

PRESS RELEASE

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wiiw Forecast for Central, East and Southeast Europe, Kazakhstan and China: Differentiated Impact of the Global Crisis

The Vienna Institute for International Economic Studies (wiiw) has just published its latest **Analyses and Forecasts**. The report, titled *Differentiated Impact of the Global Crisis*, analyses recent economic developments and short- and medium-term development prospects, covering the countries in Central and Eastern Europe (CEE) and Southeast Europe including Turkey (SEE), together with China, Kazakhstan, Russia and Ukraine. Separate chapters present an overview of developments in the European Union's New Member States (NMS) and in SEE countries, or deal with the global economic environment and the role of the energy sector.

A broad variety of growth slowdown and recession patterns

Common to all countries covered by the wiiw report is a pronounced economic downturn. Effects of the global financial crisis - a credit crunch, a decline in industrial production and foreign trade - are now observed in the CEE, the SEE and the countries more to the east as well.

The individual countries' performance, both current and projected, is not uniform. Differences follow from country-specific conditions. Several new EU members have managed to strengthen the international competitiveness of their corporate sector in recent years and attained a relatively high degree of trade diversification. In other countries, mostly in Southeast Europe, the corporate sector has been severely strained on account of the pronounced real appreciation. This is reflected in high current account deficits.

In 2009, some countries in the region will experience a significant slowdown in GDP growth: the Czech Republic, Poland and Slovakia; Albania; Kazakhstan and Russia; and last, but not least, China (see Table Overview developments 2007-2008 and outlook 2009-2011).

Other countries are expected to suffer a significant drop in GDP: Estonia, Hungary, Latvia and Lithuania; Croatia, Macedonia and Turkey; Bosnia and Herzegovina, Montenegro and Serbia; and Ukraine. Straddling the two sub-groups are three NMS, in which the GDP may stagnate or decline slightly in 2009 – Bulgaria, Romania and Slovenia.

Risks associated with major imbalances and high indebtedness

Whereas as a rule fiscal deficits shrank relative to the GDP in recent years, countries had ample manoeuvring space in which to run up substantial or even massive trade and current account deficits. Except for Turkey, in all SEE countries, the current account deficit in 2008 exceeded 10% of GDP. It ran as high as 27% in Montenegro, 25% in Bulgaria and 18% in Serbia, while it ranged between 10 and 15% in Albania, Croatia, Macedonia and Romania. Outside SEE, only in Latvia and Lithuania were the deficits of a similar magnitude: 12-13% of GDP. However, the current account deficits in the CEE and SEE countries are high in general. With the exception of the Czech Republic, current account deficits exceeded 5% of GDP throughout the region. By contrast, China and Russia have a long tradition of current account surpluses.

When international financial markets assess risks, a country's degree of indebtedness may play an even more decisive role than its current account deficits. Gross external debt is quite high in some of the CEE and SEE countries, amounting in some instances to over 100% of GDP. The countries in question are Latvia (137% in 2008), Hungary (121%), Estonia (117%), Bulgaria (112%) and Slovenia (104%). In Croatia, the ratio in 2008 was 96%. Some of this debt will fall due in 2009 and require refinancing, thus posing a major vulnerability problem.

Indicators such as government deficit, government debt, current account deficit or external debt typically tell us something about an economy's vulnerability. However, if applied to Russia, we see that the country has recorded no government deficit in recent years and government debt has been low, further to which the current account shows a large surplus and external debt is low. All that notwithstanding, Russia is suffering an economic setback and its currency is depreciating. Owing to the country's extreme dependence on revenues from energy exports, the sharp decline in energy prices has had a disastrous effect, revealing severe structural weaknesses in both the financial and non-financial sectors. Turkey, another large economy by CEE and SEE standards, faces a drop in its GDP and devaluation of its currency despite a rather strong corporate sector and a correspondingly diversified trade structure. Under the impact of the international crisis, China's growth has slowed down. The government's budget has been balanced in recent years, with the current account being in surplus.

Exchange rate regimes do matter

When current account deficits or foreign-currency debts are high, a fixed currency peg, for example in a currency board context like in Bulgaria or Estonia, may come under severe strain. This is clearly visible in the case of Latvia. In any country, the real exchange rate can develop in such a manner that puts the international competitiveness of a larger number of its companies in jeopardy; they may thus find it difficult to service their debt. Quite a few of them may turn 'Detroit' in the sense of their being both important and yet unable to survive without state aid, thus causing the governments still more trouble. Cases of this kind may occur also in some of the CEE or SEE countries, or east of them. In countries with a flexible exchange rate, the real sector, especially producers of tradables, will profit from devaluation against the lead currencies, whereas companies and households with high foreign currency debts will face trouble. This holds true for the Czech Republic, Hungary, Poland, Romania, Russia, Serbia, Turkey and Ukraine. In most cases, depreciation is likely to decrease their current account deficit (at least, in terms of percentage of the GDP). For countries with a fixed peg, regardless whether the peg is official or de facto, keeping the nominal exchange rate constant will lead to a decline in GDP, which will be pronounced enough to incur a substantial reduction in the current account deficit.

The divide between flexible-currency and fixed-peg countries will also be of significance in terms of price developments. Fixed-peg countries might well go through a phase of declining prices: a trend in fact that is already in motion. In flexible-currency countries, depreciation will have some inflationary impact, although it may be less than in periods of economic prosperity. The wiiw projection of consumer price inflation shows that only in countries experiencing major devaluation, viz. Russia and Ukraine, will the rates of inflation be two-digit in 2009, yet for both countries the report expects deceleration compared to 2008.

Very limited space for anti-cyclical fiscal policies

The government deficit in the CEE and SEE countries will probably increase in both 2009 and 2010. The main reason will be a combination of lower revenues and overextended expenditures. The increase in expenditures will mainly stem from the need to support ailing financial and non-financial companies and pay out higher unemployment benefits. Under such circumstances, the countries in question will – with very few exceptions – hardly be in a position to enact substantial demand-stimulating fiscal policies over a longer period. China's and Russia's governments, however, have some room of manoeuvre.

No swift return to high growth

The extent and eventual date of a recovery from the current slowdown and slump in the various CEE and SEE economies is shrouded in uncertainty. Increasing net exports have the highest potential of becoming the engine of future growth; the balance of CEE and SEE trade can, however, improve only in the case of some partner countries' trade balance deteriorating correspondingly vis-à-vis these countries. It is not sure whether the United States or Western Europe will assume that role in the near future. The impact of the major devaluations, and hence improved competitiveness, might ultimately be the key component of demand that leads to an upswing. In case of favourable international development, the region's economy may start growing again in 2010 or 2011. A return to high growth rates on a par with past years is somewhat unlikely in the near future as foreign financing would not return to its previous level.

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Overview developments 2007-2008 and outlook 2009-2011

	GDP					Consumer prices					Unemployment, based on LFS ¹⁾					Current account				
	real change in % against previous year					change in % against previous year					rate in %, annual average					in % of GDP				
	2007	2008	2009	2010	2011	2007	2008	2009	2010	2011	2007	2008	2009	2010	2011	2007	2008	2009	2010	2011
			Forecast	Forecast				Forecast	Forecast				Forecast	Forecast				Forecast	Forecast	
Czech Republic	6.0	3.5	0.4	2.4	3.8	2.9	6.3	1.5	2.2	2.5	5.3	4.4	6	6.0	5.5	-1.8	-2.8	-1.7	-1.3	-1.8
Hungary	1.1	0.3	-3	1.4	3	7.9	6.0	3	3	3	7.4	7.8	9	8.8	8	-6.2	-6.1	-4.9	-5.5	-5.1
Poland	6.6	4.8	1.5	2.3	3.8	2.6	4.2	3	2.6	2.5	9.6	8	12	11	10	-4.7	-5.4	-3.9	-4.4	-4.3
Slovakia	10.4	6.4	2	2	3	1.9	3.9	2	2	3	11.1	10.0	11	12	12	-5.7	-6.3	-6.6	-6.8	-6.8
Slovenia	6.8	4.4	0	2	4	3.8	5.5	2.5	2.5	2	4.8	4.5	5.5	5	4.5	-4.2	-6.3	-5.8	-4.9	-4.6
NMS-5 ²⁾³⁾	6.0	4.0	0.6	2.1	3.6	3.5	5.0	2.6	2.5	2.6	8.5	7.4	10.0	9.6	8.8	-4.4	-5.1	-4.0	-4.2	-4.1
Bulgaria	6.2	6	0	1	3	7.6	12.0	2	2	3	6.9	5.8	8	9	8	-21.8	-24.5	-13.0	-11.7	-10.2
Romania	6.2	7.8	0	1	3	4.9	7.9	5	5	4	6.4	6.0	8	9	8	-13.5	-12.1	-8.0	-6.5	-6.3
Estonia	6.3	-3.5	-7	-3.5	0.5	6.7	10.6	2	-1	-1	4.7	5.5	10.5	13	15	-18.1	-8.5	-5.8	-5.5	-6.3
Latvia	10.2	-2.8	-8	-4	0	10.1	15.2	3	-2	-1	6.0	7.2	12	15	16	-23.8	-12.2	-7.0	-5.7	-7.9
Lithuania	8.9	3.2	-5	-3.5	1	5.8	11.1	3.5	0.5	0.5	4.3	5.5	8.5	13	15	-14.6	-13.6	-7.3	-6.3	-7.9
NMS-10 ²⁾³⁾	6.2	4.4	0.0	1.5	3.3	4.2	6.3	3.0	2.7	2.7	7.7	6.9	9.4	9.6	8.9	-7.4	-7.3	-5.1	-4.9	-4.9
<i>Euro area</i> ³⁾	2.7	0.7	-1.9	0.4	.	2.1	3.3	1.0	1.8	.	7.5	7.5	9.3	10.2	.	0.2	-0.4	-0.6	-0.6	.
<i>EU-27</i> ³⁾	2.9	0.9	-1.8	0.5	.	2.4	3.7	1.2	1.9	.	7.1	7.1	8.7	9.5	.	-0.5	-0.6	-1.4	-1.4	.
Croatia	5.6	2.5	-2	1	4	2.9	6.1	4	3	2	9.6	9.0	10.5	11	10	-8.6	-10.9	-7	-8	-8
Macedonia	5.9	5.3	-1	0	2	2.3	8.3	3	3	3	34.9	33.8	34	33	33	-7.2	-13.6	-7	-8	-8
Turkey	4.5	1.5	-2.5	1	3	8.8	10.4	8	7	5	9.9	11.0	13	13	12	-5.8	-4.7	-3.6	-3.3	-3.1
<i>Candidate countries</i> ²⁾³⁾	4.6	1.6	-2.4	1.0	3.0	8.3	10.1	7.6	6.7	4.8	10.7	11.7	13.7	13.7	12.7	-6.0	-5.3	-4.0	-3.8	-3.5
Albania	6.0	6.1	3	4	6	2.9	3.4	2	3	3	13.5	12.8	13	12	11	-10.5	-12.7	-9.9	-11.4	-12.3
Bosnia & Herzegovina	6.8	5.0	-1	-1	0	1.5	7.5	-0.5	0	1	29.0	23.4	27	27	26	-12.6	-12.8	-11	-9	-8
Montenegro	10.7	8.1	-2	0	2	4.2	8.5	3	3	3	19.3	18.5	19	20	20	-29.4	-26.9	-10	-10	-10
Serbia	7.1	6.1	-2	0	2	7.0	11.7	6	3	3	18.1	14.0	18	20	20	-13.3	-17.8	-10	-10	-12
<i>Potential candidate countries</i> ²⁾³⁾	7.1	6.0	-0.9	0.4	2.2	5.0	9.2	3.8	2.4	2.6	19.2	15.7	18.5	19.0	18.4	-13.6	-16.5	-10.2	-10.1	-11.0
Kazakhstan	8.7	3.5	1	3	4.5	10.8	17.1	9.5	8	7	7.0	6.8	7.5	7	6.5	-7.0	3.7	-6.8	-4.4	-3.9
Russia	8.1	5.6	1.1	3.7	4.6	9.1	14.1	15	10	8	6.1	6.3	6.7	6.6	6.3	5.9	5.9	1.0	-0.9	-1.8
Ukraine	7.6	2.1	-5	1.5	4.5	12.8	25.2	18	12	10	6.4	6.7	7.5	7.5	7.2	-4.2	-6.9	-2.2	-0.4	-0.3
China ⁴⁾	13.0	9.0	7	8	8.2	4.8	5.9	2	2	2.5	4.0	4.2	4.4	4.3	4.2	11.0	9.3	6.2	6.6	6.1

Note: NMS: The New EU Member States.

1) LFS - Labour Force Survey. - 2) wiw estimate. - 3) Current account data include flows within the region. - 4) Registered urban unemployment rate, end of period.

Source: wiw (February 2009), Eurostat. Forecasts by wiw, European Commission (Interim Report, January 2009) for Euro area (16 countries) and EU-27.