Forecast Report

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Sailing Through Rough Waters

Economic Analysis and Outlook for Central, East and Southeast Europe

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Sailing Through Rough Waters

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Executive summary

Economic growth has weakened in most CESEE countries, hit as they have been by both financial tightening and soaring inflation, which has undermined real incomes and depressed confidence. The threat of a serious energy crisis has not materialised, as the CESEE countries have managed to drastically scale back their natural gas consumption and wean themselves off their dependence on Russian fossil fuels. However, many of them have slipped back into increased coal use as an emergency solution.

Although inflation has mostly slowed in recent months, as global energy prices declined, it remains uncomfortably high and continues to weigh on real incomes. Core inflation is still in double digits in all the CESEE countries, apart from Albania and Slovenia. As real wages have fallen, so households have had to use other sources to finance their consumption. Many CESEE governments have implemented fiscal packages to cushion the blow of higher prices for vulnerable households. Those EU-CEE members that could take advantage of access to the EU Recovery and Resilience Facility have been able to offer more generous support, through the pace of drawdown has varied considerably.

We expect inflation to take longer to subside than we previously thought and have revised our 2023 forecast upwards for most CESEE countries. However, the region will largely avoid recession – apart from Hungary, which is struggling with rampant inflation and difficulties in accessing EU funds. Overall, the Western Balkans will have the strongest economic growth in the region in 2023, with average GDP growth of 2%. In EU-CEE, economic performance will be very uneven: Romania and Croatia are expected to grow by 3.0% and 2.5%, respectively, while the Baltic states, Czechia and Slovakia will expand at below 1%. We have revised downwards our GDP forecast for Ukraine to 1.6%, as the damage caused to the country’s energy infrastructure by Russian missile attacks has raised costs for the economy and aggravated supply-chain issues.

In 2024-2025 we anticipate an overall acceleration of economic growth across the region, primarily on the back of a recovery in private consumption. Investment is also expected to recover, but its contribution to economic growth will generally be quite modest, apart from in Croatia, Romania and North Macedonia: in those countries it will grow on a par with household final consumption, supported to a large extent by FDI inflows and (in the case of the first two countries) by EU funds.

Overall, Southeast Europe, including EU and non-EU members, showed the greatest resilience in the region last year and will continue to perform better than the Visegrád group over the forecast period. The Central European manufacturing core has been particularly affected by the high energy prices for industry and by low growth in Germany, its main export market. During the forecast period, Central European economies will be further constrained by the limitations of their economic model, based as it is on labour-cost advantages.

One of the major downside risks to the forecast is that the persistently high inflation will lead to the economies making a harder landing. A sharp tightening of financial conditions could exacerbate potential structural vulnerabilities in the banking sector, which must undergo a major adjustment of its balance sheets. Those CESEE countries with high debt levels are particularly vulnerable to the rising costs of debt servicing and capital outflows. There could be a deterioration in the security situation of the region if Ukraine encounters problems in securing support from its allies following the US presidential election in November 2024. In turn, that could have a negative impact on investor sentiment towards parts of the CESEE region.

COUNTRY SUMMARIES

ALBANIA

The Albanian economy displayed remarkable resilience in 2022, with a growth rate of 4.8%, driven by a bumper tourist season, robust FDI inflows and strong household consumption on the back of rising real incomes. Inflation was the lowest in the whole CESEE region, averaging 6.7%, but is still high by the country's own standards. This year will be similar to 2022, with expected growth of 3.3% and inflation of 4%.

BELARUS

Throughout 2022, Belarus underwent a painful adjustment to the external shocks it faced. Despite massive policy support measures and Russia's continued economic backing, GDP shrank by 4.7%. That year also witnessed a sweeping reorientation of trade flows, and China became Belarus's second-largest trade partner. Despite all the measures, Belarus's crippled economy will continue to be dominated by persistent weakness. GDP growth in the coming years will remain in the range 1-2%.

BOSNIA AND HERZEGOVINA

Growth in 2022 was 3.9%. This was better than expected, thanks to a rise in private consumption and gross capital formation. However, the continuing high inflation and increasing interest rates are likely to drag growth in 2023 down to 1.7%. The formation of governments after the October 2022 elections is not yet quite complete, but the shape of most of the structures is clear and reveals a slight move away from nationalist parties. The country gained EU candidate status in December 2022, even though the conditions required had not been met. This could provide a fillip to the country's progress in the coming period.

BULGARIA

The early general election held in April 2023 – the fifth in two years – has delivered no clear winner. The absence of a stable government over the past couple of years has resulted in fiscal destabilisation and delays to the country's planned accession to the euro area. While GDP growth in 2022 was above expectations (thanks to a surge in exports), in 2023 it will slow to 1.7%. Rebalancing the public finances requires a radical shift in fiscal policies – something that may be problematic given the current political environment.

CROATIA

Thanks to robust household consumption and a stellar summer tourist season, as well as better-than-expected growth in Q4 2022, Croatia's economy grew by 6.3% in 2022. In January 2023, the country adopted the euro and joined the EU's border-free Schengen Area, which will likely boost trade, tourism and investment in the long term. Nevertheless, given the high rate of inflation, the deteriorating funding conditions and the uncertainty (which will act as a drag on private consumption and investment), we expect the economy to grow by only 2.5% in 2023.

CZECHIA

With persistently high inflation, cooling internal and external demand, tight monetary conditions and a deteriorating fiscal position, the macroeconomic challenges facing Czechia are mounting. The Czech economy will manage to keep its head just above water and will avoid a recession, but it will be stagnant this year. The slowdown is expected to be temporary, and the economy should be in a position to see renewed growth from 2024 onwards.

ESTONIA

The anticipated economic decline – driven by severe inflation and weakening foreign demand – did indeed materialise in Q4 2022. However, economic prospects are not that grim, as inflation is slowing and consumption is gradually recovering. Moreover, economic activity in those sectors that are less reliant on imports of raw materials remains strong. Yet two major risk factors overshadow the outlook – the reduced export competitiveness of Estonian firms and a deepening systemic imbalance between budget revenue and expenditure.

HUNGARY

In early 2023, Hungarian inflation was the highest in the EU. Measures to rein in inflation have been unavoidable, but do little to encourage growth. Both consumption and investment will fall this year, and the only positive contribution to GDP change will come from foreign trade, where deficits are expected to shrink substantially. This year will be split between recession in the first half and moderate recovery in the second. EU transfers continue in limbo. A new industrial policy aimed at facilitating the FDI-based mass production of batteries for electric cars has the potential to turn into a costly fiasco.

KAZAKHSTAN

Despite the anticipated decline in oil prices, which will have an adverse impact on exports, economic growth is expected to accelerate over the forecast period due to domestic demand factors. Investments in infrastructure, in particular transport and logistics, will contribute positively to growth in the coming years. Consumption is likely to start recovering in 2023, although inflation is expected to take longer to contain, amid fiscal stimulus and the recent increase in regulated fuel prices.

KOSOVO

Despite the challenges of 2022, Kosovo’s economy remained resilient, thanks to its robust export performance in both goods and services, as well as strong household consumption, encouraged by remittances. These factors are expected to continue to drive economic growth in 2023, supported by an accelerated trend in capital investment.

LATVIA

After a boom in 2022, the effects of dwindling external demand and escalating prices will bring the economy close to stagnation this year (0.3%). Enterprises are largely refraining from investment, preferring to deplete their stocks. Moreover, the ongoing decline in the purchasing power of households will curb growth in consumption. Given the tight labour market, the unemployment rate will rise only slightly in 2023, then decline again next year. Assuming that the EU economy finds its way back on track by the end of 2023, we expect a revival in Latvia’s GDP growth to 2.5% in 2024.

LITHUANIA

The economy dealt better than expected last year with the blow caused by Russia’s invasion of Ukraine, although inflation reached almost 20%. The economy will shrink in the first half of 2023, but the evident stabilisation in household and business sentiment suggests that consumption and investment activity should pick up thereafter. The government is trying to counter the loss of households’ purchasing power, and public investments should also go some way to supporting economic activity. We expect real GDP to grow by 0.9% in 2023; this will be followed by an upswing to 2.7% in 2024 and then 2.5% in 2025.

MOLDOVA

The energy crisis, soaring inflation and extreme drought were the main reasons for the economic contraction in 2022 (GDP down by 5.9%). There should be an improvement across the board in 2023, thanks to elevated external assistance, rapid structural adjustment and better weather conditions (GDP to rise by 3.5%). In the absence of negative external shocks, and with determined efforts to foster EU integration, the economy will grow by about 4% in the coming years.

MONTENEGRO

Private consumption flourished in 2022, following a tax reform that resulted in very high GDP growth of 6.1%. Against all the odds, fiscal policy is still expansionary and fiscal risks are thus rising. A further rebound in tourism and expansion of the energy sector will be the main drivers of economic growth in 2023, which is projected to be 2.9%. The recent presidential election witnessed the triumph of the new 'Europe Now' party, which will likely win a significant share in the June parliamentary election, too, and could be a game changer in contemporary Montenegrin (geo)politics.

NORTH MACEDONIA

The mild winter helped keep the pessimistic scenarios touted at the end of 2022 at bay, and as a result the economy performed better than anticipated. This was partly due to strong foreign direct investment inflows (although the sustainability of these inflows is uncertain). The government's decision to reinstate price controls on essential foodstuffs has succeeded in bringing down inflation, but it is unclear how long these controls will remain in place. Overall, the economic situation in the country seems more positive than it did three months ago, though many challenges remain.

POLAND

The Polish economy has proved surprisingly resilient so far. But growth is already slowing. High interest rates are having a major effect on private consumption and investment, while inflation is eroding the real value of current wage incomes. Symptoms of excess supply abound. However, falling inflation and a recovery in household incomes will gradually restore demand and sales, thereby paving the way for an acceleration in growth. But these positive developments will set in only towards the end of 2023.

ROMANIA

Economic growth will slow to 3% in 2023, from close to 5% the previous year. Domestic demand will be eroded by high inflation and sluggish wage growth. The dynamic expansion of investments financed mainly by EU programmes and FDI will continue. Fiscal and current account deficits will contract, but will remain elevated – which will constitute a moderate risk. The improved international position of Romania in economic, political and military aspects supports its long-term economic development.

RUSSIA

After a sharp downturn in Q2 2022, the economy stabilised in the second half of the year and is projected to broadly stagnate in 2023. The overall picture masks the very uneven impact of the war and the sanctions across sectors: while domestic trade and industries that depend heavily on cross-border linkages have suffered, military production and certain import-substituting sectors have flourished. The recently imposed energy sanctions have dealt government revenue a heavy blow and will contribute to budget deficits being much higher in the years ahead.

SERBIA

Weak investment meant that the economy grew by less than expected in 2022, but there are signs of a recovery in early 2023. Inflation has been on the rise since the government started to lift the price controls it had introduced, and this poses some additional challenges. A major deal has been struck on the normalisation of relations with Kosovo; this could mark a turning point for the country, but questions remain about the implementation of the deal.

SLOVAKIA

In 2022, Slovakia's GDP growth reached just 1.7%. This year, too, high inflation will continue to prevent stronger economic growth, which is forecast to be 0.6%. Declining household consumption and poor prospects for Germany – the country's main export market – will drag down growth, while the influx of EU funds will provide some growth momentum. The situation should improve in 2024, but domestic political instability resulting from party fragmentation might threaten future prospects in the long run.

SLOVENIA

Slovenia continues to perform well in crisis times. In 2023, real GDP will grow by 1.4%, supported by government spending on infrastructure and solid export performance. At 5.5%, inflation will remain high, but lower than the EU average. Unemployment will be at an all-time low for the second year in a row, while real wages will increase despite high inflation. The government has announced reforms in healthcare, pensions, public salaries and taxes, all of which come with long-term fiscal implications and will be a hot topic in 2023.

TURKEY

Despite the various challenges, economic momentum was strong in the first half of 2022, but began to slow in Q4. In 2023, Turkey has been grappling with the fallout from February's devastating earthquakes and the political uncertainty surrounding the upcoming May elections. Growth will slow this year, due to a combination of external vulnerabilities and internal structural challenges. The easing of political instability and increased reconstruction investment are likely to stimulate growth in 2024-2025.

UKRAINE

Ukraine's economy has been performing relatively well, considering the wartime conditions and the targeted destruction of its energy infrastructure by Russia. International financial aid will remain crucial for the economy's functioning in the short term. We expect economic growth to resume in 2023 and to accelerate in 2024-2025. But this forecast is subject to major downside risks related primarily to the intensity and duration of Russia's war in Ukraine and the continued willingness of international partners to support Ukraine.

Keywords: CESEE, Central and Eastern Europe, economic forecast, Western Balkans, Visegrad group, CIS, Ukraine, Russia, Turkey, euro area, EU, convergence, Russia-Ukraine war, Russia sanctions, commodity prices, inflation, energy crisis, gas, coal, renewable energy, electricity, monetary and fiscal policy, EU funds, purchasing power, remittances, external debt, interest rates, banking sector, financial liabilities, credit, impact on Austria, macroeconomic forecasting

JEL classification: E20, E21, E22, E24, E31, E44, E5, E62, F21, F24, F30, F50, F51, H56, H60, J30, O47, O52, O57, P24, P27, P33, P52, Q40, R30

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Cut-off date for historical data and forecasts: 13 April 2023. Most data are taken from the wiiw Databases. Direct access is available at: https://data.wiiw.ac.at/.

wiiw COUNTRY GROUPS

CESEE23 Central, East and Southeast Europe

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

EU-CEE11 Central and East European EU members

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

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

SEE9 Southeast Europe

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

non-EU12 non-European Union CESEE countries

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

WB6 Western Balkans

AL	Albania	MK	North Macedonia
BA	Bosnia and Herzegovina	RS	Serbia
ME	Montenegro	XK	Kosovo

CIS3+UA Commonwealth of Independent States-3 and Ukraine

BY	Belarus	MD	Moldova
KZ	Kazakhstan	UA	Ukraine

CIS4+UA Commonwealth of Independent States-4 and Ukraine

BY	Belarus	RU	Russia
KZ	Kazakhstan	UA	Ukraine
MD	Moldova		

EU27 European Union

AT	Austria	IE	Ireland
BE	Belgium	IT	Italy
BG	Bulgaria	LT	Lithuania
CY	Cyprus	LU	Luxembourg
CZ	Czechia	LV	Latvia
DE	Germany	MT	Malta
DK	Denmark	NL	Netherlands
EE	Estonia	PL	Poland
EL	Greece	PT	Portugal
ES	Spain	RO	Romania
FI	Finland	SE	Sweden
FR	France	SI	Slovenia
HR	Croatia	SK	Slovakia
HU	Hungary		

EA20 Euro area

AT	Austria	IE	Ireland
BE	Belgium	IT	Italy
CY	Cyprus	LT	Lithuania
DE	Germany	LU	Luxembourg
EE	Estonia	LV	Latvia
EL	Greece	MT	Malta
ES	Spain	NL	Netherlands
FI	Finland	PT	Portugal
FR	France	SI	Slovenia
HR	Croatia	SK	Slovakia

ABBREVIATIONS

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

BCI	Business Cycle Index (wiiw)
BIS	Bank for International Settlements
BOP	balance of payments
CA	current account
CARE	Cohesion’s Action for Refugees in Europe
CB	central bank
CBR	Central Bank of Russia
CIS	Commonwealth of Independent States
CNB	Czech National Bank
CPI	consumer price index/inflation
CSTO	Collective Security Treaty Organisation
EAEU	Eurasian Economic Union
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
EPPO	European Public Prosecutor’s Office
ER	exchange rate
ESA 2010	European system of accounts
EU	European Union
FDI	foreign direct investment
FISIM	Financial Intermediation Services, Indirectly Measured

FOREX	foreign exchange
GDP	gross domestic product
GFCF	gross fixed capital formation
HICP	Harmonised Index of Consumer Prices (EU wide inflation measurement)
IT	information technology
IMF	International Monetary Fund
IPA	Instrument for Pre-accession Assistance
LFS	Labour Force Survey
LNG	liquified natural gas
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne (Statistical classification of economic activities in the European Community)
NATO	North Atlantic Treaty Organisation
NBU	National Bank of Ukraine
NPL	non-performing loan
OECD	Organisation for Economic Cooperation and Development
OPEC+	Organisation of the Petroleum Exporting Countries (OPEC) plus 10 of the biggest non-OPEC oil-exporting countries
PMI	purchasing managers' index
pp	percentage points
PPI	producer price index/inflation
PPP	Purchasing Power Parity
PPS	purchasing power standard
RER	real exchange rate
RIR	real interest rate
RRF	Recovery and Resilience Facility
S&P	Standard & Poor's
SDR	special drawing rights
SDS	Slovenian Democratic Party
SME	small and medium-sized enterprise
SPE	special purpose entity
SPFS	financial messaging system of the Bank of Russia
SWIFT	Society for Worldwide Interbank Financial Telecommunications
TAP	Trans Adriatic Pipeline
UK	United Kingdom
UNHCR	United Nations High Commissioner for Refugees
US	United States

VAR	vector autoregression
VAT	value added tax
wiiw	The Vienna Institute for International Economic Studies
WTO	World Trade Organisation
.	not available (in tables)
bn	billion
m	million
p.a.	per annum
sa	seasonally adjusted
y-o-y	year on year

1. Global overview: Weak but resilient

BY RICHARD GRIEVESON

› **The euro area economy will only see very moderate growth this year, but the outlook has improved since our last forecast, and the single-currency area has shown an impressive degree of resilience to the fallout from the Russian invasion of Ukraine.**

› **Euro area inflation will stay high this year by historical standards, but is well past its peak, and European Central Bank (ECB) interest rates will end 2023 only moderately higher than the current levels, indicating limited additional monetary tightening.**

› **Growth in the US is slowing, but has proven to be more resilient than expected, while the Chinese economy will have a much better 2023 on the back of post-COVID reopening.**

› **The medium-term outlook for economic growth in the euro area and globally is solid, if unspectacular, which will be positive for CESEE economies. The major risks are to the downside, and are linked above all to the fallout from monetary tightening, as well as to the potential for a further escalation of the war in Ukraine.**

The euro area continues to struggle under the weight of the inflation shock, but has proven more resilient than anticipated; we have revised our forecast for this year upward by 0.3 percentage points, relative to our winter report. The reasons for the upgrade are 1) better-than-expected resilience, especially in industry; 2) the relatively mild winter (which capped demand for expensive gas); 3) the collapse in energy prices, which means that inflation will be lower than previously expected; 4) stronger external demand, especially with China reopening; and 5) a further easing of supply-chain bottlenecks. This year will be weak, and the euro area growth outlook remains subject to material downside risks related to the war and uncertainty about momentum in both the US and China; yet the worst-case scenarios of a year ago have proved overly pessimistic. The latest available data suggest continued resilience. German industrial output and new industrial orders both grew strongly and at above expectation in February.

Figure 1.1 wiiw spring 2023 global assumptions

	Spring 2023			Changes since winter		
	2023	2024	2025	2023	2024	2025
Euro area real GDP growth, %	0.5	1.8	1.7	0.3	-0.1	-0.1
Euro area CPI, %	5.7	3.0	2.3	-0.3	-0.4	0.0
Euro area unemployment rate, %	6.6	6.6	6.6	-0.3	-0.2	0.0
Euro area current account, % of GDP	1.0	1.5	2.5	2.4	2.5	3.3
USD/EUR exchange rate, average	1.08	1.08	1.08	0.05	0.05	0.05
ECB refinancing rate, %, eop	4.00	3.00	2.00	na	na	na
USD per barrel Brent oil, average	83.0	78.0	73.0	-2.0	-2.0	-2.0

Source: forecasts by wiiw. Cut-off date: 7 April 2023.

Beyond 2023, our outlook for the euro area remains largely unchanged, with the economy set to expand at a bit below 2% per year, roughly in line with historical norms. We have made very moderate downward revisions for growth in 2024-2025, as tightening financial conditions and a stronger euro outweigh the positive impact of lower inflation. Real growth of slightly below 2% is hardly a stellar rate of expansion, but nevertheless it should ensure a healthy level of export demand, remittance outflows, tourism and other financial flows for the economies of CESEE.

The other two main blocs of the global economy are currently on divergent paths, with growth slowing in the US, but improving in China as post-COVID reopening continues there. In the US, the lagged impact of strong monetary tightening is cooling the economy. In its Spring World Economic Outlook, released on 11 April, the International Monetary Fund (IMF) said it expected the US economy to expand by 1.6% this year, down from 2.2% in 2022.[1] Nevertheless, it revised its 2023 US forecast upward by 0.2 percentage points relative to the winter, thanks to better-than-expected resilience to monetary tightening and the continued strength of the labour market. For China, the IMF expects an expansion of 5.2% this year, a major improvement on last year's 3% outturn.

Set against our winter forecast, we have revised downward our projections for euro area inflation both this year and next. This has been driven, above all, by the collapse in energy prices due to price caps on Russian oil and impressive reductions in demand by European industry. Energy price inflation in the euro area is likely to be negative from mid-2023, due to base effects. We have made a downward revision to our oil price forecasts as well.

Given the relative economic resilience, the lower-than-expected inflation and the continued ECB monetary tightening, we have revised upward our forecasts for the euro versus the dollar during the forecast period. Despite inflation starting to trend down and problems in the US and Swiss banking sectors, the ECB is still hawkish, and plans to continue raising interest rates. We think, however, that the ECB is close to its terminal rate, and that the refinancing rate will end this year at 4%, indicating a further 50 basis points of hikes from the current level. The impact of this tightening will still take some time to work through the system, and we cannot rule out further stresses emerging in the financial sector or real estate markets in parts of the bloc. Should these stresses indeed emerge, they will have an additional negative impact on growth, over and above the general impact of monetary tightening.

Our forecasts are fairly benign in the context of a major war on the European continent and inflation at multi-decade highs, and are subject to material downside risks. While the risks emanating from the war itself are most likely limited, the impact of a major escalation – for example, the use of tactical nuclear weapons by Russia, or a direct Russia-NATO altercation – are difficult to predict. A bigger risk is probably posed by further problems in the financial sector, as sharp monetary tightening after a decade and a half of ultra-loose policy continues to cause stress in parts of the financial system. A potential faltering of China's post-COVID reopening would also have a significant negative impact on global and euro area economic growth this year, although so far there are few signs of this risk materialising.

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[1] https://www.imf.org/en/Publications/WEO/Issues/2023/04/11/world-economic-outlook-april-2023

2. CESEE Overview: Sailing through rough waters

BY OLGA PINDYUK

› **Although inflation in CESEE has mostly slowed down over the past few months, along with the falling global energy prices, it remains uncomfortably high and continues to weigh on real incomes and depress confidence.**

› **Regardless of falling real wages, household consumption has been increasing, boosted by fiscal support programmes. EU-CEE has been able to benefit from access to the resources of the EU Recovery and Resilience Facility: this has been especially important to Croatia and Romania, where the funds accounted for 3.8% and 2.6%, respectively, of 2021 GDP.**

› **CESEE countries have managed to drastically reduce their natural gas consumption and wean themselves off their dependency on Russian fossil fuels. However, many of them have slid back into increased coal use as an emergency solution.**

› **We expect inflation to take longer than previously thought to slow down, and we are revising our 2023 forecast upwards for most CESEE countries. However, the region will largely avoid recession – apart from Hungary, which is struggling with rampant inflation, as well as difficulties in accessing EU funds.**

› **Southeast Europe, including EU and non-EU members, is expected to put in a better economic performance than the Visegrád group over the forecast period. The CESEE region overall will further outperform the euro area, indicating that economic the catch-up process is still going on, albeit at a slower pace.**

› **Negative risks to the forecast remain strong. One of the major risks to the forecast is that persistently high inflation will lead to harder lending conditions in the economies. A sharp tightening of financial conditions could exacerbate potential structural vulnerabilities in the banking sector, which must undergo a major rebalancing of its balance sheets. CESEE countries with high debt levels are particularly vulnerable to the rising costs of debt servicing and capital outflows. There could be a deterioration in the security situation in the region if Ukraine has problems in securing support from its allies after the US presidential election in November 2024.**

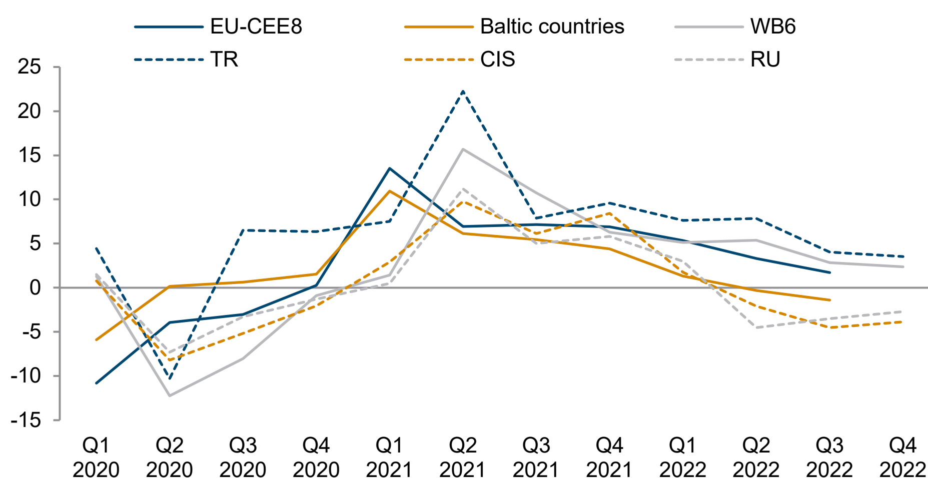
2.1. ECONOMIC PERFORMANCE IN Q4 2022 WORSENS FURTHER AS HIGH INFLATION DAMPENS ECONOMIC ACTIVITY

In Q4 2022, economic growth weakened in most of CESEE, as soaring inflation continued to weigh on real incomes and depress confidence (Figure 2.1). Ukraine had the steepest economic fall in the region in Q4 – 31.4% year on year – following the Russian missile attacks on the country's energy infrastructure (see Ukraine report). Russia managed to slow its economic fall in Q4, as high energy

prices boosted government revenues and spending; but this was a temporary phenomenon, and the situation worsened at the beginning of 2023, when the EU's oil sanctions came into force (see Russia report). The repercussions of Russia's war in Ukraine on economic activity are particularly visible in those countries with historically close economic links to Russia – the Baltic countries and the CIS, where economic performance has been the weakest in the region.

Figure 2.1 / Quarterly real GDP

change against preceding year in %



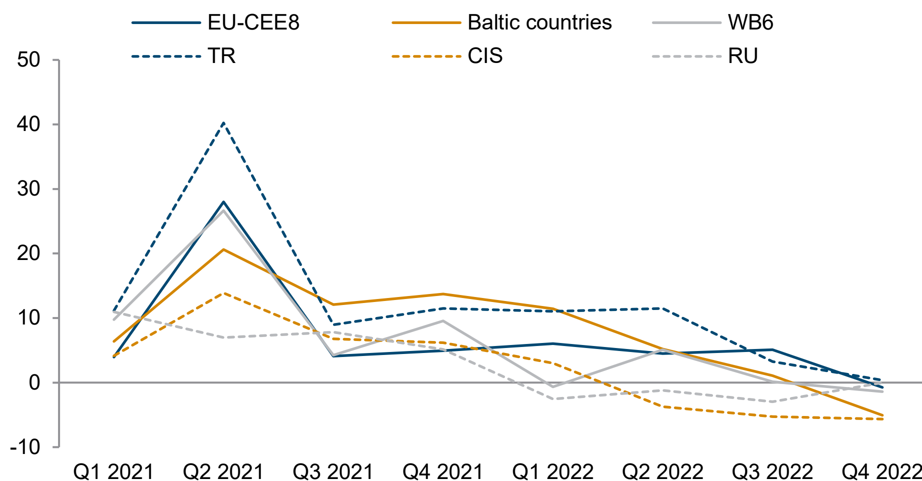
Note: simple average, EU-CEE8 includes the CEE members of the EU minus the Baltic countries.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Southeast European countries have put in the most resilient performance in the region. In Turkey, household consumption has been the primary driver of growth, despite high inflation (see Turkey report). The Western Balkan economies have been supported by a still strong growth in exports (especially tourism services), and domestic consumption has benefited from the relatively low inflation rate in some countries – achieved partly through administrative price controls (Jovanović, 2023). The Central European manufacturing core has been particularly affected by the high energy prices afflicting industry and by low growth in Germany, its main export market.

Industrial output suffered a sharp decline in Q4 2022, as industry struggled with rising input prices. The CIS and Western Balkans registered the biggest contractions of industrial output in real terms – of 5.7% and 5.1%, respectively, year on year (Figure 2.2). Only Turkey managed to avoid a decline in industrial output – but only narrowly (it increased by 0.4% year on year). EU-CEE countries showed uneven performance: some of them (Bulgaria, Czechia, Hungary and Poland) still achieved positive (albeit decelerating) growth in industrial production; others suffered a big decline – most notably Estonia (-11.2% year on year) and Slovakia (-7.1%), where the automotive sector was affected by a shortage of semiconductors and by supply-chain problems related to the Russian war in Ukraine (see Slovakia report). But given that gas demand in industry fell by 20-30% last year, these drops in industrial production can be seen as evidence of relative resilience.

Figure 2.2 / Quarterly industrial output

real change against preceding year in %

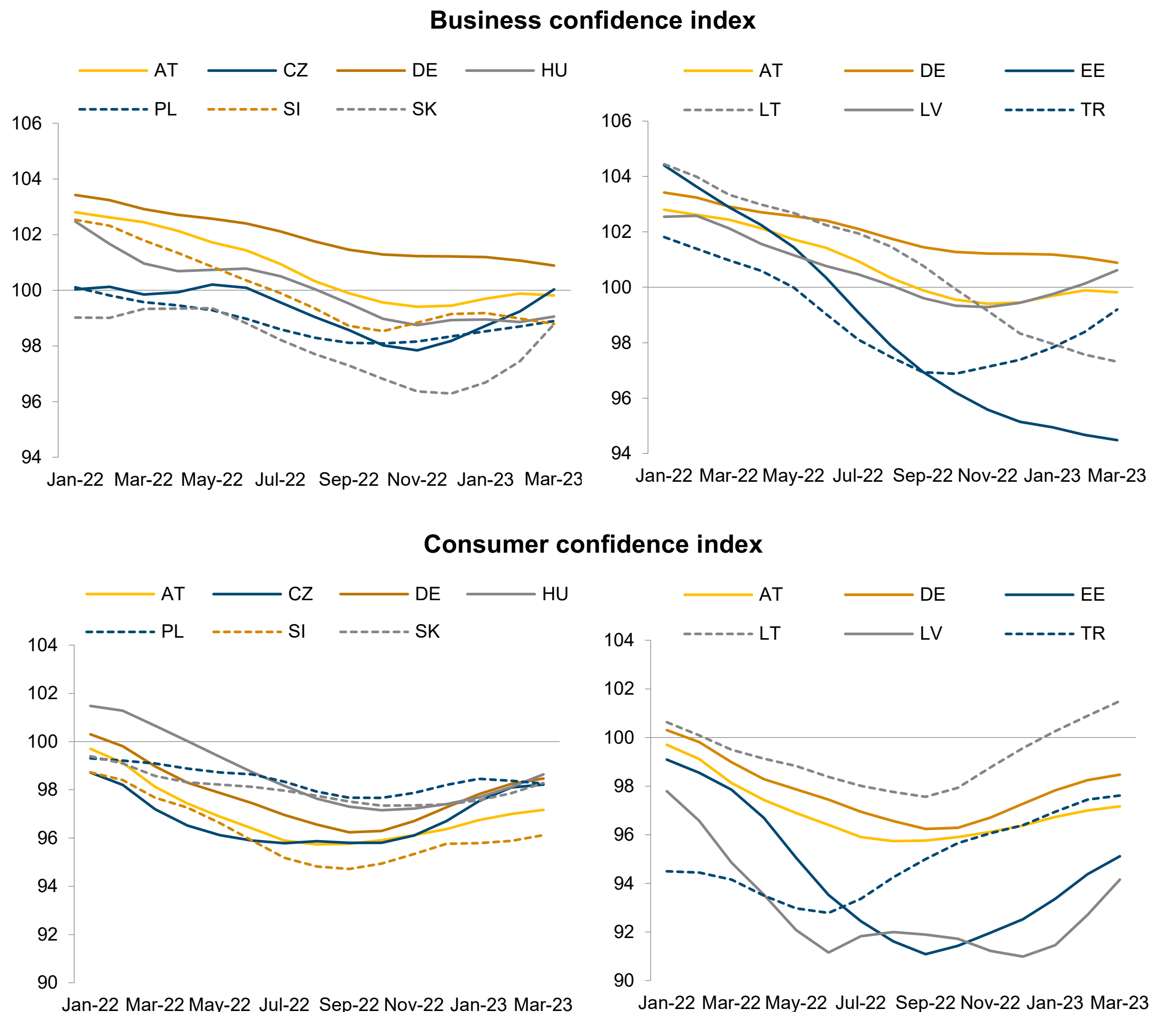


Note: simple average. EU-CEE8 includes the CEE members of the EU minus the Baltic countries.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Business and consumers both remain generally pessimistic, though sentiment appears to have started improving in some countries (Figure 2.3).[2] In 2022, all the countries in the region that are covered by OECD indices showed business confidence falling below the level for Germany; only in Latvia were companies on average mildly optimistic about their prospects (their index values rose above 100). In all the Visegrád countries (apart from Hungary), as well as in Latvia and Turkey, the business confidence indices appear to have bottomed out at the end of 2022 and have been picking up since – likely reflecting the improving prospects of the euro area and the German economy, in particular (see Global assumptions overview), and the fact that inflation appears to have peaked in some countries. The consumer confidence index shows a somewhat different pattern: even though consumers in all countries (apart from Lithuania) have on average been pessimistic, their confidence has grown over the past two quarters in all countries – apart from Poland, where it has stabilised. This probably points to consumers noticing the slowdown in inflation and hoping that the worst of the crisis is now behind them.

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

Figure 2.3 / Business and consumer confidence indices



Source: OECD, own calculation.

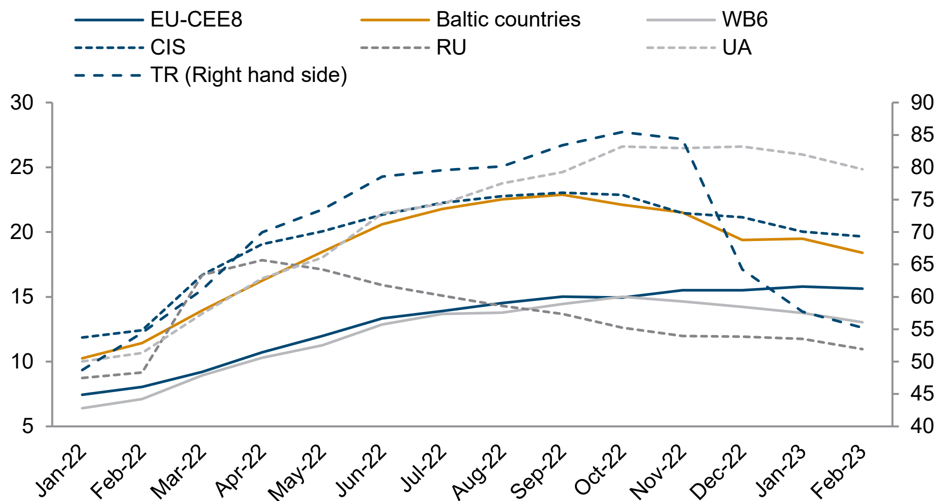
2.2. INFLATION REMAINS STUBBORNLY HIGH ACROSS VARIOUS COMPONENTS

Although inflation in CESEE has generally slowed over the past few months, as global energy prices have fallen (Figure 2.4)**, it remains uncomfortably high.** Inflation started to decelerate in Q4 2023 throughout the region, except for the EU-CEE8 countries[3] where it has been trending upwards, driven by the price dynamics in the Visegrád countries. Turkey still has the fastest-growing consumer prices in the region (55.2% year on year in February 2023), but inflation there has slowed dramatically – by 30 percentage points (pp) from the peak of October 2022. War-torn Ukraine has the second-highest inflation in the region, but there too it has started decelerating, along with global commodity prices. Russia and the Western Balkans have on average the lowest rates of inflation.

3 EU-CEE8 includes the CEE members of the EU minus the Baltic countries.

Figure 2.4 / Consumer price index

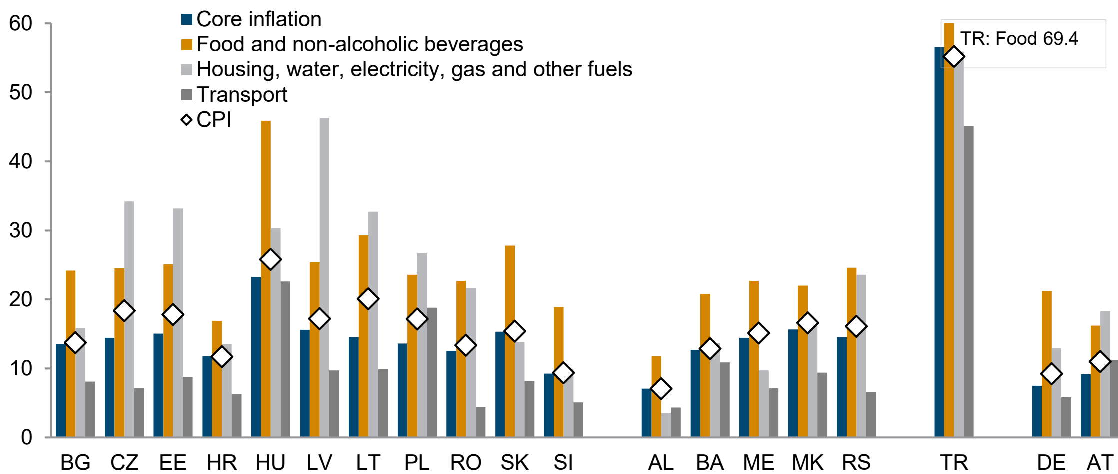
% change year on year, monthly



Note: simple average. Harmonised index of consumer prices (HICP) for EU-CEE.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Figure 2.5 / Consumer price inflation sub-components in February 2023

percentage change year on year



Source: National sources, Eurostat, wiiw.

Food prices have kept growing at double-digit rates almost throughout the region, with only a marginal deceleration in the last four months (Figure 2.5). Turkey continues to have the highest food inflation in the region, followed by Hungary, where prices increased in February by a striking 46% year on year. In addition to the common inflationary factors, these countries also had major currency depreciations, which contributed to inflation. Although global commodity prices have been falling – especially after the Black Sea Grain Initiative enabled grain exports from Ukraine from August 2022 – this has so far not been reflected in retail food prices. According to the European Central Bank (ECB),

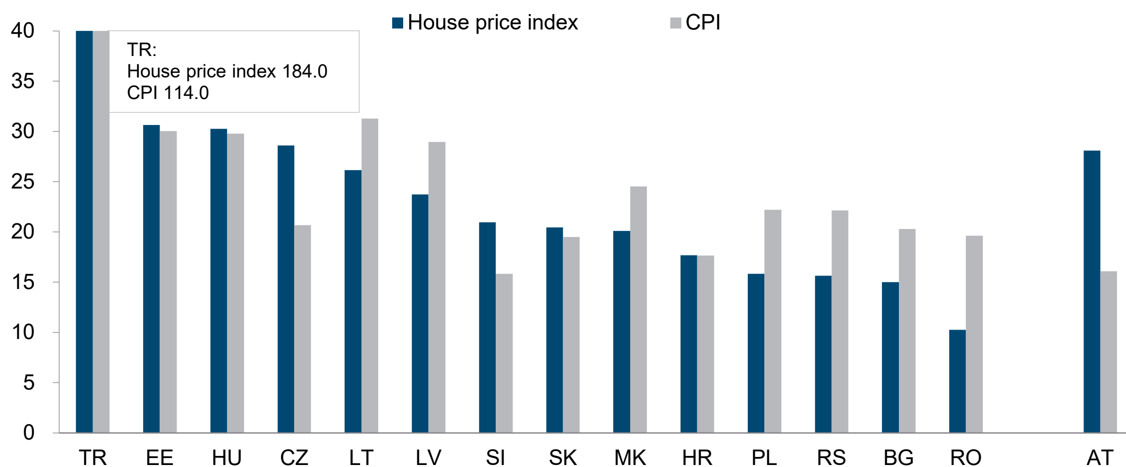
this indicates that prices may, to a large extent, be driven by the opportunistic behaviour of firms – as evidenced by the rapid profit growth in many sectors, including agriculture, manufacturing and trade, which has significantly outpaced nominal wage growth.[4]

Core inflation is still in double digits in all the countries, apart from Albania and Slovenia, indicating that the pass-through of higher costs to prices remains robust. This reinforces the concerns of monetary authorities that inflation is becoming more entrenched and could take a long time to subside.

The growth in transportation prices slowed significantly on the back of falling energy costs, but in housing the deceleration has been far more moderate. After Turkey, the most rapid growth in housing costs (in those countries for which data are available) has been seen in the Baltic states, Czechia and Hungary (Figure 2.6). Both rental and house prices in those countries have been rising rapidly on account of the high demand for housing, which has been driven by low interest rates on mortgage loans (prior to the start of aggressive monetary tightening), the COVID-triggered shift to remote working and (in the case of Estonia and Latvia) an influx of refugees – as well as by an inadequate supply of housing.[5]

Figure 2.6 / House price index and CPI, cumulative, Q1 2021 - Q4 2022

percentage change year on year



Source: wiiw Monthly Database incorporating national and Eurostat statistics and Eurostat, Bank for International Settlements.

[4] https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230322_2~af38beedf3.en.html

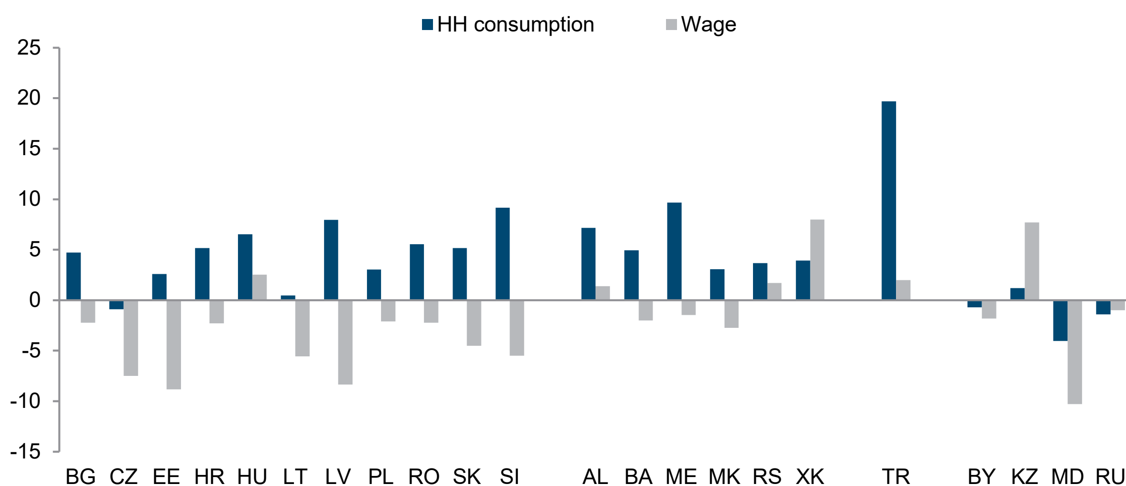
[5] https://www.euronews.com/next/2022/10/10/europes-cost-of-living-crisis-this-is-how-much-more-rent-you-are-paying-in-your-country

2.3. HOUSEHOLDS ARE INCREASINGLY RELYING ON NON-WAGE SOURCES OF INCOME

The purchasing power of households in CESEE has been eroding, with real wages decreasing (Figure 2.7). In 2022, real gross wages fell in all the countries in most of the region, apart from Hungary, Albania, Serbia, Kosovo, Turkey and Kazakhstan. The sharpest year-on-year declines were recorded in Moldova (10.3%), Estonia (8.8%), Latvia (8.3%) and Czechia (7.5%). In Montenegro, although gross wages did not increase, net wages did, as the tax reform abolished health insurance contributions.

Nonetheless, households managed to increase their consumption in most countries of the region, indicating the availability of additional sources of income, along with the possible use of savings. Countries with sufficient fiscal space were able to introduce fiscal support programmes to shield the most vulnerable households from rising prices. In poorer countries of the region, households had to rely more on remittances or consumer loans to finance their consumption.

Figure 2.7 / Household consumption and gross monthly wages in 2022, real, % change year on year, annual



Source: wiiw Annual Database incorporating national and Eurostat statistics.

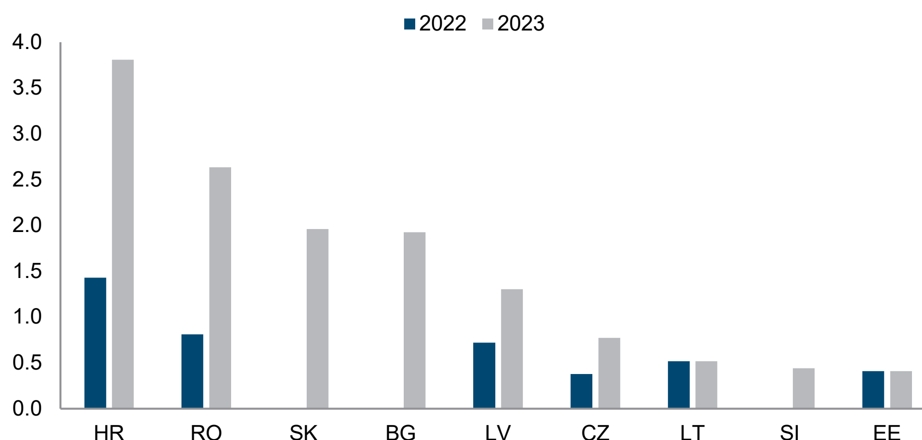
In order to cushion the blow of higher prices, CESEE governments introduced fiscal packages to subsidise household incomes (Figure 2.8). These measures included energy price caps, energy subsidies and social assistance programmes. The countries worst affected by the energy price hikes were those that had previously depended most on imports of Russian gas (Slovakia, Czechia and the Baltic countries), while soaring food prices had the greatest impact on those countries with the highest shares of the population at risk of poverty – Ukraine, Moldova, Bulgaria, Romania, Turkey and the countries of the Western Balkans (Moshammer, Pindyuk et al., 2022). Overall fiscal support programmes in the region accounted for as much as 8-9% of annual household consumption in Bulgaria, Lithuania and Czechia; meanwhile, they accounted for less than 2% in Moldova and Montenegro, which are constrained by their tight fiscal space.

Figure 2.8 / Government funding to shield households and firms from the rising energy prices, percentage shares in 2021 household consumption

Source: WB (2023); G. Sgaravatti, S. Tagliapietra, C. Trasi and G. Zachmann (2021) 'National policies to shield consumers from rising energy prices', Bruegel Datasets, first published 4 November 2021, available at https://www.bruegel.org/dataset/national-policies-shield-consumers-rising-energy-prices; wiiw Annual Database incorporating national and Eurostat statistics, own calculations

The countries of EU-CEE have been able to benefit from access to the resources of the EU Recovery and Resilience Facility (RRF) to finance their fiscal packages, but the speed of drawdown of these funds has varied widely across the region. By the end of March 2023, there had been a noticeable increase in disbursements under RRF, compared to June 2022, in seven of the 11 EU-CEE countries (Figure 2.9). RRF funds have played the most important role in Croatia and Romania, where they accounted for 3.8% and 2.6%, respectively, of 2021 GDP. Over the forecast period, the mobilisation of EU transfers will continue to be crucial for all eligible countries, in order to counteract the cost-of-living crisis.

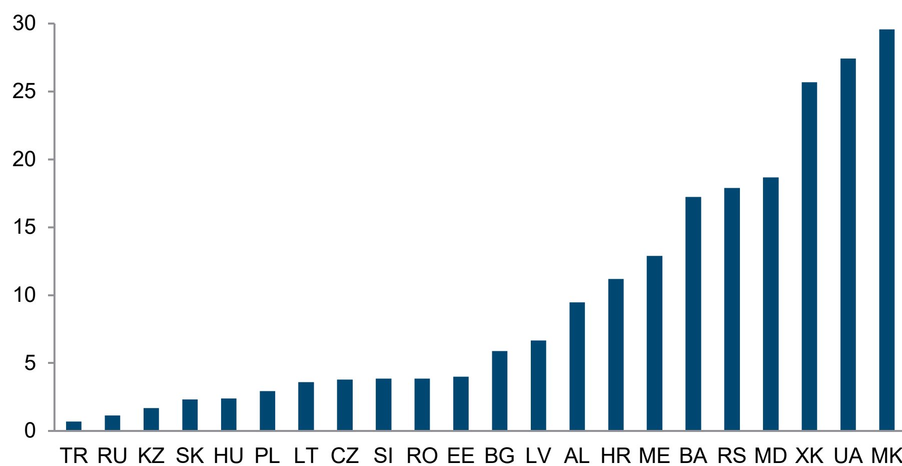
Figure 2.9 / Disbursements made under RRF by mid-June 2022 and by end-March 2023, percentage shares in 2021 GDP



Note: Hungary and Poland are not included because they have not yet drawn down any funds.
Source: European Commission.

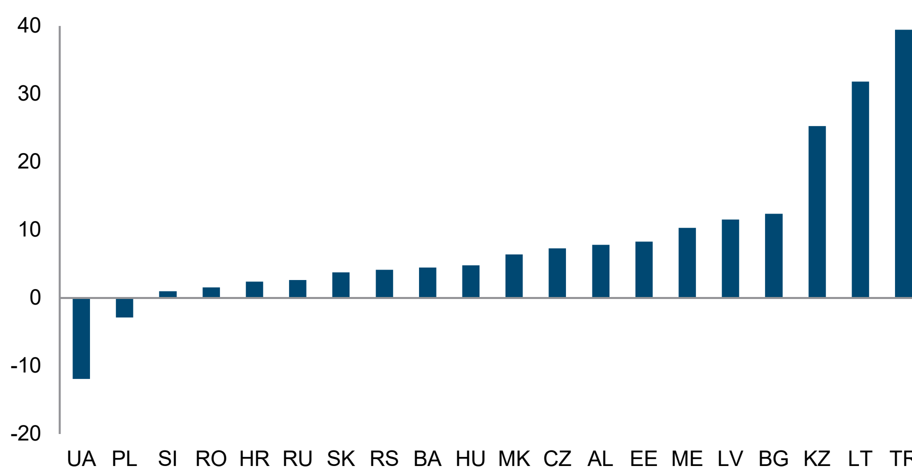
Households in the Western Balkans, Ukraine and Moldova have instead relied on remittances to finance a large share of their expenditure (Figure 2.10). In North Macedonia and Kosovo, remittances (proxied by received secondary income from the balance of payments) accounted for more than a quarter of household consumption in 2022. In Moldova and Serbia, remittances financed 18% of annual household consumption.

Figure 2.10 / Share of secondary income, credit, in household consumption in 2022, %



Note: Remittances account for the bulk of secondary income inflows in the region. In Ukraine, grants and humanitarian aid accounted for about a half of secondary income inflows in 2022.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

Figure 2.11 / Change in stock of consumer loans in 2022, year on year, %



Note: In Hungary loans are defined as loans to households excluding overdraft and housing; in Russia – loans to households excluding housing.
Source: National statistical offices, own calculations.

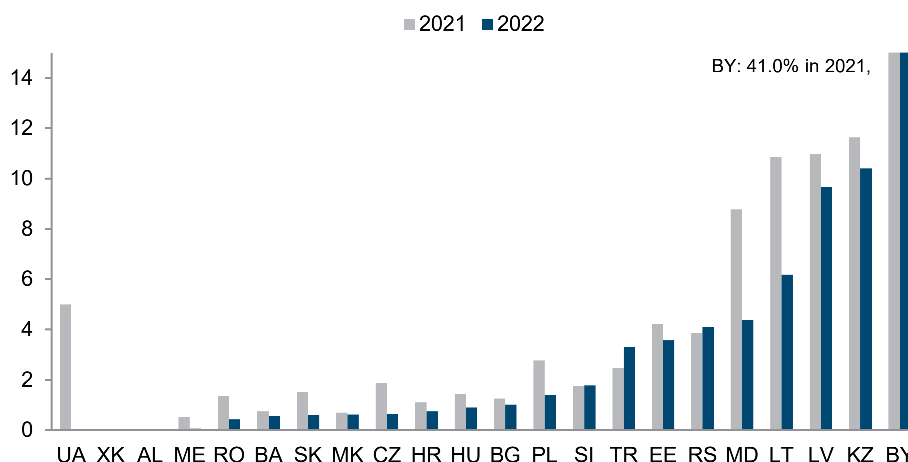
Consumer lending continued to expand in 2022 in all CESEE countries, apart from Ukraine and Poland (Figure 2.11). It grew particularly strongly in Turkey, Lithuania and Kazakhstan – by 39%, 32% and 25%, respectively, compared to 2021. This source of consumption financing is hardly sustainable in

the longer run, especially with rising interest rates on loans making it harder for cash-strapped borrowers to repay their debts. Also, in all CESEE countries apart from Albania, Kazakhstan and Lithuania, high inflation meant that real credit growth was negative; so it is not the growth driver that it would seem to be, based on the nominal figures.

2.4. CESEE HAS CONTINUED TO DECOUPLE FROM RUSSIA, BUT THE GREEN TRANSITION HAS NOT ADVANCED FAR YET

Russia's share of countries' exports decreased further in 2022 in all CESEE economies, apart from Belarus, Serbia, Slovenia and Turkey (Figure 2.12). New sectoral sanctions on Belarus's economy – which saw it completely decoupled from the Western markets – forced the country into heavier dependence on Russia (see Belarus report). The most significant export reorientation away from Russia was observed in Lithuania and Moldova: in 2022, Russia's share of Lithuanian exports fell by 5 pp, while Moldovan exports to Russia were down 4 pp. In Slovenia, Serbia and Turkey, by contrast, the share of exports to Russia increased; in the case of the latter two countries, this is largely attributable to the re-export of sanctioned goods from the EU.

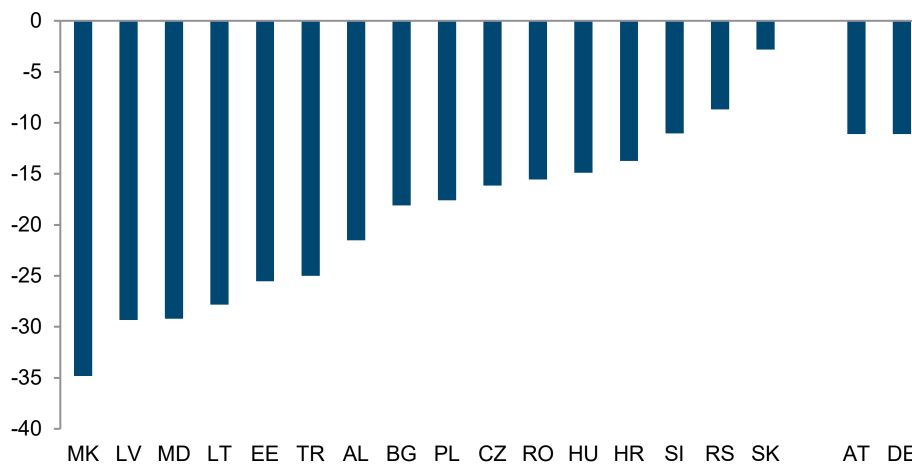
Figure 2.12 / Share of exports to Russia in total exports, %



Note: 2022 data for Belarus are for January-June; 2022 data for Ukraine are not available.
Source: National statistical offices, wiiw Annual Database, wiiw calculations.

CESEE countries also managed to drastically reduce their natural gas consumption and wean themselves off their dependency on Russian fossil fuels. Fast action by governments and industry – in addition to luck with the weather – allowed the CESEE countries to avoid the looming catastrophe as Russia weaponised its energy exports. Most countries in the region managed to reduce their natural gas consumption more rapidly than either Austria or Germany. The biggest year-on-year declines in gas consumption were achieved in North Macedonia (35%), Latvia (and Moldova (29% each) (Figure 2.13). Slovakia was the least successful in this respect, as it managed to cut its gas consumption by only 3% compared to the previous year.

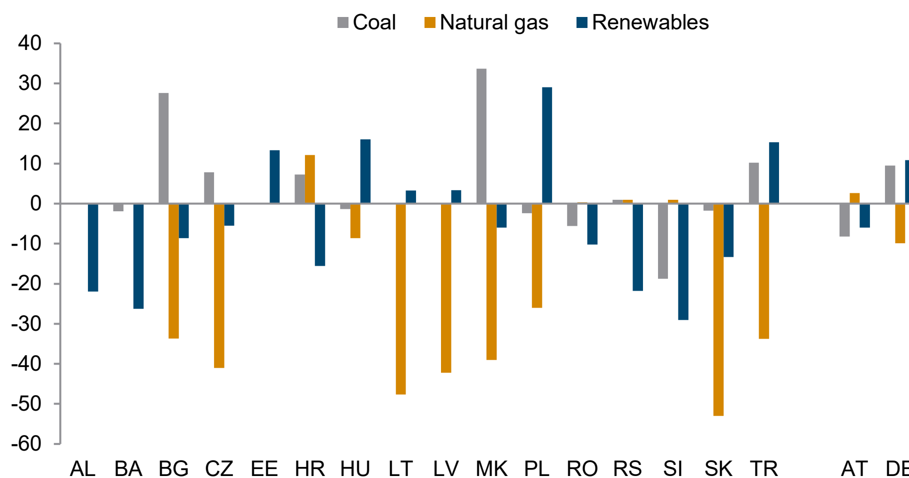
Figure 2.13 / Observed inland consumption of natural gas in 2022, percentage change year on year



Source: Eurostat, own calculations.

However, many CESEE countries reverted to increased coal use in order to compensate for the decline in natural gas consumption. As many feared, cutting dependency on Russia in an environmentally friendly way has proved difficult to achieve in the short run, regardless of the various green transition support schemes, such as the REPowerEU Plan. The most striking year-on-year increase in the use of coal in electricity generation in 2022 was recorded in North Macedonia (33.7%) and Bulgaria (27.6%) (Figure 2.14). Germany also increased its coal use by 10% last year. Only Slovenia and Romania were able to significantly reduce the use of coal in their electricity generating activities – by 19% and 6%, respectively, year on year.

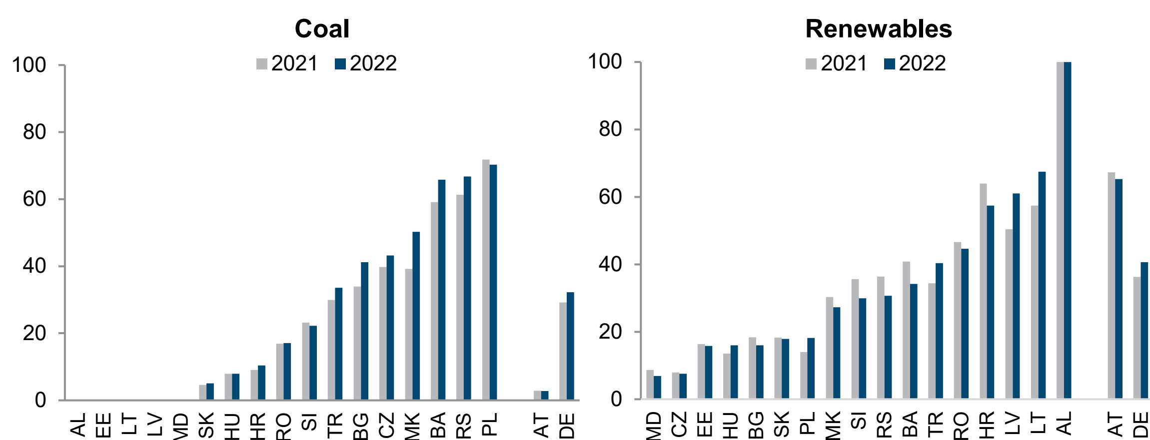
Figure 2.14 / Net electricity generation by type of fuel in 2022, percentage change year on year



Source: Eurostat, own calculations.

As a result, the share of renewable energy in electricity generation mostly decreased in CESEE, while the share of coal increased (Figure 2.15). In most countries of the region – except for Albania, Lithuania, Latvia and Croatia – renewable sources of energy account for less than half of the fuel mix in electricity generation; moreover, the share of renewables fell in 2022 in all countries, apart from Latvia, Lithuania, Turkey, Hungary and Poland. Opposite trends were observed with respect to coal use, the share of which in the fuel mix in electricity generation generally increased – with the exception of those countries with zero use of coal (Albania, Moldova and the Baltic countries), plus Poland and Slovenia. In many CESEE countries, the share of coal remains much higher than in Germany and accounts for as much as 70% of the fuel mix in electricity generation in Poland, 67% in Serbia and 66% in Bosnia and Herzegovina.

Figure 2.15 / Shares of coal and renewable energy in net electricity generation, %



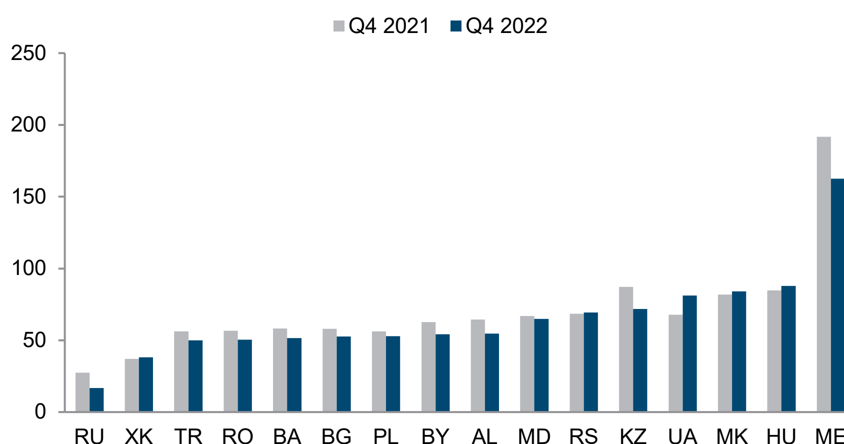
Note: Renewables consist of solar, wind, hydropower and geothermal energy.
Source: Eurostat, own calculations.

2.5. TIGHTER FINANCIAL CONDITIONS POSE RISKS FOR COUNTRIES WITH FINANCIAL VULNERABILITIES

A sharp tightening of financial conditions after the era of ultra-low interest rates poses a risk for CESEE countries with high levels of debt. Though the external-debt-to-GDP ratio dropped in 2022 in most of the region (Figure 2.16) owing to the rise in prices inflating nominal GDP and higher interest rates causing a downward revaluation of the stock of bonds, countries need to deal with the surging costs of debt servicing. External debt as a share of GDP increased in only a few countries – most notably Ukraine (by 13.3 pp in Q4 2022 compared to Q4 2021), as it has to rely heavily on external financing to keep its economy afloat under wartime conditions (see Ukraine report). Apart from Ukraine, the share of external debt increased slightly in Hungary, North Macedonia, Kosovo and Serbia. All other countries saw their external debt fall last year, relative to the size of their economies – most dramatically in Montenegro, by 29 pp. Still, the stock of external debt in that country remains the highest in the region as a proportion of GDP (163%). Hungary and North Macedonia have accumulated gross external debt above 80% of GDP. High levels of debt, accompanied by weak anticipated economic growth, could herald problems with debt servicing in the future.

The banking sector in CESEE has so far held up well, but the adjustment to rapid increases in policy and lending rates might prove painful. The collapse of several banks in the United States and Credit Suisse in Switzerland in March 2023 has raised concerns about the health of the banking sector. Although these cases are believed to be isolated and are attributable to the maturity mismatch on the balance sheets, aggravated by the rapid interest rate rises, the events also point to potential structural vulnerabilities in the banking sector, which must undergo a major rebalancing of its balance sheets. The rates of non-performing loans remain low across CESEE, with the exception of Ukraine, and a big difference between deposit rates and loan interest rates has allowed banks to make record profits. However, they have likely accumulated substantial unrealised losses on their balance sheets, as fixed-rate government bonds and loans have been losing value due to rising interest rates. Banks with a higher share of loans at variable rates, on the other hand, risk a wave of defaults from borrowers who can no longer afford to service their debts. Mortgage loans are especially at risk now, as there appears to be a reversal of an almost decade-long boom in residential property markets, and the inflated real estate prices have started to fall in some countries. Deposit withdrawals by clients in search of better returns could threaten the liquidity of banks and bring to the fore possible issues with maturity mismatch. According to the ECB,[6] depositors withdrew EUR 214bn from euro area banks in the period October 2022 to February 2023, with outflows hitting a record level in February.

Figure 2.16 / Gross external debt, nominal, % of GDP



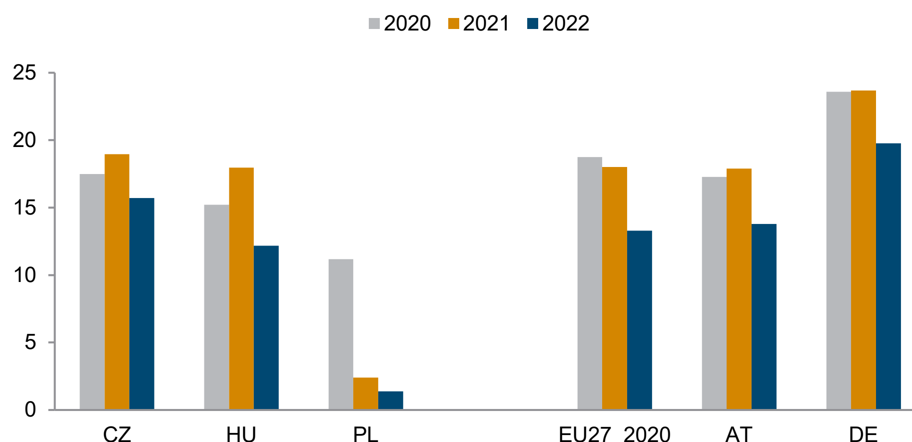
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

There are some indications that aggregate savings built up early in the pandemic – which may have provided a buffer for households and firms struggling to cope with higher prices and interest rates – have been declining. Available quarterly data show that gross household savings rates declined in 2022 on average in the EU, with the most dramatic fall observed in Poland (Figure 2.17), where it reached 1.4% on average during Q1-Q3 2022, down almost 10 pp on the same period of 2020. Hungarian and Czech households also had to decrease their savings, arriving at savings rates of 12.2% and 15.7%, respectively – markedly lower than the rate of German households (19.8%). The current savings rates roughly correspond to the pre-pandemic levels for these countries; only in

6 https://www.ecb.europa.eu/press/pr/stats/md/html/ecb.md2302~952f671d72.en.html

Czechia and Germany do they remain elevated (by about 3-4 pp). Thus, we can conclude that pandemic-enforced savings are likely to have been largely spent in many countries.

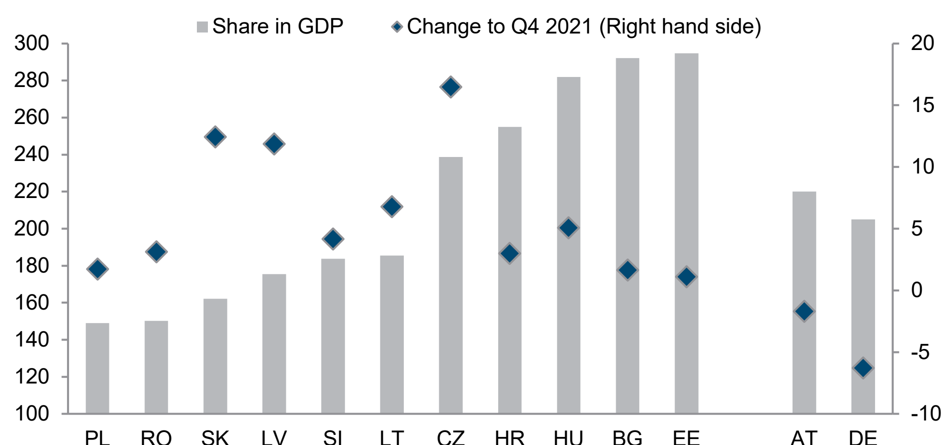
Figure 2.17 / Gross household savings rate, average in Q1-Q3 of respective year, %



Source: Eurostat, own calculations.

Companies in many CESEE countries emerged from the pandemic with high financial liabilities, but raising funding could prove hard under tighter financial conditions. This is most relevant for the corporate sector in Estonia, Bulgaria, Hungary, Croatia and Czechia, where the total financial liabilities of non-financial corporations in Q3 2022 exceeded 230% of GDP, noticeably outpacing levels in the corporate sector of Austria and Germany. De Haas and Bircan (2022) estimate that around 20-25% of all firms in the emerging Europe are currently financially vulnerable – and about a quarter of those can be classified as ‘zombies’: firms that are in distress, but avoid default thanks to their continued access to cheap funding. This suggests that the adjustment to tighter financing conditions could turn out to be quite painful in some countries of the region.

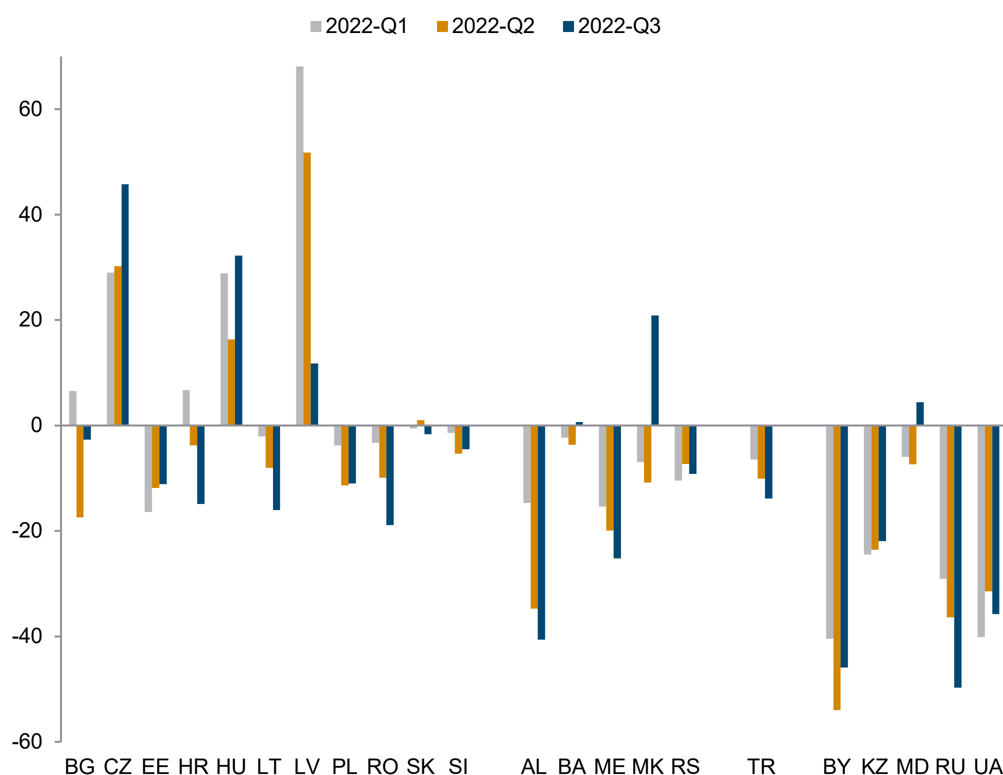
Figure 2.18 / Total financial liabilities of non-financial corporations in Q3 2022, % share of GDP and change to Q4 2021, pp



Source: Eurostat, own calculations.

The access of banks to funding worsened with decreasing cross-border bank credit. The decline in cross-border bank claims has been sharpest in the CIS and Ukraine; particularly affected have been Russia and Belarus (due to the international sanctions), as well as the Western Balkans (Figure 2.19). Among the EU-CEE countries, only Czechia, Hungary and Latvia had positive cross-border bank claims in Q3 2022; in other countries, parent bank groups appear to have been reducing their exposure to the region. In Russia, the situation has been exacerbated by the international sanctions on banks.

Figure 2.19 / Cross-border consolidated bank claims on guarantor basis in nominal USD terms, change year on year, %



Source: Bank for International Settlements, own calculations.

2.6. FORECASTS FOR 2023-2025: INFLATION TO PERSIST, BUT THE ECONOMIES WILL START RECOVERING

We expect inflation to take longer to slow down than we previously thought, and so have revised our 2023 forecast for it upwards in most CESEE countries (Table 2.1). In many countries, it will remain in double digits, with Turkey continuing to have the most rapid price growth in the region. The Western Balkan countries on average are expected to have the lowest CPI growth, while the CIS countries and Ukraine will have the highest inflation (after Turkey). Hungary stands out among EU-CEE members as having the second-highest inflation rate in CESEE, after Turkey.

Inflation is expected to subside across the region in 2024-2025, but it will still exceed 2% in all countries, apart from Estonia. The Western Balkans will continue to have the lowest CPI growth among CESEE countries, with inflation rates being practically uniform in all six countries. Turkey will still have uncomfortably high inflation of 30% even in 2025. Belarus will be the only other country in the region with double-digit CPI growth in 2025. In EU-CEE, Bulgaria and Hungary will be the least successful in bringing inflation down.

Table 2.1 / CPI growth forecasts and direction of revisions since wiiw winter forecast 2023

Region	2023	2024	2025
EU-CEE			
BG Bulgaria	10.0	7.0	5.0
CZ Czechia	10.4 ▲	4.0	3.0
EE Estonia	9.5 ▲	2.5 ▼	1.8 ▼
HR Croatia	6.5 ▲	4.0 ▲	3.0 ▲
HU Hungary	18.5 ▲	8.0 ▼	5.0 ▼
LT Lithuania	10.0 ▲	4.0 ▲	2.8
LV Latvia	11.0 ▲	4.0 ▼	3.2 ▼
PL Poland	12.5 ▼	6.0	4.0
RO Romania	9.0 ▼	5.0 ▼	4.0
SI Slovenia	6.4 ▼	3.2 ▼	2.4 ▲
SK Slovakia	10.2 ▲	5.0	3.0
Western Balkans			
AL Albania	4.0	3.0	2.5 ▼
BA Bosnia and Herzegovina	9.0 ▲	4.0 ▲	2.5 ▲
ME Montenegro	10.0 ▲	4.0 ▲	2.8 ▲
MK North Macedonia	9.0 ▼	4.0	3.0
RS Serbia	10.0 ▲	4.0	3.0
XK Kosovo	7.0	4.0 ▲	2.5 ▲
Turkey			
TR Turkey	47.7 ▲	38.2 ▲	30.0 ▲
CIS+UA			
BY Belarus	12.0	11.0	10.0
KZ Kazakhstan	14.0 ▲	9.0	6.0
MD Moldova	14.0	6.0	5.0 ▼
RU Russia	5.4	4.6 ▲	3.4 ▲
UA Ukraine	17.0 ▲	9.0	7.0

Note: Colour scale variation from the maximum (dark grey) to the minimum (dark orange).
Source: wiiw.

Table 2.2 / Real GDP growth forecasts

Region	2023		2024		2025	
EU-CEE						
BG Bulgaria	1.7	▲	2.2	▼	2.7	▼
CZ Czechia	0.2	▼	2.4		2.7	
EE Estonia	0.4	▼	2.6	▼	3.1	▼
HR Croatia	2.5		2.9	▲	3.1	▲
HU Hungary	-0.5	▲	1.5	▼	1.7	▼
LT Lithuania	0.9	▼	2.6	▼	2.5	▼
LV Latvia	0.3	▲	2.5	▼	2.3	▼
PL Poland	1.0		2.4		3.2	▲
RO Romania	3.0	▲	4.0		4.3	▲
SI Slovenia	1.4	▲	2.5	▼	2.7	▼
SK Slovakia	0.6		2.5	▲	2.2	▼
Western Balkans						
AL Albania	3.3	▲	3.8	▲	4.0	▲
BA Bosnia and Herzegovina	1.7	▲	1.9	▼	2.5	
ME Montenegro	2.9	▲	3.2	▼	3.0	
MK North Macedonia	1.6	▲	2.5		3.0	▲
RS Serbia	1.5		2.6		3.0	
XK Kosovo	3.6	▲	3.9	▲	4.1	▲
Turkey						
TR Turkey	2.6	▼	3.4	▲	3.8	▼
CIS+UA						
BY Belarus	1.3	▲	1.6	▲	2.0	▲
KZ Kazakhstan	3.5		4.0		4.0	
MD Moldova	3.0	▲	4.0		4.0	▼
RU Russia	0.0	▲	1.0		1.5	
UA Ukraine	1.6	▼	3.4	▼	5.0	▼

Note: Colour scale variation from the minimum (dark grey) to the maximum (dark orange).
Source: wiiw.

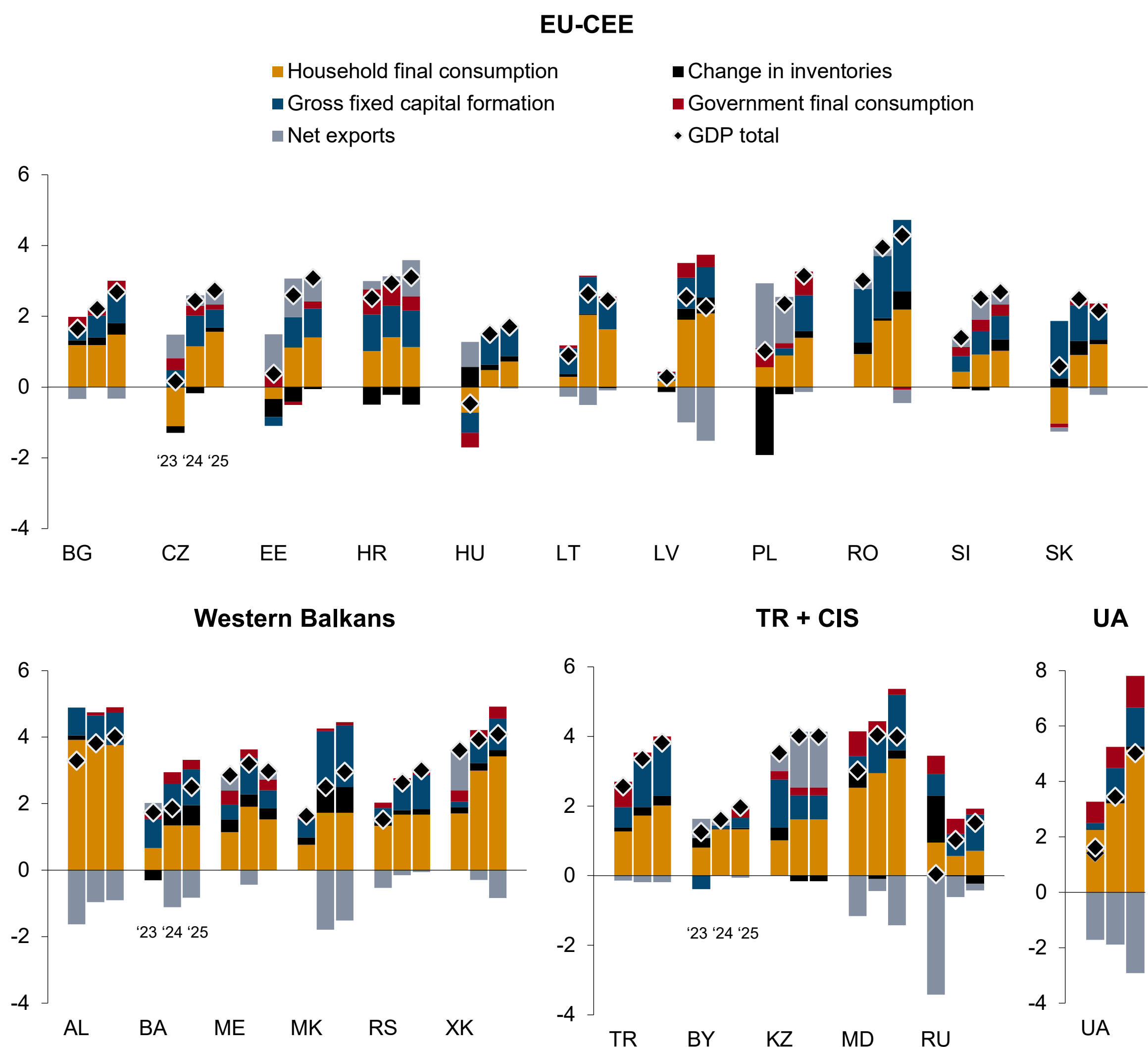
Notwithstanding the persistent inflation, the region will mostly avoid recession in 2023 (Table 2.2). Only Hungary, which is struggling with rampant inflation and difficulties in accessing EU funds, is forecast to have negative GDP growth this year. The Western Balkans will have on average the strongest economic growth in the region, with average GDP growth of 2%. In EU-CEE, economic performance will be very uneven: Romania and Croatia are expected to grow by 3.0% and 2.5%, respectively (based on the weighted average growth rates), while the Baltic countries, Czechia and Slovakia will expand at below 1%. We have revised downwards our GDP forecast for Ukraine (to 1.6%), as the damage caused to the country's energy infrastructure by Russian missile attacks has raised costs for the economy and

aggravated supply-chain issues. The forecast is subject to high downside risks related primarily to the intensity and duration of Russia's war in Ukraine and the continued willingness of Ukraine's international partners to support it (see Ukraine report). The forecast for the Russian economy, by contrast, has improved, and now the country is expected to avoid recession and merely stagnate this year, since the economy is believed to have stabilised, having adjusted to the Western sanctions (see Russia report).

In 2024-2025 we expect an overall acceleration of economic growth across the region, primarily on the back of a recovery in private consumption (Figure 2.20). Investment is also expected to recover, but its contribution to economic growth will be overall quite modest –except for in Croatia, Romania and North Macedonia: in those countries it will grow on a par with household final consumption, supported to a large extent by FDI inflows and (in the case of the first two countries) by EU funds.

Figure 2.20 / GDP growth forecast for 2023-2025

and contribution of individual demand components in percentage points

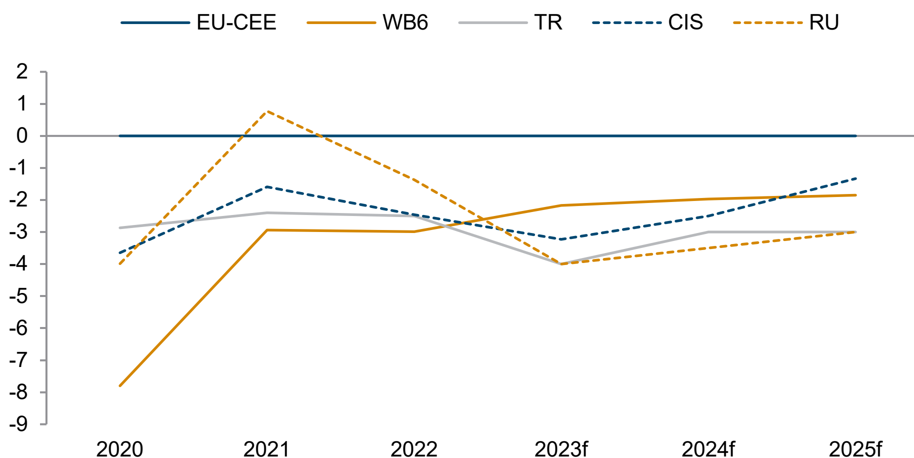


Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculations. Forecasts by wiiw.

Southeast Europe is expected to put in a better economic performance than the Visegrád group over the forecast period. The Visegrád countries have been struggling for some time with their economic model, based as it is on labour-cost advantages and participation in regional production chains (Pindyuk et al., 2020). Although growth rates in the CESEE countries will be mostly lower than they were before the global economic crisis, the region will still outperform the euro area, indicating that the economic catch-up process is still ongoing, albeit at a slower pace.

Fiscal consolidation will be very slow and fiscal balances will remain in the red. The widest budget deficit in the region is expected to be in Ukraine, where the bulk of the deficit will be further financed through official Western assistance. Aside from Ukraine, EU-CEE, Turkey and Russia are forecast to have the highest budget deficits in 2025, at around 3% of GDP on average. The countries of the Western Balkans will have to consolidate their public finances much faster than the rest, due to fiscal space constraints; Bosnia and Herzegovina will be the only country in the CESEE region to run a budget surplus during the forecast period.

Figure 2.21 / Fiscal balance in % of GDP



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

Table 2.3 / OVERVIEW 2021-2022 AND OUTLOOK 2023-2025

		GDP real change in % against prev. year					Consumer prices average change in % against prev. year					Unemployment (LFS) rate in %, annual average				
				Forecast					Forecast					Forecast		
		2021	2022	2023	2024	2025	2021	2022	2023	2024	2025	2021	2022	2023	2024	2025
BG	Bulgaria	7.6	3.4	1.7	2.2	2.7	2.8	13.0	10.0	7.0	5.0	5.3	4.3	4.3	4.2	4.2
CZ	Czechia	3.6	2.5	0.2	2.4	2.7	3.3	14.8	10.4	4.0	3.0	2.8	2.3	2.7	2.6	2.6
EE	Estonia	8.0	-1.3	0.4	2.6	3.1	4.5	19.4	9.5	2.5	1.8	6.2	5.6	7.0	6.2	5.6
HR	Croatia	13.1	6.3	2.5	2.9	3.1	2.7	10.7	6.5	4.0	3.0	7.6	7.0	6.8	6.7	6.6
HU	Hungary	7.2	4.6	-0.5	1.5	1.7	5.2	15.3	18.5	8.0	5.0	4.1	3.6	4.5	4.0	3.6
LT	Lithuania	6.0	1.9	0.9	2.6	2.5	4.6	18.9	10.0	4.0	2.8	7.1	6.0	6.8	6.5	6.0
LV	Latvia	4.1	2.0	0.3	2.5	2.3	3.2	17.2	11.0	4.0	3.2	7.6	6.8	7.2	6.8	6.6
PL	Poland	6.8	4.9	1.0	2.4	3.2	5.2	13.2	12.5	6.0	4.0	3.4	2.9	3.4	3.6	3.8
RO	Romania	5.8	4.8	3.0	4.0	4.3	4.1	12.0	9.0	5.0	4.0	5.6	5.6	5.8	5.4	5.2
SI	Slovenia	8.2	5.4	1.4	2.5	2.7	2.0	9.3	6.4	3.2	2.4	4.8	4.0	4.0	3.9	3.9
SK	Slovakia	3.0	1.7	0.6	2.5	2.2	2.8	12.1	10.2	5.0	3.0	6.8	6.1	6.3	6.2	6.0
	EU-CEE11 1)2)	*6.3*	*4.1*	*1.2*	*2.6*	*3.1*	*4.3*	*13.5*	*11.4*	*5.5*	*3.8*	*4.5*	*4.0*	*4.4*	*4.4*	*4.3*
	EA20 3)	*5.4*	*3.5*	*0.5*	*1.8*	*1.7*	*2.6*	*8.5*	*5.7*	*3.0*	*2.3*	*7.7*	*6.8*	*6.6*	*6.6*	*6.6*
	EU27 3)	*5.4*	*3.5*	*0.7*	*2.0*	*1.9*	*2.9*	*9.0*	*5.9*	*3.2*	*2.5*	*7.0*	*6.0*	*5.8*	*5.8*	*5.8*
AL	Albania	8.9	4.8	3.3	3.8	4.0	2.0	6.7	4.0	3.0	2.5	11.5	10.9	10.5	10.0	9.5
BA	Bosnia and Herzegovina	7.4	3.9	1.7	1.9	2.5	2.0	14.0	9.0	4.0	2.5	17.4	15.4	15.0	14.7	14.4
ME	Montenegro	13.0	6.1	2.9	3.2	3.0	2.4	13.0	10.0	4.0	2.8	16.6	14.7	13.8	13.1	12.0
MK	North Macedonia	3.9	2.1	1.6	2.5	3.0	3.2	14.2	9.0	4.0	3.0	15.7	14.4	14.0	13.0	12.0
RS	Serbia	7.5	2.3	1.5	2.6	3.0	4.1	11.9	10.0	4.0	3.0	11.0	9.4	9.0	8.5	8.0
XK	Kosovo	10.7	3.5	3.6	3.9	4.1	3.4	11.6	7.0	4.0	2.5	20.7	18.0	17.0	16.5	16.0
	WB6 1)2)	*7.8*	*3.2*	*2.0*	*2.8*	*3.1*	*3.2*	*11.9*	*8.7*	*3.9*	*2.8*	*13.6*	*12.1*	*11.6*	*11.1*	*10.5*
TR	Turkey	11.4	5.6	2.6	3.4	3.8	19.6	72.3	47.7	38.2	30.0	12.0	10.5	10.0	9.5	9.0
BY	Belarus	2.4	-4.7	1.3	1.6	2.0	9.5	15.2	12.0	11.0	10.0	3.9	3.6	3.8	4.0	4.0
KZ	Kazakhstan	4.3	3.2	3.5	4.0	4.0	8.0	15.0	14.0	9.0	6.0	4.9	4.9	4.8	4.8	4.8
MD	Moldova	13.9	-5.9	3.0	4.0	4.0	5.1	28.7	14.0	6.0	5.0	3.2	3.1	3.5	3.2	3.0
RU	Russia	5.6	-2.1	0.0	1.0	1.5	6.7	13.8	5.4	4.6	3.4	4.8	3.9	4.0	4.0	3.8
UA	Ukraine	3.4	-29.1	1.6	3.4	5.0	9.4	20.2	17.0	9.0	7.0	9.9	25.0	20.0	15.0	10.0
	CIS4+UA 1)2)	*5.3*	*-3.7*	*0.5*	*1.5*	*2.0*	*7.1*	*14.5*	*7.3*	*5.6*	*4.1*	*5.6*	*7.4*	*6.5*	*5.7*	*4.7*
	V4 1)2)	*6.0*	*4.1*	*0.6*	*2.3*	*2.8*	*4.6*	*13.7*	*12.8*	*5.8*	*3.9*	*3.7*	*3.2*	*3.7*	*3.7*	*3.8*
	BALT3 1)2)	*5.9*	*1.2*	*0.6*	*2.6*	*2.6*	*4.2*	*18.5*	*10.2*	*3.7*	*2.7*	*7.0*	*6.1*	*7.0*	*6.5*	*6.1*
	SEE9 1)2)	*7.3*	*4.4*	*2.5*	*3.3*	*3.7*	*3.6*	*12.0*	*8.8*	*4.9*	*3.8*	*8.7*	*7.9*	*7.7*	*7.4*	*7.1*
	CIS3+UA 1)2)	*3.9*	*-10.2*	*2.4*	*3.4*	*4.1*	*8.7*	*17.4*	*14.8*	*9.2*	*7.0*	*7.3*	*15.3*	*12.6*	*9.9*	*7.3*
	non-EU12 1)2)	*7.0*	*-0.7*	*1.2*	*2.1*	*2.6*	*10.5*	*31.5*	*19.3*	*15.2*	*11.8*	*7.4*	*8.4*	*7.6*	*6.8*	*6.1*
	CESEE23 1)2)	*6.8*	*0.8*	*1.2*	*2.3*	*2.7*	*8.7*	*25.9*	*16.9*	*12.2*	*9.3*	*6.7*	*7.3*	*6.8*	*6.2*	*5.6*

Table 2.3 / (contd.)

		Current account in % of GDP					Fiscal balance in % of GDP				
				Forecast					Forecast		
		2021	2022	2023	2024	2025	2021	2022	2023	2024	2025
BG	Bulgaria	-1.9	-0.7	-0.5	-0.3	0.3	-3.9	-5.0	-5.0	-4.0	-3.0
CZ	Czechia	-2.8	-6.1	-2.8	-1.7	-0.5	-5.1	-3.9	-4.2	-2.5	-1.9
EE	Estonia	-1.8	-2.2	0.7	1.8	1.4	-2.4	-2.0	-4.0	-3.3	-3.0
HR	Croatia	3.1	-3.3	-2.6	-2.1	-0.6	-2.6	-1.9	-2.4	-2.0	-1.8
HU	Hungary	-4.1	-8.1	-4.0	-2.8	-2.0	-7.1	-6.1	-4.5	-4.0	-3.3
LT	Lithuania	1.1	-5.1	-4.9	-4.8	-4.7	-1.0	-2.0	-5.0	-3.0	-2.0
LV	Latvia	-4.2	-6.4	-4.1	-2.6	-1.6	-7.0	-4.8	-4.5	-3.0	-2.0
PL	Poland	-1.4	-3.0	-0.3	0.4	1.0	-1.8	-3.5	-4.8	-4.0	-3.5
RO	Romania	-7.2	-9.3	-7.0	-5.9	-4.9	-7.1	-6.0	-5.3	-4.5	-4.0
SI	Slovenia	3.8	-0.4	0.8	0.8	0.7	-4.7	-3.8	-4.2	-2.6	-2.2
SK	Slovakia	-2.5	-8.3	-5.0	-3.1	-2.6	-5.5	-3.5	-6.0	-4.4	-4.5
	EU-CEE11 [1)2)]	*-2.5*	*-5.2*	*-2.6*	*-1.7*	*-1.0*	*-4.1*	*-4.2*	*-4.7*	*-3.7*	*-3.2*
	EA20 [3)]	*3.8*	*0.5*	*1.0*	*1.5*	*2.5*	*-5.1*	*-4.3*	*-3.7*	*-2.7*	*-2.6*
	EU27 [3)]	*3.4*	*0.5*	*1.0*	*1.5*	*2.5*	*-4.6*	*-3.9*	*-3.3*	*-2.3*	*-2.2*
AL	Albania	-7.7	-6.0	-5.9	-5.8	-5.8	-4.6	-3.7	-2.5	-2.5	-2.5
BA	Bosnia and Herzegovina	-2.4	-4.5	-4.0	-4.1	-4.3	-0.3	-1.0	0.5	1.0	1.0
ME	Montenegro	-9.2	-13.3	-11.7	-10.7	-10.0	-1.9	-5.2	-5.0	-4.8	-4.6
MK	North Macedonia	-3.1	-6.0	-4.5	-4.5	-4.4	-5.4	-4.5	-3.0	-2.5	-2.5
RS	Serbia	-4.2	-6.9	-5.8	-4.9	-4.2	-4.1	-3.1	-2.5	-2.0	-1.5
XK	Kosovo	-8.7	-10.5	-9.7	-9.4	-9.3	-1.3	-0.5	-0.5	-1.0	-1.0
	WB6 [1)2)]	*-4.8*	*-6.8*	*-5.9*	*-5.4*	*-5.1*	*-3.4*	*-2.9*	*-2.0*	*-1.7*	*-1.4*
TR	Turkey	-0.9	-5.3	-4.0	-3.0	-2.5	-2.4	-2.5	-4.0	-3.0	-3.0
BY	Belarus	3.1	3.7	1.5	1.2	1.0	0.2	-2.0	-3.0	-2.0	-1.0
KZ	Kazakhstan	-1.3	3.9	-0.5	-1.0	-1.5	-3.0	-2.1	-2.7	-2.5	-2.0
MD	Moldova	-12.4	-15.8	-14.4	-12.2	-11.3	-1.9	-3.3	-4.0	-3.0	-1.0
RU	Russia	6.7	10.4	4.3	3.4	2.7	0.8	-1.4	-4.0	-3.5	-3.0
UA	Ukraine	-1.9	5.0	3.1	-1.4	-4.6	-3.4	-16.3	-27.0	-15.0	-10.0
	CIS4+UA [1)2)]	*5.0*	*9.2*	*3.6*	*2.5*	*1.6*	*0.1*	*-2.4*	*-5.2*	*-4.1*	*-3.3*
	V4 [1)2)]	*-2.2*	*-4.9*	*-1.8*	*-0.8*	*0.0*	*-3.7*	*-4.0*	*-4.7*	*-3.7*	*-3.2*
	BALT3 [1)2)]	*-1.1*	*-4.7*	*-3.3*	*-2.5*	*-2.3*	*-3.0*	*-2.8*	*-4.6*	*-3.1*	*-2.2*
	SEE9 [1)2)]	*-4.6*	*-6.7*	*-5.3*	*-4.5*	*-3.7*	*-5.2*	*-4.6*	*-4.2*	*-3.5*	*-3.0*
	CIS3+UA [1)2)]	*-1.2*	*3.6*	*0.5*	*-1.1*	*-2.5*	*-2.7*	*-7.0*	*-11.0*	*-6.7*	*-4.5*
	non-EU12 [1)2)]	*3.1*	*5.1*	*1.2*	*0.4*	*-0.1*	*-0.7*	*-2.4*	*-4.8*	*-3.7*	*-3.1*
	CESEE23 [1)2)]	*1.1*	*1.6*	*-0.1*	*-0.3*	*-0.4*	*-2.0*	*-3.0*	*-4.8*	*-3.7*	*-3.1*

1) wiiw estimates. - 2) Current account data include transactions within the region (sum over individual countries). -
3) Forecasts estimated by wiiw.
Source: wiiw, Eurostat. Forecasts by wiiw. Cut-off date for historical data and forecasts: 13 April 2023.

2.7. THE DOWNSIDE RISKS REMAIN VERY STRONG

One of the major risks to the forecast is that persistently high inflation will lead to harder lending conditions. Continuing monetary tightening could trigger painful adjustments in the global financial markets, and any vulnerabilities in the domestic banking sector could be aggravated. Sudden capital outflows from the region could disproportionately affect countries with high levels of external debt.

Further stresses could emerge in the real estate markets, where inflated property prices may see a rapid adjustment. Rising interest rates on mortgage loans have significantly increased the cost to variable-rate mortgage holders of servicing their debt, and in some countries there is already a rush to sell and very few buyers. This poses a risk both for the banks (which may face rising non-performing loans) and for the real economy, as households will have to spend an increased proportion of income on their monthly mortgage payments and accordingly will reduce their consumption.

Another significant downside risk is related to a possible deterioration in the security situation of the region. This could come about if Ukraine has problems in securing support from its allies in the event that Donald Trump (or some other candidate with similar views) wins the US presidential election in November 2024: that could mean a reversal of US foreign policy, which would be a blow to Ukraine's military capabilities and economy (see Ukraine report). The increased risk of geopolitical instability in those countries close to the Russian border places them at additional risk from tighter financial conditions. An aggravation of the US-China economic and political confrontation could also have repercussions for CESEE countries.

2.8. CONCLUSIONS

Inflation has proved more persistent than we previously thought it would and has become a drag on economic activity in CESEE countries. Core inflation is still in double digits in all countries, apart from Albania and Slovenia, which indicates that the pass-through of higher costs to prices remains robust. Economies are being hit by a double whammy of aggressive monetary tightening and soaring prices, which especially puts at risk those countries with high levels of indebtedness. EU members with access to RRF funds are in a better position to withstand the crisis.

Nevertheless, the region will mainly avoid recession in 2023, and GDP growth will accelerate in 2024-2025. Only Hungary, which is struggling with rampant inflation and difficulties in accessing EU funds, is forecast to have negative GDP growth in 2023. Southeast Europe will have, on average, faster economic growth than the countries of the Visegrád group over the forecast period, as the latter appear to be struggling with their economic model, based as it is on labour-cost advantages and participation in regional production chains.

The forecast is subject to major downside risks. Harder lending is possible in the economies, if a sharp tightening of financial conditions triggers financial instability. Highly indebted countries are particularly vulnerable to rising costs of debt servicing and to capital outflows. A deterioration in the security situation of the region could have significant negative spill-overs to economic activity.

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3. Austria and CESEE: Resilience of Southeast Europe benefiting Austrian exporters, but ties with Russia yet to break

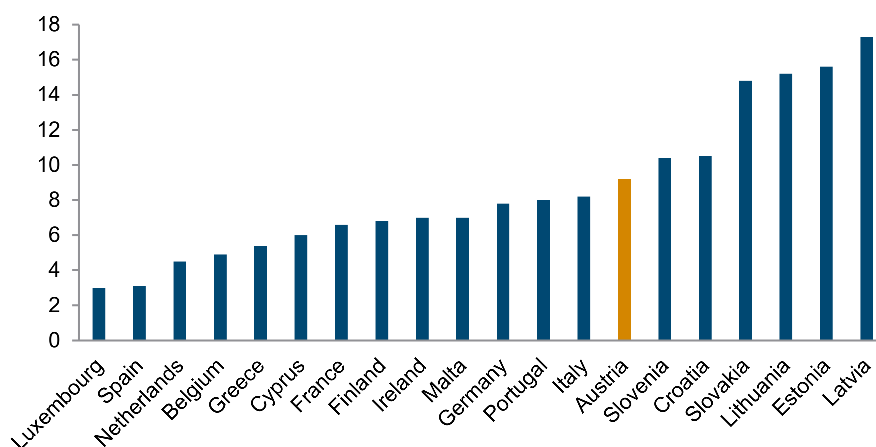
BY RICHARD GRIEVESON

- **The impact of the war and inflation on the Austrian economy is high by Western European standards, but moderate in the context of CESEE.**
- **Austria's trade with CESEE has held up well and continues to outperform its trade with the rest of the world.**
- **Austrian exports to Southeast Europe grew particularly strongly last year, reflecting the relative economic resilience of that region.**
- **Most of the CESEE region will only recover gradually from the war, with negative implications for Austria. Of Austria's main CESEE trading partners, only Romania, Czechia and Slovakia will surpass their 2018-2022 average growth rates in the next two years.**
- **Austrian exports to Russia held up better than EU exports to Russia as a whole in 2022, as Austria exports many non-sanctioned products to Russia, such as food.**
- **Almost two thirds of Austrian firms in Russia are so far continuing operations, despite the invasion – a larger share than in most neighbouring and peer Western countries. A further 16% have reduced operations and are holding off on new investments.**
- **Austria remains one of the most important foreign investors across CESEE, but its relative importance has declined in most of the region since 2013, with its share of the total inward FDI stock falling in 16 of the 23 CESEE countries covered by wiiw between 2013 and 2021.**
- **Relative to its GDP, Austria's financial support for Ukraine since the invasion has been average by EU standards, but it is heavily focused on humanitarian aid, in line with the country's neutral status.**

Austria is much more integrated into the CESEE region than almost any other Western country, and as such has been heavily exposed to the fallout from the war. The EU economy slowed almost to a standstill over the winter, above all due to energy supply disruptions and skyrocketing inflation that is partly driven by the fallout from the war and the exchange of sanctions between Russia and the West; yet it is clear that Central and Eastern Europe has been especially badly affected, compared to Western Europe. According to the European Commission's Winter Forecast, the worst-performing economies in the EU in 2023 will include large parts of EU-CEE, as well as the Nordic countries, Germany and Austria. The euro area's highest rates of inflation are also all in EU-CEE, with Austria not far behind

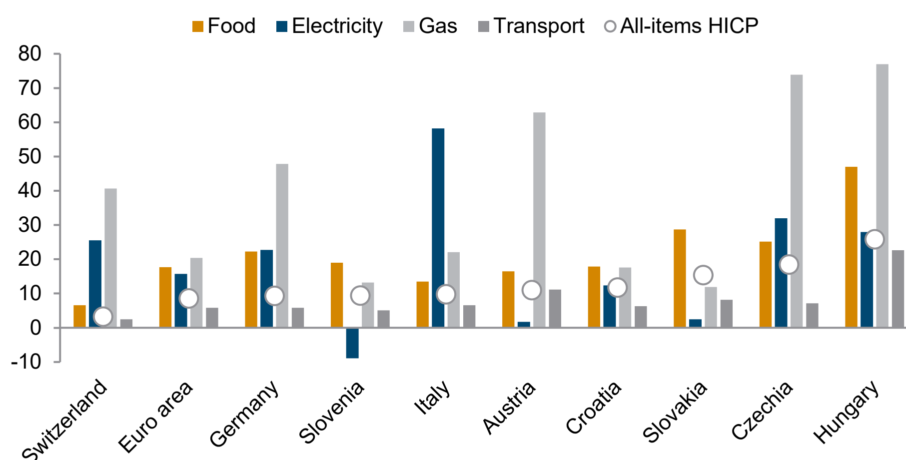
(Figure 3.1). As well as being geographically closer to the conflict, the Central European manufacturing core – of which Austria is a key component – has been affected by higher energy prices (although industry overall has been resilient, given the scale of the external shock).

Figure 3.1 / HICP, percentage change, year on year, March 2023



Source: Eurostat.

Figure 3.2 / HICP and selected sub-components, percentage change, year on year, February 2023



Note: February data are the latest available for the full HICP breakdown.
Source: Eurostat.

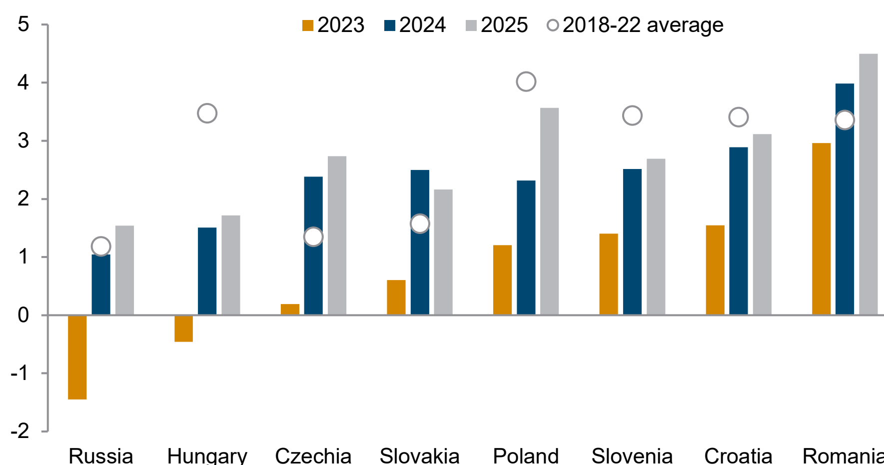
The most important direct impact has been via inflation, to which the war contributed via higher energy prices in Europe. Austrian inflation in March 2023 – as measured by the EU harmonised index of consumer prices (HICP) – rose by 9.2%, down from previous months, but still much higher than the 6.9% recorded for the euro area as a whole or Germany's 7.8%. Austria's inflation rate is substantially higher than most Western European countries, but is well below the levels of CESEE's euro countries (Figure 3.1). Austrian industrial producer prices also show continued pressure, rising by 17.4% year on year in February (latest data available), compared with 13.2% for the euro area as a whole. Relative to

its neighbours, Austria has fairly ‘average’ headline inflation; while it has higher transport and (especially) gas price inflation, electricity price inflation is very low by regional standards (Figure 3.2).

The impact of tighter financial conditions on house prices has also become visible, although so far Austria’s real estate market has been much less affected than its regional peers. Austrian house prices fell by 0.6% between Q3 and Q4 2022, but this decline was much less than in Germany (5%) or in the euro area as a whole (1.7%).

The macroeconomic situation in those parts of CESEE most important to Austria has deteriorated substantially as a result of the war and its fallout, and this will have repercussions for the Austrian economy. In trade and investment terms, Austria’s key partners in the region are the Visegrád countries, Romania, Slovenia, Croatia and Russia. All those economies are currently growing at rates well below both their pre-COVID level and what most of them managed during the post-COVID recovery of 2021. Most are struggling with especially high inflation, as outlined above. Of Austria’s main CESEE trading partners, only Romania, Czechia and Slovakia will surpass their 2018-2022 average growth rates in the next two years; and in the case of the latter two, growth this year will be barely positive (Figure 3.3). Austria has benefited from the fact that most of its key CESEE economic partners had five very good years (even taking into account the 2020 recessions); but in the coming years only Romania looks capable of continuing to expand at a similar rate. The outlook for Russia is particular bleak, but other countries (such as Hungary and Poland) also appear set for fairly lacklustre rates of expansion in the coming years – at least compared to the recent past. Nevertheless, during the forecast period the region will grow more rapidly than the euro area, meaning that convergence will continue.

Figure 3.3 / Real GDP growth, percentage change per year



Sources: National sources, wiiw forecasts.

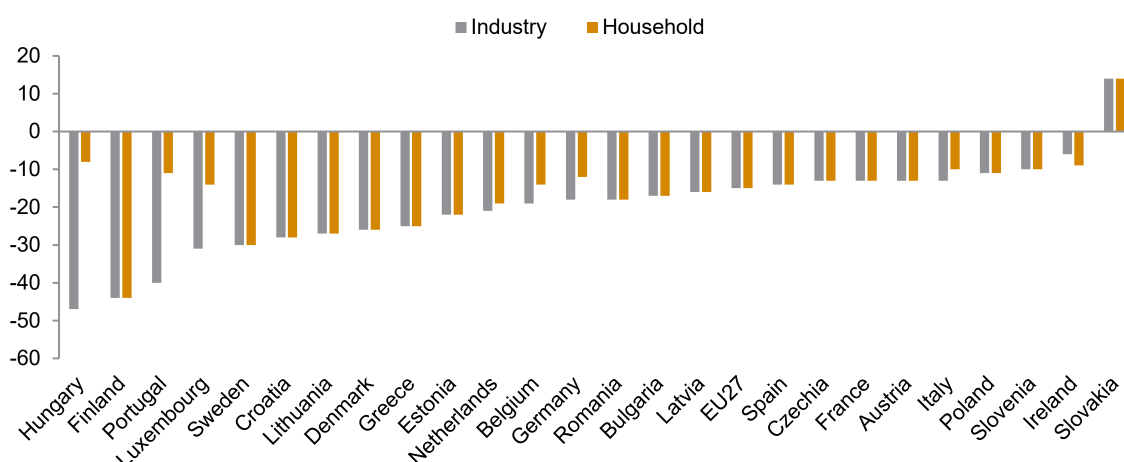
For all the difficulties, however, there has been notable resilience in Austria and CESEE. Compared with some of the doom-laden projections for the region’s economies published immediately after the Russian invasion of Ukraine, much of the region’s economy has held up well. Industry has made impressive reductions in gas demand, without corresponding declines in output. Certain countries of Southeast Europe – Romania, Croatia and Slovenia – are showing a higher level of relative resilience, to the benefit of Austrian firms with exposure in those countries. Those businesses heavily involved with

the Visegrád countries should be prepared for a lacklustre 2023, before the recovery kicks in from the end of this year.

One of the most important channels of economic integration between Austria and CESEE is trade, and preliminary data for 2022 show that, despite the war, Austrian trade with CESEE grew strongly last year, easily outstripping the increase in foreign trade as a whole. The total value of imports from Eastern European[7] countries increased by 28% year on year (compared with 19.8% for imports as a whole), while exports to that region were up by 20.6% (compared with 17.2% for exports as a whole). Both exports to and imports from this region account for over 20% of the total for Austria, making CESEE collectively its most important trading partner after Germany. Exports to key partners in Southeast Europe, in particular, grew very strongly last year, especially to Slovenia (41.2%), Croatia (28%) and Romania (25.8%) – three countries that have shown a high degree of resilience to the fallout from the war.

Austria's trade with Russia has held up considerably better than the EU average. Imports from Russia increased by 76% year on year in 2022 (largely on account of higher gas prices),[8] while exports fell by 8%. Although that 8% decline reflects the impact of the sanctions, it was only a fraction of last year's 38.1% drop in exports from the EU as a whole to Russia. Austria's exports to Russia seem to have held up better than the EU's for a variety of reasons – including the fact that sanctions were phased in only gradually: Austrian exports to Russia fell far more sharply in the final months of 2022. In addition, Austria exports many non-sanctioned products to Russia, such as food.[9] Last year's trade data nevertheless suggest that even as Austrian exports to CESEE as a whole remain strong, there is a relative reorientation away from Russia and towards more nearby parts of the region.

Figure 3.4 / Change in gas demand in 2022 versus 2019-2021 average, %



Source: Bruegel. https://www.bruegel.org/dataset/european-natural-gas-demand-tracker

[7] Defined by Statistik Austria as EU-CEE, the Western Balkans, Belarus, Moldova and Russia.

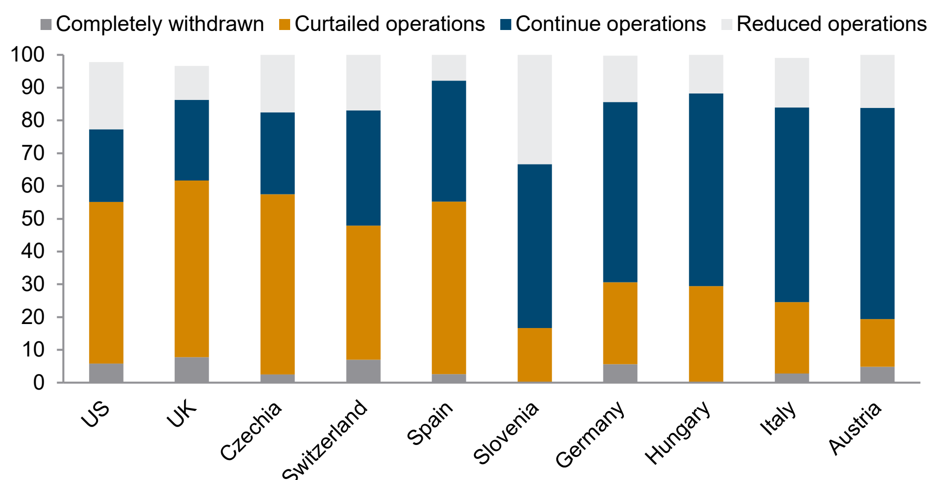
[8] Trade data should be treated cautiously, given the sharp divergence between the growth of volumes and prices, as outlined by Statistik Austria in its press release accompanying the January 2023 trade data. For example, in January the total value of Austrian gas imports increased by 2.7% year on year, yet the volume of these imports declined by 11.3%.

[9] https://www.derstandard.at/story/2000145403487/trotz-scharfer-sanktionen-gingen-oesterreichs-exporte-nach-russland-nur-leicht

Relative to the 2019-2021 average, Austrian demand for gas fell by 13% last year among both households and industry – a fairly small decline in the EU context (Figure 3.4). This is despite the fact that Austrian gas price inflation is so high (see above), and in all likelihood points to generous government support measures in the EU context, which have probably kept demand higher than would otherwise have been the case, as well as to a lack of alternative fuel supplies (given Austria's geographical position as one of the few land-locked countries in Europe). Austria is hence also one of the countries that has continued to receive large volumes of Russian gas, with deliveries from Russia making up 71% of total gas imports in December, according to ENTSOG and E-Control (although one-off factors did distort the data somewhat).[10]

Almost two thirds of Austrian firms in Russia are still continuing operations, despite the invasion – a higher share than in most neighbouring and peer Western countries (Figure 3.5). Although very few firms from any country have withdrawn fully from Russia, given the huge difficulties involved (see the Russia country report), the majority of companies active in Russia from such countries as the US, the UK, Czechia and Spain have either withdrawn or curtailed their operations. By contrast, only 20% of Austrian firms in Russia have done either; meanwhile 65% have continued operating (the rest have reduced operations and are holding off on new investments). However, this should be considered in the context of large-scale Austrian divestments from Russia since the annexation of Crimea, with the value of Austrian foreign direct investment (FDI) in Russia before the 2022 invasion substantially lower than a decade ago – in stark contrast to Germany or the EU as a whole. However, while Austria remains one of the most important foreign investors across CESEE, its relative importance has actually declined in most of the region since 2013: its share of total inward FDI stock fell in 16 of the 23 countries in CESEE covered by wiiw between 2013 and 2021 (Figure 3.6).

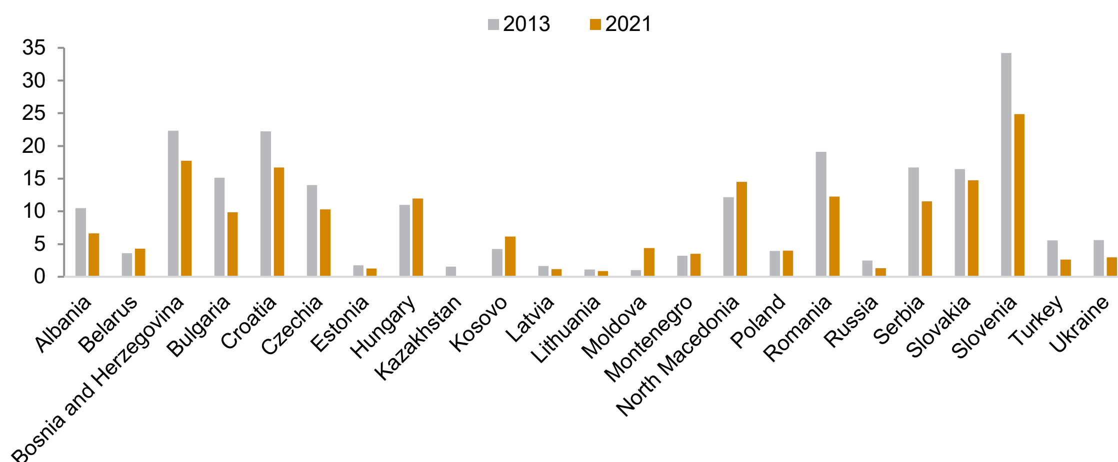
Figure 3.5 / Actions of firms active in Russia since the invasion, percentage of total, by country



Source: Kyiv School of Economics.

[10] https://www.euractiv.com/section/politics/news/austria-slides-back-into-dependence-on-russian-gas/

Figure 3.6 / Inward FDI stock, percentage from Austria



Sources: National sources, wiiw.

Austrian banks retain their strong position in CESEE, but the invasion has created serious problems for Raiffeisen in Russia. Raiffeisen Bank International is one of only two foreign banks included on Russia's list of 13 systemically important credit institutions. So far, the bank has been unable or unwilling to leave Russia, and is continuing to generate big profits there.[11] It also now handles 40-50% of all money flows in and out of Russia, according to the *Financial Times.*[12] The US is currently investigating Raiffeisen over its Russian operations,[13] and the European Central Bank has put pressure on the bank to leave Russia.[14]

Austria has come in for heavy international criticism since the war started on account of its profound ties with Russia and its apparent unwillingness to relinquish them; but proportionately speaking, it has sent as much money to Ukraine as its EU peers. Connections between Austria and Russia before the war were strong,[15] and factors such as the continued role of Raiffeisen, the relative resilience of Austria-Russia trade and – perhaps especially – the decision by many deputies to skip Ukrainian President Zelensky's speech to the Austrian parliament have led to criticism of Austria in the international media. It is also notable that the invasion has not triggered any great questioning of the country's neutral status, in stark contrast to the situation in Finland and Sweden (or even Switzerland, which has strengthened its ties with NATO since the invasion). This has reinforced the perception that Austria is unwilling to break its ties with Russia and adapt to the new reality of European security.[16] However, none of this has stopped the country supporting Ukraine financially. As a share of GDP, Austria's contribution to the support for Ukraine has been around the average for EU countries and roughly comparable with its peers, such as Spain, Germany, Portugal and Sweden (Figure 3.7). As a share of its

[11] https://www.reuters.com/business/finance/austrias-rbi-earns-growing-share-profit-russia-2023-02-01/

[12] https://www.ft.com/content/1cea1f08-83ac-4471-9fa4-1cdfcc86fcb0

[13] https://www.reuters.com/business/finance/raiffeisen-stock-slumps-after-us-sanctions-authority-asks-about-russia-business-2023-02-20/

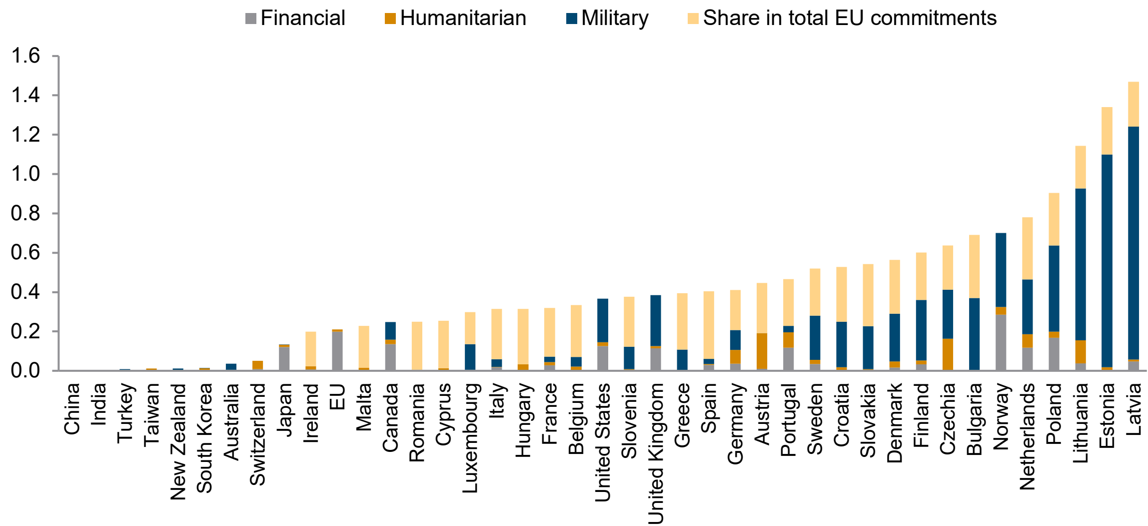
[14] https://www.reuters.com/markets/europe/ecb-pressures-austrias-raiffeisen-bank-quit-russia-sources-2023-03-23/

[15] https://www.intellinews.com/the-view-from-mitteleuropa-austria-and-russia-ending-the-special-relationship-272854/

[16] https://www.ft.com/content/a9b95774-52fc-4bba-b7a2-0e9c69b32005

GDP, since the invasion Austria has pledged more humanitarian support to Ukraine than any other country, while its military spending commitments have been negligible, in line with its continued neutrality.

Figure 3.7 / Total support to Ukraine, percentage of 2021 GDP

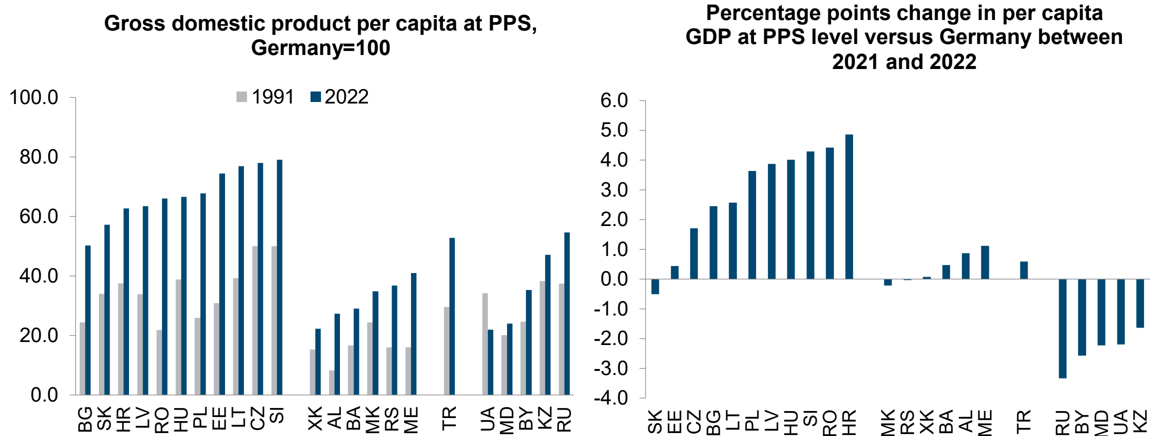


Source: Kiel Institute for the World Economy Ukraine Support Tracker.

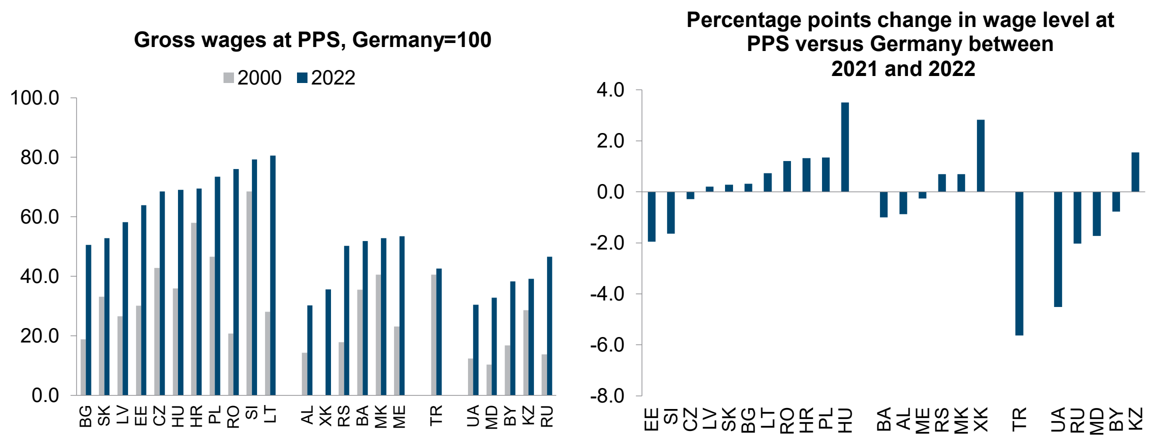
4. Convergence Monitor

BY ALEXANDRA BYKOVA AND BEATE MUCK

Figure 4.1 / GDP per capita and gross wages per employee at PPS convergence against Germany



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



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

Table 4.1 / CESEE GDP per capita and gross wages per employee at PPS, 2022

	BG	CZ	EE	HR	HU	LT	LV	PL	RO	SI	SK		EU-CEE
GDP per capita	20,680	32,060	30,620	25,810	27,380	31,620	26,110	27,890	27,190	32,540	23,550		27,670
Gross wages	18,020	24,423	22,793	24,780	24,633	28,712	20,762	26,186	27,092	28,254	18,819		24918

	AL	BA	BY	KZ	MD	ME	MK	RS	RU	TR	UA	XK	non-EU
GDP per capita	11,230	11,930	14,520	19,400	9,860	16,860	14,340	15,130	22,460	21,710	9,030	9,170	19,740
Gross wages	10,785	18,472	13,657	13,954	11,708	19,060	18,845	17,910	16,607	15,169	10,849	12,706	15,424

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

Table 4.2 / CESEE GDP per capita and gross wages per employee in EUR, 2022

	BG	CZ	EE	HR	HU	LT	LV	PL	RO	SI	SK		EU-CEE
GDP per capita	12,400	25,870	27,170	17,240	17,580	23,590	20,720	17,310	15,040	27,980	19,590		18,300
Gross wages	10,803	19,712	20,220	16,559	15,817	21,425	16,476	16,251	14,988	24,287	15,648	16,381	14,958

	AL	BA	BY	KZ	MD	ME	MK	RS	RU	TR	UA	XK	non-EU
GDP per capita	6,500	6,830	7,490	10,680	5,270	9,370	7,060	8,920	14,430	10,140	4,360	5,030	11,300
Gross wages	6,241	10,571	7,051	7,680	6,255	10,596	9,277	10,555	10,672	7,086	5,243	6,960	8,939

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

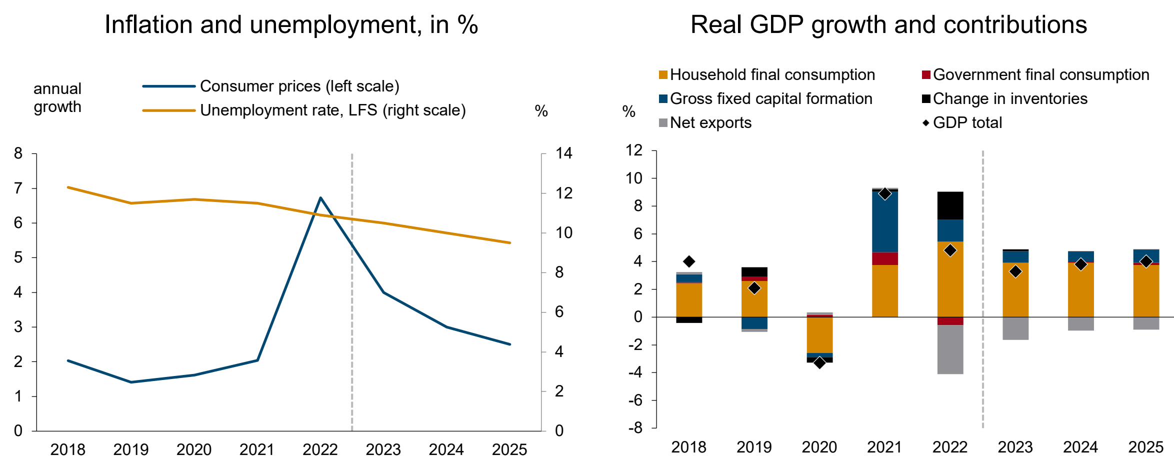
5. Country reports

ALBANIA: Impressive resilience in the face of external shocks

RAVIK MIMA

The Albanian economy displayed remarkable resilience in 2022, with a growth rate of 4.8%, driven by a bumper tourist season, robust FDI inflows and strong household consumption on the back of rising real incomes. Inflation was the lowest in the whole CESEE region, averaging 6.7%, but is still high by the country's own standards. This year will be similar to 2022, with expected growth of 3.3% and inflation of 4%.

Figure 5.1 / Albania: Main macroeconomic indicators



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

Despite facing significant supply-chain disruptions and the impact of the ongoing conflict in Ukraine, the Albanian economy displayed impressive resilience throughout 2022. GDP grew by 4.8% for the year as a whole, with the trend continuing at a similar pace in Q4. This growth owes much to the success of the tourism sector, but also to a combination of robust domestic demand and prudent macroeconomic policies, which allowed the economy to stay afloat despite rising inflationary pressures.

Trade, tourism-related services and construction were the main sectors that drove economic growth last year. Strong consumer demand and an exceptional tourist season led to a 48.5% increase in income from tourist arrivals, compared to 2021. Tourist income totalled EUR 2.84bn – 36% more than in pre-pandemic times. In 2022, the sector made a significant contribution to the economy, directly accounting for 15.8% of GDP. The construction sector also put in a healthy performance, contributing 1 percentage point to overall GDP growth. On the other hand, agriculture and the energy sector faced severe challenges on account of unfavourable weather conditions.

Inflation averaged 6.7% in 2022, the lowest in the whole CESEE region. The invasion of Ukraine by Russia intensified the inflationary pressures in Albania, as food, energy and key minerals used as inputs by various industries became more expensive, due to higher global prices, disruption to supply chains and sanctions that targeted Russia. Food and transport prices were the primary drivers of inflation in 2022: these disproportionately affected the poorest citizens, because of the greater weight those items have in their consumption baskets. Despite the price rises, Albania's inflation remains significantly lower than that of its peers in the region or the EU average, thus mitigating macroeconomic, social and political pressures. This comparatively low inflation rate is attributable to several factors: the exchange rate against the euro has continued to strengthen; the domestically generated hydropower has provided some insulation against the energy crisis; the energy price rises were pegged back for regulated customers; and transport fuels and key foodstuffs were subject to temporarily controlled profit markups, with the local fruit and vegetable production base providing a good additional cushioning effect.

The labour market has also shown considerable improvement. Employment and labour force participation recovered quickly after the pandemic-induced disruptions. The annual growth in employment accelerated to 5.4% in Q4 2022, while unemployment reached a record low of 10.8%, mainly because of the greater participation of women. At the end of 2022, the average salary in the Albanian economy stood at approximately EUR 580 a month, with a 10.8% nominal rise and a 4.1% real growth rate when adjusted for inflation. The Albanian government's decision to increase the minimum wage in April 2023 is expected to further support the labour market, stimulating household consumption and, in turn, overall economic activity.

The country enjoyed double-digit growth in both foreign direct investment (FDI) and remittances in 2022. FDI inflows reached an impressive EUR 1.37bn – a 37% increase over the previous year – and accounted for 7.6% of GDP. The Netherlands, Italy and Germany were the top three countries of origin of the FDI. The Netherlands was the biggest investor, providing EUR 218m and taking advantage of Albania's favourable tax environment and legal system, which make it an attractive destination for foreign companies to register. Reinvested profits accounted for 53% of total FDI in 2022 – up by around a half over the previous year. Mining and quarrying, real estate, and the energy, gas and water supply sectors attracted the most investment. The real estate sector has witnessed substantial growth in recent years, with foreign investments reaching a total value of EUR 291m during 2022 – a significant increase of 52% year on year. Purchases by foreign nationals are becoming a significant factor in the Albanian property market. Thanks to the country's geographical position, its climate, the favourable taxation system and its low prices, more and more foreign citizens are deciding to invest in properties in Albania, especially in the coastal areas. At the same time, net remittances in 2022 increased by 10% nominally, to EUR 834m, but declined as a share of GDP, to 4.5% of GDP.

Thanks to the strong capital inflows and the bumper tourist season, the national currency appreciated strongly in 2022. The nominal exchange rate at the end of 2022 stood at around 114 Albanian lek to the euro (compared to around 121 lek to the euro at the end of 2021). The appreciating pressures are continuing in 2023 as well. They are also partly driven by monetary tightening – the central bank raised its policy rate from 0.5% in February 2022 to 3% in March 2023. Still, this tightening is mild by regional standards – and milder than that undertaken by the European Central Bank, which hiked its rate by 350 basis points over the same period. The more moderate tightening can be explained by the lower inflation in Albania.

Despite the interest-rate hikes, the banking system in Albania is in a strong position. The capital adequacy ratio exceeds regulatory requirements, and the sector has a high level of liquidity and profitability. The provision of credit to both enterprises and households has experienced a positive trend, indicating the banking sector's commitment to supporting economic growth. Private-sector credit in Albania continued to grow strongly in 2022, with outstanding credit to the economy increasing by 7.1%. Total deposits in the banking system also increased by 5%.

Albania's fiscal position improved in 2022, with controlled spending and healthy revenue flows as a result of high inflation. The government provided direct support to households and firms amounting to about 0.8% of GDP. The reduction in public debt from 73.2% in 2021 to 67% of GDP at the end of 2022 confirms a sustained downward trajectory since the immediate aftermath of the pandemic crisis, this time also helped by the elevated inflation. On the other hand, government borrowing costs increased following the Bank of Albania's interest-rate hikes.

Looking ahead to the rest of 2023, the Albanian economy is expected to maintain its positive trajectory, with a projected growth rate of 3.3%. This will be supported by sustained expansion in household consumption, private and public investment, and exports of goods and services. Favourable financial conditions, healthy private-sector balance sheets, and continued improvements in business and household confidence are also expected to drive growth. On the other hand, the withdrawal of policy support linked to reconstruction in the aftermath of the 2019 earthquake will push growth down a bit.

Despite inflation being the lowest in the region, it remains a concern in the country. Inflation has become both more persistent and more broad based, with core inflation running slightly higher than the headline consumer price inflation since August 2022. Inflationary pressures remain high even at the start of 2023, owing to robust demand for goods and services, rapid wage and production cost increases and rising inflation expectations. Inflation in January and February stood at 7.2% and 7.1% on an annual basis, respectively, exceeding initial projections. It declined to 5.3% in March, which is still above historical levels for the country. For 2023, inflation should gradually subside to the 4% level, reaching the central bank target of 3% in 2024.

Table 5.1 / Albania: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	2,854	2,838	2,812	2,760	2,745	2,730	2,715
Gross domestic product, ALL bn, nom.	1,692	1,647	1,856	2,134	2,400	2,600	2,800
annual change in % (real)	2.1	-3.3	8.9	4.8	3.3	3.8	4.0
GDP/capita (EUR at PPP)	9,510	9,210	10,300	11,230	.	.	.
Consumption of households, ALL bn, nom.	1,340	1,318	1,411	1,607	.	.	.
annual change in % (real)	3.3	-3.3	4.7	7.2	5.2	5.2	5.0
Gross fixed capital form., ALL bn, nom.	378	373	452	511	.	.	.
annual change in % (real)	-3.6	-1.4	19.2	6.5	3.5	3.0	4.0
Gross industrial production							
annual change in % (real)	-1.1	-6.3	26.2	2.8	3.5	4.0	4.5
Gross agricultural production 2)							
annual change in % (real)	-3.0	2.6	2.0	2.0	.	.	.
Construction output total							
annual change in % (real)	-2.5	9.5	18.0	12.5	.	.	.
Employed persons, LFS, th, average	1,266	1,243	1,249	1,298	1,325	1,350	1,375
annual change in %	2.8	-1.8	0.4	4.0	2.1	1.9	1.9
Unemployed persons, LFS, th, average	165	165	163	160	160	150	140
Unemployment rate, LFS, in %, average	11.5	11.7	11.5	10.9	10.5	10.0	9.5
Reg. unemployment rate, in %, eop 3)	5.8	7.4	7.3	7.0	.	.	.
Average monthly gross wages, ALL	52,380	53,662	57,191	61,884	66,300	70,300	74,200
annual change in % (real, gross)	2.1	0.8	4.4	1.4	3.0	3.0	3.0
Consumer prices, % p.a.	1.4	1.6	2.0	6.7	4.0	3.0	2.5
Producer prices in industry, % p.a.	-0.8	-3.3	2.7	19.9	5.0	3.5	3.0
General governm. budget, nat. def., % of GDP							
Revenues	27.2	25.9	27.5	26.8	27.5	28.0	28.5
Expenditures	29.1	32.6	32.1	30.5	30.0	30.5	31.0
Deficit (-) / surplus (+)	-1.9	-6.7	-4.6	-3.7	-2.5	-2.5	-2.5
General gov. gross debt, nat. def., % of GDP	65.8	74.3	74.5	64.6	67.0	68.0	69.0
Stock of loans of non-fin. private sector, % p.a.	6.6	6.9	9.6	7.0	.	.	.
Non-performing loans (NPL), in %, eop	8.4	8.1	5.7	5.0	.	.	.
Central bank policy rate, % p.a., eop 4)	1.00	0.50	0.50	2.75	3.50	3.00	2.50
Current account, EUR m	-1,089	-1,153	-1,166	-1,080	-1,260	-1,350	-1,480
Current account, % of GDP	-7.9	-8.7	-7.7	-6.0	-5.9	-5.8	-5.8
Exports of goods, BOP, EUR m	907	794	1,265	1,933	2,340	2,690	3,010
annual change in %	-8.1	-12.5	59.4	52.8	21.0	15.0	12.0
Imports of goods, BOP, EUR m	4,050	3,776	5,094	6,202	7,380	8,410	9,500
annual change in %	5.0	-6.8	34.9	21.7	19.0	14.0	13.0
Exports of services, BOP, EUR m	3,405	2,226	3,486	4,801	5,760	6,620	7,480
annual change in %	10.8	-34.6	56.6	37.7	20.0	15.0	13.0
Imports of services, BOP, EUR m	2,141	1,174	1,690	2,400	2,860	3,230	3,550
annual change in %	9.1	-45.1	43.9	42.0	19.0	13.0	10.0
FDI liabilities, EUR m	1,072	937	1,032	1,372	.	.	.
FDI assets, EUR m	36	43	42	166	.	.	.
Gross reserves of CB excl. gold, EUR m	3,240	3,806	4,831	4,786	.	.	.
Gross external debt, EUR m	8,246	8,549	9,755	9,799	12,100	13,500	15,000
Gross external debt, % of GDP	60.0	64.2	64.4	54.6	57.0	58.0	59.0
Average exchange rate ALL/EUR	123.01	123.77	122.46	118.98	113.0	112.0	110.0

1) Preliminary and wiiw estimates. - 2) Based on UN-FAO data, wiiw estimate from 2021. - 3) wiiw estimate from 2021. - 4) One-week repo rate.

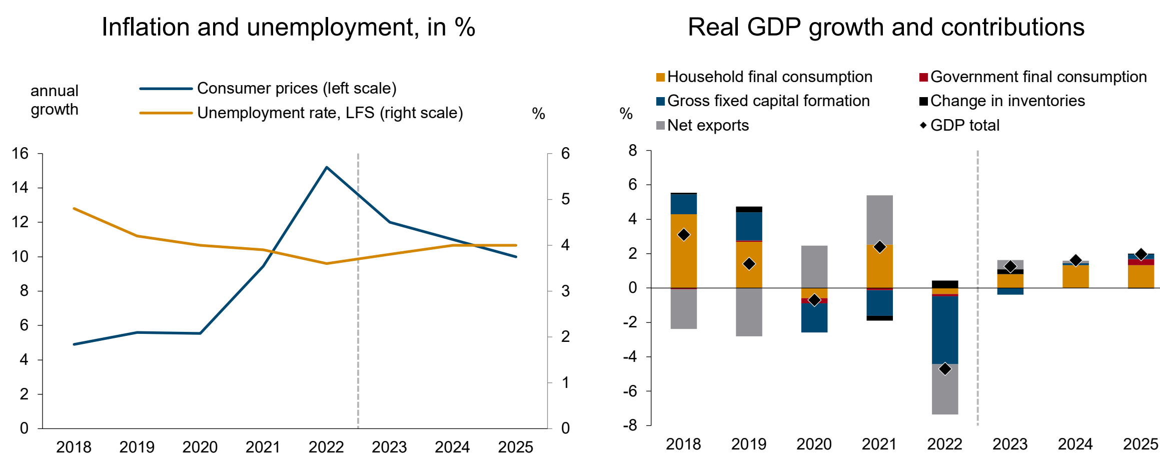
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

BELARUS: Grappling with a crippled economy

RUMEN DOBRINSKY

Throughout 2022, Belarus underwent a painful adjustment to the external shocks it faced. Despite massive policy support measures and Russia's continued economic backing, GDP shrank by 4.7%. That year also witnessed a sweeping reorientation of trade flows, and China became Belarus's second-largest trade partner. Despite all the measures, Belarus's crippled economy will continue to be dominated by persistent weakness. GDP growth in the coming years will remain in the range 1-2%.

Figure 5.2 / Belarus: Main macroeconomic indicators



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

In 2022, Belarus's economy weakened considerably. This was mostly due to the Western sanctions, which intensified considerably in both scale and scope after February 2022. The newly imposed sectoral sanctions targeted some vital segments of the Belarusian economy, including the petrochemical industry, the production of fertilisers, and such sectors as banking, financial services and transport. According to estimates by the Belarusian government, the sanctions directly affected a quarter of the Belarusian economy. They resulted in an almost complete decoupling of Belarus from the key Western markets and dealt a severe blow to economic activity in the country. As an example, the production of potash fertiliser – one of Belarus's key export commodities – fell by more than 50%. Moreover, because of its support for Russia's invasion, Belarus lost almost entirely its access to Ukraine's economic space, which used to be its second-largest export market.

Throughout 2022, Belarus underwent a painful adjustment to the external shocks. The authorities introduced a range of policy support measures aimed at mitigating the adverse effects of the sanctions and the war in Ukraine, including financial support and tax relief for the worst-affected companies, as well as small and medium-sized enterprises. Linked to that, the government started issuing government bonds earmarked to provide funding for the exceptional measures. In parallel, the authorities undertook concerted efforts (both domestically and on the international arena) to facilitate the country's enforced trade reorientation. Belarus also negotiated a set of new cooperation and support agreements with Russia.

However, these measures were not sufficient to offset the impact of the sanctions. Overall, 2022 was marked by a deep recession, with GDP shrinking by 4.7%, while gross industrial production dropped by 5.4%. Real exports of goods and services plunged by more than 20% in 2022. Real imports contracted by slightly less, and so net exports contributed negatively to GDP growth. Gross fixed capital formation collapsed, declining by 17.5%, and also subtracted considerably from GDP growth. Private and public consumption were stagnant, and only stockpiling made a small positive contribution to GDP growth. Hoarding by industrial companies kept rising, and by the end of February 2023 stocks were some 30% higher than a year earlier. The one positive development in 2022 came in the agricultural sector: thanks to a good harvest, gross agricultural production increased by 3.6%, while the value of agricultural exports rose by some 25% in US dollar terms.

Among the most visible effects of the external shocks were the shifts in Belarus's foreign trade. It is not possible to trace all the trade effects in detail, as in 2022 the authorities imposed restrictions on some previously openly published statistical data, including the detailed breakdown of trade flows. However, according to anecdotal evidence, 2022 witnessed both an abrupt decline in trade with most Western economies and a massive reorientation of trade flows to and from new markets. Thus, according to public statements by Belarusian officials, the value of Belarusian exports to Russia in 2022 increased by a half compared to the previous year – and the export of agricultural products alone rose by some 70%. Basically, the Russian market absorbed most of what Belarus used to export to Ukraine, which in the past accounted for some 17% of its exports. The value of exports to China reportedly increased by 56%, and that country took the place of Belarus's second-largest trade partner. On the import side, Belarus has been seeking to replace imports of technology and equipment from the West with imports from China.

The exchange rate dynamics in 2022 reflected changing conditions on the local currency market. Given the dominant influence of the country's economic links to Russia, the Belarusian currency followed in the main the dynamics of the Russian rouble. Thus, after an initial plunge against the US dollar and the euro, the Belarusian rouble rose rapidly, and by June it had recovered to its pre-war levels. Apart from the effect of the Russian rouble, such dynamics reflected the declining demand for the US dollar and the euro, given the shrinking trade denominated in those currencies. The introduction of capital controls also prevented a further slide by the currency and contributed to the reversal.

In parallel with the exchange rate, after an initial surge the pace of inflation moderated in the final months of the year. Average annual consumer price inflation amounted to 15.2%, outpacing the rise in incomes. Overall, the real disposable income of the population in 2022 fell by 3.6%, compared to 2021.

The movement in prices in autumn 2022 and at the beginning of 2023 was strongly affected by some radical policy moves. Following a sharp increase in the cost of basic commodities – and particularly food – in the first half of the year, Belarus put in place unprecedently harsh price controls in October 2022. Citing their intention of supporting vulnerable segments of the population, the authorities introduced price freezes on 370 items of food and non-food consumer products. Later on, these measures were relaxed somewhat, and the price freezes were replaced with other forms of rigid controls, including price ceilings, while some price controls on non-food items were further softened or abolished. Though highly controversial and disapproved of by the business community, these measures did contribute to a moderation in the pace of inflation in the final months of 2022; and this trend continued in the first months of 2023.

Unemployment has remained low, owing to persistent labour market shortages. The lasting structural factor that drives these shortages is the shrinking of the labour force, due to the combination of an ageing population and a low retirement age. In addition, 2022 was marked by a surge in the exodus of the working-age population, including skilled workers such as ICT specialists and medical personnel.

The central bank has maintained an accommodative expansionary stance. Throughout 2022, real interest rates were highly negative – a position that was intended to stimulate economic activity and consumer demand. On the other hand, such a stance was pro-inflationary, and actually the price controls were also meant to partly offset this effect. Belarus introduced changes to the central bank regulations, whereby, in addition to the objective of safeguarding price stability, the National Bank of the Republic of Belarus was tasked with 'ensuring financial stability' and 'fostering sustainable economic development'. The beginning of 2023 was marked by a further relaxation of the monetary conditions: the key policy rate has been reduced in three steps from 12.0% in January to 10.5% in April.

Russia has continued to expand considerably its measures to support Belarus. These have included a further easing of Belarus's access to the Russian market, new credit lines, oil and gas supplies at highly preferential prices and the rescheduling of some financial obligations. Thus, the price of Russian gas imported into Belarus in 2022 was fixed at USD 128.50 per thousand cubic metres – just a fraction of the prevailing price on the international markets. Plus, according to some estimates, the combined effect of preferential oil prices in 2022 amounted to USD 1.7bn (or 2.3% of GDP). Without Russia's support, the economic slump in Belarus in 2022 would have been much deeper.

New steps have been undertaken towards further economic integration between the two allies. Among the most important was agreement on the extensive use of the Russian rouble in trade between the two countries. In 2022, this regime was extended to most trade deals, and recently has also been applied to some financial transactions. As an example, Russia agreed to extend to at least 2024 the grace period for the repayment of a USD 10bn loan to Belarus and to accept the repayment in Russian roubles. Belarus and Russia have also made further steps in the implementation of the 28 economic integration programmes that the two countries signed in 2021.

In 2022, Belarus recorded a marked improvement in the terms of trade. On the import side, the country benefited from large implicit Russian energy subsidies (thanks to the highly preferential supply prices), while it continued to export petrochemicals at rising world market prices. Reflecting these developments, the current account ended the year with a positive balance.

At the same time, the servicing of Belarus's external debt has given rise to new challenges. Like Russia, Belarus announced that it would service its foreign obligations in the national currency, claiming that it was technically incapable of doing so in dollars and euros because of the financial sanctions. While this was deemed a default by international rating agencies, so far there has been no perceptible direct effect of such statements, as Belarus in any case has no access to Western financial markets. However, this situation does carry important financial risks for the future.

The trough of the recession in Belarus wase probably reached around mid-2022. Thereafter one could observe a process of slow bottoming-out, which has continued in the beginning of 2023. However, being cut off from the main suppliers of technological inputs, Belarus is facing problems with the sheer maintenance of its productive assets, not to mention their technological upgrading. Undoubtedly, this will have repercussions for the country's future international competitiveness.

Overall, Belarus's crippled economy will likely be dominated by persistent weakness in the coming years. So far there has been no sign that the economy has succeeded in putting in place engines of sustainable growth. While Russia has pledged to continue its support to Belarus, including through preferential prices for oil and gas supplies, this will hardly be sufficient to reinvigorate the economy. We expect GDP to grow by just 1.3% in 2023, with a possible continuation of the meagre recovery in 2024 and 2025. The terms-of-trade may remain favourable in the short run, but if world energy prices subside, the positive margins will diminish. The government may revert to some populist measures in order to prevent widespread discontent among the people. The gradual recovery in private consumption will probably be the main growth factor in 2023 and beyond. At the same time, the rigid price controls seem to have run their course. Given the relatively loose policy stance, and the weakening of the currency in recent months, annual inflation in 2023 will likely remain high. The pressure on Belarus's external balances is expected to increase.

Table 5.2 / Belarus: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	9,420	9,380	9,303	9,200	9,150	9,100	9,050
Gross domestic product, BYN m, nom.	134,732	149,721	176,879	191,374	217,000	244,700	274,500
annual change in % (real)	1.4	-0.7	2.4	-4.7	1.3	1.6	2.0
GDP/capita (EUR at PPP)	13,260	13,280	14,760	14,520	.	.	.
Consumption of households, BYN m, nom.	71,630	77,101	88,839	102,151	.	.	.
annual change in % (real)	5.1	-1.1	4.9	-0.7	1.5	2.5	2.5
Gross fixed capital form., BYN m, nom.	36,424	37,977	39,924	37,167	.	.	.
annual change in % (real)	6.2	-6.3	-5.9	-17.5	-2.0	0.5	1.5
Gross industrial production							
annual change in % (real)	1.0	-0.7	6.5	-5.4	1.0	2.0	2.0
Gross agricultural production							
annual change in % (real)	3.4	4.4	-4.0	3.6	.	.	.
Construction industry							
annual change in % (real)	5.1	-1.6	-13.3	-11.9	.	.	.
Employed persons, LFS, th, average	4,909	4,885	4,851	4,847	4,800	4,780	4,780
annual change in %	0.2	-0.5	-0.7	-0.1	-1.0	-0.5	0.0
Unemployed persons, LFS, th, average	213	206	197	180	190	199	199
Unemployment rate, LFS, in %, average	4.2	4.0	3.9	3.6	3.8	4.0	4.0
Reg. unemployment rate, in %, eop	0.2	0.2	0.1	0.1	.	.	.
Average monthly gross wages, BYN	1,093	1,255	1,444	1,631	1,810	2,010	2,230
annual change in % (real, gross)	6.5	8.8	5.1	-1.8	-1.0	0.0	1.0
Consumer prices, % p.a.	5.6	5.5	9.5	15.2	12.0	11.0	10.0
Producer prices in industry, % p.a. 2)	6.3	5.6	12.1	15.1	14.0	12.0	10.0
General governm. budget, nat. def., % of GDP							
Revenues	40.0	35.5	35.7	35.0	36.0	37.0	38.0
Expenditures	37.6	37.2	35.6	37.0	39.0	39.0	39.0
Deficit (-) / surplus (+)	2.4	-1.7	0.2	-2.0	-3.0	-2.0	-1.0
General gov. gross debt, nat. def., % of GDP 3)	41.0	47.5	40.3	42.0	41.0	40.0	39.0
Stock of loans of non-fin. private sector, % p.a.	10.0	21.4	3.3	3.2	.	.	.
Non-performing loans (NPL), in %, eop 4)	4.6	4.8	5.3	4.9	.	.	.
Central bank policy rate, % p.a., eop 5)	9.00	7.75	9.25	12.00	10.0	9.0	8.0
Current account, EUR m 6)	-1,115	-156	1,830	2,549	1,000	900	800
Current account, % of GDP	-1.9	-0.3	3.1	3.7	1.5	1.2	1.0
Exports of goods, BOP, EUR m 6)	28,932	24,890	33,189	35,763	33,800	34,300	34,700
annual change in %	1.8	-14.0	33.3	7.8	-5.5	1.5	1.2
Imports of goods, BOP, EUR m 6)	32,684	26,637	33,755	35,599	34,700	35,200	35,600
annual change in %	7.0	-18.5	26.7	5.5	-2.5	1.4	1.1
Exports of services, BOP, EUR m 6)	8,628	7,703	8,749	8,760	8,900	9,300	9,700
annual change in %	14.9	-10.7	13.6	0.1	1.6	4.5	4.3
Imports of services, BOP, EUR m 6)	5,237	4,249	4,815	4,792	4,900	5,100	5,300
annual change in %	14.0	-18.9	13.3	-0.5	2.3	4.1	3.9
FDI liabilities, EUR m 6)	1,139	1,221	1,044	1,536	.	.	.
FDI assets, EUR m 6)	-3	72	-67	174	.	.	.
Gross reserves of CB excl. gold, EUR m 6)7)	6,265	3,604	4,687	7,442	.	.	.
Gross external debt, EUR m 6)	36,487	34,230	37,094	37,303	42,700	42,300	41,800
Gross external debt, % of GDP	63.2	63.8	62.8	54.1	63.0	57.0	54.0
Average exchange rate BYN/EUR	2.3342	2.7888	2.9923	2.7755	3.20	3.30	3.55

1) Preliminary and wiiw estimates. - 2) Domestic output prices. - 3) Including publicly guaranteed debt. - 4) Doubtful, bad and small part of supervised assets. - 5) Refinancing rate of CB. - 6) Converted from USD. - 7) Data 2022 including gold.

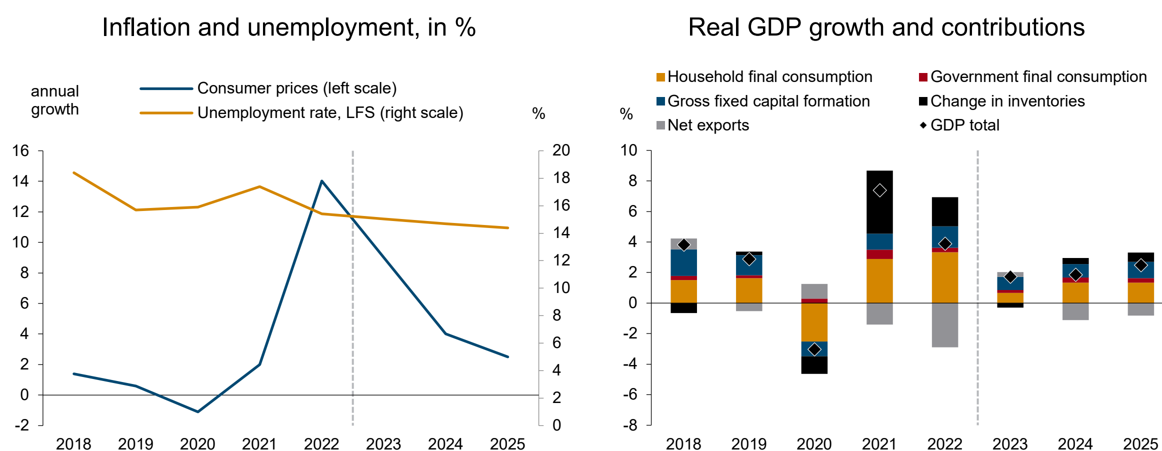
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

BOSNIA AND HERZEGOVINA: Newly approved EU candidate status offers glimmer of hope

SELENA DURAKOVIĆ

Growth in 2022 was 3.9%. This was better than expected, thanks to a rise in private consumption and gross capital formation. However, the continuing high inflation and increasing interest rates are likely to drag growth in 2023 down to 1.7%. The formation of governments after the October 2022 elections is not yet quite complete, but the shape of most of the structures is clear and reveals a slight move away from nationalist parties. The country gained EU candidate status in December 2022, even though the conditions required had not been met. This could provide a fillip to the country's progress in the coming period.

Figure 5.3 / Bosnia and Herzegovina: Main macroeconomic indicators



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

The economy grew by 3.9% in 2022, which was better than expected. This was due to positive movements in private and government consumption and in gross capital formation. Despite high inflation and falling real wages, household consumption increased by 4.9% in 2022 – presumably largely because of an increase in remittances, but partly also due to savings being used and lower unemployment. Gross capital formation also increased significantly (by 12.7%) on account of an increase in domestic investment and attempts by companies to protect their stocks against the risk of serious disturbances on the supply market and an inflationary environment. Foreign direct investments increased by 16.3%, which was manly result of reinvested profits of foreign companies already present in the country. Although remittances increased by 17% and the number of tourist arrivals rose by 50%, the current account deficit increased significantly, due to high energy and food prices. Industrial

production and retail trade turnover continued to increase throughout 2022, but at a much slower pace than in the previous year.

Inflation in 2022 was 14%, and we forecast that it will fall in the coming years. Inflation in 2022 was mainly driven by a rise in the cost of transport (25.4%), 'electricity, gas and other fuels' (14%) and food and beverages (21.5%). On the positive side, it declined in February 2023 (12.9%), which could bode well for future trends. On an annual average basis, we forecast inflation to fall to 9% in 2023 and 4% in 2024. There are still no central government measures in place to mitigate the effect of rising prices, and wages and pensions are not adequately adjusted to the increase in prices, which undermines people's standard of living.

We expect GDP growth to slow in 2023, as high inflation and increased interest rates domestically and in the EU are likely to undermine consumption and exports. We forecast growth of 1.7% in 2023 and 1.9% in 2024. The start of 2023 is already witnessing a slowdown, with a fall in industrial production of 1.6%, year on year, in the first two months. Inflation is still high and the interest rates on loans are increasing, with the prospect of further increases, which will hit consumption and investments. Furthermore, with little additional scope for dissaving, the consequences of high inflation and the negative trends in real wages might be felt more acutely in 2023 than last year.

There have been some positive changes in the various governments in the wake of the recent elections. Following the October 2022 elections, a new government is in place at the state level and in one entity (Republika Srpska). In the three-member presidency of Bosnia and Herzegovina, the Bosniak representative is no longer from the nationalist SDA party, leaving only one ethno-nationalist politician in the presidency. The SDA has also been pushed into opposition in both the state parliament and the parliament of the Federation of Bosnia and Herzegovina by a coalition of parties called 'The Eight'. However, in both the state and the two entity parliaments, the Serb and Croat representatives are again from nationalist parties. The formation of a new government is not yet complete at the level of the Federation of Bosnia and Herzegovina, even though the formal deadline has passed. This may result in a further intervention by the Office of the High Representative, which some politicians believe would be damaging for Bosnian society.

The country has finally gained EU candidate status, which offers a glimmer of hope. The EU Council decided in December 2022 to grant the country EU candidate status – even though the required conditions to implement reforms in the area of the rule of law and public administration have not been met. This should bring some political stability and perhaps improve the economic prospects of Bosnia and Herzegovina over the medium term, although the nationalist parties could make it hard to pass and enact the legislation required to ensure further progress towards the EU.

Table 5.3 / Bosnia and Herzegovina: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	3,491	3,475	3,453	3,415	3,385	3,355	3,350
Gross domestic product, BAM m, nom. 2)	35,785	34,728	39,107	45,605	50,600	53,600	56,300
annual change in % (real)	2.9	-3.0	7.4	3.9	1.7	1.9	2.5
GDP/capita (EUR at PPP) 2)	10,240	9,920	11,120	11,930	.	.	.
Consumption of households, BAM m, nom. 2)	25,565	24,659	26,300	30,586	.	.	.
annual change in % (real)	2.3	-3.5	4.1	4.9	1.0	2.0	2.0
Gross fixed capital form., BAM m, nom. 2)	8,129	7,679	8,367	9,826	.	.	.
annual change in % (real)	5.8	-4.2	4.8	6.6	4.0	4.0	5.0
Gross industrial production							
annual change in % (real)	-5.3	-6.4	9.8	1.0	1.0	2.0	4.0
Gross agricultural production 3)							
annual change in % (real)	-8.6	9.2	-16.9	0.3	.	.	.
Construction output total							
annual change in % (real)	-2.0	0.2	2.5	-0.5	.	.	.
Employed persons, LFS, th, average 4)	802.9	1,173.1	1,151.0	1,162.0	1,170	1,180	1,190
annual change in %	-2.4	.	.	1.0	0.5	1.0	1.0
Unemployed persons, LFS, th, average 4)	149.4	221.0	241.8	211.3	207	203	200
Unemployment rate, LFS, in %, average 4)	15.7	15.9	17.4	15.4	15.0	14.7	14.4
Reg. unemployment rate, in %, eop	32.8	33.7	31.2	29.5	.	.	.
Average monthly gross wages, BAM	1,421	1,476	1,542	1,723	1,860	1,940	2,010
annual change in % (real, gross)	3.7	5.0	2.4	-2.0	-1.0	0.5	1.0
Average monthly net wages, BAM	921	956	998	1,122	1,220	1,280	1,330
annual change in % (real, net)	4.2	4.9	2.4	-1.4	-0.5	1.0	1.5
Consumer prices, % p.a.	0.6	-1.1	2.0	14.0	9.0	4.0	2.5
Producer prices in industry, % p.a.	0.1	-1.2	5.6	19.8	10.0	5.0	3.0
General governm. budget, nat. def., % of GDP							
Revenues	42.0	41.6	41.1	39.0	39.5	40.0	40.5
Expenditures	40.1	46.8	41.3	40.0	39.0	39.0	39.5
Deficit (-) / surplus (+)	1.9	-5.2	-0.3	-1.0	0.5	1.0	1.0
General gov. gross debt, nat. def., % of GDP	32.3	36.1	34.0	34.0	35.0	35.0	35.5
Stock of loans of non-fin. private sector, % p.a.	6.7	-2.5	3.7	5.3	.	.	.
Non-performing loans (NPL), in %, eop	7.4	6.1	5.8	4.5	.	.	.
Central bank policy rate, % p.a., eop 5)	.	.	.	.	.	.	.
Current account, EUR m 6)	-474	-575	-472	-1,045	-1,040	-1,130	-1,250
Current account, % of GDP	-2.6	-3.2	-2.4	-4.5	-4.0	-4.1	-4.3
Exports of goods, BOP, EUR m 6)	5,205	4,818	6,499	8,249	9,240	10,110	10,870
annual change in %	-2.3	-7.4	34.9	26.9	12.0	9.4	7.5
Imports of goods, BOP, EUR m 6)	9,276	8,023	10,165	13,410	14,750	16,230	17,370
annual change in %	1.1	-13.5	26.7	31.9	10.0	10.0	7.0
Exports of services, BOP, EUR m 6)	2,121	1,251	1,930	2,719	3,080	3,540	3,750
annual change in %	8.3	-41.0	54.2	40.9	13.2	15.0	6.0
Imports of services, BOP, EUR m 6)	691	488	615	866	980	1,110	1,200
annual change in %	10.8	-29.4	26.2	40.7	13.0	13.0	8.0
FDI liabilities, EUR m 6)	397	384	529	615	.	.	.
FDI assets, EUR m 6)	20	62	69	27	.	.	.
Gross reserves of CB excl. gold, EUR m 6)	6,311	6,942	8,204	8,133	.	.	.
Gross external debt, EUR m	11,444	11,339	11,654	11,994	12,550	12,960	13,100
Gross external debt, % of GDP	62.5	63.9	58.3	51.4	48.5	47.3	45.5
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary and wiiw estimates. - 2) According to ESA'10 (FISIM reallocated to industries). - 3) Based on UN-FAO data, wiiw estimate for 2022. - 4) In 2019 survey once a year and according to census 1991. From 2020 continuous quarterly survey based on census 2013 and according to EU + ILO definition. From 2021 new methodology in line with the Integrated European Social Statistics Regulation (IESS). - 5) Bosnia and Herzegovina has a currency board. There is no policy rate and even no money market rate available. - 6) Converted from national currency.

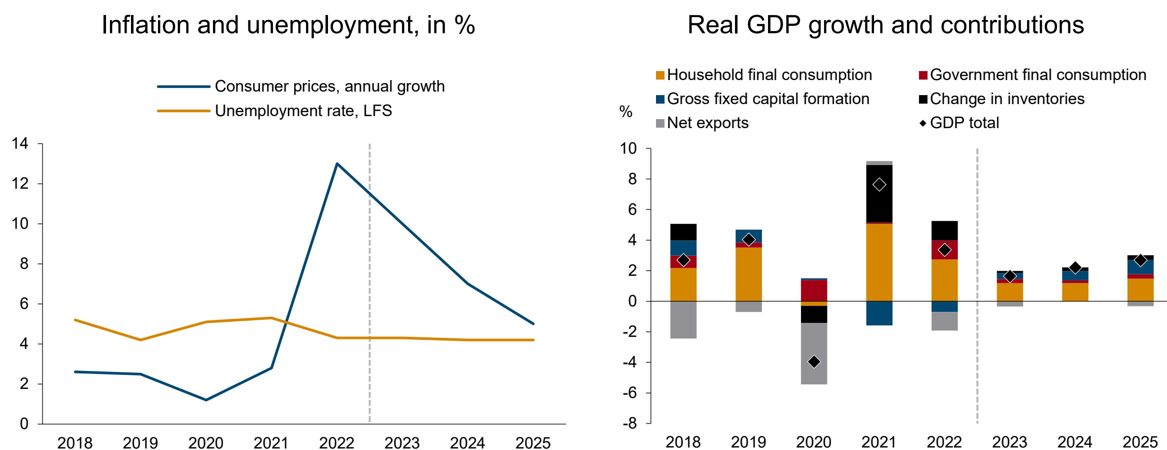
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

BULGARIA: Political mess drives the economy towards an unsustainable fiscal course

RUMEN DOBRINSKY

The early general election held in April 2023 – the fifth in two years – has delivered no clear winner. The absence of a stable government over the past couple of years has resulted in fiscal destabilisation and delays to the country's planned accession to the euro area. While GDP growth in 2022 was above expectations (thanks to a surge in exports), in 2023 it will slow to 1.7%. Rebalancing the public finances requires a radical shift in fiscal policies – something that may be problematic given the current political environment.

Figure 5.4 / Bulgaria: Main macroeconomic indicators



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

On 2 April 2023, Bulgaria held an early parliamentary election – the fifth such poll within the space of two years. In the main, the results replicated the previous votes, and there were no clear winners. GERB, led by Boyko Borisov, which was the dominant political force during the 2010s, came first, closely followed by a coalition led by the relatively new formation 'We Continue the Change', which emerged as the winners in the November 2021 election. These two political forces are quite close in their political positioning (centre-right and Western-leaning), and in principle could form a stable government backed by a parliamentary majority. However, in the past couple of years personal rivalries have led to antagonism between them. This was reinforced by the arrest of Boyko Borisov on corruption charges while the coalition led by 'We Continue the Change' was in office (the charges were subsequently dropped). Most analysts are sceptical about the prospects of such a coalition following the April election, while the parliamentary arithmetic does not suggest any other possible stable coalition. So it cannot be ruled out that the Bulgarian people will be invited to the polls once again later this year.

The lasting inability of the political class to agree on a stable government has had grave economic consequences. The most alarming has been the opening-up of a large fiscal deficit, which already appears to be structural in nature. The Ministry of Finance recently estimated that, in the absence of urgent corrective measures, the cash deficit in 2023 could reach some 6-7% of GDP – and could remain in that range in the years to come. Given the continuing rise in interest rates, the future financing of this deficit will be both more difficult and more costly.

This deterioration in the country's fiscal position is largely a result of several ill-conceived populist policy measures taken by the various short-lived governments over the past couple of years. Examples from 2022 included significant exceptional spending, such as lavish compensation during the pandemic and lax across-the-board energy subsidies, on top of a generous rise in pensions and the minimum wage. It is estimated that over the period 2020-2022, the various support measures allocated through the budget totalled BGN 11.2bn (EUR 5.7bn), or 2.6% of average GDP over these three years. While similar measures were not uncommon in other countries during the pandemic, the fiscal repercussions in Bulgaria were also due to a lack of any provisions allowing the exercise of discretion and the absence of 'sunset clauses' in the application of the measures. In consequence, the exorbitant public spending has continued into 2023. Without a regular government, parliament could not adopt a budget for the current year; thus, in accordance with the rules set down, public spending must follow the previous year's budget – even though the rationale behind some of the emergency spending is no longer valid.

Rebalancing the public finances may require a radical reversal in the patterns of public spending and/or tax hikes. Such policy shifts will inevitably entail a range of unpopular measures, and any government that ventures such a course of action will suffer a serious loss of popular support. Well aware of the possible damage to their political standing, neither of the two big parties is eager to lead a government in the current economic situation. This makes it even more problematic to find a possible way out of the current crisis. To all intents and purposes, Bulgaria has slipped into a vicious cycle: any further delay in resolving the political mess will only exacerbate the fiscal imbalance; that, in turn, will create further disincentives to address the political crisis.

A direct negative consequence of this situation has been the enforced abandonment of the earlier declared target of adopting the euro in January 2024. As early as 2022, it was evident that Bulgaria had seriously deviated from the path that would allow it to achieve this target. This was clear even on purely formal grounds: apart from the budget deficit, inflation was way above the desired level – and indeed became out of control. Moreover, the surge in inflation that was observed in 2022 was partly home-grown, resulting as it did from inconsistent policies. The absence of a stable regular government has been another obstacle in the way to joining the euro area. This February, Bulgaria announced that it would not ask the European Commission and the European Central Bank to submit their regular Convergence Report, which was supposed to seal the country's readiness to join the euro area. No future target date for adoption of the euro has yet been announced.

A further adverse consequence of the political mess has been the blatant failure over the preparation and implementation of the country's Recovery and Resilience Plan. After several revisions, the plan was shown a tentative green light by the European Commission in April 2022, pending some additional elaborations. In consequence, the first instalment (non-repayable support) under the plan (amounting to EUR 1.37bn) was only received in December 2022. The disbursement of

the second instalment of non-repayable support (amounting to EUR 724m) is conditional on the implementation of 22 measures, which require changes to 16 laws. However, the absence of a functioning parliament has meant that this could not be attended to. The fate of the funds, which were due to be disbursed in February, remains unclear. According to most analysts, given the delays already incurred, Bulgaria will not be able to absorb the funds earmarked for 2023, and it is quite likely that a similar pattern will be repeated in the coming years.

While economic activity slowed throughout 2022, the rate of GDP growth for the year as a whole came to 3.4%, which was above the prevailing expectations. GDP growth in 2022 was mainly driven by private and public consumption, while gross fixed capital formation made a negative contribution. In turn, private consumption was underpinned by a boom in consumer credit. There was also a surge in the export of goods; however, the increase in the import of goods was even greater, and so net exports of goods subtracted from GDP growth. By contrast, net exports of services made a positive contribution, partly reflecting the recovery in tourism in 2022.

One of the factors that drove the export boom and the better-than-expected economic activity was the surge in the export of weapons to Ukraine. At present, Bulgaria is among Ukraine's most important suppliers of arms and ammunition – most of which complies with the old Soviet standards. However, as the majority of Bulgaria's population is against such supplies, most of these exports have not been officially announced, but have rather been channelled to Ukraine indirectly, in particular through Romania and Poland. There are no official statistics on the export of weaponry to Ukraine, but some experts have put the value in 2022 at more than EUR 1bn. In addition, Bulgaria has supported Ukraine's military activities by substantially increasing its export of fuels. In 2022, Bulgaria's total official exports to Ukraine almost tripled (to EUR 1.15bn), and fuel exports accounted for the lion's share of that increase. Ironically, the fuel was produced using oil imported from Russia.

In 2023, Bulgaria has continued to export weapons and fuel to Ukraine at the same (or greater) pace as in 2022. Some companies involved have already announced an expansion of their production facilities to meet the growing demand. These activities will again be a factor supporting Bulgaria's overall economic activity in 2023 – and probably for as long as the war continues.

The short-term indicators for the first months of 2023 suggest a significant slowing in the pace of both manufacturing production and goods exports. Private consumption – which in 2022 was underpinned by a surge in consumer credit, against the background of low interest rates – has also slowed with the rise in interest rates. Still, private consumption will probably remain the main growth driver in 2023. Annual consumer price inflation at the start of 2023 remains high (average annual inflation in February was as high as 14.0%), due to significant carry-over effects from the previous year. The figure for 2023 as a whole is likely to stay in double digits.

Overall, and in view of the worsening external and domestic environment, we expect GDP growth in 2023 to slow to 1.7%. GDP growth will remain moderate in coming years as well: in the range 2-3%. While inflation will gradually subside, it will probably stay in high single digits. The fiscal deficit will remain as the key challenge for policy makers, as its reduction will require considerable effort and political will.

Table 5.4 / Bulgaria: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024 Forecast	2025
Population, th pers., average	6,976	6,934	6,878	6,800	6,750	6,700	6,650
Gross domestic product, BGN m, nom.	120,396	120,553	139,012	165,384	184,900	202,200	218,000
annual change in % (real)	4.0	-4.0	7.6	3.4	1.7	2.2	2.7
GDP/capita (EUR at PPP)	16,610	16,570	18,640	20,680	.	.	.
Consumption of households, BGN m, nom.	70,436	69,776	80,454	98,240	.	.	.
annual change in % (real)	5.9	-0.5	8.7	4.7	2.0	2.0	2.5
Gross fixed capital form., BGN m, nom.	22,404	22,981	22,720	25,412	.	.	.
annual change in % (real)	4.5	0.6	-8.3	-4.3	2.5	4.0	6.0
Gross industrial production 2)							
annual change in % (real)	0.6	-5.9	9.8	12.7	2.0	2.5	3.0
Gross agricultural production							
annual change in % (real)	-1.2	-11.1	18.0	-7.7	.	.	.
Construction industry 3)							
annual change in % (real)	3.8	-5.3	2.6	0.4	.	.	.
Employed persons, LFS, th, average 4)	3,233	3,122	3,077	3,151	3,170	3,190	3,210
annual change in %	2.6	-3.4	-0.6	2.4	0.5	0.5	0.5
Unemployed persons, LFS, th, average 4)	143	169	171	140	140	140	140
Unemployment rate, LFS, in %, average 4)	4.2	5.1	5.3	4.3	4.3	4.2	4.2
Reg. unemployment rate, in %, eop	5.9	6.7	4.8	4.7	.	.	.
Average monthly gross wages, BGN	1,267	1,391	1,561	1,761	1,940	2,100	2,250
annual change in % (real, gross)	7.2	7.9	8.7	-2.2	0.0	1.0	2.0
Consumer prices (HICP), % p.a.	2.5	1.2	2.8	13.0	10.0	7.0	5.0
Producer prices in industry, % p.a.	3.0	-2.0	15.5	38.1	20.0	12.0	10.0
General governm. budget, EU def., % of GDP							
Revenues	38.4	37.7	36.7	38.0	37.0	37.0	38.0
Expenditures	36.3	41.5	40.6	43.0	42.0	41.0	41.0
Net lending (+) / net borrowing (-)	2.1	-3.8	-3.9	-5.0	-5.0	-4.0	-3.0
General gov. gross debt, EU def., % of GDP	20.0	24.5	23.9	22.4	24.0	26.0	27.0
Stock of loans of non-fin. private sector, % p.a.	7.4	4.5	8.3	12.2	.	.	.
Non-performing loans (NPL), in %, eop	6.6	7.5	6.0	4.6	.	.	.
Central bank policy rate, % p.a., eop 5)	0.00	0.00	0.00	1.30	2.5	2.5	2.0
Current account, EUR m	1,148	24	-1,316	-578	-500	-300	300
Current account in % of GDP	1.9	0.0	-1.9	-0.7	-0.5	-0.3	0.3
Exports of goods, BOP, EUR m	29,120	27,272	34,405	45,927	46,500	47,000	48,000
annual change in %	5.0	-6.3	26.2	33.5	1.2	1.1	2.1
Imports of goods, BOP, EUR m	32,028	29,213	37,292	50,816	51,000	51,500	52,500
annual change in %	5.2	-8.8	27.7	36.3	0.4	1.0	1.9
Exports of services, BOP, EUR m	10,237	7,320	9,184	11,886	12,000	13,000	14,000
annual change in %	11.3	-28.5	25.5	29.4	1.0	8.3	7.7
Imports of services, BOP, EUR m	5,342	4,171	5,104	6,560	7,000	7,500	8,000
annual change in %	5.5	-21.9	22.4	28.5	6.7	7.1	6.7
FDI liabilities, EUR m	1,983	3,154	2,084	3,014	.	.	.
FDI assets, EUR m	745	395	781	1,005	.	.	.
Gross reserves of CB excl. gold, EUR m	23,072	28,830	32,490	36,198	.	.	.
Gross external debt, EUR m	37,716	38,991	41,214	44,431	45500	46000	47000
Gross external debt, % of GDP	61.3	63.3	58.0	52.5	48.0	44.0	42.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) Enterprises with 5 and more employees. - 4) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 5) Base interest rate. This is a reference rate based on the average interbank LEONIA rate of previous month (Bulgaria has a currency board).

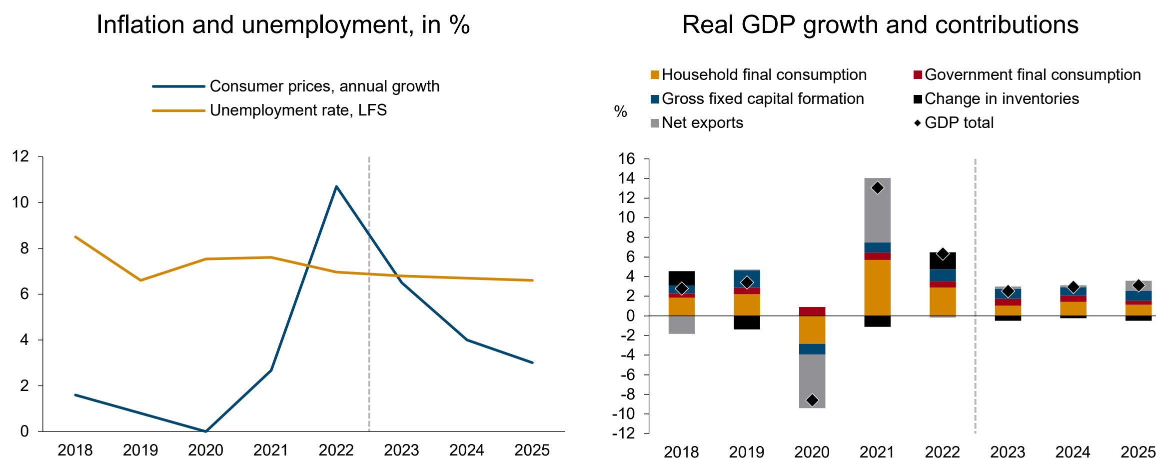
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

CROATIA: Uncertainty persists in the wake of the euro introduction

BERND CHRISTOPH STRÖHM

Thanks to robust household consumption and a stellar summer tourist season, as well as better-than-expected growth in Q4 2022, Croatia's economy grew by 6.3% in 2022. In January 2023, the country adopted the euro and joined the EU's border-free Schengen Area, which will likely boost trade, tourism and investment in the long term. Nevertheless, given the high rate of inflation, the deteriorating funding conditions and the uncertainty (which will act as a drag on private consumption and investment), we expect the economy to grow by only 2.5% in 2023.

Figure 5.5 / Croatia: Main macroeconomic indicators



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

Croatia's economy performed remarkably well in 2022, despite the cost-of-living crisis. GDP grew by 6.3% for the whole year. The drivers of growth were strong investment and public consumption, as well as a remarkable summer tourist season. At the same time, inflation surged to record levels, averaging 10.7%. The soaring cost of energy, processed food and non-energy industrial goods was the main driver behind this figure for inflation, which was higher than the EU average of 8.4%, but still substantially lower than in most of the neighbouring countries.

The first day of January 2023 was a milestone in Croatia's history, as the country adopted the euro and simultaneously joined the Schengen Area. The benefits to Croatia of joining the euro area are clear cut: participation in the euro means greater resilience to external shocks and better access to financial markets. As a result, Croatia will now be able to acquire loans at lower interest rates. Another benefit arising from adoption of the euro is a boost in investor confidence. Moreover, the removal of EU

border controls as a result of joining Schengen and the elimination of foreign exchange risks will benefit the country's vital service and tourism sector over the long term.

Introduction of the euro in January led to an immediate surge in the price of certain goods. The Croatian consumer protection association warned that people were reporting marked price rises during the two-week transition period when both the kuna and the euro were in circulation: coffee and baked goods, especially, seem to have been affected. Sudden price surges were felt across the country, as retailers, contractors and various service providers substantially hiked their prices. The Croatian government threatened retailers and service providers with countermeasures in January 2023, including fines and the cancellation of energy subsidies. The State Inspectorate and the Tax and Customs Administration were tasked with ensuring that prices returned to the level of 31 December 2022. They carried out 103 inspections in January 2023, during which they discovered that the prices of certain foodstuffs – in particular bread and other bakery products – had risen by up to 15% since 31 December 2022.

EU funding will support Croatia's economic growth in 2023. Prime Minister Plenković announced that the government would use up all the funds from the EU Solidarity Fund for post-earthquake reconstruction by the end of June 2023: so far, the government has managed to absorb some EUR 800m from the Solidarity Fund's EUR 1.3bn. Total EU funding for 2023 is capped at some EUR 4bn (5.9% of GDP). According to government estimates, projects financed by money from the EU's Recovery and Resilience Facility, including the reconstruction of earthquake-damaged infrastructure in the Zagreb, Krapina-Zagorje, Sisak-Moslavina and Karlovac counties, will contribute 1.4 percentage points to headline GDP growth in 2023.

Croatia earned EUR 13.1bn from foreign tourists in 2022. In Q4 2022, there was a 44% rise in revenue from foreign tourists, compared to the same period of 2021 – and the figure was even 24% higher than the record-breaking pre-COVID-19 levels of 2019. The Tourism Ministry estimates that the total income from tourism, including revenue from domestic tourists, reached EUR 15bn in 2022 (22.2% of GDP). In light of the country's introduction of the euro and its accession to the Schengen Area, it looks set fair to match those figures in 2023.

In March 2023, the government presented its fourth state aid package to mitigate the cost-of-living crisis. This is worth EUR 1.7bn (2.5% of GDP) and is designed to aid local households, institutions and companies in managing the surge in energy prices. The package will also introduce price caps on foodstuffs in order to counter inflation. In addition, the government has confirmed that it will maintain the lower 5% VAT rate on natural gas consumption and on heating products, such as wood and pellets. Given the government's new support package and the fact that supply-chain normalisation will bring a steeper decline in energy and food prices, inflation looks set to cool this year, to an estimated 6.5%.

The unemployment rate will fall to roughly pre-COVID-19 levels. According to the national statistical office, there were 1.72m employed persons in Croatia in Q4 2022 (27,000 more than in Q4 2021), while the number of jobseekers increased by only 9,000 (to 124,000). In anticipation of a bountiful tourist season, we expect Croatia's unemployment rate to decline to 6.8% in 2023 – almost the level seen before COVID-19.

Croatia is still faced with labour shortages, due to mass emigration to other EU countries over the past decade. The country's shrinking labour force is problematic, as is the demographic outlook. The Croatian Central Bank has revealed that an average of 2% of Croatia's population emigrated each year from 2014 until 2017, following the country's EU accession. In addition, the results of the 2021 population census showed that Croatia's population had contracted by some 10% (roughly 400,000 people) over the previous ten years. The government is attempting to address the persistent labour shortages in tourism, construction, transportation, the metal and food industries, and the agriculture sector by hiring foreign workers. In a bid to limit labour shortages, it abolished its annual quota for the employment of foreign nationals in 2021 and decided to drop the legal requirement for domestic companies to look into hiring locals before taking on foreigners.

Croatia is successfully transitioning to become an energy powerhouse in the Western Balkan region. In 2022, the country decided to invest EUR 155m in developing the Zlobin-Bosiljevo gas pipeline and EUR 25m in expanding capacity at the liquefied natural gas (LNG) terminal on the Adriatic island of Krk, to turn it into an energy hub for the region's gas supplies. To strengthen Croatia's role as an energy exporter and to contribute to energy security, the government decided that Croatia should increase its production of hydrocarbons by some 30% between 2022 and 2024. In March 2022, the INA state-owned oil and gas company embarked on drilling for natural gas in the Adriatic's Ika gas field, with the aim of producing 55m cubic metres of additional gas per year (some 7% of INA's total annual output). Despite those investments, Croatia is still planning to keep to its National Energy Development Strategy of achieving carbon neutrality by 2030. To meet this goal, it can only utilise LNG as a transitional energy solution. Additional investment in renewable energy sources, especially in the country's underutilised solar power capacities, is therefore essential.

For 2023, we are expecting Croatia's economy to grow by 2.5%. We are sticking with our previous forecast for this year's GDP growth. High inflation, paired with deteriorating funding conditions and uncertainty, will further depress real wages and hamper investor sentiment. Because of that, private investment (apart from in tourism) and household consumption will remain subdued this year. We expect public investment to act as the main driver of this year's economic growth, thanks to the allocation of generous EU funds.

Table 5.5 / Croatia: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average 2)	4,067	4,047	3,958	3,885	3,883	3,880	3,880
Gross domestic product, EUR-HRK m, nom.	54,784	50,451	58,207	67,390	74,000	79,000	84,000
annual change in % (real)	3.4	-8.6	13.1	6.3	2.5	2.9	3.1
GDP/capita (EUR at PPP)	20,830	19,450	22,560	25,810	.	.	.
Consumption of households, EUR-HRK m, nom.	30,469	29,092	32,726	38,128	.	.	.
annual change in % (real)	4.0	-5.1	9.9	5.2	1.8	2.5	2.0
Gross fixed capital form., EUR-HRK m, nom.	11,662	11,217	12,068	13,839	.	.	.
annual change in % (real)	9.0	-5.0	4.7	5.8	5.0	4.3	5.0
Gross industrial production 3)							
annual change in % (real)	0.6	-2.7	6.3	1.2	2.8	2.5	3.0
Gross agricultural production							
annual change in % (real)	-1.2	1.1	-3.4	-8.6	.	.	.
Construction output 3)							
annual change in % (real)	8.3	4.4	9.3	4.0	.	.	.
Employed persons, LFS, th, average 4)	1,680	1,657	1,678	1,707	1,730	1,760	1,790
annual change in %	1.5	-1.3	1.3	1.7	1.3	1.5	1.5
Unemployed persons, LFS, th, average 4)	119	135	138	128	130	130	130
Unemployment rate, LFS, in %, average 4)	6.6	7.5	7.6	7.0	6.8	6.7	6.6
Reg. unemployment rate, in %, eop	7.8	9.3	7.3	6.7	.	.	.
Average monthly gross wages, EUR-HRK 5)	1,163	1,223	1,274	1,380	1,500	1,600	1,700
annual change in % (real, gross)	3.0	2.4	1.6	-2.3	2.0	2.5	2.3
Average monthly net wages, EUR-HRK 5)	857	898	946	1,016	1,100	1,200	1,300
annual change in % (real, net)	2.6	2.6	2.7	-3.1	2.0	2.5	2.5
Consumer prices (HICP), % p.a.	0.8	0.0	2.7	10.7	6.5	4.0	3.0
Producer prices in industry, % p.a.	0.8	-3.2	11.6	25.5	10.0	4.0	2.2
General governm. budget, EU def., % of GDP							
Revenues	46.3	46.7	46.0	49.1	46.0	46.0	47.0
Expenditures	46.1	54.0	48.5	51.0	48.4	48.0	48.8
Net lending (+) / net borrowing (-)	0.2	-7.3	-2.6	-1.9	-2.4	-2.0	-1.8
General gov. gross debt, EU def., % of GDP	71.0	87.0	78.4	69.5	66.5	64.0	62.0
Stock of loans of non-fin. private sector, % p.a.	3.9	3.5	2.3	11.2	.	.	.
Non-performing loans (NPL), in %, eop 6)	5.5	5.4	4.3	3.0	.	.	.
Central bank policy rate, % p.a., eop 7)	3.0	3.0	3.0	3.0	.	.	.
Current account, EUR m	1,571	-262	1,798	-2,209	-1,960	-1,660	-530
Current account, % of GDP	2.8	-0.5	3.1	-3.3	-2.6	-2.1	-0.6
Exports of goods, BOP, EUR m	12,810	12,005	15,605	20,770	22,640	24,290	25,870
annual change in %	5.0	-6.3	30.0	33.1	9.0	7.3	6.5
Imports of goods, BOP, EUR m	23,298	20,845	26,244	38,488	43,100	47,100	51,300
annual change in %	6.5	-10.5	25.9	46.7	12.0	9.3	9.0
Exports of services, BOP, EUR m	15,362	8,916	14,301	18,033	21,800	24,400	28,000
annual change in %	10.9	-42.0	60.4	26.1	21.0	12.1	14.9
Imports of services, BOP, EUR m	5,084	3,618	4,491	5,229	5,500	5,600	5,700
annual change in %	9.4	-28.8	24.1	16.4	4.9	2.5	2.5
FDI liabilities, EUR m	3,509	1,108	3,929	3,562	.	.	.
FDI assets, EUR m	82	409	1,152	-323	.	.	.
Gross reserves of CB excl. gold, EUR m	18,560	18,943	25,022	27,771	.	.	.
Gross external debt, EUR m	40,589	41,285	47,213	49,554	49,600	51,400	53,800
Gross external debt, % of GDP	72.9	81.9	81.0	73.5	67.0	65.0	64.0
Average exchange rate HRK/EUR	0.9845	1.0005	0.9992	1.0001	1.0	1.0	1.0

Note: Croatia has introduced the Euro from 1 January 2023. Up to and including 2022 all time series in HRK as well as the exchange rates and PPP rates have been divided for statistical purposes by the conversion factor 7.5345 (HRK per EUR) to achieve euro-fixed series (EUR-HRK).

1) Preliminary and wiiw estimates. - 2) From 2021 based on census 2021. - 3) Enterprises with 20 and more employees. - 4) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 5) From 2020 employees expressed in full-time equivalents (FTE). - 6) Loans more than 90 days overdue and those unlikely to be paid. - 7) Discount rate of CB.

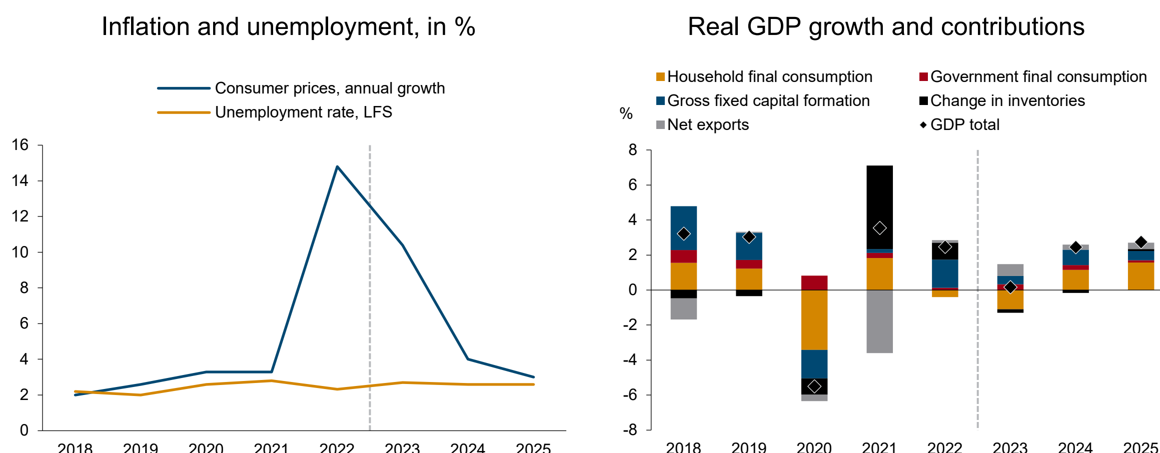
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

CZECHIA: Inflation proving hard to tame

ZUZANA ZAVARSKÁ

With persistently high inflation, cooling internal and external demand, tight monetary conditions and a deteriorating fiscal position, the macroeconomic challenges facing Czechia are mounting. The Czech economy will manage to keep its head just above water and will avoid a recession, but it will be stagnant this year. The slowdown is expected to be temporary, and the economy should be in a position to see renewed growth from 2024 onwards.

Figure 5.6 / Czechia: Main macroeconomic indicators



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

The Czech economy grew by 2.5% in 2022 – below the figure for the EU overall, but still ahead of other highly industrialised economies, such as Germany or Slovakia. Fixed investment acted as the main contributor to growth (+1.6 pp), along with a significant accumulation of inventory stocks (+1.0 pp). By contrast, household consumption contributed negatively to growth (-0.9 pp), while other components made a fairly negligible contribution.

Price pressures remained strong in Q1 2023, with consumer prices maintaining double-digit growth (year on year) for 14 consecutive months. There are multiple contributory factors to the persistently high inflation (selected food items, housing, water supply and sewerage, solid fuels), but a recent acceleration in the price of services (particularly in the areas of accommodation, catering, recreation and culture) has further intensified the situation. Assisted by the base effect, most recent figures suggest a slight slowdown in the pace of price growth, and the coming months are likely to see further deceleration. Nevertheless, inflation will remain high throughout much of 2023, and is expected to average 10.4% this year. In 2024, we will see a return to lower – albeit still somewhat elevated – inflation levels (4%).

The tight labour market could further add to the inflationary pressure. Last year saw a decline in the unemployment rate, combined with relatively dynamic nominal wage growth (7.9% year on year in Q4), and this is likely to be maintained over the forecast horizon. Still, wages have so far not been able to keep up with the steep rise in inflation. In 2022, Czech average gross real wages saw their biggest drop in three decades, falling by 7.5%. A deterioration in purchasing power will continue in 2023, before starting to recover in 2024 as inflation eases and workers demand an adjustment of their wages. Given Czechia's long-standing structural problems with labour shortages, employees are expected to be relatively well-positioned for the wage bargaining.

With depressed real wages, household consumption will continue to drag down growth in 2023. Sales in retail trade has fallen markedly in year-on-year terms. The latest (February) figures suggest that households may be trimming their spending, particularly on groceries and household equipment. Consumer confidence remains very weak,[17] well below the levels observed even at the height of the COVID-19 crisis. Concerned with their financial situation, consumers are indicating that they will be putting off making big-ticket purchases in the coming months. However, following two years of constrained spending, household consumption is expected to become the main growth driver in 2024 and 2025, as purchasing power begins to recover.

Industrial performance paints a mixed picture, and the future trajectory is highly uncertain. Industrial production was surprisingly resilient throughout 2022 and in the first months of 2023. February's figures revealed a growth of 2.6% against last year in manufacturing output, with the automotive sector posting double-digit growth for 9 months straight (year on year). In large part, this has been driven by the low base, since the comparison is against months when supply-chain issues were at their most acute. Still, it suggests that the large backlog in automotive orders is now being made up. At the same time, new orders have also been able to maintain solid growth (especially in motor vehicles and transport equipment), though non-domestic orders appear to be cooling. With depressed demand – both external and internal – Czech industry will likely struggle this year to maintain the level of resilience it has hitherto displayed.

A partial recovery in the automotive sector from chip shortages, combined with weak domestic demand, will contribute positively to the country's net export position this year. Trade figures from the first months of 2023 suggest a relatively strong international trade performance by the country. Exports to Czechia's most important partner, Germany, have been particularly upbeat in recent months, mirroring the developments in automotive production. The growth in the price of imports, as well as exports, is gradually moderating, reflecting global trends in energy prices. Exports are expected to outpace imports over the forecast period as a whole, which will help the country gradually reduce the negative current account balance it has maintained since 2021.

It is anticipated that gross fixed capital formation will be boosted by EU funds, as old money needs to be spent as the new money comes in. The remaining 2014-2020 Multiannual Financial Framework funds need to be spent by year-end, and Czechia has roughly 15% of its allocation still unspent. With regard to the Recovery and Resilience Facility, Czechia successfully completed all the milestones needed for the first payment of over EUR 1bn at the end of 2022, and will likely request the

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[17] Based on the Business Cycle Survey of the Czech Statistical Office from March 2023.

second disbursement of over EUR 800m in the second half of 2023. With high interest rates and looming uncertainty, EU finances will mitigate an otherwise tough private investment climate.

The tight monetary policy stance taken by the central bank is unlikely to be eased any time soon. Comments made by the Czech National Bank (CNB) suggest that no major changes to the policy rate can be expected before the end of the calendar year – after which a gradual easing can be anticipated, to around 3% by 2025 (from the present 7%). The Czech koruna has been exceptionally strong in recent months, which has partially aided the CNB's fight against inflation. It is likely to depreciate slightly in the coming months, as interest rate differentials vis-à-vis the euro lessen. Nevertheless, it is projected to remain stronger than the average over recent years.

On the fiscal side, Czechia has been struggling with a deteriorating public financial situation. In 2022, the country accumulated the highest government debt ever since its foundation in 1993 (45% of GDP) and posted a fiscal deficit of 3.9% of GDP. Public spending will remain high, as energy-related support measures continue to be provided to both households and firms. As of February 2023, over 40% of the deficit budgeted for the whole year had already been incurred.[18] While government revenue is also expected to be boosted by windfall taxes on the exceptional profits made by certain firms, this will not be enough to offset the higher spending. Although a gradual fiscal consolidation can be expected, a deficit will be maintained across the forecast horizon.

Overall, growth will be highly constrained in 2023, but this will be followed by a mild revival in 2024. This largely mirrors inflation developments, which are temporarily depressing both internal and external demand. EU funds will provide a boost to private investment in 2023, but the release of accumulated inventories will drag down gross capital formation. Net exports will act as the main positive contributor to GDP growth this year. In 2024 and 2025, household consumption will lead growth, as real wages start to recover and households begin to purchase the durable items they have put off buying over the past two years. However, this outlook is clouded by major uncertainty caused by the war in Ukraine, the energy transition, and supply-chain bottlenecks and chip shortages.

[18] Based on data from the Ministry of Finance: https://www.mfcr.cz/cs/aktualne/tiskove-zpravy/2023/pokladni-plneni-sr-50533

Table 5.6 / Czechia: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024 Forecast	2025
Population, th pers., average	10,672	10,698	10,506	10,525	10,550	10,580	10,600
Gross domestic product, CZK bn, nom.	5,791	5,709	6,109	6,795	7,430	7,900	8,340
annual change in % (real)	3.0	-5.5	3.6	2.5	0.2	2.4	2.7
GDP/capita (EUR at PPP)	29,180	28,050	29,710	32,060	.	.	.
Consumption of households, CZK bn, nom.	2,663	2,536	2,716	3,130	.	.	.
annual change in % (real)	2.6	-7.4	4.1	-0.9	-2.4	2.5	3.4
Gross fixed capital form., CZK bn, nom.	1,568	1,516	1,589	1,838	.	.	.
annual change in % (real)	5.9	-6.0	0.8	6.2	1.8	3.2	1.9
Gross industrial production							
annual change in % (real)	-0.3	-7.2	6.9	2.5	0.5	3.0	3.3
Gross agricultural production							
annual change in % (real)	2.0	5.2	1.5	-0.8	.	.	.
Construction industry							
annual change in % (real)	2.7	-6.3	2.7	2.6	.	.	.
Employed persons, LFS, th, average 2)	5,303	5,235	5,213	5,171	5,140	5,170	5,180
annual change in %	0.2	-1.3	-0.5	-0.8	-0.5	0.6	0.2
Unemployed persons, LFS, th, average 2)	109	137	151	123	140	140	140
Unemployment rate, LFS, in %, average 2)	2.0	2.6	2.8	2.3	2.7	2.6	2.6
Reg. unemployment rate, in %, eop	2.9	4.0	3.5	3.7	.	.	.
Average monthly gross wages, CZK	34,578	36,176	37,903	40,353	43,500	46,600	49,100
annual change in % (real, gross)	4.9	1.4	0.9	-7.5	-2.4	2.9	2.2
Consumer prices (HICP), % p.a.	2.6	3.3	3.3	14.8	10.4	4.0	3.0
Producer prices in industry, % p.a.	1.7	0.6	6.2	18.6	8.0	3.5	2.5
General governm. budget, EU def., % of GDP							
Revenues	41.3	41.5	41.4	40.1	42.2	41.5	41.5
Expenditures	41.1	47.2	46.5	44.0	46.4	44.0	43.4
Net lending (+) / net borrowing (-)	0.3	-5.8	-5.1	-3.9	-4.2	-2.5	-1.9
General gov. gross debt, EU def., % of GDP	30.0	37.7	42.0	45.0	45.8	45.0	43.0
Stock of loans of non-fin. private sector, % p.a.	5.2	4.1	8.4	4.5	.	.	.
Non-performing loans (NPL), in %, eop	2.5	2.8	2.4	1.9	.	.	.
Central bank policy rate, % p.a., eop 3)	2.00	0.25	3.75	7.00	6.50	4.75	3.00
Current account, EUR m	747	4,393	-6,639	-16,911	-8,650	-5,400	-1,750
Current account, % of GDP	0.3	2.0	-2.8	-6.1	-2.8	-1.7	-0.5
Exports of goods, BOP, EUR m	139,428	128,226	148,552	174,999	189,300	196,700	208,500
annual change in %	2.2	-8.0	15.9	17.8	8.2	3.9	6.0
Imports of goods, BOP, EUR m	130,088	117,611	145,936	179,041	190,700	196,800	204,700
annual change in %	1.2	-9.6	24.1	22.7	6.5	3.2	4.0
Exports of services, BOP, EUR m	27,204	22,842	25,275	31,985	35,800	39,000	42,000
annual change in %	4.9	-16.0	10.7	26.5	12.0	9.0	7.7
Imports of services, BOP, EUR m	23,078	18,912	21,180	28,333	31,900	34,300	37,300
annual change in %	8.5	-18.1	12.0	33.8	12.6	7.5	8.8
FDI liabilities, EUR m	9,582	7,367	10,953	10,045	.	.	.
FDI assets, EUR m	4,243	1,788	9,818	3,009	.	.	.
Gross reserves of CB excl. gold, EUR m	133,059	134,905	152,755	130,626	.	.	.
Gross external debt, EUR m	172,544	164,648	181,763	184,682	202,900	212,100	223,900
Gross external debt, % of GDP	76.5	76.3	76.3	66.8	66.1	65.5	65.5
Average exchange rate CZK/EUR	25.67	26.46	25.64	24.57	24.2	24.4	24.4

1) Preliminary and wiiw estimates. - 2) From 2021 new methodology in line with the Integrated European Social Statistics Regulation (IESS), excluding persons on parental leave from employed persons. -3) Two-week repo rate.

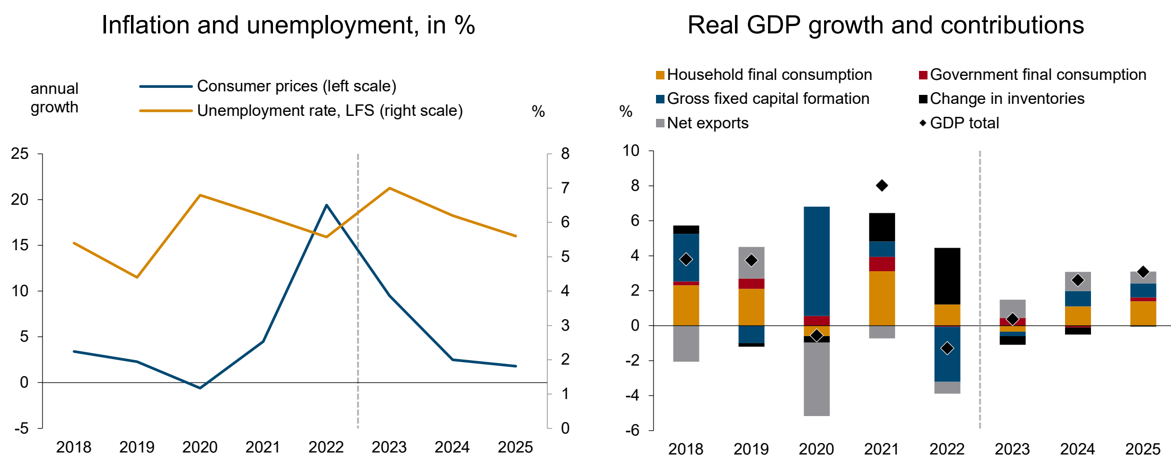
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ESTONIA: A momentary dip, rather than recession

MARYNA TVERDOSTUP

The anticipated economic decline – driven by severe inflation and weakening foreign demand – did indeed materialise in Q4 2022. However, economic prospects are not that grim, as inflation is slowing and consumption is gradually recovering. Moreover, economic activity in those sectors that are less reliant on imports of raw materials remains strong. Yet two major risk factors overshadow the outlook – the reduced export competitiveness of Estonian firms and a deepening systemic imbalance between budget revenue and expenditure.

Figure 5.7 / Estonia: Main macroeconomic indicators



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

As anticipated, economic growth was hit by high inflation in the second half of 2022, leading to overall economic decline of 1.3% for the year; the main factors were a poorly performing export sector and slackening domestic demand. Yet, prices are rising more slowly, business activity remains resilient and the labour market continues strong – all suggesting that the economic dip will be short lived. Nonetheless, sluggish domestic and foreign demand means that any marked recovery will only get under way in the second half of 2023, as purchasing power begins to revive. The economy is projected to grow by only a modest 0.4% in 2023, followed by 2.6% in 2024 and 3.1% in 2025.

As during the pandemic times, the performance of different sectors varied dramatically last year, yet the current crisis led to the best and the worst performers switching places. Whereas the pandemic hit tourism, accommodation, the food sector and agriculture, last year saw the ongoing revival of those sectors; indeed, despite the rocketing inflation and dwindling purchasing power, they made a non-negligible positive contribution to economic growth. By contrast, the business services and IT

sectors – the whales that buoyed up the Estonian economy throughout the pandemic – contributed to the economy's contraction in 2022.

Inflation is being brought under control, but there is a long way to go before it reaches the pre-crisis level. Having peaked at 25% in August 2022, inflation slowed in the second half of 2022 and was down to 15.3% by March 2023. This was mainly thanks to gas and electricity prices returning to their pre-war levels – a result both of falling market prices and government measures to make electricity, gas and heating more affordable. Reduced domestic and foreign demand in Q4 2022 narrowed firms' ability to raise prices, while climbing interest rates made borrowing more expensive for businesses and households and put the brakes on inflation in the first months of 2023 Inflation is expected to slow further in the coming months (largely due to the high reference base) and will average around 9.5% in 2023; this will be followed by a decline to 2.5% in 2024 and 1.8% in 2025.

Estonian companies are finding it harder to maintain their competitiveness on the global market. The heavy price pressure and interruptions to supply have been further exacerbated by the lack of state support for enterprises to offset the adverse effects of the energy crisis. Whereas in many other EU countries – including Estonia's main competitors – governments have introduced business-support schemes to smooth the energy crisis and supply shortages, Estonian enterprises have had to deal with the crisis largely on their own.

Rising prices, the uncertainty caused by the war and declining demand abroad led to a slump in export activity in the second half of 2022. Furthermore, many exporting sectors faced prices for raw materials and energy that were far higher than their competitors had to contend with, and this undermined the competitiveness of Estonian firms. The slowdown in goods exports pushed the current account into a 0.5% GDP deficit in Q4 2022, and the downward export dynamics have lasted through the first months of 2023. Exports of services remained strong in 2022 and provided much support to the current account, with IT, other business services and transport services accounting for 70% of service exports in 2022. Still, the full-scale recovery of exports – which used to be generally one of the drivers of economic revival in Estonia – cannot be relied upon this time, as the competitiveness of Estonian firms (especially in manufacturing) is under severe threat, with exports projected to decline by 1.5% in 2023. Subsequent years should see some revival in foreign trade.

The investment outlook for 2023 is rather bleak, due to the overall slowdown in business activity, rising interest rates and persistent uncertainty. Yet investment activity has varied dramatically across the sectors, with investments in energy efficiency remaining consistently high throughout the year. Corporate investments will likely improve in the second half of 2023, reflecting declining inflation, economic revival, stabilising energy prices and an easing of supply bottlenecks. Yet higher interest rates will rein in investment activity. Hence, one should not expect any major contribution of investments to economic revival in 2023.

The previously strong private consumption lost momentum in the second half of 2022 and will likely stay low throughout the first half of 2023, before gradually recovering. Despite all the uncertainty and the rising prices last year, consumption remained solid throughout the first two quarters of 2022, based on steady wage growth (especially in the private sector) and private savings buffers. However, it fell in the last quarters of 2022, as consumer price inflation peaked, savings were largely depleted and borrowing became more expensive. In 2023, the development of consumption will be

reinforced by various government support schemes, such as increased child and family benefits and a rise in both pensions and public-sector wages. Falling inflation will also help to buoy up consumption. However, private spending will be curbed by the rising cost of housing loans (which will reduce further the purchasing power of households with variable mortgages) and by the fact that savings were largely exhausted in 2022. Thus, private consumption will post a modest decline of 0.7% in 2023, with a subsequent revival of 2.3% in 2024 and 2.9% in 2025, built on a strong labour market and diminishing inflation.

The labour market remained strong through 2022, with nominal wages growing at 9.2% year on year and unemployment remaining at 5.4% in Q4 2022; this benefited domestic demand, though it exerted upward pressure on inflation. A slowdown in business activity will reduce labour demand in the first half of 2023, restraining wage growth and boosting joblessness. Unemployment will also be fuelled by the Ukrainian refugees who are entering the labour market this year. Over 40,000 Ukrainians fleeing the war had registered in Estonia by the end of 2022, but as of March 2023 only around 10,000 had joined the labour market. This suggests that a large share of those refugees will start looking for a job this year. Unemployment will likely reach around 7.0% in 2023, dropping to 6.2% in 2024 and to 5.6% in 2025.

Exceptionally high tax receipts aided the state budget in 2022, yet the fiscal position will deteriorate this year. High rates of inflation and an economy that was still performing relatively well brought the state budget exceptionally high tax revenues in 2022. These will largely be used in 2023 to finance mounting state expenditure – likely to grow substantially on account of increased spending on defence, welfare and family benefits, a one-off pension rise and a not inconsiderable increase in public-sector wages. Meanwhile, a rise in the tax-free income threshold and the overall economic downturn will reduce the tax inflow in 2023. We forecast a widening of the budget deficit in 2023, to 4% of GDP.

Tight fiscal discipline and the anticipated economic recovery will likely prevent this budget deficit growing any more, but it will narrow only slowly – reaching around 3% in 2025. Whereas some of the state measures aimed at supporting consumers and boosting private consumption – such as the public-sector wage increase – will have just a short-lived effect on government spending, other measures (including the raising of the tax-free income threshold) will have long-lasting repercussions for the state budget. Yet the planned increases in VAT and in income tax (in 2024 and 2025, respectively) will yield additional state revenue in the coming years. For a country with long-established strict fiscal discipline and historically very low external debt, the current fiscal imbalance is a major topic of debate and will likely remain so for the newly formed government coalition.

Table 5.7 / Estonia: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	1,327	1,330	1,331	1,345	1,350	1,349	1,347
Gross domestic product, EUR m, nom.	27,765	27,465	31,445	36,181	39,800	41,900	44,000
annual change in % (real)	3.7	-0.6	8.0	-1.3	0.4	2.6	3.1
GDP/capita (EUR at PPP)	25,780	25,850	28,840	30,620	.	.	.
Consumption of households, EUR m, nom.	13,451	13,171	14,618	17,504	.	.	.
annual change in % (real)	4.4	-1.2	6.5	2.6	-0.7	2.3	2.9
Gross fixed capital form., EUR m, nom.	7,056	8,563	9,076	9,161	.	.	.
annual change in % (real)	-3.7	24.7	2.8	-10.9	-1.0	3.4	3.2
Gross industrial production							
annual change in % (real)	6.9	-3.0	13.3	-2.0	1.0	4.2	3.5
Gross agricultural production							
annual change in % (real)	22.8	0.0	-4.9	3.9	.	.	.
Construction industry							
annual change in % (real)	5.8	-6.1	9.4	-1.2	.	.	.
Employed persons, LFS, th, average 2)	671.3	656.6	654.2	680.9	680	690	700
annual change in %	1.0	-2.2	-0.5	4.1	0.5	1.2	0.9
Unemployed persons, LFS, th, average 2)	31.3	47.9	43.1	40.2	51	46	42
Unemployment rate, LFS, in %, average 2)	4.4	6.8	6.2	5.6	7.0	6.2	5.6
Reg. unemployment rate, in %, eop 3)	5.3	8.3	6.8	7.7	.	.	.
Average monthly gross wages, EUR	1,407	1,448	1,548	1,685	1,930	2,090	2,210
annual change in % (real, gross)	5.0	3.4	2.1	-8.8	4.5	5.6	4.0
Average monthly net wages, EUR	1,150	1,185	1,266	1,379	1,590	1,720	1,820
annual change in % (real, net)	5.1	3.5	2.0	-8.8	5.0	5.8	4.1
Consumer prices (HICP), % p.a.	2.3	-0.6	4.5	19.4	9.5	2.5	1.8
Producer prices in industry, % p.a.	-0.6	-3.5	17.2	36.0	9.0	2.4	1.7
General governm. budget, EU def., % of GDP							
Revenues	39.5	39.4	39.0	45.0	41.0	42.1	42.7
Expenditures	39.4	44.9	41.5	47.0	45.0	45.4	45.7
Net lending (+) / net borrowing (-)	0.1	-5.5	-2.4	-2.0	-4.0	-3.3	-3.0
General gov. gross debt, EU def., % of GDP	8.5	18.5	17.6	19.5	21.8	20.8	19.6
Stock of loans of non-fin. private sector, % p.a.	3.3	4.8	7.5	11.7	.	.	.
Non-performing loans (NPL), in %, eop	0.5	0.4	0.2	0.2	.	.	.
Central bank policy rate, % p.a., eop 4)	0.00	0.00	0.00	2.50	.	.	.
Current account, EUR m	658	-272	-568	-790	280	750	630
Current account, % of GDP	2.4	-1.0	-1.8	-2.2	0.7	1.8	1.4
Exports of goods, BOP, EUR m	13,317	13,290	16,367	20,092	19,100	20,750	21,700
annual change in %	5.8	-0.2	23.2	22.8	-4.9	8.6	4.6
Imports of goods, BOP, EUR m	14,245	13,533	17,662	22,759	21,670	22,250	22,900
annual change in %	3.1	-5.0	30.5	28.9	-4.8	2.7	2.9
Exports of services, BOP, EUR m	7,197	5,736	8,254	10,845	12,310	12,900	13,800
annual change in %	7.7	-20.3	43.9	31.4	13.5	4.8	7.0
Imports of services, BOP, EUR m	5,154	5,470	7,073	8,382	9,450	10,300	11,700
annual change in %	8.6	6.1	29.3	18.5	12.7	9.0	13.6
FDI liabilities, EUR m	2,708	3,122	6,169	1,517	.	.	.
FDI assets, EUR m	1,634	253	5,558	2,086	.	.	.
Gross reserves of CB excl. gold, EUR m	1,256	1,615	2,081	2,068	.	.	.
Gross external debt, EUR m	21,135	24,382	26,630	30,531	34,300	35,200	36,400
Gross external debt, % of GDP	76.1	88.8	84.7	84.4	86.3	84.0	82.8

1) Preliminary and wiiw estimates. - 2) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 3) In % of labour force (LFS). - 4) Official refinancing operation rate for euro area (ECB).

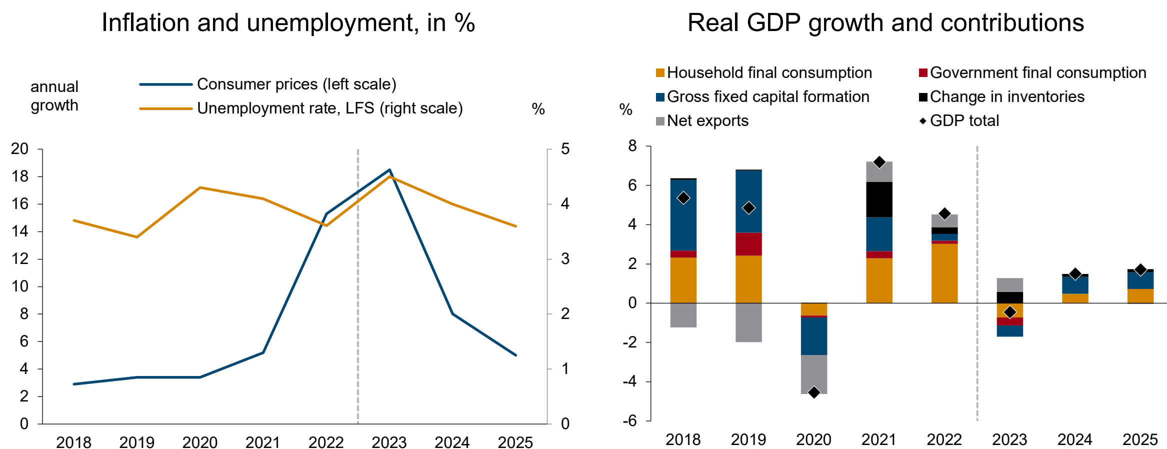
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

HUNGARY: In the grip of high inflation

SÁNDOR RICHTER

In early 2023, Hungarian inflation was the highest in the EU. Measures to rein in inflation have been unavoidable, but do little to encourage growth. Both consumption and investment will fall this year, and the only positive contribution to GDP change will come from foreign trade, where deficits are expected to shrink substantially. This year will be split between recession in the first half and moderate recovery in the second. EU transfers continue in limbo. A new industrial policy aimed at facilitating the FDI-based mass production of batteries for electric cars has the potential to turn into a costly fiasco.

Figure 5.8 / Hungary: Main macroeconomic indicators



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

Year-on-year inflation reached 25.2% in March, far higher than the EU average. Core inflation stood at 25.7%. Food prices were 42.6% higher – and the rise in the cost of certain staples even outstripped that: bread (67%), eggs (74%) and dairy products (72.8%). Household energy prices increased by 43.1%. However, inflation in March was a few decimal points lower than in January and February, suggesting that the peak may have been passed. The reasons for the high inflation do coincide in part with the situation in other countries: the rocketing cost of imported energy and the impact of the war in Ukraine. However, there are several other, more country-specific reasons as well: food inflation was exacerbated by a devastatingly bad harvest in 2022, when agricultural value added fell by 31%; during – and even before – the Covid pandemic, right up until early 2022, the government pursued a loose monetary and fiscal policy designed to maintain a 'high-pressure economy'; and the extraordinary public spending related to the 2022 elections served to top everything off. Related to this economic policy and the tight labour market, net real wages increased by 12.7% in the three Covid years (2020-2022), while

in the same period real GDP growth amounted to just 7%. A spur to more recent price rises has also come from the business sector, where profits last year grew far more strongly than wages and other cost elements. The exchange rate made its own contribution to the high inflation: from a monthly average of HUF 358 to the euro in January 2022, it deteriorated gradually to arrive at a record-weak HUF 431 to the euro by the middle of October – a depreciation of over 20%.

The dangerous weakening of the forint brought about a turning point in monetary policy. On 14 October, the central bank took an extraordinary step: while the policy rate remained at 13%, the benchmark indicator – the interest rate offered at daily overnight deposit tenders – was raised to 18%. This helped halt the depreciation of the forint, even if the exchange rate has remained fairly volatile. The government has promised to cut inflation to single digits by the end of this year. Meanwhile, the central bank is reckoning on average consumer price inflation of 15-19.5% this year – an unusually broad range – keeping inflation expectations close to the higher end of the band. The social impact of extremely high food inflation is devastating, and the lower-income strata of the population (which have a higher-than-average share of food in their consumption basket) have been hit hard. Surprisingly, the popularity of the government has remained unchanged, partly thanks to its more or less successful channelling of popular anger against Ukraine ('we have war inflation') and the EU ('we have EU sanctions inflation') via the government owned or dominated media.

The government is planning substantial fiscal consolidation this year – of over 2 percentage points of GDP – to reduce the 6.1% of GDP deficit reported for last year. This will be tough: 2023 started with a very high fiscal deficit in the first three months. The costs of servicing the public debt are on the rise (from 2.3% relative to GDP in 2021 to an estimated 3.7% this year and 4.6% in 2024). The large FDI projects envisaged will require huge government subsidies. In line with its new strategic motivations, the government intends to turn Hungary into a 'great power' in the field of the production of batteries for electric cars. As well as those factories that are already operational or are under construction, other huge projects are in the pipeline. The largest, initiated by the Chinese CATL Co., is worth EUR 7.3bn. But battery production requires ample water resources, abundant energy and plenty of labour. All three are scarce in Hungary, and there is no comparative advantage that could be mentioned in support of this peculiar industrial policy. The environmental issues related to battery production that have already been reported (as well as further potential problems) have triggered popular protests even in cities and regions where the government's political support is strong. Of medium-term concern is the energy supply for this new industrial segment: Prime Minister Orbán has referred to the possible new construction of three large natural gas-based power stations – a trend-bucking notion at a time when other European states are making huge efforts to wean themselves off natural gas (and especially Russian deliveries of it).

The relationship between the European Commission and the Hungarian government has been steadily deteriorating, with anti-EU propaganda becoming ever shriller in the mainstream Hungarian media. Contested rule-of-law issues are being addressed half-heartedly by the government, and the mainly cosmetic changes do not satisfy the Commission (which seems to have learned from the earlier fiascos when it challenged the illiberal system of Prime Minister Orbán). However, any real adjustment in the critical areas of the judiciary, the treatment of NGOs, university endowments, gender issues and – most prominently – investigation of the numerous cases of suspected corruption would critically weaken the regime. The prospects of a green light being given to release the suspended EU transfers in the first half of the year are, therefore, dim; nor are they particularly promising in the second

half of the year. However, transfers from the previous (2014-2020) Multiannual Financial Framework are still reaching Hungary, as are the EU's direct payments for farmers. Nevertheless, the continued suspension of a considerable part of the EU transfers places the government's fiscal targets in jeopardy, depresses aggregate demand and gets in the way of a more comfortable level of international currency reserves being attained. Ratings agencies are following developments closely, and downgrading may be triggered if there is no easing of the difficulties in this field.

With shrinking consumption and investment, the only support for economic growth in 2023 will come from net exports. The (most probably) lower prices for imported energy and the reduced demand for imported goods will, it is assumed, radically improve external balances. Fiscal restrictions and high interest rates are not growth friendly. All in all, a moderate (0.5%) decline in GDP is expected this year, with a recession in the first half year and a moderate recovery in the second. Inflation is expected to subside only slowly in the first six months, and then to drop in larger steps from the middle of the year. However, annual average inflation is still expected to amount to 18.5% – substantially higher than last year. While disinflation in the second half of the year would provide some grounds for a reduction in the 18% benchmark interest rate, the requirement to keep the HUF exchange rate stable will necessitate caution in this field. A green light to the lifting of the suspension of EU transfers (or indeed the absence of a green light) may influence growth prospects this year – in either direction – by up to 1 percentage point. Concerning the prospects for 2024 and 2025, there is huge uncertainty. The most likely scenario reckons with a moderate recovery, with slower disinflation than the targets set by the government and the central bank. A return to a fiscal deficit in the neighbourhood of 3% of GDP remains a major priority, putting a brake on growth.

Table 5.8 / Hungary: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	9,771	9,750	9,710	9,684	9,600	9,600	9,590
Gross domestic product, HUF bn, nom.	47,674	48,425	55,255	66,616	72,300	77,800	82,300
annual change in % (real)	4.9	-4.5	7.2	4.6	-0.5	1.5	1.7
GDP/capita (EUR at PPP)	22,860	22,380	24,380	27,380	.	.	.
Consumption of households, HUF bn, nom.	22,547	22,947	25,538	31,941	.	.	.
annual change in % (real)	5.1	-1.3	4.8	6.5	-1.5	1.0	1.5
Gross fixed capital form., HUF bn, nom.	12,873	12,841	15,139	18,909	.	.	.
annual change in % (real)	12.8	-7.1	6.5	1.2	-2.0	3.0	3.0
Gross industrial production							
annual change in % (real)	5.6	-6.0	9.6	5.7	1.5	5.0	5.0
Gross agricultural production							
annual change in % (real)	-0.1	-2.4	-0.7	-18.7	.	.	.
Construction industry							
annual change in % (real)	20.7	-9.8	11.9	3.3	.	.	.
Employed persons, LFS, th, average 2)	4,512	4,461	4,642	4,709	4,710	4,720	4,730
annual change in %	1.0	-1.1	0.7	1.4	0.0	0.3	0.2
Unemployed persons, LFS, th, average 2)	160	198	196	176	220	200	180
Unemployment rate, LFS, in %, average 2)	3.4	4.3	4.1	3.6	4.5	4.0	3.6
Reg. unemployment rate, in %, eop 3)	5.1	6.2	5.1	4.8	.	.	.
Average monthly gross wages, HUF 4)	367,833	403,616	438,814	515,766	602,000	656,700	703,300
annual change in % (real, gross)	7.7	6.2	3.4	2.5	-1.5	1.0	2.0
Average monthly net wages, HUF 4)	244,609	268,405	291,812	342,984	400,300	436,600	467,600
annual change in % (real, net)	7.7	6.2	3.4	2.6	-1.5	1.0	2.0
Consumer prices (HICP), % p.a.	3.4	3.4	5.2	15.3	18.5	8.0	5.0
Producer prices in industry, % p.a.	2.1	4.3	13.6	33.6	20.0	8.0	5.0
General governm. budget, EU def., % of GDP							
Revenues	44.0	43.5	41.2	43.9	44.5	44.0	44.0
Expenditures	46.0	51.1	48.3	50.0	49.0	48.0	47.3
Net lending (+) / net borrowing (-)	-2.0	-7.5	-7.1	-6.1	-4.5	-4.0	-3.3
General gov. gross debt, EU def., % of GDP	65.3	79.3	76.6	76.4	74.0	72.5	70.0
Stock of loans of non-fin. private sector, % p.a.	13.2	13.4	12.8	11.6	.	.	.
Non-performing loans (NPL), in %, eop 5)	4.1	3.6	3.2	3.2	.	.	.
Central bank policy rate, % p.a., eop 6)	0.90	0.60	2.40	13.00	12.50	8.00	4.00
Current account, EUR m 7)	-1,148	-1,570	-6,252	-13,725	-7,300	-5,200	-3,900
Current account, % of GDP 7)	-0.8	-1.1	-4.1	-8.1	-4.0	-2.8	-2.0
Exports of goods, BOP, EUR m 7)	92,525	88,655	100,885	124,340	132,500	141,800	150,300
annual change in %	4.5	-4.2	13.8	23.2	6.6	7.0	6.0
Imports of goods, BOP, EUR m 7)	96,212	89,990	105,311	139,246	146,900	156,400	165,000
annual change in %	5.9	-6.5	17.0	32.2	5.5	6.5	5.5
Exports of services, BOP, EUR m 7)	26,918	19,889	22,777	29,277	33,700	37,700	41,500
annual change in %	6.0	-26.1	14.5	28.5	15.0	12.0	10.0
Imports of services, BOP, EUR m 7)	19,828	15,885	17,863	21,221	23,600	25,700	28,300
annual change in %	14.5	-19.9	12.5	18.8	11.0	9.0	10.0
FDI liabilities, EUR m 7)	2,863	3,153	7,304	10,861	.	.	.
FDI assets, EUR m 7)	1,908	803	4,345	6,985	.	.	.
Gross reserves of CB excl. gold, EUR m	27,010	32,115	33,501	33,533	.	.	.
Gross external debt, EUR m 7)	107,104	111,754	130,525	149,755	143,000	144,000	145,000
Gross external debt, % of GDP 7)	73.1	81.1	84.7	88.0	79.1	76.8	75.8
Average exchange rate HUF/EUR	325.30	351.25	358.52	391.29	400	415	430

1) Preliminary and wiiw estimates - 2) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 3) In % of labour force (LFS). - 4) Enterprises with 5 and more employees. Based on tax administration data. - 5) Loans more than 90 days overdue and those unlikely to be paid. - 6) Base rate. - 7) Excluding SPE.

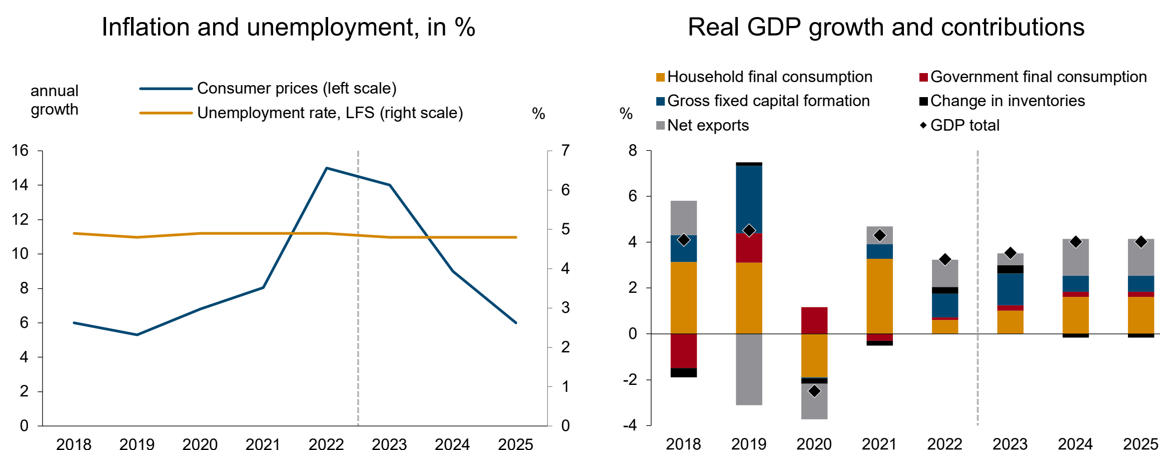
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

KAZAKHSTAN: Robust growth despite lower oil prices

ALEXANDRA BYKOVA

Despite the anticipated decline in oil prices, which will have an adverse impact on exports, economic growth is expected to accelerate over the forecast period due to domestic demand factors. Investments in infrastructure, in particular transport and logistics, will contribute positively to growth in the coming years. Consumption is likely to start recovering in 2023, although inflation is expected to take longer to contain, amid fiscal stimulus and the recent increase in regulated fuel prices.

Figure 5.9 / Kazakhstan: Main macroeconomic indicators



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

Economic performance varies by sector, but overall economic sentiment has been improving. The economy ended 2022 with real GDP growth of 3.2%, despite a 1% decline in mining on account of oil production being hit by several Caspian Pipeline Consortium (CPC) pipeline disruptions and production stoppages for maintenance and repairs. The data for January-February 2023 reflect annual growth of 4% in the main economic sectors.[19] While construction, trade and communication have recorded growth rates in double digits, the near stagnation in mining serves to weaken overall industrial performance. The growth of manufacturing is mainly driven by a robust performance by the machinery, food processing and beverages sectors, with annual growth of 31.5%, 9.6% and 22.6%, respectively, over the first two months of 2023. Leading indicators in March point to an improvement in economic

[19] The short-term indicator used captures, on a monthly basis, the real output of the main economic sectors – agriculture, industry, construction, trade, transport and communications. Altogether, these account for more than 60% of GDP and have proved to be a good proxy for real GDP growth.

sentiment across all sectors. The biggest improvement is visible in manufacturing, which can be explained by higher demand expectations and lower input costs.

Oil production is likely to recover during the year, but by less than previously expected. Production at the Tengiz oil field should rise significantly over 2023-2024, once the construction work related to the expansion project is completed. However, the overall increase in Kazakhstan's oil production in 2023 will be a few percentage points lower than the 9% estimated by OPEC in March, due to the latest OPEC+ restrictions that will be in place from May until the end of 2023. Besides, the risk of oil export disruption via the CPC pipeline is still present. A recent dispute between Kazakhstan and foreign investors involved in production sharing agreements (PSAs) at two large oil fields is a downside risk that particularly threatens FDI inflows.[20]

Transport and logistics have received a boost in response to geopolitically induced international trade shifts, and these are likely to attract investment in the medium term. An alternative oil transport route via the Caspian Sea to circumvent Russia seems to be slowly increasing its operating capacity: it is expected that 3.5m tonnes of oil will be exported through the port of Aktau in 2023, with further investments in infrastructure and the oil tanker fleet. Kazakhstan is developing its reputation as a transit route: in 2022 it increased total freight transit by 12.6% and container traffic by 6%. The Trans-Caspian International Transport Route (TITR) is growing in importance: last year, railway freight traffic in Kazakhstan increased 2.5 times (to 1.5m tonnes). To meet the challenges of changing trade flows, a new government programme will provide subsidised loans and public investment for transport and logistics development. Russian e-commerce companies are reportedly investing (or intending to invest) in the warehousing facilities needed to expand trade through CIS countries, including Kazakhstan.

Fiscal policy remains a balancing act between the need for increased spending and the longer-term objective of fiscal consolidation. Fiscal policy remains expansionary in 2023 through social-spending measures and public investment. After the ruling party confirmed its majority (54%) in the snap parliamentary elections on 19 March, new, less-popular measures, such as tax increases, are more likely to be introduced. An increase in new government bond issuance (mainly medium and long term) of up to USD 10bn per year will seek to cover the administration's financial needs, while reducing dependence on transfers from the National Oil Fund.

Private consumption is expected to rise in 2023, albeit limited by high inflation. Growth in real incomes and wages slowed throughout last year, as high inflation eroded purchasing power. Annual real income growth decelerated from 7% in Q1 2022 to 0.8% in Q4 2022. Meanwhile, the corresponding annual real wage growth slowed from 12.6% to 2.8%. After a 1% decline in the first three quarters of 2022, year on year, consumption is likely to pick up in 2023, supported by the increase in the minimum wage and pensions. This is suggested by the recent dynamics of retail trade turnover, which grew by 11.3%, year on year, in real terms in March 2023. Notwithstanding this, we expect annual real consumption growth to continue to be constrained by persistently high inflation, at least in the first half of the year.

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[20] Kazakhstan has demanded a fine of USD 5bn from the North Caspian Operating Company, the operator of Kashagan, for alleged environmental damage, which the latter denies. Kazakhstan has also initiated international legal proceedings for alleged damages due to various violations in Kashagan (USD 13bn) and Karachaganak (USD 5bn) in the period 2010-2019.

The recent inflation deceleration trend is fragile, with new domestic pro-inflationary risk factors. Four straight months of gradually slowing consumer price inflation came to an end in February; however, the trend resumed in March. Annual inflation amounted to 18.1% in March, down from 21.4% in February. Inflation expectations are volatile: after falling to 14.2% in February, they picked up again to 16.5% in March. Amid reported fuel shortages – mainly explicable by the fact that fuel prices are lower than in neighbouring countries, which leads to 'fuel tourism' – as from 12 April regulated prices have been increased by 10% for petrol and 20% for diesel. A subsequent hike in the regulated price of liquefied petroleum gas is possible. Along with extra budgetary spending of around 2% of GDP, this is likely to contribute to inflationary pressures this year. As it will probably take longer to bring inflation under control, we have revised our inflation forecast for 2023 slightly upwards.

Any policy rate cut is likely to come in the second half of the year, as inflation eases. The central bank left the key interest rate unchanged at 16.75% in April, and no further cuts are expected until the effects of the fiscal stimulus and the hike in fuel prices can be properly assessed. The high policy rate seems to have put the brakes on credit growth: the growth in consumer lending year on year slowed from 40% in February 2022 to 24% in February 2023; over the same period, the figure for lending to households slowed from 46% to 31% and for lending to companies – from 15% to 5%. However, a cut in the policy rate is possible in the second half of the year, as inflation is expected to ease amid falling global food prices and decelerating inflation among the country's main trading partners.

With the anticipated fall in oil prices, the current account is expected to return to deficit over the forecast period, after running a surplus of 3.9% of GDP last year. The big surplus in 2022 was driven by high global commodity prices: as a consequence, export growth outstripped import growth. Despite a recent spike in global oil prices following the recently announced OPEC+ production restrictions, we expect the downward trend to continue over the forecast period. Combined with limited growth in production volumes, we therefore predict lower exports in dollar terms in 2023. By contrast, imports should continue to increase, thanks to the recovery in private consumption and additional fiscal stimulus. Given these trends, we expect the tenge to depreciate over the forecast horizon: the recent appreciation was temporary and was due to the fiscal calendar and the influx of capital from non-residents into new government bonds.

The apparent large-scale re-export of high-tech consumer and capital goods to Russia puts Kazakhstan under pressure to take steps to avoid secondary sanctions. Exports to Russia increased by 25% in dollar terms in 2022: in particular, Kazakh exports of machinery and equipment to Russia (HS codes 84-92) increased by USD 1.6bn in 2022, raising Kazakhstan's share of Russian imports in this category from 0.4% to 1.9%. Simultaneously, Kazakhstan's imports in this category increased by USD 3.6bn, hinting at re-export. To ensure that the country is not used as a back door, and to avoid secondary sanctions, Kazakh officials have announced stricter monitoring of imports and exports from April and control through an electronic tracking system for cargo shipments inside the Eurasian Economic Union (EAEU).

To sum up, we expect real GDP growth to pick up slightly in 2023 to 3.5% (after 3.2% last year), with investments and private consumption the main growth drivers. Despite the anticipated decline in oil prices, limited oil production growth and high inflation that will constrain consumption growth, we are keeping our GDP forecasts for 2023 unchanged, due to the offsetting impact of larger fiscal stimulus and infrastructure investments. As inflation eases and consumption recovers, the economy is likely to accelerate to 4% annual growth over 2024-2025.

Table 5.9 / Kazakhstan: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average 2)	18,514	18,756	19,001	19,634	19,900	20,200	20,500
Gross domestic product, KZT bn, nom.	69,533	70,649	83,952	101,523	113,500	125,100	135,300
annual change in % (real)	4.5	-2.5	4.3	3.2	3.5	4.0	4.0
GDP/capita (EUR at PPP)	18,120	17,520	19,020	19,400	.	.	.
Consumption of households, KZT bn, nom.	35,571	36,661	42,419	49,400	.	.	.
annual change in % (real)	6.1	-3.7	6.3	1.2	2.0	3.2	3.2
Gross fixed capital form., KZT bn, nom.	16,318	17,463	19,342	24,100	.	.	.
annual change in % (real)	13.8	-0.2	2.6	4.5	6.0	3.0	3.0
Gross industrial production							
annual change in % (real)	4.1	-0.5	3.6	1.1	3.2	3.5	4.0
Gross agricultural production							
annual change in % (real)	-0.1	5.7	-2.3	9.1	.	.	.
Construction industry							
annual change in % (real)	13.2	11.6	8.3	9.4	.	.	.
Employed persons, LFS, th, average 2)	8,781	8,732	8,807	8,967	9,030	9,140	9,260
annual change in %	1.0	-0.6	0.9	0.2	0.7	1.2	1.3
Unemployed persons, LFS, th, average 2)	441	449	450	459	460	460	470
Unemployment rate, LFS, in %, average 2)	4.8	4.9	4.9	4.9	4.8	4.8	4.8
Reg. unemployment rate, in %, eop	1.1	1.5	1.1	1.4	.	.	.
Average monthly gross wages, KZT 3)	186,815	213,003	250,311	309,885	360,300	404,500	445,900
annual change in % (real, gross)	9.1	6.8	8.8	7.7	2.0	3.0	4.0
Consumer prices, % p.a.	5.3	6.8	8.0	15.0	14.0	9.0	6.0
Producer prices in industry, % p.a.	5.1	-8.0	32.5	27.1	3.0	3.0	3.0
General governm. budget, nat. def., % of GDP							
Revenues	18.3	20.6	18.9	19.9	19.7	19.5	19.5
Expenditures	20.2	24.5	21.9	22.1	22.4	22.0	21.5
Deficit (-) / surplus (+)	-1.8	-4.0	-3.0	-2.1	-2.7	-2.5	-2.0
General gov. gross debt, nat. def., % of GDP	24.9	30.5	27.6	26.2	27.0	27.0	27.0
Stock of loans of non-fin. private sector, % p.a.	5.9	5.5	26.5	23.3	.	.	.
Non-performing loans (NPL), in %, eop	8.1	6.9	3.3	3.4	.	.	.
Central bank policy rate, % p.a., eop 4)	9.25	9.00	9.75	16.75	13.50	10.00	8.00
Current account, EUR m 5)	-6,277	-9,602	-2,163	8,109	-1,100	-2,300	-3,700
Current account in % of GDP	-3.9	-6.4	-1.3	3.9	-0.5	-1.0	-1.5
Exports of goods, BOP, EUR m 5)	53,183	38,598	55,626	81,907	75,000	77,200	78,800
annual change in %	6.3	-27.4	44.1	47.2	-8.4	2.9	2.1
Imports of goods, BOP, EUR m 5)	36,729	33,335	35,140	47,318	51,200	54,700	56,900
annual change in %	23.8	-9.2	5.4	34.7	8.2	6.8	4.0
Exports of services, BOP, EUR m 5)	6,926	4,562	4,977	7,534	7,700	8,100	8,300
annual change in %	11.6	-34.1	9.1	51.4	2.2	5.2	2.5
Imports of services, BOP, EUR m 5)	10,309	7,398	6,685	8,954	9,100	9,500	10,100
annual change in %	0.7	-28.2	-9.6	33.9	1.6	4.4	6.3
FDI liabilities, EUR m 5)	3,332	6,312	3,846	4,667	.	.	.
FDI assets, EUR m 5)	-1,941	1,165	2,243	-2,861	.	.	.
Gross reserves of CB excl. gold, EUR m 5)	9,004	9,827	9,586	13,691	.	.	.
Gross external debt, EUR m 5)	142,474	133,664	145,234	150,654	155,000	158,000	160,000
Gross external debt, % of GDP	87.8	89.2	87.2	71.9	71.0	67.0	64.0
Average exchange rate KZT/EUR	428.51	471.44	503.88	484.22	518	529	540

1) Preliminary and wiiw estimate. - 2) From 2022 according to census 2021. - 3) Excluding small enterprises, engaged in entrepreneurial activity. - 4) Base rate (overnight repo rate as a target). - 5) Converted from USD.

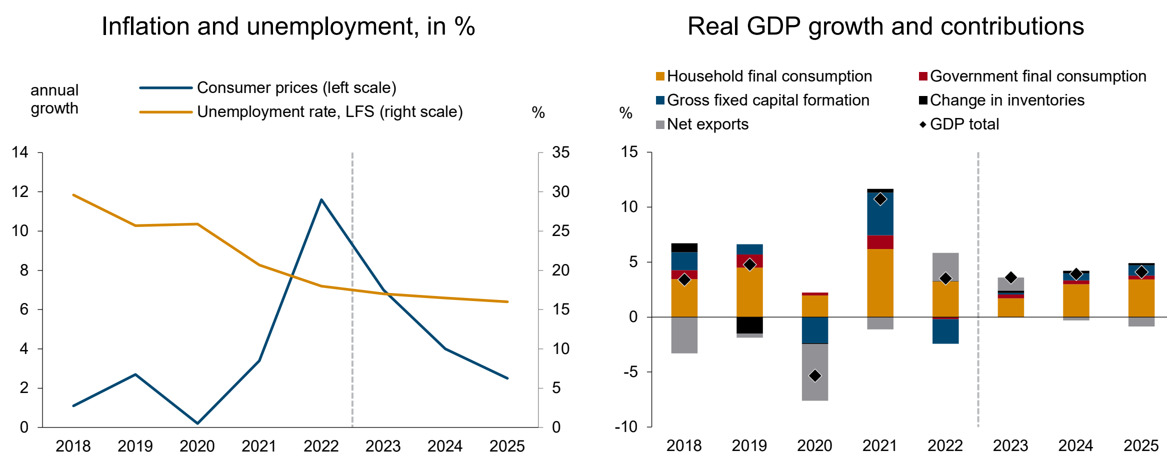
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

KOSOVO: Strong exports and public investment to sustain growth in 2023

RAVIK MIMA

Despite the challenges of 2022, Kosovo's economy remained resilient, thanks to its robust export performance in both goods and services, as well as strong household consumption, encouraged by remittances. These factors are expected to continue to drive economic growth in 2023, supported by an accelerated trend in capital investment.

Figure 5.10 / Kosovo: Main macroeconomic indicators



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

Kosovo's economy saw commendable growth in 2022, with real GDP expanding by 3.5%. This was fuelled primarily by the robust performance of exports and private consumption. Growth remained strong in the second half of the year as well, with the final quarter witnessing an expansion of 3.6% year on year, driven by the manufacturing industry and the finance and insurance sector.

Kosovo's export landscape has undergone a significant transformation. Exports of goods and services grew by 17% in 2022 (in real terms), driven by the furniture-manufacturing industry, which emerged as a major new player after ferro-nickel production was suspended on account of surging energy prices. With the new developments in the sector, there is every chance that ferro-nickel may soon regain its status as a top export product, further bolstering growth. Meanwhile, the country has also experienced an impressive double-digit expansion in service exports, with IT and call-centre services leading the charge.

Private consumption has likewise been strong, buoyed by a significant inflow of remittances. These amounted to EUR 1.2bn in 2022, or around 13% of GDP. This marked a 6% increase on the previous year, when remittances grew by even more (17%). Remittances continue to play a vital role in promoting Kosovo's economic growth and supporting household spending. While the global pandemic had a severe impact on remittances in many countries, Kosovo's resilience in this regard highlights its strong ties to its diaspora and the importance of such flows for the country's economic well-being. The latest indicators reveal a robust surge in remittances in the first two months of 2023, amounting to a notable 14.7% increase year on year.

Kosovo experienced a decline in both public and private investment in 2022, with the figures falling short of expectations. As far as public investment is concerned, the slowdown was partly caused by economic operators seeking to review their contracts due to rising costs. There is good reason for optimism over the coming period, as the unfulfilled public investments are expected to be realised in 2023, following successful negotiations between the government and the operators. This should have a positive impact on growth in the year ahead and perhaps even beyond 2023.

Inflation increased significantly in 2022, to average 11.6%. It peaked in January 2023 at 11.9% year on year, since when it has fallen – to 7.6% in March. It is expected to continue decreasing gradually, averaging 7% in 2023; this downward movement could be influenced by a decline in international commodity prices. However, moderate second-round effects could lead to inflation remaining elevated, at around 4% in 2024. Additionally, recent wage increases could contribute to inflationary pressures.

Kosovo's formalisation of its labour market has continued, and the trend is expected to persist. The data suggest that the growth in employment from 2021 to 2022 was approximately 10.6%. This was driven primarily by a shift towards formalisation, but also by the creation of new jobs and by emigration. However, the labour market still faces a degree of inactivity, as well as gender imbalances. Addressing these issues will be crucial for the long-term sustainability of Kosovo's economic growth. According to data from the National Tax Agency, there has been a marked 5% increase in employment in Q1 2023, indicating a significant fall in the unemployment rate.

Over the past two years, Kosovo has successfully replenished its fiscal buffers, thanks to positive budget revenue performance, driven by the effects of inflation and gains arising from the formalisation of the informal economy. Notably, underspending on capital investment has contributed to the accumulation of these buffers. Despite potential macroeconomic risk, the country's fiscal situation is currently favourable, providing a degree of protection against economic volatility. Thanks to its healthy fiscal position, the country may be able to mitigate the negative effects of economic risks and cushion unforeseen challenges.

The rise in global energy and food prices has had an adverse impact on the current account. The goods deficit reached EUR 4.2bn in 2022, although a surplus in services did somewhat offset the damage. Still, the overall deficit increased to EUR 2.8bn in 2022 – up EUR 350m. However, it is worth noting that the deficit is being funded by remittances and foreign direct investment (FDI), thereby mitigating the negative impact on the economy. Recent data on international trade in goods reveal a marked decline in the trade deficit for the month of February 2023. The export sector demonstrated its resilience by outpacing imports, with export values exceeding imports by a significant margin.

FDI experienced significant growth in 2022. According to central bank figures, FDI inflows to the country rose by an impressive 85% year on year, with the total amount reaching EUR 778m (8.7% of GDP), compared to EUR 421m (5.3% of GDP) in 2021. Moreover, there has been a promising start to 2023, with FDI in January alone reaching EUR 56m – year-on-year growth of 79%.

Kosovo's economic outlook for 2023 remains promising, with growth forecast at 3.6%. However, it is important to note that this forecast is contingent on several factors, including a much-needed respite from rising international commodity prices, the execution of public investments that have been lagging and adequate growth in exports. The country's policy makers must continue to monitor these factors closely, to ensure that Kosovo's economy continues on its positive trajectory.

The recent uptick in energy prices may prove something of a drag on private demand and economic activity. Kosovo's energy production continues to be dominated by lignite, and while in February and March of 2022 the government did increase the price of electricity for households consuming over 800 kW hours per month, state subsidies meant that businesses experienced no such hike. However, as from April 2023, the cost of energy has increased by 15%, and the government plans to subsidise only those households that consume less than 800 kW hours. The hike in energy prices is expected to have an impact on household spending, and businesses will have to adapt to the new cost structure. It remains to be seen how this will affect Kosovo's economic performance, given the importance of affordable energy prices for businesses and households alike.

Table 5.10 / Kosovo: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	1,789	1,790	1,786	1,782	1,778	1,774	1,770
Gross domestic product, EUR m, nom.	7,056	6,772	7,958	8,955	9,900	10,800	11,600
annual change in % (real)	4.8	-5.3	10.7	3.5	3.6	3.9	4.1
GDP/capita (EUR at PPP)	7780	7400	8660	9170	.	.	.
Consumption of households, EUR m, nom.	5,621	5,718	6,572	7,656	.	.	.
annual change in % (real)	5.7	2.5	7.3	3.9	2.0	3.5	4.0
Gross fixed capital form., EUR m, nom.	2,190	2,012	2,617	2,848	.	.	.
annual change in % (real)	2.9	-7.6	13.0	-6.8	0.5	2.0	3.0
Gross industrial production 2)							
annual change in % (real)	6.3	0.8	0.3	0.2	2.0	2.0	3.0
Gross agricultural production							
annual change in % (real)	9.5	2.7	-2.0	15.0	.	.	.
Construction output 3)							
annual change in % (real)	1.5	-9.0	8.8	10.0	.	.	.
Employed persons, LFS, th, average 4)	363.2	347.1	383.3	389.0	395	405	415
annual change in %	5.2	-4.4	10.4	1.5	1.5	2.0	2.0
Unemployed persons, LFS, th, average 4)	125.3	121.4	100.2	90.0	80	80	80
Unemployment rate, LFS, in %, average 4)	25.7	25.9	20.7	18.0	17.0	16.5	16.0
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.
Average monthly gross wages, EUR	477	466	484	580	630	670	710
annual change in % (real, gross)	2.5	-2.5	0.4	8.0	1.0	3.0	3.0
Average monthly net wages, EUR	430	416	432	520	560	600	630
annual change in % (real, net)	2.4	-3.4	0.4	8.0	1.0	3.0	3.0
Consumer prices (HICP), % p.a.	2.7	0.2	3.4	11.6	7.0	4.0	2.5
Producer prices, % p.a.	0.9	-0.6	4.9	9.3	7.0	4.0	2.5
General governm. budget, nat. def., % of GDP							
Revenues	26.8	25.4	27.4	27.7	28.5	29.0	29.5
Expenditures	29.7	33.0	28.8	28.3	29.0	30.0	30.5
Deficit (-) / surplus (+)	-2.9	-7.6	-1.3	-0.5	-0.5	-1.0	-1.0
General gov. gross debt, nat. def., % of GDP	17.0	22.0	21.1	19.6	20.0	20.0	20.0
Stock of loans of non-fin. private sector, % p.a.	10.0	7.1	15.4	16.1	.	.	.
Non-performing loans (NPL), in %, eop	2.0	2.7	2.3	2.0	.	.	.
Central bank policy rate, % p.a., eop 5)	6.42	6.01	5.80	6.29	7.0	6.5	6.0
Current account, EUR m	-399	-472	-695	-940	-960	-1020	-1080
Current account, % of GDP	-5.7	-7.0	-8.7	-10.5	-9.7	-9.4	-9.3
Exports of goods, BOP, EUR m	393	475	753	932	1,080	1,240	1,380
annual change in %	4.4	20.8	58.4	23.8	16.0	15.0	11.0
Imports of goods, BOP, EUR m	3,233	3,048	4,320	5,219	5,900	6,520	7,110
annual change in %	3.8	-5.7	41.7	20.8	13.0	10.5	9.0
Exports of services, BOP, EUR m	1,675	995	1,906	2,503	2,930	3,330	3,700
annual change in %	7.3	-40.6	91.6	31.3	17.0	13.5	11.0
Imports of services, BOP, EUR m	749	603	871	1,127	1,270	1,420	1,550
annual change in %	6.1	-19.5	44.4	29.4	13.0	11.5	9.5
FDI liabilities, EUR mn	255	346	421	778	.	.	.
FDI assets, EUR mn	66	59	100	176	.	.	.
Gross reserves of CB excl. gold, EUR m	864	901	1,100	1,176	.	.	.
Gross external debt, EUR m	2,185	2,502	2,956	3,424	3,800	4,100	4,400
Gross external debt, % of GDP	31.0	37.0	37.1	38.2	38.0	38.0	38.0

1) Preliminary and wiiw estimates. - 2) Turnover in manufacturing industry (NACE C). - 3) Based on gross value added data. - 4) Population 15-64. - 5) Average weighted effective lending interest rate of commercial banks (Kosovo uses the euro as national currency).

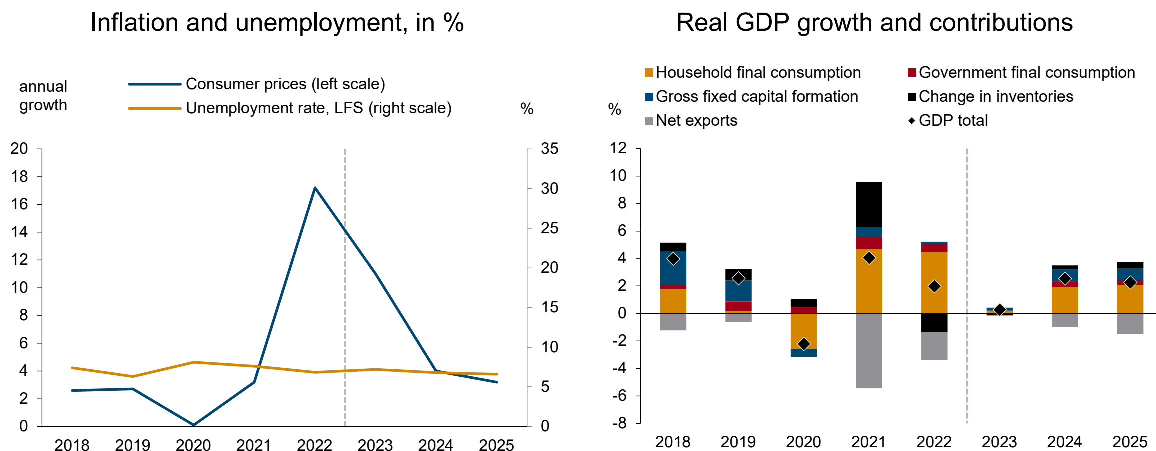
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

LATVIA: Stagnation with high employment levels

SEBASTIAN LEITNER

After a boom in 2022, the effects of dwindling external demand and escalating prices will bring the economy close to stagnation this year (0.3%). Enterprises are largely refraining from investment, preferring to deplete their stocks. Moreover, the ongoing decline in the purchasing power of households will curb growth in consumption. Given the tight labour market, the unemployment rate will rise only slightly in 2023, then decline again next year. Assuming that the EU economy finds its way back on track by the end of 2023, we expect a revival in Latvia's GDP growth to 2.5% in 2024.

Figure 5.11 / Latvia: Main macroeconomic indicators



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

Latvian goods exports continued to grow in Q4 2022 in real terms. However, by December a decline was already under way, and this has continued in the first months of 2023. The international cyclical downturn and the strong rise in the cost of inputs used in production have reduced external demand for Latvian goods. Also the transport sector – relatively important in the country – has started to ail in this context. Confounding expectations, exports to Russia remained relatively stable in 2022 and early 2023. Moreover, there has been a big increase in exports to Kazakhstan, Kyrgyzstan, Armenia and other CIS countries – most likely a large proportion of those goods are re-exported to Russia and Belarus, circumventing EU sanctions. At the same time, we have started to see a sharp decline in Latvian imports from Russia and Belarus. In general, the lower growth in imports (in nominal terms) will result in the current account deficit declining from more than 6.4% of GDP last year to around 4% in 2023.

In common with the other Baltic states, Latvia was among the EU countries worst affected by the energy and commodity price increases of 2022. In February 2023, consumer price inflation declined to 20.3% – still above the level anticipated last year. Inflation is being driven particularly by alcohol, tobacco and food products, but also by recreation, health, etc. We expect consumer price inflation to remain in double digits in 2023, before falling to 4% in 2024.

The escalating inflation meant that average real net wages declined by almost 9% in 2022, and they will keep on shrinking in 2023. The government raised the statutory minimum wage in January 2023 by 24%, to EUR 620 a month. This implies at least a revival in the purchasing power of the lowest-income groups. Nevertheless, the still-high consumer price inflation means that we expect average real net wages to decline further, by 1.5% in 2023, and only to start increasing in 2024.

Although it did have to face a period of uncertainty amid soaring energy prices, Latvia got through the winter without gas supply problems. At the beginning of April, Latvia's gas storage facilities (which also serve the needs of its Baltic neighbours), were fuller than ever before at this time of year (34%). Planning for a Latvian liquefied natural gas (LNG) terminal is under way, with the objective of making the country more energy independent. Although it is not yet clear whether it will be constructed in Skulte (as has previously been mooted) or at another, larger port, building work could start as early as 2024.

Although the economy was already slowing, nevertheless employment increased towards the end of 2022; for 2023 we expect growth in employment to be close to zero. The number of jobs increased in 2022, particularly in manufacturing and the previously ailing hospitality sector. Job vacancy rates are still high and have declined only slightly in recent months. The unemployment rate, which continued to slide throughout 2022, only inched up in the first months of 2023. Although economic activity will stagnate this year, we expect unemployment to increase by only a little in 2023 and then to fall again gradually next year. By the end of January 2023, more than 36,000 Ukraine refugees – close to 2% of the Latvian population – were benefiting from temporary protection and residing in the country. Thanks to the favourable labour market conditions at the moment, about 25% of those refugees of working age have found a job in Latvia.

Investment will be damped down again in 2023 by the multiple uncertainties triggered by the expected stagnation in the EU and Russia's war with Ukraine. The European Central Bank's (ECB) raising of interest rates to curb inflationary developments will mean Latvian entrepreneurs remain cautious when planning their investments. Figures on the number of building permits granted suggest that investment in real estate will stay low throughout 2023. Having taken advantage of the (still relatively) cheap inputs and goods to build up their inventories throughout 2022, businesses have now started running those stocks down. However, the budget envisages a rise in public investment in infrastructure this year. After declining up until winter 2022/2023, confidence levels in all sectors – including construction and industry – have again been on the rise in recent months: it would seem that entrepreneurs were anticipating even worse developments and are now pleasantly surprised about the rather short period of stagnation ahead.

The Latvian government has supported households in coping with the soaring prices, particularly for energy during the heating period (up to the end of April). The measures have helped households not only to maintain their level of consumption in the face of declining real incomes, but actually to increase it substantially. In 2023, however, we will see a greater reluctance on the part of households to spend. We expect private consumption to remain rather stagnant, before reviving in 2024.

The updated budget plan of the new government envisages a small reduction in the deficit; should the economic upswing materialise in 2024, a return to close to 2% of GDP is likely. In particular, the government has boosted defence spending to almost 2.3% of GDP, and over the medium term – up to 2025 – an increase to 2.5% of GDP is planned. Russia's war with Ukraine has also prompted parliament to reintroduce compulsory military service for young men, having relied on a fully professional army for 13 years. The first round of conscription is scheduled for July 2023. Given the additional measures outlined above and the near stagnation of the Latvian economy, the budget deficit will decline only slightly – to 4.5% in 2023. Thereafter, the government plans to reduce it further – to 2.3% of GDP in 2024 and 2% in 2025.

As expected, following parliamentary elections in October 2022, Prime Minister Kariņš was able to form his second administration in December last year. The coalition government now consists again of Kariņš's conservative people's party New Unity (which made strong gains in the election) and the far-right National Alliance (which has been part of all coalition governments since 2011), and they are joined by a newcomer – the United List, a party with a focus on the regions. Thus, the new government's economic policy will remain more or less unchanged.

All in all, we have revised our forecast for GDP growth in 2023 slightly upwards – from 0% in the winter to 0.3% now. According to the baseline scenario, however, GDP growth will pick up in 2024 to 2.5%, and will remain at 2.3% in 2025. This scenario assumes a determined willingness on the part of EU actors to cushion the economic effects of the crisis through fiscal policies, and the readiness of the ECB to refrain from being too hawkish with its interest rate rises in the coming months.

Table 5.11 / Latvia: Selected economic indicators

	2019	2020	2021	2022 [1]	2023	2024	2025
						Forecast	
Population, th pers., average	1,914	1,900	1,884	1,876	1,870	1,860	1,850
Gross domestic product, EUR m, nom.	30,679	30,294	33,588	39,081	43,500	46,400	49,000
annual change in % (real)	2.6	-2.2	4.1	2.0	0.3	2.5	2.3
GDP/capita (EUR at PPP)	21,730	21,620	23,230	26,110	.	.	.
Consumption of households, EUR m, nom.	17,479	16,822	18,868	23,248	.	.	.
annual change in % (real)	0.3	-4.5	8.4	8.0	0.3	3.2	3.5
Gross fixed capital form., EUR m, nom.	7,102	7,003	7,500	8,492	.	.	.
annual change in % (real)	6.9	-2.6	2.9	0.7	1.0	4.0	4.0
Gross industrial production [2]							
annual change in % (real)	0.9	-1.5	6.7	0.9	-2.5	2.0	4.0
Gross agricultural production							
annual change in % (real)	23.4	4.9	-8.1	0.7	.	.	.
Construction industry							
annual change in % (real)	2.9	2.7	-6.1	-11.4	.	.	.
Employed persons, LFS, th, average [3]	910.0	893.0	869.5	891.2	896	900	905
annual change in %	0.1	-1.9	-3.0	2.5	0.5	0.5	0.5
Unemployed persons, LFS, th, average [3]	61.3	78.7	70.6	65.2	70	66	64
Unemployment rate, LFS, in %, average [3]	6.3	8.1	7.6	6.8	7.2	6.8	6.6
Reg. unemployment rate, in %, eop [4]	6.2	7.7	6.7	6.1	.	.	.
Average monthly gross wages, EUR	1,076	1,143	1,277	1,373	1,500	1,600	1,700
annual change in % (real, gross)	4.2	6.0	8.2	-8.3	-1.5	2.5	3.0
Average monthly net wages, EUR	793	841	939	1,006	1,100	1,170	1,240
annual change in % (real, net)	3.9	5.8	8.1	-8.7	-1.5	2.5	3.0
Consumer prices (HICP), % p.a.	2.7	0.1	3.2	17.2	11.0	4.0	3.2
Producer prices in industry, % p.a.	1.8	-2.2	13.4	34.6	15.0	2.0	1.0
General governm. budget, EU def., % of GDP							
Revenues	37.6	37.8	37.1	39.5	38.0	37.0	38.0
Expenditures	38.2	42.2	44.1	44.3	42.5	40.0	40.0
Net lending (+) / net borrowing (-)	-0.6	-4.3	-7.0	-4.8	-4.5	-3.0	-2.0
General gov. gross debt, EU def., % of GDP	36.5	42.0	43.7	41.0	42.0	41.0	40.0
Stock of loans of non-fin. private sector, % p.a.	-1.4	-3.8	3.2	7.0	.	.	.
Non-performing loans (NPL), in %, eop [5]	5.1	3.1	2.5	1.8	.	.	.
Central bank policy rate, % p.a., eop [6]	0.00	0.00	0.00	2.50	.	.	.
Current account, EUR m	-178	788	-1,414	-2,495	-1,800	-1,200	-800
Current account, % of GDP	-0.6	2.6	-4.2	-6.4	-4.1	-2.6	-1.6
Exports of goods, BOP, EUR m	12,761	13,440	16,195	20,491	22,200	23,300	24,200
annual change in %	1.4	5.3	20.5	26.5	8.3	5.0	3.9
Imports of goods, BOP, EUR m	15,400	14,992	18,969	24,967	26,700	27,600	28,500
annual change in %	2.1	-2.6	26.5	31.6	6.9	3.4	3.3
Exports of services, BOP, EUR m	5,589	4,707	5,192	6,999	7,600	8,000	8,300
annual change in %	4.9	-15.8	10.3	34.8	8.6	5.3	3.8
Imports of services, BOP, EUR m	3,152	2,862	3,574	4,796	5,100	5,000	4,900
annual change in %	4.3	-9.2	24.9	34.2	6.3	-2.0	-2.0
FDI liabilities, EUR m	999	816	3,185	1,175	.	.	.
FDI assets, EUR m	80	168	2,338	-120	.	.	.
Gross reserves of CB excl. gold, EUR m	3,700	3,982	4,504	3,819	.	.	.
Gross external debt, EUR m	35,803	36,751	36,834	39,289	40,000	40,800	40,200
Gross external debt, % of GDP	116.7	121.3	109.7	100.5	92.0	88.0	82.0

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 4) In % of labour force (LFS). - 5) Loans more than 90 days overdue, and from 2018 also including loans unlikely to be paid. - 6) Official refinancing operation rates for euro area (ECB).

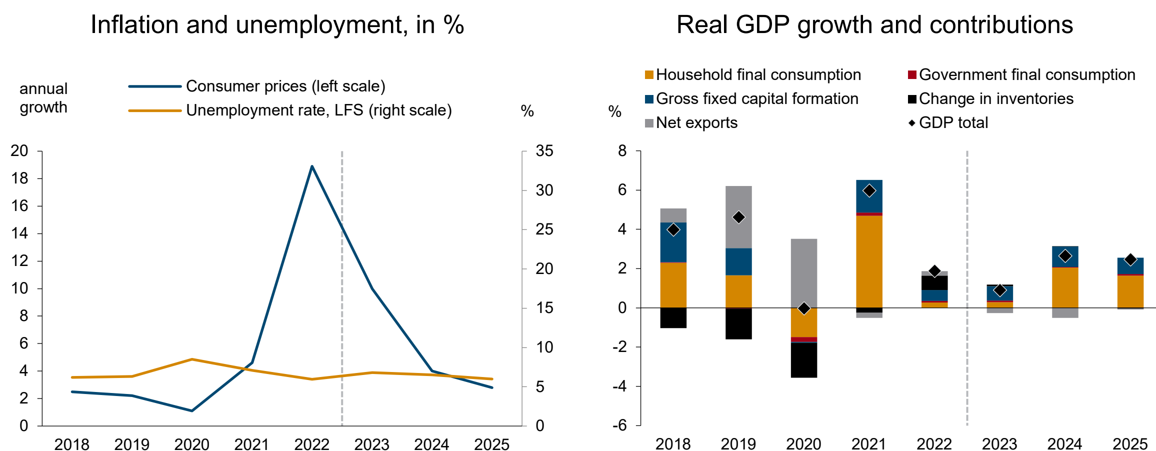
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

LITHUANIA: Cooling-down period expected to remain short

SEBASTIAN LEITNER

The economy dealt better than expected last year with the blow caused by Russia's invasion of Ukraine, although inflation reached almost 20%. The economy will shrink in the first half of 2023, but the evident stabilisation in household and business sentiment suggests that consumption and investment activity should pick up thereafter. The government is trying to counter the loss of households' purchasing power, and public investments should also go some way to supporting economic activity. We expect real GDP to grow by 0.9% in 2023; this will be followed by an upswing to 2.7% in 2024 and then 2.5% in 2025.

Figure 5.12 / Lithuania: Main macroeconomic indicators



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

The war in Ukraine resulted in escalating consumer price inflation (CPI) – with a 2022 average of 18.9%, the second-highest rate in the EU. In 2023, CPI is likely to continue in double digits. In March 2023, consumer inflation was still at 15.2%. To a large extent, this is due to housing (since the jump in energy costs has already filtered through), though foodstuffs, hospitality and durables are also increasingly playing a part. Given the upsurge in core inflation, any decline in price growth is likely to require longer than inflation took to rise in 2022. The steep price hikes resulted in a substantial decline in real incomes in 2022, despite rapidly advancing nominal wages. For this year, we expect real net wages to grow again slightly. In order to maintain the purchasing power of low-income earners, the government has implemented a 15% rise in the minimum wage from January 2023. Moreover, the budget envisages bigger wage hikes for some groups of public employees.

In the first half of 2022, the release of pent-up demand following the COVID-19-induced lockdowns resulted in a surge in private consumption; however, in the second half year we saw it decline. With the purchasing power of households already under pressure, we expect private consumption in 2023 again to increase by only 0.5% in real terms. Consumer surveys show confidence again improving month by month, following last autumn's low caused by high energy prices and the war in Ukraine. However, retail trade figures show a drop-off in household spending, especially on consumer durables. Since real incomes are likely to grow again in 2023, we expect retail trade to pick up in the second half of the year. But only in 2024 do we expect household consumption to regain its momentum.

External demand remained strong until the last quarter of 2022, but export growth will stagnate in real terms this year. While Lithuania is still in the process of disengaging from Russia and Belarus in terms of trade, exports to the EU are developing better. In particular exporters in the chemical industry, plastics and the furniture industry could benefit from stronger demand in the EU at the moment. However, we will most likely see a downturn in both exports and imports in real terms in the first half of this year; an upswing in external demand for Lithuanian goods and services is expected towards the end of 2023. We anticipate a gradual revival of export activity in 2024; however, this depends on the monetary and fiscal policy stance of the European Central Bank (ECB) and the EU in the coming months. If these institutions act in a hawkish manner, that may yet stall the expected revival. Given the reduction in transit trade, the transport sector – which used to profit from goods trade between Lithuanian ports and the country's eastern neighbours – will suffer a permanent diminution in importance.

The ongoing stabilisation in business sentiment suggests that a gradual upswing in private investment is already on the cards this year. September 2022 saw a marked decline in confidence in all sectors for the second month in a row: investment plans were revised, and entrepreneurs ran down their stocks. Nevertheless, we expect a revival in the second half of 2023. The uncertainty surrounding personal income and the likelihood of ECB interest-rate hikes means that households are scaling back investment in dwellings. Following a rally that dates back to 2020 and COVID times, early 2022 brought housing prices to a juddering halt. The rise in interest rates is clearly a burden for households, but we do not expect the rate of non-performing loans to increase markedly. In this high-inflation situation, real interest rates are still negative, and the stocks of mortgages are depreciating. Figures on construction permits granted suggest that fewer residential and commercial buildings will be erected this year.

An even stronger driver of growth will be public infrastructure investment. EU funds (including the NextGenerationEU recovery package) will underpin those public expenses. For Lithuania, the biggest single investment project is Rail Baltica, the high-speed rail service linking the capital of Estonia (Tallinn) with Latvia, Lithuania and Poland. The main construction work on the Lithuanian section of the railway started in mid-2022. Given the huge increase in the cost of building materials, we would expect a slowdown in road construction this year.

The steeply rising prices resulted in booming state revenues in 2022. Thus, even though the government introduced extra measures to offset the energy price increase, the budget deficit still narrowed to 0.6% of GDP last year. The specific circumstances associated with inflation are going to fade in the coming months. The anti-inflationary measures to help households and enterprises will lead to further government expenditure: e.g. a rise in the non-taxable minimum income; increased benefits for families and pensioners; additional public investment in renewable energy sources and energy-saving buildings; direct support for enterprises. The deficit is thus expected to be substantially higher in 2023:

we expect it to rise to 5% of GDP, given the lower economic growth and increased expenditure plans – including the extra defence spending – envisaged in the budget plan.

Employment increased by almost 4% in 2022 and is expected to continue growing (albeit at a much lower rate) despite the near stagnation of the economy in 2023. Those sectors that were hit hard by the COVID-19 pandemic (such as hospitality, trade and transport) saw a substantial increase in jobs last year. The job vacancy rate remained high in most sectors and is not expected to decline, given the tight situation in the labour market generally. Unemployment in 2023 will increase to only 7% on average. The anticipated upswing in economic growth at the end of this year will again result in an improvement – we expect unemployment to fall back to 6% towards the end of the forecast period.

Up to the beginning of April, more than 80,000 Ukrainian refugees had been registered in Lithuania, or more than 2.5% of the population – one of the highest rates in the EU. Almost half of the refugees of working age have already found a job. In a situation of tight labour markets, businesses in Lithuania are glad of the additional workforce, particularly if they are on average highly skilled – as the (mostly female) workers from Ukraine are.

Considering the higher-than-expected inflation and the concomitant lower growth in private consumption, we have revised our GDP forecast for 2023 downwards, to 0.9%. However, in our baseline scenario, GDP growth will pick up in 2024 to 2.7% and will stay at 2.5% in 2025. Nevertheless, much will depend on the war in Ukraine and on how the cost of energy and other commodities evolves in the medium term.

Table 5.12 / Lithuania: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	2,794	2,795	2,801	2,833	2,840	2,840	2,830
Gross domestic product, EUR m, nom.	48,916	49,829	56,154	66,833	74,200	79,200	83,400
annual change in % (real)	4.6	0.0	6.0	1.9	0.9	2.6	2.5
GDP/capita (EUR at PPP)	26,360	26,320	28,960	31,620	.	.	.
Consumption of households, EUR m, nom.	29,282	28,867	32,637	38,944	.	.	.
annual change in % (real)	2.7	-2.5	8.1	0.5	0.5	3.5	2.8
Gross fixed capital form., EUR m, nom.	10,482	10,616	12,017	14,006	.	.	.
annual change in % (real)	6.6	-0.2	7.8	2.6	3.5	5.0	4.0
Gross industrial production (sales)							
annual change in % (real)	3.0	-1.3	19.5	9.6	2.0	6.0	7.0
Gross agricultural production							
annual change in % (real)	10.1	10.3	-4.5	9.2	.	.	.
Construction industry							
annual change in % (real)	8.4	-1.6	4.6	4.6	.	.	.
Employed persons, LFS, th, average 2)	1,378	1,358	1,369	1,421	1,440	1,450	1,460
annual change in %	0.3	-1.5	0.8	3.8	1.0	0.8	1.0
Unemployed persons, LFS, th, average 2)	92	126	105	90	105	101	93
Unemployment rate, LFS, in %, average 2)	6.3	8.5	7.1	6.0	6.8	6.5	6.0
Reg. unemployment rate, in %, eop 3)	8.7	16.1	10.2	8.9	.	.	.
Average monthly gross wages, EUR 4)	1,296	1,429	1,579	1,785	2,000	2,140	2,280
annual change in % (real, gross)	6.4	8.9	5.6	-5.6	2.0	3.0	3.5
Average monthly net wages, EUR 4)	822	913	1,002	1,119	1,260	1,350	1,440
annual change in % (real, net)	11.6	9.8	4.8	-6.7	2.0	3.0	3.5
Consumer prices (HICP), % p.a.	2.2	1.1	4.6	18.9	10.0	4.0	2.8
Producer prices in industry, % p.a.	0.0	-9.0	9.5	26.1	10.0	2.0	0.0
General governm. budget, EUdef., % of GDP							
Revenues	35.2	35.6	36.5	40.0	37.0	36.0	36.0
Expenditures	34.7	42.7	37.5	42.0	42.0	39.0	38.0
Net lending (+) / net borrowing (-)	0.5	-7.0	-1.0	-2.0	-5.0	-3.0	-2.0
General gov. gross debt, EU def., % of GDP	35.8	46.3	43.7	39.2	42.0	40.0	39.0
Stock of loans of non-fin. private sector, % p.a.	3.3	-1.8	13.4	14.0	.	.	.
Non-performing loans (NPL), in %, eop	1.6	1.3	0.7	0.5	.	.	.
Central bank policy rate, % p.a., eop 5)	0.00	0.00	0.00	2.50	.	.	.
Current account, EUR m	1,733	3,633	641	-3,396	-3,600	-3,800	-3,900
Current account, % of GDP	3.5	7.3	1.1	-5.1	-4.9	-4.8	-4.7
Exports of goods, BOP, EUR m	25,954	25,536	31,648	41,086	43,600	45,800	47,600
annual change in %	5.7	-1.6	23.9	29.8	6.1	5.0	3.9
Imports of goods, BOP, EUR m	28,303	25,940	34,544	48,428	52,600	55,300	57,500
annual change in %	3.3	-8.3	33.2	40.2	8.6	5.1	4.0
Exports of services, BOP, EUR m	11,864	10,921	13,571	17,397	18,500	19,400	20,200
annual change in %	22.6	-8.0	24.3	28.2	6.3	4.9	4.1
Imports of services, BOP, EUR m	6,914	5,886	8,137	11,378	12,400	13,200	13,700
annual change in %	15.1	-14.9	38.2	39.8	9.0	6.5	3.8
FDI liabilities, EUR m	3,060	4,002	2,534	580	.	.	.
FDI assets, EUR m	1,921	3,438	1,286	-1,073	.	.	.
Gross reserves of CB excl. gold, EUR m	4,273	3,662	4,626	4,715	.	.	.
Gross external debt, EUR m	34,267	40,233	44,565	45,340	44,500	45,900	47,500
Gross external debt, % of GDP	70.1	80.8	79.3	67.8	60.0	58.0	57.0

1) Preliminary and wiiw estimates. - 2) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 3) In % of working age population. - 4) Including the employers' social security contribution and earnings of sole proprietors. - 5) Official refinancing operation rate for euro area (ECB).

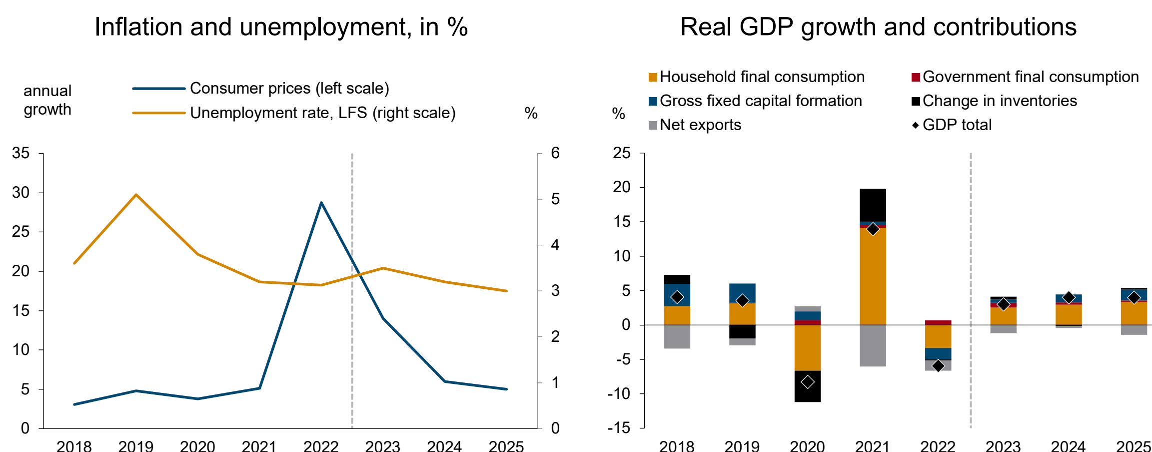
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

MOLDOVA: Recovery depends on weather conditions and foreign assistance

GÁBOR HUNYA

The energy crisis, soaring inflation and extreme drought were the main reasons for the economic contraction in 2022 (GDP down by 5.9%). There should be an improvement across the board in 2023, thanks to elevated external assistance, rapid structural adjustment and better weather conditions (GDP to rise by 3.5%). In the absence of negative external shocks, and with determined efforts to foster EU integration, the economy will grow by about 4% in the coming years.

Figure 5.13 / Moldova: Main macroeconomic indicators



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

Moldova's economic performance over the past three years has been characterised by large fluctuations, which makes it hard to predict the future with any great certainty. There was an extreme contraction in GDP in COVID-afflicted 2020 (-8.3%), followed by a very rapid recovery in 2021 (13.9%) and another steep decline in 2022 (-5.9%). It is a particular feature of the country that weather-related ups and downs in agricultural production can add to the impact of external shocks and other factors in the business cycle. The year 2022 was an extreme case, as agriculture contributed -5.6 percentage points to the development of GDP, while the negative contribution of industry was by and large compensated for by services. The economy was further depressed by a severe energy crisis and soaring inflation, so that all the demand components of GDP (bar government consumption) contributed to the contraction. The recession most probably bottomed out in Q4 2022, when GDP was 10.6% down on the same period the previous year. Many of the problems will continue in 2023, but if the weather conditions are average for the country, that would in itself facilitate an economic recovery of 2-3%.

The inflation track changed fundamentally in October 2021. The price of the main energy source – imported natural gas from Russia – increased sevenfold within just a few months. Gazprom switched from long-term price setting at below European prices to dynamic price setting based on actual market prices. With the effects of the war in Ukraine, a bad harvest and an overall inflationary international environment to boot, prices rocketed in 2022. Moldova also underwent a radical change in terms of the relative price structure, making energy a more important cost factor than before. The energy situation was further complicated by the gas shortages brought about by Gazprom's patchy delivery (which can be regarded as a component of Russia's hybrid war on the country).

Integration with the Romanian (and thereby the European) gas and electricity networks has helped overcome the worst of the situation, but occasional blackouts are unavoidable. Purchases from the EU can provide a lasting alternative to Russian gas imports via the pipeline through Ukraine. Following the overall switch to new sources in Q1 2023, Russian deliveries were confined to the separatist region of Transnistria. For the rest of the country, however, this did not end dependence on Russia: a significant part of the gas delivered to Transnistria fuels the power station there, which is the main source of electricity for the country as a whole. It is also used by the country's only steel plant, which is important for the domestic supply and moreover exports to the EU. In order to gain total independence from the unreliable Russian deliveries, further investments in transport infrastructure and renewable energy will be necessary, as well as improved relations between the two parts of the country.

A significant share of the price shock suffered in 2021/2022 can be regarded as a one-off event, so that inflation will come down to single digits in the second half of 2023. Inflation peaked in October 2022 at 34%, and by March 2023 it had moderated to 22%. Gas import prices have declined in accordance with Gazprom's pricing mechanism. Food prices are expected to fall, too, once the new harvest is gathered in.

The National Bank of Moldova (NBM) has followed a two-pronged anti-inflationary policy. It increased the policy rate several times in 2022 and also intervened on the currency market to keep the exchange rate stable. Inflation has been subsiding since December, and so the NBM has cut the policy rate from 21.5% in November 2022 to 14% in March 2023. Commercial lending rates have been below the refinancing rate (negative in real terms), but the volume of new credits has hardly grown in real terms. We expect further monetary easing, as support for economic growth has appeared as one of the targets of NBM policy.

For years Moldova has suffered from high current account deficits, 15.8% of GDP in 2022. The weakness of the export sector has been a perennial problem, which other countries have corrected through industrial investments, mainly foreign direct investment. Given its almost unlimited access to EU markets, Moldova's exports may, however, grow faster than GDP over the forecasting period, while its imports will maintain their share in GDP. Services exports provide an alternative to goods, especially in the ICT sector, which is a net foreign revenue earner. Remittances amount to USD 1.4-1.6bn annually, and this finances a diminishing share of the expanding goods and services deficit (35% in 2022). The rest must come from international institutional sources, as the country has very limited access to private foreign financing.

International donors financed most of the fiscal gap of 3.3% of GDP in 2022. The budget deficit was lower than expected, on account of a surge in inflation-related revenue. However, it will widen in 2023 because of lower inflation and more pledged external financing, and in spite of measures to improve tax collection. Due to the elevated risks, the government will have limited access to the financial markets in the coming years, too; government debt will thus not rise much, remaining at about 36% of GDP. The IMF estimates that the total external financing gap will be USD 803m in 2023 (up a third on 2022), to be covered by disbursements of USD 333m from the IMF and the World Bank; USD 173m from other official bilateral donors; and USD 297m from the EU.

The government is firm in pursuing a pro-Western policy, but progress is being hindered by the tense political situation. The war in the neighbourhood and declining living standards are sources of popular unrest. Russia offers an indirect threat to stability – not only because Gazprom is using gas deliveries as a political weapon, but also because domestic pro-Russian forces have repeatedly provoked anti-government demonstrations in Chișinău. The tension with Transnistria is also heightened from time to time. None of this has succeeded in changing the political orientation of the government, but it did lead to a reshuffle under a new prime minister in February 2023. Social and military stability are expected to receive more political prominence and fiscal support than before.

In the absence of further negative external shocks, and reckoning on average weather conditions, the country should embark on the path to recovery in 2023. Increasing exports and improving terms of trade should support a narrowing of the current account deficit to 12% of GDP. As from 2024, economic growth of about 4% can be achieved, depending on the external environment and weather conditions. Growth could be even more rapid in the event of generous foreign assistance and improved public governance. If EU Pre-Accession Assistance is opened up to Moldova, that could bring a lot of additional financing.

There are major downside risks to this forecast. Elevated political and economic uncertainty will prevail for as long as the war in Ukraine persists. Though perhaps not very likely, Russia's hybrid warfare could destabilise the country and alter its political orientation. Popular dissatisfaction – also not entirely independent of Russia's influence – could have a similar effect. Any serious breach of the conditions set by external donors would reduce external resources for growth and hinder structural change.

Table 5.13 / Moldova: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	2,664	2,635	2,615	2,600	2,580	2,560	2,530
Gross domestic product, MDL bn, nom.	206.3	199.7	242.1	272.6	309	338	362
annual change in % (real)	3.6	-8.3	13.9	-5.9	3.0	4.0	4.0
GDP/capita (EUR at PPP)	8,780	8,200	10,210	9,860	.	.	.
Consumption of households, MDL bn, nom.	172.8	162.2	199.6	229.4	.	.	.
annual change in % (real)	3.7	-7.9	17.3	-4.0	3.0	3.5	4.0
Gross fixed capital form., MDL bn, nom.	48.3	49.8	58.3	62.0	.	.	.
annual change in % (real)	12.0	5.6	1.9	-6.8	2.0	5.0	7.0
Gross industrial production							
annual change in % (real)	2.0	-5.5	12.1	-5.1	1.0	4.0	5.0
Gross agricultural production							
annual change in % (real)	-1.6	-27.2	57.9	-29.8	.	.	.
Construction industry							
annual change in % (real)	12.8	11.8	-0.3	-13.9	.	.	.
Employed persons, LFS, th, average 2)	872.4	834.2	843.4	862.3	870	880	890
annual change in %	9.9	-4.4	1.1	2.2	1.0	1.0	1.0
Unemployed persons, LFS, th, average 2)	46.9	33.1	28.2	27.7	30	30	30
Unemployment rate, LFS, in %, average 2)	5.1	3.8	3.2	3.1	3.5	3.2	3.0
Reg. unemployment rate, in %, eop	1.8	2.9	2.3	2.4	.	.	.
Average monthly gross wages, MDL	7,234	7,943	8,980	10,372	12,300	13,700	15,100
annual change in % (real, gross)	10.1	5.8	7.6	-10.3	4.0	5.0	5.0
Average monthly net wages, MDL	6,010	6,617	7,635	8,900	10,700	12,000	13,400
annual change in % (real, net)	11.5	6.1	9.8	-9.0	5.0	6.0	6.0
Consumer prices, % p.a.	4.8	3.8	5.1	28.7	14.0	6.0	5.0
Producer prices in industry, % p.a.	1.8	2.6	8.4	26.5	12.0	5.0	4.0
General governm. budget, nat. def., % of GDP							
Revenues	30.5	31.4	32.0	33.6	33.0	33.0	34.0
Expenditures	32.0	36.7	33.9	36.8	37.0	36.0	35.0
Deficit (-) / surplus (+)	-1.5	-5.3	-1.9	-3.3	-4.0	-3.0	-1.0
General gov. gross debt, nat. def., % of GDP	25.7	34.2	32.6	35.2	36.0	36.0	35.0
Stock of loans of non-fin. private sector, % p.a.	13.9	13.2	22.6	8.5	.	.	.
Non-performing loans (NPL), in %, eop 3)	8.5	7.4	6.1	6.4	.	.	.
Central bank policy rate, %, p.a., eop 4)	5.50	2.65	6.50	20.00	9.00	5.00	3.00
Current account, EUR m 5)	-988	-778	-1436	-2161	-2,230	-1,970	-1,950
Current account, % of GDP	-9.4	-7.7	-12.4	-15.8	-14.4	-12.2	-11.3
Exports of goods, BOP, EUR m 5)	1,892	1,706	2,165	3,517	3,770	3,910	4,330
annual change in %	13.1	-9.8	26.9	62.4	7.2	3.7	10.7
Imports of goods, BOP, EUR m 5)	4,850	4,420	5,706	8,251	8,840	8,990	9,780
annual change in %	8.7	-8.9	29.1	44.6	7.1	1.7	8.8
Exports of services, BOP, EUR m 5)	1,379	1,121	1,381	2,161	2,310	2,490	2,760
annual change in %	10.2	-18.7	23.2	56.4	6.9	7.8	10.8
Imports of services, BOP, EUR m 5)	1,053	772	982	1,302	1,330	1,370	1,490
annual change in %	10.9	-26.7	27.3	32.6	2.1	3.0	8.8
FDI liabilities, EUR m 5)	453	138	331	562	.	.	.
FDI assets, EUR m 5)	35	5	8	53	.	.	.
Gross reserves of CB excl. gold, EUR m 5)	2,731	3,079	3,442	4,202	.	.	.
Gross external debt, EUR m 5)	6,451	6,620	7,735	8,891	10,200	10,800	11,700
Gross external debt, % of GDP	61.5	65.4	66.9	64.9	66.0	67.0	68.0
Average exchange rate MDL/EUR	19.67	19.74	20.93	19.90	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 and wiiw estimates. - 2) Methodology in line with the Integrated European Social Statistics Regulation (IESS). - 3) Substandard, doubtful and loss credit portfolio. - 4) Overnight (refinancing) operations rate. - 5) Converted from USD.

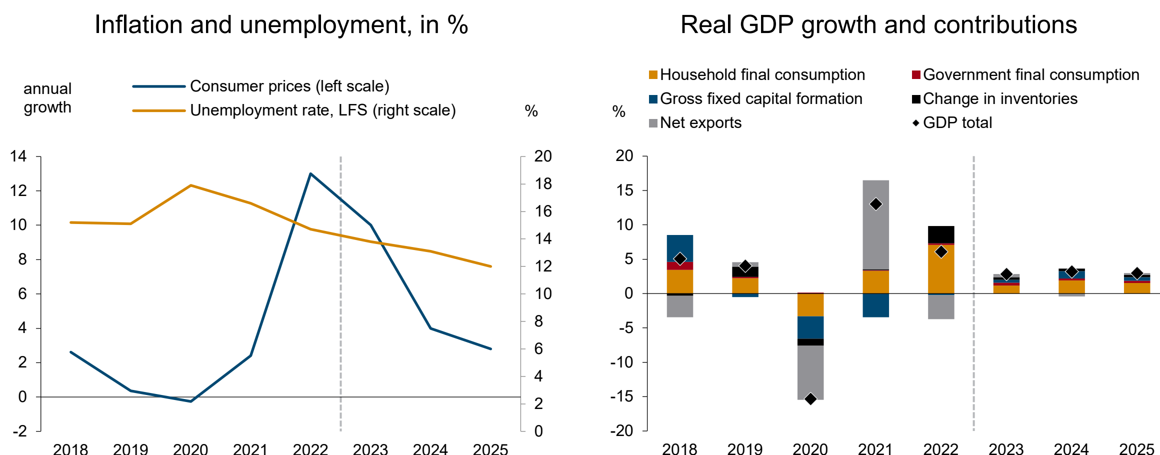
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

MONTENEGRO: A new era ahead

NINA VUJANOVIĆ

Private consumption flourished in 2022, following a tax reform that resulted in very high GDP growth of 6.1%. Against all the odds, fiscal policy is still expansionary and fiscal risks are thus rising. A further rebound in tourism and expansion of the energy sector will be the main drivers of economic growth in 2023, which is projected to be 2.9%. The recent presidential election witnessed the triumph of the new 'Europe Now' party, which will likely win a significant share in the June parliamentary election, too, and could be a game changer in contemporary Montenegrin (geo)politics.

Figure 5.14 / Montenegro: Main macroeconomic indicators



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

Montenegro's economy witnessed growth in 2022 of 6.1%, thanks to a record surge in private consumption. Household spending flourished (9.7% growth) despite high inflation, as a tax reform boosted net salaries by 18.4% in real terms. At about 9% annually, the increase in household credit matched the rise in private consumption. Growth was also supported by earnings from tourism, which rose by 35% annually (though still 17% short of pre-pandemic levels). There is likely to be a full rebound in revenue from tourism in 2023: tourist arrivals in January and February were already up 57% on 2022, while improved airline connectivity to the EU countries should boost the summer season. The energy sector will be another growth driver: in 2022, it achieved solid exports at record prices, and in the medium term it is expected to expand its solar and wind farm infrastructure, helped along by the European Bank for Reconstruction and Development. These projects are part of the plan to 'green' the energy sector and could have important economic implications, if they are implemented successfully.

Private consumption growth will slowly subside this year, but tourism and the energy sector will drive GDP growth to 2.9% in 2023 – and in the medium term to around 3%.

Inflation will continue in double digits in 2023. In February 2023, inflation stood at 15.1% – down from 17.2% in December 2022. However, it will take longer to get it into single digits. Higher excise duties are expected to be introduced in July on certain items (e.g. food, tobacco and plastic products). That – combined with a lack of monetary and fresh fiscal tools to combat inflation – could result in inflation averaging 10% in 2023.

The surge in real estate prices is another cause for concern. Despite a boom in supply, over the past two years the rise in real estate prices has been in double digits: in December 2022, the cost of new dwellings was 20% greater than a year previously. Several factors have contributed to this phenomenon: foreign direct investment (FDI) in real estate amounted to 38.9% of total FDI last year – its biggest share for nine years and slightly above the figure for 2008 (37.8%), the year preceding the real estate bust in Montenegro. The demand for real estate has been boosted by Russians and Ukrainians: the war has prompted them to attempt to safeguard their savings by purchasing property in Montenegro or even relocating there. Another factor is that higher incomes following the tax reform have brought about increased demand for housing, which has similarly pushed prices up. However, as inflation continues to erode purchasing power and as interest rates continue to rise, real estate prices could start falling soon. On a positive note, the Central Bank of Montenegro has put in place the macroprudential tools necessary to minimise the potential risk from a real estate boom.

The current account deficit reached single digits in 2021 for the first time in a decade; however, this positive result has proved short lived. The deficit widened from 9.2% of GDP in 2021 to 13.3% in 2022, following a big surge in imports of goods at a time of higher food and energy prices and greater domestic demand. However, we forecast that the current account deficit will decline over the medium term (although it will remain in double digits), thanks to larger exports of energy and a possible diversification of the economy towards manufacturing (two food-processing companies have opened in the past year).

The fiscal risks are continuing to rise. In 2022, government debt was over 70% of GDP and the government deficit was above 5% of GDP – both figures well above the Maastricht criteria (60% and 3%, respectively). They were thus at approximately the level of pre-pandemic times – mainly on account of rising economic activity. However, the fiscal outlook may become gloomier, as public spending rises due to higher social benefits. The risks are also greater because of the 2022 populistic tax reform, which abolished healthcare contributions, raised the minimum wage to EUR 450 and reduced budget revenues as a share of GDP by 5 percentage points. Earlier this year, the government borrowed EUR 100m from Deutsche Bank at the highest interest rate Montenegro has ever agreed to for a loan (5.9% plus a six-month Euribor rate, currently 3.3%). The government's strategy document (*Programme of Economic Reforms*) makes it plain that further loans are on the cards, and that the high debt and deficit levels are planned by the government itself.

A political novice and driving force behind the tax reform, Jakov Milatović won the presidential elections held in April 2023, putting an end to the three-decade dominance of the presidency by the Democratic Party of Socialists (DPS). The result showed clearly that a large majority (60%) wanted change and a better standard of living. The tax reform has contributed to this, despite the long-term

fiscal costs and risks. The ‘Europe Now’ movement, whose founding member is also the newly elected president, is now predicted to win a significant share of the vote in the parliamentary elections scheduled for June of this year.

While the change in the political elite looks likely to be more permanent, it will need to confront the elephant(s) in the room. First, whatever the government, it will have to set the country on a sounder fiscal track. The problem is compounded by the fact that the fragile healthcare system will no longer be financed by social contributions, and will thus require more fiscal spending. The second challenge will be to strengthen the institutions: the last two years have seen an unprecedented collapse of the institutional framework. The constitutional court is still incomplete, and last December the parliamentary majority passed amendments to the Law of the President, with the aim of further diminishing the already largely figurehead role of the president, despite warnings from the EU and the Venice Commission. The third challenge will be to form a stable government: Montenegro is a NATO member, but some potential coalition members side with Russia and oppose NATO – that is likely to prolong the political instability. The final challenge will be to return Montenegro to the EU path, from which it has deviated in recent years.

‘Europe Now’ may lead to ‘Open Balkan’. The newly elected president is in favour of the Open Balkan initiative. This initiative has not been well communicated to the public, but some of its clear goals are to abolish border controls and allow the free movement of labour among the Western Balkan countries. To date, only Serbia, North Macedonia and Albania have decided to join the initiative. The advantages of Montenegro potentially joining it are spurious: for instance, a study by the Ministry of European Affairs has shown that the costs to Montenegro would be higher than the benefits it would receive. Yet, if the initiative leads to a lowering of non-tariff trade barriers, it could bring the country some economic benefits, beyond the benefits derived from CEFTA. The primary goal of the Western Balkan region via this initiative, however, should be to achieve greater embeddedness in European value chains and to encourage the export industries toward the higher value-added end of global value chains. This will remain a challenge for a service-based economy such as Montenegro’s.

Table 5.14 / Montenegro: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	622	621	619	618	619	618	618
Gross domestic product, EUR m, nom.	4,951	4,186	4,955	5,797	6,600	7,100	7,500
annual change in % (real)	4.1	-15.3	13.0	6.1	2.9	3.2	3.0
GDP/capita (EUR at PPP)	15,700	13,440	15,540	16,860	.	.	.
Consumption of households, EUR m, nom. 2)	3,534	3,400	3,617	4,417	.	.	.
annual change in % (real)	3.1	-4.6	4.0	9.7	1.5	2.5	2.0
Gross fixed capital form., EUR m, nom.	1,352	1,166	1,096	1,259	.	.	.
annual change in % (real)	-1.7	-12.0	-12.3	-1.1	2.0	5.0	2.5
Gross industrial production 3)							
annual change in % (real)	-6.3	-0.9	4.9	-3.3	8.0	4.0	3.0
Net agricultural production 4)							
annual change in % (real)	-2.2	1.1	-0.5	4.0	.	.	.
Construction output							
annual change in % (real)	10.7	-5.5	-4.8	-4.4	.	.	.
Employed persons, LFS, th, average 5)	243.8	219.4	212.6	251.2	257	265	273
annual change in %	2.7	-10.0	-3.1	18.2	2.5	3.0	3.0
Unemployed persons, LFS, th, average 5)	43.4	47.8	42.2	43.2	40	40	40
Unemployment rate, LFS, in %, average 5)	15.1	17.9	16.6	14.7	13.8	13.1	12.0
Reg. unemployment rate, in %, eop	16.2	20.1	24.7	20.1	.	.	.
Average monthly gross wages, EUR	773	783	793	883	960	1,020	1,070
annual change in % (real, gross)	0.6	1.6	-1.1	-1.5	-1.0	2.0	2.5
Average monthly net wages, EUR 6)	515	524	532	712	780	820	860
annual change in % (real, net)	0.4	2.1	-0.9	18.4	-1.0	1.5	2.5
Consumer prices, % p.a.	0.4	-0.3	2.4	13.0	10.0	4.0	2.8
Producer prices in industry, % p.a. 7)	2.4	-0.1	1.3	11.2	6.0	4.0	2.6
General governm. budget, nat. def., % of GDP							
Revenues	43.4	44.6	44.3	39.7	39.2	39.0	38.9
Expenditures	45.4	55.7	46.2	44.8	44.2	43.8	43.5
Deficit (-) / surplus (+)	-2.0	-11.1	-1.9	-5.2	-5.0	-4.8	-4.6
General gov. gross debt, nat.def., % of GDP	76.5	105.3	84.0	70.8	73.0	70.0	67.0
Stock of loans of non-fin. private sector, % p.a.	6.6	2.9	3.4	8.8	.	.	.
Non-performing loans (NPL), in %, eop	4.7	5.5	6.2	5.7	.	.	.
Central bank policy rate, % p.a., eop 8)	5.46	5.33	5.16	5.45	5.8	5.5	5.4
Current account, EUR m	-707	-1,090	-456	-773	-770	-760	-752
Current account, % of GDP	-14.3	-26.1	-9.2	-13.3	-11.7	-10.7	-10.0
Exports of goods, BOP, EUR m	466	409	526	763	990	1,070	1,120
annual change in %	6.8	-12.2	28.6	45.2	30.0	8.4	5.0
Imports of goods, BOP, EUR m	2,531	2,051	2,441	3,439	3,820	4,070	4,240
annual change in %	1.8	-19.0	19.0	40.9	11.1	6.6	4.1
Exports of services, BOP, EUR m	1,706	679	1,597	2,289	2,580	2,780	2,960
annual change in %	9.1	-60.2	135.2	43.3	12.9	7.8	6.4
Imports of services, BOP, EUR m	687	503	641	971	1,070	1,140	1,210
annual change in %	9.6	-26.8	27.5	51.5	10.2	7.0	6.5
FDI liabilities, EUR m	372	466	591	833	.	.	.
FDI assets, EUR m	67	-5	9	50	.	.	.
Gross reserves of CB excl. gold, EUR m 9)	1,367	1,739	1,749	1,915	.	.	.
Gross external debt, EUR m	8,287	9,275	9,501	9,421	10,560	11,290	11,850
Gross external debt, % of GDP	167.4	221.6	191.7	162.5	160.0	159.0	158.0

1) Preliminary and wiiw estimates. - 2) Including expenditures of NPISHs. - 3) Enterprises with 5 and more employees. - 4) Based on gross value added data. - 5) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 6) From 2022 net wages excluding health insurance contributions and including an impact of personal income tax reform. - 7) Domestic output prices. - 8) Average weighted lending interest rate of commercial banks (Montenegro uses the euro as national currency). - 9) Data refer to reserve requirements of the Central Bank.

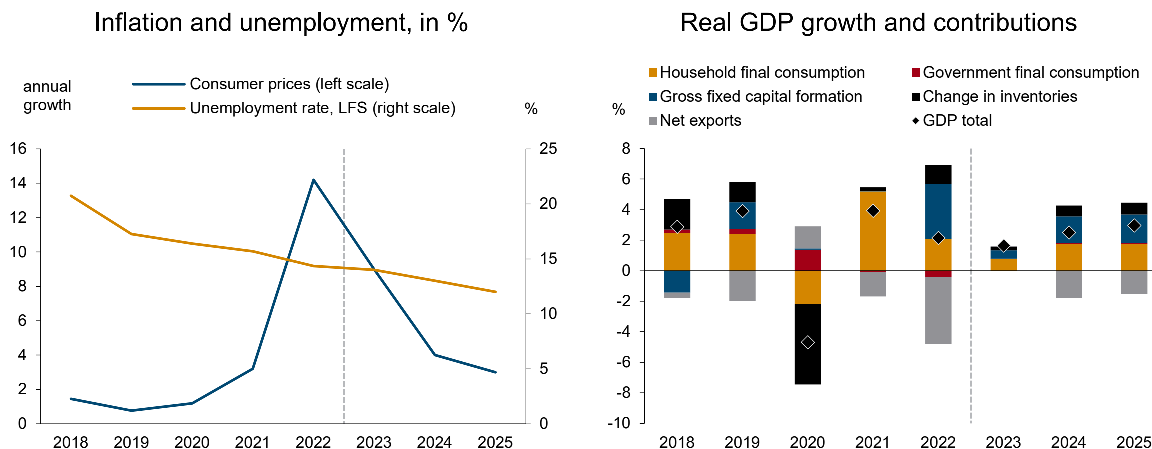
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

NORTH MACEDONIA: Defying the winter blues

BRANIMIR JOVANOVIĆ

The mild winter helped keep the pessimistic scenarios touted at the end of 2022 at bay, and as a result the economy performed better than anticipated. This was partly due to strong foreign direct investment inflows (although the sustainability of these inflows is uncertain). The government's decision to reinstate price controls on essential foodstuffs has succeeded in bringing down inflation, but it is unclear how long these controls will remain in place. Overall, the economic situation in the country seems more positive than it did three months ago, though many challenges remain.

Figure 5.15 / North Macedonia: Main macroeconomic indicators



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

GDP grew by 2.1% in 2022, exceeding our projections from the previous three rounds. This was largely due to the mild winter, which helped forestall the worst of the scenarios floated at the end of 2022. From the viewpoint of the GDP components, the primary driver of growth was investment, which increased by 15%. Household consumption also made a contribution, growing by 3.1%, despite the high inflation and the fall in real wages. Government consumption declined for a second year in a row, reflecting the fiscal conservatism of the government. Exports and imports both grew at double-digit pace (in real terms).

The growth in investment was primarily on account of strong foreign direct investment (FDI) inflows, though these may well turn out to be transitory in nature. In net terms, FDI reached 5.2% of GDP in 2022 – a significant increase over the 3.3% of the year before. However, a closer look reveals that most of this growth came from intracompany loans from the UK. Previous experience suggests that

these FDI flows may well go into reverse the following year, when the loan is repaid. Thus, the strong FDI inflows from 2022 are unlikely to stay for long. There was some increase in equity capital investment in 2022 – mainly from Germany, Turkey, Austria and Greece – which could suggest that FDI inflows will remain elevated for some years to come, albeit not at the level of last year.

Another factor that exceeded expectations in 2022 was the resilience of household consumption. Despite a 2.9% decline in real wages, household consumption grew by a solid 3.1%. This suggests that people were dipping into their savings to smooth consumption and offset the impact of the cost-of-living crisis. As inflation is expected to ease in 2023, consumption should remain robust.

Inflation proved more persistent than anticipated, and the government realised that it had to reinstate price controls to tame it. Inflation averaged 14.2% for 2022 as a whole – slightly above what we were projecting. The measures implemented by the government in the second half of the year – such as lower electricity prices and reduced taxes and tariffs for companies – failed to bring inflation down, as its primary driver was higher company profits, rather than increased production costs. With annual inflation remaining at 16.7% in February 2023, the government reinstated price caps on basic foodstuffs in March. These caps had been successful before (between November 2021 and February 2022), and once again they yielded immediate results, with inflation falling to 14.7% in March.

The high rate of inflation was also met by an aggressive monetary tightening, which may not be over yet. The central bank hiked its interest rate 10 times in a single year, so that the base interest rate in March 2023 stood at 5.5% – up from 1.25% a year before. To an extent, the tightening is understandable: the central bank has a mandate to fight inflation, and with inflation stuck in double digits for almost a year, it had to do something. Furthermore, all the major central banks are tightening, and if North Macedonia's failed to follow suit, that would lead to capital outflows and depreciation pressure on the national currency. However, the degree of tightening is open to question, given that the European Central Bank hiked its interest rate only six times over the same period, and by only 350 basis points in total. The moderation of inflation in March may put an end to the hiking cycle; but if the government lifts its price controls too soon, that could once again inflame inflation, which may well lead to another hike in the interest rate.

The tightening is unlikely to have any major effect on inflation, given its supply-side nature; but it is already taking its toll on the economy. Credit activity is slowing: overall credit growth in February dropped to 7.7% year on year, the lowest level since the end of 2021. Furthermore, the hike has increased loan interest rates more than deposit rates – the interest rate margin reached 400 basis points in February 2023, up from 360 a year before – which hurts borrowers and swells banks' profits. The level of non-performing loans remains low, though, standing at 2.8% in February.

In early 2023, economic activity is showing some sign of improvement, though there is a long way to go. Industrial production in February saw year-on-year growth of 1% for the first time in six months. Retail trade (excluding motor vehicles) in January and February grew 1.2%, year on year. The nominal value of construction works completed in January was 76% higher than a year ago, although that figure is inflated by the big increase in prices in that sector (which is anyway volatile).

There is nothing new on the political front in the country. There has been no progress in terms of EU accession, and no prospects of anything happening soon: the constitutional changes that are required to kick-start the negotiations seem far away, as the main opposition party vociferously opposes the proposed changes. In the meantime, internal politics have been marred by several scandals, including one related to the construction of a number of motorways. The Anti-Corruption Commission has raised numerous objections to this project, but such controversies have become commonplace in the country.

Taking everything into consideration, we are revising our GDP growth forecast for 2023 upwards, and our inflation forecast downwards. Thanks to the better-than-expected performance at the end of 2022, the solid start to 2023 and the improved global economic outlook, we are revising our 2023 GDP growth forecast upwards to 1.6% (from 1%). At the same time, because of the recently reinstated price caps on basic foodstuffs, we are revising our inflation forecast for 2023 downwards to 9% (from 10%).

The risks, however, are mostly on the downside, both for GDP and for inflation. In terms of GDP, much will depend on FDI inflow – the main driver of growth in 2022. One cannot expect this to be as strong in 2023 as it was in 2022 (for the reasons outlined above); the question is how much weaker it will be. The monetary tightening is another risk, especially if the central bank does not reverse its course soon. In terms of inflation, much depends on the government's price controls: if the government lifts the price caps before inflation stabilises (not expected until the autumn), inflation will reignite again.

Table 5.15 / North Macedonia: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average 2)	2,077	2,073	1,837	1,827	1,817	1,807	1,797
Gross domestic product, MKD bn, nom.	692.7	669.3	720.4	794.8	881	939	996
annual change in % (real)	3.9	-4.7	3.9	2.1	1.6	2.5	3.0
GDP/capita (EUR at PPP)	11,880	11,350	13,670	14,340	.	.	.
Consumption of households, MKD bn, nom.	447.1	436.4	480.7	549.9	.	.	.
annual change in % (real)	3.7	-3.4	8.0	3.1	1.1	2.5	2.5
Gross fixed capital form., MKD bn, nom.	145.8	144.5	162.4	197.6	.	.	.
annual change in % (real)	8.7	0.4	0.1	16.0	2.2	7.0	7.5
Gross industrial production 3)							
annual change in % (real)	3.7	-9.6	1.4	-0.2	0.5	2.0	3.0
Gross agricultural production 4)							
annual change in % (real)	-5.4	1.7	-1.2	2.0	.	.	.
Construction industry							
annual change in % (real)	3.8	1.3	-11.4	-12.1	.	.	.
Employed persons, LFS, th, average 5)	797.7	794.9	795.1	692.0	700	710	720
annual change in %	5.1	-0.3	0.0	-0.2	0.5	1.0	1.0
Unemployed persons, LFS, th, average 5)	166.4	155.9	147.9	116.0	110	110	100
Unemployment rate, LFS, in %, average 5)	17.3	16.4	15.7	14.4	14.0	13.0	12.0
Reg. unemployment rate, in %, eop 5)6)	19.6	25.8	19.7	19.8	.	.	.
Average monthly gross wages, MKD	37,446	40,566	42,887	47,637	51,900	54,800	57,900
annual change in % (real, gross)	4.3	7.0	2.4	-2.7	0.0	1.5	2.5
Average monthly net wages, MKD	25,213	27,182	28,718	31,859	34,700	36,600	38,600
annual change in % (real, net)	3.1	6.5	2.3	-2.9	0.0	1.5	2.5
Consumer prices, % p.a.	0.8	1.2	3.2	14.2	9.0	4.0	3.0
Producer prices in industry, % p.a.	2.1	0.6	11.1	17.3	7.0	3.0	2.5
General governm. budget, nat. def., % of GDP							
Revenues	31.4	29.9	32.4	32.4	32.5	32.5	32.5
Expenditures	33.5	38.1	37.8	36.9	35.5	35.0	35.0
Deficit (-) / surplus (+)	-2.1	-8.2	-5.4	-4.5	-3.0	-2.5	-2.5
General gov. gross debt, nat. def., % of GDP	40.4	50.8	52.0	50.9	51.0	52.0	53.0
Stock of loans of non-fin. private sector, % p.a.	6.1	4.6	8.2	9.4	.	.	.
Non-performing loans (NPL), in %, eop	4.6	3.3	3.2	2.8	.	.	.
Central bank policy rate, %, p.a., eop 7)	2.25	1.50	1.25	4.75	6.00	5.50	5.00
Current account, EUR m	-335	-318	-366	-772	-645	-690	-710
Current account, % of GDP	-3.0	-2.9	-3.1	-6.0	-4.5	-4.5	-4.4
Exports of goods, BOP, EUR m	5,347	4,820	6,000	7,346	8,300	9,380	10,600
annual change in %	9.5	-9.9	24.5	22.4	13.0	13.0	13.0
Imports of goods, BOP, EUR m	7,296	6,623	8,371	10,799	11,880	13,250	14,770
annual change in %	10.2	-9.2	26.4	29.0	10.0	11.5	11.5
Exports of services, BOP, EUR m	1,625	1,445	1,743	2,318	2,630	2,950	3,300
annual change in %	2.8	-11.1	20.7	32.9	13.5	12.0	12.0
Imports of services, BOP, EUR m	1,289	1,021	1,248	1,577	1,720	1,920	2,140
annual change in %	6.6	-20.8	22.2	26.4	9.0	11.5	11.5
FDI liabilities, EUR m	488	28	575	803	.	.	.
FDI assets, EUR m	125	-127	187	133	.	.	.
Gross reserves of CB excl. gold, EUR m	2,961	3,019	3,288	3,486	.	.	.
Gross external debt, EUR m	8,154	8,536	9,577	10,856	11,900	12,800	13,700
Gross external debt, % of GDP	72.4	78.7	81.9	84.2	83.0	84.0	85.0
Average exchange rate MKD/EUR	61.50	61.67	61.63	61.62	61.6	61.6	61.6

1) Preliminary and wiiw estimates. - 2) From 2021 according to census September 2021. - 3) Enterprises with 10 and more employees. - 4) wiiw estimate from 2021. - 5) From 2022 based on census 2021. - 6) In % of labour force (LFS). - 7) Central Bank bills (28-days).

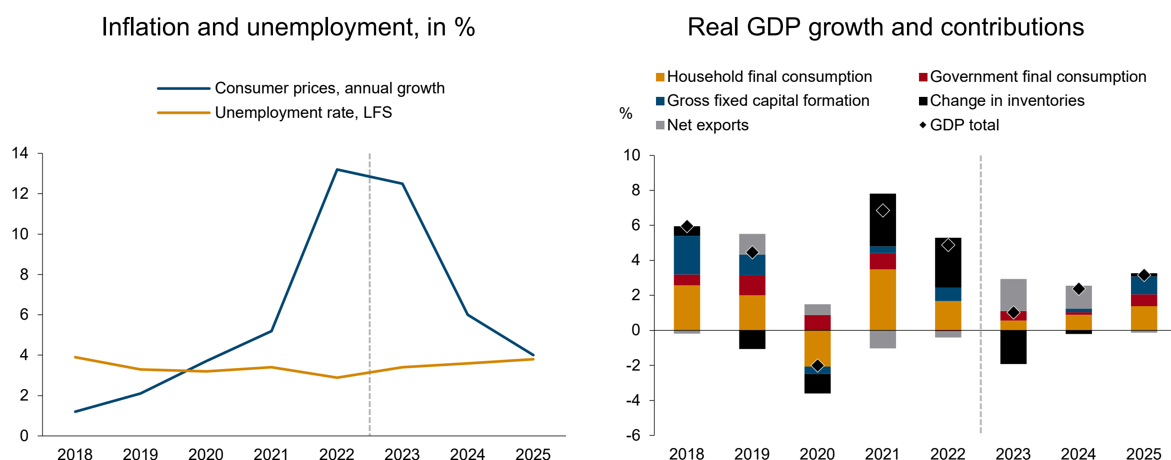
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

POLAND: A temporary slowdown in growth

ADAM ŻURAWSKI

The Polish economy has proved surprisingly resilient so far. But growth is already slowing. High interest rates are having a major effect on private consumption and investment, while inflation is eroding the real value of current wage incomes. Symptoms of excess supply abound. However, falling inflation and a recovery in household incomes will gradually restore demand and sales, thereby paving the way for an acceleration in growth. But these positive developments will set in only towards the end of 2023.

Figure 5.16 / Poland: Main macroeconomic indicators



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

GDP grew by 2% in Q4 2022 (year on year), down from 8.6% in Q1. The slowdown was due to a much weaker growth in inventories, whose contribution to overall growth fell from 6.7 percentage points (pp) to 1.1 pp. Household and public consumption each fell by 1.5%, but gross fixed capital formation rose by 4.9%. The contribution to growth of foreign trade turned positive (0.9 pp), after a figure of -2.7 pp in Q1 2022. Throughout 2022, the growth of gross value added in the major sectors of the economy slowed quite dramatically: in manufacturing from 14% in Q1 to 3.5% in Q4; and in the construction sector from 17% to 0.8%. Gross value added in the domestic trade and real estate sectors declined in the fourth quarter of 2022, indicating a clear weakening of consumer demand.

The data available for the first months of 2023 show a mixed picture (with a fairly powerful contraction in the sale of consumer durables, intermediate goods and energy). However, sales of capital goods rose quite strongly (by over 10% in January-February 2023). Export-oriented branches of industry are performing satisfactorily, while those branches that supply mainly the domestic markets have tended

to stagnate or decline. Construction output, driven by substantial infrastructural (public) investment, rose 6.6% in January-February 2023. Retail sales have performed quite badly (falling by 5% in February).

The labour market is in pretty good shape, though this is unlikely to last. Unemployment is low (2.8% in February according to the Eurostat methodology; 5.5% by registration). However, the demand for labour has stopped rising and business surveys suggest some decline in employment in coming months. This is consistent with signs of weakening demand and sales.

Foreign workers remain important. Over 700,000 Ukrainians (predominantly female) have been registered as regular employees. In total, over 1m working foreigners currently contribute to the social security system. The unregistered employment of Ukrainians (as well as of other foreigners) is bound to be quite high, too. Quite likely their presence will reduce the bargaining power of regular employees and keep a lid on wage hikes.

Wages have generally trailed slightly behind inflation, implying a gentle deterioration in the real incomes of households of wage earners. Unit labour costs have tended to decline somewhat, as labour productivity has improved. Inflation has served the business sector quite well. Firms co-owned by the public authorities (especially the fuel and electricity branches) have reaped extraordinary profits, which are then partly returned to their chief shareholder – the state budget. (The windfall taxation of profits has not yet been introduced.)

The profitability of the corporate non-financial sector remains very high, despite having recently experienced some deterioration. After a few quarters of corporate revenues rising much faster than costs, the situation has reversed. Labour’s contribution to rising business costs is negligible – unlike the cost of raw materials and energy.

Signs of excess supply are becoming visible, reflecting inadequate demand. Some 29% of corporates surveyed see signs of supply exceeding demand, whereas the opposite is reported by only 7% of firms. Firms supplying consumer durables and intermediate goods report the highest levels of excess supply. The excess supply conditions are reflected in inventories, whose levels are now considered too high by a large proportion of corporations. Excessive inventories of finished goods are adversely affecting further production growth. Also, firms are finding it much more difficult to pass their rising costs on via the prices they charge for their goods or services.

High inflation is still perceived as a serious problem by the population and politicians. However, it may have passed its peak (18.4% year on year) in February. As it is becoming clear that high inflation cannot be blamed on excessive demand or price-wage spirals, there is fairly little that conventional restrictive monetary and fiscal policies can achieve. But further disinflation will undoubtedly follow, as the price and cost effects of the initial negative shocks to the prices of imported energy carriers gradually die out. Of course, disinflation can be temporarily halted (or even reversed) should the cost of imported energy jump again and/or the administered prices be raised radically.

Monetary policy remains unchanged. The key policy interest rate stands at 6.75% (effective since September 2022), and it looks as though it will be kept unchanged at least until this coming autumn. In real terms, the policy interest rate is extremely negative. Clearly, as the central bank regards the current inflation as being driven by factors that are rather insensitive to the traditional tools of monetary policy, it

does not want to provoke a deeper recession that would follow higher policy rates. However, the market rates are already quite high. The prevailing high (nominal) interest rates charged by the commercial banks contribute to weak private demand for consumer and investment credit. The volume of household debt owing to banks is falling (and that owing to non-financial corporations is increasing very slowly), while the volume of household and corporate bank deposits is rising. In all, the monetary aggregate M3 is increasing almost entirely on the back of strongly rising foreign assets.

High inflows of foreign exchange are not affecting the exchange rate, which has held steady recently (and has been relatively 'weak', largely for geopolitical reasons). Against the euro, the złoty has lost some 4% (February 2023 vs. February 2022). The relative weakness of the exchange rate is already contributing to stronger exports (primarily to the EU) and weaker imports (a consequence of the fact that domestic demand is close to stagnant). All in all, this year foreign trade will contribute positively to output growth and the current account.

The disagreements with the European Commission are not yet of vital concern. The conflict over a number of constitutional issues, which is unlikely to be resolved before the parliamentary elections due this autumn, has already cost the country a large amount of money. But given the country's strong forex reserves, the Polish government is not yet ready to follow the 'diktat of Brussels'. Possible delays in the transfer of EU funds to Poland are not a particularly grave problem – at least not in the medium term.

The elections may not affect the economy (at least in the medium term). The opposition parties appear unable to form a 'united front', so the ruling coalition led by Mr Kaczyński's Law and Justice (PiS) party may well win a third term in power. Despite high inflation, PiS enjoys popularity – especially among the less prosperous population strata that still relish the various social security transfers made over the past eight years. The minor last-minute sweeties that the government could (and probably will) distribute won't do it (or indeed the public finances) any harm. It is fairly obvious that a victorious PiS would continue its economic policy pursued so far. A victorious opposition would have to follow this – overall successful – policy as well, at least for a year or two.

There has been a slowdown in growth, and the economy will not start to recover fully before the end of this year. The economy, which has proved surprisingly resilient so far, is now set to slow – even in Q1 2023. Leaving aside the adverse impact of high interest rates on consumption and investment, inflation has severely eroded the purchasing power of current incomes and accumulated household wealth. All this is now resulting in a weakness in consumer demand. Public consumption is also likely to stagnate. Given the weak consumer demand and the indications of generalised excess supply, private investment will also prove anaemic. The liquidation of excess inventories will support the recessionary developments. However, it is expected that falling inflation and the recovery in household incomes will gradually restore demand and sales, thereby paving the way for an acceleration in growth. But these positive developments are likely to set in only towards the end of 2023.

Table 5.16 / Poland: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024 Forecast	2025
Population, th pers., average	37,965	37,899	37,747	37,711	38,360	38,370	38,380
Gross domestic product, PLN bn, nom.	2,288	2,338	2,624	3,068	3,440	3,730	4,000
annual change in % (real)	4.5	-2.0	6.8	4.9	1.0	2.4	3.2
GDP/capita (EUR at PPP)	22,820	22,860	25,010	27,890	.	.	.
Consumption of households, PLN bn, nom.	1,303	1,300	1,454	1,710	.	.	.
annual change in % (real)	3.5	-3.6	6.3	3.0	1.0	1.6	2.5
Gross fixed capital form., PLN bn, nom.	433	428	447	515	.	.	.
annual change in % (real)	6.2	-2.3	2.1	4.5	0.0	1.2	6.0
Gross industrial production (sales) 2)							
annual change in % (real)	4.1	-1.2	14.5	10.6	2.0	4.0	5.0
Gross agricultural production							
annual change in % (real)	-0.9	8.0	-1.7	-1.0	.	.	.
Construction industry 2)							
annual change in % (real)	3.7	-3.5	1.5	7.6	.	.	.
Employed persons, LFS, th, average 3)	16,461	16,441	16,656	16,742	16,710	16,660	16,660
annual change in %	-0.1	-0.1	2.6	0.5	-0.2	-0.3	0.0
Unemployed persons, LFS, th, average 3)	558	537	580	498	590	620	660
Unemployment rate, LFS, in %, average 3)	3.3	3.2	3.4	2.9	3.4	3.6	3.8
Reg. unemployment rate, in %, eop	5.2	6.8	5.8	5.2	.	.	.
Average monthly gross wages, PLN 4)	4,920	5,226	5,683	6,346	7,250	7,920	8,480
annual change in % (real, gross)	4.8	2.9	3.3	-2.1	1.5	3.0	3.0
Consumer prices (HICP), % p.a.	2.1	3.7	5.2	13.2	12.5	6.0	4.0
Producer prices in industry, % p.a.	1.3	-0.5	8.1	23.8	12.0	8.0	4.0
General governm. budget, EU def., % of GDP							
Revenues	41.1	41.3	42.4	42.0	40.8	40.1	40.5
Expenditures	41.9	48.2	44.2	45.5	45.6	44.1	44.0
Net lending (+) / net borrowing (-)	-0.7	-6.9	-1.8	-3.5	-4.8	-4.0	-3.5
General gov. gross debt, EU def., % of GDP	45.7	57.2	53.8	50.0	47.9	48.1	48.2
Stock of loans of non-fin. private sector, % p.a.	4.7	0.4	4.6	0.2	.	.	.
Non-performing loans (NPL), in %, eop	6.7	6.9	5.8	5.7	.	.	.
Central bank policy rate, % p.a., eop 5)	1.50	0.10	1.75	6.75	6.25	5.00	4.00
Current account, EUR m 6)	-1,254	12,820	-8,268	-19,511	-2,100	2,800	8,600
Current account, % of GDP 6)	-0.2	2.4	-1.4	-3.0	-0.3	0.4	1.0
Exports of goods, BOP, EUR m 6)	220,336	220,604	263,740	320,361	358,800	394,700	430,200
annual change in %	7.4	0.1	19.6	21.5	12.0	10.0	9.0
Imports of goods, BOP, EUR m 6)	224,693	213,625	271,363	344,614	379,100	398,100	437,900
annual change in %	3.8	-4.9	27.0	27.0	10.0	5.0	10.0
Exports of services, BOP, EUR m 6)	62,956	58,308	68,731	91,118	97,500	102,900	112,200
annual change in %	8.6	-7.4	17.9	32.6	7.0	5.5	9.0
Imports of services, BOP, EUR m 6)	38,883	35,329	41,934	54,617	57,300	60,700	64,900
annual change in %	6.5	-9.1	18.7	30.2	5.0	6.0	7.0
FDI liabilities, EUR m 6)	15,669	16,646	31,371	32,779	.	.	.
FDI assets, EUR m 6)	4,804	4,132	7,964	6,806	.	.	.
Gross reserves of CB excl. gold, EUR m	104,526	114,299	134,654	143,949	.	.	.
Gross external debt, EUR m 6)	316,730	307,412	322,710	346,596	366,200	381,000	400,900
Gross external debt, % of GDP 6)	59.5	58.4	56.1	52.9	49.4	47.7	47.1
Average exchange rate PLN/EUR	4.2976	4.4430	4.5652	4.6861	4.64	4.67	4.70

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 4) Excluding employees in national defence and public safety. - 5) Reference rate (7-day open market operation rate). - 6) Including SPE.

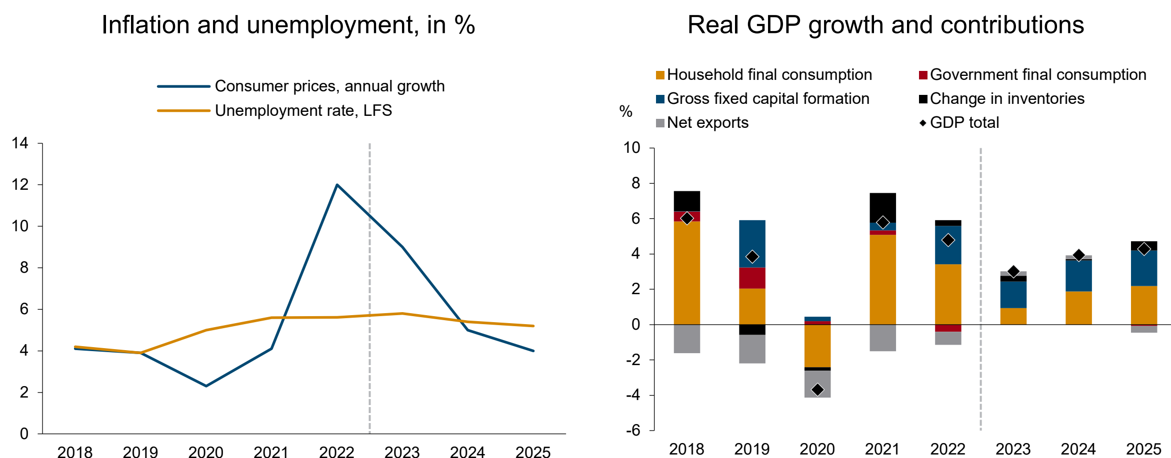
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ROMANIA: EU-financed investments cushioning the slowdown

GÁBOR HUNYA

Economic growth will slow to 3% in 2023, from close to 5% the previous year. Domestic demand will be eroded by high inflation and sluggish wage growth. The dynamic expansion of investments financed mainly by EU programmes and FDI will continue. Fiscal and current account deficits will contract, but will remain elevated – which will constitute a moderate risk. The improved international position of Romania in economic, political and military aspects supports its long-term economic development.

Figure 5.17 / Romania: Main macroeconomic indicators



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

Romania has been more resilient to recent external shocks than its peers and managed to attain economic growth of 4.8% in 2022. The growth momentum weakened only marginally in Q4: real GDP increased by 1.0% against the previous quarter and by 4.5% year on year. Household consumption bounced back in 2022 from the COVID-related depression of the previous year, despite the elevated inflation. Gross fixed capital formation increased rapidly, supported by the inflow of foreign direct investment (FDI) and EU funds. On the production side, industrial and especially agricultural value added contracted, but this was counterbalanced by increases in construction and services. The war in Ukraine had a moderately negative effect on supply, but it also had some positive effects on domestic demand by way of arriving refugees. Limited trade exposure to the Russian economy and to energy imports overall helped the country to maintain its economic stability, despite slippages in the current account and fiscal deficits.

Net exports made a negative contribution to growth, reflecting the temporary deterioration in terms of trade and supply-chain disruptions. The current account deficit widened to 9.3% of GDP in 2022 (from 7.2% the previous year); this was due not only to an expanding trade deficit, but also to a doubling of the primary income deficit. The latter included exceptionally high profits earned by foreign investors, most of which were retained in the Romanian subsidiaries and recorded as FDI inflow. Rapid GDP growth resulted in a declining foreign-debt-to-GDP ratio, which fell below 50% toward the end of 2022, against almost 57% the previous year.

The fiscal deficit of about 6% of GDP in 2022 was elevated, though lower than the previous year. Driven by inflation, revenue increased substantially, while expenditure failed to keep pace. As a result, government consumption was a burden on economic growth. Financing of foreign public debt is increasingly costly (although still barely more than 1% of fiscal expenditure), as Romania has to pay the highest risk premium of all EU-CEE countries.

High inflation and modest wage growth have dampened household consumption since mid-2022. The annual Harmonised Index of Consumer Prices (HICP) peaked in November 2022 at 14.6%, year on year, and amounted to 12% on average for the year as a whole. Inflation was both cost and demand driven, though tempered by price caps on electricity, gas and firewood for households, as well as temporary subsidies on motor fuel. Net real wages declined by 1.4%, but the real income of households did not fall, due to rising social assistance. The real growth in retail sales turnover slowed, but remained positive throughout the year.

Early 2023 data indicate a significant slowdown in economic performance, though a contraction will probably be avoided. The year-on-year change in retail trade turnover and investment outlay remained positive in January and February. The recent rise in industrial new orders (which had been down in December) indicates growing optimism. Investments in house building have subsided, but other investments have kept growing. The foreign trade deficit has narrowed, mainly on account of lower import prices. On the negative side, inflationary pressure remains elevated, fuelled mainly by food prices. Loans to the private sector have been stagnating in nominal terms since September, meaning a decrease in real terms.

The general outlook for Romania is rosier than some years ago, thanks to its improved international position in economic, political and military aspects. In terms of per capita GDP at purchasing power parity (PPP) it has made good headway internationally, achieving 77% of the EU average in 2022 (up from 57% in 2015). The grand coalition of the Social Democratic, National Liberal and Hungarian parties (PSD-PNL-UDMR) provides a political stability not seen in the country for many years. Romania is a firm supporter of EU initiatives and avoids disputes with the European Commission on ideological grounds. The war in Ukraine and the strains in the Black Sea region have bolstered Romania’s strategic role. The country plays host to new NATO military bases and technologies, provides support to Ukrainian refugees and gives invaluable backing to Moldova’s pro-EU government. All this has generated goodwill among US and EU leaders.

Romania is set to benefit from EU funds and FDI to the tune of some 4% of GDP each in 2023 and 2024. The share of EU funds in public revenues amounted to 11.8% in 2022, and the government expects this to rise to 13.2% in 2023; in terms of expenditure the share will rise from 11.7% to 16%. EU funds within the Recovery and Resilience Facility (RRF) and the Multiannual Financial Framework will

allow the financing of large-scale investment programmes. Beyond transport infrastructure, a number of projects have commenced in healthcare, green energy and environmental protection. The positive impact on society and the economy is overwhelming, even if several of the projects envisaged may not come to fruition, due to exploding construction costs and cuts in funding. As Romania's economic growth in 2020-2021 exceeded the assumptions used for the initial allocation of RRF funds, the amount of the grants earmarked for the country (EUR 14.2bn) will be cut by EUR 2.1bn. This makes it all the more important for it to stay on track by fulfilling the conditions required for the disbursement of the next instalments. Delays are looming, however, due to the non-fulfilment of politically sensitive conditionalities and sluggish project implementation.

Household consumption will slow and fiscal consolidation will be sluggish in 2023. At the start of the year, the minimum wage was raised by 17.7% and public pensions were increased by 12.5%, which compensated for the average inflation of the previous year. In the private sector, real wages will keep pace with inflation, as the labour shortage forces employers to offer real pay rises. Household demand may catch up in the second half of the year, as inflation may well come down significantly in the absence of external shocks and with more abundant food supply from domestic sources. The government plans to reduce the fiscal deficit in 2023, despite the overall economic slowdown and falling inflation (which will erode revenue). At the beginning of the year, public-sector wages were increased by 10% – below the rate of inflation. The scheduled mid-term switching of the post of prime minister from the liberals to the socialists in May 2023 may erode fiscal discipline; thus we expect the deficit to stay at above 5% of GDP this year.

The current account deficit will remain high (7% of GDP), although it will shrink thanks to improving terms of trade and the lower expected profits of foreign investors. The central bank will manage to keep the exchange rate relatively stable, which will help combat inflation but may harm the competitiveness of certain Romanian products. In Q1 2023, the RON was supported by large forex inflows (particularly following Eurobond issues), and the international financial market turbulence in mid-March 2023 had almost no impact on the daily exchange rate. Still, the Romanian currency is the most undervalued in the EU-CEE in respect of purchasing power parity, which provides scope for appreciation.

Due to sluggish demand on EU markets, the recovery of manufacturing will be slow and the structural shift to services will continue. FDI inflow will remain high and will go mainly into modernising existing capacities and targeting sectors of domestic consumption, including retail, oil, gas and electricity. The re-shoring from Russia and Ukraine that has got under way in ICT services could accelerate and encompass other sectors, too. Agriculture is expected to recover from the drought-caused low of the previous year, allowing for higher consumption by rural households, more exports and recovery in the food-processing industry.

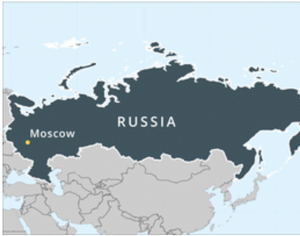
Romania will probably be able to maintain more rapid economic growth than most of its EU-CEE peers – 3% in 2023. This is largely due to its lower exposure to external markets and the more significant inflow of EU funds. By implementing the ongoing investment programmes, Romania can strengthen its energy self-sufficiency and benefit more from the transport re-direction from Ukraine and Moldova. An acceleration in economic growth to 4% or beyond is feasible from 2024, depending on the momentum of household and external demand and the influx of EU funds. The country's likely access to the Schengen area will reduce transaction costs and provide a further boost to the economy.

Table 5.17 / Romania: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024 Forecast	2025
Population, th pers., average	19,372	19,265	19,120	19,000	18,900	18,800	18,700
Gross domestic product, RON bn, nom.	1,063.8	1,066.8	1,187.4	1,412.5	1,600	1,760	1,890
annual change in % (real)	3.9	-3.7	5.8	4.8	3.0	4.0	4.3
GDP/capita (EUR at PPP)	21,790	21,830	24,040	27,190	.	.	.
Consumption of households, RON bn, nom.	653.0	642.1	732.6	883.8	.	.	.
annual change in % (real)	3.3	-3.9	8.4	5.5	1.5	3.0	3.5
Gross fixed capital form., RON bn, nom.	244.5	251.0	281.9	355.3	.	.	.
annual change in % (real)	12.6	1.1	1.9	9.2	6.0	7.0	8.0
Gross industrial production 2)							
annual change in % (real)	-2.3	-9.2	7.1	-1.8	1.0	3.0	5.0
Gross agricultural production							
annual change in % (real)	-3.8	-15.4	14.3	-15.4	.	.	.
Construction industry 2)							
annual change in % (real)	27.6	15.9	-0.6	12.9	.	.	.
Employed persons, LFS, th, average 3)	8,680	8,521	7,756	7,806	7,820	7,860	7,860
annual change in %	-0.1	-1.8	0.7	0.7	0.2	0.5	0.0
Unemployed persons, LFS, th, average 3)	353	452	459	464	480	450	430
Unemployment rate, LFS, in %, average 3)	3.9	5.0	5.6	5.6	5.8	5.4	5.2
Reg. unemployment rate, in %, eop	3.0	3.4	3.0	3.1	.	.	.
Average monthly gross wages, RON 4)	4,853	5,213	5,535	6,159	6,800	7,300	7,800
annual change in % (real, gross)	7.3	4.7	1.1	-2.2	1.0	2.0	3.0
Average monthly net wages, RON	2,986	3,217	3,416	3,832	4,200	4,500	4,800
annual change in % (real, net)	8.8	4.9	1.1	-1.4	1.5	2.5	3.5
Consumer prices (HICP), % p.a.	3.9	2.3	4.1	12.0	9.0	5.0	4.0
Producer prices in industry, % p.a.	3.8	0.0	14.9	44.7	15.0	4.0	3.0
General governm. budget, EU def., % of GDP							
Revenues	31.6	32.3	32.7	34.0	33.8	34.0	34.0
Expenditures	36.0	41.5	39.8	40.0	39.1	38.5	38.0
Net lending (+) / net borrowing (-)	-4.3	-9.2	-7.1	-6.0	-5.3	-4.5	-4.0
General gov. gross debt, EU def., % of GDP	35.1	46.9	48.6	49.5	49.0	48.0	47.0
Stock of loans of non-fin. private sector, % p.a.	7.0	5.0	14.3	11.2	.	.	.
Non-performing loans (NPL), in %, eop	4.1	3.8	3.4	2.7	.	.	.
Central bank policy rate, % p.a., eop 5)	2.50	1.50	1.75	6.25	6.00	4.00	3.00
Current account, EUR m	-10,906	-10,893	-17,471	-26,706	-22,600	-20,900	-18,400
Current account, % of GDP	-4.9	-4.9	-7.2	-9.3	-7.0	-5.9	-4.9
Exports of goods, BOP, EUR m	63,056	57,532	70,170	85,862	87,600	94,600	106,000
annual change in %	2.0	-8.8	22.0	22.4	2.0	8.0	12.0
Imports of goods, BOP, EUR m	80,900	76,476	93,286	118,222	120,600	129,000	140,600
annual change in %	4.9	-5.5	22.0	26.7	2.0	7.0	9.0
Exports of services, BOP, EUR m	27,058	23,764	27,881	37,002	38,900	43,600	48,000
annual change in %	13.7	-12.2	17.3	32.7	5.0	12.0	10.0
Imports of services, BOP, EUR m	18,408	14,321	18,462	24,290	25,500	28,100	29,800
annual change in %	19.3	-22.2	28.9	31.6	5.0	10.0	6.0
FDI liabilities, EUR m	6,574	3,056	9,933	11,295	.	.	.
FDI assets, EUR m	1,721	112	1,117	1,663	.	.	.
Gross reserves of CB excl. gold, EUR m	32,927	37,379	40,475	46,636	.	.	.
Gross external debt, EUR m	109,783	126,750	136,585	144,561	160,000	175,000	185,000
Gross external debt, % of GDP	49.0	57.5	56.6	50.5	49.5	49.7	49.4
Average exchange rate RON/EUR	4.7453	4.8383	4.9215	4.9313	4.95	5.00	5.05

1) Preliminary and wiiw estimates. - 2) Enterprises with 4 and more employees. - 3) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 4) Including the employers' social security contribution. - 5) One-week repo rate.

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

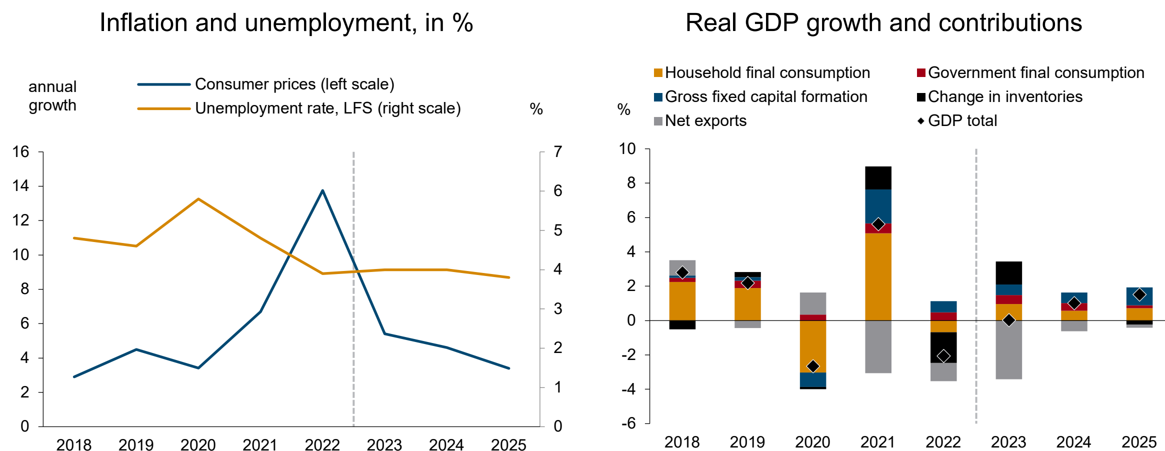


RUSSIA: Resilience to sanctions accompanied by structural change

VASILY ASTROV

After a sharp downturn in Q2 2022, the economy stabilised in the second half of the year and is projected to broadly stagnate in 2023. The overall picture masks the very uneven impact of the war and the sanctions across sectors: while domestic trade and industries that depend heavily on cross-border linkages have suffered, military production and certain import-substituting sectors have flourished. The recently imposed energy sanctions have dealt government revenue a heavy blow and will contribute to budget deficits being much higher in the years ahead.

Figure 5.18 / Russia: Main macroeconomic indicators



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

After falling sharply in Q2 2022, the economy stabilised in the second half of the year. Since its invasion of Ukraine, Russia has become the most sanctioned country globally. At the time of writing, some 14,000 sanctions are in place against Russia, including a wide range of financial, trade and personal sanctions; moreover, many foreign companies have announced their withdrawal from the country. As a result, in Q2 2022 real GDP plunged by 4.6% in quarterly (seasonally adjusted) terms, on account of falling private consumption and the depletion of inventories. However, in both Q3 and Q4 it recovered by 0.5%, helped in part by the replenishment of inventories (in Q3) and by the big increase in public consumption (in Q4). Besides, the development of gross fixed capital formation remained positive throughout, with public-sector investments gaining momentum and many private companies rushing to complete unfinished projects in the face of increased uncertainty. On an annual basis, real GDP growth improved (i.e. became less negative) from quarter to quarter; and for 2022 as a whole it shrank by a mere 2.1%.

The overall GDP picture masks the very uneven impact of the war and the sanctions across sectors. By far the worst performance last year came from wholesale and retail trade (-12.7% in value-added terms), on account of faltering consumer demand and the reduced availability of Western products; meanwhile, manufacturing value added shrank by only 2.5%. Within manufacturing, two types of industry were worst affected: (i) some export-oriented industries that were directly subject to Western sanctions and/or Russia's own restrictions, such as wood and basic chemicals (whose output in 2022 fell by 12.5% and 5.4%, respectively); and (ii) industries serving predominantly the domestic market that were largely foreign owned and/or heavily dependent on imported parts and components, most notably the production of motor vehicles and domestic appliances (-44.5% and -40.2%, respectively). On the other hand, military production appears to have flourished (e.g. the production of 'fabricated metal products not classified elsewhere', which includes weapons and ammunition, rose by 14.2% last year), as do some import-substituting industries, such as pharmaceuticals (+26.5%) and the production of electric motors, generators and transformers, etc. (+7.9%). Other sectors that recorded solid value-added growth last year were agriculture (+6.7%), construction (+5.2%), hotels and catering (+4.3%), public administration and security (+4.1%) and the financial sector (+3.4%). Agriculture benefited from an exceptionally good harvest; construction and the banking sector profited from the subsidised mortgage programme; and domestic tourism experienced a boom thanks to the sharply reduced opportunities open to Russians to travel abroad.

Part of the resilience can also be attributed to the many loopholes and exemptions from the sanctions regime. Some of Russia's important export products (such as food, fertilisers, natural gas and non-ferrous metals) have not been sanctioned, and the country reportedly continues to receive many sanctioned Western goods via third countries – although they have become more expensive as a result.[21] Besides, contrary to earlier announcements, only about 6% of foreign companies have so far withdrawn completely from Russia, while another 38% are in the process of leaving, and 16% have reduced their current operations and are holding off on new investments.[22] The subsidiaries of Western banks that continue to operate in Russia are exempt from sanctions and are an important vehicle for cross-border payments. Apart from unfavourable market conditions, there are also legal obstacles to any withdrawal. The sale of Russian assets by investors from 'unfriendly' countries (i.e. countries that have imposed sanctions) is subject to approval by a government sub-commission, which now requires at least a 50% price discount on the independent market valuation and a 5-10% 'exit tax' to be paid to the Russian budget. The exit of 'unfriendly' investors from the financial, fuel and energy sectors is prohibited altogether, unless explicitly authorised by the president.

However, the newly imposed energy sanctions have dealt the Russian budget a heavy blow. On 5 December 2022, the EU and the G-7 placed an import embargo on Russian oil and a price cap of USD 60 per barrel on oil shipments to third countries; these measures were supplemented on 5 February 2023 by similar restrictions on oil products. As a consequence, the price of Russian oil (Urals) plunged sharply, to around USD 50 per barrel. Because of this and the sharply reduced gas exports, the federal government's revenue from energy plummeted by 45% and total revenue by 21% in Q1 2023, while

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21 In order to prevent this, the US recently stepped up pressure on neutral countries, resulting inter alia in Turkey temporarily halting the transit of sanctioned Western products to Russia (it was partly resumed several weeks later) and Kazakhstan introducing an electronic tracking system of cargo shipments across the country.

22 For more on that, see V. Astrov, 'Chart of the month: Very few firms have left Russia since its invasion of Ukraine', wiiw Monthly Report No. 3, March 2023, pp 7-8.

expenditure soared by 34% (all in nominal terms, year on year).[23] As a result, Q1 2023 closed with a federal budget deficit of RUB 2.4 trillion, or 82% of the target for the *whole* year. The dismal tax collection so far this year has already prompted corrective measures. As of April, taxation of the energy sector will be based not, as before, on the price of Urals (which has become largely irrelevant, given that the bulk of Russian oil has been diverted to Asia, where prices are higher), but on the discounted Brent price, with the size of the applied discount declining progressively over time. Another measure currently under discussion is a one-off 'windfall' tax on profits (defined as the difference between profits earned in 2021-2022 and 2018-2019), which would be levied in Q4 2023 on all companies, except those in the energy sector and small and medium-sized businesses. According to the government, these two measures should bring in 0.4% and 0.2% of GDP, respectively, in additional revenue.

Recent high-frequency indicators suggest further overall economic stabilisation. According to estimates by the Ministry of Economy, after -4.2% in December 2022, the annual rate of GDP decline improved to -3.2% in January 2023 and -3.1% in February, largely on account of improved industrial performance (-4.3%, -2.4% and -1.7%, respectively) – although, on a monthly seasonally adjusted basis, industrial output has been essentially stable since the sharp downturn in April 2022. Business sentiment has been generally improving as well. The S&P Global Purchasing Managers' Index (PMI) has been rising – thanks to the markedly improved PMI in services – and reached 53 in February 2023 (50 separates expansion from contraction), thereby exceeding pre-war levels. The main drag on economic activity continues to be private consumption: according to the Ministry of Economy, the combined turnover of retail trade, catering and household services was down 3.6%, year on year, in January 2023 and 4.4% in February. Depressed private consumption stands in sharp contrast to the trend in real wages, which has been positive since October 2022.

The economy is heading for stagnation this year, to be followed by sluggish recovery in 2024-2025. With the current trends, GDP growth will likely turn positive on an annual basis starting from Q2 2023 (thanks to the low base effect) and will be close to zero for the year as a whole, with the recovering domestic demand offset by falling net (especially energy) exports. Until recently, Russian oil production was holding up well; however, it was cut by some 5% in March and will remain at the same level until the end of the year (as part of the OPEC+ production cuts). The gas sector is facing even bigger problems. Since mid-2022, Russia has been reining in its gas exports to Europe, ostensibly for political reasons. As a result, last year pipeline exports of Russian gas to Europe plunged by 55%, and overall gas exports by 31%, translating into a 12% reduction in gas production. These trends have carried over into 2023, with gas production falling by 13.5% (year on year) in the first two months and the International Energy Agency predicting a drop of 8% for the year as a whole. Unlike oil, gas exports are much more difficult to redirect geographically, given the absence (for the time being) of pipelines connecting Western Siberia and Asia, while production and exports of liquefied natural gas (LNG) could be hampered by Western restrictions on the exports of LNG technology to Russia.

Long-term prospects will depend largely on the success of forthcoming structural change. Because of the energy sanctions and economic decoupling from the West more generally, the weight of the energy sector in Russia's economy will most probably decline in the years ahead. However, successful economic diversification, which would be conducive to sustainable growth, would require the creation of modern and internationally competitive production capacities in fields other than energy and other raw materials – which may not be easy because of the sanctions and the withdrawal of many

[23] According to some estimates, nearly half of all federal spending in Q1 2023 went on defence and security.

Western firms. The key questions here are: (i) to what extent Western equipment, parts and components can be replaced through domestic production and/or increased imports from China and other 'friendly' countries; and (ii) whether this will be enough for the modernisation. The process of substitution is far from complete, but available surveys of Russian firms that previously relied on Western inputs suggest that (especially) Chinese products have already proved crucial.[24] Having said that, both Chinese and Russian-made products are generally of inferior quality, and some Western products (such as advanced semiconductor chips) reportedly cannot be replaced at all. It is therefore highly likely that diversification of the Russian economy will be accompanied by its 'primitivisation', in line with 'technologically regressive import substitution'.[25]

[24] One such survey suggests that last year, 52% of firms started importing Chinese intermediate inputs and components and 67% Chinese production equipment, while the role of 'import substitution' through domestic production was generally less pronounced, https://www.rbc.ru/economics/02/02/2023/63da2eda9a7947dc8601f42a.

[25] This term has been coined by Branko Milanovic, who argues that the challenges currently facing Russia are unique and quite unlike anything faced by Brazil or Turkey, for example, which in the past also pursued import-substitution policies: https://www.globalpolicyjournal.com/blog/18/05/2022/novelty-technologically-regressive-import-substitution

Table 5.18 / Russia: Selected economic indicators

	2019	2020	2021	2022 [1]	2023	2024	2025
						Forecast	
Population, th pers., average [2]	146,765	146,460	145,864	146,702	144,800	144,200	143,800
Gross domestic product, RUB bn, nom.	109,608	107,658	135,295	153,435	159,600	168,500	178,800
annual change in % (real)	2.2	-2.7	5.6	-2.1	0.0	1.0	1.5
GDP/capita (EUR at PPP)	19,840	19,660	22,580	22,460	.	.	.
Consumption of households, RUB bn, nom.	56,110	54,752	65,811	73,260	.	.	.
annual change in % (real)	3.8	-5.9	10.0	-1.4	2.0	1.2	1.5
Gross fixed capital form., RUB bn, nom.	22,911	23,211	26,623	31,784	.	.	.
annual change in % (real)	1.0	-4.0	9.1	3.3	3.0	3.0	5.0
Gross industrial production [3]							
annual change in % (real)	3.4	-2.1	6.4	-0.6	-3.0	2.5	3.0
Gross agricultural production							
annual change in % (real)	4.3	1.3	-0.4	10.2	.	.	.
Construction output							
annual change in % (real)	2.1	2.1	7.0	5.2	.	.	.
Employed persons, LFS, th, average	71,933	70,601	71,719	72,000	72,000	72,360	73,080
annual change in %	-0.8	-1.9	1.6	0.4	0.0	0.5	1.0
Unemployed persons, LFS, th, average	3,465	4,321	3,631	3,000	2,900	2,900	2,800
Unemployment rate, LFS, in %, average	4.6	5.8	4.8	3.9	4.0	4.0	3.8
Reg. unemployment rate, in %, eop [4]	0.9	3.7	1.0	0.8	.	.	.
Average monthly gross wages, RUB	47,867	51,344	57,244	64,460	68,600	73,500	77,900
annual change in % (real, gross)	4.8	3.8	4.5	-1.0	1.0	2.5	2.5
Consumer prices, % p.a.	4.5	3.4	6.7	13.8	5.4	4.6	3.4
Producer prices in industry, % p.a. [5]	2.0	-3.8	24.5	11.4	2.0	5.0	5.0
General governm. budget, nat. def., % of GDP							
Revenues	36.0	35.5	35.6	34.6	35.0	35.0	35.0
Expenditures	34.1	39.5	34.8	36.0	39.0	38.5	38.0
Deficit (-) / surplus (+)	1.9	-4.0	0.8	-1.4	-4.0	-3.5	-3.0
General gov. gross debt, nat. def., % of GDP	12.4	17.6	15.5	14.9	18.0	20.0	22.0
Stock of loans of non-fin. private sector, % p.a.	6.5	12.4	19.8	13.6	.	.	.
Non-performing loans (NPL), in %, eop [6]	6.0	6.1	5.1	4.7	.	.	.
Central bank policy rate, % p.a., eop [7]	6.25	4.25	8.50	7.50	7.50	6.50	6.00
Current account, EUR m [8]	58,614	30,957	103,268	220,176	91,300	68,300	53,000
Current account, % of GDP	3.9	2.4	6.7	10.4	4.3	3.4	2.7
Exports of goods, BOP, EUR m [8]	374,738	291,895	417,548	555,903	424,900	416,400	416,400
annual change in %	-0.5	-22.1	43.0	33.1	-23.6	-2.0	0.0
Imports of goods, BOP, EUR m [8]	226,668	210,118	256,781	264,900	272,600	286,200	300,500
annual change in %	7.4	-7.3	22.2	3.2	2.9	5.0	5.0
Exports of services, BOP, EUR m [8]	55,335	41,973	47,047	45,840	44,900	47,200	49,500
annual change in %	0.9	-24.1	12.1	-2.6	-2.1	5.1	4.9
Imports of services, BOP, EUR m [8]	87,918	56,666	64,137	66,817	64,200	67,400	70,700
annual change in %	9.4	-35.5	13.2	4.2	-3.9	5.0	4.9
FDI liabilities, EUR m [8]	28,548	8,296	34,166	-40,756	.	.	.
FDI assets, EUR m [8]	19,574	5,117	55,647	-13,271	.	.	.
Gross reserves of CB excl. gold, EUR m [8][9]	396,378	372,318	439,693	414,569	.	.	.
Gross external debt, EUR m [8]	438,757	380,941	426,259	353,797	319,200	277,500	258,300
Gross external debt, % of GDP	29.0	29.2	27.5	16.7	15.0	14.0	13.0
Average exchange rate RUB/EUR	72.51	82.39	87.20	72.48	75.0	85.0	90.0

Note: Including Crimean Federal District.

1) Preliminary and wiiw estimate. - 2) From 2022 according to census 2021. - 3) Excluding small enterprises. - 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 National Wealth Fund of the Russian Federation.

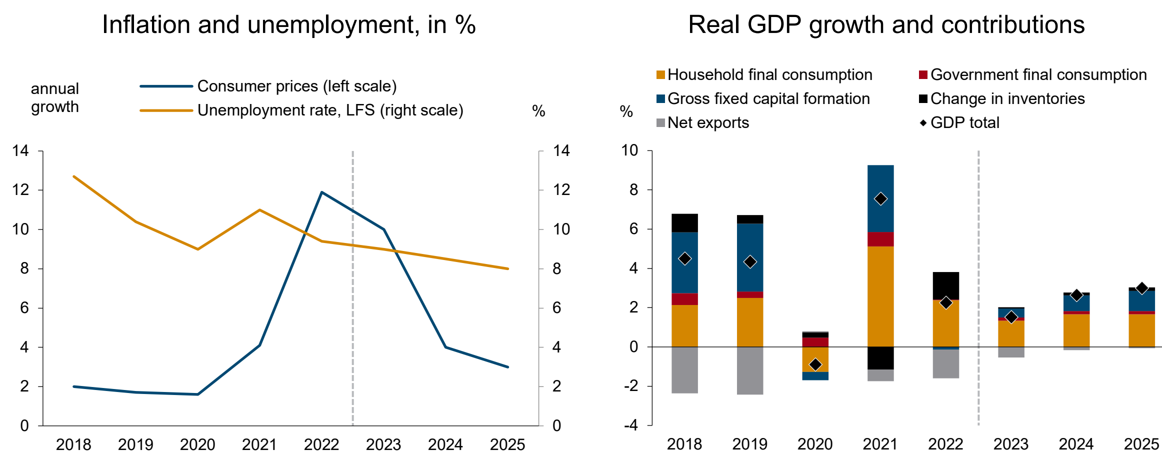
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SERBIA: Cloudy with a chance of sun

BRANIMIR JOVANOVIĆ

Weak investment meant that the economy grew by less than expected in 2022, but there are signs of a recovery in early 2023. Inflation has been on the rise since the government started to lift the price controls it had introduced, and this poses some additional challenges. A major deal has been struck on the normalisation of relations with Kosovo; this could mark a turning point for the country, but questions remain about the implementation of the deal.

Figure 5.19 / Serbia: Main macroeconomic indicators



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

Serbia's GDP in 2022 grew by 2.3%, which fell short of expectations. The poorer outturn was due to weak investment, as gross fixed capital formation declined by 0.6%, following the vibrant growth of 16% the previous year. Household consumption was solid (up 3.7%), backed by policies that raised the minimum wage and public-sector salaries. Government consumption was supportive, albeit weakly, with growth of 0.2%. Both exports and imports were strong, rising by around 18% in real terms.

The decline in investment was due to a decrease in public investment, which fell by approximately 3% in real terms. Still, public investment in Serbia remains robust, accounting for 7.2% of GDP. This is among the highest in the entire CESEE region and comes on the back of the government's ambitious public infrastructure investment programme. Foreign direct investment (FDI) inflows were also strong overall, averaging 7.3% of GDP for the year as a whole. Despite strong public investment and FDI, total investment in the country remained at below 23% of GDP, which is around the regional average. This highlights a significant structural problem in the country: namely the persistently low level of domestic private investment.

FDI had a volatile year in 2022 and will continue to be a puzzle in the coming period. In the first half of the year, it was relatively weak by Serbian standards, at just 5.7% of GDP. However, in the second half of the year investment poured in, reaching 8.6% of GDP. FDI inflows from the EU contracted significantly in 2022, falling to just 33% of total FDI (roughly half of the share in previous years). This may be attributable to Serbia's ambivalent position regarding the war in Ukraine and its still close ties with Russia, which create political uncertainty that deters European companies. On the other hand, Chinese FDI more than trebled in 2022 to reach 32% of total FDI (almost matching investment from the EU), most of it in manufacturing. While this investment clearly has positive economic effects, it is unclear whether it could also have political implications. Meanwhile, Russian FDI also grew considerably in 2022 – eight-fold, to reach 8% of total FDI inflows. The bulk of this came in the final quarter of the year and is attributable to the big influx into the country of Russian refugees, following September's military mobilisation in Russia.

Inflation in 2022 was among the lowest in the region, thanks to the government's price caps on basic foodstuffs; but that is changing in 2023. Inflation averaged 11.9% in 2022 (among the Western Balkan economies, only in Albania and Kosovo was it lower). The price caps on food staples that the government introduced towards the end of 2021 proved effective in taming inflation, but from April 2022 the government started to raise the levels at which the caps were set, which fuelled inflation in the second half of the year. Inflation continued to accelerate on an annual basis in the first three months of 2023, reaching 16.2% in March, up from 15.1% in December – the reason being that the government removed some of the price caps it had previously introduced, and also raised some other administered prices (e.g. for electricity, gas and cigarettes) from the beginning of the year.

The response to inflation by the central bank has been aggressive and is expected to continue that way. Since April 2022, the central bank has raised its policy rate every single month – on 13 consecutive occasions. As of April 2023, its policy rate stands at 6%, up from 1% in March 2022. This has been much more aggressive than the tightening of the European Central Bank, which hiked its rate only six times over the same period, and by only 350 basis points in total. While we see no indication that the tightening has had (or will have) any significant impact on inflation (given its supply-side nature), we expect the central bank to continue tightening, until such time as inflation begins to fall. On the other hand, the tightening has already had an impact on the economy: in February 2023, credit growth slowed to 4.8%, year on year – the lowest level since mid-2018.

Otherwise, the economic policies pursued by the authorities have generally been appropriate. The increase in the minimum wage and in public-sector salaries prevented real incomes from declining, and Serbia ended 2022 as one of those rare European countries to experience a rise in real wages, of 1.7%. Fiscal policy was also supportive overall: general government expenditure reached 46.5% of GDP in 2022 – slightly below the exceptional levels of the previous two years, but much higher than before the pandemic, when it was around 42% of GDP.

Despite the sound fiscal policies, economic performance in 2022 remained modest, indicating profound structural issues in the economy. The first issue concerns the persistently weak domestic private investment and the need for appropriate industrial and innovation policies to boost it. The second pertains to the persistently high poverty and inequality in the country: with a poverty rate of 22% (according to the national poverty threshold) and a Gini coefficient of disposable income of around 35% – both among the highest in Europe – Serbia clearly lacks equal opportunities for all and is in need of

comprehensive social reform. The third issue relates to the imperative to speed up the green transition in the country, particularly in terms of renewable energy – something that requires much greater public investment in this area. Unless these challenges are addressed, Serbia will struggle to achieve sustainable and inclusive growth and development in the long term.

The beginning of 2023 appears to herald an improvement in the economy, although some risks persist. Industrial production has increased by 3.1% year on year in the first two months, which is better than at the end of 2022. However, retail trade has fallen by 1.1% in the same period. We thus keep our forecast for GDP growth in 2023 unchanged, at 1.5%, which is the lowest in the Western Balkans. Because of the acceleration in inflation at the beginning of the year, we are revising our average inflation forecast for 2023 upwards, to 10% (from 9% in January).

A major positive development is the new agreement on the normalisation of relations with Kosovo; however, uncertainty remains about the deal's implementation. The agreement was reached in March in Ohrid, only verbally and without official signatures, though with mediation from the EU and support from the US. The essence of the deal is that Serbia is no longer required to officially recognise Kosovo, but should not block its integration into international organisations. Meanwhile, Kosovo is required to establish an Association of Serb majority municipalities, in order to ensure self-management for the Serbian community in Kosovo. While these provisions are promising, it remains to be seen how they will be implemented. It is worth recalling that the 2013 Brussels Agreement on the normalisation of relations looked good on paper, but was never fully implemented.

There are several important differences between the new Ohrid Agreement and the previous Brussels Agreement. One key difference is that implementation of the new deal is now a condition for EU accession: that should serve as a stick, encouraging both parties to comply. In addition, the agreement also includes a carrot, in the form of a donor conference that will put together an investment and financial aid package for the two sides. Still, there is no guarantee that the parties will adhere to the agreement, especially if their domestic support weakens and they see an opportunity to gain political advantage by promoting a nationalist agenda. But if the deal does get implemented, it will mark a turning point for Serbia, both politically and economically.

Table 5.19 / Serbia: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th. pers., mid-year	6,945	6,899	6,834	6,790	6,745	6,700	6,655
Gross domestic product, RSD bn, nom.	5,422	5,504	6,270	7,091	7,900	8,400	8,900
annual change in % (real)	4.3	-0.9	7.5	2.3	1.5	2.6	3.0
GDP/capita (EUR at PPP)	12,800	12,810	14,350	15,130	.	.	.
Consumption of households, RSD bn, nom.	3,637	3,606	4,067	4,719	.	.	.
annual change in % (real)	3.7	-1.9	7.8	3.7	2.0	2.5	2.5
Gross fixed capital form., RSD bn, nom.	1,218	1,180	1,448	1,620	.	.	.
annual change in % (real)	17.2	-1.9	15.9	-0.6	2.0	3.5	4.5
Gross industrial production 2)							
annual change in % (real)	0.3	0.4	6.3	1.7	1.5	2.5	3.0
Gross agricultural production							
annual change in % (real)	-1.2	2.0	-5.6	-8.0	.	.	.
Construction output							
annual change in % (real)	35.5	-2.5	17.0	-11.5	.	.	.
Employed persons, LFS, th, average 3)	2,901	2,895	2,849	2,913	2,940	2,970	3,000
annual change in %	2.4	-0.2	2.6	2.3	1.0	1.0	1.0
Unemployed persons, LFS, th, average 3)	336	287	352	302	290	280	260
Unemployment rate, LFS, in %, average 3)	10.4	9.0	11.0	9.4	9.0	8.5	8.0
Reg. unemployment rate, in %, eop	18.7	17.9	17.4	15.4	.	.	.
Average monthly gross wages, RSD	75,814	82,984	90,784	103,316	117,100	125,400	133,000
annual change in % (real, gross)	8.4	7.8	5.2	1.7	3.0	3.0	3.0
Average monthly net wages, RSD	54,919	60,073	65,864	74,933	84,900	90,900	96,400
annual change in % (real, net)	8.5	7.7	5.4	1.7	3.0	3.0	3.0
Consumer prices, % p.a.	1.7	1.6	4.1	11.9	10.0	4.0	3.0
Producer prices in industry, % p.a.	0.6	-1.3	8.7	14.9	6.0	3.5	2.5
General governm. budget, nat. def., % of GDP							
Revenues	42.0	41.0	43.3	43.4	44.0	44.0	44.0
Expenditures	42.2	49.0	47.4	46.5	46.5	46.0	45.5
Deficit (-) / surplus (+)	-0.2	-8.0	-4.1	-3.1	-2.5	-2.0	-1.5
General gov. gross debt, nat. def., % of GDP	52.8	57.8	57.1	55.6	57.0	58.0	59.0
Stock of loans of non-fin. private sector, % p.a.	8.9	11.1	10.2	6.5	.	.	.
Non-performing loans (NPL), in %, eop	4.1	3.7	3.5	3.0	.	.	.
Central bank policy rate, % p.a., eop 4)	2.3	1.0	1.0	5.0	6.0	5.5	5.0
Current account, EUR m	-3,161	-1,929	-2,266	-4,139	-3,900	-3,500	-3,200
Current account, % of GDP	-6.9	-4.1	-4.2	-6.9	-5.8	-4.9	-4.2
Exports of goods, BOP, EUR m	16,415	16,079	21,018	26,913	30,200	33,700	37,400
annual change in %	8.7	-2.0	30.7	28.0	12.2	11.5	11.0
Imports of goods, BOP, EUR m	22,038	21,280	27,038	36,266	40,100	43,900	48,100
annual change in %	9.1	-3.4	27.1	34.1	10.5	9.5	9.5
Exports of services, BOP, EUR m	6,934	6,191	7,800	11,087	12,400	13,800	15,300
annual change in %	14.4	-10.7	26.0	42.1	12.0	11.0	11.0
Imports of services, BOP, EUR m	5,922	5,090	6,402	8,771	9,600	10,500	11,400
annual change in %	16.9	-14.1	25.8	37.0	10.0	9.5	9.0
FDI liabilities, EUR m	3,815	3,039	3,886	4,416	.	.	.
FDI assets, EUR m	264	100	229	110	.	.	.
Gross reserves of CB, excl. gold, EUR m	12,042	11,732	14,523	17,311	.	.	.
Gross external debt, EUR m	28,254	30,787	36,488	41,885	47,800	51,600	55,500
Gross external debt, % of GDP	61.4	65.8	68.4	69.4	71.0	72.0	73.0
Average exchange rate RSD/EUR	117.85	117.58	117.57	117.46	117.3	117.2	117.1

1) Preliminary and wiiw estimates. - 2) Excluding arms industry. - 3) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 4) Key policy rate.

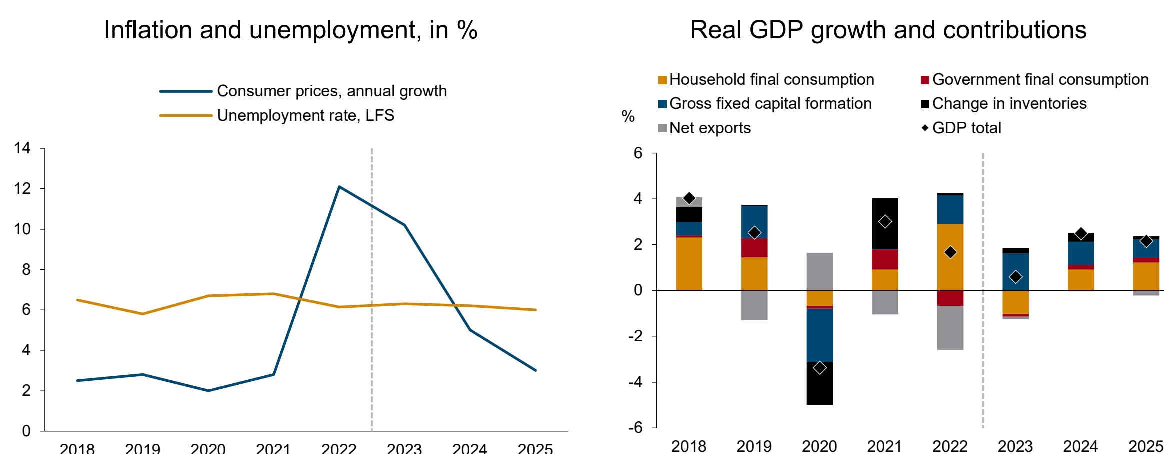
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SLOVAKIA: Political instability threatens future prospects

DORIS HANZL-WEISS

In 2022, Slovakia's GDP growth reached just 1.7%. This year, too, high inflation will continue to prevent stronger economic growth, which is forecast to be 0.6%. Declining household consumption and poor prospects for Germany – the country's main export market – will drag down growth, while the influx of EU funds will provide some growth momentum. The situation should improve in 2024, but domestic political instability resulting from party fragmentation might threaten future prospects in the long run.

Figure 5.20 / Slovakia: Main macroeconomic indicators



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

Slovak GDP grew by a mere 1.7% in 2022, the recovery from the COVID-19 pandemic being hampered by the effects of the Russian invasion of Ukraine on 24 February. Household consumption grew by a surprisingly strong 5.2%, pushed along by pent-up demand after the COVID-19 pandemic – and despite real wages declining quite markedly that year. Gross fixed capital formation also contributed to growth, rising by 6.5%. Gross capital formation was on a par with that, up 6.3%. Overall growth was, however, reduced by two factors in 2022 – first and foremost, negative net exports: while exports of goods and services grew (in real terms) by 1%, imports rose by 3%. Secondly, government consumption declined by 3.2%. Looking at sectoral developments, value added increased in almost all sectors, with trade, transportation, and accommodation and food service activities rising most (by 7.5%). Only in two sectors did it decline: slightly in industry (by 1.2%) and rather more severely in finance and insurance activities (by 20%).

The automotive sector is going electric. This year kicked off with industrial production declining by almost 7% (year on year) in the first two months. The electricity sector, rubber and other non-metallic mineral products, and computer products experienced the strongest fall. However, in the main Slovak industry – the automotive sector – production grew by about 3% in the first two months of 2023, following an increase of 1.1% last year (compared to an overall fall in industrial production of almost 4%), as production in 2022 was affected in the first half of the year by a shortage of semiconductors and by supply-chain problems related to the Russian war in Ukraine. The Slovak production of passenger cars stagnated in 2022 at 1m cars. The automotive sector in the EU-CEE region – and indeed worldwide – is starting the transition to electric vehicles. For Slovakia, new investment announcements have been quite positive in this respect: in July 2022, Volvo Cars announced it was investing more than EUR 1.2bn in building a third production plant in Slovakia that will specialise in electric car production; Porsche will invest more than EUR 1bn in battery modules for electric cars; and VW Bratislava is going to produce the all-electric Porsche Cayenne. During 2023, the Slovak automotive sector will still benefit from the backlog of orders from last year, as well as from the introduction of new models and higher production capacities due this year. On the other hand, the automotive industry will still have to cope with long-term bottlenecks in chips in 2023.

Household consumption will be dampened by still high inflation and a stagnant labour market in 2023. In 2022, the labour market recovered after a two-year strain caused by the COVID-19 pandemic. Employment grew by 1.7%, with more people employed in services and the construction sector, but slightly fewer in industry (-3%). The unemployment rate declined throughout the year and averaged 6.1% in 2022 (compared to 6.8% in 2021). The changes were most pronounced in Trnava region, as well as in the country's eastern regions (which still record the highest unemployment rates, of more than 9%). Still high inflation for this year and falling real wages will deter consumer spending. The Harmonised Index of Consumer Prices (HICP) increased by 12.1% in 2022 and continued rising in January and February of this year – by 15.1% and 15.4% (year on year); it probably finally peaked in February. One third of this increase was due to rising food prices – up by about 28% in those first two months, year on year. On the other hand, the rise in producer prices was already slowing in February (7%, compared to 21% in January). Overall, inflation will fall in the second half of the year due to the base effect. However, HICP is still forecast to average 10.2% this year, dragging real wages down, before subsiding from 2024 onwards. Households will be supported by government measures to combat rising energy prices this year.

The current account will continue in negative territory in 2023. The trade balance (according to balance of payments (BOP) data) reached a record negative figure last year, with goods exports rising by 19%, but good imports rocketing by 26%. The trade deficit with Russia reached its biggest ever figure. Though exports of services increased by 25% in 2022 and imports of services grew by 28%, the balance was positive last year. As a result, the current account was deeply in red, reaching EUR 9bn (8.3% of GDP). A comparably high figure was last recorded in 2006. The early data for 2023 are contradictory: trade statistics data show an increase in exports of 10.4% for the first two months, while imports increased by only about 7%. Machinery and transport equipment exports (including the important motor vehicle exports) were particularly successful and pulled overall growth, probably due to the reduction in inventories. However, January's BOP data show a continuation of the pattern in 2022: import growth surpassing export growth and the current account again deep in negative territory. With still high energy prices, this pattern will most probably prevail for the whole of 2023.

Parliamentary elections are due on 30 September. The Slovak government tumbled in December 2022, but was still able to pass the budget for 2023, which was necessary to support households, businesses and municipalities in countering the high energy prices. Overall, the budget deficit will thus be larger, and is planned to reach 6.4% of GDP. The disbursement of EU funds from the 2014-2020 Multiannual Financial Framework is coming to an end this year. Together with the EU's Recovery and Resilience Facility – which encompasses an overall EUR 6.3bn – EU financing should reach its maximum this year. Early parliamentary elections are scheduled for 30 September 2023. The political parties have fragmented over time, making any future government potentially very unstable (as demonstrated by the example of the last quadripartite government). In the most recent poll,[26] Smer (headed by the former prime minister, Robert Fico) was found to enjoy the greatest support, at 22.4%. It is followed by Hlas (led by Peter Pellegrini, who split from Smer in 2020), with 17%. There is a fear that Fico could lead the country in a more pro-Russian and less Ukrainian-friendly direction, probably in the Hungarian mould.

Slow growth is anticipated for this year, but it should speed up in 2024. The wiiw growth forecast for Slovakia remains unchanged for this year, becomes marginally better for next year, and has been revised slightly downwards for 2025. Slovak GDP is expected to grow by just 0.6% in 2023, by 2.5% in 2024 and by about 2.2% in 2025. In 2023, household consumption is expected to decline, due to high inflation and slightly deteriorating conditions on the labour market. For Germany – the main Slovak export market – growth forecasts remain extremely low, and this will also drag down Slovak growth prospects. The drawing of EU funds should bring some growth impetus this year, although the history of low absorption capacity in past years could pose a risk. The situation for Slovakia should improve in 2024, with a revival of both household consumption and export demand. Uncertainties remain manifold on the external side, as well as domestically: the Russian war in Ukraine is continuing, the diversification of energy supplies needs more time, and inflation is still running high. In addition, domestic political instability could threaten future prospects in the long run.

[26] Source: NMS Market Research/SME, Date: 28 March – 2 April 2023, https://spectator.sme.sk/c/23155148/ficos-smer-reaches-unshakeable-position-in-the-latest-poll.html

Table 5.20 / Slovakia: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	5,454	5,459	5,447	5,432	5,475	5,480	5,480
Gross domestic product, EUR m, nom.	94,438	93,414	98,523	107,730	119,400	128,500	135,200
annual change in % (real)	2.5	-3.4	3.0	1.7	0.6	2.5	2.2
GDP/capita (EUR at PPP)	22,080	21,550	22,510	23,550	.	.	.
Consumption of households, EUR m, nom.	52,363	52,815	55,411	65,457	.	.	.
annual change in % (real)	2.6	-1.2	1.6	5.2	-1.7	1.5	2.0
Gross fixed capital form., EUR m, nom.	20,296	18,225	18,664	21,770	.	.	.
annual change in % (real)	6.7	-10.8	0.2	6.5	8.0	5.0	4.0
Gross industrial production							
annual change in % (real)	0.7	-8.1	10.3	-3.6	-1.0	4.0	3.0
Gross agricultural production							
annual change in % (real)	-4.2	3.4	-3.4	-9.6	.	.	.
Construction industry							
annual change in % (real)	-3.6	-11.3	-2.0	0.0	.	.	.
Employed persons, LFS, th, average 2)	2,584	2,531	2,561	2,604	2600	2610	2620
annual change in %	0.7	-2.0	-1.7	1.7	0.0	0.3	0.5
Unemployed persons, LFS, th, average 2)	158	181	188	170	170	170	170
Unemployment rate, LFS, in %, average 2)	5.8	6.7	6.8	6.1	6.3	6.2	6.0
Reg. unemployment rate, in %, eop	4.9	7.6	6.8	5.9	.	.	.
Average monthly gross wages, EUR	1,092	1,133	1,211	1,304	1420	1480	1560
annual change in % (real, gross)	5.0	1.9	4.5	-4.5	-1.0	-0.5	2.5
Consumer prices (HICP), % p.a.	2.8	2.0	2.8	12.1	10.2	5.0	3.0
Producer prices in industry, % p.a.	1.9	-0.6	6.8	27.8	9.5	7.0	3.3
General governm. budget, EU def., % of GDP							
Revenues	39.3	39.4	40.9	40.5	40.0	39.5	39.3
Expenditures	40.5	44.8	46.3	44.0	46.0	43.9	43.8
Net lending (+) / net borrowing (-)	-1.2	-5.4	-5.5	-3.5	-6.0	-4.4	-4.5
General gov. gross debt, EU def., % of GDP	48.0	58.9	62.2	60.4	60.0	59.4	60.1
Stock of loans of non-fin. private sector, % p.a.	6.6	5.0	7.2	10.8	.	.	.
Non-performing loans (NPL), in %, eop	2.8	2.3	1.9	1.7	.	.	.
Central bank policy rate, % p.a., eop 3)	0.00	0.00	0.00	2.50	.	.	.
Current account, EUR m	-3,163	526	-2,465	-8,938	-6,000	-4,000	-3,500
Current account, % of GDP	-3.3	0.6	-2.5	-8.3	-5.0	-3.1	-2.6
Exports of goods, BOP, EUR m	75,522	70,011	81,303	96,534	101,400	109,500	115,000
annual change in %	0.5	-7.3	16.1	18.7	5.0	8.0	5.0
Imports of goods, BOP, EUR m	76,658	68,996	81,815	103,163	108,300	114,800	120,500
annual change in %	1.7	-10.0	18.6	26.1	5.0	6.0	5.0
Exports of services, BOP, EUR m	10,981	9,048	9,580	11,931	13,000	14,400	15,600
annual change in %	7.4	-17.6	5.9	24.5	9.0	11.0	8.0
Imports of services, BOP, EUR m	9,763	8,085	9,034	11,552	12,100	13,100	13,600
annual change in %	5.0	-17.2	11.7	27.9	5.0	8.0	4.0
FDI liabilities, EUR m	2,042	-934	818	3,876	.	.	.
FDI assets, EUR m	-162	1,475	1,097	1,528	.	.	.
Gross reserves of CB excl. gold, EUR m	5,002	6,050	6,850	7,915	.	.	.
Gross external debt, EUR m	106,016	111,746	133,051	113,065	110,000	105,000	100,000
Gross external debt, % of GDP	112.3	119.6	135.0	105.0	92.1	81.7	74.0

1) Preliminary and wiiw estimates. - 2) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 3) Official refinancing operation rates for euro area (ECB).

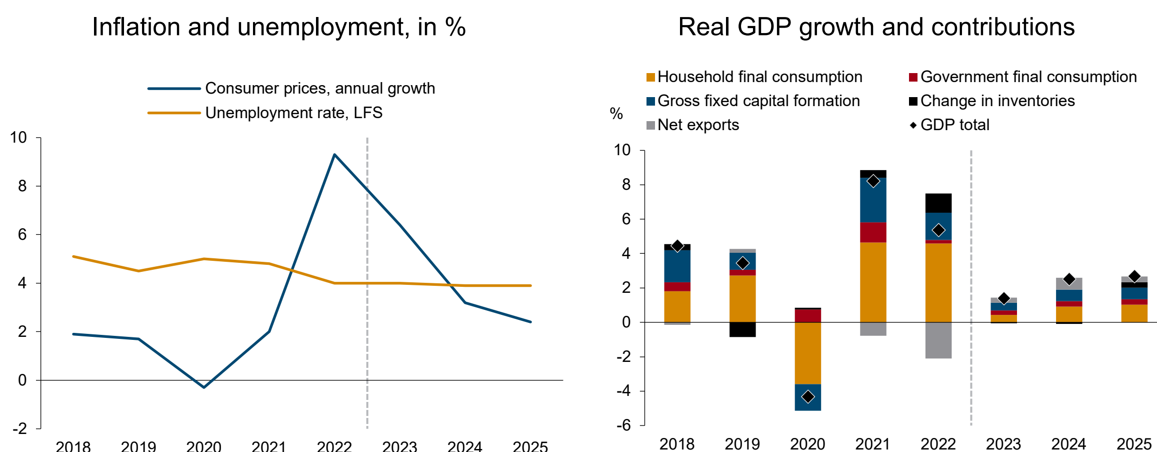
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

SLOVENIA: The economy expected to stay steady while important reforms are pending

NIKO KORPAR

Slovenia continues to perform well in crisis times. In 2023, real GDP will grow by 1.4%, supported by government spending on infrastructure and solid export performance. At 5.5%, inflation will remain high, but lower than the EU average. Unemployment will be at an all-time low for the second year in a row, while real wages will increase despite high inflation. The government has announced reforms in healthcare, pensions, public salaries and taxes, all of which come with long-term fiscal implications and will be a hot topic in 2023.

Figure 5.21 / Slovenia: Main macroeconomic indicators



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

Slovenia's growth prospects for 2023 are subdued, but remain higher than the EU average. Although the Winter did prove difficult for many companies and household as energy prices rose and some industrial plants decreased production, the country weathered the storm relatively unscathed**.** Following a disappointing Q4 of 2022, when GDP grew by only 0.2% y-o-y, growth should trend upward in 2023, especially in the second half of the year. 2023 will mark a significant slowdown in private consumption, the main driver of growth in the previous two years. In part due to the end of the post-pandemic rebound and in part due to lower consumer confidence, private consumption will grow only by 0.8% in 2023. Instead, growth will be driven by government spending on construction projects and public buildings, as well as by foreign trade. Much of this spending will be driven by EU cohesion funds from the ending MFF for 2014-2020 and incoming Recovery and Resilience funds. However, private investment growth will recede, and overall growth of investments in fixed capital will decrease from 7.8% in 2022 to 2% in 2023 due to deteriorating economic sentiment and higher interest rates. Overall, we

expect Slovenia's real GDP to grow by 1.4% in 2023, an upward revision of our previous forecast by 0.2 p.p. on account of lower energy prices and somewhat resilient foreign trade.

Despite continuing issues with high prices of raw materials, energy, industrial production should still grow by 1.8% in 2023. Energy intensive industries continue to perform worse than mid- and high-tech exporting sectors and this is likely to remain the case as long as energy prices remain at high levels. Construction will keep benefiting from increased public investment that started in 2022 and will continue in 2023 with projects, such as the 3rd developmental axis and the Koper-Divača railway. There are little worries over the possibility of a financial crisis following the recent SVB and Credit Suisse debacles. The banking system of Slovenia operates on solid fundamentals as it continues to consolidate with the Hungarian-owned OTP taking over Nova KBM, the country' second largest bank.

We expect gradual drop in inflation, although it will remain high at least in the first half of the year. After the inflation rate for 2022 settled at 9.3%, March 2023 still saw 10.5% inflation on an annual basis, fuelled by rising prices of food (by 12.9%) and electricity (by 49%) after the initial package of government relief measures ran out. However, from December 2022 to March 2023, prices have risen by only 1%. Since there are signs of gradual price stabilisation of energy markets and supply chains, we have slightly decreased our previous inflation forecast for 2023 by 0.1 p.p., to 6.4 %-

Foreign trade has once more proved to be more resilient than expected. Despite lingering issues with inflation, exports will grow by 2.6% in 2023. Demand for imports will slow down (to 2.3%) as consumers look to buy less imported goods and industrial producers import fewer expensive raw materials. After current account balance turned negative in 2022 for the first time in 10 years, it will again turn slightly positive (with 0.7% of GDP) in 2023 as the economy benefits from an improvement in terms of trade and the continuing revival of tourism.

The labour market continues to perform well as unemployment is expected to stay at historically low levels for the second year in a row. Employment is likely to increase by 1% and the unemployment rate will remain at 4,0% in 2023. There have been instances of industrial plants firing workers due to reduced demand and reorganization of supply chains, such as the once-exemplary case of FDI, the Magna automotive plant near Maribor. Nevertheless, the labour market shows overall no signs of a large slowdown. Instead, the economy is facing a shortage of workers, especially in manufacturing and construction. As a response, the government has eased certain regulations for hiring foreign workers, the majority of which come from Bosnia and Herzegovina and Albania.

Real wages will increase in 2023 despite high inflation. Pressure on wages to increase is high and an implemented uptick in the minimal wage in January 2023 will contribute to gross wages increasing by 6,7% in 2023. The government's somewhat ad hoc promises of increased wages to various groups, such as doctors and judges, have led to practically all major unions to contemplate protests in order to demand what they see as their fair share of wage increases. In response, the government has announced an overhaul of the public salary system.

Higher-than-expected fiscal revenue will keep the fiscal balance in check despite a rising trend in public spending. In 2022, the public deficit was 3,9% of GDP. For 2023, we expect the deficit to be slightly higher with 4,3%, primarily due to increases in wages and measures to address inflation. The total amount spent on anti-inflationary measures in the first three months of 2023 was 237 million EUR.

Of these, the policies addressing energy prices, including lowered VAT on selected energy sources and a temporary exemption to the national carbon tax for the industry, have totalled at over 100 million EUR. The previous three years were marked by expansionary fiscal policy in shape of anti-pandemic, anti-inflation measures and wage increases. The following year is likely to introduce increased spending for healthcare, long-term care, as well as for other purposes, such as the military. However, due to the coming return of the EU's fiscal rules, maintaining budget deficits over 3,5% of GDP, as has been the case since 2020, will likely not be allowed by the EU fiscal rules in the mid-term. To compensate for increased spending, it is likely that a new tax reform will bring increased taxes on wealth and potentially also on real estate.

The government led by Robert Golob has embarked on an ambitious reform programme. It includes long overdue reforms to the healthcare system, the public sector salary system, the pension system, a tax reform and push to build more affordable housing. However, the content of these reforms is yet unclear and the fiscal base for increased spending also remains an unsolved issue. Tensions over perceived social fairness of these reforms could swell up and results in protests or strikes. The healthcare reform will prove to be a particularly sensitive issue since a part of the public sees is it as the last attempt to prevent the slowly creeping privatisation of healthcare. Disagreements over healthcare could cause internal strife in the coalition, but due to the relative strength of Golob's party, the Freedom Movement (Gibanje Svoboda), it is not likely that smaller coalition partners will leave.

We forecast a modest further strengthening of the economic recovery in 2024, with growth increasing to 2,5%, supported by an uptick in private demand (1,7%). Inflation should recede to 3,2% and exports should recover by 4,5%, maintaining the current account surplus. Energy supply for the winter of 2023/2024 does not seem threatened after Slovenia signed an agreement with Croatia, thus securing gas supplies in case of a shortage. The largest risk factors will continue to come from abroad and will depend on the continuation of the war in Ukraine. Domestically, other important decisions that will shape the coming years are still pending and are likely to extend into 2024: more ambitious climate policy and large scale investments to decarbonize energy supply, including a potential new block of the nuclear power plant Krško.

Table 5.21 / Slovenia: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	2,088	2,102	2,108	2,108	2,115	2,119	2,125
Gross domestic product, EUR m, nom.	48,533	47,021	52,208	58,989	63,600	67,300	70,800
annual change in % (real)	3.5	-4.3	8.2	5.4	1.4	2.5	2.7
GDP/capita (EUR at PPP)	27,760	26,770	29,160	32,540	.	.	.
Consumption of households, EUR m, nom.	25,022	23,145	26,206	31,966	.	.	.
annual change in % (real)	5.3	-7.0	9.4	9.1	0.8	1.7	1.9
Gross fixed capital form., EUR m, nom.	9,496	8,870	10,619	12,961	.	.	.
annual change in % (real)	5.1	-7.9	13.7	7.8	2.0	3.0	3.0
Gross industrial production							
annual change in % (real)	3.1	-5.3	10.3	1.2	1.8	2.5	2.7
Gross agricultural production							
annual change in % (real)	-7.8	5.0	-13.3	-1.1	.	.	.
Construction industry							
annual change in % (real)	3.3	-0.7	-0.5	22.1	.	.	.
Employed persons, LFS, th, average 2)	982.5	978.0	971.6	986.1	1,000	1,010	1,020
annual change in %	0.2	-0.5	0.3	1.5	1.0	0.7	0.5
Unemployed persons, LFS, th, average 2)	45.7	51.2	48.4	41.1	40	40	40
Unemployment rate, LFS, in %, average 2)	4.5	5.0	4.8	4.0	4.0	3.9	3.9
Reg. unemployment rate, in %, eop	7.7	8.9	6.7	5.4	.	.	.
Average monthly gross wages, EUR 3)	1,754	1,856	1,970	2,024	2,300	2,510	2,700
annual change in % (real, gross)	2.7	5.9	4.1	-5.5	6.7	5.7	5.2
Average monthly net wages, EUR 3)	1,134	1,209	1,270	1,319	1,420	1,490	1,560
annual change in % (real, net)	2.1	6.6	3.1	-4.6	1.1	1.8	2.5
Consumer prices (HICP), % p.a.	1.7	-0.3	2.0	9.3	6.4	3.2	2.4
Producer prices in industry, % p.a.	0.6	-0.3	5.5	19.7	6.0	1.9	2.8
General governm. budget, EU def., % of GDP							
Revenues	43.8	43.4	44.6	46.4	45.1	46.8	47.0
Expenditures	43.2	51.2	49.3	50.2	49.3	49.4	49.2
Net lending (+) / net borrowing (-)	0.6	-7.7	-4.7	-3.8	-4.2	-2.6	-2.2
General gov. gross debt, EU def., % of GDP	65.4	79.6	74.5	72.3	71.0	68.5	68.1
Stock of loans of non-fin. private sector, % p.a.	3.5	0.0	5.9	10.2	.	.	.
Non-performing loans (NPL), in %, eop 4)	2.9	2.6	1.6	1.5	.	.	.
Central bank policy rate, % p.a., eop 5)	0.00	0.00	0.00	2.50	.	.	.
Current account, EUR m	2,884	3,552	1,986	-247	500	570	520
Current account, % of GDP	5.9	7.6	3.8	-0.4	0.8	0.8	0.7
Exports of goods, BOP, EUR m	31,999	29,622	35,255	42,611	45,080	47,970	51,140
annual change in %	3.9	-7.4	19.0	20.9	5.8	6.4	6.6
Imports of goods, BOP, EUR m	30,701	27,289	34,373	44,921	47,440	50,520	53,900
annual change in %	3.9	-11.1	26.0	30.7	5.6	6.5	6.7
Exports of services, BOP, EUR m	8,659	6,956	8,447	11,042	12,510	13,340	14,340
annual change in %	6.6	-19.7	21.4	30.7	13.3	6.6	7.5
Imports of services, BOP, EUR m	5,751	4,899	5,992	7,465	8,240	8,650	9,260
annual change in %	4.6	-14.8	22.3	24.6	10.4	5.0	7.0
FDI liabilities, EUR m	1,919	446	1,795	1,642	.	.	.
FDI assets, EUR m	1,157	708	1,397	421	.	.	.
Gross reserves of CB excl. gold, EUR m	767	913	1,838	1,962	.	.	.
Gross external debt, EUR m	44,442	47,998	50,818	51,885	54,900	57,500	60,000
Gross external debt, % of GDP	91.6	102.1	97.3	88.0	86.3	85.4	84.8

1) Preliminary and wiiw estimates. - 2) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 3) Wage increase in 2020 due to COVID emergency relief compensations. - 4) Loans more than 90 days overdue and those unlikely to be paid. - 5) Official refinancing operation rates for euro area (ECB).

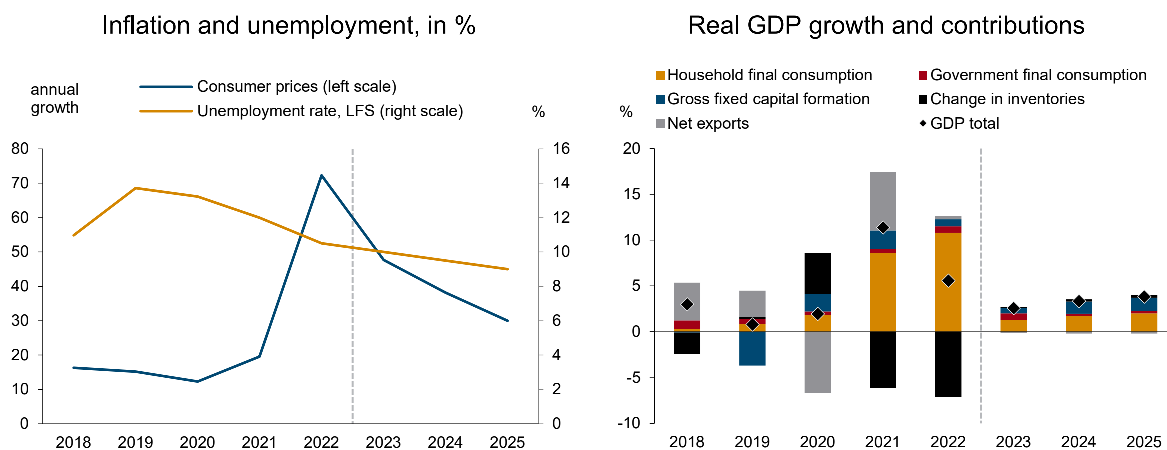
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

TURKEY: Election uncertainty looming

MERYEM GÖKTEN

Despite the various challenges, economic momentum was strong in the first half of 2022, but began to slow in Q4. In 2023, Turkey has been grappling with the fallout from February's devastating earthquakes and the political uncertainty surrounding the upcoming May elections. Growth will slow this year, due to a combination of external vulnerabilities and internal structural challenges. The easing of political instability and increased reconstruction investment are likely to stimulate growth in 2024-2025.

Figure 5.22 / Turkey: Main macroeconomic indicators



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

Despite the challenges it faced in 2022, Turkey's economy continued to grow; although the pace slowed (from the 11.4% witnessed in 2021) to 5.6%, this was still one of the highest growth rates seen in the CESEE region. Household consumption, which typically makes up well over 50% of the country's economic output, was the primary driver of growth: it increased by a significant 19.7% year on year in real terms, despite the high inflation. This surge in consumption was mainly driven by loose credit conditions, a 2% increase in real wages and pent-up demand following the COVID-19 pandemic. Government consumption also contributed positively to growth in 2022, with an increase of 5.2% year on year in real terms. In addition, a strong rebound in tourism, recovering global demand and opportunities arising from disruptions to Asian supply chains all continued to fuel exports and contribute to growth.

However, the high rate of inflation – by far the highest in the CESEE region – remains one of the main challenges facing the Turkish economy. Accelerating inflation was the most notable feature of the Turkish economy in 2022, with the year-on-year rate reaching a 24-year high of over 85% in October. In an effort to mitigate the adverse effects of soaring inflation, the Turkish government has implemented a range of measures, including hiking the minimum wage by 55% at the beginning of 2023 and increasing pensions for public-sector workers. Moreover, in an effort to stabilise the lira, the government has introduced a forex-protected lira scheme (known as 'KKM'), which features bank accounts that insulate the funds in them against exchange-rate fluctuations, and has also imposed strict regulations on foreign-currency transactions conducted by companies. However, the efficacy of the measures appears to be modest. After a significant surge of 6.65%, month on month, in January 2023, consumer prices grew in February and March by 3.15% and 2.29%, respectively. However, Turkey's annual inflation rate in March 2023 was 50.1%, showing a downward trend that is partly due to base effects.

The two devastating earthquakes that struck Turkey and Syria on 6 February 2023 will have a significant impact on the country's industrial output in 2023. Some 13m people in ten provinces have been affected by the disaster. With over 50,000 deaths, this was the deadliest event in the nation's recent history. In total, the provinces affected contribute 9.3% to GDP (almost 15% for the agricultural sector) and 8.5% to exports. The Turkish government has put the total estimated cost of the earthquakes at USD 103.6bn – equivalent to 9.5% of Turkey's forecast GDP for 2023. Although government spending on reconstruction will provide a boost in 2023, we anticipate that growth will be slower than in the last two years, due to disrupted supply chains, damaged infrastructure and machinery, loss of the labour force and reduced investment in the immediate aftermath of the earthquake. After a short-lived recovery in January, both consumer confidence and industrial production dropped, suggesting some early signs of the earthquake's impact.

Despite the recent recovery in exports, the current account deficit has surged to levels not seen since 2013, widening to 5.3% of GDP in 2022 (from 0.9% the previous year). This is largely attributable to the substantial expenses incurred as a result of energy and gold imports (net imports of energy and gold reached EUR 104bn in 2022). In order both to limit Turkish consumers' ability to hedge against inflation and to ease the pressure on the lira, following the February earthquakes Turkey introduced new restrictions on gold trading. Despite this move and the recent fall in energy prices, Turkey's current account deficit in January-February was 54% higher than in the same period last year. In 2022, more than half of the current account deficit was financed by 'net errors and omissions' – a category that consists primarily of mystery capital of unknown source. After recording outflows in January, net errors and omissions saw an inflow of about USD 1bn in February, which eased the pressure on Turkey's foreign reserves to fund the current account deficit. The opaque nature of this form of current account financing renders it impossible to reach any definite conclusions about how sustainable it is.

The upcoming presidential and parliamentary elections will determine whether the current policies continue or new economic policies are introduced; this only adds to the uncertainty surrounding the country's economic outlook. As the polls indicate a close race, with no candidate currently above 50%, the likelihood of a second round seems high. Despite the challenges posed by the state of the economy and the recent earthquakes, we believe Erdoğan may garner enough support in the second round to secure his position. If the current government and president win the elections, the current policies will most likely continue. The New Economic Model, introduced in 2022, prioritises a low policy rate (and a negative real interest rate), designed to boost exports and reduce the current account

deficit by lowering the domestic borrowing cost. Persisting with the New Economic Model in the short term could result in sustained high levels of inflation, substantial depreciation of the lira and volatile economic growth – all of which could increase the likelihood of a financial crisis.

In the event of an opposition coalition (Nation Alliance) victory, we anticipate that the government may contest the election, potentially leading to a rerun either nationwide or in certain provinces. As occurred in the 2019 local elections, this could result in a renewed opposition victory – which in turn could herald a new economic policy. Early in 2023, the Nation Alliance released a joint manifesto declaring its main economic objectives, which include lowering inflation to single digits within two years and restoring central bank independence. While the declaration does not spell out any concrete measures, it does highlight the coalition's intention of reversing certain unorthodox policies introduced by the current administration – such as repealing the KKM scheme and switching priority away from a low-interest-rate environment.

As Turkey gears up for the elections on 14 May, the nation's economic outlook remains challenging. The lira was under pressure in 2022 due to a tightening of monetary policy in the US and the euro area. While the Fed has suggested that the era of interest-rate hikes is drawing to a close, it may yet proceed to raise interest rates in the first half of 2023, thereby intensifying pressure on the lira and stoking inflation in Turkey. In the meantime, the Central Bank of the Republic of Turkey's (CBRT) commitment to continue its expansionary monetary policies, aligned with New Economic Model, is likely to fuel inflation. The CBRT reduced the benchmark rate by a total of 550 basis points between August 2022 and March 2023, ultimately reaching 8.5%. As a result, the real policy interest rate – calculated using current inflation – is at a profoundly negative level (-41.5% in March). Regardless of the election results, we do not anticipate any significant rise in the policy rate in 2023. A significant rate increase at this point could cause stress in the banking system, due to a not inconsiderable number of transactions that are tied to the current low interest rates. Hence, we expect inflation to remain at close to 50% (year on year) until the end of 2023, and to average over 47% for the year.

Household consumption is likely to slow in 2023, as pent-up demand dissipates and consumer purchasing power dwindles. Meanwhile, the government is expected to continue with its expansionary fiscal policy, with spending projected to grow by about 6.2% in real terms, as a result of public investment in infrastructure following the earthquakes and ahead of the May elections. However, lower industrial output and weak external demand will weigh on export performance. In addition, the impact on the Turkish economy of the Russian invasion of Ukraine is expected to escalate, as the country has partially halted the transit of Western-sanctioned goods to Russia. This will place a further strain on the already fragile relationship with Russia and could result in reduced Russian demand for Turkish exports (in 2022, 3.7% of all Turkish exports were destined for Russia). Given these developments, we have revised our growth projection for 2023 downward to 2.6% (from 3% in our previous forecast).

Looking beyond this year, the economy has strong growth potential; but achieving this will require a more stable form of policy making and a reduction in political risk. There is no doubt that the economy can produce bursts of very strong growth, as has been witnessed over the past two years; but this comes at the cost of extremely high inflation and rapid lira depreciation, and carries with it a high risk of macro-financial volatility and crisis. Addressing this will require a more orthodox and consistent approach to economic policy making. Among other things, if there is to be any reduction in the chronically high current account deficit (the financing of which has become more difficult in recent years

and leaves Turkey exposed to changes in foreign investor sentiment and US monetary policy), there will need to be further efforts to boost domestic production and a reduced reliance on credit-financed household spending (which contributes to the high demand for imports). Turkey's economic growth potential could be amplified if greater political and macroeconomic stability were to be achieved in 2024-2025, thereby paving the way for increased investment and foreign direct investment inflows. This will be particularly crucial in the aftermath of the recent earthquakes, when significant investment is required to ensure the country's recovery and to support the reconstruction efforts.

Table 5.22 / Turkey: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024 Forecast	2025
Population, th pers., average	82,579	83,385	84,147	84,980	86,179	87,213	88,260
Gross domestic product, TRY bn, nom.	4,312	5,048	7,249	15,007	22,700	32,400	43,700
annual change in % (real)	0.8	1.9	11.4	5.6	2.6	3.4	3.8
GDP/capita (EUR at PPP)	18,480	18,320	20,340	21,710	.	.	.
Consumption of households, TRY bn, nom.	2,441	2,847	3,983	8,633	.	.	.
annual change in % (real)	1.5	3.2	15.3	19.7	2.2	3.0	3.5
Gross fixed capital form., TRY bn, nom.	1,117	1,383	2,040	4,444	.	.	.
annual change in % (real)	-12.5	7.4	7.4	2.8	2.0	4.5	5.0
Gross industrial production 2)							
annual change in % (real)	-0.6	2.2	16.5	6.2	-0.5	2.8	3.5
Gross agricultural production 3)							
annual change in % (real)	4.3	4.1	0.5	10.0	.	.	.
Construction industry 2)							
annual change in % (real)	-8.0	-3.0	3.0	5.0	.	.	.
Employed persons, LFS, th, average 4)	28,081	26,808	28,827	30,725	31,700	32,500	33,300
annual change in %	-2.3	-4.5	8.0	6.6	3.3	2.5	2.5
Unemployed persons, LFS, th, average 4)	4,461	4,063	3,916	3,592	3,520	3,410	3,290
Unemployment rate, LFS, in %, average 4)	13.7	13.2	12.0	10.5	10.0	9.5	9.0
Reg. unemployment rate, in %, eop	.				.	.	.
Average monthly gross wages, TRY 5)	4,470	4,595	5,849	10,280	15480	21820	28930
annual change in % (real, gross)	7.9	-8.5	6.4	2.0	2.0	2.0	2.0
Consumer prices (HICP), % p.a.	15.2	12.3	19.6	72.3	47.7	38.2	30.0
Producer prices in industry, % p.a. 6)	17.6	12.1	43.9	128.5	65.7	58.4	38.2
General governm. budget, nat. def., % of GDP							
Revenues	29.8	29.6	28.0	26.0	25.5	26.0	27.0
Expenditures	33.0	32.5	30.4	28.5	29.5	29.0	30.0
Deficit (-) / surplus (+)	-3.2	-2.9	-2.4	-2.5	-4.0	-3.0	-3.0
General gov. gross debt, nat. def., % of GDP	32.6	39.7	41.8	43.5	46.4	48.0	48.0
Stock of loans of non-fin. private sector, % p.a.	10.2	35.3	32.4	56.9	.	.	.
Non-performing loans (NPL), in %, eop	5.4	4.1	3.1	2.1	.	.	.
Central bank policy rate, % p.a., eop 7)	12.00	17.00	14.00	9.00	9.00	9.00	9.00
Current account, EUR m	9,695	-28,125	-5,958	-45,849	-40,000	-37,000	-36,000
Current account, % of GDP	1.4	-4.5	-0.9	-5.3	-4.0	-3.0	-2.5
Exports of goods, BOP, EUR m	162,777	147,045	190,365	241,142	258,000	273,000	287,000
annual change in %	7.3	-9.7	29.5	26.7	7.0	6.0	5.0
Imports of goods, BOP, EUR m	177,804	180,244	215,210	326,697	343,000	360,000	378,000
annual change in %	-4.2	1.4	19.4	51.8	5.0	5.0	5.0
Exports of services, BOP, EUR m	60,155	33,370	52,206	86,650	94,000	102,000	110,000
annual change in %	20.5	-44.5	56.4	66.0	8.0	8.0	8.0
Imports of services, BOP, EUR m	25,614	20,893	25,102	38,558	41,000	44,000	47,000
annual change in %	6.0	-18.4	20.1	53.6	7.0	7.0	7.0
FDI liabilities, EUR m	8,526	6,706	11,319	12,434	.	.	.
FDI assets, EUR m	2,655	2,804	5,493	4,698	.	.	.
Gross reserves of CB excl. gold, EUR m 8)	69,974	40,776	64,182	77,714	.	.	.
Gross external debt, EUR m 8)	369,083	350,586	387,835	430,368	486,300	547,100	619,100
Gross external debt, % of GDP	54.4	55.9	56.2	49.9	48.2	43.9	42.5
Average exchange rate TRY/EUR	6.3578	8.0547	10.5124	17.4088	22.50	26.00	30.00

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees; for construction wiiw estimate. - 3) Based on UN-FAO data, wiiw estimate in 2022. - 4) From 2021 new methodology in line with the Integrated European Social Statistics Regulation (IESS). - 5) Personnel costs. 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 in 2022. - 6) Domestic output prices. - 7) One-week repo rate. - 8) Converted from USD.

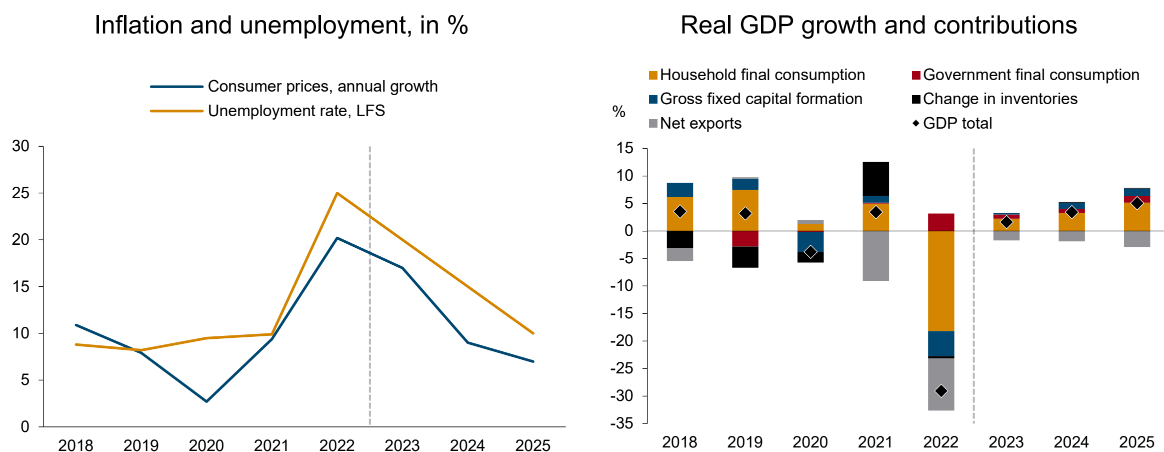
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

UKRAINE: Economy defying the odds

OLGA PINDYUK

Ukraine's economy has been performing relatively well, considering the wartime conditions and the targeted destruction of its energy infrastructure by Russia. International financial aid will remain crucial for the economy's functioning in the short term. We expect economic growth to resume in 2023 and to accelerate in 2024-2025. But this forecast is subject to major downside risks related primarily to the intensity and duration of Russia's war in Ukraine and the continued willingness of international partners to support Ukraine.

Figure 5.23 / Ukraine: Main macroeconomic indicators



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

In 2022, Ukraine's economic decline was less dramatic than had been expected at the outset of Russia's full-scale invasion. GDP declined by 29.1%, year on year, and in US dollar terms was at the level of 2020 (about USD 160bn). This is quite a remarkable result, given that about 15% of the country's territory has been either occupied by Russia or is the scene of active military hostilities; about 15% of the population has left the country; a significant part of the infrastructure and industry assets have been destroyed;[27] and the Black Sea ports have been blockaded for non-agricultural exports.[28] The economy could have suffered an even smaller decline, had it not been for Russia's missile attacks

[27] According to the Kyiv School of Economics, as of December 2022, the total amount of documented damage to Ukraine's infrastructure due to the full-scale invasion launched by Russia on 24 February 2022, was estimated at USD 137.8bn at replacement cost (or 86% of GDP).

[28] For agricultural exports, access to the seaports was blocked until the establishment of the Black Sea grain corridor in July 2022.

on the country's electricity infrastructure in the autumn, which caused damage of between 1.9% and 3.6% of GDP for the whole year, according to calculations by the National Bank of Ukraine (NBU).

Industrial production and construction have been hit hard by the war and in 2022 contracted by 37% and 65%, respectively (both year on year). Among the industrial sectors, it was the chemical industry and metallurgy that were worst affected by the energy shortages and the lack of export possibilities – they lost about two thirds of their output in 2022. Non-durable consumer goods sectors, supported by domestic and external demand, have been able to withstand the wartime conditions somewhat better, and the decline in their production in 2022 was 24%, year on year.

Things seem to be looking up in 2023, as business expectations are improving on the back of stabilisation of the situation in the energy sector. In April 2023, the country even returned to being an electricity exporter. In March 2023, the NBU's business expectations index increased to 49.5 (from 45.0 in February) and almost reached the 'neutral' level of 50.0. Some sectors are already more optimistic than others: the index exceeded 50.0 in trade (53.6) and industry (51.2). This year economic activity is expected to revive and industrial production should achieve a slight positive growth. That said, the forecast is subject to a high level of downside risks: primarily the further destruction of infrastructure and the fixed capital assets of enterprises, and continuing bottlenecks in transport logistics.

Consumer price inflation has been falling quite rapidly and should be well below 20% by the end of the year. Having reached 26.6%, year on year, in December 2022, it dropped to 21.5%, year on year, in March 2023, with prices declining for some food categories and transport services. The main factors behind the better figures are the stabilisation of electricity supplies, lower global energy prices and an improved situation on the forex market. By the end of 2023, average annual inflation is expected to slow to 17%, and by 2025 to reach 7%. In the coming years, inflation will decelerate more rapidly, thanks to the receding security risks, the recovery in logistics and better harvests.

Exports decreased sharply in 2022, but the decline was not uniform across sectors and resulted in big changes in the export structure. The fall in merchandise exports amounted to 35%, year on year, in US dollar terms, while services exports did not decline so dramatically – by just 12%, on the back of a strong performance by IT services exports (which increased by 6%). Agri-food exporters were able to benefit from the Grain Deal, which partly de-blockaded the Black Sea transport corridors, and from better access to the markets of the EU, which adopted a regulation allowing for temporary full trade liberalisation and the suspension of trade protection measures for one year, as from June 2022. The preliminary data show that this measure contributed to a recovery in Ukraine's exports to the EU of products under the Deep and Comprehensive Free Trade Area's Tariff Rate Quotas, with a significant increase in exports of poultry, eggs, milk powder, butter, sugar and oil seeds. As a result, the share of agri-food exports increased to 53% in 2022 (9 percentage points (pp) higher than a year before), and the EU's share of the country's merchandise exports increased to 57% (23 pp up on 2021). At the same time, the share of metals in exports dropped to 14% of the total (about two thirds of the previous level), as the sector lost its factories in occupied territories and did not have access to seaports.

After a sharp decline in 2022, private consumption is expected to revive slightly this year. Last year final demand contracted sharply – a consequence of a large share of the population fleeing the country; a decrease in real household incomes, brought about by a contraction in real wages (of 12%, year on year) and pensions; and persistently high unemployment, especially among internally displaced

people, among whom the figure reached 51% in February 2023.[29] In Q1 2023, private demand started to show some sign of recovery, as consumer sentiment improved, and retail trade revived in March 2023 – 95% of retail chains and shops were operating. The labour markets have been recovering as well, as evidenced by the rapid rise in the number of vacancies, which serves to push wages up. The growth in real wages in 2023 will also be supported by payments in the public sector, especially to the military.

International aid remains critical if the economy is to function under wartime conditions, as foreign financing is an important source of budget deficit coverage. As of the end of March 2023, the amount of international aid received since February 2022 exceeded USD 44bn. On 21 March 2023, Ukraine and the IMF reached staff-level agreement on a four-year Extended Fund Facility (EFF) arrangement of USD 15.6bn, which was ratified by the IMF's board on 31 March. This is the first time that the IMF has lent to a country at war. Following the budget amendments enacted on 21 March (related to extra expenditure for the army), the budget deficit target for 2023 was raised to USD 49bn (around 27% of forecast 2023 GDP). The government expects to finance it via foreign borrowing/grants (with the EU having already pledged to provide about half of the amount; the US – USD 13.4bn; and Japan – USD 5.1bn) and financing obtained directly from the IMF, and by using the IMF assistance to secure additional funds from other sources, as well as through the domestic borrowing market.

The inflow of foreign financing supports macro-financial stabilisation in the country and will be of critical importance during the forecast period. With increased inflows of external financial aid, the NBU could accumulate gross international reserves: between September 2022 and March 2023, these increased by USD 3.2bn to reach USD 31.9bn (exceeding four months' worth of imports). Depreciation pressures have been easing, as evidenced by decreasing NBU intervention on the forex market and a narrowing of the gap between the cash and non-cash exchange rates. If foreign financing continues to arrive in line with the Ukrainian government's needs, the NBU will be able to avoid having to provide monetary financing of the budget deficit, and the macro-financial situation should remain relatively stable over the forecast period.

We forecast that the economy will grow only modestly in 2023, with growth speeding up significantly in 2024-2025. Exports are expected to recover, supported by the overall revival in economic activity and an improvement in logistics. Private consumption will be supported by a recovery of the labour market and the partial return of refugees. Continued operation of the Black Sea grain corridor is crucial to avoid economic fall this year. Although the war is likely to persist, the recent battlefield dynamics suggest that it will probably be limited in scale. The economy will adapt further to conditions of war, and reconstruction work on the main infrastructure in those territories freed from Russian occupation will boost investment. Accelerated growth in 2024-2025 is conditional on there being no escalation of the war or any further deterioration in security; on a favourable outcome to the US presidential elections in 2024; on uninterrupted foreign financial and military aid; and on there being no further increase in the number of refugees from Ukraine.

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[29] According to the Rating survey https://ratinggroup.ua/en/research/ukraine/kompleksne_dosl_dzhennya_yak_v_yna_zm_nila_mene_ta_kra_nu_p_dsumki_roku.html

Downside risks to the forecast are especially high for the period after the US presidential elections in November 2024. Although there continues to be strong bipartisan backing for Ukraine among US voters (with 84% of Democrats and 70% of Republicans in favour of at least some US involvement), support for the provision of aid to Ukraine (and especially for the transmission of government funds direct to the country) has waned somewhat, especially among Republican voters.[30] The issue of how involved the United States should be in supporting Ukraine has gained prominence in the Republican presidential primary campaigns, and the GOP's potential presidential candidates remain divided on whether Russia's invasion of Ukraine amounts to a critical threat to America's interests. A win by Trump or some other candidate with similar views could mean a reversal of US foreign policy and would be a blow to Ukraine's military capabilities and economy.

Looking on the bright side, the strongly negative voter sentiment toward Russia could prevent politicians from changing course too abruptly. Gallup's 2023 World Affairs poll, conducted in February 2023,[31] finds that 90% of Americans hold an unfavourable opinion of Russia, which makes it the fourth country in the history of Gallup's polling to register a sub-10% approval score (after Iran, Iraq and North Korea). At the same time, 68% have a favourable opinion of Ukraine, 6 pp higher than a year ago. According to the Gallup web survey conducted in January 2023,[32] a stable 65% of Americans prefer that the US support Ukraine in reclaiming its territory, even if that results in prolonged conflict. Similar trends have been observed in the EU, where a recent multi-country poll for the European Council on Foreign Relations shows that Europeans have become more united in their support for Ukraine since last year, and the desire for the war to end as soon as possible is no longer as popular.[33]

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30 https://apnorc.org/projects/acontinuing-support-for-u-s-involvement-a-year-into-the-war-between-russia-and-ukraine-a/

31 https://news.gallup.com/poll/1624/Perceptions-Foreign-Countries.aspx

32 https://news.gallup.com/poll/469328/one-year-later-americans-stand-ukraine.aspx

33 A poll was conducted in January 2023 in ten European countries: Denmark, Estonia, France, Germany, Great Britain, Italy, Poland, Portugal, Romania and Spain. https://ecfr.eu/publication/fragile-unity-why-europeans-are-coming-together-on-ukraine/

Table 5.23 / Ukraine: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024	2025
						Forecast	
Population, th pers., average	42,028	41,745	41,378	35,000	36,500	37,000	38,000
Gross domestic product, UAH bn, nom.	3,977	4,222	5,451	5,191	6,200	7,000	7,900
annual change in % (real)	3.2	-3.8	3.4	-29.1	1.6	3.4	5.0
GDP/capita (EUR at PPP)	8,810	8,570	9,410	9,030	.	.	.
Consumption of households, UAH bn, nom.	2,918	3,054	3,718	3,342	.	.	.
annual change in % (real)	10.9	1.7	6.9	-26.7	3.5	5.0	8.0
Gross fixed capital form., UAH bn, nom.	701	564	720	603	.	.	.
annual change in % (real)	11.7	-21.3	9.3	-34.3	2.0	10.0	12.0
Gross industrial production							
annual change in % (real)	-0.5	-4.5	1.9	-36.9	4.0	6.0	10.0
Gross agricultural production							
annual change in % (real)	1.4	-10.1	16.4	-30.0	.	.	.
Construction output							
annual change in % (real)	23.6	5.6	6.8	-65.1	.	.	.
Employed persons, LFS, th, average	16,578	15,915	15,610	13,000	13,500	14,000	14,500
annual change in %	1.3	-4.0	-1.9	-16.7	3.8	3.7	3.6
Unemployed persons, LFS, th, average	1,488	1,674	1,712	4,330	3,380	2,470	1,610
Unemployment rate, LFS, in %, average	8.2	9.5	9.9	25.0	20	15	10
Reg. unemployment rate, in %, eop 2)	1.2	1.6	1.1	.	.	.	.
Average monthly gross wages, UAH 3)	10,497	11,591	14,014	14,847	18,100	20,900	24,600
annual change in % (real, gross)	9.7	7.5	10.5	-11.9	4.0	6.0	10.0
Consumer prices, % p.a.	7.9	2.7	9.4	20.2	17.0	9.0	7.0
Producer prices in industry, % p.a.	4.1	-1.6	40.8	26.0	10.0	5.0	5.0
General governm. budget, nat. def., % of GDP							
Revenues	32.4	32.6	30.5	42.3	40.0	40.0	40.0
Expenditures	34.6	37.9	33.9	58.6	67.0	55.0	50.0
Deficit (-) / surplus (+)	-2.2	-5.3	-3.4	-16.3	-27.0	-15.0	-10.0
General gov. gross debt, nat. def., % of GDP	50.2	60.4	49.0	78.5	88.0	90.0	93.0
Stock of loans of non-fin. private sector, % p.a.	-9.8	-2.8	8.2	-3.1	.	.	.
Non-performing loans (NPL), in %, eop	48.4	41.0	30.0	38.1	.	.	.
Central bank policy rate, % p.a., eop 4)	13.50	6.00	9.00	25.00	20.0	15.0	10.0
Current account, EUR m 5)	-3,682	4,612	-3,278	7,619	4,800	-2,300	-8,200
Current account, % of GDP	-2.7	3.4	-1.9	5.0	3.1	-1.4	-4.6
Exports of goods, BOP, EUR m 5)	41,146	39,527	53,301	38,938	39,400	41,800	45,100
annual change in %	12.2	-3.9	34.8	-26.9	1.2	6.1	7.9
Imports of goods, BOP, EUR m 5)	53,877	45,462	58,911	53,478	55,600	62,400	72,300
annual change in %	13.6	-15.6	29.6	-9.2	4.0	12.2	15.9
Exports of services, BOP, EUR m 5)	15,591	13,628	15,532	15,329	15,200	16,000	17,200
annual change in %	16.3	-12.6	14.0	-1.3	-0.8	5.3	7.5
Imports of services, BOP, EUR m 5)	14,029	9,775	12,178	25,480	21,000	19,000	19,500
annual change in %	14.3	-30.3	24.6	109.2	-17.6	-9.5	2.6
FDI liabilities, EUR m 5)	5,174	266	6,717	512	.	.	.
FDI assets, EUR m 5)	554	317	368	32	.	.	.
Gross reserves of CB excl. gold, EUR m 5)	21,590	22,422	25,920	25,282	.	.	.
Gross external debt, EUR m 5)	109,134	102,293	114,426	123,924	125,000	130,000	135,000
Gross external debt, % of GDP	79.4	74.6	67.8	81.1	81.0	67.0	62.0
Average exchange rate UAH/EUR	28.95	30.79	32.31	33.98	40.0	42.1	44.3

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. Due to the war in Ukraine, most of the usual statistical data are not being collected or published. This means that all Ukraine forecasts are subject to an unusually high degree of uncertainty.

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

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

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