Executive summary

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

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

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

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

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

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

COUNTRY SUMMARIES

ALBANIA

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

BELARUS

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

BOSNIA AND HERZEGOVINA

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

BULGARIA

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

CROATIA

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

CZECH REPUBLIC

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

ESTONIA

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

HUNGARY

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

KAZAKHSTAN

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

KOSOVO

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

LATVIA

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

LITHUANIA

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

MOLDOVA

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

MONTENEGRO

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

NORTH MACEDONIA

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

POLAND

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

ROMANIA

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

RUSSIA

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

SERBIA

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

SLOVAKIA

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

SLOVENIA

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

TURKEY

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

UKRAINE

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

Keywords: CESEE, economic forecast, Central and Eastern Europe, Southeast Europe, Western Balkans, EU, euro area, CIS, China, Japan, US, convergence, business cycle, coronavirus, Next Generation EU funds, private consumption, credit, investment, digitalisation, exports, FDI, labour markets, unemployment, short-time work schemes, exchange rates, monetary policy, fiscal policy

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