteriorated considerably in 2020. According to the national definitions (which underestimate the true deficit as they do not include extrabudgetary items and contingent fiscal liabilities), the general government balance changed from +2.4% of GDP in 2019 to -1.4% in 2020, corresponding to a relaxation of 3.8 percentage points. The significant currency depreciation triggered a resurgence of inflation which (in year-on-year terms) overshot the 2020 official central bank target of 5% by 2.4 percentage points.

The regime has launched several political initiatives in an attempt to curb social tensions. In February 2021 the authorities convened the All Belarusian People's Assembly – a periodic general meeting of members of all levels of government with representatives of business, academia and the general public. The People's Assembly is seen by the authorities as a means to legitimise the socioeconomic course to be pursued in the coming years. Apart from its regular topics, the recent Assembly officially launched an initiative for a constitutional reform. According to this initiative, this year will be devoted to collecting and discussing ideas for change, with the new constitution subject to a referendum to be held in 2022. So far, it is not clear what the proposed changes in the constitution will be, but it is expected that the main thrust of this reform would be to attain a new balance of authority between the president (the current constitution provides for presidential superpowers) and the other branches of power.

The main problem that the authorities are facing in these efforts is their low credibility. The brutal suppression of the protests that followed the presidential election considerably increased the numbers of opponents of the regime. The authorities' low credibility with wide segments of the public undermines the legitimacy of any top-down reforms that might be initiated, even if these reforms would in principle match some of the opposition's demands.

At the beginning of 2021 the economic situation remained precarious. The servicing of the foreign debt poses the biggest problem for the government. Total debt service due in 2021 amounts to USD 3.3bn. The authorities still have at their disposal some reserves for immediate use. In the early months of the year, the government managed to borrow USD 700m domestically by selling currency bonds to local banks. However, there remains a considerable financing gap, with no clear plans as to how to bridge it. Russia has made it clear that further financial support to Belarus is conditional on the

undertaking of firm policy measures towards a closer economic integration between the two countries; however, so far there are no practical signs on the part of Belarus that it is ready to move ahead with such an agenda.

The unreformed state-owned sector of the economy poses further serious problems. Belarusian businesses are heavily indebted (at the beginning of 2021 their total indebtedness was estimated at BYN 158bn, or 109% of GDP), with most of this debt held by state-owned firms. In the absence of sufficient external funding, the authorities will not have the resources to continue the support of the state-owned sector of the economy. Should they decide to resume directed lending on a large scale by printing money, this might trigger macroeconomic destabilisation and a return to high inflation.

Under these circumstances, the short-term economic outlook for Belarus is rather bleak. The economy is likely to undergo a period of instability, at least until there is more clarity on the future political and economic course. Faced with growing external and domestic financial constraints, Belarus may need to undertake a painful macroeconomic adjustment aimed at curbing domestic demand. We expect GDP to grow by 1.5% in 2021 and – assuming that the country manages to avoid a major financial crisis – by around 2% in 2022 and 2023.

Table 4.2 / Belarus: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022 Forecast	2023
Population, th pers., average	9,498	9,484	9,442	9,420	9,400	9,380	9,350
Gross domestic product, BYN m, nom.	105,748	122,320	134,732	144,900	156,700	169,200	183,300
annual change in % (real)	2.5	3.1	1.4	-0.9	1.5	1.9	2.2
GDP/capita (EUR at PPP)	12,510	12,710	13,350	13,460	.	.	.
Consumption of households, BYN m, nom.	56,843	64,491	71,630	74,800	.	.	.
annual change in % (real)	4.8	8.0	5.1	-1.0	2.5	2.5	3.0
Gross fixed capital form., BYN m, nom.	27,662	32,081	36,424	37,300	.	.	.
annual change in % (real)	5.5	4.4	6.2	-3.0	-1.0	0.5	0.5
Gross industrial production							
annual change in % (real)	6.1	5.7	1.0	-0.7	2.0	3.0	3.0
Gross agricultural production							
annual change in % (real)	4.2	-3.3	2.9	4.9	.	.	.
Construction industry							
annual change in % (real)	-3.7	2.2	0.1	-4.6	.	.	.
Employed persons, LFS, th, average	4,902	4,897	4,909	4,884	4,850	4,800	4,750
annual change in %	0.8	-0.1	0.2	-0.5	-0.7	-1.0	-1.0
Unemployed persons, LFS, th, average	293	245	213	206	207	210	213
Unemployment rate, LFS, in %, average	5.6	4.8	4.2	4.0	4.1	4.2	4.3
Reg. unemployment rate, in %, eop	0.5	0.3	0.2	0.2	.	.	.
Average monthly gross wages, BYN	822.8	971.4	1,092.9	1,250.9	1,400	1,560	1,720
annual change in % (real, gross)	7.5	12.6	7.3	7.4	5.0	5.0	4.0
Consumer prices, % p.a.	6.0	4.9	5.6	5.5	6.5	6.0	6.0
Producer prices in industry, % p.a. 2)	9.8	6.8	6.3	5.6	6.5	6.0	6.0
General governm.budget, nat. def., % of GDP							
Revenues	40.5	41.5	40.0	37.0	38.0	38.0	38.0
Expenditures	37.6	37.5	37.6	40.0	40.0	39.0	39.0
Deficit (-) / surplus (+)	3.0	4.0	2.4	-3.0	-2.0	-1.0	-1.0
General gov.gross debt, nat. def., % of GDP 3)	53.4	43.7	42.0	49.0	51.0	52.0	52.0
Stock of loans of non-fin.private sector, % p.a.	7.2	12.7	10.0	21.4	.	.	.
Non-performing loans (NPL), in %, eop 4)	12.9	5.0	4.6	6.0	.	.	.
Central bank policy rate, % p.a., eop 5)	11.00	10.00	9.00	7.75	8.5	8.0	8.0
Current account, EUR m 6)	-843	20	-1,115	-211	-200	-500	-600
Current account, % of GDP	-1.7	0.0	-1.9	-0.4	-0.4	-0.9	-1.1
Exports of goods, BOP, EUR m 6)	25,405	28,409	28,932	24,769	25,700	26,700	27,800
annual change in %	21.0	11.8	1.8	-14.4	3.8	3.9	4.1
Imports of goods, BOP, EUR m 6)	28,043	30,536	32,684	26,495	27,800	29,000	30,000
annual change in %	20.5	8.9	7.0	-18.9	4.9	4.3	3.4
Exports of services, BOP, EUR m 6)	7,000	7,511	8,628	7,701	7,800	8,100	8,300
annual change in %	11.9	7.3	14.9	-10.7	1.3	3.8	2.5
Imports of services, BOP, EUR m 6)	4,274	4,594	5,237	4,325	4,600	4,900	5,000
annual change in %	7.4	7.5	14.0	-17.4	6.3	6.5	2.0
FDI liabilities, EUR m 6)	1,130	1,212	1,139	1,220	.	.	.
FDI assets, EUR m 6)	60	47	-3	67	.	.	.
Gross reserves of CB excl. gold, EUR m 6)	4,502	4,561	6,265	3,604	.	.	.
Gross external debt, EUR m 6)	33,363	34,307	36,416	34,311	37,300	38,100	38,500
Gross external debt, % of GDP	68.9	67.3	63.1	66.0	71.5	72.0	71.5
Average exchange rate BYN/EUR	2.1833	2.4008	2.3342	2.7888	3.00	3.20	3.40

1) Preliminary and wiiw esimates. - 2) Domestic output prices. - 3) Including publicly guaranteed debt. - 4) From 2018 doubtful, bad and small part of supervised assets; previously doubtful and large part of supervised assets. - 5) Refinancing rate of CB. - 6) Converted from USD.

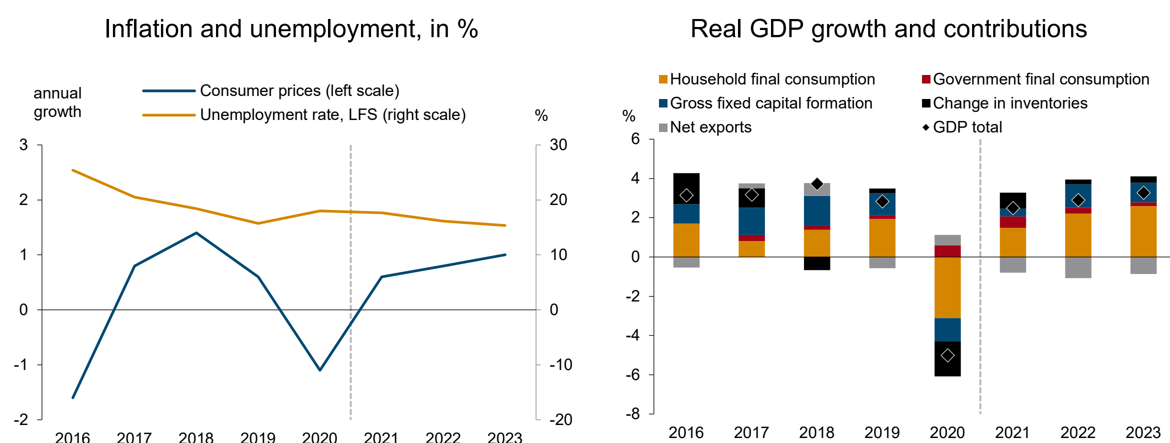
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

BOSNIA AND HERZEGOVINA: Vaccine delays and limited fiscal capacity slow down the recovery

SELENA DURAKOVIĆ

The COVID-19 pandemic caused the worst recession in Bosnia and Herzegovina since the Bosnian war, with an estimated GDP decline in 2020 of 5%. With the third wave of the pandemic, vaccine delays and the introduction of new restrictions, economic recovery will be delayed. Additional obstacles to growth include an inefficient fiscal structure and political disputes, which are preventing structural reform of the country and delaying its progress towards EU and NATO integration.

Figure 4.3 / Bosnia and Herzegovina: Main macroeconomic indicators



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

The third wave of the COVID-19 pandemic has struck, with both infections and virus-related deaths soaring; this has resulted in the introduction of new restrictions. In March 2021, the number of infections in Bosnia and Herzegovina (BiH) reached its highest level since the start of the pandemic, and there is now a shortage of hospital beds, equipment, medicines and medical personnel. BiH has one of the highest COVID-19 per capita death rates in the world (fourth place, as of the end of March). In order to try to reduce the spread of the virus, local authorities introduced new restrictions in March 2021. These include the closure of bars and restaurants, a curfew during the evening hours and the closure of schools (switching to online lessons), although the measures have not been synchronised either between the country's entities or even between cantons.

With the help of international funds, the governments have adopted a set of measures aimed at mitigating the adverse impact of the crisis on individuals and firms. According to the International Monetary Fund (IMF), COVID-19 discretionary spending in 2020 made up 2.5% of GDP and was

distributed with delays and with no coordination between the levels of government. The level of discretionary spending has been much lower than in neighbouring countries – due largely to limited fiscal capacity, which is a result of an inefficient fiscal structure and an inability to access international markets. Consequently, fiscal expenditure is limited by inadequate domestic public revenue, and the country relies heavily on international assistance, which has so far been provided mostly by the EU and the IMF.

The rigid and inefficient fiscal structure has restricted the capacity of fiscal policy to act effectively during the crisis. Rises in public-sector wages and in social benefits, as well as a high level of the grey economy, high unemployment rates and limited ability to borrow money, all severely restrict the capacity of fiscal policy. Furthermore, the rigid fiscal structure and political disputes have limited the governments' ability to redirect public expenditure to those sectors most in need. This has resulted in a slow and sluggish response to medical needs and vaccination agreements. Citizens, who do not trust the government to acquire the necessary vaccines, have been going to Serbia to be vaccinated – further proof of the government's inability to cope with the situation.

The decentralised fiscal system has resulted in complex, delayed and uncoordinated responses to the pandemic and vaccine procurement. An IMF loan worth EUR 333m (approximately 2% of BiH's GDP) was approved in April 2020, but remained tied up in the Central Bank of BiH for two months, as the politicians could not agree on its disbursement. After that, the state-level government requested another loan from the IMF of EUR 750m for the recovery; but the talks were suspended in December 2020, as the politicians from both entities could not agree to IMF requirements. All this emphasises the extent and depth of the political disfunction and the difficulty of acquiring and adequately allocating the necessary funds. With the state failing to reach any agreement on vaccine procurement, and now that it is clear that the procurement of vaccines through the COVAX scheme will be delayed, local authorities are announcing their own arrangements, with no coordination by the state: Republika Srpska started procuring vaccines in March 2021, but very slowly and in relatively small quantities, while the Federation of BiH has still had no deliveries of vaccines (except a token number of donations from Serbia). In the Federation of BiH, the funds allocated are not being used on account of political disputes and unclear jurisdictions, which are additionally delaying the whole process.

The growth rate reached its lowest level since the war. Economic activity was adversely impacted in 2020 by the COVID-19 containment measures taken by the country and its main trading and investment partners. The estimated decline in GDP in 2020 was 5%, the result of a decrease in household spending and investment, and a significant fall in the current account balance due to a big drop in the export of goods, as well as in tourism and remittances. Remittances, which made up around 8% of GDP in 2019, fell by 40% in 2020. Tourism, which accounted for around 9% of GDP in 2019, fell by 70% in 2020. Inflation turned negative once again in 2020 (as in 2013-2016), with consumer prices falling by 1.1% year on year, as a result of a decline in transport, clothing and footwear prices, and government price controls on certain products during the emergency. In January 2021, the inflation rate dipped even further into negative territory (-1.7% year on year), but the projections are that the rate will eventually increase, as economic activity starts to pick up. It is nevertheless likely to remain low in 2021 and 2022, forecast at 0.6% and 0.8%, respectively, due to the slow pace of recovery and low personal consumption.

The banking sector is sufficiently capitalised and liquid, but loans to households and enterprises are decreasing, and at 6.7% in 2020, the share of non-performing loans (NPLs) is still high. There was a drop in loans approved for enterprises and households in 2020. On the other hand, excess reserves are steadily accruing, due to the lack of safe investments and strict requirements for deposit and loan maturity matching. A moratorium on the repayment of loans has been introduced by the banks to ease liquidity constraints during the COVID-19 crisis, but this is a palliative measure that does not ease the burden of debt repayment – and indeed will even increase that burden once the moratorium ends. The share of NPLs decreased by 1.3 percentage points in 2020, compared to 2019; but the figure is likely to rise again in 2021, due to the increased number of unemployed people and business closures.

Recovery has been delayed by the rising number of infections in the first quarter of 2021, new restrictions, the uncertainty regarding the availability of vaccines and political disagreements. GDP is projected to grow by 2.5% in 2021, but the pre-crisis level is unlikely to be reached before late 2022, on account of the new restrictions introduced in 2021 following the rise in the number of infections and the delays in the delivery of vaccines. Exports of goods and services, as well as remittances, will likely recover during 2021, as trading partner countries are projected to recover at a faster pace. Investments are also likely to pick up, as there are some big public investments that have been announced (e.g. the Sarajevo-Belgrade highway, financed by Turkey). Fiscal policy will continue to be expansionary in 2021, but not too much, on account of the limited borrowing capacity. GDP growth is forecast to be low due to the small projected increase in personal consumption – a result of the high unemployment rate, which is forecast to be 17.6% in 2021. A further decline in economic activity, investments and employment is also possible, if significant previously announced public investments and international financial assistance are not continued.

Long-term growth trends are potentially threatened by political instability, a high level of emigration and the country's ageing population. Although the nationalistic ruling parties suffered losses in the two largest cities in the local elections of November 2020, political tensions are still running high as those nationalistic parties are obstructing the formation of local governments. Constant political disagreements at all levels of government and an inability to implement adequate structural reforms towards creating a single economic space could reduce investment and international financial support, with negative consequences for growth. Long-term recession or stagnation could further result in greater power for the nationalistic parties and increased traction for their ideas involving the country's disintegration. Furthermore, the country's population is ageing rapidly: BiH has the lowest fertility rate in the world and a very high emigration rate (especially among young people). Young, educated people are leaving the country due to difficulties in finding a job and on account of social discontent, which is amplified by the focus in the media – which are heavily controlled by the political parties – on divisions between the entities and political disagreements.

Table 4.3 / Bosnia and Herzegovina: Selected economic indicators

	2017	2018	2019	2020 [1]	2021	2022 Forecast	2023
Population, th pers., average	3,504	3,496	3,485	3,478	3,470	3,446	3,434
Gross domestic product, BAM m, nom. [2]	31,376	33,444	35,296	33,200	34,200	35,500	37,000
annual change in % (real)	3.2	3.7	2.8	-5.0	2.5	2.9	3.3
GDP/capita (EUR at PPP) [2]	9,030	9,620	10,080	9,740	.	.	.
Consumption of households, BAM m, nom. [2]	24,200	25,042	26,158	24,780	.	.	.
annual change in % (real)	1.0	1.8	2.6	-4.2	2.0	3.0	3.5
Gross fixed capital form., BAM m, nom. [2]	5,926	6,550	6,994	6,500	.	.	.
annual change in % (real)	7.8	8.1	5.8	-6.0	2.0	6.0	5.0
Gross industrial production							
annual change in % (real)	3.2	1.6	-5.3	-6.0	3.0	4.0	3.0
Gross agricultural production [3]							
annual change in % (real)	-15.5	21.5	2.0	-1.0	.	.	.
Construction output total							
annual change in % (real)	-1.1	0.4	-2.0	0.2	.	.	.
Employed persons, LFS, th, April	815.7	822.4	802.9	780.0	770	780	800
annual change in %	1.8	0.8	-2.4	-2.8	-1.0	1.0	2.0
Unemployed persons, LFS, th, April	210.7	185.5	149.4	171.0	165	150	145
Unemployment rate, LFS, in %, April	20.5	18.4	15.7	18.0	17.6	16.1	15.3
Reg. unemployment rate, in %, eop	38.7	34.7	32.8	33.7	.	.	.
Average monthly gross wages, BAM	1,321	1,363	1,421	1,476	1,510	1,540	1,570
annual change in % (real, gross)	0.8	1.7	3.7	5.0	1.5	1.0	1.0
Average monthly net wages, BAM	851	879	921	956	970	990	1,010
annual change in % (real, net)	0.7	1.9	4.2	4.9	1.3	1.1	1.0
Consumer prices, % p.a.	0.8	1.4	0.6	-1.1	0.6	0.8	1.0
Producer prices in industry, % p.a.	3.0	3.5	0.1	-1.2	1.0	1.4	1.5
General governm.budget, nat.def., % of GDP							
Revenues	43.1	43.0	42.6	39.0	40.0	40.5	41.0
Expenditures	40.5	40.8	40.7	43.0	42.0	41.0	40.8
Deficit (-) / surplus (+)	2.6	2.2	1.9	-4.0	-2.0	-0.5	0.2
General gov.gross debt, nat.def., % of GDP	36.1	34.2	32.8	38.5	39.0	39.0	38.0
Stock of loans of non-fin.private sector, % p.a.	7.3	5.5	6.7	-2.5	.	.	.
Non-performing loans (NPL), in %, eop	10.0	8.8	7.4	6.1	.	.	.
Central bank policy rate, % p.a., eop [4]	.	.	.	.	.	.	.
Current account, EUR m [5]	-777	-572	-556	-557	-780	-840	-880
Current account, % of GDP	-4.8	-3.3	-3.1	-3.3	-4.5	-4.6	-4.6
Exports of goods, BOP, EUR m [5]	4,776	5,327	5,205	4,808	5,020	5,320	5,480
annual change in %	21.3	11.5	-2.3	-7.6	4.5	6.0	3.0
Imports of goods, BOP, EUR m [5]	8,568	9,172	9,277	8,044	8,470	9,060	9,420
annual change in %	13.3	7.1	1.1	-13.3	5.3	7.0	4.0
Exports of services, BOP, EUR m [5]	1,781	1,944	2,100	1,146	1,320	1,480	1,570
annual change in %	10.0	9.1	8.0	-45.4	15.0	12.0	6.0
Imports of services, BOP, EUR m [5]	590	618	684	452	540	590	630
annual change in %	9.9	4.8	10.6	-33.9	20.0	10.0	6.0
FDI liabilities, EUR m [5]	455	501	346	320	.	.	.
FDI assets, EUR m [5]	88	-6	-9	-10	.	.	.
Gross reserves of CB excl. gold, EUR m [5]	5,293	5,835	6,311	6,942	.	.	.
Gross external debt, EUR m	10,712	11,284	11,486	11,364	11,750	11,650	11,550
Gross external debt, % of GDP	66.8	66.0	63.6	66.9	67.2	64.2	61.1
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary and wiiw estimates. - 2) According to ESA'10 (FISIM not yet reallocated to industries). - 3) Based on UN-FAO data, wiiw estimate from 2019. - 4) Bosnia and Herzegovina has a currency board. There is no policy rate and even no money market rate available. - 5) Converted from national currency.

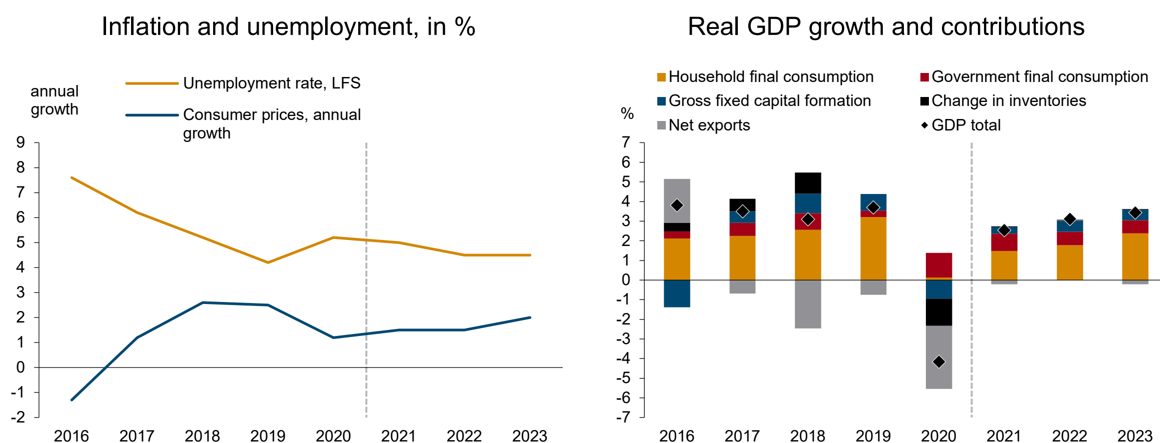
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

BULGARIA: Moderate post-COVID recovery

RUMEN DOBRINSKY

After a year of protests and social turmoil, Bulgaria is entering a new electoral cycle with uncertain outcomes. The negative macroeconomic impact of the pandemic in 2020 was moderate. The shocks were partly mitigated by the policy support measures launched by the authorities. The post-COVID recovery is also expected to be moderate, with GDP growth of 2.5% in 2021 and slightly higher in the following two years.

Figure 4.4 / Bulgaria: Main macroeconomic indicators



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

The year 2020 in Bulgaria was dominated not only by the pandemic but also by a political crisis. This took the form of prolonged mass street protests to demand the resignation of the government and reflected public frustration with ten years of almost uninterrupted rule by the GERB party (Citizens for European Development of Bulgaria), led by the prime minister, Boyko Borisov. This period has been marked by a continuous degradation of Bulgaria's social and political fabric, owing to the undermining of the constitutional separation of powers and the establishment of a system of de facto autocratic rule. However, the protest rallies of the summer and autumn did not succeed in bringing down the government. Protest fatigue translated into the scattering of the core of dissenters whose main common political objective had been the ousting of the government. In consequence, in the lead-up to the parliamentary elections scheduled for 4 April 2021, those who took part in the protests have turned to different opposition parties.

Opinion polls generally suggest a desire by the public for a change in leadership in the new electoral cycle. However, the current rulers have established a system of strongholds throughout the country: they hold most of the key administrative positions at regional and local level, and exercise a

strong grip on the mass media. The Bulgarian Socialist Party, which is the main opposition force, is torn apart by infighting, which has undermined its popular appeal. In addition, the elections are to be held amid the backdrop of the pandemic, which could suppress voter turnout. Therefore, given the dispersed protest vote, the elections may yield some surprises; there are also fears that they may result in a hung parliament and inability to form a new government.

At the beginning of the pandemic, the rapid implementation of rigid containment measures enabled Bulgaria to avert mass infections. However, the second wave that began in the late autumn of 2020 was quite severe, both in terms of the number of cases and the mortality rate. The country did not manage to overcome this phase fully before it was hit by a third wave and reintroduced a full lockdown in March.

By international comparison, the negative macroeconomic effect of the pandemic was moderate, with GDP dropping by 4.2% in 2020. The two fiscal policy support packages launched in 2020 helped to mitigate some of the negative effects. Remarkably, government final consumption expenditure (which in principle constitutes a small share of final demand) made a 1.3-percentage-point positive contribution to GDP growth. By contrast, gross fixed capital formation and net exports made sizeable negative contributions to GDP growth, while that of private consumption was nil.

The worst-hit sector of the Bulgarian economy was the hospitality industry: the number of foreign tourists in Bulgaria plunged by 60% in 2020. Compared with the situation in other CEE countries, the manufacturing sector as a whole was less affected, partly because Bulgaria is less integrated into the automotive global value chain than other countries in the region. Nevertheless, reflecting the plunge in demand in most external markets, gross manufacturing output weakened throughout the year and continued to do so in the early months of 2021. By contrast, given the boom in the demand for online services, the information technology (IT) industry fared very well, reporting growth in output of almost 10% in 2020.

However, the upturn in the exports of IT services could not offset the slump in tourism and transportation revenue. Total exports of services in 2020 fell by one-third from the 2019 level. Services imports also fell, by 23%, reflecting the drop in reverse services flows. The contraction in the exports and imports of goods was less pronounced, at 6.7% and 9.7%, respectively. Overall, these changes brought about a major shift in the current-account balance: from a surplus of 3% of GDP in 2019 to close to zero in 2020.

The shock to the labour market was mitigated by the public support measures. For the year as a whole, businesses received employment support compensation amounting to BGN 650m (equivalent to 0.55% of GDP). These measures were continued in 2021, with new outlays amounting to BGN 300m by mid-March, owing to the REACT-EU (Recovery Assistance for Cohesion and the Territories of Europe) initiative. The labour market impact of the pandemic was seen mostly in transitions from employment to inactivity; the average annual rate of unemployment increased by just 0.9 percentage point from 2019, to 5.1%.

The large-scale support measures translated into an expansionary fiscal stance. According to preliminary estimates, the general government balance in 2020 was relaxed by almost 6 percentage points compared with the previous year. The government engaged in substantial new borrowing on the

international financial markets by selling Eurobonds amounting to EUR 2.5bn. Part of the new borrowing was spent on financing the deficit and some was used to replenish fiscal reserves. Despite the overall fiscal relaxation, public capital expenditure in 2020 was down by 33% from its 2019 level.

The fiscal stance is set to remain loose in 2021. The budget for the year was adopted, with a deficit of BGN 5.5bn (4.5% of GDP). This reflects both the continued COVID-related public support measures but also a large socially oriented policy package that is not directly related to the pandemic. The latter includes significant rises in public-sector wages and pensions, which will not be of a one-off nature but will be carried over in future budgets as well. Consequently, a lasting shift towards a looser fiscal stance can be expected.

Bulgaria will be eligible for significant EU transfers in the coming years. These include EUR 16.6bn from the 2021-2027 Multiannual Financial Framework and EUR 6.2bn in grants from the Recovery and Resilience Facility. The grants envisaged for Bulgaria amount to close to 10% of GDP, which place it among the three countries (together with Croatia and Greece) that benefit the most in relative terms from this facility. In addition, Bulgaria can access loans amounting to up to EUR 4.5bn from the New Generation EU recovery fund. In principle, this generous funding should provide a solid boost to the economy; however, it remains to be seen whether Bulgaria will be capable of absorbing these funds.

In July 2020 Bulgaria officially joined the ERM-2 mechanism. According to the most recent plans, it will aim to join the euro area on 1 January 2024. The authorities are preparing a national plan for the adoption of the euro.

Economic activity remained subdued in early 2021 and, given the recent trends, it is difficult to expect a rapid rebound. The important hospitality industry will continue to suffer the shock of meagre tourist inflows, owing to the restrictive measures on international travel. Policy support will be prolonged, but despite its positive effect, this will not be sufficient to spur robust growth.

In these circumstances, we expect only a moderate recovery in 2021. Growth in the short term will be predominantly driven by domestic demand. Given the increasing social orientation of the budget, we expect a continued general rise in real disposable incomes, which should support private consumption. Gross fixed capital formation should also rebound, but the speed of its recovery will depend on two factors: the return of private investor confidence and the pace of absorption of EU funds. Domestic demand will also provide a boost to imports. The dynamics of exports will depend on the speed of recovery of global and EU import demand.

We expect Bulgaria's GDP to grow by 2.5% in 2021. Its growth rates in 2022 and 2023 are likely to be in the 3.0-3.5% range. The realignment of trade flows should contribute to a lasting downward shift in the current-account balance compared with recent years; nevertheless, it will probably remain in positive territory. Given the current budgetary stance and the envisaged continued policy support, we also expect a lasting downward shift in the fiscal position, which should translate into a negative general government balance in the coming years.

Table 4.4 / Bulgaria: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022 Forecast	2023
Population, th pers., average	7,076	7,025	6,976	6,900	6,850	6,800	6,750
Gross domestic product, BGN m, nom.	102,345	109,743	119,772	118,605	123,400	129,200	136,300
annual change in % (real)	3.5	3.1	3.7	-4.2	2.5	3.1	3.4
GDP/capita (EUR at PPP)	14,690	15,530	16,510	16,200	.	.	.
Consumption of households, BGN m, nom.	60,969	64,936	69,853	70,353	.	.	.
annual change in % (real)	3.7	4.3	5.4	0.2	2.5	3.0	4.0
Gross fixed capital form., BGN m, nom.	18,795	20,624	22,404	21,137	.	.	.
annual change in % (real)	3.2	5.4	4.5	-5.1	2.0	3.0	3.0
Gross industrial production 2)							
annual change in % (real)	3.4	0.3	0.6	-5.9	2.0	3.0	3.5
Gross agricultural production							
annual change in % (real)	6.3	-0.4	-1.4	-12.0	.	.	.
Construction industry 3)							
annual change in % (real)	4.6	1.6	3.8	-5.3	.	.	.
Employed persons, LFS, th, average	3,150	3,153	3,233	3,122	3,140	3,170	3,200
annual change in %	4.4	0.1	2.6	-3.4	0.5	1.0	1.0
Unemployed persons, LFS, th, average	207	173	143	169	170	150	150
Unemployment rate, LFS, in %, average	6.2	5.2	4.2	5.2	5.0	4.5	4.5
Reg. unemployment rate, in %, eop	7.1	6.1	5.9	6.7	.	.	.
Average monthly gross wages, BGN	1,037	1,146	1,267	1,387	1,520	1,650	1,790
annual change in % (real, gross)	7.2	7.5	7.2	7.6	8.0	7.0	6.5
Consumer prices (HICP), % p.a.	1.2	2.6	2.5	1.2	1.5	1.5	2.0
Producer prices in industry, % p.a.	5.0	3.9	3.0	-2.0	1.0	1.5	2.0
General governm.budget, EU-def., % of GDP							
Revenues	36.0	38.5	38.2	36.5	37.0	37.5	37.0
Expenditures	34.9	36.6	36.3	40.5	40.5	39.5	39.0
Net lending (+) / net borrowing (-)	1.1	2.0	1.9	-4.0	-3.5	-2.0	-2.0
General gov.gross debt, EU def., % of GDP	25.3	22.3	20.2	26.5	29.0	29.0	30.0
Stock of loans of non-fin.private sector, % p.a.	3.3	7.7	7.4	4.5	.	.	.
Non-performing loans (NPL), in %, eop	10.4	7.8	6.6	7.5	.	.	.
Central bank policy rate, % p.a., eop 4)	0.00	0.00	0.00	0.00	0.0	0.0	0.0
Current account, EUR m	1,825	554	1,848	68	300	300	100
Current account in % of GDP	3.5	1.0	3.0	0.1	0.5	0.5	0.1
Exports of goods, BOP, EUR m	26,951	27,745	29,120	27,164	28,100	29,000	30,200
annual change in %	16.6	2.9	5.0	-6.7	3.4	3.2	4.1
Imports of goods, BOP, EUR m	27,716	30,443	32,011	28,892	30,200	31,600	33,200
annual change in %	15.1	9.8	5.1	-9.7	4.5	4.6	5.1
Exports of services, BOP, EUR m	8,256	9,187	10,191	6,898	7,300	8,200	9,000
annual change in %	2.6	11.3	10.9	-32.3	5.8	12.3	9.8
Imports of services, BOP, EUR m	5,203	5,058	5,316	4,088	4,400	4,800	5,200
annual change in %	12.1	-2.8	5.1	-23.1	7.6	9.1	8.3
FDI liabilities, EUR m	1,760	1,539	1,472	600	.	.	.
FDI assets, EUR m	446	760	647	187	.	.	.
Gross reserves of CB excl. gold, EUR m	22,257	23,620	23,072	28,830	.	.	.
Gross external debt, EUR m 5)	33,852	34,487	35,178	36,825	37000	36500	36000
Gross external debt, % of GDP 5)	64.7	61.5	57.4	60.7	59.0	55.0	52.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) Enterprises with 5 and more employees. - 4) Base interest rate. This is a reference rate based on the average interbank LEONIA rate of previous month (Bulgaria has a currency board). - 5) BOP 5th edition.

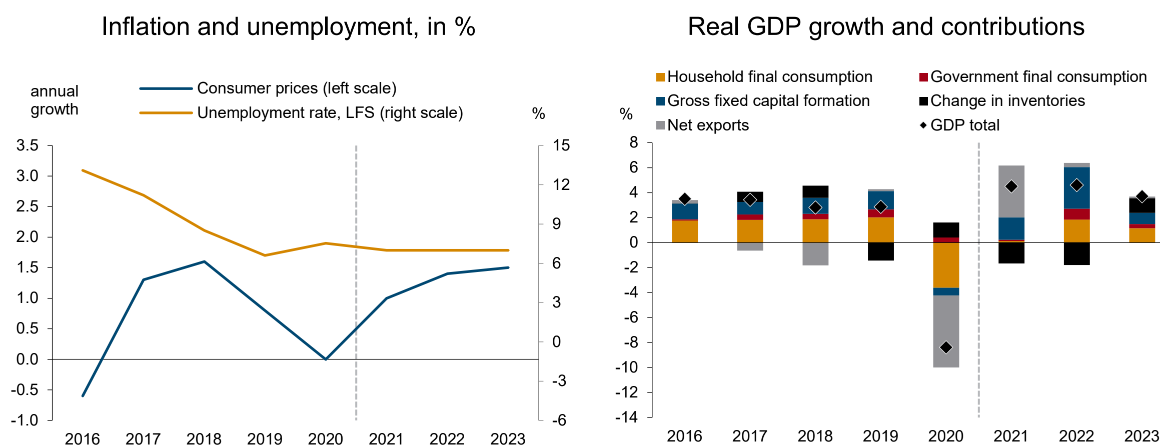
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

CROATIA: EU funds will support recovery

BERND CHRISTOPH STRÖHM

After 2015, Croatia witnessed an economic recovery; however, the COVID-19 pandemic stopped it in its tracks. GDP contracted by 8.4% in 2020, due largely to the pandemic's devastating impact on the tourism sector, but also because the country was rocked by two earthquakes in March and December. EU aid will likely mitigate the earthquakes' adverse effects on Croatia's economic recovery, which is why we expect solid growth of 4.5% in 2021.

Figure 4.5 / Croatia: Main macroeconomic indicators



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

Croatia's GDP is set to bounce back in 2021 as its tourism industry recovers. The deterioration in consumer sentiment and the sharp reduction in private consumption and service exports due to COVID-19 contributed to an 8.4% contraction in Croatia's GDP in 2020. The restrictions imposed on travel and freedom of movement as a result of the pandemic had a particularly pernicious impact on Croatia: while goods exports recovered somewhat toward the end of 2020, the sharp slump in services continued throughout the year, due to the crash in revenue from tourism. On top of the pandemic, the two earthquakes that shook the country in 2020 contributed further to Croatia's economic woes. In 2021, we expect economic recovery, with GDP bouncing back to 4.5% in the wake of an anticipated recovery in tourism earnings, as well as an increase in foreign demand.

COVID-19 vaccination efforts and the maximisation of revenue from tourism will remain major challenges for policy makers in 2021. The extent of the country's economic recovery in 2021 depends on whether the government can limit the spread of COVID-19 without imposing additional hard lockdowns in Q2-Q3 2021 (beyond the measures that the health authorities introduced in Q1). With Croatia set to receive 700,000 doses of COVID-19 vaccines by the end of March, the government will

launch a proper nationwide vaccination campaign in Q2. From an appalling 2020, the country is likely to see a rebound in tourist numbers in 2021; however, because of the possible virus-related travel restrictions imposed in EU member states, its tourism sector will also depend on arrivals from other countries of Central, Eastern and Southeastern Europe (CESEE). The country's reliance on tourist revenue means that the pandemic will dominate as the key policy driver in 2021. Next to COVID-19 and the earthquake reconstruction efforts, the government will focus on adopting the euro by 2023; this will require certain conditions to be met and could result in cuts to public spending for the next two years. An important milestone toward adoption of the euro was Croatia's entry into the Exchange Rate Mechanism (ERM II), one of the few uplifting events for the country in 2020.

As well as tackling the pandemic, the government needs to roll out spending in order to deal with the 2020 earthquakes. The earthquake that hit the capital Zagreb in March caused on its own an estimated EUR 11.5bn in damage (around 45% of the state budget for 2020). The country was rocked by a second earthquake in December, which also brought devastation to villages and cities in central Croatia. The European Parliament approved EUR 683.7m to help the country address earthquake-related structural damage. In March 2021, the government sent a request to the EU for the allocation of an additional EUR 319.1m in earthquake relief grants under the EU Solidarity Fund mechanism. It remains to be seen, however, what proportion of those funds will actually be mobilised by policy makers in 2021.

Croatia's battered tourism industry will likely recover in 2021, despite the uncertainties surrounding COVID-19. The country witnessed a crash in tourist arrivals in Q2 2020, following the imposition of travel restrictions. The pandemic will likely continue to disrupt travel between EU member states well into Q2 2021. There are likely to be fewer tourist arrivals from EU countries, as people opt to holiday at home. However, the fact that Croatia can be reached in just a few hours by car from Austria, Italy and Germany – and without passing through more than two other countries – will benefit Croatian tourist arrivals this year. EU economic recovery in 2021 will inevitably support Croatia's service export side, despite the uncertainties created by COVID-19.

The government's measures imposed in 2020 to combat the COVID-19 pandemic will adversely affect Croatia's private consumption well into 2021. Uncertainty about economic recovery and employment developments in light of the 2020 economic downturn will likely dampen the population's propensity to consume. We still expect private consumption to gain some momentum in Q2 and Q3, as Croatia embarks on this year's tourist season.

The Croatian labour market was dealt a heavy blow by the pandemic in 2020. Nevertheless, the total number of unemployed persons in Q1 2021 continued to fall, compared to the end of 2020, thanks to the government's extensive job-retention measures, which have now been extended to the end of April. The rise in unemployment in 2020 particularly hit the country's younger population, since the seasonal workers who provide services in the country's dominant tourism industry are mostly younger people. The youth unemployment rate in Croatia stood at 22.2% in Q4 2020, with 31,000 young people out of work.

Croatia will be one of the biggest beneficiaries of the EU's Multiannual Financial Framework (MFF) scheme in the period 2021-2027, which will aim to support the country's economic recovery from the COVID-19 pandemic. The EU funds allocated under the MFF scheme – including financial aid equivalent to 35% of Croatia's 2019 GDP – will be used, in particular, to finance research

and development, as well as digitalisation and infrastructure projects in the period 2021-2027. The country is very dependent on EU financing schemes: the EU allocated structural funding in the period 2014-2020 worth about 80% of all public investment in the country. Over the next seven years, Croatia will therefore seek to absorb as much of the EU funds as possible, in an effort to stop emigration and improve general living standards, by facilitating investment in its less-developed regions. The European Commission has, in addition, allocated EUR 510m to Croatia in state aid under the SURE instrument, as a means of supporting the government in financing job-retention schemes in the wake of COVID-19.

The austerity policies are likely to cause problems with recovery from COVID-19 and the earthquakes. In light of the government's support measures aimed at limiting the economic downturn caused by COVID-19, and the additional measures to deal with the aftermath of the 2020 earthquakes, the government can be expected to exceed its projected budget deficit of 2.9% in 2021. To finance general government expenditure, in February 2021 the government also placed two Eurobond issues worth some EUR 2bn on the international financial markets. Croatia's public debt ratio surged to 88.0% in 2020 on account of COVID-19, thereby wiping out years of fiscal consolidation and robust nominal GDP growth, which had succeeded in narrowing the debt-to-GDP ratio to 73% in 2019. In 2021, this ratio will likely fall to 85%.

A gradual pick-up in long-term investment projects is expected in 2021 and 2022. Goods exports will increase strongly in light of the improved global economic outlook this year. Investments will also increase in 2021, and especially in 2022, due to EU co-financing schemes. This should facilitate investment projects in the country's transport, waste, sewerage and energy sectors. The largest project co-financed by the EU in Croatia in 2021 is the construction of the Pelješac Bridge (valued at some EUR 550m), which should be completed in 2022.

Croatia's current account depends on the economic recovery of its most important economic partners. The country's current account was hit hard in 2020 by COVID-19, resulting in a steep decline in service revenue, following a collapse in tourist arrivals. Foreign demand will boost Croatia's economic growth in 2021, with goods exports rising in line with the economic recovery of Croatia's main trading partners – Germany, Austria and Italy. Service sector exports, dominated by tourism, will, however, remain under pressure from COVID-19. Boosted by an increase in the export of goods and services, we expect the country's current account to record a surplus of about 0.2% of GDP in 2021, following a deficit of 4.1% in 2020.

Triggered by an increase in energy prices, inflation will rise slightly in 2021. Inflation stood at 0% in 2020, due to lower transport and energy costs. In 2021, we expect it to pick up again to around 1%, as a result of an increase in energy prices and pandemic-related supply-chain disruptions.

Table 4.5 / Croatia: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022	2023
						Forecast	
Population, th pers., average	4,130	4,091	4,067	4,000	4,000	3,995	3,990
Gross domestic product, HRK bn, nom.	367.5	385.4	402.3	370.2	391	415	437
annual change in % (real)	3.4	2.8	2.9	-8.4	4.5	4.6	3.7
GDP/capita (EUR at PPP)	18,380	19,350	20,300	18,970	.	.	.
Consumption of households, HRK bn, nom.	208.4	218.4	228.0	214.0	.	.	.
annual change in % (real)	3.2	3.3	3.6	-6.4	0.2	3.2	2.0
Gross fixed capital form., HRK bn, nom.	73.3	78.5	84.6	82.6	.	.	.
annual change in % (real)	5.1	6.5	7.1	-2.9	8.0	15.0	4.0
Gross industrial production 2)							
annual change in % (real)	1.4	-1.0	0.6	-2.7	3.0	2.0	2.0
Gross agricultural production							
annual change in % (real)	-4.9	6.4	-0.5	3.1	.	.	.
Construction output 2)							
annual change in % (real)	1.7	4.9	8.3	4.4	.	.	.
Employed persons, LFS, th, average	1,625	1,655	1,680	1,657	1,690	1,720	1,750
annual change in %	2.2	1.8	1.5	-1.3	2.0	1.5	1.5
Unemployed persons, LFS, th, average	205	152	119	135	130	130	130
Unemployment rate, LFS, in %, average	11.2	8.5	6.6	7.5	7.0	7.0	7.0
Reg. unemployment rate, in %, eop	11.2	8.9	7.8	9.5	.	.	.
Average monthly gross wages, HRK 3)	8,055	8,448	8,766	9,216	9,500	9,900	10,300
annual change in % (real, gross)	2.8	3.3	3.0	2.3	2.0	2.5	2.5
Average monthly net wages, HRK 3)	5,985	6,242	6,457	6,763	7,000	7,300	7,600
annual change in % (real, net)	4.1	2.8	2.7	2.6	2.1	2.2	2.2
Consumer prices (HICP), % p.a.	1.3	1.6	0.8	0.0	1.0	1.4	1.5
Producer prices in industry, % p.a.	2.0	2.2	0.8	-3.2	1.4	2.0	2.0
General governm.budget, EU-def., % of GDP							
Revenues	46.1	46.3	47.4	42.0	46.0	46.0	46.0
Expenditures	45.3	46.0	47.0	50.0	49.0	49.0	48.5
Net lending (+) / net borrowing (-)	0.8	0.2	0.4	-8.0	-3.0	-3.0	-2.5
General gov.gross debt, EU def., % of GDP	77.5	74.3	72.8	87.0	85.0	84.0	82.0
Stock of loans of non-fin.private sector, % p.a.	-0.1	2.3	3.9	3.5	.	.	.
Non-performing loans (NPL), in %, eop 4)	8.7	7.5	5.5	5.4	.	.	.
Central bank policy rate, % p.a., eop 5)	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Current account, EUR m	1,681	932	1,478	-1,990	120	520	840
Current account, % of GDP	3.4	1.8	2.7	-4.1	0.2	1.0	1.5
Exports of goods, BOP, EUR m	11,707	12,240	12,861	10,460	11,920	13,170	14,090
annual change in %	11.4	4.6	5.1	-18.7	14.0	10.5	7.0
Imports of goods, BOP, EUR m	20,152	21,882	23,305	19,250	20,500	22,500	24,800
annual change in %	11.2	8.6	6.5	-17.4	6.5	9.7	10.0
Exports of services, BOP, EUR m	12,881	13,847	15,341	9,960	12,000	13,300	15,200
annual change in %	9.9	7.5	10.8	-35.1	20.0	11.0	14.0
Imports of services, BOP, EUR m	4,108	4,639	5,013	4,760	5,100	5,300	5,500
annual change in %	15.3	12.9	8.1	-5.0	8.0	3.0	3.0
FDI liabilities, EUR m	445	1,074	1,278	1,000	.	.	.
FDI assets, EUR m	-673	231	175	200	.	.	.
Gross reserves of CB excl. gold, EUR m	15,706	17,438	18,560	18,943	.	.	.
Gross external debt, EUR m	43,683	42,710	40,877	42,700	43,700	45,300	47,200
Gross external debt, % of GDP	88.7	82.2	75.4	87.0	85.0	83.0	82.0
Average exchange rate HRK/EUR	7.4637	7.4182	7.4180	7.5384	7.6	7.6	7.6

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) From 2020 employees expressed in full-time equivalents (FTE). - 4) Loans more than 90 days overdue and those unlikely to be paid. - 5) Discount rate of CB.

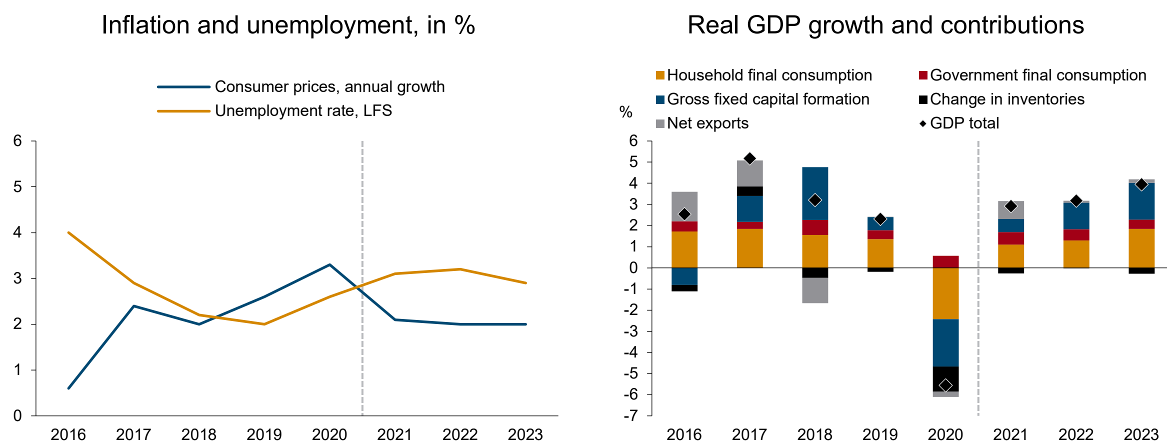
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

CZECHIA: Light at the end of the tunnel?

LEON PODKAMINER

GDP fell by 5.6% in 2020, a smaller decline than had been expected. Although the intensity of the recession was still evident in the fourth quarter of 2020, manufacturing is recovering. A moderate decline in employment is still under way. Czechia's economic fundamentals remain strong: the level of public debt is low, foreign-exchange reserves are very high and the trade balance is in surplus. Positive growth will return in 2021, although the rebound will not be particularly strong.

Figure 4.6 / Czechia: Main macroeconomic indicators



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

The authorities responded promptly to the initial outbreak of the pandemic. Although this came at a significant cost to economic activity, it was successful in restricting the spread of the virus. The lockdown was relaxed in May 2020, but this may have been a premature move. After a lull, the situation worsened again and the government was forced to impose a second lockdown in November. Essentially, this has been in place ever since.[15] The prevailing assumption at present is that the stringency of the measures already introduced will gradually soften, paving the way for economic recovery, possibly towards the end of the second quarter of 2021.

GDP fell by 5.6% in 2020, although the decline was less steep than generally expected. All major GDP expenditure items, except public consumption, declined very strongly during the year: gross capital formation (-12.7%), fixed capital formation (-8.5%), household consumption (-5.2%), and exports and imports of goods and services (-5.9 % and -6.1 %, respectively).

15 See https://bsg.ox.ac.uk/research/research-projects/covid-19-government-response-tracker

The intensity of the recession was not much less pronounced in the fourth quarter. GDP fell by 5.1% (year on year), with household consumption plummeting by 9.3% and gross capital formation by 18.2% (gross fixed capital formation was down by 12.3%). However, exports posted fairly strong growth (4.7 %), with imports more or less stagnating. Trade's contribution to GDP growth in the fourth quarter was positive, at about 3.3 percentage points (pp), compared with -0.3 pp for the full year. The surplus on trade in goods and services reached 8% of GDP. Public consumption grew by a remarkable 4.8% in the fourth quarter.

The recession in manufacturing is slowing down. In 2020 as a whole, gross value added (GVA) generated by manufacturing fell by close to 7%, whereas in the fourth quarter it contracted by only 0.9%. However, the recession in most other important sectors deepened in the fourth quarter. In the construction sector, GVA fell by more than 5% in the fourth quarter (compared with 3.5% for the full year); in transportation, trade, accommodation and catering (combined), the fourth quarter saw a 14% decline (compared with a fall of less than 12% in 2020 as a whole).

On the supply side, the overall recovery hinges on manufacturing, which is the major supplier of export goods. In 2020 manufacturing output fell by 7.2% in real terms. Sales of capital and intermediate goods experienced the heaviest losses. Manufacture of motor vehicles, which is of critical importance, declined by 12%. But the production figures for the fourth quarter indicate that a recovery in manufacturing is under way. It is quite obvious that industry's production potential is currently underutilised. That potential may be put into operation should the demand situation improve. Unfortunately, the most recent available data indicate that the volume of new orders (domestic as well as external) placed with manufacturing industry is not yet satisfactory. This situation may well change with an improvement in consumer sentiment at home and abroad.

A moderate decline in employment is still under way. However, a steep decline in hours worked (by more than 5%) is evident. Although average real wages grew quite strongly in the fourth quarter of 2020 (by close to 4%), the total wage bill continues to decline, even in nominal terms. Employees seem to prefer stable employment, even with a reduction in the number of hours worked (and hence a reduction in wages) to the risk of seeking new work opportunities. Certainly, the fact that government support to firms is conditional on the maintenance of employment is a factor in the slow pace of the rise in unemployment. The downward adjustments in employment will continue in 2021. However, as gradual disinflation is under way, inflation will become less of a drag on real wages, household incomes and private consumption.

The strong decline in household consumption in 2020 stemmed not only from the erosion of real incomes but also from an increased propensity to save[16] – the latter most probably related to prevailing income uncertainties (but possibly also to the restrictions imposed on the purchases of various services and non-essential goods during the lockdown). Since May 2020 the monetary aggregates have been growing at speeds twice as high as had previously been the case: in January 2021 the stock of overnight deposits was 19% larger than in January 2020. At the same time, the stock of credit to residents increased by 3% and the stock of credit to the government rose by more than 60%. With attenuated income and employment uncertainties, voluntary household savings are likely to return to normal and demand for durables, apparel and various services may rise above normal levels, to make up for the

[16] The Czech finance ministry's estimates suggest that households' saving propensity increased to 18% in 2020, from 12.5% in 2019. For 2021 the ministry expects a 17.4% saving propensity.

recent restrictions. The extent of the rebound in private consumption will determine the pace of recovery in 2021 and beyond. We expect a muted recovery in household consumption to take place, not earlier than the second half of 2021.

The fiscal deficit ballooned in 2020. At an estimated 6.1% of GDP, it may have raised the public debt/GDP ratio above 38%, still a very low level. The measures taken in response to the pandemic may have cost the public purse as much as 4.6% of GDP (2.2% in foregone tax revenue and 2.4% in additional expenditure). That 'cost' saved about 4% of GDP in 2020. Interestingly, public spending directly supporting households' (and firms') monetary incomes may prove less effective in softening the recession than other types of measures. As already indicated, the rising saving propensities pre-empt effective spending of direct monetary transfers to households.

The Czech National Bank lowered its policy rates quite aggressively, from 2.25% in February 2020 to 0.25% in May. This has pushed down interbank interest rates (and also yields on Treasury bonds) without preventing ongoing disinflation. Low interest rates, likely to prevail in 2021, may be important in promoting greater lending (or making the domestic public debt cheaper to service), and also because of their impact on the depreciated exchange rate of the koruna. The strong (temporary) devaluation during the first half of 2020 (from an average of CZK 25.6:EUR in the first half of 2020 to CZK 27 per EUR in the second) may be partly attributed to a somewhat indiscriminate treatment of 'peripheral' economies in the early stages of the pandemic. But Czechia's economic fundamentals are quite strong, foreign reserves are high and the trade balance is in surplus.

Table 4.6 / Czechia: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022	2023
						Forecast	
Population, th pers., average	10,594	10,630	10,672	10,700	10,720	10,740	10,760
Gross domestic product, CZK bn, nom.	5,111	5,410	5,749	5,651	5,920	6,230	6,610
annual change in % (real)	5.2	3.2	2.3	-5.6	2.9	3.2	3.9
GDP/capita (EUR at PPP)	26,670	27,900	28,890	27,750	.	.	.
Consumption of households, CZK bn, nom.	2,383	2,524	2,671	2,603	.	.	.
annual change in % (real)	3.9	3.3	2.9	-5.2	2.4	2.8	4.0
Gross fixed capital form., CZK bn, nom.	1,273	1,423	1,509	1,414	.	.	.
annual change in % (real)	4.9	10.0	2.3	-8.5	2.5	5.0	7.0
Gross industrial production							
annual change in % (real)	6.5	3.1	-0.3	-7.2	6.0	5.0	5.0
Gross agricultural production							
annual change in % (real)	-6.2	-0.9	2.1	4.0	.	.	.
Construction industry							
annual change in % (real)	3.3	9.2	2.7	-6.3	.	.	.
Employed persons, LFS, th, average	5,222	5,294	5,303	5,235	5,250	5,250	5,260
annual change in %	1.6	1.4	0.2	-1.3	0.2	0.0	0.1
Unemployed persons, LFS, th, average	155	122	109	137	170	170	160
Unemployment rate, LFS, in %, average	2.9	2.2	2.0	2.6	3.1	3.2	2.9
Reg. unemployment rate, in %, eop	3.8	3.1	2.9	4.0	.	.	.
Average monthly gross wages, CZK	29,638	32,051	34,111	35,611	36,900	38,300	39,800
annual change in % (real, gross)	4.1	5.9	3.5	1.2	1.5	1.8	2.0
Consumer prices (HICP), % p.a.	2.4	2.0	2.6	3.3	2.1	2.0	2.0
Producer prices in industry, % p.a.	0.7	0.7	1.7	0.6	0.8	1.0	1.1
General governm. budget, EU-def., % of GDP							
Revenues	40.5	41.5	41.6	41.4	40.3	40.0	40.0
Expenditures	39.0	40.6	41.3	47.5	46.8	45.6	44.5
Net lending (+) / net borrowing (-)	1.5	0.9	0.3	-6.1	-6.5	-5.6	-4.5
General gov.gross debt, EU def., % of GDP	34.2	32.1	30.2	38.4	43.3	46.7	48.4
Stock of loans of non-fin.private sector, % p.a.	6.5	6.8	5.2	4.1	.	.	.
Non-performing loans (NPL), in %, eop	4.0	3.3	2.5	2.7	.	.	.
Central bank policy rate, % p.a., eop 2)	0.50	1.75	2.00	0.25	0.50	0.75	0.75
Current account, EUR m	2,892	962	-660	6,900	5,000	6,700	6,200
Current account, % of GDP	1.5	0.5	-0.3	3.2	2.2	2.8	2.4
Exports of goods, BOP, EUR m	129,241	136,370	139,277	129,526	141,600	152,900	165,100
annual change in %	9.2	5.5	2.1	-7.0	9.3	8.0	8.0
Imports of goods, BOP, EUR m	119,448	128,516	130,082	118,460	129,100	139,300	151,600
annual change in %	9.8	7.6	1.2	-8.9	9.0	7.9	8.8
Exports of services, BOP, EUR m	24,206	25,942	27,120	21,800	23,500	24,900	27,000
annual change in %	9.9	7.2	4.5	-19.6	8.0	6.0	8.5
Imports of services, BOP, EUR m	19,468	21,262	23,054	17,801	19,000	20,800	22,300
annual change in %	7.7	9.2	8.4	-22.8	7.0	9.5	7.0
FDI liabilities, EUR m	9,997	7,129	8,314	5,825	.	.	.
FDI assets, EUR m	8,288	5,156	5,942	2,212	.	.	.
Gross reserves of CB excl. gold, EUR m	123,273	124,142	133,059	134,608	.	.	.
Gross external debt, EUR m	171,115	171,534	172,504	170,900	175,300	179,000	194,400
Gross external debt, % of GDP	88.1	81.3	77.0	80.0	77.0	74.0	75.0
Average exchange rate CZK/EUR	26.33	25.65	25.67	26.46	26.0	25.8	25.5

1) Preliminary and wiiw estimates. - 2) Two-week repo rate.

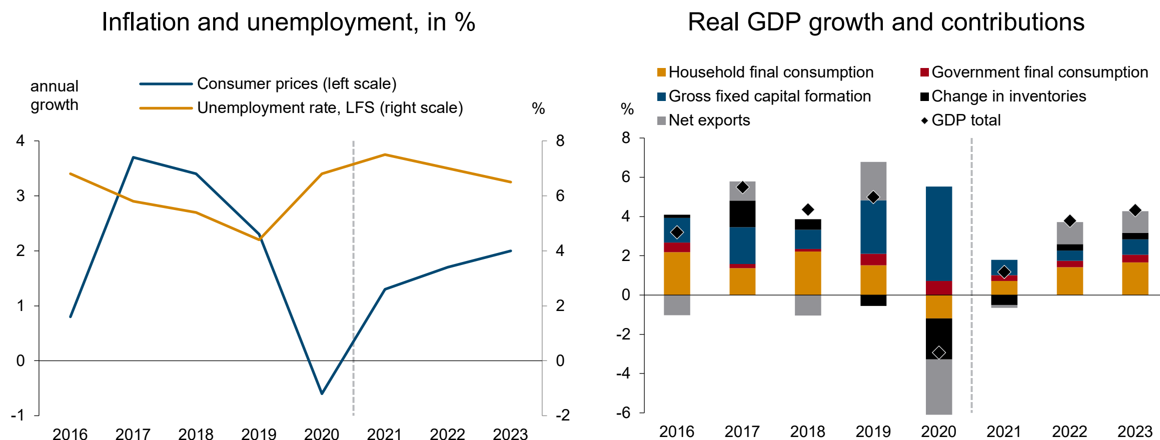
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ESTONIA: The second wave has put the brakes on economic recovery

MARYNA TVERDOSTUP

The rebound in economic activity in the second half of 2020 suggested that the Estonian economy would bounce back once the virus was contained and restrictions were removed. However, an upswing of infections at the beginning of 2021 has turned out much worse than expected and is jeopardising economic recovery. We have downgraded our GDP growth forecast to 1.2% in 2021. The economy is expected to return to its pre-crisis path only in 2022, with a 3.8% growth rate, followed by 4.3% in 2023.

Figure 4.7 / Estonia: Main macroeconomic indicators



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

A revival of economic activity, coupled with very loose restrictions in the second half of 2020, resulted in a minor fall in GDP of 2.9% for the year as a whole. Estonia has acquired a solid position as one of the EU countries least affected economically. After a slump in Q2, caused by restrained foreign trade, reduced consumption, and falling investment, the rest of the year was marked by a rapid bounce-back. The tempo of recovery in Q3 and Q4 indicated that the Estonian economy had great potential. Once the restrictions were lifted, the economy commenced a swift upturn, despite a sluggish recovery in exports and imports, a badly shaken service sector, and vulnerable consumer confidence. The country's sound banking system, combined with sufficient reserves to relaunch business activity and government support, has so far safeguarded the recovery.

The second wave of COVID-19 started to gather momentum from November 2020 and culminated in a second lockdown from 11 March. The very loose to non-existent restrictions between November 2020 and February of this year proved a double-edged sword. No doubt they fostered economic recovery momentum in Q3 and Q4; but recent developments have revealed the downside – a record

high infection rate, increasing public healthcare pressure, a strict lockdown, and the inevitable risks to further recovery.

A massive rise in investments buoyed GDP growth in Q4 2020 and – for the first time in a long while – turned Estonia into a net borrower. Despite earlier forecasts, corporate and government capital investments in the second half of 2020 topped the previous year's level, boosting gross fixed capital formation by 18.4% year on year. A surge in foreign direct investment (FDI) was mostly channelled into car-production software. And an upswing in the development of various pandemic-related technologies by Estonian IT companies suggests their potential to attract FDI financing. Information technology appears to have been the sector least disrupted by the recession. Targeted investments are strengthening the position of the sector even further, fostering wage growth and increasing sectoral labour demand. We expect this trend to continue and FDI in the IT industry to fall only marginally in 2021, particularly due to the persistent relevance of technological solutions related to COVID-19.

There has been a gradual revival of foreign trade and an unforeseen current account deficit, fuelled by the extraordinary one-off import of IT services in Q4 2020. Estonia's relatively minor position on the global market and the rather good performance of its main trading partners – Finland, Latvia, and Lithuania – predetermined the relatively moderate impact that the collapse in foreign trade had on the Estonian economy. As expected, the second half of 2020 marked a gradual upturn in exports and imports of goods (electronic equipment, food) and exports of services (in the telecommunications, information, and insurance sectors). However, a stark 11% jump in foreign trade turnover in Q4 was driven by an unexpectedly large purchase of computer software, which was probably linked to the surge in FDI mentioned above. Other service imports – particularly in transport, construction, and the service sector – remained in the doldrums. External demand for information and communication technology (ICT) and insurance services is expected to ensure steady growth in the crisis period, though foreign tourism is unlikely to recover in 2021. As the crisis is dragging on and foreign demand lacks clarity, we predict moderate growth of 3.5% for exports and 3.9% for imports in 2021. A full-blooded foreign trade revival is expected to start only in 2022.

Fear matters more than restrictions, as private consumption started to shrink well before the second lockdown was announced. While overall household consumption shrank by 2.5% in 2020, a dip in retail sales was largely avoided, as that sector saw a 4.1% growth rate in Q4. Although the retail sector operated as usual throughout autumn and winter, its turnover fell in the first months of 2021. A pension system reform – designed to eliminate the mandatory second pillar – has been introduced (among other things) to provide at least a temporary consumption boost in 2021. However, in light of the restrictions currently imposed, a mounting infection rate, the uncertain vaccination outlook, and household income distortions, consumers will likely spend cautiously, and the propensity to save will remain strong in the first half of 2021. Consumer confidence indicators support this forecast, with the index slipping below the level of spring 2020. We expect a very slow recovery in household consumption, with only a 1.5% increase in 2021. Assuming good progress with the vaccination campaign, a recovery in employment, and improving consumer confidence, we expect steadier growth of 3.0% and 3.5% in the coming two years.

The rising cost of electricity has restored the consumer price index to its pre-crisis level. In December 2020, the consumer price index (CPI) was 0.8% lower than in December 2019, with goods being cheaper and services more expensive. A big hike in the cost of electricity meant that inflation stopped falling in January 2021 (0.2% higher than last year). Energy prices constitute 12% of the consumer basket in Estonia (compared to an EU average of 9%), thus any such fluctuations serve to fuel inflation. Because of the high cost of carbon dioxide quotas, the production of electricity from oil shale is limited and Estonia imports expensive electricity from the Nordic countries. The upward trend in the CPI is expected to last until summer 2021, when the exchange price for electricity will likely be adjusted. Otherwise, price pressures remain weak at the beginning of 2021, due to a slump in wage growth and cautious private consumption. We expect this to remain the case until at least the second half of the year. Service price inflation was expected to increase in the second half of 2021; but the rapid spread of the virus, the uncertain vaccination outlook and the new restrictions may push the rise back until 2022. We predict inflation of 1.3% in 2021, followed by 1.7% in 2022 and 2% in 2023.

The aftermath of the pandemic could be mounting labour market inequalities. The overall unemployment rate reached 7.8% in Q3 2020, slipping back to 7.5% by the end of the year. Job distortion appeared uneven across sectors, regions, socio-demographic groups, and types of employment. The least-protected workers – informal employees, short-time, and part-time workers – suffered massive layoffs, mainly in the construction, accommodation, and food industries. Women, young people, the Russian minority, rural dwellers, and people living in the north-eastern region stood out in terms of raised unemployment; this may serve to exacerbate the existing socioeconomic disparities even further, placing disproportionate pressure on the welfare system and hampering overall economic recovery. The persistent nature of the imbalances hints at slow labour market stabilisation and potential structural changes, if the crisis drags on. We predict that the unemployment rate will stay at around 7.5% in 2021 and will fall only marginally in the coming two years.

Wage growth in 2020 owes much to the high-tech and financial sectors. Average wages maintained a steady growth rate of 3.4% in 2020, despite increased supply and a declining demand for labour. This points towards low-income workers being the most vulnerable to layoffs and wage reductions. Highly paid workers – particularly in ICT, the financial and insurance sectors, which are on a rise, despite the crisis – are in great demand and are driving the average wage upward.

A lower-than-expected budget deficit of 5.4% of GDP in 2020 suggests that there is still fiscal space to support the economy. An increased inflow of tax revenues – mostly payroll tax and VAT – coupled with the massive sale of foreign debt securities, largely covered up the fiscal hole produced by the substantial rescue package in Q2. With the pandemic still in full swing, the government plans to freeze wage and operating costs in 2021-2024. However, a major rise in pensions and increased unemployment benefits, coupled with mounting capital investments, will keep expenditure high, which leaves very little scope for closing the budget deficit within the forecast horizon.

While this year started out with a positive outlook for economic performance in 2021, the unforeseen lockdown has cast doubt on the initial forecast of 3.9% GDP growth. We have downgraded the forecast to 1.2% GDP growth in 2021, followed by a full-scale recovery and growth of 3.8% in 2022 and 4.3% in 2023. Estonian businesses and private consumers had enough reserves to relaunch activities and facilitate a rapid bounce-back after the first wave; but there is no guarantee that the same thing will happen after the second wave: reserves and savings cannot last forever. Despite the

vaccination roll-out, EU support measures to combat the crisis and a stronger overall external environment, state financial aid is needed to prevent the economy from sinking deeper into recession. This simply means that another government rescue package may be launched in spring 2021. Favourable EU funding is another possible source of support for economic recovery. EU funds largely propped up the economy in 2020, although Estonia was less dependent on EU support than other countries of Central and Eastern Europe, thanks to adequate national reserves and a well-run banking system.

Looking beyond the pandemic, a stronger position in a global value chain, broader funding options for businesses and a further strengthening of the technological sector seem likely. The crisis has placed the cornerstones of future economic development in the spotlight of political and economic debate. The crisis has showcased the importance of high-tech sectors in sustaining employment, investment, and tax revenues, proving that the focus on a technologically advanced economy is leading the country in the right direction. An educated labour force, strong technical knowledge, and an advanced level of digitalisation provide solid grounds for attracting investors and gaining a better position in a global value chain. Given the small population and the country's rather limited natural resources, it is essential to stay on the road to a sustainable science- and technology-based economy, and not to lose momentum. However, investment in innovations and technology, particularly in the private sector, remains well below the EU average, which could threaten Estonia's competitiveness in the long term.

Table 4.7 / Estonia: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022	2023
						Forecast	
Population, th pers., average	1,317	1,322	1,327	1,327	1,340	1,342	1,342
Gross domestic product, EUR m, nom.	23,858	25,938	28,112	27,167	27,800	29,300	31,200
annual change in % (real)	5.5	4.4	5.0	-2.9	1.2	3.8	4.3
GDP/capita (EUR at PPP)	23,280	24,680	26,110	25,890	.	.	.
Consumption of households, EUR m, nom.	11,613	12,592	13,315	12,904	.	.	.
annual change in % (real)	2.8	4.6	3.1	-2.5	1.5	3.0	3.5
Gross fixed capital form., EUR m, nom.	5,940	6,377	7,369	8,504	.	.	.
annual change in % (real)	7.8	3.9	11.1	18.4	3.0	2.0	3.0
Gross industrial production							
annual change in % (real)	4.1	4.7	-0.5	-5.2	2.0	4.0	3.0
Gross agricultural production							
annual change in % (real)	6.5	-6.3	22.8	-2.0	.	.	.
Construction industry							
annual change in % (real)	21.5	12.3	3.2	-6.0	.	.	.
Employed persons, LFS, th, average	658.6	664.7	671.3	656.0	657	665	670
annual change in %	2.2	0.9	1.0	-2.3	0.2	1.2	0.8
Unemployed persons, LFS, th, average	40.3	37.7	31.3	47.9	53	50	47
Unemployment rate, LFS, in %, average	5.8	5.4	4.4	6.8	7.5	7.0	6.5
Reg. unemployment rate, in %, eop 2)	4.8	4.8	5.3	8.3	.	.	.
Average monthly gross wages, EUR	1,221	1,310	1,407	1,448	1,520	1,610	1,700
annual change in % (real, gross)	3.0	3.8	5.0	3.4	3.4	4.0	3.8
Average monthly net wages, EUR	986	1,070	1,150	1,185	1,240	1,310	1,390
annual change in % (real, net)	3.2	5.0	5.1	3.5	3.4	4.0	3.8
Consumer prices (HICP), % p.a.	3.7	3.4	2.3	-0.6	1.3	1.7	2.0
Producer prices in industry, % p.a.	3.3	3.9	-0.6	-3.5	1.5	3.0	2.5
General governm.budget, EU-def., % of GDP							
Revenues	38.5	38.7	39.0	45.0	39.0	38.8	38.8
Expenditures	39.2	39.2	38.9	50.4	43.0	40.8	39.3
Net lending (+) / net borrowing (-)	-0.7	-0.5	0.1	-5.4	-4.0	-2.0	-0.5
General gov.gross debt, EU def., % of GDP	9.1	8.2	8.4	17.4	19.0	20.0	18.0
Stock of loans of non-fin.private sector, % p.a.	0.7	5.1	3.3	4.8	.	.	.
Non-performing loans (NPL), in %, eop	0.8	0.5	0.5	0.4	.	.	.
Central bank policy rate, % p.a., eop 3)	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR m	546	238	553	-239	-270	50	380
Current account, % of GDP	2.3	0.9	2.0	-0.9	-1.0	0.2	1.2
Exports of goods, BOP, EUR m	11,964	12,592	13,316	13,297	13,750	14,400	14,900
annual change in %	6.5	5.2	5.8	-0.1	3.4	4.7	3.5
Imports of goods, BOP, EUR m	12,873	13,816	14,207	13,459	14,500	15,200	15,500
annual change in %	6.8	7.3	2.8	-5.3	7.7	4.8	2.0
Exports of services, BOP, EUR m	6,082	6,633	7,180	5,594	6,200	6,700	7,100
annual change in %	10.3	9.1	8.3	-22.1	10.8	8.1	6.0
Imports of services, BOP, EUR m	4,229	4,739	5,161	5,442	5,500	5,600	5,900
annual change in %	8.1	12.1	8.9	5.4	1.1	1.8	5.4
FDI liabilities, EUR m	1,552	1,022	2,627	2,836	.	.	.
FDI assets, EUR m	613	-197	1,640	264	.	.	.
Gross reserves of CB excl. gold, EUR m	279	651	1,256	1,616	.	.	.
Gross external debt, EUR m	19,905	20,069	20,749	25,000	21,700	23,400	25,000
Gross external debt, % of GDP	83.4	77.4	73.8	92.0	78.0	80.0	80.0

1) Preliminary and wiiw estimates. - 2) In % of labour force (LFS). - 3) Official refinancing operation rate for euro area (ECB).

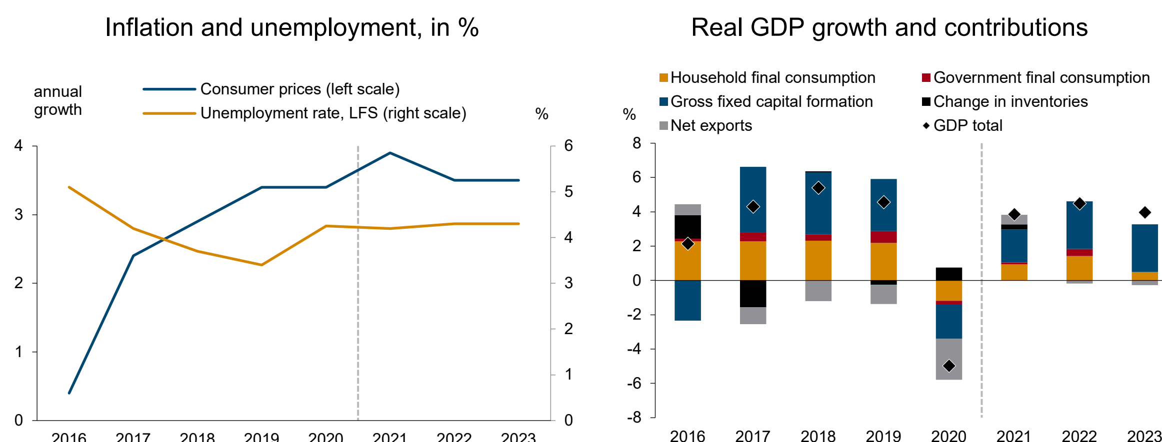
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

HUNGARY: Recovery with strong downside risks

SÁNDOR RICHTER

Hungary's GDP dropped by 5% in 2020, due mostly to declining net exports, but also, to a smaller extent, to shrinking investment and household consumption. The key issues for a recovery are the early revitalisation of international value chains in the automotive industry, resilience of the small and medium-sized enterprise (SME) sector and restoration of the pre-crisis spending propensity of households. The political stakes are high in the wake of the government's growing confrontation with the EU and the approaching elections, scheduled for early 2022.

Figure 4.8 / Hungary: Main macroeconomic indicators



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

Hungarian GDP dropped by 5% in 2020, with an abrupt COVID-19-related dive in Q2 and a better-than-expected performance in Q4. On the production side, both industry and services declined overall, but there were big intra-sector differences: in industry, output in the manufacture of transport equipment fell by over 10%, whereas in the computer and electronics industry and in food, output actually increased moderately. Meanwhile, in services, tourism was the hardest hit (-33%), followed by transportation and storage (-16.6%) and, surprisingly, health and social work activities (-10.2%). Despite the crisis, growth was recorded in some sectors: information and communications technology, financial services, wholesale and retail trade, and public administration and defence. Construction shrank by almost 10%, while in agriculture value added declined more than the overall GDP drop. On the distribution side, half of the overall 5% GDP contraction can be attributed to an unfavourable turn of events in net exports, as trade in services collapsed, with exports hit far harder than imports. A quarter of the decline in GDP came from consumption, and another quarter from gross capital formation. Investment declined by 7.3%, but a strong accumulation of inventories helped to curb the shrinkage in gross capital formation.

The principles and practices of COVID-19 crisis management changed over the course of 2020. Until the middle of the year, the main instrument was an (optional) moratorium on credit repayment by both households and businesses, coupled with moderate fiscal measures. In the second half of the year, government spending gradually gained momentum, and in December alone, the fiscal deficit relative to GDP leapt from about 5% to 9%, reflecting a huge one-off outflow of resources. The opacity of official information means that it is hard to gain a clear picture of the actual crisis management. Of the funds earmarked for 'protection of the economy' (amounting to some 7.6% of GDP), only about a quarter seem to have been spent on purposes related to crisis management itself.[17] Most of the resources went on financing re-badged (but already ongoing) investments, as well as on items that will bolster the ruling party's 2022 election campaign – e.g. support for Hungarians who live in those areas of neighbouring countries that once formed part of Hungary (and who are dyed-in-the-wool Fidesz voters), projects that benefit certain religious establishments, etc. Investment in prestige projects also continued, such as sport infrastructure, the preparations for this year's World Hunting Expo, etc.[18]

Ever since 2010, Fidesz has heavily promoted the creation of a 'work-based' society in Hungary. This mindset led to underestimate the significance of partially replacing wages that evaporated because of COVID-19; thus income support has been modest, compared to other countries. In health care, a highly controversial reform was introduced, which led to some personnel leaving the sector in the most critical period of the pandemic.

Behind the scenes of crisis management, a new wave of power centralisation has been set in motion by Prime Minister Orbán, with local governments deprived of important resources.[19] Although they may apply to central government for compensation, applications are not assessed uniformly: Fidesz-led local authorities stand a better chance than those under opposition control.[20] Extreme centralisation has been seen in both the healthcare sector and higher education. Steps taken to bolster the government's political influence – but marketed as 'crisis management' – include investment in public enterprises and government-friendly private businesses (which are informally given the nod in the public procurement process); 'friendly' subsidies and grants; and the use of offshore companies in transactions to hide inexplicable profits.[21] Those sectors and businesses most impacted by this recent wave of Fidesz offensives are: the energy infrastructure, the banking sector, key tourist facilities around Lake Balaton, important software programs for the government, railway development projects and the military industry (imports and production), universities (which are being turned into nominal foundations), facilities for elite sports, agriculture and casinos (which were allowed to remain open, while the catering industry was forced to close its doors).[22]

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17 É. Várhegyi, Veszteségeink, *Élet és Irodalom*, 12 March 2021.

18 Z. Barotányi, interview with György Surányi, former governor of the National Bank of Hungary (*Magyar Narancs*, 24 February 2021).

19 ibid.

20 E. Csendes-Erdei, Kérj kölcsön valakitől!, *Magyar Narancs*, 24 March 2021.

21 A masterpiece of investigative journalism: A. Bódis, Amíg Ön a járványra figyelt, a NER bevette az országot – leltár a „hazavitt" stratégiai ágazatokról, *Válasz online*, 28 January 2021, https://www.valaszonline.hu/2021/01/28/amig-on-a-jarvanyra-figyelt-a-ner-bevette-az-orszagot-leltar-a-hazavitt-strategiai-agazatokrol/

22 ibid.

Orbán's course of confrontation with the EU is gaining momentum. Now that Fidesz has left the European Parliament's European People's Party group (long a moderating influence), Orbán may move towards more extreme positions. Since November 2020, an EU mechanism linking the disbursement of EU funds to a country's respect for the rule of law has been in place, although whether any practical steps could be taken to implement the mechanism within a relatively short space of time (i.e. before the 2022 Hungarian elections) is a moot point. EU transfers – especially those from the 'Next Generation EU' package, which are scheduled to reach recipient countries as early as summer 2021 – will be of crucial importance in lifting the economy out of the COVID-19 recession and restoring a sustainable fiscal position. They could mean a net inflow of grants amounting to 5% of Hungary's GDP on average in 2021-2023 (probably less this year).

There is considerable uncertainty looming over the forecast horizon. The next elections are less than a year away, and recent polls have indicated that the united list of opposition parties is catching up with (or even overtaking) Fidesz. Popular dissatisfaction over the government's crisis management may play an important role. Without rapid economic recovery fostered by the massive inflow of EU transfers, Orbán's victory in the elections is in jeopardy; but the alternative – a retreat in his political confrontation with the EU and greater room for manoeuvre by the opposition – may be no less dangerous for him. Should Fidesz lose the elections, the politically fairly fragmented opposition would have to deal with the entrenched institutional power of Fidesz (the immovable loyalist attorney general, the constitutional court, the vast majority of the electronic and printed media, which are kept firmly in check, etc.) and the rapidly expanding economic empire of Orbán loyalists.[23] This would be an enormously difficult undertaking, with economic risks on top of everything else. If Orbán does win the 2022 elections, Hungary's access to EU transfers could be suspended at some point. An early suspension could be more troublesome than a later one, once the economy has already returned to its pre-crisis growth path.

Our forecast for 2021-2023 is definitely optimistic. We reckon on a substantial influx of EU resources and a fair pace of revitalisation in the business sector, among both large foreign companies and domestically owned SMEs. A moderate recovery in household consumption is also on the cards, assuming a gradual catching-up with pre-crisis spending propensity. Yet the downside risks – both political and economic – are high. Should one or more of them come to pass, then the likely outcome would be significantly slower recovery, or even stagnation.

[23] ibid.

Table 4.8 / Hungary: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022	2023
						Forecast	
Population, th pers., average	9,788	9,776	9,771	9,750	9,670	9,620	9,600
Gross domestic product, HUF bn, nom.	39,233	43,347	47,514	47,605	51,000	55,000	59,000
annual change in % (real)	4.3	5.4	4.6	-5.0	3.9	4.5	4.0
GDP/capita (EUR at PPP)	20,230	21,580	22,800	22,620	.	.	.
Consumption of households, HUF bn, nom.	18,961	20,522	22,397	22,527	.	.	.
annual change in % (real)	4.7	4.8	4.6	-2.5	2.0	3.0	3.0
Gross fixed capital form., HUF bn, nom.	8,699	10,742	12,937	13,101	.	.	.
annual change in % (real)	19.7	16.4	12.2	-7.3	7.0	10.0	10.0
Gross industrial production							
annual change in % (real)	4.7	3.5	5.6	-6.2	6.0	6.0	5.0
Gross agricultural production							
annual change in % (real)	-4.1	2.7	0.4	-2.1	.	.	.
Construction industry							
annual change in % (real)	29.7	21.2	20.7	-9.2	.	.	.
Employed persons, LFS, th, average	4,421	4,470	4,512	4,460	4,505	4,550	4,550
annual change in %	1.6	1.1	1.0	-1.1	1.0	1.0	0.0
Unemployed persons, LFS, th, average	192	172	160	198	200	200	200
Unemployment rate, LFS, in %, average	4.2	3.7	3.4	4.3	4.2	4.3	4.3
Reg. unemployment rate, in %, eop 2)	5.6	5.2	5.1	4.5	.	.	.
Average monthly gross wages, HUF 3)	297,017	329,943	367,833	403,616	432,200	460,700	491,100
annual change in % (real, gross)	10.3	8.3	7.7	6.2	3.0	3.0	3.0
Average monthly net wages, HUF 3)	197,516	219,412	244,609	268,405	287,400	306,400	326,600
annual change in % (real, net)	10.3	8.3	7.7	6.2	3.0	3.0	3.0
Consumer prices (HICP), % p.a.	2.4	2.9	3.4	3.4	3.9	3.5	3.5
Producer prices in industry, % p.a.	3.3	5.6	2.1	4.3	3.0	3.0	3.0
General governm.budget, EU-def., % of GDP							
Revenues	44.1	43.8	43.5	41.0	45.0	45.0	45.0
Expenditures	46.5	45.9	45.6	50.0	50.5	48.9	48.5
Net lending (+) / net borrowing (-)	-2.4	-2.1	-2.1	-9.0	-5.5	-3.9	-3.5
General gov.gross debt, EU def., % of GDP	72.2	69.1	65.4	78.0	77.7	75.7	74.3
Stock of loans of non-fin.private sector, % p.a.	5.5	10.5	13.2	13.4	.	.	.
Non-performing loans (NPL), in %, eop 4)	7.5	5.4	4.1	3.9	.	.	.
Central bank policy rate, % p.a., eop 5)	0.90	0.90	0.90	0.60	0.60	0.70	1.20
Current account, EUR m 6)	2,536	408	-659	99	0	0	100
Current account, % of GDP 6)	2.0	0.3	-0.5	0.1	0.0	0.0	0.1
Exports of goods, BOP, EUR m 6)	85,285	88,662	93,054	88,706	94,000	100,600	106,100
annual change in %	8.5	4.0	5.0	-4.7	6.0	7.0	5.5
Imports of goods, BOP, EUR m 6)	83,573	90,346	96,097	89,572	96,700	104,000	110,200
annual change in %	12.0	8.1	6.4	-6.8	8.0	7.5	6.0
Exports of services, BOP, EUR m 6)	23,817	25,359	27,112	19,627	24,900	27,400	30,100
annual change in %	8.9	6.5	6.9	-27.6	27.0	10.0	10.0
Imports of services, BOP, EUR m 6)	16,870	17,671	19,944	15,661	19,100	21,000	23,100
annual change in %	7.1	4.7	12.9	-21.5	22.0	10.0	10.0
FDI liabilities, EUR m 6)	7,024	6,606	2,345	695	.	.	.
FDI assets, EUR m 6)	4,987	3,748	1,419	728	.	.	.
Gross reserves of CB excl. gold, EUR m	23,261	26,273	27,010	32,115	.	.	.
Gross external debt, EUR m 6)	105,523	107,155	104,562	106,742	110,000	110,000	110,000
Gross external debt, % of GDP 6)	83.2	78.8	71.6	78.8	78.7	74.0	69.9
Average exchange rate HUF/EUR	309.19	318.89	325.30	351.25	365	370	375

1) Preliminary and wiiw estimates. - 2) From 2020 unemployed in % of working-age population 15-64 (% of LFS labour force before). - 3) Enterprises with 5 and more employees. From 2018 new source to define the staff categories; from 2019 based on tax administration data, survey data before. - 4) Loans more than 90 days overdue and those unlikely to be paid. - 5) Base rate (two-week CB bill). - 6) Excluding SPE.

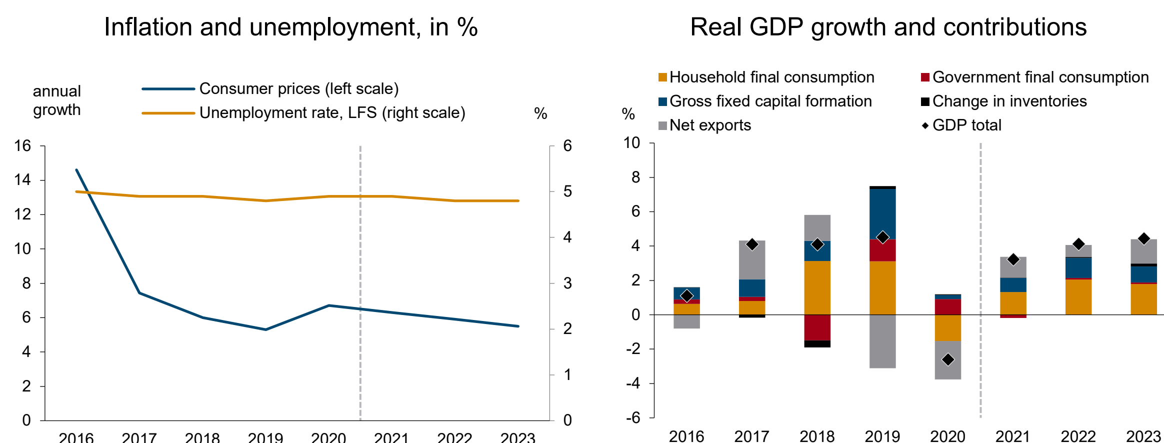
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

KAZAKHSTAN: Rapid recovery in doubt

ALEXANDRA BYKOVA

After a relatively moderate real GDP decline of 2.6% in 2020 (thanks to a large anti-crisis fiscal package), economic recovery of 3.2% is expected for 2021. Although the high price of oil could suggest a more robust economic revival, the remaining pandemic-related restrictions on economic activity and the slow vaccination rate will impede a full recovery in consumption this year. Economic growth is likely to accelerate to above 4% in 2022-2023, driven by consumption, exports and investment.

Figure 4.9 / Kazakhstan: Main macroeconomic indicators



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

Despite the adverse impact of the lockdowns, the decline in the price of oil and the oil production cut agreed by OPEC+, the recession in 2020 was relatively mild – thanks in part to the large fiscal stimulus. The annual real contraction in the economy of 2.6% in 2020 was mainly due to a 7.3% decline in trade and a 17.2% slump in transport and storage activities; together, these contributed 2.8 percentage points (p.p.) to the decline in real GDP. In addition, the mining sector contributed 0.6 p.p. to the fall – a result of the collapse in the oil price and the cut in oil production from May 2020, in compliance with the OPEC+ decision. Government support measures, such as subsidised loans and direct public orders, cushioned the effects of the recession and stimulated high annual growth in agriculture (5.6%), manufacturing (3.9%) and construction (11.2%); together, these contributed 1.6 p.p. to last year's economic performance. The anti-crisis measures taken under the government programme 'Economy of Simple Things' reinforced the import-substitution direction of government policy. This was especially visible in the way pharmaceutical production soared by 47% year on year in 2020.

The labour market impact of the pandemic was limited, thanks to specially targeted programmes that prevented a big spike in unemployment. While employment fell by 0.5% on an annual basis, more than 120,000 people were classified as inactive, leaving the unemployment rate almost unchanged at 4.9% in 2020, according to the Labour Force Survey. The labour market responded to the pandemic merely by reducing working hours and increasing part-time employment, which rose from 6.7% of total employment in 2019 to 8.5% in 2020. Additionally, the share in total employment of those temporarily absent from work jumped from 1.5% in 2019 to 3.4% last year. More unemployed persons started to register their status officially, as that allowed them to benefit from new state support measures. Although the number of registered unemployed peaked in September 2020, there were still 50,000 more registered unemployed at the end of February 2021 than a year previously. The anti-crisis labour market measures included public works organised by local authorities and a targeted employment programme. In particular, guaranteed purchase of production, included by the Samruk-Kazyna state investment company in its offtake contracts, was conditional on firms retaining their employees or creating new jobs. Consequently, around 200,000 jobs were reportedly preserved in 2020.

The fiscal pandemic response in 2021 is expected to be far more muted than last year, assuming no full prolonged lockdowns in 2021. Since the fiscal support measures had mostly expired by the end of 2020, the fiscal support package for 2021 currently envisaged by the government is estimated to be less than 1% of GDP, compared to 8.7% in 2020. Employment support measures and subsidised lending for small and medium-sized enterprises have been extended until the end of 2021, amid the ongoing pandemic. The salaries of medical workers will be hiked again this year, as will pensions and the salaries of teachers, as was already envisaged under the pre-crisis budget for 2021. The amount of business support is uncertain, as the regulation of import substitution still needs to be adjusted to comply with World Trade Organization (WTO) rules (after the transition period for Kazakhstan expired in 2020) and local content provisions in oil and gas sector investment contracts need to be abolished. Meanwhile, better tax administration measures (specially aimed at reducing the hidden economy and customs declaration fraud in trade with China), public-sector reforms and cuts to budget spending are all back on the government agenda. Therefore, the budget deficit is likely to decline gradually over the next years, from 4% of GDP in 2020 to 3.5% in 2021 and 2% in 2023.

If the health crisis worsens and new restrictions are introduced, Kazakhstan has enough fiscal space to fund new anti-crisis measures. The announcement of new measures in the event of a strict lockdown seems plausible, given that targeted state support was increased several times last year after new lockdowns (most recently in early September). Kazakhstan has enough fiscal space for additional measures, thanks to the National Oil Fund, which amounted to 35% of GDP as of the end of February 2021 and which protects the economy against oil price fluctuation shocks. A slump in oil prices last year and an upward rally this year had no impact on the budget, as revenues from oil exports – except export duties on crude oil and petroleum products – flow directly into the National Oil Fund. In turn, a particular sum set by the budget law – so-called transfers from the National Oil Fund – constitutes a part of the budget revenue each year. As a result, it was possible to allow the non-oil budget deficit – calculated without oil revenues and transfers – to balloon from 6.3% in 2019 to 11.6% in 2020; that could potentially be repeated in 2021, if the course of the pandemic requires it, even though the baseline scenario for this year envisages a figure of 8%. Along with an increase in transfers from the National Oil Fund of USD 4.1bn in 2020 (compared to 2019) and a widening of the budget deficit by USD 3.7bn, the fiscal package funding last year was achieved by extra-budgetary financing of around USD 6bn.

Possible further restrictions on economic activity due to the ongoing pandemic and the slow rate of vaccination are jeopardising the rapid revival of consumption in 2021. In view of the weak capacity of the health system to cope with a spike in COVID-19 infections and mortality – most dramatically illustrated in July 2020, when monthly mortality rose to over 2.3 times[24] the figure for July 2019 and containment measures were reintroduced – a new wave of the pandemic can be expected to lead to further restrictions, limiting the consumption revival this year. Currently, Kazakhstan is trying to impose only local restrictions in those regions that see a spike in coronavirus infections. The full lifting of restrictions is unlikely in 2021, as vaccination roll-out is very slow. On the supply side of the vaccination campaign, local production of the Sputnik V vaccine started in December 2020, while the delivery of the Pfizer/BioNTech and Sinovac vaccines are expected later in 2021. The vaccination of priority groups started in February 2021 and should be opened up to the broader population from May, with a target of having a third of the population vaccinated by the end of 2021. On the demand side, the low rate of willingness of the population to be vaccinated – put at just 56% of the population by the BISAM Central Asia Survey – may prevent a speedy uptake. We do not expect real consumption to recover to its 2019 level this year, owing to the ongoing pandemic and the low vaccination rates. Moreover, the reintroduction of stricter containment measures – such as full lockdowns, which are not in the baseline scenario – is quite possible, and this remains a downside risk for recovery.

An acceleration in investment, especially in the oil sector, is expected in the coming years. The government housing construction programme is continuing, and oil-sector investment projects are likely to resume and accelerate, given the favourable oil prices. In particular, the Tengiz oil field enlargement project is likely to be speeded up, after pandemic containment measures delayed work in 2020. Despite investment promotion measures, there are no signs of expected higher investment inflows in other sectors of the economy. An acceleration in house prices is a risk that may materialise, if demand for new apartments – stimulated by a programme of partial subsidies on mortgage loan repayments – outstrips construction volumes.

The National Bank of Kazakhstan is likely to focus on the macroeconomic stabilisation goal amid current inflationary pressure, and therefore no major stimuli for the economy and no policy rate cuts are expected in 2021. The acceleration in inflation, driven by food prices, is expected to continue for at least the first months of this year. As well as high global market prices, distribution channel distortions have contributed to the rapid growth of food prices, which has persisted despite price controls being introduced in 2020 on some categories of socially important products. A slowing of food price inflation is likely after the new harvest, but non-food and tariff sub-components of inflation could pick up later this year, as the recovery gets under way. Movement in the exchange rate has been decoupled from oil price dynamics since 2020. Only a very small appreciation (1.3%) was visible in early 2021, despite rapidly rising oil prices. Due to high inflation and a weaker Russian rouble, a slight tenge depreciation trend for 2021-2023 is more plausible. A small policy rate cut can be expected in the next years if inflation slows. High interest rates will prevent credit growth for business as soon as subsidised lending stops, but consumer lending is likely to resume along with the recovery. The banking sector shows no sign of deterioration so far, with the non-performing loans ratio down to 6.9% as of the end of February 2021. As from 2021, foreign banks and insurance companies are allowed to open branches in Kazakhstan, in accordance with WTO rules; this could make it hard for smaller banks to compete and may lead to consolidation in the next few years.

[24] Annual excess mortality in Kazakhstan in 2020, relative to the average number of deaths in 2015-2019 is expected to reach 24%.

The recovery in merchandise exports in dollar terms will be quicker than previously anticipated, given the rapid upward correction of the oil price. A revival of exports was an important factor behind a revision of real GDP growth forecasts for 2021 – up from 2.5% to 3.2%. Although the trade balance nearly halved in 2020 compared to the previous year (from 8% to 4.5% of GDP), lower foreign direct investment (FDI) income outflows prevented a large current account deterioration last year. The current account deficit will improve only gradually over the next few years, as the repatriation of FDI income is likely to increase due to higher oil revenues. Along with a higher oil price, a partial relaxation of the oil production cut imposed by OPEC+ will lead to a small growth in physical export volumes in 2021-2022. Yet in 2023, the government of Kazakhstan expects the oil production level to increase by 10m tonnes after completion of the Tengiz oil field expansion project. Volatility in oil prices reflects uncertainty about future price development, and a downward correction remains a downside risk to the growth forecast.

Forecasts for 2021 are associated with great uncertainty as regards both the pandemic and the recovery of consumption, and no rapid recovery is likely this year. An acceleration in economic activity to above 4% is expected in 2022-2023, driven by household consumption, exports and investment. On the upside, a higher-than-predicted oil price could lead to a stronger recovery. The downside risks include fresh lockdowns if the virus spread accelerates, a slower-than-expected vaccination roll-out in 2021 and 2022, a drop in the oil price and a slower recovery on the part of trading partners. No political changes can be expected in Kazakhstan, as the parliamentary elections held in January 2020 – criticised by international observers – unsurprisingly preserved the majority of the ruling Nur Otan party.

Table 4.9 / Kazakhstan: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022 Forecast	2023
Population, th pers., average	18,038	18,276	18,514	18,754	19,000	19,200	19,400
Gross domestic product, KZT bn, nom.	54,379	61,820	69,533	70,134	77,500	84,700	92,000
annual change in % (real)	4.1	4.1	4.5	-2.6	3.2	4.1	4.4
GDP/capita (EUR at PPP)	17,020	17,200	17,950	17,510	.	.	.
Consumption of households, KZT bn, nom.	27,987	31,514	35,571	36,800	.	.	.
annual change in % (real)	1.5	6.1	6.1	-3.0	2.6	4.0	3.5
Gross fixed capital form., KZT bn, nom.	11,799	13,091	16,318	16,600	.	.	.
annual change in % (real)	4.5	5.4	13.8	1.0	3.5	5.0	4.0
Gross industrial production							
annual change in % (real)	7.3	4.4	4.1	-0.7	2.8	3.0	4.5
Gross agricultural production							
annual change in % (real)	3.0	3.5	-0.1	5.6	.	.	.
Construction industry							
annual change in % (real)	2.8	4.6	13.2	11.2	.	.	.
Employed persons, LFS, th, average	8,585	8,695	8,781	8,739	8,870	9,000	9,120
annual change in %	0.4	1.3	1.0	-0.5	1.5	1.5	1.3
Unemployed persons, LFS, th, average	442	444	441	451	460	450	460
Unemployment rate, LFS, in %, average	4.9	4.9	4.8	4.9	4.9	4.8	4.8
Reg. unemployment rate, in %, eop	0.8	1.0	1.1	1.5	.	.	.
Average monthly gross wages, KZT 2)	150,827	162,673	186,815	214,090	216,700	235,700	254,900
annual change in % (real, gross)	-1.7	1.7	9.1	7.3	2.3	2.7	2.5
Consumer prices, % p.a.	7.4	6.0	5.3	6.7	6.3	5.9	5.5
Producer prices in industry, % p.a.	15.3	19.0	5.1	-8.0	8.0	3.0	3.0
General governm.budget, nat.def., % of GDP							
Revenues	21.3	17.5	18.3	20.7	18.0	18.5	19.0
Expenditures	23.9	18.8	20.2	24.7	21.5	21.0	21.0
Deficit (-) / surplus (+)	-2.7	-1.3	-1.8	-4.0	-3.5	-2.5	-2.0
General gov.gross debt, nat.def., % of GDP	25.7	26.0	24.9	30.7	31.0	30.5	30.0
Stock of loans of non-fin.private sector, % p.a.	0.0	3.0	5.9	5.5	.	.	.
Non-performing loans (NPL), in %, eop	9.3	7.4	8.1	6.8	.	.	.
Central bank policy rate, % p.a., eop 3)	10.25	9.25	9.25	9.00	9.00	8.75	8.50
Current account, EUR m 4)	-4,516	-117	-6,437	-5,139	-4,900	-3,300	-1,700
Current account in % of GDP	-3.1	-0.1	-4.0	-3.5	-3.1	-1.9	-0.9
Exports of goods, BOP, EUR m 4)	41,866	50,712	51,953	41,043	51,700	53,800	57,000
annual change in %	30.6	21.1	2.4	-21.0	26.0	4.1	5.9
Imports of goods, BOP, EUR m 4)	27,060	29,030	35,759	31,668	33,300	35,300	36,700
annual change in %	14.2	7.3	23.2	-11.4	5.2	6.0	4.0
Exports of services, BOP, EUR m 4)	5,757	6,205	6,952	4,549	5,000	5,300	5,600
annual change in %	4.7	7.8	12.0	-34.6	9.9	6.0	5.7
Imports of services, BOP, EUR m 4)	8,924	10,156	10,244	7,281	8,000	8,500	8,900
annual change in %	0.3	13.8	0.9	-28.9	9.9	6.3	4.7
FDI liabilities, EUR m 4)	4,171	71	3,010	6,739	.	.	.
FDI assets, EUR m 4)	847	-3,933	-1,833	1,332	.	.	.
Gross reserves of CB excl. gold, EUR m 4)	15,505	14,460	9,004	9,827	.	.	.
Gross external debt, EUR m 4)	140,153	139,732	141,600	131,650	142,000	142,500	143,000
Gross external debt, % of GDP	94.9	91.9	87.3	88.5	88.0	82.0	77.0
Average exchange rate KZT/EUR	368.32	406.66	428.51	471.44	483	489	495

1) Preliminary and wiiw estimates. - 2) Excluding small enterprises, engaged in entrepreneurial activity. - 3) One-day (overnight) repo rate. - 4) Converted from USD.

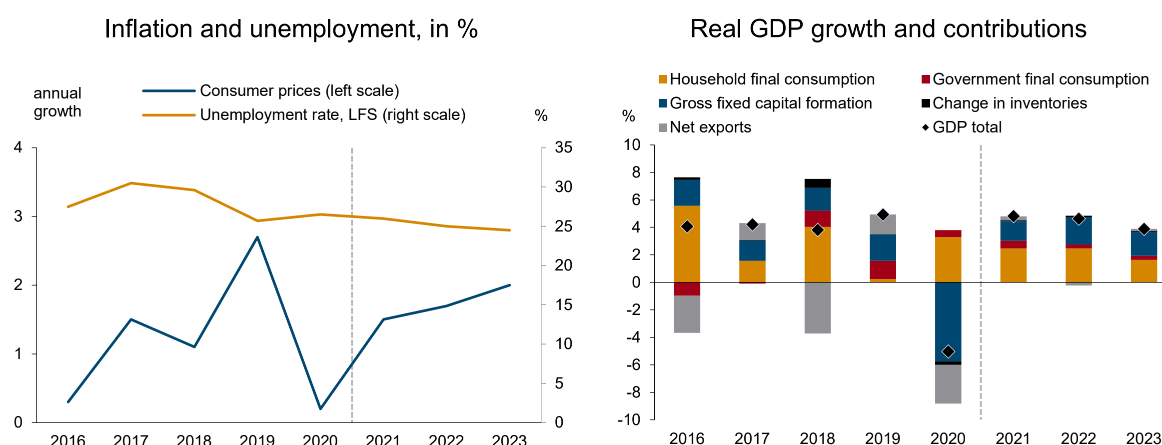
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

KOSOVO: Major future challenges and high expectations of new government

ISILDA MARA

The economy contracted by 5% in 2020, but growth will return to 4.5% in the medium term, supported by domestic and external demand. However, the downside risks remain high, with the current pandemic still raging and vaccines far off on the horizon. The triumphant return of a Kurti government ('Kurti 2') represents a new opportunity for Kosovo to gain political stability. In March 2021, the European Parliament reaffirmed its call to the EU council to adopt visa liberalisation for Kosovo.

Figure 4.10 / Kosovo: Main macroeconomic indicators



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

Kosovo's economy contracted by 5% in 2020, but is expected to grow by 4.8% this year. In particular, the lockdown in the second quarter of 2020 led to a 9.3% fall in economic activity – although the subsequent lifting of the containment measures meant that the pandemic's impact diminished. Investments declined by 24% in the first three quarters of 2020. By contrast, consumption continued to grow at 7% over the same period, thanks to strong remittance flows. There were some interesting developments in foreign demand for goods and services: exports of the former increased by 21% (though as a proportion of trade, goods exports remain low), while exports of the latter fell by 39%. Imports of goods and services decreased by 6% and 21%, respectively. The overall effect was a drop in real net exports of 2.7% in 2020. In terms of output, in the first three quarters of 2020, those sectors that experienced a sharp decline in their activities on an annual basis were construction (25%) and retail trade and transport (13%); meanwhile, industrial production and manufacturing increased their activity to double-digit levels – 10% and 11%, respectively.

No vaccine has yet been made available to Kosovo, and the public healthcare system is coming under strain. A rapid government response at the start of the pandemic helped to keep the number of infections and deaths under control. However, as in other Western Balkan countries, while the first wave of the pandemic was weathered fairly well, the second half of 2020 and the first quarter of 2021 saw average weekly infections rise to almost 2,000 per million inhabitants. In March 2021, infections exceeded 4,700 cases per week and deaths were running at over 50 per week. The World Health Organization's COVAX scheme has announced that the first delivery of vaccines to Kosovo will not take place before May 2021. Albania offered to vaccinate 500 health workers in Kosovo, and the process started in the second half of March.

In 2020, consumption remained positive, thanks to remittances acting as a safety net in Kosovo. Remittances grew by 12% to reach almost EUR 1bn or 15% of GDP in 2020. The solidarity of the diaspora and the support of the Kosovar migrant community for family members back home were particularly apparent among those residing in Germany, Switzerland and Austria. As regards the employment situation, statistics for the first three quarters of 2020 show that employment decreased by 4%, while unemployment increased by 1 percentage point (p.p.) to 26.5%. Those sectors that constitute the main sources of employment – retail trade and construction – are also those that have been severely affected by the pandemic. The social benefit system in Kosovo is weak, and remittances are seen as the main safety net; this explains the sharp increase in remittances.

The banking sector remains robust, and demand for credit has continued to expand, albeit at a slower pace. The private-sector demand for loans increased by 7% in 2020; this was a smaller increase than in previous years, but is understandable, given the pandemic and the tightening of credit standards by banks. The increase in the demand for credit was driven by small and medium-sized enterprises, and the loans were mainly destined for inventories and the restructuring of firms, but also for debt restructuring. Meanwhile, although the level of non-performing loans remains very low (2.7%), it did increase by 0.7 p.p. in 2020 and is expected to increase further, since the pandemic-related moratorium on debt restructuring ended in September 2020. As regards deposits, which are an important source of loan financing, 2020 saw a further increase of more than 12%, to reach EUR 4bn.

Public debt is rising sharply, but is still sustainable. The fiscal stimulus and financial support package offered to mitigate the negative effects of the pandemic (focusing mainly on subsidies, but also covering social transfers and wages) led to a sharp increase in fiscal expenditure of 8.8%, to approach 34.8% of GDP. The adverse effects of the pandemic resulted in a decline of 7.4% in general government revenues (including loans). As a result, the budget deficit reached 7.2% of GDP in 2021, while public debt increased to almost 22% of GDP. At this level, public debt is still sustainable, but with the pandemic ongoing and public finances coming under pressure, the figure will rise further.

The export of goods seems to have benefited from the pandemic, and will continue to do so. Foreign demand led to a big increase in the export of goods, which contrasted with a sharp reduction in the export of services. Kosovo's exports of goods to the EU and Central European Free Trade Agreement (CEFTA) countries – its main trading partners – increased by 28% in 2020. As far as the EU is concerned, in particular there was an increase in exports to Germany, Italy and the Netherlands. As regards CEFTA, half of the exports went to Albania – a record increase of 60% in 2020, year on year – and the rest went mainly to other neighbouring countries such as Bosnia and Herzegovina and Serbia. Those categories of goods that witnessed an expansion of their exports included basic metals,

agricultural products and chemicals. This positive trend has continued into early 2021. The pandemic has apparently sparked an intensification of trade relations with countries that geographically are closer: in part, this explains Kosovo's exports of goods gaining momentum. By contrast, exports of services fell sharply, by almost 40%. In 2020, imports of goods and services fell by 6% and 21%, respectively. That said, imports of goods from CEFTA increased by 22%, as imports from Serbia were reinstated, following the lifting of the 100% tariff on such imports. Foreign direct investment (FDI) had a good year in 2020, recording a 16% increase. In particular, FDI inflows from Austria, Slovenia and Albania more than doubled; but other countries – such as Hungary, the United States and Serbia – also significantly increased their FDI inflows into Kosovo. The outlook for 2021 is rather uncertain, as the pandemic remains a concern.

There are great expectations of the Kurti 2 government, which nevertheless faces considerable challenges. Parliamentary elections were held on 14 February 2021. The Vetëvendosje party, led by Albin Kurti, obtained 50.3% of the vote, securing 58 out of the 120 seats in parliament. A government was formed on 23 March, with Albin Kurti as prime minister. This time around, the Kurti administration's chances of pursuing its ambitious programme for at least four years are good, given the big representation of the Vetëvendosje party in parliament and government. In the coming weeks, the next milestone is the election of president: Vjosa Osmani – now aligned with Albin Kurti – is currently the president-designate (until May 2021) and is the main candidate for this position (since former President Hashim Thaçi was indicted in The Hague by the Kosovo Specialist Chambers on war crimes charges). Negotiations between the leading party and the opposition parties are still ongoing, as a two-thirds majority in parliament is needed to elect the president. The probability that Vjosa Osmani will be elected president remains high. Management of the pandemic, the vaccination programme, the promotion of employment and the fight against corruption are among the top priorities of the Kurti 2 government. As regards dialogue with Serbia, Kurti has stated that he will prioritise the issue of 1,604 missing persons – still an open wound for families in Kosovo.

We expect the economy to return to 4.5% growth in the medium term. Goods exports have gained momentum, and this trend will continue – even though their weight in foreign trade remains low. Growth will be driven mainly by domestic demand. Albin Kurti has assumed office in difficult times: high expectations are pinned on him, but there is also optimism for political stability and economic prosperity that could reassure also international partners. A further source of optimism is the EU Parliament's vote in March 2021 which calls for the EU council to adopt visa liberalisation for Kosovo.

Table 4.10 / Kosovo: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022 Forecast	2023
Population, th pers., average	1,791	1,797	1,789	1,772	1,764	1,763	1,769
Gross domestic product, EUR m, nom.	6,414	6,726	7,104	6,800	7,200	7,700	8,200
annual change in % (real)	4.2	3.8	4.9	-5.0	4.8	4.6	3.9
GDP/capita (EUR at PPP)	7210	7340	7790	7580	.	.	.
Consumption of households, EUR m, nom.	5,370	5,738	5,836	6,100	.	.	.
annual change in % (real)	1.8	4.8	0.3	4.0	3.0	3.0	2.0
Gross fixed capital form., EUR m, nom.	1,729	1,888	2,038	1,600	.	.	.
annual change in % (real)	5.7	6.1	6.8	-20.0	4.9	7.0	6.0
Gross industrial production 2)							
annual change in % (real)	4.9	-1.3	6.3	0.8	1.2	3.0	3.0
Gross agricultural production							
annual change in % (real)	-4.1	-8.8	9.5	-1.5	.	.	.
Construction output 3)							
annual change in % (real)	8.6	9.3	3.5	-3.0	.	.	.
Employed persons, LFS, th, average 4)	357.1	345.1	363.2	348.6	355	365	375
annual change in %	7.6	-3.4	5.2	-4.0	1.0	2.0	2.0
Unemployed persons, LFS, th, average 4)	156.6	145.0	125.3	130.0	120	120	120
Unemployment rate, LFS, in %, average 4)	30.5	29.6	25.7	26.5	26.0	25.0	24.5
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.
Average monthly gross wages, EUR	528	558	600	630	660	680	700
annual change in % (real, gross)	1.7	4.7	5.0	5.0	3.0	1.5	1.5
Average monthly net wages, EUR	471	498	550	580	610	630	660
annual change in % (real, net)	1.5	4.6	7.0	4.5	3.0	2.0	2.0
Consumer prices (HICP), % p.a.	1.5	1.1	2.7	0.2	1.5	1.7	2.0
Producer prices, % p.a.	0.6	1.4	0.9	-0.6	1.4	1.5	1.7
General governm.budget, nat.def., % of GDP 5)							
Revenues	30.0	29.8	31.3	32.8	31.0	31.0	32.0
Expenditures	28.6	29.4	30.3	34.8	32.0	31.5	31.0
Deficit (-) / surplus (+)	1.3	0.4	1.0	-2.0	-1.0	-0.5	1.0
General gov.gross debt, nat.def., % of GDP	15.5	16.3	16.9	22.0	23.0	23.0	22.0
Stock of loans of non-fin.private sector, % p.a.	11.6	10.8	10.0	7.1	.	.	.
Non-performing loans (NPL), in %, eop	3.1	2.7	2.0	2.7	.	.	.
Central bank policy rate, % p.a., eop 6)	6.83	5.99	6.42	6.01	6.00	6.00	6.00
Current account, EUR m	-349	-509	-399	-429	-500	-530	-470
Current account, % of GDP	-5.4	-7.6	-5.6	-6.3	-6.9	-6.9	-5.7
Exports of goods, BOP, EUR m	378	377	393	475	510	540	560
annual change in %	22.9	-0.4	4.4	20.8	8.2	6.0	4.0
Imports of goods, BOP, EUR m	2,843	3,114	3,233	3,048	3,170	3,300	3,370
annual change in %	9.4	9.6	3.8	-5.7	4.0	4.0	2.0
Exports of services, BOP, EUR m	1,359	1,562	1,675	1,019	1,110	1,180	1,240
annual change in %	20.2	14.9	7.3	-39.1	9.0	6.5	5.5
Imports of services, BOP, EUR m	531	706	749	589	630	670	700
annual change in %	8.1	32.8	6.1	-21.3	6.5	6.0	4.0
FDI liabilities, EUR mn	255	272	255	322	.	.	.
FDI assets, EUR mn	43	46	66	54	.	.	.
Gross reserves of CB excl. gold, EUR m	683	769	864	901	.	.	.
Gross external debt, EUR m	2,088	2,036	2,201	2,380	2,200	2,300	2,500
Gross external debt, % of GDP	32.6	30.3	31.0	35.0	31.0	30.0	30.0

1) Preliminary and wiiw estimates. - 2) Turnover in manufacturing industry (NACE C). - 3) Value added. - 4) Population 15-64. - 5) According to IMF Government Finance Statistics and ESA 2010 requirements. - 6) Average weighted effective lending interest rate of commercial banks (Kosovo uses the euro as national currency).

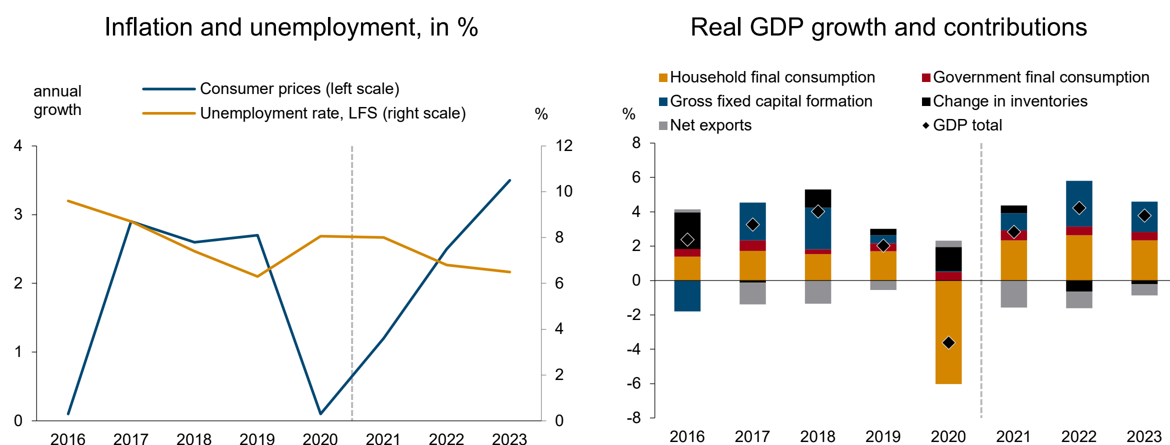
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

LATVIA: Trying to overcome the economic spillover effects of the pandemic

SEBASTIAN LEITNER

With GDP declining by 3.6% the Latvian economy has experienced a milder recession than expected; however, the subsequent revival of 2021 will be restrained. Last year household consumption slumped by more than 10%, while capital investments remained afloat. For this year we see a continuation of the revival in household consumption, but also external demand. Similarly, gross fixed capital investment will gain momentum, also boosted by public expenditures. In 2021 we expect GDP to increase by 2.8%; this will be followed by strong growth of 4.2% in 2022 and a somewhat slower upswing of 3.8% in 2023.

Figure 4.11 / Latvia: Main macroeconomic indicators



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

In 2020 the overall decline in GDP at 3.6% in real terms was somewhat less than expected. In March-April, Latvia was one of the EU countries with the lowest rates of COVID-19 infections per million inhabitants, and the second wave of infections in autumn was also milder than in most other European countries. Following the economic slump in the second quarter of the year, growth resumed in all sectors of the economy, except for hospitality, transport, financial services and surprisingly also ICT.

The second wave of infections resulted in a reinforcement of restrictions in November 2020 and extensions into the second quarter of 2021. Infection levels peaked in January at about 300 cases per 100 persons, well below the average of other European countries. Distance learning was introduced and only lifted for pupils in primary schools from mid-March onwards. Personal services could be offered again from the beginning of March onwards. Further lifting of restrictions planned for April this year may

be introduced with delay. The resurgence of infections throughout Europe in March may also induce the Latvian government to act with more caution, since at the same time progress concerning vaccination of the population is rather slow. By beginning of April still only 8 vaccination doses per 100 persons had been administered – in line with Bulgaria and Russia but lower than in all other EU countries.

Exports of goods recovered strongly in the second half of 2020 resulting in even higher total annual growth last year than in 2019. The slump in March-May was recouped and strong demand was recorded for metals, machinery and equipment, plastics and wood products. At the same time, imports of goods remained depressed, while import price deflation reduced the amount of traded goods even more in nominal terms. This resulted in the current account turning strongly positive (more than 3% of GDP) in 2020. In general we expect growth in goods exports to remain lively and imports to revive in line with household consumption. Compared to trade in goods, however, there was a much sharper decline in trade in services, an important economic activity for Latvia. Income from travel more than halved and exports in transport services were reduced by a third in 2020. Activity in those two branches will recover only slowly in the next two years.

Investment has not fallen in 2020; a slight upswing is expected for the second half of this year. Last year's stagnation in investment was surprising, given that most other EU countries saw a steep decline. Based on figures for building permits, we expect investment in real estate to stagnate in the coming quarters, particularly in residential, but also non-residential buildings. House prices have declined only in the second quarter of last year; they are likely to stagnate until overall demand rebounds. Meanwhile, households are increasing their savings and the stock of mortgage loans is not growing. In the enterprise sector, capital investment in machinery and equipment has remained stable, while increased public sector investment has cushioned the overall investment decline.

Both the first and second lockdown strongly compressed household consumption, which will only pick up more strongly in the second half of 2021: retail trade remains well below 2019 levels even at the beginning of 2021.Since mass-incomes have however not fallen dramatically, the household savings rate has improved strongly. For the second half of 2021 and 2022 this will mean a lot of backlog demand for durable and non-durable goods, when spending will be possible again. Then household consumption will again become the most important driver of growth for the Latvian economy.

The Latvian government counteracted the economic fallout from the crisis with substantial fiscal measures. These comprise loans, state guarantees and also public investment in ailing businesses, sectoral support for the air and transport industry, and help for the education and health sectors. The EU Commission allowed the government to support airBaltic, the main carrier in the Baltic region, and Riga's airports in order to prevent bankruptcies. Short-time work subsidies were introduced both for full- and part-time employees as well as for the self-employed. Companies can attain monthly grants to compensate for the decline in the flow of their working capital. In total however, the government deficit remained relatively low at 5.4% of GDP in 2020. The budget plan for 2021 envisages additional measures to support economic growth; however, the budget deficit is expected to decline to 4% of GDP. The start of construction of the main tracks and infrastructure (e.g. bridges and stations) for Rail Baltica, the high-speed rail project, will lead to a revival of public investment growth. Further investment projects will be front-loaded in 2021.

Employment started to decline in the second quarter of 2020, and decreased in total by 1.5% year on year in 2020. Substantial job losses were recorded in accommodation and hospitality, domestic trade and transport, but also in construction. At the same time employment remained stable in manufacturing and ICT and the number of business service jobs increased. The decline in employment was cushioned by the short-time working schemes introduced by the government. About 5% of the workforce (that would most probably be unemployed otherwise) receives idle-work payments. This covers 75% of employees' wages, up to a monthly maximum of EUR 1000. The SURE loan facility of the EU Commission, approved in April with the purpose of keeping employees in work, supports these allowances by about EUR 200 million by now. The unemployment rate increased to 8.1% in 2020 on average, but has already declined slightly in the past months. We expect the situation on the labour market to improve in the coming quarters, and the unemployment rate to decline gradually to its pre-crisis level over the next three years.

The drop in labour demand resulted in a slowdown in wage growth; however salaries still increased in 2020 by more than 6% in real terms year on year, while for this year a further increase of over 5% is likely. Only in the hospitality sector and transport did wages decrease or stagnate. Since the minimum wage was not increased in 2020, the government decided to raise it from EUR 430 to EUR 500 a month from January 2021 onwards. Although it will rise by 15% this year, Latvia's wage level is still quite low; it exceeds only that of Bulgaria, Romania and Hungary within the EU. The non-taxable minimum will increase in 2021 and 2022, in order to strengthen the purchasing power of low-income households. Part of the wage increase however is due to the crisis-induced structural changes on the labour market, i.e. low-wage earners were more affected by job losses in the past quarters.

Consumer prices started to drop in the second half of last year and will continue to do so until the second quarter of 2021. The decline was driven largely by falling energy prices, which however rebounded towards the end of last year. Given ongoing rises in the prices of services due to this year's wage increases and a rebound in food prices, we anticipate that consumer price inflation will pick up in 2021 to 1.2% and then 2.5% in 2022.

All in all, since our previous report in autumn 2020, we have had to lower the forecast GDP growth rate for 2021 from 4.4% to 2.8%. On the one side this is due to the much better than expected developments in 2020. External demand rebounded quickly after the first lockdown; by the end of 2020 capacity utilisation levels had returned to 'almost normal' levels in several sectors of the economy. Thus, the rebound in growth cannot be that strong in 2021. On the other hand, the second wave of infections and the subsequent prolonged restrictions will delay the release of pent-up consumer demand. Therefore only in the second half of 2021 and 2022 will household consumption recover. External demand, which developed much better than had been imagined, will continue to grow steadily. Imports, which declined particularly due to reluctant household demand, will pick up again. The government will continue to support employers and workers and will continue to invest next year to support economic growth. Household incomes will continue to rise, spurred by a strongly rising minimum wage and a reduced income tax burden. Thus, private consumption will again grow steadily. The unemployment rate will fall more markedly only from 2022 onwards. We forecast GDP growth of 2.8% for 2021; in 2022, external and domestic demand should accelerate, resulting in real GDP growth of 4.2%.

Table 4.11 / Latvia: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022	2023
						Forecast	
Population, th pers., average	1,942	1,927	1,914	1,910	1,890	1,885	1,880
Gross domestic product, EUR m, nom.	26,962	29,143	30,421	29,334	30,500	32,600	35,000
annual change in % (real)	3.3	4.0	2.0	-3.6	2.8	4.2	3.8
GDP/capita (EUR at PPP)	19,680	20,890	21,500	21,170	.	.	.
Consumption of households, EUR m, nom.	15,943	16,839	17,845	16,147	.	.	.
annual change in % (real)	2.9	2.6	2.9	-10.3	4.0	4.5	4.0
Gross fixed capital form., EUR m, nom.	5,559	6,449	6,758	6,854	.	.	.
annual change in % (real)	11.4	11.8	2.1	0.2	4.5	12.0	8.0
Gross industrial production 2)							
annual change in % (real)	8.3	1.5	0.9	-1.5	2.0	3.0	3.0
Gross agricultural production							
annual change in % (real)	1.5	-9.0	21.0	4.7	.	.	.
Construction industry							
annual change in % (real)	18.7	21.8	2.9	2.7	.	.	.
Employed persons, LFS, th, average	894.8	909.4	910.0	895.8	900	905	910
annual change in %	0.2	1.6	0.1	-1.6	0.5	0.6	0.6
Unemployed persons, LFS, th, average	85.4	72.8	61.3	78.6	78	66	63
Unemployment rate, LFS, in %, average	8.7	7.4	6.3	8.1	8.0	6.8	6.5
Reg. unemployment rate, in %, eop 3)	6.8	6.4	6.2	7.7	.	.	.
Average monthly gross wages, EUR	926.0	1,004.0	1,076.0	1,120.0	1,190	1,290	1,400
annual change in % (real, gross)	4.7	5.7	4.2	4.0	5.0	6.0	5.0
Average monthly net wages, EUR	676.0	742.0	793.0	830.0	880	960	1,040
annual change in % (real, net)	4.1	7.0	3.9	4.0	5.0	6.0	5.0
Consumer prices (HICP), % p.a.	2.9	2.6	2.7	0.1	1.2	2.5	3.5
Producer prices in industry, % p.a.	2.5	4.3	1.8	-2.2	0.5	2.0	3.0
General governm.budget, EU-def., % of GDP							
Revenues	37.9	38.5	37.9	40.6	36.3	36.5	36.5
Expenditures	38.7	39.4	38.4	45.7	40.3	39.5	38.0
Net lending (+) / net borrowing (-)	-0.8	-0.8	-0.6	-5.1	-4.0	-3.0	-1.5
General gov.gross debt, EU def., % of GDP	39.0	37.1	37.0	49.8	47.0	44.0	41.0
Stock of loans of non-fin.private sector, % p.a.	-4.7	-5.2	-1.4	-3.8	.	.	.
Non-performing loans (NPL), in %, eop 4)	4.1	5.3	5.0	3.1	.	.	.
Central bank policy rate, % p.a., eop 5)	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR m	339	-84	-197	866	483	83	-417
Current account, % of GDP	1.3	-0.3	-0.6	3.0	1.6	0.3	-1.2
Exports of goods, BOP, EUR m	11,623	12,566	12,730	13,281	14,000	15,000	16,000
annual change in %	10.7	8.1	1.3	4.3	5.4	7.1	6.7
Imports of goods, BOP, EUR m	14,073	15,108	15,407	14,754	15,900	17,500	19,000
annual change in %	12.1	7.4	2.0	-4.2	7.8	10.1	8.6
Exports of services, BOP, EUR m	4,992	5,333	5,588	4,402	5,000	5,500	6,000
annual change in %	8.0	6.8	4.8	-21.2	13.6	10.0	9.1
Imports of services, BOP, EUR m	2,717	3,021	3,167	2,589	3,000	3,300	3,800
annual change in %	9.6	11.2	4.8	-18.3	15.9	10.0	15.2
FDI liabilities, EUR m	1,005	374	949	684	.	.	.
FDI assets, EUR m	496	-270	75	155	.	.	.
Gross reserves of CB excl. gold, EUR m	3,620	3,578	3,700	3,982	.	.	.
Gross external debt, EUR m	38,142	35,939	35,673	38,700	38,100	39,100	42,000
Gross external debt, % of GDP	141.5	123.3	117.3	130.0	125.0	120.0	120.0

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) In % of labour force (LFS). - 4) Loans more than 90 days overdue, and from 2018 also including loans unlikely to be paid. - 5) Official refinancing operation rates for euro area (ECB).

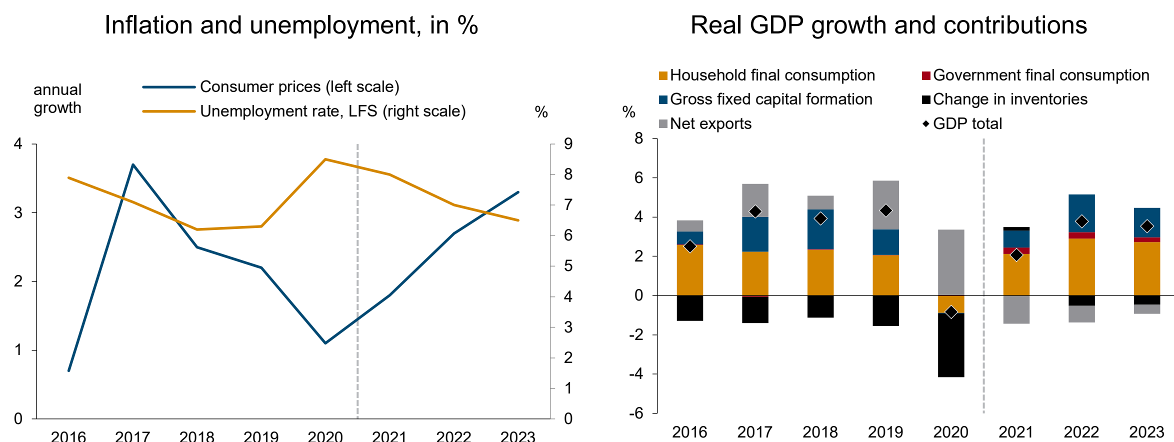
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

LITHUANIA: Recession prevented, revival delayed

SEBASTIAN LEITNER

The Lithuanian economy experienced a short-lived recession in the second quarter of 2020, recovering quickly and experiencing just a small GDP decline of 0.8% for the full year 2020. Better-than-expected export performance and swiftly rebounding household consumption were coupled with a slump in imports. In 2021 the ongoing restrictions due to the second and third wave of infections will keep the economic revival subdued. The government continues to deliver substantial fiscal stimulus, and the announced public investments will support recovery over the next two years. For 2021 we expect real GDP to grow by 2.1%, followed by a faster upswing of 3.8% in 2022 and 3.1% in 2023.

Figure 4.12 / Lithuania: Main macroeconomic indicators



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

Following strong rises in infection figures in autumn the Lithuanian government had to reintroduce a lockdown at the beginning of November. The measures were tightened in December, including the closure of non-essential shops, restrictions on movement between regions of the country, home-teaching in schools, etc. The pick-up in infections and the resurgence of high figures in February resulted in an extension of the lockdown, with some gradual easing from the beginning of March onwards. However, following the appearance of the 'South African' virus mutation in mid-March the Lithuanian government announced that more stringent lockdown measures may have to be reintroduced. At the same time progress with vaccinations was relatively successful in Lithuania in comparison with other European countries. With about 14 vaccination doses administered per 100 persons, Lithuania was in sixth place within the EU and in line with Estonia and other Nordic countries.

Goods exports recovered strongly in the second half of 2020 after the slump experienced in the second quarter of last year. Following the upswing in the EU economy, demand also rebounded for refined petroleum products, the Lithuanian economy's most important category of export goods. At the same time, trade increased in many other commodities, particularly food, chemicals and furniture. Similarly, total industrial production rebounded strongly; from January to February 2021 developments continued to be promising with a growth rate of 6.4% in real terms year on year. Goods imports, however, declined substantially, by almost 10% in nominal terms in 2020 on average, since companies were cautious and ran down their stocks of imported inputs. Trade in services also declined strongly last year, particularly transport services. However, the fairly low share of tourism meant that the Lithuanian economy was hit less hard than its Baltic neighbours. For this year we expect trade in services to rebound to almost the same levels as experienced in 2019. Due to strongly declining imports, the current account surplus jumped to an unprecedented 8% of GDP last year. This year and in 2022 we expect the surplus to remain above 4% of GDP.

After a slump in the second quarter of 2020, investment activity rebounded shortly thereafter and the total of 2020 amounted to the 2019 level. Business started to spend again strongly in machinery and equipment. Looking ahead, we expect a slight increase in overall investments, however enterprises will remain somewhat reluctant until restrictions are lifted and longer-term planning is possible. Investment by households – i.e. spending on private housing – is likely to increase this year, based on dwelling construction and building permit figures. House prices have continued to grow from October 2020 onwards. After a slump in the second quarter, new mortgage loans have also continued to rise. Although unemployment increased last year, mass incomes are rising strongly, thus robust demand for real estate is likely to continue.

The government's substantial fiscal support initiatives have resulted in an 8% budget deficit in 2020 and 7% forecast by the government for 2021. The measures comprise wage subsidies for affected firms, additional public investment, loan guarantees and support for the health sector and agriculture. A business support fund started operating in October to provide liquidity to medium and large enterprises. Sectoral support has been provided for travel and accommodation services. The budget of the general government foresees additional discretionary expenditure measures for 2021 including an increase in old-age pensions amounting to 0.7% of GDP, expenditures for short-time work schemes (0.6% of GDP), further subsidies to companies (0.5% of GDP), and a rise in public sector wages (0.6% of GDP).

The parliamentary elections in October 2020 resulted in a change of government from a centre-green to a conservative-liberal coalition. We expect no major changes in economic policy by the new government. The government has to deliver a National Recovery and Resilience Plan to the Commission by the end of April this year, defining concrete projects to apply for funds from the facility created in response to the COVID crisis last year. Through 2026 an additional amount of about 4% of GDP will be available for the Lithuanian government to invest in the areas of green transition, digital transformation, health, science and innovation, education and social issues.

We expect overall employment to recover slightly in 2021 following a decline of 1.5% in 2020. Jobs were lost in hospitality services, real estate and agriculture (while only to a small extent in manufacturing, domestic trade and construction). However, the overall vacancy rate is still high, showing that growth prospects are good in those parts of the economy that are not affected directly by COVID

measures. The unemployment rate increased by about 2 percentage points to 8.5% in 2020 on average. Over the next two years, we expect this rate to fall again slightly – to 8% in 2021 and 7% in 2022. Net migration towards Lithuania was increasingly positive in 2020. Apart from immigration from the Ukraine and Belarus, an increasing number of Lithuanian citizens returned from the UK last year.

A 6.6% rise in the minimum wage (to EUR 642 a month) from January 2021 will result in gross salaries growing by another 6% in real terms this year. Lithuania thus has the highest minimum wage within the EU CEE countries, except for Slovenia. Labour taxation was reduced in 2020, and this year the non-taxable income threshold has been raised to EUR 500. We expect household consumption to recover substantially and grow by 3.5% in 2021, after having declined slightly last year.

Although import and producer prices collapsed last year, consumer prices kept growing; inflation will again reach 1.8% in 2021. After a slump in the oil price during the first lockdown, it revived to a longer-term normal of USD 65 per barrel. Core inflation will be pushed upwards by rapidly increasing wages. Moreover, excise duties have been raised for tobacco. We expect a further increase in consumer price inflation to 2.7% in 2022 and 3.3% in 2023.

Since our previous forecast in autumn, the decline of GDP turned out to be with 0.8% much milder than expected. For 2021, however, we have reduced our GDP growth forecast from 4.5% to 2.1%. In terms of both external and domestic demand, growth picked up in the second half of 2020 much faster than anticipated. For 2021, we expect exports to increase, albeit only slightly, since the COVID induced restrictions are curtailing demand by most trade partners in the first half of this year. Imports however will revive faster this year given that entrepreneurs ran down their stocks in 2020. Public investment will pick up strongly – not only in 2020, but also in the coming years. Strongly rising household incomes – pushed upwards by increases in the minimum wage and by tax cuts – will help private consumption to grow steadily again. Thus, we expect GDP growth to bounce back to 1.8% in 2021, and to continue in 2022 at a higher pace of 3.8%.

Table 4.12 / Lithuania: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022	2023
						Forecast	
Population, th pers., average	2,828	2,802	2,794	2,795	2,780	2,770	2,760
Gross domestic product, EUR m, nom.	42,276	45,491	48,797	48,794	50,700	54,000	57,800
annual change in % (real)	4.3	3.9	4.3	-0.8	2.1	3.8	3.5
GDP/capita (EUR at PPP)	23,180	24,640	26,030	26,170	.	.	.
Consumption of households, EUR m, nom.	26,198	27,903	29,445	29,262	.	.	.
annual change in % (real)	3.6	3.8	3.3	-1.5	3.5	4.8	4.5
Gross fixed capital form., EUR m, nom.	8,504	9,531	10,429	10,585	.	.	.
annual change in % (real)	8.9	10.0	6.2	-0.2	4.0	9.0	7.0
Gross industrial production (sales)							
annual change in % (real)	7.0	4.8	3.4	-1.8	3.5	4.0	3.8
Gross agricultural production							
annual change in % (real)	2.6	-10.0	10.1	7.1	.	.	.
Construction industry							
annual change in % (real)	8.9	13.8	8.4	-1.6	.	.	.
Employed persons, LFS, th, average	1,355	1,375	1,378	1,358	1,363	1,370	1,375
annual change in %	-0.5	1.5	0.3	-1.5	0.4	0.5	0.4
Unemployed persons, LFS, th, average	103	90	92	126	119	103	96
Unemployment rate, LFS, in %, average	7.1	6.2	6.3	8.5	8.0	7.0	6.5
Reg. unemployment rate, in %, eop 2)	8.7	8.9	8.7	16.1	.	.	.
Average monthly gross wages, EUR 3)	840.4	924.1	1,296.4	1,421.2	1,530	1,650	1,820
annual change in % (real, gross)	4.7	7.1	6.4	8.3	6.0	5.0	6.5
Average monthly net wages, EUR 3)	660.2	720.0	822.1	908.9	980	1,060	1,160
annual change in % (real, net)	5.7	6.2	11.6	9.3	5.5	5.0	6.0
Consumer prices (HICP), % p.a.	3.7	2.5	2.2	1.1	1.8	2.7	3.3
Producer prices in industry, % p.a.	5.1	5.6	0.0	-9.0	1.0	3.0	4.0
General governm.budget, EU-def., % of GDP							
Revenues	33.6	34.4	34.9	34.9	34.0	34.8	35.0
Expenditures	33.2	33.8	34.6	40.9	40.0	37.8	36.5
Net lending (+) / net borrowing (-)	0.5	0.6	0.3	-6.0	-6.0	-3.0	-1.5
General gov.gross debt, EU def., % of GDP	39.1	33.7	35.9	46.9	52.0	50.0	47.0
Stock of loans of non-fin.private sector, % p.a.	4.5	6.0	3.3	-2.4	.	.	.
Non-performing loans (NPL), in %, eop	3.1	2.4	1.6	1.5	.	.	.
Central bank policy rate, % p.a., eop 4)	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR m	231	137	1,632	3,880	2,600	2,400	2,300
Current account, % of GDP	0.5	0.3	3.3	8.0	5.1	4.4	4.0
Exports of goods, BOP, EUR m	22,763	24,552	25,954	25,479	26,000	27,000	28,300
annual change in %	16.9	7.9	5.7	-1.8	2.0	3.8	4.8
Imports of goods, BOP, EUR m	24,815	27,333	28,303	25,681	27,800	29,700	31,500
annual change in %	16.2	10.1	3.6	-9.3	8.3	6.8	6.1
Exports of services, BOP, EUR m	8,350	9,678	11,841	10,292	11,700	13,200	14,800
annual change in %	22.5	15.9	22.3	-13.1	13.7	12.8	12.1
Imports of services, BOP, EUR m	5,319	6,055	6,949	5,626	6,600	7,500	8,700
annual change in %	14.6	13.9	14.8	-19.0	17.3	13.6	16.0
FDI liabilities, EUR m	1,192	1,096	1,402	798	.	.	.
FDI assets, EUR m	359	866	486	434	.	.	.
Gross reserves of CB excl. gold, EUR m	3,509	4,831	4,273	3,662	.	.	.
Gross external debt, EUR m	34,940	35,542	33,047	38,000	40,600	40,500	40,500
Gross external debt, % of GDP	82.6	78.1	67.7	77.9	80.0	75.0	70.0

1) Preliminary and wiiw estimates. - 2) In % of working age population. - 3) Including earnings of sole proprietors. From 2019 the employer's social security contribution (28.9%) was transferred to the employees; real growth in 2019 estimated by wiiw. - 4) Official refinancing operation rate for euro area (ECB).

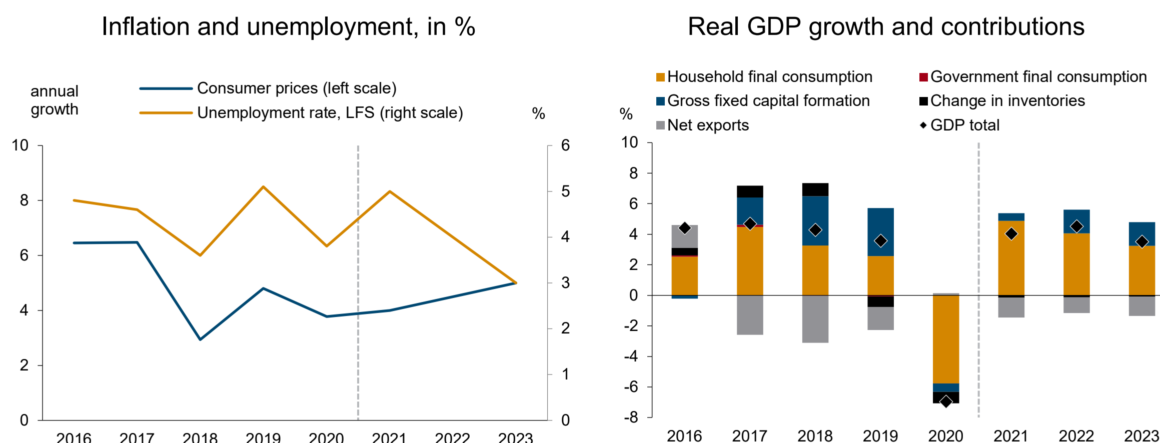
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

MOLDOVA: Cumbersome recovery from deep recession

GÁBOR HUNYA

The 7% drop in GDP in 2020 was mainly the result of contracting household demand and an extremely bad harvest. Official employment and unemployment both declined, as people were forced into irregular work. Economic growth will resume in 2021 (+4%), but slow progress in vaccination will delay a full recovery to the pre-crisis level. Surprisingly low inflation will not be sustainable once the economy starts growing.

Figure 4.13 / Moldova: Main macroeconomic indicators



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

GDP declined by 7% in 2020 on account of a sharp drop in domestic and foreign demand. Household consumption contracted at the same rate as the overall economy. This came despite the rather mild COVID-19-related restrictions during the second wave of infections. All other demand components also posted negative growth. Although investments in infrastructure generated a boom in the construction sector, investments in the private sector as a whole were held back by uncertainty, and so gross fixed capital formation made a negative contribution to growth. Unfavourable weather conditions led to a significant decline in agricultural production, contributing 2.7 percentage points to the decline in value added. Retail trade contributed 2.1 percentage points to the decline. Manufacturing production fell in two key segments, food and drinks, in response to the shortfall in domestic input; and the export-oriented production of machinery and car parts. The latter was a major blow to structural modernisation, foreign direct investment inflows and the foreign trade balance.

The general government budget deficit widened to 8% of GDP, mainly on account of revenue shortfalls. The major part of the public deficit was financed by international donors (IMF, World Bank etc.) extending the necessary loans for budget support. The country has no access to international bond

markets, and sovereign ratings are not expected to reach investment grade in the near future. A smaller part of the financing came from domestic bond issues, given households' higher savings rates during the pandemic. Nominal yields came down to record-low levels, as did interest rates on borrowing for investment. They responded to falling inflation, but remained positive in real terms.

Inflation slowed between January 2020 and January 2021, on account of declining energy prices and sluggish domestic demand for goods and services. Food products were the exception; prices soared, owing to contracting domestic supplies of basic staples. Inflation will begin to accelerate during 2021, but the average rate will be about 4%, not much above the 2020 level and below the target set by the National Bank of Moldova (the central bank). Employment contracted in 2020 at a remarkable rate; the participation rate fell to only 51% of the working-age population. People affected by the pandemic either left the labour market altogether or were put on involuntary leave. The latter phenomenon was especially widespread in the second quarter of the year, but it returned to the level of the previous year in the second half of 2020 when restrictions were relaxed. As a result, the unemployment rate fell below 4% last year, despite the crisis – a lower level than in 2019 (which saw a very large employment downturn in the first quarter).

The current-account deficit contracted to about 7% of GDP, after having soared for two years. Imports subsided on account of falling oil prices and sluggish domestic demand. Exports fell even more sharply, but they amounted only to half of the value of imports. The surplus on the primary income account contracted, but the secondary income surplus widened. Detailed data on these two balance-of-payments positions suggest that short-term migrants reduced their mobility and remittances, while long-term migrants increased their remittances. The volume of money transfers to Moldova for households through banks amounted to USD 1.5bn (12.5% of GDP) in 2020, up by almost 22% from the 2019 level. This may not mean a similar increase in total remittances as restrictions on movement meant that less cash came into the country. Imports will bounce back in 2021 in the new environment of higher international energy prices, and the current-account deficit may return to 9% of GDP.

The current political stalemate is not supportive of crisis management. Since December 2020 the country has had a pro-Western president, Maia Sandu, who is determined to put an end to corrupt practices and the reign of the oligarchy. But her supporters lack a majority in parliament and Constitutional Court rulings tend not to go in their favour. They have thus been unable to bring about early elections, which could change the balance of power to their benefit. The pro-Russian prime minister resigned in December 2020, giving way to an interim government whose term has now expired. The president and parliament have been seeking to appoint a new prime minister, but so far they have blocked each other's candidates. However, there may be some chance of a compromise as the spread of the pandemic accelerates.

Shortage of vaccines delays both political and economic improvements. Moldova failed to start vaccination until early March 2021. Vaccines were donated by Romania and some doses were purchased through the World Health Organisation's co-sponsored COVAX programme. With the number of infections rising, restrictive measures under a state of emergency were reintroduced on 20 March; these will suppress economic activity for at least a month. International value chains are set to be disrupted once more, and the international movement of labour further restricted. The situation is also serious in Transnistria. The Chisinau government has reportedly included the separatist region in international humanitarian assistance programmes and is providing medical support.

Growth can resume in 2021, given normal weather conditions and positive developments in Moldova's main export market, Romania. The government aims to bring down the fiscal deficit to 6% of GDP. It has prolonged the guarantee schemes and the possibility of deferred tax payments for small and medium-sized enterprises. Nevertheless, access to finance has become increasingly difficult for the private sector; liquidity-constrained small companies are facing the greatest challenges. Bankruptcies and unemployment may worsen before the situation improves. A return to the pre-crisis level of economic activity is feasible only in mid-2022.

Table 4.13 / Moldova: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022 Forecast	2023
Population, th pers., average	2,755	2,706	2,663	2,600	2,560	2,500	2,500
Gross domestic product, MDL bn, nom.	178.9	192.5	210.4	206.4	225	247	268
annual change in % (real)	4.7	4.3	3.6	-7.0	4.0	4.5	3.5
GDP/capita (EUR at PPP)	7,980	8,330	8,870	8,580	.	.	.
Consumption of households, MDL bn, nom.	150.8	160.5	174.6	167.6	.	.	.
annual change in % (real)	5.3	3.9	3.1	-7.0	6.0	5.0	4.0
Gross fixed capital form., MDL bn, nom.	39.9	46.8	54.0	53.0	.	.	.
annual change in % (real)	8.0	14.5	12.9	-2.1	2.0	6.0	6.0
Gross industrial production							
annual change in % (real)	3.4	3.7	2.0	-5.5	6.0	7.0	5.0
Gross agricultural production							
annual change in % (real)	9.1	2.9	-1.9	-27.1	.	.	.
Construction industry							
annual change in % (real)	3.6	17.6	12.8	3.7	.	.	.
Employed persons, LFS, th, average	800	794	872	834	830	840	850
annual change in %	-3.8	-0.8	9.9	-4.4	0.0	1.0	1.0
Unemployed persons, LFS, th, average	38.9	29.6	46.9	33.1	40.0	40.0	30.0
Unemployment rate, LFS, in %, average	4.6	3.6	5.1	3.8	5.0	4.0	3.0
Reg. unemployment rate, in %, eop	2.1	1.7	1.8	2.9	.	.	.
Average monthly gross wages, MDL	5,587	6,268	7,234	8,104	8,800	9,700	10,700
annual change in % (real, gross)	5.0	9.0	10.1	6.2	4.0	5.0	5.0
Average monthly net wages, MDL	4,564	5,142	6,010	6,600	7,100	7,800	8,600
annual change in % (real, net)	4.5	9.4	11.5	6.2	4.0	5.0	5.0
Consumer prices, % p.a.	6.5	2.9	4.8	3.8	4.0	4.5	5.0
Producer prices in industry, % p.a.	3.3	0.3	1.8	2.6	5.0	4.0	3.0
General governm.budget, nat.def., % of GDP							
Revenues	29.8	30.1	29.9	30.4	30.0	31.0	31.0
Expenditures	30.5	31.0	31.4	35.5	36.0	33.0	32.0
Deficit (-) / surplus (+)	-0.6	-0.8	-1.4	-5.1	-6.0	-3.0	-1.0
General gov.gross debt, nat.def., % of GDP	29.1	27.2	25.1	30.7	34.0	34.0	32.3
Stock of loans of non-fin.private sector, % p.a.	-3.3	6.0	13.9	13.2	.	.	.
Non-performing loans (NPL), in %, eop 2)	18.4	12.5	8.5	7.4	.	.	.
Central bank policy rate, %, p.a., eop 3)	6.50	6.50	5.50	2.65	2.70	3.00	3.50
Current account, EUR m 4)	-492	-1004	-1000	-740	-1,010	-990	-850
Current account, % of GDP	-5.7	-10.4	-9.3	-7.1	-9.0	-8.4	-7.0
Exports of goods, BOP, EUR m 4)	1,657	1,672	1,892	1,620	1,720	1,770	1,880
annual change in %	17.7	1.0	13.1	-14.4	6.2	2.9	6.2
Imports of goods, BOP, EUR m 4)	3,928	4,462	4,850	4,410	4,780	4,930	5,130
annual change in %	19.6	13.6	8.7	-9.1	8.4	3.1	4.1
Exports of services, BOP, EUR m 4)	1,109	1,247	1,378	1,230	1,350	1,430	1,530
annual change in %	15.1	12.5	10.4	-10.7	9.8	5.9	7.0
Imports of services, BOP, EUR m 4)	838	947	1,064	800	900	950	1,010
annual change in %	10.5	12.9	12.5	-24.8	12.5	5.6	6.3
FDI liabilities, EUR m 4)	133	244	448	40	.	.	.
FDI assets, EUR m 4)	9	29	36	0	.	.	.
Gross reserves of CB excl. gold, EUR m 4)	2,346	2,628	2,731	3,079	.	.	.
Gross external debt, EUR m 4)	5,725	6,430	6,626	7,100	7,500	7,800	7,900
Gross external debt, % of GDP	66.7	66.3	62.0	68.0	67.0	66.0	65.0
Average exchange rate MDL/EUR	20.83	19.84	19.67	19.74	20.0	21.0	22.0

Note: All series excluding data on districts from the left side of the river Nistru and municipality Bender.

1) Preliminary and wiiw estimates. - 2) Substandard, doubtful and loss credit portfolio. - 3) Overnight (refinancing) operations rate. - 4) Converted from USD.

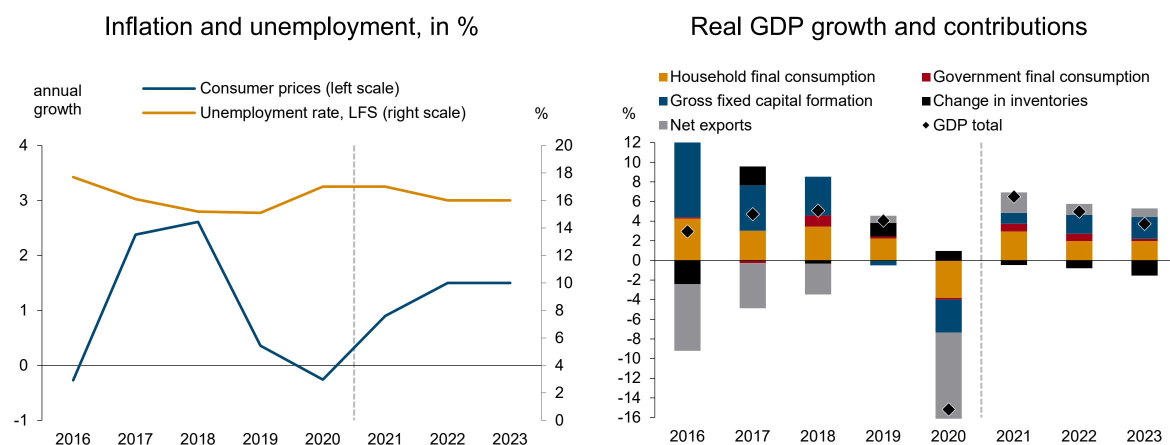
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

MONTENEGRO: Tourism to drive recovery in 2021

BERND CHRISTOPH STRÖHM

Montenegro suffered comfortable CESEE's deepest contraction in economic activity in 2020, with GDP shrinking by 15.2% on the back of a steep decline in tourism revenue and the country's limited fiscal cushion. In 2021, we expect economic recovery to be somewhat inhibited, with the government's COVID-19 restrictions from 2020 radiating well into 2021. We still expect GDP to grow by 6.5%, boosted by tourism and remittances.

Figure 4.14 / Montenegro: Main macroeconomic indicators



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

Despite COVID-19 having a profound impact on Montenegro's growth in 2020, economic recovery is expected in 2021 and 2022. Montenegro suffered extensively from the pandemic-related travel restrictions of 2020, which caused a steep decline in revenue from tourism. Next to tourism, retail earnings and employment also collapsed. The drop in tourist arrivals led to a deep slump in domestic consumption and investments in 2020. In 2021, Montenegro will see a recovery from the economic downturn, thanks to bigger earnings from tourism and remittances. Nevertheless, the country will not regain the full potential of its tourism sector this year, compared to pre-pandemic levels. Since tourism revenue accounts for more than 20% of Montenegro's GDP, the country's recovery in 2021 will also depend on whether the pandemic leads to travel restrictions in Western European countries in Q2-Q3, which could get in the way of a successful tourist season. We expect an increase in revenue from tourism this year; however, the outlook for Montenegro's tourist industry remains uncertain. We expect GDP to recover by 6.5% in 2021, supported by revenue from tourism and remittances. With COVID-19 subsiding in 2021, we expect GDP to grow by about 5% in 2022.

Tourism revenue, foreign direct investment and remittances from Montenegro's diaspora should curb the country's current account deficit in 2021. As a result of the pandemic, imports and the export of services both crashed in 2020, with Montenegro's current account deficit contracting sharply. In particular, the regional travel restrictions were damaging for the country, which relies heavily on service exports and remittances. The virus-related restrictions further widened Montenegro's traditionally large current account deficit, to an astonishing 26% in 2020, making it by far the largest contraction in the CESEE region. However, low domestic demand from consumers and investors helped to limit the country's trade deficit. For 2021, we expect imports to rise, due to the planned completion of the first section of the Bar-Boljare motorway, as well as other investment projects. Service exports will surge as well, with the recovery of the Montenegrin tourism industry. Rising income from tourism, remittances from Montenegrins living abroad and foreign direct investment should rein in the current account deficit to about 20.9% in 2021.

FDI and remittances in 2021 will remain strong and will continue to support the country's economic recovery. FDI inflow into the Montenegrin real estate and energy sectors will remain buoyant and will support several energy-transition projects in 2021, such as the Komarnica hydropower plant, in which the government invested some EUR 246m in 2020. The country's role as a hub for electricity traffic, new investment projects in the energy and construction sectors, and investment in telecommunications and 5G network expansion projects will likely boost FDI to 8.3% in 2021.

The slow progress of the government's COVID-19 vaccination campaign could create difficulties for the start of the Montenegrin tourism season. The previous government managed to sign an agreement in October 2020, by which Montenegro joined the World Health Organization (WHO) COVAX mechanism. The aim was to procure some 250,000 COVID-19 vaccination doses, allowing up to 20% of the country's population to be inoculated. However, following Foreign Minister Radulović's announcement in February 2021 that the health authorities had not yet received a single dose of any COVID-19 vaccine approved by the EU, it seems unlikely that the government will manage to fully launch an inoculation campaign by Q2 2021. The government received a donation of 30,000 doses of the Sinopharm vaccine from China. In addition, the Serbian government has pledged to donate 4,000 doses of the Russian-made Sputnik V vaccine. On 25 February, Prime Minister Krivokapić's cabinet secured the delivery of a further 5,000 Sputnik V doses from Russia. However, those symbolic deliveries alone will not suffice to ensure the launch of an effective vaccination campaign. The first batch of 24,000 AstraZeneca doses finally arrived in Montenegro through the COVAX mechanism on 28 March.

Montenegro's parliamentary elections of August 2020 ended 21 years of government by the Democratic Party of Socialists (DPS). The new prime minister, Zdravko Krivokapić (whose party has very close ties to Serbia), will likely continue to drive the country's EU accession efforts forward, despite initial concerns that the new coalition would abandon the pro-West stance of the former government. The new administration, however, seems rather fragile, on account of diverging policy views within the governing coalition and with only a small majority in parliament. One of the new cabinet's key policy drivers, next to COVID-19, is how to service the EUR 900m loan that was issued in 2014 to facilitate construction of the Bar-Boljare motorway project. The government has already called on the EU to help Montenegro repay the loan from the Chinese Exim Bank. As for EU membership, of all the CESEE EU candidate countries, Montenegro still has the best prospects for EU accession.

The Montenegrin government exhausted its fiscal capacity in 2020 by financing measures to mitigate the economic downturn caused by COVID-19. Because of the pandemic, the budget deficit ended up at about 10% in 2020, with budget revenue some 13% lower than in 2019. Deferred tax payments – a move introduced by the government to help companies in the face of the economic downturn – contributed to the surge in the country's budget deficit. The new government has managed to gain some financial leeway for 2021, after a EUR 750m Eurobond sale in December 2020. This has enabled the repayment of unfavourable credits and has forestalled the planned cuts to pensions in 2021. The government's measures to mitigate the COVID-19 economic downturn mean that the country is expected to record a budget deficit of 6% in 2021, with a debt-to-GDP ratio of 98%. Without the construction of the Bar-Boljare motorway section, the debt-to-GDP ratio would have fallen to some 65% of GDP in 2021.

Employment prospects for 2021 are linked to the recovery of Montenegro's service sector. Following the drop in tourist arrivals and the government-mandated closure of bars and nightclubs, Montenegro recorded a deep contraction in employment, with unemployment growing to 17% in 2020. As COVID-19 subsides, unemployment will likely return to its pre-pandemic levels in 2022. Any forecasts regarding the development of Montenegro's labour market in 2021 are still subject to a high degree of uncertainty, given that the tourist industry is responsible – either directly or indirectly – for a fifth of all employment in the country. The country's unemployment rate in 2021 is expected to exceed 2019's 15%.

With the expected economic recovery, higher demand will support a slight increase in inflation in 2021. A sharp drop in international oil prices caused inflation to remain low in 2020. As oil prices rise, so we expect inflation to increase slightly to 0.9% in 2021.

Table 4.14 / Montenegro: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022 Forecast	2023
Population, th pers., average	622	622	622	625	630	630	630
Gross domestic product, EUR m, nom. 2)	4,299	4,663	4,951	4,193	4,500	4,800	5,100
annual change in % (real)	4.7	5.1	4.1	-15.2	6.5	5.0	3.7
GDP/capita (EUR at PPP)	13,520	14,610	15,680	13,440	.	.	.
Consumption of households, EUR m, nom. 2)	3,216	3,425	3,534	3,336	.	.	.
annual change in % (real)	3.9	4.6	3.1	-5.4	3.7	2.5	2.5
Gross fixed capital form., EUR m, nom.	1,157	1,364	1,352	1,158	.	.	.
annual change in % (real)	18.7	14.7	-1.7	-12.3	4.0	7.0	8.0
Gross industrial production 3)							
annual change in % (real)	-4.2	22.4	-6.3	-0.9	3.2	3.4	3.4
Net agricultural production 4)							
annual change in % (real)	-3.1	3.3	-2.2	-3.0	.	.	.
Construction output 4)							
annual change in % (real)	51.5	24.9	10.7	-5.5	.	.	.
Employed persons, LFS, th, average	229.3	237.4	243.8	222.0	226	231	236
annual change in %	2.3	3.5	2.7	-8.9	2.0	2.0	2.0
Unemployed persons, LFS, th, average	43.9	42.5	43.4	50.0	50	40	40
Unemployment rate, LFS, in %, average	16.1	15.2	15.1	17.0	17.0	16.0	16.0
Reg. unemployment rate, in %, eop	22.1	17.8	16.2	20.5	.	.	.
Average monthly gross wages, EUR	765	766	773	783	790	800	810
annual change in % (real, gross)	-0.5	-2.4	0.6	1.6	0.2	0.2	0.2
Average monthly net wages, EUR	510	511	515	524	530	540	550
annual change in % (real, net)	-0.2	-2.3	0.4	2.0	0.2	0.2	0.2
Consumer prices, % p.a.	2.4	2.6	0.4	-0.3	0.9	1.5	1.5
Producer prices in industry, % p.a. 5)	0.4	1.7	2.4	-0.1	1.1	2.5	2.5
General governm.budget, nat.def., % of GDP							
Revenues	41.5	42.2	43.4	42.0	43.0	41.0	41.0
Expenditures	46.8	46.2	45.4	52.0	49.0	45.0	44.0
Deficit (-) / surplus (+)	-5.3	-3.9	-2.0	-10.0	-6.0	-4.0	-3.0
General gov.gross debt, nat.def., % of GDP	64.2	70.1	76.5	100.0	98.0	97.0	95.0
Stock of loans of non-fin.private sector, % p.a.	7.7	9.1	6.6	2.8	.	.	.
Non-performing loans (NPL), in %, eop	7.3	6.7	4.7	5.5	.	.	.
Central bank policy rate, % p.a., eop 6)	6.16	5.75	5.46	5.84	5.5	5.5	5.5
Current account, EUR m	-691	-793	-744	-1,089	-940	-890	-820
Current account, % of GDP	-16.1	-17.0	-15.0	-26.0	-20.9	-18.5	-16.1
Exports of goods, BOP, EUR m	382	436	466	409	440	470	490
annual change in %	9.0	14.0	6.8	-12.2	7.0	7.0	5.0
Imports of goods, BOP, EUR m	2,243	2,485	2,531	2,049	2,110	2,280	2,500
annual change in %	11.7	10.8	1.8	-19.0	3.0	8.0	9.5
Exports of services, BOP, EUR m	1,382	1,563	1,698	671	960	1,180	1,480
annual change in %	10.2	13.1	8.6	-60.5	43.0	23.0	25.0
Imports of services, BOP, EUR m	531	627	678	490	580	610	640
annual change in %	9.3	18.1	8.1	-27.7	18.0	5.0	5.0
FDI liabilities, EUR m	494	415	373	463	.	.	.
FDI assets, EUR m	10	92	67	-5	.	.	.
Gross reserves of CB excl. gold, EUR m 7)	847	1,050	1,367	1,738	.	.	.
Gross external debt, EUR m	6,905	7,612	8,310	8,345	8,820	9,260	9,690
Gross external debt, % of GDP	160.6	163.2	167.9	199.0	196.0	193.0	190.0

1) Preliminary and wiiw estimates. - 2) Including expenditures of NPISHs. - 3) Enterprises with 5 and more employees. - 4) Based on gross value added data. - 5) Domestic output prices. - 6) Average weighted lending interest rate of commercial banks (Montenegro uses the euro as national currency). - 7) Data refer to reserve requirements of the Central Bank.

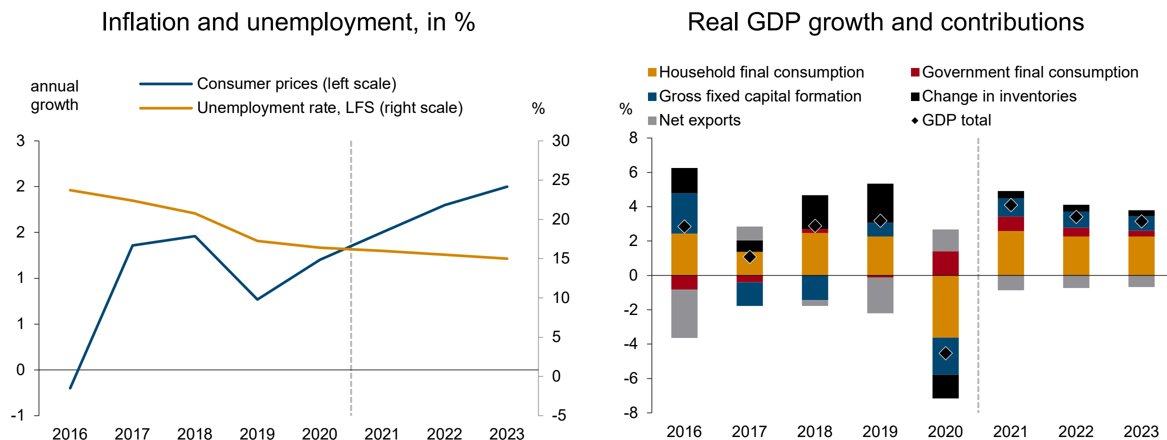
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

NORTH MACEDONIA: Healing COVID-19 Wounds

BRANIMIR JOVANOVIC

After a large initial decline, North Macedonia's economy improved in the second half of 2020, ending the year with a minus of 4.5%. The improvement came as a result of government fiscal support. 2021 will be a year when the damage created by the pandemic will be slowly repaired, with real GDP growing by 4.1%. The pre-crisis level of activity will be reached at the beginning of 2022, and then, when ground zero is reached after two lost years, old structural challenges will come to the fore.

Figure 4.15 / North Macedonia: Main macroeconomic indicators



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

North Macedonia's economy went through two phases during the COVID-19 pandemic in 2020. The first one, from the second quarter of the year, saw GDP decline by 14.9% year on year, among the biggest contractions in Europe. Then in the second half of the year it declined by just 2%, among the best in Europe. For the whole year GDP contracted 4.5%, the European average.

Looking at the individual components of GDP, they all dropped for the year as a whole, except government consumption. Household consumption declined by 5.6% as people were reluctant to spend amidst the burning pandemic. Gross capital formation declined 10.2%, as companies refrained from investing due to high uncertainty. Exports declined by 10.9% due to reduced demand from abroad. Imports declined by 10.5% as a result of reduced domestic demand, offsetting the decline in exports. In contrast, government consumption grew by 10.1% owing to government support for the economy, thus cushioning 1.4 pp of the GDP decline.

The government was perhaps a bit slow with its support to the economy, but at the end of the day, the support was solid. It enacted four stimulus packages during 2020, consisting of wage subsidies to firms, credit guarantees, favourable credit lines, direct financial support to selected groups and tax holidays. The first three were adopted in Q2, with implementation in Q2 and Q3, while the fourth one was adopted in Q3, with implementation in Q4. Consequently total government expenditures grew by 12% for the whole year (10% in the first half, 14% in the second). As a share of GDP, they reached 36.8% of GDP for the whole year, which is some 4 pp above the average of the past three years. The deficit reached 8.2%, the highest in the last two decades.

The labour market response was muted due to government measures. Employment for the whole of 2020 declined by just 0.3% (3,000 people), but this was also driven by an increase in employment in Q1. Starting from Q2 employment fell by 2.7% (22,000 people). Inactivity increased due to the pandemic, with 13,000 people becoming inactive throughout the year. As the increase in inactivity was more pronounced than the decline in employment, unemployment actually declined for the whole year, by 10,000 people, bringing the rate of unemployment to 16.4% (from 17.3% in 2019). Average net wages rose 6.5% in real terms, driven by increases in the minimum-wage and public-sector wages.

The recession was evident in other sectors of the economy as well. FDI halted almost completely, reaching just EUR 74 million for the whole year, down from EUR 488 million in 2019. Secondary income, driven primarily by remittances, which are very important for the country, declined sizeably, by 20%, amounting to EUR 1.4 billion. Private sector credit growth slowed to 4.6% from 6.1% in 2019, but the banking sector remained stable, with non-performing loans falling to 3.3% due to the debt moratoria. Inflation averaged 1.2% over the whole year, reflecting weak domestic demand and low global commodity prices. It would have been even lower had the government not raised the fuel excise duty and electricity prices during the pandemic.

Expectations for 2021 cannot be very optimistic as the year seems to be starting off on the wrong foot. The country is going through a new pandemic wave, with figures at early April exceeding the peak from December. The government prioritised business over health for a long time, avoiding a lockdown, which overwhelmed hospitals. This was also hurting the economy indirectly as it leaves the disease to spread freely, forcing people and businesses to refrain from spending and investing. Light lockdown was eventually introduced at the begging of April, with a curfew and a closure of restaurants and bars, but at the time of the writing of this text, there were no indications that the situation started to improve.

General vaccination seems light years away; at the beginning of April, the country only started to immunize the risky groups. The government failed to obtain vaccines on its own, so had to rely on the COVAX mechanism. The first batch of these vaccines, 24,000 doses, arrived only at the end of March, but will not be enough even for the people at risk. Previously, Serbia donated around 5,000 doses, which has been enough for just a part of healthcare personnel. It is unclear when general inoculation will start but it will certainly not be finished before autumn, meaning that the economy will remain anaemic throughout the summer, growing only compared to the significant decline of the previous year.

High-frequency data for January 2021 are mixed, but are more indicative of a sluggish recovery than of a rebound. Industrial production is 13.5% down compared to the year before, while retail trade is 2% up (in real terms). Total government revenues are 5% below the previous year, whereas goods exports are growing strongly at 15%. Still, this is entirely due to higher commodity prices, as the country exports metals. Given the high volatility of metals prices on international markets, exports may well decline in the coming months.

We forecast only a partial recovery of economic activity in 2021, growing 4.1%, and reaching the pre-pandemic level only at the beginning of 2022. All GDP components are expected to grow - household consumption by 4%, gross investment by 5%, exports by 9.5%, and imports by 9% - but they will all remain below 2019 levels. Only government consumption will remain elevated, growing by 5% this year, reflecting the supportive fiscal policy announced by the government.

The government has adopted another, fifth package of support to the economy in early 2021, but parliament still has to pass the required laws. The package is similar to the previous ones including wage subsidies, zero-interest credit and direct support to selected groups of businesses and people. It is smaller than previous packages though, amounting to 1.5% of GDP. It brings the planned deficit for 2021 to 5% of GDP, which seems like a careful and gradual consolidation after last year's deficit of 8.2%. It is questionable, however, whether the government will be able to achieve this deficit, as it has suffered from insufficient spending capacity in previous years, resulting in poor enactment of planned budgets.

To be able to finance the planned fiscal support, the government issued a 7-year Eurobond in March 2021, for the amount of EUR 700 million, with a yield of 1.866%. This is the lowest yield the country has achieved so far, reflecting favourable conditions on global financial markets. This external borrowing implies that domestic financial resources will be available for private initiatives, which might prove useful for the recovery. In addition, the central bank reduced its main interest rate again in March to 1.25%, meaning that domestic financing conditions are likely to be favourable in 2021.

All economic indicators are expected to improve marginally in 2021, following the recovery of economic activity. Employment will increase by 0.5% (5,000 new jobs). Unemployment will decline by 6,000, pushing the rate of unemployment to 16% (from 16.4% in 2020). Wages will grow 3% in real terms due to the minimum-wage increase, slowing from the growth observed in previous years. Despite higher commodity prices, inflation will average 1.5%, reflecting still weak domestic demand. FDI will increase from the previous year, reaching EUR 400 million (3.5% of GDP), but will still remain 18% below the 2019 level. Secondary income will reach EUR 1.55 billion, 10% higher than in 2020, but also 10% below that of 2019.

The pre-crisis level of economic activity will be reached at the beginning of 2022, and then, when COVID-19 wounds are healed, two years will be lost, but old structural problems will remain. The economy will be faced with poor governance and non-functional institutions; high unemployment, poverty and inequality; low competitiveness and innovation capacity; low human capital and high emigration. Medium-term prospects will depend on whether the government tries to address these issues, or will let yet another good crisis go to waste.

Table 4.15 / North Macedonia: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022 Forecast	2023
Population, th pers., average	2,075	2,076	2,077	2,075	2,075	2,075	2,075
Gross domestic product, MKD bn, nom.	618.1	660.9	689.4	664.0	702	739	778
annual change in % (real)	1.1	2.9	3.2	-4.5	4.1	3.4	3.2
GDP/capita (EUR at PPP)	10,790	11,340	11,850	11,490	.	.	.
Consumption of households, MKD bn, nom.	405.9	429.2	446.4	434.5	.	.	.
annual change in % (real)	2.1	3.8	3.5	-5.6	4.0	3.5	3.5
Gross fixed capital form., MKD bn, nom.	139.0	132.4	146.1	132.0	.	.	.
annual change in % (real)	-5.7	-6.4	4.0	-10.2	5.0	4.5	4.0
Gross industrial production 2)							
annual change in % (real)	0.2	5.4	3.7	-9.6	7.0	6.0	5.0
Gross agricultural production 3)							
annual change in % (real)	-9.9	10.0	-0.3	1.7	.	.	.
Construction industry							
annual change in % (real)	-27.2	-6.8	3.8	1.3	.	.	.
Employed persons, LFS, th, average	740.6	759.1	797.7	794.9	800	810	820
annual change in %	2.4	2.5	5.1	-0.3	0.5	1.5	1.5
Unemployed persons, LFS, th, average	213.6	198.6	166.4	155.9	150	150	140
Unemployment rate, LFS, in %, average	22.4	20.7	17.3	16.4	16	15.5	15.0
Reg. unemployment rate, in %, eop	20.1	19.3	19.6	25.8	.	.	.
Average monthly gross wages, MKD	33,688	35,626	37,446	40,566	42,400	44,500	46,800
annual change in % (real, gross)	1.2	4.2	4.3	7.0	3.0	3.0	3.0
Average monthly net wages, MKD	22,928	24,276	25,213	27,182	28,400	29,800	31,300
annual change in % (real, net)	1.2	4.4	3.1	6.5	3.0	3.0	3.0
Consumer prices, % p.a.	1.4	1.5	0.8	1.2	1.5	1.8	2.0
Producer prices in industry, % p.a.	4.8	0.9	2.1	0.6	2.5	1.5	2.0
General governm.budget, nat.def., % of GDP							
Revenues	31.0	30.4	31.5	28.6	29.0	29.5	30.0
Expenditures	33.8	31.5	33.7	36.8	34.0	33.0	32.5
Deficit (-) / surplus (+)	-2.8	-1.1	-2.2	-8.2	-5.0	-3.5	-2.5
General gov.gross debt, nat.def., % of GDP	39.4	40.4	40.6	51.2	52.5	53.0	53.0
Stock of loans of non-fin.private sector, % p.a.	5.4	7.2	6.1	4.6	.	.	.
Non-performing loans (NPL), in %, eop	6.2	5.1	4.6	3.3	.	.	.
Central bank policy rate, %, p.a., eop 4)	3.25	2.50	2.25	1.50	1.25	1.50	2.00
Current account, EUR m	-105	-7	-372	-373	-380	-440	-470
Current account, % of GDP	-1.0	-0.1	-3.3	-3.5	-3.3	-3.7	-3.7
Exports of goods, BOP, EUR m	4,075	4,883	5,323	4,813	5,370	5,930	6,520
annual change in %	15.4	19.8	9.0	-9.6	11.5	10.5	10.0
Imports of goods, BOP, EUR m	5,862	6,619	7,293	6,621	7,380	8,150	8,920
annual change in %	9.7	12.9	10.2	-9.2	11.5	10.5	9.5
Exports of services, BOP, EUR m	1,434	1,580	1,635	1,445	1,600	1,780	1,970
annual change in %	3.2	10.2	3.4	-11.6	11.0	11.0	10.5
Imports of services, BOP, EUR m	1,060	1,209	1,285	1,013	1,120	1,230	1,350
annual change in %	1.0	14.1	6.2	-21.1	10.5	10.0	9.5
FDI liabilities, EUR m	351	539	488	74	.	.	.
FDI assets, EUR m	171	-65	125	-131	.	.	.
Gross reserves of CB excl. gold, EUR m	2,097	2,619	2,961	3,019	.	.	.
Gross external debt, EUR m	7,372	7,844	8,154	9,000	9,800	10,500	11,300
Gross external debt, % of GDP	73.4	73.0	72.7	83.4	86.0	88.0	90.0
Average exchange rate MKD/EUR	61.57	61.51	61.50	61.67	61.7	61.7	61.7

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) wiiw estimate from 2019. - 4) Central Bank bills (28-days).

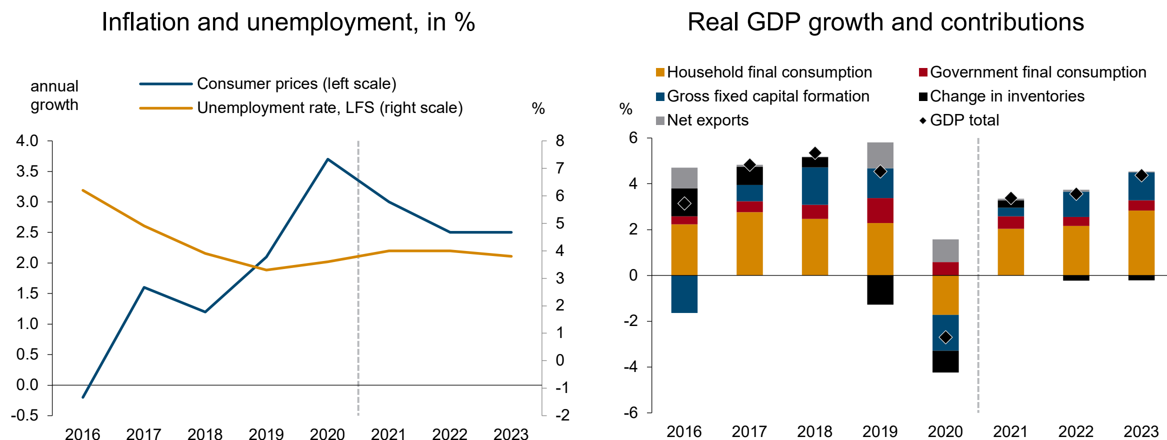
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

POLAND: Not bad, in these circumstances

LEON PODKAMINER

The decline in GDP in 2020 turned out to be quite shallow. Trade made a positive contribution to growth, and industry is recovering. Inadequate demand remains the chief problem for the corporate sector, while shortages of labour have ceased to be a serious problem. During the forecast period, expansive monetary and fiscal policies are likely to continue, but the recovery in investment will be muted at best. Improvements in 2021 and beyond are possible, but not guaranteed.

Figure 4.16 / Poland: Main macroeconomic indicators



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

The GDP decline in 2020 proved to be unexpectedly shallow (-2.7%). A steep fall (of 8.4%, year on year) in the second quarter was followed by a mild one (of just 1.5%) in the third quarter and by a somewhat stronger one (2.8%) in the fourth. Almost all GDP components – with the notable exception of public consumption – followed a similar pattern. Over the year as a whole, public consumption, supported by extraordinary spending, increased by 3.2%. Despite continuing growth in disposable incomes (wages and social benefits), household consumption fell by 3% in 2020. The decline in gross fixed investment (8.4% during 2020) has accelerated. Inventories were significantly reduced during the second and third quarters, shaving 0.9 percentage points off the overall GDP growth rate in 2020. After initial slumps, imports and exports of goods and non-factor services recovered in the second half of the year, recording remarkably high growth rates in the fourth quarter. Foreign trade contributed positively (by 1 percentage point) to GDP growth in 2020.

Following high growth in the second half of 2020, industry's gross value added (GVA) has already recovered. But most other sectors, with the exceptions of public administration, health services, and information and communications, have yet to recover. Having lost close to 50% of its GVA in 2020, the catering and accommodation sector has fared particularly badly. Industrial sales continue to expand, with those in some branches (such as manufacture of computers and electrical equipment) rising at double-digit rates. However, sales in the economically important motor vehicle manufacturing sector remain strongly depressed. Overall in 2020 sales of capital goods were down by 8% in real terms, while sales of consumer durables rose by 3.5%. Construction has fared much worse than industry. The value of sales is down in all segments of the sector (excluding specialised construction activities co-financed by the EU).

Inadequate demand remains the chief problem for the business sector – second only to the debilitating uncertainties over COVID, and ahead of concerns related to taxation and bureaucratic regulations. In the first half of 2020 the corporate non-financial sector (firms employing over 50 persons) experienced a very strong decline in net profits (of nearly 23%). In manufacturing corporations, the decline was even steeper – almost 40%. Automotive manufacturing performed particularly badly, ending with a net loss (mining companies and those in accommodation and catering also made losses). However, in the second half of the year profitability and liquidity indicators improved quite radically. Firms (of all sizes, in most branches) benefited from government programmes designed to shield them from the worst effects of the earlier lockdowns. Also, firms have learned to take advantage of costs (including labour costs) falling slightly ahead of sales. Low interest rates and a low level of credit liabilities have been helpful as well. Contrary to earlier expectations, supply-chain disruptions do not seem to be widespread. The net profit of the banking sector contracted by nearly half in 2020 compared with 2019. The major factor – but not the only one – behind this development relates to the fact that financial assets owned by the banks lost much of their book value in 2020.

Earlier shortages of labour ceased to be a serious problem, although this was not the case in some sectors, such as health care and delivery services. Foreign workers (primarily from Ukraine, and also Belarus) have not left in huge numbers for Germany, as had been feared at the end of 2019.

Employment declined in 2020, but not very strongly (by 1.1% in the corporate sector and 2% in manufacturing). Nominal average wages in the corporate sector rose by 4.8% in 2020 (a mere 1.4% rise in real terms). Pensions and other social benefits increased quite strongly in 2020, by 7.8% nominally (4.3% in real terms). Under these circumstances, falling household consumption must stem primarily from rising propensities for precautionary saving. The same tendency can be expected in 2021. Household consumption may therefore stay depressed even if employment and wages should improve more significantly (which is not very likely).

Investment recovery will be muted, at best. Gross fixed capital formation, which fell by 8.4% in 2020, does not yet show any sign of recovery. Given low levels of capacity utilisation, prevailing uncertainties, and stagnant or reduced incomes in both household and business sectors, a 'wait and see' approach is the rational one to take towards investment. This approach is reflected not only in the current business climate surveys but also in the statistics on the non-financial sector's bank deposits and loans. During 2020 deposit stocks of households rose by 11% and those of corporates by 19%. The stock of loans to households rose by 3%, but the stock of loans to corporates fell by nearly 4.5%. (Interestingly, the stock

of loans to central government institutions increased by almost 33%.) Continuing public-sector investment is unlikely to compensate for the effects of the private sector's restraint in this respect

Expansive monetary and fiscal policy is likely to continue. Since June the policy interest rate has been symbolic (0.10%). Low policy interest rates help to keep the exchange rate relatively depressed. (Until March 2020 the PLN/EUR rate averaged about 4.26, compared with 4.45 afterwards.. A weaker zloty could help to achieve a sizeable trade surplus, although the recent rather sharp weakening may prove temporary; increased inflows of EU 'reconstruction' funds are likely to strengthen the local currency. Extraordinary benefits (partly in the form of subsidies transferred to firms, employees and selected population groups) and foregone taxes on the private sector were very high (loosely assessed as approaching 9% of GDP) in 2020. These policies are heavily criticised by the opposition and by experts who fear the return of high inflation and, eventually, the state's default on its rising public debt. But marketplace inflation is actually quite low, although rather high in cartelised and uncompetitive sectors such as electricity generation and distribution. Meanwhile, public debt is still quite low and, as it is denominated primarily in the domestic currency, cannot really lead to a sovereign default.

Moderate improvements in 2021 and beyond are possible, but are not guaranteed. Although nothing guarantees the recovery of private investment in fixed assets, further cuts in inventories may be less significant. The exceptional factors suppressing household consumption in 2020 may not reappear, but consumption is unlikely to recover very strongly. Foreign trade is likely to continue to make a modest positive contribution to GDP growth. Of course, many negative factors will come to the fore, including the intensity of the extinction of small-scale business in the service sector. Last, but not least, it is unclear whether the government is ready to extend fiscal support measures in 2021. Lavish public deficit spending (reflected in strong growth in public consumption and the resilience of infrastructural investment, which helped to limit the recession in 2020) would have to continue this year.

The pandemic (which intensified strongly in November 2020) has been making a dramatic return in March 2021. After several months of inaction regarding preparations for the second and third waves of the virus, the government seems painfully helpless now. Under such conditions, excessive – but not economically helpful – reactions cannot be ruled out.

Table 4.16 / Poland: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022 Forecast	2023
Population, th pers., average	38,434	38,423	38,397	38,380	38,370	38,360	38,360
Gross domestic product, PLN bn, nom.	1,990	2,122	2,288	2,317	2,450	2,590	2,770
annual change in % (real)	4.8	5.4	4.5	-2.7	3.4	3.6	4.4
GDP/capita (EUR at PPP)	20,400	21,430	22,690	22,510	.	.	.
Consumption of households, PLN bn, nom.	1,152	1,221	1,297	1,300	.	.	.
annual change in % (real)	4.8	4.3	4.0	-3.0	3.6	3.8	5.0
Gross fixed capital form., PLN bn, nom.	349	386	424	397	.	.	.
annual change in % (real)	4.0	9.4	7.2	-8.4	2.0	6.0	6.5
Gross industrial production (sales) 2)							
annual change in % (real)	6.6	5.9	4.1	-1.2	6.5	5.0	5.0
Gross agricultural production							
annual change in % (real)	2.9	-0.9	-1.1	4.4	.	.	.
Construction industry 2)							
annual change in % (real)	13.7	19.7	3.7	-3.5	.	.	.
Employed persons, LFS, th, average	16,423	16,484	16,461	16,210	16,130	16,210	16,450
annual change in %	1.4	0.4	-0.1	-1.5	-0.5	0.5	1.5
Unemployed persons, LFS, th, average	844	659	558	610	670	680	650
Unemployment rate, LFS, in %, average	4.9	3.9	3.3	3.6	4.0	4.0	3.8
Reg. unemployment rate, in %, eop	6.6	5.8	5.2	6.2	.	.	.
Average monthly gross wages, PLN 3)	4,284	4,590	4,918	5,167	5,480	5,840	6,260
annual change in % (real, gross)	3.7	5.5	5.0	5.6	3.0	4.0	4.5
Consumer prices (HICP), % p.a.	1.6	1.2	2.1	3.7	3.0	2.5	2.5
Producer prices in industry, % p.a.	2.7	2.1	1.3	-0.6	1.0	1.8	1.5
General governm.budget, EU-def., % of GDP							
Revenues	39.8	41.3	41.1	40.6	40.0	40.0	39.0
Expenditures	41.3	41.5	41.8	49.4	45.5	44.5	42.0
Net lending (+) / net borrowing (-)	-1.5	-0.2	-0.7	-8.8	-5.5	-4.5	-3.0
General gov.gross debt, EU def., % of GDP	50.6	48.8	45.7	53.9	56.7	58.3	57.5
Stock of loans of non-fin.private sector, % p.a.	3.1	7.1	4.7	0.4	.	.	.
Non-performing loans (NPL), in %, eop	6.8	6.9	6.7	7.0	.	.	.
Central bank policy rate, % p.a., eop 4)	1.50	1.50	1.50	0.10	0.10	0.10	0.25
Current account, EUR m 5)	-1,544	-6,514	2,604	18,356	13,700	10,300	12,500
Current account, % of GDP 5)	-0.3	-1.3	0.5	3.5	2.5	1.7	2.0
Exports of goods, BOP, EUR m 5)	202,108	217,110	232,971	232,443	246,400	263,600	279,400
annual change in %	13.9	7.4	7.3	-0.2	6.0	7.0	6.0
Imports of goods, BOP, EUR m 5)	202,460	223,330	231,766	220,706	236,300	256,400	276,300
annual change in %	15.4	10.3	3.8	-4.8	7.1	8.5	7.8
Exports of services, BOP, EUR m 5)	50,976	57,672	62,480	57,879	63,700	68,200	72,300
annual change in %	15.8	13.1	8.3	-7.4	10.0	7.0	6.0
Imports of services, BOP, EUR m 5)	33,137	36,403	38,831	33,884	37,100	40,100	42,900
annual change in %	9.5	9.9	6.7	-12.7	9.5	8.0	7.0
FDI liabilities, EUR m 5)	10,182	14,809	12,809	8,653	.	.	.
FDI assets, EUR m 5)	3,430	1,954	4,268	3,536	.	.	.
Gross reserves of CB excl. gold, EUR m	90,967	97,633	104,526	114,299	.	.	.
Gross external debt, EUR m 5)	319,716	316,682	315,659	312,400	326,700	365,000	396,600
Gross external debt, % of GDP 5)	68.4	63.6	59.3	59.9	60.0	62.0	63.0
Average exchange rate PLN/EUR	4.2570	4.2615	4.2976	4.4430	4.50	4.40	4.40

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) Excluding employees in national defence and public safety. - 4) Reference rate (7-day open market operation rate). - 5) Including SPE.

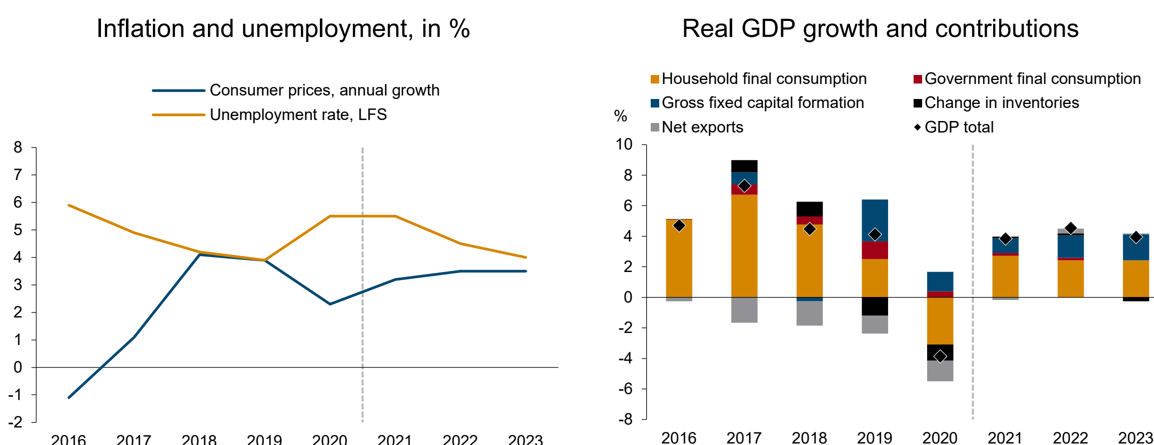
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ROMANIA: Modest slowdown, moderate recovery

GÁBOR HUNYA

The Romanian economy weathered the 2020 COVID-19 storm better than many others in the EU. Restrictions were less severe than elsewhere during the winter, and so the full-year contraction of GDP remained below 4%. The recovery in 2021 will not be fast (+3.8%), owing to protracted lockdowns and austerity measures in the government budget. Huge inflows of EU funds could boost investment in the coming years.

Figure 4.17 / Romania: Main macroeconomic indicators



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

The second wave of the COVID-19 pandemic in Romania was milder and restrictions were less severe than in many other European countries. Restaurants, hotels and shops were allowed to remain open, with some restrictions, and a curfew was applied only between 11 pm and 5 am. Foreign tourists were absent, but domestic winter tourism was only one-third lower than in the previous year. As a result, real GDP grew by 5.3% on a quarterly basis in the fourth quarter of 2020 and the downturn was only 3.9% for the whole year. A decline in household consumption was responsible for most of the economic contraction. Net exports also made a negative contribution to GDP growth, although no more than had been the case in the previous three years. The structure of the Romanian economy – specifically, its relatively limited reliance on foreign trade and tourism – also mitigated the economic impact of the pandemic. Government consumption was up by 2.3%, and gross fixed capital formation by 5.6%, moderating the economic decline.

Industrial production shrank by 9% in 2020, mainly on account of sluggish foreign demand. Production of motor vehicles was 16% lower than in the previous year, while that of non-metallic minerals, electrical machinery and computers remained flat. Only the production of chemicals and

pharmaceuticals expanded, benefiting from orders in the health sector. The food industry contracted by 3%, on account of falling agricultural output (-20%), despite elevated domestic demand for food. Rising food prices and imports balanced the market. Had agriculture not suffered from adverse weather conditions, the GDP contraction last year could have been about 1 percentage point smaller.

Retail sales declined only in April and May 2020; otherwise, they were in positive territory on an annual basis (including in January 2021). Sales of goods did not decline in 2020, but household services fell by 36% in the wake of the restrictions. Services to the business sector were up by 4.2%, among which information technology services expanded by as much as 25%. Construction was another booming economic sector, expanding by 16% in 2020. All segments of construction, including roads and dwellings, grew by double-digit rates. A mild winter and an abundant labour force allowed increased investment from rising personal incomes and from EU funds.

Inflation slowed to 2.3% in 2020, although food prices rose by twice as much. Consumer prices got an upward push in January 2021, when electricity prices were liberalised and customers failed to take advantage of a competitive retail market. This one-time effect may subside during the year, but higher international oil prices and rising consumer demand are likely to increase inflation to about 3.2% in 2021.

The otherwise tight labour market felt the impact of the recession: employment fell and unemployment expanded, mostly in industry. Companies in other economic activities relied more on short-time work schemes and thus kept up employment levels. Although demand will recover in 2021, not all companies currently surviving on government support will be able to recover, and so unemployment may increase further.

The current-account deficit reached 5% of GDP last year, mostly because of the expanding trade deficit in goods. The decline in industrial production was matched by a 10% contraction in merchandise exports. Imports declined by only 5%, mainly on account of fuels, while food imports increased. The balance of services improved compared with the previous year. The negative tourism balance diminished, and the trade surplus in telecommunications and other business services increased. Remittances declined by 13%, mainly those of short-term migrants whose mobility was hindered by the pandemic. FDI slumped by 63%, and the remaining inflows targeted mainly existing enterprises. The number of new projects was small and chiefly confined to services with low capital intensity and real-estate investments. Portfolio investments expanded more than fivefold, mainly on account of government bond placements. Public debt soared from 35% to 46% of GDP, which is still relatively low by international comparison. A depletion of international reserves was also necessary to bring the balance of payments into equilibrium.

Fiscal policy has been lax over the last three years; the extra spending in 2020 came on top of the earlier procyclical loosening. The general government deficit of almost 10% of GDP did not cause problems in the current international environment, but the government is committed to keeping the deficit under control. The 2021 budget law seems realistic, free from the excesses that characterised the previous few years. The public deficit is planned to reach 7.16% of GDP (based on an optimistic 4.3% increase in GDP). The deficit will be cut by curtailing increases in public-sector wages, pensions and other social benefits. Bonuses and other benefits in the public sector will be maintained at 2020 levels, and holiday-related bonuses and vouchers waived. Social security expenditures will increase only by the

rate of inflation. Moderate fiscal austerity is planned to continue in subsequent years, bringing down the deficit further, to 5.8% of GDP in 2022 and 4.4% in 2023.

The economy will embark on a growth track in 2021, but expectations are moderated by the current new wave of infections. After months of large-scale opening, the third wave saw secondary schools and indoor restaurants close again in the second week of March. Interruptions in international supply chains – as was the case early this year, when car assembly plants had to restrict production owing to the short supply of chips – may further moderate the recovery.

The government intends to concentrate resources on health care and investments, but keep salaries under tight control in 2021. It will continue to support short-time work and will delay tax payments until the middle of the year. Deferred taxes may become due in the second half of the year, bringing a wave of bankruptcies and an increase in unemployment. Monetary policy will stay moderately lax, with marginally negative real interest rates. After a small cut in the policy rate to 1.25% in January 2021, an increase may follow towards the end of the year if inflation continues to rise. The external balance might not improve as imports could rise more strongly than exports. A current-account deficit of 5% of GDP is rare among EU member states, but related financial inflows can support further economic growth.

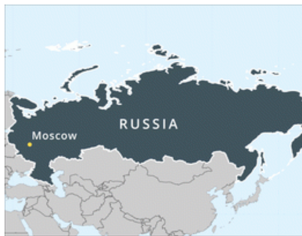
Abundant resources from the EU will be at Romania's disposal this year and next. Only 47% of the ESIF 2014-2020 had been spent by the end of 2020; the rest will be available for three more years. In addition, the disbursement of the EU Recovery and Resilience Facility, of which Romania is entitled to some EUR 30bn (13% of GDP), may start in the second half of 2021. The European Commission has already approved the modification of the Operational Programme 'Competitiveness', redirecting EUR 550m of funding to cushion the adverse effects of the coronavirus crisis. Financial support will be given to more than 120,000 SMEs and to initiatives for digitalisation and e-education. The government also agreed a EUR 4.1bn soft loan from the EU SURE programme, to be disbursed in tranches over an 18-month period ending in March 2022. Further EU funds will finance investment activities, making gross fixed capital formation a permanent source of economic recovery. Although absorption capacity and the efficiency of spending remain problematic, the centre-right coalition government installed late last year has the prerogatives and intentions that are needed to improve public governance.

Table 4.17 / Romania: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022	2023
						Forecast	
Population, th pers., average	19,589	19,474	19,372	19,300	19,200	19,000	19,000
Gross domestic product, RON bn, nom.	857.9	951.7	1,058.2	1,053.9	1,140	1,240	1,340
annual change in % (real)	7.3	4.5	4.1	-3.9	3.8	4.5	4.0
GDP/capita (EUR at PPP)	18,630	19,830	21,690	21,220	.	.	.
Consumption of households, RON bn, nom.	536.7	599.4	654.8	636.5	.	.	.
annual change in % (real)	10.9	7.6	4.0	-5.0	4.5	4.0	4.0
Gross fixed capital form., RON bn, nom.	192.2	200.4	239.4	257.2	.	.	.
annual change in % (real)	3.5	-1.1	13.0	5.6	4.0	6.0	7.0
Gross industrial production 2)							
annual change in % (real)	7.9	3.5	-2.3	-9.2	6.0	7.0	5.0
Gross agricultural production							
annual change in % (real)	12.5	7.2	-3.8	-20.1	.	.	.
Construction industry 2)							
annual change in % (real)	-5.5	-4.1	27.6	15.9	.	.	.
Employed persons, LFS, th, average	8,671	8,689	8,680	8,550	8,590	8,620	8,620
annual change in %	2.6	0.2	-0.1	-1.5	0.5	0.3	0.0
Unemployed persons, LFS, th, average	449	380	353	440	500	410	360
Unemployment rate, LFS, in %, average	4.9	4.2	3.9	5.5	5.5	4.5	4.0
Reg. unemployment rate, in %, eop	4.0	3.3	3.0	3.4	.	.	.
Average monthly gross wages, RON 3)	3,223	4,357	4,853	5,162	5,500	5,900	6,400
annual change in % (real, gross)	13.2	8.0	7.3	3.6	3.0	4.0	5.0
Average monthly net wages, RON	2,338	2,642	2,986	3,186	0	0	0
annual change in % (real, net)	12.8	8.0	8.9	4.0	3.0	4.0	5.0
Consumer prices (HICP), % p.a.	1.1	4.1	3.9	2.3	3.2	3.5	3.5
Producer prices in industry, % p.a.	3.5	5.1	3.8	0.0	3.0	2.0	3.0
General governm.budget, EU-def., % of GDP							
Revenues	30.8	31.9	31.8	35.0	33.0	33.0	33.0
Expenditures	33.5	34.9	36.2	44.7	40.0	38.0	37.0
Net lending (+) / net borrowing (-)	-2.6	-2.9	-4.4	-9.7	-7.0	-5.0	-4.0
General gov.gross debt, EU def., % of GDP	35.1	34.7	35.3	46.0	49.0	50.0	50.0
Stock of loans of non-fin.private sector, % p.a.	5.3	7.9	7.0	5.0	.	.	.
Non-performing loans (NPL), in %, eop	6.4	5.0	4.1	3.8	.	.	.
Central bank policy rate, % p.a., eop 4)	1.75	2.50	2.50	1.50	1.25	1.50	1.75
Current account, EUR m	-5,239	-8,961	-10,481	-10,981	-11,600	-11,300	-10,100
Current account, % of GDP	-2.8	-4.4	-4.7	-5.0	-5.0	-4.6	-3.9
Exports of goods, BOP, EUR m	57,162	61,814	63,086	57,579	61,600	65,300	69,500
annual change in %	9.6	8.1	2.1	-8.7	7.0	6.0	6.5
Imports of goods, BOP, EUR m	69,365	76,617	80,510	76,377	82,500	86,600	90,900
annual change in %	12.8	10.5	5.1	-5.1	8.0	5.0	5.0
Exports of services, BOP, EUR m	21,730	23,791	27,057	23,436	25,500	28,100	30,900
annual change in %	15.1	9.5	13.7	-13.4	9.0	10.0	10.0
Imports of services, BOP, EUR m	13,544	15,431	18,404	13,802	15,500	16,700	18,000
annual change in %	23.1	13.9	19.3	-25.0	12.0	8.0	8.0
FDI liabilities, EUR m	5,225	6,205	6,571	2,166	.	.	.
FDI assets, EUR m	348	1,259	1,723	419	.	.	.
Gross reserves of CB excl. gold, EUR m	33,494	33,065	32,927	37,379	.	.	.
Gross external debt, EUR m	97,446	99,841	109,783	125,453	130,000	135,000	140,000
Gross external debt, % of GDP	51.9	48.8	49.2	57.6	56.4	55.0	54.3
Average exchange rate RON/EUR	4.5688	4.6540	4.7453	4.8383	4.95	5.05	5.20

1) Preliminary and wiiw estimates. - 2) Enterprises with 4 and more employees. - 3) From 2018 the employers' social security contribution was transferred to the employees; real growth 2018 refers to net wages. - 4) One-week repo rate.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

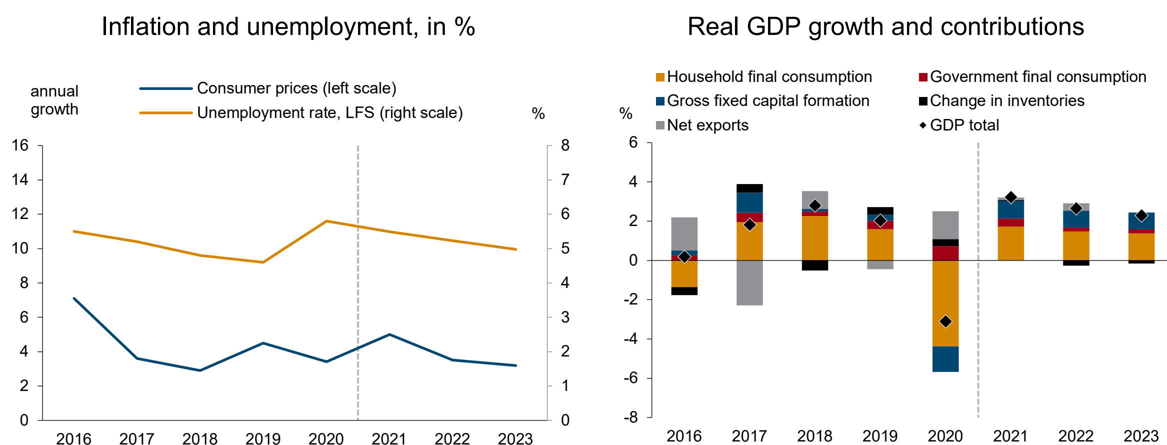


RUSSIA: Recession contained at the expense of health outcomes

VASILY ASTROV

Few restrictions in response to the second wave of the pandemic have resulted in a sharp rise in infections and deaths, but have also mitigated the extent of economic downturn. GDP declined by only 3.1% last year, of which 1 pp was due to oil production cuts. In the baseline scenario, we project a recovery of 3.2% this year, while growth should gradually revert to the long-term average of around 2% in the years thereafter.

Figure 4.18 / Russia: Main macroeconomic indicators



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

Russia has been hard hit by the COVID-19 pandemic, especially its second wave which broke out in autumn 2020. Officially, the number of COVID-related deaths in 2020 was put at around 58 thousand. However, excess mortality (compared to 2019), which rose sharply by the end of the year, reached 324 thousand, suggesting that the true situation was likely much worse.[25] High mortality was the main reason for the natural decline in population by nearly 700 thousand last year – the steepest decline recorded since 2005. It also implies that at the time of writing this report, more than half of the Russian population may have already contracted the virus, which is not far from the threshold required for herd immunity. This may partly explain why the number of new infections has been declining in the past few months, despite lax restrictions and the sluggish vaccination campaign.[26] The latter is all the more surprising, since Russia has been a front-runner in developing COVID-19 vaccines, three of which are now officially registered in the country, and the country has signed a number of export contracts.

[25] According to official statements, 80% of excess mortality should be attributed to COVID-19.

[26] Another reason may be that COVID-19 mutations have not (yet) spread much in Russia, unlike elsewhere in Europe.

The high pandemic toll has been partly due to government policies which prioritised the economy over public health. Unlike during the first wave of the pandemic, the restrictions imposed during the second wave were generally very mild (albeit varying by region). No general lockdown was imposed, and even restaurants remained largely open. Mainly thanks to this, real GDP decline was contained at 3.1% last year. Besides, around 1 pp of this decline was not due to the pandemic per se but to oil production cuts under the OPEC++ deal, which was agreed in May 2020 (value-added in the mining sector dropped by 10.2% as a result). The structure of the economy played a role as well: the small business sector, which has been the worst affected by the pandemic, accounts for only 20% of GDP, compared to 55-60% in the advanced economies.

Private consumption was the main drag on GDP growth last year: it plunged by 8.6%, reflecting lower incomes, rising saving propensity, and increased uncertainty. The decline of other final demand components was less spectacular: gross fixed capital formation dropped by 6.2% and real exports of goods and services by 5.1% - much less than imports (-13.7%), resulting in a positive contribution of net exports of 1.4 pp to headline GDP growth. Public consumption went up by 4% on account of increased social spending and other anti-crisis measures. Across sectors, the sharpest decline in value-added was registered unsurprisingly in hospitality and catering (-24.1%), followed by entertainment (-11.4%) and transportation (-10.3%). The dynamics in agriculture, manufacturing and construction were flat, while the financial sector emerged as the biggest winner of the pandemic (+7.9%).

Despite the positive contribution of real net exports, external balances deteriorated last year on account of the oil price shock. Nominal exports of crude oil, oil products and natural gas plummeted by 41%, 34% and 40% in US dollar terms, respectively, while exports of other goods were unchanged. This led to a situation for the first time in modern Russian history when the share of hydrocarbons in the structure of Russian exports fell below 50%. (This is however not a sustainable situation, as this share will rebound back this year in line with much higher energy prices.) Another interesting development was that for the first time Russia recorded a trade surplus in food: agriculture has been an undisputed success story over the past years, hugely benefitting from Russian counter-sanctions on western food imports imposed in 2014. Still, because of the oil price shock, overall exports of goods contracted by 21% last year, whereas imports only by 6%. The trade deficit in services improved especially because of a sharp drop in foreign travel, but this was not enough to prevent a deterioration in the current account. The current account surplus halved in absolute terms and was over-compensated by net capital outflows.

With the government package of a mere 4% of GDP, Russia's fiscal response to the pandemic has been rather modest, both by international comparison and given the country's excellent fiscal fundamentals. Also, it has differed in several important ways from the measures adopted in the EU. The bulk of wage support to businesses was channelled in the form of subsidised credit rather than subsidies, and there has been no short-time work scheme akin to that implemented in EU countries. Besides, many of the support programmes were not prolonged after 1 October 2020. Nevertheless, government expenditures went up by 13% in nominal terms last year, and the budget closed the year with a deficit of 4% of GDP (after a surplus of 1.9% recorded in 2019), covered primarily by domestic borrowing. Thanks to government support measures, the decline in the overall wage bill was contained at 1% (despite a nearly 2% drop in employment), and social transfers increased by 7.6% (both in real terms). Other types of household income did not fare as well: income from property and entrepreneurship and 'other', essentially grey, income (which has a high weight) contracted at double-

digit rates. All in all, real disposable incomes shrank by 3.5% last year (while they posted modest growth in the euro area).

Inflation has risen markedly over the past few months, largely on account of food prices. On an annual basis, consumer price inflation climbed to 5.7% in February – far above the 4% inflation target. The main reason has been a sharp increase in food prices (+7.7% year on year in February), prompting the authorities to impose export restrictions and urge producers and retailers to set 'voluntary' price caps on selected products such as butter, sugar, and poultry.[27] Besides, the pass-through from last year's rouble depreciation, disruptions in supply chains because of COVID restrictions and higher transportation costs on account of higher oil prices have pushed up input prices, which have been shifted to consumers given the improved demand conditions. Due to the acceleration of inflation, the policy interest rate turned negative in real terms by the end of last year, prompting the Central Bank to end its earlier easing cycle.[28] In March, it raised the policy rate by 25 bp, to 4.5%, and further hikes are likely in the remainder of the year, bringing monetary policy more in line with its usual hawkish stance. At the same time, since most of the factors which have caused the recent spike in inflation are of a one-off nature, it will probably subside regardless, to around 4% by the end of the year.

The latest high-frequency data suggest that the economic recovery has been gaining momentum. The Purchasing Managers Index has recovered to pre-pandemic levels and is comfortably hovering above the 50-line, which separates expansion from contraction. Inventories accumulated during the acute phase of the pandemic have been depleted to meet rising demand, and employment in the services sector marginally expanded in February for the first time in six months. However, on an annual basis retail trade turnover in January-February was still marginally negative (-0.7%), household services were down by 7.4% and gross industrial production down by 2.8%, held back especially by mining (-8.1%) on account of the still binding OPEC++ quotas. Economic growth will only turn positive on an annual basis starting from the second quarter of 2021, helped by the low statistical base.

For 2021 as a whole the economy is projected to rebound by 3.2% in the baseline scenario, which assumes no further lockdowns. The recovery will be driven primarily by domestic demand, while the contribution of net exports will likely turn negative. Higher oil prices, now projected to average some USD 65 per barrel, will support the Russian rouble and domestic demand, export volumes will be still constrained by the OPEC++ restrictions, which will be eased only gradually (although Russia, along with Kazakhstan, has negotiated some increase in its oil production compared to the previous quota). In the medium term, growth should gradually revert to the long-term average of around 2%, as the long-standing (above all institutional) structural bottlenecks become increasingly binding. The deadline for the implementation of 'national projects' – flagship government programmes in a wide range of areas, from infrastructure to demography – has now been pushed back from 2024 to 2030 because of the pandemic.

The Navalny case has exposed social tensions and marks another low point in Russia-Western relations. The recent arrest of the opposition politician and corruption fighter Alexey Navalny (who received a 2.8-year prison sentence) has triggered a wave of mass protests, the largest Russia has seen in a decade. They also had an economic component and were a manifestation of the dismal living standards of the population, whose real incomes have plunged by nearly 11% since 2013. In response to the Navalny

[27] The bird flu epidemic in poultry farms in southern Russia and some other European countries has played a role as well.

[28] Last year the policy rate was cut by a total of 175 basis points, and credit to the real economy picked up by 12.4% in nominal terms.

case, the EU and the US have announced new sanctions on Russia, targeting selected high-ranking officials and research institutes believed to be involved in the case. Besides, the possibility of US sanctions against Russian sovereign debt (which were dropped by the previous Trump administration over concerns about their broader economic impact) is reportedly on the agenda again. On a positive note, the change in the US administration has enabled a speedy prolongation of the Strategic Arms Reduction Treaty (START) with Russia for another five years, which reduces the chances of a renewed nuclear arms race. But apart from that, it is hardly realistic to expect any improvement in Russia-Western relations in the near term, let alone their return to the pre-Ukraine crisis state.[29]

[29] In the wiiw Monthly Report from January 2021, Tatiana Romanova outlines five reasons why one should not expect an improvement in EU-Russia relations anytime soon: https://wiiw.ac.at/monthly-report-no-1-2021-p-5546.html

Table 4.18 / Russia: Selected economic indicators

	2017	2018	2019	2020 [1]	2021	2022 Forecast	2023
Population, th pers., average	146,842	146,831	146,765	146,493	146,400	146,450	146,500
Gross domestic product, RUB bn, nom.	91,843	103,862	109,193	106,607	117,200	125,100	132,600
annual change in % (real)	1.8	2.8	2.0	-3.1	3.2	2.7	2.3
GDP/capita (EUR at PPP)	17,800	18,770	18,880	18,600	.	.	.
Consumption of households, RUB bn, nom.	48,178	51,884	55,440	52,374	.	.	.
annual change in % (real)	3.7	4.3	3.2	-8.6	3.5	3.0	2.8
Gross fixed capital form., RUB bn, nom.	20,189	21,452	23,088	22,761	.	.	.
annual change in % (real)	4.7	0.6	1.5	-6.2	4.2	4.0	4.0
Gross industrial production [2]							
annual change in % (real)	3.7	3.5	3.3	-2.9	2.5	2.5	2.2
Gross agricultural production							
annual change in % (real)	2.9	-0.2	4.3	1.5	.	.	.
Construction output							
annual change in % (real)	-1.2	5.3	2.1	0.1	.	.	.
Employed persons, LFS, th, average [3]	72,142	72,532	71,933	70,601	70,600	70,650	70,700
annual change in %	-0.3	0.3	-0.8	-1.9	0.0	0.1	0.1
Unemployed persons, LFS, th, average [3]	3,967	3,658	3,465	4,321	4,100	3,900	3,700
Unemployment rate, LFS, in %, average [3]	5.2	4.8	4.6	5.8	5.5	5.2	5.0
Reg. unemployment rate, in %, eop [4]	1.0	0.9	0.9	3.7	.	.	.
Average monthly gross wages, RUB	39,167	43,724	47,867	51,083	55,700	59,700	63,500
annual change in % (real, gross)	2.9	8.5	4.8	3.2	4.0	3.5	3.0
Consumer prices, % p.a.	3.6	2.9	4.5	3.4	5.0	3.5	3.2
Producer prices in industry, % p.a. [5]	7.7	12.1	2.0	-3.8	8.0	4.5	4.0
General governm.budget, nat.def., % of GDP							
Revenues	33.8	35.9	36.2	35.5	36.0	36.0	36.0
Expenditures	35.3	33.0	34.2	39.5	38.5	37.5	37.0
Deficit (-) / surplus (+)	-1.5	2.9	1.9	-4.0	-2.5	-1.5	-1.0
General gov.gross debt, nat.def., % of GDP	12.6	12.1	12.4	17.8	19.7	20.0	20.0
Stock of loans of non-fin.private sector, % p.a.	3.5	13.9	6.5	12.4	.	.	.
Non-performing loans (NPL), in %, eop [6]	5.9	5.3	6.0	6.1	.	.	.
Central bank policy rate, % p.a., eop [7]	7.75	7.75	6.25	4.25	5.00	5.50	5.50
Current account, EUR m [8]	28,504	98,142	57,861	28,443	43,700	51,900	55,300
Current account, % of GDP	2.0	7.0	3.8	2.2	3.2	3.6	3.6
Exports of goods, BOP, EUR m [8]	312,636	376,612	374,854	288,369	320,900	340,200	353,800
annual change in %	22.9	20.5	-0.5	-23.1	11.3	6.0	4.0
Imports of goods, BOP, EUR m [8]	211,161	211,127	227,313	210,128	219,200	228,000	237,100
annual change in %	22.1	0.0	7.7	-7.6	4.3	4.0	4.0
Exports of services, BOP, EUR m [8]	50,970	54,845	55,275	38,945	42,600	44,700	46,900
annual change in %	11.5	7.6	0.8	-29.5	9.4	4.9	4.9
Imports of services, BOP, EUR m [8]	78,716	80,366	88,081	54,961	62,800	65,900	69,200
annual change in %	16.9	2.1	9.6	-37.6	14.3	4.9	5.0
FDI liabilities, EUR m [8]	25,296	7,453	28,548	1,200	.	.	.
FDI assets, EUR m [8]	32,559	26,620	19,574	5,500	.	.	.
Gross reserves of CB excl. gold, EUR m [8][9]	297,823	333,617	396,378	372,318	.	.	.
Gross external debt, EUR m [8]	433,606	397,860	438,727	382,979	388,400	400,000	408,600
Gross external debt, % of GDP	31.1	28.3	29.1	29.6	28.5	27.5	26.5
Average exchange rate RUB/EUR	65.87	73.87	72.51	82.39	86.0	86.0	86.0

Note: Including Crimean Federal District.

1) Preliminary and wiiw estimate. - 2) Excluding small enterprises. - 3) From 2018 population 15+, population 15-72 before. - 4) In % of labour force (LFS). - 5) Domestic output prices. - 6) According to Russian Accounting Standards overdue debt is defined as debt service overdue, therefore the data are not fully comparable with other countries. - 7) One-week repo rate. - 8) Converted from USD. - 9) Including part of resources of the Reserve Fund (in 2017) and the National Wealth Fund of the Russian Federation.

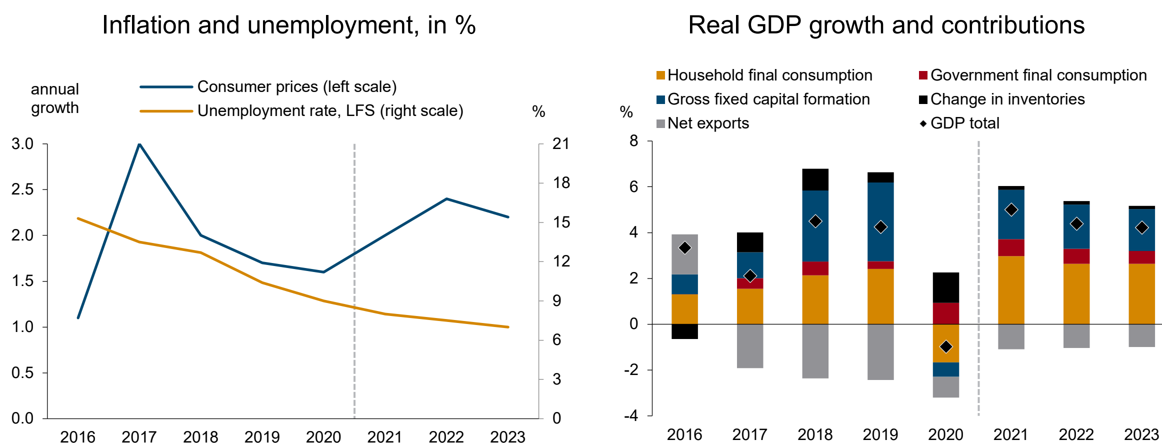
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SERBIA: Setting an example for the region

BRANIMIR JOVANOVIC

Serbia finished 2020 as one of the best-performing European economies, and started 2021 in a similar manner. Real GDP fell by just 1% in 2020, fuelled by strong public spending. Thanks to an excellent vaccine roll-out and growth in high-frequency indicators, we project 5% growth for 2021. The main risks lie with the ongoing pandemic wave, which might stall the economy for a while, and the announced fiscal consolidation, which could hamper growth if undertaken too soon.

Figure 4.19 / Serbia: Main macroeconomic indicators



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

No economy did well in 2020, but Serbia's performance was almost as good as it gets. Its GDP declined by just 1%, cushioned by growth of public consumption (5.6%) and gross investment (2.7%). Household consumption was the main cause of the decline, falling 2.5% due to the reduced propensity to consume amidst the pandemic. Exports also fell by 5.9%, though this was largely offset by a reduction in imports of 3.5%.

The main driver behind these relatively good results was expansionary fiscal policy. General government expenditures increased by 18% in 2020 in nominal terms. In the second quarter, in the trough of the recession, the increase was 35%. As a share of GDP, expenditures for the whole year amounted to 49.4% of GDP, which is 8 pp up from the average of the previous three years. The deficit for the whole year reached 8.1% of GDP, the highest in 15 years. The increase was not only due to higher pandemic-related transfers. Capital spending was also 10% higher than the year before at 5.5% of GDP, owing to the ambitious public infrastructure investment plan the government has been pursuing in recent years.

Supportive public spending contributed to an overall benign economic picture for the year. Wage subsidies prevented massive lay-offs and employment declined by just 6,000 people. As inactivity increased due to the pandemic, unemployment actually declined to 9%, from 10.4% the year before. Increases in the minimum wage and public sector wages pushed average wages up by 7.7% in real terms, improving general purchasing power. Despite the wage increases, inflation remained low (1.6%), owing to low commodity prices. The banking sector remained stable – a debt moratoria pushed down non-performing loans to 3.4% (from 4.1% in 2019), while credit guarantee schemes accelerated private sector credit growth to 11.1% (from 8.9% in 2019). This was also supported by the national bank, which reduced its interest rate to an historical low of 1%. The exchange rate was kept stable at an average parity of 117.6 RSD/EUR, minimizing currency risks. The picture is completed by FDI which declined by 21%, but still reached EUR 3bn, or 6.5% of GDP.

The supportive fiscal policy came at the expense of increased indebtedness. Public debt rose to 57% of GDP at the end of 2020 from 52.9% in 2019 due to two Eurobonds issued during the year. The first one was in May, for EUR 2 billion with a maturity of 7 years and a yield of 3.375%, and the second in December, for USD 1.2 billion, with a maturity of 10 years and a yield of 2.350%. These were partly used to repay old debts with higher interest.

The country also seems to have prioritised the economy over public health. No lockdowns were introduced after the spring wave, with milder restrictions instated towards the end of the year. This made the number of daily COVID-19 infections jump to 8,000 in early December, 16 times higher than the summer peak. Despite that, the death toll remained rather low, among the lowest in Europe, which gave rise to widespread suspicion about the way the numbers are calculated. Excess mortality in December was 84% according to The Economist, supporting suspicions. Serbia's President Vucic announced that a full review of the death toll would be undertaken, but these results have never been published.

2021 is off to a good start with positive developments on the vaccination front. Vaccination roll-out has been excellent, and at the end of March the country has administered around 35 vaccine doses per 100 people, only lagging behind the UK in the whole of Europe. The process has proved to be very safe so far, with just around 600 cases of adverse reactions on more than 2 million shots. Most of the vaccines come from China and Russia, another sign of the country's foreign policy of maintaining good relations with these two countries. The vaccine success is strengthening the position of President Vucic and has allowed him to engage in regional vaccine diplomacy. Serbia first donated vaccines to North Macedonia, Montenegro, Bosnia and Herzegovina (both Republika Srpska and Federation BiH) and Kosovo (the Serb-populated part), and then, during the last weekend of March, vaccinated around 25,000 foreign citizens on its territory, most of them from neighbouring countries. Both actions were seen positively by the public and are likely to improve relations in the region. Serbia has also announced that it will start producing both the Russian and Chinese vaccines soon. The production of the Russian Sputnik V vaccine is expected to begin this year at the Torlak Institute in Belgrade, while for the Chinese Sinopharm vaccine a new factory is expected next year.

The first economic data for 2021 are also positive. Industrial production in January was up 2.5% compared to the previous year, retail trade was up 3.2%, while general government revenues were 2.9% higher than the year before (all in real terms). Exports in January were on the same level as in 2020, but imports were 11% down (nominally), implying a positive contribution of net exports to GDP growth. FDI inflows in January were EUR 232 million, the same as the year before.

Positive expectations for the coming year are widely-shared. Moody's upgraded the country's credit rating in March 2021 by one notch to Ba2 with a stable outlook. As key drivers for the upgrade they note the country's relative economic resilience to the coronavirus shock, solid medium term growth prospects and the expectation that Serbia's fiscal situation will continue to outperform its peers over the next few years. Serbia also issued another Eurobond in March 2021 for EUR 1 billion with a maturity of 12 years, which is the longest maturity the country has had so far, with a relatively low yield of 1.920%.

We are thus projecting growth of 5% for 2021, among the highest in the region and in Europe, and the country should exceed the pre-crisis level of activity by mid-year. Growth is expected to be broad-based. Household consumption will grow by 4.5% as the health situation improves and people start spending again. Investment will grow by 10%, driven by the announced investment in public infrastructure, improved FDI, and revived domestic private investment, due to improved business confidence. Exports will grow by 9%, led by improved foreign demand and restored exports from the zones, though this will be offset by an increase in imports of 9.5%. Government consumption will grow 4%, driven by the increase in public sector wages.

Positive trends are expected in all sectors of the economy. Employment will increase by 2.5% (75,000 new jobs), unemployment will decline to 8% (260,000 people), while average wages will rise by 5% in real terms. The banking sector will remain stable, with credit growth continuing and non-performing loans remaining low. FDI will reach EUR 3.8 billion (7.6% of GDP), close to the pre-crisis level, with positive prospects for the future. Inflation will increase slightly, averaging 2% for the whole year, driven by the rise in global commodity prices. The exchange rate will remain stable at 117.6 RSD/EUR as the central bank will continue to intervene on the forex market to prevent currency appreciation. However, we expect slight monetary tightening by the end of the year with the central bank interest rate rising to 1.5%, due to the improved economic situation.

We see two main risks to the above-described positive outlook, related to the pandemic unfolding and fiscal support. The country is currently going through a fourth wave of the pandemic, with the number of daily COVID-19 infections around 4,000 at the beginning of April. So far the government has been very reluctant to introduce restrictions, enacting only mild and short-time closures. But if the health situation does not improve, harsher measures may be required. Some recent studies have argued that vaccination alone may not always be sufficient to contain the pandemic, and that it needs to be accompanied by certain restrictions. In addition, even though the country has been a champion in terms of inoculation so far, there is also widespread scepticism about vaccines. According to a Gallup poll conducted at the end of 2020 just 49% of the Serbian population would take the vaccine, significantly lower than the global average of 67%. Even with the best vaccine roll-out it is possible that collective immunity will not be reached soon, as a large part of the population will simply reject getting the shot. These things may well drag economic growth down.

The second risk factor is related to the planned fiscal consolidation. The government has announced that it will start consolidation already in 2021, with the budget deficit for the year projected at 3% of GDP, down from 8.1% in 2020. We expect it to be slightly higher at around 4%, considering the likelihood that the government will have to provide slightly stronger support to keep the economy afloat and maintain popular support. But if the government presses too strongly with consolidation and sticks to its plan to keep the deficit at 3% of GDP, it will certainly retard growth.

Table 4.19 / Serbia: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022	2023
						Forecast	
Population, th. pers., mid-year	7,021	6,983	6,945	6,915	6,885	6,855	6,830
Gross domestic product, RSD bn, nom.	4,761	5,073	5,418	5,464	5,900	6,300	6,700
annual change in % (real)	2.1	4.5	4.2	-1.0	5.0	4.4	4.2
GDP/capita (EUR at PPP)	11,410	12,020	12,710	12,810	.	.	.
Consumption of households, RSD bn, nom.	3,317	3,463	3,634	3,603	.	.	.
annual change in % (real)	2.2	3.1	3.5	-2.5	4.5	4.0	4.0
Gross fixed capital form., RSD bn, nom.	844	1,017	1,218	1,174	.	.	.
annual change in % (real)	6.6	17.5	17.2	-2.8	10.0	9.0	8.5
Gross industrial production 2)							
annual change in % (real)	3.9	1.3	0.3	0.4	5.0	4.5	4.0
Gross agricultural production							
annual change in % (real)	-11.9	14.3	-1.2	4.3	.	.	.
Construction output							
annual change in % (real)	8.5	14.1	35.5	-4.2	.	.	.
Employed persons, LFS, th, average	2,795	2,833	2,901	2,895	2,970	3,040	3,110
annual change in %	2.8	1.4	2.4	-0.2	2.5	2.4	2.3
Unemployed persons, LFS, th, average	435	412	336	287	260	250	230
Unemployment rate, LFS, in %, average	13.5	12.7	10.4	9.0	8.0	7.5	7.0
Reg. unemployment rate, in %, eop	23.0	20.3	18.7	17.9	.	.	.
Average monthly gross wages, RSD 3)	65,976	68,629	75,814	82,984	88,900	95,100	101,100
annual change in % (real, gross)	0.9	3.9	8.4	7.8	5.0	4.5	4.0
Average monthly net wages, RSD 3)	47,893	49,650	54,919	60,073	64,300	68,800	73,100
annual change in % (real, net)	0.9	4.4	8.5	7.7	5.0	4.5	4.0
Consumer prices, % p.a.	3.0	2.0	1.7	1.6	2.0	2.4	2.2
Producer prices in industry, % p.a.	2.3	0.9	0.6	-1.3	3.0	1.5	2.0
General governm.budget, nat.def., % of GDP							
Revenues	41.5	41.5	42.1	41.3	41.0	41.5	42.0
Expenditures	40.4	40.9	42.3	49.4	45.0	44.5	44.0
Deficit (-) / surplus (+)	1.1	0.6	-0.2	-8.1	-4.0	-3.0	-2.0
General gov.gross debt, nat.def., % of GDP	58.6	54.4	52.9	57.0	56.0	55.0	54.0
Stock of loans of non-fin.private sector, % p.a.	2.1	9.9	8.9	11.1	.	.	.
Non-performing loans (NPL), in %, eop	9.8	5.7	4.1	3.4	.	.	.
Central bank policy rate, % p.a., eop 4)	3.5	3.0	2.3	1.0	1.5	2.0	2.5
Current account, EUR m	-2,051	-2,076	-3,161	-1,981	-2,800	-3,500	-4,200
Current account, % of GDP	-5.2	-4.8	-6.9	-4.3	-5.6	-6.5	-7.3
Exports of goods, BOP, EUR m	14,066	15,106	16,415	16,032	17,800	19,500	21,300
annual change in %	9.8	7.4	8.7	-2.3	11.0	9.5	9.0
Imports of goods, BOP, EUR m	18,064	20,191	22,038	21,257	23,700	26,200	28,800
annual change in %	13.4	11.8	9.1	-3.5	11.5	10.5	10.0
Exports of services, BOP, EUR m	5,246	6,061	6,934	6,163	7,100	8,000	9,000
annual change in %	14.8	15.5	14.4	-11.1	15.0	13.0	13.0
Imports of services, BOP, EUR m	4,280	5,066	5,922	5,089	5,900	6,800	7,800
annual change in %	16.8	18.4	16.9	-14.1	16.0	15.0	14.0
FDI liabilities, EUR m	2,548	3,464	3,815	3,014	.	.	.
FDI assets, EUR m	130	308	264	112	.	.	.
Gross reserves of CB excl. gold, EUR m	9,287	10,526	12,042	11,732	.	.	.
Gross external debt, EUR m	25,526	26,662	28,254	31,000	35,100	38,600	40,700
Gross external debt, % of GDP	65.1	62.2	61.5	66.7	70.0	72.0	71.0
Average exchange rate RSD/EUR	121.34	118.27	117.86	117.58	117.6	117.5	117.0

1) Preliminary and wiiw estimates. - 2) Excluding arms industry. - 3) From 2018 based on tax administration data, before on wage survey data supplemented by tax administration data. - 4) Two-week repo rate.

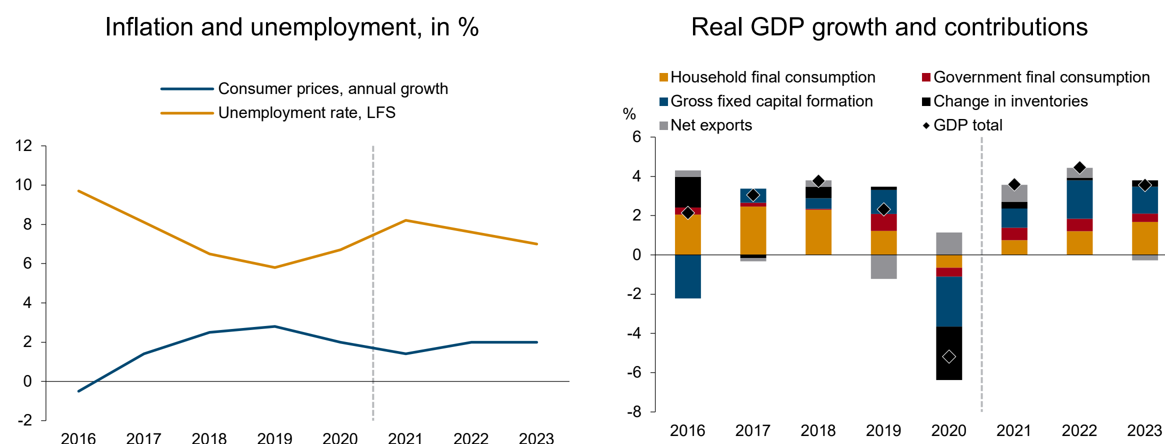
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SLOVAKIA: Uncertainties prevail

DORIS HANZL-WEISS

Slovakia's GDP dropped by 5.2% in 2020. This year the economy is expected to recover by 3.6%; in the following years the inflow of EU funds should foster gross fixed capital formation. However, the pandemic plus internal and external uncertainties pose several downside risks.

Figure 4.20 / Slovakia: Main macroeconomic indicators



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

The COVID-19 pandemic hit Slovakia in 2020, cutting GDP by 5.2%. The decline was less than expected but still constituted a major decline for the economy. While GDP fell markedly in the second quarter (-12.1%) due to the hard lockdown in March, it recovered during the second half of 2020 and experienced only smaller declines in the third and fourth quarters (-2.4% and -2.7%). This was due to household consumption being less affected than in other EU countries (it even grew in the third quarter), as well as rising exports towards the end of the year. Overall, household consumption decreased by 1.2% during 2020, while the savings rate rose only modestly. Gross fixed capital formation experienced a steep slump of 11.9%, and gross capital formation fell by 22.4%. In fact, construction was the hardest hit sector within the economy (value added fell by more than 20%). Net exports showed a positive contribution to growth: while exports of goods and services decreased by 7.8%, imports declined by 8.5%.

The automotive industry is both an engine of growth and matter of concern for the future. Industry's good overall performance by the end of the year could not make up for the huge drop witnessed during the first lockdown and the closure of automotive plants in March. Over the whole year 2020, industry declined by 9.1% (and was thus the second most affected sector in the economy). Due to its size, the transport equipment sector contributed most to this decline, followed by machinery & equipment, other manufacturing & repair, and rubber & plastic & other non-metallic mineral products. Only two sectors, chemicals & chemical products and coke & refined petroleum products, actually grew

in 2020. In the first month of 2021 industry declined by 4.7% and transport equipment by 15%, but this is no reason for concern due to the strong base effect of last January. Production of passenger cars by the four large car manufacturers in Slovakia - Volkswagen Slovakia, Stellantis (previously PSA Peugeot-Citroen), KIA Motors Slovakia, and Jaguar Land Rover – dropped by 11% in 2020 to 985,000 cars and thus again fell below the 1 million threshold first reached in 2015. Current challenges - not only for the Slovak automotive industry- include disturbed trade due to Germany's border closures with Czechia and Austria, and a shortage of semiconductors caused by incorrect forecasting of future demand – the latter having already affected the company Stellantis in Slovakia. The move towards electric car production is rather slow and thus matter of concern: Recently Stellantis launched production of the electric Peugeot 208 and Kia began producing a diesel mild hybrid car. At the end of 2020 the Volkswagen group announced new investment plans for Volkswagen Slovakia of EUR 1bn for five years and production of two new models in 2023 but with conventional engines (combustion engines but with the possibility of a plug-in hybrid electric version).

The labour market was only modestly affected in 2020, and retail trade was down due to pandemic measures in January. The COVID-19 pandemic hit the labour market in 2020 but the deterioration was softened by governmental measures (Kurzarbeit). Employment declined by 2% during the year. Unemployment, which stood at its lowest level ever in 2019 (at 5.8%), climbed only slowly to 6.7%. While real wages fell during the first half of 2020, growth accelerated during the second half (2.7% in Q1 and 4.2% in Q3) and real wages finally increased by 2% for the whole year. Retail trade was affected negatively mostly during the first lock-down in March but recovered over the summer months, and thus declined by only 1.1% during 2020. The savings rate thus rose only slightly. The first month of 2021, however, saw retail trade plunge by 17%, a decline not even witnessed during the first lockdown.

Developments in the external sector show a positive trend. The strong decline of goods exports that occurred during the lockdown in March was followed by a swift recovery during the summer months and towards the end of the year. Overall, however, goods exports declined by 6% in 2020, whereby exports to Slovakia's main export partners Germany (18% of all exports) and Czechia (10% of all exports) fell by 6% and 10% respectively. Exports outside the EU, towards the US and China, increased by 13% and 21% on the other hand. Negative and then positive trends in automotive exports shaped these developments as machinery and transport equipment (SITC7) represent two thirds of exports and half of goods imports. Goods imports declined by 8% during 2020, while imports from Slovakia's main trading partner Germany (22% of all imports) increased by 1.6%, and those from Czechia (11% of all imports) declined by about 12%. The first data for January 2021 are quite good and show a slight decrease in exports (-0.6%), with exports from the most important sector of machinery and transport growing by 3.4%, while imports fell by 3.6% in that month.

A coalition crisis after one year in office brings additional instability. Overall, the COVID-19 pandemic has shifted the government deficit and debt level upwards in 2020, due to less revenue and increased expenditures, including pandemic aid measures. This amounted to EUR 4.6bn or 5.1% of GDP in 2020, not all of it however affecting the budget. For 2020, the government deficit is forecast to reach about 9%, with government debt to GDP at about 62% (up from 48% in 2019), but still no cause for concern. At the beginning of March a coalition crisis emerged among the four-party government headed by Igor Matovič, increasing uncertainty at a time when clear measures and regulations are needed. Also, Slovakia's recovery plan, implementing the EU's Recovery and Resilience Facility for Slovakia, is now at inter-departmental review and should be sent to Brussels by April 30. It has five

priority areas adding up to a sum of EUR 6bn: green economy (about EUR 2.17bn), healthcare (EUR 1.45bn), effective public administration (EUR 1.04bn), education (EUR 80m) and science, research and development (EUR 700m). This opportunity to move the Slovak economy towards a greener and more digitalised economy should not be missed or delayed, but this might now be at stake.

The pandemic situation worsened in the first three months of 2021. Slovakia was less seriously affected during the first wave of the pandemic in 2020 as measured by cases and death rates. At the end of October 2020 Slovakia was the first country to conduct mass testing and thus circumvented a lockdown. Nevertheless, the pandemic situation deteriorated during the first three months of 2021 with high numbers of cases and deaths. On March 25, 2021 there were 1,654 new cases and 52 deaths in Slovakia. With a death rate of 170 per 100,000 population, Slovakia ranks thirteenth among the most affected countries (in fact Czechia is in third place and Hungary in fourth).[30] Due to the lack of doctors the country had to call for international help. The vaccination rollout has been slow. Measures were tightened accordingly and non-essential shops have been closed since the start of the year, a regional alert system was introduced, and aid measures partly extended.

Future growth subject to high uncertainty. Wiiw growth forecasts for Slovakia have been revised downwards for the coming years. Slovak GDP is expected to grow by 3.6% this year, 4.4% in 2022 and about 3.5% in 2023. This year's forecast rests on a strong base effect, a gradual reopening of the economy in spring and the assumption of relatively good export performance by the automotive industry. Next year's surge in GDP results from an extra impulse of gross fixed capital formation due to the EU's budgeting period 2014-2020 coming to an end, as well as from the distribution of funds resulting from the recovery plan. However, several uncertainties are ahead and pose a number of downward risks: foremost the evolution of the pandemic, its mutations and the role of vaccination. Internal risks such as the revival of household consumption, and external risks including uncertainty about the pace of export recovery, should be added to this.

[30] https://www.worldometers.info/coronavirus/ data as of 25 March 2021.

Table 4.20 / Slovakia: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022 Forecast	2023
Population, th pers., average	5,439	5,447	5,454	5,459	5,465	5,470	5,475
Gross domestic product, EUR m, nom.	84,532	89,506	93,865	91,105	95,700	102,000	107,700
annual change in % (real)	3.0	3.8	2.3	-5.2	3.6	4.4	3.5
GDP/capita (EUR at PPP)	20,670	21,400	21,860	21,110	.	.	.
Consumption of households, EUR m, nom.	46,535	49,590	52,052	52,530	.	.	.
annual change in % (real)	4.5	4.2	2.2	-1.2	1.3	2.1	2.9
Gross fixed capital form., EUR m, nom.	17,889	18,765	20,090	17,827	.	.	.
annual change in % (real)	3.5	2.6	5.8	-11.9	5.0	10.0	7.0
Gross industrial production							
annual change in % (real)	3.2	4.4	0.4	-9.0	7.0	5.0	5.0
Gross agricultural production							
annual change in % (real)	-6.1	-2.4	-4.2	0.0	.	.	.
Construction industry							
annual change in % (real)	3.0	8.5	-3.6	-11.1	.	.	.
Employed persons, LFS, th, average	2,531	2,567	2,584	2,531	2510	2540	2570
annual change in %	1.5	1.4	0.7	-2.0	-1.0	1.0	1.0
Unemployed persons, LFS, th, average	224	180	158	181	220	210	190
Unemployment rate, LFS, in %, average	8.1	6.5	5.8	6.7	8.2	7.6	7.0
Reg. unemployment rate, in %, eop	5.9	5.0	4.9	7.6	.	.	.
Average monthly gross wages, EUR	954	1,013	1,092	1,133	1170	1220	1290
annual change in % (real, gross)	3.3	3.6	5.0	1.9	1.5	2.5	3.3
Consumer prices (HICP), % p.a.	1.4	2.5	2.8	2.0	1.4	2.0	2.0
Producer prices in industry, % p.a.	2.5	2.3	1.9	-0.6	1.0	1.7	2.0
General governm.budget, EU-def., % of GDP							
Revenues	40.4	40.7	41.4	40.7	40.4	40.9	41.0
Expenditures	41.4	41.7	42.7	49.7	47.5	47.0	47.0
Net lending (+) / net borrowing (-)	-0.9	-1.0	-1.4	-9.0	-7.1	-6.1	-6.0
General gov.gross debt, EU def., % of GDP	51.7	49.9	48.5	61.7	62.5	63.6	65.0
Stock of loans of non-fin.private sector, % p.a.	9.9	9.8	6.6	5.0	.	.	.
Non-performing loans (NPL), in %, eop	3.6	3.1	2.8	2.4	.	.	.
Central bank policy rate, % p.a., eop 2)	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR m	-1,618	-1,973	-2,547	-307	-200	-100	-500
Current account, % of GDP	-1.9	-2.2	-2.7	-0.3	-0.2	-0.1	-0.5
Exports of goods, BOP, EUR m	70,510	75,142	75,657	69,737	75,200	79,700	83,300
annual change in %	5.7	6.6	0.7	-7.8	7.9	6.0	4.5
Imports of goods, BOP, EUR m	69,913	75,381	76,636	69,122	74,300	78,400	82,600
annual change in %	6.8	7.8	1.7	-9.8	7.5	5.5	5.3
Exports of services, BOP, EUR m	9,339	10,228	11,009	8,855	9,600	10,200	10,800
annual change in %	11.8	9.5	7.6	-19.6	8.0	6.0	6.0
Imports of services, BOP, EUR m	8,457	9,300	9,783	7,762	8,200	8,600	9,000
annual change in %	6.1	10.0	5.2	-20.7	6.0	5.0	5.0
FDI liabilities, EUR m	3,749	1,906	2,067	496	.	.	.
FDI assets, EUR m	1,367	760	16	2,439	.	.	.
Gross reserves of CB excl. gold, EUR m	1,609	3,426	5,002	6,050	.	.	.
Gross external debt, EUR m	91,574	102,701	105,517	114,000	117,000	120,000	122,000
Gross external debt, % of GDP	108.3	114.7	112.4	125.1	122.3	117.6	113.3

1) Preliminary and wiiw estimates. - 2) Official refinancing operation rates for euro area (ECB).

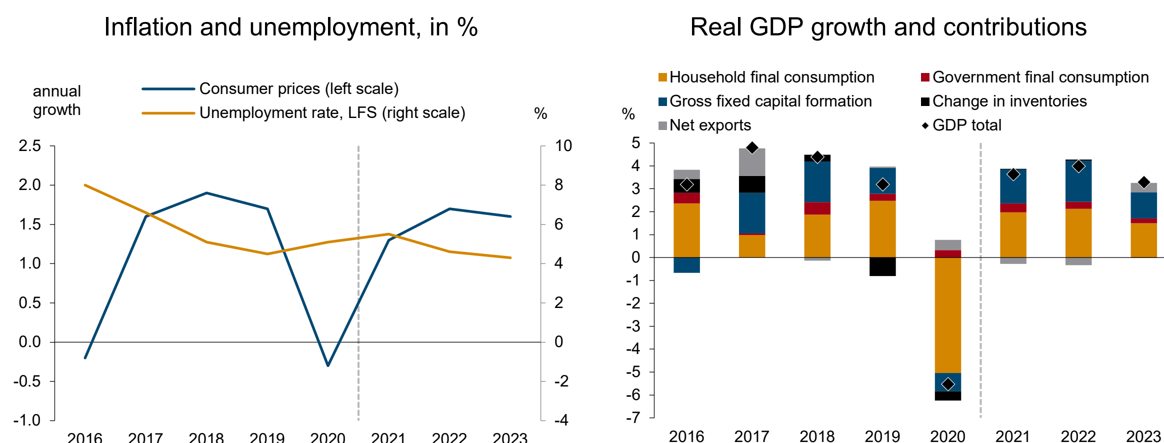
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

SLOVENIA: Economic resilience in light of a disastrous second wave

NIKO KORPAR

The economy remained robust during the strong second wave of the pandemic, which got under way in October. Exports, manufacturing and construction covered the losses in services and retail incurred by a prolonged lockdown. Government support measures continue to shield domestic firms and the labour market from shocks. In 2021 the ongoing pandemic will dampen the recovery and restrict the projected growth rate to 3.6%, underpinned by a strong current-account surplus and European recovery funds.

Figure 4.21 / Slovenia: Main macroeconomic indicators



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

The second wave of the coronavirus in the fourth quarter of 2020 proved to be far worse than the first one from a health standpoint, but it did less damage to the economy than expected. Slovenian GDP thus fell by 5.5% in full-year 2020, 1.2 percentage points less than had been forecast by wiiw. Strong foreign demand and manufacturing kept the economy afloat as exports returned to their pre-crisis levels by the end of 2020, while the construction sector grew by 18.1% in November 2020 compared with the same month in 2019. The second lockdown again impacted private consumption, hitting retail trade (down by about 12%), and services. The labour market has shown resilience. Although the number of unemployed rose by 4.8% in January 2021 from the December 2020 level, the increase did not deviate from annual seasonal trends. This can be attributed to extended government schemes, but perhaps also to a structural adaption, as the workplace-preserving measures include less than half of the labour force included in April in May of 2020.

In the second wave, Slovenia became one of the worst-hit European countries, having previously had one of the best records in handling the pandemic. A total of 150 people died as a result of COVID-19 between the beginning of the pandemic and 1 October 2020. But from then until 20 March 2021, the pandemic took 3,820 lives. After closing bars and restaurants in October, the government soon introduced much stricter lockdown measures. Schools were closed from the end of October until mid-February; non-essential shops were also closed for almost three months; movement was restricted to within municipalities; and a curfew (ongoing) has been imposed. However, the incidence of infections barely responded to the lockdown. Although the government was quick to blame private gatherings for the high incidence of cases, large numbers of people were infected in workplaces as many employers proved to be unenthusiastic about teleworking, and also were not fully compensated for losses resulting from having quarantined workers. The vaccination programme began in January 2021, with about 11% of the population having received their first dose by late March. At around the same time, infection rates began climbing again and another 11-day lockdown was announced for the beginning of April.

The government continued its loose fiscal policy and addressed the second wave with another four recovery packages, amounting to EUR 2.22bn, or 4.5% of annual GDP. These mostly extended various support schemes introduced during the first half of 2020, such as furloughs, basic income for the self-employed and tourist vouchers. The total value of government support packages introduced in 2020 amounted to about EUR 9.5bn. However, according to Slovenia's Fiscal Council, the total fiscal impact of these measures was only about EUR 2.9bn. A major reason for this discrepancy is the underuse of the scheme for liquidity loans guaranteed by the state. Nevertheless, support measures cushioned the fall of GDP by about 3 percentage points and will continue to aid the economy in 2021.

Slovenian firms have entered 2021 in remarkably good shape – except for the hospitality sector. According to a survey by the Slovenian Chamber of Commerce and Industry, 85% of firms ended 2020 with a positive EBITDA. The total number of bankruptcies in 2020 was lower than in previous years. Data on non-performing loans showed only a slight overall uptick (0.1 percentage points) for the previous year, but a 10% rise within the hospitality sector. Loan deferrals are a major reason for the generally good condition of companies.

In light of the prolonged second wave, and the possibility of a third, we have downgraded our GDP growth forecast for 2021 from 4.3% to 3.6%. The expected recovery will be delayed by at least a quarter. Growth in 2021 will be led by the export sector and a cautious rise in private investment, especially through the expansion of construction of housing and large infrastructure projects, such as the Koper-Divača railway. Growth in household consumption, expected to reach 4.1%, will depend on the activation of domestic savings, which grew by about 10% in the first half of 2020. The key risk factors for the recovery remain the possibility of further waves of infections and declines in demand in the EU's economic core. The use of the recovery funds provided by the EU, which is expected to start in the latter half of 2021, is not likely to play a major role in the recovery in 2021. The effectiveness of the EUR 5.2bn made available through the Recovery and Resilience Facility will depend on how it is allocated. The draft investment plan, submitted to the Commission, raised concerns over the government's understanding of the purpose of the funds, as too little was allocated to projects supporting the green transformation. With a projected growth rate of 4% in 2022, Slovenian GDP should return to pre-crisis levels next year.

Massive fiscal expansion increased the budget deficit, but by somewhat less than was expected (to 8.4% of GDP). Besides the above-mentioned underutilisation of certain support schemes, the difference is also a consequence of an overall lower level of realisation of planned projects and use of EU funds, an issue that could translate into 2021, when the deficit will be around 5.2% of GDP. Fiscal policy is expected to remain proactive in 2021. Support measures will be removed only gradually, not least because parliamentary elections are due in 2022.

Large increases in average monthly gross earnings put additional pressure on the budget in 2020. Salaries in the public sector increased by 7.8%, owing to payments of pandemic-related allowances and previously scheduled wage rises. Salaries in the private sector increased by 4.4%, mostly as a result of relief compensation. This situation should not be repeated in 2021, although payments of emergency bonuses and other add-ons will be extended as the pandemic continues.

Although imports will grow more strongly than exports, a current-account surplus exceeding 6% is expected for a second consecutive year. The recovery in 2020 was slower in exporting sectors utilising a low or medium level of technology (such as machinery and equipment), and fastest in high-tech sectors, such as pharmaceuticals. Tourism will continue to benefit from the national voucher scheme, but the 2021 season is shaping up to be worse than expected, owing to the prolonged pandemic.

Inflation in 2021 will only slightly exceed the expected EU average. In 2020 prices in Slovenia fell by 0.3%, in large part because of deflationary energy prices; any early inflationary pressure was relieved by the drop in consumption during the second lockdown period. In 2021 higher energy prices and economic recovery will raise the price level by 1.3%, while in 2022 the cost of services will begin to rise again and inflation will reach 1.7%.

Unemployment should not be a major issue in 2021, owing to the continuation of government measures. Despite some uncertainty over the situation once the unprecedented government support is removed, significant jumps in unemployment (which will hover around 5.5%) are not expected. Nevertheless, another slow tourist season could have an adverse impact on the mainly young population employed in various service industries, and some closures of businesses – currently postponed as a result of government support – could push up the unemployment figures.

In a rare occurrence, Slovenian politics became a topic of discussion in the European press. The prime minister, Janez Janša, who has not hidden his affinity to governments in Hungary and Poland, made the headlines with incendiary tweets and sharp responses to accusations that his government is limiting the freedom of the press in Slovenia. Although he survived an attempt by the opposition to install a new government, his support in parliament has declined to the point of losing parliamentary majority. His position now depends on the smallest of the three coalition partners, the Modern Centre Party (SMC), itself shaken by internal strife. Growing disappointment with the government's handling of the pandemic and its authoritarian tendencies could yet contribute to political instability before the beginning of Slovenia's presidency of the Council of the EU in the latter half of 2021, but it appears more likely that economic interests will prevail and that the government coalition will hold until the elections in 2022.

Table 4.21 / Slovenia: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022	2023
						Forecast	
Population, th pers., average	2,066	2,074	2,088	2,110	2,115	2,120	2,125
Gross domestic product, EUR m, nom.	43,009	45,863	48,393	46,297	48,600	51,400	53,900
annual change in % (real)	4.8	4.4	3.2	-5.5	3.6	4.0	3.3
GDP/capita (EUR at PPP)	25,080	26,410	27,660	26,130	.	.	.
Consumption of households, EUR m, nom.	22,223	23,484	24,937	22,345	.	.	.
annual change in % (real)	1.8	3.6	4.8	-9.8	4.1	4.4	3.1
Gross fixed capital form., EUR m, nom.	7,877	8,822	9,503	9,207	.	.	.
annual change in % (real)	10.2	9.6	5.8	-4.1	7.4	9.0	5.8
Gross industrial production							
annual change in % (real)	7.7	5.1	3.1	-5.1	6.0	3.6	3.4
Gross agricultural production							
annual change in % (real)	-9.5	28.5	-7.8	5.2	.	.	.
Construction industry							
annual change in % (real)	17.7	19.7	3.3	0.3	.	.	.
Employed persons, LFS, th, average	959.1	980.6	982.6	970.0	970	980	990
annual change in %	4.8	2.2	0.2	-1.3	-0.3	1.4	0.9
Unemployed persons, LFS, th, average	67.4	52.8	45.7	52.0	56	47	44
Unemployment rate, LFS, in %, average	6.6	5.1	4.5	5.1	5.5	4.6	4.3
Reg. unemployment rate, in %, eop	9.0	8.1	7.7	8.9	.	.	.
Average monthly gross wages, EUR 2)	1,627	1,682	1,754	1,856	1,910	1,980	2,050
annual change in % (real, gross)	1.3	1.7	2.7	5.9	1.4	1.8	2.0
Average monthly net wages, EUR 2)	1,062	1,093	1,134	1,209	1,220	1,250	1,290
annual change in % (real, net)	1.7	1.2	2.1	6.6	-0.1	0.9	1.2
Consumer prices (HICP), % p.a.	1.6	1.9	1.7	-0.3	1.3	1.7	1.6
Producer prices in industry, % p.a.	2.2	2.1	0.6	-0.3	0.8	1.0	1.2
General governm.budget, EU-def., % of GDP							
Revenues	44.0	44.3	43.8	43.1	43.2	43.8	44.2
Expenditures	44.1	43.5	43.3	50.1	48.4	47.1	45.0
Net lending (+) / net borrowing (-)	-0.1	0.7	0.5	-7.0	-5.2	-3.3	-0.8
General gov.gross debt, EU def., % of GDP	74.1	70.3	65.6	83.0	85.3	85.1	84.8
Stock of loans of non-fin.private sector, % p.a.	1.9	3.0	3.5	0.0	.	.	.
Non-performing loans (NPL), in %, eop 3)	8.4	5.6	2.9	2.6	.	.	.
Central bank policy rate, % p.a., eop 4)	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR m	2,674	2,680	2,723	3,366	3,030	2,980	2,930
Current account, % of GDP	6.2	5.8	5.6	7.3	6.2	5.8	5.4
Exports of goods, BOP, EUR m	28,372	30,817	32,013	29,627	31,760	34,170	36,700
annual change in %	14.0	8.6	3.9	-7.5	7.2	7.6	7.4
Imports of goods, BOP, EUR m	26,756	29,535	30,682	27,098	29,830	32,600	34,950
annual change in %	14.5	10.4	3.9	-11.7	10.1	9.3	7.2
Exports of services, BOP, EUR m	7,394	8,104	8,548	6,853	7,680	8,680	9,410
annual change in %	13.5	9.6	5.5	-19.8	12.0	13.0	8.4
Imports of services, BOP, EUR m	5,140	5,478	5,762	4,827	5,300	6,250	7,130
annual change in %	12.3	6.6	5.2	-16.2	9.8	18.0	14.0
FDI liabilities, EUR m	1,065	1,307	1,521	680	.	.	.
FDI assets, EUR m	570	373	773	692	.	.	.
Gross reserves of CB excl. gold, EUR m	632	702	767	913	.	.	.
Gross external debt, EUR m	43,231	42,148	43,796	48,252	50,100	50,900	52,300
Gross external debt, % of GDP	100.5	91.9	90.5	104.2	103.0	99.0	97.0

1) Preliminary and wiiw estimates. - 2) Wage increase in 2020 due to COVID emergency relief compensations. - 3) Loans more than 90 days overdue and those unlikely to be paid. - 4) Official refinancing operation rates for euro area (ECB).

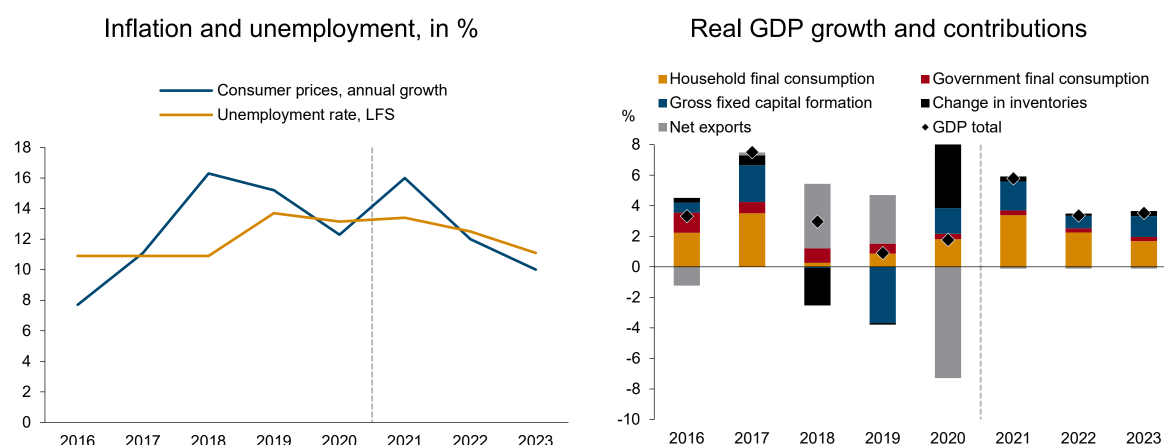
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

TURKEY: Back to boom and bust

RICHARD GRIEVESON

Uniquely in CESEE, the Turkish economy posted positive full-year economic growth in 2020, reflecting credit expansion in response to the pandemic. A period of higher nominal interest rates stabilised the lira, but is likely now at an end thanks to yet another change at the top of the central bank. Growth will be strong this year but slow by 2022, either due to high real interest rates to get inflation under control, or a lira collapse and balance of payments crisis.

Figure 4.22 / Turkey: Main macroeconomic indicators



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

The Turkish economy has so far weathered the pandemic relatively well, posting the only full-year positive growth rate in CESEE last year. This performance reflected a strong credit-driven rebound from Q2's downturn in the second half of 2020, as the government used its favourite method to stimulate aggregate demand. As elsewhere, growth performance differed widely between sectors of the economy. Private consumption overall rebounded strongly thanks to the credit stimulus and pent up demand from Q2, while industry performed well on the back of the weaker lira and rapid unwinding of the Q2 breakdown in global supply chains. By the end of 2020, both the seasonally-adjusted indices of industrial output and retail trade were above pre-pandemic levels. However, key areas of the services economy struggled due to pandemic-related restrictions. Foreign tourism, a key pillar of growth, had a very bad year. Total arrivals reached 12.9m in 2020 according to the central bank, down from 44.7m in 2019.

Most recently available high-frequency data suggest that the strong economic performance continued up to the end of 2020 and into the early part of this year. The manufacturing purchasing managers' index (PMI), compiled by the Istanbul Chamber of Industry and IHS Markit, was at 51.7 in

February, above the 50 level separating expansion from contraction. Meanwhile consumer confidence reached a 31-month high in March 2021.

In public health terms, Turkey has suffered from the pandemic but not to the same extent as many other parts of CESEE. According to Worldometer data, as of late March Turkey had recorded 357 deaths from COVID-19 per million, just over half of the level for Russia (659), and only a fraction of the rates for the worst-affected countries in Europe such as Czechia (2355), Hungary (1965) or Belgium (1958). Data measuring the level of government restrictions or impact on mobility indicate that Turkey is a fairly average case by CESEE standards, meaning that the reason for the relative lack of public health impact may lay elsewhere. It seems reasonable to assume that at least part of the reason is Turkey's young population, which is in stark contrast to almost anywhere else in CESEE. However, in a context of mutations and indications that younger people are now more badly affected, there are risks to the public health outlook this year. As in many other countries, Turkey is in the grip of a third wave of the pandemic, with cases rising rapidly at the time of writing, albeit still well below the peaks of the second wave in November-December.

The labour market has suffered in the pandemic, and we expect the rate of unemployment to rise further in 2021. The total number of people registered as employed in Turkey in 2020 fell by over a million, from 28.1m in 2019 to 26.8m last year. However, job losses in the services sector most affected by the pandemic have been partly offset by gains elsewhere, especially in the industrial sector on the back of rising exports. The headline unemployment rate actually fell in 2020, to 13.2%, from 13.7% in 2019, but this reflected people who lost their job moving to inactivity. As a result, the labour force declined by almost 1.7m in 2020 according to Turkstat, despite population growth of 1.1m over the same period.

The initial expansionary monetary response to the pandemic was followed by several important changes to the policy set-up towards the end of 2020, which appeared to show a greater awareness of the economy's vulnerabilities and acceptance that a different growth model was required. It appears that the pandemic and its fallout delivered a shock to President Erdogan and his inner circle. Turkey burnt through its foreign currency reserves in a failed attempt to support the lira. This was followed by the removal of Berat Albayrak, the President's son in law and economy minister, and the instalment of a new central bank governor, Naci Agbal. These changes were welcomed by the market, especially after the new governor raised the nominal policy rate by 875 basis points to 19%, putting the real rate well into positive territory. During the first couple of months of 2021, the lira was the best performing emerging market currency in the world.

The move towards a more orthodox policy stance could also be understood as an attempt to better protect the economy in the context of the US election and Turkey's more assertive foreign policy role. Although Turkey sparred with the US over the detaining of Pastor Andrew Brunson in 2018, in general it appears that the Erdogan government got off lightly under the Trump presidency. Various potential flashpoints, including the purchase of a missile defence system from Russia, allegations that Halkbank helped Iran to evade US sanctions, and Turkey's involvement in Syria, all could have led to a much more bitter fallout between Turkey and the US. Many in Washington were indeed pushing for such an outcome, but it seems that President Trump largely prevented this. Under the new US administration Turkey may not be so well protected, and concern about possible future US sanctions could have played into the decision to try to ringfence the economy with more orthodox policy. However, with its large current account deficit and external borrowing needs, Turkey is a long way from such ringfencing. More

than almost any other country in CESEE, Turkey is vulnerable to US sanctions, reflecting the fact that the dollar remains the primary funding currency and large short-term external financing needs.

In recent developments that are familiar to those following the Turkish economy, this period of stability is now over. In late March, President Erdogan sacked Mr Agbal and appointed in his place a loyalist, Sahap Kavcioglu. Mr Kavcioglu is a former AKP deputy, and a supporter of Mr Erdogan's view that high interest rates cause inflation. It seems almost certain that this appointment will be followed by a reversal of recent interest rate hikes, in a bid to use expansionary credit policy to drive economic growth. In recent newspaper columns Mr Kavcioglu argued against using high interest rates to keep down inflation, saying that they only attracted portfolio flows and not the productive investment that Turkey needs. He also seems to support the previous policy of Mr Albayrak to use foreign currency reserves to support the lira.

The decisive shift back towards expansionary policy produced the predictable immediate market reaction: a sharp drop in the value of the lira and the stock market. Turkey may get away with it for some time, as it has before, reflecting the unprecedented levels of global dollar liquidity since 2008. However, at some point–feasibly this year–Turkey will again hit up against the reality that running negative real rates with a large dollar-financed current account and zero investor confidence in the independence of the central bank is not sustainable. This will result in a weaker lira, higher inflation, struggles to attract capital to plug the current account deficit, and a sharp slowdown in growth. The fact that this is taking place in a climate of rising US treasury yields (see global overview) is a particularly big problem. Higher US yields will suck dollars back and away from markets like Turkey, substantially increasing the risks of a balance of payments crisis. It may also not help that Mr Kavcioglu was vice President of Halkbank during a period when it is accused of helping Iran to evade US sanctions (Mr Kavcioglu is not implicated in the charges; Halkbank denies any wrongdoing, and the trial is due to start this spring). Any expanded US sanctions on Turkey will exaggerate the gravity of the situation.

The real surprise about the late March change of course is the timing: the period of policy 'orthodoxy' this time lasted only a few months. It seems that Mr Erdogan was enraged by the central bank's decision to further raise rates on March 18th; three days later the bank had a new governor. Although the broad implications are the same–Turkey will continue to go through boom and bust cycles–the length of these cycles may be becoming shorter. The timing may also reflect complacency after several months of a strengthening lira and market stability. There is also some speculation that President Erdogan is going for an early election (the next is not due to take place until 2023), and that the change at the top is part of a gamble to use loose policy to drive a boom for a couple of quarters until the election, and deal with the consequences afterwards. However, this would be a very risky strategy. Mr Erdogan's AKP party is struggling in the polls; one poll by Research Istanbul showed its support at below 30% in March for the first time in almost two decades. Much of this disquiet is likely related to economic factors. Although headline growth has been mostly strong during the AKP's time in office, in recent years it has been accompanied by persistently high inflation, which has eaten substantially into real incomes. As a result, many people do not perceive the last few years to have been especially good in economic terms. Despite strong headline growth, in per capita terms adjusted for purchasing power standards, Turkey's performance over the past decade has been fairly mediocre by emerging market standards.

The risk of a serious financial crisis in Turkey is arguably as high as it has been since 2008. Whatever the beliefs of Mr Erdogan and his inner circle, they remain stuck with the same three options

as before: i) keep rates high to get a grip on inflation but at the expense of economic growth, ii) accept a substantial and persistent weakening of the lira accompanied by high inflation, macroeconomic volatility and social problems, or iii) implement capital controls. The first option now seems highly unlikely given the recent change at the top of the central bank. The third option also still seems politically difficult to imagine, albeit now moderately more likely. Therefore, the most likely scenario is the second, which means that the economy is again in for a rocky ride.

In this context, making any kind of prediction about short and medium-term macroeconomic trends is particularly challenging. It is possible that the authorities will get away with it for a while, and that the economy will boom this year on the back of improved global growth and sentiment as the health situation improves. However, this 'positive' scenario would also mean an even faster rise in US rates, putting additional pressure on Turkey's external financing ability. Conversely, a negative scenario with a bad third wave of the pandemic would also dent investor confidence and cause a renewed flight to safety and away from economies like Turkey.

Our best guess is that growth will benefit in the short run, and so we have revised up our forecast for this year. Since 2017, during periods of negative real interest rates the economy has grown at an average of around 6%; we therefore use this as a baseline for this year. However, this will come at a cost, as it will be followed by a sharp hike in real rates and at least a couple of quarters of weak growth or even contraction. We have therefore revised down our forecast for next year to around 3.5%. A scenario like 2018 is not hard to imagine, when loose policy produced a boom followed by a sharp tightening of policy and a slump in economic activity. Then, the net result was a growth rate of 3%, followed by just 0.9% in 2019, despite the economy having grown by 7.5% in 2017 and 6.8% on average in 2010-17. The timing of the boom and bust cycle is naturally highly uncertain. The risks to this forecast are primarily to the downside.

Table 4.22 / Turkey: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022	2023
						Forecast	
Population, th pers., average	80,313	81,407	82,579	83,385	84,385	85,398	86,423
Gross domestic product, TRY bn, nom.	3,134	3,758	4,320	5,048	6,200	7,200	8,200
annual change in % (real)	7.5	3.0	0.9	1.8	5.8	3.4	3.5
GDP/capita (EUR at PPP)	19,360	19,160	18,540	18,960	.	.	.
Consumption of households, TRY bn, nom.	1,827	2,098	2,441	2,846	.	.	.
annual change in % (real)	5.9	0.5	1.5	3.2	6.0	4.0	3.0
Gross fixed capital form., TRY bn, nom.	936	1,115	1,118	1,373	.	.	.
annual change in % (real)	8.3	-0.3	-12.4	6.5	7.0	3.0	5.0
Gross industrial production 2)							
annual change in % (real)	9.1	1.1	-0.6	2.2	5.1	3.1	2.8
Gross agricultural production 3)							
annual change in % (real)	5.2	-1.3	0.5	3.0	.	.	.
Construction industry 2)							
annual change in % (real)	3.8	-5.0	-8.0	-3.0	.	.	.
Employed persons, LFS, th, average	28,197	28,734	28,081	26,808	27,500	28,200	28,900
annual change in %	3.6	1.9	-2.3	-4.5	2.5	2.5	2.5
Unemployed persons, LFS, th, average	3,451	3,535	4,461	4,063	4,260	4,030	3,610
Unemployment rate, LFS, in %, average	10.9	10.9	13.7	13.2	13.4	12.5	11.1
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.
Average monthly gross wages, TRY 4)	2,470	2,820	3,250	3,750	4460	5120	5770
annual change in % (real, gross)	-2.5	-2.0	0.0	2.8	2.5	2.5	2.5
Consumer prices (HICP), % p.a.	11.1	16.3	15.2	12.3	16.0	12.0	10.0
Producer prices in industry, % p.a. 5)	15.8	27.0	17.6	12.1	17.3	13.3	11.3
General governm.budget, nat.def., % of GDP							
Revenues	29.9	29.8	29.7	28.5	30.0	31.0	32.0
Expenditures	31.9	32.5	32.9	33.0	33.5	33.5	33.5
Deficit (-) / surplus (+)	-2.0	-2.8	-3.2	-4.5	-3.5	-2.5	-1.5
General gov.gross debt, nat.def., % of GDP	28.0	30.2	32.6	36.7	40.4	43.5	46.4
Stock of loans of non-fin.private sector, % p.a.	19.9	9.6	10.2	35.3	.	.	.
Non-performing loans (NPL), in %, eop	2.9	3.9	5.4	4.1	.	.	.
Central bank policy rate, % p.a., eop 6)	8.00	24.00	12.00	17.00	14.00	12.00	10.00
Current account, EUR m	-35,796	-16,735	6,220	-32,152	-26,500	-26,600	-27,700
Current account, % of GDP	-4.7	-2.5	0.9	-5.1	-3.8	-3.6	-3.5
Exports of goods, BOP, EUR m	149,908	151,682	162,818	147,299	155,000	163,000	171,000
annual change in %	8.6	1.2	7.3	-9.5	5.0	5.0	5.0
Imports of goods, BOP, EUR m	201,279	185,579	177,819	180,461	189,000	198,000	208,000
annual change in %	15.6	-7.8	-4.2	1.5	5.0	5.0	5.0
Exports of services, BOP, EUR m	46,936	50,108	56,908	30,138	38,000	40,000	42,000
annual change in %	12.1	6.8	13.6	-47.0	25.0	5.0	5.0
Imports of services, BOP, EUR m	23,969	23,555	25,082	21,698	23,000	24,000	25,000
annual change in %	2.7	-1.7	6.5	-13.5	5.0	5.0	5.0
FDI liabilities, EUR m	9,804	11,041	8,084	6,770	.	.	.
FDI assets, EUR m	2,419	3,017	2,611	2,716	.	.	.
Gross reserves of CB excl. gold, EUR m 7)	70,202	63,666	69,975	40,776	.	.	.
Gross external debt, EUR m 7)	378,289	386,686	386,777	376,000	404,000	404,500	414,000
Gross external debt, % of GDP	49.7	58.7	56.9	60.0	58.0	54.5	52.0
Average exchange rate TRY/EUR	4.1206	5.7077	6.3578	8.0547	8.90	9.70	10.30

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees; for construction wiiw estimate. - 3) Based on UN-FAO data, wiiw estimate from 2019. - 4) Data based on Annual Industry and Service Statistics excluding NACE activities agriculture and fishing, finance and insurance, public administration, defence and social security. wiiw estimate. - 5) Domestic output prices. - 6) One-week repo rate. - 7) Converted from USD.

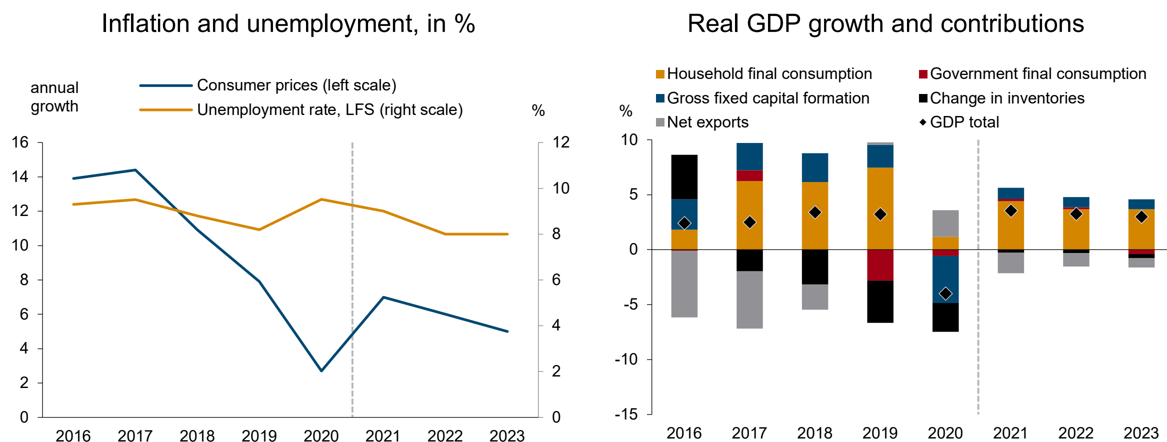
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

UKRAINE: Good luck can get you only so far

OLGA PINDYUK

Ukraine's GDP contracted in 2020 by only 4%, largely because of favourable conditions in key export markets and resilient household incomes. In 2021 the economy will return to growth, supported by a rebound in private consumption and a revival in investment. Negative risks to the forecast have been growing, due to the suspension of the IMF loan programme and a slow vaccine roll-out.

Figure 4.23 / Ukraine: Main macroeconomic indicators



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

The Ukrainian economy contracted in 2020 by 4% – more moderately than had been expected at the beginning of the COVID-19 pandemic. In Q4 2020 GDP shrank only by 0.5% year on year, despite the second wave of the pandemic. Luck was on the country's side as Ukrainian exporters could benefit from high global prices of corn, other grains, and metals, while prices of imported energy were, until recently, relatively low. Owing to the asymmetric effects of the pandemic on foreign trade in 2020, exports of goods and services decreased by only 4.6% year on year, while imports of goods and services fell by 18.1% year on year. As a result, the current account posted a surplus of USD 6.6bn (more than 4% of GDP), compared with a USD 4.1bn deficit (2.7% of GDP) in 2019.

The resumption of household income growth and easing of quarantine restrictions in the second half of the year stimulated private consumption. Ukraine was one of only a few countries in the CESEE region where private consumption increased in real terms in 2020, regardless of the lack of sufficient fiscal stimulus. In 2020 real household consumption was estimated to have increased by about 2% year on year, while real government final consumption contracted by 3% – the steepest decline in the region. Private consumption was supported by strong real wage growth (7.4% year on year on

average in 2020) and decreasing saving propensity (1.0% in Q3 2020, down by 0.7 percentage points from Q2). A recent survey of households[31] showed that food accounts for about 45% of total household expenditure, with utilities and other mandatory payments accounting for a further 15% – reflecting a low level of income for the majority of the population, which makes saving hardly possible.

The key driver of the fall in GDP was the reduction in investment, which was the steepest in the region. High uncertainty about the future and lack of access to affordable funding sources made businesses postpone their investment projects; as a result, gross fixed capital formation decreased in 2020 by about 24% year on year. Notable growth in capital investment was registered only in postal and courier activities as delivery services and online trade experienced a boom.

After reaching a markedly low level of 2.7% in annual average terms in 2020, inflation picked up significantly in January-February 2021. Inflation reached 7.5% year on year in February, well outside the 4-6% target range set by the National Bank of Ukraine (NBU). Acceleration was driven mostly by rising food and fuel prices, as well as by hikes in administered prices for a number of goods and services. In order to combat inflationary pressures, the NBU has abandoned its accommodative monetary stance; it raised its policy rate by 50 basis points to 6.5% on 5 March 2021. In light of elevated inflation expectations, further increases in the policy rate are likely; we expect it to reach 7.5% by the end of 2021. We expect inflation to slow in the second half of the year, when a new harvest arrives, and forecast average annual inflation of 7% this year. In 2022-2023 inflation is forecast to return to the target range, and depreciation pressure is likely to remain contained during the forecast period.

Government securities accounted for the lion's share of growth in banks' net assets in 2020, while the stock of loans to the real sector of the economy declined. Domestic government debt securities, which accounted for two thirds of the growth in banks' net assets in 2020, were seen as a relatively safe haven. After a slump in H1 2020, newly issued household loans started to grow again in H2, with mortgage lending picking up the fastest – issuance of new loans almost doubled from its H1 level. New corporate loans also resumed growth in H2 2020, although the stock of loans was decreasing as banks actively wrote off non-performing loans (NPLs). Credit risk remains high, owing to pandemic-related threats to the solvency of households and companies. Despite the radical loosening of monetary policy, interest rates for new household loans have remained in double digits in both the consumer and mortgage loan segments (30.5% and 14.2% per year respectively in February 2021), raising questions about sustainability and a possible future increase in NPLs.

The third wave of the coronavirus pandemic has begun to have a significant impact on the economy. A lack of meaningful quarantine restrictions in the second half of 2020 has led to a recent rapid increase of coronavirus cases. COVID-19 deaths exceeded 300 per day at the end of March 2021. The National Academy of Sciences of Ukraine believes that the third wave is going to last until mid-May and be the deadliest yet; it expects 40,000 infections and 1,000 deaths each day. Several regions of Ukraine already face a lack of capacity in the healthcare sector to deal with a surge of patients. Ukraine remains in adaptive quarantine, where each oblast is assigned one of four epidemiological levels, depending on the COVID-19 situation there. New lockdowns have been introduced in the worst-affected regions; it is likely that a country-wide lockdown will soon be introduced.

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[31] https://www2.deloitte.com/content/dam/Deloitte/ua/Documents/Press-release/RWD%202020%20UA.pdf.

A slow vaccine roll-out is aggravating the situation and reduces the chances of restoring a normal level of activity in 2021. By the end of March Ukraine had vaccinated fewer than 200,000 people (less than 0.5% of the total population). There are issues both with supply of vaccines and the willingness of people to be vaccinated. Ukraine received a fresh supply of 215,000 doses of Sinovac, a Chinese-made vaccine, on 25 March. However, the anticipated delivery of 1.5m doses of the AstraZeneca/Covishield vaccine from India is at risk. India has announced that it will halt exports until the local producer satisfies the country's own demand for vaccines. Meanwhile, according to recent surveys, more than 40% of Ukraine's population are not willing to be vaccinated.[32]

Lack of progress in anti-corruption reforms puts at risk Ukraine's access to external finance. After completing an unusually long virtual mission to Ukraine, which lasted for almost two months, the IMF has frozen a USD 5bn 18-month stand-by programme approved in June 2020. Ukraine had received only the first tranche of USD 2.1bn on 12 June. According to the IMF's statement, the country must show more progress on reforms (in particular, judicial reform) to be eligible for a new tranche. The Constitutional Court has been the focus of criticism for issuing a ruling in October 2020 that effectively destroyed Ukraine's entire asset declaration system for state officials (as well as for a ruling in August 2020 that undermined the authority of the national anti-corruption bureau, NABU). The IMF also voiced concern over the recent government's decision to regulate household gas prices. The new US administration is leaning on the Ukrainian government to prosecute those responsible for the fraud relating to the nationalised PrivatBank. In March 2021 the US imposed a visa ban on the bank's former owner, Ihor Kolomoisky, and his family over his involvement in significant corruption in 2014-2015. Under external pressure, the president, Volodymyr Zelensky, has started to take the first steps against oligarchs. In March 2021 he ousted two Constitutional Court judges for being threats to national security, a potentially unconstitutional move that was deemed necessary to break an impasse that had lasted for months. Additionally, NABU has charged three former senior executives at PrivatBank with embezzlement, the first criminal proceedings since its nationalisation. In the absence of an active IMF programme, loose external monetary conditions may not be sufficient for the resumption of capital inflows into the country and the government could face the risk of default.[33]

In 2021 Ukraine's economy is projected to grow by 3.5%, supported by a rebound in private consumption and an investment revival. The forecast assumes that Ukraine will satisfy the requirements of the IMF and receive the next tranches of loans from it, as well as from the EU and the World Bank, and that vaccine roll-out speeds up enough to avoid prolonged lockdowns. The current account will return to deficit as economic activity recovers and import demand grows. In 2022-2023 we forecast that the economy will grow by about 3% per year, primarily on the back of household final consumption; the contribution of net exports will become negative as imports demand recovers.

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[32] http://ratinggroup.ua/research/ukraine/vakcinaciya_v_ukraine_barery_i_vozmozhnosti_18-19_marta_2021.html?fbclid=IwAR2q4_iRqT9chUJMqKwGGkGLIa8Uaccc7F3Z16WmbYzsxh3SR17g0zZA8-o.

[33] In 2021 Ukraine's loan repayment and servicing costs will be more than USD 15.5bn (or about 10% of 2020 GDP).

Table 4.23 / Ukraine: Selected economic indicators

	2017	2018	2019	2020 1)	2021	2022 Forecast	2023
Population, th pers., average	42,485	42,270	42,028	41,750	41,460	41,250	41,040
Gross domestic product, UAH bn, nom.	2,984	3,561	3,978	4,194	4,600	5,000	5,400
annual change in % (real)	2.5	3.4	3.2	-4.0	3.5	3.2	3.0
GDP/capita (EUR at PPP)	8,130	8,310	8,730	8,570	.	.	.
Consumption of households, UAH bn, nom.	1,978	2,439	2,918	3,079	.	.	.
annual change in % (real)	9.5	9.3	10.9	1.6	6.0	5.0	5.0
Gross fixed capital form., UAH bn, nom.	470	628	701	547	.	.	.
annual change in % (real)	16.1	16.6	11.7	-24.4	8.0	7.0	7.0
Gross industrial production							
annual change in % (real)	1.1	3.0	-0.5	-4.5	2.0	3.0	3.0
Gross agricultural production							
annual change in % (real)	-2.2	8.2	1.4	-11.5	.	.	.
Construction output							
annual change in % (real)	26.4	8.6	23.6	4.0	.	.	.
Employed persons, LFS, th, average	16,156	16,361	16,578	15,915	16,200	16,500	16,600
annual change in %	-0.7	1.3	1.3	-4.0	1.8	1.9	0.6
Unemployed persons, LFS, th, average	1,698	1,579	1,488	1,674	1,600	1,430	1,440
Unemployment rate, LFS, in %, average	9.5	8.8	8.2	9.5	9.0	8.0	8.0
Reg. unemployment rate, in %, eop 2)	1.4	1.3	1.3	1.7	.	.	.
Average monthly gross wages, UAH 3)	7,104	8,865	10,497	11,591	13,300	15,200	17,200
annual change in % (real, gross)	18.5	13.2	9.7	7.4	7.0	8.0	8.0
Consumer prices, % p.a.	14.4	10.9	7.9	2.7	7.0	6.0	5.0
Producer prices in industry, % p.a.	26.4	17.4	4.1	-1.6	10.0	3.0	4.0
General governm.budget, nat.def., % of GDP							
Revenues	34.1	33.3	32.4	32.8	32.0	33.5	33.0
Expenditures	35.5	35.2	34.6	38.2	37.0	36.5	35.0
Deficit (-) / surplus (+)	-1.4	-1.9	-2.2	-5.3	-5.0	-3.0	-2.0
General gov.gross debt, nat.def., % of GDP	71.8	60.9	50.2	60.8	62.0	57.0	55.0
Stock of loans of non-fin.private sector, % p.a.	1.9	5.6	-9.8	-2.8	.	.	.
Non-performing loans (NPL), in %, eop	54.5	52.8	48.4	41.0	.	.	.
Central bank policy rate, % p.a., eop 4)	14.50	18.00	13.50	6.00	7.5	7.0	6.5
Current account, EUR m 5)	-3,079	-5,443	-3,682	5,648	2,800	900	-300
Current account, % of GDP	-3.1	-4.9	-2.7	4.1	2.0	0.6	-0.2
Exports of goods, BOP, EUR m 5)	35,192	36,677	41,146	39,544	41,200	42,500	43,700
annual change in %	16.1	4.2	12.2	-3.9	4.2	3.2	2.8
Imports of goods, BOP, EUR m 5)	43,758	47,436	53,877	45,192	48,400	51,400	53,900
annual change in %	19.6	8.4	13.6	-16.1	7.1	6.2	4.9
Exports of services, BOP, EUR m 5)	12,625	13,401	15,591	13,517	14,100	15,200	16,400
annual change in %	12.3	6.1	16.3	-13.3	4.3	7.8	7.9
Imports of services, BOP, EUR m 5)	11,811	12,270	14,029	9,457	9,800	10,800	11,900
annual change in %	9.4	3.9	14.3	-32.6	3.6	10.2	10.2
FDI liabilities, EUR m 5)	3,473	3,872	5,207	-97	.	.	.
FDI assets, EUR m 5)	207	98	554	282	.	.	.
Gross reserves of CB excl. gold, EUR m 5)	14,872	15,955	21,590	22,422	.	.	.
Gross external debt, EUR m 5)	96,741	92,352	109,134	102,299	113,000	116,000	117,000
Gross external debt, % of GDP	97.3	83.4	79.4	75.1	82.0	80.0	78.0
Average exchange rate UAH/EUR	30.00	32.14	28.95	30.79	33.4	34.5	35.7

Note: Excluding the occupied territories of Crimea and Sevastopol and, with the exception of the population, excluding the temporarily occupied territories in the Donetsk and Luhansk regions.

1) Preliminary and wiiw estimates. - 2) In % of working age population. From 2019 wiiw estimate. - 3) Enterprises with 10 and more employees. - 4) Discount rate of CB. - 5) Converted from USD.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

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