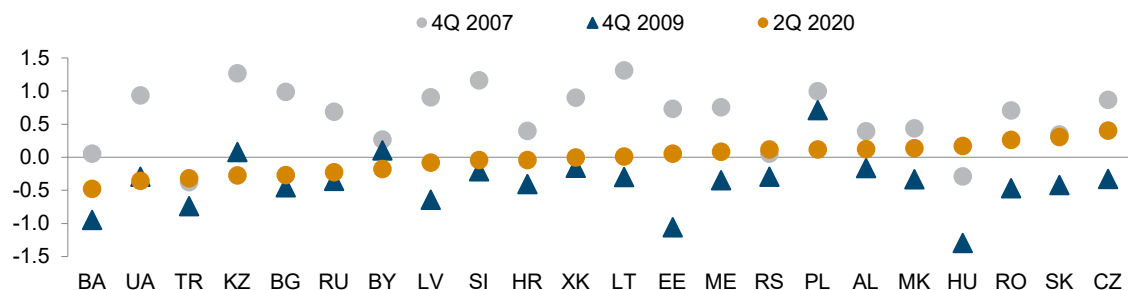


3.2. BUSINESS CYCLE MONITOR: WIDENING OF BUDGET DEFICITS CUSHIONS ECONOMIC DOWNTURN

by Alexandra Bykova

- › Our headline business cycle index for the whole CESEE region remained slightly negative at -0.02 in Q2 2020 (representing a four-quarter trailing average). Due to a substantial contraction in most economies in the second quarter of the year, the index shows clearly visible 'underheating' for GDP. More countries than in our previous update in spring post high negative deviations relative to historical averages for the current account (smaller deficits in many cases) and CPI inflation. Overheating in CESEE labour markets has diminished (see Table 3.4). The Czech Republic, Slovakia and Romania achieved the highest scores for the headline business cycle index in Q2 2020, while Bosnia and Herzegovina and Ukraine slipped to the bottom of the ranking behind Turkey.
- › Despite the negative economic fallout from the Covid-19 pandemic, the latest headline index values for most countries are still more positive than at the end of 2009, a reference point encompassing the most acute phase of the global financial crisis for CESEE. As of Q2 2020, only Poland, Kazakhstan and Belarus have headline index values that are lower than in 2009. We observe the biggest positive differences comparing to 4Q 2009 for Hungary, Estonia and Czech Republic (see Figure 3.2).
- › The domestic finance sub-component of the Business Cycle Index was positive for 14 countries in CESEE in Q2 2020, reflecting among other things a strongly counter-cyclical fiscal response to the downturn across large parts of the region. Fiscal deficits are above long-term averages in many countries, as governments roll out anti-crisis fiscal packages. The underheating observed for many countries for this indicator in our last update in spring has switched in some cases to overheating, with the swing especially strong in Serbia, Belarus and Poland. Based on a four-quarter trailing average, Montenegro, Romania, and Serbia have the largest budget deficits in the region. Regarding real GDP growth, Serbia, Lithuania and Kazakhstan record the most positive values on average over last four quarters, while Slovakia, Slovenia and Montenegro are the worst performers among CESEE countries according to this measure (see Table 3.4 and Table 3.5).
- › By contrast, we observe negative values for 16 countries on the domestic economy sub-component, and for 12 countries on the external finance sub-component of the Business Cycle Index. For the domestic economy sub-index, underheating continues in particular in Turkey, reflecting negative trends for both real GDP and unemployment rate. Underheating within external finance is visible in Bosnia and Herzegovina thanks to smaller current account deficits and real exchange rate depreciation, and also in Poland due to larger current account surplus. Meanwhile, Albania is the only country with persistent overheating for the external finance sub-index, due to the appreciation of the real exchange rate (see Figure 3.3 and Table 3.4).

Figure 3.2 / Business Cycle Index



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

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

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

overheating

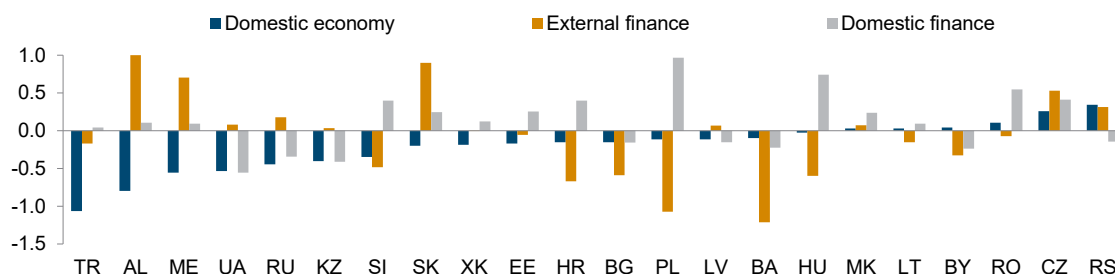
> 1 SD above historical average

underheating

> 1 SD below historical average

Notes: CPI: consumer price index; CA: current account; RER: real exchange rate (EUR) CPI deflated, values more than 100 means appreciation and vice versa; RIR: real interest rate CPI deflated. Data for unemployment, current account, real interest rate, fiscal balance are inverted (as for these indicators lower values would indicate overheating). Historical mean calculated for 4Q 2000 - 4Q 2019. Calculations are based on four-quarter trailing averages.

Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

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

Note: Number of standard deviations from historical mean, average of indicators in each sub-component. Indicators are those in Table 3.4.

Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

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

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

potential overheating/instability
relative to regional peers

underheating/stability
relative to regional peers

Notes: CPI: consumer price index; CA: current account; RER: real exchange rate (EUR) CPI deflated, values more than 100 means appreciation and vice versa; RIR: real interest rate CPI deflated.

For all indicators higher values indicate overheating, except unemployment, current account, real interest rate, and fiscal balance.

Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.