Forecast Report

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No Quick Recovery in Sight, with Coronavirus Risks Looming Large

Economic Analysis and Outlook for Central, East and Southeast Europe

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No Quick Recovery in Sight, with Coronavirus Risks Looming Large

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Executive summary

Most economies of CESEE withstood the first wave of the coronavirus pandemic better than Western Europe, even if the lockdowns introduced there were generally as strict as – or even stricter than – those in Western Europe. This can partly be explained by the relatively small size of the service sector, which suffered the most from the pandemic. However, there were strong negative spill-overs from the effective closure of borders during the lockdowns and from the slump in the euro area. As a result, those CESEE economies that rely on tourism (Croatia and Montenegro) and foreign trade (the smaller Visegrád countries and Slovenia) were the worst affected during the first wave.

As in Western Europe, CESEE governments have responded with a marked policy relaxation, taking advantage of the fiscal and monetary space available. Policy rates have been cut sharply, contributing to currency depreciations (of more than 20% since the start of the year, in some cases) which mitigated the impact of the external demand shock. Besides, a wide range of government support measures has been adopted, including most notably subsidised short-time work schemes, which saved many jobs and have limited the rise in unemployment, at least so far.

Partly due to the policy stimuli enacted (especially on the fiscal side), CESEE economies rebounded strongly in the third quarter. Retail trade benefited from purchases delayed during the lockdown, and international production chains largely resumed their operation. However, the pre-crisis levels of economic activity have not been reached. Besides, the second wave of the pandemic, which started in many CESEE countries in September, has given rise to concerns over the ability of healthcare systems to cope with the soaring numbers of hospitalisations. This has already prompted a renewed full lockdown in the Czech Republic and partial lockdowns in Poland, Slovakia and Slovenia, while other countries may soon follow suit, making double-dip recessions (on a quarterly basis) almost unavoidable this year. The region as a whole will post a full-year contraction of 4.5% for 2020, with risks to this estimate now weighted quite heavily on the downside.

The medium-term economic prospects for CESEE are surrounded by enormous uncertainty. In our baseline scenario, which assumes that an effective vaccine/treatment for COVID-19 will contain the pandemic without the need for lengthy lockdowns, CESEE economies are projected to grow on average by 3.1% in 2021 and 3.3% in 2022. Across the CESEE countries, the economies of Croatia and Montenegro are expected to grow by 5% next year, as the tourism industry partly recovers the losses incurred this year. By contrast, in Russia and Kazakhstan, growth will barely exceed 2.5%, as the oil prices are unlikely to recover substantially from their current levels and oil production will still be constrained by the OPEC+ quotas. Even in this benign scenario, the 2019 levels of economic activity in CESEE countries will not be reached before 2022 (except in Lithuania, Serbia and Turkey), and Belarus will record another year of recession due to the fallout from the current political crisis.

The risks to the above forecasts are clearly on the downside. Any further spread of the virus would not only necessitate further lockdowns (in both CESEE and Western Europe), with direct contractionary effects for the economies of the countries involved, but would also affect the demand for durable consumer and investment goods, due to the high level of uncertainty. Besides, the pandemic – even if successfully contained – may leave a lasting legacy in the form of depressed demand for many services, such as aviation, hospitality and recreation, making businesses in those sectors dependent on continued government support. The need for such support will clearly increase in the event of renewed lockdowns.

In EU-CEE countries, continued government support should be less of a problem: they have generally enough fiscal space and will benefit from various EU transfers, including the Next Generation EU funds, which in some cases (such as Croatia and Bulgaria) will exceed 3% of GDP per year. However, such government support may be more problematic in some Western Balkan countries, as well as Ukraine and Moldova, which have high public debt-to-GDP ratios and/or are highly dependent on external assistance. Similarly, the continuation of monetary stimulus in Turkey renders it vulnerable to any change in sentiment on international markets. Any premature withdrawal of government support will result in a fresh wave of bankruptcies, a rise in unemployment and further income losses. This would weigh heavily on the economic prospects of countries located on the southern and eastern periphery of the CESEE region.

COUNTRY SUMMARIES

ALBANIA

The economy is expected to contract by 6.4% in 2020. Recovery is unlikely to be just around the corner, given the current pandemic. The public debt is in danger of becoming unsustainable and public finances have little room for manoeuvre. In the medium term, the prospects for FDI inflows look positive. Assuming that the pandemic does not trigger a second lockdown, we expect the economy to resume growing at over 4%, backed by an upsurge in external demand and a rebound of private consumption in 2021.

BELARUS

The ongoing protests in Belarus have triggered the worst political crisis in recent history and brought to light some deep-seated problems. The economy is weakened and its prospects are bleak, as Belarus is facing grave structural problems and balance of payments constraints. A recent bailout by Russia is not sufficient to secure future financial sustainability. In the short run, Belarus will likely experience a protracted recession and possible further political and economic turbulence.

BOSNIA AND HERZEGOVINA

The COVID-19 pandemic has led to a substantial slump in exports, tourism earnings, private consumption and industrial production, causing BiH's GDP to contract by an estimated 5.1% in 2020. To mitigate the economic downturn, the central government has received a combined EUR 741 million in financial aid and loans from the EU and the IMF. However, the complex BiH federative structure limits the country in introducing fiscal response measures.

BULGARIA

Political turmoil in Bulgaria continues for a third consecutive month, with daily protests demanding the resignation of the government. The negative economic shock of the COVID-19 pandemic was most pronounced in the second quarter, and its intensity has now subsided. In response, the authorities launched two packages of fiscal support measures. For 2020 as a whole, GDP should decline by some 5%, while a gradual recovery is expected over the following two years.

CROATIA

The economy's heavy reliance on tourism means that Croatia will suffer one of the biggest contractions in CESEE in 2020, with real GDP projected to decline by 9.4%. Unemployment will rise, and inflation will average 0% for the year as a whole. To mitigate the economic downturn caused by COVID-19, the government initiated a support package worth about 9% of GDP. The tourism sector should stage at least a partial recovery next year, which will underpin growth of around 5%.

CZECH REPUBLIC

In the first half of 2020, all the components of aggregate demand (except for public consumption) declined strongly, with foreign trade making a particularly big contribution to the overall drop in GDP. The rise in unemployment has been moderate, but real wages have declined. The modest improvements optimistically expected in the second half of the year will not be enough to compensate for the initial losses. Positive growth may return in 2021, but a strong showing is not expected.

ESTONIA

The economic slump of March-May 2020 was short-lived and was followed by an upswing in external and household demand. Nevertheless, the second wave of infections is likely to result in restrained economic activity in the coming months. A substantial government rescue package helped to cushion the downturn, and the medium-term budget strategy envisages further substantial public support for economic growth. We project a recession of 4.8% of GDP in 2020, followed by a revival of 3.9% in 2021 and a smaller upswing of 3% in 2022.

HUNGARY

The COVID-19 crisis has hit the economy hard, with the export of vehicles and tourism suffering the most. Household consumption and investment have declined sharply, due partly to sub-optimal crisis management by the government. The pre-crisis economic level will only be reached in late 2022, at the earliest. Support from the EU rescue programme is indispensable for this, but non-compliance with rule-of-law requirements may render participation problematic.

KAZAKHSTAN

A substantial anti-crisis package is mitigating the impact on the economy of two lockdowns and low oil prices. The cut in oil production, in line with the OPEC+ agreement, will hinder any strong revival of exports in coming years. Thanks to a massive fiscal stimulus, real GDP in 2020 is expected to fall by only 3%. Economic growth will resume in 2021, but will be moderate, at 2.5%; in 2022, it will accelerate to 4%. Further lockdowns and the absence of any recovery in oil prices are the main downside risks to the forecast.

KOSOVO

Against all expectations, remittances, foreign direct investment and goods exports rose during the pandemic. Still, the negative economic fallout has been considerable and the economy is expected to contract by 5% in 2020. The government has approved a recovery plan worth EUR 365 million to relaunch the economy. Remittances will continue to cushion consumption, and private investments will gain momentum in the medium term. The economy is expected to bounce back in 2021, with growth of 5%. However, recovery remains uncertain, given the continued presence of COVID-19.

LATVIA

The Latvian economy has experienced a sharp decline, but seems to have bounced back quite quickly in the third quarter of 2020. Household consumption fell by more than 20% in the second quarter, but more recently has picked up again. The decline in external demand was much less than expected. Similarly, gross fixed capital investment fell only slightly, but is likely to be depressed in the second half of the year. In 2020, we expect GDP to shrink by 4.6%; this will be followed by strong growth of 4.4% in 2021 and a somewhat slower upswing of 2.8% in 2022.

LITHUANIA

The Lithuanian economy experienced only a short-lived and contained recession in the second quarter of 2020, with GDP declining by 4.2% year on year. Within the European Union, only Ireland was hit less hard. A better-than-expected export performance and swiftly rebounding household consumption in the months thereafter is likely to result in a decline in the Lithuanian economy of only 2% over 2020. The government undertook substantial fiscal stimulus measures, and the public investments announced will support recovery over the next two years. For 2021, we expect real GDP to grow by 4.5%, followed by a somewhat slower upswing of 3.2% in 2022.

MOLDOVA

The poorest country in Europe also has the highest figures for COVID-19 infections and fatalities in relation to population. Fiscal policy has very limited scope to mitigate the impact of the crisis from the country's own revenues. The government needs to rely on foreign agencies for financing (although these impose conditions that are difficult to meet) and has to maintain a balanced relationship with Russia and the EU. Economic decline of at least 7% in 2020 will be followed by a slow recovery in coming years.

MONTENEGRO

The COVID-19 pandemic is exacting a heavy toll on the Montenegrin economy, largely because of the country's reliance on its tourism sector: arrivals were 77.9% down in the first eight months of the year. This has had serious repercussions for employment, and foreign direct investment has also declined. Alongside Croatia, Montenegro is one of those countries in CESEE that will be hardest hit by COVID-19, with GDP contracting by 9% in 2020. In 2021, we expect a partial recovery in tourism, supporting overall growth of 5%.

NORTH MACEDONIA

Since May, North Macedonia has failed to contain the pandemic. The government has also not provided adequate fiscal support to the economy. That led to a decline in GDP in Q2 of 12.7% year on year, which was greater than expected. We are thus downgrading our GDP forecast for 2020 from -5% to -6%. Prospects for the future depend crucially on the government's fiscal support and on management of the health aspects of the pandemic.

POLAND

In the second quarter of 2020, GDP fell by 7.9%, but the third quarter has brought some respite to industry. Monetary and fiscal policies have been very expansionary so far, limiting the scale of GDP decline. Inadequate demand remains the chief problem, followed by the falling profitability of firms and continuing uncertainty, also over the pandemic. Consumption may not recover and investment will decline further. Moderate improvements in 2021 and beyond are possible, but not guaranteed.

ROMANIA

Despite the high epidemiological risk, the government plans only local lockdowns in future. GDP is projected to decline by 5.5% in 2020 and to hit its 2019 level only in 2022. A budget deficit of close to 10% of GDP has caused a rise in bond yields and currency depreciation, but presents no immediate risk to external financing. The December election should produce a centre-right coalition government; it is expected to improve public governance – an important precondition for spending EU funds.

RUSSIA

In the second quarter, the economy shrank by a relatively moderate 8%, and the subsequent rebound has been reasonably strong. However, a recent upsurge in new infections and the currency's weakening will dampen economic activity in the months to come. In the baseline scenario, GDP is expected to decline by 4.5% this year, with a moderate recovery of 2-2.5% per year projected for 2021-2022.

SERBIA

Serbia has been among the best-performing European countries during the COVID-19 pandemic. GDP fell by just 0.8% in the first half of the year, and data for Q3 suggest a solid recovery. We are thus upgrading our forecast for 2020, from -4% to -2%. The good results are mainly due to the massive fiscal support by the government, which has borrowed abroad and used the money to support the economy during the crisis. This cannot continue indefinitely, and prospects for the future depend on the viability of its current economic model, based on attracting FDI, in the post-coronavirus world.

SLOVAKIA

The COVID-19 pandemic and a related severe lockdown hit the Slovak economy in the second quarter of 2020, when GDP contracted by 12.1% year on year. There was a rapid recovery in the automotive industry, with production and exports growing again by July. However, with the number of infections rising again since September, a sustainable recovery is in doubt. We expect GDP to drop by 7.3% in 2020, and to recover in 2021 by 4.1%.

SLOVENIA

Although Slovenia's economy was hit hard by the pandemic and will decline by 6.7% in 2020, this is a significant revision upwards from the previous forecast. A combination of fiscal measures, improving domestic and foreign demand, and stable corporate and bank finances give grounds for cautious optimism for recovery, which will be gradual and uneven. However, much will depend on the global epidemiological situation in the coming months, as well as on the strength of export demand from Slovenia's major trading partners.

TURKEY

The economy staged an impressive rebound in Q3, but this relied heavily on credit, resulting in a weaker lira, higher inflation and a widening of the current account deficit. Growth in Q4 will therefore slow, with the full-year 2020 decline likely to be a bit over 3%. In 2021, we expect a strong bounce-back, with growth above 4%. The risks, as ever, are the financing of the external deficit, delayed monetary policy reaction and geopolitics.

UKRAINE

After a sharp contraction in the second quarter of 2020, the Ukrainian economy has started to recover. We expect economic growth to return in 2021-2022, but to be fragile and subject to many downside risks. The coronavirus pandemic and the inability of the government to tackle corruption represent major threats to the economy in the future.

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

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The statistical data until 2019 presented in this Report are as of 20 October 2020, forecasts as of November 2020. 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	Czech Republic	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	Czech Republic	PL	Poland
EE	Estonia	RO	Romania
HR	Croatia	SI	Slovenia
HU	Hungary	SK	Slovakia
LT	Lithuania		

V4	**Visegrád countries**	**BALT3**	**Baltic countries**
CZ	Czech Republic	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	Czech Republic	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	LT	Lithuania
BE	Belgium	LU	Luxembourg
CY	Cyprus	LV	Latvia
DE	Germany	MT	Malta
EE	Estonia	NL	Netherlands
EL	Greece	PT	Portugal
ES	Spain	SI	Slovenia
FR	France	SK	Slovakia
IE	Ireland	UK	United Kingdom
IT	Italy		

ABBREVIATIONS

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

BIS	Bank for International Settlements
BOP	balance of payments
BPM5	Balance of Payments Manual Fifth Edition
BPM6	Balance of Payments and International Investment Position Manual Sixth Edition
CA	current account
CE	Central Europe
CIS	Commonwealth of Independent States
CIS-STAT	Interstate Statistical Committee of the Commonwealth of Independent States
CPI	consumer price index
EA	euro area 19 countries
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
ER	exchange rate
ESA'95	European system of national and regional accounts, ESA 1995
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
GNP	Gross National Product
GVA	Gross Value Added
HH	households

ICP	International Comparison Project
ICT	Information Communication Technology
IMF	International Monetary Fund
LFS	Labour Force Survey
MFF	Multiannual Financial Framework
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne (Statistical classification of economic activities in the European Community)
NACE Rev. 1	first revision of the original NACE (1970)
NACE Rev. 2	revised classification, introduced in 2008
NB	National Bank
NC	national currency
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
PPI	producer price index
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
SNA	System of National Accounts
SPE	Special Purpose Entity
STW	short-time work
US	United States
VAT	value added tax
WIFO	Austrian Institute of Economic Research
wiiw	The Vienna Institute for International Economic Studies

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

1. Global overview: A long and bumpy road back to normality

BY RICHARD GRIEVESON

- **The Northern Hemisphere winter looks set to be tough, with the renewed spread of the pandemic leading to increased restrictions on economic life.**
- **However, by the end of Q1 2021, the restrictions should again be relaxed, allowing economic activity to rise.**
- **Major players will continue to engage in ultra-loose fiscal and monetary policy, providing an important source of stability and demand to the whole global economy, including CESEE.**
- **The economic recovery at the global level will be slow and bumpy, with a general upward trend punctuated by periods of weakness. Nevertheless, the trough of the downturn is likely to have been in Q2 2020, and the global economy should post positive growth in 2021 and 2022.**
- **Risks to global projections remain unusually high in both directions, albeit at present weighted quite heavily to the downside. The future path of economic recovery is heavily dependent on the pandemic and any future vaccine.**

1.1. ECONOMIC RESTRICTIONS: A TOUGH WINTER AHEAD, FOLLOWED BY ZIGZAGGING BACK TO NORMALITY

Various media reports suggest that a vaccine for COVID-19 is getting closer. However, this is only one of several important steps, and will not in itself lead to a sharp economic rebound. The testing, manufacture and distribution of any vaccine will take time. There is a great deal of uncertainty about the timing of all those steps, but it seems unlikely that there will be a successful mass immunisation programme before the middle of 2021. However, mass inoculation is not necessary for large parts of the economy to get back to something like normal, especially once the Northern Hemisphere winter has passed.

The most likely scenario is that there will be a difficult few months over the winter, with the return of lockdowns in at least some regions of Europe. There will be a general zigzag pattern of restrictions, with specific conditions at any given time dictating whether the constraints are tightened or loosened. However, nobody knows how bad the second wave will be, or to what extent it will be exacerbated by the winter weather. Nevertheless, by next summer, even without a vaccine, our baseline scenario is that economic life will be much closer to normal than is currently the case.

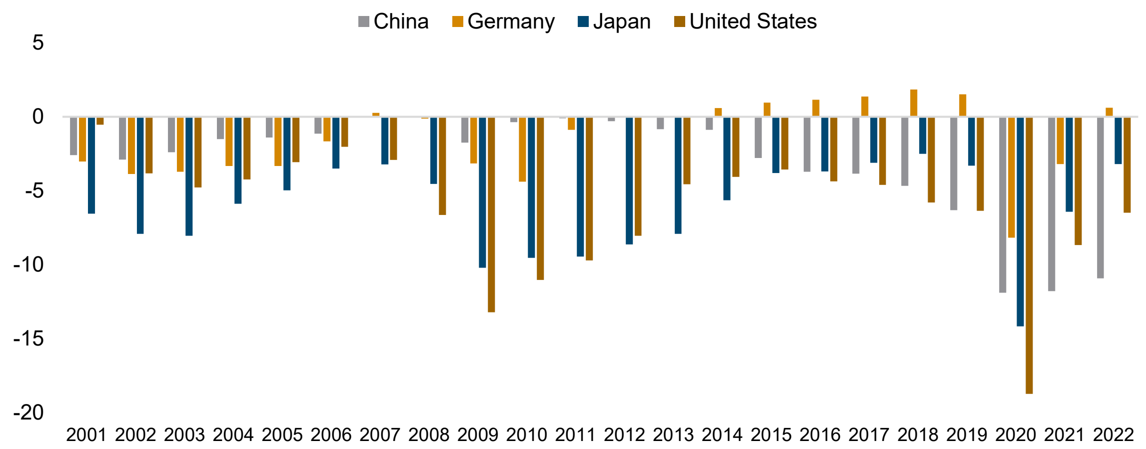
1.2. POLICY RESPONSE: EXTRAORDINARY STIMULUS

The impact of the current pandemic on the real economy is much greater than after the global financial crisis of 2008. According to the IMF, the global economy will contract by more than 4% in 2020, compared with basically flat growth in 2009. However, for large parts of the economy, the fallout this time does not seem as dramatic as post-2008. The main reason for this is the unprecedented scale of monetary and fiscal loosening this time. In 2009 and thereafter, especially in Europe, the fiscal and monetary authorities trod especially cautiously, in constant fear of the impact of looser policy on inflation and public debt. This time, such a debate is (for now at least) quite marginal.

The scale of the fiscal response to the pandemic in 2020 is unprecedented in peacetime: according to the latest IMF Fiscal Monitor, the world will run a budget deficit equivalent to 12.7% of its GDP this year (compared to 3.9% in 2019).[1] The shortfall will be 18.7% of GDP in the US, 14.2% in Japan, 10.1% in the euro area and 11.9% in China. These numbers dwarf those of the 2008 crisis and its aftermath (Figure 1.1), testifying both to the gravity of the current situation, and also to a much more 'Keynesian' consensus in economic policy making than a decade ago (the IMF's October 2020 Fiscal Monitor notably urged countries to spend during the acute phase of the crisis). The EU's Recovery Fund of EUR 750 billion is remarkable not only for its scale, but also for the fact that over half of the money is in the form of grants, rather than loans (see Regional Overview Box 2.1). This is a serious step forward for EU fiscal integration, and indicates a game-changing shift in thinking on this issue in Germany.

The outcome of the recent elections in the US suggests that fiscal policy in the world's major economy is not going to be especially loose in the coming years. At the time of writing, the final results of the US presidential, senate and house elections have not yet been confirmed. However, it seems likely that the outcome will be a Democratic presidency and a Republican-controlled Senate. This probably means that there will be frequent stalemate in US fiscal policy, with President Joe Biden pushing for an expansionary policy to aid recovery, but being thwarted by a fiscally conservative Senate.

Figure 1.1 / Budget balance, % of GDP, big four global economies



Note: 2020 data onwards are IMF October 2020 World Economic Outlook projections.
Source: IMF.

On the monetary side, the response so far has been more like business as usual – only more so. Big central banks – specifically the US Federal Reserve, the ECB and the Bank of Japan –have dramatically increased the amount of liquidity in the global economy since 2008 (albeit the ECB started rather later). Unlike in 2008, the current crisis is not financial, and nor is there a desperate shortage of dollar liquidity. Capital outflows from emerging markets reached an all-time high in Q1 2020, according to the Institute

1 https://www.imf.org/en/Publications/FM/Issues/2020/09/30/october-2020-fiscal-monitor

of International Finance, but 'big bazooka' responses from the Fed and ECB at the end of March stabilised the situation. With nominal rates already close to or below zero, central banks may not be able to do much more to stimulate economies. However, their commitment to keeping rates low for years will help to underpin macro-financial stability until the recovery takes hold.

Especially (but not only) in Germany, the debate about the riskiness of such massive fiscal and monetary loosening in the medium term remains prevalent. The criticisms voiced include the observations that so much of the monetary loosening appears to have ended up in the property and stock markets, rather than consumer prices and wages, and that paying back the large piles of public debt will constrain growth far into the future (and put huge pressure on a shrinking working-age population in much of Europe and Japan). Once the acute phase of the current crisis passes, this debate will probably come back more into focus.

In terms of monetary policy, it would seem that central banks are effectively trapped: so much of the economy (for example, the property market) is now based on the assumption that real rates will stay low or negative for decades, and therefore central banks cannot really hike their rates without causing a deep recession. Moreover, the impetus to raise rates may never come if inflation stays well below target. Although the reasons for such low inflation remain disputed, it does seem that structural factors (such as demographic trends), competition from online retail and a persistent shortfall in demand in many developed economies (exacerbated massively by the current crisis) are central to the story. As such, a change in inflation dynamics will only come about slowly, if at all.

Regarding public debt, it is true that current levels are high, and that this crisis will certainly push them higher. Global public debt is projected by the IMF to rise to 98.7% of GDP this year, an increase of 15.7 percentage points relative to 2019. This includes levels of 131.2% of GDP for the US, 134.8% for Italy and 238% for Japan. However, debt/GDP loads can only be considered in the context of the real cost of borrowing for governments, which for the big global economies is at a historically very low level. In the US, for example, although real rates on long-term debt have been lower in the past – around the Second World War, for example, or during the stagflation of the 1970s – those were times of heightened volatility in prices and interest rates. What is so notable about the current period, and indeed most of the last decade, is the persistent stability of real interest rates at or close to zero across the developed world.

1.3. SHAPE AND SPEED OF RECOVERY: SLOW AND BUMPY

Taking into account the assumptions about the future path of the pandemic, government responses, and the fiscal and monetary backdrop, we think that the recovery will most likely take a zigzag path, with alternating waves of tighter and looser restrictions on economic life. From next spring, the recovery should firm up, but it will take at least a couple of years to regain 2019 levels of output in most major economies.

Nevertheless, the downturn itself seems not to have been as bad as many expected during the summer. Reflecting this fact, in its October World Economic Outlook the IMF made some serious upward revisions to its 2020-2021 economic projections. In particular, it improved its 2020 projection for the US by 3.7 percentage points relative to June, and for the euro area by 1.9 percentage points. The IMF now expects the US and euro area economies to decline by 4.3% and 8.3%, respectively, in 2020 as a whole, and for the Chinese economy to grow by 1.9%. In 2021, it expects robust growth in all three key pillars of the global economy: 3.1% in the US, 5.2% in the euro area and 8.2% in China.

2. CESEE Overview

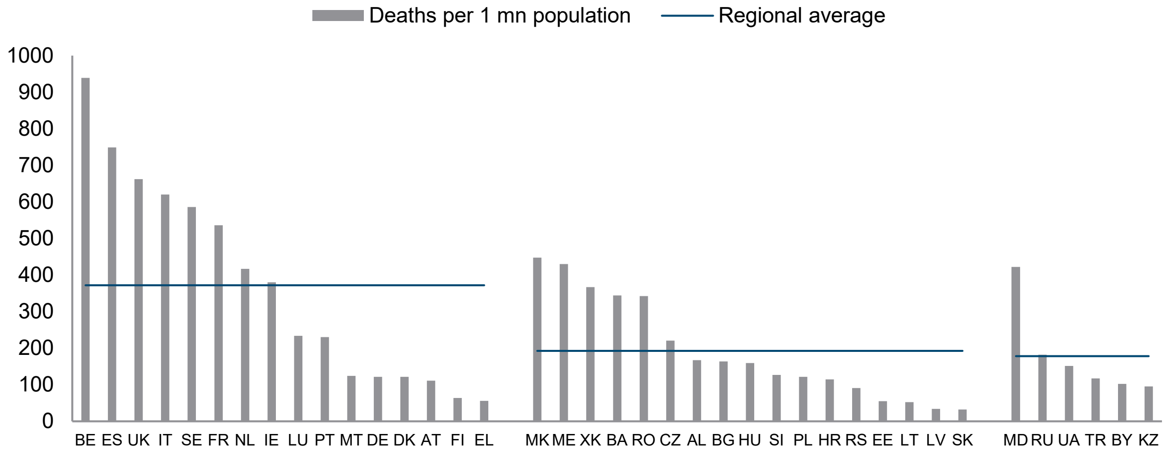
BY VASILY ASTROV[2]

2.1. CESEE WITHSTOOD THE FIRST WAVE OF THE PANDEMIC BETTER THAN WESTERN EUROPE

The first wave of the COVID-19 pandemic prompted most CESEE governments to impose strict lockdowns... The infection and mortality rates from COVID-19 in the countries of Central, East and Southeast Europe (CESEE) have been generally lower than in Western Europe. Nonetheless, governments were quick to impose lockdowns, which in some cases were stricter than in Western Europe. The most stringent measures were taken in Southeast Europe, where several countries recorded particularly high mortality rates (Figure 2.1), partly because the first wave of the pandemic lasted longer there than, for instance, in EU-CEE and extended well into the summer months. By contrast, in Estonia the coronavirus restrictions were much milder, while Belarus did not impose them at all, as its president openly questioned the existence of the coronavirus (although large sections of the population voluntarily followed safety measures).

Figure 2.1 / Deaths linked to COVID-19 per 1 million population

Western Europe (left) and CESEE (right)



Source: Worldometers, updated 27 October 2020. XK: WHO.

… but economic losses were generally smaller than in Western Europe. The sharpest drops in real GDP in the second quarter of 2020 were recorded in Montenegro (20% year on year) and Croatia (15%) – figures that, respectively, exceeded and matched the decline in the euro area (Figure 2.2). Elsewhere in CESEE, declines in real GDP in the second quarter were smaller, ranging from 13.6% in Hungary to

2 The author thanks Alexandra Bykova, Richard Grieveson, Peter Havlik, Gábor Hunya, Branimir Jovanovic, Isilda Mara, Olga Pindyuk, Sándor Richter and Robert Stehrer, all wiiw, for valuable comments and suggestions on the first draft.

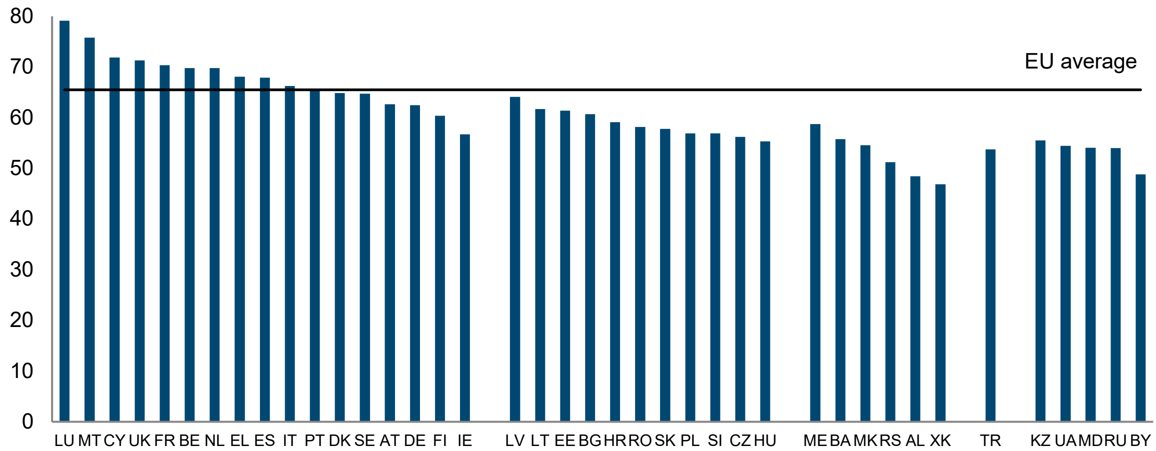
3.3% in Belarus. One of the reasons for this relatively better growth performance of CESEE countries is structural: their share of services in GDP – the sector that was most affected by the spring lockdowns – is generally lower than in Western Europe, ranging as it does from 64% in Latvia to 47% in Kosovo. On average in the EU, services account for two thirds of GDP, and in some Western European countries such as France and the UK, they reach 70% (Figure 2.3).

Figure 2.2 / Real GDP growth of the CESEE countries

real growth rate in Q2 2020 as % of corresponding period of previous year

Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Figure 2.3 / Share of value added in services in GDP in 2019, as %



Note: Data for TR refer to 2018.
Source: wiiw Annual Database incorporating national and Eurostat statistics, AMECO.

Table 2.1 / OVERVIEW 2018-2019 AND OUTLOOK 2020-2022

		GDP real change in % against prev. year					Consumer prices average change in % against prev. year				
				Forecast					Forecast		
		2018	2019	2020	2021	2022	2018	2019	2020	2021	2022
BG	Bulgaria	3.1	3.7	-5.1	1.7	2.6	2.6	2.5	1.5	2.0	2.0
CZ	Czech Republic	3.2	2.3	-6.6	3.9	3.5	2.0	2.6	3.0	2.1	2.0
EE	Estonia	4.4	5.0	-4.8	3.9	3.0	3.4	2.3	-0.2	1.5	2.3
HR	Croatia	2.7	2.9	-9.4	5.0	4.0	1.6	0.8	0.0	1.0	1.4
HU	Hungary	5.4	4.6	-6.5	3.0	4.6	2.9	3.4	3.8	3.5	3.5
LT	Lithuania	3.9	4.3	-2.0	4.5	3.2	2.5	2.2	0.7	1.8	2.3
LV	Latvia	4.0	2.1	-4.6	4.4	2.8	2.6	2.7	0.5	1.8	2.5
PL	Poland	5.4	4.5	-4.4	3.5	3.4	1.2	2.1	3.2	2.0	2.0
RO	Romania	4.5	4.2	-5.5	3.7	4.5	4.1	3.9	2.5	3.0	3.0
SI	Slovenia	4.4	3.2	-6.7	4.5	3.0	1.9	1.7	0.3	1.3	1.7
SK	Slovakia	3.8	2.3	-7.3	4.1	3.9	2.5	2.8	1.9	1.8	2.0
	EU-CEE11 1)2)	*4.5*	*3.9*	*-5.4*	*3.6*	*3.7*	*2.2*	*2.6*	*2.6*	*2.3*	*2.3*
	EA19 3)	*1.9*	*1.3*	*-8.5*	*5.8*	*2.5*	*1.8*	*1.2*	*0.3*	*1.0*	*1.3*
	EU27 3)	*2.1*	*1.5*	*-8.3*	*6.0*	*2.7*	*1.8*	*1.4*	*0.4*	*1.2*	*1.5*
AL	Albania	4.1	2.2	-6.4	4.6	4.0	2.0	1.4	1.5	1.8	2.2
BA	Bosnia and Herzegovina	3.7	2.7	-5.1	3.2	3.1	1.4	0.6	-0.4	1.4	1.6
ME	Montenegro	5.1	4.1	-9.0	5.0	4.1	2.6	0.4	-0.1	1.1	1.5
MK	North Macedonia	2.9	3.2	-6.0	4.5	4.0	1.5	0.8	1.2	1.5	1.8
RS	Serbia	4.5	4.2	-2.0	4.5	4.1	2.0	1.7	1.7	2.2	2.2
XK	Kosovo	3.8	4.9	-5.1	4.8	4.3	1.1	2.7	0.5	1.5	1.7
	WB6 1)2)	*4.1*	*3.6*	*-4.2*	*4.3*	*3.9*	*1.8*	*1.4*	*1.1*	*1.8*	*2.0*
TR	Turkey	3.0	0.9	-3.5	4.1	4.6	16.3	15.2	12.0	11.0	10.2
BY	Belarus	3.1	1.2	-2.5	-1.2	1.3	4.9	5.6	5.0	4.5	4.5
KZ	Kazakhstan	4.1	4.5	-3.0	2.5	4.0	6.0	5.3	7.0	5.5	5.0
MD	Moldova	4.3	3.6	-7.0	4.0	4.0	2.9	4.8	4.3	4.5	5.0
RU	Russia	2.5	1.3	-4.5	2.5	2.1	2.9	4.5	3.4	3.3	2.8
UA	Ukraine	3.4	3.2	-5.0	2.0	3.6	10.9	7.9	2.5	5.0	4.0
	CIS4+UA 1)2)	*2.8*	*1.8*	*-4.4*	*2.4*	*2.4*	*4.0*	*5.0*	*3.7*	*3.7*	*3.2*
	V4 1)2)	*4.8*	*3.9*	*-5.4*	*3.6*	*3.6*	*1.7*	*2.4*	*3.1*	*2.2*	*2.2*
	BALT3 1)2)	*4.1*	*3.9*	*-3.4*	*4.3*	*3.1*	*2.7*	*2.4*	*0.4*	*1.7*	*2.4*
	SEE9 1)2)	*4.0*	*3.8*	*-5.5*	*3.7*	*4.0*	*3.1*	*2.8*	*1.8*	*2.4*	*2.4*
	CIS3+UA 1)2)	*3.7*	*3.4*	*-3.9*	*1.8*	*3.4*	*7.9*	*6.5*	*4.7*	*5.1*	*4.5*
	non-EU12 1)2)	*2.9*	*1.6*	*-4.1*	*2.9*	*3.1*	*7.5*	*7.7*	*6.0*	*5.7*	*5.1*
	CESEE23 1)2)	*3.4*	*2.3*	*-4.5*	*3.1*	*3.3*	*6.0*	*6.2*	*5.0*	*4.7*	*4.3*

ctd.

Table 2.1 / (ctd.)

		Unemployment (LFS) rate in %, annual average					Current account in % of GDP				
				Forecast					Forecast		
		2018	2019	2020	2021	2022	2018	2019	2020	2021	2022
BG	Bulgaria	5.2	4.2	7.0	7.0	6.0	1.0	3.0	2.2	2.0	1.6
CZ	Czech Republic	2.2	2.0	2.7	3.1	3.0	0.5	-0.3	0.5	0.0	0.2
EE	Estonia	5.4	4.4	8.0	7.5	7.0	0.9	2.0	3.1	1.7	0.7
HR	Croatia	8.5	6.6	9.0	5.5	5.0	1.8	2.7	-3.9	-0.6	-1.2
HU	Hungary	3.7	3.4	4.5	4.5	4.0	0.3	-0.2	-1.8	-1.4	-0.6
LT	Lithuania	6.2	6.3	9.0	8.5	7.5	0.3	3.3	7.1	4.1	4.4
LV	Latvia	7.4	6.3	8.3	7.5	6.8	-0.3	-0.6	2.2	1.5	1.4
PL	Poland	3.9	3.3	3.6	4.0	3.8	-1.3	0.5	0.7	0.4	0.2
RO	Romania	4.2	3.9	5.5	6.0	5.0	-4.4	-4.7	-4.7	-4.6	-4.7
SI	Slovenia	5.1	4.5	5.8	5.4	4.6	5.8	5.6	5.8	6.0	6.4
SK	Slovakia	6.5	5.8	7.0	8.2	7.4	-2.2	-2.7	-3.9	-2.9	-3.2
	EU-CEE11 1)2)	*4.3*	*3.8*	*4.9*	*5.1*	*4.6*	*-0.8*	*-0.2*	*-0.3*	*-0.4*	*-0.4*
	EA19 3)	*8.1*	*7.5*	*9.0*	*9.4*	*8.9*	*3.6*	*3.0*	*2.5*	*2.5*	*2.3*
	EU27 3)	*7.2*	*6.7*	*8.3*	*8.7*	*8.2*	*3.2*	*2.9*	*2.4*	*2.4*	*2.2*
AL	Albania	12.3	11.5	14.5	13.0	12.0	-6.8	-8.0	-9.6	-8.2	-7.5
BA	Bosnia and Herzegovina	18.4	15.7	18.0	16.0	16.0	-3.3	-3.1	-2.6	-3.9	-3.6
ME	Montenegro	15.2	15.1	19.0	17.5	16.0	-17.0	-15.0	-14.8	-13.0	-12.5
MK	North Macedonia	20.7	17.3	17.0	16.5	16.0	-0.1	-3.3	-5.2	-4.5	-3.7
RS	Serbia	12.7	10.4	8.0	7.5	7.0	-4.8	-6.9	-5.7	-5.5	-5.7
XK	Kosovo	29.6	25.7	26.5	26.0	25.0	-7.6	-5.6	-6.0	-7.2	-8.3
	WB6 1)2)	*15.7*	*13.4*	*13.6*	*12.5*	*11.7*	*-5.1*	*-6.3*	*-6.0*	*-5.9*	*-5.9*
TR	Turkey	10.9	13.7	13.5	13.4	11.5	-2.5	1.2	-2.8	-3.3	-3.9
BY	Belarus	4.8	4.2	4.5	4.4	4.2	0.0	-2.0	-2.9	-3.4	-4.4
KZ	Kazakhstan	4.9	4.8	5.2	5.0	4.8	-0.1	-4.0	-3.5	-3.3	-3.4
MD	Moldova	3.0	5.1	5.5	6.5	6.0	-10.4	-9.3	-6.5	-6.8	-7.5
RU	Russia	4.8	4.6	6.0	5.6	5.0	6.9	3.8	1.2	2.4	2.3
UA	Ukraine	8.8	8.2	10.0	8.5	8.0	-4.9	-2.7	3.6	-0.6	-2.9
	CIS4+UA 1)2)	*5.4*	*5.2*	*6.6*	*6.0*	*5.4*	*5.3*	*2.4*	*0.8*	*1.5*	*1.2*
	V4 1)2)	*3.8*	*3.3*	*3.8*	*4.3*	*4.0*	*-0.8*	*-0.1*	*-0.2*	*-0.3*	*-0.2*
	BALT3 1)2)	*6.4*	*5.9*	*8.5*	*8.0*	*7.2*	*0.3*	*1.9*	*4.7*	*2.7*	*2.6*
	SEE9 1)2)	*8.6*	*7.4*	*8.8*	*8.4*	*7.5*	*-3.0*	*-3.1*	*-4.0*	*-3.5*	*-3.7*
	CIS3+UA 1)2)	*6.9*	*6.6*	*7.7*	*6.8*	*6.5*	*-2.0*	*-3.3*	*-0.8*	*-2.4*	*-3.5*
	non-EU12 1)2)	*7.1*	*7.5*	*8.4*	*7.9*	*7.1*	*2.8*	*1.8*	*-0.4*	*0.0*	*-0.4*
	CESEE23 1)2)	*6.4*	*6.6*	*7.5*	*7.2*	*6.5*	*1.5*	*1.1*	*-0.4*	*-0.2*	*-0.4*

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 (November 2020).

Those CESEE economies with the highest dependence on tourism and foreign trade have suffered the most. It is no coincidence that Montenegro, Croatia and Albania, where tourism accounts indirectly for more than 20% of GDP, have been among the CESEE countries worst hit. Montenegro and Croatia recorded particularly steep GDP declines in the second quarter of 2020, and are projected to be the CESEE countries that perform worst over the year as a whole, with Albania trailing not far behind (Overview Table 2.1). In Montenegro, tourist arrivals plunged by 80% (in the first eight months) and in Albania by 65% (in the first seven months); Croatia fared somewhat better (-60% in the first seven months), largely thanks to its better accessibility from the 'core' EU countries, such as Germany, Austria and the Czech Republic. The small, open EU-CEE economies with a high degree of specialisation in the automotive industry (Hungary, Slovenia, Slovakia and the Czech Republic) have also been hit disproportionately by COVID-linked disruptions, as demand for cars collapsed during the lockdown and many factories suspended their production. However, the economic downturn in these countries in the second quarter was less pronounced than in Croatia and Montenegro, and the subsequent rebound has been stronger: the supply shock (though very severe initially) was rectified rapidly, and they soon got their supply chains going again. By contrast, in the tourism-dependent Balkan economies, the demand shock has proved to be more lasting. The smallest decline in real GDP in the second quarter was recorded by Belarus, which did not impose a lockdown at all (Figure 2.2).

2.2. DOMESTIC DEMAND TAKING THE MAIN HIT

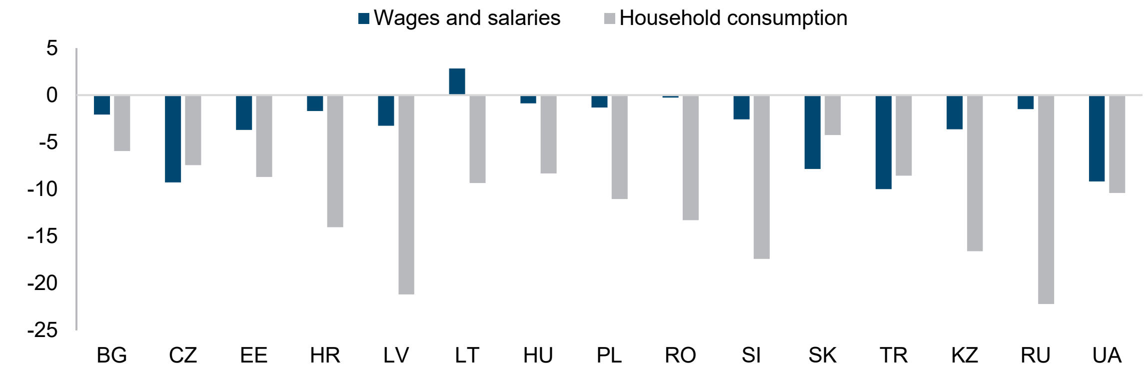
Household incomes were hit hard by the first wave of the pandemic. The effective shutdown of entire economic sectors under lockdown conditions had an effect on both profits (especially of SMEs) and salaries. Wage reductions have also resulted from the sharply reduced working hours, often (though not only) because of the short-time work schemes sponsored by the governments. Private remittances from abroad – an important pillar of household demand, especially in the Western Balkans, Ukraine and Moldova – have suffered as well (except in Kosovo).[3] Social transfers have generally risen – in many cases, representing higher pensions, as well as unemployment and child benefits – but have hardly mitigated the decline in other sources of income.

However, in most CESEE countries, real wages declined less than private consumption, suggesting an increased propensity to save (Figure 2.4). This is hardly surprising, as the supply of most goods and services was administratively restricted during lockdown. Besides, demand for durable consumer goods suffered in the face of sharply increased uncertainties. The accumulated savings were partly used once the coronavirus restrictions were lifted, thereby fuelling consumer demand over the summer months. However, consumer expenditure financed from savings cannot be sustained over a protracted period of time, especially when household incomes remain depressed and credit expansion loses steam (for more on that, see above).

3 It seems that CESEE migrants in Western Europe sent a bigger share of their incomes in the form of remittances during the pandemic, in order to help their relatives back home. However, this was offset by the loss of income (or indeed employment) of many migrants in the host countries. Many of them were even forced to leave the host country, at least temporarily. So, our assumption is that it made a net positive difference to remittance inflows into CESEE only in Kosovo, which is both very small and poor.

Figure 2.4 / Wages and household consumption

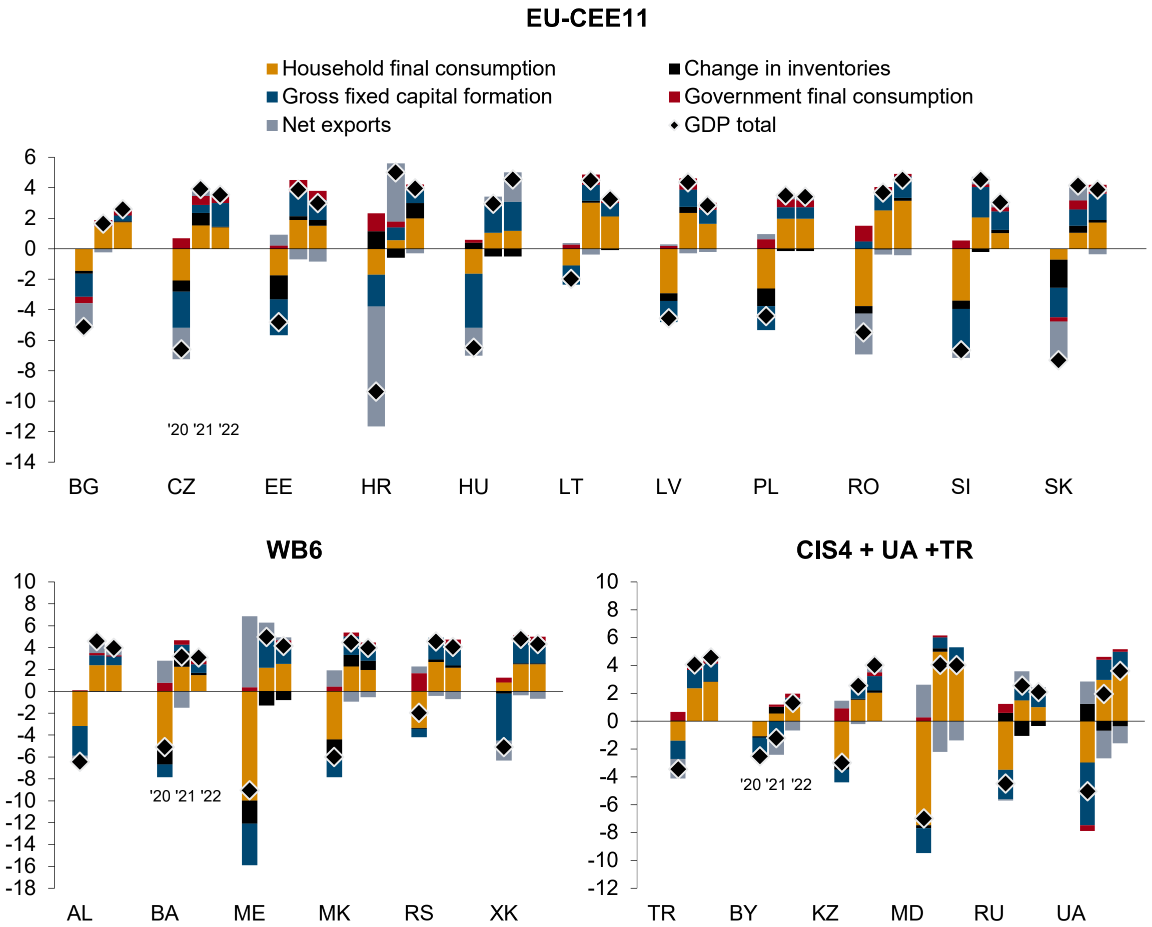
real growth rate in Q2 2020 as % of corresponding period of previous year



Note: Wages and salaries from national accounts (for TR, KZ and RU compensation of employees) deflated by CPI.
Source: Eurostat and national statistics.

Figure 2.5 / GDP growth forecasts for 2020-2022

and contribution of individual demand components in percentage points

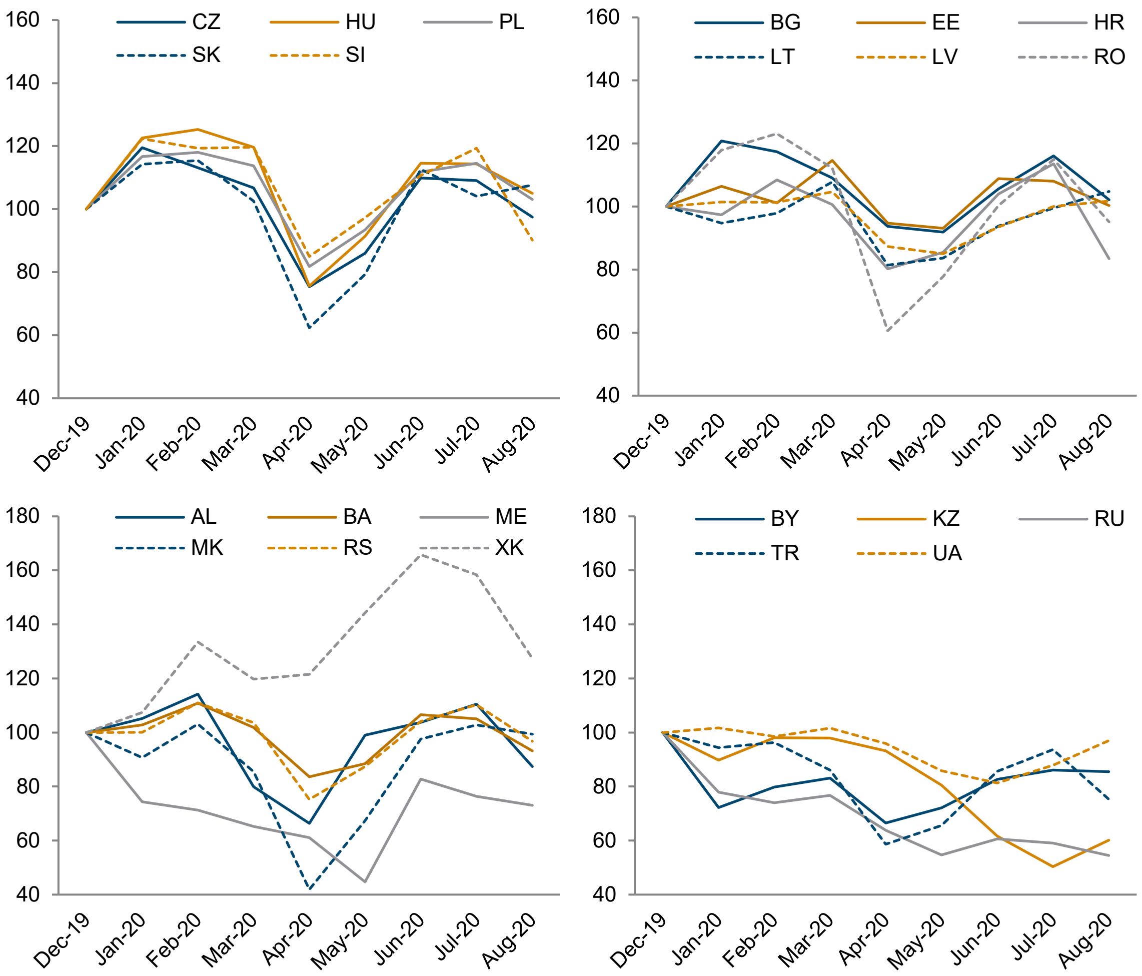


Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculations. Forecasts by wiiw.

Among the final demand components, it is investments that are projected to suffer the most. Gross fixed capital formation (GFCF) fell strongly in most CESEE countries even in the second quarter, on account of sharply increased uncertainties and reduced levels of capacity utilisation. In the very few cases where GFCF has held up well so far (such as Romania), the full impact of the crisis has arguably not yet been felt. Besides, in non-EU countries, public-sector investments have typically fallen victim to budget reshuffling, with the spending priorities shifting towards support for labour markets and incomes. By contrast, in most EU-CEE countries (except Hungary and Bulgaria), they have continued to perform strongly, thanks to the steady inflow of EU transfers. Nevertheless, overall GFCF in most of those countries is projected to be in deep red and represent the main drag on economic growth this year (Figure 2.5). Besides, in many CESEE countries, inventories have also been depleted.

Figure 2.6 / Exports of goods (customs statistics, EUR based)

index, December 2019=100

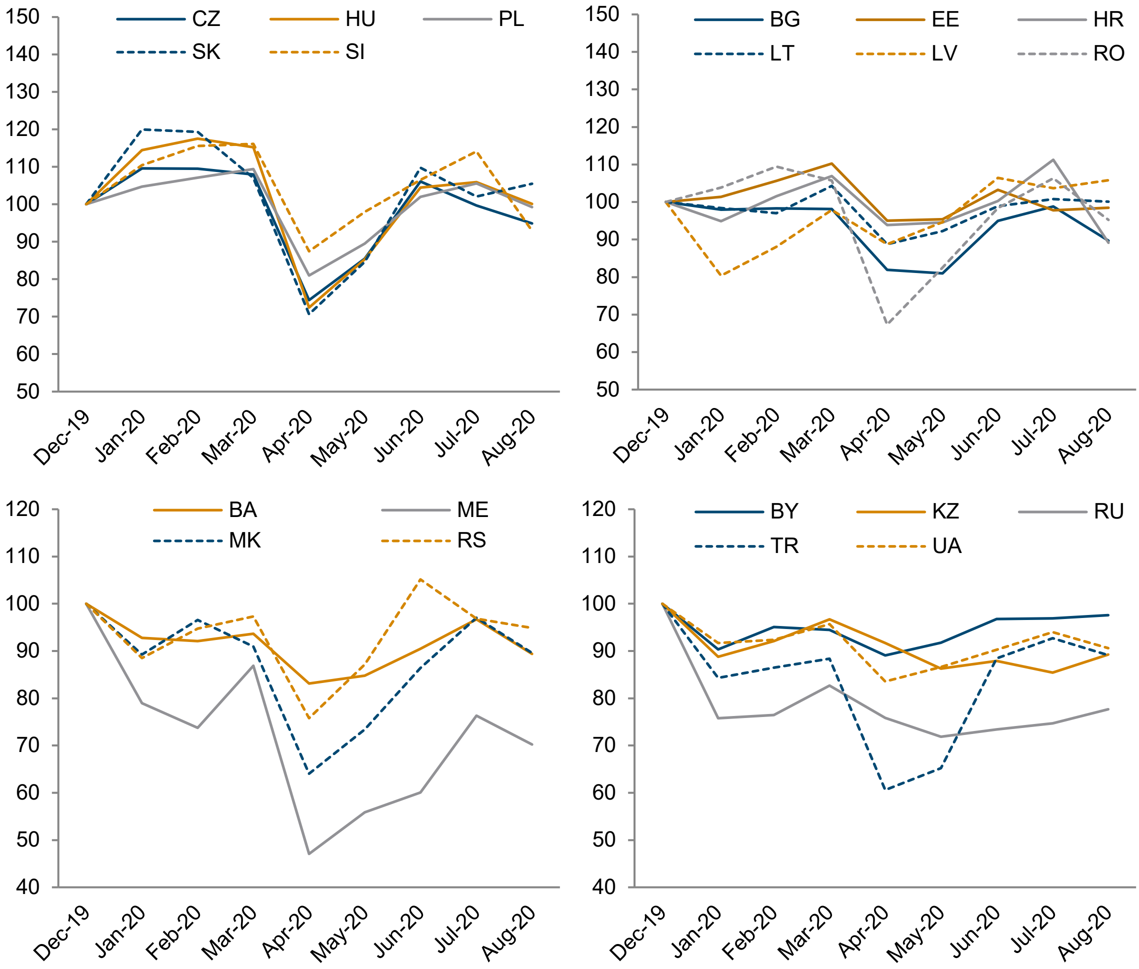


Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Exports declined sharply almost everywhere in the second quarter, mirrored by trends in industrial production. This is especially true of the Visegrád countries, as well as Slovenia and Romania, where the slump in exports of goods (by 30-40% in Q2 2020) was largely synchronised and went hand in hand with the decline in industrial production (Figures 2.6 and 2.7), driven to a large extent by the ailing automotive industry. In Russia and Kazakhstan, exports suffered in the second quarter on account of the oil price shock (and to a lesser extent oil production cuts under the OPEC+ agreement) and – unlike in EU-CEE countries – have not recovered subsequently. Elsewhere in CESEE, the slump in exports has tended to be less pronounced. In particular, agricultural exports have done well, benefiting countries such as Ukraine.

Figure 2.7 / Real gross industrial production

index, December 2019=100



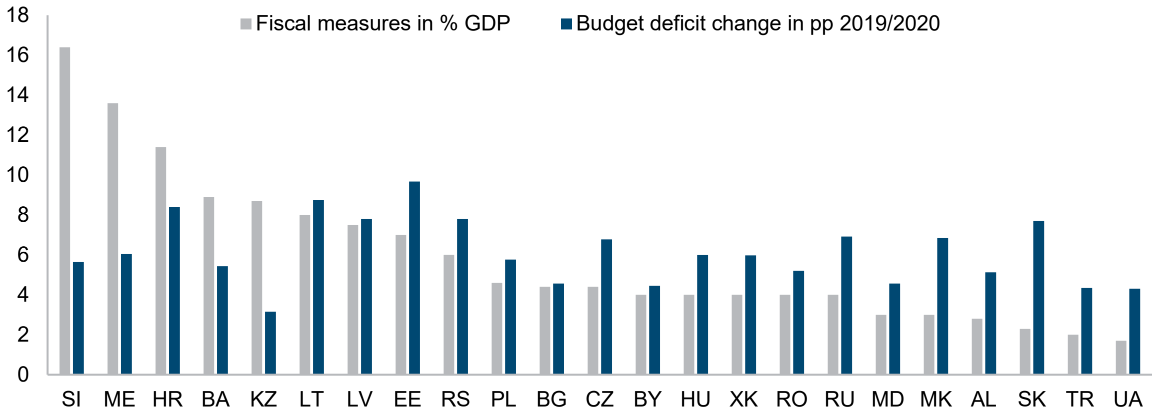
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

However, the contribution of net exports to GDP growth has been mixed. In most EU-CEE countries, the contribution of real net exports (of goods and services) to GDP growth is projected to be negative in 2020 and will amplify the contractionary effect of the slump in domestic demand (Figure 2.5). However, in Poland, the Baltic and several Western Balkan countries, as well as in Kazakhstan, Moldova and Ukraine, it is the other way around, thanks to imports (of goods and services) falling more than exports in real terms. Apart from the generally lower dependence on import demand from the ailing euro area, another reason for this in the case of non-EU CESEE countries is the fact that travel abroad has been severely constrained by largely closed borders, sharply reducing services imports.

2.3. FISCAL SUPPORT MEASURES SWELL BUDGET DEFICITS

The budget deficits of CESEE countries have widened markedly this year… The projected increase in budget deficits in 2020, compared with last year, ranges from 3 percentage points (pp) of GDP in Kazakhstan to nearly 10 pp in Estonia (Figure 2.8). In view of the economic impact of the lockdowns, strict EU fiscal policy rules have been temporarily abandoned. As a result, EU-CEE countries that previously had difficulty in complying with the rules and had been subject to the Excessive Deficit Procedure (such as Romania) have found themselves in a more comfortable position, at least for the time being. Global liquidity conditions have been generally supportive as well, nurtured by ultra-loose monetary policy in the euro area and the US. The initial spike in risk aversion in the early stages of the pandemic subsided fairly rapidly, so that the governments of EU-CEE countries, as well as Russia, had little trouble in borrowing privately at affordable interest rates. However, the Western Balkan countries, Croatia, Belarus, Ukraine and Moldova had to rely also on official sources of finance, such as the EU, the IMF, the World Bank and Russia (in the case of Belarus). In EU-CEE countries, EU support has played a role as well – for instance, in the form of funding short-time work (STW) schemes (for more on this, see the next section).

Figure 2.8 / Budget deficit and fiscal measures, as of October 2020



Source: wiiw estimates.

… mostly on account of new fiscal support measures. Only in Slovakia, North Macedonia, Turkey and Ukraine is the widening of the budget deficit this year driven primarily by a shortfall in tax revenues, rather than by fiscal expansion measures. The size of the fiscal packages adopted for 2020 differs markedly from country to country, ranging from less than 2% of GDP in Turkey and Ukraine to 16% in Slovenia (Figure 2.8).[4] The measures typically include STW schemes, tax deferrals, hikes in unemployment and social benefits, higher minimum wages, moratoriums on bankruptcies, and subsidised credits (especially for SMEs, which were hit hardest by the pandemic). Indiscriminate ‘helicopter money’ schemes have been implemented by some countries, as well. For instance, Serbia provided a lump sum of EUR 100 to every adult citizen and Albania a lump sum of EUR 400 to every employee, while Slovenia distributed EUR 200 worth of vouchers to each citizen, in order to support the

4 These figures should be seen as rough estimates, given the difficulties of quantifying the precise monetary value of the measures adopted. In particular, many of the measures (such as STW schemes) depend not only on funds earmarked by the government, but also on the ‘absorption capacity’ of those targeted.

domestic tourism industry. In some countries, notably Slovenia, credit lines and credit guarantee schemes make up a large part of the headline fiscal package, but the actual payments made will be at most only a fraction of the total (which explains the very large size of the package shown in Figure 2.8).[5] Many of the support measures extend into the next few years.

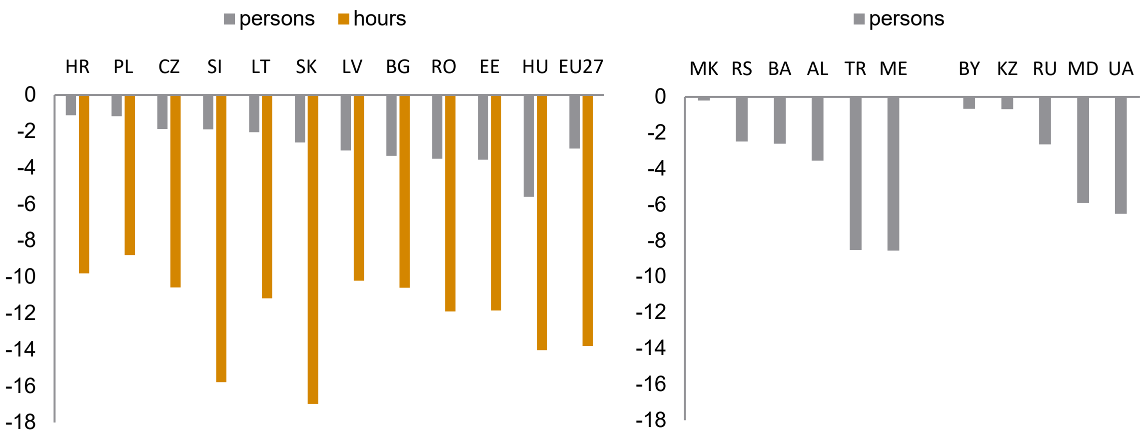
2.4. SHORT-TIME WORK HAS LIMITED LABOUR SHEDDING – SO FAR

by Sebastian Leitner

The lockdowns resulted in a noticeable decline in employment in the second quarter. According to national accounts figures, the number of jobs fell by 2.4% on average year on year in EU-CEE, which was somewhat less than in the EU27 as a whole (2.9%). While in Hungary employment dropped by almost 6%, in Croatia and Poland the reduction was rather limited (1%). In the Southeast Europe region, the plunge (based on LFS data) was remarkable in Turkey and Montenegro (more than 8%). In Moldova and Ukraine, employment also declined sharply (by about 6%).

Figure 2.9 / Employment and hours worked

growth rate in Q2 2020 as % of corresponding period of previous year



Note: Data for EU-CEE11 and EU27 based on national accounts statistics, HR, PL, RO (estimate); WB+TR and CIS4+UA according to LFS statistics. For BA, the data refer to the number of persons in paid employment.
Source: Eurostat and wiiw Annual Database incorporating national statistics.

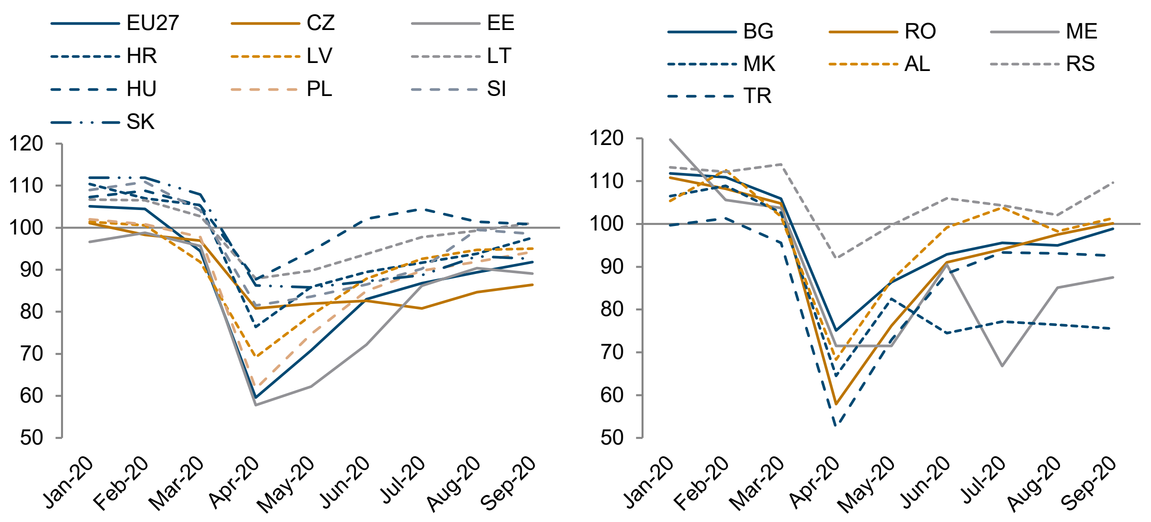
However, in terms of hours worked, the slump in labour demand was about three times greater than the decline in jobs (see Figure 2.9). In all EU-CEE countries, hours worked decreased by between 9% and 17% in the second quarter of 2020, year on year. The sectors domestic trade, transport and the hospitality industry accounted for about a third of the reduction; another third was in industry; and the remainder came in other sectors. This difference between persons and hours worked results from the various government measures aimed at keeping people in employment. Thus, many employees took holidays, used up their accumulated overtime and took advantage of possible exemptions to care for their children.

5 In Kazakhstan, fiscal support measures are financed to a large extent by tapping the sovereign oil fund, which allows any widening of the budget deficit to be kept in check.

The most important measures to prevent stronger job losses were the short-time work schemes. To this end, all EU-CEE countries (except Estonia) will receive support from the EU Commission in the form of loans granted on favourable terms both this year and in 2021. The total amount will range from 0.4% of GDP for Hungary to slightly more than 2% of GDP for Poland and Slovenia. The funds can be used for the creation or extension of STW schemes, and for similar measures targeting the self-employed. In EU-CEE countries the STW allowances paid range from 50% of the original gross wage in Poland to 80% in Slovenia. Various STW schemes have also been introduced in some Western Balkan countries (such as Serbia, Albania, Kosovo, Montenegro and North Macedonia), as well as in Turkey.

Thanks to the widespread support measures, unemployment rates increased only slightly. Rates rose by 1.5 percentage points on average in the CESEE region between February and June 2020, and remained stable in the months thereafter. However, in some countries, workers moved directly from employment into inactivity, which meant that unemployment rose less (Bulgaria and Slovenia) or even declined (Turkey and Serbia). Job search was next to impossible under lockdown conditions, and labour demand collapsed in some sectors. So far, the employment rate of elderly persons has remained stable, while the employment rate of young persons has declined, on average. Their entrance into the labour market became harder (at least for a while), particularly in Slovenia, Turkey, Estonia, Lithuania, Poland and Bulgaria.

Figure 2.10 / Employment expectations indicator (EEI) over the next 3 months



Notes: The EEI summarises managers' employment plans in the four business sectors surveyed (industry, services, retail trade, construction). Figures above 100 indicate an increase in the number of jobs; below 100 – a decline in the number of jobs.
Source: Eurostat database.

However, there may be more job losses in the near future. Managers' short-term expectations for employment improved following the end of lockdown; but in most CESEE countries, businesses still anticipate a decline in jobs over the next three months (see Figure 2.10). Only in Hungary, Lithuania, Bulgaria, Romania and Albania is employment expected to stagnate; while in Serbia, a substantial increase in jobs is anticipated.

In the CESEE region, the unemployment rate is expected to increase less than in the euro area this year and in 2021. This reflects the stronger recession in the euro area and the still rather tight labour markets in many CESEE countries at the time the coronavirus crisis hit. In EU-CEE11, the unemployment rate is likely to remain low, at about 5% on average. The average level of the rate is, at about 13.5%, traditionally higher in the Western Balkan countries and Turkey; however, it is likely to decline again as early as 2021. This is also the case for the CIS countries covered, which feature rates at or below 6%. Only in Ukraine is the annual average unemployment rate expected to peak at 10% this year.

A downside labour market risk is the rising number of bankruptcies in the first half of 2021, which could result in more severe job losses, with a subsequent sharper reduction in disposable incomes. With the expiry of crisis-related income support schemes, particularly the long-term unemployed will be in danger of getting into dire financial straits. In a couple of EU-CEE countries (see Table 2.2), after a spell of unemployment of just seven months, the net income replacement rates for average-income earners decline to well below 50% of the previous wage. And after 13 months, only in the Baltic states, Poland and Slovenia are social benefits likely to be high enough to prevent the unemployed from sliding into poverty.

Table 2.2 / Net replacement rate provided by social benefits, 2019

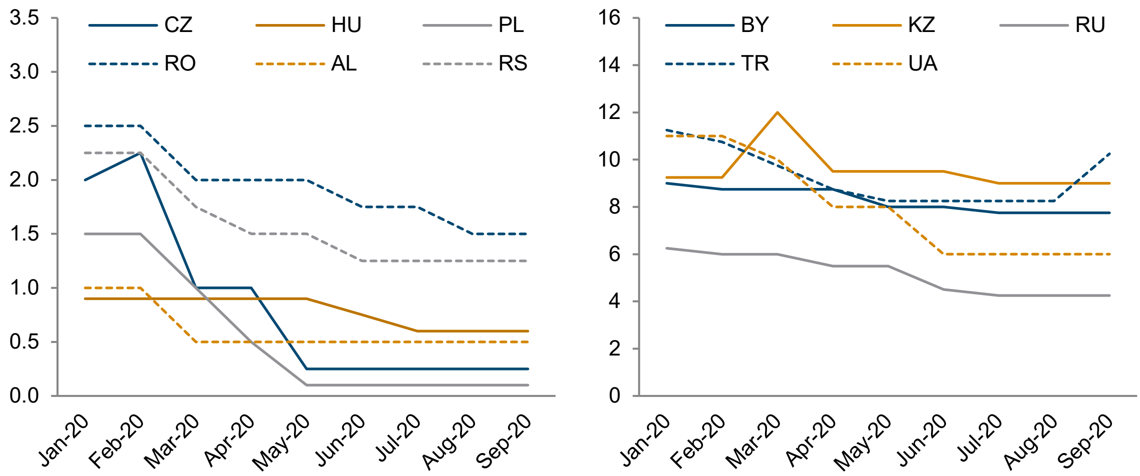
	Unemployment benefits, housing benefits and social assistance Duration of unemployment spell		
	2 months	7 months	13 months
Bulgaria	79	79	25
Estonia	61	57	57
Latvia	76	51	51
Lithuania	85	71	62
Croatia	68	38	38
Poland	71	71	71
Romania	37	26	26
Slovakia	61	32	32
Slovenia	78	78	78
Czech Republic	69	30	30
Hungary	56	16	16
EU27	**69**	**62**	**57**
Austria	**69**	**69**	**64**

Notes: The rate shows the net earnings (covering unemployment, housing benefits and social assistance) of an unemployed person receiving unemployment and other benefits, expressed as a share of the income received previously in the job. The person is the sole earner in a two-adult household with two children, and received the average income of the country concerned. The net replacement rate is shown for unemployment spells of 2, 7 and 13 months.
Source: DG ECFIN - Tax and benefits indicators database, February 2020.

2.5. CURRENCY DEPRECIATION MITIGATES THE IMPACT OF EXTERNAL DEMAND SHOCK

Monetary policy has been relaxed markedly as one of the responses to the crisis… In CESEE countries with a floating exchange rate regime (and which thus retain monetary policy autonomy), policy interest rates have been cut sharply in the wake of the crisis, in some cases to very low levels (Figure 2.11). Unlike the euro area, where the zero-interest-rate bound was reached some time ago, CESEE countries still had enough space for such reductions. Furthermore, the programmes of subsidised credit adopted in many countries reduced the borrowing costs for businesses and households as well. However, in Turkey, where the real interest rate had been deep in negative territory, the central bank changed course sharply in September (in order to avoid a looming balance-of-payments crisis), and our expectation is that the policy rate will rise further, to well above zero in real terms. In the Western Balkans, CIS and Ukraine, rates are already positive – recent cuts notwithstanding (for more on this, see Figure 3.4).

Figure 2.11 / Central bank policy rates, in % per annum



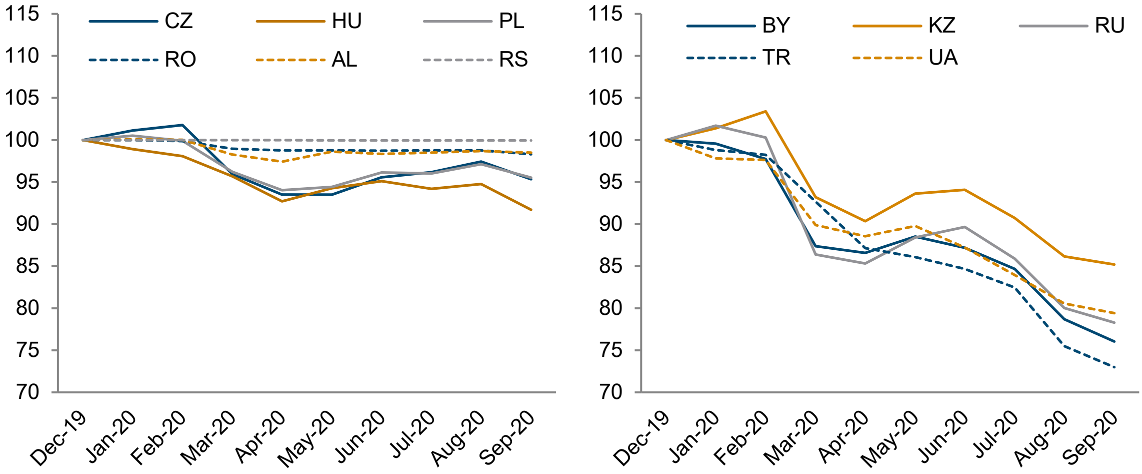
Source: wiiw Monthly Database incorporating national statistics.

… but in the face of great uncertainty, this has not translated into increased credit expansion. In fact, the dynamics of household loans has been decelerating year on year, although loans to non-financial corporations have proved more resilient: only in EU-CEE did their dynamics turn negative by August on an annual basis (Figure 3.4). The major exception to these trends has been Turkey: there, credit to both households and businesses has expanded dramatically since the onset of the crisis, bolstered by aggressive government policies. However, this expansion in Turkey will slow significantly in months to come, due to the recent monetary tightening.

An arguably more effective transmission channel for monetary easing has been the exchange rate... Since the eruption of the crisis, the currencies of many CESEE countries have been generally tending to depreciate (albeit with a brief period of appreciation in May-June). In the CIS and Turkey, the currency depreciations have been particularly pronounced: in Turkey, Belarus and Russia, the domestic currencies have lost between 20% and 30% of their value against the euro since the start of the year. Meanwhile, in the EU-CEE countries depreciations have been more contained and have stayed below 10% (Figure 2.12).

Figure 2.12 / Nominal exchange rates, EUR to national currency, monthly average

index, December 2019=100



Note: Values above 100 indicate appreciation relative to December 2019.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

… helping price competitiveness in EU-CEE and public finances in Russia. By raising the prices of imported goods, currency depreciations have counteracted the deflationary effects of the slump in domestic demand and of lower energy prices, resulting in a modest acceleration of inflation in countries such as Hungary, Poland and the Czech Republic (Overview Table 2.2). However, they have also partly absorbed the external demand shock, helping these countries' external competitiveness. In Russia, where a large share of export revenues is appropriated by the state in the form of energy sector taxes, depreciation has mitigated the increase in the budget deficit, limiting the decline in energy tax receipts in national currency terms.

2.6. RECENT REBOUND STRONG, BUT DARKER CLOUDS ON THE HORIZON

The economic bounce-back was generally strong over the summer months… Retail trade turnover, industry and exports all rebounded strongly from the slump recorded in spring (Figures 2.6 and 2.7). In many CESEE countries, retail trade turnover had reached (or was approaching) pre-crisis levels by August – partly the effect of delayed demand, as households made purchases that had been postponed during the lockdowns. In Estonia, Latvia, Ukraine and Kosovo, retail trade turnover even exceeded the levels recorded a year ago.

… resulting in mostly upward GDP forecast revisions for 2020, compared to those in May. Out of 23 CESEE countries surveyed, 13 have seen their growth forecasts revised upwards, compared to our May forecasts (Table 2.3).[6] By and large, the upward revisions have been either on account of the better-than-expected external environment (such as in Latvia and Lithuania, which have strong economic ties with Scandinavia, a region that suffered relatively little from the pandemic), or due to the greater-than-expected scale of domestic policy response: fiscal in the cases of Slovenia and Serbia, monetary in the case of Turkey. However, for the Visegrád countries (except Slovakia) and the Western Balkans (except Serbia) the growth forecasts have been revised downwards. In the Visegrád countries, the external demand shock in spring proved stronger than initially expected, while in the Western Balkans the economies have suffered from the coronavirus pandemic being generally more dramatic than initially assumed. In general, our forecast revisions – whether upward or downward – have been particularly large this time, compared to previous years – in itself a reflection of the very great uncertainty surrounding economic forecasts at present.

Table 2.3 / Real GDP growth forecasts and revisions

		Forecast, %			Revisions, pp	
		2020	2021	2022	2020	2021
EU-CEE11	BG	-5.1	1.7	2.6	1.2	0.0
	CZ	-6.6	3.9	3.5	-1.8	1.4
	EE	-4.8	3.9	3.0	2.2	-0.1
	HR	-9.4	5.0	4.0	1.6	1.0
	HU	-6.5	3.0	4.6	-1.0	1.0
	LT	-2.0	4.5	3.2	4.5	0.2
	LV	-4.6	4.4	2.8	3.4	-0.1
	PL	-4.4	3.5	3.4	-0.4	0.5
	RO	-5.5	3.7	4.5	1.5	0.7
	SI	-6.7	4.5	3.0	2.8	0.5
	SK	-7.3	4.1	3.9	1.7	-0.5
WB6	AL	-6.4	4.6	4.0	-1.4	0.8
	BA	-5.1	3.2	3.1	-0.1	0.2
	ME	-9.0	5.0	4.1	-1.0	0.0
	MK	-6.0	4.5	4.0	-1.0	0.5
	RS	-2.0	4.5	4.1	2.0	0.5
	XK	-5.1	4.8	4.3	-0.7	0.8
Turkey	TR	-3.5	4.1	4.6	2.5	-1.4
CIS4+UA	BY	-2.5	-1.2	1.3	2.8	-0.5
	KZ	-3.0	2.5	4.0	0.0	0.5
	MD	-7.0	4.0	4.0	-4.0	1.0
	RU	-4.5	2.5	2.1	2.5	1.0
	UA	-5.0	2.0	3.6	1.0	-0.5

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

6 wiiw (2020).

Nevertheless, by September economic activity had generally failed to reach pre-crisis levels… The recovery of private consumption has been hampered by a depressed demand for services, such as transport, accommodation, food services, entertainment and recreation, which were the hardest hit by the pandemic. Although their rebound over the summer was often as strong as that of retail trade, it started from a much lower base. As a result, economic activity in the services sector is still far below pre-crisis levels. The dynamics of industrial production and exports, though initially encouraging, has also been losing pace recently (Figures 2.6 and 2.7).

… and will weaken in the months to come. The prospects for near-term economic recovery in the CESEE countries are bleak. Even prior to the second wave of the coronavirus pandemic, the confidence indicators for both services and industry – despite some improvements during the summer – remained in negative territory (Figures 2.13 and 2.14). The employment expectations indicator (Figure 10) was also pointing downwards, potentially heralding depressed incomes and consumer demand over the next few months. Needless to say, the second wave of the pandemic has made things even worse.

Figure 2.13 / Service confidence indicator, seasonally adjusted

balance of positive over negative survey results

Note: In the services survey, managers are asked for their assessment of the business climate, and the recent evolution in demand, employment and selling prices in their business, as well as past and future changes in their company's turnover and employment. Data for RU not seasonally adjusted.
Source: DG ECFIN Business and Consumer surveys (Eurostat) and the Russian Federal State Statistics Service.

Figure 2.14 / Industry confidence indicator

balance of positive over negative survey results

Note: In the ***industry survey*** the main questions refer to an assessment of recent trends in production, of the current levels of order books and stocks, as well as expectations about production, selling prices and employment.
Source: DG ECFIN Business and Consumer surveys (Eurostat) and OECD for Russia.

The second wave of coronavirus infections in CESEE appears to be stronger than the first…[7]
Countries which did particularly well during the first wave, such as the Czech Republic and Slovakia, are now among the worst affected. Admittedly, the high number of new infections detected is a consequence of increased testing, implying that many more asymptomatic cases are now being uncovered. However, the number of hospitalisations has gone up dramatically as well, putting pressure on the healthcare systems of many CESEE countries. In some countries, such as Russia, Ukraine and Moldova, the healthcare systems can barely cope as it is, with a shortage of vacant hospital beds and a large number of medical personnel infected. Even in the Czech Republic and Slovenia, the situation is reportedly approaching critical.[8]

[7] In reality, the division between the ‘first’ and the ‘second’ waves of coronavirus infections is not always clear cut. While it holds well for the EU-CEE countries and Belarus, in other parts of the CESEE region the dynamics of the pandemic has been more muted. For instance, in most Western Balkan countries, Ukraine and Kazakhstan, the second wave arrived back in summer (prompting renewed lockdowns in some cases). In Russia, it can be argued that the first wave has never really ended, as the number of new infections declined only slowly over the summer months, before starting to rise again in September.

[8] See, for instance, https://www.abc.net.au/news/2020-10-22/20-european-countries-record-highest-daily-covid-infections/12800772

… making renewed lockdowns rather likely in at least some CESEE countries in the weeks to come, which may result in 'double-dip' recessions this year. So far, the restrictions put in place in response to the second wave of the pandemic have been milder than during the first wave. They typically include shorter opening hours for restaurants and bars, caps on the number of people gathering in one place, and in some cases distance learning in schools. However, the example of the Czech Republic, which has reimposed a nearly full lockdown (on 21 October), demonstrates that such a scenario may be repeated in other CESEE countries as well, should the number of new infections surge higher and test the capacities of the healthcare systems to cope. Poland, Slovakia and Slovenia have already introduced partial lockdowns, including among other things the closure of restaurants and bars, while Hungary closed its borders on 1 September in order to contain the spread of the virus. The experience so far suggests that the extent of economic downturn has generally gone hand in hand with the stringency of the measures imposed.[9] In Russia and Kazakhstan, near-term prospects have deteriorated markedly also on account of the renewed oil price decline. All in all, and given the recently reimposed lockdowns in many countries of the euro area – the CESEEs' main export market – it may be hard to avoid 'double-dip' recessions this year (on a quarterly basis).

2.7. NO QUICK RECOVERY IN SIGHT, CORONAVIRUS RISKS LOOMING LARGE

In the baseline scenario, the CESEE economies will return to growth in the coming years... Because of the huge uncertainties associated with the further spread of the coronavirus pandemic and with the progress in finding an effective vaccine/treatment, economic forecasts are currently extremely unsettled. Our baseline scenario assumes that the pandemic will be successfully contained next year without resort to new lengthy lockdowns. Under this benign scenario, the economy of the CESEE region is expected to rebound by 3.1% next year and by 3.3% in 2022 (Overview Table 2.1). A major 'pull' factor will be the recovery in the euro area: by 5.8% and 2.5%, respectively, according to the latest European Commission forecast. However, the bounce-back in CESEE next year will not be as strong as in the euro area, as the starting point is higher (i.e. the slump this year was smaller than in the euro area). Not until 2022 is the convergence of the CESEE region with the EU average expected to resume – and even then, its pace will be slower than in the past. The respective growth differential projected for 2022 is only 0.6 pp, less than the 1-2 pp typically recorded before the coronavirus crisis and the 2-3 pp before the global financial crisis of 2008-2009.

… facilitated in the EU-CEE countries by EU transfers, especially from the newly established Next Generation EU (NGEU) recovery fund. The planned NGEU recovery fund, totalling EUR 750 billion, to be distributed over the period 2021-2023 in the form of grants and loans, is aimed at facilitating economic recovery in EU member states, and at the same time also at fostering structural reforms, especially in such areas as digitalisation and climate change (for details, see Box 2.1). If approved,[10] NGEU disbursements to the EU-CEE countries will be rather large relative to their economies – especially in the cases of Croatia and Bulgaria, where they will average 3.7% and 3.3% of annual GDP, respectively. This is comparable to the size of the transfers that EU-CEE countries have been receiving under the outgoing EU Multiannual Financial Framework (MFF) for 2014-2020 (3-4% of GDP per year

[9] See, for instance, https://think.ing.com/articles/eurozone-hangover-in-the-making-while-the-partys-in-full-swing/

[10] At the time of writing, it is not yet certain whether the NGEU package will be adopted, since it includes conditions pertaining to the 'rule of law', to be met as a prerequisite for the disbursements – something that is opposed by countries such as Hungary and Poland.

on average); these have been an important pillar, especially of public-sector investments in those countries.[11]

BOX 2.1 / NEXT GENERATION EU WILL BOOST ECONOMIC RECOVERY IN THE EU-CEE COUNTRIES

by Philipp Heimberger

Next Generation EU is the core building block of the fiscal policy response to the coronavirus crisis at the EU level. It provides for a total of EUR 750 billion, with EUR 390 billion in grants and EUR 360 billion in repayable loans. The European Commission will issue bonds on behalf of the EU to finance a temporary increase in the EU budget over the period 2021-2023. The grants will be channelled through several EU spending programmes (European Council 2020).

Of central importance is the so-called Recovery and Resilience Facility (RRF), through which EUR 310 billion of the grants are set to flow throughout the EU. The remaining EUR 80 billion in grants will flow through additional EU spending programmes (e.g. the Just Transition Fund). Some 70% of the RRF funds will be distributed in the years 2021 and 2022, and the remaining 30% in 2023. The allocation of grants for the years 2021-2022 has already been fixed: the numbers for each EU member state are based on population size in 2019, the inverse of GDP per capita in 2019, and the average unemployment rate over the period 2015-2019. However, the distribution key for the approximately EUR 94 billion in grants to be distributed in 2023 will change, as the unemployment criterion is to be replaced by the loss of real GDP in 2020 and the cumulative loss in real GDP over 2020-2021. These GDP numbers, however, are not yet known and will only be calculated in June 2022 and fixed thereafter; therefore, the exact allocation of grants through the RRF in 2023 currently remains unknown. Nevertheless, a couple of important observations can be made on the basis of the grants allocation in 2021-2022 and forecasts for what the funds distribution could look like in 2023.

Box Figure 2.1 presents the allocation of RRF grants across EU countries in relation to GDP. It can be seen that Croatia (11.0% of 2019 GDP) and Bulgaria (9.9%) are expected to receive the most grants in relation to the size of their economy over the next three years, while, of the EU-CEE countries, the Czech Republic will benefit the least (3.1% of GDP). On an average annual basis, the RRF grants to EU-CEE countries will thus range from 3.7% of GDP in Croatia to 1% in the Czech Republic.

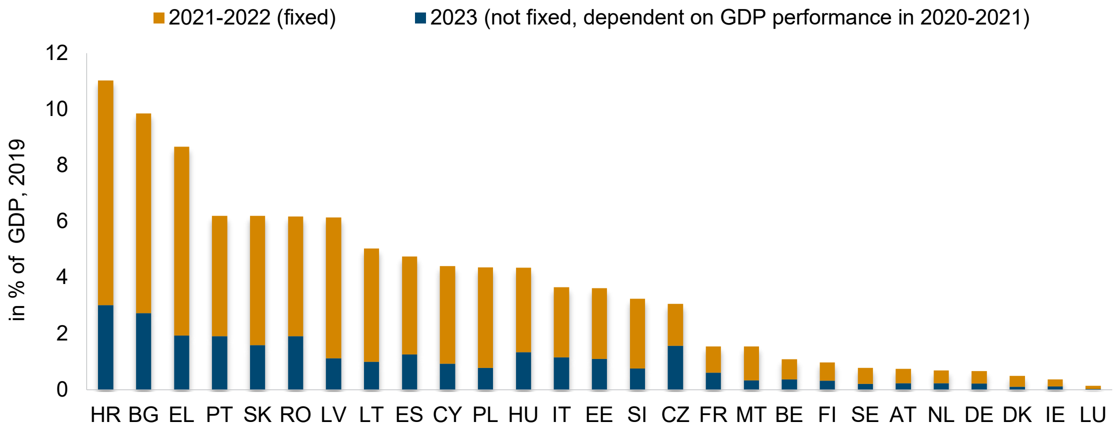
RRF grants will be vitally important for EU-CEE countries when it comes to compensating for the negative impact of the coronavirus pandemic on economic activity. National recovery and resilience plans – which every EU member state will need to submit by the end of April 2021, before RRF grants can flow – must, however, include a minimum of 37% of expenditure on climate. The European Commission encourages member states to speed up the development and use of renewables, to increase the energy and resource efficiency of public and private buildings, and to promote sustainable transport infrastructure (European Commission 2020). Despite these broad suggestions, there remains scope for interpretation about what will count as 'expenditure on climate'. Furthermore, in terms of investment and reforms, it will be important for the spending plans of the individual member states to take into account the European Commission's country-specific recommendations from the European semester.

[11] The next EU MFF for 2021-2027 has also yet to be approved; judging by past experience, funds will not be disbursed before 2023.

The RRF grants allocation data show that EU-CEE countries will receive relatively large direct contributions. There are, however, severe problems with only looking at how much specific countries are set to receive at the national level, as this ignores the coordinated nature and the demand spill-over effects from a simultaneous increase in public spending across all EU countries. In particular, there will be substantial spill-overs from EU-CEE countries to Germany and other euro area countries, due to trade networks and interconnected industrial structures. In the opposite direction, demand spill-overs are likely to be much smaller: the majority of euro area countries (and especially countries in Europe's industrial core, such as Austria, the Netherlands and particularly Germany) will receive a smaller direct boost to their GDP owing to relatively small grants contributions.

By relating the funds dispensed in the home country (in terms of grants) to the overall GDP effects from all Next Generation EU spending, Picek (2020) estimates relatively low domestic grant multipliers for the EU-CEE countries, ranging from a multiplier of 1.8 for Croatia to 3.0 for the Czech Republic. These relatively low multipliers reflect relatively small demand spill-overs from other EU countries. For countries such as Germany (4.1), the Netherlands (5.0) and Austria (6.4), we can expect much higher domestic grant multipliers, due to positive spill-overs from EU-CEE countries and member states (Picek 2020, p. 331).

Box Figure 2.1 / Grants from EU Recovery and Resilience Facility, 2021-2023, as % of GDP



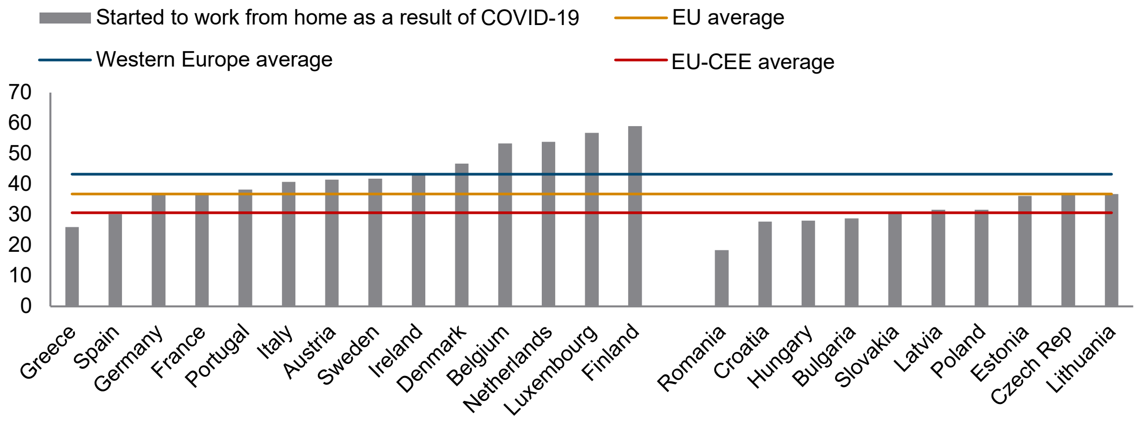
Source: European Commission, own calculations.

However, even in the benign baseline scenario, the pre-crisis levels of real GDP will not be reached next year. For the CESEE region as a whole, economic recovery next year will fall short of this year's recession (Overview Table 2.1). Only in Turkey, Lithuania and Serbia do we expect this to be the other way around, as strong growth momentum will carry over into next year. However, in Turkey large external imbalances make the country particularly vulnerable to any change in global investor sentiment. The economies of Croatia and Montenegro are expected to rebound quite strongly as well (by 5%) in the baseline scenario, as the tourism industry will partially recover the losses incurred this year, although their GDP will fall far short of pre-crisis levels. By contrast, in Russia and Kazakhstan growth in 2021-2022 will barely exceed 2.5%, as oil prices are unlikely to recover substantially and export volumes will still be constrained by the OPEC+ quotas; and in Ukraine, recovery will be similarly muted. Belarus is the only CESEE country which in the baseline scenario will record another year of recession (-1.2%), mainly due to the expected fallout from the current political crisis.

The main risks to our baseline forecast are (i) premature withdrawal of government support and (ii) the further spread of the coronavirus pandemic, which may necessitate renewed lockdowns. The latter will not only have a direct contractionary impact on the CESEE economies, but will also weigh heavily on the demand for durable consumer and investment goods because of the high uncertainties. The economic impact of domestic lockdowns will be clearly amplified, if accompanied by renewed lockdowns in the euro area countries.

Even in the baseline scenario, the coronavirus pandemic is likely to leave lasting legacies in the CESEE region, especially in the form of reduced demand for services. It is conceivable that depressed demand for some types of services, such as transportation, accommodation, food services, entertainment and recreation, may become a ‘new normal’ over the forecast horizon and beyond, even if the coronavirus pandemic is successfully contained. Some other sectors, such as ICT, will probably benefit from the new situation and flourish, but may not offset the shortage of demand for more traditional services. Besides, the shift to digitalisation may be less pronounced in CESEE than, for instance, in Western Europe. Surveys suggest that on average only 31% of the population in EU-CEE have started working from home due to the COVID crisis, and in the remainder of the CESEE region this percentage is likely to be even lower (Figure 2.15). By contrast, in Western Europe 43% of respondents started working from home during the pandemic (although the discrepancy may be partly due to the above-mentioned structural differences, such as the lower share of services in CESEE as compared to Western Europe).

Figure 2.15 / Respondents who started to work at home during the COVID-19 crisis, %



Note: No comparable data for Slovenia.
Source: Eurofound (2020), Living, working and COVID-19 dataset.

Under these conditions, a lot will depend on the continuation of government support measures, which may be especially difficult in the Western Balkans, Moldova and Ukraine due to financing constraints. So far, government support measures have provided a temporary lifeline for many businesses, especially in the services sector. However, as fiscal space dwindles, and as the political willingness to support arguably hopeless businesses eventually subsides,[12] a new wave of bankruptcies and a further surge in unemployment may follow, with repercussions for domestic demand. Fiscal space may become a binding constraint, especially in tourism-dependent countries with high public debt, such as Albania and Montenegro, as well as in countries that are heavily dependent on external support, such as Ukraine, Belarus, Moldova and Bosnia and Herzegovina. Non-EU CESEE countries will benefit from EU transfers much less than EU-CEE, where especially NGEU funds will play an important role next year and beyond. Most importantly, unless the pandemic is brought under control, renewed lockdowns will require an extension of existing – and possibly the reintroduction of new – government support measures to minimise the painful fallout for the economy. Whether this is possible in all CESEE countries is open to question and represents – along with the coronavirus pandemic itself – the main risk to our medium-term forecasts.

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[12] Indeed, active labour market policies aimed at retraining the labour force that has been (or may be) rendered idle in the wake of the pandemic may be the preferred policy option.

3. CESEE monitors

3.1. CONVERGENCE MONITOR: CATCH-UP MOSTLY ON TRACK BEFORE PANDEMIC HIT

by Alexandra Bykova

› In 2019, the convergence process continued in almost all CESEE economies, except Turkey, Russia and Belarus. The Czech Republic reached 76.9% and Slovenia 72.8% of German GDP per capita at Purchasing Power Standards (PPS) by the end of last year (Figure 3.1)[13].

› The speed of convergence was higher in countries of EU-CEE last year, with nine out of eleven economies gaining more than 1 percentage point (pp) against Germany, and Romania gaining even 3.8 pp. Outside of EU-CEE, only Serbia, Montenegro and Kazakhstan achieved more than 1 pp of convergence relative to Germany (Figure 3.1).

› Wages per employee at PPS relative to Germany rose across most of CESEE last year. Only Turkey registered a decline, by 1.6 pp compared with 2018. The biggest increases were registered in Romania (3.9 pp), Hungary (3.4 pp) and Serbia (3.0 pp). Wage convergence was stronger than that of per capita GDP in 17 CESEE countries in 2019, with the largest positive differential in Russia, Ukraine and Serbia.

› Taking the 2000-2019 period as a whole, catch-up with Germany for per capita GDP at PPS was strongest in Lithuania (37 pp), Romania (36 pp) and Estonia (35 pp). For wages at PPS, the strongest convergence with Germany took place in Estonia (32 pp), Russia and Montenegro (both 31 pp).[14]

› Non-EU-CEE economies have particularly low wages per employees at PPS relative to Germany. Within this group, only Montenegro and Bosnia and Herzegovina recorded wages at PPS above 50% of the German level in 2019. By contrast, among EU member states in CESEE only Bulgaria had not yet reached 50% of the German level by the end of last year.

› Large disparities in nominal gross wages per employee persist across CESEE. Euro-denominated gross wages per employee in EU-CEE as a whole were almost double the average level of non-EU CESEE in 2019. For individual countries, the disparities were even greater. Whereas Slovenia recorded gross annual wages per employee of above EUR 21,000, Moldova and Ukraine posted values only slightly higher than EUR 4,000 (Table 3.3).

3.1.1. Methodological note

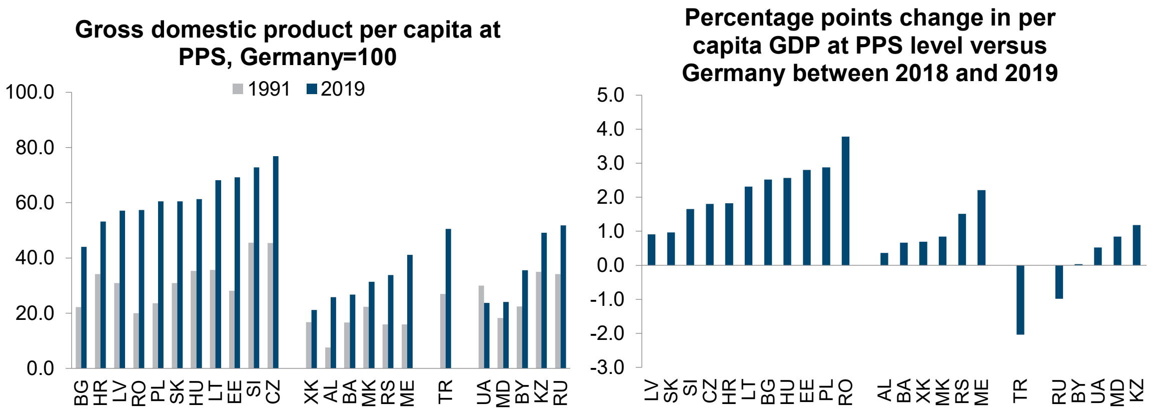
In this report we follow Eurostat in changing the Purchasing Power Standards (PPS) definition for the EU. As the EU now consists of 27 countries, the average purchasing power of one euro in the EU27 is taken as equal to one PPS. According to this new definition, the PPS rate for the EU28 (i.e. including the United Kingdom) was equal to 1.02129 in 2019. This impacts our data in Table 3.1 for both per capita

[13] Please see a methodological note, explaining changes in calculations of GDP per capita and wages at PPS, below.

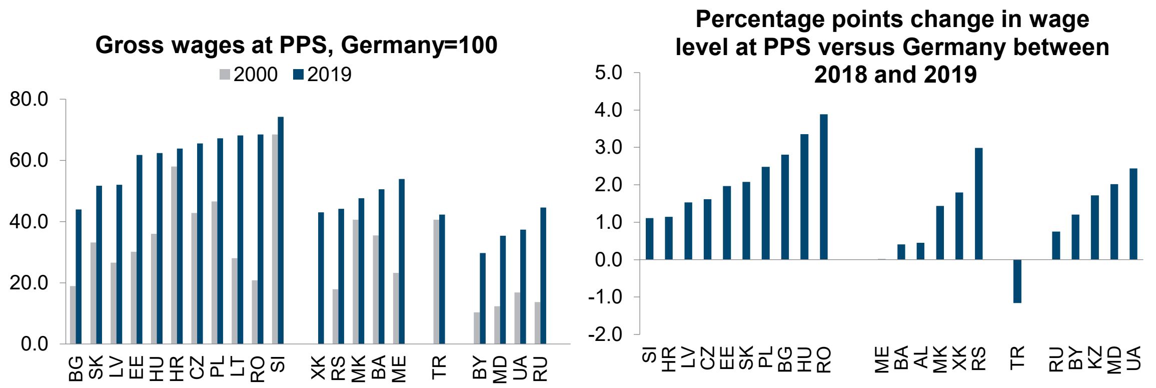
[14] It should also be noted that data for Romania and Lithuania are not taken into account as they are not directly comparable as both countries now include in this indicator employers' social security contributions.

GDP and wages, both of which we adjust for PPS to remove differences in purchasing power. For comparison we publish Table 3.2 with data based on PPS=1 for the pre-Brexit EU (EU28) which shows that the new approach reduced all values of indicators in Table 1 comparing to Table 2 by 2.1%.

Figure 3.1 / GDP per capita at PPS convergence against Germany



Note: Data 1990 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. In 2019 Lithuanian and Romanian wages include employers' social security contributions. Turkey wages: data 2000 refer to 2003; wiiw estimate for 2019.
Source: wiiw Annual Database incorporating national statistics and Eurostat.

Table 3.1 / CESEE GDP per capita and gross wages per employee at PPS (EU27), 2019

	BG	CZ	EE	HR	HU	LT	LV	PL	RO	SI	SK	EU-CEE11
GDP per capita	16,600	29,000	26,100	20,080	23,110	25,720	21,560	22,810	21,620	27,440	22,820	22,920
Gross wages	14,779	22,034	20,767	21,469	20,977	22,908	17,481	22,590	23,009	24,926	17,374	21,505

	AL	BA	BY	KZ	MD	ME	MK	RS	RU	TR	UA	XK	non-EU12
GDP per capita	9,710	10,080	13,390	18,540	9,080	15,530	11,830	12,730	19,540	19,040	8,940	7,980	17,230
Gross wages	10,378	17,002	12,546	11,064	9,983	18,105	16,015	14,852	14,969	14,193	11,902	14,470	14,051

Note: Gross wages are based on administrative data. Lithuanian and Romanian 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 PPS (EU28), 2019

	BG	CZ	EE	HR	HU	LT	LV	PL	RO	SI	SK	EU-CEE11
GDP per capita	16,960	29,620	26,660	20,500	23,600	26,270	22,020	23,300	22,080	28,020	23,310	23,410
Gross wages	15,094	22,503	21,209	21,926	21,424	23,396	17,853	23,071	23,499	25,457	17,744	21,963

	AL	BA	BY	KZ	MD	ME	MK	RS	RU	TR	UA	XK	non-EU12
GDP per capita	9,920	10,290	13,680	18,930	9,280	15,870	12,080	13,010	19,960	19,440	9,130	8,150	17,600
Gross wages	10,599	17,364	12,813	11,299	10,196	18,491	16,356	15,168	15,288	14,495	12,155	14,778	14,350

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

Table 3.3 / CESEE GDP per capita and gross wages per employee EUR at ER, 2019

	BG	CZ	EE	HR	HU	LT	LV	PL	RO	SI	SK	EU-CEE11
GDP per capita	8,780	20,990	21,220	13,260	14,950	17,460	15,920	13,870	11,530	23,170	17,210	14,500
Gross wages	7,814	15,946	16,884	14,181	13,569	15,554	12,912	13,733	12,272	21,046	13,104	13,504

	AL	BA	BY	KZ	MD	ME	MK	RS	RU	TR	UA	XK	non-EU12
GDP per capita	4,780	5,170	5,990	8,760	4,010	7,960	5,400	6,620	10,340	8,230	3,270	3,970	8,300
Gross wages	5,110	8,720	5,608	5,232	4,412	9,276	7,306	7,719	7,922	6,134	4,351	7,200	6,821

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

3.2. BUSINESS CYCLE MONITOR: WIDENING OF BUDGET DEFICITS CUSHIONS ECONOMIC DOWNTURN

by Alexandra Bykova

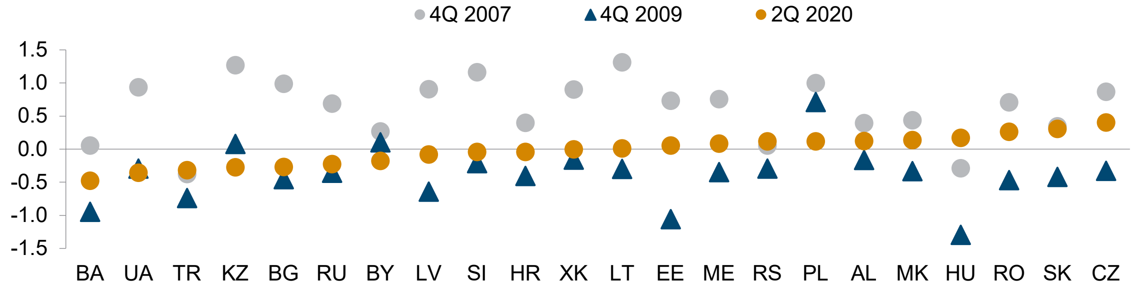
› Our headline business cycle index for the whole CESEE region remained slightly negative at -0.02 in Q2 2020 (representing a four-quarter trailing average). Due to a substantial contraction in most economies in the second quarter of the year, the index shows clearly visible 'underheating' for GDP. More countries than in our previous update in spring post high negative deviations relative to historical averages for the current account (smaller deficits in many cases) and CPI inflation. Overheating in CESEE labour markets has diminished (see Table 3.4). The Czech Republic, Slovakia and Romania achieved the highest scores for the headline business cycle index in Q2 2020, while Bosnia and Herzegovina and Ukraine slipped to the bottom of the ranking behind Turkey.

› Despite the negative economic fallout from the Covid-19 pandemic, the latest headline index values for most countries are still more positive than at the end of 2009, a reference point encompassing the most acute phase of the global financial crisis for CESEE. As of Q2 2020, only Poland, Kazakhstan and Belarus have headline index values that are lower than in 2009. We observe the biggest positive differences comparing to 4Q 2009 for Hungary, Estonia and Czech Republic (see Figure 3.2).

› The domestic finance sub-component of the Business Cycle Index was positive for 14 countries in CESEE in Q2 2020, reflecting among other things a strongly counter-cyclical fiscal response to the downturn across large parts of the region. Fiscal deficits are above long-term averages in many countries, as governments roll out anti-crisis fiscal packages. The underheating observed for many countries for this indicator in our last update in spring has switched in some cases to overheating, with the swing especially strong in Serbia, Belarus and Poland. Based on a four-quarter trailing average, Montenegro, Romania, and Serbia have the largest budget deficits in the region. Regarding real GDP growth, Serbia, Lithuania and Kazakhstan record the most positive values on average over last four quarters, while Slovakia, Slovenia and Montenegro are the worst performers among CESEE countries according to this measure (see Table 3.4 and Table 3.5).

› By contrast, we observe negative values for 16 countries on the domestic economy sub-component, and for 12 countries on the external finance sub-component of the Business Cycle Index. For the domestic economy sub-index, underheating continues in particular in Turkey, reflecting negative trends for both real GDP and unemployment rate. Underheating within external finance is visible in Bosnia and Herzegovina thanks to smaller current account deficits and real exchange rate depreciation, and also in Poland due to larger current account surplus. Meanwhile, Albania is the only country with persistent overheating for the external finance sub-index, due to the appreciation of the real exchange rate (see Figure 3.3 and Table 3.4).

Figure 3.2 / Business Cycle Index



Note: Number of standard deviations from historical mean, average of 11 indicators. Indicators are those in Table 3.4.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

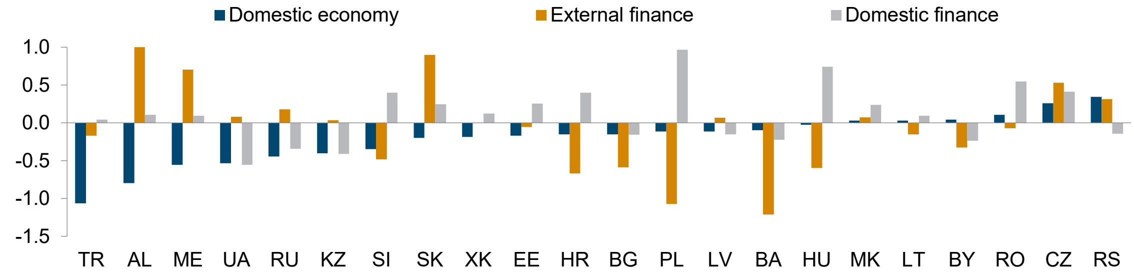
Table 3.4 / Number of standard deviations from historical mean, 2Q 2020

	Domestic economy			External finance			Domestic finance				
	Real GDP	Unemployment	CPI	CA	RER	External debt	RIR	Private credit	Broad money	Fiscal balance	Property prices
BG	-1.38	1.38	-0.46	-1.06	0.56	-1.26	0.03	-0.37	-0.63	0.16	0.01
CZ	-1.85	1.94	0.69	-0.84	0.99	1.44	1.06	-0.55	0.25	0.24	1.04
EE	-0.56	1.10	-1.05	-1.21	1.30	-0.26	-0.15	-0.44	-0.11	1.99	-0.02
HR	-1.38	1.95	-1.03	-1.42	-0.39	-0.19	0.50	-0.13	-0.21	-0.07	1.91
HU	-1.19	1.44	-0.32	-0.30	-0.85	-0.64	1.97	0.88	0.32	0.25	0.29
LT	-0.54	0.87	-0.23	-1.87	1.23	0.18	0.59	-0.50	0.09	0.09	0.19
LV	-0.89	1.11	-0.55	-0.87	0.93	0.14	0.23	-0.46	-0.52	-0.18	0.17
PL	-2.15	1.49	0.33	-2.70	-0.72	0.21	1.72	-0.66	0.65	1.11	2.03
RO	-1.14	1.99	-0.53	-0.21	0.03	-0.03	1.01	-0.48	-0.59	1.77	1.03
SI	-1.60	1.33	-0.76	-1.49	-0.23	0.27	0.63	-0.14	0.25	0.56	0.70
SK	-2.23	1.80	-0.16	-0.29	0.82	2.17	1.27	-0.65	0.18	-0.13	0.56
AL	-3.00	1.61	-1.00	-0.21	2.39	0.98	1.40	-0.48	-0.50	0.01	
BA	-1.63	2.26	-0.91	-1.34	-2.00	-0.29	-0.24	-0.54	-0.45	0.33	
ME	-1.98	1.11	-0.79	0.01	0.65	1.46	0.05	-0.39	-0.73	1.43	
MK	-1.54	2.37	-0.74	-0.20	-1.06	1.48	0.68	-0.65	-0.45	1.51	0.10
RS	-0.37	1.99	-0.59	-0.15	0.89	0.19	-0.12	-0.37	-0.55	1.84	-1.51
XK	-2.01	1.60	-0.15	-1.28	0.59	0.68	1.12	-0.58	-0.30	0.26	
TR	-1.03	-1.90	-0.27	-0.72	-1.92	2.13	0.62	-1.01	0.21	-0.02	0.41
BY	-1.10	1.88	-0.66	-0.70	-1.06	0.78	-0.40	-0.90	-0.74	1.09	
KZ	-1.36	0.93	-0.77	0.22	-1.05	0.93	-1.62	-0.43	-0.90	1.31	
RU	-1.11	1.16	-1.38	1.00	0.07	-0.54	-0.33	-0.74	-1.04	0.74	-0.35
UA	-0.70	-0.12	-0.78	-0.43	0.17	0.49	-1.11	-1.01	-0.52	0.41	

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 2019. Calculations are based on four-quarter trailing averages.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

Figure 3.3 / Sub-components of the Business Cycle Index, 2Q 2020



Note: Number of standard deviations from historical mean, average of indicators in each sub-component. Indicators are those in Table 3.4.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

Table 3.5 / Over-/under-heating in relation to regional peers, 2Q 2020 (4-q trailing average)

	Domestic economy			External finance			Domestic finance				
	Real GDP	Unemployment	CPI	CA	RER	External debt	RIR	Private credit	Broad money	Fiscal balance	Property prices
	%	%	% yoy	% of GDP	2015 = 100	% of GDP	%	% yoy	% yoy	% of GDP	% yoy
BG	-0.1	4.6	2.2	3.6	100.0	57.8	-2.1	6.4	8.9	-0.3	4.9
CZ	-1.9	2.1	3.1	0.2	108.7	78.2	-1.8	5.6	8.0	-3.1	8.5
EE	1.0	5.0	1.0	3.7	104.3	80.3	-0.9	3.6	11.8	-3.1	8.0
HR	-2.3	6.6	0.6	1.8	99.2	81.1	2.4	3.9	7.7	-3.6	8.9
HU	-0.6	3.8	3.4	-1.1	96.4	77.2	-2.4	14.6	10.5	-5.0	7.2
LT	1.6	7.1	1.9	6.3	104.1	68.2	-1.8	2.5	13.2	-2.6	6.5
LV	-1.6	7.0	1.5	1.1	102.7	119.5	-1.5	-1.8	7.8	-1.6	8.0
PL	0.4	3.1	3.1	2.4	96.6	59.0	-2.0	4.9	11.9	-5.8	10.2
RO	0.0	4.4	3.2	-4.5	96.0	49.7	-1.0	6.1	11.8	-7.4	5.8
SI	-2.6	4.7	1.0	6.1	99.3	97.5	-1.0	3.3	8.6	-5.1	5.5
SK	-3.0	6.0	2.8	-3.1	101.5	117.9	-2.7	6.7	8.2	-3.7	11.3
AL	-2.1	11.5	1.6	-8.7	115.6	63.5	-0.8	6.8	5.6	-4.2	
BA	-0.5	15.7	-0.2	-2.9	95.1	24.3	0.2	4.1	8.2	-0.7	
ME	-2.4	15.7	0.1	-20.8	99.2	60.2	5.6	6.1	-1.8	-8.4	
MK	-1.4	16.7	0.4	-3.3	97.8	77.6	1.6	6.0	9.7	-5.1	2.4
RS	2.4	9.1	1.4	-6.4	105.6	63.3	0.6	11.0	12.6	-6.6	-8.4
XK	0.1	25.1	1.4	-5.1	99.9	31.8	4.9	9.0	11.5	-0.7	
TR	0.5	13.5	11.9	-2.0	71.5	60.9	-0.3	12.7	27.3	-3.0	11.7
BY	-0.1	4.1	5.1	-2.3	91.7	60.3	3.5	15.8	16.3	-1.1	
KZ	1.5	4.9	5.9	-1.7	72.8	91.8	3.8	8.6	9.5	-3.0	
RU	-0.7	4.9	3.4	2.6	104.3	30.8	2.5	8.8	9.8	-1.4	7.2
UA	-1.8	8.6	4.6	1.7	128.4	82.7	6.6	-6.3	15.8	-2.5	

potential overheating/instability relative to regional peers — underheating/stability relative to regional peers

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.
For all indicators higher values indicate overheating, except unemployment, current account, real interest rate, and fiscal balance.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

3.3. CREDIT MONITOR

by Olga Pindyuk

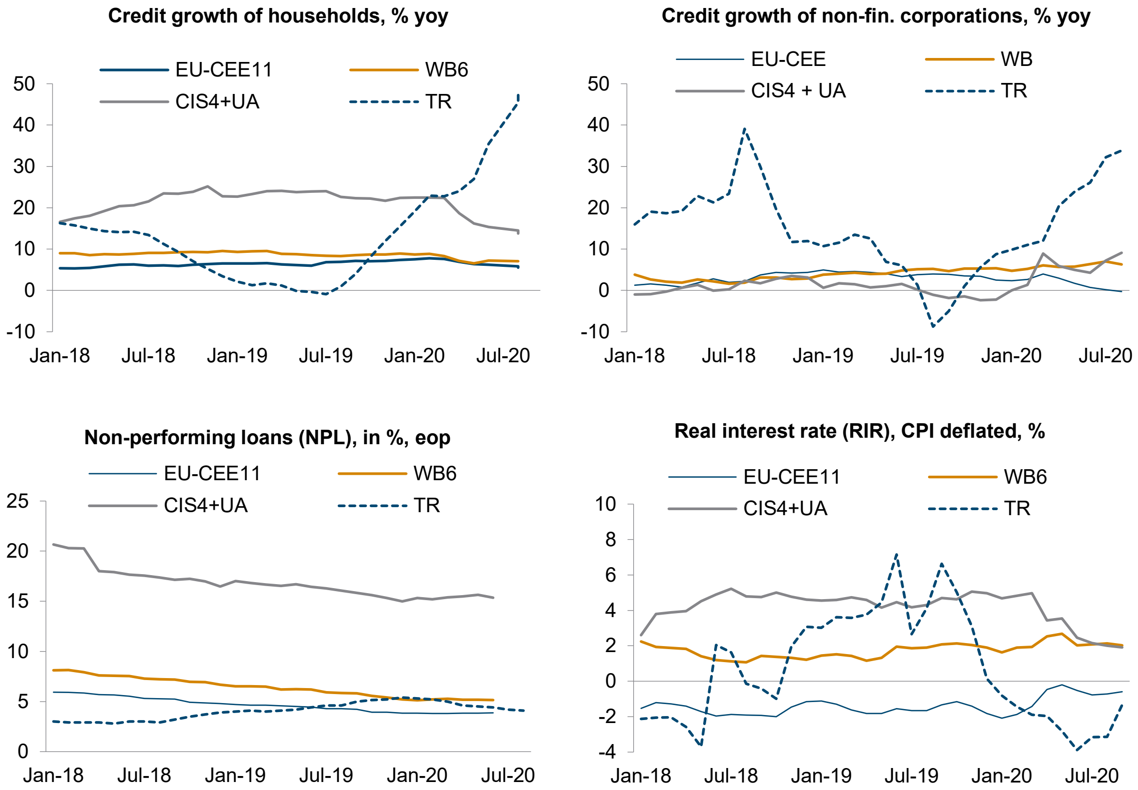
Table 3.6 / Indicators of financial sector developments, September 2020 or last available data

	AL	BA	BG	BY	CZ	EE	HR	HU	KZ	LT	LV	MD	ME	MK	PL	RO	RS	RU	SI	SK	TR	UA	XK
Loans to non-fin.corp., % yoy	5.1	-1.4	2.0	30.2	2.1	-1.5	5.0	10.6	2.0	-11.5	-9.0	3.7	8.4	5.2	-3.7	2.8	14.4	12.3	-2.5	4.6	33.8	-3.0	7.7
Loans to households, % yoy	5.6	1.1	7.5	18.7	6.2	4.6	4.2	16.3	12.9	6.8	-0.5	19.7	5.8	9.5	2.6	5.4	14.3	13.6	1.4	6.6	48.3	4.4	7.6
Real interest rate, CPI defl., %	-1.0	1.6	-0.6	1.6	-3.0	1.3	3.4	-2.8	2.0	-0.6	0.4	0.3	5.8	-0.4	-3.6	-0.5	-0.6	0.5	0.8	-1.4	-1.3	3.6	6.9
Non-perf. loans (NPL), in %, eop	8.1	6.7	8.1	5.1	2.4	0.5	5.5	4.0	8.7	1.7	3.7	8.9	5.3	3.4	7.0	4.3	3.7	5.7	2.6	2.6	4.1	48.1	2.6

potential overheating/instability relative to regional peers — underheating/stability relative to regional peers

Note: The deeper the orange shading, the greater the potential instability/overheating relative to regional peers; the deeper the grey shading, the greater the stability/under-heating.
Source: wiiw Monthly Database incorporating national statistics.

Figure 3.4 / Indicators of financial sector developments over time



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

3.4. FDI MONITOR

by Olga Pindyuk

Table 3.7 / FDI inflow

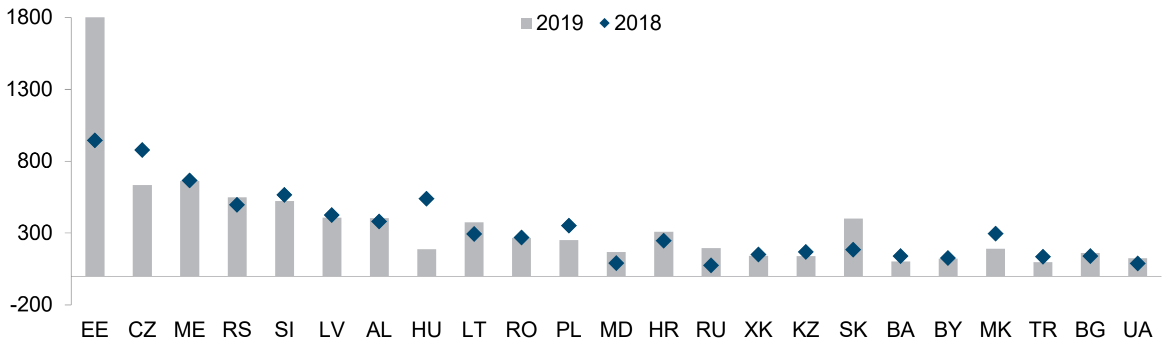
EUR mn

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
EU-CEE11	23,577	25,527	30,101	13,471	26,489	25,275	35,944	36,222	40,481	33,734
WB6	3,473	5,675	2,806	3,577	3,487	4,450	4,198	4,933	6,343	6,388
TR	6,861	11,576	10,341	10,212	10,039	17,362	12,584	9,825	11,027	8,087
CIS3+UA	14,790	18,250	18,210	13,024	8,374	4,980	12,333	8,673	8,300	9,432
RU	23,875	26,476	23,483	40,196	22,037	10,664	33,568	22,990	11,222	28,638
CESEE23	72,575	87,504	84,942	80,480	70,427	62,731	98,627	82,642	77,373	86,279

Note: Data are based on Direct Investment Statistics (directional principle), excluding Special Purpose Entities (SPEs). For Hungary also excluding capital in transit and restructuring of asset portfolios.
Source: wiiw FDI Database incorporating national bank statistics.

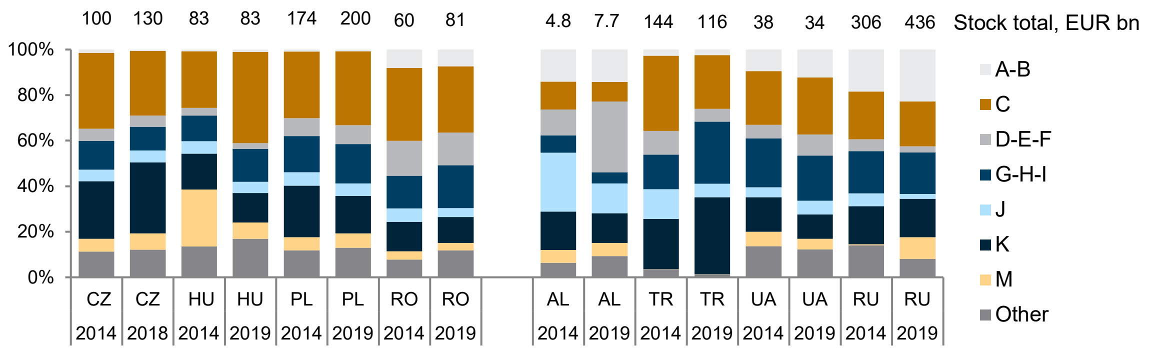
Figure 3.5 / FDI inflow per capita, 2018 and 2019

EUR mn



Note: Data are based on Direct Investment Statistics (directional principle), excluding Special Purpose Entities (SPEs). For Hungary also excluding capital in transit and restructuring of asset portfolios.
Source: wiiw FDI Database incorporating national bank statistics.

Figure 3.6 / Inward FDI stock by economic activities 2014 and 2019



Note: NACE Rev. 2: A-B Agriculture+Mining, C Manufacturing, D-E-F Electricity+Water+Construction, G-H-I Trade+Transport+Accommodation, J Info-communication, K Finance, M Professional activities.
Source: wiiw FDI Database incorporating national bank statistics.

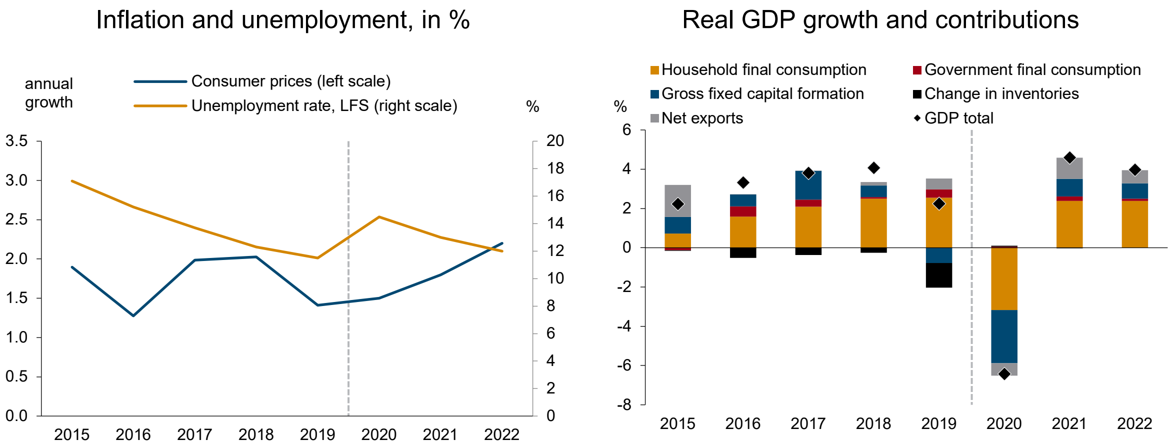
4. Country reports

ALBANIA: Light at the end of the tunnel, but still far off

ISILDA MARA

The economy is expected to contract by 6.4% in 2020. Recovery is unlikely to be just around the corner, given the current pandemic. The public debt is in danger of becoming unsustainable and public finances have little room for manoeuvre. In the medium term, the prospects for FDI inflows look positive. Assuming that the pandemic does not trigger a second lockdown, we expect the economy to resume growing at over 4%, backed by an upsurge in external demand and a rebound of private consumption in 2021.

Figure 4.1 / Albania: Main macroeconomic indicators



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

The economic contraction has been greater than expected. The consequences for the economy of the double whammy of the November 2019 earthquake and the lockdown in March-June 2020 have been more severe than anticipated. For three quarters in a row – Q4 2019, Q1 and Q2 2020 – the economy contracted, by 0.1%, 2.5% and 10.3% y-o-y. In particular, in the second quarter of 2020, the stringent measures applied during the COVID-19 lockdown led to private consumption declining by 7%, investments by 11% and real net exports by 3% (exports of goods and services shrank by 49%, while imports of goods and services fell by 36%). In terms of production, activity fell in all sectors, except for agriculture and real estate activities, whose positive contributions to GDP growth were 0.7 and 0.3 percentage points (pp) in Q2 2020, year-on-year. The negative supply shock to the economy came mainly through trade, transport and accommodation services (4.1 pp) and manufacturing (1.5 pp) – a reflection of how acutely the restrictions on mobility hit tourism and export-oriented businesses.

The lockdown triggered from mid-March 2020 was able to contain the coronavirus pandemic for only a while. The effects of the pandemic witnessed in Italy in February and early March 2020 were a wake-up call for the Albanian government, which responded immediately with a lockdown. However, the gradual reopening of the economy towards the end of April, the start of the tourist season on 1 June and a further relaxation of the restrictions led to a rapid rise in infections over the summer months. Accordingly, some measures (such as the wearing of masks in enclosed areas) were reinstated and a number of activities – especially recreation, arts and entertainment activities – were again shut down. In October, the daily number of new infections is double the figure for July. Still, infections have not risen exponentially and the death toll has remained flat throughout the pandemic, fluctuating at between two and four lives lost each day since June 2020. As of 15 October, masks are compulsory in all public areas, both indoor and outdoor.

Public finances have come under strain. Revenue declined by 12% in January-August 2020, y-o-y, partly as a result of the various tax deferrals offered during the pandemic. The anti-COVID-19 financial packages are estimated to be worth close to 3% of GDP. A number of fiscal measures were introduced to help stimulate economic activity and support businesses. The submission of annual financial statements was postponed (until the end of July) and a moratorium was offered on loan repayments (until the end of May). Tax payment deferrals until 2021 were granted to a number of companies in the garment industry, call centres, tourism and small businesses – sectors that are vital for employment, but were hindered by the lockdown. Also, the government offered EUR 88 million as a 'sovereign guarantee fund' for large companies, so that they could get bank loans to pay their employees' salaries, and another EUR 132 million as collateral to support companies to secure investment loans from banks. At the same time, many infrastructure projects have been facing delays due to budgetary shifts. All in all, the public deficit is estimated at 5% of GDP for the first eight months of 2020, and the public debt to GDP ratio is expected to exceed 80% by the end of 2020.

The lockdown threw the job creation successes of 2018 and 2019 into reverse. In Q2 2020, employment fell back to 2017 levels, dropping by 48,000 compared to Q4 2019 – a fall of 4.1% of total employment. Given the high level of informality, the actual number of jobs lost is probably much higher. The restrictions on mobility meant that inactivity rose even more than unemployment. Job destruction affected particularly the private sector: 61% of jobs lost were in that sector; a further 36% were in agriculture; and the rest involved the public sector. Also, the lockdown had repercussions for those Albanians who usually work seasonally in Greece or other EU countries.

The support measures to tackle job retention and earnings during the pandemic have helped, but they are not sufficient. The government approved two COVID-19 packages to assist employment. The first allotted EUR 52 million to pay the salaries (equivalent to the minimum wage of LEK 26,000 (EUR 210)) of workers in small businesses for three months. Further measures within this package included doubling unemployment and social assistance benefits for April-June 2020. The second COVID-19 financial package in support of job retention and earnings – EUR 57 million – offered a one-off payment of LEK 40,000 (EUR 322) to 176,000 employees, distributed among workers in big companies (37%), small businesses (57%) and tourism (6%). Another EUR 50 million was allocated from the European Union in support of business recovery. Given the structure of the Albanian economy and the high dependence of employment on export-oriented firms, job creation is much slower than job destruction. Therefore, the recovery in employment will depend on how quickly these businesses can crank up their activity.

Private consumption contracted sharply and will pick up again only in 2021. Remittances – a vital income source – dropped by 19% in the first half of 2020, y-o-y. No rapid rebound is to be expected: the economies of the main sending countries – e.g. Italy and Greece – have been badly hit by the pandemic. High-frequency indicators suggest that consumption will remain depressed throughout the second half of 2020. The prognosis is better for 2021, assuming that the pandemic does not trigger a second lockdown. Expectations are rising on account of certain moves by the government, which in September 2020 launched a number of new schemes to promote employment and assist with the reintegration into work of those who lost their jobs during the pandemic. The government will fund 100% of the minimum wage and the mandatory social security contributions for a period of 4-12 months. In support of earnings, the government has proposed to raise the minimum wage by 15% (to LEK 30,000, equivalent to EUR 242 a month) – a move that will affect 26% of employees from 1 January 2021. A pay rise of 40% for health professionals and 15% for education staff has been proposed from 1 January 2021. Given the big exodus of medical staff over the past decade, such a wage hike could help to halt the brain drain for this category of workers.

External sector demand contracted sharply, but in the medium term the signals are mixed. High-frequency data indicate a big drop in exports and in goods imports during the lockdown, although these picked up again rapidly with the relaxation of the restrictions: in March and April exports declined (from month to month) by 29% and 16%, respectively, and imports fell by 14% and 18%; but in May, exports rose by 47% month to month, and imports similarly increased by 23%. Overall, from January to August, merchandise exports contracted by 15.4% and imports by 12.3%. Exceptionally, food exports remained positive, rising by 8% to attain an export share of 15%. The pandemic changed the configuration of trading partners, with exports to Germany, Serbia and Turkey growing fastest. Looking ahead, goods exports (largely textile products and mainly in partnership with Italian businesses) are likely to remain depressed this year, but will very likely recover next year, given that the Italian economy is expected to contract by 14% in 2020, but then to see growth bounce back to 5% in 2021.

The prospects for FDI inflows look positive in the medium term. FDI inflows dropped by 17% in the first half of 2020 (y-o-y), mainly because large-scale investment projects such as the Trans Adriatic Pipeline and the Moglice hydropower plant on the river Devoll have already been completed. The latter project was the second hydropower station to be constructed in Albania by the Norwegian company Statkraft (following the plant at Banja). Moglice Hydropower started its operations in June 2020. It has an annual capacity of 450 GWh, and jointly with Banja will increase electricity production by 13%. In the short to medium term, two FDI projects are on the cards. The first is a solar power plant in Karavasta, in the western part of the country, close to the Adriatic. This will be an investment by the French company Voltalia and will be worth EUR 100 million. It will have a capacity of 140 MW and construction will begin by the end of 2020. The second infrastructure project is the Skavica hydropower station, to be built on the river Drin, in northeast Albania, following a deal signed with the American company Bechtel. The estimated investment will be between EUR 300 million and EUR 500 million. The Skavica hydropower plant will have a capacity of 210 MW. Certainly, such investments will provide a positive impetus to growth and will make the energy sector more resilient to droughts which have become more frequent in Albania given the global warming.

Demand for services – and especially tourism – has fallen sharply. Demand for services and tourism contracted by 35% and 52%, respectively, in the first half of 2020. The number of foreign and domestic tourists fell by 64% in January-August 2020, y-o-y. Tourists from the neighbouring countries –

especially Kosovo - but also Ukraine and Belarus provided some respite for the sector. However, the recovery has been fairly feeble, and now the summer season – which sees the highest number of tourists, and also Albanian migrants returning for their summer vacation – is over. With the ongoing pandemic, a ban on travel to Albania imposed by a number of EU countries and closed EU borders, the outlook for tourism remains bleak, particularly as the restrictions will continue to affect the sector throughout the second half of 2020, and most likely also at the start of 2021.

The banking sector remains stable and supportive to the economy. Non-performing loans dropped to 8% in Q1 2020, and remained at this level during the pandemic. The demand for credit recovered during the first quarter of the year in the wake of the earthquake; it then received a setback during the lockdown and only started to recover again later. The demand for loans was mainly driven by non-financial corporations – at 6% in January-July 2020. The central bank has kept the interest rate at 0.5%, and it will probably stay at that level until 2022. During the lockdown, the domestic currency depreciated by 7% against the euro, but since May 2020 it has been relatively stable. Inflation has fluctuated quite a lot, jumping from 1.2% to 2.1% between March and April, falling back to 1.3% over the summer, before rising slightly to 1.5% in September. It is mainly (imported) food products – especially fruit – that have driven the price instability, although the earthquake has also had an impact on rents.

The EU integration process is slowly moving in the right direction. In October 2020, the European Commission confirmed the commitment of the Albanian government to pursue the necessary reforms, despite the pandemic and the devastating earthquake of November 2019. The European Commission affirmed that the first inter-governmental meeting with the EU member states should take place by the end of 2020, under the German EU presidency.

Uncertainty looms and the economic recovery will be long in coming. The consequences for the economy of the double whammy (the earthquake and the lockdown) have been graver than expected, and we have revised downwards our forecast for 2020, from -5% to -6.4%. The lockdown wiped out the gains in the export of goods and services achieved over the past decade, and this year’s figures are expected to be back at 2011 levels. The current account deficit will widen to 10% in 2020, mainly because of the major contraction of services exports and a fall in FDI and remittances inflows. In the medium term, we expect economic activity to grow at above 4%, assuming a second lockdown can be avoided. In 2021, depending on how rapidly economic activity and tourism grow, external demand could regain its momentum. Large infrastructure projects in the energy sector are expected to provide a positive impetus to growth in 2021-2022. Consumption is expected to resume its growth in 2021, assuming that the employment situation improves as a result of the job-promotion and retention programmes launched by the government.

Table 4.1 / Albania: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average	2,873	2,866	2,854	.	.	.	2,846	2,844	2,840
Gross domestic product, ALL bn, nom.	1,551	1,636	1,678	373	387	761	1,600	1,700	1,800
annual change in % (real)	3.8	4.1	2.2	-2.3	-10.2	-6.6	-6.4	4.6	4.0
GDP/capita (EUR at PPP)	8,940	9,440	9,710	.	.	.	.	.	.
Consumption of households, ALL bn, nom.	1,224	1,277	1,333	323	342	665	.	.	.
annual change in % (real)	2.6	3.2	3.3	1.4	-7.6	-3.5	-4.0	3.0	3.0
Gross fixed capital form., ALL bn, nom.	381	391	378	66	87	152	.	.	.
annual change in % (real)	6.0	2.4	-3.3	-15.7	-11.1	-13.2	-12.0	4.0	3.5
Gross industrial production									
annual change in % (real)	-0.6	18.5	-1.1	-0.1	-22.0	-11.8	-12.0	4.0	1.0
Gross agricultural production 2)									
annual change in % (real)	0.9	1.9	5.0	.	.	.	.	.	.
Construction output total									
annual change in % (real)	19.6	5.6	-2.5	-9.7	2.0	-3.4	.	.	.
Employed persons, LFS, th	1,195	1,231	1,266	1,258	1,225	1,241	1,225	1,250	1,280
annual change in %	3.3	3.0	2.8	1.1	-3.6	-1.2	-3.2	2.0	2.4
Unemployed persons, LFS, th	190	173	165	162	166	164	210	190	170
Unemployment rate, LFS, in %	13.7	12.3	11.5	11.4	11.9	11.7	14.5	13.0	12.0
Reg. unemployment rate, in %, eop	7.2	5.4	5.8	5.6	7.1	7.1	.	.	.
Average monthly gross wages, ALL	48,967	50,589	52,380	53,232	54,149	53,691	54,200	56,800	59,500
annual change in % (real, gross)	1.0	1.3	2.1	1.7	0.9	1.3	2.0	3.0	2.5
Consumer prices, % p.a.	2.0	2.0	1.4	1.6	1.9	1.8	1.5	1.8	2.2
Producer prices in industry, % p.a.	2.6	1.7	-0.8	-2.1	-4.1	-3.1	-3.0	1.0	0.4
General governm.budget, nat.def., % of GDP									
Revenues	27.8	27.5	27.4	27.9	23.5	25.7	25.0	28.0	28.0
Expenditures	29.8	29.1	29.3	28.6	32.7	30.7	32.0	30.0	29.0
Deficit (-) / surplus (+)	-2.0	-1.6	-1.9	-0.8	-9.3	-5.1	-7.0	-2.0	-1.0
General gov.gross debt, nat.def., % of GDP	70.2	67.7	66.3	72.6	79.1	79.1	80.0	72.0	69.0
Stock of loans of non-fin.private sector, % p.a.	0.7	-3.6	6.6	8.9	6.6	6.6	.	.	.
Non-performing loans (NPL), in %, eop	13.2	11.1	8.4	8.2	8.1	8.1	.	.	.
Central bank policy rate, % p.a., eop 3)	1.25	1.00	1.00	0.5	0.5	0.5	0.5	0.5	0.5
Current account, EUR mn	-866	-866	-1,089	-234	-378	-612	-1,240	-1,140	-1,100
Current account, % of GDP	-7.5	-6.8	-8.0	-7.7	-12.2	-10.0	-9.6	-8.2	-7.5
Exports of goods, BOP, EUR mn	797	986	907	200	171	370	760	800	840
annual change in %	11.7	23.7	-8.1	-4.7	-29.5	-18.0	-16.0	5.0	5.0
Imports of goods, BOP, EUR mn	3,621	3,857	4,050	853	827	1,680	3,600	3,690	3,760
annual change in %	9.2	6.5	5.0	-5.7	-19.2	-12.9	-11.0	2.5	2.0
Exports of services, BOP, EUR mn	2,856	3,073	3,405	648	317	965	2,350	2,560	2,690
annual change in %	19.2	7.6	10.8	-4.4	-61.2	-35.4	-31.0	9.0	5.0
Imports of services, BOP, EUR mn	1,774	1,962	2,141	379	178	557	1,500	1,610	1,670
annual change in %	11.0	10.6	9.1	-2.9	-68.1	-41.3	-30.0	7.0	4.0
FDI liabilities, EUR mn	900	1,020	1,072	233	221	454	800	.	.
FDI assets, EUR mn	-94	-3	36	12	-1	11	-50	.	.
Gross reserves of NB excl. gold, EUR mn	2,941	3,342	3,240	3,195	4,026	4,026	.	.	.
Gross external debt, EUR mn	7,949	8,353	8,246	8,198	8,908	8,908	9,000	9,400	9,100
Gross external debt, % of GDP	68.8	65.2	60.4	63.5	69.1	69.2	70.0	68.0	62.0
Average exchange rate ALL/EUR	134.15	127.59	123.01	122.84	124.51	123.68	124.2	123.0	123.0

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

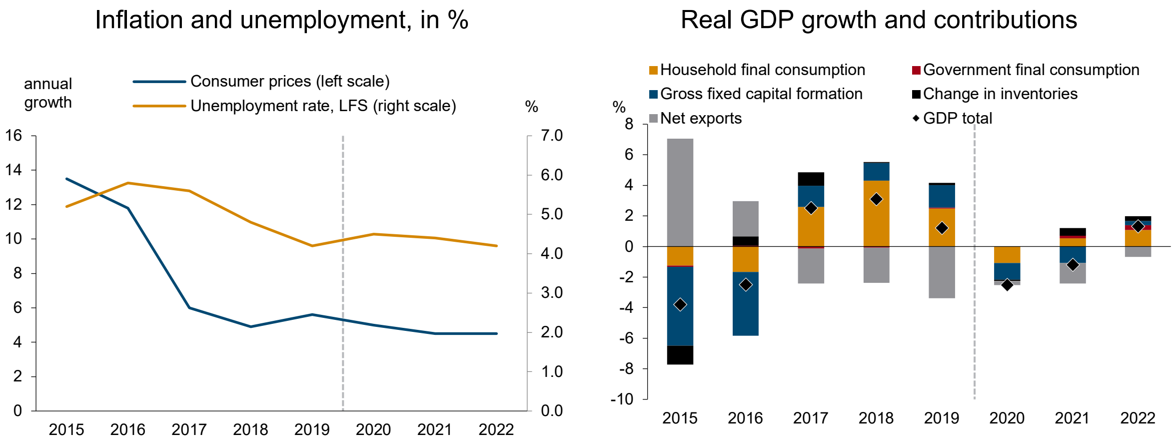
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

BELARUS: Popular revolt with uncertain prospects

RUMEN DOBRINSKY

The ongoing protests in Belarus have triggered the worst political crisis in recent history and brought to light some deep-seated problems. The economy is weakened and its prospects are bleak, as Belarus is facing grave structural problems and balance of payments constraints. A recent bailout by Russia is not sufficient to secure future financial sustainability. In the short run, Belarus will likely experience a protracted recession and possible further political and economic turbulence.

Figure 4.2 / Belarus: Main macroeconomic indicators



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

The disputed presidential elections held in August sparked an unprecedented wave of mass protests in Belarus. These rallies reflect the accumulated popular discontent with President Lukashenko’s authoritarian rule and his hazardous neglect of the COVID-19 threat. However, the outcome of the protests is far from certain, as the regime has a firm grip on the security forces and can apply oppressive means. The protests have also revealed a split in society, with younger, well-educated urban dwellers joining the protests, while the older generations living in the countryside still seem to be sticking with Lukashenko.

Following a decision single-handedly taken by Mr Lukashenko, Belarus did not introduce any form of COVID-related lockdown. Moreover, the containment measures initiated by the government were only marginal. It is difficult to judge the health-related consequences of this neglect, as the official Belarusian health statistics are incomplete and probably distorted, especially as regards the death rates attributable to the pandemic.

Despite the lax containment measures, the pandemic has led to a weakening of domestic demand, while exports have plunged. In view of this, the authorities launched two packages of policy support measures in April and May. The first envisaged financial support for the worst-affected economic sectors, such as retail trade and transport, but also manufacturing and some service industries. The second targeted social protection, with a rise in unemployment benefits and an increase in budgetary allocations to the healthcare system.

The Belarusian economy has so far suffered only a relatively mild negative shock. GDP in the first six months dropped by only 1.7% year on year, with a 0.2% decline in the first quarter and a drop of 3.3% in the second. On the supply side, such an outcome reflected the fact that most businesses continued to operate without interruption. On the demand side, it partly results from some populist income-support measures undertaken prior to the elections. The situation in the labour market did not change significantly either.

The negative impact was more pronounced in the manufacturing industry, due to a plunge in demand for exports. In the first half of the year, the export of goods dropped by 18% year on year in current US dollar terms. The import of goods shrank by the same margin, mostly due to the reduced import of intermediates intended for processing and exports. Gross industrial output fell by 3.1% year on year in the first six months, and the likelihood is that there will be a further deterioration in manufacturing performance.

The years 2018 and 2019 were marked by rumbling disputes with Russia over the price of imported hydrocarbons, and this spat intensified in 2020. This resulted in frequent disruptions to the supply of Russian oil. In 2019, Belarus imported just 18 million tonnes of oil, instead of the 24 million tonnes envisaged by the medium-term framework contract between the two countries. With the deepening of the disputes at the beginning of 2020, oil deliveries based on the framework agreement even stopped entirely for some time and Belarus started exploring alternative sources for the supply of crude oil.

However, since the outbreak of the political crisis, Belarus has been much more accommodating in its energy dispute with Russia. Although no concrete details have been revealed, there are indications that Belarus withdrew its previous contentions and that the new agreements between the two countries were concluded on Russian price terms. This paved the way for the resumption of regular oil deliveries: reportedly, the regular supply of Russian oil has now been restored, which will allow Belarusian petrochemical plants to work at close to full capacity in October. Nevertheless, according to preliminary estimates, total oil imports from Russia in 2020 will drop further to just 16-16.5 million tonnes, on account of the disruption at the beginning of the year. This has impacted on the key export-oriented petrochemical industry, as well as on Belarus's fiscal revenue.

The fiscal situation deteriorated in 2020 under the combined effect of various adverse factors, which will limit the government's room for manoeuvre in dealing with the pandemic and political crisis. While the central budget was in the comfortable positive zone in recent years, a sizeable deficit is expected in 2020. This has aggravated further the situation with macroeconomic management.

Given the current political stalemate, the risks for the Belarusian economy have increased significantly. In the short run, the greatest risks are associated with the servicing of the public debt, most of which is denominated in foreign currency. At the beginning of 2020, it was estimated that the government needed to borrow about USD 3.3 billion (or some 7% of GDP) over the course of the year, in order to service its foreign debt.

It was envisaged that one part of this sum would be borrowed on the international financial markets. Indeed, in June Belarus issued USD 1.25 billion dual-tranche benchmark Eurobonds (USD 500 million at 5.875%, due February 2026, and USD 750 million at 6.378%, due February 2031). These were the first bonds issued by Belarus to be admitted to the London Stock Exchange.

However, the political crisis has put further implementation of these plans on hold. While for the time being there are no formal bars to Belarus's access to the international financial markets, subsequent bond issues will likely be problematic, due to the deterioration in the country's international standing. Belarus's sovereign risk premium has increased considerably, which is evidenced in the selloff of Belarusian bonds in the aftermath of the elections: investors started dumping Belarusian bonds and their prices fell by several percentage points. This implies that any future borrowing would come at a much higher cost for Belarus. Moreover, the IMF declined Belarus's request for USD 940 million emergency financial aid to support economic activity in the situation of COVID-19.

The month of August was also marked by a moderate run on the banking system, highlighting increased risks to macro-financial stability. In the course of the month, private individuals withdrew deposits worth a total of some USD 1 billion, of which USD 624 million were foreign currency deposits and USD 380 million were deposits in the local currency. People also started converting their holdings into US dollars. This put growing pressure on the currency, and the Belarusian rouble depreciated rapidly over the course of the month, despite massive intervention by the central bank (in August, Belarus's official foreign exchange reserves declined by USD 1.4 billion). While the situation calmed down somewhat in September, this episode is indicative of the growing financial and macroeconomic risks.

As Belarus started facing possible balance of payments constraints, it was forced to revert to its 'lender of last resort' – Russia. During his recent visit there, Mr Lukashenko secured new emergency loans amounting to USD 1.5 billion. USD 1 billion is expected to be disbursed before the end of 2020 (of which USD 500 million is in the form of Russian government credit and the other USD 500 million is due to be negotiated as credit from the Eurasian Development Bank). The remaining USD 500 million of Russian government credit is due to be disbursed in 2021.

There is one tricky aspect of this new funding agreement. It is related to the fact that the bulk of the Eurasian Development Bank credit (some USD 330 million) is already earmarked to settle the accumulated debt claimed by Gazprom for past deliveries of gas. Such debt was accounted for by the Russian side on the basis of the higher prices unilaterally demanded. Until recently, Belarus systematically refused to accept the Russian price (and hence, to acknowledge the debt); but apparently this was part of the new deal reached by Mr Lukashenko. This will probably not be the last such bailout, and it remains to be seen what political concessions the Russian leadership will demand in return for its financial support.

At present, the prospects for the Belarusian economy are bleak. Apart from the mounting financial problems, it is faced with the prospect of a protracted recession. In addition to its chronic structural problems, the real economy will also undoubtedly be adversely affected by the ongoing mass protests and their possible further escalation.

The main headache for Belarusian policy makers is associated with some deep-seated and interlinked economic problems that have long been neglected. These include, among others, the need to restructure the large and inefficient state-owned enterprises (which continue to drain public financial resources), to establish a viable social safety net and to secure long-term financial sustainability. Given the current fragile macroeconomic situation, these problems call for an urgent reform agenda, no matter who is at the helm of economic policy.

Unless there is a further dramatic deterioration in the political situation, we expect the GDP decline to reach some 2.5% for 2020 as a whole. Given the political and economic uncertainties, we anticipate the recession to continue in 2021, and GDP to fall by a further 1% or more. A modest recovery can be expected to start only in 2022.

However, worse scenarios cannot be excluded. A further dramatic escalation of the protests could lead to significant economic disruption, the economic fallout of which would be difficult to predict. Furthermore, an eventual launch of the much-needed fundamental reforms will undoubtedly be associated with additional economic turmoil.

Table 4.2 / Belarus: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average	9,498	9,484	9,442	.	.	.	9,420	9,400	9,380
Gross domestic product, BYN mn, nom.	105,748	122,320	131,952	32,356	33,634	65,990	135,000	139,400	147,600
annual change in % (real)	2.5	3.1	1.2	-0.2	-3.3	-1.7	-2.5	-1.2	1.3
GDP/capita (EUR at PPP)	12,700	13,400	13,900	.	.	.	.	.	.
Consumption of households, BYN mn, nom.	56,843	64,491	71,559	18,171	17,400	35,571	.	.	.
annual change in % (real)	4.8	8.0	4.7	5.1	-7.0	-1.3	-2.0	1.0	2.0
Gross fixed capital form., BYN mn, nom.	27,662	32,081	35,636	7,311	8,367	15,678	.	.	.
annual change in % (real)	5.5	4.4	5.6	4.0	-8.0	-2.4	-4.0	-4.0	1.0
Gross industrial production									
annual change in % (real)	6.1	5.7	1.0	-2.7	-3.5	-3.1	-5.0	-2.0	1.0
Gross agricultural production									
annual change in % (real)	4.2	-3.3	2.9	5.5	1.9	3.7	.	.	.
Construction industry									
annual change in % (real)	-3.7	2.2	0.1	7.9	-1.1	3.4	.	.	.
Employed persons, LFS, th	4,902	4,897	4,909	4,821	4,855.9	4,838.2	4,820	4,800	4,770
annual change in %	0.8	-0.1	0.2	-2.2	-0.7	-1.4	-1.8	-0.4	-0.6
Unemployed persons, LFS, th	293	245	213	207	213	210	227	221	209
Unemployment rate, LFS, in %	5.6	4.8	4.2	4.1	4.2	4.2	4.5	4.4	4.2
Reg. unemployment rate, in %, eop	0.5	0.3	0.2	0.2	0.2	0.2	.	.	.
Average monthly gross wages, BYN	822.8	971.4	1,090.9	1,150	1,224	1,187	1,210	1,320	1,410
annual change in % (real, gross)	7.5	12.6	7.3	9.4	8.2	8.8	6.0	4.0	2.0
Consumer prices, % p.a.	6.0	4.9	5.6	4.6	5.2	4.9	5.0	4.5	4.5
Producer prices in industry, % p.a. 2)	9.8	6.8	6.3	4.4	4.8	4.6	5.5	5.0	5.0
General governm.budget, nat. def., % of GDP									
Revenues	40.5	41.5	40.9	39.0	34.5	36.7	38.0	39.0	39.0
Expenditures	37.6	37.5	38.4	38.0	41.8	39.9	40.0	40.0	39.0
Deficit (-) / surplus (+)	3.0	4.0	2.5	1.0	-7.3	-3.2	-2.0	-1.0	0.0
General gov.gross debt, nat. def., % of GDP 3)	53.4	43.7	42.0	.	.	.	48.0	50.0	52.0
Stock of loans of non-fin.private sector, % p.a.	7.2	12.7	10.0	26.4	18.4	18.4	.	.	.
Non-performing loans (NPL), in %, eop 4)	12.9	5.0	4.6	5.3	5.1	5.1	.	.	.
Central bank policy rate, % p.a., eop 5)	11.0	10.0	9.0	8.8	8.0	8.0	7.8	7.5	7.0
Current account, EUR mn 6)	-843	20	-1,126	-1,251	249	-1,003	-1,300	-1,500	-1,900
Current account, % of GDP	-1.7	0.0	-2.0	-9.6	2.0	-3.9	-2.9	-3.4	-4.4
Exports of goods, BOP, EUR mn 6)	25,405	28,409	28,932	5,858	5,516	11,374	22,400	23,500	24,300
annual change in %	21.0	11.8	1.8	-13.3	-22.5	-18.0	-22.6	4.9	3.4
Imports of goods, BOP, EUR mn 6)	28,043	30,536	32,684	6,443	5,984	12,427	25,900	27,400	28,700
annual change in %	20.5	8.9	7.0	-9.9	-25.6	-18.2	-20.8	5.8	4.7
Exports of services, BOP, EUR mn 6)	7,000	7,511	8,609	2,005	1,728	3,733	7,700	7,900	8,100
annual change in %	11.9	7.3	14.6	8.6	-13.8	-3.0	-10.6	2.6	2.5
Imports of services, BOP, EUR mn 6)	4,274	4,594	5,229	1,083	935	2,019	4,700	4,900	5,000
annual change in %	7.4	7.5	13.8	4.4	-25.6	-12.0	-10.1	4.3	2.0
FDI liabilities, EUR mn 6)	1,130	1,212	1,139	1,337	-168	1,169	900	.	.
FDI assets, EUR mn 6)	60	47	-3	26.8	9	36	100	.	.
Gross reserves of NB excl. gold, EUR mn 6)	4,502	4,561	6,265	4,727	5,324	5,324	.	.	.
Gross external debt, EUR mn 6)	33,363	34,307	36,416	35,672	36,511	36,511	36,900	37,000	37,300
Gross external debt, % of GDP	68.9	67.3	64.4	61.0	62.4	81.1	82.0	85.0	86.0
Average exchange rate BYN/EUR	2.1833	2.4008	2.3342	2.4740	2.6765	2.5753	3.00	3.20	3.40

1) Preliminary. - 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 NB. - 6) Converted from USD.

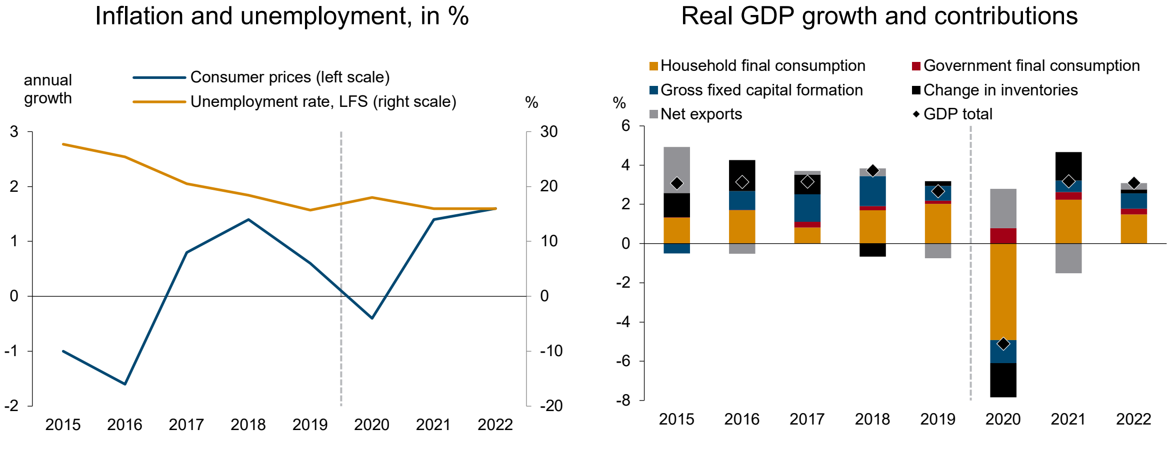
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

BOSNIA AND HERZEGOVINA: Limited policy options restrict pandemic response

BERND CHRISTOPH STRÖHM

The COVID-19 pandemic has led to a substantial slump in exports, tourism earnings, private consumption and industrial production, causing BiH's GDP to contract by an estimated 5.1% in 2020. To mitigate the economic downturn, the central government has received a combined EUR 741 million in financial aid and loans from the EU and the IMF. However, the complex BiH federative structure limits the country in introducing fiscal response measures.

Figure 4.3 / Bosnia and Herzegovina: Main macroeconomic indicators



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

Due to the slump in private consumption and losses in the service sector caused by COVID-19, GDP will likely contract by 5.1% in 2020. In particular, private consumption, which accounts for about 75% of the country's GDP, suffered badly this year due to the pandemic. The country recorded a decrease in retail trade of about 7.5% in the first half of 2020, compared to the first six months of 2019, which is why we expect private consumption to contract by 6.6% in 2020, year on year. In addition, the pandemic caused a substantial drop in BiH's industrial production, which contributes about 20% of the country's GDP. This was triggered by a slide in output in the country's manufacturing industry in the first eight months of the year, with industrial production falling by a monthly average of about 8.5% year on year.

BiHs service sector suffered a severe blow due to COVID-19. This is particularly visible in the collapse of revenue generated by tourism: data from Bosnia's state statistics agency show that tourism earnings fell by 70.6% year on year in the first six months of 2020. Foreign tourist overnight stays fell by 71.1% over the same period. Prior to 2020, revenue generated by the tourism sector, boosted by BiHs diaspora, had become an important pillar of economic growth, with 1.5 million tourists visiting the country in 2019. Sarajevo Canton, in particular, has proved a popular European holiday destination for tourists from the United Arab Emirates and Saudi Arabia, thanks to the country's liberal visa policy.

The lack of foreign demand caused by COVID-19 severely affects BiHs exports, 75% of which go to the EU. BiH recorded a fall of about 16% in exports of goods and services in the period from January to June 2020, compared to the same period in 2019. This decline in exports was substantially influenced by BiH's close ties to Italy, which nearly disappeared as an essential trade destination for at least the first and second quarters. Germany, Croatia and neighbouring Serbia remained vital countries for BiH exports in 2020. The pandemic also led to a decrease in foreign remittances. Nevertheless, the substantial slump in imports of about 18% in the first six months of 2020 means it can be expected that BiH's current account deficit will narrow to 2.6% of GDP this year, before widening again to 3.9% in 2021.

The COVID-19 pandemic has led to an increase in unemployment. A constant rise in employment and emigration ensured that the unemployment rate in BiH had fallen steadily since 2015. But the COVID-19 pandemic has reversed this trend: between March and July an increase was recorded of about 28,000 registered unemployed people. The adverse effects of COVID-19 on the country's labour market were felt particularly within BiH's service sector, which employed about 50,000 people in 2019. It is expected that the unemployment rate will rise from 15.7% in 2019 to around 18% in 2020.

On the fiscal side, Bosnia faces two particular challenges in its response to the pandemic: a lack of policy space in general, and difficulties in distributing and targeting what money is available. The FBiH and RS governments will still disburse direct fiscal support amounting to 4.3% of GDP, resulting in an increase in public debt from 32.8% in 2019 to 38% of GDP in 2020. This fiscal injection is helpful, but is lower as a share of GDP than most regional peers. Moreover, the complicated BiH federative structure could further hamper the effective distribution of the money. The upcoming local election scheduled for November 2020 may also create political disagreements over the country's fiscal policies.

The relative lack of fiscal space is increasing the importance of international lending. Here the picture is more positive, with various instruments being made available to BiH. External fiscal support will play an important role in mitigating the fallout in 2020. The allocation of EUR 330 million by the IMF from the Rapid Financing Instrument (RFI) is aimed at financing the RS and FBiH stability funds. The EU earmarked investments of EUR 3.3 billion for the Western Balkans will also help: of this, EUR 411 million has been granted to BiH. However, here too, the complicated structure of the country has already had an impact, with political obstacles having delayed the distribution of the RFI funds.

For 2021, we project a GDP recovery of 3.2%. Investments will likely pick up again, with a resumption of postponed public projects, such as the expansion of the energy and transport infrastructure. However, adverse factors remain: the complex BiH federative structure, fiscal, political and legal uncertainty, over-bureaucratisation, and the unfavourable demographic development due to high levels of emigration and the continuous 'brain drain'. This last feature is particularly visible in BiH's health sector, which even prior to COVID-19 was suffering from a lack of trained medical personnel. This trend will likely continue in 2021, due to the country's dysfunctional political system, which inhibits the central government from introducing effective policies to counter BiH's brain drain.

Table 4.3 / Bosnia and Herzegovina: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020	2021 Forecast	2022
Population, th pers., average	3,504	3,496	3,485	.	.	.	3,490	3,485	3,480
Gross domestic product, BAM mn, nom. 2)	31,376	33,444	35,229	8,323	7,945	16,269	33,300	34,800	36,500
annual change in % (real)	3.2	3.7	2.7	2.2	-9.3	-3.8	-5.1	3.2	3.1
GDP/capita (EUR at PPP) 2)	9,050	9,690	10,080	.	.	.	.	.	.
Consumption of households, BAM mn, nom. 2)	24,200	25,144	26,301	6,579	6,422	13,001	.	.	.
annual change in % (real)	1.0	2.2	2.7	1.4	-9.4	-4.2	-6.6	3.0	2.0
Gross fixed capital form., BAM mn, nom. 2)	5,926	6,550	6,863	.	.	.	.	.	.
annual change in % (real)	7.8	8.1	3.8	.	.	.	-6.0	3.0	4.0
Gross industrial production									
annual change in % (real)	3.2	1.6	-5.3	-3.6	-14.0	-8.9	-6.0	3.0	4.0
Gross agricultural production 3)									
annual change in % (real)	4.1	2.3	2.0	.	.	.	.	.	.
Construction output total									
annual change in % (real)	-1.1	0.4	-2.0	-2.9	-0.9	-1.9	.	.	.
Employed persons, LFS, th, April	815.7	822.4	802.9	.	.	.	780	790	790
annual change in %	1.8	0.8	-2.4	.	.	.	-3.0	0.7	0.5
Unemployed persons, LFS, th, April	210.7	185.5	149.4	.	.	.	171	150	150
Unemployment rate, LFS, in %, April	20.5	18.4	15.7	.	.	.	18.0	16.0	16.0
Reg. unemployment rate, in %, eop	38.7	34.7	32.6	32.4	34.4	34.4	.	.	.
Average monthly gross wages, BAM	1,321	1,363	1,421	1,459	1,466	1,463	1,470	1,510	1,550
annual change in % (real, gross)	0.8	1.7	3.7	4.3	5.3	4.8	4.0	1.5	1.0
Average monthly net wages, BAM	851	879	921	945	949	947	950	980	1,010
annual change in % (real, net)	0.7	1.9	4.2	4.1	5.2	4.6	4.0	1.3	1.1
Consumer prices, % p.a.	0.8	1.4	0.6	0.4	-1.6	-0.6	-0.4	1.4	1.6
Producer prices in industry, % p.a.	3.0	3.5	0.1	-1.0	-1.6	-1.3	-0.5	2.0	2.5
General governm.budget, nat.def., % of GDP									
Revenues	43.1	43.0	42.6	.	.	.	39.0	40.0	40.5
Expenditures	40.5	40.8	40.7	.	.	.	42.5	42.0	42.0
Deficit (-) / surplus (+)	2.6	2.2	1.9	.	.	.	-3.5	-2.0	-1.5
General gov.gross debt, nat.def., % of GDP	36.1	34.2	32.8	.	.	.	38.0	37.0	35.0
Stock of loans of non-fin.private sector, % p.a.	7.3	5.5	6.7	3.5	0.4	0.4	.	.	.
Non-performing loans (NPL), in %, eop	10.0	8.8	7.4	6.6	6.7	6.7	.	.	.
Central bank policy rate, % p.a., eop 4)	.	.	.	.	.	.	.	.	.
Current account, EUR mn 5)	-777	-572	-556	-195	-119	-313.2	-450	-700	-680
Current account, % of GDP	-4.8	-3.3	-3.1	-4.6	-2.9	-3.8	-2.6	-3.9	-3.6
Exports of goods, BOP, EUR mn 5)	4,776	5,327	5,205	1,187.1	1,083	2,270	4,660	4,940	5,380
annual change in %	21.3	11.5	-2.3	-2.0	-21.4	-12.3	-10.5	6.0	9.0
Imports of goods, BOP, EUR mn 5)	8,568	9,172	9,277	2,045.2	1,776	3,822	8,120	8,810	9,400
annual change in %	13.3	7.1	1.1	-5.7	-27.2	-17.1	-12.5	8.5	6.7
Exports of services, BOP, EUR mn 5)	1,781	1,944	2,100	316.2	223	539	1,780	1,870	2,020
annual change in %	10.0	9.1	8.0	-18.3	-61.6	-44.3	-15.3	5.0	8.0
Imports of services, BOP, EUR mn 5)	590	618	684	124.5	82	207	640	660	690
annual change in %	9.9	4.8	10.6	-2.2	-49.1	-28.4	-7.0	3.0	4.8
FDI liabilities, EUR mn 5)	455	501	346	118.9	60	179	450	.	.
FDI assets, EUR mn 5)	88	-6	-9	-3.4	-2	-5	10	.	.
Gross reserves of NB excl. gold, EUR mn 5)	5,293	5,835	6,311	6,234	6,506	6,506	.	.	.
Gross external debt, EUR mn 6)	8,711	9,251	10,015	.	.	.	11,100	11,100	11,050
Gross external debt, % of GDP 6)	54.3	54.1	55.6	.	.	.	65.2	62.4	59.2
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary. - 2) According to ESA'10 (FISIM not yet reallocated to industries). - 3) Based on UN-FAO data, wiiw estimate. - 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. - 6) Based on IMF estimates.

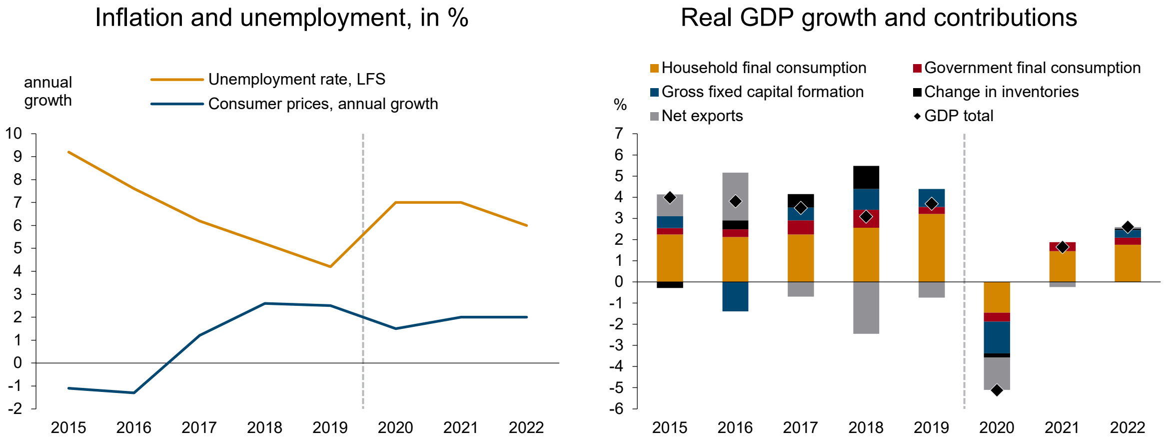
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

BULGARIA: Economy heading towards a slow recovery amidst continuing political unrest

RUMEN DOBRINSKY

Political turmoil in Bulgaria continues for a third consecutive month, with daily protests demanding the resignation of the government. The negative economic shock of the COVID-19 pandemic was most pronounced in the second quarter, and its intensity has now subsided. In response, the authorities launched two packages of fiscal support measures. For 2020 as a whole, GDP should decline by some 5%, while a gradual recovery is expected over 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.

In recent months, the political scene in Bulgaria has been dominated by daily mass protest marches against the ruling coalition. These started on 9 July and have continued ever since. The rallies reflect widespread public frustration over the state of affairs in Bulgaria's social, political and economic life after 10 years of almost uninterrupted rule by the GERB party, led by Prime Minister Boyko Borisov. During this period, Mr Borisov has managed to undermine the constitutional separation of powers and to establish a system of authoritarian rule, in which he personally takes (or imposes) the important decisions in all three branches of power: executive, legislative and judicial.

The protestors' main demand is the resignation of Mr Borisov, as they claim he is responsible for the endemic corruption in the country. President Rumen Radev has also raised his voice in support of the protestors, stating his solidarity with their main concerns; however, he has no constitutional power to end a government's term in office. At the same time, Mr Borisov and the GERB party seem to be ignoring what is happening in the streets and are continuing with business as usual.

In September, Bulgaria was hit by a second wave of COVID-19. At first it was weaker than in other European countries, but the number of new cases has subsequently risen sharply. During the summer months, the spread of COVID-19 had subsided, largely thanks to the relatively rigorous containment measures. However, with the relaxation of the restrictions and the start of the school year, the coronavirus struck again. What is also worrying is that the mortality rate during this second wave has been higher than in the first wave.

The first policy response to the pandemic was launched by the government back in March. It amounted to fiscal support measures worth BGN 2.8 billion (some 2.4% of GDP). Within this package, the direct and indirect employment protection measures alone were estimated to account for BGN 1.5 billion. However, implementation of the policy support measures was rather slow: as of the end of August, total disbursements of employment support were put at some BGN 185 million. Nevertheless, according to estimates by one of the biggest trade unions, some 200,000 jobs have been saved thanks to the public support measures. Around two thirds of the payments were allocated to the three worst-affected sectors: manufacturing, the hospitality industry and retail trade. Apart from that, small and medium-sized enterprises received public support funds amounting to BGN 72 million.

In late summer, the government announced a second package of fiscal support measures worth some BGN 2.2 billion (2% of GDP). These included employment protection measures for a fresh period until the end of January 2021, to be backed by a EUR 511 million loan under the EU's SURE instrument. The government hopes that these measures will help save some 250,000 jobs this year. In addition, the new package contains social protection measures amounting to BGN 1.2 billion, including temporary increases in all pensions, extra pay for healthcare workers top-ups to unemployment benefits, and other similar instruments.

Within the overall negative context of the pandemic, some economic sectors have suffered badly, while others have proved quite resilient. The sector of the economy worst hit has been the important tourism industry, as the country's borders have remained closed for most of the year. According to preliminary estimates, the number of foreign tourists fell in 2020 by 75%, compared to 2019, while the total earnings of the tourism industry are estimated to have plunged by EUR 800 million, 22% down on 2019. Transportation has also suffered a blow. At the same time, gross manufacturing output only dipped by 3.7% year on year in the first quarter, and by 4.2% in the second. And indeed, some business services sectors such as ICT and financial services even recorded positive year-on-year growth in the first half of the year.

Overall, GDP dropped by 3.8% year on year in the first six months, the result of 1.8% growth in the first quarter followed by an 8.5% decline in the second. The shock to the labour market was weaker than initially feared: the annual average rate of unemployment for the year as a whole should not be above 7%. The weakening of domestic and external demand has contributed to a reduction in inflationary pressures.

All the major components of aggregate demand made a negative contribution to GDP growth in the first half of the year, with the exception of the net export of goods. That said, both goods exports and goods imports fell sharply in this period: the positive figure only reflects the fact that imports fell more than exports.

In monthly terms, the export of goods recorded its worst performance in April and May; thereafter the decline decelerated. Overall exports of services dropped considerably in 2020, reflecting the dismal tourist season. That notwithstanding, the robust export of ICT services continued to support a positive current account balance in 2020.

Fiscal performance deteriorated, but overall the government retained a relatively tight fiscal stance. The consolidated general government revenue in January-August dropped by 1.7% year on year, while in cash terms, total expenditure fell by 3.3%, despite the extraordinary outlays on coronavirus-related public support. This was achieved largely at the expense of public investment projects: public capital expenditure in January-August was slashed by 53%, compared to the same period of 2019.

In September, the Bulgarian government raised EUR 2.5 billion on the international bond markets in a dual-tranche sale of 10-year and 30-year Eurobonds, each tranche worth EUR 1.25 billion. No particular purpose of the new borrowing was announced and – given that Bulgaria already had a considerable fiscal reserve (around EUR 5 billion at mid-year) – this was likely a precautionary move in a favourable situation on the international financial markets.

In July, Bulgaria's bid to join ERM-2 was officially approved by euro area finance ministers and the European Central Bank. This decision followed years of effort by the Bulgarian authorities and was accompanied by a pledge that the country would undertake a series of additional structural reforms, including to strengthen prudential banking regulations and supervise the non-bank financial sector. So far, no target dates for joining the euro area have been announced.

Current business statistics indicate that the economy probably bottomed out in May-June and is now on the road to slow, gradual recovery. In annual terms, aggregate output in the second half of the year is expected to continue sinking, largely as a result of the slump recorded in the first quarter. For 2020 as a whole, the rate of GDP decline will probably be around 5%. The current account should remain in positive territory for the year as a whole.

A pattern of gradual recovery will likely prevail in 2021 and 2022, but the growth of aggregate output will remain sluggish. At the time of writing, the COVID-19 containment measures are not expected to be made tougher, and so the revival of private consumption and fixed investment is likely to precede that of exports; in the short run, the recovery is likely to be predominantly driven by domestic demand.

Table 4.4 / Bulgaria: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average	7,076	7,025	6,976	.	.	.	6,900	6,850	6,800
Gross domestic product, BGN mn, nom.	102,345	109,743	119,772	25,993	27,774	53,767	115,300	119,500	125,100
annual change in % (real)	3.5	3.1	3.7	1.8	-8.5	-3.8	-5.1	1.7	2.6
GDP/capita (EUR at PPP)	14,660	15,430	16,600	.	.	.	.	.	.
Consumption of households, BGN mn, nom.	60,969	64,936	69,853	16,315	16,247	32,562	.	.	.
annual change in % (real)	3.7	4.3	5.4	3.0	-4.1	-0.7	-2.5	2.5	3.0
Gross fixed capital form., BGN mn, nom.	18,795	20,624	22,404	3,557	5,181	8,739	.	.	.
annual change in % (real)	3.2	5.4	4.5	-10.2	-11.8	-11.2	-8.0	0.0	2.0
Gross industrial production 2)									
annual change in % (real)	3.4	0.3	0.7	-2.3	-12.9	-7.6	-6.0	2.0	3.0
Gross agricultural production									
annual change in % (real)	6.3	-0.4	-1.9	.	.	.	.	.	.
Construction industry 3)									
annual change in % (real)	4.6	1.6	3.8	-4.0	-10.1	-7.1	.	.	.
Employed persons, LFS, th, average	3,150	3,153	3,233	3,107	3,080	3,093	3,170	3,170	3,230
annual change in %	4.4	0.1	2.6	-1.3	-5.6	-3.5	-2.0	0.0	2.0
Unemployed persons, LFS, th, average	207	173	143	149	192	171	240	240	210
Unemployment rate, LFS, in %, average	6.2	5.2	4.2	4.6	5.9	5.3	7.0	7.0	6.0
Reg. unemployment rate, in %, eop	7.1	6.1	5.9	6.7	8.3	8.3	.	.	.
Average monthly gross wages, BGN	1,037	1,146	1,274	1,317	1,337	1,327	1,360	1,470	1,590
annual change in % (real, gross)	7.2	7.5	7.8	5.3	4.5	4.9	5.0	6.0	6.0
Consumer prices (HICP), % p.a.	1.2	2.6	2.5	3.0	1.1	2.0	1.5	2.0	2.0
Producer prices in industry, % p.a.	5.0	3.9	3.0	1.4	-4.4	-1.5	-2.0	1.0	2.0
General governm.budget, EU-def., % of GDP									
Revenues	36.0	38.5	38.0	.	.	.	36.0	37.0	39.0
Expenditures	34.9	36.5	36.0	.	.	.	38.5	38.0	39.0
Net lending (+) / net borrowing (-)	1.1	2.0	2.1	.	.	.	-2.5	-1.0	0.0
General gov.gross debt, EU def., % of GDP	25.3	22.3	20.2	.	.	.	25.0	24.0	23.0
Stock of loans of non-fin.private sector, % p.a.	3.3	7.7	7.4	7.1	4.9	4.9	.	.	.
Non-performing loans (NPL), in %, eop	10.4	7.8	6.6	8.0	8.1	8.1	.	.	.
Central bank policy rate, % p.a., eop 4)	0.00	0.00	0.00	0.00	0.00	0.00	0.0	0.0	0.0
Current account, EUR mn	1,825	554	1,848	409	250	659	1,300	1,200	1,000
Current account in % of GDP	3.5	1.0	3.0	3.1	1.8	2.4	2.2	2.0	1.6
Exports of goods, BOP, EUR mn	26,951	27,745	29,120	7,148	5,918	13,066	27,000	27,500	28,000
annual change in %	16.6	2.9	5.0	1.9	-16.1	-7.1	-7.3	1.9	1.8
Imports of goods, BOP, EUR mn	27,716	30,443	32,011	7,536	6,068	13,603	29,000	29,500	30,500
annual change in %	15.1	9.8	5.1	-1.1	-23.5	-12.5	-9.4	1.7	3.4
Exports of services, BOP, EUR mn	8,256	9,187	10,191	1,737	1,387	3,124	8,200	8,600	9,000
annual change in %	2.6	11.3	10.9	-1.6	-42.7	-25.4	-19.5	4.9	4.7
Imports of services, BOP, EUR mn	5,203	5,058	5,316	1,030	792	1,823	4,500	5,000	5,500
annual change in %	12.1	-2.8	5.1	-9.1	-41.7	-26.9	-15.4	11.1	10.0
FDI liabilities, EUR mn	1,760	1,539	1,472	274	291	565	2000	.	.
FDI assets, EUR mn	446	760	647	2	172	174	500	.	.
Gross reserves of NB excl. gold, EUR mn	22,257	23,620	23,072	24,578	25,972	25,972	.	.	.
Gross external debt, EUR mn 5)	33,852	34,487	35,178	34,501	34,472	34,472	35600	35000	34500
Gross external debt, % of GDP 5)	64.7	61.5	57.4	58.5	58.4	58.5	60.0	57.0	54.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary. - 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.

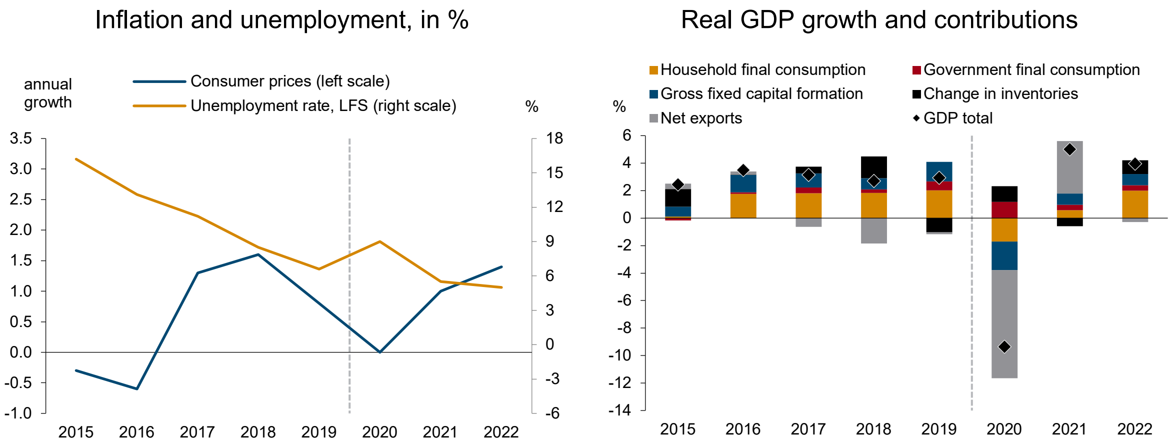
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

CROATIA: In the eye of the storm

BERND CHRISTOPH STRÖHM

The economy's heavy reliance on tourism means that Croatia will suffer one of the biggest contractions in CESEE in 2020, with real GDP projected to decline by 9.4%. Unemployment will rise, and inflation will average 0% for the year as a whole. To mitigate the economic downturn caused by COVID-19, the government initiated a support package worth about 9% of GDP. The tourism sector should stage at least a partial recovery next year, which will underpin growth of around 5%.

Figure 4.5 / Croatia: Main macroeconomic indicators



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

The Croatian economy will suffer a severe setback in 2020, since COVID-19 has caused domestic and international demand to shrink dramatically. The consequences of the pandemic will be felt much more keenly in Croatia than in most other CESEE countries, with GDP contracting by an estimated 9.4% in 2020. The reason for this sharp decline is the country's reliance on its tourism sector, which accounts for between 20% and 25% of Croatia's GDP (directly and indirectly). On top of the disruptions generated by COVID-19, Croatia has had to cope with the impact of a powerful earthquake that struck the capital Zagreb and its surroundings on 22 March, causing damage in the region of EUR 5.7 billion. Nevertheless, due to the anticipated recovery of tourism earnings, as well as an increase in private consumption and foreign demand, it can be expected that the country's GDP will bounce back to 5% in 2021.

The tourism industry has suffered a severe blow due to COVID-19. In the first seven months of 2020, Croatia recorded 58.9% fewer tourist nights, compared to the same period in 2019. The most severe drop in tourism arrivals was in Q2 2020, when stringent international restrictions on travel were in place; since these were lifted at the end of June, the situation has improved moderately. Monthly data show that the tourism sector bounced back somewhat in July, recording a total of 2.2 million tourist arrivals and 14.7 million tourist nights. It is likely that the moderate recovery continued in August. Croatia seems to have benefited from being within driving distance of key sources of tourism, especially Germany. However, the July data still revealed a sharp fall in tourist arrivals, compared to the same period in 2019: tourist arrivals were 48.1% down and 42.5% fewer tourist nights were recorded.

The pandemic resulted in a significant deterioration in Croatia's public finance situation, compared to 2019. In 2019, the state budget was on a path of consolidation. The government had recorded a budget surplus of about 0.4%, with public debt falling to 73.2% of GDP. However, this positive trend changed dramatically with the arrival of COVID-19. The pandemic resulted in Croatia's public finance situation deteriorating significantly, mainly due to the country's heavy dependence on tourism. In order to mitigate the effects of the pandemic on the country's economy, the government launched a support package worth about 9% of GDP. The support measures included wage subsidies, tax deferrals or tax exemptions, access to financing and the establishment of a short-time working (*Kurzarbeit*) scheme. The government's fiscal measures are additionally supported by the World Bank, which announced on 26 June that it had approved USD 300 million to provide emergency support to the Croatian authorities. In light of those measures, it can be expected that Croatia will record a budget deficit of about 8% and a rise in public debt to about 86% of GDP in 2020.

The COVID-19 pandemic has already had a negative impact on investment, and this is likely to remain the case for some time. Due to the uncertainty caused by COVID-19, foreign investments are also affected, particularly in the country's aviation industry, including the planned construction of a factory for lightweight components for commercial aircraft passenger cabins by the Austrian company FACC. This is why gross fixed capital formation in Croatia saw a noticeable decrease from EUR 2.6 billion in the first quarter of 2020 to EUR 2.4 billion in the second. Nevertheless, overall investments facilitated by the government, especially in infrastructure projects co-financed by the EU, will go ahead in spite of COVID-19. Public investment is also supported by a USD 200 million loan facilitated by the World Bank and aimed at rebuilding Zagreb's infrastructure after the March 2020 earthquake.

Inflation has decelerated due to lower energy prices and a slump in consumer demand caused by COVID-19; only a moderate pick-up is projected for 2021. The average annual consumer price inflation rate will likely fall from 0.8% in 2019 to 0% in 2020, largely due to the decrease in energy prices; this will also lead to a 4% drop in the Producer Price Index. The expected slowdown in inflation in 2020 is also a result of lower demand in the context of the pandemic, particularly in tourism-related services, recreational and cultural services, and semi-durable and durable consumer goods. As the economy recovers in 2021, price pressure should firm somewhat, but inflation next year will average just 1%.

The COVID-19 pandemic and the measures put in place to contain the spread of the infection are likely to result in a decline in the number of people employed, especially in the tourism sector. Negative economic consequences will also be felt in sectors such as transport (e.g. the port of Rijeka), retail trade and the export-oriented manufacturing sectors. The rise in unemployment will likely hit the country's younger population, since seasonal workers – especially those providing services and in the country's dominant tourism sector – tend mostly to consist of younger people. Nevertheless, thanks to the government's coronavirus support measures (which have been extended until the end of 2020 in the most severely affected sectors), the rise in unemployment has so far been mitigated. To head off further unemployment, in August the government set before parliament a bill of amendments to the Law on Foreigners; this would require employers to request a test of the labour market by the Croatian Employment Service prior to employing a foreigner. It can be expected that unemployment will likely rise to 9% in 2020.

Net exports of services are expected to fall sharply in 2020. The substantial slump in tourism earnings, most notably in Q2 2020, will severely affect the country’s current account in 2020. However, tourist consumption by Croatian nationals abroad and imports of other services are also expected to fall, which will mitigate the strong impact of the decline in revenue from tourism on the country’s current account balance. Nevertheless, due to the country’s dependence on the tourism sector (creating a surplus in Croatia’s current account at an average of about 2.2% of GDP over the past six years) and its traditional deficit in trade in goods, Croatia’s current account may be expected to switch to a deficit of 3.9% in 2020. With the anticipated recovery of tourism earnings next year, this deficit will likely narrow to 0.6% in 2021.

Table 4.5 / Croatia: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average	4,130	4,091	4,067	.	.	.	3,980	3,980	3,980
Gross domestic product, HRK bn, nom.	366.4	383.0	400.1	90	84.7	174.9	363	385	406
annual change in % (real)	3.1	2.7	2.9	0.4	-15.1	-7.8	-9.4	5.0	4.0
GDP/capita (EUR at PPP)	18,220	19,120	20,080	.	.	.	.	.	.
Consumption of households, HRK bn, nom.	208.4	218.2	227.9	55	49.4	104.5	.	.	.
annual change in % (real)	3.2	3.2	3.6	0.7	-14.0	-6.8	-3.0	1.0	3.5
Gross fixed capital form., HRK bn, nom.	73.3	76.7	82.7	20	19.0	39.4	.	.	.
annual change in % (real)	5.1	4.1	7.1	3.1	-14.7	-6.3	-10.0	4.0	4.0
Gross industrial production 2)									
annual change in % (real)	1.4	-1.0	0.6	-2.8	-8.6	-5.7	-5.0	3.0	2.0
Gross agricultural production									
annual change in % (real)	-4.9	6.4	-0.2	.	.	.	.	.	.
Construction output 2)									
annual change in % (real)	1.7	4.9	8.3	6.1	0.2	3.1	.	.	.
Employed persons, LFS, th, average	1,625	1,655	1,680	1,649	1,668	1,659	1,670	1,680	1,690
annual change in %	2.2	1.8	1.5	-0.7	-0.6	-0.6	-0.5	0.5	0.5
Unemployed persons, LFS, th, average	205	152	119	123	115	119	170	100	90
Unemployment rate, LFS, in %, average	11.2	8.5	6.6	7.0	6.5	6.8	9.0	5.5	5.0
Reg. unemployment rate, in %, eop	11.2	8.9	7.8	8.6	9.1	9.1	.	.	.
Average monthly gross wages, HRK	8,055	8,448	8,766	9,240	9,124	9,182	8,900	9,200	9,600
annual change in % (real, gross)	2.8	3.3	3.0	1.9	1.3	1.6	1.5	2.0	2.5
Average monthly net wages, HRK	5,985	6,242	6,457	6,766	6,684	6,725	6,600	6,800	7,000
annual change in % (real, net)	4.1	2.8	2.7	1.8	1.5	1.7	1.5	2.1	2.2
Consumer prices (HICP), % p.a.	1.3	1.6	0.8	1.2	-0.4	0.4	0.0	1.0	1.4
Producer prices in industry, % p.a.	2.0	2.2	0.8	-0.1	-5.4	-2.8	-4.0	1.9	2.0
General governm.budget, EU-def., % of GDP									
Revenues	46.1	46.5	47.5	.	.	.	42.0	45.5	46.0
Expenditures	45.3	46.3	47.1	.	.	.	50.0	49.0	48.5
Net lending (+) / net borrowing (-)	0.8	0.2	0.4	.	.	.	-8.0	-3.5	-2.5
General gov.gross debt, EU def., % of GDP	77.8	74.7	73.2	.	.	.	86.0	84.0	82.0
Stock of loans of non-fin.private sector, % p.a.	-0.1	2.3	3.9	6.0	4.1	4.1	.	.	.
Non-performing loans (NPL), in %, eop 3)	8.8	7.6	5.5	5.4	5.5	5.5	.	.	.
Central bank policy rate, % p.a., eop 4)	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Current account, EUR mn	1,681	932	1,478	-1,424	-669	-2,093	-1,900	-300	-650
Current account, % of GDP	3.4	1.8	2.7	-11.8	-6.0	-9.0	-3.9	-0.6	-1.2
Exports of goods, BOP, EUR mn	11,707	12,240	12,861	3,018	2,596	5,614	10,500	11,400	12,200
annual change in %	11.4	4.6	5.1	-0.1	-17.5	-9.0	-18.0	9.0	7.0
Imports of goods, BOP, EUR mn	20,152	21,882	23,305	5,523	4,503	10,026	19,900	20,600	22,600
annual change in %	11.2	8.6	6.5	-1.4	-27.0	-14.8	-14.5	3.5	9.5
Exports of services, BOP, EUR mn	12,881	13,847	15,341	1,350	1,182	2,531	10,700	12,300	13,300
annual change in %	9.9	7.5	10.8	-7.1	-67.1	-49.8	-30.0	15.0	8.0
Imports of services, BOP, EUR mn	4,108	4,639	5,013	946	710	1,655	4,800	5,200	5,400
annual change in %	15.3	12.9	8.1	-22.7	-42.5	-32.6	-5.0	8.0	3.0
FDI liabilities, EUR mn	445	1,074	1,278	435	237	671	1,000	.	.
FDI assets, EUR mn	-673	231	175	99	52	151	200	.	.
Gross reserves of NB excl. gold, EUR mn	15,706	17,438	18,560	16,512	17,311	17,311	.	.	.
Gross external debt, EUR mn	43,683	42,710	40,877	40,447	41,251	41,251	41,100	40,500	40,100
Gross external debt, % of GDP	89.0	82.7	75.8	83.6	85.2	85.2	85.0	80.0	75.0
Average exchange rate HRK/EUR	7.4637	7.4182	7.4180	7.4893	7.5786	7.5340	7.5	7.6	7.6

1) Preliminary. - 2) Enterprises with 20 and more employees. - 3) Loans more than 90 days overdue and those unlikely to be paid. - 4) Discount rate of NB.

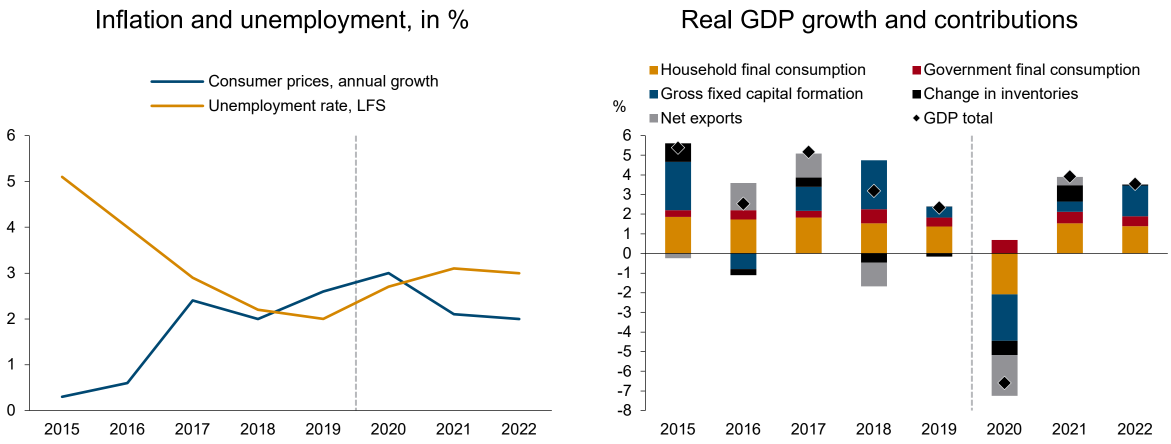
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

CZECH REPUBLIC: No V-shaped recovery in sight

LEON PODKAMINER

In the first half of 2020, all the components of aggregate demand (except for public consumption) declined strongly, with foreign trade making a particularly big contribution to the overall drop in GDP. The rise in unemployment has been moderate, but real wages have declined. The modest improvements optimistically expected in the second half of the year will not be enough to compensate for the initial losses. Positive growth may return in 2021, but a strong showing is not expected.

Figure 4.6 / Czech Republic: 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. This was very costly for economic activity, but brought some success in restricting the spread of COVID-19 and led to an easing of the lockdown as early as May. However, that may have been premature and the relaxation may have gone too far. Of late, the situation has deteriorated quite badly, and a second lockdown is likely in the last quarter. Depending on its severity and length, all current expectations for the economy may prove invalid. The (optimistic) assumption currently prevailing is that the slow economic recovery observed since April (the lowest point) will continue further in the second half of 2020 and in 2021.

The Czech economy was not faring too well even before the pandemic. GDP was declining even in the first quarter of 2020 (by 1.6%), primarily because of a big drop in capital formation. Then came the proper slump in the second quarter, with GDP falling by 11% and household consumption plummeting by an unprecedented 7.4%. Over the first half of the year as a whole, all the components of GDP saw a decline, apart from public consumption. The intensity of the recession in the second half of 2020 is expected to be somewhat less pronounced. Nonetheless, 2020 will not end well: GDP will have fallen by close to 7%, if not more. Only in 2021 will the recession lift – provided the epidemic situation at home and abroad does not spin out of control. But no V-shaped recovery is on the cards. Growth in 2021-2022 will be moderate, on account of the inevitable losses suffered by firms during, and after, the lockdown.

The very big declines in exports (of goods and services) were not matched by equally strong falls in imports. In the second quarter of 2020, exports fell by over 23% in real terms, but imports by only 18.4%. In effect, the impact of trade on GDP growth turned strongly negative (-5 percentage points). Czech foreign trade (and much of the country's domestic economy) is exposed not only to the risks stemming from the foreign demand side, but also to those pertaining to cross-border supply chains. The Czech Republic is paying a high price for its external openness, its intensive participation in global value chains, its highly skewed production structure and its reliance on imports. Its main industrial sector (automotive) depends hugely on external demand, which may not be forthcoming. In addition, the Czech automotive industry will have to adjust to the global trend toward the increasing replacement of hydrocarbon-powered vehicles with hybrid and electric cars, as well as to changes in mobility patterns. The improvements in the euro area business climate generally expected in the closing months of 2020 and in 2021 will be helpful for the Czech economy. But a renewed recession in Germany would have grave repercussions for the Czech Republic.

The decline in employment has been quite moderate, at least so far. Instead, one observes a severe drop in terms of hours worked (by 11% in total, with 14% in manufacturing and 16% in trade, accommodation and catering) and stagnating average nominal wages (rising by 0.5%). Businesses seem to prefer to maintain employment, apparently counting on the return of better times and tight labour markets. Employees seem to prefer stable employment (even with lower wages) to the risk of having to seek out new working opportunities. Accordingly, real wages have been declining and unemployment has been rising, albeit quite slowly. The downward adjustments in employment, hours worked and wages will continue in 2021. However, as a gradual disinflation is under way, inflation will become less of a drag on real wages, household incomes and private consumption.

The big drop in household consumption in the second quarter of 2020 was due not only to the erosion of real incomes (with average real wages falling by 2.7% and the total wage bill declining by over 5% nominally), but also to people's increased propensity to save – most probably related to the prevailing income uncertainties (but also to the restrictions imposed on the purchases of various services and non-essential goods during lockdown). With lower incomes and employment uncertainties, voluntary household savings are likely to return to normal, and the effective demand for durables, apparel and various services may even rise above normal levels, to make up for the recent restrictions. All in all, one should expect less of a decline in household consumption in the second half of 2020.

In the first half of 2020, business investment fell markedly (by an estimated 11%), but publicly financed investment in infrastructure (other than residential construction) still flourished (showing close to 10% real growth). This pattern will be preserved in the second half of the year. In addition, the inventories will likely continue to contract.

Fiscal measures to aid firms and employees hit by the epidemic-related restrictions were introduced relatively early on. As elsewhere, the scale of additional public spending has been significant: it is estimated to be in the region of 5% or more of GDP for the whole year – quite unprecedented in the Czech context, but still fairly modest given the very low level of public debt. Fiscal support measures may need to be prolonged, especially if the pandemic situation deteriorates further.

The national bank has reduced its policy rates quite aggressively, from 0.75% to 0.25%. This has pushed down interbank interest rates (and also the yields on treasury bonds) without preventing the ongoing disinflation. Low interest rates may be important – not so much by way of promoting greater lending (or making the domestic public debt cheaper to service), but rather through their impact on the depreciated exchange rate of the domestic currency. The strong devaluation during the first half of 2020 (from an average of 25.6 CZK/EUR in the first quarter of 2020 to 27 CZK/EUR in the second) may be partly attributed to the fairly indiscriminate treatment of all 'emerging markets' in the early stages of the pandemic. But the Czech Republic's economic fundamentals differ from those of emerging economies: the level of its foreign exchange reserves is quite high and the country's trade balance is still in surplus. Moreover, neither the level nor the structure of the country's foreign debt is a cause for concern. It may be assumed that the domestic currency's depreciation is likely to be reversed (though not necessarily too fast) as soon as the initial dust settles. For some time to come, the devalued currency will act as a buffer, moderating the GDP decline through differential impacts on exports and imports.

Table 4.6 / Czech Republic: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average	10,594	10,630	10,672	10,694	10,697	10,695	10,700	10,720	10,740
Gross domestic product, CZK bn, nom.	5,111	5,409	5,749	1,354	1,338	2,691	5,480	5,800	6,130
annual change in % (real)	5.2	3.2	2.3	-1.6	-10.8	-6.4	-6.6	3.9	3.5
GDP/capita (EUR at PPP)	26,650	27,920	29,000	.	.	.	.	.	.
Consumption of households, CZK bn, nom.	2,383	2,524	2,670	652	635	1,287	.	.	.
annual change in % (real)	3.9	3.3	2.9	0.0	-7.4	-3.8	-4.5	3.3	3.0
Gross fixed capital form., CZK bn, nom.	1,273	1,423	1,507	314	343	657	.	.	.
annual change in % (real)	4.9	10.0	2.2	-3.8	-4.6	-4.2	-9.0	2.0	6.0
Gross industrial production									
annual change in % (real)	6.5	3.1	-0.3	-4.1	-23.5	-13.9	-10.0	6.0	6.0
Gross agricultural production									
annual change in % (real)	-6.2	-1.1	1.3	.	.	.	.	.	.
Construction industry									
annual change in % (real)	3.3	9.2	2.7	2.7	-8.7	-4.3	.	.	.
Employed persons, LFS, th, average	5,222	5,294	5,303	5,277	5,213	5,245	5,250	5,260	5,260
annual change in %	1.6	1.4	0.2	-0.5	-1.6	-1.1	-1.0	0.2	0.0
Unemployed persons, LFS, th, average	155	122	109	106	126	116	150	170	160
Unemployment rate, LFS, in %, average	2.9	2.2	2.0	2.0	2.4	2.2	2.7	3.1	3.0
Reg. unemployment rate, in %, eop	3.8	3.1	2.9	3.0	3.7	3.7	.	.	.
Average monthly gross wages, CZK	29,638	32,051	34,111	34,132	34,271	34,202	34,800	35,400	36,500
annual change in % (real, gross)	4.1	5.9	3.5	1.4	-2.7	-0.6	-1.0	-0.5	1.0
Consumer prices (HICP), % p.a.	2.4	2.0	2.6	3.7	3.3	3.5	3.0	2.1	2.0
Producer prices in industry, % p.a.	0.7	0.7	1.7	0.1	1.0	0.5	1.0	1.0	1.0
General governm. budget, EU-def., % of GDP									
Revenues	40.5	41.5	41.4	.	.	.	38.5	39.0	40.0
Expenditures	39.0	40.6	41.2	.	.	.	45.0	43.0	40.5
Net lending (+) / net borrowing (-)	1.5	0.9	0.3	.	.	.	-6.5	-4.0	-0.5
General gov.gross debt, EU def., % of GDP	34.2	32.1	30.2	.	.	.	39.0	41.0	40.0
Stock of loans of non-fin.private sector, % p.a.	6.5	6.8	5.2	6.4	5.6	5.6	.	.	.
Non-performing loans (NPL), in %, eop	4.0	3.3	2.5	2.4	2.4	2.4	.	.	.
Central bank policy rate, % p.a., eop 2)	0.50	1.75	2.00	1.00	0.25	0.25	0.15	0.50	0.75
Current account, EUR mn	2,892	962	-660	3,103	275	3,302	1,000	100	500
Current account, % of GDP	1.5	0.5	-0.3	5.9	0.6	3.2	0.5	0.0	0.2
Exports of goods, BOP, EUR mn	129,241	136,370	139,277	33,977	26,324	60,099	119,600	130,400	139,500
annual change in %	9.2	5.5	2.1	-3.1	-26.5	-15.2	-14.1	9.0	7.0
Imports of goods, BOP, EUR mn	119,448	128,516	130,082	31,315	25,139	56,292	114,200	122,800	132,600
annual change in %	9.8	7.6	1.2	-2.9	-23.2	-13.4	-12.2	7.5	8.0
Exports of services, BOP, EUR mn	24,206	25,942	27,120	6,526	5,206	11,697	24,400	26,600	28,600
annual change in %	9.9	7.2	4.5	3.2	-22.7	-10.4	-10.0	9.0	7.5
Imports of services, BOP, EUR mn	19,468	21,262	23,054	5,015	4,174	9,166	20,700	22,500	24,500
annual change in %	7.7	9.2	8.4	0.5	-21.2	-10.9	-10.0	8.5	9.0
FDI liabilities, EUR mn	9,997	7,129	8,314	2,582	-624	1,871	2,500	.	.
FDI assets, EUR mn	8,288	5,156	5,942	2,591	-2,212	249	500	.	.
Gross reserves of NB excl. gold, EUR mn	123,273	124,142	133,059	131,906	134,744	134,744	.	.	.
Gross external debt, EUR mn	171,115	171,534	172,504	163,792	164,413	164,413	165,400	171,800	171,400
Gross external debt, % of GDP	88.1	81.3	77.0	79.2	79.5	79.5	80.0	77.0	72.0
Average exchange rate CZK/EUR	26.33	25.65	25.67	25.61	27.07	26.34	26.5	26.0	25.8

1) Preliminary. - 2) Two-week repo rate.

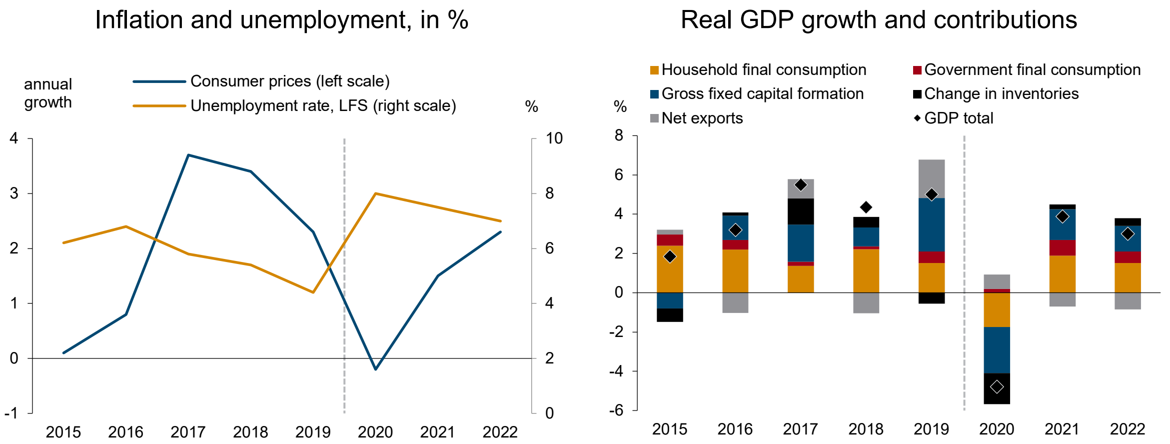
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ESTONIA: Government uses fiscal space to support a bounce-back

SEBASTIAN LEITNER

The economic slump of March-May 2020 was short-lived and was followed by an upswing in external and household demand. Nevertheless, the second wave of infections is likely to result in restrained economic activity in the coming months. A substantial government rescue package helped to cushion the downturn, and the medium-term budget strategy envisages further substantial public support for economic growth. We project a recession of 4.8% of GDP in 2020, followed by a revival of 3.9% in 2021 and a smaller upswing of 3% in 2022.

Figure 4.7 / Estonia: Main macroeconomic indicators



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

Estonian GDP contracted by 6.9% in the second quarter of 2020, but the economy bounced back remarkably in the following months. The first half of this year showed strongly declining investments and imports, which collapsed even more than exports. Household consumption, however, declined less than expected. The second wave of infections, in autumn, has also hit Estonia; however, with about 25 cases per million inhabitants in mid-October (average over previous week), the country is so far performing better than all other EU countries in this respect.

Following a slump in foreign trade in April to May, things stabilised in the following months. We expect the decline in goods exports to be 2.7% in nominal terms in 2020 – smaller than previously anticipated and fairly limited by European standards. The main reason is that the economies of Sweden and Finland – Estonia's main trading partners – are likely to perform better than the EU average, with a fall in GDP of about 5% in 2020. In particular, demand from Sweden will become quite lively, pushed along by the country's substantial fiscal support measures. Simultaneously, imports are falling more than exports this year, since entrepreneurs run down their stock of inputs in uncertain times. Moreover, households are reluctant to spend on imported durable consumer goods. A similar development can be observed in the case of services. Particularly in transport, construction and business services, imports are declining much more than exports. Tourism income has dwindled and will remain minimal this year and in the first half of 2021. At 5.5% of GDP, service exports by the tourism sector are about as important for the Estonian economy as they are for Spain, Austria or Slovenia. We should not expect a V-shaped development of goods and services exports in 2021; however, a substantial recovery is likely next year, given the fiscal stimulus in the EU to get the economy back on track.

Household consumption shrank by almost 7% in the second quarter of 2020; however, monthly retail trade figures show that it has already recovered. Although the containment measures taken by the Estonian government were laxer than in other countries in the lockdown period (e.g. shops outside malls did not have to close, and restaurants and bars could stay open till 10 p.m.), a slump in consumer spending could not be prevented in March-May. Forward-looking consumer confidence indicators and business sentiment figures suggest that households have regained their good spending mood and are only cautious about spending on durables at the moment. Overall, consumption will continue as a driver of growth in the coming two years.

Having surged in 2019, investment activity was expected to decline this year even prior to the pandemic. In the first half of 2020, in total it decreased by 11.6% year on year. In particular, businesses spent less on buildings and on upgrading their vehicle fleets, whereas investment in machinery and other equipment remained relatively stable. Looking ahead, enterprises will remain reluctant to invest until a vaccine is available that can ensure herd immunity. Investment by households – i.e. private housing construction – will also remain depressed in coming years. After a slump in the second quarter, new mortgage loans stabilised again in August 2020. House prices are still growing year on year. However, we expect households to become more cautious in the case of real estate acquisition.

Immediately after implementing the lockdown measures, the Estonian government announced a rescue package worth no less than 7% of GDP. In particular, it included subsidies for short-time work schemes, state loans to businesses and state guarantees for loans already issued. Moreover, it was announced that public investments would be front-loaded. Additional support measures were implemented for the sectors of tourism, agriculture and food production, and the government increased its share capital in the Estonian airline Nordica, which will keep it going until next summer. In April 2020, a supplementary budget was passed that envisages a budget deficit of 10% of GDP in 2020. However, given the improvement in the growth forecast, the shortfall in tax revenues and social security contributions will be less. Thus, we expect the final budget deficit to be only 8% by the end of the year. The 2021 government budget envisages a further rise in the ratio of public investments from 4.9% of GDP (2019) and 6.3% (2020), to 6.6% in 2021. The focus will be on modernising hospitals and improving the digital capacity of the economy. The budget deficit is planned to stay above 3% until 2024.

After a sharp increase to 8% in June 2020, the unemployment rate has since remained at that level. We expect the same rate for the year as a whole (according to the Labour Force Survey). Employment fell considerably in domestic trade, transport and accommodation, while remaining stable in manufacturing and construction. In the short to medium term, the government's short-time work scheme has helped to contain job losses. However, in the coming months the bankruptcy of ever more enterprises will be unavoidable – not only in the service sector, but also in production. Since households on low incomes will be the worst affected, the social safety net needs to be strengthened in order to deal with longer phases of joblessness, since unemployment benefits are rather low. In the coming two years, however, we expect an amelioration of the labour market situation, with gradually falling unemployment rates.

Given the considerable rise in unemployment, we expect wages to increase by only 2% in real terms in 2020. The government's short-time work scheme encourages enterprises to reduce the wages of at least 30% of staff by at least 30% (or down to the minimum wage) as one of the options for qualifying to receive subsidies. Thus, in those sectors hit hardest by the crisis, a decline in average wages could already be observed in the second quarter of 2020, compared to the same period last year; meanwhile, in other industries (e.g. ICT, finance, utilities), the considerable rise in wages seen in previous years as a result of skills shortages continues. The government has announced a freeze on the salaries of teachers for a couple of years, and this may be applied to other groups of public employees. Core inflation will fall throughout the year: the rise in consumer prices started to turn negative in March, largely due to the falling price of imported goods, particularly fuel. This will result in overall deflation in 2020, while we expect a revival of consumer inflation in 2021 and thereafter, on the back of rising import prices and accelerated real wage growth.

Since our interim forecast in spring, we have become more optimistic, increasing the forecast GDP growth rate for 2020 from -7% to -4.8% on the back of a stabilisation in foreign demand in recent months and resurgent household consumption. The government's budget plan for the coming years shows a willingness to use the fiscal space in order to boost investment for a longer time and buoy up the income of households. Our base scenario rests upon the assumption of a rollout of a vaccine in the coming year that will enable herd immunity to be attained within a relatively short time. Thus, a rebound in all demand categories of GDP, except net exports, is likely. Consequently, we forecast a revival of GDP growth of 3.9% in 2021, and another 3% in 2022.

Table 4.7 / Estonia: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average	1,317	1,322	1,327	.	.	1,325	1,335	1,340	1,342
Gross domestic product, EUR mn, nom.	23,858	25,938	28,112	6,537	6,446	12,983	26,700	28,100	29,600
annual change in % (real)	5.5	4.4	5.0	-0.7	-6.9	-3.9	-4.8	3.9	3.0
GDP/capita (EUR at PPP)	23,220	24,690	26,100	.	.	.	.	.	.
Consumption of households, EUR mn, nom.	11,613	12,592	13,315	3,224	3,004	6,228	.	.	.
annual change in % (real)	2.8	4.6	3.1	1.4	-8.7	-3.8	-3.7	4.0	3.2
Gross fixed capital form., EUR mn, nom.	5,940	6,377	7,369	1,508	1,609	3,117	.	.	.
annual change in % (real)	7.8	3.9	11.1	-7.1	-15.4	-11.6	-9.0	6.0	5.0
Gross industrial production									
annual change in % (real)	4.1	4.7	-0.1	-6.5	-2.5	-9.7	-6.0	4.0	3.0
Gross agricultural production									
annual change in % (real)	6.5	-6.3	23.6	.	.	.	.	.	.
Construction industry									
annual change in % (real)	21.5	12.3	3.2	7.3	-8.4	-1.8	.	.	.
Employed persons, LFS, th, average	658.6	664.7	671.3	670.3	643.9	667.7	668	670	675
annual change in %	2.2	0.9	1.0	1.3	-1.2	0.4	-0.5	0.3	0.7
Unemployed persons, LFS, th, average	40.3	37.7	31.3	35.0	49.4	42.2	58	54	51
Unemployment rate, LFS, in %, average	5.8	5.4	4.4	5.0	7.1	6.1	8.0	7.5	7.0
Reg. unemployment rate, in %, eop 2)	4.8	4.8	5.3	6.3	7.8	7.8	.	.	.
Average monthly gross wages, EUR	1,221	1,310	1,407	1,404	1,433	1,419	1,430	1,500	1,590
annual change in % (real, gross)	3.0	3.8	5.0	3.1	2.5	2.6	2.0	3.4	3.4
Average monthly net wages, EUR	986	1,070	1,150	1,149	1,172	1,161	1,170	1,220	1,290
annual change in % (real, net)	3.2	5.0	5.1	3.4	2.3	2.8	2.2	2.7	3.0
Consumer prices (HICP), % p.a.	3.7	3.4	2.3	1.0	-1.6	0.0	-0.2	1.5	2.3
Producer prices in industry, % p.a.	3.3	3.9	-0.6	-4.9	-2.8	-4.8	-2.2	1.0	3.0
General governm. budget, EU-def., % of GDP									
Revenues	38.4	38.7	38.6	.	.	.	39.0	39.0	38.8
Expenditures	39.2	39.3	38.9	.	.	.	45.0	43.0	40.8
Net lending (+) / net borrowing (-)	-0.8	-0.6	-0.3	.	.	.	-8.0	-4.0	-2.0
General gov.gross debt, EU def., % of GDP	9.3	8.4	8.4	.	.	.	15.0	18.0	19.0
Stock of loans of non-fin.private sector, % p.a.	0.7	5.1	3.3	3.9	1.9	1.9	.	.	.
Non-performing loans (NPL), in %, eop	0.8	0.5	0.5	0.5	0.5	0.5	.	.	.
Central bank policy rate, % p.a., eop 3)	0.00	0.00	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR mn	546	238	553	281	316	597	820	470	220
Current account, % of GDP	2.3	0.9	2.0	4.3	4.9	4.6	3.1	1.7	0.7
Exports of goods, BOP, EUR mn	11,964	12,592	13,316	3,273	2,953	6,227	12,700	13,200	13,900
annual change in %	6.5	5.2	5.8	-1.9	-13.1	-7.6	-4.6	3.9	5.3
Imports of goods, BOP, EUR mn	12,873	13,816	14,207	3,282.5	2,977	6,260	13,300	14,100	15,200
annual change in %	6.8	7.3	2.8	-3.6	-18.6	-11.4	-6.4	6.0	7.8
Exports of services, BOP, EUR mn	6,082	6,633	7,180	1,516	1,199	2,715	5,800	6,400	7,100
annual change in %	10.3	9.1	8.3	4.5	-36.2	-18.4	-19.2	10.3	10.9
Imports of services, BOP, EUR mn	4,229	4,739	5,161	1,070.8	800	1,871	4,000	4,600	5,100
annual change in %	8.1	12.1	8.9	-1.1	-38.7	-21.6	-22.5	15.0	10.9
FDI liabilities, EUR mn	1,552	1,022	2,627	721	194	915	1800	.	.
FDI assets, EUR mn	613	-197	1,640	289	-284	5	100	.	.
Gross reserves of NB excl. gold, EUR mn	279	651	1,256	1,418	1,678	1,678	.	.	.
Gross external debt, EUR mn	19,766	19,886	20,653	21,214	24,172	24,172	20,800	21,900	23,700
Gross external debt, % of GDP	82.8	76.7	73.5	79.5	90.5	90.5	78.0	78.0	80.0

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

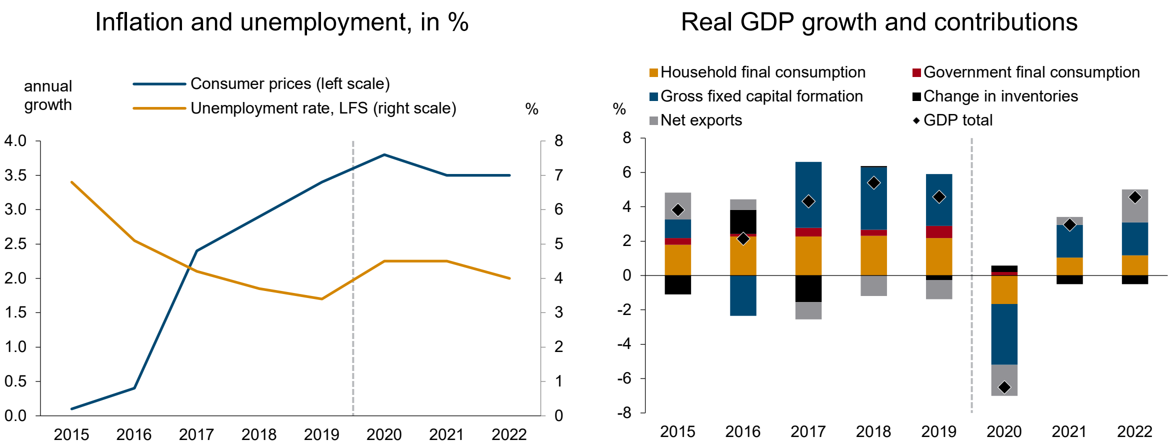
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

HUNGARY: Next Generation EU funds crucial to avoid delayed recovery

SÁNDOR RICHTER

The COVID-19 crisis has hit the economy hard, with the export of vehicles and tourism suffering the most. Household consumption and investment have declined sharply, due partly to sub-optimal crisis management by the government. The pre-crisis economic level will only be reached in late 2022, at the earliest. Support from the EU rescue programme is indispensable for this, but non-compliance with rule-of-law requirements may render participation problematic.

Figure 4.8 / Hungary: Main macroeconomic indicators



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

In the second quarter, GDP dropped by 13.6% year on year. The decline was over 20% in manufacturing, and was 13% in construction and 12% in services. The lockdown and the partial break-up of international production linkages hit the output of transport vehicles especially hard (a sector that accounts for about a third of manufacturing output). Within services, income from cross-border tourism and transportation suffered a decline of over 25%. Agriculture, the information and telecom sector, financial services and the food industry all proved resilient to the COVID-19 crisis: they showed either minimal decline or even modest expansion.

On the expenditure side of GDP, the decline in household consumption (over 8%) contributed massively to the Q2 shrinkage of the economy. This resulted from the loss of jobs and related income, more cautious spending by households (reflected in an increased propensity to save) and the lockdown-related restriction of opportunities to spend earned income, primarily through the purchase of services. Government consumption increased but was only sufficient to moderate the contraction of actual final consumption, which amounted to 6.7%. While gross fixed capital formation dropped by 11%, gross capital formation fell by only 6%, indicating a strong accumulation of inventories (or measurement problems). Foreign trade contributed heavily to the GDP decline, with a huge quarterly deficit. Exports and imports of goods fell by over 20% in nominal euro terms. As for trade in services, exports fell by no less than 40%, following the disruption to inward cross-border tourism, while services imports dropped by 27%.

The Hungarian government's strategy for crisis management deviated from that pursued by most other EU members. Its principal consideration was that the resources to address the crisis should come primarily from a restructuring of budgeted government expenditure and by generating additional fiscal revenues. Although the strict EU requirements for fiscal deficits were eased, Prime Minister Orbán has long had strong reservations about excessive fiscal deficits: he regards these as potential triggers that could enable the EU Commission or the IMF to gain influence over the Hungarian economy, should a bailout programme prove unavoidable. This consideration has limited the government's readiness to employ a classical deficit spending programme to check the shrinkage of aggregate demand. The original fiscal deficit target for 2020 of less than 3% of GDP was maintained well after game-changing information about the gravity of the economic crisis became known. In the critical Q2, public investment decreased by 19% – nearly twice as much as private-sector investment. In line with Orbán's vision of turning Hungary into a 'work-based society' (i.e. all social support should be kept at the lowest possible level), the government has been reluctant to supplement household incomes hit by the COVID-19 crisis. Unemployment benefits continue to be paid for a maximum of three months, and the Hungarian version of short-time working (or *Kurzarbeit*) has been far from generous. Those involved in public workfare earn EUR 150 a month, and those relying on social aid get EUR 63.

The main tool of crisis management has been a moratorium on credit repayment for both households and businesses. This is intended to curb the decline in aggregate demand, and the positive effect was supposed to be in the region of 4% of GDP. However, the households involved do not necessarily spend what they thus save, while those who are hardest hit by the crisis – i.e. low-income households and small or micro businesses – are typically not involved in the moratorium. The unemployment statistics do not include data for firms with fewer than five employees, and the lost incomes of people in the unreported economy are also missing from the statistics. This explains the sharp fall in household consumption, despite a relatively mild deterioration in reported unemployment and a strong increase in wages.

The current second wave of the epidemic means that the likelihood of a V-shaped economic recovery is small. GDP is expected to decline by 6.5% in 2020, within a band of -5.5% to -8.5%. All major GDP components will contribute to the contraction of the economy: consumption, investment and net exports. As a result of both plunging budget revenues (due to the deep recession) and the increased expenditure undertaken in the second half of the year (following a slight easing of the government's aversion to classic deficit spending), the fiscal deficit may amount to 8-9% of GDP this year. Public debt will again rise to well over 70% of GDP, with an increased share of foreign financing. The central bank has been forced to tacitly tighten its monetary policy, in order to curb the depreciation of the HUF (which amounted to 9% against the euro in the first three quarters of the year).

The pre-crisis level of economic activity will only be achieved in late 2022, at the earliest. Participation in the Next Generation EU (NGEU) programme is crucial in this respect. The programme would enable the huge resources earmarked for Hungary (about EUR 6 billion in transfers and EUR 10 billion in preferential credits) to be accessed from early 2021. Such a capital injection could plug the ‘hole’ in free external financing that has been punched by (a) the deliberate early utilisation of EU transfers from the 2014-2020 EU Multiannual Financial Framework (MFF), and (b) the severely delayed start of actual money flow from the next, 2021-2027 EU MFF. However, the arrival of NGEU funds is by no means assured, as strings could be attached in the form of a ‘rule of law’ requirement – potentially a major problem for the Hungarian government. With the NGEU recovery programme now coming on top of MFF, clearly there is more money at stake. The desire to rein in EU transfer-related corruption is stronger than ever both in the European Parliament and in those member states that are net contributors to the EU budget. Obvious non-compliance by the Hungarian government with certain fundamental political values of the EU may aggravate the situation still further.

Table 4.8 / Hungary: Selected economic indicators

	2017	2018	2019 [1)]	2020 1Q	2020 2Q	2020 1-2Q	2020	2021 Forecast	2022
Population, th pers., average	9,788	9,776	9,771	.	.	.	9,700	9,670	9,620
Gross domestic product, HUF bn, nom.	39,233	43,347	47,514	10,985	10,831	21,816	45,800	48,700	52,500
annual change in % (real)	4.3	5.4	4.6	2.2	-13.6	-6.1	-6.5	3.0	4.6
GDP/capita (EUR at PPP)	20,390	21,830	23,110	.	.	.	.	.	.
Consumption of households, HUF bn, nom.	18,961	20,522	22,397	5,664	5,283	10,947	.	.	.
annual change in % (real)	4.7	4.8	4.6	4.6	-8.3	-2.0	-3.5	2.2	2.5
Gross fixed capital form., HUF bn, nom.	8,699	10,742	12,937	2,297	3,273	5,570	.	.	.
annual change in % (real)	19.7	16.4	12.2	-4.1	-10.9	-8.2	-13.0	7.0	7.0
Gross industrial production									
annual change in % (real)	4.7	3.5	5.4	0.3	-25.4	-12.6	-9.5	6.0	6.0
Gross agricultural production									
annual change in % (real)	-4.1	2.7	-0.3	.	.	.	.	.	.
Construction industry									
annual change in % (real)	29.7	21.2	20.7	-0.3	-12.4	-7.3	.	.	.
Employed persons, LFS, th, average	4,421	4,470	4,512	4,466	4,408	4,437	4,420	4,464	4,510
annual change in %	1.6	1.1	1.0	-0.7	-2.3	-1.5	-2.0	1.0	1.0
Unemployed persons, LFS, th, average	192	172	160	173	214	194	180	210	190
Unemployment rate, LFS, in %, average	4.2	3.7	3.4	3.7	4.6	4.2	4.5	4.5	4.0
Reg. unemployment rate, in %, eop [2)]	5.6	5.2	5.1	4.4	5.8	5.8	.	.	.
Average monthly gross wages, HUF [3)]	297,017	329,943	367,833	384,307	406,903	395,605	400,900	424,100	445,500
annual change in % (real, gross)	10.3	8.3	7.7	4.6	8.3	6.4	5.0	2.2	1.5
Average monthly net wages, HUF [3)]	197,516	219,412	244,609	255,564	270,591	263,078	266,600	282,000	296,200
annual change in % (real, net)	10.3	8.3	7.7	4.6	8.3	6.4	5.0	2.2	1.5
Consumer prices (HICP), % p.a.	2.4	2.9	3.4	4.4	2.5	3.4	3.8	3.5	3.5
Producer prices in industry, % p.a.	3.3	5.6	2.1	4.1	2.8	3.5	3.5	3.0	3.0
General governm.budget, EU-def., % of GDP									
Revenues	44.1	43.8	43.3	.	.	.	41.0	45.0	45.0
Expenditures	46.5	45.9	45.3	.	.	.	49.0	49.9	48.9
Net lending (+) / net borrowing (-)	-2.4	-2.1	-2.0	.	.	.	-8.0	-4.9	-3.9
General gov.gross debt, EU def., % of GDP	72.2	69.1	65.3	.	.	.	74.0	73.0	71.0
Stock of loans of non-fin.private sector, % p.a.	5.5	10.6	13.2	18.4	13.7	13.7	.	.	.
Non-performing loans (NPL), in %, eop [4)]	7.5	5.4	4.1	4.2	4.0	4.0	.	.	.
Central bank policy rate, % p.a., eop [5)]	0.90	0.90	0.90	0.90	0.75	0.75	0.60	0.60	0.60
Current account, EUR mn [6)]	2,490	377	-363	317	-847	-531	-2,300	-1,900	-900
Current account, % of GDP [6)]	2.0	0.3	-0.2	1.0	-2.8	-0.8	-1.8	-1.4	-0.6
Exports of goods, BOP, EUR mn [6)]	85,285	88,662	93,078	23,346	18,160	41,506	81,400	89,500	98,500
annual change in %	8.5	4.0	5.0	-0.4	-22.8	-11.6	-12.5	10.0	10.0
Imports of goods, BOP, EUR mn [6)]	83,573	90,346	96,069	23,538	18,948	42,487	84,100	93,800	103,200
annual change in %	12.0	8.1	6.3	-0.6	-20.6	-10.6	-12.5	11.5	10.0
Exports of services, BOP, EUR mn [6)]	23,817	25,359	26,928	5,542	4,087	9,630	17,500	20,100	24,100
annual change in %	8.9	6.5	6.2	-7.3	-40.2	-24.9	-35.0	15.0	20.0
Imports of services, BOP, EUR mn [6)]	16,870	17,671	19,363	4,107	3,437	7,544	13,600	15,000	17,300
annual change in %	7.1	4.7	9.6	-5.9	-27.0	-16.8	-30.0	10.0	15.0
FDI liabilities, EUR mn [6)]	7,083	8,937	-294	243	-647	-404	1,000	.	.
FDI assets, EUR mn [6)]	5,037	6,202	-197	-323	-916	-1,238	2,000	.	.
Gross reserves of NB excl. gold, EUR mn	23,261	26,273	27,010	24,287	28,593	28,593	.	.	.
Gross external debt, EUR mn [6)]	105,600	107,975	105,734	103,014	107,356	107,356	110,000	110,000	110,000
Gross external debt, % of GDP [6)]	83.2	79.4	72.4	78.7	82.0	82.0	84.1	82.4	77.5
Average exchange rate HUF/EUR	309.19	318.89	325.30	339.08	351.71	345.40	350	365	370

1) Preliminary. - 2) From 2020 unemployed in % of working-age population 15-64 (% of 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 NB bill). - 6) Excluding SPE.

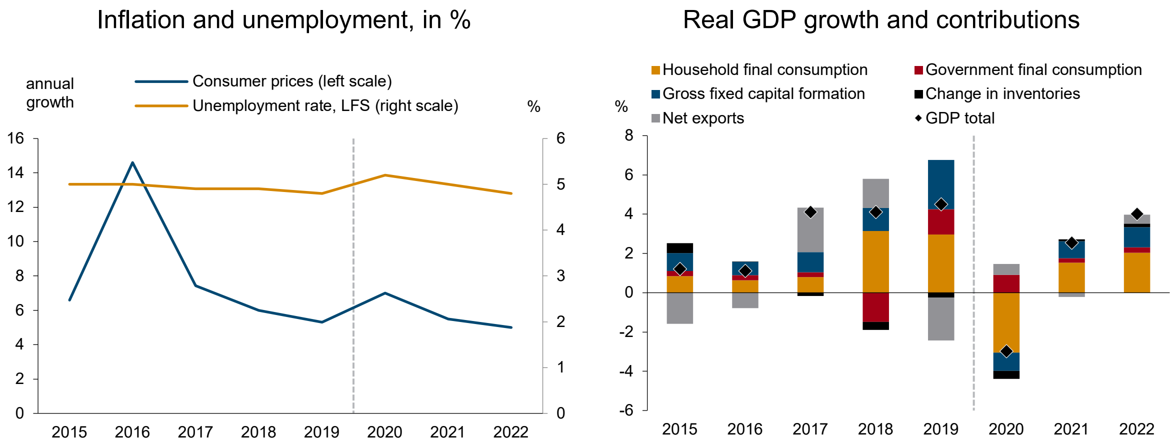
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

KAZAKHSTAN: Fiscal policy to the rescue

ALEXANDRA BYKOVA

A substantial anti-crisis package is mitigating the impact on the economy of two lockdowns and low oil prices. The cut in oil production, in line with the OPEC+ agreement, will hinder any strong revival of exports in coming years. Thanks to a massive fiscal stimulus, real GDP in 2020 is expected to fall by only 3%. Economic growth will resume in 2021, but will be moderate, at 2.5%; in 2022, it will accelerate to 4%. Further lockdowns and the absence of any recovery in oil prices are the main downside risks to the forecast.

Figure 4.9 / Kazakhstan: Main macroeconomic indicators



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

Despite the fallout from the pandemic, a collapse in the oil price in the first half of the year and a cut in oil production in the second half, Kazakhstan will experience a relatively mild recession this year, thanks mainly to a large fiscal stimulus. Compared to other CESEE countries, Kazakhstan recorded a relatively small decline (of 6.1%) in real GDP in the second quarter of 2020 year on year (y-o-y). Nevertheless, the contraction of the economy was more than double that suffered in the worst quarter following the global financial crisis (-2.6% in Q2 2009). After the economy's strong performance in the first quarter, when it saw growth of 2.7% (y-o-y), overall it contracted by 1.8% (y-o-y) in the first half of the year. The negative growth has likely remained in the third quarter: first of all, containment measures were reintroduced in July to mid-August, following a spike in COVID-19 infections and mortality, and in view of the weak capacity of the health system to cope; and secondly, better compliance with OPEC+ obligations to cut oil production means that industrial activity has slowed since June. However, the substantial, targeted state support package – which has been expanded several times during the year (most recently in early September) – has done much to mitigate the negative impact of the crisis. Assuming no new lockdowns, we are keeping our GDP growth forecast for 2020 unchanged at -3%.

While part of the economy has been severely hit by the restrictions imposed, some industries have stayed afloat thanks to additional public orders, increasing import substitution and growing demand for online activities. Over the first nine months of 2020, the retail and wholesale trade sector recorded a real contraction of 9.5% on an annual basis, while transport suffered a slump of 17.1%. Together, these sectors account for around a quarter of GDP and total employment. By contrast, agriculture, construction and manufacturing grew by 5%, 10.5% and 3.3%, respectively. Demand for digital infrastructure, distance learning and remote work propelled the communication sector to 8.2% real growth y-o-y over the same period. Agriculture has been given special priority under the state anti-crisis measures, due to a concern over food security and the sector's large share of employment (13% of total). It has profited from subsidised loans, tax incentives and direct subsidies. Public orders have boosted pharmaceutical production – essential to ensure that the medicines needed to fight the pandemic are available domestically. Manufacturing enterprises in the priority areas received subsidised loans and direct state funding under the state programme 'Economy of Simple Things', in order to keep them afloat and not jeopardise the longer-term diversification and import-substitution strategy. Since the second lockdown restrictions were lifted in mid-August, business sentiment has been improving, as is reflected in the manufacturing Purchasing Managers' Index (52.6 in September 2020).[15] According to a sentiment indicator compiled by the national statistical office, the heads of industrial enterprises have noted an increase in production volumes and demand in Q3 2020, compared to Q2 2020.

The resources of the National Oil Fund that were accumulated during the economic upswing offer enough flexibility to continue with an expansionary fiscal policy. At the end of September 2020, the assets of the National Oil Fund amounted to USD 57 billion (or 33% of GDP); since the beginning of the year, they have declined by only 7% in dollar terms. The outflow of transfers to the state budget (USD 10 billion in the first nine months of 2020) has been partially offset by an increase in the value of the fund's assets, thanks to an upturn on the financial markets. The transfers have provided for the funding of the fiscal stimuli – both those planned before the pandemic and those introduced subsequently, as part of the anti-crisis package (around 8.7% of GDP). An expansionary fiscal policy will persist in 2021-2022, with a focus on social spending. In 2021, an additional USD 1 billion will be spent on increased pensions and on raising the salaries of teachers and medical workers. Manufacturing and agriculture will be supported with USD 4 billion via the prolongation of targeted programmes. The anti-crisis programme of subsidised loans to small and medium-sized businesses affected by the lockdowns was recently extended to the end of 2021, and its volume was boosted by USD 0.5 billion, to an overall USD 1.9 billion.[16] The moderate revenue from oil and the large fiscal stimuli will mean bigger than anticipated budget deficits in 2020-2022, although a gradual reduction is planned through efficiency gains once public sector reforms are implemented.

Merchandise exports are not expected to return to their 2019 levels before 2022, and their recovery depends greatly on global oil prices. In merchandise exports, the 15.7% contraction in dollar terms over January-August 2020 y-o-y was less pronounced than might have been expected after the plunge in oil prices in March-April. In the first half year, the decline in prices and the reduced demand

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15 A value of over 50 means better sentiment than the previous month.

16 Until September, banks reportedly granted credits to 1,279 SMEs worth a total amount of USD 0.8 billion.

for oil among some trading partners were partially offset by an increase in export volumes, and a reorientation toward other destinations. Despite OPEC+ obligations to cut production, the volume of oil exports in the first eight months of 2020 was greater than in the same period of 2019. The contraction in oil exports to France, South Korea and Spain (which were among Kazakhstan's top six oil export destinations in 2019) of more than 40% y-o-y in physical terms in the first eight months of 2020 was offset by increased exports to India (which trebled) and to China (which more than doubled) over the same period. Thus, those two countries became Kazakhstan's third and fourth largest oil export destinations. We expect the recovery in exports next year to be moderate, as the OPEC+ obligations will limit oil production until 2022, and will thus restrict the potential for high growth in physical export volumes. The government of Kazakhstan does not expect the 2019 oil production level of 90.5 million tonnes to be reached in the next few years, according to official projections (85 million tonnes in 2020, 86 million in 2020 and 89.6 million in 2022). The possible absence of a recovery in oil prices is a serious downside risk that may hamper the price-based acceleration of exports.

The tenge has weakened rather less this year than it might have done, had there been no policy moves; the depreciation will likely slow further in the next two years, although the dynamics is very uncertain. First, interventions by the national bank and then the mandatory sale of dollar revenues by quasi-state exporters and the conversion from dollars into tenge of the monthly National Oil Fund transfers to the budget have helped to stabilise the currency, in the wake of the oil price collapse. However, the recent weakening of emerging economy currencies, especially the Russian rouble, has again put the tenge under stronger pressure. A sharper tenge depreciation is a downside risk to the recovery of imports. In the baseline scenario, we expect current account deficits of 3.5% for 2020 and 3.2% for 2021. The upward correction of the current account deficit forecast for this year is due to a smaller than expected export decline and a very low net outflow of income on direct investment (the value in the first two quarters of 2020 was only half that in the same period of 2019).

Overall, the investment decline in 2020 will be moderate, as the reduction in investment due to postponed projects in the oil industry is offset by government construction programmes. A large negative contribution to the investment dynamics comes from delayed or postponed investment projects, in particular, from temporary work disruptions at the Tengiz oil field enlargement project, due to COVID-19 clusters in sub-contracting firms and state-imposed lockdowns. However, investment in construction, especially housing, expanded by 17% in the first eight months y-o-y. State programmes of road and housing construction have supported the supply side. The volume of new mortgage loans, partly subsidised by the state, expanded by 42% in August y-o-y (the stock of mortgage loans grew by 27% y-o-y), reinforcing demand for apartments. The adequate supply has prevented a disproportionate acceleration in house prices, which remained in line with CPI inflation over January-August (+6.5% y-o-y). Investment projects, especially in the oil sector, are expected gradually to resume and then to accelerate, in order to meet previously agreed deadlines; this suggests a recovery in investment from 2021 and an acceleration in 2022.

The moderate impact of the crisis on the labour market, thanks to the rescue measures, provides a sound precondition for a recovery in consumption once restrictions are lifted – although the recovery is likely to be slow, on account of slower growth in incomes. As a result of the containment measures, private consumption declined by 8.3% y-o-y over the first half of 2020. The restrained consumption translated into deposit growth of 19% y-o-y in August 2020. Maintaining employment and income have been among the main priorities of the anti-crisis package. Public works by local authorities and a targeted employment programme have partially absorbed the unemployed, which is a positive factor for the revival of consumption. However, the current slowdown in the growth of wages suggests that consumption will pick up only moderately in the future. Moreover, a tightening of the social distancing restrictions could be on the cards this winter, if infections rise substantially. To sum up, we expect private consumption to increase by 3% in 2021 and by 4% in 2022.

Subsidised loans for some categories of borrower supported credit growth in 2020, while unsecured consumer lending slowed. The anti-crisis package included a moratorium on loan repayments, and the anticipated deterioration in asset quality will be visible only next year. The supervisory authority is closely monitoring several banks with particularly high levels of non-performing loans in their portfolios and low capital adequacy, and the Tengri Bank is the first bank to have had its licence revoked.

A slow recovery is expected in 2021, with real GDP growth of 2.5%; in 2022, growth will accelerate to 4%. Growth will be broad based, supported by a revival in private consumption, exports and investment. Downside risks include another lockdown, a fall in oil prices, another oil production cut by OPEC+, and the slow recovery of trading partners. The parliamentary elections to be held next year are unlikely to bring any political change and the ruling party is likely to retain its majority.

Table 4.9 / Kazakhstan: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020	2021 Forecast	2022
Population, th pers., average	18,038	18,276	18,514	18,661	18,725	18,696	18,800	19,000	19,200
Gross domestic product, KZT bn, nom.	54,379	61,820	69,533	15,093	13,306	28,400	70,200	76,300	84,100
annual change in % (real)	4.1	4.1	4.5	2.7	-6.1	-1.8	-3.0	2.5	4.0
GDP/capita (EUR at PPP)	17,060	17,840	18,540	.	.	.	.	.	.
Consumption of households, KZT bn, nom.	27,987	31,514	35,374	7,203	6,185	13,388	.	.	.
annual change in % (real)	1.5	6.1	5.8	1.0	-16.6	-8.3	-6.0	3.0	4.0
Gross fixed capital form., KZT bn, nom.	11,799	13,091	16,010	2,654	3,232	5,887	.	.	.
annual change in % (real)	4.5	5.4	11.9	0.1	-5.4	-2.5	-4.0	3.8	4.5
Gross industrial production									
annual change in % (real)	7.3	4.4	4.1	5.8	0.4	3.1	-1.0	2.0	3.0
Gross agricultural production									
annual change in % (real)	3.0	3.5	-0.1	2.5	2.6	2.4	.	.	.
Construction industry									
annual change in % (real)	2.8	4.6	13.2	11.9	8.0	11.2	.	.	.
Employed persons, LFS, th, average	8,585	8,695	8,781	8,794	8,704	8,749	8,780	8,910	9,030
annual change in %	0.4	1.3	1.0	0.7	-0.7	0.0	0.0	1.5	1.3
Unemployed persons, LFS, th, average	442	444	441	442	454	448	480	470	460
Unemployment rate, LFS, in %, average	4.9	4.9	4.8	4.8	5.0	4.9	5.2	5.0	4.8
Reg. unemployment rate, in %, eop	0.8	1.0	1.1	1.6	2.0	2.0	.	.	.
Average monthly gross wages, KZT 2)	150,827	162,673	186,815	200,332	212,035	206,184	210,900	228,100	246,700
annual change in % (real, gross)	-1.7	1.7	9.1	12.2	6.4	9.2	5.5	2.5	3.0
Consumer prices (HICP), % p.a.	7.4	6.0	5.3	6.0	6.8	6.4	7.0	5.5	5.0
Producer prices in industry, % p.a.	15.3	19.0	5.1	1.8	-18.6	-8.6	-8.0	5.0	3.0
General governm.budget, nat.def., % of GDP									
Revenues	21.3	17.5	18.3	22.1	28.0	24.9	25.0	22.0	20.0
Expenditures	23.9	18.8	20.2	22.4	33.8	27.7	30.0	26.0	23.0
Deficit (-) / surplus (+)	-2.7	-1.3	-1.8	-0.2	-5.8	-2.8	-5.0	-4.0	-3.0
General gov.gross debt, nat.def., % of GDP	25.7	26.0	24.9	26.6	27.2	27.2	29.0	31.0	31.0
Stock of loans of non-fin.private sector, % p.a.	0.0	3.0	5.9	14.7	7.9	7.9	.	.	.
Non-performing loans (NPL), in %, eop	9.3	7.4	8.1	8.9	9.0	9.0	.	.	.
Central bank policy rate, % p.a., eop 3)	10.25	9.25	9.25	12.00	9.50	9.50	9.00	8.75	8.50
Current account, EUR mn 4)	-4,516	-117	-6,437	2,557	-1,021	1,542	-5,200	-5,100	-5,700
Current account in % of GDP	-3.1	-0.1	-4.0	7.3	-3.5	2.4	-3.5	-3.3	-3.4
Exports of goods, BOP, EUR mn 4)	41,866	50,712	51,953	12,952	10,589	23,546	40,300	46,300	48,600
annual change in %	30.6	21.1	2.4	10.3	-22.3	-7.2	-22.4	14.9	5.0
Imports of goods, BOP, EUR mn 4)	27,060	29,030	35,759	6,483	7,859	14,341	31,300	32,500	33,800
annual change in %	14.2	7.3	23.2	1.5	-14.8	-8.1	-12.5	3.8	4.0
Exports of services, BOP, EUR mn 4)	5,757	6,205	6,952	1,393	998	2,391	5,000	5,900	6,500
annual change in %	4.7	7.8	12.0	-3.8	-40.5	-23.5	-28.1	18.0	10.2
Imports of services, BOP, EUR mn 4)	8,924	10,156	10,244	2,212	1,614	3,827	7,500	8,900	9,300
annual change in %	0.3	13.8	0.9	-1.1	-35.5	-19.2	-26.8	18.7	4.5
FDI liabilities, EUR mn 4)	4,171	71	3,010	911	2,863	3,771	4,400	.	.
FDI assets, EUR mn 4)	847	-3,933	-1,833	-341	950	607	900	.	.
Gross reserves of NB excl. gold, EUR mn 4)	15,505	14,460	9,004	9,137	10,066	10,066	.	.	.
Gross external debt, EUR mn 4)	140,153	139,732	141,600	139,876	141,802	141,802	145,000	147,000	149,000
Gross external debt, % of GDP	94.9	91.9	87.3	94.2	95.5	95.5	98.0	94.0	88.0
Average exchange rate KZT/EUR	368.32	406.66	428.51	429.88	459.91	444.89	473	489	495

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

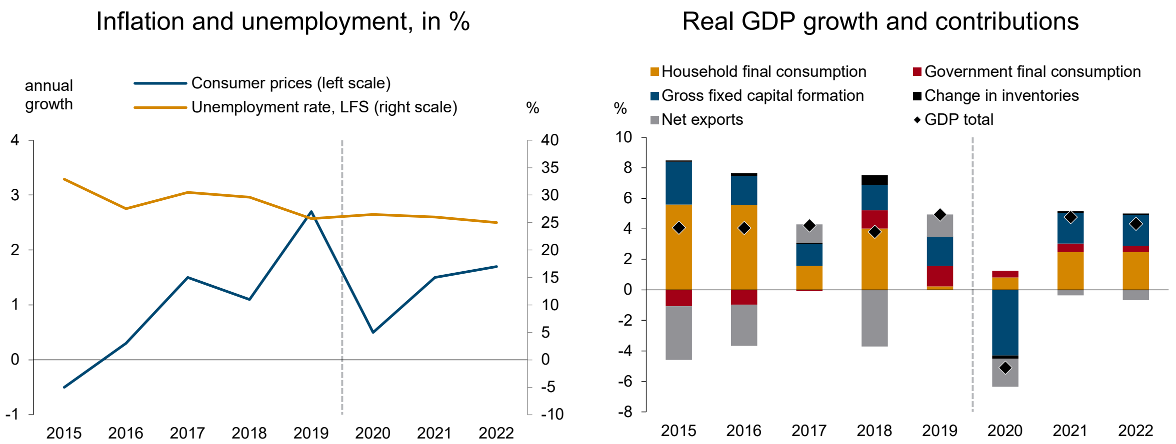
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

KOSOVO: Rising remittances limit the extent of economic decline

ISILDA MARA

Against all expectations, remittances, foreign direct investment and goods exports rose during the pandemic. Still, the negative economic fallout has been considerable and the economy is expected to contract by 5% in 2020. The government has approved a recovery plan worth EUR 365 million to relaunch the economy. Remittances will continue to cushion consumption, and private investments will gain momentum in the medium term. The economy is expected to bounce back in 2021, with growth of 5%. However, recovery remains uncertain, given the continued presence of COVID-19.

Figure 4.10 / Kosovo: Main macroeconomic indicators



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

The economy is expected to contract by over 5% in 2020, due to a sharp fall in investment and real net exports. Economic activity grew slightly (1.4%) in the first quarter of 2020, year on year (y-o-y). The second quarter, however, saw a strong contraction of 9.3% y-o-y. The lockdown imposed from mid-March until May hit certain sectors particularly hard: the services, transport and trade sector contracted by 26%; construction activity dropped by 48%; and extraction industry output fell by 8%. By contrast, the manufacturing sector (which accounts for a fifth of GDP) saw output rise by 19% in the second quarter y-o-y. On the demand side, gross fixed capital formation slumped by 30% in the first half of 2020 (y-o-y). Meanwhile, consumption – with a 90% share of GDP in the first half of 2020 – continued in positive mode in both the first and the second quarters. Government consumption rose by 8% and household consumption by 3%. The external demand shock was mainly felt in the export of services, which fell by 32% over the first half of 2020, year on year. Meanwhile, goods exports gained momentum, soaring 17%

over the same period (although, at 7%, their share of GDP is modest). Overall, net exports declined by 2% over the first half of 2020. Imports contracted by 10%, owing mainly to a fall in the import of services.

The effects of COVID-19 on the population have been severe. Close to 16,000 people have been infected by COVID-19, and more than 630 have lost their lives. The number of both infections and deaths peaked in July, and from August the figure for both declined steadily.[17] However, during October the number of daily infections has been fluctuating, raising concerns about winter trends.

The Kosovo-Serbia dialogue has resumed and the US is again playing an important role. A step towards the normalisation of economic relations was taken on 4 September, with an agreement signed by Kosovo and Serbia in Washington. Both optimism and scepticism have surrounded this agreement. Nevertheless, the outcome of the Washington meeting looks promising. Two weeks later, Richard Grenell, the US envoy to the Kosovo-Serbia dialogue, visited both Kosovo and Serbia. A new agreement was signed between Kosovo and the US which envisages US investments worth EUR 1 billion for infrastructure projects in Kosovo. For a small economy such as Kosovo's, such an investment will provide a powerful stimulus to growth. Another positive outcome of the Washington agreement was the announcement of Kosovo's recognition by Israel. Ukraine also seems to be moving in the same direction, having recognised Kosovo passports.

The precariousness of the labour market stems from the high proportion of temporary employment. With an employment rate of 29.1% and with more than 60% of employees on temporary employment contracts, labour market vulnerability is considerable. Both unemployment and inactivity have most likely increased (although the statistics for the second quarter of 2020 are not yet available). The growth in remittances during the lockdown was probably a response to the rising vulnerability of family members at home. The strong upsurge in remittances inflows, especially in the second quarter of 2020, could also explain why consumption did not contract, with household consumption being cushioned by the financial transfers from abroad. Remittances – especially from Germany and Switzerland – intensified, and in July exceeded EUR 500 million, an increase of 10% (y-o-y).

Merchandise exports rose during the pandemic. In January-July 2020, merchandise exports rose by 17% year on year, mainly to Albania and EU countries such as Germany, Italy and the UK. This stemmed largely from a surge in the export of base metals and articles manufactured from base metals, which increased by 37% in January-July (y-o-y) and accounted for 42% of total goods exports. Merchandise imports fell by 9% generally, although imports from the CEFTA countries rose by more than 5%. In April, Kosovo annulled the 100% tariff on Serbian imports. As a result, imports from Serbia surged and 20% of the imports from the CEFTA countries in January-July were Serbian in origin. The 'green corridors' established during the pandemic, with support from the Regional Cooperation Council, have been instrumental in bolstering trade relations within the region. During the pandemic there has been an intensification of trade relations with neighbouring countries, especially as concerns the export of goods; this has benefited Kosovo and may continue to do so.

The first half of 2020 saw an increase in FDI inflows of EUR 165 million – almost 48% (y-o-y). Sectors such as financial services and real estate, renting and business activities absorbed 50% of the FDI inflows, but the sectors that recorded the strongest growth were mining and energy. Countries such

[17] https://covid19.who.int/region/euro/country/xk

as Hungary, Albania, Germany and Switzerland have been the main senders. The FDI inflows in the energy sector benefited from the start of construction works at a wind farm at Mitrovica, in northern Kosovo. This is an investment by SOWI Kosovo LCC, a German-Kosovo-Israeli joint venture and is worth EUR 169 million. The wind farm, with its 30 turbines, will have a total capacity of 105 megawatts and is expected to be operational by 2021.

The banking sector continued expanding its lending activity, but at a slower pace. Until August 2020, year on year, deposits (which are the main funding source for the banks) rose by 10.6%, while demand for loans – especially for households and non-financial corporations – increased by 7.1% over the same period. The central bank's three-month moratorium on loan payments during the pandemic affected more than 50% of bank loans, according to the IMF. The level of non-performing loans is relatively low. In August, their share rose slightly to 2.6% – 0.5 percentage points up on their proportion prior to the pandemic. However, the performance of loans is expected to deteriorate, given that 70% of them affect the service sector – wholesale, retail trade and services – which was severely hit by the lockdown.

The public debt to GDP ratio is expected to deteriorate as the budget deficit rises. In January-August, government revenue fell by 21% (with a sharp drop in both direct and indirect tax revenue), while expenditure rose by 8%. Total spending on wages, salaries and social transfers – which absorb the largest slice of budgetary expenditure – rose by more than 8%. Capital investments suffered the most, falling by 36% and accounting for only 8% of total expenditure. The public debt to GDP ratio may deteriorate to over 22%, given the fiscal deficit of 5% recorded for the first half of 2020. The financial package put together by the government to deal with the effects of COVID-19 is estimated at 3.1% of GDP. In July, the government approved a recovery package for 2020-2023 worth EUR 365 million. More specifically, the recovery plan envisages the allocation of EUR 100 million to facilitate access to loans for businesses and EUR 15 million to ease the tax burden and support short-term liquidity; more than EUR 67 million have been proposed to support job retention and reintegration into work; and financial support worth EUR 26 million is foreseen to sustain agricultural production and employment in that sector.

Given the high dependence on imports, consumer prices will remain subdued. In September, the consumer price index declined by -0.4% (y-o-y). This was due largely to lower import prices, but also to meagre consumer demand in the second quarter, given the restrictions on mobility. The lifting of the 100% import tariff on Serbian goods may also have prevented prices rising further. Given the high dependence on imports, we expect inflation to remain subdued and to hover at around 1.5%.

Overall, we expect economic activity to contract by 5% in 2020; assuming there is no second lockdown, it is anticipated that the economy will bounce back in 2021, with growth of 5%. Domestic demand and merchandise exports will continue to drive the economy. Given the ongoing pandemic, external demand dynamics are subject to a high level of uncertainty, especially as concerns the export of services. Private investments are expected to gain momentum in the medium term, thanks to the agreement with the US to provide financial support for infrastructure projects in Kosovo.

Table 4.10 / Kosovo: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average	1,791	1,797	1,789	.	.	.	1,765	1,764	1,763
Gross domestic product, EUR mn, nom.	6,414	6,726	7,104	1,438	1,636	3,074	6,800	7,200	7,600
annual change in % (real)	4.2	3.8	4.9	1.3	-9.3	-4.6	-5.1	4.8	4.3
GDP/capita (EUR at PPP)	7220	7610	7980	.	.	.	.	.	.
Consumption of households, EUR mn, nom.	5,370	5,738	5,836	1,308	1,549	2,856	.	.	.
annual change in % (real)	1.8	4.8	0.3	5.2	3.5	4.3	1.0	3.0	3.0
Gross fixed capital form., EUR mn, nom.	1,729	1,888	2,038	.	.	.	.	.	.
annual change in % (real)	5.7	6.1	6.8	.	.	.	-15.0	7.0	7.0
Gross industrial production 2)									
annual change in % (real)	4.9	-1.3	6.3	2	-17	-8.9	-2.0	2.0	3.0
Gross agricultural production 3)									
annual change in % (real)	-4.1	-20.4	11.2	.	.	.	.	.	.
Construction output 4)									
annual change in % (real)	8.6	9.3	3.5	.	.	.	.	.	.
Employed persons, LFS, th, average 5)	357.1	345.1	363.2	.	.	.	350	355	360
annual change in %	7.6	-3.4	5.2	.	.	.	-3.5	1.0	2.0
Unemployed persons, LFS, th, average 5)	156.6	145.0	125.3	.	.	.	135	120	120
Unemployment rate, LFS, in %, average 5)	30.5	29.6	25.7	.	.	.	26.5	26.0	25.0
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.	.	.
Average monthly gross wages, EUR	528	558	600	.	.	.	630	660	700
annual change in % (real, gross)	1.7	4.7	5.0	.	.	.	4.0	3.0	4.0
Average monthly net wages, EUR	471	498	550	.	.	.	570	600	620
annual change in % (real, net)	1.5	4.6	7.0	.	.	.	4.0	3.0	2.0
Consumer prices (HICP), % p.a.	1.5	1.1	2.7	1.1	0.2	0.6	0.5	1.5	1.7
Producer prices, % p.a.	0.6	1.4	0.9	-0.2	-1.5	-0.9	-1.0	1.4	1.5
General governm.budget, nat.def., % of GDP									
Revenues	30.0	29.8	31.3	28.0	35.7	32.1	29.0	32.0	32.0
Expenditures	28.6	29.4	30.3	27.8	32.6	30.4	34.0	31.5	31.5
Deficit (-) / surplus (+)	1.3	0.4	1.0	0.1	3.1	1.7	-5.0	0.5	0.5
General gov.gross debt, nat.def., % of GDP	15.5	16.3	16.9	16.3	18.2	18.2	22.0	21.0	20.0
Stock of loans of non-fin.private sector, % p.a.	11.6	10.8	10.0	9.2	6.4	6.4	.	.	.
Non-performing loans (NPL), in %, eop	3.1	2.7	2.0	2.9	2.6	2.6	.	.	.
Central bank policy rate, % p.a., eop 6)	6.83	5.99	6.42	6.3	6.3	6.3	6.00	5.50	5.50
Current account, EUR mn	-349	-509	-399	-72	-145	-217	-405	-520	-630
Current account, % of GDP	-5.4	-7.6	-5.6	-5.0	-8.9	-7.1	-6.0	-7.2	-8.3
Exports of goods, BOP, EUR mn	378	377	393	98	115	213	420	440	460
annual change in %	22.9	-0.4	4.4	25.0	10.5	16.7	6.0	4.0	5.0
Imports of goods, BOP, EUR mn	2,843	3,114	3,233	679	673	1,352	3,140	3,270	3,430
annual change in %	9.4	9.6	3.8	3.3	-18.6	-8.9	-3.0	4.0	5.0
Exports of services, BOP, EUR mn	1,359	1,562	1,675	282	115	396	1,340	1,430	1,530
annual change in %	20.2	14.9	7.3	-0.1	-62.4	-32.5	-20.0	7.0	7.0
Imports of services, BOP, EUR mn	531	706	749	140	107	247	700	750	810
annual change in %	8.1	32.8	6.1	10.6	-36.0	-15.9	-7.0	6.5	8.0
FDI liabilities, EUR mn	255	272	272	105	60	165	340	.	.
FDI assets, EUR mn	43	46	66	8	8	17	40	.	.
Gross reserves of NB excl. gold, EUR mn	683	769	864	845	900	900	.	.	.
Gross external debt, EUR mn	2,088	2,036	2,201	2,207	2,273	2,273	2,300	2,200	2,300
Gross external debt, % of GDP	32.6	30.3	31.0	33.4	34.4	33.4	34.0	31.0	30.0

1) Preliminary. - 2) Turnover in manufacturing industry (NACE C). - 3) wiiw estimate in 2019. - 4) Value added. - 5) Population 15-64. -
6) Average weighted effective lending interest rate of commercial banks (Kosovo uses the euro as national currency).

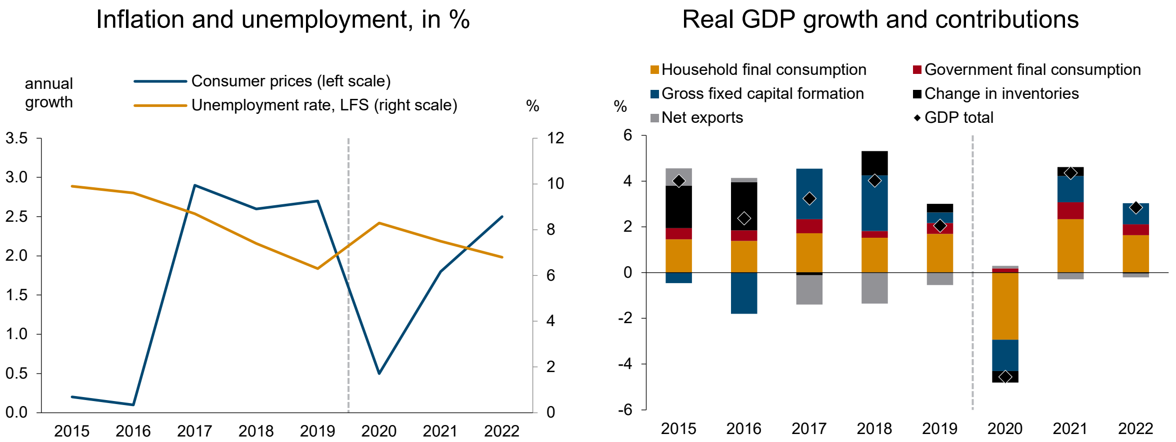
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

LATVIA: After the slump, heading for a well-shaped recovery

SEBASTIAN LEITNER

The Latvian economy has experienced a sharp decline, but seems to have bounced back quite quickly in the third quarter of 2020. Household consumption fell by more than 20% in the second quarter, but more recently has picked up again. The decline in external demand was much less than expected. Similarly, gross fixed capital investment fell only slightly, but is likely to be depressed in the second half of the year. In 2020, we expect GDP to shrink by 4.6%; this will be followed by strong growth of 4.4% in 2021 and a somewhat slower upswing of 2.8% in 2022.

Figure 4.11 / Latvia: Main macroeconomic indicators



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

Following a contraction of GDP by almost 9% in the second quarter of 2020, the Latvian economy has shown signs of recovery in subsequent months. 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 is also milder than in most other European countries. In the first half of the year, value added fell in almost all sectors of the economy – except for construction, where it increased by 5.3% in real terms. Household consumption contracted markedly, while investments stagnated.

After an initial slump, exports have recovered more strongly than imports. The slowdown in global economic activity resulted in Latvia's exports slumping in March-May. However, from June onwards, there was once again some nominal growth, with electrical machinery and equipment and wood products bouncing back most strongly. At the same time, there has been a more pronounced decline in imports of goods, driven not least by substantial import price deflation – in particular, cheaper fuels. This has resulted in the current account turning positive (more than 2% of GDP) in 2020. Compared to goods, there has been a much sharper decline in trade in services, which is an important economic activity for Latvia. Income from travel collapsed and exports in transport services in 2020 will probably be half the figure for 2019. Activity in those two branches will recover only slowly in the next two years.

Investments have so far fallen only slightly, but they are unlikely to bounce back any time soon. In particular, we expect investment in real estate to decline in the coming quarters, both in non-residential and residential buildings. Recent figures show that construction companies have started to postpone the erection of planned buildings, while house prices declined slightly in the second quarter of the year. Meanwhile, the stock of mortgage loans continues to grow, demonstrating the eagerness of households with higher earnings to profit from the good conditions on the market (low real interest rates and the option to fix rates for years ahead). In the enterprise sector, capital investment in machinery and equipment has remained stable, while increased public sector investments have cushioned the overall investment decline.

By contrast, household consumption has picked up strongly: retail trade has recovered to close to (or even above) the levels of last year. As well as non-durables, households are also spending money on durables of all kinds. Thus, having slumped by more than 12% in real terms year on year in the first half of 2020, household consumption will rally in the second half and in 2021, when it will again become the most important driver of growth for the Latvian economy.

Massive fiscal stimulus has cushioned the economic fallout from the crisis. The initial fiscal stimulus package announced by the government in spring amounted to 12% of GDP (funds provided for 2020 and 2021). It comprised particularly loans and state guarantees to 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 invest EUR 250 million in airBaltic, which is the main carrier in the Baltic region. Short-time working subsidies were also introduced. The budget plan for 2021 envisages additional measures to support economic growth; however, the budget deficit is expected to amount to only 4% of GDP again. Next year, the start of the 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 fall in the second quarter of 2020, by 1.5% year on year. Substantial job losses were recorded in construction, as well as in accommodation and hospitality, domestic trade and transport. The decline in employment was cushioned by the short-time working allowances introduced by the government. These allowances cover 75% of the wages of employees, up to a monthly maximum of EUR 700. The scheme is supported by almost EUR 200 million via the SURE loan facility of the EU Commission, approved in April with the express purpose of keeping employees in work. The unemployment rate jumped to 8.9% in July, but has since declined slightly. 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 lower wage growth in the first half of 2020, but salaries still increased by more than 4% in real terms year on year. Since the minimum wage has not been increased in 2020, the government decided to raise it from EUR 430 to EUR 500 a month from January 2021. Wage increases for public healthcare workers, teachers and academic staff have also been agreed. Moreover, the non-taxable minimum will increase in 2021 and 2022, in order to strengthen the purchasing power of low-income households.

Consumer price inflation has dropped substantially, but remains positive at 0.6% in 2020. The decline is driven largely by falling prices for energy. Given a rebound in prices for imported goods and next year's expected wage increases, we anticipate that consumer price inflation will pick up in 2021 to 1.8% and then 2.5% in 2022.

All in all, since our interim forecast in May, we have become much more optimistic and have increased the forecast GDP growth rate for 2020 from -8% to -4.6%. External demand, in particular, contracted much less than expected during the slump in March-May 2020 and thereafter rallied more rapidly than had been imagined. Also, industrial production is once again close to the level of last year. Similarly, consumption has picked up much faster than anticipated. The government introduced a substantial rescue package, and will continue to invest next year to support economic growth. Household incomes will continue to rise, spurred by a strongly rising minimum wage, a reduced income tax burden and a declining unemployment rate. Thus, private consumption will again grow steadily. We forecast GDP growth of 4.4% for 2021; in 2022, further stabilisation will result in GDP increasing by 2.8% in real terms.

Table 4.11 / Latvia: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average	1,942	1,927	1,914	1,907	1,904	1,906	1,910	1,900	1,890
Gross domestic product, EUR mn, nom.	26,962	29,143	30,463	6,734	6,894	13,628	29,200	31,000	32,700
annual change in % (real)	3.3	4.0	2.1	-1.0	-8.9	-5.2	-4.6	4.4	2.8
GDP/capita (EUR at PPP)	19,600	20,920	21,560	.	.	.	.	.	.
Consumption of households, EUR mn, nom.	15,943	16,839	17,845	4,156	3,580	7,737	.	.	.
annual change in % (real)	2.9	2.6	2.9	-3.5	-21.2	-12.6	-5.0	4.0	2.8
Gross fixed capital form., EUR mn, nom.	5,559	6,449	6,758	1,335	1,547	2881.7	.	.	.
annual change in % (real)	11.4	11.8	2.1	4.7	-4.9	-0.6	-6.0	5.0	4.0
Gross industrial production 2)									
annual change in % (real)	8.3	1.5	0.9	-1.4	1.9	-3.6	-3.0	2.0	3.0
Gross agricultural production									
annual change in % (real)	1.5	-10.0	20.7	.	.	.	.	.	.
Construction industry									
annual change in % (real)	18.7	21.8	2.9	14.8	-0.6	5.5	.	.	.
Employed persons, LFS, th, average	894.8	909.4	910.0	902.1	892.1	897.1	900	905	910
annual change in %	0.2	1.6	0.1	-0.2	-1.5	-0.8	-1.1	0.6	0.6
Unemployed persons, LFS, th, average	85.4	72.8	61.3	72.2	83.5	77.9	81	73	66
Unemployment rate, LFS, in %, average	8.7	7.4	6.3	7.4	8.6	8.0	8.3	7.5	6.8
Reg. unemployment rate, in %, eop 3)	6.8	6.4	6.2	6.8	8.6	8.6	.	.	.
Average monthly gross wages, EUR	926.0	1,004.0	1,076.0	1,099.7	1,117.3	1,108.5	1,120	1,170	1,250
annual change in % (real, gross)	4.5	6.0	4.2	4.5	4.3	4.4	3.3	3.0	4.0
Average monthly net wages, EUR	676.0	742.0	793.0	812.0	824.0	818.0	820	860	920
annual change in % (real, net)	3.8	7.0	3.9	4.3	4.3	4.3	3.2	3.0	4.2
Consumer prices (HICP), % p.a.	2.9	2.6	2.7	1.4	-1.1	0.6	0.5	1.8	2.5
Producer prices in industry, % p.a.	2.5	4.3	1.8	-1.9	-3.2	-2.2	-3.0	1.5	2.0
General governm.budget, EU-def., % of GDP									
Revenues	37.9	38.5	38.7	.	.	.	36.4	36.3	36.5
Expenditures	38.7	39.4	38.9	.	.	.	44.4	40.3	39.5
Net lending (+) / net borrowing (-)	-0.8	-0.8	-0.2	.	.	.	-8.0	-4.0	-3.0
General gov.gross debt, EU def., % of GDP	39.0	37.1	36.9	.	.	.	49.0	48.0	47.0
Stock of loans of non-fin.private sector, % p.a.	-4.7	-5.2	0.6	-3.2	-4.3	-4.3	.	.	.
Non-performing loans (NPL), in %, eop 4)	4.1	5.3	5.0	3.5	3.7	3.7	.	.	.
Central bank policy rate, % p.a., eop 5)	0.00	0.00	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR mn	339	-84	-197	71	261	332	650	450	450
Current account, % of GDP	1.3	-0.3	-0.6	1.1	3.8	2.4	2.2	1.5	1.4
Exports of goods, BOP, EUR mn	11,623	12,566	12,730	3,231.0	2,897	6,128	12,650	13,200	13,800
annual change in %	10.7	8.1	1.3	4.6	-7.5	-1.5	-0.6	4.3	4.5
Imports of goods, BOP, EUR mn	14,073	15,108	15,407	3,707	3,178	6,885	14,400	15,200	16,000
annual change in %	12.1	7.4	2.0	2.9	-17.9	-7.9	-6.5	5.6	5.3
Exports of services, BOP, EUR mn	4,992	5,333	5,588	1,181.0	988	2,169	4,550	5,000	5,500
annual change in %	8.0	6.8	4.8	-5.4	-29.5	-18.2	-18.6	9.9	10.0
Imports of services, BOP, EUR mn	2,717	3,021	3,167	694	533	1,227	2,550	2,800	3,100
annual change in %	9.6	11.2	4.8	-3.6	-31.5	-18.1	-19.5	9.8	10.7
FDI liabilities, EUR mn	1,005	374	949	230	91	321	450	.	.
FDI assets, EUR mn	496	-270	75	56	9	65	100	.	.
Gross reserves of NB excl. gold, EUR mn	3,620	3,578	3,700	3,955	3,882	3,882	.	.	.
Gross external debt, EUR mn	37,922	35,697	35,398	34,745	36,444	36,444	33,600	34,100	36,000
Gross external debt, % of GDP	140.6	122.5	116.2	119.0	124.8	124.8	115.0	110.0	110.0

1) Preliminary. - 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).

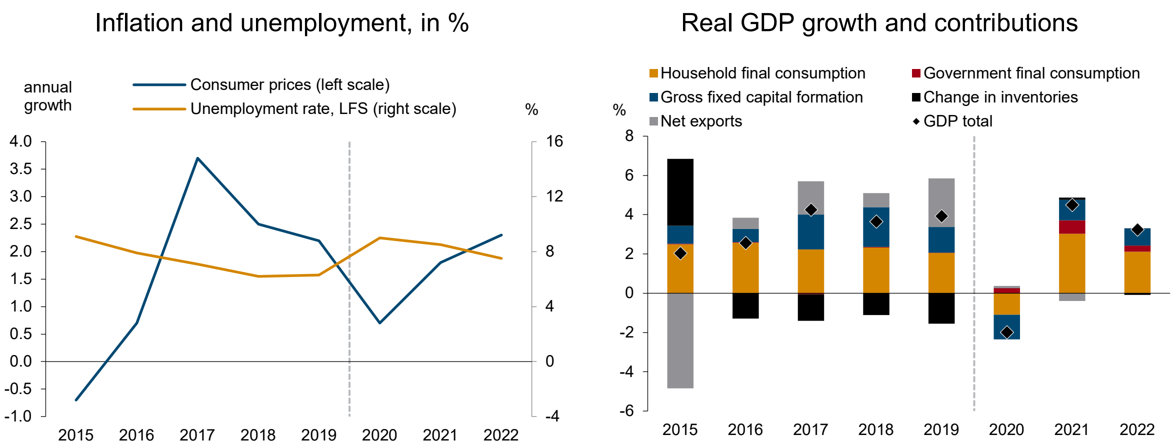
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

LITHUANIA: Rather a dip than an economic crisis

SEBASTIAN LEITNER

The Lithuanian economy experienced only a short-lived and contained recession in the second quarter of 2020, with GDP declining by 4.2% year on year. Within the European Union, only Ireland was hit less hard. A better-than-expected export performance and swiftly rebounding household consumption in the months thereafter is likely to result in a decline in the Lithuanian economy of only 2% over 2020. The government undertook substantial fiscal stimulus measures, and the public investments announced will support recovery over the next two years. For 2021, we expect real GDP to grow by 4.5%, followed by a somewhat slower upswing of 3.2% in 2022.

Figure 4.12 / Lithuania: Main macroeconomic indicators



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

Goods exports slumped in the second quarter, although matters improved in the following months. In particular, there was a substantial decline in demand for refined petroleum products, the Lithuanian economy's most important category of export goods. At the same time, trade increased in many other commodities, such as food, chemicals and furniture. Similarly, total industrial production rebounded strongly in June and July. Goods imports, however, declined by substantially more than exports in the first half of 2020, since companies are cautious and ran down their stocks of imported inputs. Trade in services also declined strongly in the second quarter of 2020. However, the fairly low share of tourism meant that the Lithuanian economy was hit less hard than its Baltic neighbours. In the most recent months, trade in services has thus recovered to a similar level as in the corresponding months of 2019. As a result, the current account surplus will likely jump to an unprecedented 7% of GDP for the year 2020, and the contribution of net exports to GDP growth will be positive.

The political tensions in neighbouring Belarus prompted the Lithuanian government to support the opposition, offer asylum to dissidents and impose sanctions on 118 Belarusian officials, including Alexander Lukashenko, whom Lithuania does not regard as the legitimate president. The economic ties between Lithuania and Belarus are smaller than one might expect: about 4% of exports from Lithuania go to that neighbouring country, but only about 10% of those goods are of Lithuanian origin. In the event of a disruption in trade between the two countries, as far as Lithuania is concerned, the biggest effect would be felt in the port of Klaipeda and in the country's transit trade services generally. However, the impact would be more severe for the Belarus economy, since transit costs would rise substantially. Moreover, in recent years more and more Belarusian citizens have become labour migrants in Lithuania: the number of work permits granted has more than tripled over the past five years.

The Lithuanian government imposed quite a strict lockdown from March to May 2020: non-essential shops, schools, cultural and recreational establishments were closed and public events cancelled. The rate of infection thereafter was quite low. Since mid-September, recorded cases of COVID-19 have increased substantially, and the containment measures have been tightened; in October, the Raseiniai district in central Lithuania was placed in quarantine.

With the public support initiatives taken and the additional measures planned, the budget deficit is expected to amount to 8.5% this year and 5% in 2021. As early as mid-March, the government announced a fiscal package worth 5% of GDP, which contained wage subsidies for affected firms, additional public investment, loan guarantees and support for the health sector and agriculture. A couple of further measures were implemented later. 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. Another 2% of GDP has been earmarked for wage subsidies and support for persons returning from unemployment, along with increased social benefits and additional funds for the self-employed and for vocational training. In June, an investment plan was approved with 4.5% of new public expenditure in human capital, the digital economy, infrastructure, climate change, innovation and research; moreover, public investment of about 10% of GDP is to be front-loaded and implemented by the end of 2021.

We expect overall employment to decrease only slightly in 2020 and to recover in the next two years. Jobs were lost in the first half of 2020 year on year, particularly in accommodation, food services, real estate and agriculture (though only to a small extent in manufacturing and construction). The unemployment rate increased somewhat and is likely to amount to 9% in 2020 on average. Over the next two years, we expect this rate to fall again slightly – to 8.5% in 2021 and 7.5% in 2022.

A 9.4% rise in the minimum wage (to EUR 607 a month) from January 2020 has resulted in gross salaries keeping on growing, by 6% in real terms this year. Labour taxation has been reduced, and next year the non-taxable income threshold will be raised further to EUR 500. Another rise in the minimum wage of 5.8% for 2021 has recently been under discussion in the tripartite council of government, trade unions and employers' organisations. In addition, parliament is debating a proposal to increase the purchasing power of pensioners by introducing a 13th monthly pension payment from next year. We expect household consumption to decline only slightly in 2020 and to become a substantial driver of growth again in 2021. The generosity of the government is related to the parliamentary elections, which took place in October. The main opposition party, the conservative Homeland, won additional support and is likely to head a new coalition government, together with one or two smaller liberal parties.

Although import and producer prices collapsed, consumer prices will still increase by 0.7% in 2020. We expect a further slight increase to 1.8% in 2021 and 2.3% in 2022. While the price of fossil fuels has declined, core inflation has remained positive due to rapidly increasing wages. Moreover, excise duties have been raised.

Since our interim forecast in May, we have become much more optimistic and have increased our forecast for real GDP growth from -6.5% to -2% in 2020. In terms of both external and domestic demand, the contraction in the second quarter was more moderate than expected, and growth picked up much faster than anticipated. At the same time, however, imports slumped considerably. Thus, we expect exports to decrease only slightly compared to last year. Public investment in particular will pick up strongly – not only in 2020, but also in coming years. Sentiment indicators show improved confidence levels among both businesses and consumers. 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 strongly to 4.5% in 2021, and to continue in 2022 at the somewhat slower pace of 3.2%.

Table 4.12 / Lithuania: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average	2,828	2,802	2,794	2,794	2,794	2,794	2,760	2,740	2,730
Gross domestic product, EUR mn, nom.	42,276	45,491	48,797	11,218	11,572	22,790	48,200	51,300	54,200
annual change in % (real)	4.3	3.9	4.3	2.4	-4.6	-1.2	-2.0	4.5	3.2
GDP/capita (EUR at PPP)	23,120	24,500	25,720		.	.	.	.	.
Consumption of households, EUR mn, nom.	26,198	27,903	29,445	6,939	6,804	13,743	.	.	.
annual change in % (real)	3.6	3.8	3.3	1.6	-9.3	-4.1	-1.8	5.0	3.5
Gross fixed capital form., EUR mn, nom.	8,504	9,531	10,429	2,203	2,418	4,620	.	.	.
annual change in % (real)	8.9	10.0	6.2	3.0	-10.6	-4.6	-6.0	5.0	4.2
Gross industrial production (sales)									
annual change in % (real)	7.0	4.8	3.4	-1.1	-1.2	-4.3	-3.0	4.5	3.7
Gross agricultural production									
annual change in % (real)	2.6	-10.0	11.2	.	.	.	.	.	.
Construction industry									
annual change in % (real)	8.9	13.8	8.4	10.0	-7.3	-0.7	.	.	.
Employed persons, LFS, th, average	1,355	1,375	1,378	1,386	1,352	1,369	1,370	1,375	1,378
annual change in %	-0.5	1.5	0.3	0.9	-2.2	-0.7	-0.6	0.4	0.2
Unemployed persons, LFS, th, average	103	90	92	106	126	116.1	135	128	112
Unemployment rate, LFS, in %, average	7.1	6.2	6.3	7.2	8.6	7.9	9.0	8.5	7.5
Reg. unemployment rate, in %, eop 2)	8.7	8.9	8.7	9.8	12.1	12.1	.	.	.
Average monthly gross wages, EUR 3)	840.4	924.1	1,296.2	1,370.2	1,387.6	1,378.9	1,380	1,460	1,550
annual change in % (real, gross)	4.7	7.1	6.0	3.2	2.2	7.3	6.0	4.0	3.5
Average monthly net wages, EUR 3)	660.2	720.0	822.0	873.1	883.0	878.1	880	930	980
annual change in % (real, net)	5.7	6.2	11.6	6.9	7.5	7.5	6.0	3.5	3.5
Consumer prices (HICP), % p.a.	3.7	2.5	2.2	1.7	0.9	1.5	0.7	1.8	2.3
Producer prices in industry, % p.a.	5.1	5.6	0.0	-9.0	-11.5	-8.8	-8.0	1.0	1.0
General goverm.budget, EU-def., % of GDP									
Revenues	33.6	34.5	34.9	.	.	.	35.5	34.8	34.8
Expenditures	33.2	33.9	34.6	.	.	.	44.0	39.8	34.5
Net lending (+) / net borrowing (-)	0.5	0.6	0.3	.	.	.	-8.5	-5.0	-3.0
General gov.gross debt, EU def., % of GDP	39.1	33.7	35.9	.	.	.	46.0	50.0	50.0
Stock of loans of non-fin.private sector, % p.a.	4.5	6.0	3.3	3.4	-0.6	-0.6	.	.	.
Non-performing loans (NPL), in %, eop	3.1	2.4	1.6	.	.	.	.	.	.
Central bank policy rate, % p.a., eop 4)	0.00	0.00	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR mn	231	137	1,632	905	758	1,663	3,400	2,100	2,400
Current account, % of GDP	0.5	0.3	3.3	8	6.5	7.3	7.1	4.1	4.4
Exports of goods, BOP, EUR mn	22,763	24,552	25,954	6,276	5,400	11,676	24,750	26,000	27,500
annual change in %	16.9	7.9	5.7	1.4	-15.7	-7.3	-4.6	5.1	5.8
Imports of goods, BOP, EUR mn	24,815	27,333	28,303	6,566	5,469	12,035	25,500	28,100	30,200
annual change in %	16.2	10.1	3.6	-2.6	-24.6	-14.0	-9.9	10.2	7.5
Exports of services, BOP, EUR mn	8,350	9,678	11,841	2,800	2,408	5,208	11,400	11,800	13,600
annual change in %	22.5	15.9	22.3	10.6	-20.6	-6.4	-3.7	3.5	15.3
Imports of services, BOP, EUR mn	5,319	6,055	6,949	1,588	1,241	2,828	6,500	6,900	7,900
annual change in %	14.6	13.9	14.8	4.4	-29.5	-13.8	-6.5	6.2	14.5
FDI liabilities, EUR mn	1,192	1,096	1,402	426	-209	217	500	.	.
FDI assets, EUR mn	359	866	486	313	-162	151	700	.	.
Gross reserves of NB excl. gold, EUR mn	3,509	4,831	4,273	4,474	3,934	3,934	.	.	.
Gross external debt, EUR mn	34,940	35,542	33,047	31,171	34,240	34,240	32,800	33,300	33,600
Gross external debt, % of GDP	82.6	78.1	67.7	64.7	71.0	71.0	68.0	65.0	62.0

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

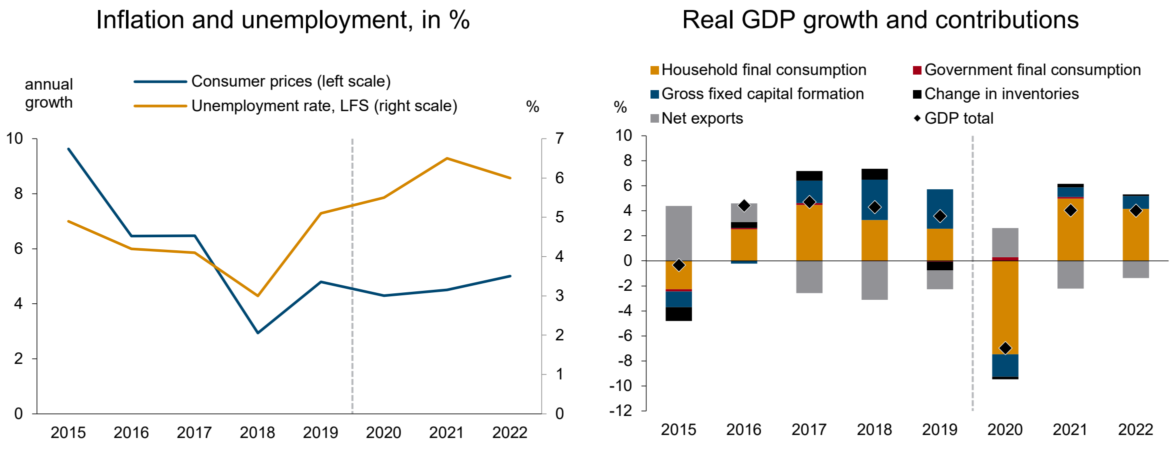
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

MOLDOVA: Dependent on aid from both East and West

GÁBOR HUNYA

The poorest country in Europe also has the highest figures for COVID-19 infections and fatalities in relation to population. Fiscal policy has very limited scope to mitigate the impact of the crisis from the country's own revenues. The government needs to rely on foreign agencies for financing (although these impose conditions that are difficult to meet) and has to maintain a balanced relationship with Russia and the EU. Economic decline of at least 7% in 2020 will be followed by a slow recovery in coming years.

Figure 4.13 / Moldova: Main macroeconomic indicators



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

The poorest country in Europe also has the highest figures for COVID-19 infections and deaths as a proportion of population. The authorities managed the epidemic fairly well in the second quarter of 2020, by applying a total lockdown; but this in return generated steep economic decline. Measures were less stringent under the 'state of alert' in the third quarter, and the economy recovered somewhat – but at the cost of a renewed rapid spread of the disease. The numbers of new cases and fatalities increased through September and have remained at a high level in October. Moldova does not have the resources necessary to substantially improve the health situation or to seriously mitigate the economic consequences of the pandemic. The country relies mainly on foreign donors (among them China, Russia and the EU) to provide protective equipment for its medical personnel.

Growth in the economy had slowed to 0.9% (year on year) even in the first quarter of 2020, but it then contracted by 14% in the second; thus GDP fell by 7.2% in the first half of 2020. Household consumption and investments made a negative contribution, government consumption was modestly positive and net exports were highly positive, as imports fell more than exports. Fuel and energy imports declined in both volume and value terms, while more agricultural products were imported than a year before. The third quarter will have been rather better in terms of household consumption, if the July data are anything to go by. Retail sales were up by 12% compared with the previous year, though services to the population were still 25% down. In a not unrelated development, imports recovered more strongly than exports. The positive contribution of net exports to GDP will be maintained in the second half of the year.

A bad harvest is hampering the prospects for recovery by reducing export volumes and the value of on-farm consumption. Severe drought has led to talk of an agricultural crisis. Support in the face of agricultural calamity mainly relies on instruments that are applied to the economy as a whole – namely tax relief, interest support and rapid VAT refunds; whereas what farmers need above all is cash. Agriculture contributes about 10% to GDP, yet it provides a living for about a third of the population.

Industrial production collapsed during the April shutdown, but has since recovered somewhat. It was 7.5% lower in the first six months of 2020 than a year previously, and will be even lower for the year as a whole. The worst affected by the downturn are the export-oriented branches of the processing industry, which have been integrated into international value chains by foreign investors. Automotive and electrical machinery components production fell by almost 40% in the first seven months, but the production of chemical products and construction materials increased. Recovery will be cumbersome, as value chains are slow to get connected.

The labour force participation rate of the population aged 15 and over dropped to 40% in the second quarter of 2020, from 43.4% the previous year. The generally low participation rate is due to emigration and to methodological changes, as those peasants who produce only for their own consumption – 30% of total agricultural employment – have been dropped from the statistics. The impact of the lockdown has so far not shown up in the unemployment statistics: the Labour Force Survey (LFS) unemployment rate (4.2%) was, in fact, lower in the first half of 2020 than the year before. The effects appear in the number of temporarily idle persons. According to the second quarter LFS, 7% of respondents said they had lost their jobs due to the pandemic, while 24% had been laid off or were on reduced worktime. The latter were disregarded in the calculation of average real wages, which therefore surpassed the second quarter of 2019 by almost 3%, while household consumption nosedived by 17%. Increasing unemployment will be the longer-term result of the pandemic, once more businesses go bankrupt.

Monetary policy switched to supplying liquidity to the economy. The national bank reduced its policy rate from 5.5% to 2.75% from the start of 2020 until the end of September, but left the corridor of the overnight lending facility at 3 percentage points. This move is justified by the declining rate of inflation, which fell from 7% to 3.5% in the same period. We expect another minor rate cut (to 2.5%) in the fourth quarter, when inflation is set to fall even further. But food prices are bound to rise in the near future, and medium-term inflation is forecast to climb to the national bank target of 5%.

The current account deficit to GDP figure is projected to come down to 6.5%, due to a smaller trade deficit; this will reduce the pressure on external financing in 2020. Remittances were 16% down in the second quarter, but only due to restrictions on commuters working abroad; the personal transfers of long-term migrants were at the same level as the previous year. Despite employment uncertainty all over Europe, the level of transfers may be even higher than in the previous year, as these are governed more by need in the home country than by the income of migrants abroad.

Fiscal policy has very limited scope to mitigate the impact of the crisis; but with aid and credits flowing in, the estimated fiscal stimulus could reach about 3% of GDP. Tax and credit reliefs have been the major provisions, while little action has appeared on the expenditure side. Foreign financing is mainly in the form of credits and donations from multilateral agencies (IMF, EU, etc.) and bilateral credit lines (Russia, Romania). But disbursement is slow: in spring, the EU pledged EUR 100 million in macroeconomic support to help mitigate the economic fallout of the coronavirus epidemic, and yet the first tranche of EUR 50 million arrived only in September. The European Commission also recently approved the disbursement of EUR 30 million in macro-financial assistance, pledged last year to help the country cover its external financing needs, after the IMF staff and the Moldovan authorities reached agreement in July on an economic reform programme to be supported by USD 558 million over three years. Both EU and IMF assistance is linked to conditionalities, mainly to do with implementing institutional reform aimed at improving public governance and the rule of law. Although some parties that are in opposition to the present government and president support such a move, it is a cumbersome process, as it affects the vested interests of political and economic stakeholders.

Russia promised USD 200 million in new loans to show its support for the Russia-friendly government and president. This provoked political controversy in Moldova between government supporters and those who oppose the country’s dependence on Russia. The credit is now cleared to arrive by 1 November to support the re-election of the socialist and pro-Russian incumbent, President Igor Dodon. The opposition is split between several candidates, but the pro-Western Maia Sandu is most likely to qualify for the second round, to be held on 15 November. Ever since Moldova’s independence, the choice between the two directions of integration has remained unresolved. There has been a shift from Russia to the EU in terms of foreign trade and migration, but Russia strongly influences the media. The Russian military presence in Transnistria sets another limit to Moldova’s Western orientation. Whoever wins the presidential election (and a possible later snap parliamentary election) will have to find a balance between East and West. It would be advantageous for economic progress if all foreign stakeholders were to maintain their financial support.

Economic decline of about 7% in 2020 will be followed by a slow recovery in coming years. The decline in 2020 could be more severe if there are large losses in agricultural output or a renewed lockdown. Recovery will be slow, as foreign demand will only gradually return to normal. Domestic demand will be plagued by bankruptcies and growing unemployment when tax reliefs expire in 2021. Private investment will start growing, once the government embarks on budgetary consolidation. But the credit line of EUR 300 million – recently agreed by the European Bank for Reconstruction and Development and the European Investment Bank for major road repairs – could generate additional investment. It is essential that foreign donors maintain an interest in financing economic recovery and structural reform.

Table 4.13 / Moldova: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average 2)	2,755	2,706	2,663	.	.	.	2,600	2,560	2,500
Gross domestic product, MDL bn, nom.	178.9	192.5	210.4	43.7	44.6	88.3	204	222	241
annual change in % (real)	4.7	4.3	3.6	0.9	-14.0	-7.2	-7.0	4.0	4.0
GDP/capita (EUR at PPP)	7,990	8,640	9,080	.	.	.	.	.	.
Consumption of households, MDL bn, nom.	150.8	160.5	174.6	37.1	34.1	71.1	.	.	.
annual change in % (real)	5.3	3.9	3.1	-1.8	-17.0	-9.6	-9.0	6.0	5.0
Gross fixed capital form., MDL bn, nom.	39.9	46.8	54.0	9.3	12.8	22.0	.	.	.
annual change in % (real)	8.0	14.5	12.9	9.3	-15.6	-6.4	-7.0	3.0	4.0
Gross industrial production									
annual change in % (real)	3.4	3.7	2.0	0.0	-14.9	-7.4	-9.0	5.0	7.0
Gross agricultural production									
annual change in % (real)	9.1	2.9	-1.9	.	.	.	.	.	.
Construction industry									
annual change in % (real)	3.6	10.3	11.2	.	.	.	.	.	.
Employed persons, LFS, th, average 3)	1,208	1,252	872	806	822	814	820	800	800
annual change in % 3)	-1.0	3.7	.	-2.7	-8.8	-5.9	-6.0	-2.0	0.0
Unemployed persons, LFS, th, average 3)	51.6	38.4	46.9	34.2	36.2	35.2	50.0	60.0	50.0
Unemployment rate, LFS, in %, average	4.1	3.0	5.1	4.1	4.2	4.2	5.5	6.5	6.0
Reg. unemployment rate, in %, eop	2.1	1.7	1.8	2.0	3.8	3.8	.	.	.
Average monthly gross wages, MDL	5,587	6,268	7,234	7,634	7,849	7,741	7,700	8,400	9,200
annual change in % (real, gross)	5.0	9.0	10.1	3.6	2.7	3.1	2.0	4.0	4.0
Average monthly net wages, MDL	4,564	5,142	6,010	.	.	.	6,400	7,000	7,600
annual change in % (real, net)	4.5	9.4	11.5	.	.	.	2.0	4.0	4.0
Consumer prices, % p.a.	6.5	2.9	4.8	6.5	4.6	5.5	4.3	4.5	5.0
Producer prices in industry, % p.a.	3.3	0.4	1.8	2.7	2.7	2.7	2.0	3.0	3.0
General governm. budget, nat.def., % of GDP									
Revenues	29.8	30.1	29.9	34.4	31.4	32.9	32.0	32.0	32.0
Expenditures	30.5	31.0	31.4	35.3	38.3	36.8	38.0	36.0	33.0
Deficit (-) / surplus (+)	-0.6	-0.8	-1.4	-0.9	-6.9	-3.9	-6.0	-4.0	-1.0
General gov.gross debt, nat.def., % of GDP	29.1	27.2	25.1	26.7	29.5	29.5	31.9	33.3	31.7
Stock of loans of non-fin.private sector, % p.a.	-3.3	6.0	13.9	15.8	8.1	8.1	.	.	.
Non-performing loans (NPL), in %, eop 4)	18.4	12.5	8.5	8.5	8.7	8.7	.	.	.
Central bank policy rate, %, p.a., eop 5)	6.50	6.50	5.50	3.25	3.25	3.25	2.50	2.50	3.00
Current account, EUR mn 6)	-492	-1004	-1000	-181.8	-17	-199.5	-660	-720	-860
Current account, % of GDP	-5.7	-10.4	-9.3	-8.1	-0.8	-4.4	-6.5	-6.8	-7.5
Exports of goods, BOP, EUR mn 6)	1,657	1,672	1,892	488	363	851	1,780	1,850	2,050
annual change in %	17.7	1.0	13.1	2.4	-8.4	-2.6	-5.9	3.9	10.8
Imports of goods, BOP, EUR mn 6)	3,928	4,462	4,850	1138	868	2006	4,370	4,540	4,990
annual change in %	19.6	13.6	8.7	4.0	-26.6	-11.9	-9.9	3.9	9.9
Exports of services, BOP, EUR mn 6)	1,109	1,247	1,378	299	235	535	1,160	1,270	1,410
annual change in %	15.1	12.5	10.4	-2.3	-32.8	-18.5	-15.8	9.5	11.0
Imports of services, BOP, EUR mn 6)	838	947	1,064	227	154	381	900	980	1,080
annual change in %	10.5	12.9	12.5	2.2	-41.7	-21.6	-15.5	8.9	10.2
FDI liabilities, EUR mn 6)	133	244	448	21	-21	0	40	.	.
FDI assets, EUR mn 6)	9	29	36	6	3	9	0	.	.
Gross reserves of NB excl. gold, EUR mn 6)	2,346	2,628	2,731	2,660	2,826	2,826	.	.	.
Gross external debt, EUR mn 6)	5,725	6,430	6,626	6684	6,898	6898	7,100	7,200	7,600
Gross external debt, % of GDP	66.7	66.3	62.0	65.5	67.6	67.6	70.0	68.0	66.0
Average exchange rate MDL/EUR	20.83	19.84	19.67	19.4	19.5	19.5	20.0	21.0	21.0

Note: All series excluding data on districts from the left side of the river Nistru and municipality Bender.
1) Preliminary. - 2) According to census May 2014, usual residence. - 3) From 2019 according to census May 2014 and further adjustments to international standards. Data not comparable with previous years. - 4) Substandard, doubtful and loss credit portfolio. -
5) Overnight (refinancing) operations rate. - 6) Converted from USD.

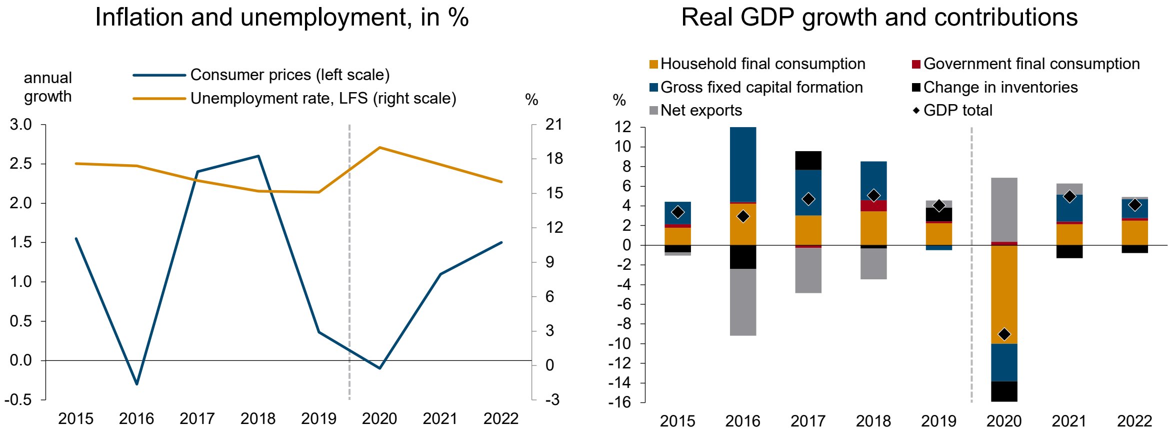
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

MONTENEGRO: Tourism decline drives major slump in economic growth

BERND CHRISTOPH STRÖHM

The COVID-19 pandemic is exacting a heavy toll on the Montenegrin economy, largely because of the country's reliance on its tourism sector: arrivals were 77.9% down in the first eight months of the year. This has had serious repercussions for employment, and foreign direct investment has also declined. Alongside Croatia, Montenegro is one of those countries in CESEE that will be hardest hit by COVID-19, with GDP contracting by 9% in 2020. In 2021, we expect a partial recovery in tourism, supporting overall growth of 5%.

Figure 4.14 / Montenegro: Main macroeconomic indicators



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

The COVID-19 pandemic has had a profound effect on Montenegro's economic growth in 2020. With tourism the most important pillar of the country's economy, generating around 22% of its GDP and creating revenue of between EUR 1.1 billion and EUR 1.3 billion, Montenegro's growth prospects have been badly damaged by COVID-19. Tourism directly and indirectly creates around 36,000 jobs – a fifth of all employment in the country. According to data supplied by Montenegro's statistical office, the tourism industry reported an astonishing 77.9% drop in tourist arrivals in the first eight months of the year, compared to 2019. According to data from the Central Bank of Montenegro, the tourism industry's income in the first seven months of 2020 was only EUR 73.2 million, compared to EUR 532 million in the same period last year. Aside from tourism, Montenegro's economic growth also depends on its role as a hub for electricity traffic between the Balkans and Italy; in this respect, it is suffering badly after a drop in foreign direct investment (FDI) and the COVID-19-induced temporary shutdown of large investment projects in the energy and construction sectors. Remittances by Montenegro's diaspora are traditional drivers of the country's economic growth: in 2019, remittances amounted to about 10% of GDP. According to the World Bank, however, the figure in 2020 will likely plummet to only 3.4% of GDP, as a result of COVID-19. Especially due to the slump in tourism revenue, the country's GDP is expected to contract by 9% in 2020, to be followed in 2021 by a solid recovery of 5%.

The government has limited fiscal space to react to the economic downturn, as public debt is already close to 80% of GDP, higher than in other Western Balkan countries. The government is additionally faced with a sharp drop in tax revenue, due to the slump in economic activity and the tax deferrals. For those reasons, the stimulus package of the Montenegrin government is smaller than those of other Western Balkan countries. Short-term measures in 2020 aimed at supporting the country's tourism sector amounted to EUR 82.7 million. Montenegro uses the euro and so has no monetary levers to help cushion the downturn. However, like the rest of the Western Balkans, it will benefit from spill-overs from ultra-loose monetary policy in the euro area.

The country's economy continues to face a severe challenge in ensuring the sustainability of its public finances. The country's indebtedness problem remains a significant burden for the Montenegrin economy, which in Q2 2020 already stood at about 80% of GDP. This follows the financing of infrastructure projects such as the Bar–Boljare motorway project, for which the government took out a loan of EUR 800 million. Considering the increase in government consumption due to COVID-19, it is expected that public debt will rise to 88% of GDP, with a budget deficit of about 8% in 2020.

The COVID-19 pandemic is exacting a heavy toll on all sectors of the economy, with a sharp decline in industrial production and exports. The pandemic created major disruptions in the country's supply side, due to the lockdown imposed in March and April; this led to a 12.4% decline in industrial output in Q2 2020, compared to the same period in 2019. The drop in industrial production was also partly due to a fall in demand abroad and the non-diversification of the country's exports, which are dominated by aluminium.

The COVID-19 pandemic has resulted in negative trends in disposable income, the labour market and private consumption. According to the State Employment Office, unemployment stood at above 16% in the vital months of June and July, and could well rise further due to the downturn in the tourism sector. A drop in FDI is further negatively affecting employment in the country. All in all, unemployment will likely rise to 19% on average in 2020 – nearly 4 percentage points higher than last year. This will severely affect the country's young people, who are at greatest risk of losing their jobs. The drop in disposable income means that private consumption in 2020 will likely fall by 14% compared to 2019. As tourism starts to pick up next year, the situation in the labour market should improve, and private consumption should begin to recover.

COVID-19 will weaken the country's export of services and lead to a substantial decline in demand for imported goods. Montenegro traditionally runs a strong current account deficit, with an average of about 16% of GDP over the past three years. However, falling consumer and investment expenditure means that the drop in demand for imported goods will likely be sharper than the decline in exports. This slump in demand for imported goods will therefore likely cause a decrease in Montenegro's current account deficit in 2020 to about 14.8%. It is expected that the country's current account deficit will narrow further to 13% in 2021, driven by the recovery of its tourism sector and the expected completion of the Bar–Boljare motorway project.

The sharp drop in international oil prices caused inflation to stay low in 2020. This was further supported by a decline in domestic demand. We expect consumer prices to fall to about 0.1% on average in 2020. With the expected economic recovery in 2021, as demand picks up and oil prices stage a moderate recovery, inflation will likely increase to 1.1%.

Table 4.14 / Montenegro: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020	2021 Forecast	2022
Population, th pers., average	622	622	622	.	.	.	625	630	630
Gross domestic product, EUR mn, nom.	4,299	4,663	4,951	913	900	1,814	4,500	4,800	5,100
annual change in % (real)	4.7	5.1	4.1	2.7	-20.2	-10.3	-9.0	5.0	4.1
GDP/capita (EUR at PPP)	13,470	14,490	15,530	.	.	.	.	.	.
Consumption of households, EUR mn, nom. 2)	3,216	3,425	3,534	808	765	1,572	.	.	.
annual change in % (real)	3.9	4.6	3.1	3.8	-15.0	-6.2	-14.0	3.0	3.5
Gross fixed capital form., EUR mn, nom.	1,157	1,364	1,352	285	274	558	.	.	.
annual change in % (real)	18.7	14.7	-1.7	2.2	-26.3	-13.9	-14.0	10.0	7.0
Gross industrial production 3)									
annual change in % (real)	-4.2	22.4	-6.3	12.7	-15.9	-0.9	-5.0	3.2	3.4
Net agricultural production 4)									
annual change in % (real)	-3.2	2.0	2.0	.	.	.	.	.	.
Construction output 3)									
annual change in % (real)	51.5	24.9	10.7	4.6	-15.9	-6.9	.	.	.
Employed persons, LFS, th, average	229.3	237.4	243.8	237.0	226.8	231.9	246	247	248
annual change in %	2.3	3.5	2.7	0.8	-8.5	-4.0	1.0	0.4	0.5
Unemployed persons, LFS, th, average	43.9	42.5	43.4	46.2	40.7	43.5	60	50	50
Unemployment rate, LFS, in %, average	16.1	15.2	15.1	16.3	15.2	15.8	19.0	17.5	16.0
Reg. unemployment rate, %, average	21.7	18.7	15.3	15.3	18.1	16.7	.	.	.
Average monthly gross wages, EUR	765	766	773	786	780	783	780	790	800
annual change in % (real, gross)	-0.5	-2.4	0.6	1.4	1.9	1.6	1.0	0.2	0.2
Average monthly net wages, EUR	510	511	515	524	522	523	520	530	540
annual change in % (real, net)	-0.2	-2.3	0.4	1.4	2.4	1.9	1.0	0.2	0.2
Consumer prices, % p.a.	2.4	2.6	0.4	0.8	-0.7	0.1	-0.1	1.1	1.5
Producer prices in industry, % p.a. 5)	0.4	1.7	2.4	1.3	-0.4	0.4	2.1	2.3	2.5
General governm.budget, nat.def., % of GDP									
Revenues	41.5	42.2	43.4	.	.	,	42.0	43.0	41.0
Expenditures	46.8	46.2	45.4	.	.	,	50.0	46.5	44.0
Deficit (-) / surplus (+)	-5.3	-3.9	-2.0	.	.	,	-8.0	-3.5	-3.0
General gov.gross debt, nat.def., % of GDP	64.2	70.1	76.5	.	.	.	88.0	88.0	85.0
Stock of loans of non-fin.private sector, % p.a.	7.7	9.1	6.6	5.4	7.0	7.0	.	.	.
Non-performing loans (NPL), in %, eop	7.3	6.7	4.7	5.1	5.3	5.3	.	.	.
Central bank policy rate, % p.a., eop 6)	6.16	5.75	5.46	6.0	5.9	5.9	5.5	5.5	5.5
Current account, EUR mn	-691	-793	-744	-322	-316	-638	-665	-625	-635
Current account, % of GDP	-16.1	-17.0	-15.0	-35.3	-35.1	-35.2	-14.8	-13.0	-12.5
Exports of goods, BOP, EUR mn	382	436	466	96	87	182	440	460	490
annual change in %	9.0	14.0	6.8	-5.5	-23.9	-15.2	-6.0	4.0	7.0
Imports of goods, BOP, EUR mn	2,243	2,485	2,531	521	489	1,010	1,950	2,120	2,310
annual change in %	11.7	10.8	1.8	2.1	-29.8	-16.3	-23.0	8.5	9.0
Exports of services, BOP, EUR mn	1,382	1,563	1,698	178	115	293	1,360	1,540	1,700
annual change in %	10.2	13.1	8.6	1.9	-68.1	-45.2	-20.0	13.0	10.3
Imports of services, BOP, EUR mn	531	627	678	138	106	245	610	620	630
annual change in %	9.3	18.1	8.1	-7.1	-39.0	-24.3	-10.5	2.0	1.5
FDI liabilities, EUR mn	494	415	412	135	119	254	400	.	.
FDI assets, EUR mn	10	92	67	0	-6	-5	20	.	.
Gross reserves of NB excl. gold, EUR mn 7)	847	1,050	1,367	947	1,212	1,212	.	.	.
Gross external debt, EUR mn	6,905	7,612	8,310	.	.	.	8,440	8,780	9,130
Gross external debt, % of GDP	160.6	163.2	167.9	.	.	.	187.5	183.0	179.0

1) Preliminary. - 2) Including expenditures of NPISHs. - 3) Enterprises with 5 and more employees. - 4) Based on UN-FAO data, wiiw estimate. - 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.

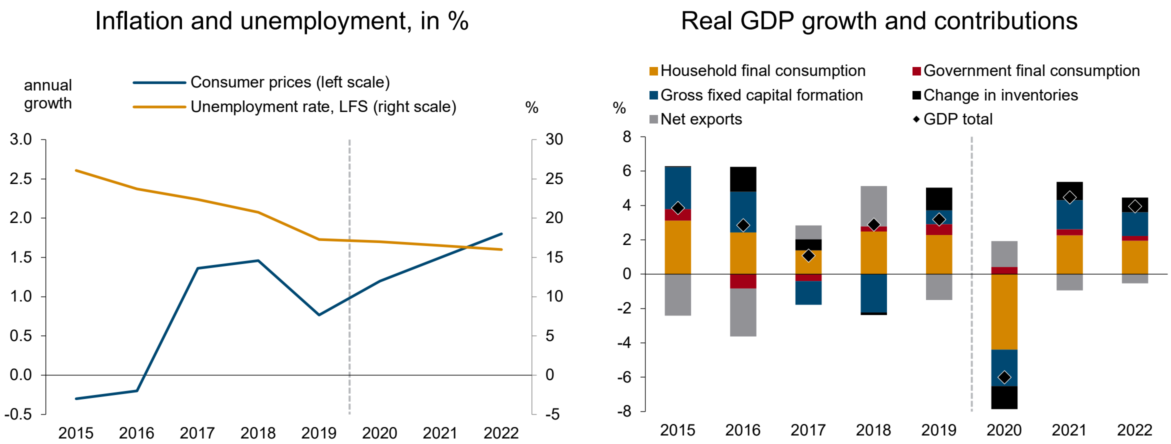
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

NORTH MACEDONIA: Pandemic mishandling and inadequate fiscal support take toll on the economy

BRANIMIR JOVANOVIC

Since May, North Macedonia has failed to contain the pandemic. The government has also not provided adequate fiscal support to the economy. That led to a decline in GDP in Q2 of 12.7% year on year, which was greater than expected. We are thus downgrading our GDP forecast for 2020 from -5% to -6%. Prospects for the future depend crucially on the government's fiscal support and on management of the health aspects of the pandemic.

Figure 4.15 / North Macedonia: Main macroeconomic indicators



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

North Macedonia mishandled the pandemic. Following the gradual and timely restrictions of March and April, which kept the number of COVID-19 cases among the lowest in Europe, the government started reopening the economy too early, ahead of the July parliamentary elections. As a result, the country never saw an end to the first wave of the pandemic, and since May the number of new and fatal cases has consistently been among the highest in Europe.

This, accompanied by the inadequate fiscal support, caused GDP in Q2 to decline by 12.7% year on year (y-o-y). The large number of cases created uncertainty and pessimism in society and caused households and companies to refrain from spending. Household final consumption declined by 11.6% y-o-y in Q2, while gross capital formation (which also includes changes in inventories) fell even more – by 25.6%. At the same time, the actual support that the government provided to the economy was very modest. Government consumption grew by only 1.5% y-o-y in Q2, and total general government spending in Q2 amounted to 39.7% of GDP (much lower than in other countries), which was clearly inadequate.

The weak fiscal support was not because of limited fiscal space, but because of poor enactment and targeting of the stimulus packages. The government adopted three stimulus packages in Q2, worth in total EUR 550 million (5% of GDP). The structure of the packages was similar to that in other countries – tax exemptions, debt moratoria, cheap credits, credit guarantees, and various direct subsidies to firms and households, the biggest one being the minimum wage per worker, for firms affected by the crisis, for a duration of three months. To finance these packages, the country borrowed heavily, issuing a Eurobond and taking loans from the IMF, the World Bank and the European Commission of more than EUR 1 billion in total (approximately 10% of GDP). This raised the public debt to 59.5% of GDP at the end of Q2, from 48.9% at the end of 2019, but provided money to support the economy during the crisis. Still, implementation of the stimulus packages was dismal, and only around EUR 200 million, or 36% of the amount announced, was actually spent.

Despite the sizeable decline in economic activity, the labour market did not fare too badly in Q2. Employment declined by 2.2%, compared to Q1. Most of the people affected became inactive, due to the pandemic and the government subsidies, and so the rate of unemployment increased by only 0.5 percentage points, to 16.7%. The y-o-y growth of net wages for the first six months of 2020 averaged 7.3% in real terms, driven by an increase in the minimum wage and public sector wages that dated from before the pandemic.

Inflation remains low, despite the modest increase in recent months. It averaged 0.9% for the first nine months of the year, although it did reach 1.9% in September. Apart from the wage increase, two main factors have led to this rise – a hike in the fuel excise duty from April and a jump in the cost of electricity from August. We still expect inflation to remain at below 2% in the coming years.

Monetary policy was supportive during the crisis. The central bank reduced its main rate twice, in March and May, by 50 basis points (bps) in total, to 1.5%. This is the lowest level in history. Commercial banks followed suit and lowered their interest rates, both on deposits and on loans, by approximately 15 bps. Total credits grew by 6.6% y-o-y at the end of Q2, more than the central bank projection of 4.3%, which implies that the easing of the monetary policy has probably had an effect. There are no signs that the rate will increase, and we expect it to stay at the current level until the end of 2021. The central bank also initiated two rounds of debt moratoria, which have likely supported needy companies and households.

The current account deficit widened to 4.6% of GDP in the first half of the year, from 3.3% in 2019. This was driven by remittances, which are very important for the country and which declined by 21% y-o-y in the first six months, due to the pandemic. At the same time, the trade balance improved, as the decline in exports of goods of 22.5% was offset by a decline in imports of 17%. Foreign direct investment inflows in the first half of the year amounted to EUR 205 million, which is slightly worse than last year's EUR 423 million for the whole year.

Data for Q3 indicate that economic activity remains anaemic and that the recovery will be very sluggish. Industrial production in July and August remains 9% lower than in the same period of 2019. Retail trade in July was still 10% below the July level last year. Preliminary data from the Employment Agency suggest that unemployment may increase in Q3 even more than in Q2, as the government's protective measures have expired. New claims for unemployment benefits in July and August were 2% of the total number of employed persons, which is close to the figure for Q2.

The fourth stimulus package adopted at the end of September seems unlikely to bring any substantial change. It is very similar, both in nature and in size (EUR 470 million), to the previous three. Given the poor implementation of the first three packages, and considering the limited time until the end of the year, we do not foresee that it will provide the support needed.

Meanwhile, the number of COVID-19 cases started growing again in October and for the first time in several months the government announced new restrictions. The restrictions announced by mid-October are still mild and closures like those from March and April seem unlikely; the economy is not expected to suffer terribly from them. The bigger question is whether they will prevent a fresh upsurge in COVID-19 cases. Recalling the failure in April-May, and taking into account that public support for restrictions is now much weaker than in spring, we doubt whether the new restrictions will prove successful.

Overall, the economic prospects for North Macedonia over the coming months seem pretty gloomy. The inappropriate management of the health aspects of the crisis and the weak fiscal support are taking their toll on the economy. We are thus downgrading our GDP forecast for 2020 from -5% to -6%. Due to the bigger drop in 2020, we are revising our forecast for 2021 upwards, from +4% to +4.5%.

Table 4.15 / North Macedonia: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020	2021 Forecast	2022
Population, th pers., average	2,075	2,076	2,077	.	.	.	2,100	2,100	2,100
Gross domestic product, MKD bn, nom.	618.1	660.9	689.4	165.7	149.8	315.5	656	696	737
annual change in % (real)	1.1	2.9	3.2	0.2	-12.7	-6.4	-6.0	4.5	4.0
GDP/capita (EUR at PPP)	10,690	11,350	11,830	.	.	.	.	.	.
Consumption of households, MKD bn, nom.	405.9	428.8	446.0	104.6	105.7	210.3	.	.	.
annual change in % (real)	2.1	3.8	3.5	1.2	-11.6	-5.6	-6.8	3.5	3.0
Gross fixed capital form., MKD bn, nom.	139.0	132.4	146.1	.	.	.	.	.	.
annual change in % (real)	-5.7	-9.9	4.0	.	.	.	-10.0	8.0	6.5
Gross industrial production 2)									
annual change in % (real)	0.2	5.4	3.7	-3.7	-25.0	-14.6	-10.0	8.0	6.0
Gross agricultural production 3)									
annual change in % (real)	-9.9	10.0	4.0	.	.	.	.	.	.
Construction industry									
annual change in % (real)	-27.2	-6.8	3.8	6.3	-5.1	-0.7	.	.	.
Employed persons, LFS, th, average	740.6	759.1	797.7	811.1	793.4	802.3	780	800	810
annual change in %	2.4	2.5	5.1	2.7	-0.1	1.3	-2.5	2.0	1.5
Unemployed persons, LFS, th, average	213.6	198.6	166.4	156.6	159.6	158.1	160	160	150
Unemployment rate, LFS, in %, average	22.4	20.7	17.3	16.2	16.8	16.5	17	16.5	16.0
Reg. unemployment rate, in %, eop	20.1	19.3	19.6	20.1	22.4	22.4	.	.	.
Average monthly gross wages, MKD	33,688	35,626	37,446	40,371	39,357	39,864	40,900	42,800	44,900
annual change in % (real, gross)	1.2	4.2	4.3	10.7	5.2	7.9	8.0	3.0	3.0
Average monthly net wages, MKD	22,928	24,276	25,213	27,056	26,362	26,709	27,400	28,600	30,000
annual change in % (real, net)	1.2	4.4	3.1	10.0	4.6	7.3	7.5	3.0	3.0
Consumer prices, % p.a.	1.4	1.5	0.8	0.6	0.5	0.5	1.2	1.5	1.8
Producer prices in industry, % p.a.	4.8	0.9	2.1	2.0	-0.1	0.9	1.0	1.3	1.6
General governm. budget, nat.def., % of GDP									
Revenues	31.0	30.4	31.5	28.1	27.3	27.7	28.0	28.5	29.0
Expenditures	33.8	31.5	33.7	32.5	39.7	35.9	37.0	34.0	33.0
Deficit (-) / surplus (+)	-2.8	-1.1	-2.2	-4.5	-12.4	-8.2	-9.0	-5.5	-4.0
General gov.gross debt, nat.def., % of GDP	39.4	40.4	40.6	41.8	50.7	50.7	52.0	55.0	58.0
Stock of loans of non-fin.private sector, % p.a.	5.4	7.2	6.1	5.9	6.7	6.7	.	.	.
Non-performing loans (NPL), in %, eop	6.2	5.1	4.6	4.8	4.6	4.6	.	.	.
Central bank policy rate, %, p.a., eop 4)	3.25	2.50	2.25	2.00	1.50	1.50	1.50	1.50	2.50
Current account, EUR mn	-105	-7	-372	-149	-86	-235	-550	-510	-440
Current account, % of GDP	-1.0	-0.1	-3.3	-5.5	-3.5	-4.6	-5.2	-4.5	-3.7
Exports of goods, BOP, EUR mn	4,075	4,883	5,323	1,131	876	2,007	4,390	4,980	5,580
annual change in %	15.4	19.8	9.0	-9.2	-34.8	-22.5	-17.5	13.5	12.0
Imports of goods, BOP, EUR mn	5,862	6,619	7,293	1,679	1,232	2,911	6,130	6,900	7,660
annual change in %	9.7	12.9	10.2	-2.4	-31.1	-17.0	-16.0	12.5	11.0
Exports of services, BOP, EUR mn	1,434	1,580	1,635	383	295	678	1,350	1,530	1,710
annual change in %	3.2	10.2	3.4	1.3	-17.0	-7.5	-17.5	13.5	12.0
Imports of services, BOP, EUR mn	1,060	1,209	1,285	216	188	404	1,080	1,220	1,350
annual change in %	1.0	14.1	6.2	-21.7	-27.2	-24.3	-16.0	12.5	11.0
FDI liabilities, EUR mn	351	539	488	233	-28	205	400	.	.
FDI assets, EUR mn	171	-65	125	106	-13	93	150	.	.
Gross reserves of NB excl. gold, EUR mn	2,097	2,619	2,961	2,695	3,292	3,292	.	.	.
Gross external debt, EUR mn	7,372	7,844	8,154	8,310	8,782	8,782	8,900	9,800	10,800
Gross external debt, % of GDP	73.4	73.0	72.7	78.4	82.8	82.6	84.0	87.0	90.0
Average exchange rate MKD/EUR	61.57	61.51	61.50	61.6	61.7	61.7	61.7	61.7	61.7

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

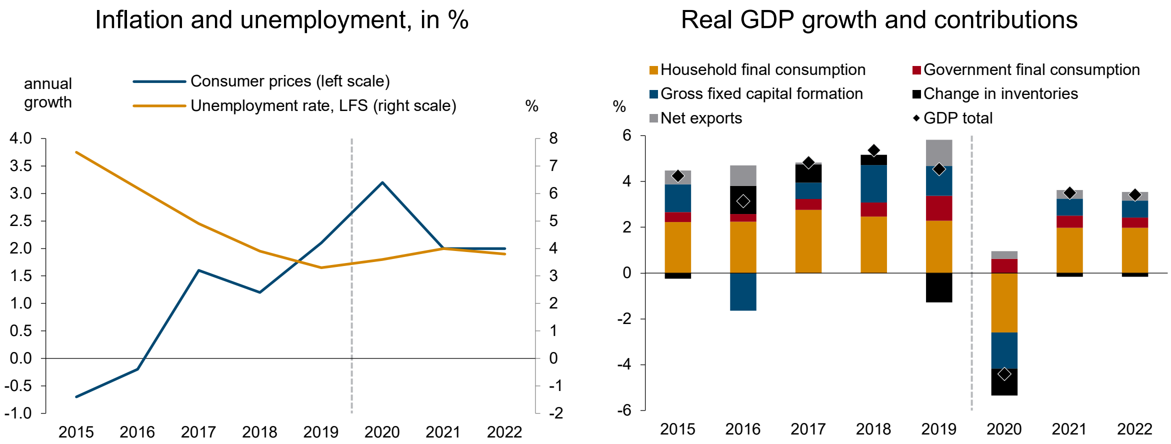
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

POLAND: This time not quite a success story

LEON PODKAMINER

In the second quarter of 2020, GDP fell by 7.9%, but the third quarter has brought some respite to industry. Monetary and fiscal policies have been very expansionary so far, limiting the scale of GDP decline. Inadequate demand remains the chief problem, followed by the falling profitability of firms and continuing uncertainty, also over the pandemic. Consumption may not recover and investment will decline further. Moderate 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.

After a modest 1.7% growth in the first quarter of 2020, GDP fell quite sharply, by 7.9%, in the second quarter (year on year). The GDP decline of 3.2% in the first half of the year still does not look very alarming. Almost all GDP components followed the same pattern: initially modest growth, followed by deep slump. Only public consumption weathered the storm. In the first half of the year as a whole, public consumption, supported by extraordinary spending, rose steadily, by 4.6%. Household consumption fell by 5% in the first six months and gross fixed investment by 6%. Inventories were sharply reduced, shaving 1.7 percentage points off the GDP growth rate in the second quarter. In real terms imports of goods and non-factor services have fallen more than exports (in the first half of the year, the decline was about 8% and 7%, respectively). Foreign trade thus contributed positively to the overall GDP growth. The size of that contribution increased to 0.8% in the second quarter of 2020.

The third quarter of 2020 brought respite to industry, but not to the construction sector. Over the first eight months of 2020, industrial sales were down by 4.5% (year on year). However, the decline had already ceased in June, and in August sales were nearly 2% higher than in the previous year. The sales (and output) losses were largest in the segment supplying capital goods and smallest in the segment supplying durable consumer goods. Moreover, sales have continued to decline in the former segment, while they are growing rapidly in the latter. Overall, the prospects for industry are not very encouraging, as the volume of orders placed is falling (though they remain unchanged so far as export orders are concerned). The construction sector has fared rather worse: after a very strong (9%) growth in sales in the first quarter of the year and just a modest decline (of 2.4%) in the second, output slumped in July and August. The prospects for the sector are rather bleak, as the volume of orders placed is continuing to fall off.

Inadequate demand remains the chief problem facing the economy – on a par with the debilitating uncertainty. Declining profit margins (amid falling sales, rising labour costs and falling producer prices) are also hurting. In the corporate non-financial sector (firms employing over 50 persons), net profits fell by nearly 23% in the first half of the year. In manufacturing corporations the decline was even worse – nearly 40%. The automotive sector fared particularly badly, ending the half year with a net loss (matching the losses made by mining and the accommodation and catering sectors). Despite the fact that many firms (of all sizes) benefited in the second quarter from the various government programmes designed to shield them from the worst effects of the lockdown, about a quarter of those manufacturing firms polled reckon on going out of business within three months if present conditions continue. (In the construction sector, the figure exceeds 40%.) Net profits in the banking sector were nearly halved in the first half of the year; many smaller banks (primarily the cooperative ones) are loss makers and may not survive.

Earlier shortages of labour have ceased to be a serious problem – though not in some activities, such as health care and delivery services. Foreign workers (primarily from Ukraine, and also Belarus) have not left in droves for Germany, as was feared at the end of 2019.

Employment has declined, but so far not very strongly. Nominal average wages in the corporate sector rose by 4.3% in the first eight months of 2020. But in real terms, wages are close to stagnant, as are pensions and other social benefits. All that (plus lower employment and an inevitable rise in the propensity to save) explains the rather sharp fall in household consumption. As further cuts in employment seem inevitable, and as many firms have no option other than to restrict wages, the disposable incomes of households are likely to stay depressed. Under these conditions, private consumption may be rather weak in the second half of the year as well.

Investment in fixed assets will decline further. Gross fixed capital formation rose by 0.8% in the first quarter of 2020 – but then plummeted by over 11% in the second. Quite obviously, this is not the end of the story. Given falling levels of capacity utilisation, prevailing uncertainty and reduced incomes in both the household and the business sectors, ‘wait and see’ is the rational approach to investment. This is reflected in the statistics on the non-financial sector’s bank deposits and loans: in the first seven months of 2020, the deposit stocks of households rose by 7% and of corporates by 15%. At the same time, the stock of loans to households rose by 1.6% – though the stock of loans to corporates fell by nearly 3%. (Interestingly, the stock of loans to central government institutions rose by close to 18%.) Continuing public sector investment is unlikely to make up for the effects of the private sector’s restraint in this respect. Already in the second quarter of 2020, the sales of construction and assembly firms fell by 2.4%

in total. Sales related to civil engineering works rose by 6.7%, whereas sales of works related to investment in industry declined by over 17% and sales of works on construction of buildings by 1.5%.

Monetary and fiscal policies have so far been very expansionary. Since June, the policy interest rate has been merely symbolic (0.10%). Low policy interest rates have helped to keep the exchange rate relatively depressed: until March, the PLN/EUR rate averaged about 4.26 (against 4.42 thereafter). A weaker currency may have helped to achieve a sizeable trade surplus. Extraordinary spending – partly in the form of subsidies transferred to firms, employees and selected population groups – has so far been very high (loosely estimated at close to 6% of GDP). These policies have been heavily criticised by the opposition and experts, who fear the return of high inflation and possibly even default by the state on its rising public debt. But inflation is actually receding, while public debt is still quite low (and, being denominated primarily in the domestic currency, cannot really lead to default). Lavish public deficit spending (reflected in the strong growth of public consumption and the resilience of infrastructure investment) has clearly helped to limit the recession.

Moderate improvements in the second half of 2020 and beyond are possible, but far from being guaranteed. While nothing can guarantee the recovery of private investment in fixed assets, further cuts in inventories may be less significant. The exceptional factors suppressing household consumption in the second quarter of 2020 may not reappear; but consumption is unlikely to recover, though it will not decline as strongly as before. 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 widespread closure of smaller businesses. Last, but not least, it is unclear whether the government is ready to extend its fiscal support measures in the closing months of the year and beyond. Moreover, since the beginning of October the pandemic situation has deteriorated dramatically. After a few months of complete inaction in terms of preparations for a ‘second wave’, the government seems close to panic now. Under such conditions, excessive – but not really economically helpful – reactions cannot be ruled out.

Table 4.16 / Poland: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020	2021 Forecast	2022
Population, th pers., average	38,434	38,423	38,397	38,382	38,368	38,354	38,380	38,380	38,380
Gross domestic product, PLN bn, nom.	1,990	2,122	2,288	552	525	1,077	2,250	2,380	2,510
annual change in % (real)	4.8	5.4	4.5	1.7	-7.9	-3.2	-4.4	3.5	3.4
GDP/capita (EUR at PPP)	20,370	21,420	22,810	.	.	.	.	.	.
Consumption of households, PLN bn, nom.	1,152	1,221	1,297	339	290	628	.	.	.
annual change in % (real)	4.8	4.3	4.0	0.8	-11.1	-5.0	-4.6	3.5	3.5
Gross fixed capital form., PLN bn, nom.	349	386	424	72	84	156	.	.	.
annual change in % (real)	4.0	9.4	7.2	0.8	-11.1	-6.0	-8.5	4.0	4.0
Gross industrial production (sales) 2)									
annual change in % (real)	6.6	5.9	4.1	-2.6	0.3	-6.7	-5.5	4.0	3.8
Gross agricultural production									
annual change in % (real)	2.9	-0.7	-2.3	.	.	.	.	.	.
Construction industry 2)									
annual change in % (real)	13.7	19.7	3.7	3.7	-2.3	0.5	.	.	.
Employed persons, LFS, th, average	16,423	16,484	16,461	16,425	16,274	16,274	16,210	16,130	16,100
annual change in %	1.4	0.4	-0.1	0.9	-1.3	-1.3	-1.5	-0.5	-0.2
Unemployed persons, LFS, th, average	844	659	558	529	527	527	610	670	640
Unemployment rate, LFS, in %, average	4.9	3.9	3.3	3.1	3.1	3.1	3.6	4.0	3.8
Reg. unemployment rate, in %, eop	6.6	5.8	5.2	5.4	6.1	6.1	.	.	.
Average monthly gross wages, PLN 3)	4,284	4,590	4,918	5,489	5,286	5,299	5,130	5,340	5,610
annual change in % (real, gross) 3)	3.7	5.5	5.0	.	.	.	1.0	2.0	3.0
Consumer prices (HICP), % p.a.	1.6	1.2	2.1	3.9	3.8	3.6	3.2	2.0	2.0
Producer prices in industry, % p.a.	2.7	2.1	1.3	-0.3	-0.8	-0.4	0.0	1.0	1.8
General governm.budget, EU-def., % of GDP									
Revenues	39.8	41.3	41.0	.	.	.	38.5	39.0	40.0
Expenditures	41.2	41.5	41.8	.	.	.	45.0	43.5	43.0
Net lending (+) / net borrowing (-)	-1.5	-0.2	-0.7	.	.	.	-6.5	-4.5	-3.0
General gov.gross debt, EU def., % of GDP	50.6	48.8	45.7	.	.	.	56.0	57.5	57.0
Stock of loans of non-fin.private sector, % p.a.	3.1	7.1	4.7	6.0	2.9	2.9	.	.	.
Non-performing loans (NPL), in %, eop	6.8	6.8	6.6	6.6	6.9	6.9	.	.	.
Central bank policy rate, % p.a., eop 4)	1.50	1.50	1.50	1.00	0.10	0.10	0.10	0.25	0.50
Current account, EUR mn 5)	-1,544	-6,514	2,604	4,624	6,582	11,205	3,300	1,900	1,100
Current account, % of GDP 5)	-0.3	-1.3	0.5	3.6	5.6	4.6	0.7	0.4	0.2
Exports of goods, BOP, EUR mn 5)	202,108	217,110	232,971	58,807	48,552	107,359	216,700	229,500	243,700
annual change in %	13.9	7.4	7.3	1.7	-15.9	-7.1	-7.0	5.9	6.2
Imports of goods, BOP, EUR mn 5)	202,460	223,330	231,766	57,726	44,645	102,371	210,200	224,900	240,600
annual change in %	15.4	10.3	3.8	0.1	-22.6	-11.3	-9.3	7.0	7.0
Exports of services, BOP, EUR mn 5)	50,976	57,672	62,480	14,930	12,351	27,282	51,500	58,600	65,600
annual change in %	15.8	13.1	8.3	5.6	-20.2	-7.9	-17.5	13.7	12.0
Imports of services, BOP, EUR mn 5)	33,137	36,403	38,831	8,665	7,245	15,910	30,700	33,300	36,600
annual change in %	9.5	9.9	6.7	2.7	-23.9	-11.4	-21.0	8.5	10.0
FDI liabilities, EUR mn 5)	10,182	14,809	12,809	4,845	-1,167	3,678	3,500	.	.
FDI assets, EUR mn 5)	3,430	1,954	4,268	205	-1,763	-1,557	4,000	.	.
Gross reserves of NB excl. gold, EUR mn	90,967	97,633	104,526	99,375	103,455	103,455	.	.	.
Gross external debt, EUR mn 5)	319,716	314,642	314,120	299,341	299,022	299,022	303,400	302,900	311,600
Gross external debt, % of GDP 5)	68.4	63.2	59.0	59.2	59.1	59.1	60.0	56.0	54.0
Average exchange rate PLN/EUR	4.2570	4.2615	4.2976	4.4406	4.4450	4.4136	4.45	4.40	4.35

1) Preliminary. - 2) Enterprises with 10 and more employees. - 3) Half-year data refer to enterprises with 10 and more employees. - 4) Reference rate (7-day open market operation rate). - 5) Including SPE.

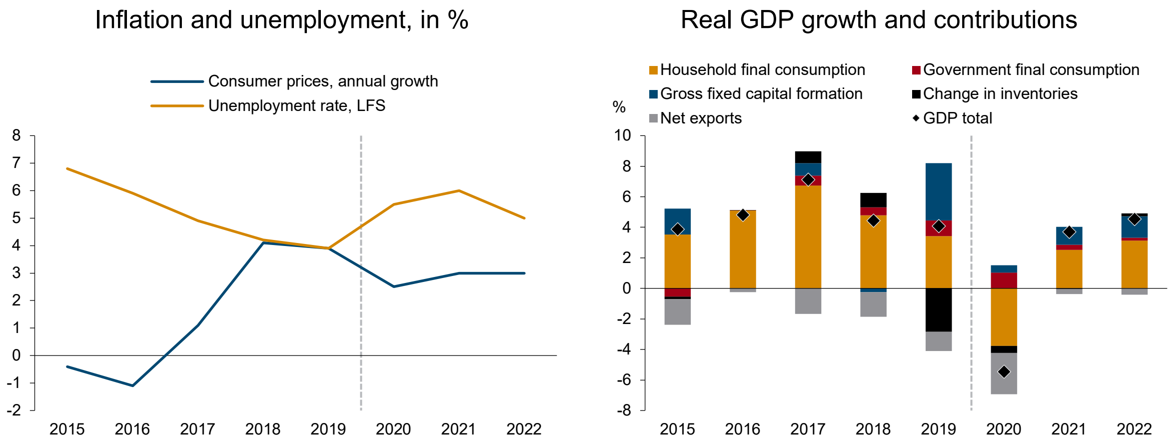
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ROMANIA: Getting away with large fiscal imbalances

GÁBOR HUNYA

Despite the high epidemiological risk, the government plans only local lockdowns in future. GDP is projected to decline by 5.5% in 2020 and to hit its 2019 level only in 2022. A budget deficit of close to 10% of GDP has caused a rise in bond yields and currency depreciation, but presents no immediate risk to external financing. The December election should produce a centre-right coalition government; it is expected to improve public governance – an important precondition for spending EU funds.

Figure 4.17 / Romania: Main macroeconomic indicators



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

Romania has suffered severe losses in terms of human life and economic performance due to the COVID-19 pandemic. The number of infections first peaked in April 2020, but subsided in May after a general shutdown. Numbers rose again in July, when the lockdown was lifted, peaking for a second time in early October, when the daily number of infections and deaths was more than three times greater than in April. With 3.7 fatalities per hundred thousand inhabitants, Romania had the second highest death rate in the EU in the first half of October (after the Czech Republic and just ahead of Spain). Despite the high medical risk, the government has ruled out a return to lockdown, but has been forced recently to impose it partially and locally. Following the Coronavirus cycle, economic performance improved in the third quarter over the second; if this trend continues, the annual GDP decline in 2020 will be 5.5%, rather better than the wiiw Spring forecast. The recession may be deeper, however, if lockdowns affect major cities and industrial centres in the fourth quarter.

GDP fell by 10.3% in the second quarter of 2020, year on year, after a 2.5% growth in the first three months. Household consumption and net exports made a negative contribution to growth in the first half of 2020, while government consumption and investments mitigated the decline. Retail sales, personal services and the hospitality sector all suffered large setbacks during the lockdown, although Romania is not a frequent tourism destination and has a negative account on travel services. The most remarkable GDP position was the positive development in gross fixed capital formation: it saw no decline, even in the second quarter of the year.

Construction was a sector that witnessed positive growth in the first six months. Both EU-financed infrastructure projects and private housebuilding managed to avoid recession. Gross fixed capital formation is expected to grow throughout the year, but stocks are depleted; thus, capital formation will remain at the level of 2019. Information and communication technology has been another expanding economic sector, reflecting the intensive use of telephones and the internet.

Industrial production is expected to fall by 13% in 2020. It had started to decline in the first quarter, responding to sluggish external demand even before the pandemic, and was 16% lower in the first six months than the year before. Export-oriented industries – and primarily the automotive sector – suffered the largest setback, whereas food and beverages production and the electronics industry kept on growing. Industry, exports and the retail sector recovered in July, the latter almost reaching the level of the previous year. International production chains have revived production at least partially, and the Renault subsidiary Dacia has presented the revamped versions of its models. Agricultural production dropped as a result of adverse weather conditions. This has also curtailed farmers' consumption and has generated food price inflation.

The Romanian labour market usually witnesses a relatively minor response to economic shocks. The unemployment rate is expected to reach 5.5% in 2020 – up from 4% in the previous year. The most visible effect of the pandemic has been an increase in the number of employed persons absent from work: they made up 10% of the employed population in the second quarter – a rate seven times higher than a year earlier. Some of these people returned to normal working hours in the third quarter. The number of the unemployed is expected to grow during the winter, as companies (some of which may go bankrupt) shed excess employees. Government support for employment and EU programmes to benefit SMEs may mitigate the process. Romanians working abroad are reported to have returned to Western Europe after the Easter lockdown. Still, remittances in the first half of 2020 (some 2.6% of GDP) were about 16% down on the year before; depending on the job situation, this figure may not decline any further in the second half of the year.

Romania was to become subject to the EU excessive deficit procedure, on account of the budget deficit posted in 2019 (4.3% of GDP), following the socialist government's pro-cyclical fiscal policy. The recent relaxation of EU fiscal rules has rendered the procedure redundant and has allowed Romania to spend about 4% of GDP in connection with the epidemic, while at the same time enduring revenue loss on account of the recession and tax reliefs. Public spending was set to surge from September, as the socialist parliamentary majority insisted on implementing the 40% rise in pensions that was agreed earlier and included in the so-called budget rectification law, which is actually intended to restructure resources in the fight against COVID-19. In response, the government and the president have decided to use all available means to postpone implementation and apply only a 14% increase.

The fiscal deficit may rise to 9.5% of GDP (or more) in 2020, and is likely to fall only slowly in the coming two years. At the same time, household consumption may receive a fillip, although part of the population may prefer to save rather than spend, in anticipation of difficult times ahead. External financing of the deficit by the markets seems likely, but that could be jeopardised in the event of a financial shock. In the short term, the possibility of a budget deficit of close to 10% of GDP has triggered a rise in bond yields and a depreciation of the Romanian currency. A weaker RON could actually help improve the trade balance: annual depreciation is expected to be 2.3%, close to the consumer price index but considerably more than the stagnating industrial producer prices.

The National Bank has taken steps to increase liquidity in the economy, by reducing the policy rate three times, by altogether 1 percentage point (to 1.5%), and has narrowed the interest rates corridor to ±0.5 percentage points (from ±1.0 percentage points), which has further reduced the lending facility rate. However, further rate cuts are unlikely, due to rising external financing needs, a current account deficit of about 4.5% of GDP and the recent depreciation.

Local and regional elections on 27 September brought success for the National Liberal Party of the interim prime minister, Ludovic Orban. He thus stands a good chance of heading a centre-right coalition government after the parliamentary elections on 6 December. The likely new government is expected to oversee a stabilisation of the rule of law and to exercise better public governance than was the case under the former socialist government.

An improvement in public governance is of the utmost necessity, as the country will be in a position to spend a huge amount of EU money over the next few years – mostly grants, but also credits. Under the EU's Economic and Social Recovery Plan (Next Generation EU – NGEU), Romania will be entitled to receive EUR 33 billion (of which EUR 19.6 billion will be non-reimbursable) – money that it will have to absorb by 2023. This comes in addition to the EUR 30 billion European Structural and Investment Funds (ESIF) for 2014-2020, of which only 40% had been spent by the end of September 2020, one of the lowest rates in the EU. The deadline for spending the rest is also 2023, which will be a huge challenge for the country's public administration. Further EU support of EUR 4 billion in preferential loans may also become available in 2020 to target the fight against unemployment – especially the short-time work scheme. The disbursement of this loan may be hampered by the recent increase in spending on pensions, which could be seen as misuse of fiscal resources for purposes unrelated to the fight against COVID-19. The new resources from the 2021-2027 EU MFF will be in the range of EUR 40 billion, but this will barely be accessed during the forecasting period. Nevertheless, the preparation of strategies and projects will be on the agenda.

Although we expect a recovery in 2021, this will fall short of a V shape; the GDP level of 2019 will only be attained in 2022. GDP will shrink by about 5.5% in 2020 and will grow by less than 4% in 2021, and then more robustly the following year. A downside risk to the growth forecast in the second half of 2020 and 2021 is provided by the spread of the COVID-19 virus and the severity of restrictions in Romania and its main markets. At the same time, an extremely loose fiscal policy, coupled with EU transfers, will mitigate the negative effects of the pandemic. Financing the fiscal deficits will not be a problem, even if private investors are displaying growing concern: EU funds will balance much of the current account deficit and will partly replace FDI.

Table 4.17 / Romania: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average	19,587	19,473	19,366	.	.	.	19,300	19,200	19,000
Gross domestic product, RON bn, nom.	857.9	951.7	1,059.8	216.0	223.1	439.1	1,030	1,100	1,200
annual change in % (real)	7.3	4.5	4.2	2.4	-10.3	-4.5	-5.5	3.7	4.5
GDP/capita (EUR at PPP)	18,650	19,910	21,620	.	.	.	.	.	.
Consumption of households, RON bn, nom.	536.7	599.4	665.1	143.7	138.6	282.3	.	.	.
annual change in % (real)	10.9	7.6	5.4	3.8	-13.3	-4.9	-6.0	4.0	5.0
Gross fixed capital form., RON bn, nom.	192.2	200.4	250.5	36.8	59.7	96.5	.	.	.
annual change in % (real)	3.5	-1.1	17.8	13.1	2.2	6.7	2.0	5.0	6.0
Gross industrial production 2)									
annual change in % (real)	7.9	3.5	-2.3	-6.0	-26.7	-16.3	-13.0	6.0	7.0
Gross agricultural production									
annual change in % (real)	12.5	7.2	-3.0	.	.	.	.	.	.
Construction industry 2)									
annual change in % (real)	-5.5	-4.1	27.6	34.2	10.8	19.4	.	.	.
Employed persons, LFS, th, average	8,671	8,689	8,680	8,519.5	8,505	8,512	8,510	8,420	8,420
annual change in %	2.6	0.2	-0.1	0.4	-3.5	-1.6	-2.0	-1.0	0.0
Unemployed persons, LFS, th, average	449	380	353	382.4	482	432	500	540	440
Unemployment rate, LFS, in %, average	4.9	4.2	3.9	4.3	5.4	4.9	5.5	6.0	5.0
Reg. unemployment rate, in %, eop	4.0	3.3	3.0	2.9	3.0	3.0	.	.	.
Average monthly gross wages, RON 3)	3,223	4,357	4,853	5,285	5,253	5,269	5,100	5,400	5,800
annual change in % (real, gross)	13.2	8.0	7.3	4.4	0.4	2.4	2.5	3.0	5.0
Average monthly net wages, RON	2,338	2,642	2,986	3,228	3,220	3,224	3,100	3,300	3,600
annual change in % (real, net)	12.8	8.0	8.9	4.9	0.7	2.7	2.5	3.0	5.0
Consumer prices (HICP), % p.a.	1.1	4.1	3.9	3.1	2.1	2.6	2.5	3.0	3.0
Producer prices in industry, % p.a.	3.5	5.1	3.8	2.6	-1.4	0.6	0.5	2.0	2.0
General governm.budget, EU-def., % of GDP									
Revenues	30.8	31.9	31.7	.	.	.	30.0	30.0	30.0
Expenditures	33.5	34.9	36.0	.	.	.	39.5	37.0	34.0
Net lending (+) / net borrowing (-)	-2.6	-2.9	-4.3	.	.	.	-9.5	-7.0	-4.0
General gov.gross debt, EU def., % of GDP	35.1	34.7	35.2	.	.	.	45.0	48.0	50.0
Stock of loans of non-fin.private sector, % p.a.	5.3	7.9	7.0	6.2	4.1	4.1	.	.	.
Non-performing loans (NPL), in %, eop	6.4	5.0	4.1	3.9	4.4	4.4	.	.	.
Central bank policy rate, % p.a., eop 4)	1.75	2.50	2.50	2.00	1.75	1.75	1.50	1.50	1.75
Current account, EUR mn	-5,239	-8,961	-10,480	-933	-2,975	-3,908	-10,000	-10,200	-11,200
Current account, % of GDP	-2.8	-4.4	-4.7	-2.1	-6.5	-4.3	-4.7	-4.6	-4.7
Exports of goods, BOP, EUR mn	57,162	61,814	63,075	15,785	10,672	26,456	52,400	56,900	62,600
annual change in %	9.6	8.1	2.0	-1.4	-32.7	-17.0	-17.0	8.5	10.0
Imports of goods, BOP, EUR mn	69,365	76,617	80,492	20,167	14,995	35,162	71,600	77,300	85,000
annual change in %	12.8	10.5	5.1	2.2	-24.5	-11.2	-11.0	8.0	10.0
Exports of services, BOP, EUR mn	21,730	23,791	27,058	6,234	5,196	11,431	23,300	25,400	29,200
annual change in %	15.1	9.5	13.7	3.5	-22.1	-9.9	-14.0	9.0	15.0
Imports of services, BOP, EUR mn	13,544	15,431	18,408	4,019	2,924	6,943	15,100	16,200	18,000
annual change in %	23.1	13.9	19.3	-4.8	-33.6	-19.5	-18.0	7.0	11.0
FDI liabilities, EUR mn	5,225	6,205	6,574	-646	647	0	500	.	.
FDI assets, EUR mn	348	1,259	1,721	-242	-879	-1,121	500	.	.
Gross reserves of NB excl. gold, EUR mn	33,494	33,065	32,927	34,123	35,002	35,002	.	.	.
Gross external debt, EUR mn	97,446	99,841	105,873	107,919	111,452	111,452	117,000	120,000	122,000
Gross external debt, % of GDP	51.9	48.8	47.4	50.8	52.5	52.5	55.1	54.0	51.3
Average exchange rate RON/EUR	4.5688	4.6540	4.7453	4.7969	4.8378	4.8174	4.85	4.95	5.05

1) Preliminary. - 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.

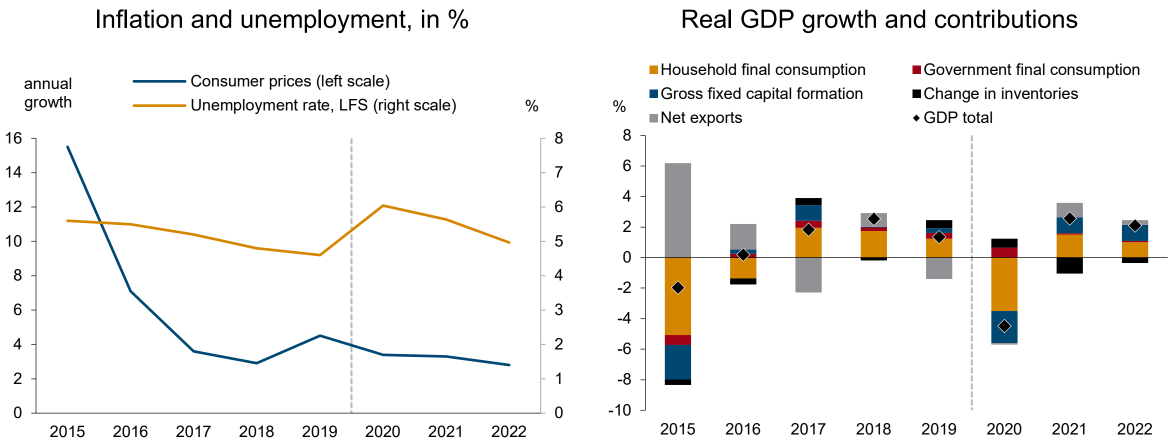
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

RUSSIA: Economic losses manageable so far, but clouds on the horizon

VASILY ASTROV

In the second quarter, the economy shrank by a relatively moderate 8%, and the subsequent rebound has been reasonably strong. However, a recent upsurge in new infections and the currency's weakening will dampen economic activity in the months to come. In the baseline scenario, GDP is expected to decline by 4.5% this year, with a moderate recovery of 2-2.5% per year projected for 2021-2022.

Figure 4.18 / Russia: Main macroeconomic indicators



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

Russia has been hit hard by the Coronavirus pandemic, and many Russian regions faced strict lockdowns during April-May. The number of new infections declined only slowly over the summer months and started rising again in September (to around 15,000 a day at the time of writing), which is above the levels recorded in spring. In response, some Coronavirus restrictions have been reimposed (notably in Moscow), and another strict lockdown cannot be ruled out, should the situation deteriorate further. Poor compliance by the population with the existing restrictions, such as social distancing rules and the wearing of masks, only increases the chances of a new lockdown.

…but the economic fallout has so far been relatively modest. In the second quarter, real GDP fell by 8% on a year-on-year (yoy) basis – rather moderate, given the circumstances. The main drags on growth were private consumption (-22.2%) and, to a lesser extent, gross fixed capital formation (-11.7%); meanwhile net exports contributed positively, thanks to a strong contraction in real imports (-22.2%). The relatively mild GDP decline, despite the very strong contraction in private consumption, is explained by the fact that the latter accounts for only half of Russian GDP[18] (its share has fallen still further, to 47%, during the crisis). The two

18 As of the second quarter of 2019.

sectors that have been especially hard hit by the pandemic – hospitality and catering (-57% in value-added terms in the second quarter) and culture and recreation (-28%) – each account for only 0.9% of GDP.[19] At the same time, trade – which is a much bigger sector – proved more resilient during the lockdown (-13%).

Private consumption has declined much more than real disposable incomes (which dropped by 8% in the second quarter yoy), suggesting a sharp rise in the propensity to save in the face of lockdown and uncertainty. As is often the case in Russia, the negative demand shock has primarily been absorbed by falling wages[20] and incomes, while the increase in unemployment has been relatively modest – from 4.7% before the pandemic to 6.4% in August, according to LFS methodology. However, given the widespread incidence of short-time work and unpaid leave, unemployment is likely to climb, especially once the many government support measures expire (for more on that, see below).

The decline in investments has been almost entirely confined to the small-business segment. According to estimates, fixed investment outlays by small businesses plunged by 36% in the second quarter (yoy), while those of medium-sized and large companies remained nearly unchanged (-0.4%), probably due to inertia in corporate decision-making. Therefore, in the remainder of the year the investment dynamics is likely to change for the worse, particularly given the high degree of uncertainty and the reduced levels of capacity utilisation.

High-frequency data present a picture of a reasonably strong economic rebound during the summer months, albeit weakening recently. In June-July, retail trade turnover and paid services to households picked up by a cumulated 20% (compared to May), although on an annual basis both remained in negative territory. However, in August retail trade turnover went negative again (-1.5% month on month (mom)), potentially suggesting that the one-off effect of delayed consumer demand is now exhausted. The recovery in industrial production lost pace as well: after healthy growth in July and August (on a monthly basis), both extraction industry and manufacturing production turned negative in September (-0.6% and -0.3% mom, respectively). On an annual basis, overall industrial production in September remained in deep red (-5%).

Macroeconomic policy has been relaxed markedly in response to the crisis, especially on the monetary side. The policy rate has been slashed by a total of 175 basis points since the start of the year, to 4.25% (although, unlike in most other CESEE countries, it is still positive in real terms). As a result, the volume of credit to the real economy picked up by nearly 12% in the first eight months (although non-performing loans have been on the rise as well). Particularly popular has been the programme of subsidised mortgages at an interest rate of 6.5%. However, in the face of supply-side constraints, this has primarily translated into booming housing prices, rather than increased construction, so that the effect of monetary easing policies has not been very significant.

In contrast, the fiscal stimulus has been relatively modest, despite ample fiscal space: the public debt amounts to only 12% of GDP, while the National Welfare Fund (NWF) likewise accounts for some 12% of GDP. The latest government plan envisages supporting measures of overall 6% of GDP in 2020-2021. However, it also includes items that had already been earmarked, such as infrastructure

19 As of the second quarter of 2019.

20 According to official statistics, real wages *grew* by 4.3% in the first half of 2020. But this does not square with anecdotal evidence and the sharp decline in personal income tax collection, and raises doubts over the validity of the statistical methodology under the conditions of a lockdown and various government support measures.

projects. In addition, two thirds of this fiscal package have already been spent this year. Government measures have targeted households (50% higher unemployment benefit, extra child benefit and credit holidays in the event of a steep loss of income), businesses (salary subsidies, subsidised salary credits, tax holidays and a moratorium on bankruptcies) and especially SMEs (credit holidays, delayed rent payments and lower social security contributions). However, many of these measures expired before 1 October and have not been prolonged – despite the fresh upsurge in Coronavirus cases.

For 2021-2023, the budget adopted by the parliament in the first reading envisages a moderate fiscal consolidation of around 0.9 pp of GDP (compared to 2020); of this, revenue-side measures account for 0.6 pp. These include higher corporate taxes in the oil industry, increased mineral extraction taxes on metals and chemicals, a tax on interest from bank deposits over RUB 1 million (some USD 13,000), and a hike in the excise tax on tobacco (from 4 to 20%). Besides, the 13% flat personal income tax, which has been in place for the past two decades, will be scrapped starting from 2021, with a tax rate of 15% on annual incomes over RUB 5 million (some USD 60,000). Although the move is rather symbolic, it does represent a step in the right direction in the current economic environment, which is different from that of the early 2000s (and is characterised by a generally smaller degree of tax evasion), and will contribute, even if marginally, to a reduction in the high level of income inequality in Russia. On the expenditure side, the deadline for many of the so-called 'national projects' – flagship government programmes aimed at raising living standards and making Russia the world's fifth biggest economy by 2024 – has been pushed back to 2030, and the respective allocations for 2021-2023 have been cut accordingly, particularly for the environment and digitalisation.

External balances have deteriorated strongly, mostly on account of the oil price shock. In the first nine months of 2020, the trade surplus nearly halved, and the current account surplus more than halved in US dollar terms compared to the same period last year. Nominal exports of crude oil, oil products and natural gas plummeted by 41%, 32% and 48%, respectively, on account of weak demand, low prices and later oil production cuts within the framework of the OPEC+ deal. At the same time, income from foreign investments declined by 38% and travelling abroad by 73%, as the borders were effectively closed. Both of those factors have helped keep the current account in positive territory. By contrast, the contraction of goods imports was much more modest (-7%), despite rouble depreciation.

The short-term prospects are clouded by the recent upsurge in new Coronavirus cases and by the recent weakening of the rouble. The second wave of the pandemic will weigh on consumer and investment demand even in the absence of a full-fledged lockdown. As for the rouble, there was an initial slump in the early stages of the pandemic, and since July the depreciation has resumed – a trend that has been reinforced by the risk of new western sanctions following the alleged poisoning of opposition politician Alexei Navalny and the (albeit lukewarm) Russian support for the embattled Belarusian President Alexander Lukashenko. All in all, since the beginning of the year the rouble has depreciated by about 20% in nominal terms against the US dollar – the third-worst currency performance among emerging markets so far.

According to the baseline scenario, we project a real GDP decline of 4.5% for 2020, followed by a modest recovery of 2.5% next year and 2.1% in 2022. This scenario assumes no further strict lockdown and the availability of an effective vaccine against COVID-19 by mid-2021 at the latest (the merits of the existing Russian vaccine 'Sputnik V' are currently disputed). Besides, the projection is based on a further relaxation of oil production quotas under the OPEC+ agreement (reflecting a gradual pick-up in demand) and a gradual recovery of the oil price substantially above USD 42.4 per barrel – the 'break-even' price required to balance the Russian budget in 'normal times'. However, these times are not normal, and the budget will remain in deficit over the forecast horizon (albeit diminishing over time), regardless of the oil price, mostly on account of Coronavirus-related expenditure. These deficits will be mainly financed by borrowing without tapping the NWF, resulting in a moderate increase in the public debt-to-GDP ratio. Even in this rather favourable scenario, growth will remain moderate in the years to come, reflecting the long-standing (above all institutional) structural bottlenecks. The risks to the above forecast are primarily on the downside and will materialise if the second wave of the pandemic prompts further lockdowns and if the oil price declines markedly from current levels in the face of global weakness.

Table 4.18 / Russia: Selected economic indicators

	2017	2018	2019 [1]	2020 1Q	2020 2Q	2020 1-2Q	2020	2021 Forecast	2022
Population, th pers., average	146,842	146,831	146,765	146,711	146,602	146,640	146,660	146,600	146,600
Gross domestic product, RUB bn, nom.	91,843	104,630	110,046	25,318	23,288	48,606	105,100	112,100	119,000
annual change in % (real)	1.8	2.5	1.3	1.6	-8.0	-3.4	-4.5	2.5	2.1
GDP/capita (EUR at PPP)	17,840	19,630	19,540	.	.	.	.	.	.
Consumption of households, RUB bn, nom.	48,178	51,363	55,020	13,491	10,756	24,248	.	.	.
annual change in % (real)	3.7	3.3	2.5	3.3	-22.2	-9.8	-7.0	3.0	2.0
Gross fixed capital form., RUB bn, nom.	20,189	21,293	23,114	3,887	4,630	8,517	.	.	.
annual change in % (real)	4.7	0.2	1.5	1.8	-11.7	-6.1	-10.0	5.0	5.0
Gross industrial production [2]									
annual change in % (real)	2.1	3.5	3.3	2.9	-6.5	-1.9	-3.5	3.0	3.5
Gross agricultural production									
annual change in % (real)	2.9	-0.2	4.3	3.0	3.1	3.0	.	.	.
Construction output									
annual change in % (real)	-1.2	5.3	0.6	1.1	-1.8	-0.5	.	.	.
Employed persons, LFS, th, average [3]	72,142	72,532	71,933	71,289	70,112	70,700	70,000	70,300	70,800
annual change in %	-0.3	0.3	-0.8	-0.2	-2.1	-1.1	-2.7	0.4	0.7
Unemployed persons, LFS, th, average [3]	3,967	3,658	3,465	3,464	4,468	3,966	4,500	4,200	3,700
Unemployment rate, LFS, in %, average [3]	5.2	4.8	4.6	4.7	6.0	5.4	6.0	5.6	5.0
Reg. unemployment rate, in %, eop [4]	1.0	0.9	0.9	1.0	3.7	3.7	.	.	.
Average monthly gross wages, RUB	39,167	43,724	47,867	48,293	50,725	49,509	51,000	54,800	58,600
annual change in % (real, gross)	2.9	8.5	4.8	7.4	1.5	4.3	3.0	4.0	4.0
Consumer prices, % p.a.	3.6	2.9	4.5	2.5	3.2	2.8	3.4	3.3	2.8
Producer prices in industry, % p.a. [5]	7.7	12.1	2.0	-2.4	-12.1	-7.3	-7.0	5.0	4.5
General governm.budget, nat.def., % of GDP									
Revenues	33.8	35.7	35.5	36.4	37.2	36.8	36.0	36.6	36.6
Expenditures	35.3	32.8	33.6	34.0	43.5	38.5	41.0	40.1	39.1
Deficit (-) / surplus (+)	-1.5	2.9	1.9	2.5	-6.3	-1.7	-5.0	-3.5	-2.5
General gov.gross debt, nat.def., % of GDP	12.6	12.0	12.3	13.8	14.0	14.0	16.0	19.0	20.0
Stock of loans of non-fin.private sector, % p.a.	3.5	13.9	6.5	11.6	8.9	8.9	.	.	.
Non-performing loans (NPL), in %, eop [6]	5.2	4.7	5.4	5.3	5.4	5.4	.	.	.
Central bank policy rate, % p.a., eop [7]	7.75	7.75	6.25	6.00	4.50	4.50	4.25	4.00	3.75
Current account, EUR mn [8]	28,504	98,142	58,335	20,043	-459	19,607	15,700	33,900	33,500
Current account, % of GDP	2.0	6.9	3.8	5.8	-0.2	3.1	1.2	2.4	2.3
Exports of goods, BOP, EUR mn [8]	312,636	376,612	374,854	80,345	62,993	143,364	261,500	290,300	307,700
annual change in %	22.9	20.5	-0.5	-11.0	-30.2	-20.6	-30.2	11.0	6.0
Imports of goods, BOP, EUR mn [8]	211,161	211,127	227,313	50,977	49,057	100,040	198,800	206,900	217,200
annual change in %	22.1	0.0	7.7	4.1	-11.1	-3.9	-12.5	4.1	5.0
Exports of services, BOP, EUR mn [8]	50,970	54,845	56,057	12,212	8,879	21,096	37,500	40,800	42,900
annual change in %	11.5	7.6	2.2	0.6	-36.7	-19.3	-33.1	8.8	5.1
Imports of services, BOP, EUR mn [8]	78,716	80,366	88,389	18,380	10,986	29,375	52,100	56,800	60,800
annual change in %	16.9	2.1	10.0	5.6	-50.1	-25.4	-41.1	9.0	7.0
FDI liabilities, EUR mn [8]	25,296	7,453	28,548	-3,454	5,580	2,117	7,000	.	.
FDI assets, EUR mn [8]	32,559	26,620	19,574	516	4,182	4,695	11,400	.	.
Gross reserves of NB excl. gold, EUR mn [8][9]	297,823	333,617	396,378	402,206	389,476	389,476	.	.	.
Gross external debt, EUR mn [8]	433,606	397,860	438,727	413,376	428,140	428,140	435,800	434,400	416,500
Gross external debt, % of GDP	31.1	28.1	28.9	32.3	33.4	33.4	34.0	31.0	28.0
Average exchange rate RUB/EUR	65.87	73.87	72.51	73.11	79.64	76.38	82.0	80.0	80.0

Note: Including Crimean Federal District.

1) Preliminary. - 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.

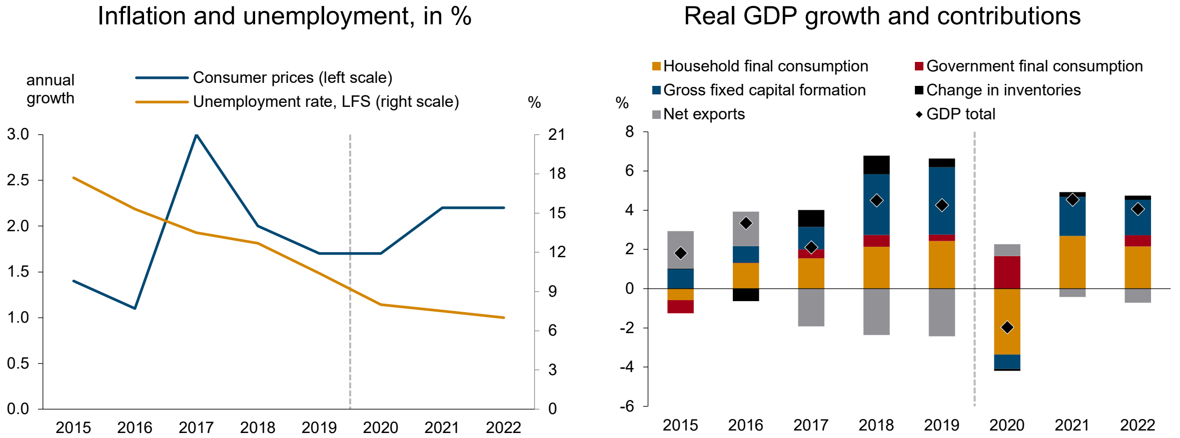
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SERBIA: Expansionary fiscal policy helping the economy weather the crisis

BRANIMIR JOVANOVIC

Serbia has been among the best-performing European countries during the COVID-19 pandemic. GDP fell by just 0.8% in the first half of the year, and data for Q3 suggest a solid recovery. We are thus upgrading our forecast for 2020, from -4% to -2%. The good results are mainly due to the massive fiscal support by the government, which has borrowed abroad and used the money to support the economy during the crisis. This cannot continue indefinitely, and prospects for the future depend on the viability of its current economic model, based on attracting FDI, in the post-coronavirus world.

Figure 4.19 / Serbia: Main macroeconomic indicators



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

Serbia was expected to do relatively well during this crisis. In our previous forecast, we projected that its GDP would shrink by 4% this year, which was among the smallest contractions of all the countries for which we forecast. The main reason behind that relatively benign expectation was that the country is not too dependent on tourism and it depends a lot on domestic factors, such as agriculture, which was expected to do well this year.

But the performance of the Serbian economy in the first half of the year exceeded all expectations. In Q1, GDP grew by 5.1% year on year (y-o-y), driven by solid investment (+10.8% y-o-y) and government consumption (+11.8% y-o-y). Then, in Q2, it did decline, due to the lockdown – but by only 6.4% y-o-y, which was one of the smallest contractions in Europe. The lockdown caused most GDP components to decline in Q2 – household consumption by 8%, investment by 11.9%, exports by 20.7% and imports by

19.3%. The exception was government consumption, which grew by 8.9% and provided a much-needed stimulus to the economy.

The fiscal stimulus provided by the Serbian government in Q2 was really exceptional. General government total spending amounted to 58% of GDP in Q2, which was 16-17 percentage points above the average level of government spending over the past three years. Serbia enacted the biggest stimulus package of all the Western Balkan countries, announced at EUR 5.1 billion (11% of GDP). Its largest part was the credit guarantee scheme of EUR 2 billion, which resulted in cheaper credits for firms and was used extensively. Another important component was the favourable credit line of EUR 200 million for SMEs. The government also provided wage subsidies to firms, for three months, in an amount equivalent to the monthly minimum wage per worker. The most controversial component of the package was the infamous cash giveaway programme of EUR 100 for every adult citizen, which amounted to EUR 600 million in total. This was untargeted, giving money even to better-off citizens, and was introduced just a few weeks ahead of the parliamentary elections in June, raising concerns of vote buying. But it has probably supported consumption and cushioned the economic decline.

The budget deficit for 2020 is anticipated to be around 8% of GDP, pushing public debt above 60% of GDP. The government is expected to enact fully the planned budget for 2020, which implies general government expenditure for 2020 of 48% of GDP, the highest in recent years. At the same time, general government revenues are expected to decline to 40% of GDP, due to the crisis. The difference of 8% of GDP will be covered by borrowing, and back in May the government issued a Eurobond of EUR 2 billion. This raised public debt to 58% of GDP in Q2, and further domestic borrowing up to the end of the year is likely to push it above 60%. The interest rate on the new debt is also rising: the yield of this year's Eurobond was 3.375%, which is much higher than that of the Eurobond from 2019 (1.619%), raising questions about future debt developments.

The labour market performed relatively well during the pandemic. Perhaps surprisingly, the rate of unemployment (according to the Labour Force Survey) dropped to 7.3% in Q2, from 9.7% in Q1. Still, this decline was mostly due to a rise in inactivity, which increased by 113,100 people in Q2. Basically, many people stopped looking for jobs during the pandemic, either because of the lockdown or on account of the government subsidies. Employment, however, did not improve; indeed, it actually declined by 33,200 people, or 1.2%. The growth of net wages in the first half of the year averaged 7.9% in real terms, driven by an increase in the minimum wage from the beginning of the year and the public-sector wage increase from the previous year.

Monetary policy has also been supportive during the crisis. The National Bank of Serbia, following the example of other central banks around the world, relaxed its monetary policy in an effort to boost the economy, lowering its base interest rate on three occasions in 2020, to 1.25% in June. In addition, the central bank initiated two waves of debt payment moratoria, which were taken up by approximately 80% of households and 60% of businesses.

Inflation and the exchange rate have been stable throughout 2020 and are expected to remain so in the coming period. Inflation reached 1.9% in August in year-on-year terms, and we expect it to remain close to 2% for some time to come, continuing the trend from 2018, since when it has consistently been around that level. This stands in stark contrast to the period before 2014, when inflation never fell below 6%, driven by the depreciating dinar. The dinar has since stabilised, and has actually gone through a trend of appreciation, moving from around 124 RSD/EUR in 2017 to its current level of 117.6 RSD/EUR, due to strong capital inflows into the country (FDI and exports). That has made the central bank start intervening more on the forex market, buying foreign currency to prevent further appreciation; this has stabilised the dinar at around 117.6 RSD/EUR for the past year. We foresee no major changes in these trends in the coming period, and expect the dinar and inflation to remain stable at their current levels.

Foreign trade declined markedly in Q2, but the external balance improved. Exports and imports of goods both declined by around 20% in Q2; but as imports are bigger, this actually closed the trade deficit somewhat. Therefore, the current account deficit is expected to narrow slightly in 2020, to 5.7% of GDP (from 6.9% in 2019), and will be fully covered by the solid FDI inflows. These reached EUR 1.5 billion in the first half of the year, driven by the solid investments in manufacturing (EUR 477 million) and transport (EUR 353 million), the former being due to the free zones and the latter to the TurkStream natural gas pipeline. It is notable that foreign direct investment remained fairly stable even in Q2, when it reached EUR 674 million; for that reason, we expect it to reach EUR 3.5 billion for the whole year (7.6% of GDP) – slightly lower than in 2019, but still solid. For the last two years, FDI in Serbia has exceeded 8% of GDP and is the main driver of growth. We currently do not foresee any slowdown in FDI inflows in coming years, but acknowledge that this will essentially depend on what happens elsewhere in the world. If the global economy recovers sluggishly, that could slow FDI, and thus GDP growth.

Data for July and August indicate a solid recovery of economic activity already in Q3. Industrial production in July and August was already growing by 2% y-o-y, while retail trade was expanding even more, at around 4%. This, accompanied by the relatively good results from the first half year, has led us to revise upwards our GDP growth forecast for 2020, from -4% in spring to -2% now.

The prospects until the end of the year also depend on coronavirus developments. The number of new cases has started growing again in the second half of October, but the number of fatal cases remains still low. There are also doubts about the official number of cases that the authorities are admitting to. Investigative journalists have published documents showing that the numbers are much higher than the official figures, and certain doctors, members of the national crisis council, have made similar statements. Even the president of the country has announced that a full review of the death toll will be undertaken. At present, we do not envisage dramatic changes in the country before the end of the year, but if there is a big new wave, it might take a toll on the economy.

Overall, the short-term economic prospects for Serbia seem rather good, though the medium term is less clear. The current good economic results are primarily due to an expansionary fiscal policy, which has been accompanied by a sizeable increase in the public debt. This is fine for the time being, but the country cannot borrow and spend indefinitely. Public debt will likely exceed 60% of GDP soon, and the interest rate on new debt is already growing. Medium-term prospects will depend crucially on the viability of the country's recent economic model in the post-pandemic economic order. Whether Serbia can continue to attract FDI in years to come remains to be seen.

Table 4.19 / Serbia: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020	2021 Forecast	2022
Population, th. pers., mid-year	7,021	6,983	6,945	.	.	.	6,915	6,885	6,855
Gross domestic product, RSD bn, nom.	4,761	5,073	5,418	1,296	1,264	2,560	5,400	5,800	6,200
annual change in % (real)	2.1	4.5	4.2	5.1	-6.4	-0.8	-2.0	4.5	4.1
GDP/capita (EUR at PPP)	11,360	11,990	12,730	.	.	.	.	.	.
Consumption of households, RSD bn, nom.	3,317	3,463	3,634	855	853	1,708	.	.	.
annual change in % (real)	2.2	3.1	3.5	3.2	-8.0	-2.7	-5.0	4.0	3.2
Gross fixed capital form., RSD bn, nom.	844	1,017	1,218	267	248	515	.	.	.
annual change in % (real)	6.6	17.5	17.2	10.8	-11.9	-1.5	-3.3	8.9	8.0
Gross industrial production 2)									
annual change in % (real)	3.9	1.3	0.3	4.4	-4.2	0.0	-2.0	5.0	4.5
Gross agricultural production									
annual change in % (real)	-11.9	14.3	0.0	.	.	.	.	.	.
Construction output									
annual change in % (real)	8.5	14.1	35.5	26.2	-0.8	9.7	.	.	.
Employed persons, LFS, th, average	2,795	2,833	2,901	2,877	2,844	2,861	2,860	2,920	2,980
annual change in %	2.8	1.4	2.4	2.4	-2.5	-0.1	-1.5	2.0	2.0
Unemployed persons, LFS, th, average	435	412	336	310	223	267	250	240	220
Unemployment rate, LFS, in %, average	13.5	12.7	10.4	9.7	7.3	8.5	8.0	7.5	7.0
Reg. unemployment rate, in %, eop	23.0	20.3	18.7	19.1	19.2	19.2	.	.	.
Average monthly gross wages, RSD 3)	65,976	68,629	75,814	81,815	81,841	81,828	82,900	89,000	93,700
annual change in % (real, gross)	0.9	3.9	8.4	8.4	7.6	8.0	7.5	5.0	3.0
Average monthly net wages, RSD 3)	47,893	49,650	54,919	59,251	59,188	59,220	60,000	64,400	67,800
annual change in % (real, net)	0.9	4.4	8.5	8.3	8.3	7.9	7.5	5.0	3.0
Consumer prices, % p.a.	3.0	2.0	1.7	1.8	1.4	1.4	1.7	2.2	2.2
Producer prices in industry, % p.a.	2.3	0.9	0.6	0.3	-2.7	-1.2	0.0	2.5	2.5
General governm.budget, nat.def., % of GDP									
Revenues	41.5	41.5	42.1	41.4	37.6	39.5	40.0	41.0	41.5
Expenditures	40.4	40.9	42.3	45.5	58.0	51.7	48.0	46.0	44.5
Deficit (-) / surplus (+)	1.1	0.6	-0.2	-4.1	-20.5	-12.2	-8.0	-5.0	-3.0
General gov.gross debt, nat.def., % of GDP	58.6	54.4	52.9	52.8	58.1	58.1	61.0	64.0	66.0
Stock of loans of non-fin.private sector, % p.a.	2.1	9.9	8.9	11.5	13.9	13.9	.	.	.
Non-performing loans (NPL), in %, eop	9.8	5.7	4.1	4.0	3.7	3.7	.	.	.
Central bank policy rate, % p.a., eop 4)	3.5	3.0	2.3	1.8	1.3	1.3	1.3	1.3	2.5
Current account, EUR mn	-2,051	-2,076	-3,160	-973	-367	-1,340	-2,600	-2,700	-3,000
Current account, % of GDP	-5.2	-4.8	-6.9	-8.8	-3.4	-6.2	-5.7	-5.5	-5.7
Exports of goods, BOP, EUR mn	14,066	15,106	16,428	3,934	3,372	7,306	14,500	16,700	18,300
annual change in %	9.8	7.4	8.8	2.7	-20.2	-9.3	-12.0	15.0	9.8
Imports of goods, BOP, EUR mn	18,064	20,191	22,044	5,560	4,400	9,960	19,600	22,300	24,400
annual change in %	13.4	11.8	9.2	9.0	-19.6	-5.8	-11.0	14.0	9.2
Exports of services, BOP, EUR mn	5,246	6,061	6,971	1,634	1,307	2,941	6,100	7,000	7,700
annual change in %	14.8	15.5	15.0	10.1	-19.6	-5.4	-12.0	14.0	9.8
Imports of services, BOP, EUR mn	4,280	5,066	5,922	1,319	1,080	2,399	5,300	6,000	6,600
annual change in %	16.8	18.4	16.9	3.0	-25.1	-11.9	-11.0	14.0	9.2
FDI liabilities, EUR mn	2,548	3,464	3,825	806	674	1,480	3,500	.	.
FDI assets, EUR mn	130	308	242	11.0	19.5	30.5	250	.	.
Gross reserves of NB, excl. gold, EUR mn	9,287	10,526	12,042	11,659	12,359	12,359	.	.	.
Gross external debt, EUR mn	25,526	26,662	28,254	28,738	31,024	28,738	31,700	35,000	37,700
Gross external debt, % of GDP	65.1	62.2	61.5	62.6	67.6	62.6	69.0	71.0	72.0
Average exchange rate RSD/EUR	121.34	118.27	117.86	117.57	117.57	117.57	118	118	119

1) Preliminary. - 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.

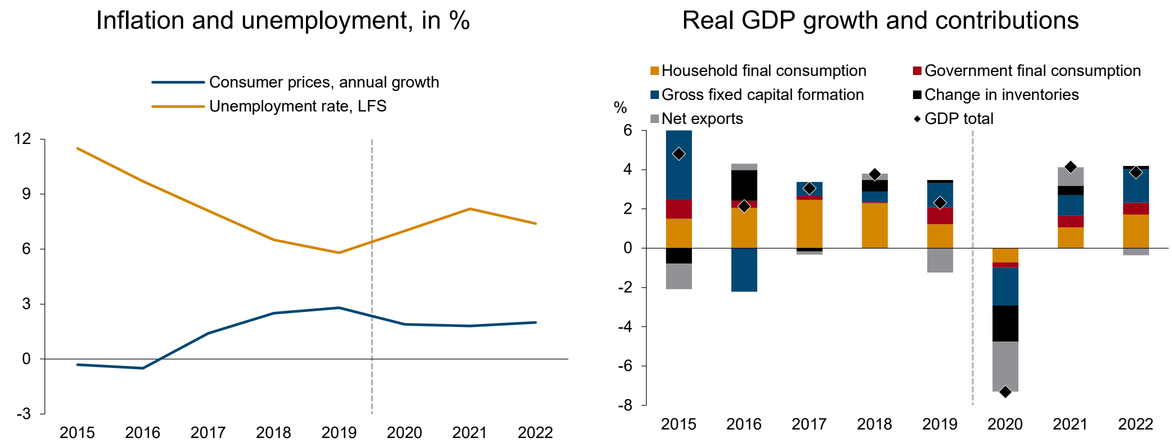
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SLOVAKIA: Second wave threatens recovery

DORIS HANZL-WEISS

The COVID-19 pandemic and a related severe lockdown hit the Slovak economy in the second quarter of 2020, when GDP contracted by 12.1% year on year. There was a rapid recovery in the automotive industry, with production and exports growing again by July. However, with the number of infections rising again since September, a sustainable recovery is in doubt. We expect GDP to drop by 7.3% in 2020, and to recover in 2021 by 4.1%.

Figure 4.20 / Slovakia: Main macroeconomic indicators



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

There was a major decline in GDP in the second quarter of 2020 as a result of COVID-19 pandemic restrictions. In the first half of 2020, Slovak GDP declined by 8.1%. While GDP had already decreased in the first quarter of 2020 by 3.7% year on year (y-o-y), the effects of the COVID-19 pandemic and the related lockdown (starting 16 March) fully hit the Slovak economy in the second quarter: GDP contracted by 12.1% y-o-y. All components of GDP declined during the second quarter: household consumption fell by 4.2% and government consumption by 10.4%. Gross fixed capital formation declined by 14.6% and gross capital formation by 32.3%. Both exports and imports of goods and services decreased by about 27%, and the contribution of net exports was thus slightly negative.

Industry faced the biggest impact. The sectors most severely affected in the second quarter were industry (-25%), arts, entertainment and recreation (-22%) and construction (-18%, all y-o-y). Tourism, which was hit hard by the pandemic, is included in the combined service sector (together with wholesale and retail trade, transportation and storage, accommodation, and food service activities), which fell by 16%. In the first seven months of 2020, the overall number of tourists in Slovakia declined by 47%: the number of foreign visitors tumbled by 60%, while domestic tourists were down by 40%. Bratislava was especially hard hit by the decline in visitor numbers. However, overall, tourism (i.e. accommodation and food services) is rather a small sector of the economy, accounting for only 1.6% of value added in 2019.

The automotive industry contracted most, but also witnessed the quickest recovery. Within industry, the automotive industry was affected most by the shutdown of the main automotive plants for over a month. The four largest car manufacturers in the country – Volkswagen Bratislava, PSA Peugeot Citroen, Kia Motors and Jaguar Land Rover (JLR) – closed their factories in mid-March due to a collapse in demand, fear of COVID-19 spreading in large companies (12,000 employees in VW Bratislava), trade union demands for closure (JLR) and problems in the supply chains. Thus, automotive production fared worst in April (-80%); but it recovered quickly, and by July the automotive industry was already doing better than last year. August, however, saw a renewed decline in the automotive industry, while a few other industries (especially rubber and non-metallic mineral products) finally recovered. Over the first eight months of 2020, industrial production decreased by 14%.

Construction is still in decline. Construction saw a serious drop during the first eight months of 2020, with output falling by 10%. However, unlike in the automotive industry, no recovery was witnessed in the summer months.

While the labour market is still not too badly affected, wages are down. On the labour market, employment fell by 2% in the first half of 2020: the first quarter had already seen a 1.4% decline, and this was followed by a drop of 2.5% in the second quarter. The unemployment rate rose to 6.0% in the first quarter and 6.6% in the second. The labour market stabilised in August. Meanwhile, real wages stagnated in the first half of 2020: while they continued to rise in the first quarter of 2020 (+3.1%), they fell in the second quarter by 3.1%. Although household consumption was negatively impacted by the lockdown in the second quarter, retail trade recovered and actually grew in July (by 1.5%) and August (by 4%), compared to 2019.

Exports were strongly affected by the severe supply shock, but started to recover from June, while demand remains depressed. Exports of goods declined by 12% in the first eight months of 2020, and imports of goods by 13%. While exports picked up from June onwards (thanks to the recovery of the automotive industry), imports continued to decline. Exports to Slovakia's main export partners of Germany and the Czech Republic fell by about 16% each (January to July 2020, y-o-y). Export destinations outside Europe were also badly affected: goods exports to the United States fell by 33%, to Russia by 28% and to China by 10%.

Public finances are suffering from the effects of the COVID-19 pandemic, but there is no cause for concern. The government deficit and debt-to-GDP ratio reached -1.3% and 48%, respectively, in 2019. Debt reduction has not been ambitious in recent years, despite the good growth performance of the Slovak economy. The coronavirus crisis will shift debt level upwards, due to less revenue and increased expenditure: government debt will reach about 62% of GDP in 2020, while the deficit will increase to -9%. During the first lockdown phase, the government announced EUR 2.2 billion in financial aid (2.3% of 2019 GDP). Several state guarantee schemes up to EUR 4 billion were introduced for both SMEs and large firms, in order to ease liquidity pressures. On October 14 a second package was announced that will provide help for medical workers (higher sickness benefit), entrepreneurs, culture and tourism. At the beginning of October, the Finance Ministry published a reform plan entitled 'A Modern and Successful Slovakia' (Moderné a úspešné Slovensko), designed to govern spending of the

EUR 7.5 billion that is to be received from the Next Generation EU recovery fund. It mentions eight areas: fiscal reforms; the green economy; the labour market and social sustainability; education; science, research and innovation; health; public institutions and regulations; and digitalisation.

A second wave of the pandemic that has gripped the country since mid-September could threaten the recovery and have an impact on GDP in the last quarter of the year. Since mid-September, the daily numbers of COVID-19 infections have again been on the rise: this time the numbers are much higher than during the first wave. However, the death toll is still very low compared to other countries (61 as of 12 October). Nonetheless, on 1 October, a national emergency was declared and even stricter regulations were introduced on 15 October. Universities and schools have again shifted to online teaching. The Czech Republic has been placed on the list of ‘red’ countries, meaning the imposition of tougher travel restrictions (although in this case many exemptions are granted). Hungary and Austria, by contrast, are still not considered risk countries.

A robust recovery is likely in 2021, but the downside risks are rising. The wiiw forecast for this year has been revised upwards, due to better-than-expected data for the second quarter and the promising pace of recovery since the middle of the year; furthermore, a second lockdown is not anticipated. We expect the Slovak GDP to decline by 7.3% in 2020, before recovering by 4.1% in 2021 and by 3.9% in 2022. In 2020, household consumption should decline less than initially anticipated, although investments will suffer from uncertainty and risk aversion. Demand is still depressed on the export markets, but Slovakia’s trade should improve once the recovery in world trade arrives next year. Overall, however, the risks are rising, as the second wave is threatening many countries in Europe and lockdowns may again be on the cards. Global automotive demand remains sluggish and could threaten the recovery of this important Slovak sector.

Table 4.20 / Slovakia: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average	5,439	5,447	5,454	.	.	.	5,455	5,460	5,460
Gross domestic product, EUR mn, nom.	84,532	89,506	93,865	21,485	21,200	42,685	88,700	94,000	99,600
annual change in % (real)	3.0	3.8	2.3	-3.7	-12.1	-8.1	-7.3	4.1	3.9
GDP/capita (EUR at PPP)	21,130	22,140	22,820	.	.	.	.	.	.
Consumption of households, EUR mn, nom.	46,535	49,590	52,052	13,004	12,652	25,656	.	.	.
annual change in % (real)	4.5	4.2	2.2	1.0	-4.2	-1.6	-1.3	1.9	3.1
Gross fixed capital form., EUR mn, nom.	17,889	18,765	20,090	3,894	4,093	7,987	.	.	.
annual change in % (real)	3.5	2.6	5.8	-4.8	-14.6	-10.1	-9.0	5.0	8.0
Gross industrial production									
annual change in % (real)	3.2	4.4	0.4	-7.3	-28.2	-17.7	-10.0	7.0	5.0
Gross agricultural production									
annual change in % (real)	-6.1	-2.4	-2.7		.	.	.	.	.
Construction industry									
annual change in % (real)	3.0	8.5	-3.6	2.7	-14.5	-7.4	.	.	.
Employed persons, LFS, th, average	2,531	2,567	2,584	2,552	2,505	2,528	2520	2490	2510
annual change in %	1.5	1.4	0.7	-1.4	-2.5	-2.0	-2.4	-1.0	1.0
Unemployed persons, LFS, th, average	224	180	158	162	178	170	190	220	200
Unemployment rate, LFS, in %, average	8.1	6.5	5.8	6.0	6.6	6.3	7.0	8.2	7.4
Reg. unemployment rate, in %, eop	5.9	5.0	4.9	5.2	7.4	7.4	.	.	.
Average monthly gross wages, EUR	954	1,013	1,092	1,086	1,088	1,087	1110	1150	1210
annual change in % (real, gross)	3.3	3.6	5.0	3.1	-3.1	0.0	0.0	1.5	3.3
Consumer prices (HICP), % p.a.	1.4	2.5	2.8	2.9	2.0	2.5	1.9	1.8	2.0
Producer prices in industry, % p.a.	2.5	2.3	1.9	1.7	-1.4	0.1	-0.6	1.0	1.7
General governm.budget, EU-def., % of GDP									
Revenues	40.5	40.8	41.6	.	.	.	40.7	40.4	40.9
Expenditures	41.5	41.9	42.9	.	.	.	49.7	47.5	47.0
Net lending (+) / net borrowing (-)	-1.0	-1.1	-1.3	.	.	.	-9.0	-7.1	-6.1
General gov.gross debt, EU def., % of GDP	51.3	49.5	48.2	.	.	.	61.7	63.2	63.4
Stock of loans of non-fin.private sector, % p.a.	9.9	9.8	6.6	6.6	6.1	6.1	.	.	.
Non-performing loans (NPL), in %, eop	3.6	3.1	2.8	2.8	2.7	2.7	.	.	.
Central bank policy rate, % p.a., eop 2)	0.00	0.00	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR mn	-1,618	-1,973	-2,547	-897	-306	-1,204	-3,500	-2,700	-3,200
Current account, % of GDP	-1.9	-2.2	-2.7	-4.2	-1.4	-2.8	-3.9	-2.9	-3.2
Exports of goods, BOP, EUR mn	70,510	75,142	75,657	18,141	13,437	31,578	64,900	70,700	73,900
annual change in %	5.7	6.6	0.7	-7.6	-29.0	-18.1	-14.2	9.0	4.5
Imports of goods, BOP, EUR mn	69,913	75,381	76,636	18,874	13,423	32,297	67,400	72,100	75,600
annual change in %	6.8	7.8	1.7	-2.9	-30.0	-16.3	-12.1	7.0	4.9
Exports of services, BOP, EUR mn	9,339	10,228	11,009	2,351	1,930	4,281	8,900	9,500	10,500
annual change in %	11.8	9.5	7.6	-3.4	-31.1	-18.2	-19.0	7.0	10.0
Imports of services, BOP, EUR mn	8,457	9,300	9,783	2,066	1,659	3,725	7,900	8,300	9,000
annual change in %	6.1	10.0	5.2	-5.8	-30.5	-18.7	-19.0	5.0	8.0
FDI liabilities, EUR mn	3,749	1,906	2,067	1,204	47	1,251	1,300	.	.
FDI assets, EUR mn	1,367	760	16	861	874	1,734	900	.	.
Gross reserves of NB excl. gold, EUR mn	1,609	3,426	5,002	5,239	6,111	6,111	.	.	.
Gross external debt, EUR mn	91,574	102,016	105,517	105,735	113,021	113,021	120,000	125,000	127,000
Gross external debt, % of GDP	108.3	114.0	112.4	119.2	127.4	127.4	135.3	133.0	127.5

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

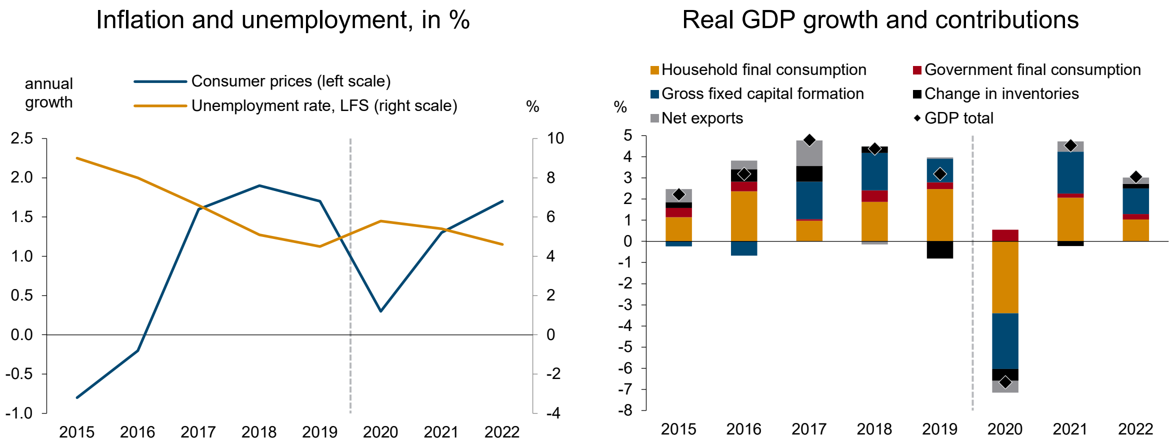
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

SLOVENIA: Weathering the storm better than expected, but will it last?

NIKO KORPAR

Although Slovenia's economy was hit hard by the pandemic and will decline by 6.7% in 2020, this is a significant revision upwards from the previous forecast. A combination of fiscal measures, improving domestic and foreign demand, and stable corporate and bank finances give grounds for cautious optimism for recovery, which will be gradual and uneven. However, much will depend on the global epidemiological situation in the coming months, as well as on the strength of export demand from Slovenia's major trading partners.

Figure 4.21 / Slovenia: Main macroeconomic indicators



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

Before the COVID-19 outbreak, Slovenia's small but open economy was already going through a slowdown, and the country was in the middle of a power transfer between governments. After the relatively stringent lockdown measures (deemed by the Oxford COVID-19 Government Response Tracker to be on a par with Austria's) were put in place, the economy ground to a halt.

Thanks to a cooperative population and receding infection rates, Slovenia was the first European country to declare an end to the first wave of the pandemic (in mid-May) and to reopen its borders. Signs of economic recovery soon followed, with better-than-expected results in private spending and export demand. However, the epidemiological situation worsened gradually over the summer, and a second wave of infections struck in September. Restrictions were being reimposed since July, and by mid-October, Slovenia entered another partial lockdown. At the time of writing, most businesses apart from bars and restaurants were still open.

The second quarter of 2020 marked a low point in indicators across the board. Sluggish growth of 2.5% in the first quarter of 2020 (albeit containing positive signs, such as increased FDI inflows) was followed by a 13% fall in GDP in the second quarter, so that GDP dropped by 7.9% in the first half year. Private spending fell sharply, as did investments and trade. Consumer confidence collapsed to levels not seen since the 1990s. Government spending was the sole category that saw an uptick – of 3%; it will account for 21% of national GDP in 2020. This rise in government consumption is mainly due to the fiscal stimulus packages and will be temporary. The services sector and manufacturing were hit especially hard, although the construction sector has remained surprisingly buoyant.

In 2020, Slovenian GDP will contract by 6.7%, the largest fall since 2009. However, this marks an improvement of 2.8 percentage points over wiiw's spring Forecast Report. The reasons for this are the speed with which the first wave of the epidemic was overcome, the strength of the government's fiscal measures and improving demand. For example, while tourism collapsed to practically zero in April, by August it had recovered to about 75% (incoming tourists) of the previous year's results, in part thanks to the new emergency national tourist voucher scheme.

Imports of both goods and services fell more sharply than did exports during the second quarter of the year. Exports slowed particularly in tourism and in manufactured products. The export-oriented automotive industry, dependent on the situation in Germany (and France), has seen a large contraction in business. Export prices dropped, but very low fuel prices had a stronger deflationary effect on import prices. Slovenia's current account surplus thus rose to record levels in the second quarter of 2020.

Government measures, especially the furlough scheme and subsidised short-time working arrangements have cushioned the fall in employment. In 2020, the number of the unemployed will increase by 15,000 compared to 2019, leading to a 5.8% unemployment rate, which is less dramatic than originally anticipated. Unsurprisingly, young people working in the services industry were most likely to lose their jobs in the second quarter of 2020. The labour market started to improve over the summer, as both services and the manufacturing industry took on new workers. The much-publicised threatened layoff of over 830 workers at the white-goods manufacturer Gorenje, owned by the Chinese company Hisense, did not materialise, thanks to a renewed surge in demand for products. In the first half of 2020, wages rose steadily – partly as a result of agreements and policies made pre-pandemic and partly because of additional benefits and rewards paid out to workers in the public sector. However, wages are expected to decline by 0.5% in 2021.

Five stimulus packages were introduced in the period May-September, totalling 16% of national GDP. The first (worth EUR 1 billion) included wage subsidies for furlough, credits, guarantees and financial support for companies; the second (EUR 3 billion) brought selective tax exemptions, additional wage subsidies (especially for small companies and the self-employed), social contributions for pensioners and other at-risk groups, and a loan guarantee scheme for companies. The third package (EUR 2 billion) amended the previous packages and introduced new guarantee options; and the fourth (EUR 1 billion) introduced tourist vouchers worth EUR 200, which were given to each citizen to spend on accommodation, as well as a scheme to subsidise short-time working and new liquidity loans. The fifth package (EUR 420 million) was implemented in October and focuses mainly on the health sector and on preparing the employers to more easily administer quarantined workers. It also extends the subsidised furlough option and other support schemes until the end of the year. In addition, a moratorium on bank credits was also introduced. A priority list of infrastructure projects that are to be speeded up was also published. While the amount of help given to the economy has been substantial, according to the national Fiscal Council only about EUR 1.5 billion of the full amount of EUR 7.42 billion will have a direct fiscal impact, while the rest represents various repayable options, not all of which have been extensively used by companies.

In order to finance the EUR 7.42 billion recovery packages, and faced with the fall in revenue, the government has announced a budget deficit of 9.3% of GDP. After several rounds of borrowing in the form of bond issues, the public debt will rise to about 82%, a level not seen since 2015. External debt will jump to 108% of GDP.

Politically, 2020 is a year of change. The current prime minister and political mainstay, Janez Janša, was able to form a government after the centre-left administration of Marjan Šarec collapsed in January when the smaller coalition parties turned their backs on him. Relations within the coalition will be a key factor of political stability, and a limited restructuring of the government could get under way in late 2020, after a hot summer of internal conflict among the coalition partners. Weekly protests have been taking place in major cities since May, following allegations of corruption. The government seems stable for the time being, but the looming presidency of the European Council in the second half of 2021, a reinvigorated opposition, and a new wave of economic and political issues could provide ample opportunity for a tumultuous winter and spring.

Another development to keep an eye on is the upcoming founding of the National Demographic Fund. A long time in coming, this new overarching state fund will pool all state assets to support the pension system in a total amount of about EUR 8 billion, which is currently held by several public institutions, and will aim to help with Slovenia's issues of financing care for the elderly in light of an ageing population.

Recovery in 2021 is likely to be strong, with a growth rate of 4.6%, though there are some downside risks. Slovenia has weathered the storm better than expected, but the worsening of the situation during the winter could imply a mild form of a W-shaped recovery. Although another full lockdown is unlikely, Slovenia's limited hospital beds have already forced the government to again declare a state of public epidemic. Private spending will rise only cautiously. Nevertheless, new investment, government spending and improved imports and exports (due to grow by about 8%), will drive growth in the next year. Much is expected of the EUR 2.1 billion grants allocated by the EU Recovery Fund, as well as of the greater-than-expected share of the Cohesion Funds and other (mostly repayable) sources from the European 2021-2027 budget.

In 2022, once the pandemic is finally overcome, the economy will resume growing at a modest 3%. While there are grounds for cautious optimism about Slovenia's resilience and ability to bounce back, the key question in coming years is whether the government and corporate leaders can repeat the success story of 2017-2018, when the country enjoyed one of the highest growth rates in the EU. It remains to be seen whether government measures and plans to improve the economy's competitiveness can steer Slovenia onto a path of faster convergence, or if the current crisis will further hamper the process.

Table 4.21 / Slovenia: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020	2021 Forecast	2022
Population, th pers., average	2,066	2,074	2,088	.	.	.	2,090	2,100	2,110
Gross domestic product, EUR mn, nom.	43,009	45,863	48,393	11,270	10,828	22,097	45,300	48,000	50,300
annual change in % (real)	4.8	4.4	3.2	-2.4	-13.1	-7.9	-6.7	4.5	3.0
GDP/capita (EUR at PPP)	25,070	26,440	27,440	.	.	.	.	.	.
Consumption of households, EUR mn, nom.	22,223	23,484	24,937	5,377	5,165	10,542	.	.	.
annual change in % (real)	1.8	3.6	4.8	-6.3	-17.4	-12.0	-6.6	4.0	2.0
Gross fixed capital form., EUR mn, nom.	7,877	8,822	9,503	2,138	2,078	4,216	.	.	.
annual change in % (real)	10.2	9.6	5.8	-5.4	-16.5	-11.2	-13.4	10.1	6.2
Gross industrial production			-						
annual change in % (real)	7.7	5.1	3.3	-1.4	-17.4	-9.4	-6.0	6.0	3.4
Gross agricultural production			-						
annual change in % (real)	-9.5	26.9	-6.2	.	.	.	.	.	.
Construction industry			-						
annual change in % (real)	17.7	19.7	3.3	3.3	-12.2	-5.7	.	.	.
Employed persons, LFS, th, average	959.1	980.6	982.6	982	967.8	975.0	970	970	980
annual change in %	4.8	2.2	0.2	0.4	-2.3	-1.0	-1.6	0.3	1.4
Unemployed persons, LFS, th, average	67.4	52.8	45.7	47	52.5	49.7	60	55	47
Unemployment rate, LFS, in %, average	6.6	5.1	4.5	4.6	5.2	4.9	5.8	5.4	4.6
Reg. unemployment rate, in %, eop	9.0	8.1	7.7	8.0	9.2	9.2	.	.	.
Average monthly gross wages, EUR 2)	1,627	1,682	1,754	1,788	1,881	1,834	1,820	1,830	1,880
annual change in % (real, gross) 2)	1.3	1.7	2.7	1.7	10.0	5.8	3.4	-0.5	0.8
Average monthly net wages, EUR 2)	1,062	1,093	1,134	1,163	1,229	1,196	1,160	1,170	1,200
annual change in % (real, net) 2)	1.7	1.2	2.1	2.5	11.5	7.0	2.3	-0.1	0.5
Consumer prices (HICP), % p.a.	1.6	1.9	1.7	1.6	-1.2	0.2	0.3	1.3	1.7
Producer prices in industry, % p.a.	2.2	2.1	0.6	-0.1	-0.6	-0.3	-0.1	0.8	1.0
General governm.budget, EU-def., % of GDP			-						
Revenues	44.0	44.2	43.9	.	.	.	40.0	42.9	43.5
Expenditures	44.1	43.5	43.3	.	.	.	45.1	44.1	43.5
Net lending (+) / net borrowing (-)	0.0	0.7	0.5	.	.	.	-5.1	-1.2	0.0
General gov.gross debt, EU def., % of GDP	74.1	70.3	65.6	.	.	.	82.3	81.7	80.9
Stock of loans of non-fin.private sector, % p.a.	1.9	3.0	3.5	4.5	0.9	0.9	.	.	.
Non-performing loans (NPL), in %, eop 3)	8.4	5.6	2.9	2.8	2.6	2.6	.	.	.
Central bank policy rate, % p.a., eop 4)	0.00	0.00	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR mn	2,674	2,680	2,723	862.9	653	1,516	2,610	2,860	3,230
Current account, % of GDP	6.2	5.8	5.6	7.7	6.0	6.9	5.8	6.0	6.4
Exports of goods, BOP, EUR mn	28,372	30,817	32,013	7,843.0	6,415	14,258	27,560	30,150	31,990
annual change in %	14.0	8.6	3.9	-1.8	-22.7	-12.4	-13.9	9.4	6.1
Imports of goods, BOP, EUR mn	26,756	29,535	30,682	7,266.7	5,822	13,089	25,800	28,510	30,960
annual change in %	14.5	10.4	3.9	-4.0	-25.9	-15.2	-15.9	10.5	8.6
Exports of services, BOP, EUR mn	7,394	8,104	8,548	1,777.9	1,450	3,228	7,110	7,820	8,870
annual change in %	13.5	9.6	5.5	-0.9	-30.9	-17.0	-16.8	10.0	13.4
Imports of services, BOP, EUR mn	5,140	5,478	5,762	1,226.3	1,041	2,267	4,810	5,190	5,610
annual change in %	12.3	6.6	5.2	-2.7	-26.0	-15.0	-16.6	8.0	8.0
FDI liabilities, EUR mn	1,065	1,307	1,521	204.7	327	532	800	.	.
FDI assets, EUR mn	570	373	773	13.5	188	202	320	.	.
Gross reserves of NB excl. gold, EUR mn	632	702	767	833	859	859	.	.	.
Gross external debt, EUR mn	43,231	42,148	43,796	45,866	48,143	48,143	48,900	49,400	48,800
Gross external debt, % of GDP	100.5	91.9	90.5	101.3	106.3	106.3	108.0	103.0	97.0

1) Preliminary. - 2) Wage increase in 2Q 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).

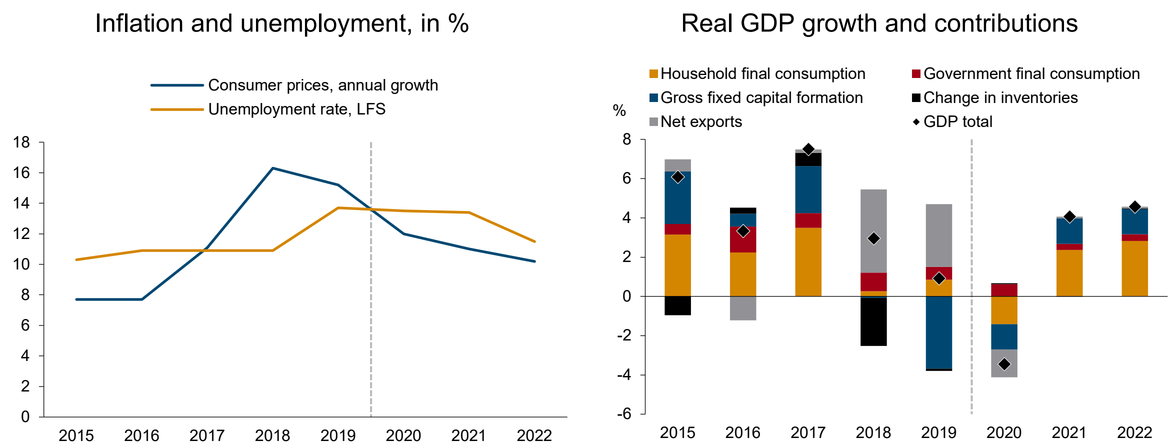
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

TURKEY: Sailing close to the wind again

RICHARD GRIEVESON

The economy staged an impressive rebound in Q3, but this relied heavily on credit, resulting in a weaker lira, higher inflation and a widening of the current account deficit. Growth in Q4 will therefore slow, with the full-year 2020 decline likely to be a bit over 3%. In 2021, we expect a strong bounce-back, with growth above 4%. The risks, as ever, are the financing of the external deficit, delayed monetary policy reaction and geopolitics.

Figure 4.22 / Turkey: Main macroeconomic indicators



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

The Turkish economy finds itself again in the midst of heightened volatility, with a robust rebound from a deep downturn in Q2, but a host of headwinds potentially set to slow this momentum. In 2020, the economy has had to deal not only with a global pandemic, but also with a further dramatic decline in the value of the lira and the fallout from various international tensions.

The economy slowed substantially in Q2 as a result of COVID-19. Turkey's economy contracted by 10% year on year in Q2 2020 (working-day adjusted), the sharpest decline on this basis since the first quarter of 2009. In quarterly terms, the contraction was even more severe: 11% (working-day and seasonally adjusted), almost double the scale of the downturn in Q1 2009, and comfortably the sharpest quarterly real GDP decline in the statistics office series going back to 1998. On a quarterly basis, fixed investment fell by 7.2%, government spending by 1.2% and household consumption by 8.9%. However, the most dramatic collapse came on the external side, with imports of goods and services down by 15.8% and exports by 33.6%, no doubt heavily influenced by a near collapse in tourism inflows (consistent with trends across Europe during that period).

In the third quarter of the year, the Turkish economy staged a very strong recovery, leading us to revise up our growth forecast for this year by over 2 percentage points. Although V-shaped recoveries are a Turkish speciality, the fact that the economy picked up so quickly from such a shock is still noteworthy. Measured by retail sales, the initial COVID-19 shock in April wiped out eight years of growth. However, by July the working-day and seasonally adjusted index of retail sales was almost back to February 2020 levels, and was at its second-highest point for at least a decade. In industry, the story was fairly similar: in April, the index was at roughly its 2011 level, and yet by July it had sprung back to above the January 2020 outturn and was close to February's production peak. As a result of this vigorous bounce-back, we have revised up our 2020 forecast by more than 2 percentage points. We now expect a full-year contraction of only 3.5% in 2020, followed by growth of 4.1% in 2021.

The macroeconomic developments have come against the background of a rapidly weakening lira; as a result of this, the Turkish central bank sharply tightened monetary policy, which will at least partly stall the recovery. At the end of September, the central bank increased its one-week repo rate by 200 basis points (bps) to 10.25%, with the lira at that point down by over 20% against the US dollar since the start of the year. Following the 2018 crisis, the real policy rate had been adjusted sharply upwards to protect the lira and tame inflation, and in 2019 it averaged almost 4% (CPI adjusted). However, sharp cuts to the base rate and still high inflation saw the real policy rate decline to an average -2.9% in Q2 2020 and -3.1% in July and August.

Although the central bank reacted quite strongly in September, further tightening will be necessary to move the real policy rate back into positive territory. We expect the central bank to have to raise the benchmark rate by about another 175bps by the end of the year, and by another 200bps next year (up to 14%). That would leave the rate comfortably positive in real terms, and will be necessary to support the lira at a time of heightened volatility (also related to geopolitical factors; see below), but will naturally slow the current economic recovery.

This centrality of monetary policy for Turkish economic growth is due to the reliance on credit. As usual, the role of credit growth has been important in the sharp bounce-back from the Q2 contraction. The nominal value of loans to non-financial corporations increased by 33.8% year on year in August, while the equivalent for households was 48.3%. Amid strong monetary tightening more recently, it seems unlikely that this rate of growth – and the support for economic growth more broadly – will be maintained. So far at least, the rapid expansion of credit amid a global pandemic has not had any impact on asset quality, with non-performing loans falling to just 4.1% of the total in August, down from 5.3% at the start of the year.

The most recent available high-frequency indicators suggest that the economy was still expanding at a rapid pace in September, but give some indications that the recovery could face challenges in the near term. IHS Markit's manufacturing Purchasing Managers' Index, for example, posted a headline reading of 52.8 in September, above the 50 level that separates expansion from contraction. Firms reported hiring at the fastest pace since February 2018, while both output and new orders rose for the fourth consecutive month. Nevertheless, the headline reading was down from 54.3 in August, and the impact of currency weakness appeared to be a key theme of the September survey. Although some firms reported improved external competitiveness as a result, the key fallout was higher input costs. These higher input costs – and the (questionable) extent to which firms can pass them on to consumers – will be a key theme for the Turkish economy in coming months. This will mean either a further sharp rise in inflation or a squeeze on firms' margins at a time when many are struggling with the after-effects of the Q2 downturn. Moreover, the September survey showed that the rate of increase in new orders and output was lower than in previous months.

Monetary tightening may stop the weakening of the lira, but the depreciation that has already happened will drive up inflation further in the coming months. Consumer price inflation has been very steady in recent months, standing at just under 12% in July, August and September (on an annual basis). We expect the consumer price index to have risen by 12% as a whole in 2020, implying a further increase from current levels in the remainder of the year. In 2021, we expect average full-year inflation of 11%, although this is reliant on further strong tightening by the central bank. If this does not materialise, then inflation will be significantly higher next year.

The shape and speed of the recovery from here will naturally be influenced by the spread of the pandemic and measures to contain it. Since the start of September, restrictions on economic life have increased fairly significantly. In September, both the Oxford Blavatnik School of Government Stringency Index and Google mobility data suggested more extensive restrictions (and consequently lower mobility relative to the baseline) for Turkey, compared to many of its CESEE peers, including other big countries like Russia and Poland. Combined with high inflation and a tighter monetary policy stance, this could imply a materially slower rate of growth in Q4 than in Q3.

Turkish foreign policy is increasingly assertive, and it is likely that this will have at least some economic implications. The most obvious example of the economic blowback from international tensions came in 2018, when a spat with the US contributed to a sharp sell-off of the lira and necessitated a massive central bank response. Events in 2020 cannot be compared to that (not least because the key relationship, with the US, is relatively calm). Nevertheless, tensions with the EU over gas exploration close to Cyprus, and potentially with Russia over Turkey's role in the current Azerbaijan-Armenia conflict, are a risk. These tensions have certainly already contributed to the weakening of the lira.

Internationally, the most important factors to watch for in the case of Turkey remain its political relationship with the US, the strength of the dollar and US monetary policy. This is particularly relevant, given the renewed widening of the current account deficit this year, which again leaves Turkey reliant on foreign capital flows, chiefly in US dollars. Neither the EU nor Russia is able to hurt the Turkish economy nearly as much as the US can, and Turkey is exposed to any volatility in the value of the dollar and international capital flows linked to the upcoming US presidential election. However, the recent announcement by the US Federal Reserve that it will keep policy rates close to zero until at least 2023 is excellent news for Turkey, and will be a key factor of stability for the external accounts in the coming years. Over the past decade, even hints by the Fed of moderate tightening have at times resulted in strong capital outflows from Turkey. A few more years of massive dollar liquidity does not guarantee anything, but it makes a serious crisis in Turkey less likely than would otherwise be the case.

It is probably fair to say that a Democratic victory in November in the US would be bad news for Turkish President Recep Tayyip Erdogan. There is no serious pro-Turkish lobby in Washington, but there are plenty of potential threats, not least related to possible sanctions on parts of the banking sector (owing to allegations of Turkish help for Iran in evading US sanctions). Whether by accident or design, these potential threats have not materialised under the current US president, who – at least at times – has seemed to be fairly positive towards President Erdogan. Under a Democratic administration in Washington, this may change.

Table 4.22 / Turkey: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average	80,313	81,407	82,579	.	.	.	82,700	83,600	84,400
Gross domestic product, TRY bn, nom.	3,134	3,758	4,320	1,074	1,042	2,115	4,700	5,400	6,200
annual change in % (real)	7.5	3.0	0.9	4.4	-9.9	-3.2	-3.5	4.1	4.6
GDP/capita (EUR at PPP)	19,420	19,530	19,040		.	.	.	.	.
Consumption of households, TRY bn, nom.	1,827	2,098	2,441	604	597	1,201	.	.	.
annual change in % (real)	5.9	0.5	1.5	4.5	-8.6	-2.4	-2.5	4.2	5.0
Gross fixed capital form., TRY bn, nom.	936	1,115	1,118	276	292	568	.	.	.
annual change in % (real)	8.3	-0.3	-12.4	-0.3	-6.1	-3.3	-5.0	5.0	5.0
Gross industrial production 2)									
annual change in % (real)	9.1	1.1	-0.6	5.7	-16.7	-5.8	3.0	3.0	3.0
Gross agricultural production 3)									
annual change in % (real)	2.0	0.5	0.5	.	.	.	.	.	.
Construction industry 2)									
annual change in % (real)	3.8	-5.0	-8.0	.	.	.	.	.	.
Employed persons, LFS, th, average	28,197	28,734	28,081	26,753	25,858	26,306	26,700	27,400	28,100
annual change in %	3.6	1.9	-2.3	-2.2	-8.5	-5.4	-5.0	2.5	2.5
Unemployed persons, LFS, th, average	3,451	3,535	4,461	4,228	3,826	4,027	4,170	4,240	3,650
Unemployment rate, LFS, in %, average	10.9	10.9	13.7	13.6	12.9	13.3	13.5	13.4	11.5
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.	.	.
Average monthly gross wages, TRY 4)	2,470	2,820	3,250	.	.	.	3740	4300	4900
annual change in % (real, gross)	-2.5	-2.0	0.0	.	.	.	2.8	3.5	3.5
Consumer prices (HICP), % p.a.	11.1	16.3	15.2	12.1	11.7	11.9	12.0	11.0	10.2
Producer prices in industry, % p.a. 5)	15.8	27.0	17.6	8.9	6.1	7.5	15.0	13.0	11.0
General governm. budget, nat.def., % of GDP									
Revenues	29.9	29.8	29.7	33.0	28.5	30.8	27.5	31.5	33.8
Expenditures	31.9	32.5	32.9	34.9	34.9	34.9	35.0	36.2	36.6
Deficit (-) / surplus (+)	-2.0	-2.8	-3.2	-1.8	-6.4	-4.1	-7.5	-4.7	-2.8
General gov.gross debt, nat.def., % of GDP	28.0	29.9	31.7	.	.	.	32.0	31.2	31.0
Stock of loans of non-fin.private sector, % p.a.	19.9	9.6	10.5	14.7	28.4	28.4	.	.	.
Non-performing loans (NPL), in %, eop	2.9	3.9	5.4	5.0	4.4	4.4	.	.	.
Central bank policy rate, % p.a., eop 6)	8.00	24.00	12.00	9.75	8.25	8.25	12.00	14.00	9.00
Current account, EUR mn	-35,800	-16,699	7,973	-7,144	-10,828	-17,972	-16,500	-20,600	-25,700
Current account, % of GDP	-4.7	-2.5	1.2	-4.5	-7.9	-6.1	-2.8	-3.3	-3.9
Exports of goods, BOP, EUR mn	149,978	151,636	162,896	38,919	28,816	67,734	151,000	159,000	167,000
annual change in %	8.7	1.1	7.4	-1.4	-27.1	-14.3	-7.0	5.0	5.0
Imports of goods, BOP, EUR mn	201,348	185,533	177,763	47,636	36,670	84,306	174,000	186,000	199,000
annual change in %	15.7	-7.9	-4.2	13.7	-15.4	-1.1	-2.0	7.0	7.0
Exports of services, BOP, EUR mn	46,927	50,286	57,851	10,293	4,485	14,777	40,000	42,000	44,000
annual change in %	12.1	7.2	15.0	6.7	-66.9	-36.3	-30.0	5.0	5.0
Imports of services, BOP, EUR mn	23,963	23,709	24,663	6,384	5,065	11,449	23,000	25,000	27,000
annual change in %	2.5	-1.1	4.0	11.7	-13.2	-0.9	-5.0	8.0	8.0
FDI liabilities, EUR mn	9,831	11,105	7,837	2,171	416	2,587	6,269	.	.
FDI assets, EUR mn	2,417	3,082	2,615	495	347	841	2,092	.	.
Gross reserves of NB excl. gold, EUR mn 7)	70,202	63,666	69,975	55,437	42,219	42,219	.	.	.
Gross external debt, EUR mn 7)	378,386	386,525	386,496	391,458	376,698	376,698	377,200	376,700	359,500
Gross external debt, % of GDP	49.8	58.7	56.9	65.4	62.9	62.9	63.0	60.0	54.5
Average exchange rate TRY/EUR	4.1206	5.7077	6.3578	6.7391	7.5650	7.1521	7.85	8.60	9.40

1) Preliminary. - 2) Enterprises with 20 and more employees; for construction wiiw estimate. - 3) Based on UN-FAO data, wiiw estimate. - 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.

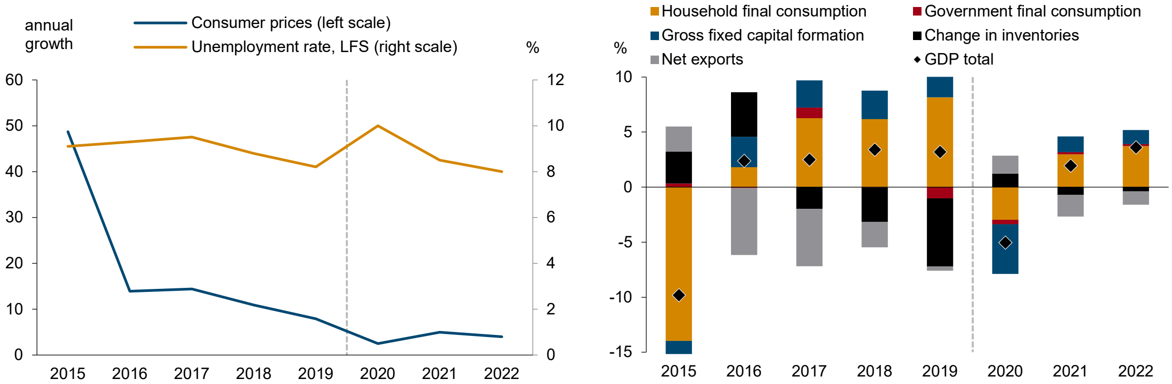
UKRAINE: Fragile recovery in the face of growing risks

OLGA PINDYUK

After a sharp contraction in the second quarter of 2020, the Ukrainian economy has started to recover. We expect economic growth to return in 2021-2022, but to be fragile and subject to many downside risks. The coronavirus pandemic and the inability of the government to tackle corruption represent major threats to the economy in the future.

Figure 4.23 / Ukraine: Main macroeconomic indicators

Inflation and unemployment, in %　　　Real GDP growth and contributions



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

The coronavirus pandemic pushed the Ukrainian economy into severe decline in the second quarter of 2020. GDP contracted by 11.4% year on year (y-o-y), due primarily to a weakening of domestic demand. Private consumption, which accounts for about 74% of GDP, decreased during the second quarter by 10.4% y-o-y – the first negative result since 2015. The fall in investment was even more dramatic – gross fixed capital formation decreased by 22.3% y-o-y, as many investment projects were put on ice in a climate of unprecedentedly high uncertainty. In terms of economic activities, all sectors registered negative y-o-y growth in the second quarter of 2020. The heaviest falls were recorded in restaurants and hotels (-58.1% y-o-y), agriculture (-29.1%) and transport (-26.9%). But the contraction was in double digits in many other sectors, including manufacturing.

The external sector gained in stability, as imports have been shrinking much faster than exports. During January-August 2020, exports of goods and services decreased by 8.2% y-o-y in USD terms, while for imports the decline reached 21.1% y-o-y. Falling energy prices and weakening domestic demand were the driving forces behind the merchandise imports fall, while restrictions on international travel accounted for the bulk of the decline in services imports. Remittances, which accounted for about 8% of GDP in 2019, turned out to be rather resilient and fell by only 6.4% y-o-y in USD terms during January-August 2020.

As a result of these trends, a current account surplus is expected in 2020 (for the first time since 2015); but according to our forecast, this will revert to a deficit in 2021, as the demand for imports revives.

The national bank has been pursuing an accommodative monetary policy, but monetary conditions remain relatively tight compared to the rest of CESEE. The policy rate was lowered to 6% in June 2020 – 7.5 percentage points lower than at the end of 2019; but annual inflation of about 2.5% means that the real interest rate still exceeds 3%. Interest rates on loans to the corporate sector are still measured in double digits (around 15% for SMEs), which indicates that the efficiency of monetary transmission remains limited in the high-risk environment.

We have revised upwards our GDP forecast for 2020, as economic recovery in the third quarter of 2020 has exceeded all expectations. The decline in exports has slowed on the back of rising global prices for grain and iron ore – key export commodities of Ukraine. Private consumption, supported by the relatively robust remittances and real wage growth (which accelerated in August to 6% y-o-y), has also recovered – as evidenced by the 8% y-o-y growth in retail trade in August. As a result of these trends, the fall in GDP is expected to moderate to -5% for 2020 as a whole.

However, the second wave of the coronavirus pandemic represents a major threat to Ukraine in the near future. With the easing of quarantine restrictions, the epidemic has started to spread much faster around the country, with daily new coronavirus cases exceeding 5,000 by 8 October, and with the daily death toll topping 90. Compared to most other European countries, the rollout of COVID-19 testing has been slow (only about 56,000 tests per 1 million people, as compared, for example, to 140,000 tests per 1 million people in Romania).[21] Accordingly, the actual scale of the epidemic in the country is likely to be much greater. Ukraine faces a shortage of medical supplies for acute care, such as masks, protective suits and ventilators. By the beginning of October, more than 17,000 healthcare workers (about 3% of the total number of healthcare workers, representing 5% of the total number of COVID-19 cases) in Ukraine had contracted the virus.[22] It appears that the government has opted to prioritise the economy over anti-epidemic measures, as it has been decided to allocate half of the modest coronavirus fund resources (the total amount of which is about UAH 66 billion or 1.7% of GDP) to road construction and repairs. The situation is aggravated by the population's poor compliance with the existing social distancing requirements. All these factors have significantly increased the probability of a collapse of the healthcare system, which would have an additional detrimental impact on the economy.

Another major threat to the economy stems from the government's inability to tackle corruption, which also places at risk Ukraine's access to external finance. Efforts to undermine the independence of the national bank and anti-corruption institutions, and lack of progress with reform of the judiciary,[23] forced the IMF to put its stand-by programme on hold, and by September the government had not yet received the expected USD 700 million tranche. The European Union and the World Bank have also postponed disbursements of EUR 600 million and USD 350 million, respectively. Given that non-residents have continued to abandon hryvnia-denominated domestic government debt securities, generating capital outflows from the public sector, and given that the government needs to increase social expenditure amid economic decline, the importance of the IMF funds has increased. In 2021, Ukraine's loan repayment and servicing costs will be more than USD 15.5 billion (or 10% of 2019 GDP). In the absence of the active IMF programme, investor confidence in the country could dwindle even further and the government could face much higher costs of borrowing – or even the risk of default.

21 See https://www.worldometers.info/coronavirus/#countries

22 According to the data of the Ministry of Health of Ukraine.

23 See https://www.ft.com/content/f014fe13-7381-4efc-a492-48f80ac01d99

The government's initiative to increase the minimum wage by 37% in 2021 carries a risk to macro-financial stability. If adopted, it could lead to a fiscal deficit exceeding 6% of GDP in 2021, bringing total financing needs to over 13% of GDP; this would fuel inflation expectations, because of the likely depreciation of the hryvnia.

We expect economic growth to turn positive in 2021-2022, though it will be on a lower trajectory than projected before the onset of the pandemic. In 2021, real GDP growth will reach 2% y-o-y, and will accelerate to 3.6% in 2021 – mostly on the back of private consumption. Investment is expected to recover in 2021, but its growth will not be sufficiently high for the pre-crisis level to be reached by 2022. The lack of progress in reform is one of the key issues hindering an improvement in the investment climate in the country. Net exports will again become a drag on growth, starting from 2021, as imports will recover with rising private consumption and investment demand.

The forecast is subject to significant downside risks, in particular related to the healthcare system and macro-financial stability. In the baseline scenario, we assume that the authorities will get the coronavirus epidemic under control and that financing by the IMF and other international financial organisations will shortly be resumed. However, this is far from certain. Besides, a deeper/more prolonged global economic recession could also powerfully affect the Ukrainian economy.

Table 4.23 / Ukraine: Selected economic indicators

	2017	2018	2019 [1]	2020 1Q	2020 2Q	2020 1-2Q	2020	2021	2022
							Forecast		
Population, th pers., average	42,485	42,270	42,028	41,867	41,796	41,832	41,750	41,540	41,330
Gross domestic product, UAH bn, nom.	2,984	3,561	3,975	846	868	1,714	3,900	4,200	4,500
annual change in % (real)	2.5	3.4	3.2	-1.3	-11.4	-6.9	-5.0	2.0	3.6
GDP/capita (EUR at PPP)	8,140	8,620	8,940	.	.	.	.	.	.
Consumption of households, UAH bn, nom.	1,978	2,439	2,954	733	649	1,383	.	.	.
annual change in % (real)	9.5	9.3	11.9	8.1	-10.4	-2.3	-4.0	4.0	5.0
Gross fixed capital form., UAH bn, nom.	470	628	716	99	121	220	.	.	.
annual change in % (real)	16.1	16.6	14.2	-21.4	-22.3	-21.9	-25.0	8.0	7.0
Gross industrial production									
annual change in % (real)	1.1	3.0	-0.5	-4.8	-11.7	-8.2	-6.0	3.0	3.0
Gross agricultural production									
annual change in % (real)	-2.2	8.2	1.4	-1.8	-32.7	-18.7	.	.	.
Construction output									
annual change in % (real)	26.4	8.6	23.6	-5.2	-5.3	-5.5	.	.	.
Employed persons, LFS, th, average	16,156	16,361	16,578	16,490	15,621	16,056	16,080	16,300	16,500
annual change in %	-0.7	1.3	1.3	1.4	-6.5	-2.6	-3.0	1.4	1.2
Unemployed persons, LFS, th, average	1,698	1,579	1,488	1,549	1,712	1,631	1,790	1,510	1,430
Unemployment rate, LFS, in %, average	9.5	8.8	8.2	8.6	9.9	9.3	10.0	8.5	8.0
Reg. unemployment rate, in %, eop [2]	1.4	1.3	.	.	.	.	.	.	.
Average monthly gross wages, UAH [3]	7,104	8,865	10,497	11,007	10,850	10,928	11,400	12,800	14,200
annual change in % (real, gross)	19.8	12.5	9.7	11.4	1.9	6.4	6.0	7.0	7.0
annual change in % (real, net)	19.0	12.5	9.8	11.3	1.9	6.5	6.0	7.0	7.0
Consumer prices, % p.a.	14.4	10.9	7.9	2.6	2.1	2.4	2.5	5.0	4.0
Producer prices in industry, % p.a. [4]	26.4	17.4	4.1	-5.9	-4.4	-5.2	-4.5	5.0	3.0
General governm.budget, nat.def., % of GDP									
Revenues	34.1	33.3	32.5	33.2	43.0	38.2	30.0	32.0	33.5
Expenditures	35.5	35.2	34.6	35.2	41.4	38.4	36.5	37.0	35.5
Deficit (-) / surplus (+)	-1.4	-1.9	-2.2	-2.1	1.6	-0.2	-6.5	-5.0	-2.0
General gov.gross debt, nat.def., % of GDP	71.8	60.9	50.3	57.8	58.2	58.2	59.0	62.0	57.0
Stock of loans of non-fin.private sector, % p.a.	1.9	5.6	-9.8	-2.0	-3.3	-3.3	.	.	.
Non-performing loans (NPL), in %, eop	54.5	52.8	48.4	48.9	48.5	48.5	.	.	.
Central bank policy rate, % p.a., eop [5]	14.50	18.00	13.50	10.00	6.00	6.00	6.0	6.0	5.0
Current account, EUR mn [6]	-3,079	-5,443	-3,682	2,060	1,535	3,596	4,500	-800	-3,800
Current account, % of GDP	-3.1	-4.9	-2.7	6.7	5.2	6.0	3.6	-0.6	-2.9
Exports of goods, BOP, EUR mn [6]	35,192	36,677	41,146	10,227	8,954	19,183	36,800	37,100	37,900
annual change in %	16.1	4.2	12.2	3.1	-10.2	-3.5	-10.6	0.8	2.2
Imports of goods, BOP, EUR mn [6]	43,758	47,436	53,877	11,767	9,523	21,292	43,900	47,000	49,900
annual change in %	19.6	8.4	13.6	-1.0	-25.9	-13.9	-18.5	7.1	6.2
Exports of services, BOP, EUR mn [6]	12,625	13,401	15,591	3,636	3,050	6,687	13,900	14,400	15,200
annual change in %	12.3	6.1	16.3	7.7	-20.9	-7.5	-10.8	3.6	5.6
Imports of services, BOP, EUR mn [6]	11,811	12,270	14,029	2,877	1,625	4,504	10,600	11,200	12,400
annual change in %	9.4	3.9	14.3	-5.4	-54.6	-32.0	-24.4	5.7	10.7
FDI liabilities, EUR mn [6]	3,473	3,872	5,207	-1,313	1,159	-156	-4,400	.	.
FDI assets, EUR mn [6]	207	98	554	101	19	120	400	.	.
Gross reserves of NB excl. gold, EUR mn [6]	14,872	15,955	21,590	21,399	24,139	24,139	.	.	.
Gross external debt, EUR mn [6]	96,741	92,352	109,134	109,067	109,439	109,439	108,701	112,874	115,652
Gross external debt, % of GDP	97.3	83.4	79.5	86.2	86.4	86.4	85.8	89.8	88.7
Average exchange rate UAH/EUR	30.00	32.14	28.95	27.60	29.61	28.60	30.8	33.4	34.5

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. - 2) In % of working age population. - 3) Enterprises with 10 and more employees. - 4) Domestic output prices. - 5) Discount rate of NB. - 6) Converted from USD.

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

5. Appendix

Table 5.1 / European Union-Central and Eastern Europe (EU-CEE11): an overview of economic fundamentals, 2019

	BG	CZ	EE	HR	HU	LT	LV	PL	RO	SI	SK	*EU-CEE11* [1)]	*EU27* [2)]
Gross domestic product													
EUR bn, at ER	61.2	223.9	28.1	53.9	146.1	48.8	30.5	532.3	223.3	48.4	93.9	*1,490*	*13,964*
EUR bn, at PPP	115.8	309.4	34.6	81.7	225.8	71.9	41.2	875.7	418.7	57.3	124.4	*2,357*	*13,964*
EU27=100, at PPP	0.8	2.2	0.2	0.6	1.6	0.5	0.3	6.3	3.0	0.4	0.9	*16.9*	*100.0*
Per capita, EUR, at PPP	16,600	29,000	26,100	20,080	23,110	25,720	21,560	22,810	21,620	27,440	22,820	*22,920*	*31,160*
Per capita, EU27=100, at PPP	53	93	84	64	74	83	69	73	69	88	73	*74*	*100*
1990=100 [3)]	148.2	176.1	185.6	122.5	164.3	155.5	135.1	257.9	189.0	184.6	211.4	*210.0*	*148.2*
2007=100	129.3	124.2	117.2	103.9	124.1	124.0	106.1	153.1	139.7	115.3	134.0	*136.4*	*129.3*
Price level													
EU-27=100 (PPP/ER)	53	72	81	66	65	68	74	61	53	84	75	*63*	*100*
Industrial production													
2007=100 [4)]	99.3	119.8	131.7	91.7	127.1	134.3	125.1	158.5	149.2	121.0	155.5	*140.2*	*103.2*
Population													
in thousand, average	6,976	10,672	1,327	4,067	9,771	2,794	1,914	38,397	19,366	2,088	5,454	*102,827*	*448,081*
Employed persons, LFS													
in thousand, average	3,233	5,303	671	1,680	4,512	1,378	910	16,461	8,680	983	2,584	*46,395*	*199,961*
Unemployment rate, LFS													
in %	4.2	2.0	4.4	6.6	3.4	6.3	6.3	3.3	3.9	4.5	5.8	*3.8*	*6.7*
Average gross monthly wages													
EUR [5)]	651	1,329	1,407	1,182	1,131	1,296	1,076	1,144	1,023	1,754	1,092	*1,125*	*2,458*
EU27=100	26.5	54.1	57.2	48.1	46.0	52.7	43.8	46.6	41.6	71.4	44.4	*45.8*	*100.0*
General government budget, EU-def., % of GDP													
Revenues	38.2	41.6	39.0	47.6	43.5	34.9	37.8	41.1	31.8	43.8	41.4	*39.9*	*46.1*
Expenditures	36.3	41.3	38.9	47.2	45.6	34.6	38.4	41.8	36.1	43.3	42.7	*40.9*	*46.7*
Balance	1.9	0.3	0.1	0.4	-2.1	0.3	-0.6	-0.7	-4.4	0.5	-1.4	*-1.0*	*-0.5*
Public debt, EU def., % of GDP	20.2	30.2	8.4	73.2	65.4	35.9	36.9	45.7	35.3	65.6	48.5	*43.3*	*77.6*
BOP items, % of GDP													
Current account	3.0	-0.3	2.0	2.7	-0.2	3.3	-0.6	0.5	-4.7	5.6	-2.7	*-0.2* [6)]	*2.8* [6)]
Exports of goods	47.6	62.2	47.4	23.8	63.7	53.2	41.8	43.8	28.2	66.2	80.6	*42.6* [6)]	*33.1* [6)]
Imports of goods	52.3	58.1	50.5	43.2	65.8	58.0	50.6	43.5	36.0	63.4	81.6	*44.2* [6)]	*32.7* [6)]
Exports of services	16.6	12.1	25.5	28.4	18.4	24.3	18.3	11.7	12.1	17.7	11.7	*12.5* [6)]	*14.3* [6)]
Imports of services	8.7	10.3	18.4	9.3	13.3	14.2	10.4	7.3	8.2	11.9	10.4	*8.0* [6)]	*13.1* [6)]
FDI stock per capita, EUR [7)]	6,667	14,210	18,210	6,465	8,943	6,644	8,348	5,458	4,571	7,638	9,745	*7,178*	*15,469*

Note: Country specific methodological remarks see in the respective country table in this report.

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) For Poland 1989=100 is the appropriate reference year. - 4) EU27 working-day adjusted. - 5) LT: Income tax reform and transfer of the employer's social security contribution (28.9%) to employees. EU27: Gross wages according to national accounts concept. - 6) Data for EU-CEE and EU27 include transactions within the region (sum over individual countries). - 7) Excluding SPE. For EU27 year 2018

Source: wiiw Annual Database, Eurostat.

Table 5.2 / Western Balkans and Turkey, selected CIS countries and Ukraine: an overview of economic fundamentals, 2019

	AL	BA	ME	MK	RS	XK	TR	BY	KZ	MD	RU	UA	EU-CEE11 [1]	EU27 [2]
Gross domestic product														
EUR bn, at ER	13.6	18.0	5.0	11.2	46.0	7.1	679.5	56.5	162.3	10.7	1,517.7	137.3	1,490	13,964
EUR bn, at PPP	27.7	35.1	9.7	24.6	88.4	14.3	1,572.2	126.5	343.2	24.2	2,867.9	375.6	2,357	13,964
EU27=100, at PPP	0.2	0.3	0.1	0.2	0.6	0.1	11.3	0.9	2.5	0.2	20.5	2.7	16.9	100.0
Per capita, EUR, at PPP	9,710	10,080	15,530	11,830	12,730	7,980	19,040	13,390	18,540	9,080	19,540	8,940	22,920	31,160
Per capita, EU27=100, at PPP	31	32	50	38	41	26	61	43	59	29	63	29	74	100
1990=100	246.1	.	.	152.2	.	.	346.4	199.6	219.0	81.3	124.4	65.5	210.0	148.2
2007=100	143.7	125.0	133.9	135.3	124.3	158.6	169.0	131.5	161.6	153.9	117.1	90.0	136.4	129.3
Price level														
EU27=100 (PPP/ER)	49	51	51	46	52	50	43	45	47	44	53	37	63	100
Industrial production														
2007=100 [3]	285.9	119.2	73.5	122.1	104.8	199.5	165.3	142.1	140.8	125.3	121.1	72.4	140.2	103.2
Population														
in thousand, average	2,854	3,485	622	2,077	6,945	1,789	82,579	9,442	18,514	2,663	146,765	42,028	102,827	448,081
Employed persons, LFS in thousand, average	1,266	803	244	798	2,901	363	28,081	4,330	8,781	872	71,933	16,578	46,395	199,961
Unemployment rate, LFS in %	11.5	15.7	15.1	17.3	10.4	25.7	13.7	4.2	4.8	5.1	4.6	8.2	3.8	6.7
Average gross monthly wages														
EUR at ER	426	727	773	609	643	600	511	467	436	368	660	363	1,125	2,458 [4]
EU27=100	17.3	29.6	31.4	24.8	26.2	24.4	20.8	19.0	17.7	15.0	26.9	14.8	45.8	100.0
General government budget, nat. def., % of GDP														
Revenues	27.4	42.6	43.4	31.5	42.1	31.3	29.7	40.9	18.3	29.9	35.5	32.5	39.9 [5]	46.1 [5]
Expenditures	29.3	40.7	45.4	33.7	42.3	30.3	32.9	38.4	20.2	31.4	33.6	34.6	40.9 [5]	46.7 [5]
Balance	-1.9	1.9	-2.0	-2.2	-0.2	1.0	-3.2	2.5	-1.8	-1.4	1.9	-2.2	-1.0 [5]	-0.5 [5]
Public debt, nat. def., % of GDP	66.3	32.8	76.5	40.6	52.9	16.9	31.7	42.0	24.9	25.1	12.3	50.3	43.3 [5]	77.6 [5]
BOP items, % of GDP														
Current account	-8.0	-3.1	-15.0	-3.3	-6.9	-5.6	1.2	-2.0	-4.0	-9.3	3.8	-2.7	-0.2 [6]	2.8 [6]
Exports of goods	6.6	28.9	9.4	47.5	35.7	5.5	24.0	51.2	32.0	17.7	24.7	30.0	42.6 [6]	33.1 [6]
Imports of goods	29.7	51.5	51.1	65.1	48.0	45.5	26.2	57.8	22.0	45.4	15.0	39.2	44.2 [6]	32.7 [6]
Exports of services	25.0	11.7	34.3	14.6	15.2	23.6	8.5	15.2	4.3	12.9	3.7	11.4	12.5 [6]	14.3 [6]
Imports of services	15.7	3.8	13.7	11.5	12.9	10.5	3.6	9.2	6.3	10.0	5.8	10.2	8.0 [6]	13.1 [6]
FDI stock per capita, EUR [7]	2,622	2,207	7,791	2,747	5,632	2,227	1,751	1,370	7,276	1,584	3,000	1,099	7,178	15,469

Note: Country specific methodological remarks see in the respective country table in this report.

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) EU27 working-day adjusted. - 4) Gross wages according to national account concept. - 5) EU definition: expenditures and revenues according to ESA 2010, excessive deficit procedure. - 6) Data for EU-CEE and EU27 include transactions within the region. - 7) Excluding SPE. For EU27 year 2018.

Source: wiiw Annual Database, Eurostat.

Table 5.3 / GDP per capita at current PPPs (EUR), from 2020 at constant PPPs and population

		1990	1995	2000	2005	2010	2015	2017	2018	2019	2020	2021	2022
											Forecast		
BG	Bulgaria	4,560	6,490	5,330	8,340	11,050	13,190	14,660	15,430	16,600	15,700	16,000	16,400
CZ	Czech Republic	9,380	11,610	13,460	18,050	21,020	24,380	26,650	27,920	29,000	27,100	28,200	29,200
EE	Estonia	5,930	5,380	7,810	13,570	16,470	21,160	23,220	24,690	26,100	24,800	25,800	26,600
HR	Croatia	7,780	6,680	9,160	12,530	14,960	16,520	18,220	19,120	20,080	18,200	19,100	19,900
HU	Hungary	6,800	7,700	9,850	13,980	16,430	19,250	20,390	21,830	23,110	21,600	22,200	23,200
LT	Lithuania	6,940	4,970	7,020	11,880	15,210	20,730	23,120	24,500	25,720	25,200	26,300	27,200
LV	Latvia	6,440	4,620	6,670	11,370	13,360	17,950	19,600	20,920	21,560	20,600	21,500	22,100
PL	Poland	4,660	6,490	8,870	11,380	15,750	19,080	20,370	21,420	22,810	21,800	22,600	23,400
RO	Romania	4,190	4,550	4,860	7,860	12,850	15,530	18,650	19,910	21,620	20,400	21,200	22,200
SI	Slovenia	9,170	11,420	14,950	19,530	21,060	22,740	25,070	26,440	27,440	25,600	26,800	27,600
SK	Slovakia	6,620	7,280	9,430	13,590	18,930	21,520	21,130	22,140	22,820	21,200	22,100	23,000
	EU-CEE11	5,640	6,710	8,330	11,700	15,630	18,690	20,440	21,600	22,920	21,700	22,500	23,300
AL	Albania	1,900	1,990	3,240	4,800	7,290	8,380	8,940	9,440	9,710	9,100	9,500	9,900
BA	Bosnia & Herzeg.	.	.	3,790	5,200	6,820	8,420	9,050	9,690	10,080	9,600	9,900	10,200
ME	Montenegro	.	.	4,990	6,820	10,320	11,740	13,470	14,490	15,530	14,100	14,800	15,400
MK	North Macedonia	4,370	3,980	5,110	6,430	8,600	9,980	10,690	11,350	11,830	11,100	11,600	12,100
RS	Serbia	.	3,170	5,000	7,520	9,690	10,730	11,360	11,990	12,730	12,500	13,100	13,600
XK	Kosovo	.	.	3,820	5,070	5,890	6,880	7,220	7,610	7,980	7,600	8,000	8,300
TR	Turkey	4,990	5,950	7,870	9,750	13,130	18,590	19,420	19,530	19,040	18,400	19,100	20,000
BY	Belarus	4,300	3,230	4,820	7,900	11,610	12,970	12,540	13,190	13,390	13,100	12,900	13,100
KZ	Kazakhstan	7,040	4,970	6,420	11,410	14,540	16,690	17,060	17,840	18,540	18,000	18,500	19,200
MD	Moldova	4,030	2,160	2,060	3,240	3,890	6,650	7,990	8,640	9,080	8,400	8,700	9,000
RU	Russia	6,600	4,710	5,670	9,680	15,500	17,310	17,840	19,630	19,540	18,700	19,200	19,600
UA	Ukraine	6,010	3,350	3,410	5,930	6,480	7,310	8,140	8,620	8,940	8,500	8,700	9,000
AT	Austria	17,660	19,850	24,400	28,680	31,810	35,910	37,250	38,660	39,480	36,700	38,800	39,600
DE	Germany	22,170	19,830	22,800	26,400	30,030	34,230	36,390	37,180	37,710	35,300	37,200	37,900
EL	Greece	12,070	12,930	16,210	20,950	21,130	19,210	19,540	20,090	20,560	18,700	19,800	20,200
IE	Ireland	12,490	15,900	25,080	33,120	32,770	49,700	54,030	58,050	60,780	55,600	59,100	60,300
IT	Italy	16,980	18,760	22,490	24,580	26,370	26,530	28,550	29,190	29,620	26,300	27,900	28,500
PT	Portugal	10,580	12,070	15,680	18,610	20,640	21,320	22,610	23,460	24,500	22,100	23,400	23,900
ES	Spain	12,410	13,650	17,940	22,600	23,990	25,110	27,080	27,620	28,250	25,200	27,000	27,500
US	United States	19,610	24,050	30,150	36,070	36,610	40,830	41,200	42,950	43,630	42,000	43,700	44,600
	EU27 average	13,470	14,910	18,380	22,010	24,900	27,460	29,280	30,230	31,160	28,600	30,300	31,100

ctd.

Table 5.3 / ctd.

European Union (27) average = 100

	1990	1995	2000	2005	2010	2015	2017	2018	2019	2020	2021	2022
BG Bulgaria	34	44	29	38	44	48	50	51	53	55	53	53
CZ Czech Republic	70	78	73	82	84	89	91	92	93	95	93	94
EE Estonia	44	36	42	62	66	77	79	82	84	87	85	86
HR Croatia	58	45	50	57	60	60	62	63	64	64	63	64
HU Hungary	50	52	54	64	66	70	70	72	74	76	73	75
LT Lithuania	52	33	38	54	61	75	79	81	83	88	87	87
LV Latvia	48	31	36	52	54	65	67	69	69	72	71	71
PL Poland	35	44	48	52	63	69	70	71	73	76	75	75
RO Romania	31	31	26	36	52	57	64	66	69	71	70	71
SI Slovenia	68	77	81	89	85	83	86	87	88	90	88	89
SK Slovakia	49	49	51	62	76	78	72	73	73	74	73	74
EU-CEE	42	45	45	53	63	68	70	71	74	76	74	75
AL Albania	14	13	18	22	29	31	31	31	31	32	31	32
BA Bosnia & Herzeg.	.	.	21	24	27	31	31	32	32	34	33	33
ME Montenegro	.	.	27	31	41	43	46	48	50	49	49	50
MK North Macedonia	32	27	28	29	35	36	37	38	38	39	38	39
RS Serbia	.	21	27	34	39	39	39	40	41	44	43	44
XK Kosovo	.	.	21	23	24	25	25	25	26	27	26	27
TR Turkey	37	40	43	44	53	68	66	65	61	64	63	64
BY Belarus	32	22	26	36	47	47	43	44	43	46	43	42
KZ Kazakhstan	52	33	35	52	58	61	58	59	59	63	61	62
MD Moldova	30	14	11	15	16	24	27	29	29	29	29	29
RU Russia	49	32	31	44	62	63	61	65	63	65	63	63
UA Ukraine	45	22	19	27	26	27	28	29	29	30	29	29
AT Austria	131	133	133	130	128	131	127	128	127	128	128	127
DE Germany	165	133	124	120	121	125	124	123	121	123	123	122
EL Greece	90	87	88	95	85	70	67	66	66	65	65	65
IE Ireland	93	107	136	150	132	181	185	192	195	194	195	194
IT Italy	126	126	122	112	106	97	98	97	95	92	92	92
PT Portugal	79	81	85	85	83	78	77	78	79	77	77	77
ES Spain	92	92	98	103	96	91	92	91	91	88	89	88
US United States	146	161	164	164	147	149	141	142	140	147	144	143
EU27 average	100	100	100	100	100	100	100	100	100	100	100	100

Note: For the first time in this table, the EU27 average is used together with the PPP for EU27=1.
Sources: wiiw Annual Database incorporating national and Eurostat statistics; forecasts by wiiw.

Table 5.4 / Indicators of macro-competitiveness, 2015-2022, annual changes in %

	2015	2016	2017	2018	2019	2020	2021	2022	2015-19
							Forecast		average
Bulgaria									
GDP deflator	2.4	2.5	3.9	4.0	5.3	1.4	1.9	2.0	3.6
Real ER (CPI-based)	-1.1	-1.6	-0.5	0.7	1.0	1.1	0.8	0.5	-0.3
Real ER (PPI-based)	0.0	-1.7	1.9	1.0	2.3	-3.0	-0.3	0.5	0.7
Average gross wages, real (PPI based)	9.2	11.5	4.2	6.4	7.9	9.0	7.0	6.0	7.8
Average gross wages, real (CPI based)	8.0	9.4	8.1	7.7	8.4	5.2	6.0	6.0	8.3
Average gross wages, EUR (ER)	6.8	8.0	9.4	10.5	11.1	7.5	7.1	8.0	9.2
Employed persons (LFS)	1.7	-0.5	4.4	0.1	2.6	-2.0	0.0	1.9	1.6
GDP real per employed person, NC	2.3	4.3	-0.9	3.0	1.1	-3.2	1.7	0.7	2.0
Unit labour costs, ER (EUR) adjusted	4.5	3.5	10.4	7.3	9.9	10.3	6.3	7.4	7.1
Czech Republic									
GDP deflator	1.0	1.1	1.3	2.6	3.9	2.1	1.9	2.1	2.0
Exchange rate (ER), EUR/NC	0.9	0.9	2.7	2.6	-0.1	-3.1	1.9	0.8	1.4
Real ER (CPI-based)	1.2	1.2	3.4	2.7	1.0	-7.9	2.8	1.3	1.9
Real ER (PPI-based)	0.7	-0.9	0.4	0.5	0.9	-10.2	1.6	0.3	0.3
Average gross wages, real (PPI based)	5.7	7.9	6.0	7.4	4.6	1.0	0.7	2.1	6.3
Average gross wages, real (CPI based)	2.9	3.8	4.2	6.0	3.7	-1.0	-0.4	1.1	4.1
Average gross wages, EUR (ER)	4.2	5.4	9.6	11.0	6.3	-1.4	3.8	3.7	7.3
Employed persons (LFS)	1.4	1.9	1.6	1.4	0.2	-1.0	0.2	0.0	1.3
GDP real per employed person, NC	4.0	0.6	3.5	1.8	2.2	-5.7	3.7	3.5	2.4
Unit labour costs, ER (EUR) adjusted	0.2	4.7	5.9	9.1	4.1	4.7	0.0	0.4	4.8
Estonia									
GDP deflator	1.1	2.3	3.1	4.2	3.2	-0.2	1.3	2.3	2.8
Real ER (CPI-based)	0.1	0.5	2.0	1.5	0.8	-0.6	0.3	0.8	1.0
Real ER (PPI-based)	-0.3	0.5	0.3	1.0	-1.3	-3.2	-0.3	1.5	0.0
Average gross wages, real (PPI based)	8.7	8.6	3.1	3.3	8.1	3.9	3.9	2.9	6.3
Average gross wages, real (CPI based)	5.9	6.8	2.7	3.8	5.0	1.8	3.3	3.6	4.8
Average gross wages, EUR (ER)	6.0	7.6	6.5	7.3	7.4	1.6	4.9	6.0	7.0
Employed persons (LFS)	2.6	0.6	2.2	0.9	1.0	-0.5	0.3	0.7	1.4
GDP real per employed person, NC	-0.7	2.6	3.3	3.4	4.0	-4.3	3.6	2.2	2.5
Unit labour costs, ER (EUR) adjusted	6.7	4.9	3.2	3.8	3.3	6.2	1.3	3.7	4.4
Croatia									
GDP deflator	0.1	-0.1	1.2	1.8	1.5	0.1	1.0	1.4	0.9
Exchange rate (ER), EUR/NC	0.3	1.1	0.9	0.6	0.0	-1.1	-1.3	0.0	0.6
Real ER (CPI-based)	0.0	0.2	0.5	0.3	-0.7	-5.4	-1.5	-0.1	0.1
Real ER (PPI-based)	-1.4	-1.9	0.0	-0.1	0.1	-10.0	-0.7	0.5	-0.7
Average gross wages, real (PPI based)	5.3	6.5	1.9	2.6	2.9	5.8	1.4	2.3	3.8
Average gross wages, real (CPI based)	1.3	3.7	1.9	3.9	1.4	1.5	2.3	2.9	2.4
Average gross wages, EUR (ER)	1.6	3.0	4.9	5.5	3.8	0.7	1.7	4.1	3.7
Employed persons (LFS)	1.3	0.3	2.2	1.8	1.5	-0.6	0.6	0.6	1.4
GDP real per employed person, NC	1.2	3.2	0.9	0.8	1.4	-8.9	4.4	3.4	1.5
Unit labour costs, ER (EUR) adjusted	0.4	-0.2	3.9	4.6	2.3	10.2	-2.3	0.9	2.2
Hungary									
GDP deflator	2.8	1.4	4.0	4.8	4.8	3.1	3.2	3.1	3.5
Exchange rate (ER), EUR/NC	-0.4	-0.5	0.7	-3.0	-2.0	-7.1	-4.1	-1.4	-1.0
Real ER (CPI-based)	-0.3	-0.4	1.4	-2.1	-0.1	-19.2	-1.9	0.6	-0.3
Real ER (PPI-based)	0.7	-0.8	1.0	-0.5	-0.6	-15.3	-2.5	0.1	0.0
Average gross wages, real (PPI based)	5.5	8.0	9.3	5.4	9.1	5.3	2.7	2.0	7.4
Average gross wages, real (CPI based)	4.3	8.0	10.7	10.2	8.9	5.0	2.2	1.5	8.4
Average gross wages, EUR (ER)	3.9	5.7	13.7	7.9	9.2	1.7	0.9	3.4	8.0
Employed persons (LFS)	2.7	3.4	1.6	1.1	1.0	-2.0	1.0	1.0	1.9
GDP real per employed person, NC	1.1	-1.2	2.7	4.3	3.6	-4.6	2.0	3.5	2.1
Unit labour costs, ER (EUR) adjusted	2.7	6.9	10.7	3.5	5.4	6.1	-0.5	0.1	5.8
Lithuania									
GDP deflator	0.1	1.6	4.2	3.5	2.8	0.8	1.8	2.4	2.4
Real ER (CPI-based)	-0.7	0.4	2.0	0.6	0.7	-5.1	0.6	0.8	0.6
Real ER (PPI-based)	-7.7	-3.0	2.0	2.6	-0.7	-8.9	-0.3	-0.5	-1.4
Average gross wages, real (PPI based)	16.7	13.4	3.3	4.1	8.8	15.7	4.7	5.1	9.1
Average gross wages, real (CPI based)	5.4	10.3	6.5	8.9	6.4	5.7	3.9	3.8	7.5
Average gross wages, EUR (ER)	5.4	8.4	8.6	10.0	8.8	6.4	5.8	6.2	8.2
Employed persons (LFS)	1.2	2.0	-0.5	1.5	0.3	-0.6	0.4	0.2	0.9
GDP real per employed person, NC	0.8	0.5	4.8	2.4	4.1	-1.4	4.1	3.0	2.5
Unit labour costs, ER (EUR) adjusted	4.6	7.8	3.6	7.3	4.6	8.0	1.6	3.1	5.6

(Table 5.4 ctd.)

Table 5.4 / (ctd.)

	2015	2016	2017	2018	2019	2020	2021 Forecast	2022	2015-19 average
Latvia									
GDP deflator	0.0	0.9	3.0	3.9	2.4	0.5	1.7	2.6	2.0
Real ER (CPI-based)	0.2	-0.2	1.2	0.7	1.2	0.9	0.6	1.0	0.6
Real ER (PPI-based)	1.2	-1.1	-0.5	1.4	1.1	-3.1	0.2	0.5	0.4
Average gross wages, real (PPI based)	8.0	7.7	5.2	4.0	5.3	7.3	2.9	4.7	6.0
Average gross wages, real (CPI based)	6.7	4.9	4.8	5.7	4.4	3.6	2.6	4.2	5.3
Average gross wages, EUR (ER)	6.9	5.0	7.8	8.4	7.2	4.1	4.5	6.8	7.1
Employed persons (LFS)	1.3	-0.3	0.2	1.6	0.1	-1.1	0.6	0.6	0.6
GDP real per employed person, NC	2.7	2.7	3.1	2.4	2.0	-3.5	3.8	2.2	2.6
Unit labour costs, ER (EUR) adjusted	4.1	2.3	4.6	5.9	5.1	7.9	0.6	4.5	4.4
Poland									
GDP deflator	1.0	0.3	1.9	1.2	3.1	2.9	2.2	2.0	1.5
Exchange rate (ER), EUR/NC	0.0	-4.1	2.5	-0.1	-0.8	-3.4	1.1	1.1	-0.5
Real ER (CPI-based)	-0.7	-4.6	2.4	-0.8	-0.3	-5.2	1.9	1.6	-0.8
Real ER (PPI-based)	0.0	-3.0	2.2	-0.9	-0.2	-8.7	0.9	1.4	-0.4
Average gross wages, real (PPI based)	5.8	4.0	2.9	4.9	5.8	4.3	3.1	3.2	4.7
Average gross wages, real (CPI based)	4.2	3.9	4.0	5.9	4.9	1.1	2.1	3.0	4.6
Average gross wages, EUR (ER)	3.5	-0.6	8.4	7.0	6.3	0.5	5.2	6.6	4.9
Employed persons (LFS)	1.4	0.7	1.4	0.4	-0.1	-1.5	-0.5	-0.2	0.7
GDP real per employed person, NC	2.8	2.4	3.4	5.0	4.7	-2.9	4.0	3.6	3.6
Unit labour costs, ER (EUR) adjusted	0.7	-2.9	4.8	2.0	1.5	3.8	1.2	2.6	1.3
Romania									
GDP deflator	3.3	2.4	4.7	6.2	6.9	2.8	3.0	4.4	4.7
Exchange rate (ER), EUR/NC	0.0	-1.0	-1.7	-1.8	-1.9	-2.2	-2.0	-2.0	-1.3
Real ER (CPI-based)	-0.4	-2.4	-2.3	0.3	0.4	-5.4	-0.3	-0.5	-0.9
Real ER (PPI-based)	-0.1	-1.4	-1.2	0.3	1.1	-7.7	-1.3	-1.5	-0.3
Average gross wages, real (PPI based)	12.3	12.0	10.9	7.5	7.3	4.6	3.8	5.3	10.0
Average gross wages, real (CPI based)	10.2	11.2	13.5	8.5	7.2	2.5	2.8	4.3	10.1
Average gross wages, EUR (ER)	9.7	8.8	12.8	10.9	9.2	2.7	3.8	5.5	10.3
Employed persons (LFS)	-0.9	-1.0	2.6	0.2	-0.1	-2.0	-1.1	0.0	0.2
GDP real per employed person, NC	3.9	5.8	4.6	4.3	4.3	-3.6	4.8	4.5	4.5
Unit labour costs, ER (EUR) adjusted	5.6	2.9	7.8	6.4	4.8	6.7	-1.0	0.7	5.5
Slovenia									
GDP deflator	1.0	0.9	1.5	2.2	2.3	0.3	1.4	1.7	1.6
Real ER (CPI-based)	-0.8	-0.5	-0.1	0.0	0.2	-0.1	0.1	0.2	-0.2
Real ER (PPI-based)	2.0	0.0	-0.8	-0.8	-0.1	-1.1	-0.5	-0.5	0.1
Average gross wages, real (PPI based)	0.9	3.3	0.5	1.2	3.7	3.9	-0.2	1.7	1.9
Average gross wages, real (CPI based)	1.5	2.1	1.1	1.4	2.6	3.5	-0.7	1.0	1.7
Average gross wages, EUR (ER)	0.7	1.8	2.7	3.4	4.3	3.8	0.5	2.7	2.6
Employed persons (LFS)	0.1	-0.3	4.8	2.2	0.2	-1.3	0.0	1.0	1.4
GDP real per employed person, NC	2.1	3.5	0.0	2.1	3.0	-5.5	4.5	1.9	2.1
Unit labour costs, ER (EUR) adjusted	-1.4	-1.6	2.7	1.2	1.3	9.8	-3.8	0.8	0.4
Slovakia									
GDP deflator	-0.2	-0.5	1.2	2.0	2.5	1.9	1.8	2.0	1.0
Real ER (CPI-based)	-0.3	-0.8	-0.3	0.6	1.3	1.5	0.6	0.5	0.1
Real ER (PPI-based)	-0.7	-2.5	-0.5	-0.6	1.2	-1.6	-0.3	0.2	-0.6
Average gross wages, real (PPI based)	6.0	7.5	2.1	3.8	5.8	2.3	2.6	3.5	5.0
Average gross wages, real (CPI based)	3.2	3.8	3.2	3.6	4.9	-0.2	1.8	3.2	3.7
Average gross wages, EUR (ER)	2.9	3.3	4.6	6.2	7.8	1.6	3.6	5.2	4.9
Employed persons (LFS)	2.6	2.8	1.5	1.4	0.7	-2.5	-1.2	0.8	1.8
GDP real per employed person, NC	2.2	-0.7	1.5	2.3	1.6	-5.0	5.4	3.1	1.4
Unit labour costs, ER (EUR) adjusted	0.7	4.0	3.1	3.8	6.1	7.0	-1.7	2.1	3.5
Albania									
GDP deflator	0.6	-0.6	1.5	1.4	0.4	1.8	1.6	1.8	0.6
Exchange rate (ER), EUR/NC	0.2	1.7	2.4	5.1	3.7	-1.0	1.0	0.0	2.6
Real ER (CPI-based)	2.1	2.7	2.7	5.3	3.6	-1.3	1.6	0.7	3.3
Real ER (PPI-based)	0.3	1.7	2.0	3.9	2.2	-6.2	0.7	-1.1	2.0
Average gross wages, real (PPI based)	7.4	0.7	0.4	1.6	4.4	6.7	3.8	4.3	2.9
Average gross wages, real (CPI based)	3.2	-2.0	1.0	1.3	2.1	1.9	2.9	2.5	1.1
Average gross wages, EUR (ER)	5.4	0.9	5.5	8.6	7.4	3.3	4.5	4.3	5.5
Employed persons (LFS)	4.8	6.5	3.3	3.0	2.8	-3.2	2.0	2.4	4.1
GDP real per employed person, NC	-2.4	-3.0	0.5	1.0	-0.6	-3.3	2.5	1.6	-0.9
Unit labour costs, ER (EUR) adjusted	8.0	4.0	5.0	7.5	8.0	6.0	3.2	3.1	6.5

(Table 5.4 ctd.)

Table 5.4 / (ctd.)

	2015	2016	2017	2018	2019	2020	2021	2022	2015-19
							Forecast		average
Bosnia and Herzegovina									
GDP deflator	1.4	1.4	1.7	2.7	2.6	-0.4	1.3	1.7	2.0
Real ER (CPI-based)	-1.0	-1.9	-0.9	-0.5	-0.9	-0.8	0.2	0.1	-1.0
Real ER (PPI-based)	2.9	-0.7	0.0	0.6	-0.6	-1.5	0.7	1.0	0.4
Average gross wages, real (PPI based)	-0.6	3.1	-1.4	-0.4	4.2	3.9	0.7	0.1	1.0
Average gross wages, real (CPI based)	1.0	2.5	0.8	1.7	3.7	3.8	1.3	1.0	1.9
Average gross wages, EUR (ER)	0.0	0.9	1.6	3.1	4.3	3.2	2.7	2.6	2.0
Employed persons (LFS)	1.2	-2.5	1.8	0.8	-2.4	-2.8	1.3	0.0	-0.2
GDP real per employed person, NC	1.9	5.8	1.3	2.9	5.2	-2.3	1.9	3.1	3.4
Unit labour costs, ER (EUR) adjusted	-1.9	-4.6	0.3	0.2	-0.8	5.9	0.8	-0.4	-1.4
Montenegro									
GDP deflator	2.2	5.1	3.8	3.2	2.0	-0.1	1.6	2.1	3.3
Real ER (CPI-based)	1.5	-0.6	0.7	0.7	-1.1	-0.5	-0.1	0.0	0.2
Real ER (PPI-based)	2.6	1.3	-2.5	-1.2	1.7	1.1	1.0	1.0	0.4
Average gross wages, real (PPI based)	0.0	3.7	1.5	-1.5	-1.5	-1.2	-1.0	-1.2	0.4
Average gross wages, real (CPI based)	-1.3	3.9	-0.5	-2.4	0.6	1.0	0.2	-0.2	0.0
Average gross wages, EUR (ER)	0.3	3.6	1.9	0.1	0.9	0.9	1.3	1.3	1.3
Employed persons (LFS)	2.5	1.1	2.3	3.5	2.7	0.9	0.4	0.4	2.4
GDP real per employed person, NC	0.9	1.8	2.4	1.5	1.3	-9.8	4.6	3.7	1.6
Unit labour costs, ER (EUR) adjusted	-0.6	1.8	-0.5	-1.3	-0.4	11.9	-3.1	-2.3	-0.2
North Macedonia									
GDP deflator	2.0	3.5	2.8	3.9	1.1	1.2	1.5	1.8	2.6
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.1	0.0	-0.3	0.0	0.0	0.0
Real ER (CPI-based)	-0.3	-0.5	-0.3	-0.3	-0.7	0.3	0.3	0.3	-0.4
Real ER (PPI-based)	-1.7	-1.7	1.8	-1.8	1.4	-0.5	0.0	0.1	-0.4
Average gross wages, real (PPI based)	6.9	5.3	-2.1	4.8	2.9	8.1	3.3	3.3	3.5
Average gross wages, real (CPI based)	3.0	2.2	1.3	4.2	4.3	7.9	3.1	3.1	3.0
Average gross wages, EUR (ER)	2.7	2.0	2.7	5.9	5.1	8.4	4.5	5.8	3.7
Employed persons (LFS)	2.3	2.5	2.4	2.5	5.1	-2.2	2.6	1.3	2.9
GDP real per employed person, NC	1.5	0.4	-1.3	0.4	-1.8	-3.9	1.9	2.7	-0.2
Unit labour costs, ER (EUR) adjusted	1.2	1.7	4.0	5.4	7.0	13.3	2.7	2.1	3.8
Serbia									
GDP deflator	1.9	1.5	3.0	2.0	2.4	1.7	2.8	2.7	2.2
Exchange rate (ER), EUR/NC	-2.8	-1.9	1.5	2.6	0.3	-0.1	0.0	-0.8	-0.1
Real ER (CPI-based)	-1.5	-1.2	2.8	2.7	0.5	-13.6	1.0	-0.2	0.7
Real ER (PPI-based)	0.3	-0.5	0.8	0.6	0.2	-15.6	1.2	0.1	0.3
Average gross wages, real (PPI based)	-1.4	3.8	1.6	5.1	9.8	9.3	4.7	2.7	3.7
Average gross wages, real (CPI based)	-1.8	2.7	0.9	3.9	8.6	7.5	5.0	3.0	2.8
Average gross wages, EUR (ER)	-3.3	1.8	5.5	8.7	10.9	8.8	7.1	5.3	4.6
Employed persons (LFS)	0.6	5.6	2.8	1.4	2.4	-1.4	2.1	2.1	2.5
GDP real per employed person, NC	1.2	-2.2	-0.6	3.1	1.8	-0.6	2.4	2.0	0.6
Unit labour costs, ER (EUR) adjusted	-4.4	4.1	6.2	5.5	8.9	9.9	4.9	2.3	3.9
Kosovo									
GDP deflator	0.2	0.4	1.4	1.0	0.6	0.9	1.0	1.2	0.7
Real ER (CPI-based)	-0.5	0.0	-0.2	-0.8	1.2	0.1	0.3	0.2	-0.1
Real ER (PPI-based)	5.0	1.3	-2.3	-1.5	0.2	-2.0	0.1	0.0	0.5
Average gross wages, real (PPI based)	3.0	1.9	1.1	4.2	6.6	6.1	3.3	4.5	3.3
Average gross wages, real (CPI based)	6.3	1.5	0.2	4.5	4.7	4.5	3.2	4.3	3.4
Average gross wages, EUR (ER)	5.8	1.8	1.7	5.7	7.5	5.0	4.8	6.1	4.5
Employed persons (LFS)	-8.2	11.7	7.6	-3.4	5.2	-3.6	1.4	1.4	2.3
GDP real per employed person, NC	13.4	-6.9	-3.2	7.4	-0.3	-1.5	3.3	2.9	1.8
Unit labour costs, ER (EUR) adjusted	-6.7	9.3	5.1	-1.6	7.8	6.6	1.4	3.1	2.6
Turkey									
GDP deflator	7.8	8.1	11.0	16.5	13.9	12.7	10.4	9.8	11.4
Real ER (CPI-based)	3.5	-2.8	-11.4	-17.6	1.9	-40.4	0.1	-0.7	-5.6
Real ER (PPI-based)	3.4	-4.3	-8.8	-10.9	4.8	-39.1	1.8	0.1	-3.3
Average gross wages, real (PPI based)	5.1	8.5	-6.4	-10.1	-2.0	0.1	1.7	2.7	-1.2
Average gross wages, real (CPI based)	2.8	5.1	-2.5	-1.8	0.0	2.7	3.6	3.4	0.7
Average gross wages, EUR (ER)	6.3	2.4	-12.1	-17.6	3.5	-6.1	4.2	4.0	-4.0
Employed persons (LFS) 5)	2.7	2.2	3.6	1.9	-2.3	-4.9	2.6	2.6	1.6
GDP real per employed person, NC	3.3	1.1	3.8	1.0	3.3	1.5	1.4	2.0	2.5
Unit labour costs, ER (EUR) adjusted	2.9	1.4	-15.3	-18.4	0.2	-8.2	3.5	2.2	-6.3

(Table 5.4 ctd.)

Table 5.4 / (ctd.)

	2015	2016	2017	2018	2019	2020	2021 Forecast	2022	2015-19 average
Belarus									
GDP deflator	16.0	8.3	8.7	12.2	6.6	4.9	4.5	4.5	10.3
Exchange rate (ER), EUR/NC	-25.8	-19.0	0.8	-9.1	2.9	-22.2	-6.3	-5.9	-10.7
Real ER (CPI-based)	-15.8	-9.7	5.1	-6.4	7.0	-81.7	-3.2	-3.1	-4.4
Real ER (PPI-based)	-11.1	-8.0	7.5	-5.6	8.6	-81.7	-2.8	-2.6	-2.1
Average gross wages, real (PPI based)	-5.3	-3.9	3.7	10.5	5.6	5.1	3.9	1.7	2.0
Average gross wages, real (CPI based)	-2.2	-3.7	7.4	12.5	6.3	5.6	4.4	2.2	3.9
Average gross wages, EUR (ER)	-17.7	-12.8	14.8	7.4	15.5	-14.4	2.5	0.0	0.4
Employed persons (LFS)	-1.2	-2.0	0.8	-0.1	0.2	-1.8	-0.4	-0.6	-0.5
GDP real per employed person, NC	-2.6	-0.5	1.7	3.2	1.0	-0.7	-0.8	1.9	0.5
Unit labour costs, ER (EUR) adjusted	-15.5	-12.4	12.9	4.0	14.4	-13.1	3.1	-1.4	-0.1
Kazakhstan									
GDP deflator	1.8	13.6	8.4	9.2	7.6	4.1	6.0	6.0	8.1
Exchange rate (ER), EUR/NC	-3.1	-35.1	2.8	-9.4	-5.1	-9.4	-3.3	-1.2	-11.1
Real ER (CPI-based)	3.3	-25.8	8.6	-5.8	-1.5	-23.1	0.8	2.2	-5.1
Real ER (PPI-based)	-21.3	-23.1	15.1	4.7	-1.0	-34.3	0.3	0.2	-6.3
Average gross wages, real (PPI based)	31.0	-2.9	-8.5	-9.4	9.3	22.7	3.0	5.0	2.9
Average gross wages, real (CPI based)	-2.3	-1.1	-1.8	1.7	9.1	5.5	2.5	3.0	1.1
Average gross wages, EUR (ER)	0.9	-26.4	8.5	-2.3	9.0	3.2	4.4	6.4	-3.0
Employed persons (LFS)	1.3	-0.8	0.4	1.3	1.0	0.0	1.5	1.3	0.6
GDP real per employed person, NC	-0.1	1.9	6.4	2.8	3.5	-3.0	1.0	2.6	2.9
Unit labour costs, ER (EUR) adjusted	1.0	-27.8	1.9	-5.0	5.3	5.4	3.6	4.1	-5.7
Moldova									
GDP deflator	9.6	5.7	6.3	3.2	5.5	4.3	4.6	4.4	6.0
Exchange rate (ER), EUR/NC	-10.8	-5.2	5.9	5.0	0.9	-1.6	-4.8	0.0	-1.1
Real ER (CPI-based)	-2.3	0.6	10.9	6.0	4.1	-19.8	-1.7	3.4	3.8
Real ER (PPI-based)	-3.1	0.4	6.2	2.4	2.0	-22.0	-3.1	1.5	1.5
Average gross wages, real (PPI based)	4.4	5.4	8.2	11.7	13.3	4.4	5.9	6.3	8.6
Average gross wages, real (CPI based)	1.2	3.4	5.0	9.0	10.1	2.1	4.4	4.3	5.7
Average gross wages, EUR (ER)	-1.1	4.3	18.4	17.7	16.4	6.1	2.6	10.0	10.9
Employed persons (LFS)	1.6	1.3	-1.0	3.7	.	-6.0	-2.4	0.0	.
GDP real per employed person, NC	-1.9	3.0	5.7	0.6	.	-1.1	6.6	4.0	.
Unit labour costs, ER (EUR) adjusted	0.8	1.3	12.0	17.1	.	5.8	-2.5	5.3	.
Russia									
GDP deflator	7.2	2.8	5.3	11.1	3.8	0.0	4.1	4.0	6.0
Exchange rate (ER), EUR/NC	-25.1	-8.8	12.7	-10.8	1.9	-11.6	2.5	0.0	-6.9
Real ER (CPI-based)	-13.5	-2.6	14.9	-10.0	4.9	-45.9	4.6	1.3	-1.8
Real ER (PPI-based)	-12.7	-3.6	17.9	-2.9	3.2	-51.6	6.3	3.0	-0.1
Average gross wages, real (PPI based)	-7.7	3.5	-0.9	-0.4	7.3	14.6	2.3	2.3	0.2
Average gross wages, real (CPI based)	-9.0	0.7	3.0	8.5	4.8	3.0	4.0	4.0	1.4
Average gross wages, EUR (ER)	-21.3	-1.6	20.3	-0.5	11.5	-6.1	11.3	5.8	0.7
Employed persons (LFS)	-0.4	0.1	-0.3	0.3	-0.8	-2.7	0.4	0.7	-0.2
GDP real per employed person, NC	-1.6	0.1	2.2	2.2	2.2	-1.9	2.1	1.4	1.0
Unit labour costs, ER (EUR) adjusted	-20.0	-1.7	17.7	-2.6	9.1	-4.0	7.9	5.5	-0.3
Ukraine									
GDP deflator	38.9	17.1	22.0	15.4	8.2	3.3	5.6	3.4	19.9
Exchange rate (ER), EUR/NC	-35.1	-14.4	-5.7	-6.7	11.0	-6.0	-7.8	-3.2	-11.5
Real ER (CPI-based)	-3.5	-2.7	6.1	1.6	18.0	-58.3	-4.3	-0.8	3.6
Real ER (PPI-based)	-9.8	4.7	15.7	6.5	14.8	-61.4	-4.4	-1.8	6.0
Average gross wages, real (PPI based)	-11.4	2.5	8.4	6.3	13.7	13.7	6.9	7.7	3.6
Average gross wages, real (CPI based)	-18.9	8.5	19.8	12.5	9.7	6.0	6.9	6.7	5.4
Average gross wages, EUR (ER)	-21.8	5.8	29.2	16.5	31.5	2.1	2.7	7.9	10.4
Employed persons (LFS)	-0.4	-1.0	-0.7	1.3	1.3	-3.0	1.4	1.2	0.1
GDP real per employed person, NC	-9.4	3.4	3.3	2.1	1.8	-2.1	0.6	2.3	0.1
Unit labour costs, ER (EUR) adjusted	-13.7	2.3	25.2	14.1	29.1	4.2	2.9	4.9	10.2
Austria									
GDP deflator	2.3	1.8	0.9	1.7	1.7	1.9	1.6	1.6	1.7
Real ER (CPI-based)	0.9	0.6	0.4	0.1	0.0	0.9	0.3	0.1	0.4
Real ER (PPI-based)	0.7	-0.4	-1.1	-0.5	-0.6	2.4	0.3	0.1	-0.4
Average gross wages, real (PPI based)	3.6	4.2	-0.2	0.4	2.9	-2.5	-0.4	0.5	2.2
Average gross wages, real (CPI based)	1.1	1.4	-0.4	0.8	1.4	-0.5	-0.3	0.5	0.9
Average gross wages, EUR (ER)	2.1	2.3	1.6	2.8	3.0	0.8	1.2	2.1	2.4
Employed persons (LFS)	0.9	1.7	1.0	1.4	0.8	-2.4	1.2	0.9	1.2
GDP real per employed person, NC	0.1	0.3	1.4	1.2	0.6	-4.5	3.2	0.5	0.7
Unit labour costs, ER (EUR) adjusted	1.9	2.1	0.2	1.6	2.4	5.5	-1.9	1.6	1.6

For country-specific notes please see the respective country table (especially for LT 2019, RO 2018, MD 2019).
Positive growth of real exchange rates means real appreciation. Unit labour costs are defined as average gross wages per employee relative to labour productivity (real GDP per employed person, LFS).

Sources: wiiw Annual Database incorporating national and Eurostat statistics, WIFO, wiiw estimates. Forecasts by wiiw, WIFO (for Austria).

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