JANUARY 2023

Monthly Report

Winter Forecast Update

Resilience Put to the Test by War Fallout

Economic Forecasts for Eastern Europe for 2023-25

The Vienna Institute for International Economic Studies
Wiener Institut für Internationale Wirtschaftsvergleiche

Winter Forecast Update

Resilience Put to the Test by War Fallout

Economic Forecasts for Eastern Europe for 2023-25

RICHARD GRIEVESON

et al. (including Vasily Astrov, Alexandra Bykova, Rumen Dobrinsky, Selena Duraković, Doris Hanzl-Weiss, Gábor Hunya, Branimir Jovanović, Niko Korpar, Sebastian Leitner, Isilda Mara, Olga Pindyuk, Sándor Richter, Bernd Christoph Ströhm, Maryna Tverdostup, Nina Vujanović, Zuzana Zavarská and Adam Żurawski)

The authors of this report wish to thank Beata Borosak, Alexandra Bykova, Nadja Heger, Beate Muck, Monika Schwarzhappel, Galina Vasaros and David Zenz for statistical assistance, as well as Clive Liddiard for language editing and Michaela Bönisch for layout.

Press date: 30 January 2023

CONTENTS

Winter 2023 interim forecast update 10

1. Overview: Resilience put to the test by war fallout 13

1.1 Global assumptions: Dark new world, but economic resilience in Europe 13
1.2 Inflation-driven slowdown in 2022 17
1.3 2023: A further slowdown, but most countries will avoid recession 21
1.4 Inflation: We have passed the peak 25
1.5 Political risk high on the agenda in CESEE in 2023 29

2. Country updates 30

Albania: Weaker though resilient growth expected 31
Belarus: Decoupling from Europe leads to lasting economic weakness 31
Bosnia and Herzegovina: One step closer to EU membership 32
Bulgaria: Imbalances likely to stay as snap elections result in another split parliament 32
Croatia: A new euro area member 33
Czechia: Growth constrained by struggling domestic demand 33
Estonia: Combating the effects of the energy crisis 34
Hungary: Bleak short-term growth prospects 34
Kazakhstan: Hopes for investment-driven growth 35
Kosovo: Another difficult year ahead to meet energy needs 35
Latvia: Rising confidence in the recession to be short-lived 36
Lithuania: Resisting a war-induced recession 36
Moldova: Emerging from the energy crisis? 37
Montenegro: Growing, despite instability 37
North Macedonia: FDI lifting the economy? 38
Poland: A slowdown in the making 38
Romania: Deceleration despite an engine change 39
Russia: Energy exports crippled by sanctions 39
Serbia: The price of close relations with Russia 40
Slovakia: Outlook threatened by political turmoil 40
Slovenia: Despite subdued prospects, still ahead of the EU average 41
Turkey: Foot to the floor as election approaches 41
Ukraine: Defying Russia’s bombs 42

3. Index of subjects – January 2022 to January 2023 43

TABLES AND FIGURES

Table 1 / OVERVIEW 2021-2022 AND OUTLOOK 2023-2025 ... 10
Table 2 / Policy rate and exchange rate for selected CESEE countries: overview 2021-2022 and outlook 2023-2025 ... 12
Table 3 / wiiw winter 2023 global assumptions ... 16
Table 4 / Real GDP growth forecast and revisions ... 23

Figure 1 / EU gas imports from Russia per week, million cubic metres (left) and EU total weekly gas imports, by source, in 2022, million cubic metres (right) ... 14
Figure 2 / Dutch TTF natural gas futures, EUR/megawatt hour ... 15
Figure 3 / Economic Policy Uncertainty Index, long-term average = 100 ... 17
Figure 4 / Monthly consumer price inflation, %, year on year ... 18
Figure 5 / Retail trade volume, % change, year on year ... 18
Figure 6 / Real wage growth, % change, year on year, November 2022 or latest available ... 19
Figure 7 / Industrial output volume, % change, year on year ... 20
Figure 8 / Manufacturing production volume, seasonally and working-day adjusted, % change in November 2022 versus earlier periods ... 20
Figure 9 / European Commission economic sentiment indicator, long-term average = 100 ... 21
Figure 10 / Real GDP growth, % per year ... 22
Figure 11 / Turkish exports to Russia per month, USD bn ... 24
Figure 12 / Natural gas consumption in March-October 2022, % change versus year earlier ... 25
Figure 13 / Consumer price index, % change, year on year ... 26
Figure 14 / Dutch TTF natural gas futures price, % change, year on year ... 26
Figure 15 / Nominal central bank policy rates, % ... 27
Figure 16 / Core inflation, % year on year ... 28

Cut-off date for historical data and forecasts: 19 January 2023.
Most data are taken from the wiiw Databases. Direct access is available at: https://data.wiiw.ac.at/.

ABBREVIATIONS

EUR	euro
USD	US dollar
CIS	Commonwealth of Independent States
COVID-19	coronavirus disease
CPI	consumer price index
ECB	European Central Bank
EU	European Union
GDP	gross domestic product
HICP	harmonized index of consumer prices
LNG	liquified natural gas
NATO	North Atlantic Treaty Organisation
PMI	purchasing managers' index
pp	percentage points
RRF	Recovery and Resilience Facility
SME	small and medium-sized enterprise
TTF	Title Transfer Facility
wiiw	The Vienna Institute for International Economic Studies
.	not available (in tables)
bn	billion
eop	end of period
m	million
p.a.	per annum
Q1 2021	first quarter of 2021
y-o-y	year on year

Keywords: CESEE, economic forecast, Central and Eastern Europe, Western Balkans, EU, euro area, CIS, war in Ukraine, Ukrainian refugees, energy dependence, EU accession, COVID-19, EU Recovery and Resilience Facility, economic growth, labour markets, inflation, stagflation, monetary policy, fiscal policy

JEL classification: E20, E21, E22, E23, E24, E31, E32, E5, E62, F21, F31, H60, I18, J20, J30, O47, O52, O57, P24, P27, P33, P52

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

Winter 2023 interim forecast update

Table 1 / 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 1)	2023	2024	2025	2021	2022	2023	2024	2025	2021	2022 1)	2023	2024	2025
BG	Bulgaria	7.6	3.0	1.5	2.5	3.0	2.8	13.0	10.0	7.0	5.0	5.3	4.7	4.6	4.5	4.5
CZ	Czechia	3.6	2.0	0.4	2.4	2.7	3.3	14.8	9.0	4.0	3.0	2.8	2.5	3.0	2.8	2.6
EE	Estonia	8.0	0.3	0.9	3.1	4.2	4.5	19.4	8.8	3.5	3.0	6.2	5.9	7.5	6.7	6.0
HR	Croatia	13.1	5.8	2.5	2.8	2.5	2.7	10.7	6.0	3.0	2.0	7.6	6.7	6.5	6.3	6.1
HU	Hungary	7.1	4.9	-1.0	1.7	2.5	5.2	15.3	16.0	10.0	6.0	4.1	3.6	4.5	4.0	3.5
LT	Lithuania	6.0	2.5	1.3	2.8	3.0	4.6	18.9	8.5	3.3	2.8	7.1	6.2	6.8	6.5	6.3
LV	Latvia	4.1	2.2	0.0	3.3	2.8	3.2	17.2	10.0	4.5	3.3	7.6	7.0	7.4	7.2	6.8
PL	Poland	6.8	4.6	1.0	2.4	3.0	5.2	13.2	13.0	6.0	4.0	3.4	3.0	3.1	3.2	3.1
RO	Romania	5.8	4.7	2.4	4.0	4.0	4.1	12.0	11.0	6.0	4.0	5.6	5.3	5.5	5.4	5.3
SI	Slovenia	8.2	5.7	1.2	2.7	2.9	2.0	9.3	6.5	3.6	2.0	4.8	4.1	4.3	4.2	4.2
SK	Slovakia	3.0	1.7	0.6	2.3	2.4	2.8	12.1	8.0	5.0	3.0	6.8	6.1	5.9	6.2	6.0
	EU-CEE11 1)2)	*6.3*	*4.0*	*1.0*	*2.7*	*3.1*	*4.3*	*13.5*	*11.4*	*5.8*	*3.9*	*4.5*	*4.1*	*4.3*	*4.3*	*4.1*
	EA20 3)	*5.3*	*3.1*	*0.2*	*1.9*	*1.8*	*2.6*	*8.5*	*6.0*	*3.4*	*2.3*	*7.7*	*6.8*	*6.9*	*6.8*	*6.6*
	EU27 3)	*5.4*	*3.3*	*0.4*	*2.1*	*2.0*	*2.9*	*9.0*	*6.2*	*3.6*	*2.5*	*7.0*	*6.0*	*6.1*	*6.0*	*5.8*
AL	Albania	8.5	3.4	3.0	3.6	3.8	2.0	6.7	4.0	3.0	2.8	11.5	11.1	10.5	10.0	9.5
BA	Bosnia and Herzegovina	7.5	3.5	1.5	2.2	2.5	2.0	14.2	8.0	3.0	2.0	17.4	16.4	16.1	15.7	15.6
ME	Montenegro	13.0	5.9	2.6	3.3	3.0	2.4	13.0	7.5	3.5	2.5	16.6	14.9	15.0	13.9	13.0
MK	North Macedonia	3.9	1.5	1.0	2.5	2.5	3.2	14.2	10.0	4.0	3.0	15.7	14.5	14.0	13.5	13.0
RS	Serbia	7.5	2.3	1.5	2.6	3.0	4.1	11.9	9.0	4.0	3.0	11.0	9.5	9.0	8.5	8.0
XK	Kosovo	10.7	3.1	3.4	3.8	4.0	3.4	11.6	7.0	2.5	2.0	20.7	24.2	23.5	23.2	22.5
	WB6 1)2)	*7.7*	*2.8*	*1.8*	*2.8*	*3.0*	*3.2*	*11.9*	*8.0*	*3.6*	*2.7*	*13.6*	*12.7*	*12.3*	*11.8*	*11.3*
TR	Turkey	11.4	5.1	3.0	3.2	4.0	19.6	72.3	37.0	19.0	11.0	12.0	11.5	10.5	9.5	9.0
BY	Belarus	2.4	-4.7	1.0	1.5	1.5	9.5	15.2	12.0	11.0	10.0	3.9	4.1	4.0	4.0	4.0
KZ	Kazakhstan	4.3	3.0	3.5	4.0	4.0	8.0	15.0	13.0	9.0	6.0	4.9	4.9	4.9	4.8	4.8
MD	Moldova	13.9	-5.0	1.0	4.0	6.0	5.1	28.7	14.0	6.0	6.0	3.2	2.7	4.0	3.5	3.0
RU	Russia	5.6	-2.5	-3.0	1.0	1.5	6.7	13.8	5.4	4.2	3.2	4.8	4.2	4.8	5.0	5.0
UA	Ukraine	3.4	-30.0	3.0	8.0	8.0	9.4	20.2	16.0	9.0	7.0	9.9	30.0	20.0	9.0	7.0
	CIS4+UA 1)2)	*5.3*	*-4.7*	*-1.7*	*1.9*	*2.3*	*7.1*	*14.6*	*7.3*	*5.3*	*4.0*	*5.6*	*8.6*	*7.0*	*5.5*	*5.2*
	V4 1)2)	*6.0*	*3.9*	*0.6*	*2.3*	*2.8*	*4.6*	*13.7*	*12.3*	*6.1*	*4.0*	*3.7*	*3.3*	*3.6*	*3.5*	*3.3*
	BALT3 1)2)	*5.9*	*1.9*	*0.9*	*3.0*	*3.2*	*4.2*	*18.6*	*9.0*	*3.7*	*3.0*	*7.0*	*6.4*	*7.1*	*6.8*	*6.4*
	SEE9 1)2)	*7.3*	*4.1*	*2.1*	*3.4*	*3.5*	*3.6*	*12.0*	*9.6*	*5.3*	*3.6*	*8.7*	*8.0*	*7.9*	*7.7*	*7.4*
	CIS3+UA 1)2)	*3.9*	*-12.4*	*2.8*	*5.3*	*5.4*	*8.7*	*17.6*	*14.2*	*9.2*	*7.0*	*7.3*	*18.3*	*12.4*	*6.8*	*5.7*
	non-EU12 1)2)	*7.0*	*-1.7*	*-0.3*	*2.3*	*2.8*	*10.5*	*30.6*	*15.6*	*9.1*	*5.9*	*7.4*	*9.5*	*8.1*	*6.8*	*6.4*
	CESEE23 1)2)	*6.8*	*0.0*	*0.1*	*2.4*	*2.9*	*8.7*	*25.6*	*14.4*	*8.1*	*5.3*	*6.7*	*8.1*	*7.1*	*6.1*	*5.8*

Table 1 / OVERVIEW 2021-2022 AND OUTLOOK 2023-2025

		Current account in % of GDP					Fiscal balance in % of GDP				
				Forecast					Forecast		
		2021	2022 1)	2023	2024	2025	2021	2022 1)	2023	2024	2025
BG	Bulgaria	-0.5	-1.2	-0.9	0.5	0.0	-3.9	-4.0	-5.0	-4.0	-3.0
CZ	Czechia	-0.9	-2.6	-3.8	-2.6	-0.9	-5.1	-4.7	-4.0	-2.5	-1.9
EE	Estonia	-1.8	-0.7	0.5	0.3	0.4	-2.4	-3.7	-4.2	-3.9	-3.1
HR	Croatia	3.1	-0.3	-0.5	0.5	0.7	-2.6	-1.9	-2.5	-2.0	-1.9
HU	Hungary	-4.2	-7.0	-5.0	-4.6	-3.5	-7.1	-6.5	-4.7	-4.0	-3.5
LT	Lithuania	1.1	-6.2	-5.0	-4.0	-3.0	-1.0	-1.5	-4.5	-2.8	-2.2
LV	Latvia	-4.2	-5.6	-1.5	-2.0	-2.5	-7.0	-7.2	-5.0	-3.5	-2.5
PL	Poland	-1.4	-1.6	-1.0	0.0	0.5	-1.8	-4.0	-4.5	-3.0	-3.0
RO	Romania	-7.2	-9.8	-8.7	-7.5	-6.5	-7.1	-6.5	-5.0	-4.5	-4.0
SI	Slovenia	3.8	1.7	1.1	1.3	1.7	-4.7	-3.8	-3.7	-4.2	-3.0
SK	Slovakia	-2.5	-7.4	-6.4	-5.7	-5.2	-5.5	-5.1	-6.4	-4.4	-3.7
	EU-CEE11 1)2)	*-2.2*	*-3.9*	*-3.4*	*-2.5*	*-1.7*	*-4.1*	*-4.7*	*-4.6*	*-3.4*	*-3.0*
	EA20 3)	*3.7*	*0.5*	*-1.4*	*-1.0*	*-0.8*	*-5.1*	*-4.3*	*-3.7*	*-2.7*	*-2.6*
	EU27 3)	*3.3*	*0.5*	*-1.4*	*-1.0*	*-0.8*	*-4.6*	*-3.9*	*-3.3*	*-2.3*	*-2.2*
AL	Albania	-7.6	-7.6	-6.4	-6.0	-6.5	-4.5	-0.5	0.0	0.5	0.5
BA	Bosnia and Herzegovina	-2.4	-4.2	-4.4	-3.7	-4.0	-0.3	-1.0	-0.5	-0.2	0.7
ME	Montenegro	-9.2	-13.0	-12.0	-10.7	-9.5	-2.1	-8.5	-7.5	-7.5	-6.0
MK	North Macedonia	-3.1	-7.5	-4.5	-3.3	-3.0	-5.4	-3.0	-2.0	-2.0	-2.0
RS	Serbia	-4.3	-6.0	-5.0	-4.0	3.0	-4.1	-1.0	-3.0	-2.5	-2.0
XK	Kosovo	-8.7	-8.9	-8.2	-7.4	-7.0	-1.3	1.0	-1.0	0.5	0.5
	WB6 1)2)	*-4.8*	*-6.6*	*-5.6*	*-4.7*	*-1.3*	*-3.4*	*-1.3*	*-2.1*	*-1.7*	*-1.2*
TR	Turkey	-0.9	-6.3	-5.0	-3.5	-3.5	-2.3	-4.9	-3.0	-2.5	-2.0
BY	Belarus	3.1	1.7	1.5	1.3	1.1	0.2	-4.0	-3.0	-2.0	-1.0
KZ	Kazakhstan	-4.0	3.5	0.5	-0.5	-1.0	-3.0	-2.0	-2.7	-2.6	-2.0
MD	Moldova	-12.4	-15.0	-12.0	-10.0	-8.0	-1.9	-5.5	-5.0	-4.5	-4.0
RU	Russia	6.6	10.4	6.5	6.0	5.5	0.8	-2.0	-3.0	-2.0	-1.5
UA	Ukraine	-1.9	6.0	4.0	3.0	3.0	-3.4	-19.0	-20.0	-12.0	-10.0
	CIS4+UA 1)2)	*4.8*	*9.3*	*5.5*	*4.9*	*4.4*	*0.1*	*-3.4*	*-4.3*	*-2.8*	*-2.2*
	V4 1)2)	*-1.8*	*-3.1*	*-2.7*	*-1.7*	*-0.9*	*-3.7*	*-4.6*	*-4.6*	*-3.2*	*-2.9*
	BALT3 1)2)	*-1.1*	*-4.6*	*-2.6*	*-2.3*	*-2.0*	*-3.0*	*-3.7*	*-4.6*	*-3.3*	*-2.5*
	SEE9 1)2)	*-4.4*	*-6.7*	*-5.9*	*-4.8*	*-3.6*	*-5.2*	*-4.4*	*-4.0*	*-3.5*	*-3.0*
	CIS3+UA 1)2)	*-2.3*	*3.3*	*1.2*	*0.5*	*0.3*	*-2.7*	*-8.8*	*-9.3*	*-6.1*	*-4.9*
	non-EU12 1)2)	*3.0*	*5.5*	*2.7*	*2.3*	*2.1*	*-0.7*	*-3.7*	*-3.9*	*-2.7*	*-2.1*
	CESEE23 1)2)	*1.1*	*2.3*	*0.4*	*0.4*	*0.6*	*-1.9*	*-4.1*	*-4.1*	*-3.0*	*-2.4*

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: 19 January 2023.

Table 2 / Policy rate and exchange rate for selected CESEE countries: overview 2021-2022 and outlook 2023-2025

		Policy rate eop, p.a.					Exchange rate NCU/EUR average				
				Forecast					Forecast		
		2021	2022	2023	2024	2025	2021	2022	2023	2024	2025
AL	Albania	0.50	2.75	3.00	3.50	3.00	122.5	119.0	116.0	116.0	117.0
BY	Belarus	9.25	12.00	10.00	8.00	8.00	2.992	2.776	3.0	3.2	3.4
CZ	Czechia	3.75	7.00	6.00	4.75	3.00	25.6	24.6	24.6	24.5	24.5
HU	Hungary	2.40	13.00	13.00	7.00	3.50	358.5	391.3	410.0	420	425
KZ	Kazakhstan	9.75	16.75	12.50	10.00	8.00	503.9	484.2	485.0	495	500
MD	Moldova	6.50	20.00	14.00	6.00	5.00	20.9	19.9	20.5	21.0	21.5
MK	North Macedonia	1.25	4.75	4.75	4.50	4.25	61.6	61.6	61.7	61.7	61.7
PL	Poland	1.75	6.75	6.00	5.00	3.00	4.565	4.686	4.6	4.60	4.60
RO	Romania	1.75	6.25	7.00	5.00	3.00	4.922	4.931	5.0	5.00	5.00
RS	Serbia	1.00	5.00	5.50	5.00	4.50	117.6	117.5	117.0	116.5	116.0
RU	Russia	8.50	7.50	7.00	6.25	5.75	87.2	72.2	75.0	85.0	90.0
TR	Turkey	14.00	9.00	20.00	12.00	10.00	10.51	17.41	23.0	26.0	29.0
UA	Ukraine	9.00	25.00	20.00	16.00	12.00	32.3	34.0	40.0	42.0	45.0

Source: wiiw, forecasts by wiiw. Cut-off date for historical data and forecasts: 19 January 2023.

1. Overview: Resilience put to the test by war fallout

BY RICHARD GRIEVESON[1]

1.1 GLOBAL ASSUMPTIONS: DARK NEW WORLD, BUT ECONOMIC RESILIENCE IN EUROPE

One year ago, our inaugural Winter Forecast started with several paragraphs discussing the latest Omicron wave of the coronavirus, vaccination rates, the likelihood of new lockdowns and rising inflation in the developed world.[2] Only several pages in, after a lengthy discussion of Fed and European Central Bank (ECB) policy, did we note the risk of 'a new exchange of sanctions between Russia and the West and a spike in energy prices as a result of a fresh conflict in Ukraine'. What a difference a year makes.

The world, but especially Europe, changed forever on 24 February 2022, as Russian tanks rolled into Ukraine and missile started to fall on Kyiv and other Ukrainian cities. Since then, thousands of people have lost their lives, unspeakable atrocities have been committed, and millions of people have been forced to leave their homes. The scale of destruction and the humanitarian crisis dwarfs even the wars of the 1990s in the former Yugoslavia. This is the biggest war on the European continent since 1945.

February 2022 was the bookend which closed an era that started in 1989 – an era of steadily progressing European integration in its broadest, continental sense. It is possible that eventually a narrower version of European integration may receive a decisive push forward as a result of the conflict, and that Ukraine is firmly integrated within the EU in a way that dramatically improves the living standards of its population. Yet for some time – perhaps for many years to come – Ukrainians will continue to suffer terribly, and the war will cast a long shadow across the lives of all Europeans. Meanwhile the much discussed 'broader' European integration or 'integration of integrations' (i.e. involving Russia) is dead and buried. Economically and otherwise, the situation we are in (and in which we will remain) will look far more like the Cold War than anything we have seen since 1989. It is indeed plausible that the degree of economic integration between Russia and most of the rest of Europe will end up being less than it was pre-1990.

Our assumptions about the future course of the war, which underlie our economic assumptions, are similar to those we outlined in our Autumn Report:[3]

› The war will last until at least the end of this year. Neither side has the means to deliver a decisive knock-out blow, but neither is anywhere near exhausted.

› We assume that the war will remain centred on particular areas of southern and eastern Ukraine and will not spread further.

---

1 The author thanks Doris Hanzl-Weiss and Branimir Jovanović for helpful comments and suggestions.

2 https://wiiw.ac.at/monthly-report-no-1-2022-p-6010.html

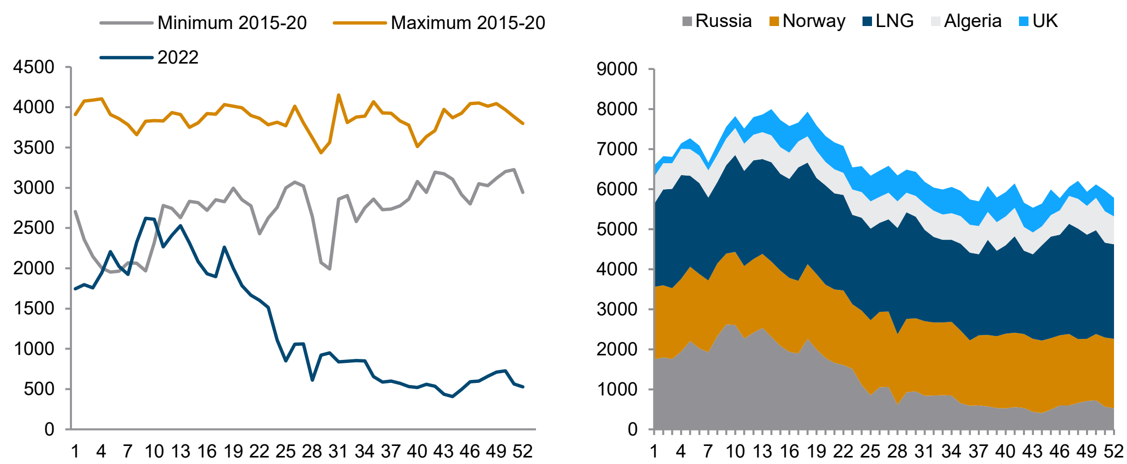
3 https://wiiw.ac.at/bracing-for-the-winter-p-6364.html

› We assume that Russia will not use nuclear weapons or attack a NATO member state, and therefore that the war will not expand to become a NATO-Russia conflict.

› We do not think that Russia will supply Europe with energy to any meaningful extent throughout the forecast period.

On the basis of these assumptions, we think that the rest of Europe is already in the process of absorbing the worst of the economic 'hit' from the war. Even before the conflict, Europe's non-energy economic integration with Russia was generally very limited. Decoupling started after the exchange of sanctions following Russia's annexation of Crimea, now almost a decade ago. Once the 'sticking plaster' of energy dependence on Russia is ripped off – not an easy procedure, but now largely accomplished – the channels of economic contagion from the conflict are very limited for the rest of Europe. Russian gas deliveries to Europe have collapsed not because of European sanctions, but because of a decision taken by the Russian government itself to try to weaponise energy and put pressure on Europe to drop its support for Ukraine over the winter (Figure 1). The EU now imports a much larger relative share of its gas from Norway and via liquefied natural gas (LNG), while the relative importance of Algeria and the UK as sources of gas has also increased.

Figure 1 / EU gas imports from Russia per week, million cubic metres (left) and EU total weekly gas imports, by source, in 2022, million cubic metres (right)



Note: Numbers on the x-axis represent weeks, starting at the beginning of each year.
Sources: B. McWilliams, G. Sgaravatti and G. Zachmann (2021), 'European natural gas imports', Bruegel Datasets.

Putin's attempt to weaponise energy has clearly failed. The EU economy has already adapted enormously and impressively. One survey in Germany found that 75% of firms that use gas in their production have been able to curtail gas consumption without cutting production.[4] Controlling for factors such the weather, researchers at the Leibniz Information Centre for Economics found a 19% reduction in gas use by German industry, as of September 2022; meanwhile, German consumers and small businesses cut their use of gas by 10-36% in March-September of last year.[5] Across the EU, as of November 2022, gas demand was down by around 25%, compared with the same period in previous

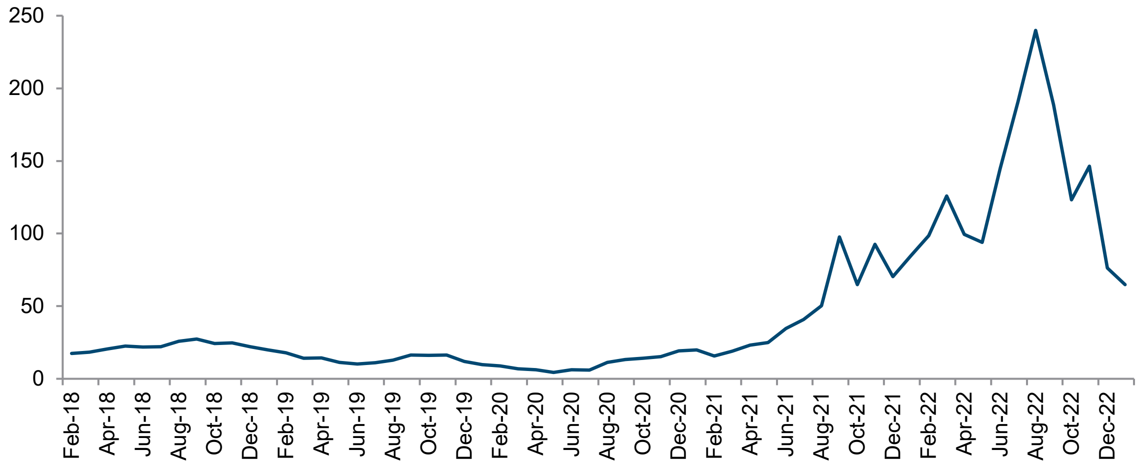
[4] https://www.ifo.de/en/press-release/2022-11-22/many-industrial-companies-germany-cut-gas-consumption-without-curbing

[5] https://www.econstor.eu/handle/10419/265522

years.[6] This was despite the second half of the month seeing temperatures close to the seasonal average (the first half of November was warmer). Most of the reduction came from industry, which in part reflected reduced use due to higher prices. And importantly from a climate perspective, this reduction in gas demand does not seem to have been offset by higher oil imports or energy generation by coal.[7]

However, while not wishing to downplay this (so far) very positive news, it should be pointed out that the challenges will last into next winter and beyond. A large share of the global gas supply has now disappeared for several years at least: Russia will not sell this gas to the EU, and cannot sell it to others (e.g. China) until the required pipeline infrastructure is built. As a consequence, gas prices will remain higher than historical average levels for several years. This presents a major challenge to European industry's external competitiveness. Although European gas prices have fallen a lot, the Dutch TTF benchmark is still around three times higher than it was in the first half of 2021, before the Russian military build-up on Ukraine's borders and 'technical difficulties' started to disrupt Russian gas supplies to Europe.

Figure 2 / Dutch TTF natural gas futures, EUR/megawatt hour



Source: Investing.com

The sharp rise in inflation in the euro area – much of which occurred before the invasion, although it has since intensified – has been accompanied by an abrupt tightening of financial conditions, as the ECB has raised its benchmark interest rate. Since mid-2022, the ECB has increased both its deposit facility rate and its main refinancing rate by a cumulative 250 basis points.[8]

Taking all this into account, our growth forecasts for the euro area in 2023 and 2024 remain unchanged: we expect the economy to grow by 0.2% this year, with current weaker conditions followed by a pick up from around the middle of this year. Although the 2023 outturn is hardly stellar, the worst-case scenarios have certainly not come to pass, and – helped by milder weather – the euro area has demonstrated considerable resilience in coping with the economic fallout from the war in Ukraine and the sharp

[6] https://www.ft.com/content/0ab21afc-d034-4279-8ce1-4469d0ce8489

[7] https://www.ft.com/content/ab5ea968-d725-422e-97ec-f9f5fcb7a40c

[8] https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html

tightening of financial conditions. Nevertheless, we may well come quite close to a global recession this year, and certainly growth will be weaker than in previous years. Expected weakness in the US will play a major part in this. That said, there, too, the predictions may be rather gloomy, and the economy may prove more resilient. Meanwhile, the Chinese economy is open again for business after three years of at least partial lockdown. It is hard to determine exactly how much the Chinese reopening will add to global growth, but it will certainly be positive for global economic momentum in 2023.

Table 3 / wiiw winter 2023 global assumptions

	Winter 2023			Changes since autumn	
	2023	2024	2025	2023	2024
Euro area real GDP growth, %	0.2	1.9	1.8	0.0	0.0
Euro area CPI, %	6.0	3.4	2.3	0.0	1.1
USD/EUR exchange rate, average	1.03	1.03	1.03	0.04	0.04
USD per barrel Brent oil, average	85.0	80.0	75.0	-12.0	-10.0

Source: Forecasts by wiiw. Cut-off date: 19 January 2023.

The main change in our global assumptions since autumn 2022 is that the oil price will be substantially lower than we previously expected. We have revised the projected cost of Brent crude oil down by USD 12 per barrel in 2023 and USD 10 per barrel in 2024. This reflects a substantial decline in prices that started in the middle of last year, and it owes a great deal to the significant impact of the EU oil price cap. The effectiveness of the oil price cap underlines not only the EU's direct power as a major source of demand, but also its indirect power, via its control of large parts of the global shipping and insurance industries.

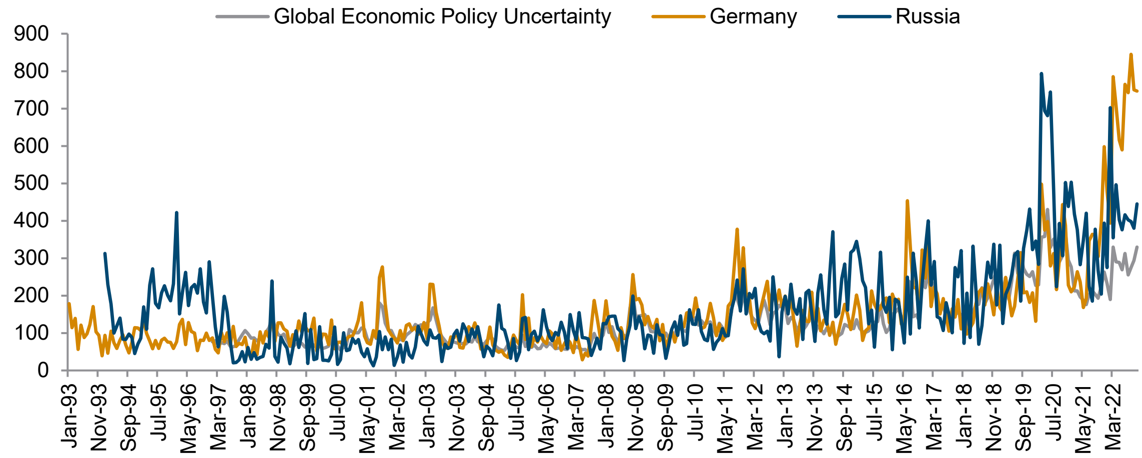
Despite this, we are not revising our 2023 inflation forecast downward. This is because prices in other parts of the basket will be stickier or will rise (energy directly accounts for only around 10% of the HICP basket in the euro area). As for the ECB, the sharp drop in natural gas prices will certainly ease the pressure to continue rapid monetary tightening. Headline inflation fell back into single digits at the most recent data point, and ECB communications now sound, if not dovish, at least much less hawkish than previously. Nevertheless, core inflation continues to rise strongly; if gas prices do indeed remain substantially lower than last year, that could increase demand-side pressures and keep core inflation higher for longer. As a result, it is probably too early to expect a rapid winding-down of the ECB's tightening cycle.

There are material downside risks to this forecast. It seems likely that Russia, having called up hundreds of thousands of new troops, will launch a new offensive in the spring.[9] That could see the war cover a larger part of Ukraine again, with potentially further-reaching economic consequences for the rest of Europe. The potential for a sharp 'escalation' by Russia (a euphemism for the use of nuclear weapons) would have even further dramatic consequences. It is extremely difficult to construct economic assumptions around such a scenario. In addition, the reopening of the Chinese economy also introduces significant risks to the forecast: while increasing demand for European exports, a stronger-than-expected recovery in China would also cause upward pressure on commodity prices, higher inflation and more monetary tightening. What is clear is that uncertainty is high and will remain so for some time. The fact that the Economic Policy Uncertainty Index is so high for European countries such as Germany

9 https://www.kyivpost.com/post/11125

(relative to both Russia and the global level) underlines the particular challenges facing the European economy during the forecast period (Figure 3).

Figure 3 / Economic Policy Uncertainty Index, long-term average = 100



Source: Economic Policy Uncertainty, https://www.policyuncertainty.com/index.html.

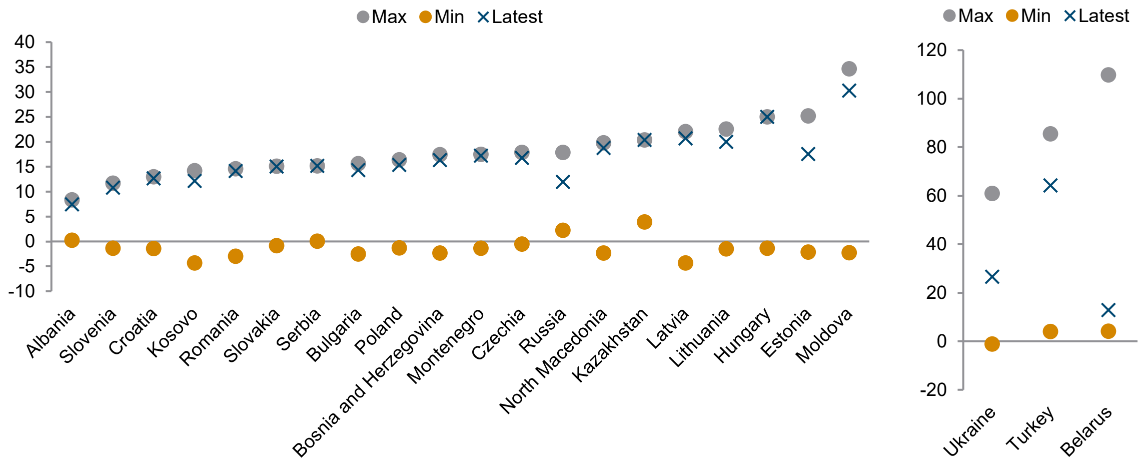
1.2 INFLATION-DRIVEN SLOWDOWN IN 2022

The war and its fallout will certainly put CESEE's economic resilience—demonstrated so strongly in response to the pandemic in 2020 and 2021—to the test. In CESEE, economic growth momentum has slowed sharply, reflecting in particular much higher inflation and the consequent adverse impact on real incomes and private consumption. Excluding Ukraine and Russia, we estimate that CESEE's regional economic growth in 2022 already slowed to 2.6% on a simple average basis. This was a sharp slowdown after the 7.5% growth of the previous year, but was nevertheless a robust outturn considering the war and the high inflation faced by CESEE countries.[10] The Ukrainian economy contracted by an estimated 30% last year, and the Russian economy by 2.5% (the latter substantially less than initially expected, reflecting a high degree of resilience, discussed in greater detail below).

We estimate that inflation in CESEE, excluding Russia and Ukraine, averaged 17.1% last year, up from 4.8% in 2021. Almost all CESEE countries currently have inflation rates (based on the latest available monthly data, mostly December 2022) at or very close to the highest level since at least 2007 (Figure 4), and in many cases since the 1990s. Perhaps surprisingly, the only significant exceptions to this are Russia, Ukraine and Belarus, all of which have had considerably higher inflation at some point in the last 15 years. These inflation rates are substantially depressing real incomes and weighing on consumer and investor confidence.

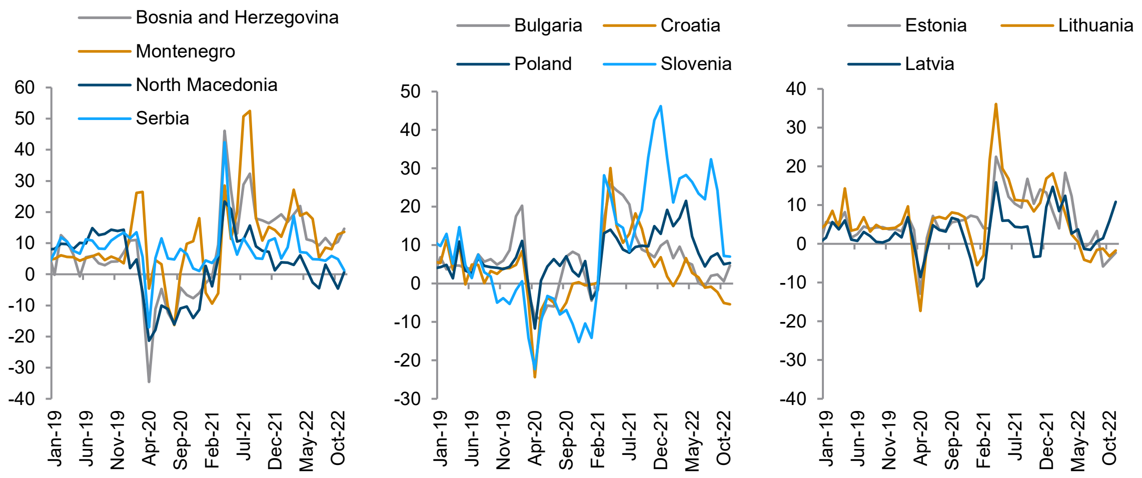
[10] On a weighted average basis, CESEE contracted by 0.5%; the difference between the simple and weighted averages reminds us that Russia is a big economy.

Figure 4 / Monthly consumer price inflation, %, year on year



Note: Max and min values are for monthly data between 2007 and 2022.
Sources: National sources, Eurostat, wiiw.

Figure 5 / Retail trade volume, % change, year on year

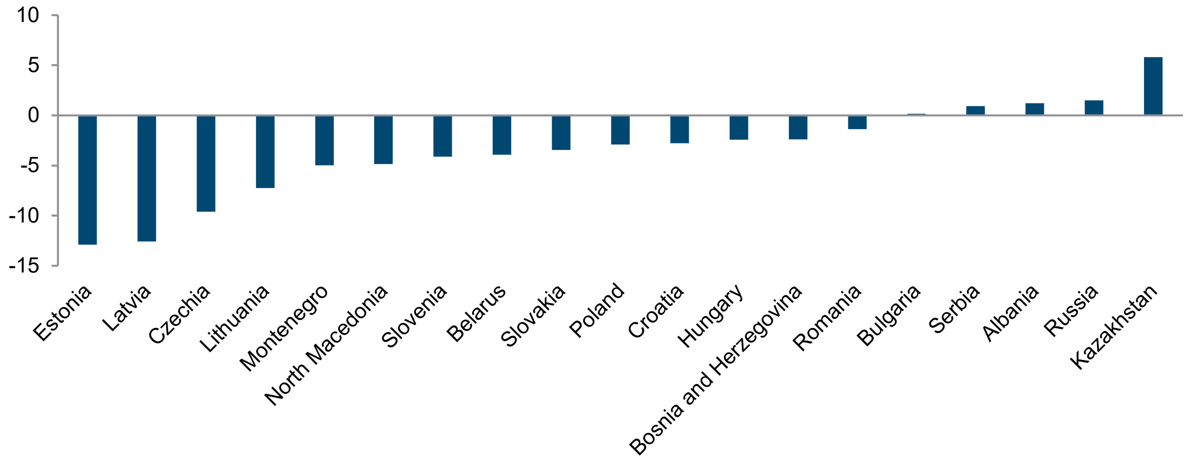


Source: Eurostat.

In retail trade – a key barometer of consumer spending – across most EU member states and the Western Balkan countries for which recent comparable data are available, momentum has certainly slowed since the pandemic bounce-back, but volume growth remains in positive territory in most places (Figure 5). Apart from Latvia and Lithuania, which are both struggling with especially high inflation, the only country (of those with data available) with negative growth in retail trade in November 2022 was Croatia. However, with real growth in incomes mostly negative across the region (Figure 6), the resilience of retail trade growth suggests either savings drawdowns (potentially still from forced savings built up during the pandemic) or credit-financed consumption. Neither is sustainable: the first will eventually run out, while credit is becoming more expensive. While some of the least developed countries of the region finance consumption via remittances, which are more sustainable and often counter-cyclical, overall the arithmetic is clear: unless inflation falls quite quickly (not our core scenario;

see below), real consumption growth will not be able to maintain the positive growth rates seen in most countries through to the end of 2022.

Figure 6 / Real wage growth, % change, year on year, November 2022 or latest available

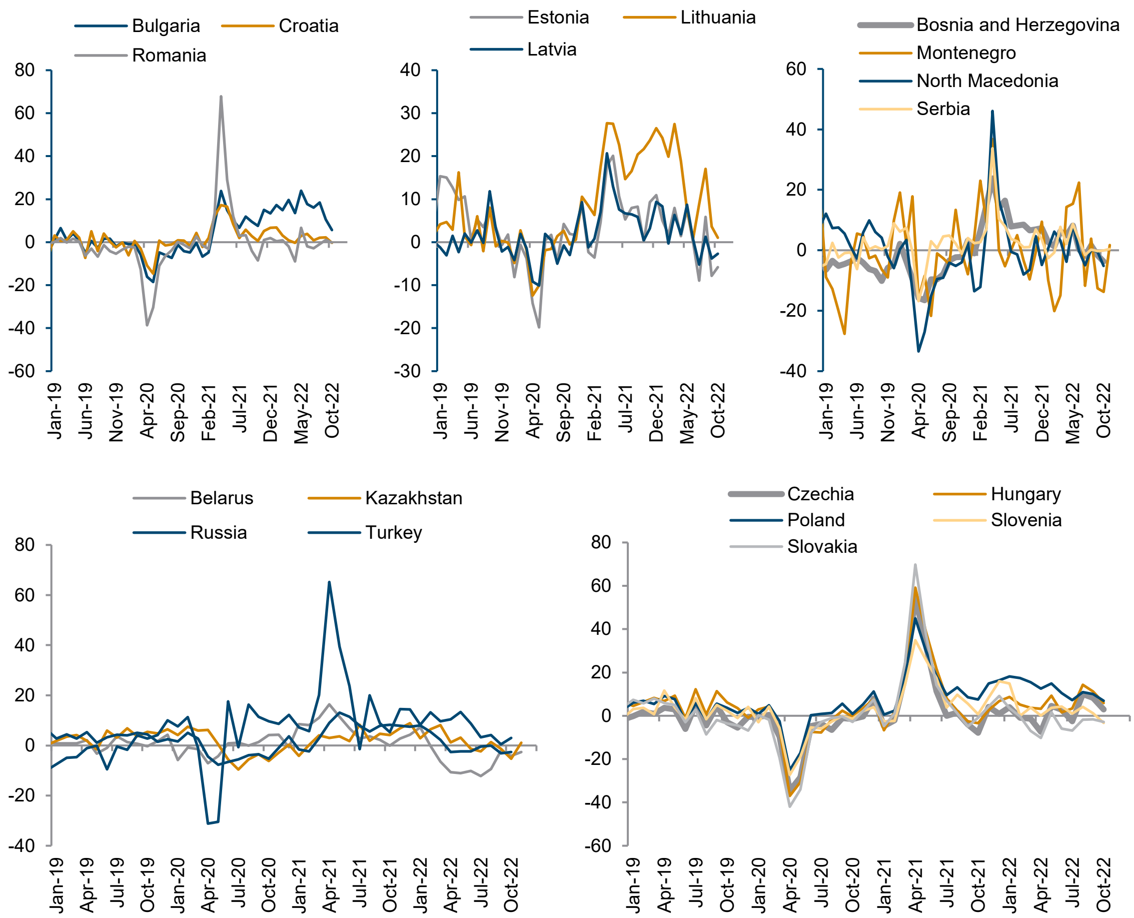


Sources: National sources, wiiw.

Meanwhile, for industrial output, widely predicted to struggle in the face of consumer caution and higher energy prices, the results are more mixed, though here, too, there are clear pockets of resilience: Czechia, Hungary, Poland, Bulgaria, Turkey, Kazakhstan, Montenegro, Serbia and Lithuania all recorded positive outturns, based on the latest available data. Unsurprisingly, Russia and Belarus showed contractions, along with some EU-CEE and Western Balkan countries. Again, some of the Baltic states showed weakness, in this case notably Estonia and Latvia. Inflation may again be part of the explanation, along with proximity to the conflict and the impact on confidence, and greater pre-war trade ties with Russia.

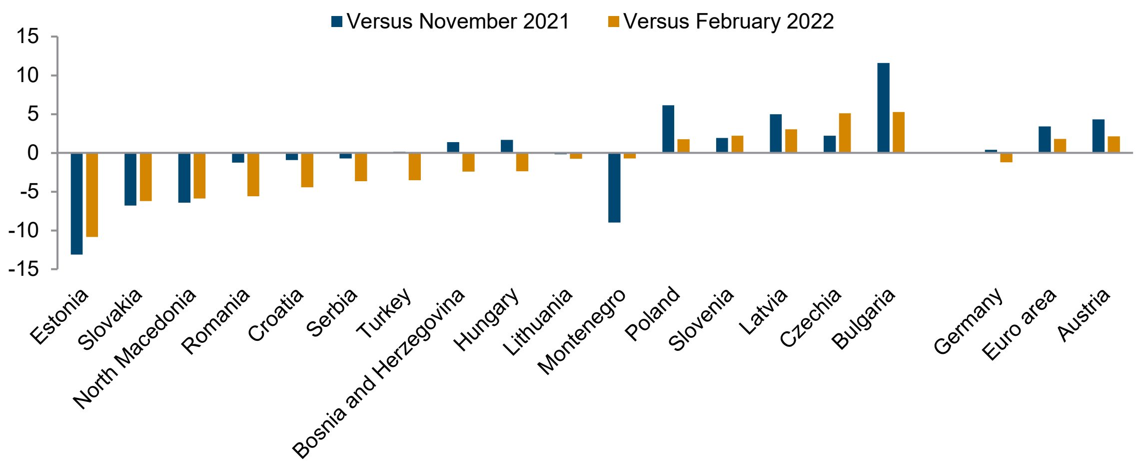
The broad picture in CESEE is not as rosy as in the euro area, where the relative resilience of the industrial sector has gained quite a bit of attention. In November 2022, the euro area's seasonally adjusted real volume of manufacturing output was 1.8% higher than in February, the month of the Russian invasion of Ukraine. Within CESEE, however, that was only the case in five countries for which Eurostat provides comparable data: Bulgaria, Czechia, Latvia, Slovenia and Poland (compared with a year earlier, November 2021, the picture is quite similar). In the other ten CESEE countries for which data are available, output was lower in November than in February. There seems to be no strong sub-regional thread running through the data, as the worst performers include representatives of the Baltic states (Estonia), the Central European manufacturing core (Slovakia), the Western Balkans (Serbia) and Turkey. This could imply the importance of country-specific levels of preparedness, storage, availability of alternative fuel sources, or other factors.

Figure 7 / Industrial output volume, % change, year on year



Source: Eurostat.

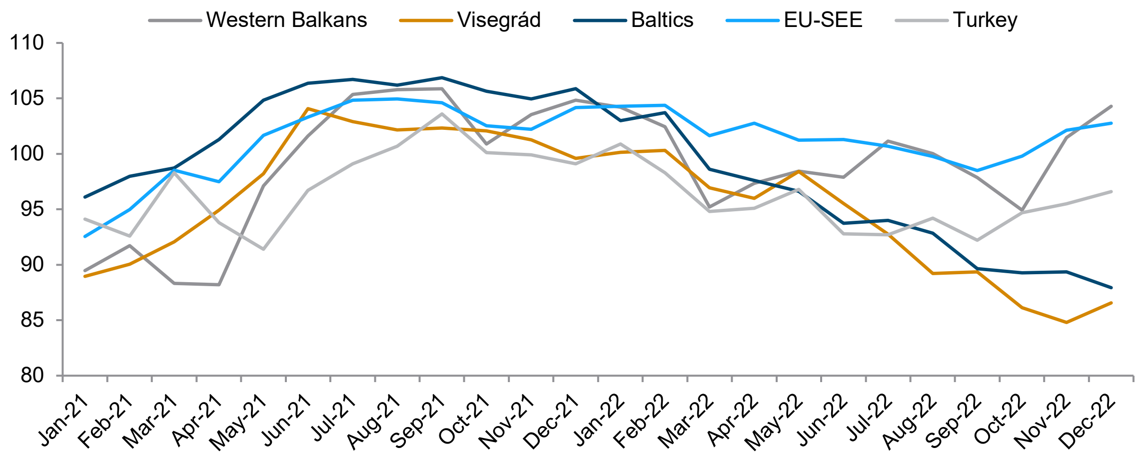
Figure 8 / Manufacturing production volume, seasonally and working-day adjusted, % change in November 2022 versus earlier periods



Source: Eurostat.

Broadly speaking, confidence indicators paint an even worse picture, albeit one strongly differentiated by region (Figure 9). The Baltic states – which have some of the region's highest inflation rates, are geographically closer to the conflict and tended to have stronger pre-war economic ties with Russia – show a clear negative downward trend continuing until the end of the year. The same can be seen for the Visegrád countries, possibly reflecting their high level of external exposure and concerns among businesses regarding supply-chain disruptions linked to the war. By contrast, while sentiment in Southeast Europe (including the EU member states, the Western Balkans and Turkey) also fell initially, as inflation surged and the invasion began, it recovered noticeably in the final quarter of 2022. One hypothesis is that consumers and firms in Southeast Europe overestimated the impact that the war and its fallout would have, or possibly underestimated their own resilience and adaptability. Moreover, in the Visegrád countries, the 'hard' data on industrial output have mostly held up better than confidence indicators would suggest, pointing to greater-than-expected resilience there, as well.

Figure 9 / European Commission economic sentiment indicator, long-term average = 100



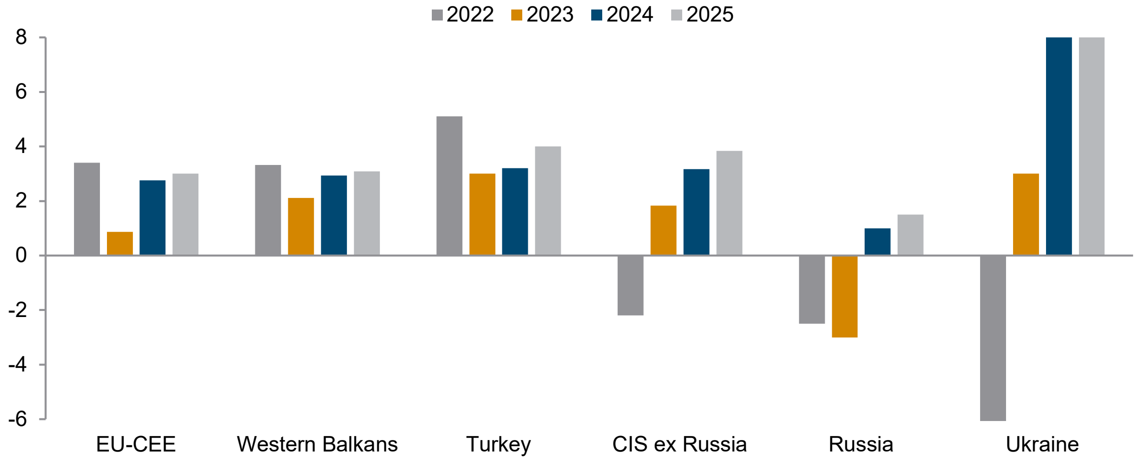
Note: Simple average of each country group. Western Balkans: Albania, Montenegro, North Macedonia; EU-SEE: Bulgaria, Croatia, Romania, Slovenia.
Source: European Commission, Eurostat.

1.3 2023: A FURTHER SLOWDOWN, BUT MOST COUNTRIES WILL AVOID RECESSION

Despite the clear resilience in much of CESEE, real GDP growth in 2023 will be lower than in 2022, and will fall a long way short of 2021's stellar outturns (Figure 10). On a simple average basis,[11] we project overall CESEE growth (excluding Russia and Ukraine) to be just 1.5% this year, down from 7.5% in 2021 and 2.6% in 2022. We have downgraded our 2023 real GDP growth forecasts for most EU-CEE countries, as well as Serbia, Kazakhstan and Ukraine.

[11] On a weighted average, the outturn from 2022 looks considerably worse; but all this tells us is that the region's biggest economy, Russia, suffered a deep recession.

Figure 10 / Real GDP growth, % per year



Note: Country groups use simple averages.
Sources: National sources, wiiw.

Below these headline numbers, the sub-regional variations are very significant, as Figure 10 shows. EU-CEE faces a very sharp slowdown this year, with average growth of 1% (on a weighted average basis), compared with an estimated 4% in 2022. The key drivers of this sharp slowdown include Hungary, where we expect a recession (-1%), and Poland, where we expect growth to slow from 4.6% in 2022 to just 1% this year. Both are struggling with exceptionally high inflation in the regional context. In Hungary, the central bank has had to significantly increase interest rates to support the currency, which has weighed on economic activity. This has coincided with a low point in the EU funds cycle for Hungary.

The Turkish economy will also slow to an estimated 3% growth, from 5.1% last year. Although momentum in retail trade and industrial output appeared quite robust through to the end of 2022, extremely high inflation rates – comfortably the highest in CESEE – are sharply diminishing real wages and denting investor confidence. We also expect somewhat tighter monetary policy after the upcoming general election (scheduled for May), which will further slow economic momentum.

In the Western Balkans we also expect a slowdown this year, with weighted average growth falling from 2.8% last year to 1.8% in 2023. In this sub-region, we expect relative resilience in both Albania (3%) and Kosovo (3.4%). Albania seems to have been especially successful in reining in inflation via price controls. Meanwhile, North Macedonia (1%), Bosnia and Herzegovina (1.5%) and Serbia (1.5%) will struggle. In Serbia, which has been one of CESEE's top performers over several years, the meagre 2023 outturn will reflect both its exposure to the fallout from the war (owing to its relatively close ties with Russia) and the impact of negative policy noise on the economy, due to tensions with Kosovo.

In the CIS (excluding Russia), 2023 should look somewhat better than 2022: all the countries have taken a big hit as a result of the fallout from the war and therefore benefit much more than the rest of CESEE from base effects. We forecast that especially Belarus and Moldova will do considerably better than last year. In Moldova, which contracted by 5% in 2022 owing to its having had the region's highest inflation rate (bar Turkey), the economy should bounce back to grow by 1% this year. Meanwhile Kazakhstan, which posted robust growth of 3% in 2022 (helped by the higher energy prices), will see growth improve further to 3.5% in 2023.

Table 4 / Real GDP growth forecast and revisions

		Forecast, %		Revisions, pp	
		2023	2024	2023	2024
EU-CEE	BG	1.5	2.5	0.0	-0.5
	CZ	0.4	2.4	-0.6	-0.4
	EE	0.9	3.1	-0.5	0.0
	HR	2.5	2.8	0.0	-0.3
	HU	-1.0	1.7	0.2	0.0
	LT	1.3	2.8	0.4	0.2
	LV	0.0	3.3	-0.6	1.0
	PL	1.0	2.4	-0.7	0.0
	RO	2.4	4.0	0.2	0.5
	SI	1.2	2.7	-0.7	0.0
	SK	0.6	2.3	0.0	-0.1
Western Balkans	AL	3.0	3.6	0.0	0.0
	BA	1.5	2.2	0.0	-0.3
	ME	2.6	3.3	0.0	0.0
	MK	1.0	2.5	0.4	0.5
	RS	1.5	2.6	-0.4	-0.1
	XK	3.4	3.8	0.5	0.0
Turkey	TR	3.0	3.2	0.5	0.0
CIS+UA	BY	1.0	1.5	0.0	-0.5
	KZ	3.5	4.0	-0.1	-0.1
	MD	1.0	4.0	1.0	2.0
	RU	-3.0	1.0	0.0	0.0
	UA	3.0	8.0	-2.5	-4.0

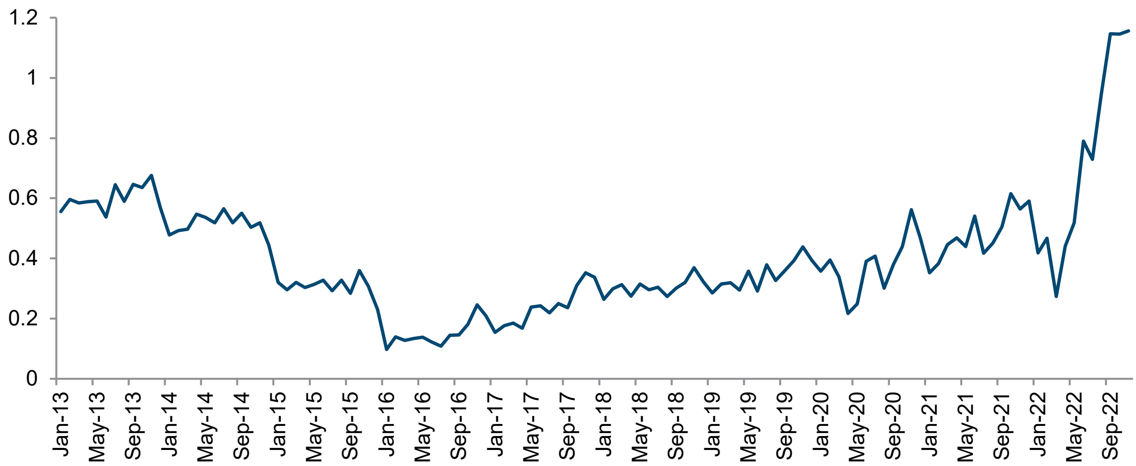
Note: Current forecast and revisions relative to the wiiw Autumn forecast 2022. Colour scale variation from the minimum (red) to the maximum (green).
Source: wiiw January 2023 forecasts.

Ukraine will also start its recovery in 2023, albeit after last year's 30% decline, the projected 3% growth is only a tiny step forward. The country's economic activity has been badly affected by Russia's targeting of its power infrastructure – a strategy that seems unlikely to stop anytime soon. Despite quite impressive business adaptation (both to the invasion in general and to the regular disruptions to the power supply), production costs have risen and uncertainty has increased. Under these conditions, reconstruction of the economy and a more robust recovery in real GDP will only come about gradually.

We expect a full-year contraction in Russia for the second year in a row, with the economy declining by 3% in 2023. Although Russia has been somewhat more resilient to sanctions than many expected earlier in 2022, the economy is facing severe difficulties. While spending on weapons and the armed forces has increased, in other sectors of the economy indicators show a downturn that is much greater than the headline GDP figure would suggest. Retail sales, a core indicator of consumer spending, have been falling by 8-10% year on year in real terms since April.

Moreover, throughout the rest of the forecast period, it is difficult to see where the drivers of any recovery in Russia will come from. The economy has lost access to a large part of the technology and inputs it needs. It is true that certain imports no longer available from the West can be rerouted as imports via countries such as Turkey and China (the monthly value of imports from Turkey, which had been rising since 2016, more than doubled between November 2021 and November 2022, as Figure 11 shows); however, many other imports cannot be secured that way, as the travails of the automotive and aviation industries show. Russia is also suffering a massive brain drain, has no alternative market for the gas it used to supply to Europe, and is being forced to sell its oil at a big discount. Latest data indicate that the recent further drop in energy prices is already putting a strain on the state budget; and if energy prices fall even more during the forecast period (as we expect), the fiscal situation will deteriorate even further. This will constrain the ability of the country's fiscal policy to provide a positive impetus to the domestic economy.

Figure 11 / Turkish exports to Russia per month, USD bn



Source: Turkstat.

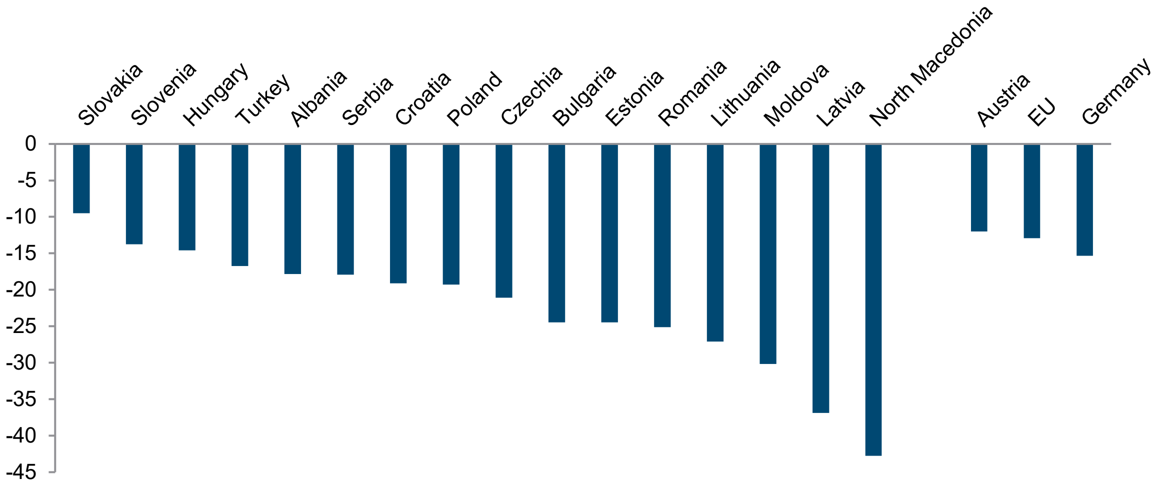
One hypothesis explaining much of CESEE's relative resilience has to do with the weather. According to this theory, the warmer weather has reduced energy demand, thereby forestalling a further upward spiral in prices and inflation – and a blow to economic activity – over the winter. That is definitely part of the story: the winter has been uncharacteristically warm so far – seven European countries recorded their highest ever January temperature on 1 January 2023.[12] This could imply that, should the weather change (and at the time of writing, temperatures have dropped), demand for gas will rise, as will prices, and much of CESEE's relative resilience will wither.

However, there is much more to Europe's (and CESEE's) relative resilience than just the weather, and these factors will be important in driving a gradual recovery from around the middle of the year. For example, demand reduction measures have proved at least partly successful. As already outlined above for the case of Germany, the industrial sector (in particular) has already made impressive efficiency gains to offset higher energy prices. According to Eurostat, across those CESEE countries for which data are available, natural gas consumption in March-October 2022 fell year on year by between 9.5% (Slovakia) and 42.8% (North Macedonia) (Figure 12). This was at a time when all countries were still posting positive real economic growth rates. Moreover, the vast majority of CESEE countries reduced

[12] https://www.politico.eu/article/europe-mild-winter-energy-blessing-farmers-curse/

gas consumption more than Germany, Austria or the EU average. However, this was partly achieved by switching to coal, with the concomitant negative environmental impact that will have.

Figure 12 / Natural gas consumption in March-October 2022, % change versus year earlier



Source: Eurostat.

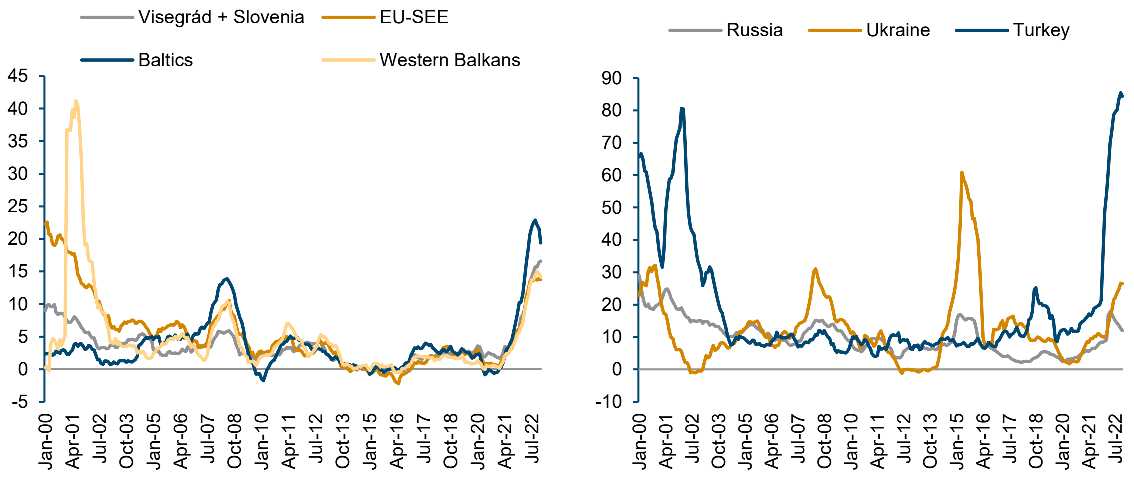
Moreover, as we highlighted in previous forecast reports, for the EU member states of the region, the new EU funds cycle will be a very significant positive factor promoting growth over the forecast period. Drawdowns of NextGenerationEU funding were quite limited in 2022, but they should pick up this year. Many countries of the region are entitled to several percentage points of their GDP per year during the forecast period.

Beyond 2023, the region's economies should continue to strengthen. We expect average regional growth (excluding Russia and Ukraine) to reach 2.9% in 2024 and 3.2% in 2025. Throughout the forecast period, most countries will grow more quickly than the euro area, indicating continued convergence. By the standards of emerging markets globally, CESEE showed itself during the worst of the pandemic in 2020-21 to be a highly resilient region economically, and despite the current challenges, this may prove to be the case again. Should the trend toward the regionalisation of supply chains gather pace in the wake of the pandemic and the war, CESEE could stand to benefit from near-shoring. The region's main weaknesses, and the main barriers to attracting significant near-shoring investment, will include labour and skills shortages, energy prices that are several times higher than pre-2021, and a potential increase in perceived risk among foreign investors due to the proximity of the war in Ukraine.

1.4 INFLATION: WE HAVE PASSED THE PEAK

The spike in inflation across CESEE dominated much of the narrative around the region in 2022. For a decade or more, inflation was generally a minor factor in CESEE economies; but that all changed last year. As outlined above (Figure 4), most of CESEE last year had its highest monthly inflation for at least 15 years; and in many cases, 2022 saw the strongest price growth since the 1990s. CESEE's own 'great moderation' in inflation rates, which occurred especially after 2008, decisively ended in 2022 (Figure 13).

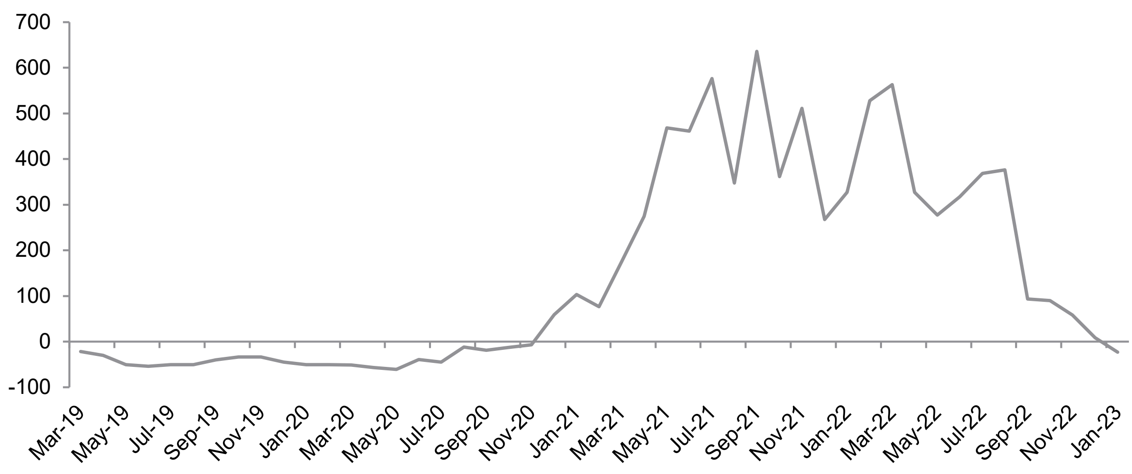
Figure 13 / Consumer price index, % change, year on year



Note: Simple average for country groups.
Sources: National sources, wiiw.

As the charts above illustrate, inflation in the region started to pick up strongly from about the middle of 2021, in line with global trends, and well before the Russian invasion of Ukraine. This reflected largely global factors – in particular, supply dislocations stemming from the pandemic (resulting in an excess of demand over supply in some sectors) and massive fiscal stimulus in the US. In the energy markets specifically, gas prices started to shoot up from mid-2021, driven by both rising Chinese demand and ‘disruptions’ in Russian supplies to Europe even before the war (Figure 14). Nevertheless, the invasion, the ensuing sanctions exchange and Russia’s decision to severely restrict gas supplies to most of Europe certainly contributed further to inflation. European gas prices continued to grow by several hundred per cent year on year until August 2022.

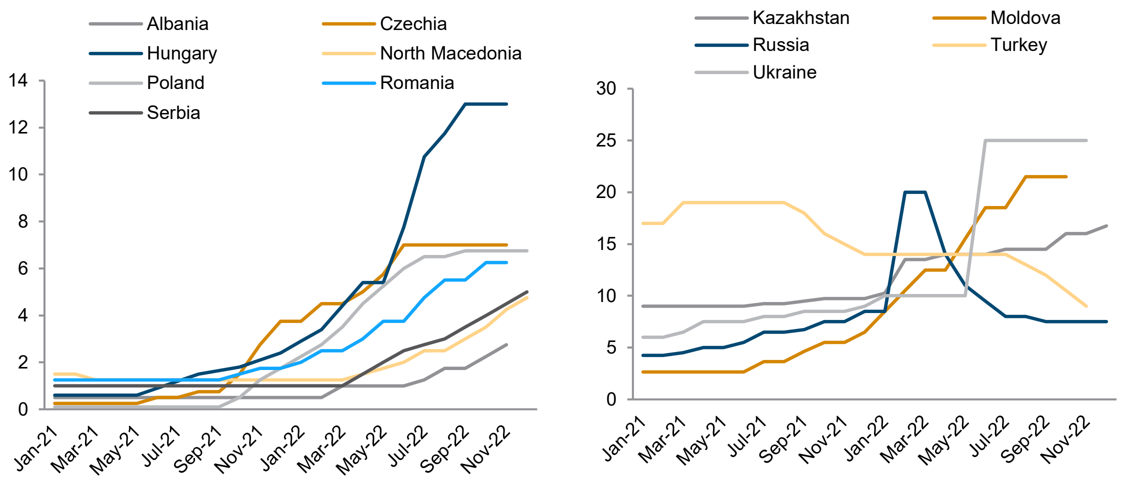
Figure 14 / Dutch TTF natural gas futures price, % change, year on year



Source: Investing.com

Considering how sharply energy prices rose last year, it may be surprising that overall inflation in CESEE was not higher in 2022. Partly, this again could be explained by luck, in the form of the warmer winter weather (as outlined above); however, this only really accounts for a couple of months of the data. A sharp monetary policy reaction, the implementation of various price controls (with varying degrees of success), efficiency improvements to reduce gas demand, and interventions on FX markets to limit depreciation (and thereby reduce important inflationary pressures) no doubt also played a part. With the exception of Turkey's, all CESEE central banks hiked their rates sharply in 2021-2022, and in general were well ahead of the ECB in their reactions (Figure 15; the Russian central bank has also since eased policy). In countries where a large share of the population have floating rate mortgages, such as Poland, this has been an additional factor that has weighed heavily on disposable income and that therefore passes fairly rapidly through to the real economy.

Figure 15 / Nominal central bank policy rates, %



Sources: National central banks, wiiw.

As Figure 14 shows, at the time of writing, the cost of gas in Europe based on the Dutch benchmark fell in year-on-year terms in January for the first time since late 2020. In combination with the decline in oil prices already outlined above, this indicates that the upside pressure on inflation from energy has dissipated, and this could point to a much more benign outlook for inflation in CESEE in 2023. Inflation may already have peaked: in many CESEE countries, the rate of inflation started to trend downward in the final months of 2022. Although, compared with autumn 2022, we have made upward revisions to our 2023 inflation forecasts for most CESEE countries, in every one of those countries, bar Poland and Hungary, we expect inflation to be lower in 2023 than in 2022.

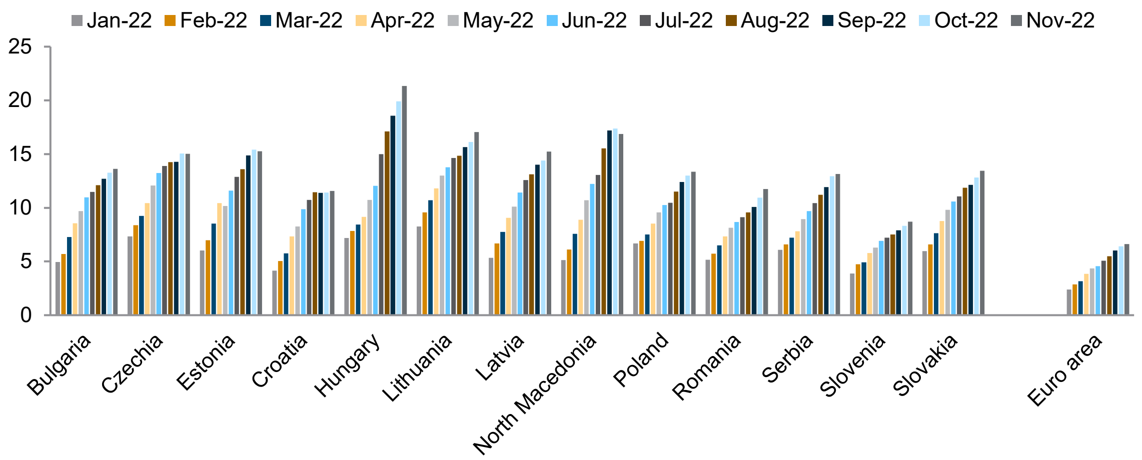
Even though we expect inflation to be on average lower this year than last in most CESEE countries, there are three reasons for caution.

First, there remains a strong potential for commodity-induced spikes in inflation to come from other sources related to Russia. While food price pressures have eased and the Black Sea grain deal between Russia and Ukraine was renewed in November 2022, there remains the potential for renewed disruptions to food supplies linked to the war and another spike in prices. There are also legitimate concerns about next winter, if European gas stocks –currently at very high levels – are depleted and then prove much harder to replenish without a Russian supply.

The second potential trigger for higher inflation is the Chinese economy. Although impossible to quantify at this stage, it seems highly likely that the reopening of the world's second-biggest economy after three years of partial lockdowns will generate a sizeable increase in commodity demand. Surging copper prices – a key bellwether of Chinese demand – already point to the impact that this is likely to have.

The third reason for caution on inflation this year is that, while headline inflation has peaked in the majority of CESEE countries, core inflation is continuing to rise (the exceptions being Czechia, Estonia and North Macedonia, where it is either stable or falling). This indicates that price growth is being driven by non-energy sources, with second-round effects now much clearer than even six months ago. In the CESEE countries for which comparable, up-to-date inflation data exist (mostly the EU member states, plus some Western Balkan countries), core inflation was at its highest for the whole year in November 2022 (Figure 16). Moreover, in the same sample of countries, the cost of food and non-alcoholic beverages continued to climb until November 2022 everywhere, except Serbia and North Macedonia.

Figure 16 / Core inflation, % year on year



Note: Core inflation is headline inflation excluding energy and unprocessed food.
Sources: Eurostat.

Nevertheless, the profoundly negative real wage growth across most of the region suggests that the consumer demand needed to sustain elevated inflation is largely lacking. Moreover, the available surveys suggest that, on the household side, inflation expectations remain well 'anchored' (i.e. households do not anticipate that inflation will continue to rise sharply, and are therefore less likely to demand big pay rises). On the side of firms, manufacturing purchasing managers' indices (PMIs) for CESEE countries suggest that, while input cost pressures are in some cases continuing to rise strongly, the ability to pass these on to consumers remains quite constrained. This is hardly surprising, given the real wage data. The Czech manufacturing PMI in December 2022, for example, noted that 'input price inflation regained momentum in December, with cost burdens rising at a sharper pace. This was not mirrored in the trend for output charges, however, which rose at the slowest rate since March 2021.'[13]

[13] https://www.pmi.spglobal.com/Public/Release/PressReleases

The equivalent survey for Poland reported output charges ‘rising sharply but to the weakest degree since the start of 2021’. Even the survey for Turkey reported on the output side ‘a rate of inflation much softer than seen earlier in the year’.

Taking all of this together, while there is a high degree of uncertainty, especially in relation to the Chinese reopening, it seems that by the second half of the year inflation in most of CESEE will be much lower than is currently the case. Financial markets expect several CESEE central banks to start cutting interest rates before the end of the year. Our forecasts also reflect this: we expect policy rates to end 2023 lower than 2022 in Belarus, Czechia, Kazakhstan, Moldova, Poland, Russia and Ukraine.

1.5 POLITICAL RISK HIGH ON THE AGENDA IN CESEE IN 2023

We will cover political risk in the region in more detail in upcoming monthly reports and in our full Spring Forecast. However, it would be impossible to avoid the topic now as well. The war in Ukraine reminds us brutally, daily, that we should not ignore political risk or underestimate its impact on the economy. Political developments can render economic forecasts ridiculous almost overnight.

The war itself retains the potential to affect economies across the region. The negative risk is the further escalation by Russia (already outlined in the ‘global assumptions’ section above). We do not feel qualified to estimate the likelihood of that scenario. If it does materialise, it seems reasonable to assume that it would have a significant, adverse impact on economic activity across the region. In terms of positive risks, we can still hope for a quicker-than-anticipated end to the war. However, even if the war does end sooner than expected, for example this year, it is hard to make the case that this would really be a game-changer for CESEE economies. Even for Ukraine, the benefits might be fleeting. Any ‘peace’ deal is likely to be fragile. Russia could again start firing missiles at Ukrainian infrastructure at any time. From an economic perspective, the only ‘positive’ game-changer related to the war would be a deal that sees Russia resume gas deliveries, leading to a rapid fall in prices in Europe and a big boost to demand. That scenario is highly unlikely.

Political risk in the Western Balkans is also high, not least between Serbia and Kosovo and within Bosnia and Herzegovina. These two issues remain the most intractable in the region and represent the biggest political barrier to a higher level of economic development and faster EU integration for the region. It may be that the latest increase in tensions on both issues is ‘noise’, driven by the carving-out of bargaining positions, and that actually there is hope of some progress. Nevertheless, the experience of the last two decades should remind us to stay realistic about the hopes of decisive breakthroughs in 2023.

The other main thing on our radar in terms of political risk in CESEE is the quite crowded election calendar. There is a great deal that could be said here, but the two elections that really stand out are in Poland and Turkey, the region’s second- and third-biggest economies. Both look too close to call at the moment, and the result of both will matter a great deal for economic policy in the two countries. In Turkey, whoever wins will have to deal with a difficult situation caused by ultra-loose monetary policy and very high inflation. The next government will be obliged to make some very difficult choices, and a financial crisis certainly cannot be ruled out. Meanwhile, in Poland the result will also be hugely consequential – and not only domestically, given the very different attitudes of the two main parties toward Germany and the EU in general.

2. Country updates

ALBANIA: WEAKER THOUGH RESILIENT GROWTH EXPECTED

by Isilda Mara

The economy in 2022 showed remarkable resilience, despite risks stemming from external and domestic factors. Inflation picked up, but not too dramatically – 6.7% for the year. This was thanks to a government move to impose price controls on energy and food staples. Moreover, a steep rise in exports of goods and services, remittances and foreign direct investment led to appreciation of the currency, which served to contain inflationary pressures. November saw a fall in demand for credit, following a hike in the policy rate (up from 0.5% to 2.75% last year); demand will most likely weaken further, as monetary policy normalisation continues. The positive momentum seen in public finances – due to rising inflation and the concomitant higher revenues – will favour fiscal consolidation. Labour market conditions have been improving, and the unemployment rate dropped to a historic low of 11.1% at the end of 2022. Persistent emigration is helping to maintain the flow of remittances, though labour and skills shortages are looming. The weather has become a crucial factor in how well the country copes with the bottlenecks in the energy sector. Overall, in 2023 we expect growth to hover at around 3%, before recovering slightly to above 3.5% in 2024-2025.

BELARUS: DECOUPLING FROM EUROPE LEADS TO LASTING ECONOMIC WEAKNESS

by Rumen Dobrinsky

The severe Western economic sanctions in response to Lukashenko’s support for Russia’s invasion of Ukraine have resulted in an almost total economic decoupling of Belarus from its traditional European partners. Despite the policy support measures undertaken by the government, and the easing of Belarus’s access to the Russian market, the unavoidable trade reorientation and the painful macroeconomic adjustment to the new external environment have resulted in a deep recession. According to preliminary estimates, GDP fell by 4.7% in 2022 (close to our October forecast). The recession probably bottomed out around mid-2022, since when there has been a slow improvement. Russia recently announced further support measures that may help Belarus counterbalance some of the adverse shocks. However, given the loss of important markets and suppliers of technological inputs, the prospects for the country are bleak in the medium term, with lingering economic weakness and macroeconomic instability. Even if the external environment does not deteriorate further, Belarus’s GDP in 2023 may grow by only 1%, and its rate of growth in 2024-2025 is unlikely to exceed 2%.

BOSNIA AND HERZEGOVINA: ONE STEP CLOSER TO EU MEMBERSHIP

by Selena Duraković

The economy grew by an estimated 3.5% in 2022. This was better than expected, thanks to positive momentum in private consumption and investment in the first half year. Inflation probably averaged 14.2%, fuelled by rising food and energy prices; but it is likely to moderate to 8% this year. GDP is expected to grow by only 1.5% in 2023, as high inflation and interest rates in the euro area and at home are likely to undermine consumption and exports significantly. A general election was held in October, and although the new government has not yet been formed, its overall shape can already be discerned. There are some changes in the presidency, as the Bosniak representative will not be from the nationalist SDA party. Also, the coalition of eight parties will probably shunt the SDA into opposition in both the state parliament and the parliament of the Federation of BiH. However, the Serb and Croat representatives are again from nationalist parties at both state and entity level. The EU Council decided in December 2022 to grant Bosnia and Herzegovina EU candidate status, even though the required conditions have not been met. This should bring a degree of stability and perhaps improve economic prospects over the medium term, although the nationalist parties may make it hard to enact the legislation required for further progress towards the EU.

BULGARIA: IMBALANCES LIKELY TO STAY AS SNAP ELECTIONS RESULT IN ANOTHER SPLIT PARLIAMENT

by Rumen Dobrinsky

Output performance weakened in the second half of 2022, reflecting the harsh external environment; meanwhile, GDP growth for the year as a whole is likely to have been 3% (unchanged from the autumn forecast). The early elections of October 2022 produced another scattered vote, reflecting the country's profound societal rifts. There is still no agreement among the parties on the formation of a government, so the country may face fresh elections in spring. In the absence of a regular government, parliament was unable to pass a budget for 2023: under the rules, public spending this year should follow the previous budget's guidelines. Public finances ended 2022 deep in the red, partly due to a range of extraordinary spending items that stemmed from the budgetary revision of last summer. Given this and the lack of a clear policy line, there is a risk that the abnormally elevated 2022 expenditure will be 'locked in', which could lead to a chronic fiscal gap. All components of final demand are expected to weaken further in 2023, resulting in GDP growth slowing to about 1.5%. Inflation should subside somewhat, but the carry-over effects from 2022 mean that it will remain high and could even reach double digits in 2023.

CROATIA: A NEW EURO AREA MEMBER

by Bernd Christoph Ströhm

Thanks to robust household consumption and a solid summer tourist season, the economy grew by an estimated 5.8% in 2022. Despite COVID-19 related macroeconomic headwinds and surging inflation, the government managed to introduce the euro in Croatia in January 2023, alongside joining the Schengen area. Nevertheless, the positive effects of these events – such as improved access to EU markets – will be limited. Carry-over effects from last year's record inflation (10.7%) will continue to put real incomes, external demand and investment sentiment under pressure. In addition, the role of the vital tourism sector will be subdued, owing to the marked deceleration of growth in such countries as Germany, Italy and Austria. All in all, we expect the economy to grow by 2.5% in 2023 and inflation to hover at around 6%. On a positive note, Croatia is successfully developing into an energy powerhouse in the Western Balkan region. The government is planning to expand capacities at the liquefied natural gas terminal on the Adriatic island of Krk and to turn it into a hub for the region's gas supplies.

CZECHIA: GROWTH CONSTRAINED BY STRUGGLING DOMESTIC DEMAND

by Zuzana Zavarská

At the start of 2023, the Czech economy continues to face strong pressure from high borrowing costs and double-digit inflation, though a slowdown in price growth appears to be around the corner. The deterioration in real wages is taking its toll on household consumption; this, combined with gross fixed capital formation, will act as the main drag on growth in 2023. By contrast, industry is coping better than expected with the headwinds: the automotive sector is particularly strong and is contributing positively to Czechia's exports. Still, many of the challenges from 2022 will carry over into the first half of this year; consequently, the Czech economy is expected to report close to no growth (0.4%) in 2023, followed by a modest rebound (2.4%) in 2024. In the wake of pressure from firms struggling with soaring energy prices, the government has extended its support package to cover large enterprises (alongside SMEs and households); this will limit the scope for fiscal consolidation. Inflation will return to the Czech National Bank's target range only in 2024. The policy rate will most likely remain stable at 7% over the coming months, before gradually decreasing towards the end of the year.

ESTONIA: COMBATING THE EFFECTS OF THE ENERGY CRISIS

by Maryna Tverdostup

By the end of 2022, the country's economic resilience – which had been based on strong consumption – had largely faded, while the negative effects of inflation had come to the fore. By the onset of winter, purchasing power had evaporated, private savings had shrunk, corporate profits were falling and job vacancies were declining. In terms of energy prices, however, the worst seems to have passed in autumn and, while still high, the inflation rate is on a downward path. We expect only slight economic growth of 0.9% in 2023 (largely predicated on increased government support for families and businesses), followed by a steeper recovery of 3.1% and 4.2% in 2024 and 2025, respectively. Inflation will decelerate to 8.8% in 2023, thanks largely to tighter monetary policy and higher borrowing costs. Increased government spending to support those worst affected by the cost-of-living crisis, and a personal income tax reform that will raise the tax threshold, will leave a shortfall of around 4.2% of GDP in the state budget in 2023; the budget deficit will persist in the years to come.

HUNGARY: BLEAK SHORT-TERM GROWTH PROSPECTS

by Sándor Richter

The remarkable average GDP growth of around 5% in 2022 disguises some worrying trends, particularly a marked decline in the growth rate from quarter to quarter. Overheating (induced by economic policies pursued ahead of last April's general election) resulted in a mounting macroeconomic imbalance. The restrictive measures introduced to address this imbalance coincided with a dramatic deterioration in terms of trade in the wake of the war in Ukraine, soaring inflation (due to both internal and external factors) and a low ebb in EU transfers. The deceleration in growth will yield to recession in the first two or three quarters of 2023 – a consequence of shrinking private consumption and investment, along with only a moderate expansion of exports. Annual GDP is expected to decline slightly this year. Fiscal and external balances may improve somewhat, but will not be sustainable in the medium term. Annual inflation will likely peak early in the year at about 26% and will thereafter subside gradually. In principle, the door is still open for both the EU's RRF and its traditional Cohesion Policy transfers; but if the Commission insists on its preconditions being met before any disbursement, we can expect protracted quarrels with the Hungarian government – and a delay in actual money flows (or even their repeated suspension). EU resources are already badly needed in the short term to ensure a soft landing and a return to more balanced growth.

KAZAKHSTAN: HOPES FOR INVESTMENT-DRIVEN GROWTH

by Alexandra Bykova

The economy ended 2022 with broad-based growth of around 3%, despite weak retail trade and oil production disruption. Economic sentiment was showing signs of a slight deterioration towards the end of the year. Consumption growth is expected to remain moderate in 2023, as real incomes are constrained further by stubbornly high inflation (which may be further fuelled by the increase in the minimum wage and pensions). This is in spite of the last policy rate hike in December, which was billed as marking the end of the tightening cycle. We expect real oil exports to increase this year, although the risk of disruption remains high. However, the lower global oil prices mean that oil revenues will be moderate in US dollar terms, which will increase the pressure for depreciation. Substantial public and private investment – especially in transport and logistics infrastructure projects and new manufacturing facilities under the import-substitution strategy – will be the main growth driver in 2023. We expect GDP growth to reach 3.5% in 2023 and to accelerate to 4% a year in 2024-2025, as lower inflation takes the brakes off consumption.

KOSOVO: ANOTHER DIFFICULT YEAR AHEAD TO MEET ENERGY NEEDS

by Isilda Mara

Year-on-year growth was 8.4% in Q1 2022. But thereafter the economy lost steam: for the year as a whole, it probably grew by only 3.1%. Highly dependent as Kosovo is on imports, the transmission of high international food and energy prices resulted in an 11% broad-based rise in consumer prices in 2022. The trade balance deteriorated further, although goods exports maintained their positive showing; the level of remittances continued high (close to 15% of GDP); and, against all the odds, foreign direct investment inflows recorded another good year. The expectation is that 2023 will be another difficult year in terms of the country’s energy requirements: the government extended its energy emergency measures for January, although the mild winter has helped keep heating systems (often) switched off. Wage rises following the new law on public-sector salaries – expected to come into force in February – will certainly have positive spill-overs for consumption, but will have an adverse impact on the fiscal deficit. Overall, we expect economic growth to pick up to 3.4% this year – driven mainly by domestic demand – though the downside risks remain elevated.

LATVIA: RISING CONFIDENCE IN THE RECESSION TO BE SHORT-LIVED

by Sebastian Leitner

The effects of the war in Ukraine and the decoupling of Latvia from Russian energy sources resulted in recession arriving sooner than expected, in Q3 2022. Only in the second half of 2023 will an upswing in external demand and investment result in the revival of economic activity; for the year as a whole, we expect GDP to stagnate. Public infrastructure projects that were postponed in 2022 due to rising prices will need to commence in 2023, in order to make full use of the funds from the NextGenerationEU programme. Inflation has led to a decline in the purchasing power of households, which in recent months has curbed growth in consumption; but lower inflation later this year will result in brisker retail trade. The labour market will remain tight in 2023, and the high level of vacancies will keep unemployment rates low. In the coming years, growth is projected to pick up to 3.3% in 2024 and 2.8% in 2025.

LITHUANIA: RESISTING A WAR-INDUCED RECESSION

by Sebastian Leitner

Although the economy has been buffeted by Russia’s war on Ukraine and the world-wide decline in economic activity, recent developments appear less gloomy. External demand from EU countries has picked up more strongly than expected. The government’s energy and income-support measures to assist businesses and households in 2023 and the additional public investment announced are helping to stabilise overall sentiment in the economy. The influx of refugees and immigrant workers is reducing existing tensions in the labour market, while the unemployment rate remains low. Although energy prices are again declining, we have raised our inflation forecast for 2023 to 10%, as commodity prices and wages will rise more sharply than previously expected. Lithuania is heading for a period of stagnation, rather than recession; however, the economy should manage to overcome this as early as in the second half of 2023. We expect real GDP to continue to grow – by 1.3% in 2023, followed by 2.8% in 2024 and 3% in 2025.

MOLDOVA: EMERGING FROM THE ENERGY CRISIS?

by Gábor Hunya

The economy contracted sharply in the second half of 2022 and will only emerge slowly from recession in 2023. Eroding real incomes, falling private consumption and declining investment are all consequences of the power shortage and the surging prices of energy and food. The government has passed the elevated cost of energy onto households, though it has provided some compensation to those in greatest need. International and bilateral donors almost trebled their financial support in 2022 to about 5% of GDP, which enabled the country to survive. Similar donor efforts are expected in 2023; but in addition, external conditions may improve and the harvest could be better. Lower gas prices on the international markets may bring some relief, but that depends on Gazprom sticking to the agreed price mechanism. The country thus remains vulnerable to Russian policy on gas supplies, since replacing Russian imports with Western sources will take over a year to complete. We expect a recovery in industrial and agricultural output and a moderation of inflation and interest rates to help the economy in the second half of 2023. The years ahead could see an upturn, provided the situation in Ukraine improves and Moldova makes progress in implementing reforms designed to bring it closer to EU standards.

MONTENEGRO: GROWING, DESPITE INSTABILITY

by Nina Vujanović

In 2022, Montenegro experienced its highest inflation for 20 years – an average of 13%. Yet private consumption still grew, thanks to a tax reform that boosted household income and a growth in tourism, which bounced back nearly to pre-pandemic levels. This led to GDP growth of over 5%. The fiscal deficit widened significantly in 2022 and will likely only narrow gradually during the forecast period, due to higher budgetary spending on health, social security and the public sector. We predict a more modest GDP growth rate in 2023 of 2.6%, supported by growth in tourism and the energy sector (where further investments are planned). Private consumption will dry up as high inflation continues into 2023, due to the carry-over effects from last year and the limited fiscal space left to control it. The country still faces unprecedented institutional instability, owing to the dysfunctional constitutional court and the caretaker government. EU officials have already stated that this could lead to the suspension of talks over EU accession. Presidential and parliamentary elections this year may put the country back on a more even road; or they may trap it in the current vicious circle.

NORTH MACEDONIA: FDI LIFTING THE ECONOMY?

by Branimir Jovanović

Inflation began to moderate in Q4 2022, but it still averaged 14.2% for the year as a whole – the highest figure since 1995. Despite its adverse effect on real incomes and consumer confidence, the economy performed better than expected in the second half of the year. This was thanks to strong FDI inflows (6.5% of GDP in Q3): in the first nine months of the year, they averaged 5% of GDP, more than double the previous year's level. These good results mean that we have revised our GDP growth estimate for 2022 upwards by 0.5 percentage points (pp), to 1.5%. This year will continue in similar vein, with prices keeping on rising (albeit at a slower pace). Inflation will average 10%, causing real incomes to decline for the second year in a row. The central bank will maintain its restrictive monetary policy, keeping the policy interest rate in the vicinity of 5%. As a result, GDP growth will remain anaemic, at around 1%. This is still an improvement of 0.4 pp over the previous forecast, thanks to the better-than-expected results from the second half of 2022 and the relatively mild winter. A potentially positive factor for the economy could be FDI: if it continues to perform as strongly as in 2022, the economy could expand by more than the forecast 1%.

POLAND: A SLOWDOWN IN THE MAKING

by Adam Żurawski

Throughout 2022, cost and markup inflation outstripped the rise in nominal wages, thus eroding the real disposable income of households and private consumption spending. In parallel, tighter monetary policy kept the demand for loans sluggish, which additionally suppressed investment growth. A gradual and moderate disinflation in 2023 – a consequence of the generally expected stabilisation of the world energy market – could lead to a measured decline in official interest rates. However, this is unlikely to spur investment growth overnight. Also, with high (albeit falling) inflation, any recovery in real wages will come with a delay. Positive developments (a decline in interest rates and a bridging of the wage-price gap) will take some time before they have any positive impact on the real economy. Because of near-stagnant domestic demand, we expect 2023 to be fairly weak in terms of output growth and capital formation. At the same time, unemployment will stay quite low and the external balances close to zero. Only in 2024, with greater investment activity and recovering household disposable income, will growth be appreciably stronger.

ROMANIA: DECELERATION DESPITE AN ENGINE CHANGE

by Gábor Hunya

The household consumption-based economic boom has given way to slower growth, driven mainly by fixed capital formation. The erosion of purchasing power – a result of soaring inflation and sluggish wage growth – will persist in the first half of 2023. Inflation may start to fall by the middle of the year, as import prices stabilise and agricultural production recovers from last year's slump. The country's slight exposure to the Russian economy and its limited reliance on energy imports overall should help maintain stability. The moderate fiscal consolidation planned may not depress the economy and should allow the energy subsidies to continue. The current account deficit will stay high, but external financing needs will shrink somewhat. The central bank is managing to keep the exchange rate stable, which helps in the fight against inflation but damages the competitiveness of Romanian products. Elevated FDI and EU transfers will continue to play a crucial role in financing fixed investments. Romania is on track to meet the conditions for the disbursement of EU funds, though delays could possibly emerge due largely to the sluggish implementation of projects. In 2023, Romania will take further steps to strengthen its energy self-sufficiency; will continue to benefit from the trade and transport re-direction from Ukraine and Moldova; and will most probably gain access to the Schengen area, which will reduce transaction costs.

RUSSIA: ENERGY EXPORTS CRIPPLED BY SANCTIONS

by Vasily Astrov

In Q4 2022, economic contraction is likely to have intensified following the announcement of military mobilisation and new export restrictions. Still, for the year as a whole, the recession will probably not have exceeded 2.5%, as the effects of Western sanctions were mitigated by successful financial stabilisation measures, a reorientation of trade towards Asia, and high energy prices and exports. However, more recently energy exports have been hit by new EU restrictions (imposed on 5 December): an oil import embargo and a price cap on oil shipped to third countries – arguably the most painful Western sanctions imposed on Russia so far. Although, in volume terms, oil exports have recovered swiftly, the resulting price decline has been spectacular: in the four weeks up to mid-January, the average price of Russian Urals plunged to USD 47 per barrel, with the discount to Brent reaching a record 43%. Moreover, since mid-2022 Russia has been reining in its gas pipeline exports to Europe, ostensibly for political reasons. With yet another EU embargo (on oil products) coming into force on 5 February, falling energy exports will be decisive in pushing the economy into yet another recession. They will also hit government revenue, some 40% of which comes from the energy sector, though the budget deficit will probably stay in low single digits over the forecast horizon. The economy is likely to bottom out by 2024; that will be followed by years of near stagnation, as access to new technology is severely hampered and as some of the most highly qualified workers emigrate (if they have not already done so).

SERBIA: THE PRICE OF CLOSE RELATIONS WITH RUSSIA

by Branimir Jovanović

Inflation moderated in Q4 2022, to average 11.9% for the whole year. GDP grew by 2.3% in 2022, with a slowdown in the latter half year – a result of stagnation in total investment. This was principally due to lower FDI inflows, which declined to 6% of GDP over the first three quarters of 2022 (from 7.3% in the previous five years). A significant factor in this decline was the reduction in FDI from the EU, whose share in Serbia's FDI fell to 32% – roughly half of that seen in previous years. This can be attributed to uncertainty surrounding Serbia's position on the war in Ukraine and its decision to remain close to Russia. For 2023, we forecast inflation to average 9% and GDP to expand by 1.5%. The main concerns lie in the realm of politics: as well as its close ties with Russia, Serbia faces a significant challenge in relation to the status of Kosovo, a source of tension over recent months. Bound up with these two factors is the country's progress toward EU accession, which was not very rapid in 2022. If Serbia can navigate these challenges wisely – by finding a good resolution to the Kosovo issue, aligning itself with the EU and accelerating its accession process – its economic prospects are bright.

SLOVAKIA: OUTLOOK THREATENED BY POLITICAL TURMOIL

by Doris Hanzl-Weiss

On 1 January 2023, amidst some turbulence, Slovakia marked its 30th birthday. In 2022, weakening household consumption meant that GDP year-on-year growth rates headed south: from 2.9% in Q1 to 1.3% in Q2 and 1.4% in Q3. The important automotive industry contracted by about 2% in 2022. While the semiconductor shortage will still hamper the sector in 2023, there are slightly better prospects ahead. In 2023, real GDP is expected to rise by only 0.6% because of the war in Ukraine, the energy crisis, continued high inflation and political uncertainty (the Slovak government fell in December). Nevertheless, it proved possible to pass the 2023 budget by the end of the year – an essential step to support households, businesses and municipalities in countering the high energy prices. The budget deficit is expected to reach 6.4% of GDP, although household consumption may still decline. On the positive side, the increased influx of EU funds should provide growth impetus, although the political chaos could undermine their successful drawing. In 2024 and 2025, growth should pick up to 2.3% and 2.4%, respectively, backed by a recovery in household consumption and improved trade performance.

SLOVENIA: DESPITE SUBDUED PROSPECTS, STILL AHEAD OF THE EU AVERAGE

by Niko Korpar

Although we expect growth to slow significantly in 2023, compared to the previous two years, it will still be well above the EU average. The war in Ukraine and inflation will have a profoundly negative impact on Slovenia, keeping growth very subdued at least in Q1 2023, with private spending well down on 2022. The government has introduced a record high, pro-investment budget for 2023, so fiscal spending will contribute to growth. Exports will keep contracting until Q2 2023, and the growth of imports is again expected to exceed that of exports this year. Inflation will slow somewhat, but will still reach 6.5% in 2023, fuelled mainly by price hikes for food and services. Having signed a gas provision contract with Algeria in November 2022, Slovenia is close to fully replacing imports of Russian gas. The government has implemented various measures to support struggling businesses and households, including a cap on electricity prices for SMEs. Should foreign demand (particularly German) remain robust, industrial output will grow by a solid 2.2% this year.

TURKEY: FOOT TO THE FLOOR AS ELECTION APPROACHES

by Richard Grieveson

The economy ended 2022 relatively strong, propelled by ultra-loose monetary policy. Deeply negative real interest rates – in stark contrast to the large-scale coordinated monetary tightening across much of the rest of the world – have delivered a short-term boost to credit expansion and real economic growth. However, they have also led Turkey to have easily the highest rate of inflation in CESEE, which has meant significant challenges for households and firms. Exports performed well in 2022, supported by a post-COVID tourism boom and a weaker lira. However, the current account deficit has widened and continues to be financed largely by ‘net errors and omissions’, making it difficult to assess the sustainability of the financing gap. We expect the economy to grow by about 3% in 2023, and for fiscal and monetary policy to remain loose at least until the general election scheduled for May 2023. So long as the central bank keeps interest rates deep in negative territory, the exchange rate will depreciate and inflation will stay at eye-watering levels. The election result is currently too close to call; but whoever wins, we expect the post-election period to be characterised by higher interest rates to bring inflation back under control.

UKRAINE: DEFYING RUSSIA’S BOMBS

by Olga Pindyuk

Russia’s relentless missile and drone attacks, which started in October 2022, have caused significant damage to Ukraine’s critical infrastructure, and the resulting power outages greatly hampered economic activity in Q4 2022. For the year as a whole, the mild winter and the good performance of the agricultural sector ensured a smaller economic decline than had previously been expected (-30%); however, the outlook for 2023 has deteriorated. Although most businesses have adjusted to the power outages by installing autonomous power generators and by changing their work patterns, their performance is being adversely affected by the rising production costs and uncertainty. Given the scale of the damage to the infrastructure, Ukraine’s external financing needs are likely to be much higher than planned in 2023, and may prove difficult to secure. We assume that the hot phase of the war will be over by the end of 2023 and that full-scale reconstruction of the economy will be able to start then, allowing growth to accelerate to about 8% per year in 2024-2025.

3. Index of subjects – January 2022 to January 2023

Albania	economic situation	2023/1, 2022/7-8
Austria	economic impact of the war in Ukraine	2022/7-8
Belarus	economic situation	2023/1, 2022/7-8
Bosnia and Herzegovina	economic situation	2023/1, 2022/7-8
Bulgaria	economic situation	2023/1, 2022/7-8
China	FDI from the EU	2022/3
Croatia	economic situation	2023/1, 2022/7-8
Czechia	economic situation	2023/1, 2022/7-8
Estonia	economic situation	2023/1, 2022/7-8
Hungary	economic situation	2023/1, 2022/7-8
Kazakhstan	economic situation	2023/1, 2022/7-8
Kosovo	economic situation	2023/1, 2022/7-8
Latvia	economic situation	2023/1, 2022/7-8
Lithuania	economic situation	2023/1, 2022/7-8
Moldova	economic situation	2023/1, 2022/7-8
Montenegro	economic situation	2023/1, 2022/7-8
North Macedonia	economic situation	2023/1, 2022/7-8
Poland	economic situation	2023/1, 2022/7-8
Romania	economic situation	2023/1, 2022/7-8
Russia	economic effects of mobilisation	2022/10
	economic situation	2023/1, 2022/7-8
	role in EU energy crisis	2022/10
	trade and value chain integration with the EU and EU-CEE	2022/4
	war economy	2022/3
Serbia	economic situation	2023/1, 2022/7-8
Slovakia	economic situation	2023/1, 2022/7-8
Slovenia	economic situation	2023/1, 2022/7-8
Turkey	economic situation	2023/1, 2022/7-8
Ukraine	economic situation	2023/1, 2022/7-8
	fiscal situation	2022/10
	trade and value chain integration with the EU and EU-CEE	2022/4
	war refugees	2022/4

(continued on the next page)

multi-country articles and statistical overviews

business services sector in CESEE 2022/2
current developments: CESEE 2023/1, 2022/7-8
digital endowments and comparative advantage 2022/6
economic and environmental convergence of EU regions 2022/9
economic transformation: thirty years 2022/9
energy crisis and phasing out of coal in EU regions 2022/9
energy dependence on Russia and inflation in the EU 2022/12
EU economic policy 2022/6
EU institutions 2022/12
FDI in CESEE: recent trends 2022/11, 2022/5
functional specialisation in CESEE 2022/11
great disinflation hypothesis 2022/4
inflation and monetary policy response 2022/2
political risks: CESEE 2022/1
public debt and short-term interest rates 2022/12
semiconductor shortages in CESEE 2022/2

The *wiiw Monthly Report* summarises wiiw's major research topics and provides current statistics and analyses exclusively to subscribers to the wiiw Service Package. This information is for the subscribers' internal use only and may not be quoted except with the respective author's permission and express authorisation. Unless otherwise indicated, all authors are members of the Vienna Institute's research staff or research associates of wiiw.

Economics editors: Vasily Astrov and Richard Grieveson

IMPRESSUM

Herausgeber, Verleger, Eigentümer und Hersteller:
Verein „Wiener Institut für Internationale Wirtschaftsvergleiche“ (wiiw),
Wien 6, Rahlgasse 3

ZVR-Zahl: 329995655

Postanschrift: A 1060 Wien, Rahlgasse 3, Tel: [+431] 533 66 10, Telefax: [+431] 533 66 10 50
Internet Homepage: www.wiiw.ac.at

Offenlegung nach § 25 Mediengesetz: Medieninhaber (Verleger): Verein "Wiener Institut für Internationale Wirtschaftsvergleiche", A 1060 Wien, Rahlgasse 3. Vereinszweck: Analyse der wirtschaftlichen Entwicklung der zentral- und osteuropäischen Länder sowie anderer Transformationswirtschaften sowohl mittels empirischer als auch theoretischer Studien und ihre Veröffentlichung; Erbringung von Beratungsleistungen für Regierungs- und Verwaltungsstellen, Firmen und Institutionen.

wiiw

wiiw.ac.at

https://wiiw.ac.at/p-6454.html