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Monthly Report

Light at the End of the Tunnel?

Economic Forecasts for Eastern Europe for 2021-23

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

Light at the End of the Tunnel?

Economic Forecasts for Eastern Europe for 2021-23

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Executive summary

Q1 2021 saw a very strong COVID-19 pandemic wave right across Europe. On average, CESEE was hit even harder than the rest of Europe. Still, the economic results in the region from Q1 were better than expected, and better than in the rest of Europe. Although GDP declined in most of the economies, on average (unweighted) it increased by 0.4%, on a year-on-year basis.

This may be partially due to the relatively mild restrictions in CESEE in Q1, but it also suggests that economies have learned to live with COVID-19. The toll that COVID-19 and the ensuing restrictions are taking on the economy is now smaller than before. People and companies have adapted their behaviour to the new circumstances and have found ways to continue with 'business as usual' even during severe pandemic waves.

Investment was the main driver of the relatively good economic results from Q1. Gross fixed capital formation grew in 12 of the 19 CESEE economies for which we have data, and the (unweighted) average year-on-year growth was 5%. This was similar to the growth in the pre-pandemic period, as companies resumed implementing the projects that they postponed in 2020, foreseeing a rosier future.

Exports of goods and services also contributed, growing in 13 of the 19 economies with available data, by 1.4% on average (unweighted). This growth came after four quarters of decline and was driven by the strong recovery in the two biggest world economies – the US and China.

Government consumption also grew, on average by 2.3% (unweighted), but this was much less than in the Western European economies, where the corresponding growth was 5.3%. Limited fiscal space, as well as fiscal conservatism, contributed to this.

On the other hand, household consumption, the biggest component of GDP, declined in Q1 by 0.6% on average (unweighted), due to the strong pandemic wave and government restrictions. Still, that decline was the smallest seen in the last four quarters.

Labour market scarring was visible in Q1 2021, as employment was down on a year-to-year basis in 12 of the 13 CESEE economies that have consistent data. It is possible that these numbers are distorted by the powerful COVID-19 wave and the government containment measures in this period, which kept some businesses closed for a while; but there are definitely indications that the pandemic has left many people without a job.

Inflation is back. Average inflation (unweighted) in CESEE in May 2021 reached 4.5% – a level unseen since late 2015 – with only three economies recording inflation rates of below 2%. The main reason is the global rise in energy and food prices; but core inflation is also up, suggesting that higher energy prices are translating into higher overall prices. Supply-chain disruptions are also contributing, as are demand-pull factors, stemming from the faster recovery. In certain countries exchange rate depreciation is also playing a role.

Foreign direct investment is pouring into the region, and in Q1 averaged 6.5% of GDP (unweighted), which is on a par with the best pre-pandemic years. This may be a one-off, as foreign investors are reinstating the projects they postponed during 2020. But it may also be indicative of possible near-shoring trends in the region.

Bank lending remains robust, but is shifting to households. Government-sponsored credit lines, credit guarantees and other similar schemes that supported business lending throughout 2020 are beginning to expire. But credit demand from households is rising, both for mortgages and for consumption, and banks are turning towards that segment of the market.

The better-than-expected developments in the first quarter of the year have led us to upgrade our GDP growth forecasts for 2021 for 20 of the 23 CESEE economies. We expect the region as a whole to grow by 4.2% on a weighted average basis, more than compensating for the setback of last year (-2.3%). Growth in the remainder of the year will be driven primarily by household consumption, which will boom as the pandemic moderates. Business investment will also contribute (as companies resume postponed projects), as will exports (driven by a favourable external environment). The economic recovery is likely to improve labour markets as well.

We have also revised upwards our inflation forecasts, but we consider the factors that are fuelling inflation to be transitory, and so predict that it will settle down by the second half of 2022. The higher inflation and the improved economic activity will lead central banks to consider raising their policy rates in 2021 – six have already done so in recent months, and we expect several more to follow suit. Still, we do not expect these hikes to have great adverse effect on economic or credit activity.

The risks surrounding the forecasts are primarily to the downside. The first refers to the new pandemic wave that will almost certainly come by the end of the year, as vaccination rates in the region are generally rather low. Still, we are of the opinion that it will not wreak such economic damage as previous waves, since the economies have largely adapted to the COVID-19 reality. It will slow economic activity, but will not cause recession. The second risk refers to the possibility of premature fiscal consolidation, due to the better-than-expected economic growth. If governments pursue this line, it will retard the recovery.

Keywords: CESEE, economic forecast, Central and Eastern Europe, Southeast Europe, Western Balkans, EU, euro area, CIS, coronavirus, COVID-19, pandemic, restrictions, lockdowns, Stringency Index, EU Recovery and Resilience Facility, private consumption, public consumption, credit, investment, exports, FDI, labour markets, unemployment, inflation, exchange rates, monetary policy, fiscal policy, near-shoring

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

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Cut-off date for historical data and forecasts: 29 June 2021. 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
COVAX	COVID-19 Vaccines Global Access
CPI	consumer price index
EA	euro area 19 countries
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GVA	Gross Value Added
IMF	International Monetary Fund
LFS	Labour Force Survey
NCU	national currency units
OPEC	Organization of the Petroleum Exporting Countries
pp	percentage points
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

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		

EA19 **Euro area**

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

June 2021 interim forecast update

Table 1 / OVERVIEW 2019-2020 AND OUTLOOK 2021-2023

		GDP real change in % against prev. year					Consumer prices average change in % against prev. year				
				Forecast					Forecast		
		2019	2020	2021	2022	2023	2019	2020	2021	2022	2023
BG	Bulgaria	3.7	-4.2	3.0	3.5	3.8	2.5	1.2	2.5	2.5	2.0
CZ	Czechia	2.3	-5.6	3.0	3.9	3.3	2.6	3.3	2.5	2.2	2.0
EE	Estonia	5.0	-2.9	4.2	4.5	4.3	2.3	-0.6	2.3	2.7	2.2
HR	Croatia	2.9	-8.0	5.1	5.3	4.0	0.8	0.0	1.6	1.5	1.5
HU	Hungary	4.6	-5.0	4.9	4.5	3.9	3.4	3.4	4.2	3.5	3.5
LT	Lithuania	4.3	-0.9	3.0	4.0	3.5	2.2	1.1	2.0	2.7	3.3
LV	Latvia	2.0	-3.6	3.2	5.0	3.8	2.7	0.1	1.7	2.5	3.5
PL	Poland	4.7	-2.7	4.0	4.5	4.4	2.1	3.7	3.5	3.0	2.5
RO	Romania	4.1	-3.9	5.2	4.5	4.5	3.9	2.3	3.5	3.3	3.0
SI	Slovenia	3.2	-5.5	4.0	4.3	3.4	1.7	-0.3	1.7	1.7	1.6
SK	Slovakia	2.5	-4.8	4.0	4.4	3.9	2.8	2.0	2.2	2.0	2.0
	EU-CEE11 1)2)	*4.0*	*-3.9*	*4.1*	*4.4*	*4.1*	*2.6*	*2.7*	*3.1*	*2.8*	*2.6*
	EA19 3)	*1.3*	*-6.5*	*4.4*	*4.2*	*2.1*	*1.2*	*0.3*	*1.9*	*1.5*	*1.4*
	EU27 3)	*1.6*	*-6.1*	*4.5*	*4.2*	*2.5*	*1.4*	*0.7*	*2.1*	*1.7*	*1.6*
AL	Albania	2.1	-3.8	5.0	4.4	4.2	1.4	1.6	2.1	2.4	2.6
BA	Bosnia and Herzegovina	2.8	-4.3	2.9	3.3	3.3	0.6	-1.1	1.0	1.3	1.2
ME	Montenegro	4.1	-15.2	6.5	6.0	4.0	0.4	-0.3	1.7	1.7	1.5
MK	North Macedonia	3.2	-4.5	4.1	3.4	3.2	0.8	1.2	2.5	2.2	2.0
RS	Serbia	4.2	-1.0	6.0	4.2	4.2	1.7	1.6	3.0	2.6	2.2
XK	Kosovo	4.8	-3.0	5.3	4.7	4.4	2.7	0.2	1.5	1.7	2.0
	WB6 1)2)	*3.6*	*-3.1*	*5.1*	*4.1*	*3.9*	*1.4*	*0.9*	*2.3*	*2.2*	*2.0*
TR	Turkey	0.9	1.8	5.8	3.4	3.5	15.2	12.3	16.0	12.0	10.0
BY	Belarus	1.4	-0.9	2.5	1.6	2.1	5.6	5.5	8.0	7.0	7.0
KZ	Kazakhstan	4.5	-2.6	3.5	4.1	4.4	5.3	6.7	7.2	6.2	5.8
MD	Moldova	3.7	-7.0	7.0	4.5	4.0	4.8	3.8	3.6	4.2	4.5
RU	Russia	2.0	-3.0	3.5	3.0	2.6	4.5	3.4	6.2	4.4	3.2
UA	Ukraine	3.2	-4.0	4.3	3.5	3.5	7.9	2.7	8.3	6.0	5.5
	CIS4+UA 1)2)	*2.4*	*-3.0*	*3.6*	*3.1*	*2.8*	*5.0*	*3.7*	*6.5*	*4.8*	*3.8*
	V4 1)2)	*4.1*	*-3.8*	*3.9*	*4.4*	*4.1*	*2.4*	*3.4*	*3.3*	*2.8*	*2.5*
	BALT3 1)2)	*3.9*	*-2.1*	*3.3*	*4.4*	*3.8*	*2.4*	*0.4*	*2.0*	*2.6*	*3.1*
	SEE9 1)2)	*3.8*	*-4.1*	*4.9*	*4.4*	*4.2*	*2.8*	*1.6*	*2.9*	*2.7*	*2.5*
	CIS3+UA 1)2)	*3.5*	*-3.1*	*3.8*	*3.5*	*3.7*	*6.5*	*4.7*	*7.7*	*6.2*	*5.8*
	non-EU12 1)2)	*2.0*	*-1.6*	*4.3*	*3.2*	*3.1*	*7.7*	*6.1*	*9.1*	*6.8*	*5.5*
	CESEE23 1)2)	*2.6*	*-2.3*	*4.2*	*3.6*	*3.4*	*6.2*	*5.1*	*7.3*	*5.6*	*4.6*

.

Table 1 / OVERVIEW 2019-2020 AND OUTLOOK 2021-2023 (contd.)

		Unemployment (LFS) rate in %, annual average					Current account in % of GDP					Fiscal balance in % of GDP				
				Forecast					Forecast					Forecast		
		2019	2020	2021	2022	2023	2019	2020	2021	2022	2023	2019	2020	2021	2022	2023
BG	Bulgaria	4.2	5.1	5.0	4.5	4.5	1.8	-0.7	-1.2	-1.0	-0.8	2.1	-3.4	-3.5	-2.5	-2.0
CZ	Czechia	2.0	2.6	3.2	3.2	2.9	0.3	3.6	2.2	2.0	1.5	0.3	-6.2	-6.5	-4.5	-3.0
EE	Estonia	4.4	6.8	6.5	5.5	4.7	2.0	-0.6	-0.3	0.1	0.4	0.1	-4.9	-6.0	-4.0	-2.5
HR	Croatia	6.6	7.5	7.0	6.8	6.8	2.7	-1.1	0.6	0.5	0.6	0.3	-7.4	-4.0	-3.0	-2.5
HU	Hungary	3.4	4.3	4.3	4.0	4.0	-0.5	-0.1	0.3	0.0	0.5	-2.1	-8.1	-6.5	-4.5	-3.5
LT	Lithuania	6.3	8.5	8.5	7.3	6.5	3.3	8.3	5.1	4.2	3.3	0.5	-7.4	-6.0	-3.0	-2.0
LV	Latvia	6.3	8.1	8.0	6.8	6.0	-0.6	3.0	1.6	0.4	0.1	-0.6	-4.5	-7.5	-3.0	-1.5
PL	Poland	3.3	3.2	4.0	4.0	3.8	0.5	3.5	2.5	1.7	1.5	-0.7	-7.0	-5.5	-4.0	-3.0
RO	Romania	3.9	5.0	4.8	4.5	4.0	-4.9	-5.2	-5.2	-4.6	-4.0	-4.4	-9.2	-7.5	-5.0	-4.0
SI	Slovenia	4.5	5.0	5.2	4.5	4.3	5.6	7.1	6.3	5.9	5.6	0.4	-8.4	-5.2	-3.3	-0.8
SK	Slovakia	5.8	6.7	7.6	7.4	7.0	-2.7	-0.4	-0.1	-0.1	-0.2	-1.3	-6.1	-7.1	-5.1	-4.1
	EU-CEE11 1)2)	*3.8*	*4.4*	*4.8*	*4.5*	*4.3*	*-0.2*	*1.5*	*0.8*	*0.5*	*0.5*	*-1.0*	*-7.1*	*-6.1*	*-4.2*	*-3.1*
	EA19 3)	*7.6*	*7.9*	*8.2*	*7.9*	*7.4*	*3.2*	*3.0*	*2.5*	*2.5*	*2.5*	*-0.6*	*-7.2*	*-7.1*	*-3.4*	*-2.6*
	EU27 3)	*6.7*	*7.1*	*7.4*	*7.1*	*6.6*	*3.1*	*3.0*	*2.5*	*2.5*	*2.5*	*-0.5*	*-6.9*	*-6.9*	*-3.2*	*-2.5*
AL	Albania	11.5	11.7	11.4	11.2	11.0	-7.9	-8.8	-7.8	-7.2	-6.7	-1.9	-6.8	-4.5	-3.5	-2.0
BA	Bosnia and Herzegovina	15.7	15.9	15.8	15.0	14.5	-3.1	-3.2	-3.6	-3.8	-4.1	1.9	-4.0	-2.0	-0.5	0.2
ME	Montenegro	15.1	17.9	17.5	16.0	16.0	-14.3	-26.0	-23.5	-18.6	-16.1	-2.0	-10.0	-5.4	-4.0	-3.0
MK	North Macedonia	17.3	16.4	16.0	15.5	15.0	-3.3	-3.5	-3.3	-3.7	-3.7	-2.2	-8.2	-5.0	-3.5	-2.5
RS	Serbia	10.4	9.0	8.0	7.5	7.0	-6.9	-4.3	-5.0	-6.0	-6.6	-0.2	-8.1	-4.0	-3.0	-2.0
XK	Kosovo	25.7	26.5	26.0	25.0	24.5	-5.7	-7.0	-6.5	-6.2	-5.7	1.0	-1.8	-1.0	-0.5	1.0
	WB6 1)2)	*13.4*	*13.1*	*12.2*	*11.7*	*11.0*	*-6.2*	*-5.7*	*-5.9*	*-6.1*	*-6.3*	*-0.3*	*-6.9*	*-3.7*	*-2.6*	*-1.5*
TR	Turkey	13.7	13.2	13.0	12.3	11.1	0.9	-5.2	-3.8	-3.6	-3.5	-3.2	-2.8	-3.5	-2.5	-2.5
BY	Belarus	4.2	4.0	4.1	4.2	4.3	-1.9	-0.4	0.8	0.4	0.0	2.4	-1.7	-2.0	-2.0	-1.0
KZ	Kazakhstan	4.8	4.9	4.9	4.8	4.8	-4.0	-3.7	-2.7	-1.8	-0.9	-1.8	-4.0	-3.5	-2.5	-2.0
MD	Moldova	5.1	3.8	4.0	3.5	3.0	-9.3	-6.7	-8.5	-8.4	-8.0	-1.4	-8.5	-5.0	-4.0	-3.0
RU	Russia	4.6	5.8	5.2	4.9	4.7	3.8	2.3	3.2	3.6	3.6	1.9	-4.0	-1.0	0.5	1.0
UA	Ukraine	8.2	9.5	9.0	8.0	8.0	-2.7	4.0	0.5	-1.0	-3.0	-2.2	-5.4	-5.0	-3.0	-2.5
	CIS4+UA 1)2)	*5.2*	*6.2*	*5.7*	*5.4*	*5.2*	*2.4*	*1.7*	*2.3*	*2.5*	*2.5*	*1.3*	*-4.1*	*-1.6*	*-0.2*	*0.4*
	V4 1)2)	*3.3*	*3.5*	*4.2*	*4.2*	*4.0*	*0.0*	*2.7*	*1.9*	*1.4*	*1.2*	*-0.7*	*-6.9*	*-6.0*	*-4.3*	*-3.2*
	BALT3 1)2)	*5.9*	*8.0*	*7.9*	*6.7*	*5.9*	*1.9*	*4.5*	*2.7*	*2.1*	*1.7*	*0.1*	*-5.9*	*-6.4*	*-3.3*	*-2.0*
	SEE9 1)2)	*7.4*	*8.1*	*7.5*	*7.1*	*6.6*	*-3.3*	*-4.2*	*-4.1*	*-3.9*	*-3.6*	*-1.9*	*-7.7*	*-5.7*	*-3.9*	*-3.0*
	CIS3+UA 1)2)	*6.6*	*7.2*	*7.0*	*6.4*	*6.4*	*-3.3*	*-0.3*	*-1.2*	*-1.4*	*-1.8*	*-1.3*	*-4.3*	*-3.9*	*-2.7*	*-2.1*
	non-EU12 1)2)	*7.5*	*8.0*	*7.6*	*7.2*	*6.7*	*1.7*	*-0.4*	*0.3*	*0.5*	*0.5*	*0.1*	*-3.9*	*-2.2*	*-0.9*	*-0.5*
	CESEE23 1)2)	*6.6*	*7.1*	*6.9*	*6.5*	*6.0*	*1.0*	*0.3*	*0.5*	*0.5*	*0.5*	*-0.3*	*-5.1*	*-3.7*	*-2.1*	*-1.5*

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: 29 June 2021.

Table 2 / Policy rate and exchange rate for selected CESEE countries: overview 2019-2020 and outlook 2021-2023

		Policy rate eop, p.a.					Exchange rate NCU/EUR average				
				Forecast					Forecast		
		2019	2020	2021	2022	2023	2019	2020	2021	2022	2023
AL	Albania	1.00	0.50	0.50	0.50	0.50	123.0	123.8	123.0	122.5	122.0
BY	Belarus	9.00	7.75	9.00	9.00	8.00	2.334	2.789	3.0	3.2	3.4
CZ	Czechia	2.00	0.25	0.50	0.75	0.75	25.7	26.5	26.00	25.75	25.50
HR	Croatia	3.00	3.00	3.00	3.00	3.10	7.418	7.538	7.5	7.5	7.5
HU	Hungary	0.90	0.60	1.20	1.50	1.50	325.3	351.3	359	363	366
KZ	Kazakhstan	9.25	9.00	9.00	9.00	8.50	428.5	471.4	510	515	520
MD	Moldova	5.50	2.65	2.80	3.00	3.50	19.7	19.7	21	22	23
MK	North Macedonia	2.25	1.50	1.50	1.75	2.00	61.5	61.7	61.7	61.7	61.7
PL	Poland	1.50	0.10	0.10	0.10	0.50	4.298	4.443	4.5	4.4	4.4
RO	Romania	2.50	1.50	1.75	2.00	2.25	4.745	4.838	4.95	5.05	5.15
RS	Serbia	2.25	1.00	1.50	2.00	2.50	117.9	117.6	117.6	117.0	116.0
RU	Russia	6.25	4.25	6.25	6.50	6.00	72.5	82.4	89	87	87
TR	Turkey	12.00	17.00	14.00	12.00	10.00	6.358	8.055	8.9	9.7	10.3
UA	Ukraine	13.50	6.00	8.00	7.00	6.50	29.0	30.8	33.4	34.5	35.7

Source: wiiw, forecasts by wiiw. Cut-off date for historical data and forecasts: 29 June 2021.

Regional overview

BY BRANIMIR JOVANOVIĆ[1]

GLOBAL ECONOMY BACK ON TRACK

The global economy seems to be recovering well from the COVID-19 pandemic. In Q1 2021, the US economy grew by 1.6% year on year, while China's expanded by 18.3%, both in line with expectations. The euro area and the EU contracted by 0.6% and 0.4%, respectively, which was less than in the previous period, despite the severe wave of COVID-19 in the first quarter. **As a consequence, the outlook for the euro area and the EU has improved since our spring forecast, for both 2021 and 2022.** A number of major forecasters have revised their projections significantly upwards in recent months. And so do we (Table 3). **For 2021, we now forecast that the euro area will grow by 4.4% and the EU by 4.5%** – 0.7 and 0.3 percentage points (pp) up on the previous forecast. For 2022, we forecast growth of 4.2% for both, which is an improvement of 0.5 pp and 0.1 pp, respectively.

Table 3 / Current projections for the euro area and the EU, and changes with respect to the previous forecast

	Euro area			EU		
	2021	2022	2023	2021	2022	2023
Real GDP growth, % per year	4.4	4.2	2.1	4.5	4.2	2.5
CPI, % per year	1.9	1.5	1.4	2.1	1.7	1.6
Unemployment rate, %	8.2	7.9	7.4	7.4	7.1	6.6
Current account, % of GDP	2.5	2.5	2.5	2.5	2.5	2.5
Fiscal balance, % of GDP	-7.1	-3.4	-2.6	-6.9	-3.2	-2.5
EUR/USD	1.19	1.19	1.19			
Brent crude, USD per barrel	65	60	60			
Change since spring 2021	**Euro area**			**EU**		
	2021	2022	2023	2021	2022	2023
Real GDP growth, % per year	0.7	0.5	0.1	0.3	0.1	0.1
CPI, % per year	0.8	0.3	0.0	0.8	0.3	0.0
Unemployment rate, %	-0.7	-0.5	-0.7	-0.8	-0.6	-0.8
Current account, % of GDP	-0.5	-0.5	-0.5	-0.4	-0.4	-0.4
Fiscal balance, % of GDP	n/a	n/a	n/a	n/a	n/a	n/a
EUR/USD	0.04	0.04	n/a			
Brent crude, USD per barrel	0	0	n/a			

Source: wiiw projections.

Inflation forecasts are also up, on the grounds of the upturn seen in recent months. Year-on-year inflation in May reached 2.0% in the euro area and 2.3% in the EU, primarily due to higher energy prices. We have upgraded our 2021 inflation forecasts for the euro area and the EU by 0.8 pp, to 1.9% and 2.1%,

1 The author thanks Vasily Astrov and Richard Grieveson for their valuable comments on the first draft.

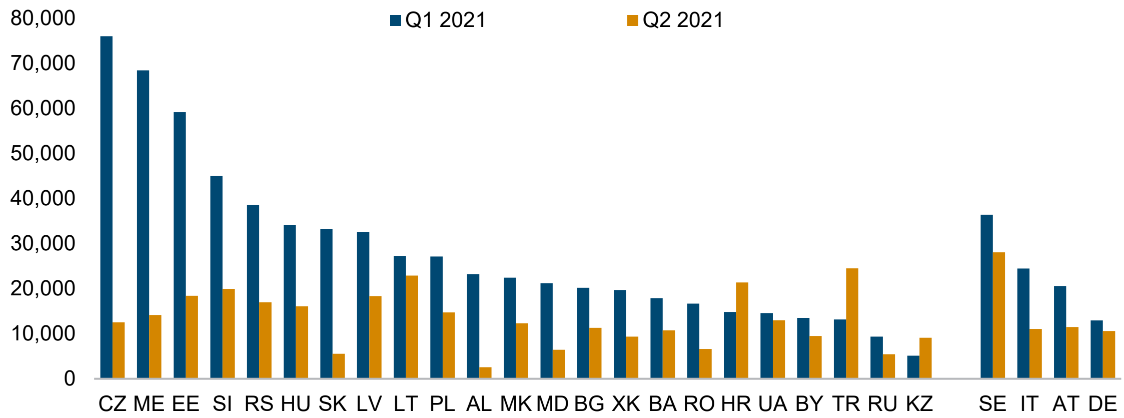
respectively. Since the current rise in prices is mainly supply driven, we expect it to be transitory; but because of the carry-over effects, we have also raised our inflation forecasts for 2022, by 0.3 pp.

The stronger economy will lead to greater labour demand and will push unemployment down. Our new forecasts for unemployment in 2021 are 8.2% for the euro area and 7.4% for the EU – 0.7 pp and 0.8 pp better than previously expected. The unemployment outlook has improved for 2022 and 2023, too. Stronger labour markets in the EU could drive up demand for workers from CESEE, thus improving the labour markets there, too.

COVID-19 IS NOT GOING AWAY

As elsewhere in Europe, 2021 in CESEE began with a severe wave of COVID-19, an extension of the winter wave from the end of 2020. But new infections in the first quarter of the year were generally higher in CESEE than in the EU. Things started to settle down during the second quarter, apart from in Croatia, Kazakhstan and Turkey (Figure 1). By the end of June, the numbers had dropped in most of the countries. Russia is a notable exception, as the number of new infections there soared in June (mostly from the delta variant).

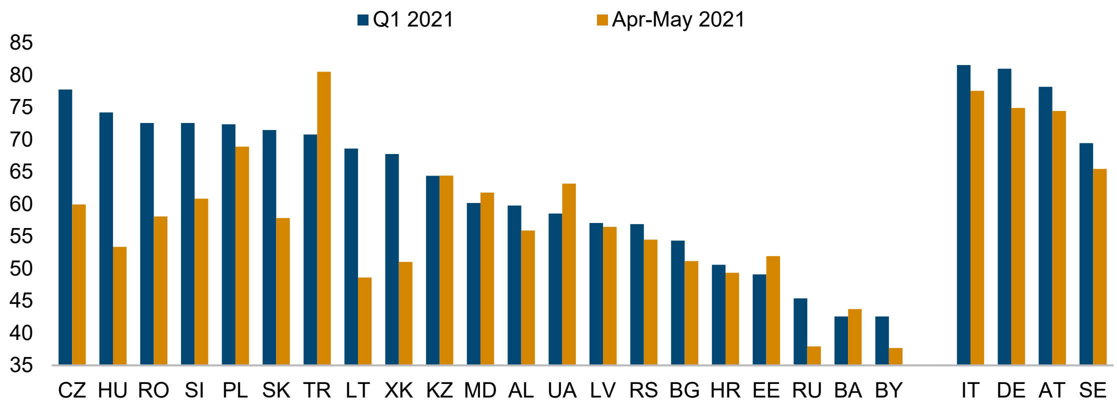
Figure 1 / Number of new COVID-19 cases (per million population)



Source: Our World in Data, Oxford University. Data for Q2 2021 end on 23 June.

One of the reasons for the large number of infections in CESEE in Q1 was that many governments there resisted imposing lockdowns. They did introduce some restrictions, but these were generally minor – far milder than in Western Europe and often lighter even than in Sweden (Figure 2). After infections declined in Q2, the measures were eased further, so that by the end of Q2 most of the countries had just a few minor restrictions.

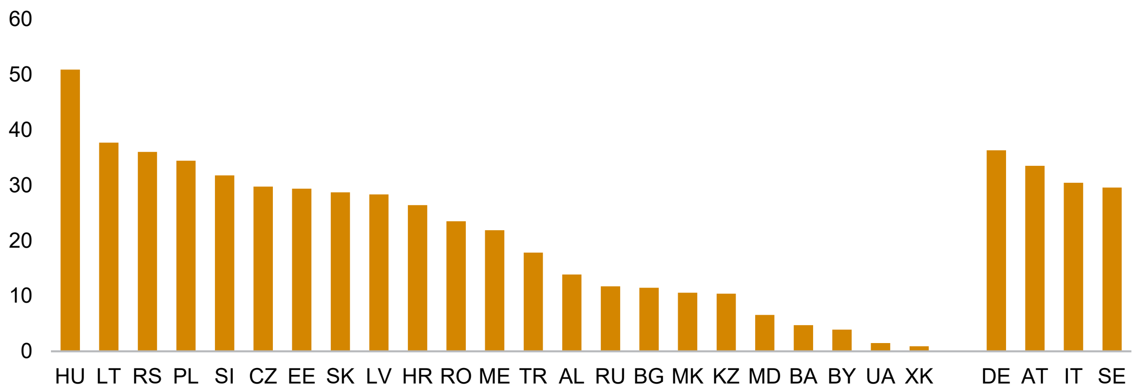
Figure 2 / Stringency Index



Source: Blavatnik School of Government, Oxford University.

Vaccination is under way in all CESEE countries, but the pace has generally been slow and there is little promise of herd immunity. Even though some CESEE countries – Hungary, Lithuania and Serbia – have among the best figures in Europe, most CESEE countries fall well below Western European levels of vaccination, due to a shortage of vaccines and a reluctance on the part of the population to have the jab. Rates of inoculation at the end of June generally still fell far short of the level required for herd immunity: only Hungary had managed to fully vaccinate more than 50% of its population (Figure 3). The numbers are likely to increase over the summer, but they will hardly be adequate to forestall a new wave in autumn/winter.

Figure 3 / Share of population fully vaccinated against COVID-19 at end of June 2021 (%)



Source: Our World in Data, Oxford University. Data refer to 29 June, except for BA (25 June), BY (13 June), RS (20 June) and XK (20 June).

ECONOMIES ARE LEARNING TO LIVE WITH THE PANDEMIC

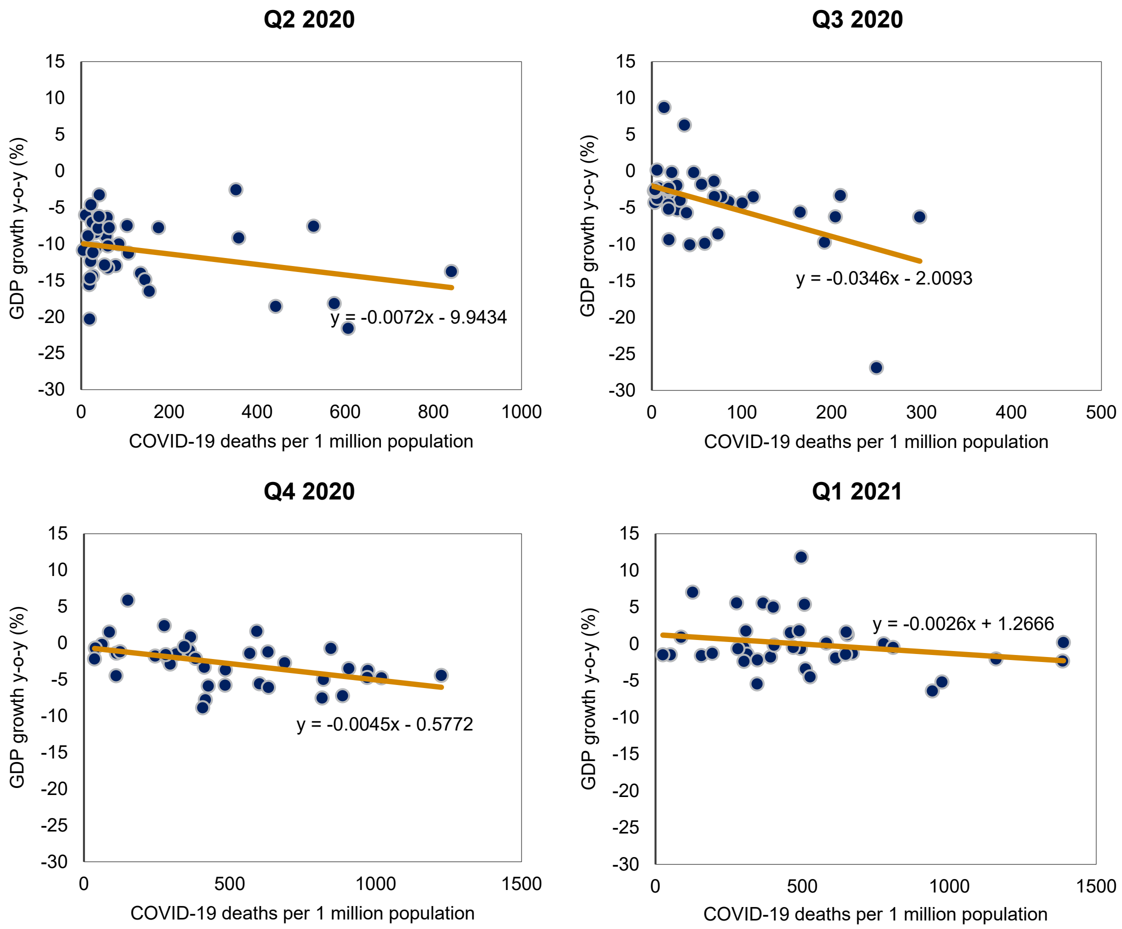
Despite the depressing health picture from Q1, the economic results in CESEE were better than expected. GDP did decline in most of the economies, but by less than had been predicted. The toll that the powerful wave of the disease and the ensuing restrictions took on the economy was smaller than anticipated, suggesting that the economies have learned to live with the pandemic (Box 1).

BOX 1 / LEARNING TO LIVE WITH THE PANDEMIC

In wiiw Monthly Report No. 3/2021, we discussed the relationship between the number of COVID-19 deaths and GDP growth.[2] We concluded that worse health outcomes were associated with greater economic contraction in Q2 and Q3 2020 – even after controlling for the stringency of the restrictions imposed. So does this relationship still hold, or has it changed since then?

Box Figure 1 shows the scatterplots between GDP growth and COVID-19 deaths for the four quarters covering Q2 2020 to Q1 2021 for the Western European and CESEE economies. The relationship is negative in all quarters, but it weakens over time. The coefficient of association between GDP growth and COVID-19 deaths in Q2 2020 and Q3 2020 was -0.007 and -0.035, whereas in Q4 2020 and Q1 2021 it declined to -0.005 and -0.003, respectively.

Box Figure 1 / Relationship between GDP growth and COVID-19 mortality in 39 European countries



Source: COVID-19 deaths are from Oxford University's Our World in Data. GDP growth is from Eurostat and wiiw Monthly Database.

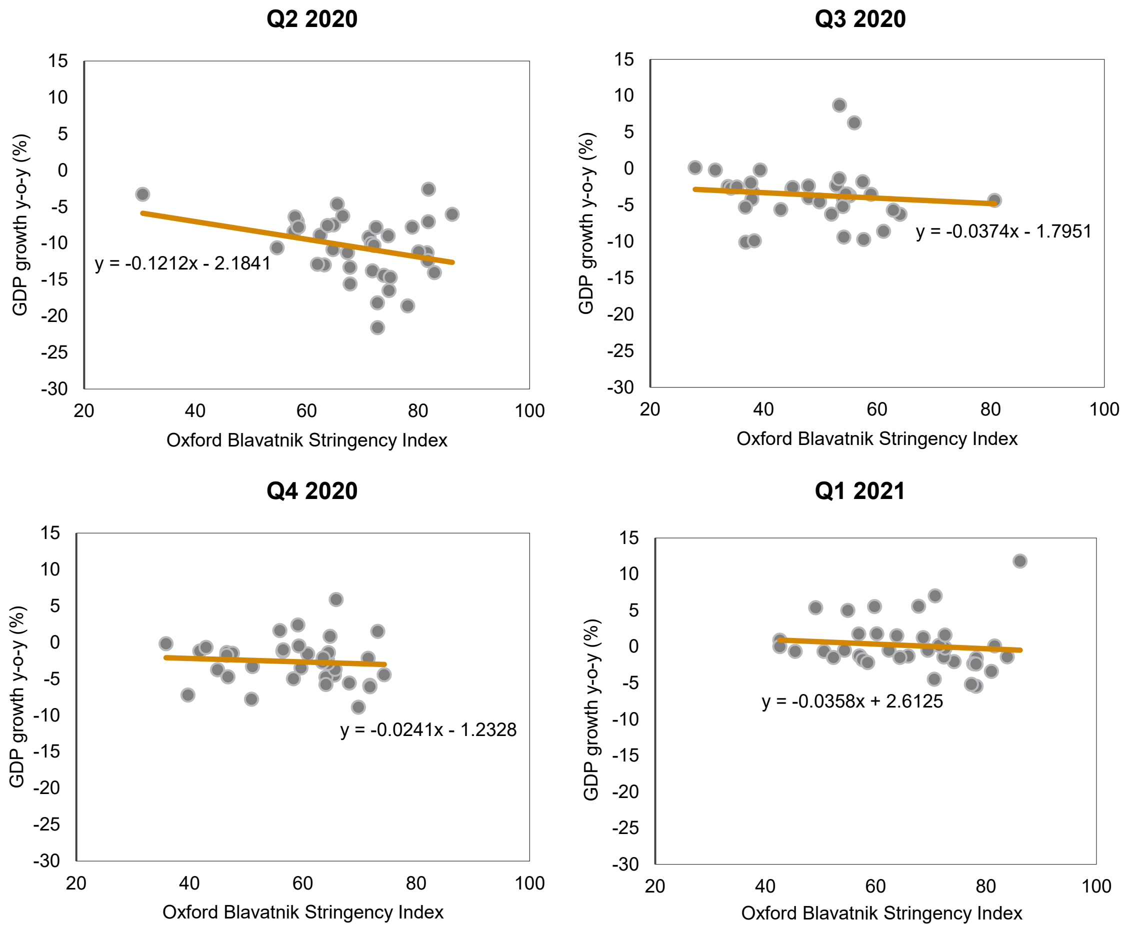
[2] Jovanovic, Branimir (2021), 'Is higher COVID-19 mortality hurting economic growth?', in: wiiw Monthly Report, No. 3, Vienna, March 2021, pp. 13-17

The lower value of the coefficients in the latter two quarters implies that economic activity has become less sensitive to the adverse health outcomes of the pandemic. **High COVID-19 mortality is today nowhere nearly as closely associated with damage to the economy as it was at the start of the pandemic. People and companies have adapted their behaviour, so that they get on with 'business as usual' even during severe waves of the pandemic.**

And what about the effect of lockdowns on economic activity? Has that changed as well? Box Figure 2 presents the scatterplots between the Stringency Index (which measures government restrictions) and GDP growth for the same periods. The relationship is again negative in all four quarters; but again, the coefficient of association has declined considerably. In Q2 2020 and Q3 2020 it was -0.12 and -0.04, whereas in the next two quarters it was -0.02 and -0.04.

Lockdowns and other government restrictions do not seem to hurt the economy now as much as they did at the start of the pandemic. Economic agents have modified their behaviour, and government-imposed restrictions no longer take that much of a toll on the economy.

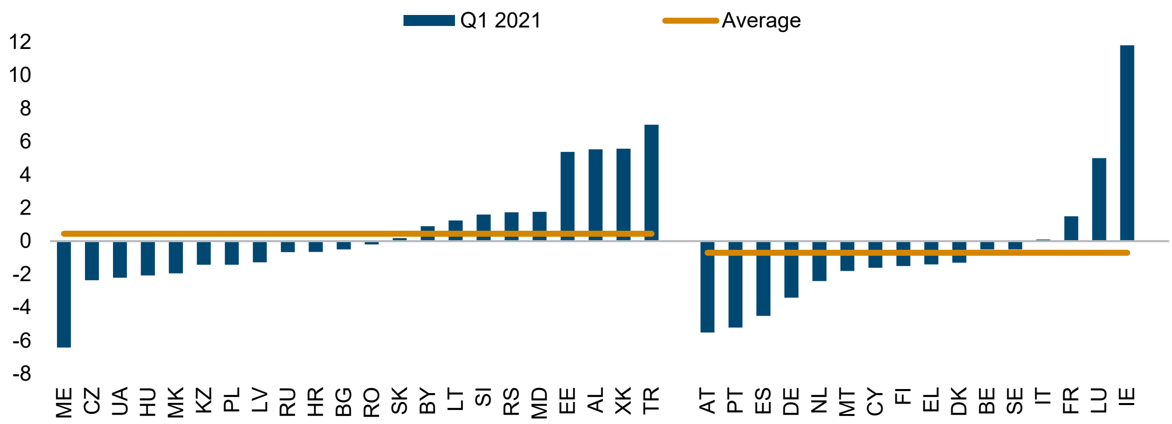
Box Figure 2 / Relationship between GDP growth and the Stringency Index in 39 European countries



Source: COVID-19 deaths are from Oxford University's Our World in Data. GDP growth is from Eurostat and wiiw Monthly Database.

There were again notable differences between countries, but CESEE overall did better than Western Europe. The average (unweighted) rate of growth of GDP in CESEE in Q1 was 0.4% (year on year), whereas in Western Europe it was -0.7% (Figure 4). This is partly a result of the relatively weaker restrictions in CESEE, but it is also probably because CESEE economies have managed to adapt faster than the Western European economies to the pandemic.

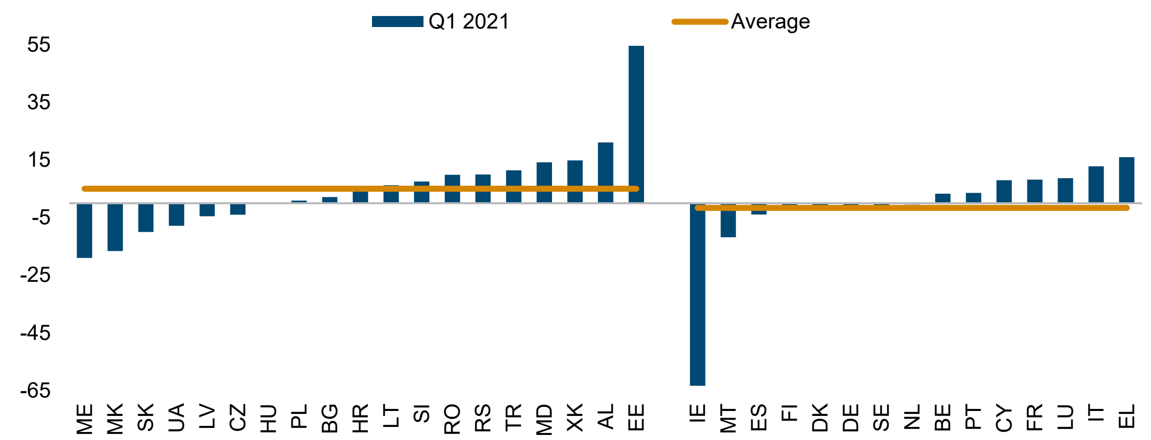
Figure 4 / Real GDP growth in Q1 2021 (%, year on year)



Source: Eurostat and wiiw Monthly Database.

The good GDP figures from Q1 in CESEE are largely the result of a strong rebound in investment. Gross fixed capital formation increased in 12 of the 19 CESEE countries for which there are data. The (unweighted) average investment growth for the whole region was 5% (Figure 5), which was similar to the growth observed in 2019. This might be explained by delayed investment projects now being implemented; but it also suggests that businesses in CESEE are fairly positive about the future.

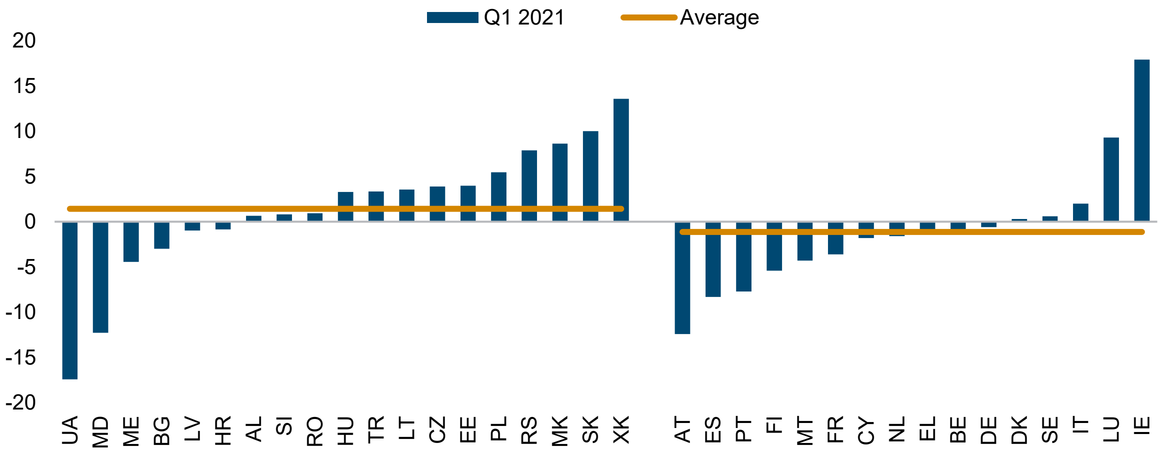
Figure 5 / Real growth of gross fixed capital formation in Q1 2021 (%, year on year)



Source: Eurostat and wiiw Monthly Database. Data for BA, MK and XK refer to gross capital formation.

Exports of goods and services also performed well in Q1, with 13 of the 19 CESEE economies on which there are data recording growth. The average (unweighted) growth for the region was 1.4%, which came after four quarters of decline. While the good results owe something to last year's low starting base, they are also due in part to the improved global economy, especially in the US and China. In contrast to CESEE, the Western European economies still reported rather bleak export results in Q1 (Figure 6).

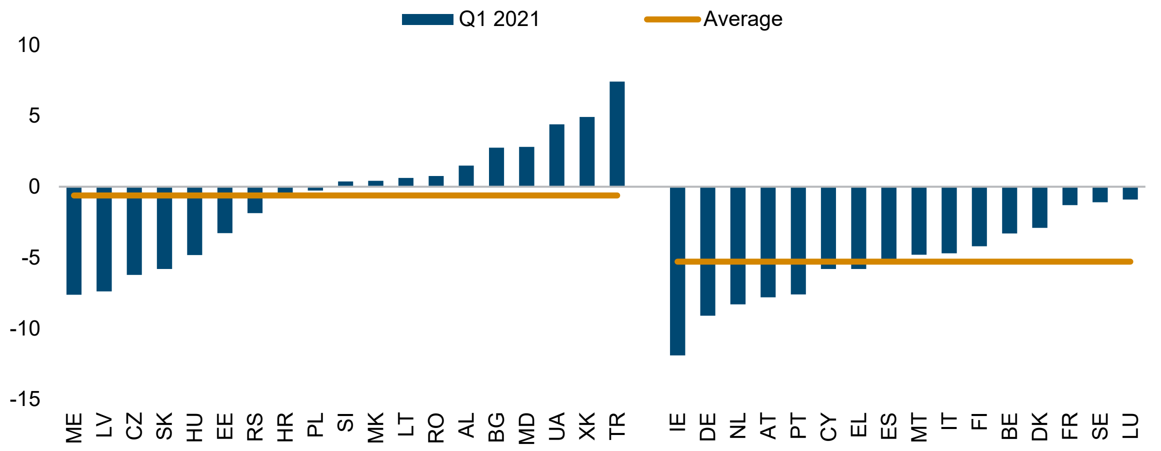
Figure 6 / Real growth in exports of goods and services in Q1 2021 (%, year on year)



Source: Eurostat and wiiw Monthly Database.

Household consumption, the biggest component of GDP, remained weak in CESEE economies in Q1, declining on average (unweighted) by 0.6%. This was only to be expected, given the strong wave of the pandemic in this period and the (mostly minor) restrictions that governments imposed. Still, the decline was the smallest of the last four quarters, and was much smaller than that observed in Western Europe (Figure 7). This was to some extent a consequence of the milder restrictions that the CESEE governments imposed, but it also suggests that the CESEE economies have adapted to the pandemic reality.

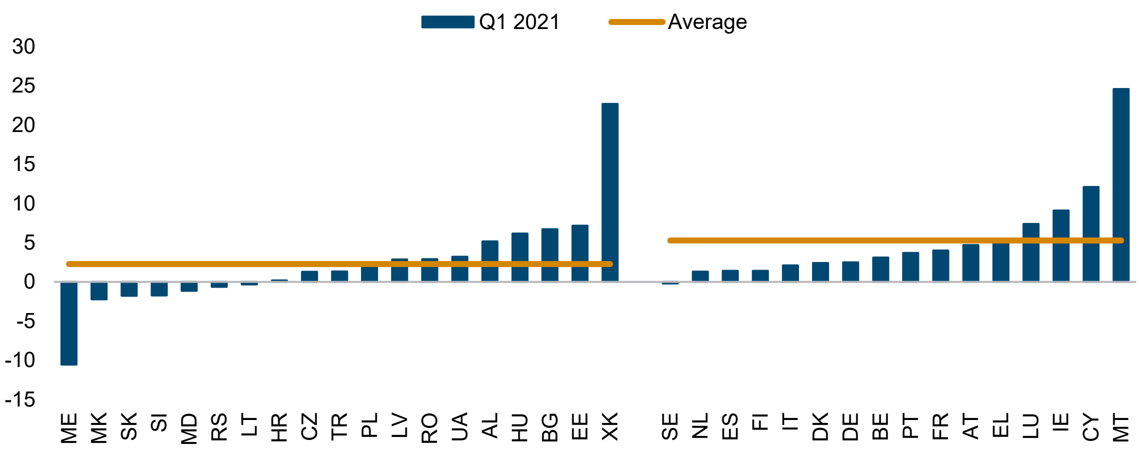
Figure 7 / Real growth in household consumption in Q1 2021 (%, year on year)



Source: Eurostat and wiiw Monthly Database.

The only GDP component that was weaker in CESEE than in Western Europe in Q1 was government consumption. It did increase in most of the CESEE economies, and its average (unweighted) growth of 2.3% was similar to that seen over the previous four quarters (Figure 8). But this was still much smaller than the growth in the Western European economies, where government consumption in Q1 rose by 5.3% on average (unweighted). To some extent, the difference is a consequence of the smaller fiscal space available to CESEE governments, which do not have the luxury of next-to-zero borrowing costs; but it also reflects the greater fiscal prudence and conservatism of CESEE governments.

Figure 8 / Real growth in government consumption in Q1 2021 (%, year on year)

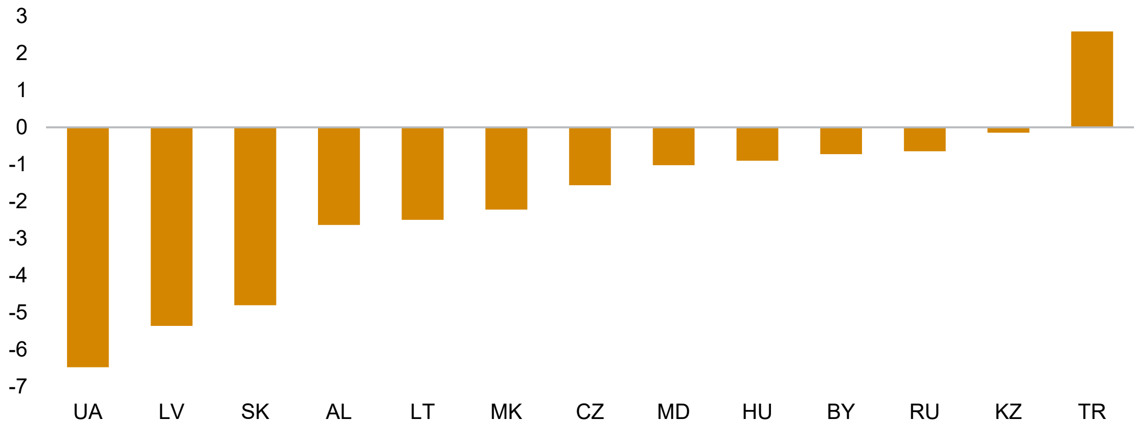


Source: Eurostat and wiiw Monthly Database.

LABOUR MARKET SCARRING IS VISIBLE

A year on from the start of the pandemic, it is slightly easier to gauge the impact it has had on the labour market. While the unemployment rate remains close to pre-pandemic levels in most countries, including CESEE, it is now evident that the number of people employed has declined considerably in most of the CESEE economies, which means that part of the newly idle labour force has moved to inactivity. New labour market data are plagued by methodological changes, but looking at those countries that have consistent data, one can see that employment in Q1 2021 was below the level of a year ago in 12 out of 13 CESEE economies (Figure 9). It is possible that these numbers are distorted by the powerful COVID-19 wave and the government containment measures in Q1 2021, which had repercussions for employment. But there are some indications that the pandemic has left many people without jobs. That said, it will only be possible to assess the full labour market fallout in later quarters.

Figure 9 / Employment in CESEE in Q1 2021 (%, year on year change)

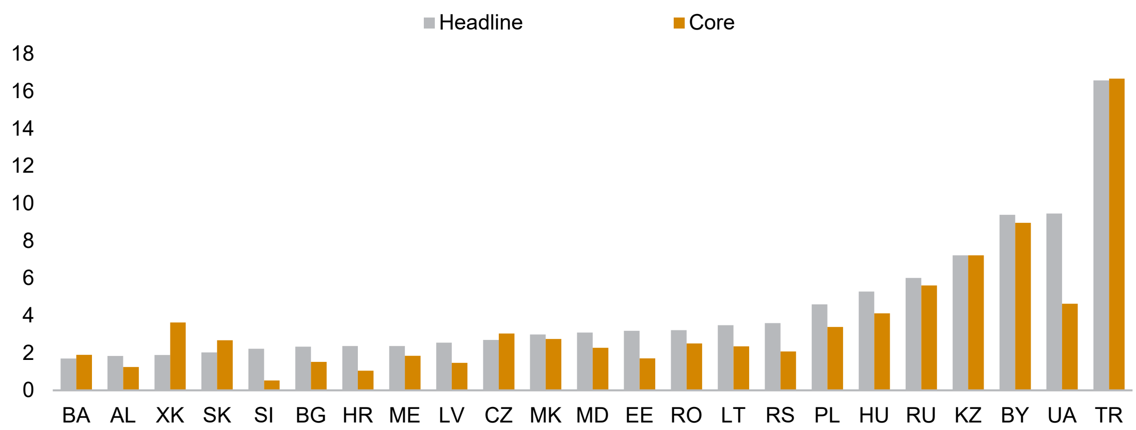


Source: wiiw Monthly Database; data are according to Labour Force Surveys.

INFLATION IS BACK

The higher global food and energy prices have lifted inflation in CESEE to levels unseen for several years. Average inflation (unweighted) in CESEE in May 2021 was 4.5%: the last time it was at that level was in late 2015. Only Bosnia and Herzegovina, Albania and Kosovo had inflation rates of below 2% in May. In general, we regard these developments as transitory. As the base effect of the very low oil prices recorded a year ago (largely a result of the inability of OPEC and Russia to agree at the time on production cuts in response to the pandemic) vanishes toward the end of the year, inflation will fall. But in many countries the higher energy prices are translating into higher overall prices, as can be seen from the higher core inflation (Figure 10). In addition, supply-chain disruptions may feed inflation. Moreover, in some countries there are demand-pull influences, stemming from the strong recovery. And in certain countries (Belarus, Kazakhstan, Russia, Turkey, Ukraine), exchange rate depreciation is also fuelling inflation.

Figure 10 / Headline and core consumer price inflation in CESEE in May 2021 (%, year on year)



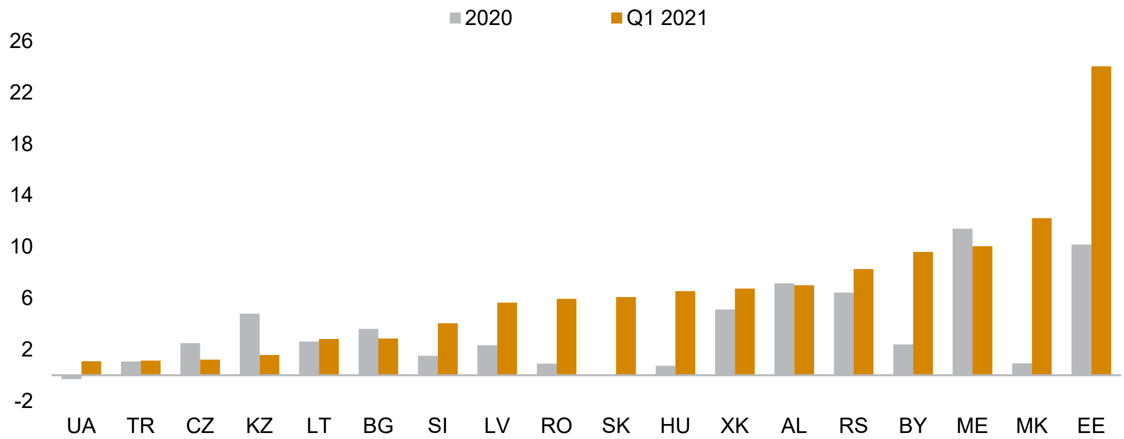
Source: wiiw Monthly Database and own calculations based on data from statistical offices.

Higher inflation has already brought about monetary policy tightening in some CESEE economies, and may well bring further hikes in policy rates in the coming months. While the Fed and the European Central Bank have been very cautious about any changes related to monetary policy, some central banks in CESEE have been much keener to take action. Six of them have already raised their interest rates in 2021 in the wake of rising inflation – Belarus, Russia, Turkey, Ukraine, Hungary and Czechia. We expect to see several more follow suit by the end of the year, once it becomes evident that the country in question's economy has improved.

FOREIGN DIRECT INVESTMENT IS POURING IN

After a drought in 2020, Q1 2021 brought a flood of foreign direct investment (FDI) into CESEE. The (unweighted) average for Q1 was 6.5% of GDP, which is on a par with the best quarters from the pre-pandemic period (Figure 11). This may be a one-off, as many investment projects that were postponed during 2020 are now being resumed. But the increase could also be indicative of potential near-shoring trends. Many Western Europe multinational companies have experienced problems with their supply chains during the pandemic, and are now devising strategies to address these problems. These could involve investment in regions closer to Western Europe, such as the CESEE countries. Whatever the reason, the expectation for 2021 is that levels of FDI will be much higher than in 2020.

Figure 11 / FDI inflows in CESEE countries in 2020 and Q1 2021 (% of GDP)

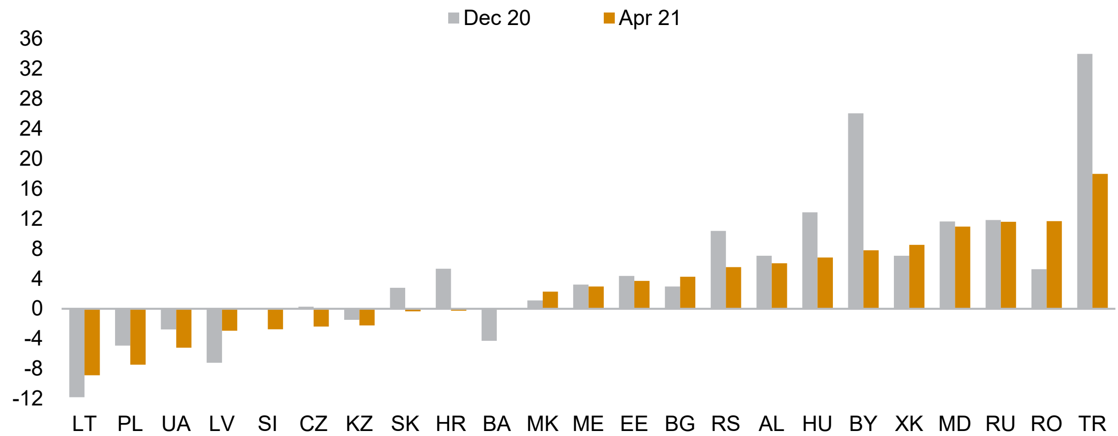


Source: Central Banks of the respective countries. The data refer to FDI inflows (liabilities) from Balance of Payments statistics.

CREDIT ACTIVITY IS SHIFTING TO HOUSEHOLDS

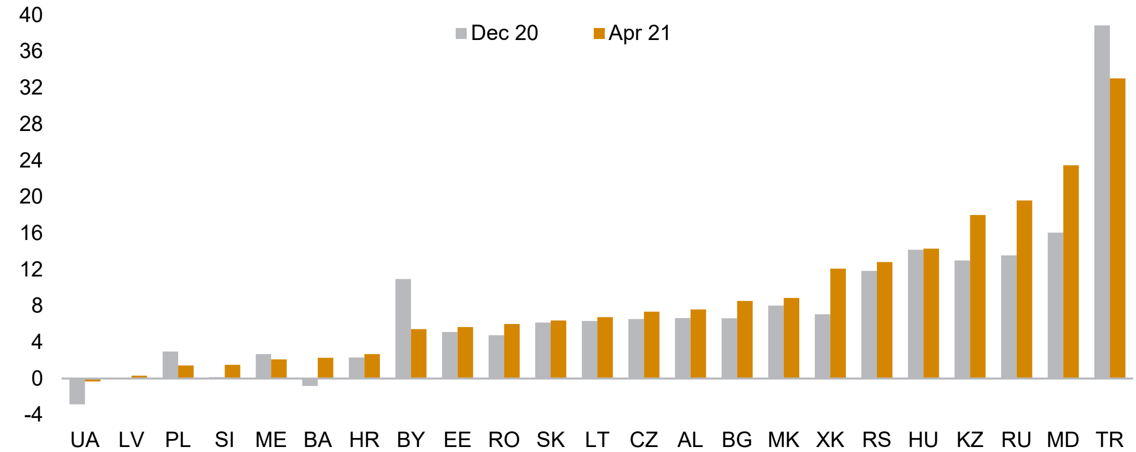
Overall credit activity continues at a pace similar to that seen throughout 2020, but there are signs of a shift towards greater lending to households. Bank lending remained robust in 2020, thanks to the favourable credit instruments that governments introduced to support business. Those instruments are either due to expire sometime in 2021 or will continue, but on a more modest scale – and that is having a cooling effect on business lending. Meanwhile, demand for credit from households is hotting up – both for mortgages and for consumption. Households are starting to spend more as the pandemic moderates, and banks are shifting their focus towards that market segment. These trends are expected to continue throughout 2021, implying that overall credit activity will remain robust during the year.

Figure 12 / Growth in loans to non-financial corporations in CESEE in 2020 and 2021 (%, year on year)



Source: wiiw Monthly Database.

Figure 13 / Growth in loans to households in CESEE in 2020 and 2021 (%, year on year)



Source: wiiw Monthly Database.

CAUTIOUS OPTIMISM FOR THE MONTHS AHEAD

The improved global outlook for 2021 and the better-than-expected developments in the first quarter of the year have led us to upgrade our GDP forecasts for 2021 for 20 of the 23 CESEE economies (Table 4).

Growth in the remainder of the year will be driven primarily by household consumption, which will boom as the pandemic moderates, fuelled by the accumulated savings from 2020 and supportive bank lending. Business investment will also contribute, as it already has in Q1, with companies resuming the projects they put on the back burner in 2020. This will be supported by the strong inflow of FDI that we are already seeing. Exports will also rise, driven by a favourable external environment and increased foreign demand.

The stronger economy will improve the labour markets as well. Employment is expected to increase in the second half of the year, and unemployment should drop; but these twin developments will depend largely on the fiscal support provided by governments. Should governments decide to start retrenching this year, labour markets might be put at risk.

Inflation will be higher than previously expected, driven primarily by the global increase in energy and food prices. Greater domestic demand and exchange rate depreciations in some CESEE economies will also play a role. But we consider these dynamics by and large to be transitory. Carry-over effects will indeed raise inflation in 2022 a little, but that will have settled down by the second half of 2022.

Table 4 / Real GDP growth forecasts and revisions

		Forecast, %			Revisions, pp	
		2021	2022	2023	2021	2022
EU-CEE	BG	3.0	3.5	3.8	0.5	0.4
	CZ	3.0	3.9	3.3	0.1	0.7
	EE	4.2	4.5	4.3	3.0	0.7
	HR	5.1	5.3	4.0	0.6	0.7
	HU	4.9	4.5	3.9	1.0	0.0
	LT	3.0	4.0	3.5	0.9	0.2
	LV	3.2	5.0	3.8	0.4	0.8
	PL	4.0	4.5	4.4	0.6	0.9
	RO	5.2	4.5	4.5	1.4	0.0
	SI	4.0	4.3	3.4	0.4	0.3
	SK	4.0	4.4	3.9	0.4	0.0
Western Balkans	AL	5.0	4.4	4.2	0.5	0.0
	BA	2.9	3.3	3.3	0.4	0.4
	ME	6.5	6.0	4.0	0.0	1.0
	MK	4.1	3.4	3.2	0.0	0.0
	RS	6.0	4.2	4.2	1.0	-0.2
	XK	5.3	4.7	4.4	0.5	0.1
Turkey	TR	5.8	3.4	3.5	0.0	0.0
CIS+UA	BY	2.5	1.6	2.1	1.0	-0.3
	KZ	3.5	4.1	4.4	0.3	0.0
	MD	7.0	4.5	4.0	3.0	0.0
	RU	3.5	3.0	2.6	0.3	0.3
	UA	4.3	3.5	3.5	0.8	0.3

Note: Current forecast and revisions relative to the wiiw April forecast 2021. Colour scale variation from the minimum (red) to the maximum (green).
Source: wiiw.

The higher inflation and the improved economic activity will lead more and more central banks to consider raising their policy rates in 2021. Six CESEE central banks have already done so in 2021, and we expect several more to do the same. As the hikes have so far been mostly symbolic, we do not expect them to have any great adverse effects on economic or credit activity.

Tourism will also improve this year, with positive implications for certain CESEE economies. Restrictions have been eased pretty much throughout Europe, and international travel is starting to pick up; this will bring the tourists flocking back. Still, pre-pandemic levels will not be reached this year, and the improvement in the figures for tourism will mainly be due to the low base in 2020. There will also be notable differences between countries in this respect, with Croatia and Albania faring better than Bulgaria and Montenegro. Countries that rely on tourists from faraway places will recover less, as long-distance travel is still difficult.

The risks surrounding the forecasts are mainly on the downside and refer primarily to the new wave of the pandemic that will almost certainly break by the end of the year. Despite the vaccination campaigns, herd immunity will not be reached in most of CESEE this year, as coverage is inadequate. This will mean another wave of the pandemic and the partial reintroduction of restrictions towards the end of the year. The likelihood of such a scenario is suggested by the experience of certain countries, such as Chile and Israel, where even high vaccination rates have failed to prevent fresh outbreaks and where restrictions have been reimposed.

But this new wave is unlikely to wreak such damage on the CESEE economies as the various waves did in 2020, as societies and economies have learned to cope with the pandemic. The restrictions imposed will not be as stringent as before – something we have already glimpsed in Q1 2021. The economies have also been gradually adapting to pandemic conditions (with a switch to working from home and online shopping, and structural change away from those sectors worst affected by the pandemic). There might be exceptions in certain countries, but these will only prove the rule. Thus, the new wave, when it strikes (probably in autumn), will only lead to a slowdown in growth, rather than a recession.

The second risk that we perceive refers to the possibility of premature fiscal consolidation. Revived economic activity may impel some CESEE governments to consider consolidating their finances as early as 2021; and if that happens, it is likely to stall the recovery. Despite the current positive developments, economies are still very fragile and labour market scarring is visible. This warrants an extension of fiscal support throughout 2021 – and possibly beyond. Any new wave of the pandemic towards the end of the year will make such an extension all the more important.

Country updates

ALBANIA: PUBLIC INVESTMENT AND TOURISM WILL BOOST GROWTH FURTHER

by Isilda Mara

Growth accelerated to 5.5% in Q1 2021 year on year, boosted by a 21% increase in gross fixed capital formation. Consumption is back as well, supported by remittances (up 11% in Q1). Exports of goods rose by 35% in the first four months of 2021, year on year. Exports of services, mainly tourism, are also recovering rapidly, though tourism this year will rely heavily on visitors from neighbouring countries. The fiscal situation has improved, with revenues growing by 7% in the first four months, but the government's purse will remain open and the fiscal balance will be negative (albeit less negative than in 2020). Monetary policy will stay loose, as inflation continues at below its target of 3%.

The mass vaccination campaign launched in March has had the desired effect, and the number of COVID-19 cases has declined markedly. Still, there are downside risks from new variants of the virus and from the influx of tourists. The Socialist Party emerged victorious from the April 2021 election and will govern the country for another term – its third one. This implies certain stability and the continuation of several infrastructure projects that will attract investment. Thus, we have upgraded our growth forecast for 2021 from 4.5% to 5%, and for the next two years to above 4%.

BELARUS: FURTHER REORIENTATION TOWARDS RUSSIA

by Rumen Dobrinsky

In the first quarter of 2021, GDP grew by 0.9% year on year. Aside from deteriorating relations with the West, the external economic environment in the early months was favourable, and the rising oil and commodity prices provided a windfall to the economy. Increasingly isolated, the Belarusian leadership has sought to secure greater economic support from Russia. Trade links with Russia have been fully restored, which has contributed to an overall recovery in exports.

While the short-term indicators suggest that growth accelerated further in the following months, this was likely a one-off development and growth will slow in the second half of the year. Following the forced landing of a Ryanair plane in May, the EU imposed sectoral sanctions on Belarus, targeting industries such as petroleum products, potash fertilisers and tobacco-related products (meanwhile, Belarus has announced in response that it is leaving the EU Eastern Partnership). Still, GDP growth in 2021 as a whole may somewhat exceed the spring forecast, reaching 2.5%. However, the balance-of-payments constraints are of a lasting nature, putting the brakes on domestic demand. In consequence, sluggish economic performance will likely prevail in the years ahead.

BOSNIA AND HERZEGOVINA: RECOVERY UNDER WAY, BUT CONCERN OVER SLUGGISH VACCINATION CAMPAIGN

by Selena Duraković

Despite the third wave of the pandemic, available data for the first four months of 2021 suggest an improvement in economic activity, with both industrial production and retail trade growing (by 11.5% and 11%, year on year, respectively). To an extent, this is a consequence of the low statistical base; however, industrial production grew in each of the first four months even on a monthly basis (seasonally adjusted). Average inflation was negative in the first four months of 2021 (-0.7%), but in May it reached +1.7%.

Due to the stronger-than-expected economic recovery in the first four months, our forecasts for GDP growth and inflation have been revised upwards. We expect GDP to grow by 2.9% in 2021 and by 3.3% in 2022 – an upward revision of 0.4 percentage points (pp) for both years. Inflation will also rise further, to reach 1% in 2021 and 1.3% in 2022 – up 0.4 pp and 0.7 pp, respectively, on the previous forecast. Although the number of COVID-19 cases has declined significantly over the past two months, there remains the threat of a new wave, as the vaccination campaign is proving sluggish (with less than 10% of the population vaccinated). It must also rely on the COVAX scheme and donations, as no deal has yet been struck for the mass procurement of vaccines.

BULGARIA: RECOVERY AMIDST POLITICAL UNCERTAINTY

by Rumen Dobrinsky

While GDP dropped by 1.8% year on year in the first quarter of 2021, the current statistics nevertheless indicate a trend towards recovery. Both manufacturing and exports have reported robust growth since April, and recent business surveys reveal improved business and consumer sentiment. The regular elections, held in April, resulted in a split parliament, which has been unable to agree on a new government, and so a snap election is due in July. The caretaker administration did not submit the draft National Recovery and Resilience Plan prepared by the former government to the European Commission, as the new authorities intended to revise it.

The short-term economic prospects have improved, and we expect GDP to grow by some 3% in 2021 – up from the 2.5% expected in April. The recovery in the key EU markets should support robust export growth, and domestic demand is also expected to rebound strongly. However, uncertainties remain as regards the tourist industry, as foreign visitors are not expected to return in large numbers. Another negative factor is the delay already experienced in accessing EU funds from the Recovery and Resilience Facility. We expect a small current account deficit for the year as a whole, due to the probable shortfall in tourism revenue.

CROATIA: ECONOMIC REBOUND IN SIGHT

by Bernd Christoph Ströhm

In Q1 2021, GDP contracted by only 0.7% year on year, while retail sales increased by some 12%. Croatia also recorded a 58% year-on-year increase in overnight tourist stays from the beginning of 2021 until June, signalling that the country is well on the road to economic recovery. This is largely thanks to government measures, such as the co-financing of COVID-19 testing and the vaccination of some 60% of workers in the tourist industry by June. Still, any economic rebound in 2021 is dependent on epidemiological developments in the EU, as Germany, Austria and Italy are among Croatia's most important economic partners.

Croatia will likely enjoy a bountiful tourist season this year, with revenue from tourism at around 70% of pre-pandemic levels. Because of this, domestic demand and private consumption will see robust recovery in Q2 and Q3 2021. Croatia will also likely benefit from some EUR 6.5bn (equivalent to 13.2% of Croatia's 2020 GDP) from the EU's Recovery and Resilience Facility. Owing to an increase in energy prices and persistent pandemic-related supply-chain disruptions, we expect this year's inflation to pick up to around 1.6%. Stronger investments and an increase in service exports have led us to raise our growth forecast to 5.1% in 2021 (from 4.5%).

CZECHIA: RECOVERY DELAYED

by Leon Podkaminer

GDP decline during Q1 2021 (-2.4%) was greater than generally expected. This was due to the continuing contraction in gross fixed capital formation and household consumption, and occurred despite the high growth in inventories. Gross value added (GVA) in manufacturing recorded a 1.7% growth, but there was quite a substantial GVA decline in construction (7.6%). Rather unexpectedly, the growth in imports was much stronger than in exports, suggesting increased replenishment of stocks of intermediate inputs. The result was that foreign trade contributed negatively to overall growth.

With quite stable employment and wage levels, the labour market shows little sign of change. An upturn in inflation, driven primarily by energy prices, has already led to a tightening of monetary policy, with the policy rate rising from 0.25% to 0.5%. Inflation will be contained (at about 2.5% in 2021). But the interest rate hike may have negative consequences for the exchange rate, foreign trade and real activity. Recent data suggest double-digit growth rates for sales and orders, especially for exports. Industry (and exports) may be set to lead the recovery over the rest of the year, with GDP likely to grow by about 3% in 2021. Fiscal policy will continue to be supportive.

ESTONIA: SPRINTING TO RECOVERY

by Maryna Tverdostup

The pace of economic recovery in Q1 2021 exceeded all expectations, reaching 5.4% year on year and 4.8% quarter on quarter. It was boosted by the service sector (IT, financial and insurance services), increased private consumption and investment (due to pension reform and accumulated savings), a construction boom and an upswing in retail trade. With inflation back on track at 3.6% year on year in May and foreign trade again at pre-crisis levels, the economic outlook for the rest of the year is better than previously projected.

We are upgrading our growth forecast to 4.2% in 2021, followed by 4.5% in 2022 and 4.3% in 2023, driven by private consumption and exports of goods and services. The unemployment rate will continue to decline in coming years, reaching the pre-crisis level by 2023. A steady growth in the prices of durable goods and services, coupled with a gradual upswing in food prices, will bring inflation to 2.3% in 2021. However, elimination of the fiscal deficit is not anticipated, even by 2025, even though maintaining a low budget deficit and minimising government borrowing are primary objectives for the coming years.

HUNGARY: CHANGE IN MONETARY POLICY WITH RISING INFLATION

by Sándor Richter

While GDP in Q1 2021 declined by 2.1%, the data suggest a remarkable recovery in industry and agriculture, but a weaker performance in services and construction. Household consumption was about 5% down on a year ago, but this was partially balanced by a double-digit increase in public consumption. Gross fixed capital formation reached the level of Q1 2020. The net contribution of external trade to GDP turned positive. Inflation is back: in May, the CPI climbed to 5.1% on an annual basis. The central bank announced the start of a tightening cycle and lifted the policy rate from 0.6% to 0.9%.

The growth forecast for 2021 has been revised upwards, to 4.9% (from 3.9%). The main driver of growth will be investment. Household consumption will be boosted by pre-election fiscal ‘handouts’, but will simultaneously be curbed by the end of the moratorium on loan repayments, prevailing uncertainties and loss of income across broad sections of society. A justified fiscal expansion in the wake of the pandemic may tip over to become extreme, in order to secure an election victory for Prime Minister Orbán in April 2022. Economic growth will be slowed by fiscal consolidation in 2022 and 2023.

KAZAKHSTAN: RECOVERY GAINS MOMENTUM, BUT COULD FALTER IN THE EVENT OF PANDEMIC RESURGENCE

by Alexandra Bykova

Despite real GDP decline of 1.4% in Q1 2021, the short-time indicator for January-May points to an incipient broad recovery (2%). The strong performance in manufacturing over the first five months (7.2%) is especially visible in the automotive sector (26.4%), pharmaceuticals (25.7%) and the production of construction materials (21.4%). Construction grew by 11.3%, boosted by the new opportunity to finance housing construction from surplus pension savings, and retail sales grew by 7.5%. Mining still posted a 4.9% decline, but the recent easing of OPEC+ oil production cuts should favour a recovery later this year. The recent increase in budget spending of 1.7% of GDP will not have an impact on the deficit, thanks to the higher tax revenues. Although inflation overshot its target to reach 7.2% in January-May (year on year), the policy rate has so far remained unchanged.

Our economic growth forecast for 2021 has been revised upwards to 3.5% (from 3.2%), thanks to the recent strong performance, higher-than-expected oil prices, better prospects for global recovery and new fiscal stimulus. However, the late start to mass vaccination and the low vaccination rate render the recovery vulnerable to a resurgence of the pandemic. Stronger growth of above 4% is expected only in the coming years.

KOSOVO: OUTLOOK FOR GROWTH IMPROVES, WITH ROBUST DOMESTIC AND EXTERNAL DEMAND

by Isilda Mara

The economy bounced back in Q1 2021, growing by 5.6% year on year on the back of strong domestic and external demand. Consumption and investment grew year on year by 7.4% and 14.9%, respectively. Remittances soared by 30% in the first three months and the labour market is also recovering. Foreign direct investment from Germany, Austria and Switzerland has surged in remarkable fashion, suggesting that Kosovo may already be capitalising on near-shoring by EU companies. The trade balance is also starting to benefit from a steep rise in goods exports, which grew by 62% year on year in January to May 2021.

A very promising fiscal performance in the first five months of the year has created ample scope for further necessary public spending in support of businesses and families that have been hard hit by the pandemic. Though a further rise in public debt is unavoidable, it will not be too enormous. Inflation has been picking up, reaching 2% in the first five months; but it will remain at a tolerable level, averaging 1.5% for the year. The banking sector is stable and well capitalised. Thus, we have upgraded our growth projection for 2021 slightly – from 4.8% to 5.3%. The slow progress of vaccination and the new variants of the virus are the main sources of uncertainty.

LATVIA: PUBLIC FINANCES PROVIDING STRONG SUPPORT FOR THE RECOVERY

by Sebastian Leitner

A severe second wave of COVID-19 at the beginning of 2021 and the subsequent extended lockdown measures resulted in a further decline in GDP of 1.3% in Q1. The Latvian government took the decision to boost support measures markedly, making use of EU funds to finance short-time work programmes and further expand public investment. From April onwards, consumption started to surge; and in May, business confidence returned to pre-COVID levels in all the broad sectors. In particular, manufacturing showed an upswing that surpassed all expectations in production and especially exports.

We have raised our GDP forecast for 2021 slightly to 3.2% (from 2.8%) on the back of stronger external demand and household consumption, the latter driven by net wage growth of above 6%. In 2022, we expect GDP to grow more robustly, by 5%, given the surge in public investment. Latest figures show that the increase in commodity prices has resulted in the consumer price index rising faster than expected; however, inflation will remain at below 2% this year, and even in 2022 is expected to reach only 2.5% for the year. The general budget deficit in 2021 will with 7.5% of GDP substantially exceed last year's level.

LITHUANIA: STRONG REVIVAL IN GROWTH FOLLOWING LAST YEAR'S MILD RECESSION

by Sebastian Leitner

Surprisingly, the harsh and protracted lockdown measures introduced at the beginning of the year had only a slight dampening effect on retail trade and GDP growth (+1% year on year in Q1 2021). Swiftly increasing external demand was driven by, among other things, the need for Lithuanian chemicals for use in COVID-19-related pharmaceutical production elsewhere. Short-time work schemes served to cushion the rise of unemployment. However, it will take some considerable time for those workers affected to be reabsorbed by the labour market.

Given the higher-than-expected growth in household consumption and exports, we have substantially raised our GDP growth forecast for 2021 from 1.8% to 3%. For 2022, investment will be driven by expanded public spending. The steadily and rapidly rising real wages and the higher savings accumulated during the lockdowns will be used by households in 2022 to boost consumption. However, the newly introduced EU sanctions against Belarus will adversely affect the Lithuanian transport sector, since Belarus's most important export products – such as oil products and potassium fertiliser – are shipped via the Lithuanian port of Klaipeda.

MOLDOVA: RAPID RECOVERY AND THE CHANCE TO FIND AN ANCHOR WITH THE EU

by Gábor Hunya

In Q1 2021, GDP grew by 1.8% to exceed the 2020 level and compensate for the major COVID-related setback. The economy gained momentum, despite the continuing COVID-related restrictions. Manufacturing production rose by 3% and construction output by 8% year on year. Wages were 10% up in real terms, while employment maintained its 2020 level. An expansion of over 14% in gross fixed capital formation supported GDP growth. The trade deficit widened in Q1 after a temporary contraction last year. In more recent months, the COVID-19 infection rate has declined, despite sluggish vaccination.

We have revised the 2021 growth forecast to 7% (from 4%), assuming that there is no severe lockdown and agriculture recovers from last year's slump. Inflation may reach 4.5% by the end of the year, triggering a modest rise in the base rate. Improved external conditions – especially a strong recovery in Romania – may boost the economy in the future. Moldova is set to receive a EUR 600m economic recovery package from the EU in the form of aid and credit over a three-year period, conditional on judicial and anti-corruption reforms. If the pro-EU forces win the snap elections scheduled for 11 July, Moldova could finally find an anchor in the West, but retaliation from Russia may prove a challenge.

MONTENEGRO: STRUGGLING TO RECOVER PROPERLY FROM LAST YEAR'S CRASH

by Bernd Christoph Ströhm

After suffering Europe's deepest recession last year (-15.2%), Montenegro's economic bounce-back is still subject to numerous risks and is crucially dependent on a successful tourist season. The country's tourist industry is particularly reliant on CESEE inter-regional arrivals, mainly from Serbia and BiH. However, given BiH's slow COVID-19 vaccination campaign, realistically in 2021 the country is only likely to benefit inter-regionally from Serbian arrivals. Besides, so far Montenegro has scarcely benefited from any Russian arrivals, as there is a formal ban on flights between the two countries.

COVID-19 continues to cast its shadow well into 2021, with GDP contracting by 6.4% in Q1. Economic recovery is also inhibited by the government's failure to swiftly approve the country's state budget for 2021. So far, it has only been able to adopt a draft budget for the year, with a projected 3% deficit. However, with the COVID-19 support measures, we expect that deficit to surge to 5.4%. Higher oil prices will stoke energy costs, which is why we expect this year's inflation to increase to 1.7%. The pandemic-related uncertainties and the overcast prospects for the tourist season mean that we maintain our rather pessimistic GDP growth forecast in 2021 of 6.5%.

NORTH MACEDONIA: GOVERNMENT FAILS TO SUPPORT THE ECONOMY, YET AGAIN

by Branimir Jovanović

The economy just cannot seem to begin to recover from the pandemic. GDP in Q1 2021 was 1.9% down year on year – the fourth consecutive quarter of decline. It also fell compared to the previous quarter – by 0.6%, seasonally adjusted. Household consumption was inhibited by the severe pandemic wave and grew just 0.4% year on year, despite a surge in remittances (+18%) and the relatively good labour market. Gross capital formation dropped by 17% year on year, despite the strong inflows of foreign direct investment (12% of GDP). The government failed to step in, and the budget deficit in Q1 ended up as 4% of GDP – short of the 4.9% that had been announced. Especially weak was the execution of capital expenditures, which fell 34% below plan.

We have maintained the growth projection for 2021 unchanged at 4.1%, as the government has adopted a new budget that envisages capital spending 27% higher than previously announced. Household consumption and business investment are also expected to revive from Q2 onward, due to the moderation of the pandemic. The risks are to the downside, with the main two being the weak execution of the government budget and a probable new wave of COVID-19 in autumn. Higher energy and food prices have increased inflation, bringing it to 3% in May (year on year). We have thus upgraded the inflation forecast for 2021 to 2.5%.

POLAND: RECOVERY UNDER WAY

by Leon Podkaminer

The GDP decline during Q1 2021 (0.9%) was less than expected. Strong growth in public consumption was the main factor limiting the decline, with rising household consumption and gross fixed capital formation also contributing. Perhaps surprisingly, imports grew much more robustly than exports: foreign trade in goods and services contributed negatively to overall growth. Gross value added rebounded very sharply in industry, but contracted in construction. Rising employment and real wages and clear signs of a rapid acceleration in manufacturing bode well for the second half of 2021: recent data suggest double-digit growth in export sales and export orders (though growth remains more sluggish on the domestic market). In addition, there will be a recovery of investment in fixed assets, and foreign trade is set to produce rising surpluses.

The hefty upturn in inflation (4.7% in May), driven primarily (though not exclusively) by hikes in administered prices, does not seem to be of much concern to the central bank. Despite a very low policy interest rate (0.1%) and large fiscal deficits, the exchange rate is likely to resist depreciation. All in all, we expect a significant recovery over the rest of 2021. We forecast that GDP will grow by 4% over the year as a whole.

ROMANIA: RAPID POST-COVID RECOVERY AMID LARGE IMBALANCES

by Gábor Hunya

In Q1 2021, GDP remained roughly at the level of the previous year (-0.2%). Information and communication technology was the fastest-growing sector, but industry also expanded rapidly. Net exports were the only negative item on the demand side. Imports of goods increased at double the speed of exports, as consumption recovered more quickly than production. Services trade produced surpluses, especially in the telecom and computer sector. A 10% expansion in investments has provided a boost to growth. FDI inflows worth EUR 2bn (3.4% of GDP) were a major item of good news, especially viewed against the capital withdrawal of 2020.

The growth momentum is expected to hold for the rest of 2021 and beyond, provided there is no severe COVID-related shutdown. Thus, we have revised our growth forecast upwards, to 5.2% in 2021 (from 3.8%). The V-shaped recovery will trigger a fall in unemployment and a return to labour shortages. Increased amounts of EU funds will support investment. External and internal factors have boosted inflation (3.5%) to beyond the central bank target of 2.5%, and that will trigger a gradual policy rate rise. The government may curb its plans for further fiscal expansion and seek to stabilise public debt at around 50% of GDP.

RUSSIA: DELTA VARIANT LOOMING OVER ECONOMIC RECOVERY

by Vasily Astrov

Although the economy declined by 0.7% year on year in Q1 2021, it performed well in April and May, as revealed by the high growth of industrial production (7.6% and 11.8%, respectively, year on year) and the upbeat sentiment indicators. In the first five months, retail sales soared by 10% and ‘paid services to the population’ by 12.5%. This development was fuelled by people spending their accumulated savings, vibrant consumer lending and – to all intents and purposes – largely closed borders (the Russian Sputnik V vaccine has not been recognized by the EU). But inflationary pressures have intensified, too, and are no longer purely supply-side driven: by May, the year-on-year inflation reached 6%. In response, the policy rate has been raised by a combined 1.25 percentage points (pp) since March (to 5.5%), with further hikes likely to follow soon.

On the strength of recent performance, our growth forecast for 2021 has been revised upwards by 0.3 pp, to 3.5%. The economy would grow even more strongly, were it not for the renewed surge in COVID-19 infections that engulfed Russia in June (and which, given the low vaccination rate, is unlikely to subside soon). The newly imposed measures in a number of regions will weaken the pace of recovery in coming months.

SERBIA: CONTINUING TO IMPRESS

by Branimir Jovanović

The economy got off to a flying start in 2021: GDP in Q1 grew by 1.7% year on year and 1.9% quarter on quarter, seasonally adjusted. This happened despite a severe pandemic wave, suggesting that the economy is learning how to live with COVID-19. The main driver of growth was government investment: it grew by 59% year on year, leading to a rise in total investment of 10% and an increase in construction of 19.5%. Exports of goods and services also contributed, growing by 8.9% (in real terms). The rest of the year should see even stronger growth. The pandemic has moderated and the vaccination campaign has been quite successful, boosting consumption and investment. Industrial production in April grew 34% year on year, while retail trade was 42% up; both are now well above their pre-crisis levels. We are thus revising our growth forecast for 2021 from 5% to 6%.

The robust economic recovery, together with higher energy and food prices, has brought the return of inflation, at least temporarily. Headline inflation in May 2021 reached 3.6% year on year, the highest in four years. At 2.1% in May, core inflation is also up. We are hence upgrading our inflation projection for 2021 from 2% to 3%. The central bank will likely increase its policy rate in the second half of the year.

SLOVAKIA: SHORTAGE OF COMPUTER CHIPS COULD DAMPEN PROSPECTS

by Doris Hanzl-Weiss

Slovak GDP increased by just 0.2% year on year in Q1 2021. Recovery was hampered by lockdown and followed the 3.5% decline recorded in the corresponding quarter of 2020. Household consumption declined by 5.8%, while the negative sentiment and uncertainties over the path of the pandemic proved a drag on investment; gross fixed capital formation fell by 10% year on year. On the other hand, the positive trends in exports seen in Q3 and Q4 2020 continued into 2021, and net exports contributed positively to growth: real exports increased by 10% in Q1 2021, while imports grew by 5.4%.

Better growth prospects lie ahead. We have revised our growth forecast for this year upwards, to 4% (from 3.6%), and have maintained the same forecast for 2022 (4.4%). Household consumption will recover modestly, and the good export performance should continue. Investment should recover this year and will play a major role in future years, with the next EU Multiannual Financial Framework commencing and additional funds from the Recovery and Resilience Facility becoming available (EUR 6.3bn were approved on 21 June). The downside risks include the pandemic and a shortage of semiconductors, which could affect the Slovak automotive industry. Among the upside risks is a stronger than expected global recovery.

SLOVENIA: THE UPCOMING PRESIDENCY OF THE EU COUNCIL PLACES INTERNAL POLITICS IN THE SPOTLIGHT

by Niko Korpar

Slovenia experienced a protracted second wave of COVID-19, with persistently high rates of infection until April 2021. Still, GDP grew by 1.6% in Q1 2021 year on year, helped by an uptick in fixed capital investments, especially in machinery and equipment (up by 7.6%). By the end of June, most of the restrictions had been removed and the government had started to revoke support measures. Private consumption has also started to grow since April. Thus, the growth projection for 2021 has been revised upwards, from 3.6% to 4%. Mostly due to rising energy prices, we have revised our forecast for inflation in 2021 to 1.7% (up from 1.3%). Politically, the government occupies a weak position in parliament and is facing domestic protests. It also continues to quarrel with EU institutions, on the eve of the country assuming the presidency of the EU Council.

In 2022, we expect the economy to grow by 4.3%, as private spending and investments return to pre-crisis levels and the first effects of the Recovery and Resilience Facility spending (EUR 2.5 billion) are felt. Services are also due for a rebound and unemployment will drop to below 5%. Inflation is not projected to accelerate further, although increasing employment will put some pressure on consumer prices.

TURKEY: PERFORMING WELL AGAIN IN 2021

by Richard Grieveson

Turkey was hit by a severe wave of COVID-19 infections during the spring, but strict lockdown measures resulted in an improvement in the public health situation in May and June. Consumer price inflation rose above 17% in April, and the lira has continued to weaken against the euro and the US dollar. Despite these challenges, the economy remains resilient, with double-digit year-on-year industrial output and retail trade growth in the early months of 2021, and a real GDP expansion of 7% in Q1.

We expect the economy to expand by 5.8% overall in 2021 – one of the best outturns in CESEE – before growth slows to around 3.5% per year over the rest of the forecast period. Credit expansion will remain robust, but is unlikely to drive growth to the same extent as it has over the past 12 months. Manufacturing should continue to perform strongly in 2021, helped by the recovery in the global economy and the weaker lira; but the tourist industry looks to be in for another difficult year. Despite continued high inflation, monetary policy is likely to be eased; this may well boost short-term growth, but it will also increase external vulnerabilities, particularly as US dollar interest rates rise.

UKRAINE: RECOVERY DRIVEN BY A SPENDING SPREE

by Olga Pindyuk

In Q1 2021, real GDP decreased by 2.2% year on year due to the negative contribution of net exports and the ongoing investment decline. Although in nominal USD terms exports still grew at a double-digit rate, the fall in real exports deepened, mainly because of last year's poor harvests. Household final expenditure increased by 4.4% year on year on the back of high wage growth, an increase in pensions and rising remittances. The retail trade dynamics in May (+22.7% year on year in real terms) indicates a further acceleration in consumer spending. Inflation has increased significantly (to 9.5% year on year in May), mostly on the back of global commodity prices.

We have revised our GDP forecast for 2021 upwards – to 4.3% – owing to faster growth in private consumption and higher prices for key export commodities. In 2022-2023, economic growth will slow to 3.5%, as the low base will no longer be a factor. Inflation will subside as global commodity prices stabilise. Cooperation with the IMF remains frozen, and failure to reinvigorate it poses a significant risk to financial stability. The slow roll-out of the COVID-19 vaccination campaign means that the next wave of the pandemic could present another major risk to economic recovery.

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