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Economic convergence despite political uncertainty

Report on wiiw's most recent growth projections for countries in Central, East and Southeast Europe (CESEE) and their economic ties with Austria

- **Compared with the wiiw Spring Forecast, growth projections for the CESEE region were for the most part revised upwards.**
- **We expect the region's GDP to grow by 2.4% in 2017 and an acceleration of growth rates to 2.6% and 2.7%, respectively, in the next two years.**
- **The most important factors driving growth are the economic recovery in the euro area and the relatively low oil price. Many countries in the CESEE region are also experiencing favourable developments in private consumption and investments.**
- **(Geo)political turmoil remains a constraint on growth in Ukraine, Russia and some countries in the Western Balkans. Negative political developments in Poland, Romania, Hungary and Turkey have not yet had a material negative economic impact. However, together with Brexit, they represent the greatest sources of uncertainty in the medium term.**

Economies in EU member states in Central and Eastern Europe (EU-CEE) are performing better than we had expected at the time of our Spring Forecast, with a projected average growth rate of 3.5% this year. The growth differential compared to the euro area therefore amounts to 1.8 percentage points. On the country level, GDP growth projections for 2017 range from 2.3% for Estonia to 4.8% for Romania. Exports are increasing strongly, reflecting the economic recovery in the euro area. Wages are continuously increasing – on the one hand caused by a shortage of skilled labour, on the other hand supported politically by increases in minimum wages (e.g. in Hungary, Latvia, Poland, Romania, and Slovakia), social benefits, and wages paid in the public sector. At the same time inflation remains low, partly due to the low oil price. This environment supports private consumption in particular as the most important growth driver in the region. The start of the new EU funding programming period is also expected to result in an increase in EU co-financed investments.

For Turkey, growth projections for 2017 were raised by 0.7 percentage points to 2.8% based on increased public investment and stronger supply of loans. In addition, the currently weak Turkish lira is supporting export growth and the recovery of the tourism sector. In the medium term, however, negative political developments, high inflation and high levels of external debt (particularly in US dollars) could erode the confidence of local businesses and

consumers, and foreign investors. Turkey's large external financing needs leave it vulnerable to swings in market sentiment, particularly at a time of tightening US dollar liquidity.

Sluggish public investments have reduced growth prospects for the Western Balkans to around 2.9% for 2017. In Macedonia and Montenegro in particular, political turmoil after recent elections led to a standstill in public investments. In the Western Balkans, Albania is developing most dynamically with an expected growth rate of 3.9%, based on a positive export performance and investments such as the construction of the Trans Adriatic Pipeline or the Devoll Hydropower plant.

The persistently low oil price and the conflict in eastern regions of Ukraine are still determining economic developments in the region. The negative impact of the conflict for Ukraine has been intensified by a trade blockade of the separatist-controlled areas of Donbas, which has been in place since the end of January. Electricity shortages and the related collapse of steel production led to a downward revision of growth projections to 2% for 2017. Russian exports have recovered with the increase of the oil price. Simultaneously, however, the Russian rouble has appreciated, resulting in import growth developing more dynamically than export growth. Therefore, net exports will contribute negatively to Russian GDP growth in 2017. Assuming a stable oil price (50-55 US dollar per barrel), we expect GDP for the region of CIS and Ukraine to increase only by 1.5% this year.

Austria continues to be one of the main investors in CESEE. Based on the stock of foreign direct investment (FDI), Austria was the largest investor in Slovenia (30.7%), Bosnia and Herzegovina (20.4%) and Croatia (19.2%) in 2016. It also featured among the top 10 investors in another 14 CESEE countries. From an Austrian perspective, the Visegrád countries (Poland, Czech Republic, Slovakia and Hungary) form the core of investment activity in the region.

Austrian trade figures are still dominated by Germany. However, a trade reorientation towards the East has been visible for some time, and is set to continue. In 2016, the share of CESEE in Austrian exports was 22%, and 21% in terms of imports. Trade with EU member states in the region is gaining particularly in importance for Austria. Between 2006 and 2016 the share of EU-28 in Austrian trade shrank by two percentage points, while the share of CESEE (including EU-CEE) grew by a similar amount. In 2016 Austria generated a merchandise trade surplus with CESEE of EUR 5.4 billion, while the trade in services showed a deficit of EUR 2.2 billion.

From 2015 to 2016 the unemployment rate in Austria, for both Austrians and nationals of EU-CEE, fell for the first time since the onset of the global economic crisis. While the Austrian unemployment rate fell from 8.1% to 8.0%, the unemployment rate for EU citizens in the aggregate fell by 0.6 percentage points to 9.3% and for nationals of the EU countries of Central and Eastern Europe by 0.9 percentage points to 10% in 2016. In total, 9.3% of the Austrian population originated from CESEE in 2016, 48% of which was accounted for by EU-CEE nationals.

In summary, the economies in Central, East and South East Europe are on average performing very well and are – with the exception of Ukraine and some parts of the Western Balkans – firmly shrugging off negative political developments. Due to its close ties with CESEE – in particular with EU-CEE – Austria should, at least in the short term, continue to benefit from the current growth acceleration in the region.

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OVERVIEW 2015-2016 AND OUTLOOK 2017-2019

	GDP					Consumer prices					Unemployment (LFS)					Current account				
	real change in % against prev. year					change in % against prev. year					rate in %, annual average					in % of GDP				
	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019
			Forecast					Forecast					Forecast					Forecast		
Bulgaria	3.6	3.4	3.5	3.5	3.6	-1.1	-1.3	0.5	1.0	1.5	9.2	7.6	7.0	6.5	6.0	-0.1	4.2	2.6	2.3	2.0
Croatia	1.6	2.9	2.7	2.9	3.0	-0.3	-0.6	1.3	1.6	1.6	16.2	13.1	13.0	12.5	12.0	4.8	2.6	2.3	2.3	2.0
Czech Republic	4.5	2.4	2.7	2.7	2.4	0.3	0.6	1.6	2.0	2.0	5.1	4.0	3.9	3.8	3.6	0.2	1.1	0.6	0.2	0.1
Estonia	1.4	1.6	2.3	2.5	2.6	0.1	0.8	3.0	3.2	3.2	6.2	6.8	6.7	7.0	7.0	2.2	2.7	1.4	1.3	1.2
Hungary	3.1	2.0	4.0	3.9	3.3	0.1	0.4	2.9	3.2	3.3	6.8	5.1	4.4	4.3	4.2	3.4	4.9	4.5	3.7	2.8
Latvia	2.7	2.0	2.9	3.0	2.9	0.2	0.1	2.9	2.7	2.5	9.9	9.6	9.1	8.5	8.0	-0.8	1.5	0.2	-0.2	-0.5
Lithuania	1.8	2.3	3.0	3.2	3.3	-0.7	0.7	3.0	2.8	2.5	9.1	7.9	7.3	6.8	6.3	-2.3	-0.9	-0.7	-0.2	-0.2
Poland	3.8	2.7	3.3	3.2	3.1	-0.7	-0.2	1.4	1.9	2.0	7.5	6.2	6.2	6.1	6.1	-0.6	-0.3	-0.3	-0.7	-1.0
Romania	3.9	4.8	4.8	4.3	4.3	-0.4	-1.1	1.3	2.5	3.0	6.8	5.9	5.3	5.0	4.8	-1.2	-2.3	-2.8	-3.1	-3.4
Slovakia	3.8	3.3	3.3	3.6	3.9	-0.3	-0.5	1.2	1.8	1.8	11.5	9.7	8.3	7.7	7.2	0.2	-0.7	-0.2	0.6	1.5
Slovenia	2.3	2.5	3.5	3.2	3.1	-0.8	-0.2	1.5	1.8	1.8	9.0	8.0	7.5	6.9	6.5	5.2	6.8	6.4	4.6	4.5
EU-CEE ¹⁾²⁾	3.6	3.0	3.5	3.4	3.3	-0.4	-0.2	1.6	2.1	2.3	7.8	6.5	6.2	5.9	5.7	0.3	0.7	0.4	0.0	-0.2
EA-19	2.0	1.8	1.7	1.8	.	0.0	0.2	1.6	1.3	.	10.9	10.0	9.4	8.9	.	3.7	3.6	3.0	2.9	.
EU-28	2.2	1.9	1.9	1.9	.	0.0	0.3	1.8	1.7	.	9.4	8.5	8.0	7.7	.	2.2	2.2	1.9	1.9	.
Albania	2.2	3.5	3.9	4.0	4.1	1.9	1.3	2.3	2.8	3.0	17.1	15.2	14.2	14.0	13.6	-10.8	-9.6	-9.6	-9.3	-9.0
Bosnia and Herzegovina	3.0	2.0	3.2	3.4	3.4	-1.0	-1.1	1.2	1.6	1.9	27.7	25.4	25.3	25.1	25.0	-5.5	-4.5	-3.8	-3.8	-3.8
Kosovo	4.3	3.4	3.7	3.8	3.7	-0.5	0.3	1.6	1.9	2.3	32.9	27.5	25.8	25.5	25.2	-8.6	-9.2	-10.0	-10.6	-11.1
Macedonia	3.8	2.4	2.6	3.3	3.4	-0.3	-0.2	1.0	1.5	2.0	26.1	23.7	24.0	23.0	23.0	-2.1	-3.1	-3.2	-3.9	-4.0
Montenegro	3.4	2.5	2.5	2.7	2.5	1.4	0.1	1.5	2.0	2.0	17.6	17.7	17.0	16.5	16.5	-13.3	-19.0	-21.4	-23.7	-23.7
Serbia	0.8	2.8	2.5	2.6	2.8	1.4	1.1	2.0	2.0	2.0	17.7	15.3	15.0	14.0	14.0	-4.7	-4.0	-3.9	-4.2	-3.9
WB ¹⁾²⁾	2.1	2.7	2.9	3.1	3.2	0.7	0.5	1.7	2.0	2.1	21.2	18.7	18.3	17.6	17.5	-6.1	-5.8	-5.9	-6.2	-6.1
Turkey	6.1	2.9	2.8	2.9	3.0	7.7	7.8	10.9	7.8	6.8	10.3	10.9	11.2	10.8	10.4	-3.7	-3.8	-3.7	-3.8	-4.1
Belarus ³⁾	-3.8	-2.6	1.4	2.1	2.6	13.5	11.8	10.0	9.0	8.0	1.0	0.8	1.0	1.0	1.0	-3.3	-3.6	-3.4	-3.1	-3.1
Kazakhstan	1.2	1.0	2.5	3.0	3.0	6.6	14.6	7.0	6.0	6.0	5.0	5.0	5.0	5.0	5.0	-2.8	-6.3	-2.6	-1.9	-1.9
Russia	-2.8	-0.2	1.3	1.6	1.8	15.5	7.1	5.0	4.0	5.0	5.6	5.3	5.5	5.5	5.5	5.0	1.9	3.1	3.5	3.5
Ukraine	-9.8	2.3	2.0	3.0	3.0	48.7	13.9	12.0	5.9	5.0	9.1	9.3	9.1	8.7	8.3	-0.2	-4.1	-4.4	-4.4	-4.5
CIS + Ukraine ¹⁾²⁾	-3.0	0.0	1.5	1.9	2.1	17.1	8.6	6.0	4.6	5.2	5.9	5.9	5.9	5.9	5.8	3.6	0.7	1.8	2.3	2.3
V-4 ¹⁾²⁾	3.9	2.6	3.3	3.2	3.1	-0.4	0.0	1.6	2.1	2.2	7.3	5.9	5.7	5.6	5.5	0.2	0.7	0.6	0.3	0.1
BALT-3 ¹⁾²⁾	2.0	2.0	2.8	3.0	3.0	-0.3	0.5	3.0	2.9	2.7	8.7	8.2	7.7	7.4	7.0	-0.7	0.7	0.1	0.2	0.0
SEE-9 ¹⁾²⁾	3.2	3.9	3.9	3.7	3.8	-0.2	-0.7	1.3	2.0	2.4	12.8	11.2	10.7	10.2	9.9	-1.4	-1.6	-2.1	-2.4	-2.6
NON-EU-11 ¹⁾²⁾	-0.2	1.0	1.9	2.2	2.4	13.8	8.1	7.3	5.4	5.6	7.6	7.6	7.7	7.5	7.3	0.9	-1.1	-0.3	-0.1	-0.3
CESEE-22 ¹⁾²⁾	0.9	1.6	2.4	2.6	2.7	9.7	5.6	5.6	4.4	4.6	7.6	7.3	7.3	7.1	7.0	0.7	-0.5	-0.1	-0.1	-0.3

Note: EU-CEE: Central and East European EU countries; V-4: Visegrád countries: Czech Republic, Hungary, Poland, Slovakia; BALT-3: Baltic countries: Estonia, Latvia, Lithuania; SEE-9: Southeast Europe: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Macedonia, Montenegro, Romania, Serbia; NON-EU-11: Non-European Union countries: Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, Serbia, Turkey, Belarus, Kazakhstan, Russia, Ukraine; CESEE-22: Central, East and Southeast Europe: EU-CEE + NON-EU-11.

1) wiiw estimates. - 2) Current account data include transactions within the region (sum over individual countries). - 3) Unemployment rate by registration.

Source: wiiw, Eurostat. Forecasts by wiiw (June 2017) and European Commission for EU and euro area (Spring Report, May 2017).