

October 25th 2022

JVI Webinar: The economic outlook for Europe

Autumn 2022 Forecast for CESEE: Bracing for the Winter

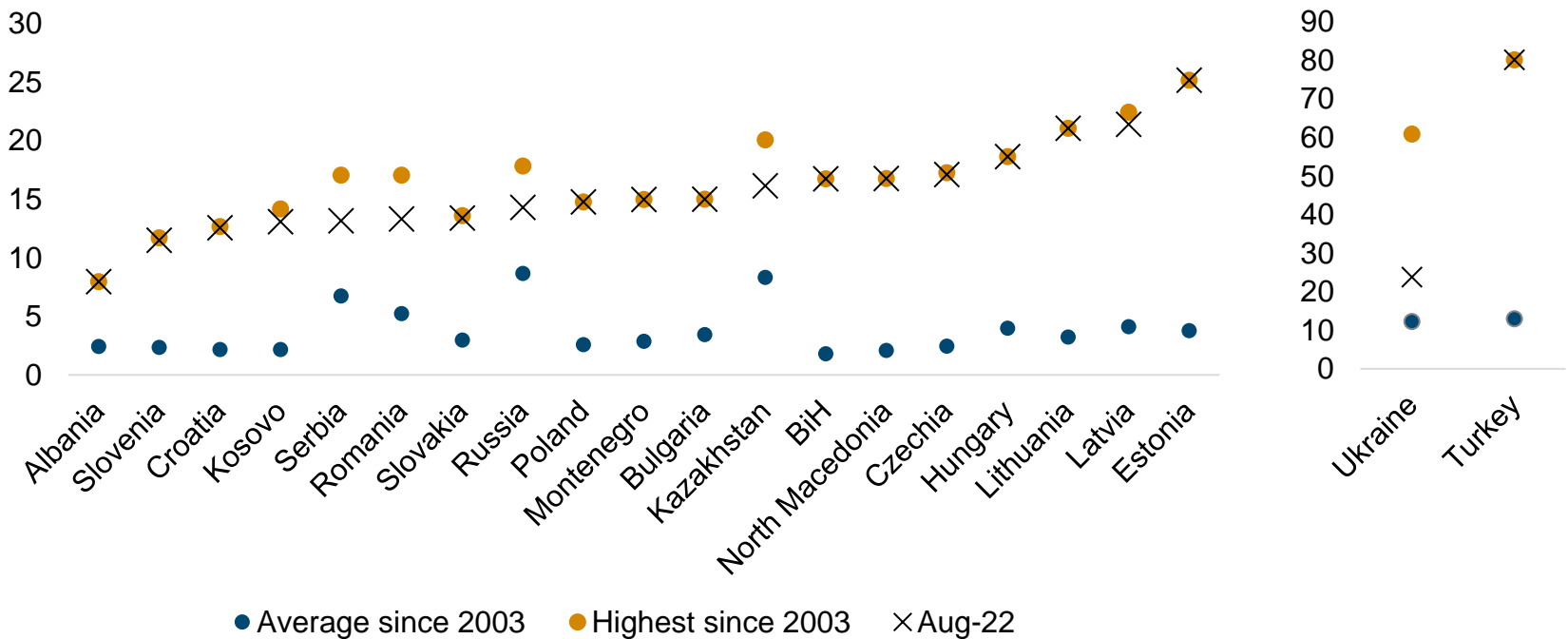
Richard Grieveson, wiiw Deputy Director

Overview

1. Impact on CESEE so far
2. wiiw Autumn 2022 forecasts
3. Risks to the outlook, opportunities and threats

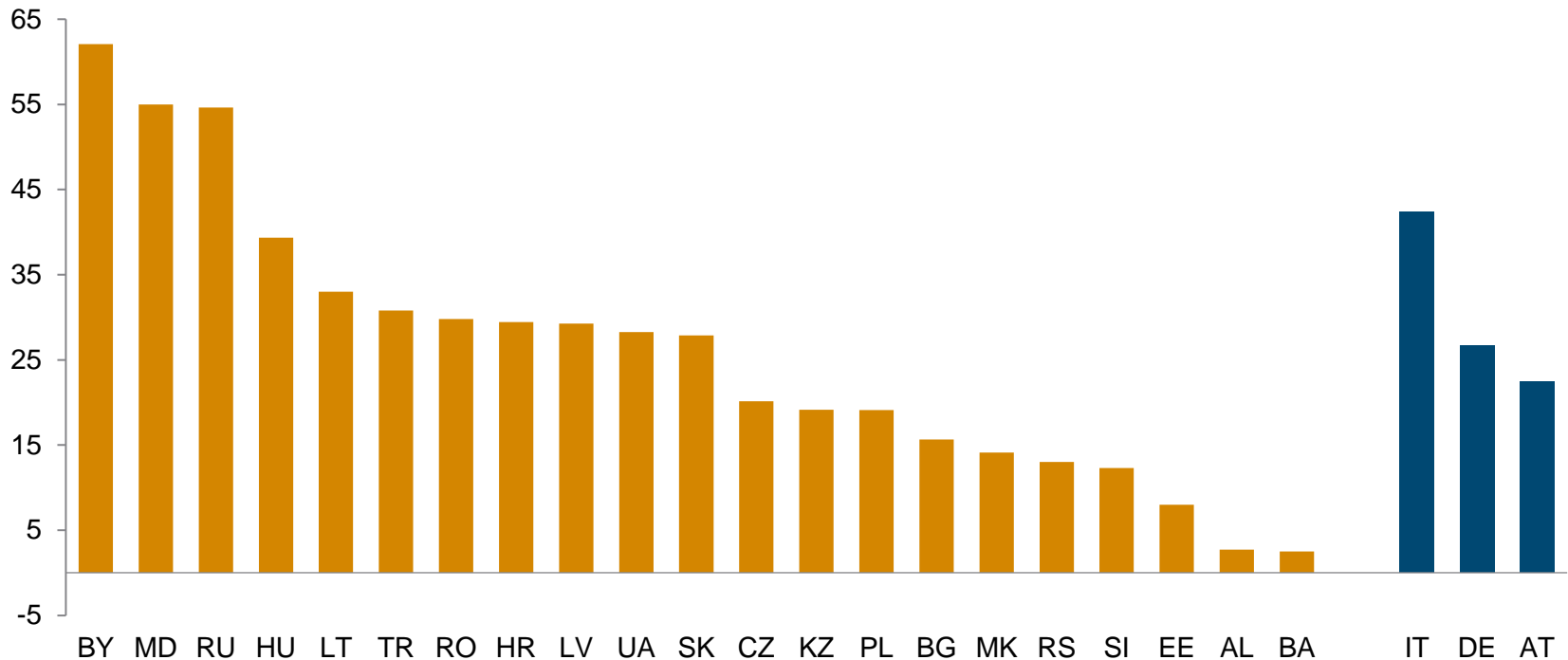
Initial economic resilience fading as inflation reaches multi-decade highs almost everywhere

Consumer price inflation, % change per year



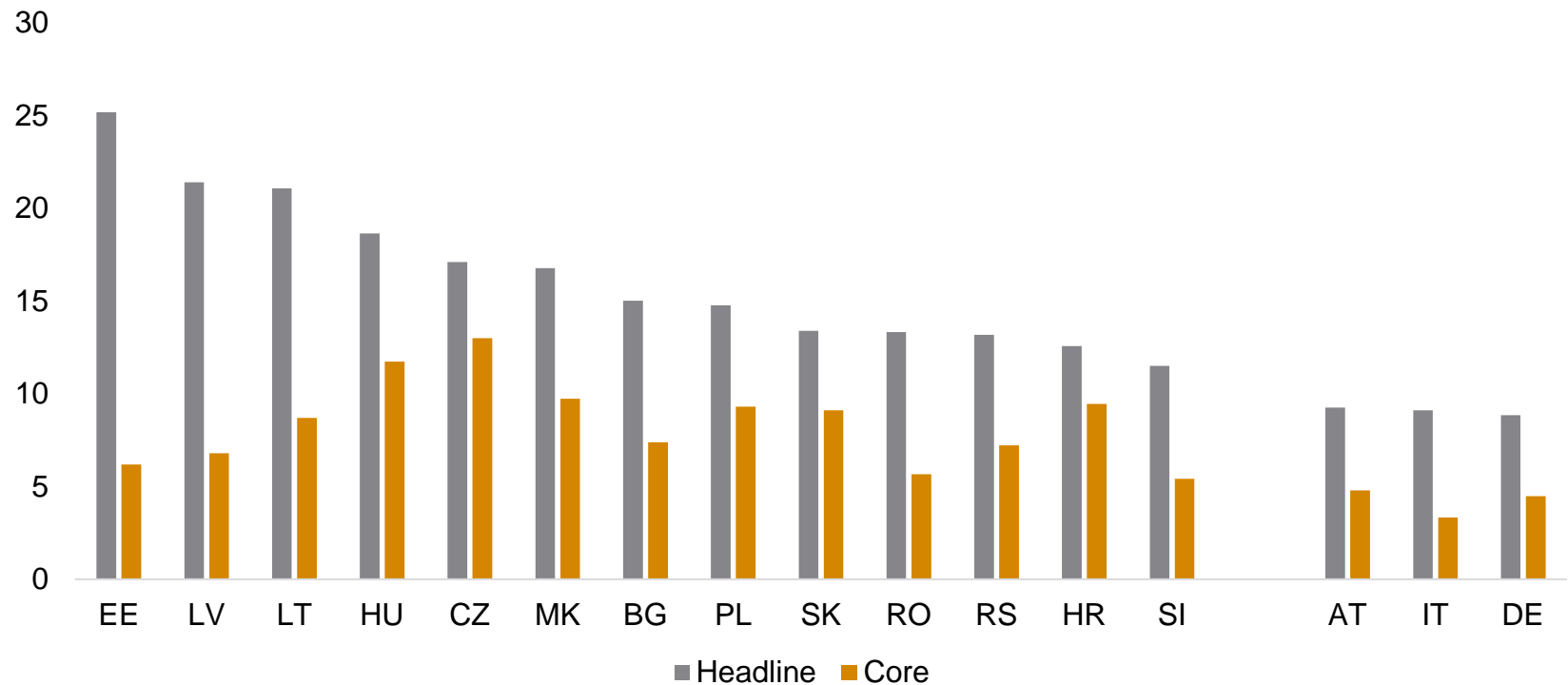
Around half of the CESEE countries depend more on gas than Austria or Germany

Share of gas in total energy consumption in 2021, %



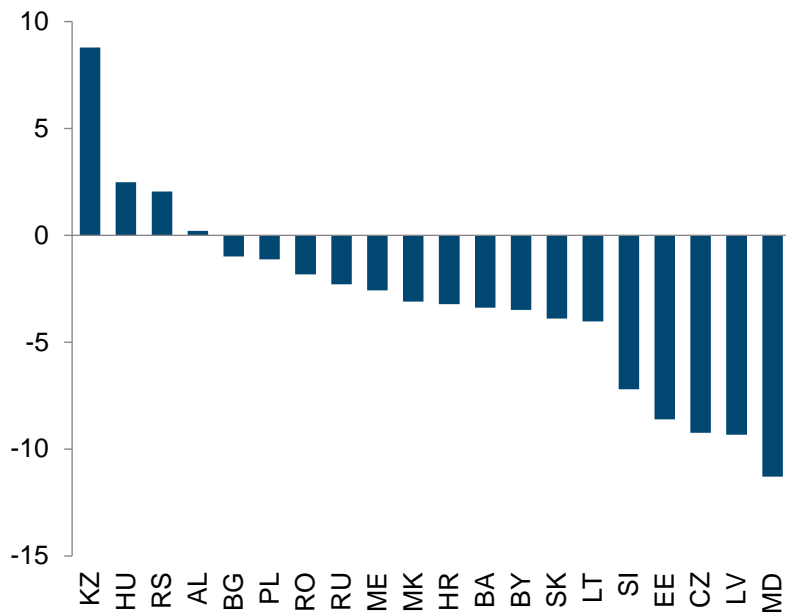
Inflation was driven initially by energy/food but now becoming much more broad-based

Headline and core inflation in CESEE in August (% , year on year)

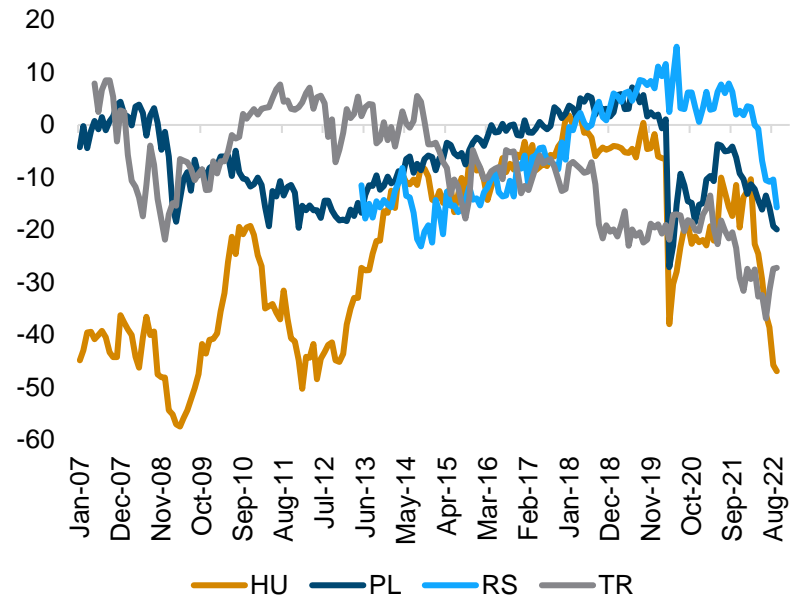


Already by mid-2022 clear decline in real wages, and consumer confidence in freefall

Change in real gross wages in June 2022 (% , year on year)

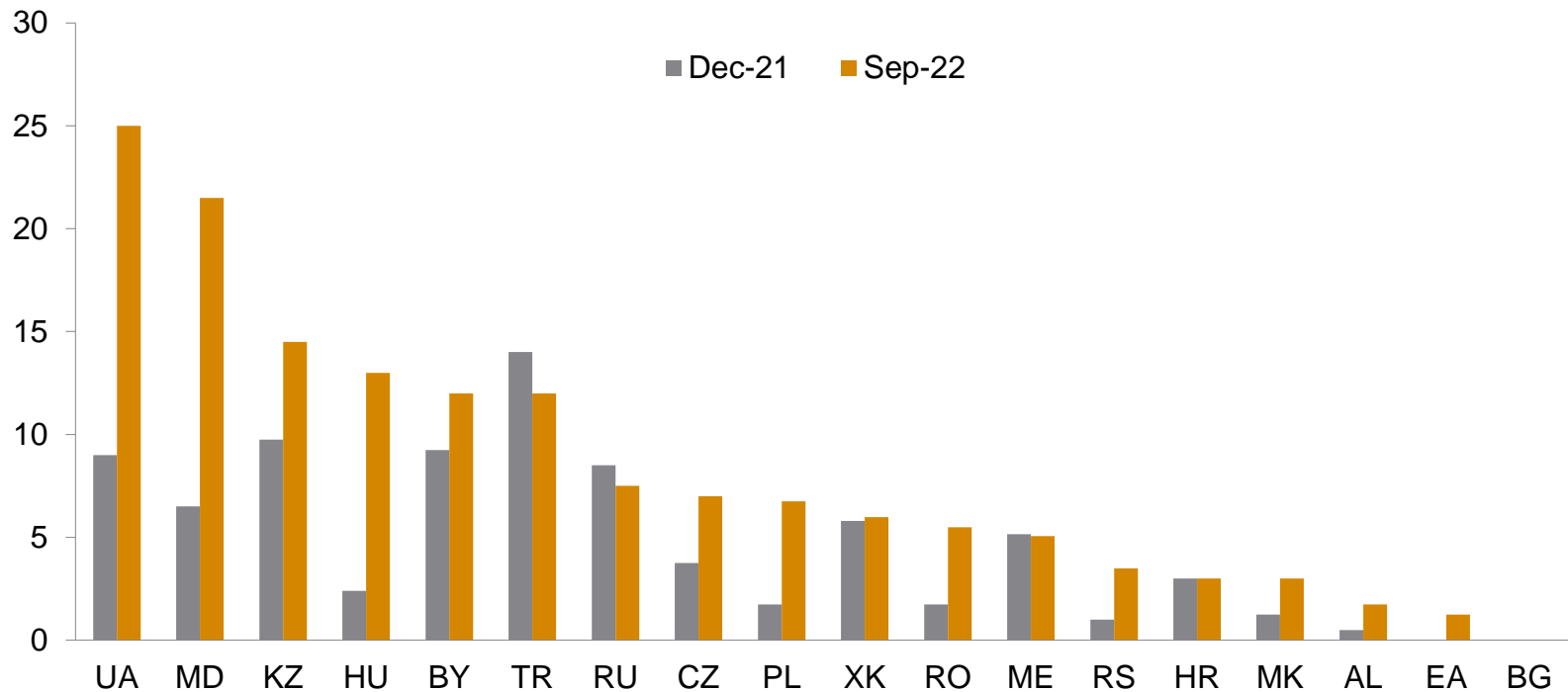


Consumer confidence indicator, seasonally adjusted (balance of answers)



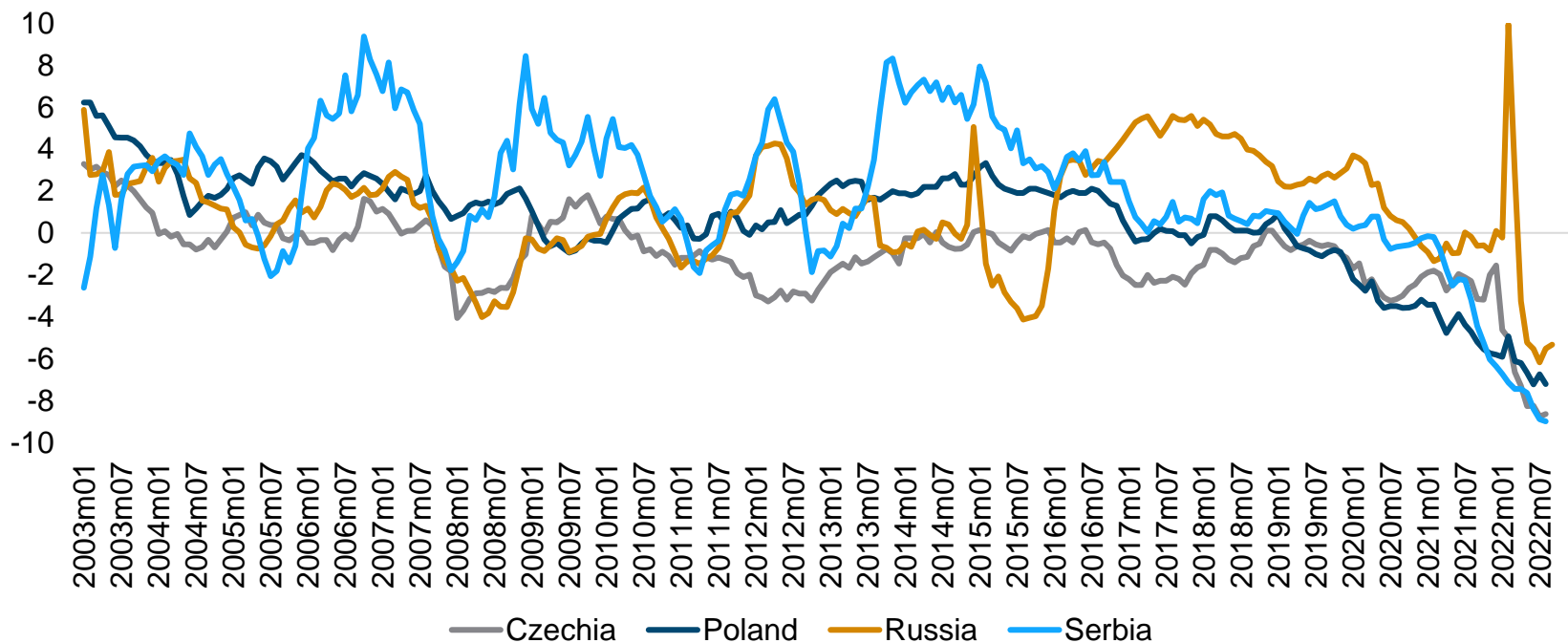
Almost all CESEE countries have strongly hiked interest rates this year

Central bank policy rate, %



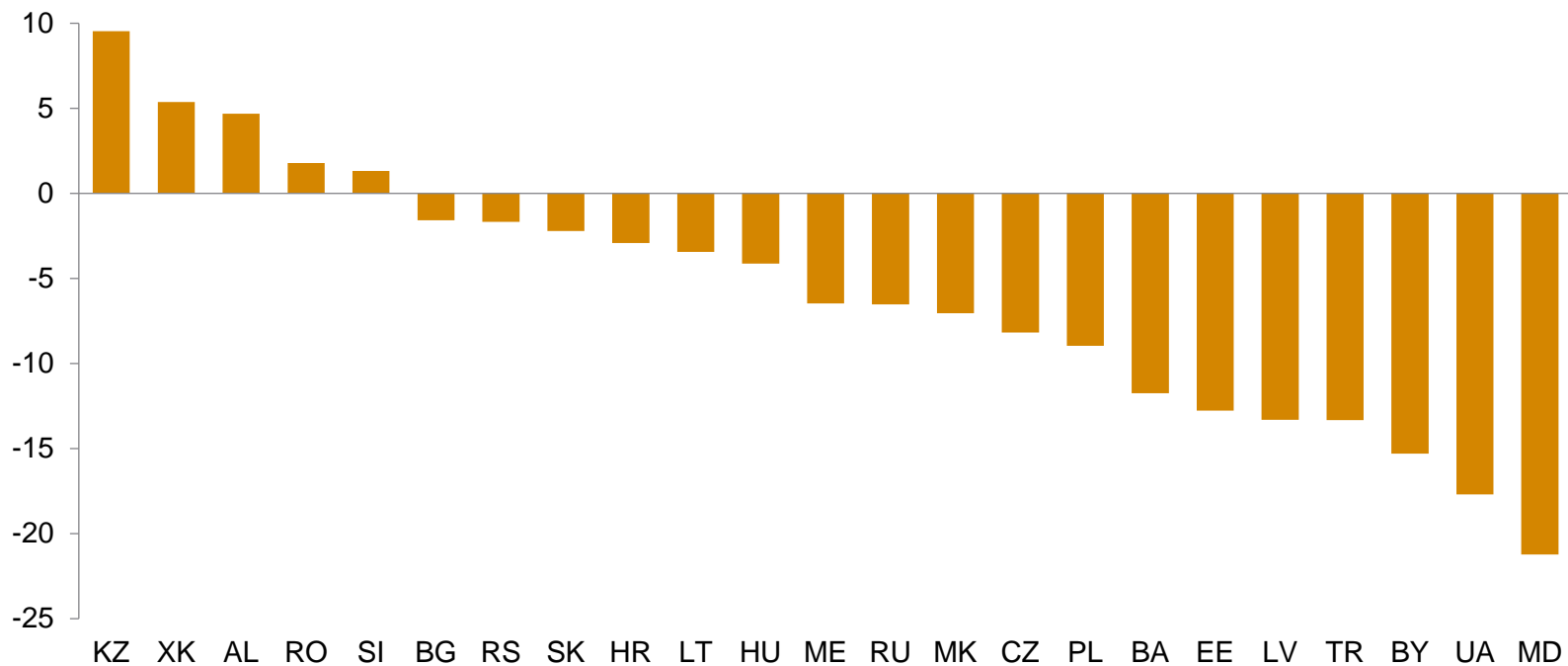
But in real terms interest rates are increasingly negative and some have paused hiking (growth worries)

Real interest rates, CPI-adjusted, %; selected CESEE economies



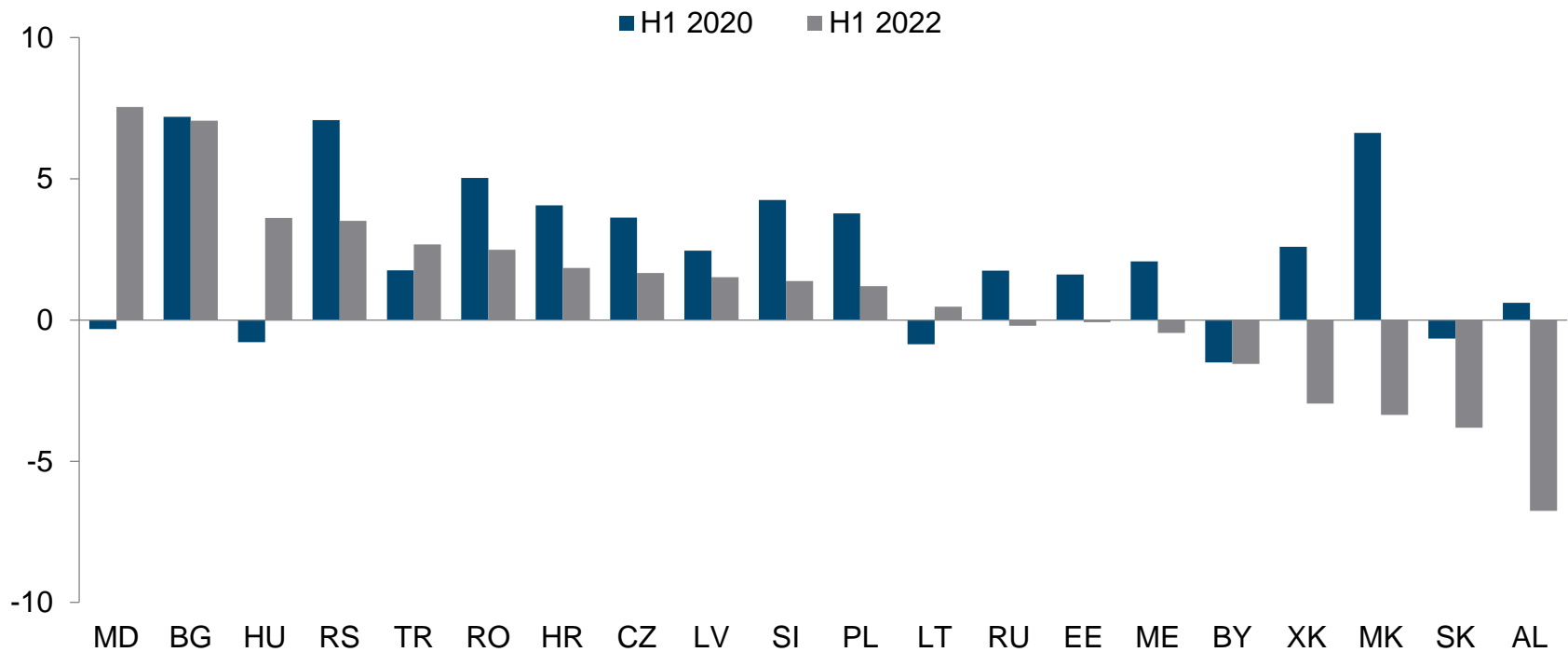
Inflation and rate hikes have already had a visible impact on real credit activity

Real growth of loans to non-financial private sector in August 2022 (% , year on year)



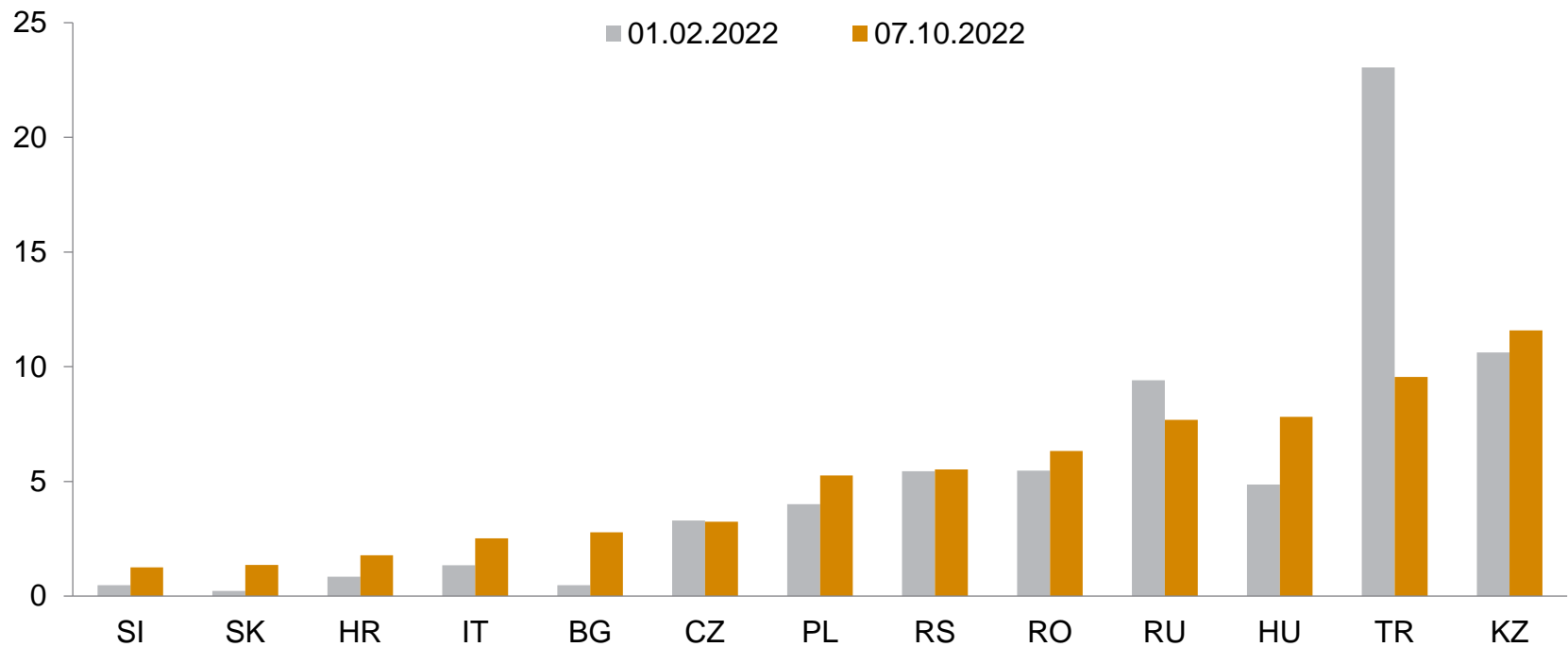
Fiscal support is limited relative to 2022, reflecting much less room for governments to act

Real growth of government consumption in H1 2020 and H1 2022 (% , y-o-y)



Limited fiscal space: Sovereign debt yields across CESEE have risen sharply (RU and TR exceptions)

Spread of 10-year government bond yields over German equivalent, percentage points

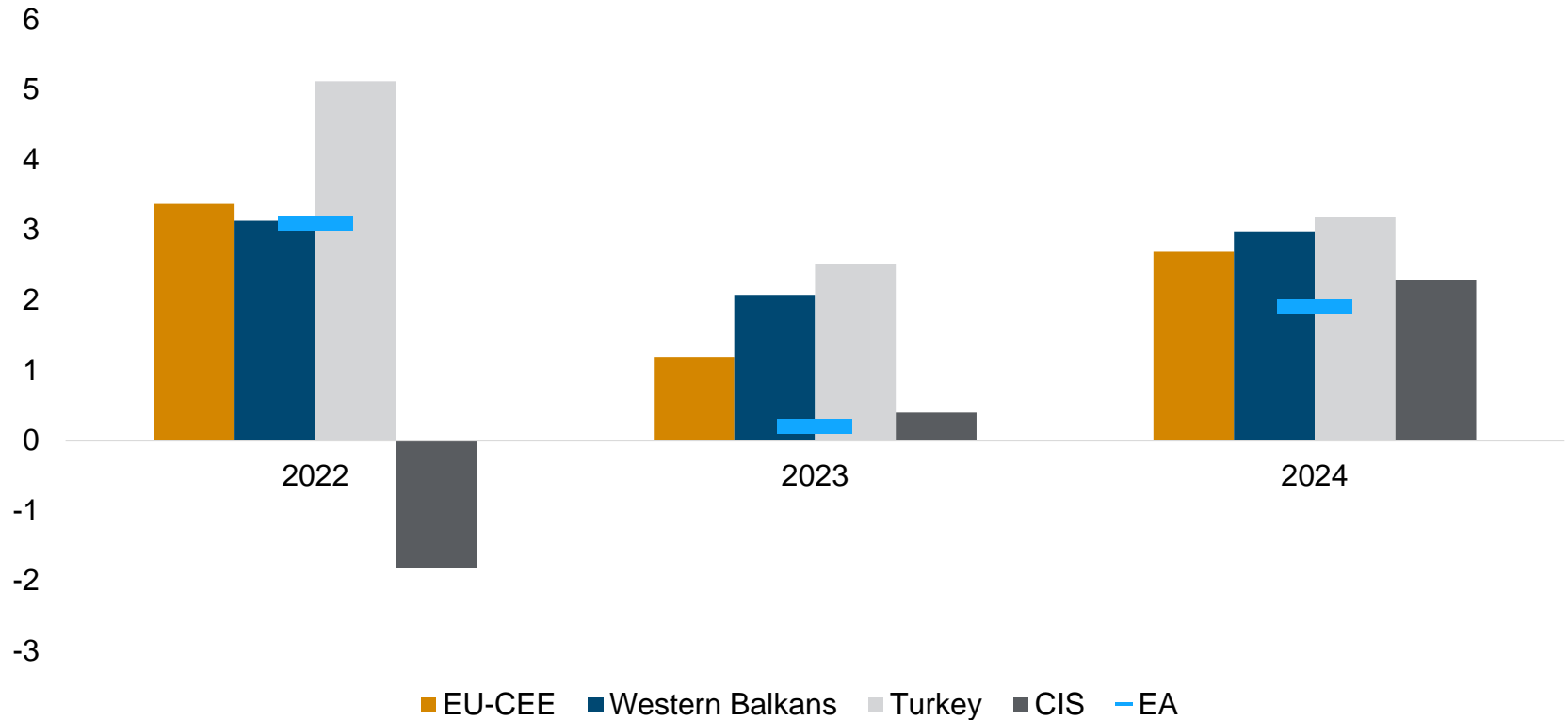


wiiw Autumn growth forecasts: 2022 better than expected (resilience) but 2023 looks much worse

		Forecast, %			Revisions, pp		
		2022	2023	2024	2022	2023	2024
EU-CEE	BG	3.0	1.5	3.0	↑ 0.5	↓ -2.2	↓ -0.5
	CZ	2.0	1.0	2.8	↑ 0.2	↓ -1.9	↓ -0.9
	EE	1.0	1.4	3.1	↓ -1.1	↓ -2.0	⇒ 0.0
	HR	5.0	2.5	3.1	↑ 1.7	↓ -1.0	↓ -0.5
	HU	4.2	-1.2	1.7	↑ 1.1	↓ -2.7	↓ -1.0
	LT	2.1	0.9	2.6	↑ 0.2	↓ -1.9	⇒ 0.0
	LV	2.8	0.6	2.3	↑ 0.7	↓ -1.8	↓ -0.3
	PL	4.6	1.7	2.4	↑ 0.4	↓ -1.9	↓ -1.4
	RO	4.8	2.2	3.5	↑ 1.3	↓ -1.3	↓ -1.0
	SI	5.7	1.9	2.7	↑ 1.2	↓ -1.1	↓ -0.1
	SK	1.8	0.6	2.4	↓ -0.4	↓ -2.2	↓ -1.0
Western Balkans	AL	3.4	3.0	3.6	↓ -0.1	↓ -0.5	↓ -0.1
	BA	2.6	1.5	2.5	↑ 1.2	↓ -0.3	↑ 0.2
	ME	5.1	2.6	3.3	↑ 1.5	↓ -1.1	⇒ 0.0
	MK	1.0	0.6	2.0	⇒ 0.0	↓ -1.9	↓ -0.5
	RS	3.6	1.9	2.7	⇒ 0.0	↓ -1.5	↓ -0.7
	XK	3.1	2.9	3.8	↓ -0.2	↓ -0.8	↓ -0.1
Turkey	TR	5.1	2.5	3.2	↑ 2.4	↓ -0.3	⇒ 0.0
CIS+UA	BY	-4.5	1.0	2.0	⇒ 0.0	⇒ 0.0	⇒ 0.0
	KZ	2.8	3.6	4.1	⇒ 0.0	↓ -0.3	↓ -0.1
	MD	-2.0	0.0	2.0	↓ -1.0	↓ -3.0	↓ -2.0
	RU	-3.5	-3.0	1.0	↑ 3.5	⇒ 0.0	⇒ 0.0
	UA	-33.0	5.5	12.0	↑ 5.0	↑ 0.5	↓ -1.0

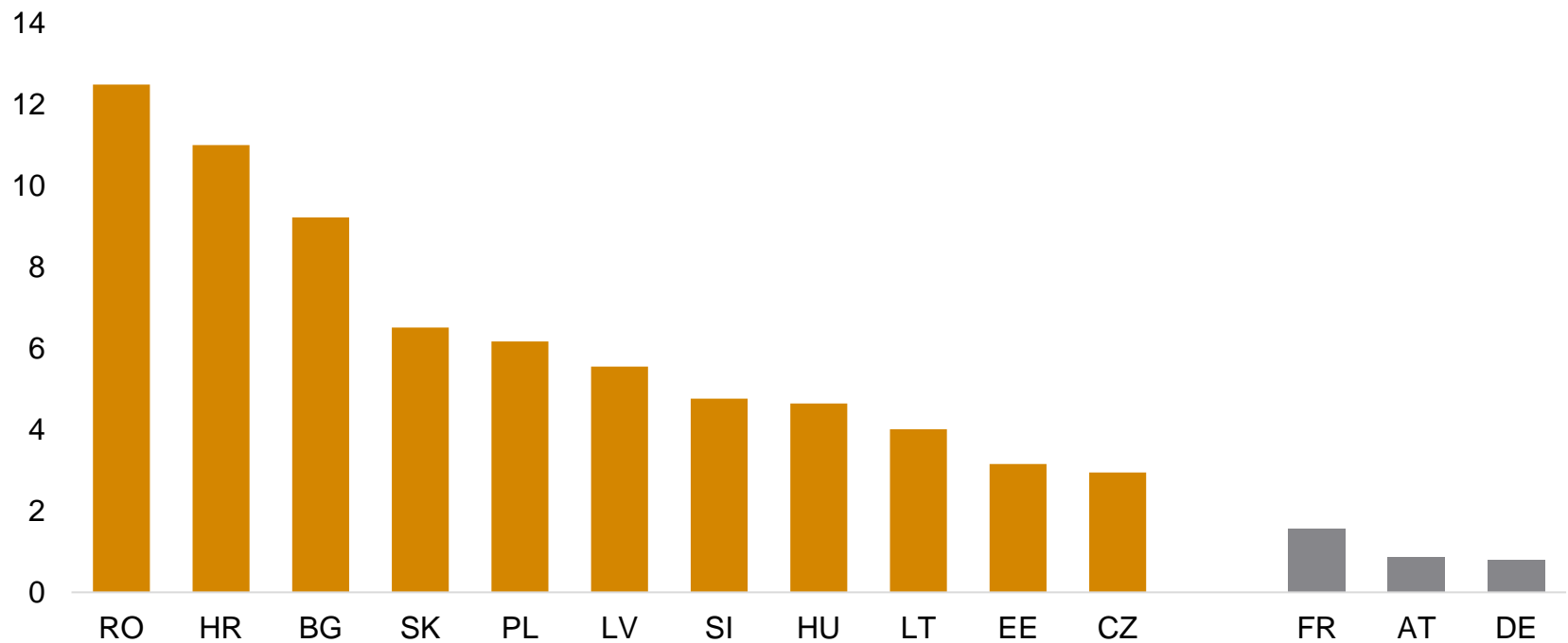
Most of CESEE will again survive the slowdown better than the euro area

Real GDP forecasts by region, %



EU-CEE will slow down but region is resilient; expanded EU funds will act as shock absorber

RRF allocation per country, % of 2021 GDP



Western Balkans: Crisis will have strong impact on the region

- Factors of stability/resilience:
 - Less reliant on gas than much of rest of Europe
 - Turkstream not affected so far
 - Crisis has pushed diversification efforts (LNG/interconnectors)

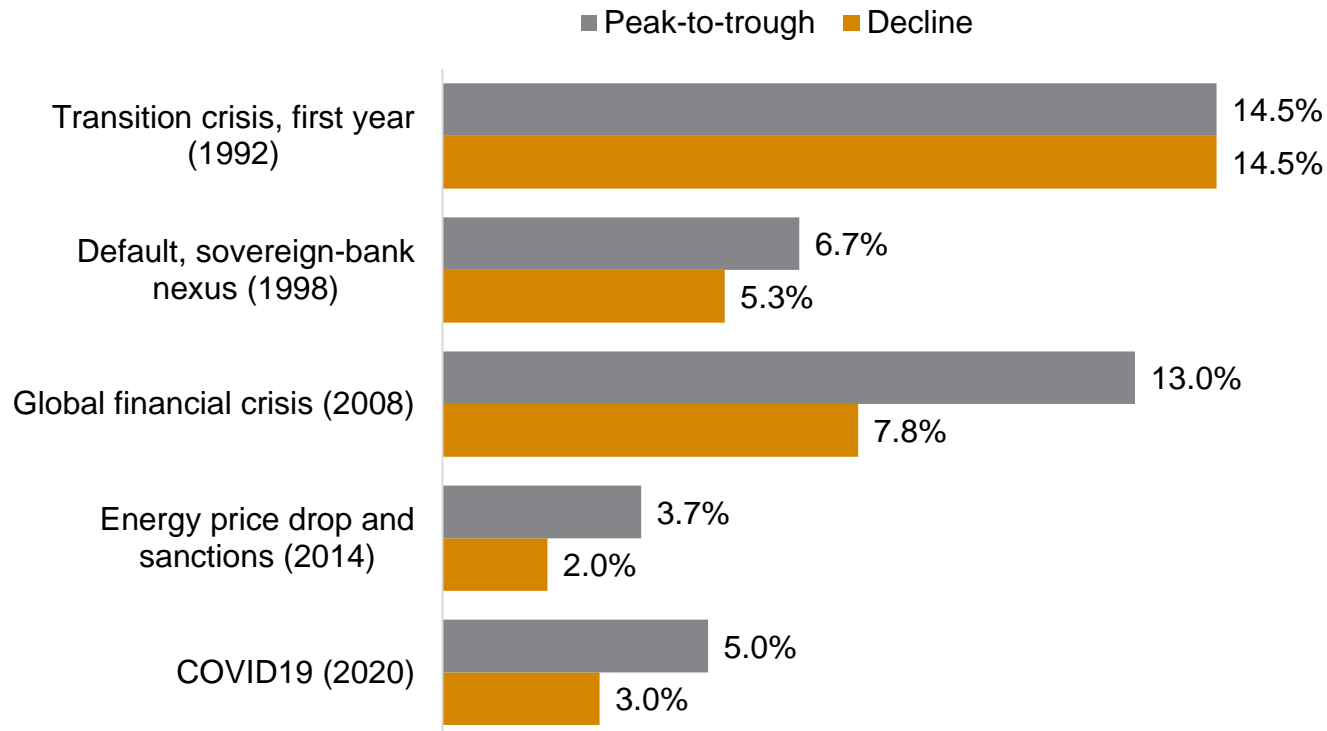
- Factors of vulnerability:
 - Electricity prices rising with gas, and less fiscal space to cushion the impact on populations
 - Geo-economic fallout has particular relevance for SEE: Growth drivers (FDI, tourism etc) often rely on non-aligned policy. This middle way is now much more challenging and could have costs.

Ukraine: Recovery should start in 2023

- War has caused major damage: 58% of GDP as of September.
- 7.6m refugees in Europe; 6.9m internally displaced people.
- Economy will have contracted by roughly 1/3 this year.
- But economy has stabilised and external financing (mostly US) is supporting budget.
- Major concerns about energy situation over winter.
- But return to positive growth in 2023. Assumptions:
 - War will stay confined to East and economy will continue to adapt,
 - Grain deal will continue,
 - International aid will arrive, start of reconstruction.
- But all subject to major risks.

Russia: Cumulative 2022-23 downturn similar to 1998

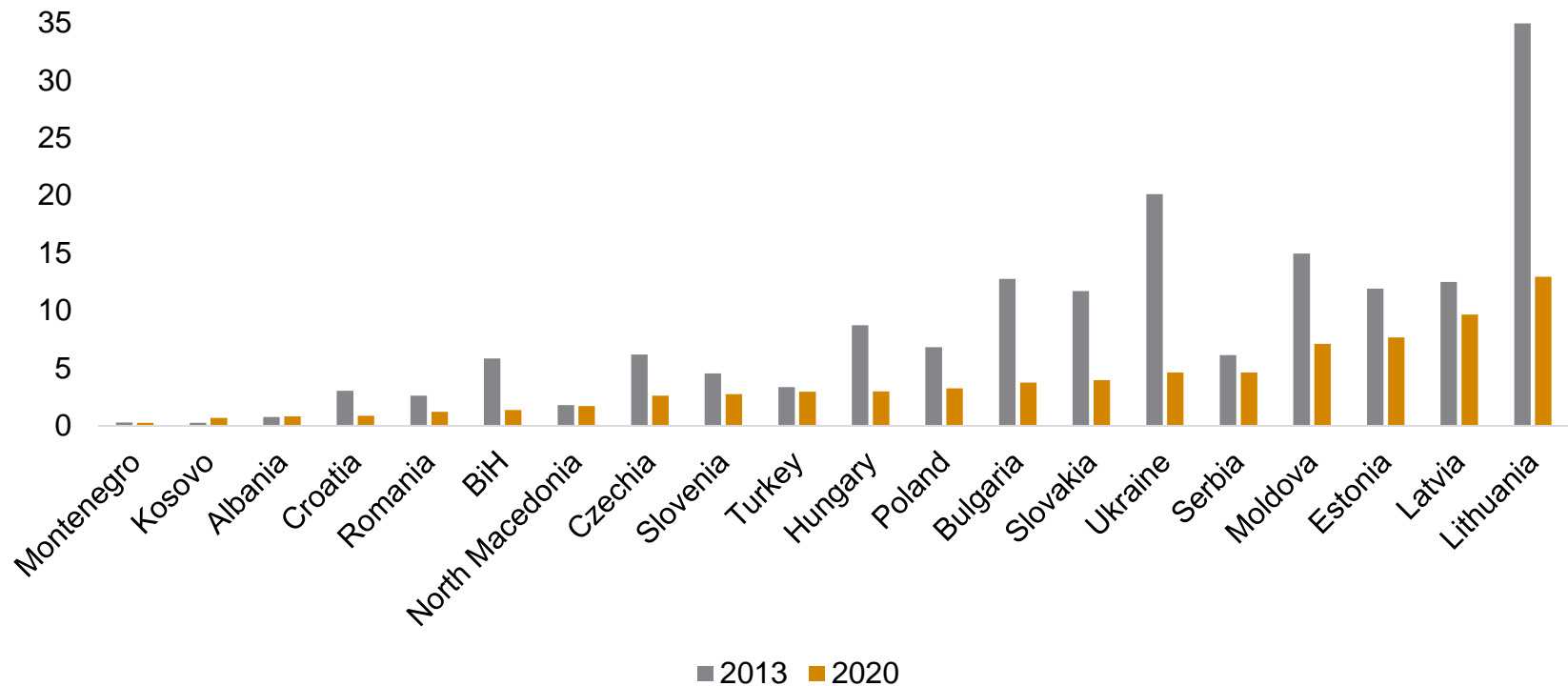
How does this compare to previous crisis episodes?



Note: Peak-to-trough value for 1992 calculated as a simple growth rate due to no negative growth rates in 1990 and 1991. Transition crisis 1992 reflects only the strongest episode of GDP decline in a single year. Value for 2014 compares with 2013 growth rate due to macroeconomic turbulence of Russia in Q4 2014. Sources: IMF, national sources, wiiw.

But war and sanctions will intensify Russia/Europe decoupling that started in 2014

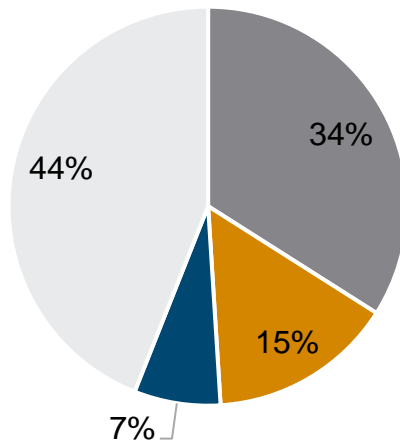
Goods trade with Russia (exports + imports), % of GDP



Mass exodus of foreign firms from Russia further underlines fracture

600 biggest foreign firms active in Russia* as of early September 2022

- curtailed operations
- sold assets
- left assets behind without selling
- business as usual



Main reason:

- Concern for public image

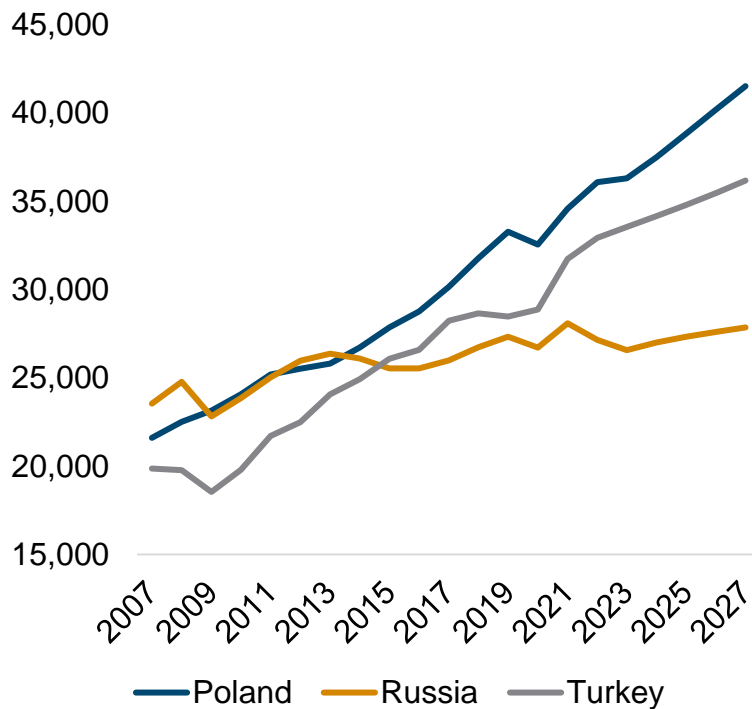
But also:

- Sanctions
- Logistical and payment difficulties
- Fears of nationalization

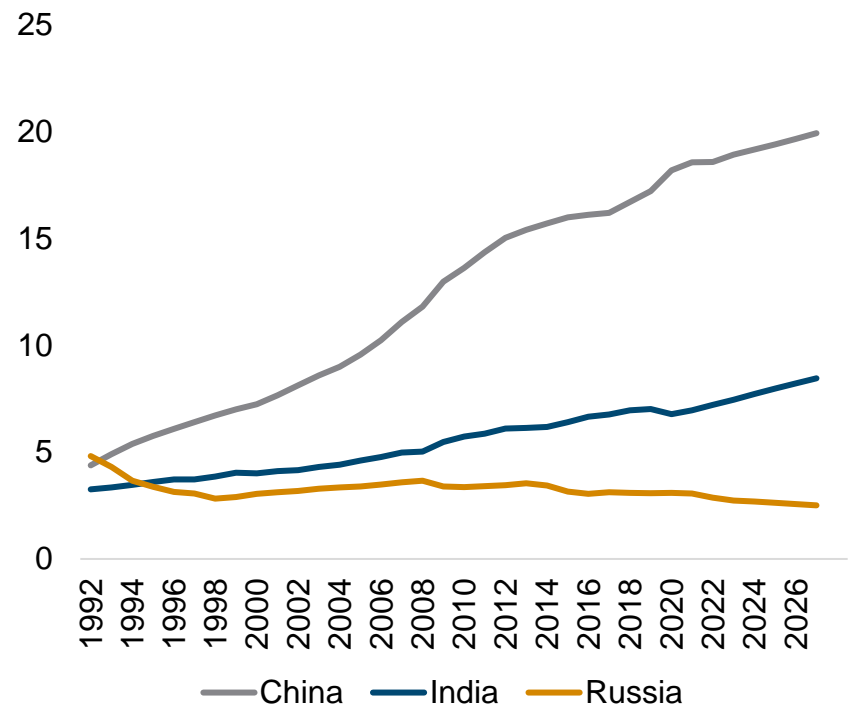
* Companies with at least RUB 5.7bn market turnover in Russia.

Ever-increasing divergence between Russia and its regional/global peers

Real GDP per capita, USD at PPP



GDP at PPP, % of global GDP

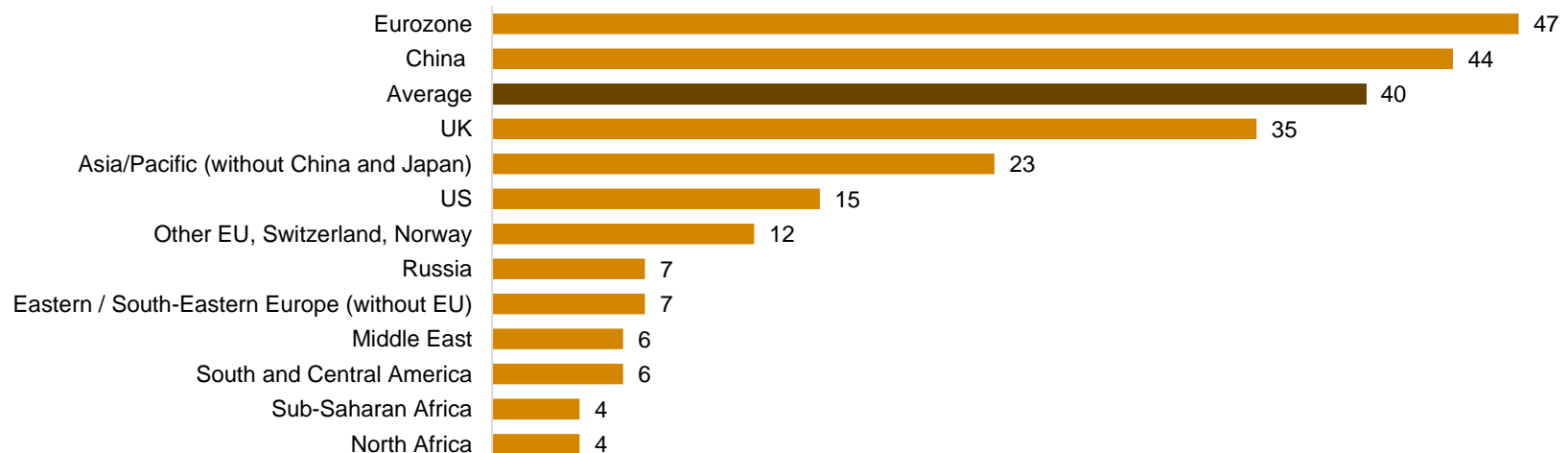


For whole of CESEE, downside risks are quite strong:

- Full stop in Russian energy supplies to Europe (although we are already a large part of the way there)
- Intensification of war causes further increase in inflation and decline in confidence
- Higher interest rates lead to broader financial crisis (e.g. via property market)
- Further weakening of global economy with negative impact on CESEE's open/trade dependent economies

Opportunity for CESEE: Near-shoring as German firms shorten supply chains due to pandemic and war; 40% have problems with supply chains, and 2/3 of them considering changes

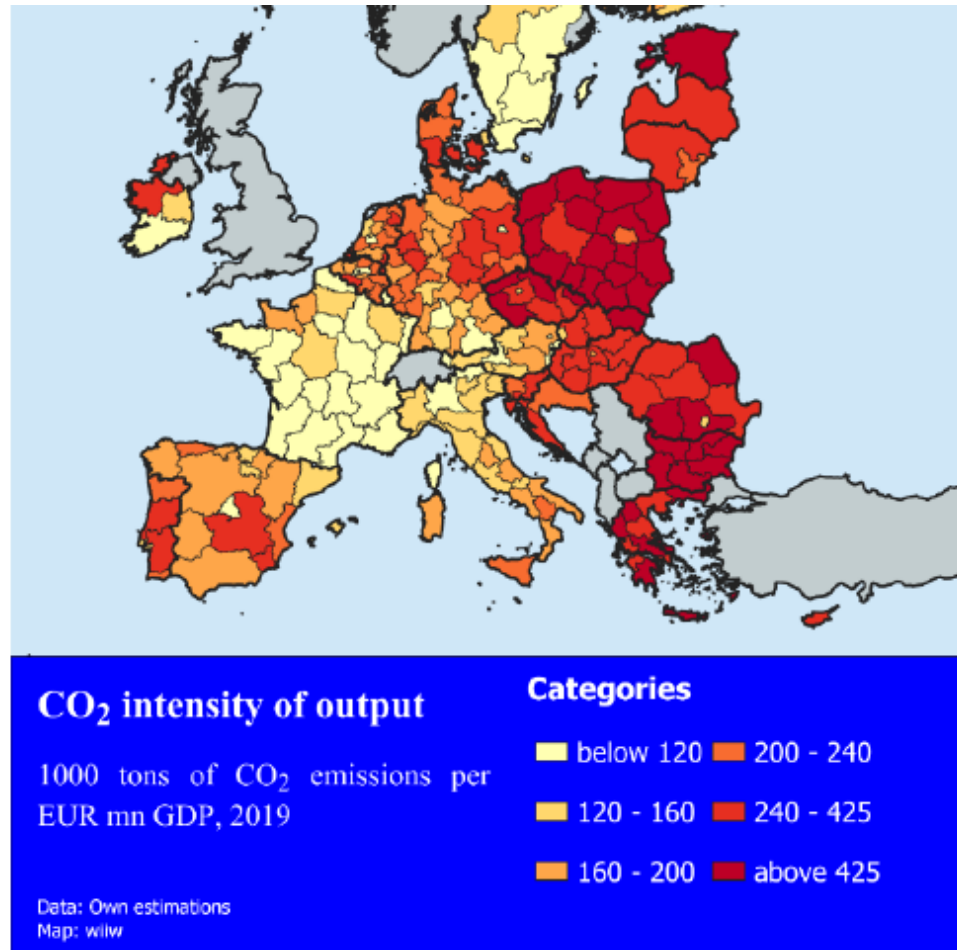
Share of German companies with supply chains problems, by countries/regions (in %)



The war could feasibly be good or bad for near-shoring, too early to say which will dominate

- Scenario 1: As war **speeds up geo-economic fragmentation and increases economic regionalism**, EU-CEE countries receive new investment from Western firms.
- Scenario 2: **Foreign investor perceptions of EU-CEE become more negative** due to proximity to the war. If NATO commitment becomes less certain after next US election, the risks of this scenario will increase.

Challenge for CESEE: High carbon intensity of production in accelerated green transition



Conclusions

- CESEE showed resilience in 2022, but this is now fading due to rising inflation and collapsing confidence.
- Downturn over the winter, some technical recessions, but only RU + HU will post full-year negative growth in 2023. Most of CESEE will recover more quickly than euro area.
- In EU-CEE growth will slow a lot next year but is resilient. RRF funds will be partial shock absorber. Western Balkans also has points of resilience, but it will suffer a lot from the war's fallout.
- In Ukraine, recovery should start next year, but major risks. Russia will decline further next year and is decoupling from the West.
- Risks for whole CESEE region are to the downside: War, energy supply/price, financial instability due to higher rates, global economy.
- War fallout will create opportunities (near-shoring) but also challenges (energy transition) for CESEE.

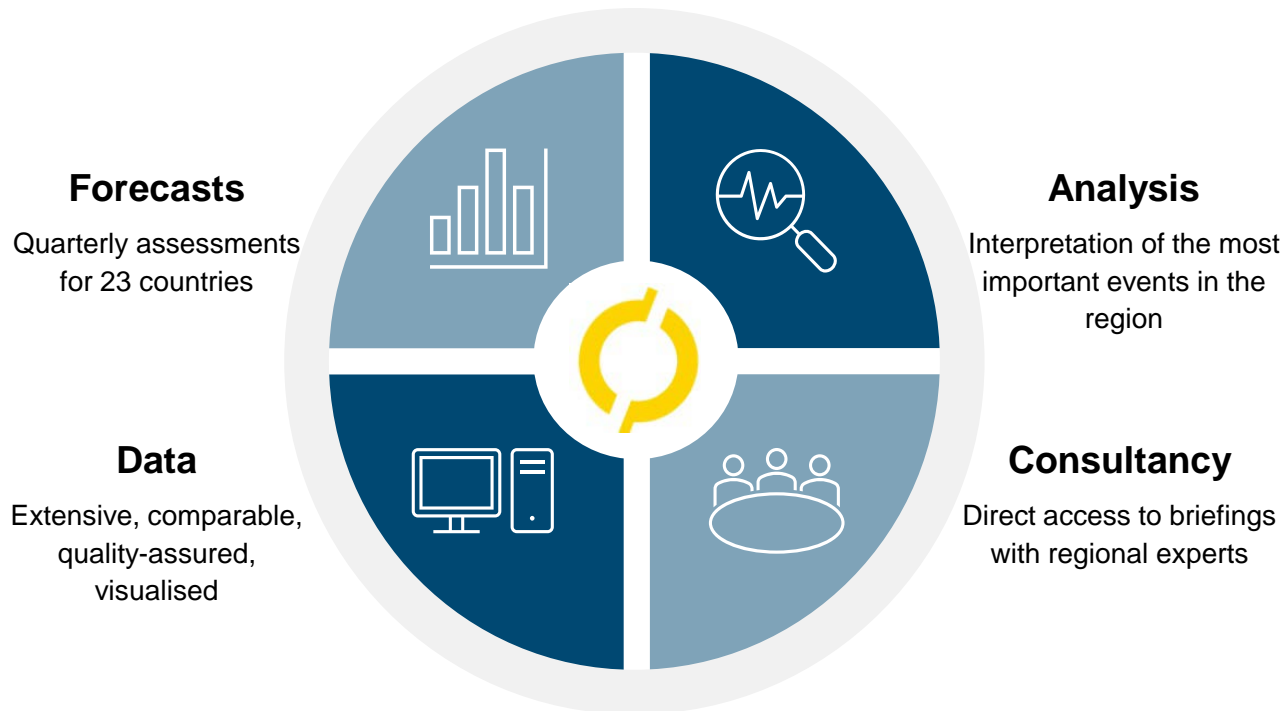
Thank you for your attention!

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wiiw membership package: making sense of the noise in CEE



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wiiw Autumn 2022 Forecast Report



CONTENTS

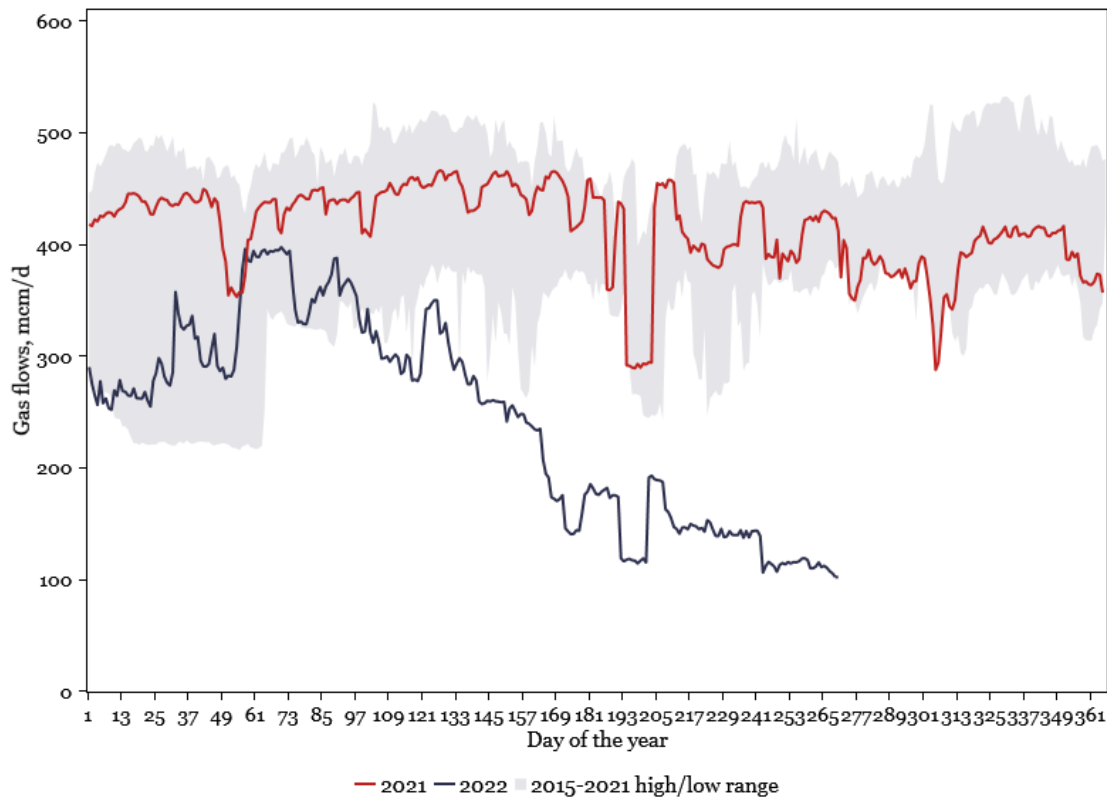
Executive summary	1
1. Global overview: Euro area heading into recession	1
1.1. The war will continue, with no decisive victory for either side	1
1.2. Recession now, recovery from spring 2023	2
1.3. Interest rates have broken out of their decades-long downward trend	3
1.4. Downside risks are prevalent	6
2. Russia's war in Ukraine: Variables, scenarios and outlook	8
2.1. The political aims of Russia and Ukraine	9
2.2. The balance of military superiority	10
2.3. The economic outlook for Russia and Ukraine	14
2.4. The international response to the war	14
2.5. Government instability	17
2.6. Wildcard: Nuclear escalation	18
2.7. Conclusion	19
3. CESEE overview: Bracing for the Winter	22
3.1. Growth beat expectations in the first half of 2022	22
3.2. Inflation is beginning to bite	28
3.3. Real incomes are being eroded by inflation	30
3.4. Consumer confidence in freefall	33
3.5. Is monetary policy throttling the economy?	35
3.6. Fiscal policy not supportive enough	37
3.7. The worst is yet to come	39
3.8. Higher growth this year, lower growth next	42
3.9. Conclusions	48
4. Austria and CESEE: Growth badly affected by invasion fallout	50
5. CESEE monitors	54
5.1. Convergence monitor	54
5.2. Business cycle monitor: Dominated by high inflation	56
6. Country reports	59
Albania: Fingers crossed for abundant rainfall	60
Belarus: Struggling to loosen the grip of sanctions	64

Extra slides



Russian gas imports to Europe at around 25% of normal level

Fig 3: Russian gas imports to Europe, 2022 flows vs 2015-2021 high/low range



Source: Longview Economics, ENTSOG

EU member states benefit from support through the NGEU plan, though that support has been quite limited so far

Disbursements made under the Recovery and Resilience Facility to EU member states from CESEE by end-July 2022

		Amount, EUR m	Share in 2021 GDP, %
RO	Romania	3,793.6	1.58
HR	Croatia	1,518.4	2.65
SK	Slovakia	1,221.4	1.26
CZ	Czechia	914.6	0.38
LT	Lithuania	289.1	0.52
LV	Latvia	237.4	0.72
SI	Slovenia	231.0	0.44
EE	Estonia	126.0	0.40
HU	Hungary	n/a	n/a
PL	Poland	n/a	n/a
BG	Bulgaria	n/a	n/a