3. CESEE overview: Bracing for the Winter

BY BRANIMIR JOVANOVIĆ

- **Economic growth in the CESEE region in the first half of 2022 was, in general, better than expected, thanks largely to the release of pent-up consumption. Accordingly, we are revising our growth forecasts for this year upwards for most CESEE countries.**
- **Still, the surge in global food and energy prices has generated very aggressive inflation in the CESEE region. Consequently, we are also revising our inflation forecasts for 2022 upwards for most of the countries.**
- **The worst is yet to come. Inflation is eroding real incomes, consumer confidence is evaporating, business sentiment is deteriorating, interest rates are soaring and the fiscal space is shrinking. And on top of all that, there is the energy crunch.**
- **Our new inflation forecasts for 2023 are much higher than before. On a weighted average basis, we expect inflation in CESEE in 2023 to be 11.6% – far higher than the figure of 6% in the euro area.**
- **By the same token, we are revising our next year's GDP forecasts downwards for almost all CESEE economies. On a weighted average basis, we forecast that the CESEE region will grow by 0.3% next year, close to the 0.2% growth that we assume for the euro area.**

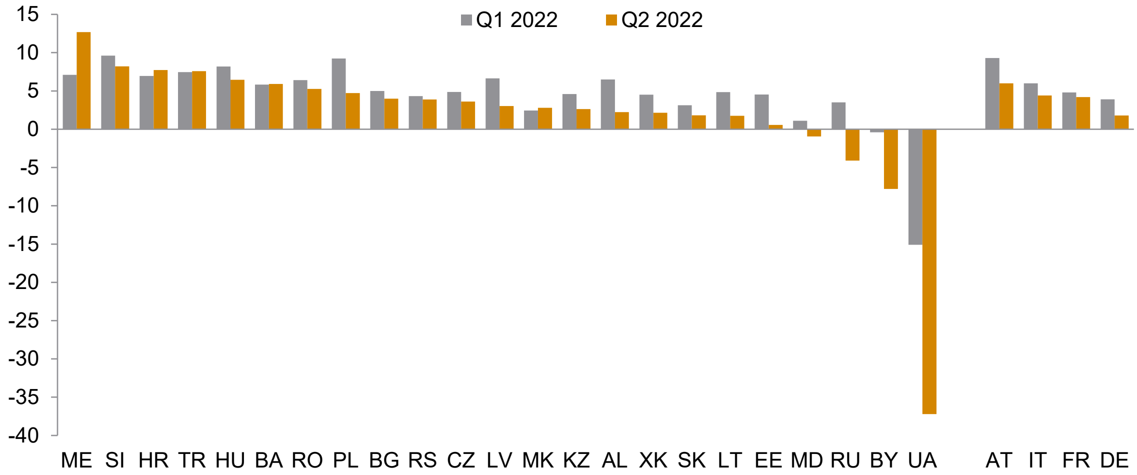
3.1. GROWTH BEAT EXPECTATIONS IN THE FIRST HALF OF 2022

Despite the war in Ukraine and the surge in global prices that it brought, economic growth in CESEE in the first half of the year turned out better than expected. On a simple average basis, the economies of the region (excluding Ukraine and Russia) grew by 4.6% in the first six months of 2022. This was on a par with the 4.7% growth in the euro area, although the CESEE economies were building on the much stronger growth they had seen in 2021, and some of them are also very close to the war-affected areas.

Notwithstanding the overall solid results, there are notable differences between individual countries (Figure 3.1). At one end of the spectrum are those countries that are geographically close to the conflict zone, like Belarus and Moldova, whose GDP either contracted or stagnated. The Baltic countries are in a similar position, especially Estonia and Lithuania. At the opposite end are the heavily tourist-oriented economies, like Montenegro, Croatia and Turkey, which all saw close to double-digit growth as tourism bounced back strongly, though in some cases, they were also helped by the low starting base – a consequence of the bigger contraction their economies experienced during the pandemic. Ukraine's GDP declined by 26% in the first half year (37% in Q2), while Russia's contracted by just 0.3% in the first six months (4.1% in Q2). If we compare the CESEE countries with Western European economies, we find that most of them performed better than Germany, but worse than Austria. It is also clearly the case that in most of the countries growth lost momentum in Q2 2022: in 18 of the

23 CESEE economies, GDP expanded less in the second quarter than in the first. This suggests that by Q2 the CESEE economies had started feeling the effects of the war in Ukraine.

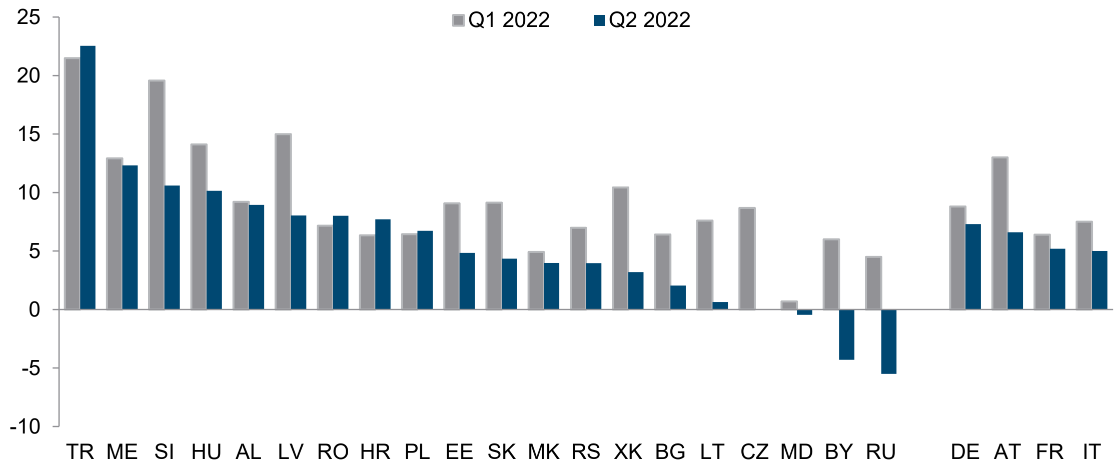
Figure 3.1 / Real GDP growth in the first half of 2022, %, year on year



Source: Eurostat and wiiw Monthly Database.

The driver of growth in the first half of the year was household consumption. It grew in 19 of the 20 countries that published data on GDP components. On a simple average basis, the growth in the first two quarters was 7.4% year on year (Figure 3.2). To a large extent, this was due to the low base the previous year – especially in Q1 2021, as many countries had quite strict COVID measures in place at the start of that year. Real wages were also still growing in many CESEE countries in the first half of 2022, and credit activity was supportive, as well. It is also possible that people brought forward big-ticket purchases, in anticipation of the approaching higher inflation. Turkey was a remarkable outlier: growth in consumption there exceeded 20%, despite the country's very high inflation. This can be attributed to the low base the previous year, the surge in tourism, the increase in wages and buoyant credit activity. On the other hand, Russia was the only country where consumption contracted in the first half year (Ukraine has not published data on its GDP components). Belarus also saw a decline in consumption in Q2, but there the growth in Q1 more than covered the decline in Q2. Compared to Western Europe, most of the CESEE countries witnessed weaker growth in consumption than Austria, and similar growth to Germany, Italy and France. As with GDP growth, one can discern a general slowdown in consumption in Q2: this was true of 16 of the 20 countries considered.

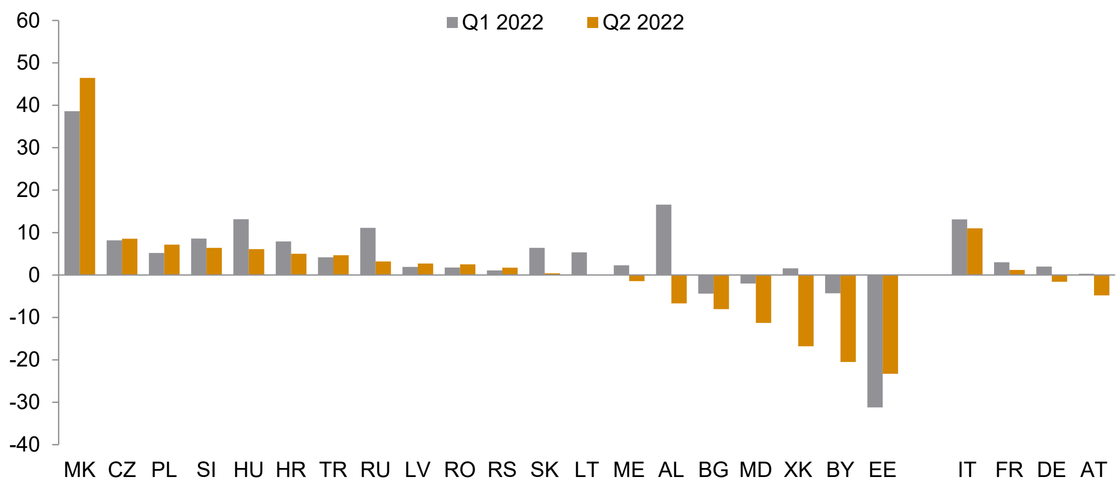
Figure 3.2 / Real growth in household consumption in first half of 2022, %, year on year



Note: Bosnia and Herzegovina, Kazakhstan and Ukraine have not published data on household consumption for Q2 2022.
Source: Eurostat and wiiw Monthly Database.

Investment, on the other hand, was much less impressive. It declined in 5 of the 20 CESEE countries for which data are available (Figure 3.3). Average growth in the region (simple average) in the first half year was 2.5%, which was below the growth in both GDP and consumption. This comes as no surprise, since investment is recognised as being the most volatile GDP component and the one to react first to negative shocks. North Macedonia was a positive exception: its growth in investment was an impressive 42% in the first half year; however, that was mainly due to the big decline over the previous two years.

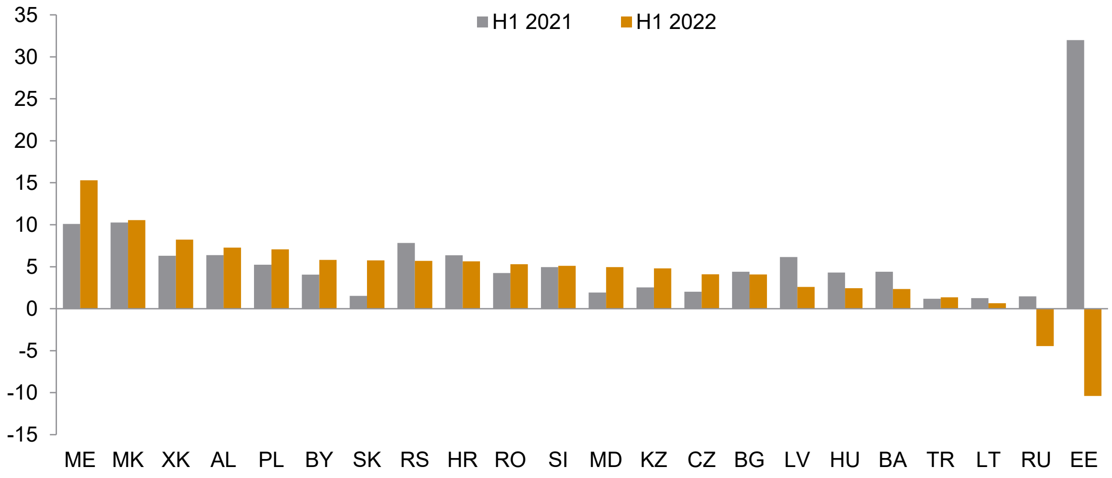
Figure 3.3 / Real growth in gross investment in first half of 2022, %, year on year



Note: Bosnia and Herzegovina, Kazakhstan and Ukraine have not published data on gross investment for Q2 2022.
Source: Eurostat and wiiw Monthly Database.

In contrast to the decline in gross investment, foreign direct investment (FDI) inflows remained strong in the first half year. They averaged 5.3% of GDP for the whole region (excluding Estonia). This was even better than the year before, when they had averaged 4.6% of GDP. In 15 of the 22 countries for which data are available, inflows in 2022 were greater than inflows in 2021 (Figure 3.4). It is hard to say what it was that drove these strong FDI figures, as FDI is known to be very volatile. The flows may slow substantially in the coming months; but if they continue to be strong, one possible explanation is that the region is benefiting from a shift to near-shoring, with Western European companies moving production closer to home on account of the heightened global uncertainty (Jovanović et al., 2021; Jovanović, 2021). Estonia is an interesting case, as it recorded negative FDI inflows of 10% of GDP in the first half year. It is as yet unclear what drove this, but it is likely to be related to the very strong inflows that the country enjoyed the previous year (32% of GDP). There may have been a reversal of some of this investment, or negative reinvested earnings (i.e. Estonian companies paying dividends greater than their profits). Russia is another notable case: it registered outflows of 3.4% of GDP, as many international companies left the country following the invasion of Ukraine.

Figure 3.4 / FDI inflows into CESEE countries in H1 2021 and H1 2022, % of GDP



Note: The data refer to FDI inflows (liabilities) from Balance of Payments statistics.
Source: central banks, wiiw calculations.

Table 3.1 / OVERVIEW 2020-2021 AND OUTLOOK 2022-2024

		GDP real change in % against prev. year					Consumer prices average change in % against prev. year					Unemployment (LFS) rate in %, annual average				
				Forecast					Forecast					Forecast		
		2020	2021	2022	2023	2024	2020	2021	2022	2023	2024	2020	2021	2022	2023	2024
BG	Bulgaria	-4.4	4.2	3.0	1.5	3.0	1.2	2.8	14.0	10.0	8.0	5.1	5.3	4.7	4.6	4.5
CZ	Czechia	-5.5	3.5	2.0	1.0	2.8	3.3	3.3	15.0	8.5	3.2	2.6	2.8	2.5	2.6	2.6
EE	Estonia	-0.6	8.0	1.0	1.4	3.1	-0.6	4.5	18.5	8.0	4.5	6.8	6.2	5.9	6.5	5.0
HR	Croatia	-8.1	10.2	5.0	2.5	3.1	0.0	2.7	9.5	6.0	3.0	7.5	7.6	7.3	7.4	7.4
HU	Hungary	-4.5	7.1	4.2	-1.2	1.7	3.4	5.2	16.0	15.0	8.0	4.3	4.1	3.6	4.5	4.0
LT	Lithuania	-0.1	5.0	2.1	0.9	2.6	1.1	4.6	19.5	8.0	4.0	8.5	7.1	6.2	7.0	6.5
LV	Latvia	-3.8	4.5	2.8	0.6	2.3	0.1	3.2	17.0	9.0	3.5	8.1	7.6	7.0	7.2	6.6
PL	Poland	-2.2	5.9	4.6	1.7	2.4	3.7	5.2	11.5	6.5	3.5	3.2	3.4	3.0	3.1	3.2
RO	Romania	-3.7	5.9	4.8	2.2	3.5	2.3	4.1	13.0	8.0	5.0	5.0	5.6	5.3	5.5	5.4
SI	Slovenia	-4.3	8.2	5.7	1.9	2.7	-0.3	2.0	9.4	5.5	2.3	5.0	4.8	4.1	4.0	4.3
SK	Slovakia	-4.4	3.0	1.8	0.6	2.4	2.0	2.8	11.4	8.0	3.0	6.7	6.8	6.0	5.9	6.2
	EU-CEE11 [1)2)]	*-3.5*	*5.7*	*3.9*	*1.4*	*2.6*	*2.7*	*4.3*	*13.1*	*8.1*	*4.3*	*4.4*	*4.5*	*4.1*	*4.3*	*4.3*
	EA19 [3)]	*-6.1*	*5.2*	*3.1*	*0.2*	*1.9*	*0.3*	*2.6*	*8.5*	*6.0*	*2.3*	*7.9*	*7.7*	*6.8*	*7.1*	*6.6*
	EU27 [3)]	*-5.7*	*5.3*	*3.3*	*0.4*	*2.1*	*0.7*	*2.9*	*9.0*	*6.3*	*2.5*	*7.1*	*7.0*	*6.0*	*6.6*	*5.8*
AL	Albania	-3.5	8.5	3.4	3.0	3.6	1.6	2.0	7.0	4.0	2.5	11.7	11.5	11.1	10.5	10.0
BA	Bosnia and Herzegovina	-3.1	7.5	2.6	1.5	2.5	-1.1	2.0	13.0	7.0	2.0	15.9	17.4	16.4	16.1	15.7
ME	Montenegro	-15.3	13.0	5.1	2.6	3.3	-0.3	2.4	12.5	6.0	2.0	17.9	16.6	15.2	14.9	13.9
MK	North Macedonia	-6.1	4.0	1.0	0.6	2.0	1.2	3.2	14.0	9.0	4.0	16.4	15.7	14.5	14.3	14.0
RS	Serbia	-0.9	7.4	3.6	1.9	2.7	1.6	4.1	11.0	8.0	4.0	9.0	11.0	9.5	9.0	8.5
XK	Kosovo	-5.3	10.7	3.1	2.9	3.8	0.2	3.4	10.5	6.5	2.0	25.9	24.5	24.2	23.5	23.2
	WB6 [1)2)]	*-3.2*	*7.7*	*3.1*	*1.9*	*2.8*	*0.9*	*3.2*	*11.2*	*7.2*	*3.2*	*13.0*	*13.9*	*12.8*	*12.3*	*12.0*
TR	Turkey	1.9	11.4	5.1	2.5	3.2	12.3	19.6	70.7	26.7	19.5	13.2	12.0	11.5	10.5	9.5
BY	Belarus	-0.7	2.3	-4.5	1.0	2.0	5.5	9.5	17.0	12.0	11.0	4.0	3.9	4.1	4.0	4.0
KZ	Kazakhstan	-2.5	4.3	2.8	3.6	4.1	6.8	8.0	14.0	10.0	7.0	4.9	4.9	4.9	4.8	4.8
MD	Moldova	-8.3	13.9	-2.0	0.0	2.0	3.8	5.1	30.0	15.0	8.0	3.8	3.2	2.7	3.5	4.0
RU	Russia	-2.7	4.7	-3.5	-3.0	1.0	3.4	6.7	13.9	6.7	4.0	5.8	4.8	4.2	4.8	4.5
UA	Ukraine	-3.8	3.4	-33.0	5.5	12.0	2.7	9.4	21.0	10.0	6.0	9.5	9.9	28.0	15.0	10.0
	CIS4+UA [1)2)]	*-2.7*	*4.6*	*-5.8*	*-1.4*	*2.4*	*3.7*	*7.2*	*14.8*	*7.5*	*4.7*	*6.2*	*5.6*	*8.1*	*6.1*	*5.2*
	V4 [1)2)]	*-3.3*	*5.4*	*3.8*	*1.1*	*2.4*	*3.4*	*4.7*	*12.8*	*8.2*	*4.1*	*3.5*	*3.7*	*3.3*	*3.5*	*3.5*
	BALT3 [1)2)]	*-1.2*	*5.6*	*2.0*	*0.9*	*2.6*	*0.4*	*4.2*	*18.6*	*8.3*	*4.0*	*8.0*	*7.0*	*6.4*	*6.9*	*6.2*
	SEE9 [1)2)]	*-4.1*	*6.5*	*4.2*	*2.1*	*3.2*	*1.6*	*3.6*	*12.3*	*7.9*	*4.8*	*8.1*	*8.7*	*8.1*	*8.0*	*7.9*
	CIS3+UA [1)2)]	*-2.9*	*3.9*	*-13.5*	*3.9*	*7.1*	*4.8*	*8.7*	*17.9*	*10.4*	*7.2*	*7.2*	*7.3*	*17.3*	*9.8*	*7.3*
	non-EU12 [1)2)]	*-1.4*	*6.6*	*-2.3*	*-0.2*	*2.6*	*6.0*	*10.6*	*30.6*	*13.0*	*8.9*	*8.0*	*7.4*	*9.1*	*7.4*	*6.6*
	CESEE23 [1)2)]	*-2.0*	*6.3*	*-0.5*	*0.3*	*2.6*	*5.0*	*8.7*	*25.5*	*11.6*	*7.6*	*7.1*	*6.7*	*7.9*	*6.7*	*6.0*

Table 3.1 / (contd.)

		Current account in % of GDP					Fiscal balance in % of GDP				
				Forecast					Forecast		
		2020	2021	2022	2023	2024	2020	2021	2022	2023	2024
BG	Bulgaria	0.0	-0.5	-1.3	-1.0	-0.5	-4.0	-4.1	-6.0	-5.0	-4.0
CZ	Czechia	2.0	-0.9	-2.6	-4.0	-3.1	-5.8	-5.9	-4.7	-3.7	-1.9
EE	Estonia	-1.0	-1.8	-0.7	0.1	0.3	-5.5	-2.3	-3.5	-4.2	-3.9
HR	Croatia	-0.5	3.2	-2.0	-2.4	-2.7	-7.3	-2.9	-3.0	-2.9	-2.5
HU	Hungary	-1.1	-4.2	-6.3	-5.7	-4.6	-7.8	-6.8	-6.5	-4.5	-4.0
LT	Lithuania	7.3	1.1	-6.2	-6.0	-5.3	-7.3	-1.0	-3.0	-2.5	-2.0
LV	Latvia	2.7	-4.3	-5.6	-3.5	-3.3	-4.5	-7.3	-6.5	-4.0	-2.0
PL	Poland	2.9	-0.7	-1.6	-0.2	1.2	-6.9	-1.9	-4.0	-3.4	-3.0
RO	Romania	-5.0	-7.0	-9.2	-8.6	-7.7	-9.3	-7.1	-6.5	-6.0	-5.5
SI	Slovenia	7.6	3.8	1.7	1.3	0.8	-7.8	-5.2	-3.8	-3.7	-1.8
SK	Slovakia	0.4	-2.0	-7.4	-8.4	-7.9	-5.5	-6.2	-5.1	-4.1	-3.5
	EU-CEE11 1)2)	*1.0*	*-1.8*	*-3.8*	*-3.4*	*-2.5*	*-6.9*	*-4.3*	*-4.8*	*-4.1*	*-3.3*
	EA19 3)	*2.8*	*3.7*	*0.5*	*1.0*	*1.5*	*-7.0*	*-5.1*	*-4.3*	*-3.1*	*-1.8*
	EU27 3)	*2.9*	*3.3*	*0.5*	*1.0*	*1.5*	*-6.7*	*-4.7*	*-3.9*	*-2.7*	*-1.4*
AL	Albania	-8.7	-7.6	-7.6	-6.4	-6.0	-6.7	-4.5	-0.5	0.0	0.5
BA	Bosnia and Herzegovina	-3.3	-2.4	-2.6	-2.0	-1.7	-5.3	-0.3	-1.0	0.5	1.0
ME	Montenegro	-26.1	-9.2	-11.7	-12.0	-10.7	-11.1	-1.8	-8.1	-7.5	-7.1
MK	North Macedonia	-3.0	-3.1	-9.2	-8.5	-7.3	-8.3	-5.4	-3.0	-2.0	-1.5
RS	Serbia	-4.1	-4.3	-8.3	-8.0	-7.8	-8.0	-4.1	-1.0	-2.0	-2.0
XK	Kosovo	-7.0	-8.7	-8.9	-7.8	-7.1	-7.6	-1.3	1.0	0.5	0.3
	WB6 1)2)	*-5.6*	*-4.8*	*-7.5*	*-7.0*	*-6.5*	*-7.5*	*-3.3*	*-1.3*	*-1.4*	*-1.2*
TR	Turkey	-5.0	-1.7	-4.9	-4.6	-4.1	-2.9	-2.3	-3.2	-2.4	-2.0
BY	Belarus	-0.3	3.2	2.2	1.8	1.4	-1.7	0.2	-4.0	-2.0	-1.0
KZ	Kazakhstan	-4.4	-4.0	3.0	-0.5	-1.5	-4.0	-3.0	-2.0	-2.7	-2.6
MD	Moldova	-7.7	-12.4	-12.6	-14.2	-13.7	-5.3	-1.9	-5.0	-4.0	-3.0
RU	Russia	2.4	6.9	13.0	10.2	10.1	-4.0	0.8	-2.0	-3.0	-2.0
UA	Ukraine	3.4	-1.6	5.5	5.0	-1.0	-5.3	-3.4	-25.0	-20.0	-8.0
	CIS4+UA 1)2)	*1.7*	*4.9*	*11.4*	*8.5*	*7.8*	*-4.0*	*0.1*	*-3.2*	*-3.8*	*-2.4*
	V4 1)2)	*1.9*	*-1.4*	*-3.0*	*-2.6*	*-1.4*	*-6.6*	*-3.9*	*-4.6*	*-3.7*	*-2.9*
	BALT3 1)2)	*3.9*	*-1.1*	*-4.6*	*-3.7*	*-3.3*	*-6.0*	*-3.1*	*-4.1*	*-3.4*	*-2.5*
	SEE9 1)2)	*-3.9*	*-4.3*	*-6.8*	*-6.5*	*-5.8*	*-7.9*	*-5.3*	*-4.8*	*-4.5*	*-4.0*
	CIS3+UA 1)2)	*-0.8*	*-2.2*	*3.1*	*0.9*	*-1.3*	*-4.2*	*-2.7*	*-9.4*	*-7.4*	*-3.9*
	non-EU12 1)2)	*-0.3*	*2.8*	*7.4*	*4.8*	*4.1*	*-3.9*	*-0.7*	*-3.1*	*-3.4*	*-2.2*
	CESEE23 1)2)	*0.2*	*1.1*	*3.6*	*1.7*	*1.5*	*-5.0*	*-2.0*	*-3.7*	*-3.6*	*-2.7*

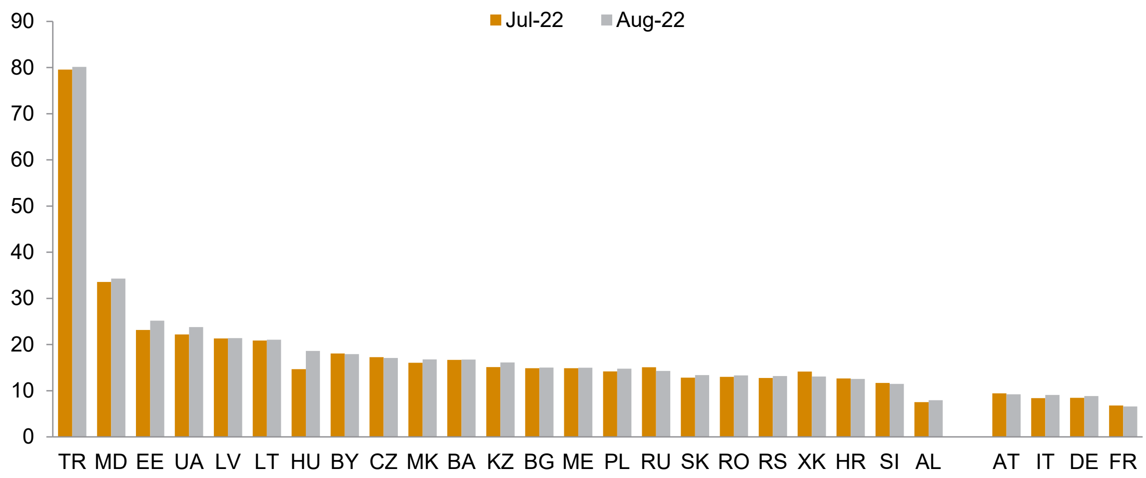
1) wiiw estimates. - 2) Current account data include transactions within the region (sum over individual countries). - 3) Forecasts estimated by wiiw.

Source: wiiw, Eurostat. Forecasts by wiiw. Cut-off date for historical data and forecasts: 3 October 2022.

3.2. INFLATION IS BEGINNING TO BITE

Inflation reached double-digit levels in all CESEE countries, except Albania, and is showing no sign of slowing down. Turkey had the highest inflation – 80.1% in August, largely due to depreciation of the lira. Albania's figure of 8% in August was substantially lower than anybody else's (Figure 3.5). This could owe something to the price controls introduced in March, but it may also be due to inaccurate measurement. All the CESEE countries (again excluding Albania) had higher inflation than the major Western European economies: that is not surprising, given that incomes in CESEE are generally lower, so that households spend more of their budget on food. Thus food, the price of which rose substantially in 2022, plays a much greater role in consumer price inflation in CESEE countries than it does in Western Europe. There is no indication of inflation coming down any time soon: in 17 of the 23 CESEE countries, it was higher in August than in July.

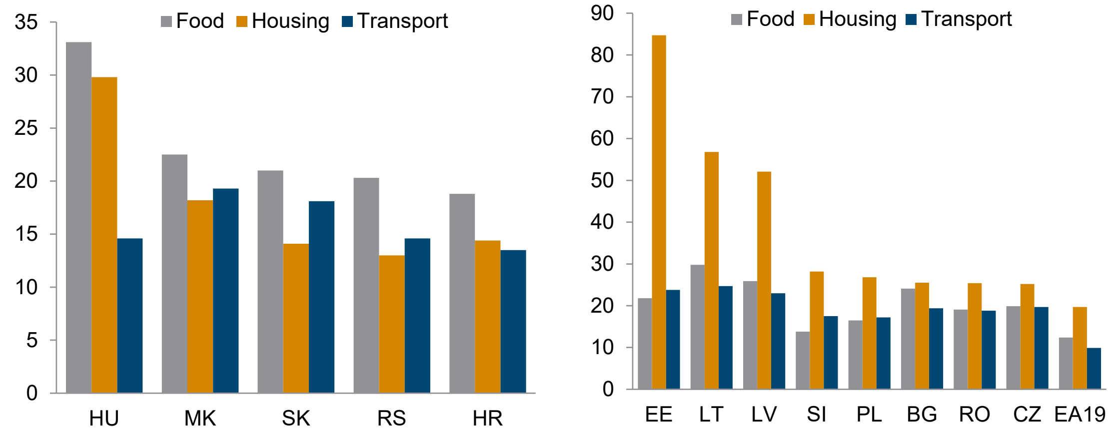
Figure 3.5 / Headline inflation in CESEE in July and August, %, year on year



Source: Eurostat and wiiw Monthly Database.

Three categories of expenditure have been driving inflation – food, housing and transport. Spending on food has risen on account of the global surge in food prices caused by the war in Ukraine. Expenditure on housing, water, electricity, gas and other fuels is higher due to the rise in domestic electricity and gas tariffs – again a result of global prices and the war. And transport costs have increased because of the rise in the price of fuel for personal vehicles – a consequence of the high oil prices on the international markets, again owing to the war in Ukraine. But although all the CESEE countries have witnessed an increase in all three categories of expenditure, there are some interesting differences between individual countries. In the less developed Balkan economies, as well as in Hungary and Slovakia, the biggest increase has been in food prices, which have risen more than in other regions – possibly owing to abuse of the market power of traders (Figure 3.6, left panel). In the more developed Baltic countries and most of the Central European economies, just as in the euro area the biggest increase has been in housing expenses – a result of the surge in electricity and gas prices (Figure 3.6, right panel). But Turkey and Russia are totally different: in those countries, it is transport costs that have increased most, due to the rise in the price of motor vehicle fuel (countries not shown in the figure).

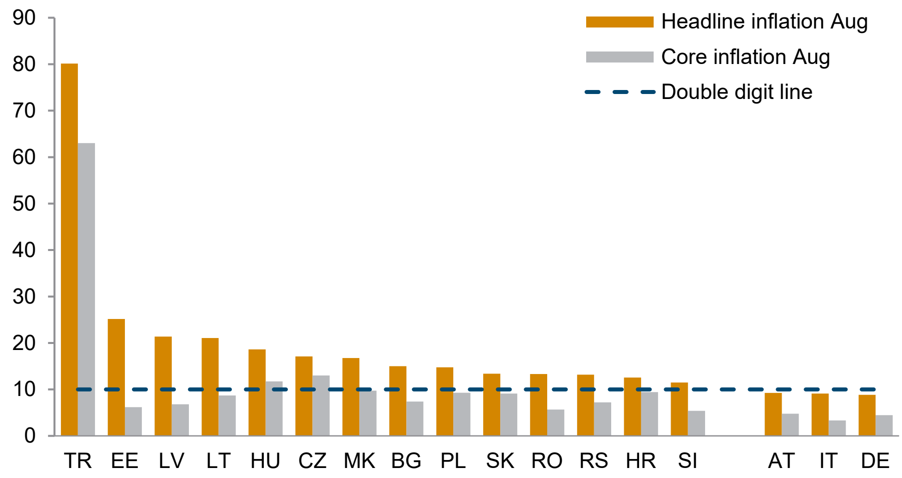
Figure 3.6 / Inflation in CESEE in August, by main sub-components, %, year on year



Source: wiiw calculations, using data from Eurostat and wiiw Monthly Database. Some CESEE countries are omitted, due to unavailability of data on inflation by sub-components in the Eurostat database.

Disregarding these three categories, inflation remains in single figures in almost all CESEE economies. Only in Turkey, Hungary and Czechia was core inflation (thus defined) over 10% in August (Figure 3.7). Still, even core inflation exceeded 5% in all the CESEE countries, which clearly suggests that the price rises are broad based, rather than confined to food and energy.

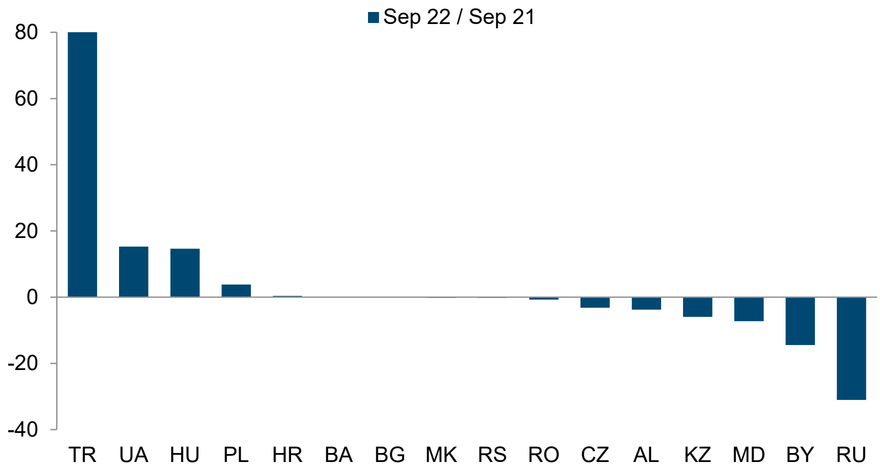
Figure 3.7 / Headline and core inflation in CESEE in August, %, year on year



Note: Core inflation is defined as inflation excluding food, housing and transport costs.
Source: wiiw calculations, using data from Eurostat and wiiw Monthly Database.

The depreciating currency has also fuelled inflation in some countries. Turkey is the prime example of this. Its lira depreciated against the euro by around 80% in September 2022, compared to the same period last year (in September 2022, 1 euro was trading at around 18 lira, whereas in September 2021 it was trading at 10 lira), which is identical to the country's inflation rate in August (80%). The situation is similar in Hungary and Ukraine: their currencies depreciated against the euro by 15% and 18%, respectively, in September 2022, compared to the year before, and they had inflation rates of 19% and 24%, respectively. At the other end of the spectrum is Russia, whose rouble in September 2022 was worth 31% more than a year ago, due to the capital controls that the country introduced to prevent fallout from the sanctions. This helped its inflation to slow somewhat – from around 18% in April to around 14% in August. The Belarusian rouble also appreciated against the euro – by 11% in September on an annual basis – but inflation in Belarus shows no sign of slowing. The other countries had more or less stable exchange rates (Figure 3.8). In many of them, this was due to interest-rate hikes by their central banks, which prevented capital outflow and currency depreciation.

Figure 3.8 / Exchange rate depreciation vs. EUR, September 2022, %, year on year

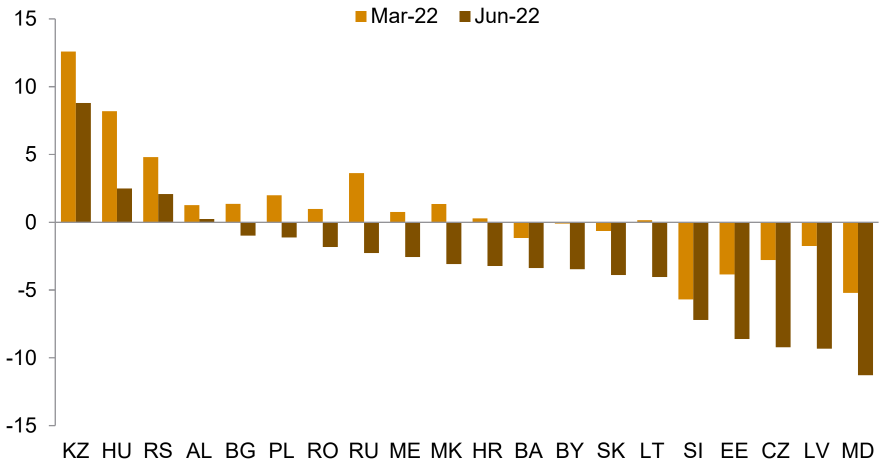


Note: A positive value = depreciation. Countries that have the euro as their national currency are not shown.
Source: wiiw Monthly Database.

3.3. REAL INCOMES ARE BEING ERODED BY INFLATION

Real wages are starting to decline almost everywhere in the region, and that will be a serious drag on the CESEE economies in coming months. Already in June, the average gross wage was worth less than the year before in 16 of the 20 CESEE countries for which data are available. This is in stark contrast to just three months previously, when only 8 of the 20 had seen a decline in real wages (Figure 3.9). With inflation having picked up further since June, real wages will probably have declined even more in most CESEE countries. This will drag down household consumption, the main driver of growth in the first half year. Accumulated savings may help for a while; but if inflation turns out to be persistent, and if nominal wages do not grow accordingly, then it is just a matter of time before household consumption declines as well.

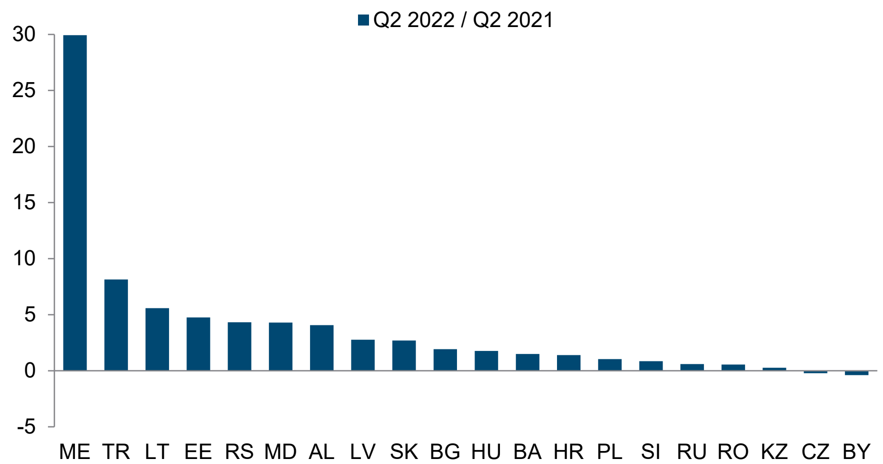
Figure 3.9 / Change in real gross wages in CESEE economies in March and June 2022, %, year on year



Note: Montenegro has seen a decline in the real gross wage, but a huge increase in the real net wage (30%), due to the tax reform it introduced at the beginning of the year, which scrapped the health insurance contribution and raised non-taxable income substantially.
Source: wiiw Monthly Database.

The labour markets, on the other hand, seem to be recovering well from the pandemic. Employment in Q2 2022 grew in virtually all the CESEE economies, compared to the previous year. Montenegro turned in the most impressive performance, with an increase in employment in Q2 of around 30% on an annual basis, thanks to a strong rebound in tourism. Only Czechia and Belarus saw a year-on-year decline in employment in Q2 2022, but even that decline was minor (Figure 3.10).

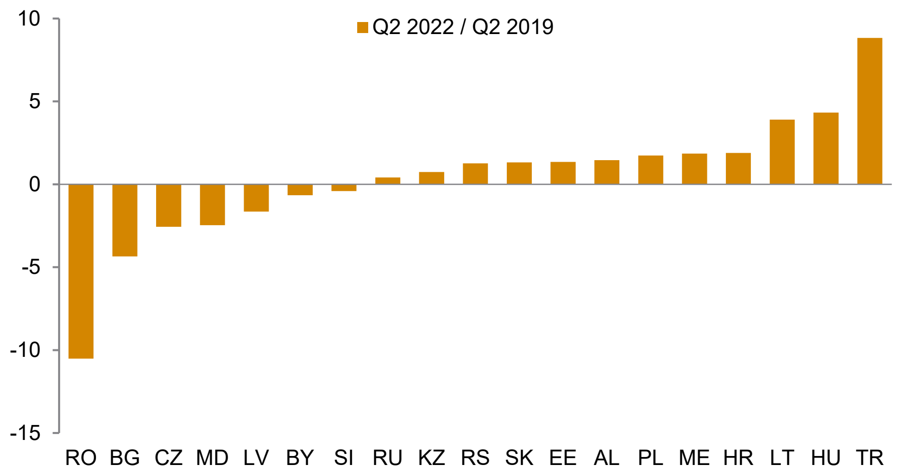
Figure 3.10 / Change in the number of employed persons in Q2 2022, %, year on year



Source: wiiw Monthly Database.

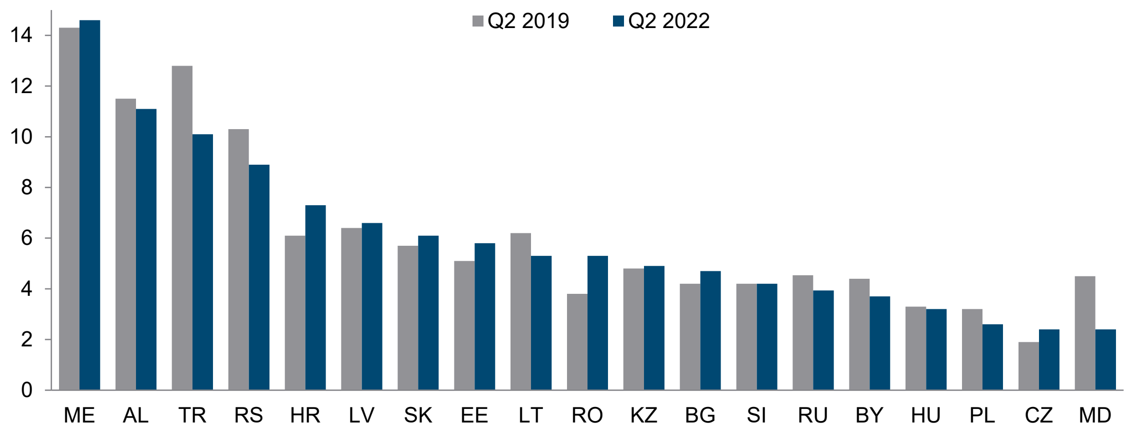
Nevertheless, a degree of labour market scarring from the pandemic is visible, at least in some CESEE countries. Employment is still below the pre-pandemic level (Q2 2019) in 7 of the 19 countries for which data are available (Figure 3.11). Similarly, the unemployment rate remains at above the pre-pandemic level in roughly half of the economies (Figure 3.12). These trends may also be driven by methodological changes, since several of the CESEE countries changed their Labour Force Survey methodologies in 2021, with implications especially for the treatment of workers in agriculture. In any case, unemployment remains elevated in many countries, especially in the Western Balkans, where it is close to or above 10%. On the other hand, some countries – like Czechia, Hungary and Poland – have unemployment close to or below 3%, and may even face labour shortages in certain sectors.

Figure 3.11 / Change in the number of employed persons in Q2 2022 with respect to Q2 2019, %, year on year



Note: Since 2021, a new methodology in line with the Integrated European Social Statistics (IESS) Regulation has been used for EU-CEE countries, Montenegro, Serbia and Turkey.
Source: wiiw Monthly Database.

Figure 3.12 / Unemployment rate in CESEE economies in Q2 2019 and Q2 2022, %

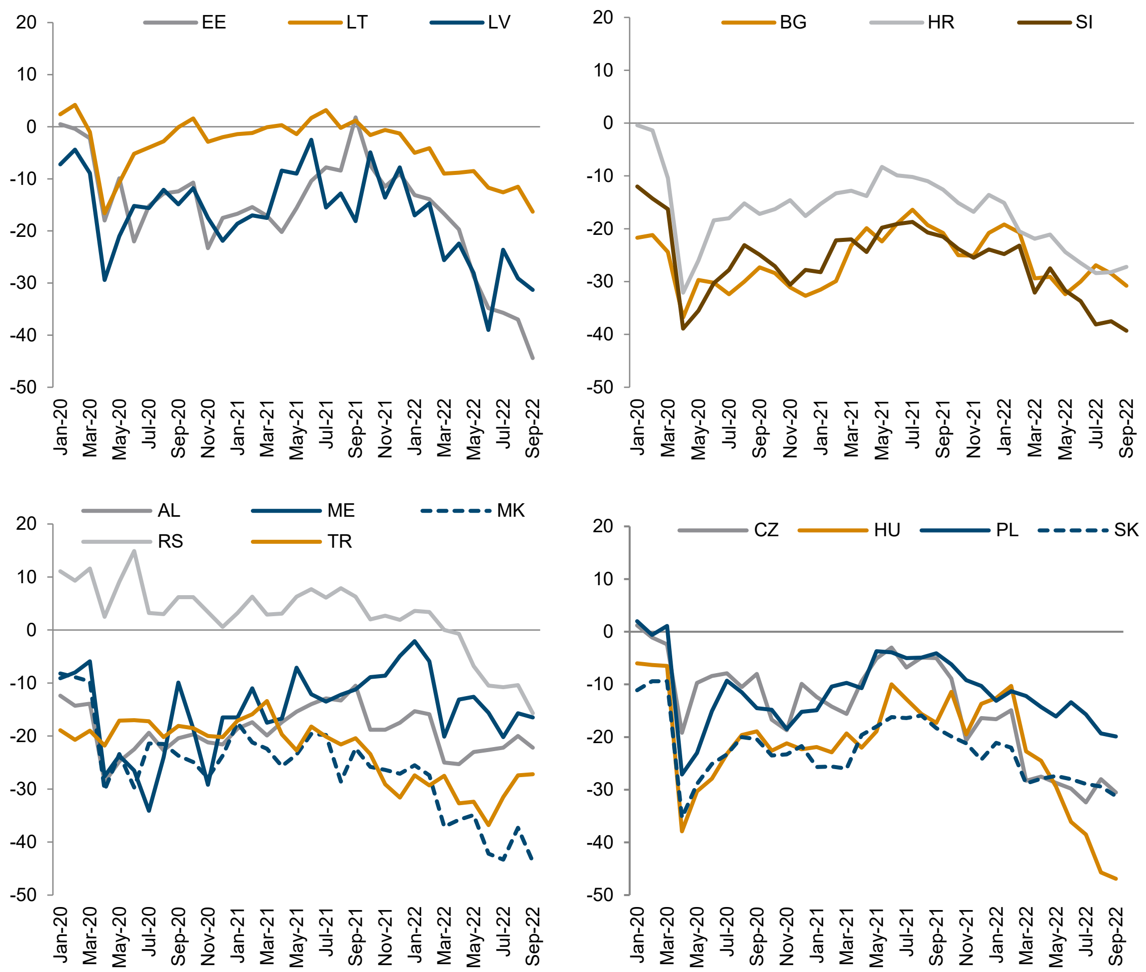


Note: Since 2021, a new methodology in line with the Integrated European Social Statistics (IESS) Regulation has been used for EU-CEE countries, Montenegro, Serbia and Turkey.
Source: wiiw Monthly Database.

3.4. CONSUMER CONFIDENCE IN FREEFALL

Rising inflation has depressed consumer confidence to levels unseen even at the onset of the pandemic. Of the 15 CESEE countries that publish data on this, in 12 consumer confidence in September 2022 was close to or below the April 2020 level (Figure 3.13). Only in Albania, Montenegro and Poland is consumer confidence still better than during the pandemic – in Albania probably because of the relatively low inflation; in Montenegro likely because of the strong rise in nominal incomes after the tax reform; and in Poland perhaps because of the historically low unemployment rate. Still, it is gradually declining even in those countries. As inflation is likely to remain close to or above the current level for some time, consumer confidence will probably continue to decline in coming months as well. This will be another channel that will tend to bring consumption down, along with declining real incomes.

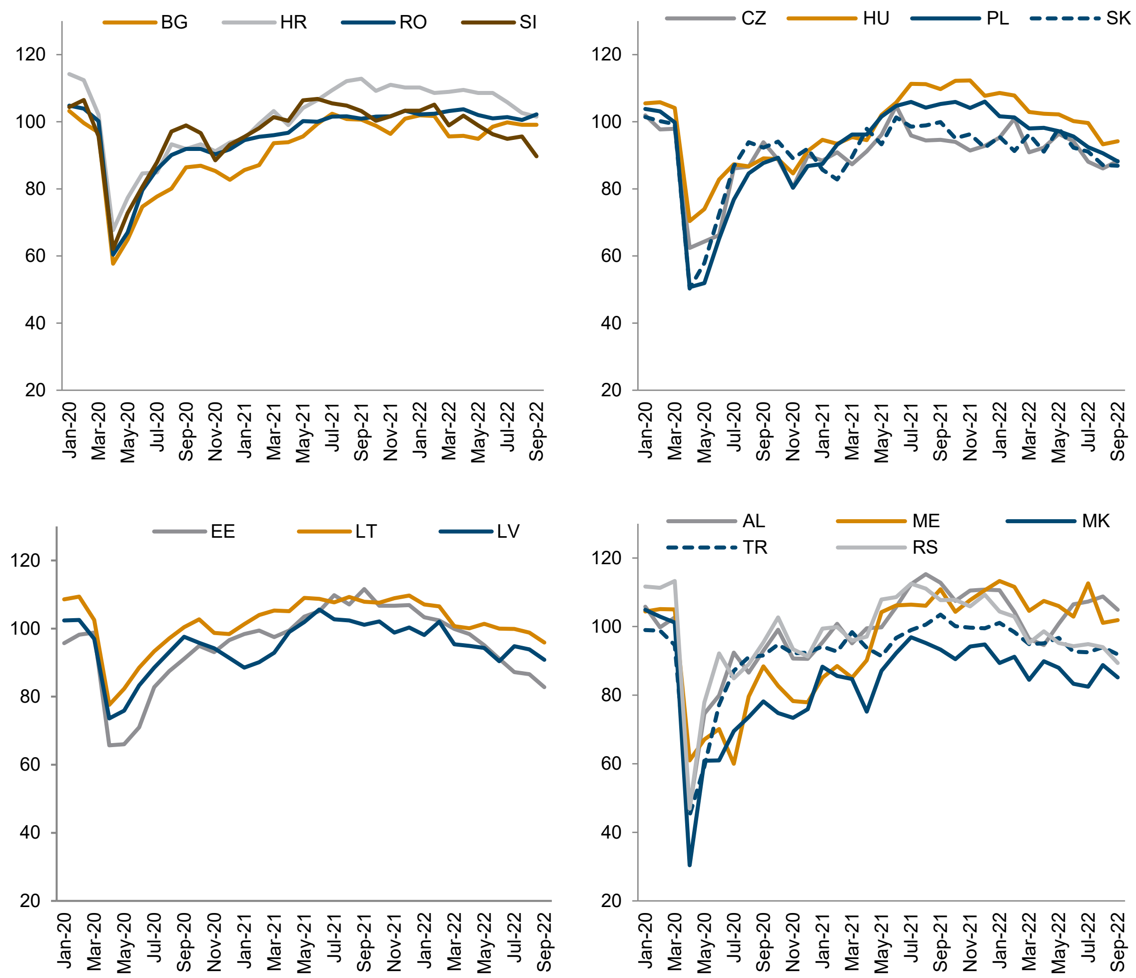
Figure 3.13 / Consumer confidence in CESEE, 2020-2022, balance of positive over negative answers



Note: Higher values indicate higher confidence.
Source: Eurostat.

Business sentiment is also deteriorating, although it is still far from the dire situation of early 2020. The Economic Sentiment Indicator is declining in 13 of the 15 CESEE countries that publish such data (Romania and Bulgaria are the two exceptions); but it is much better than in the early days of the pandemic, and the pace of decline is much slower than in the case of consumer confidence (Figure 3.14). This suggests that businesses have not yet been hit too badly by the cost-of-living crisis, and that the burden is falling on the shoulders of workers, at least for now. There may also be a delayed reaction: business confidence might decline sharply during the winter, when the energy crisis intensifies. Anyhow, even the current downward trends in the economic sentiment indicators suggest that business investment in CESEE is likely to slow in the second half of 2022, from the already low levels.

Figure 3.14 / Economic sentiment in CESEE, 2020-2022, index (long-term average = 100)

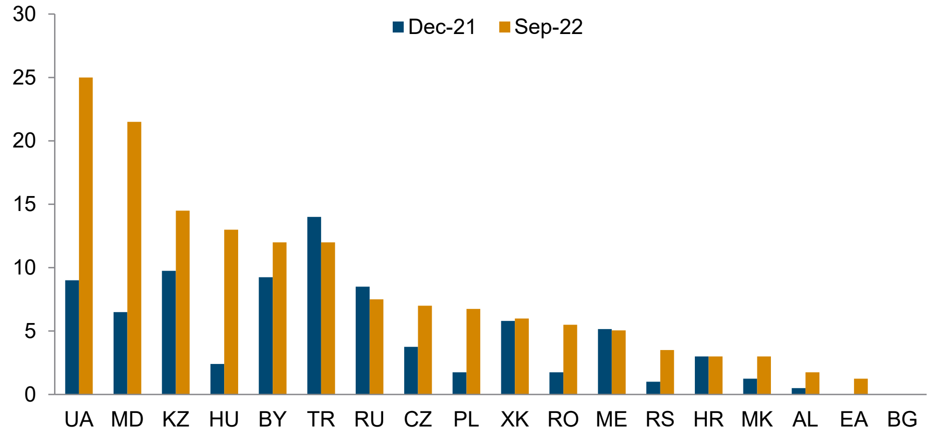


Note: Higher values indicate more optimistic sentiment.
Source: Eurostat.

3.5. IS MONETARY POLICY THROTTLING THE ECONOMY?

All the central banks in CESEE have tightened their monetary policy since the beginning of the year, except Turkey. Consequently, as of the end of September 2022, all central banks in the region had much higher interest rates than the European Central Bank (ECB): in Albania (where the rate is lowest), it stood at 1.75% in September, which is still higher than the ECB rate of 1.25% (Figure 3.15). Turkey is a notable outlier in this respect, due to the unique monetary policy philosophy of its president. Despite average inflation of around 70% over the first eight months of the year, it cut the interest rate twice, in August and September, from 14% to 12%. Russia is another interesting case – after hiking its rate following the invasion of Ukraine in February from 8.5% to 20%, it has gradually cut it on five separate occasions, so that it currently stands at 7.5%, below the level at the beginning of the year.

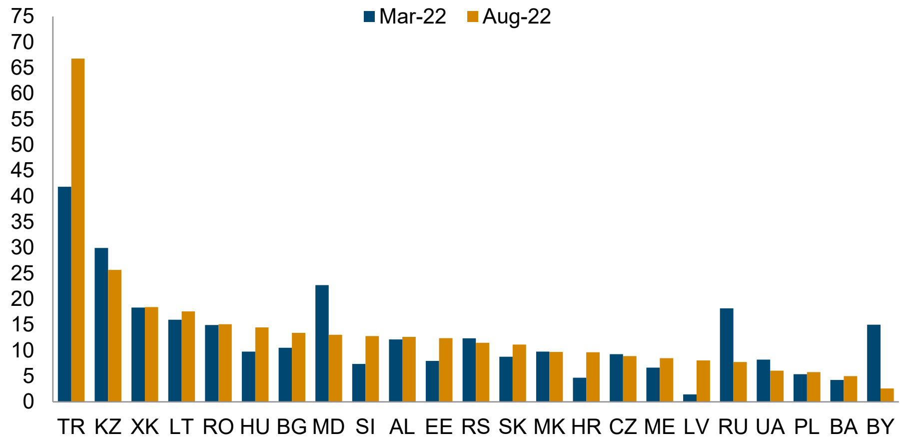
Figure 3.15 / Central bank policy rate in CESEE countries, end of period, %



Note: Countries that have the euro as their national currency are not shown.
Source: wiiw Monthly Database.

The tightening of monetary policy is understandable to some extent, but it comes with a big price tag. The region is facing double-digit inflation, and central banks have a clear mandate to control it. Some of the countries are also being forced to hike their rates to prevent capital outflow and currency depreciation, due to the rising interest rates of the US Fed. But excessive tightening could come at a substantial cost to the economy. The financial systems in CESEE have got used to low interest rates, so if rates rise sharply it is very likely that any vulnerabilities in those financial systems will be exposed. One area where this could happen is the property market, if a large share of the people have variable-rate mortgages. Monetary tightening is also likely to slow credit activity and, through it, economic growth. In nominal terms, credit activity in CESEE is continuing to grow, and the growth even appears to be accelerating: in 15 of the 23 countries, the nominal growth in loans to the non-financial private sector was higher in August than in March (Figure 3.16).

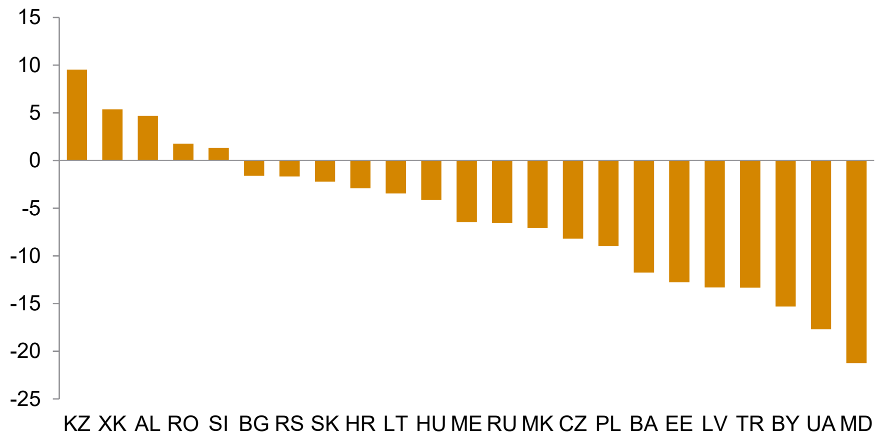
Figure 3.16 / Nominal growth in loans to non-financial private sector in March and August 2022, %, year on year



Note: data for Russia for July 2022.
Source: wiiw Monthly Database.

But in real terms, adjusted for inflation, credit growth is deep in negative territory in most CESEE countries. Only 5 of the 23 countries had positive credit growth in August in real terms (Figure 3.17). Things will only get worse in coming months, as interest-rate hikes by central banks usually take some time to filter through. This will place an additional burden on economic growth in CESEE in the coming months.

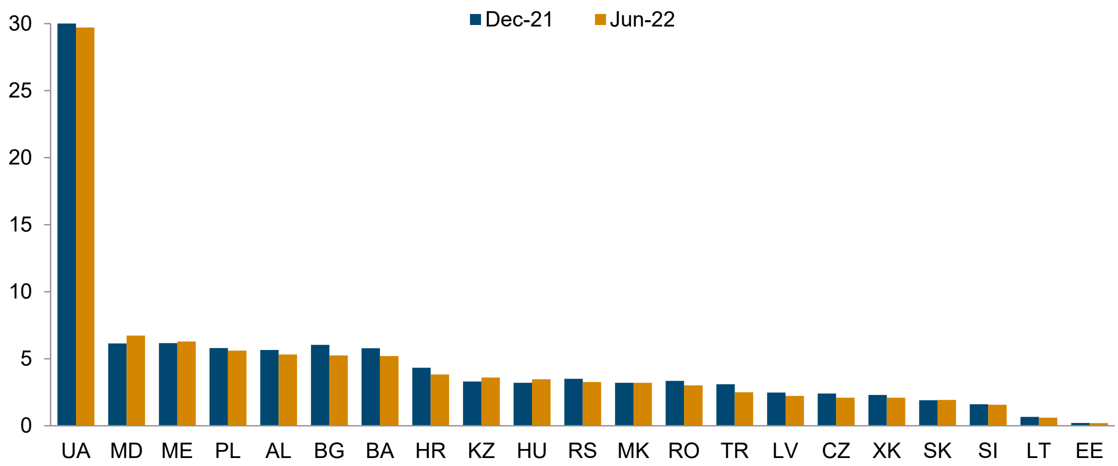
Figure 3.17 / Real growth in loans to non-financial private sector in August 2022, %, year on year



Note: Real credit growth is defined as nominal growth adjusted for consumer price inflation.
Source: wiiw Monthly Database.

Despite the rise in interest rates and the slowdown in real credit growth, the banking systems remain stable in all CESEE countries. In June, non-performing loans were below 7% in all the countries, except Ukraine. Furthermore, such loans have actually fallen in the course of 2022: in 13 of the 21 countries for which data are available, there were fewer non-performing loans in June 2022 than in December 2021 (Figure 3.18). It may be too early to see any effects of the tightening cycle on non-performing loans, as these things take time to filter through. One would not expect the deterioration in credit activity to destabilise the banking sector, but the rise in interest rates could increase the share of non-performing loans.

Figure 3.18 / Non-performing loans in CESEE in December 2021 and June 2022, % of total loans

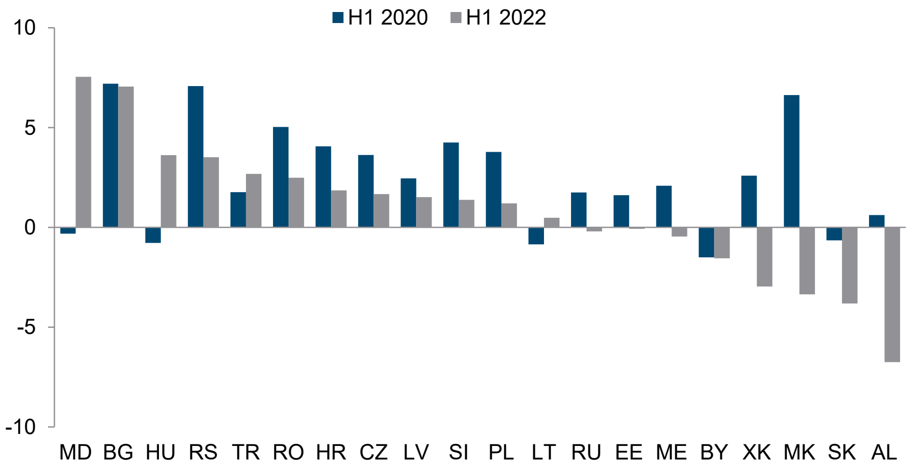


Source: wiiw Monthly Database.

3.6. FISCAL POLICY NOT SUPPORTIVE ENOUGH

Fiscal policy was only moderately supportive in the first half of the year. Government consumption increased in real terms in 12 of the 20 CESEE countries for which data are available (Figure 3.19), but in only two of them was the increase above 5% (Moldova and Bulgaria). The simple average increase for the region as a whole was just 0.8% year on year. This is much less than the increase during the early stages of the pandemic. In the first half of 2020, 15 of the 20 countries saw a rise in government consumption, and the simple average growth for the whole region was 2.5% year on year (Figure 3.19). Strong fiscal support during the pandemic was the main reason why the CESEE economies overcame that crisis without major scarring. By the same token, the weak fiscal support that we are currently seeing across the region will place an additional hurdle in the way of the CESEE economies as they seek to overcome this current crisis.

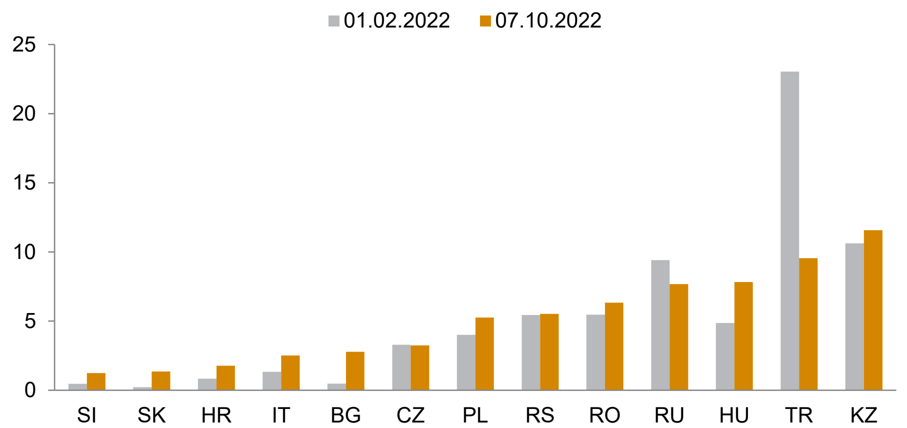
Figure 3.19 / Real growth in government consumption in CESEE in the first half of 2020 and 2022, %, year on year



Source: wiiw Monthly Database.

Governments are finding it increasingly difficult to borrow on international financial markets, and that is certainly limiting the fiscal support they can provide. Due to the interest-rate hikes of all the major central banks, government bond yields have also risen substantially. Furthermore, the spread of the government bond yields of CESEE countries over German government bond yields has also increased since the Russian invasion, reflecting investors' flight to quality in time of crisis (Figure 3.20). For most of the countries, the increase has been even bigger than that for Italy, which is often considered a risky country in the EU. The only two of the CESEE countries considered here that have not seen an increase in their government bond yields since February are Russia and Turkey, due to the better-than-expected performance of their economies in the first half of the year. In Turkey's case, it has also been government policy to push banks to buy lira-denominated bonds.

Figure 3.20 / Spread of 10-year government bonds over the German 10-year bond, February and October 2022, percentage points



Source: wiiw calculations using data from www.investing.com

Those CESEE economies that are EU member states benefit from support through the NextGenerationEU plan, though that support has been quite limited so far. Three of the countries have not yet received any disbursements; meanwhile, of the eight countries that have received some support, in just three has that support been greater than 1% of GDP (Table 3.2). This falls far short of what was promised. The reasons for the low rate of disbursement may relate to the low absorption capacity of the member states; but they may also have something to do with the complicated procedures on the EU side. Whatever the reason, if the disbursement rate does not improve in the coming period, even those CESEE countries that are EU member states will struggle to provide support to their economies in this crisis.

Table 3.2 / Disbursements made under the Recovery and Resilience Facility to EU member states from CESEE by end-July 2022

		Amount, EUR m	Share in 2021 GDP, %
RO	Romania	3,793.6	1.58
HR	Croatia	1,518.4	2.65
SK	Slovakia	1,221.4	1.26
CZ	Czechia	914.6	0.38
LT	Lithuania	289.1	0.52
LV	Latvia	237.4	0.72
SI	Slovenia	231.0	0.44
EE	Estonia	126.0	0.40
HU	Hungary	n/a	n/a
PL	Poland	n/a	n/a
BG	Bulgaria	n/a	n/a

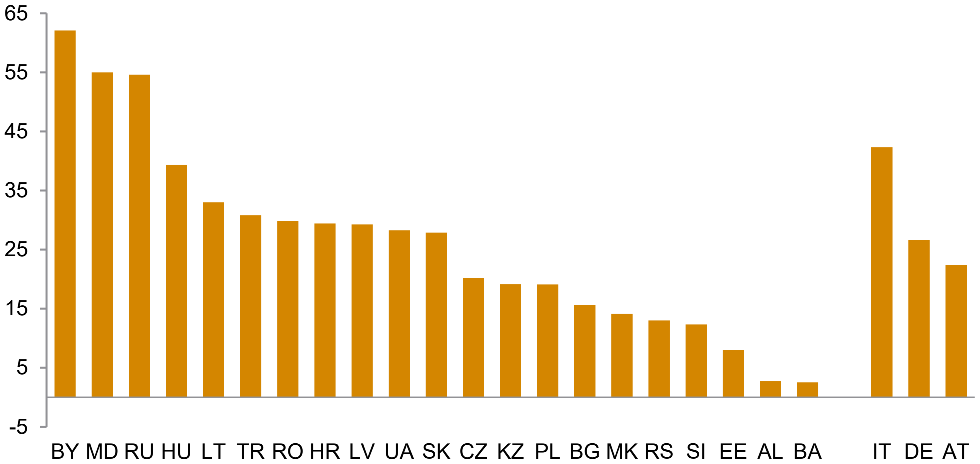
Source: European Commission.

3.7. THE WORST IS YET TO COME

But the real crisis for the CESEE economies will come only in the last quarter of 2022. Household consumption – the engine of growth in the first half year – will lose steam, as real incomes continue to drop, consumer confidence vanishes and credit activity slows down. Contractionary monetary policy and limited fiscal support will rub salt into the wounds. On top of all that, there is the energy crunch, which could get very serious during the winter.

Gas dependency in the CESEE region varies substantially, and so different countries will be affected in different ways. In Moldova, gas constitutes more than half of the total energy consumed, so the country might run into serious trouble during the winter, especially given its tense relations with Russia. Hungary is also very heavily dependent on gas, with around 40% of its energy consumption coming from that source. But given its rather more friendly relations with Russia, it should not have any great difficulty surviving the winter. Around half of the countries have gas dependency in excess of Austria's (22%) or Germany's (27%), most of them in the Baltic area or Central Europe (Figure 3.21). Those countries will be at serious risk both of gas shortages during the winter and of price hikes due to the high cost of gas. The other half of the countries – mostly from the Balkans – have a dependency of around or below 20% of their total energy consumption. They should be more secure over the winter – at least in this respect.

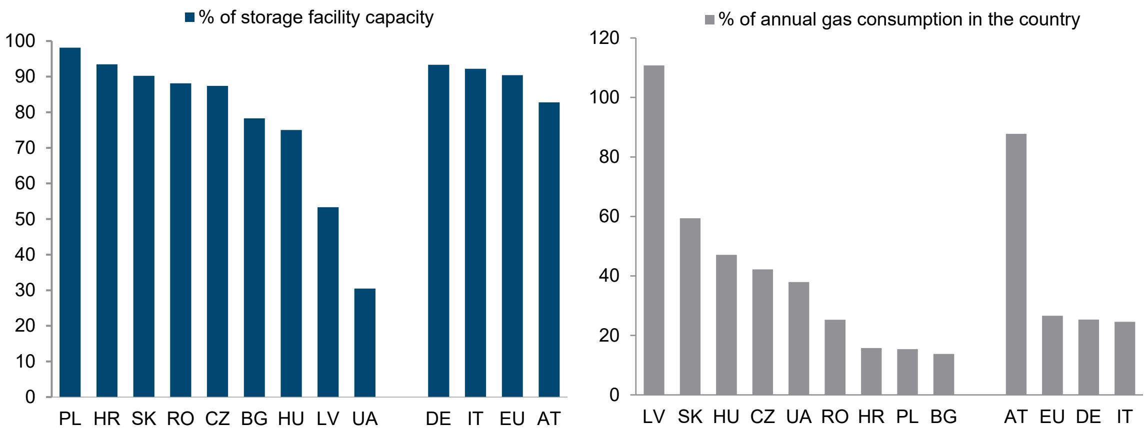
Figure 3.21 / Share of gas in total energy consumption in 2021, %



Note: Data on Moldova, Serbia, Albania and Bosnia and Herzegovina are from the International Energy Agency, refer to 2019, and reflect the share of gas in total energy supply, not consumption.
Source: Oxford University's Our World in Data and International Energy Agency.

Gas storage facilities are well filled up, but the volume of gas stored is sufficient for only a short period of time. As of early October, all the storage facilities in CESEE are more than 75% full, except for the one in Latvia (53% full) and the facilities in Ukraine (30% full) (Figure 3.22, left panel). But of the CESEE countries for which data are available, only Latvia has enough gas stored to meet its needs for a whole year (Figure 3.22, right panel). In Slovakia, the gas stored is enough to satisfy around 60% of the country's annual requirements; and in Hungary and Czechia – around 45%. Everywhere else, the volume of gas stored is only enough to satisfy 40% or less of the annual requirement. This means that if the winter is severe, most CESEE countries will struggle to meet their gas needs.

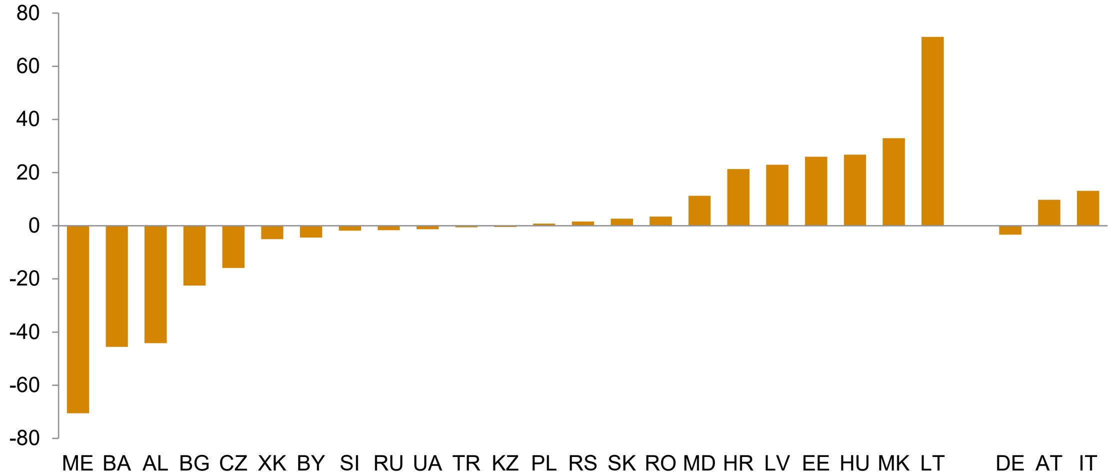
Figure 3.22 / Gas stored in storage facilities in CESEE and EU on 7 October 2022, %



Source: Gas Infrastructure Europe.

Another source of risk stems from the rather high imports of electricity in some CESEE countries. Again, there is wide divergence across the region regarding this (Figure 3.23). In some Balkan countries – like Montenegro, Bosnia and Herzegovina, and Bulgaria – net exports of electricity exceed 20% of the total demand for electricity, which means they might even benefit from the currently high electricity prices. On the other hand, the Baltic countries, as well as North Macedonia, Hungary and Croatia, import more than 20% of their total electricity requirements, so they could be in serious trouble this winter: some businesses may be forced to close temporarily during the winter on account of the high electricity prices. However, most of the countries (13 out of 23) are somewhere in between: the high electricity prices should not affect them much more than they have already been affected.

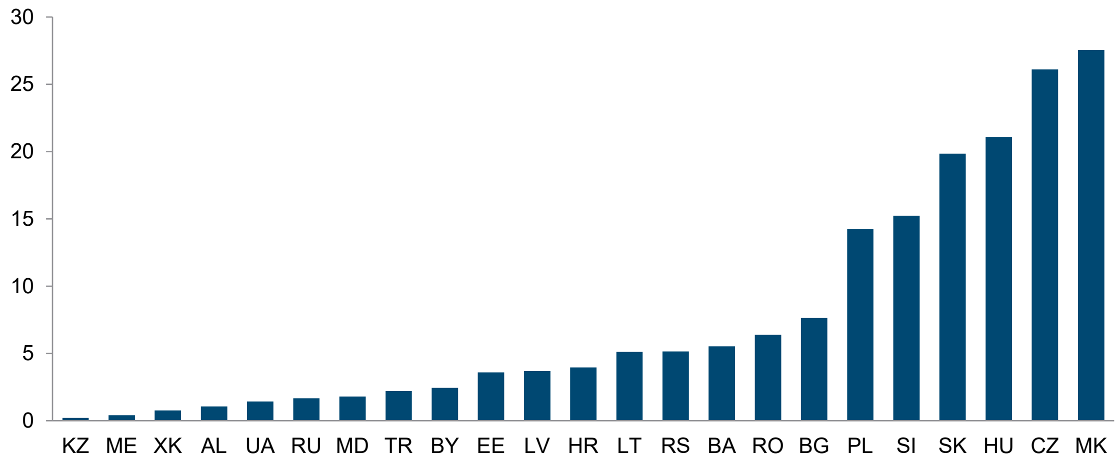
Figure 3.23 / Share of net imports of electricity in total electricity demand in the country in 2021, %



Note: Negative values represent net exports of electricity. Data for Albania and Kosovo are for 2020.
Source: Oxford University's Our World in Data.

Finally, some CESEE economies could be severely affected by the likely recession in Germany, due to their close integration into German value chains. This is particularly true for North Macedonia and Czechia, whose exports to Germany exceed 25% of their GDP. The other Visegrád countries and Slovenia are also very vulnerable, with exports to Germany of between 14% and 21% of GDP (Figure 3.24). Any temporary closure of certain industrial plants in Germany over the winter would likely lead to temporary closures in those countries, too. The other CESEE countries are in a somewhat better position, although the other Balkan countries also have exposure to Germany in excess of 5% of their GDP.

Figure 3.24 / Exports to Germany, as a share of GDP, in 2021, %



Source: wiiw Annual Database.

3.8. HIGHER GROWTH THIS YEAR, LOWER GROWTH NEXT

Due to the better-than-expected outturn from the first half of the year, we are upgrading our GDP forecasts for 2022 for most of the CESEE countries. Concretely, for 14 of the 23 countries, we now expect higher GDP growth; for four countries we are keeping the forecast unchanged; and for five we are revising the projection downwards (Table 3.3). Most notably, we are upgrading the growth forecast for Ukraine by 5 percentage points (pp), thanks to the way the economy has adjusted to war conditions, as well as to the country's success on the battlefield. At the same time, we are also upgrading our growth forecast for Russia, by 3.5 pp, since that country's economic situation is obviously better than anybody expected, at least for the time being. Turkey is another positive outlier: we are revising our projection for GDP growth there upwards by 2.4 pp, as its economy is continuing to perform, despite inflation approaching three digits. On the other hand, we have downgraded the growth forecasts for this year for Moldova and Estonia by around 1 pp, as those two countries seem to have been affected by the war in Ukraine much more than was previously thought, due to their proximity to the war-affected regions.

Table 3.3 / Real GDP growth forecasts and revisions over previous forecast, October 2022

		Forecast, %			Revisions, pp		
		2022	2023	2024	2022	2023	2024
EU-CEE	BG	3.0	1.5	3.0	0.5	-2.2	-0.5
	CZ	2.0	1.0	2.8	0.2	-1.9	-0.9
	EE	1.0	1.4	3.1	-1.1	-2.0	0.0
	HR	5.0	2.5	3.1	1.7	-1.0	-0.5
	HU	4.2	-1.2	1.7	1.1	-2.7	-1.0
	LT	2.1	0.9	2.6	0.2	-1.9	0.0
	LV	2.8	0.6	2.3	0.7	-1.8	-0.3
	PL	4.6	1.7	2.4	0.4	-1.9	-1.4
	RO	4.8	2.2	3.5	1.3	-1.3	-1.0
	SI	5.7	1.9	2.7	1.2	-1.1	-0.1
	SK	1.8	0.6	2.4	-0.4	-2.2	-1.0
Western Balkans	AL	3.4	3.0	3.6	-0.1	-0.5	-0.1
	BA	2.6	1.5	2.5	1.2	-0.3	0.2
	ME	5.1	2.6	3.3	1.5	-1.1	0.0
	MK	1.0	0.6	2.0	0.0	-1.9	-0.5
	RS	3.6	1.9	2.7	0.0	-1.5	-0.7
	XK	3.1	2.9	3.8	-0.2	-0.8	-0.1
Turkey	TR	5.1	2.5	3.2	2.4	-0.3	0.0
CIS+UA	BY	-4.5	1.0	2.0	0.0	0.0	0.0
	KZ	2.8	3.6	4.1	0.0	-0.3	-0.1
	MD	-2.0	0.0	2.0	-1.0	-3.0	-2.0
	RU	-3.5	-3.0	1.0	3.5	0.0	0.0
	UA	-33.0	5.5	12.0	5.0	0.5	-1.0

Note: Current forecast and revisions relative to the wiiw Summer Forecast Update (wiiw, 2022). Colour scale variation from the minimum (red) to the maximum (green).
Source: wiiw.

As the rise in prices has turned out to be much more aggressive than anticipated, we have revised our inflation forecasts for 2022 upwards for all but two CESEE countries (Table 3.4). Russia is a notable exception – we have revised its forecast for this year downwards by 1.7 pp, due to the slowdown in its inflation in recent months, mainly because of the appreciation of the rouble. For Bulgaria, we keep our forecast the same as three months ago (14%), as it turns out that the high forecast then was justified. Turkey will have the highest inflation in 2022, around 71% for the year as a whole. The only three countries that will have single-digit inflation are Albania (7%), Croatia and Slovenia (both around 9.5%).

Table 3.4 / Inflation forecasts and revisions over previous forecast, October 2022

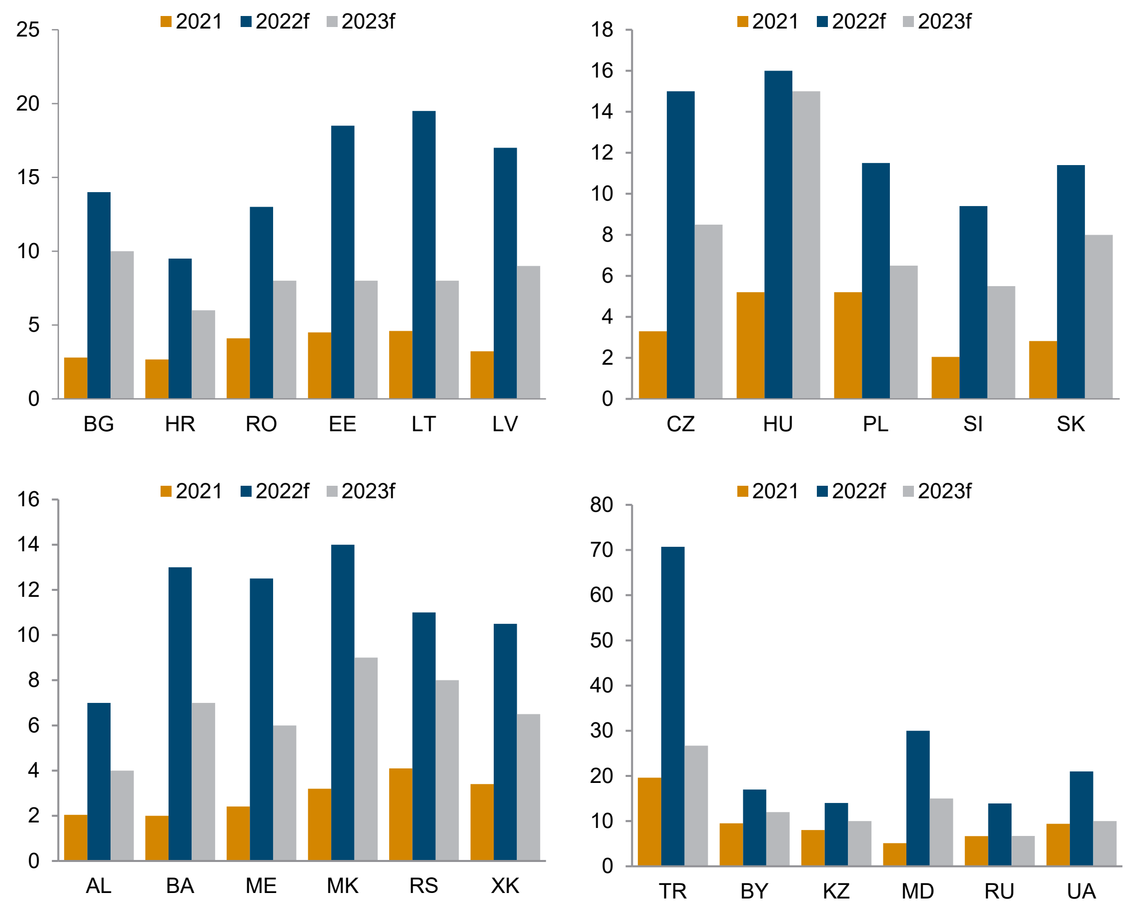
		Forecast, %			Revisions, pp		
		2022	2023	2024	2022	2023	2024
EU-CEE	BG	14.0	10.0	8.0	0.0	2.0	3.0
	CZ	15.0	8.5	3.2	2.8	2.7	0.9
	EE	18.5	8.0	4.5	4.0	0.5	0.5
	HR	9.5	6.0	3.0	1.3	2.5	0.0
	HU	16.0	15.0	8.0	5.0	9.0	4.0
	LT	19.5	8.0	4.0	5.0	1.5	0.0
	LV	17.0	9.0	3.5	4.0	2.5	0.5
	PL	11.5	6.5	3.5	1.0	-1.5	-1.0
	RO	13.0	8.0	5.0	1.0	1.0	1.0
	SI	9.4	5.5	2.3	1.3	1.2	0.0
	SK	11.4	8.0	3.0	0.9	1.5	0.5
Western Balkans	AL	7.0	4.0	2.5	0.9	0.5	0.0
	BA	13.0	7.0	2.0	3.0	3.0	-1.0
	ME	12.5	6.0	2.0	2.5	2.0	0.0
	MK	14.0	9.0	4.0	3.0	3.0	0.0
	RS	11.0	8.0	4.0	1.0	2.0	0.0
	XK	10.5	6.5	2.0	2.0	2.2	0.0
Turkey	TR	70.7	26.7	19.5	3.0	4.1	-0.1
CIS+UA	BY	17.0	12.0	11.0	2.0	0.0	0.0
	KZ	14.0	10.0	7.0	1.0	1.0	1.0
	MD	30.0	15.0	8.0	5.0	2.0	0.0
	RU	13.9	6.7	4.0	-1.7	-3.0	0.3
	UA	21.0	10.0	6.0	1.0	-2.0	0.0

Note: Current forecast and revisions relative to the wiiw Summer Forecast Update (wiiw, 2022). Colour scale variation from the minimum (red) to the maximum (green).
Source: wiiw.

The economic outlook for 2023 is much gloomier now than it was three months ago, as the war is dragging on for longer than expected and the energy situation has gotten worse. In a way, our forecasts for 2023 are similar to our adverse scenario from this spring, when we assumed that the EU would ban Russian energy imports. The one difference is that it was not the EU that banned Russian energy imports, but rather Russia decided to cut the gas supply to the EU. The overall effect is similar, though – the unavailability of gas means its price increases, fuelling inflation and crippling growth.

Consequently, we have raised our inflation forecasts for next year for 19 of the 23 countries that we cover. Russia is again an exception, with a downward revision of 3 pp, due to its lower inflation from this year and the stronger rouble. Ukraine is another exception, with a downgrade of 2 pp on account of its military successes, which will ease some supply-chain issues. On the other hand, Turkey has the highest upward revision, of 4.1 pp, as its inflation this year is turning out to be higher than previously expected. On a weighted average basis, the region next year will have average inflation of 11.6% – very high and much higher than the euro area average of 6% (Table 3.1). This is dominated by the inflation in Turkey, of close to 27%. On a simple-average basis, the region will have an inflation of 9.3%, which is still well above the euro area one. Compared to this year's inflation, price growth next year will moderate in all CESEE countries (Figure 3.25); but that is entirely to be expected, given the high comparative basis from this year.

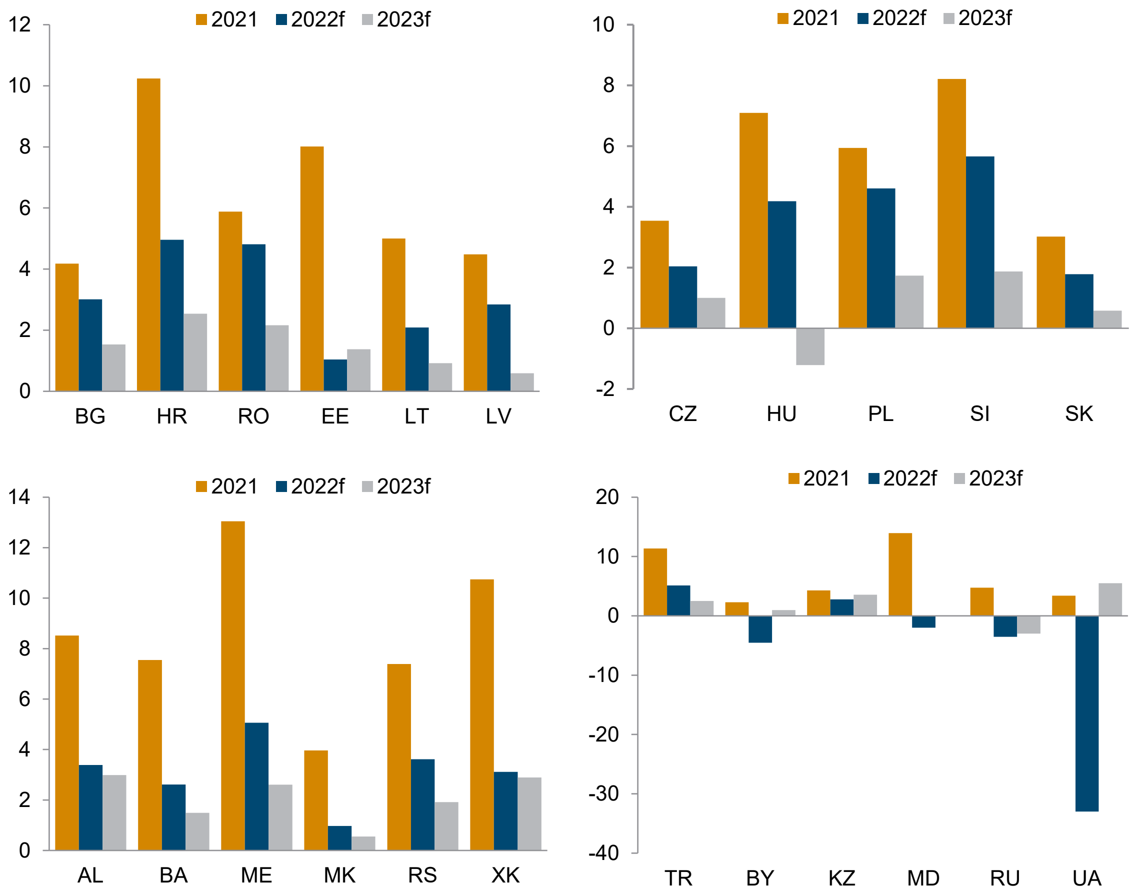
Figure 3.25 / Inflation in 2021 and forecast inflation for 2022 and 2023, %, year on year



Source: wiiw Annual Database for 2021 and wiiw forecasts for 2022 and 2023.

In turn, we have revised downwards the forecasts for next year's GDP growth for almost all CESEE countries. The biggest revisions are for Moldova (3 pp downwards), due to the dire energy situation there, and Hungary (2.7 pp), due to its twin deficits and the likely continued suspension of the EU transfers that it was supposed to receive. Despite the deteriorating outlook, we still project that only two countries will see their GDP decline in 2023 as a whole – Russia (by 3%) and Hungary (by 1.2%). Ukraine will have the strongest growth (5.5%), although that forecast is very uncertain and is dependent on the course of the war. In most of the countries, growth next year will be worse than this year (Figure 3.26). The CIS countries and Ukraine are clear exceptions to this: next year all those countries will have better economic growth than this year (Figure 3.26, bottom right panel). As a whole, on a weighted average basis, the region will grow by 0.3% next year, which is very close to growth in the euro area, which we assume to be 0.2% (Table 3.1). However, this figure is dominated by the largest economy in the region, Russia, which will suffer a decline next year. On a simple average basis, the growth in CESEE next year will be 1.5% – clearly better than growth in the euro area.

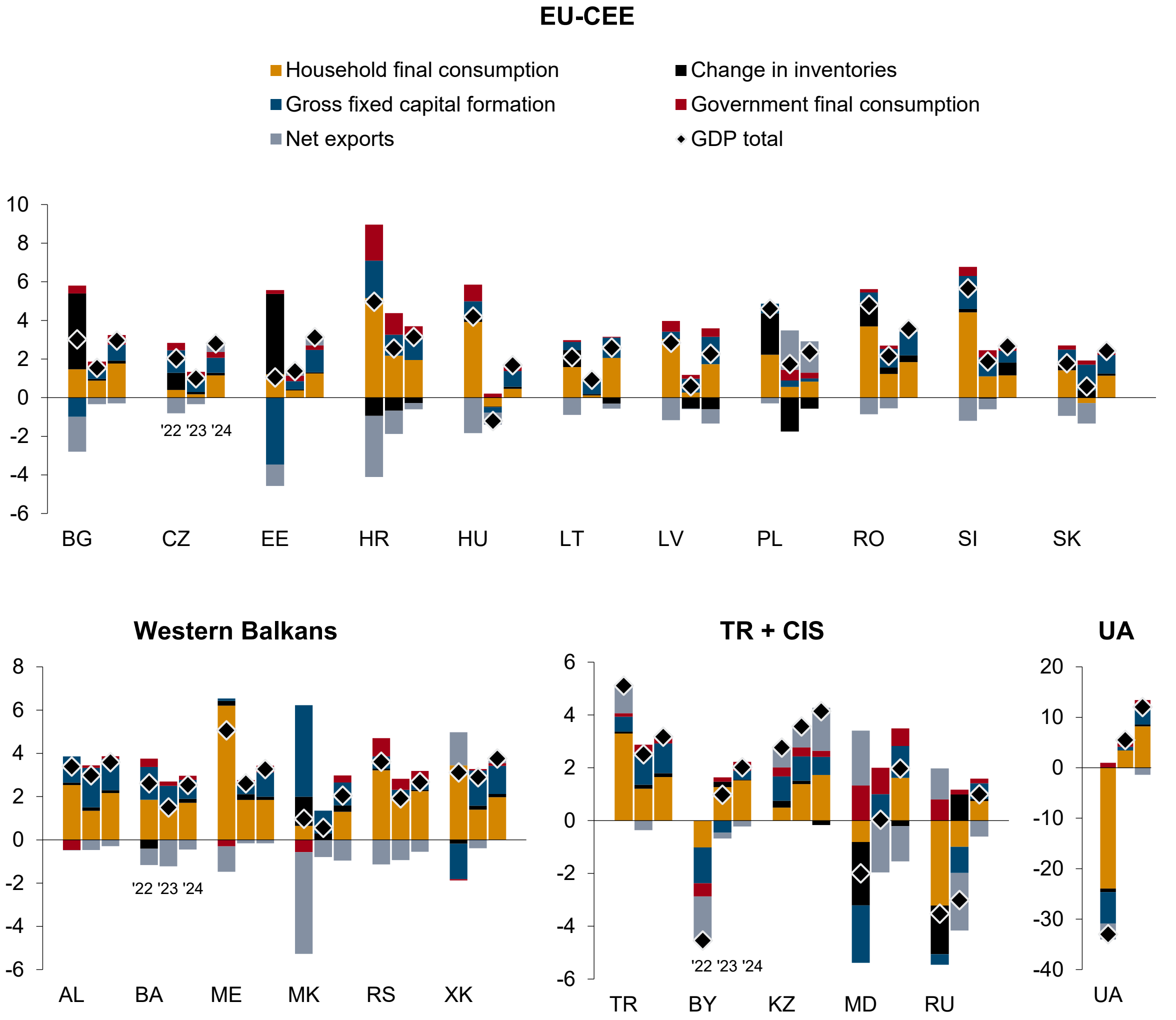
Figure 3.26 / GDP growth in 2021 and growth forecasts for 2022 and 2023, %, year on year



Source: wiiw Monthly Database for 2021 and wiiw forecasts for 2022 and 2023.

The main driver of growth in 2023 will again be household consumption; but because it will be much weaker than in 2022, overall growth will also be lower. In some countries from the Western Balkans and CIS, investment will also contribute. Net exports will make a negative contribution, except in the resource-exporting countries. The contribution of government consumption will be negligible virtually everywhere (Figure 3.27).

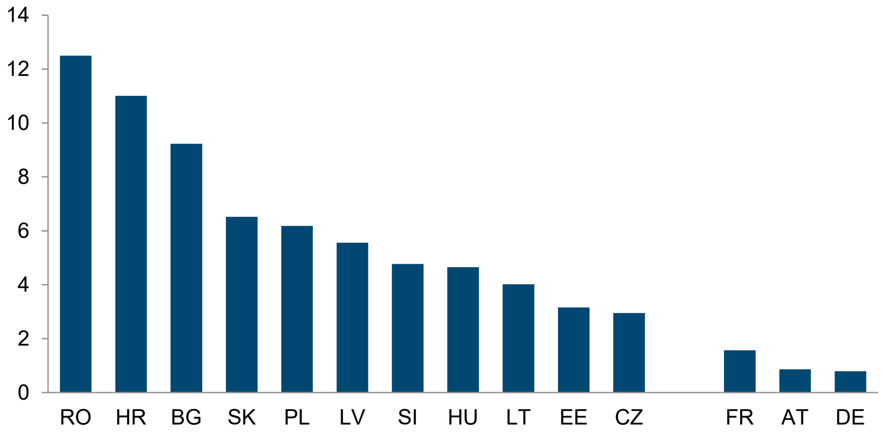
Figure 3.27 / Contribution of individual demand components to GDP growth for 2022-2024, percentage points



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculations. Forecasts by wiiw.

There are several reasons why most of the CESEE countries will outperform the euro area next year in terms of economic growth. The first is that these countries, being less developed, are still growing at a higher rate on average; this is due to the catching-up process, which – though perhaps slow in the region – is still ongoing. A second reason is that many of the CESEE countries will not have such serious energy issues as Western Europe – either because of their low reliance on gas, or because of their adequate domestic production of electricity, or because of their still close ties to Russia. The third reason is that many of the CESEE countries, especially those with a poor energy outlook, are expected to receive sizeable amounts of money next year through the EU's Recovery and Resilience Facility (RRF), which should help their economies remain afloat. Even Czechia and Estonia, the CESEE countries with the lowest allocated amounts of RRF funds, are still expected to receive total support of around 3% of GDP – far above the funding that Austria, Germany or France will receive (around 1% of GDP) (Figure 3.28). Those countries with the largest allocations – Romania and Croatia – are expected to receive RRF funding of more than 10% of GDP.

Figure 3.28 / RRF funds allocation per country, as a percentage of 2021 GDP



Source: European Commission.

Having said that, there is an important factor that may lead to weaker growth in CESEE next year, related to the limited fiscal space that these countries have. If things turn bad, CESEE governments will have less scope to support households and businesses than Western European governments; and that may result in lower growth. This is also likely to magnify the social disparities – already very high in most CESEE countries – which will again deal economic growth a blow.

Looking beyond the short term, the main question for the CESEE economies will be how they manage the green transition. This will be important in reducing the two key energy risks that they currently face – their heavy dependence on gas and their high imports of electricity. Investment in renewable energy will thus be crucial, if these countries are to improve their resilience and increase their longer-term growth prospects. The limited fiscal space that they currently have may be a serious obstacle to the achievement of this. But if the countries do find ways of improving their fiscal revenue – through windfall taxes or progressive taxation, for example – they could indeed emerge stronger from the current crisis.

3.9. CONCLUSIONS

Economic growth in CESEE in the first half of 2022 has generally been better than expected. Because of that, we are revising our growth forecasts for this year upwards for most of the CESEE countries.

Still, the surge in the global price of food and energy has led to very aggressive inflation in the CESEE region. Price rises have already reached double-digit levels in virtually all the CESEE countries. Because of that, we are also revising upwards our inflation forecasts for 2022 for most of the countries.

The economic damage from the higher and more persistent inflation will become evident only in the months and years to come. Real incomes are in freefall almost everywhere in CESEE; consumer confidence is evaporating; business sentiment is deteriorating; interest rates are soaring; and the fiscal space is shrinking. On top of all this comes the energy crunch, caused by the cut in the supply of Russian gas to Europe.

Different countries will be affected differently by the energy crunch, but no country will be spared. Some countries are heavily dependent on gas, and they may suffer because of the lack of it. Others are large importers of electricity: they may have trouble finding affordable electricity, which could lead to the closure of some big industrial plants. Yet other countries will pay the price of their exposure to Germany, as their exports could collapse if the German economy enters a recession.

Our forecasts for 2023 are much more pessimistic than three months ago. On average, we expect inflation in CESEE in 2023 to be 11.6% – far higher than the 6% inflation in the euro area.

We have revised GDP prospects for next year downwards for almost all CESEE economies. We forecast that on average the CESEE region will grow by 0.3% next year, close to what we assume for the euro area (0.2%).

REFERENCES

Jovanović, Branimir, Mahdi Ghodsi, Olga van Zijverden, Sophia Kluge, Martin Gaber, Ravik Mima, Belma Hasić, Ognjenka Lalović, Muela Ibrahimi, Antoaneta Manova Stavreska, Sanja Nikolova, Balša Ćulafić, Jelena Vasić and Marko Mandić (2021), 'Getting Stronger After COVID-19: Nearshoring Potential in the Western Balkans', *wiiw Research Report*, No. 453, Vienna, May 2021

Jovanović, Branimir (2021), 'Are we already seeing some near-shoring to the Western Balkans?', in Vasily Astrov (ed.), Monthly Report No. 11/2021 - FDI in Central, East and Southeast Europe, *wiiw Monthly Report*, No. 11, Vienna, November 2021, 16-22

wiiw (2022), Impressive Resilience is Unlikely to Last: Economic forecasts for Eastern Europe for 2022-24, Summer Forecast Update, *wiiw Monthly Report* No. 7-8.