Wiener Institut für Internationale Wirtschaftsvergleiche
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New wiiw forecast for Central, East and Southeast Europe (CESEE) in 2019-2021: Braced for fallout from global slowdown

wiiw has published its new forecasts for 23 economies in CESEE up to 2021. The main conclusions are as follows:

› **Much of CESEE has so far weathered the slowdown in the global economy well, but signs of contagion are starting to emerge.**

› **Global economic growth is at its weakest since the 2008-2009 crisis, and there is no way that the region will be able to avoid being affected, given its high degree of reliance on exports and its integration with Germany.**

› **Although the peak years are over, we expect a soft landing for CESEE, rather than an outright collapse. Domestic demand will remain resilient, helped by strong wage growth, robust public investment, loose fiscal policy and plentiful credit.**

› **Turkey will continue to recover in its typical high-beta fashion and post growth well above 3% in both 2020 and 2021. By contrast, Russia will remain stuck in a rut and will be CESEE's weakest performer over the next two years.**

› **Downside risks to our projections are significant, and include a smaller post-Brexit EU budget, the fallout from global trade tensions, the impact of political developments in CESEE on institutions, and potential instability emanating from the financial sector.**

An impressive degree of domestic resilience

The main factor of resilience to global headwinds in CESEE remains stubbornly strong domestic demand. This reflects a combination of labour shortage-induced wage increases, loose fiscal policy, rapid credit growth and robust public investment. Real income is also being supported by weak price growth. Inflation remains at generally subdued levels, despite around half of the countries in the region running negative real interest rates. This reflects lower energy prices, as well as structural factors such as negative demographic trends and the impact of online retail (which has depressed firms' pricing power). Even in countries with extremely high inflation rates, such as Ukraine and Turkey, monetary policy is being loosened.

External challenges are formidable

The region's economies are generally quite export reliant, with only three (Russia, Turkey and Kosovo) having an export/GDP ratio below the global average. However, a sizeable number of CESEE economies are heavily plugged into the German manufacturing core. This is problematic, given that the German manufacturing sector is currently at its lowest ebb since the depths of the 2008-2009 crisis. Countries with particularly high degrees of exposure to Germany and/or where the automotive sector plays a large role in manufacturing – including the Visegrád countries, Romania, North Macedonia and Serbia – are particularly vulnerable. This over-specialisation in automotive production represents a risk for the future.

Growth now well past the peak

Our view that the peak of regional growth was in 2017-2018 remains unchanged. For CESEE as a whole, we estimate real GDP growth of 3% in 2019 (using a simple, unweighted average), down from 3.8% last year and 3.9% in 2017. In 2020-2021 we forecast regional growth of 2.9% on average. For our Autumn Forecast, we have made several quite substantial downgrades to our growth forecasts, especially for EU-CEE countries in 2020, largely on the back of worse-than-expected external developments.

The region's two biggest economies, Russia and Turkey, continue to struggle, but the outlook for the latter is much better than that for the former. In Russia, after a dip this year, growth will pick up somewhat in 2020-2021 due to moderate fiscal relaxation, but it will be the worst performer in CESEE in these years. The Turkish economy will continue to rebound from the recent crisis, with real GDP growth set to be well above 3% in both 2020 and 2021. However, downside risks remain substantial.

EU-CEE countries will in particular be affected by negative external trends, albeit there may be some moderate relief next year. We expect these economies to grow by around 3% (weighted average) in 2020 and 2021. For the Western Balkans, we project similar growth rates, which will mean only very limited convergence with wealthier parts of Europe. The delay to EU accession in particular may stall the fragile reform momentum in the region.

Risks largely on the downside

Risks to the forecast for CESEE are significant and are largely on the downside. A possibly smaller EU budget would primarily affect EU-CEE countries, although potentially also the Western Balkans. Otherwise, we are most concerned about the threat of higher US tariffs on EU car exports, and a further decline in the quality/independence of institutions in many parts of the region.

We also see two key risks emanating from the financial sector for sub-regions of CESEE: rapid consumer credit growth in the CIS and Ukraine, and strong property price increases in EU-CEE. First, our credit monitor continues to highlight sustained double-digit consumer lending growth in the CIS and Ukraine, at the same time as a deterioration in asset quality across the region, most significantly in Kazakhstan. Secondly, years of ultra-loose monetary policy have pushed down mortgage rates across much of the region, leading to the creation of potential bubbles in many EU-CEE property markets. In Hungary, housing prices have increased by 86% over the past five years; in the Czech Republic by 46%; and in most other EU-CEE countries by between 30% and 40%.

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OVERVIEW 2017-2018 AND OUTLOOK 2019-2021

		GDP real change in % against prev. year					Consumer prices average change in % against prev. year					Unemployment (LFS) rate in %, annual average					Current account in % of GDP				
		2017	2018	2019 Forecast	2020	2021	2017	2018	2019 Forecast	2020	2021	2017	2018	2019 Forecast	2020	2021	2017	2018	2019 Forecast	2020	2021
BG	Bulgaria	3.8	3.1	3.5	2.7	2.4	1.2	2.6	3.0	2.5	2.0	6.2	5.2	4.6	4.5	4.4	3.5	5.4	6.0	4.4	3.2
CZ	Czech Republic	4.4	3.0	2.5	2.4	2.6	2.4	2.0	2.5	2.1	2.1	2.9	2.2	2.0	2.0	2.0	1.6	0.3	0.4	0.3	0.2
EE	Estonia	5.7	4.8	3.3	2.6	2.4	3.7	3.4	2.6	2.3	2.1	5.8	5.4	5.0	5.2	5.0	2.7	2.0	2.8	2.2	2.1
HR	Croatia	2.9	2.6	2.9	2.7	2.7	1.3	1.6	1.0	1.5	1.5	11.2	8.5	6.5	6.0	5.5	3.4	1.9	0.6	0.2	0.1
HU	Hungary	4.3	5.1	4.3	3.1	2.6	2.4	2.9	3.5	3.2	3.0	4.2	3.7	3.5	3.5	3.5	2.3	-0.5	-0.1	-0.1	-0.1
LT	Lithuania	4.2	3.6	3.6	2.4	2.6	3.7	2.5	2.2	1.9	2.0	7.1	6.2	5.8	5.6	5.5	0.5	0.3	0.8	0.2	0.0
LV	Latvia	3.8	4.6	2.8	2.2	2.4	2.9	2.6	3.0	2.3	2.4	8.7	7.4	6.5	6.3	6.0	1.0	-0.7	-0.2	-0.5	-0.6
PL	Poland	4.9	5.1	4.4	3.5	3.3	1.6	1.2	2.0	2.7	2.5	4.9	3.9	3.7	3.4	3.4	0.1	-1.0	-1.0	-1.2	-0.9
RO	Romania	7.1	4.0	4.2	3.3	3.0	1.1	4.1	4.0	3.5	3.5	4.9	4.2	3.8	3.7	3.7	-3.2	-4.6	-5.2	-5.0	-4.9
SI	Slovenia	4.8	4.1	2.9	2.8	2.8	1.6	1.9	1.8	1.8	2.0	6.6	5.1	4.5	4.0	4.0	6.1	5.7	4.8	4.6	4.4
SK	Slovakia	3.0	4.0	2.3	2.2	2.6	1.4	2.5	2.7	2.1	2.0	8.1	6.5	5.8	5.8	5.6	-1.9	-2.6	-3.0	-2.8	-2.5
	EU-CEE11 1)2)	*4.9*	*4.3*	*3.8*	*3.1*	*2.9*	*1.8*	*2.2*	*2.6*	*2.7*	*2.5*	*5.3*	*4.3*	*3.9*	*3.8*	*3.7*	*0.5*	*-0.7*	*-0.8*	*-1.0*	*-0.9*
	EA19 3)	*2.5*	*1.9*	*1.1*	*1.2*	*1.4*	*1.5*	*1.8*	*1.2*	*1.3*	*1.5*	*9.1*	*8.2*	*7.7*	*7.5*	*7.4*	*3.6*	*3.5*	*2.8*	*2.7*	*2.5*
	EU28 3)	*2.6*	*2.0*	*1.4*	*1.4*	*1.6*	*1.7*	*1.9*	*1.8*	*1.9*	*1.9*	*7.6*	*6.8*	*6.2*	*6.0*	*6.0*	*2.4*	*2.1*	*1.5*	*1.4*	*1.3*
AL	Albania	3.8	4.1	2.8	3.8	3.4	2.0	2.0	1.7	2.1	2.4	13.7	12.3	11.3	11.0	10.5	-7.5	-6.7	-7.3	-6.6	-6.1
BA	Bosnia and Herzegovina	3.2	3.6	2.6	2.7	2.7	0.8	1.4	1.2	1.6	1.4	20.5	18.4	15.8	15.0	14.0	-4.3	-3.7	-4.5	-4.3	-4.0
ME	Montenegro	4.7	5.1	3.1	3.0	2.1	2.4	2.6	1.5	1.8	1.9	16.1	15.2	14.3	14.0	13.9	-16.1	-17.0	-17.8	-18.0	-14.3
MK	North Macedonia	0.2	2.7	3.3	3.4	3.4	1.4	1.5	1.4	2.4	2.5	22.4	20.7	18.5	17.5	17.5	-1.1	-0.1	-1.4	-2.5	-3.1
RS	Serbia	2.0	4.4	2.9	2.7	2.6	3.0	2.0	1.8	2.2	2.6	13.5	12.7	11.5	10.8	10.3	-5.2	-5.2	-6.0	-5.5	-5.4
XK	Kosovo	4.2	3.8	4.2	4.0	4.3	1.5	1.1	2.7	2.5	2.5	30.5	29.6	25.0	23.5	21.0	-5.4	-7.6	-7.2	-7.5	-7.9
	WB6 1)2)	*2.6*	*4.0*	*3.0*	*3.1*	*2.9*	*2.1*	*1.8*	*1.7*	*2.1*	*2.3*	*16.9*	*15.7*	*13.8*	*13.2*	*12.6*	*-5.4*	*-5.3*	*-6.1*	*-5.8*	*-5.6*
TR	Turkey	7.5	2.8	-0.7	3.1	3.3	11.1	16.3	16.5	13.0	11.2	10.9	10.9	13.5	13.4	11.5	-5.5	-3.4	-0.2	-1.6	-2.3
BY	Belarus	2.5	3.0	1.3	1.5	1.7	6.0	4.9	6.0	5.5	5.0	5.6	4.8	4.4	4.5	4.5	-1.7	-0.1	-0.4	-1.2	-1.4
KZ	Kazakhstan	4.1	4.1	4.0	3.5	3.5	7.4	6.0	5.3	5.0	5.0	4.9	4.9	4.8	4.8	4.8	-3.1	-0.2	-2.4	-2.0	-1.9
MD	Moldova	4.7	4.0	4.7	3.8	4.0	6.5	2.9	4.5	4.5	4.5	4.1	3.0	6.0	6.0	6.0	-5.7	-10.6	-9.8	-9.2	-8.2
RU	Russia	1.6	2.3	1.1	1.7	1.9	3.6	2.9	4.5	2.9	2.9	5.2	4.8	4.6	4.5	4.4	2.1	6.8	5.1	5.9	6.0
UA	Ukraine	2.5	3.3	3.3	3.1	3.3	14.4	10.9	8.0	6.0	5.0	9.5	8.8	8.4	8.1	7.8	-2.2	-3.3	-2.6	-3.0	-3.5
	CIS4+UA 1)2)	*2.0*	*2.6*	*1.6*	*2.0*	*2.2*	*4.9*	*3.9*	*4.9*	*3.4*	*3.4*	*5.9*	*5.4*	*5.2*	*5.1*	*5.0*	*1.2*	*5.3*	*3.6*	*4.2*	*4.3*
	V4 1)2)	*4.6*	*4.6*	*3.8*	*3.1*	*3.0*	*1.9*	*1.7*	*2.4*	*2.6*	*2.4*	*4.7*	*3.8*	*3.6*	*3.4*	*3.4*	*0.5*	*-0.8*	*-0.8*	*-0.8*	*-0.7*
	BALT3 1)2)	*4.5*	*4.2*	*3.3*	*2.4*	*2.5*	*3.5*	*2.7*	*2.5*	*2.1*	*2.1*	*7.3*	*6.4*	*5.9*	*5.7*	*5.5*	*1.2*	*0.4*	*1.1*	*0.5*	*0.4*
	SEE9 1)2)	*5.1*	*3.7*	*3.7*	*3.1*	*2.8*	*1.4*	*3.0*	*3.0*	*2.8*	*2.8*	*9.7*	*8.6*	*7.6*	*7.3*	*7.0*	*-1.9*	*-2.5*	*-3.2*	*-3.3*	*-3.3*
	CIS3+UA 1)2)	*3.3*	*3.6*	*3.3*	*3.0*	*3.1*	*9.6*	*7.5*	*6.3*	*5.4*	*5.0*	*7.5*	*6.9*	*6.7*	*6.6*	*6.4*	*-2.6*	*-1.5*	*-2.4*	*-2.4*	*-2.6*
	non-EU12 1)2)	*3.7*	*2.7*	*1.0*	*2.3*	*2.5*	*6.7*	*7.5*	*8.2*	*6.2*	*5.7*	*7.5*	*7.1*	*7.5*	*7.4*	*6.8*	*-1.0*	*2.6*	*2.3*	*2.4*	*2.3*
	CESEE23 1)2)	*4.1*	*3.2*	*1.8*	*2.6*	*2.7*	*5.3*	*6.0*	*6.6*	*5.2*	*4.7*	*7.0*	*6.4*	*6.6*	*6.5*	*6.1*	*-0.5*	*1.4*	*1.2*	*1.2*	*1.1*

Note: 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 2019).