

2. CESEE Overview: Coronavirus hits; in search of new sources of growth

by Olga Pindyuk

- › Last year, 2019, was a decent one for most of CESEE, but the slowdown from the peak year of 2017 continued for the region as a whole. Even before coronavirus, an external slowdown was evident, driven by the US-China trade war, weaker global growth in general, and extremely sluggish performance in Germany.
- › However, the spread of the coronavirus to Europe has already had negative economic effects, and these could intensify in the coming months, including for CESEE.
- › The cut-off date for our Spring Forecast round was before the full impact of the coronavirus became clear. Therefore, in addition to our baseline scenario, we have produced three further real GDP projections for 2020, based on 'mild', 'medium' and 'severe' scenarios for the spread of the coronavirus.
- › Under our baseline scenario, we project that aggregate real GDP growth for CESEE will rise to 2.9% this year, from 2.1% in 2019, largely on account of improvements in Russia and Turkey. In our 'mild' scenario, regional growth rates would be 0.2-0.6 percentage points below the baseline. For the 'severe' scenario, we project that growth would be around 1-2 percentage points lower. In all cases, the CIS countries and Turkey would be worst affected, with the EU member states and some Western Balkan countries faring relatively better.
- › The extent of the impact will vary by country, depending on specific areas of vulnerability. Countries with higher levels of trade integration with China (particularly CIS countries) or Italy (especially Albania, Bulgaria, Croatia, Romania and Slovenia) will be worse affected, as will those reliant on energy exports (Russia and Kazakhstan) or tourism (Croatia, Slovenia, Albania and Montenegro). The capacity of healthcare systems to cope is also likely to vary considerably across the region.
- › We expect the coronavirus to have a notable negative impact on economic activity in the first half of 2020, but that this will then fade in the second half of the year. Overall, we expect much of the GDP lost now to be made up later. However, we cannot exclude a more 'longer-lasting demand shock, and a recession in parts of CESEE.
- › We are likely to see further loosening of fiscal and monetary policies in EU-CEE11, in order to counteract the economic slowdown caused by the coronavirus. The Western Balkans and CIS and Ukraine will be limited by considerations of macro-financial stability and will have less fiscal room for manoeuvre.
- › Beyond 2020, our outlook remains broadly unchanged. In 2021-2022, we expect economic growth of below 3% in EU-CEE, whereas the Western Balkans are expected to avoid a growth deceleration during that period. Outside EU-CEE and the Western Balkans, pre-coronavirus we

had made significant upward revisions to our GDP forecasts for the bigger economies (Turkey, Russia and Ukraine), based on more expansionary fiscal and/or monetary policies. However, without structural reforms there are substantial negative risks to the sustainability of growth.

- › The coronavirus has temporarily diverted the attention of economists and policy makers from fundamental issues facing CESEE. One of the biggest issues is the shortage of labour, which is likely to become more acute and will subsequently threaten the sustainability of the region's economic model, based as it is on labour-cost advantages and participation in regional production chains.
- › Digitalisation could help CESEE to increase the productivity of its economies by developing more productive service sectors and increasing the servitisation of their production processes. The region is believed to be well equipped for further digitisation. However, it is important to develop adequate government policies to ensure reskilling of the labour force and to support investment in new technologies.

2.1. REVIEW OF 2019: STILL STRONG PERFORMANCE IN MOST OF CESEE, BUT SIGNS OF DECELERATION STARTING TO SHOW IN THE EU MEMBER STATES

In 2019, economic growth in CESEE slowed to 2.1%, but in 2020, thanks to a recovery in the two biggest economies, it is expected to bounce back to 2.9% and to stay at around 3% thereafter. In 2019, EU-CEE11 saw a second consecutive year of growth deceleration from the peak of 4.9% in 2017; this time the slowdown affected all the Visegrad countries. Policy-induced recovery in Russia and Turkey will be the main reason for growth speeding up in 2020. However, a return to the growth level of 2017 is not expected in the short run, as the external environment will remain unfavourable and internal drivers of growth will have limited power.

Economic activity in EU-CEE11 was robust in 2019, but started to show signs of slowing down.

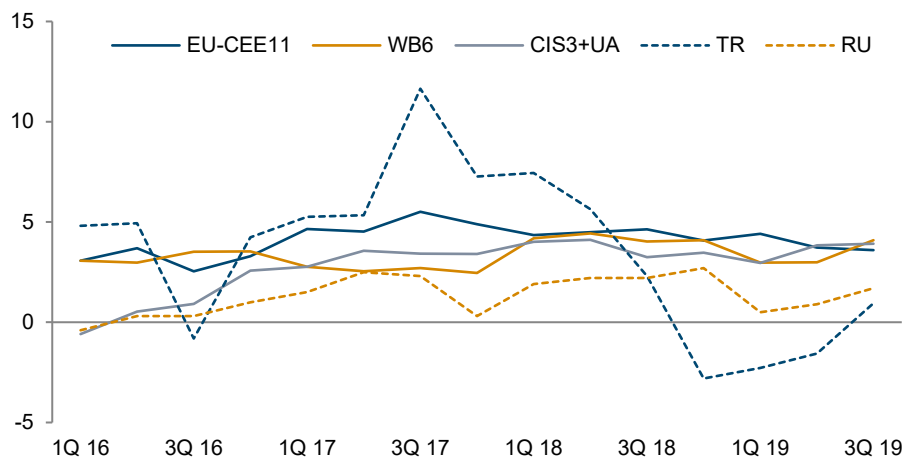
The region remained the leader in terms of real GDP growth in 2019, but there was a continuous slowdown in GDP growth over the preceding four quarters (Figure 2.1). Within the region, the performance of individual countries varied considerably. On the one hand, strong growth was achieved in Hungary, Poland and Romania. Hungary outperformed its peers and reached almost 5% annual growth in 2019, on the back of record strong investment, supported by EU funds and robust private consumption; the latter two countries posted relatively high annual growth rates of 4.3% and 4.0%, respectively. On the other hand, GDP growth rates in the Czech Republic, Slovakia, Slovenia and Latvia were below 3%.

Russia and Belarus were the worst-performing economies in CESEE, whereas Ukraine's economy appears to have got into better shape.

The economies of Belarus and Russia, hampered by chronic weaknesses, managed to grow at only slightly above 1% in 2019. On the other hand, Ukraine, Kazakhstan and Moldova recorded relatively rapid growth, supported by both domestic demand and exports (with the exception of Kazakhstan, which had to rely solely on domestic demand for growth, as exports stagnated in the wake of unfavourable conditions on the global oil markets).

Figure 2.1 / Quarterly real GDP growth

real change against preceding year in %



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

The Western Balkans showed further robust growth performance, albeit somewhat weaker than in the previous year. Economic deceleration was noted in all the countries, apart from North Macedonia and Kosovo: the former has finally got back on the track of stable GDP growth after two years of mediocre performance, caused by shrinking investment. Serbia and Kosovo recorded the fastest real GDP growth in the region (4% and 4.1%, respectively, in annual terms) on the back of strong gross fixed capital formation.

The Turkish economy rebounded in the second half of 2019 on the back of a new phase of a credit-driven boom, and according to its whole year results managed to avoid recession. The country exceeded even our quite optimistic expectations and confirmed its status as the most high-beta economy in CESEE. Though the country had the lowest GDP growth in CESEE (0.5% in annual terms), a host of indicators suggests that a V-shaped recovery is in process (see Turkey report).

2.2. CORONAVIRUS HAS ARRIVED IN EUROPE

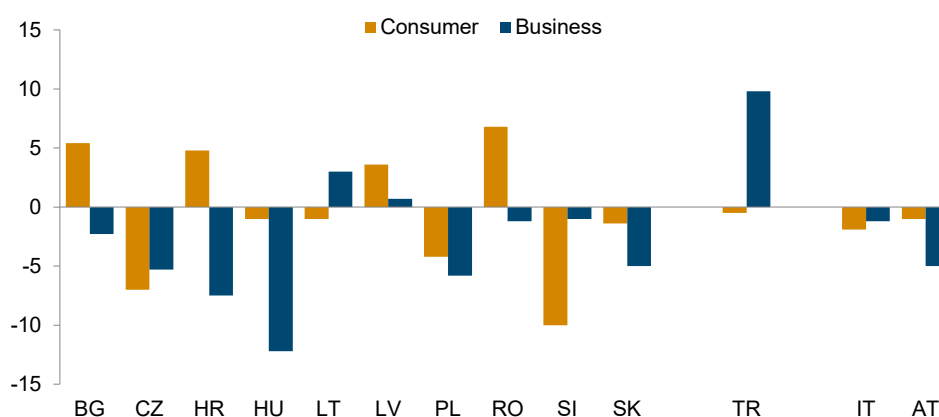
Coronavirus has already arrived in Europe – especially in Italy, but also in other countries including Germany. So far there have been relatively few cases in CESEE, but it is highly likely that the number will increase, given the large flows of tourists and labour migrants between the region and Western Europe.

It is impossible to measure fully the current economic impact of the virus outbreak, due to the lag with which most statistical data are collected, but it seems safe to say that it was not yet significant in February 2020. The European Commission's economic sentiment indicator improved that month, rising to 103.5 from 102.6 the previous month. However, the global Purchasing Managers' Index fell in February to 46.1 – its lowest level since 2009 – after a record decline of 6.1 points. China was at the centre of the downturn, but the US and Japan also contracted.

It is almost certain that the euro area will start contracting very soon and will drag the CESEE down with it, as Italy and Germany are important economic partners for most countries of the region. This is already reflected in the expectations of economic agents (Figure 2.2), and this will have an impact on private consumption and investment plans. Business confidence declined in February 2020 in all the countries, apart from Turkey, Latvia and Lithuania – those countries with a relatively low exposure to China, Germany and Italy. The greatest decline in business confidence was seen in the Visegrad countries and Croatia – and this seems to be a realistic assessment by businesses of the degree of exposure of those countries to the coronavirus-driven crisis.

Figure 2.2 / Business and consumer confidence in February 2020

change against preceding month in %



Source: CEIC Data.

2.3. WEAK EXTERNAL DEMAND HAS WEIGHED ON MERCHANDISE EXPORTS, BUT SERVICES EXPORTS STAY BUOYANT

The external slowdown – driven by the US-China trade war, weaker global growth in general and extremely sluggish performance in Germany – started to be a drag on the region's growth from the end of 2018,¹⁴ and its effects have now become clearly visible. On top of that, the spread of the coronavirus to Europe has already had negative economic effects on CESEE, and these could intensify in the coming months. The EU-CEE countries appear to be the most susceptible to a weakening of global growth, due to their high degree of trade openness. Commodity exporters in the region are affected by falling global prices, as the demand for commodities weakens worldwide.

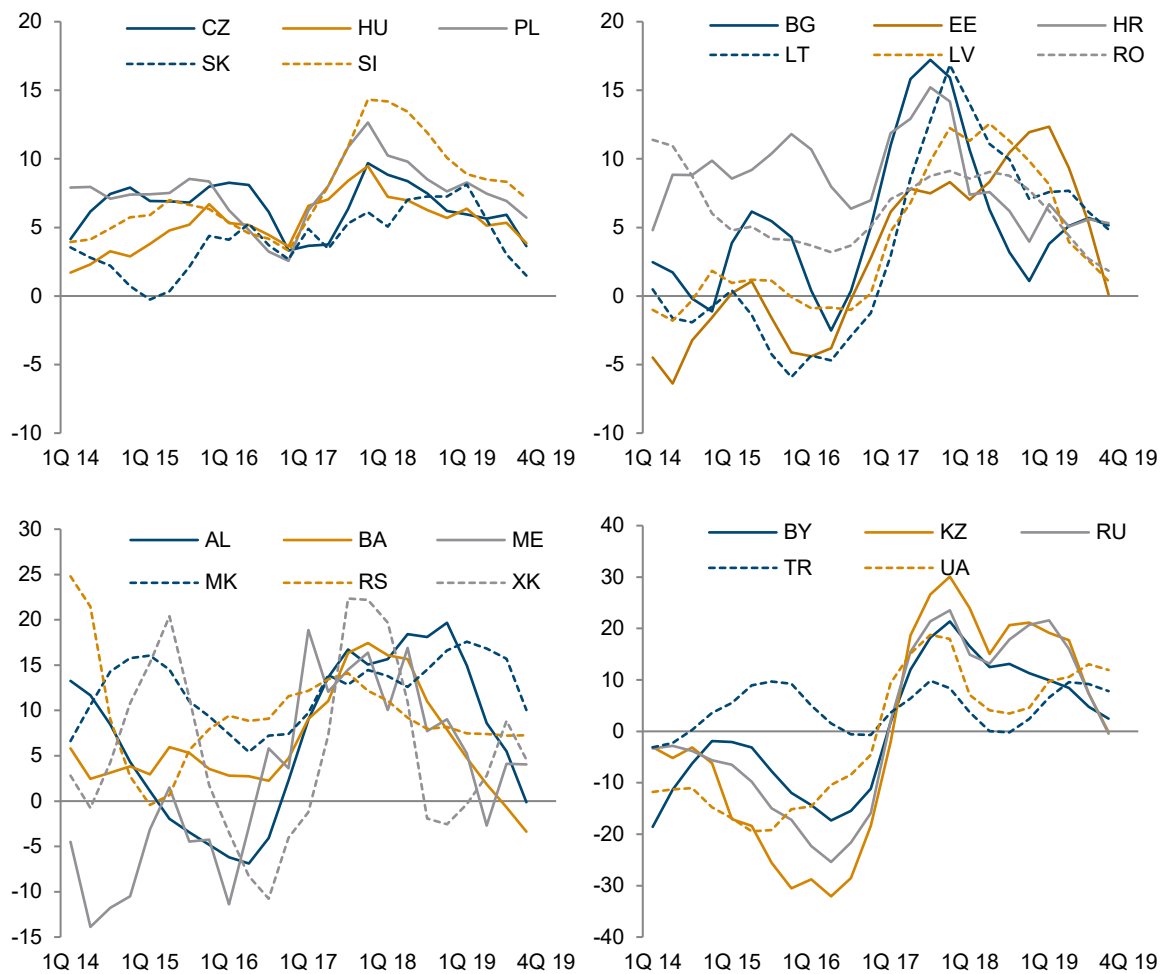
Exports growth followed a sharp downward trend in most countries of CESEE. In the fourth quarter of 2019, annual merchandise exports growth in EUR terms decelerated (or even turned negative) in all the countries, apart from Serbia (where it stagnated) (Figure 2.3). The oil exporters Kazakhstan and Russia were particularly hard hit, as were some of the EU-CEE11 countries that are most tightly integrated into the regional production chains: exports from Latvia and Estonia have been hurt by the slowdown in the Swedish economy, while Slovakia's exports have proved extremely

¹⁴ See Adarov et al. (2018).

vulnerable to the crisis in the German automotive sector (see Global Economic Outlook). Growth rates were still quite healthy in Ukraine, Turkey, North Macedonia and Slovenia.

Figure 2.3 / Exports of goods (customs statistics, EUR based), growth in %

4 quarters moving average



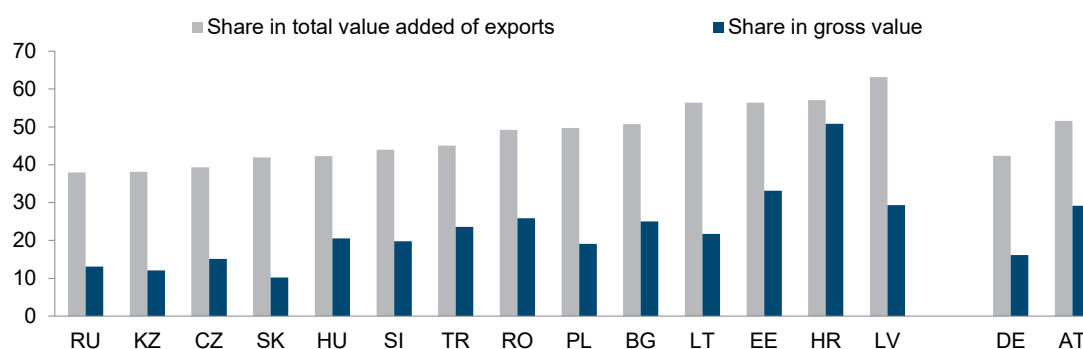
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Industrial output has been losing momentum. The slowdown has been most noticeable in the automotive sector and intermediate-demand goods. Capacity utilisation rates have declined in these sectors and labour shortages have become slightly less acute in Croatia, Poland, Romania and Slovenia (also helped by active government policies to attract labour immigration). Still, overall labour markets remain quite tight in most of the countries – especially when it comes to demand for skilled labour in the case of the Western Balkan countries – and constitute the major impediment to future business expansion.

BOX 1 / CESEE EXPORTS MORE SERVICES THAN IT WOULD APPEAR AT FIRST GLANCE

If one accounts for intermediate linkages, the share of services in exports of the CESEE countries is significantly higher than reported in the balance-of-payments (BOP) statistics. Ultimately it is the linkages between trade and value added that establish a relation between trade and the pattern of national income and labour market conditions. And if one takes these into account, then domestically produced services constitute between 38% of exports value added (Russia) and 63% (Latvia) (Figure 2.4). Even in the V4 countries, which are traditionally regarded as the manufacturing base of Central and Eastern Europe, services comprise between 40% and 50% of exports value added. As technological progress and fundamental changes in the structure/organisation of production alter the nature of services, the consequences of deindustrialisation and increased servitisation of manufacturing need not be seen as negative – services are increasingly more tradable, no longer characterised by low productivity, and can create ‘good jobs’ (Ghani and O’Connell, 2014). The increasing digitalisation of services trade in many countries (Figure 2.5) can be seen as evidence of a shift in this direction.

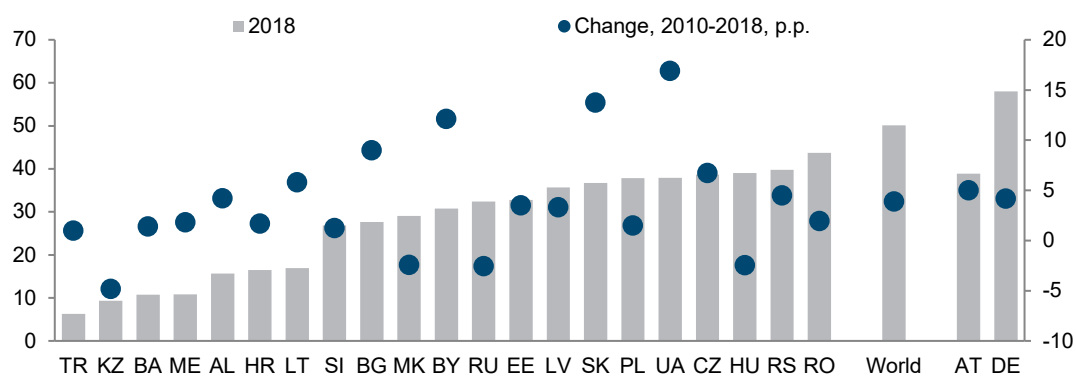
Figure 2.4 / Share of services in value added and gross value of exports in 2015, %



Note: The value-added share of domestic services in gross exports is estimated as the share of value added originating from all domestic service industries in the total gross exports of a given industry.

Source: OECD TiVA dataset, own calculations.

Figure 2.5 / Share of digitally deliverable services in total services exports, %



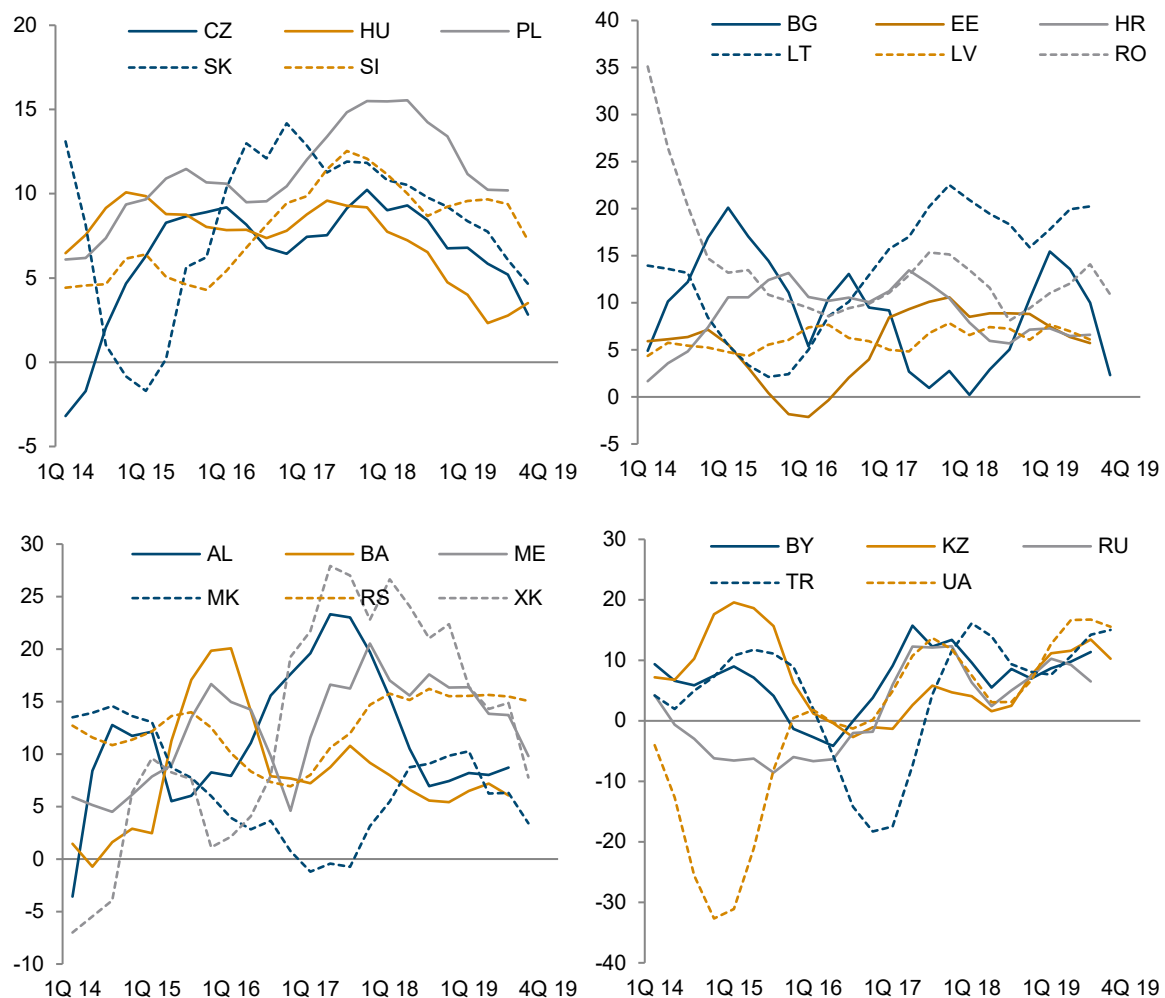
Source: UNCTADstat.

On the other hand, services exports continued to be less vulnerable to negative external shocks.

In all the CESEE countries, apart from Bulgaria, Hungary and North Macedonia, services exports in 2019 grew faster than merchandise exports – in some cases, the difference in growth rates was measured in double digits (Figure 2.6). The most rapid expansion of services exports was in IT and business services (Lithuania, Serbia, Ukraine, Belarus and Romania) and tourism (Turkey and the Western Balkans). This relative resilience of the services sector will, however, now be severely tested by the spread of the coronavirus.

Figure 2.6 / Exports of services (balance-of-payments statistics, EUR based), growth in %

4 quarters moving average



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Household consumption continued as the main driver of growth in the region last year, supported by rapidly rising wages, fiscal measures and consumer credit (see Credit Monitor). Only in Estonia, Hungary and Romania did the contribution to GDP growth of household consumption come second to that of gross fixed capital formation, which generally had a boom year in these countries, largely on the back of EU transfers and fiscal projects. Turkey stands out as the only country with stagnating private

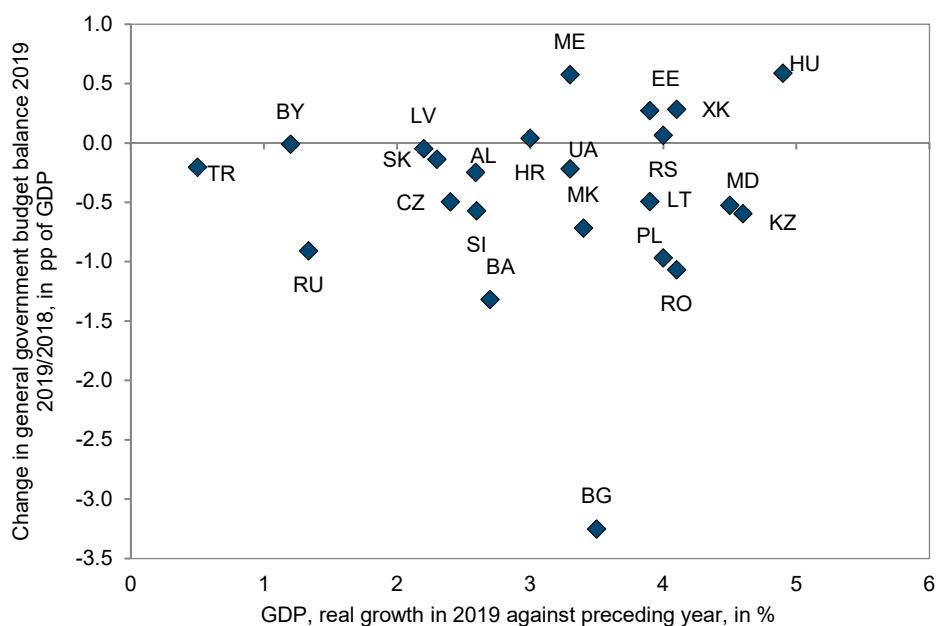
consumption: its economic growth was generated solely through net exports. However, in H2 2019 this trend was already changing, as inflation fell and consumption rose, thanks to huge monetary easing.

Fiscal policy was made increasingly lax in EU-CEE11, in order to stimulate growth. The governments of many countries continued to increase the minimum wage, pensions and social transfers in order to boost private consumption, as wage growth in the private sector started to lose speed, having reached a relatively high level (this is particularly relevant for the V4 countries). Public surpluses decreased significantly in 2019 in Bulgaria, the Czech Republic, Lithuania and Slovenia (in the case of Bulgaria, the general government balance decreased by a whopping 3.3% of GDP and turned into a deficit), signalling the intention of governments to generate pro-growth impulse. Romania posted the highest public deficit in CESEE in 2019 – 4% of GDP.

After a long period of consolidation, Russia's fiscal policy has done a U-turn in order to provide stimulus to the ailing economy (see Russia report) – the first indications of this came back in 2019, when government expenditure as a share of GDP increased by 0.9 p.p. and the budget surplus decreased by the same amount (to 2% of GDP). The fiscal stance of a country can be roughly derived by juxtaposing the change in the government budget balance and the country's growth performance.¹⁵ Using this method, Russian fiscal policy now can be classified as clearly expansionary (Figure 2.7). Kazakhstan and Moldova have also been pursuing expansionary fiscal policies, whereas Belarus and Ukraine, as well as the Western Balkans, lack the fiscal scope to do this.

Figure 2.7 / Fiscal stance in CESEE countries in 2019

change against preceding year



Source: wiiw Annual Database incorporating national statistics and Eurostat statistics.

¹⁵ For the reasoning behind this, please see Astrov (2019), p. 22.

We expect fiscal policy to become even looser soon, in order to combat the coronavirus impact on economies. The EU-CEE11 countries will be better positioned to increase fiscal stimulus, as they generally have a bigger fiscal space and will have access to resources provided at the EU level. As of 11 March 2020, the European Commission has vowed to help member states boost their response to the coronavirus outbreak by permitting aid for struggling businesses and deploying flexibility in its budget rules to allow a surge in public spending. It has also announced the creation of an investment fund worth up to EUR 25 billion. Overall, the CESEE region will benefit from likely further interest rate cuts by the big central banks, which will push down borrowing yields even more and enable the loosening of fiscal policy.

The Western Balkans, Turkey, CIS and Ukraine will have the least fiscal room for manoeuvre, limited as they are by macro-financial stability concerns. In addition, they face the risk of capital flight, as investors could withdraw their capital and go back to safe havens. There are already indications of this happening, as portfolio capital flows to emerging markets securities declined significantly in February 2020: according to the Institute of International Finance, emerging markets securities – both debt and equity – attracted only USD 3.4 billion that month, a sharp drop from the USD 29.5 billion recorded in January.

2.4. WHAT ARE THE TRANSMISSION MECHANISMS OF UNCONVENTIONAL MONETARY POLICY?

In the years since the global economic crisis, there has been almost unprecedented expansion of global liquidity in the world, brought about by quantitative easing. Use of unconventional monetary policy tools appears to have brought us into uncharted waters, where the traditional monetary models no longer work. The persistently low inflation that has followed has led economists to question the ability of central banks to deliver on their mandate.

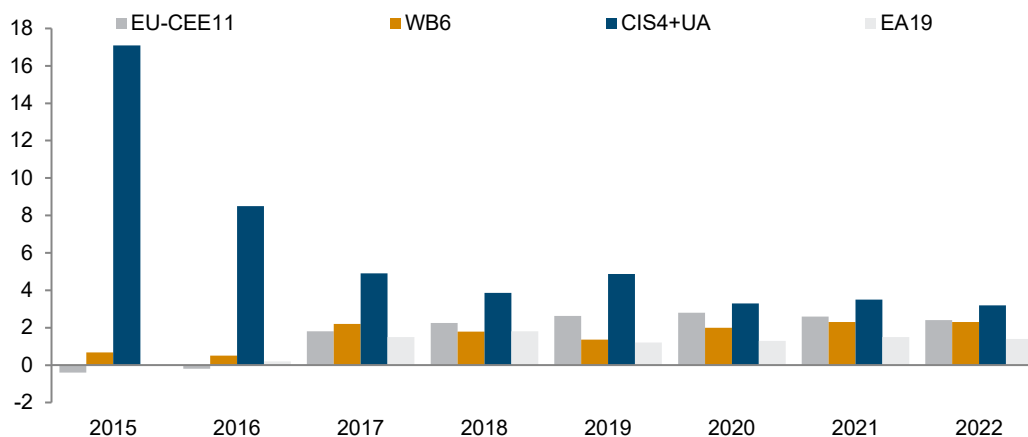
The EU-CEE11 countries have benefited from access to cheap liquidity, which has allowed for loose monetary policy in the region, as evidenced by continually negative real interest rates in the region (see Credit Monitor). However, negative real interest rates have not had a significant impact on inflation in most places, despite rapid wage growth; and even where inflation is back on target, it has taken several years of negative real interest rates. Several possible explanations for the ‘missing inflation’ mystery have been posited, including demographic trends, low import prices, stronger competition in the retail sector (in particular, due to e-commerce), high savings rates and outflows of remittances.¹⁶

In our pre-coronavirus baseline forecast, we expect inflation rates in EU-CEE11 to pick up slightly in 2020, and then to decline to below the 2019 level by 2022. Thus, they will be on a converging trend with inflation rates in the Western Balkans, which have rather limited fiscal and monetary space compared with EU-CEE11. In 2019, the average CPI differential between the two sub-regions was 1.2 p.p., while the average difference between the real interest rates was about 3 p.p. By 2022, the CPI levels in the two sub-regions are expected to be almost identical (Figure 2.8).

¹⁶ For a more detailed discussion, see Grieveison (2019a).

Figure 2.8 / Consumer prices

average change against preceding year in %



Note: Simple averages for country aggregates.

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

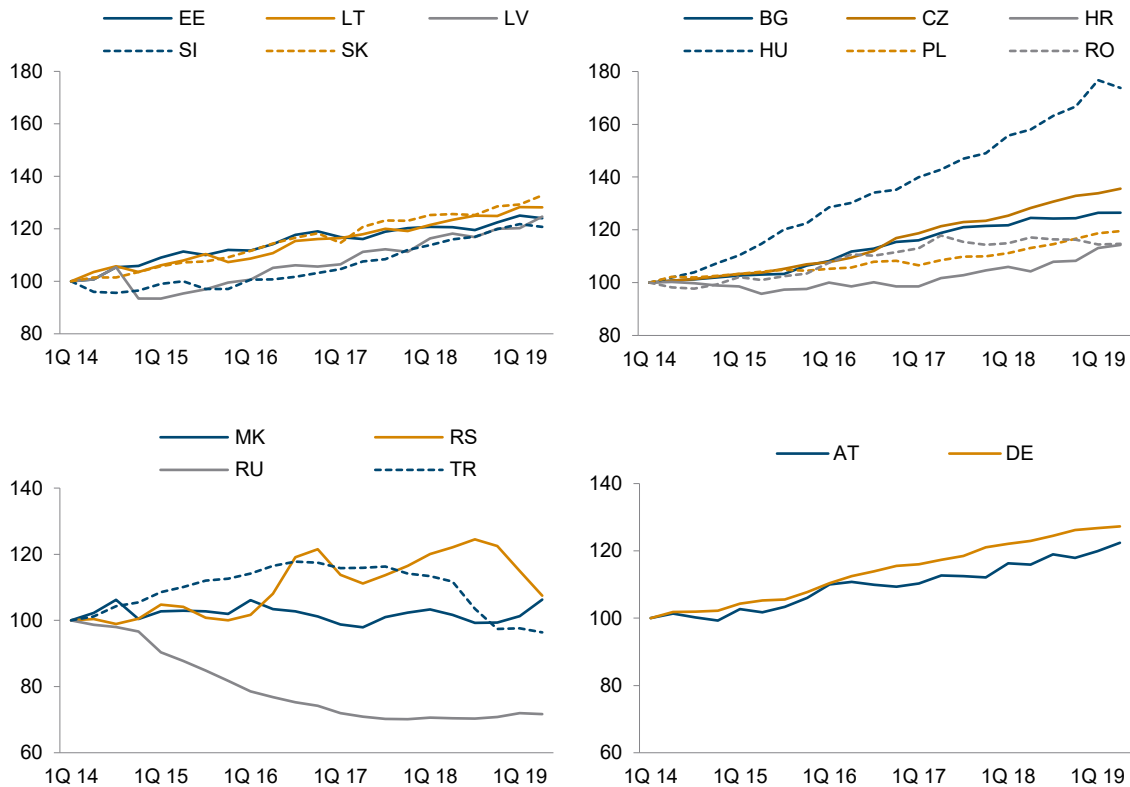
The coronavirus outbreak is likely to influence monetary policy decision making in the region. It can mean different things for different sub-regions. It appears that central banks in EU-CEE11 are likely to reverse their course of monetary tightening to counter economic slowdown. Even Hungary, which has a rather high risk of overheating relative to its peers (see Credit Monitor), is expected to abstain from a previously flagged policy rate hike at the end of March. In the CIS and Ukraine (in particular in oil exporters Kazakhstan and Russia), as well as Turkey, considerations of macro-financial stability are likely to dominate and tightening of monetary policy appears to be on the cards. The National Bank of Kazakhstan already raised its policy rate by 2.75 percentage points to 12% on 10 March 2020 to protect the national currency from increased external risks.

It would appear that asset prices have replaced CPI as the more important channel of monetary policy pass-through in EU-CEE11. Real residential property prices have been increasing steadily over the past five years in the EU-CEE11 countries, both among members of the euro area and in non-euro states (Figure 2.9). A particularly strong growth in property prices has been taking place in Hungary. Meanwhile, the Czech Republic, Slovakia and Bulgaria have seen residential property prices rise faster in real terms than in Germany or Austria. In contrast, in North Macedonia, Serbia, Turkey and Russia, where real interest rates have been positive, residential property prices in 2014-2019 stagnated – or in the case of Russia actually declined.

These trends provide yet another reason for concern over the effectiveness of extra-loose monetary policy, as it would appear that the main effect of the liquidity glut is to inflate asset prices, rather than impact on the real economy. Historically, lower interest rates have been assumed to spur economic growth by reducing the cost of borrowing and encouraging higher spending and investment. But this mechanism appears to have become defective: real interest rates have been languishing in negative territory for a long time, as they seem to have less impact on inflation

expectations.¹⁷ Low rates of return on deposits in commercial banks and savings in pension funds act as an additional factor of rising demand for real estate.¹⁸

Figure 2.9 / Index of real residential property prices, 1Q 2014=100



Source: BIS.

2.5. FORECASTS FOR 2020-2022: EU-CEE11 CONTINUES TO RUN OUT OF STEAM, WHILE OTHER REGIONS MAINTAIN GROWTH ON THE BACK OF POLICY STIMULUS

Though several of the EU-CEE11 countries finished 2019 in better shape than we expected last summer, prospects for the immediate future do not appear so bright. As the external environment deteriorates, so the region – with its mostly export-focused economies – will struggle. In 2020, even under our pre-coronavirus baseline projections, we forecast GDP growth to slow down in all 11 countries, apart from in Slovenia (where it will stagnate) (Table 2.2). The sharpest deceleration will take place in Hungary, Estonia, Lithuania, Romania and Bulgaria, which were among the top performers in CESEE in 2019. In 2021-2022, there will be either continued deceleration of growth or a very modest increase in growth rates; as a result, all the countries, apart from Poland and Romania, will have to reckon with economic growth of below 3% in the coming years. Poland will be a leader in terms of economic growth in EU-CEE11 during the forecast period; meanwhile, Hungary and Bulgaria will become laggards in the sub-region.

¹⁷ See, for example, Gnan et al. (2018), Rehn (2020).

¹⁸ For a more detailed discussion of the effects of quantitative easing on CESEE, see Pindyuk (2019).

Table 2.1 / OVERVIEW 2018-2019 AND OUTLOOK 2020-2022

	GDP					Consumer prices				
	real change in % against prev. year					average change in % against prev. year				
	2018	2019	Forecast			2018	2019	Forecast		
2020			2021	2022	2020			2021	2022	
BG Bulgaria	3.1	3.5	2.8	2.3	2.0	2.6	2.5	2.5	2.0	2.0
CZ Czech Republic	2.8	2.4	2.2	2.4	2.6	2.0	2.6	2.5	2.2	2.0
EE Estonia	4.8	3.9	2.7	2.6	2.7	3.4	2.3	2.4	2.5	2.6
HR Croatia	2.7	3.0	2.7	2.7	2.6	1.6	0.8	1.5	1.5	2.0
HU Hungary	5.1	4.9	3.3	2.6	2.2	2.9	3.4	3.5	3.5	3.5
LT Lithuania	3.6	3.9	2.8	2.6	2.7	2.5	2.2	2.5	2.3	2.3
LV Latvia	4.6	2.2	2.0	2.3	2.6	2.6	2.7	2.3	2.4	2.5
PL Poland	5.1	4.0	3.6	3.3	3.3	1.2	2.1	2.8	2.5	2.2
RO Romania	4.4	4.1	3.2	2.8	3.2	4.1	3.9	3.5	3.5	3.0
SI Slovenia	4.1	2.6	2.6	2.7	2.7	1.9	1.7	1.8	2.0	2.0
SK Slovakia	4.0	2.3	2.0	2.4	2.6	2.5	2.8	2.4	2.0	1.8
<i>EU-CEE11</i> ¹⁾²⁾	4.4	3.7	3.1	2.8	2.9	2.2	2.6	2.8	2.6	2.4
<i>EA19</i> ³⁾	1.9	1.1	1.2	1.3	1.3	1.8	1.2	1.3	1.5	1.4
<i>EU28</i> ³⁾	2.0	1.4	1.4	1.6	1.6	1.9	1.5	1.9	1.9	2.0
AL Albania	4.1	2.6	3.2	3.4	3.4	2.0	1.4	1.9	2.2	2.4
BA Bosnia and Herzegovina	3.7	2.7	2.5	2.8	2.9	1.4	0.6	1.3	1.6	1.7
ME Montenegro	5.1	3.3	2.8	2.9	3.1	2.6	0.4	1.8	1.9	1.8
MK North Macedonia	2.7	3.4	3.3	3.3	3.3	1.5	0.8	2.4	2.5	2.0
RS Serbia	4.4	4.0	3.7	3.5	3.3	2.0	1.7	2.2	2.6	2.8
XK Kosovo	3.8	4.1	4.3	4.2	4.2	1.1	2.7	1.5	1.7	1.5
<i>WB6</i> ¹⁾²⁾	4.0	3.5	3.4	3.4	3.3	1.8	1.4	2.0	2.3	2.3
TR Turkey	2.8	0.5	3.9	4.1	4.1	16.3	15.2	10.2	8.5	8.0
BY Belarus	3.1	1.2	1.0	1.3	1.3	4.9	5.6	5.0	4.5	4.0
KZ Kazakhstan	4.1	4.5	3.7	3.8	3.8	6.0	5.3	5.2	5.0	5.0
MD Moldova	4.3	4.6	4.0	4.0	4.0	2.9	4.8	4.5	4.5	4.0
RU Russia	2.5	1.3	2.1	2.3	2.4	2.9	4.5	2.7	3.1	2.8
UA Ukraine	3.3	3.3	3.6	4.2	4.5	10.9	7.9	5.8	5.0	5.0
<i>CIS4+UA</i> ¹⁾²⁾	2.8	1.8	2.4	2.6	2.6	3.9	4.9	3.3	3.5	3.2
<i>V4</i> ¹⁾²⁾	4.6	3.7	3.1	2.9	2.9	1.7	2.5	2.8	2.5	2.3
<i>BALT3</i> ¹⁾²⁾	4.2	3.4	2.5	2.5	2.7	2.7	2.4	2.4	2.4	2.4
<i>SEE9</i> ¹⁾²⁾	4.0	3.7	3.1	2.8	3.0	3.1	2.8	2.8	2.8	2.6
<i>CIS3+UA</i> ¹⁾²⁾	3.7	3.6	3.2	3.6	3.6	7.4	6.2	5.4	4.9	4.8
<i>non-EU12</i> ¹⁾²⁾	2.8	1.5	2.9	3.0	3.1	7.4	7.7	5.2	4.9	4.6
<i>CESEE23</i> ¹⁾²⁾	3.3	2.1	2.9	3.0	3.0	5.9	6.2	4.5	4.2	3.9

ctd.

Table 2.1 / (ctd.)

		Unemployment (LFS)					Current account				
		rate in %, annual average					in % of GDP				
		2018	2019	Forecast			2018	2019	Forecast		
2020	2021			2022	2020	2021			2022		
BG	Bulgaria	5.2	4.3	3.8	3.6	3.4	5.4	9.9	6.2	5.2	5.0
CZ	Czech Republic	2.2	2.0	2.1	2.2	2.2	0.3	-0.1	0.3	0.3	0.4
EE	Estonia	5.4	4.4	4.8	4.8	4.8	2.0	1.7	1.1	2.3	1.7
HR	Croatia	8.5	6.5	6.0	5.5	5.0	1.9	2.6	2.1	2.1	1.9
HU	Hungary	3.7	3.4	3.5	3.5	3.5	-0.5	-0.3	-0.1	0.0	0.1
LT	Lithuania	6.2	6.3	6.2	6.0	5.8	0.3	0.5	3.0	2.4	3.2
LV	Latvia	7.4	6.5	6.3	6.3	6.0	-0.7	-0.3	-0.7	-0.7	-0.4
PL	Poland	3.9	3.5	3.6	3.7	3.7	-1.0	1.1	0.2	0.4	0.6
RO	Romania	4.2	3.9	4.0	4.0	4.0	-4.4	-4.7	-4.9	-4.6	-4.2
SI	Slovenia	5.1	4.6	4.0	3.8	3.7	5.7	6.6	5.9	5.7	5.6
SK	Slovakia	6.5	5.8	5.8	5.6	5.6	-2.6	-2.9	-3.2	-2.9	-2.7
	<i>EU-CEE11</i> ¹⁾²⁾	4.3	3.9	3.9	3.9	3.8	-0.7	0.2	-0.2	-0.1	0.1
	<i>EA19</i> ³⁾	8.2	7.6	7.5	7.4	7.3	3.6	2.8	2.7	2.5	2.4
	<i>EU28</i> ³⁾	6.8	6.4	6.0	6.0	5.9	2.2	1.5	1.4	1.3	1.2
AL	Albania	12.3	11.3	11.0	10.5	10.0	-6.8	-7.6	-6.9	-6.8	-6.4
BA	Bosnia and Herzegovina	18.4	15.7	15.6	14.6	13.7	-3.7	-5.2	-5.3	-5.1	-5.1
ME	Montenegro	15.2	14.8	14.1	14.0	13.8	-17.0	-16.7	-17.0	-14.8	-12.9
MK	North Macedonia	20.7	17.0	16.7	16.1	16.0	-0.1	-0.7	-0.7	-1.0	-1.4
RS	Serbia	12.7	10.7	10.8	10.3	9.8	-5.2	-6.2	-5.7	-5.3	-4.9
XK	Kosovo	29.6	24.5	23.5	22.5	21.0	-7.6	-6.8	-7.1	-7.6	-8.1
	<i>WB6</i> ¹⁾²⁾	15.7	13.4	13.2	12.7	12.0	-5.3	-6.2	-5.9	-5.6	-5.4
TR	Turkey	10.9	13.7	13.5	13.4	11.5	-3.4	0.2	-1.3	-2.1	-2.6
BY	Belarus	4.8	4.2	4.5	4.6	4.7	-0.1	-0.5	-1.4	-1.3	-0.9
KZ	Kazakhstan	4.9	4.8	4.8	4.8	4.8	-0.2	-3.1	-2.4	-2.0	-1.7
MD	Moldova	3.0	5.5	5.0	5.0	5.0	-10.6	-10.7	-8.6	-8.4	-7.3
RU	Russia	4.8	4.6	4.5	4.4	4.4	6.8	4.2	3.5	3.4	3.3
UA	Ukraine	8.8	8.4	8.1	7.8	7.6	-3.3	-0.7	-3.3	-3.0	-2.8
	<i>CIS4+UA</i> ¹⁾²⁾	5.4	5.2	5.1	5.0	5.0	5.3	3.0	2.3	2.2	2.3
	<i>V4</i> ¹⁾²⁾	3.8	3.4	3.5	3.5	3.5	-0.8	0.3	-0.2	0.0	0.2
	<i>BALT3</i> ¹⁾²⁾	6.4	5.9	5.9	5.8	5.6	0.4	0.6	1.4	1.5	1.8
	<i>SEE9</i> ¹⁾²⁾	8.6	7.5	7.3	7.0	6.8	-2.5	-2.1	-2.7	-2.7	-2.5
	<i>CIS3+UA</i> ¹⁾²⁾	6.9	6.5	6.5	6.4	6.3	-1.5	-2.0	-2.8	-2.5	-2.2
	<i>non-EU12</i> ¹⁾²⁾	7.1	7.5	7.3	7.2	6.8	2.6	1.9	1.1	0.8	0.7
	<i>CESEE23</i> ¹⁾²⁾	6.4	6.6	6.5	6.4	6.1	1.4	1.3	0.6	0.5	0.5

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 (February 2020).

Table 2.2 / Baseline real GDP forecasts and revisions

		Forecast, %				Revisions, pp		
		2019	2020	2021	2022	2019	2020	2021
EU-CEE11	BG	3.5	2.8	2.3	2.0	⇒ 0.0	↑ 0.1	↓ -0.1
	CZ	2.4	2.2	2.4	2.6	↓ -0.1	↓ -0.2	↓ -0.2
	EE	3.9	2.7	2.6	2.7	↑ 0.6	↑ 0.1	↑ 0.2
	HR	3.0	2.7	2.7	2.6	↑ 0.1	⇒ 0.0	⇒ 0.0
	HU	4.9	3.3	2.6	2.2	↑ 0.6	↑ 0.2	⇒ 0.0
	LT	3.9	2.8	2.6	2.7	↑ 0.3	↑ 0.4	⇒ 0.0
	LV	2.2	2.0	2.3	2.6	↓ -0.6	↓ -0.2	↓ -0.1
	PL	4.0	3.6	3.3	3.3	↓ -0.4	↑ 0.1	⇒ 0.0
	RO	4.1	3.2	2.8	3.2	↓ -0.1	↓ -0.1	↓ -0.2
	SI	2.6	2.6	2.7	2.7	↓ -0.3	↓ -0.2	↓ -0.1
	SK	2.3	2.0	2.4	2.6	⇒ 0.0	↓ -0.2	↓ -0.2
WB6	AL	2.6	3.2	3.4	3.4	↓ -0.2	↓ -0.6	⇒ 0.0
	BA	2.7	2.5	2.8	2.9	↑ 0.1	↓ -0.2	↑ 0.1
	ME	3.3	2.8	2.9	3.1	↑ 0.2	↓ -0.2	↑ 0.8
	MK	3.4	3.3	3.3	3.3	↑ 0.1	↓ -0.1	↓ -0.1
	RS	4.0	3.7	3.5	3.3	↑ 1.1	↑ 1.0	↑ 0.9
	XK	4.1	4.3	4.2	4.2	↓ -0.1	↑ 0.3	↓ -0.1
Turkey	TR	0.5	3.9	4.1	4.1	↑ 1.2	↑ 0.8	↑ 0.8
CIS4+UA	BY	1.2	1.0	1.3	1.3	↓ -0.1	↓ -0.5	↓ -0.4
	KZ	4.5	3.7	3.8	3.8	↑ 0.5	↑ 0.2	↑ 0.3
	MD	4.6	4.0	4.0	4.0	↓ -0.1	↑ 0.2	⇒ 0.0
	RU	1.3	2.1	2.3	2.4	↑ 0.2	↑ 0.4	↑ 0.4
	UA	3.3	3.6	4.2	4.5	⇒ 0.0	↑ 0.5	↑ 0.9

Note: Current forecast and revisions are relative to the wiiw Autumn Forecast 2019. Colour scale variation from the minimum (red) to the maximum (green).

The Western Balkans appear to be less vulnerable to global trade tensions, and before the coronavirus hit we had expected it to be able to avoid a deceleration of economic growth during 2020-2022. Only the Serbian economy will lose some speed, but it will still grow much faster than we previously forecast – at above 3% per year during the forecast period. However potential growth in the region will be inhibited by uncertainty with regard to EU accession prospects¹⁹ and by skilled labour shortages. Additional negative risk stems from a migrant crisis that could erupt in Bosnia as early as 2020 and potentially spread to other countries (see Bosnia report).

Outside EU-CEE and the Western Balkans, pre-coronavirus we had made significant upward revisions to GDP forecasts for the bigger economies (Turkey, Russia and Ukraine). The most important driver behind the acceleration in growth has been a switch to more expansionary fiscal and/or monetary policies, facilitated by increased appetite for emerging markets among yield-hungry investors. However, without structural reforms, these measures can provide only a short-term boost to the economies, and we see substantial negative risks to successful implementation of the reform programmes and to the sustainability of growth.

- › **Turkey's** unbalanced economic growth model and the start of a new credit boom leave it exposed to external volatility and changes in investor sentiment. The government's plans to tackle this issue will yield some results; but we are sceptical that they can really engineer a fundamental change in the way the economy operates.

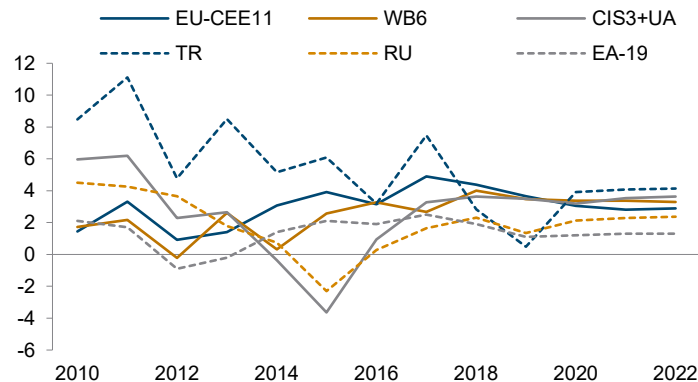
¹⁹ For more details, see Grievson (2020).

- › **Russia** has started to correct for an overly restrictive fiscal and monetary stance over the past few years with significant fiscal stimulus and monetary easing. However, so far there has not been much progress in reforming the country's institutions and investment climate, which leaves its economy heavily dependent on the energy sector and thus vulnerable to global market volatility.
- › **Ukraine's** new government has initiated an ambitious reform agenda, aimed at improving the business climate and attracting investment. The main risk to its successful implementation is the failure of the government to loosen the grip of the oligarchs on large sections of the economy and to limit their ability to direct policy in their own personal interests. In the worst-case scenario, the IMF could stop cooperation with the country, which could have a detrimental effect on investor confidence and macro-financial stability.

In such conditions, the pace of income convergence with Western Europe will remain inadequate. Moreover, it is projected to slow down in EU-CEE11 – in 2022, the GDP growth differential with the euro area will be a mere 1.6 p.p. (Figure 2.10). The Western Balkans and CIS + Ukraine will be able to achieve higher catch-up rates during 2020-2022; but given their very low levels of GDP per capita, a 2-3 p.p. growth differential with the euro area can hardly be considered sufficient.

Figure 2.10 / Real GDP

change in % against preceding year



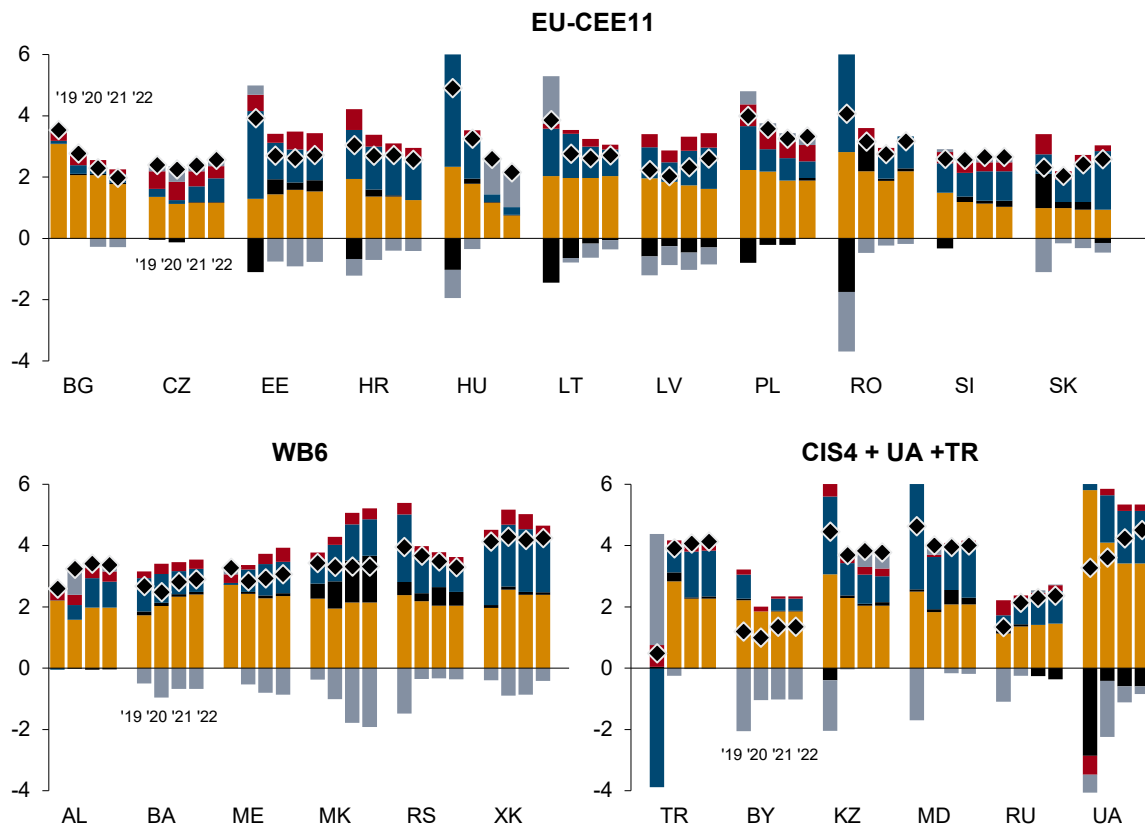
Note: Weighted averages for country aggregates.

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

Household consumption will continue to be the main driver of economic growth in CESEE during 2020-2022 (Figure 2.11). However, its expansion will decelerate in all the countries, apart from Bosnia, Turkey and Russia – due to a slowdown in the growth of wages and declining consumer confidence, which will reduce the propensity to consume. The contribution of net exports to growth will be either negative or close to zero in all the countries – apart from Hungary, where it will increase and reach about 50% of the (much slower) GDP growth in 2022.

Figure 2.11 / GDP growth in 2019-2022

and contribution of individual demand components in percentage points



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

2.6. CORONAVIRUS IMPACT: SCENARIOS FOR GDP GROWTH IN 2020 AND CHANNELS OF CONTAGION

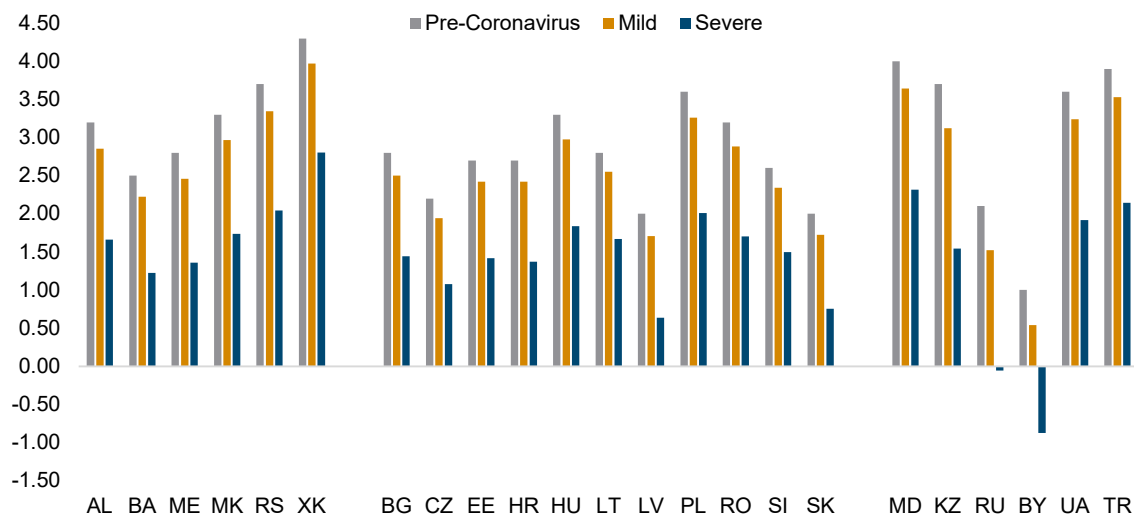
Risks to the forecast lie mainly on the downside, and in light of the coronavirus we have calculated new real GDP growth rates based on ‘mild’, ‘medium’ and ‘severe’ scenarios²⁰ (Figure 2.12 and Table 2.3). We took into account both the impact of a contraction of domestic and import demand and the influence of weaker domestic demand and demand for imports in key trading partners, including those worst affected (so far) by the coronavirus. Additionally, we built assumptions about the oil price into our projections for Russia and Kazakhstan. Given the extremely high level of uncertainty at present, these projections should be understood as a rough guide to the range within which the coronavirus is likely to impact CESEE economies this year.

²⁰ We used as benchmarks OECD scenarios for the global economy, including projections for China specifically, as well as our own assessments for the major global economies in the three scenarios. Based on these assumptions, we used the World Input Output Database to make projections for growth in CESEE countries. We also applied an extra adjustment for Russia and Kazakhstan to reflect the impact of the decline in the oil price.

Our ‘mild’ (and now best-case) scenario suggests that the coronavirus will subtract 0.2-0.6 percentage points from growth in CESEE countries this year. In terms of the change versus the pre-coronavirus baseline, we expect Russia, Kazakhstan and Belarus to be worst affected, with Lithuania suffering the least. Our ‘medium’ scenario suggests a GDP decline versus the baseline of 0.6-1.2 percentage points. Again, the CIS oil exporters would be the worst affected, with the region’s EU Member States faring relatively better.

In our ‘severe’ (worst-case) scenario, real GDP growth would be 1.1-2.5 percentage points lower than our baseline projection for this year. Many countries would experience a technical recession (i.e. two consecutive quarters of negative growth), and both Russia and Belarus would experience full-year contractions. No country in the region would grow by more than 2.8% (Kosovo).

Figure 2.12 / Real GDP growth projection scenarios for 2020, %



Source: wiiw projections.

Our current assumption is that the virus will have a ‘severe’ impact on economic growth in CESEE. We expect the impact on the economies of CESEE to become much more significant than is currently visible in the headline data, but we also expect that this impact will be short lived, and that most of the GDP currently being lost will be regained in subsequent quarters. However, this is far from guaranteed.

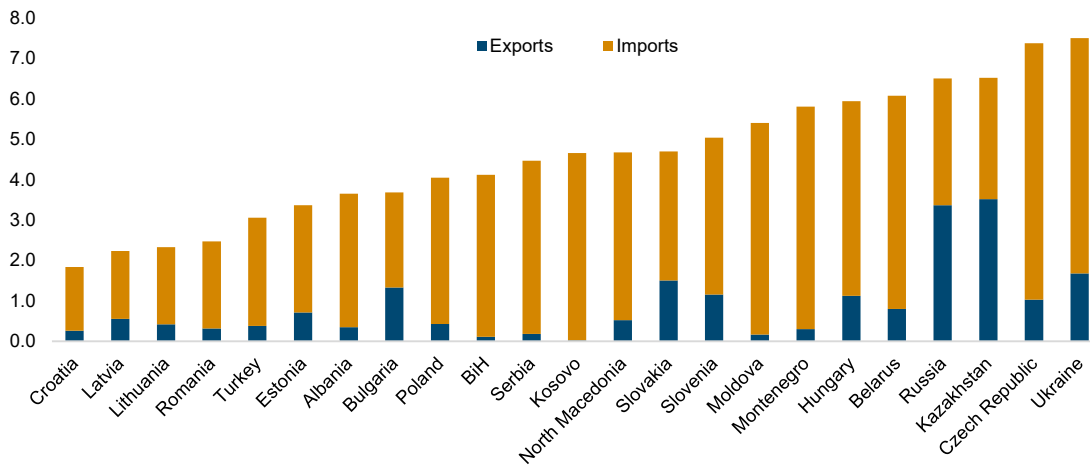
Table 2.3 / Real GDP growth projection scenarios for 2020, %

	Pre-coronavirus forecast	Real GDP growth, %, 2020			Percentage-point change from pre-coronavirus forecasts		
		Mild	Medium	Severe	Mild	Medium	Severe
AL	3.2	2.9	2.4	1.7	-0.4	-0.8	-1.5
BA	2.5	2.2	1.9	1.2	-0.3	-0.7	-1.3
ME	2.8	2.5	2.1	1.4	-0.3	-0.8	-1.4
MK	3.3	3.0	2.5	1.7	-0.3	-0.8	-1.6
RS	3.7	3.3	2.9	2.0	-0.4	-0.8	-1.7
XK	4.3	4.0	3.5	2.8	-0.3	-0.8	-1.5
BG	2.8	3.0	2.1	1.4	-0.3	-0.7	-1.4
CZ	2.2	2.0	1.6	1.1	-0.3	-0.6	-1.1
EE	2.7	2.4	2.1	1.4	-0.3	-0.7	-1.3
HR	2.7	2.4	2.0	1.4	-0.3	-0.7	-1.3
HU	3.3	3.0	2.6	1.8	-0.3	-0.8	-1.5
LT	2.8	2.6	2.2	1.7	-0.3	-0.6	-1.1
LV	2.0	1.7	1.3	0.6	-0.3	-0.7	-1.4
PL	3.6	3.2	2.8	2.0	-0.3	-0.8	-1.6
RO	3.2	2.9	2.4	1.7	-0.3	-0.8	-1.5
SI	2.6	2.3	2.0	1.5	-0.3	-0.6	-1.1
SK	2.0	1.7	1.4	0.8	-0.3	-0.6	-1.3
MD	4.0	3.6	3.2	2.3	-0.4	-0.9	-1.7
KZ	3.7	2.8	2.2	1.2	-0.9	-1.5	-2.5
RU	2.1	1.5	0.9	-0.1	-0.6	-1.2	-2.2
BY	1.0	0.5	0.0	-0.9	-0.5	-1.0	-1.9
UA	3.6	3.2	2.6	1.9	-0.4	-0.6	-1.7
TR	3.9	3.5	3.0	2.2	-0.4	-0.9	-1.8

Source: wiiw.

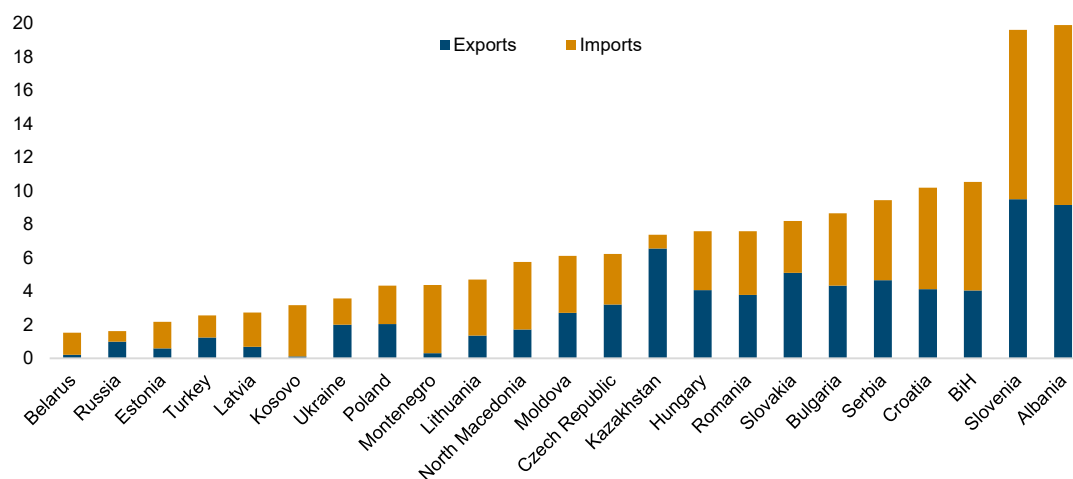
As the data above show, our region is exposed in various ways to the coronavirus, and we do not expect all countries to be equally affected. In particular, we highlight the following channels of contagion:

- › **Economic integration with China:** The coronavirus has caused huge dislocation to supply chains in China. Given China's importance in the global economy, this has already had implications for many firms in Europe that rely on Chinese inputs. Within CESEE, all economies have some level of integration with China, but this is more clearly the case for some than for others (Figure 2.13). The CIS countries, Ukraine and the Czech Republic are particularly exposed. Many other EU-CEE countries have reasonably high levels of trade integration with China, reflecting their integration in global value chains more generally.

Figure 2.13 / External trade with China, % of GDP, 2019

Source: wiiw.

- › **Economic integration with Italy:** By far the worst affected European country is Italy. Although Italy's economy has been weak for many years, and its relative importance as a trading partner for the rest of Europe has declined, it remains an important economy from the perspective of many countries in Southeast Europe (Figure 2.14). For Slovenia and Albania, trade with Italy constitutes around 20% of GDP.

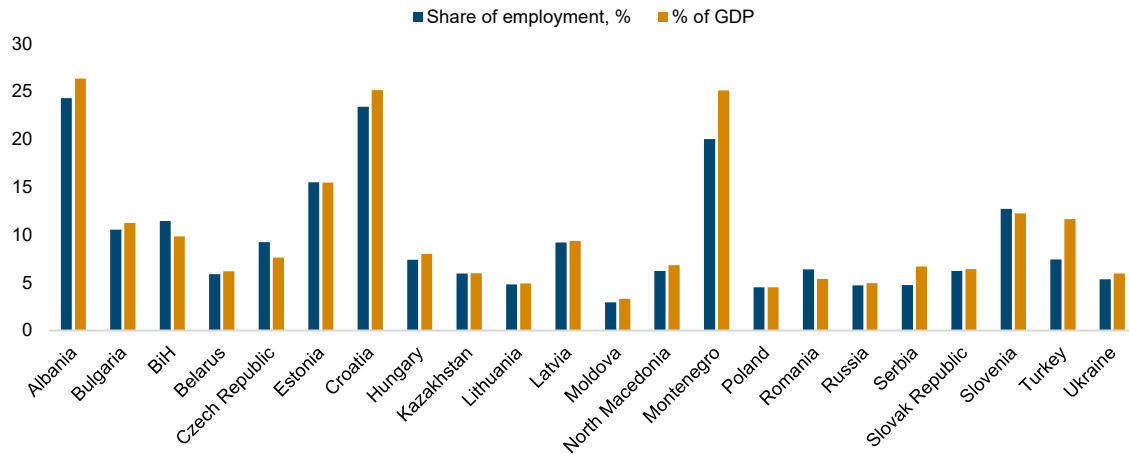
Figure 2.14 / External trade with Italy, % of GDP, 2019

Source: wiiw.

- › **Role of tourism in the economy:** Although no hard data are yet available, anecdotal evidence suggests that tourism has already been badly hit. Images in the media show empty planes and airports across Europe. Several CESEE economies, especially Croatia, Slovenia, Bulgaria, Romania, Montenegro and Albania, rely heavily on tourism in overall GDP, and for employment (Figure 2.15). Tourism has also become an increasingly important part of the Turkish growth story in recent years.

The impact may be limited somewhat if (as many experts seem to expect) the coronavirus abates in time for the peak summer tourism season.

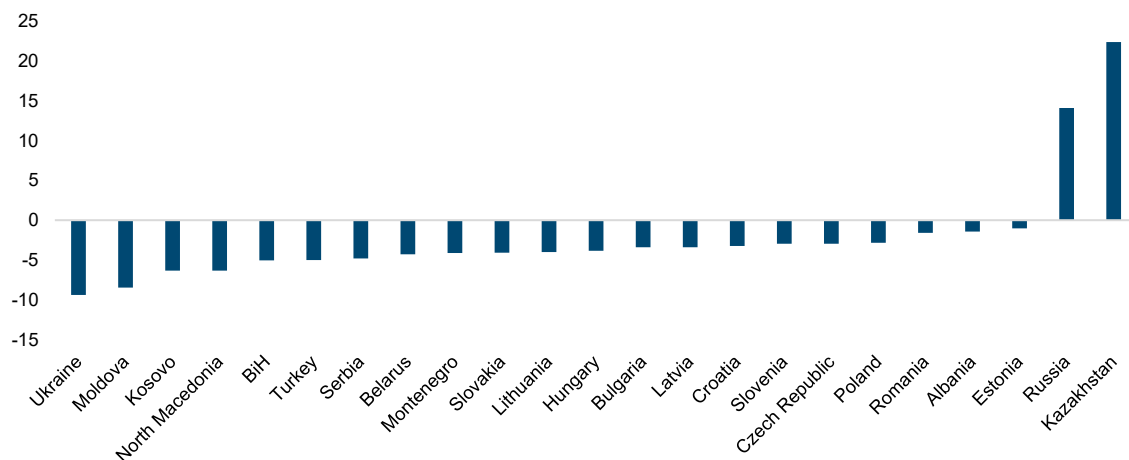
Figure 2.15 / Role of tourism in CESEE economies, 2018



Source: World Bank.

› **Importance of energy exports in GDP: The economies of Russia and Kazakhstan** will be hit by the collapsing global oil prices. In 2019, mineral fuels accounted for about 60% and 73% of merchandise exports, respectively, and state revenues from energy exports were the main source of financing for various national projects, in particular investment in infrastructure and support for small and medium-sized enterprises. Belarus will also be affected indirectly, through possible reduced import demand in Russia, its main trading partner.

Figure 2.16 / Trade balance in minerals, lubricants and related materials, % of GDP, 2018



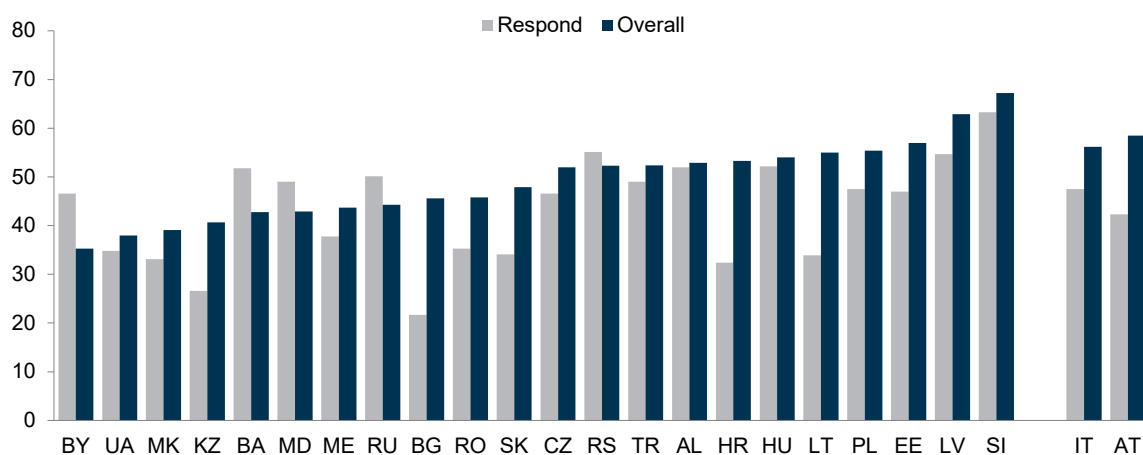
Source: wiiw.

› **Capacity of the healthcare system to react:** According to the Global Health Security (GHS) Index report (2019), around the globe international preparedness to deal with health security crises is weak.

The index's average overall score is 40.2 out of 100, and only rises to 51.9 for high-income countries. In the CESEE region, three countries perform at below the world average overall score: Belarus, Ukraine and North Macedonia (Figure 2.17). Bulgaria, Romania and Slovakia have the worst performance among the EU-CEE11 countries. The Baltic States, Poland and Slovenia appear to have the strongest health security systems in the region, with Latvia and Slovenia even outperforming Austria. An important sub-index of the GHS Index is readiness to respond rapidly and to mitigate the spread of an epidemic. It is remarkable that this sub-index is lower than overall national health security in all the CESEE countries, apart from Belarus, Moldova, Russia, Bosnia and Herzegovina, and Serbia. By this metric, the least prepared for an epidemic are Bulgaria and Kazakhstan. Croatia and Lithuania, although they have among the best overall health security systems in CESEE, perform quite badly on this score.

Figure 2.17 / Indices of overall national health security and of readiness to respond rapidly and mitigate the spread of an epidemic

Maximum score 100 indicates the highest health security / full readiness



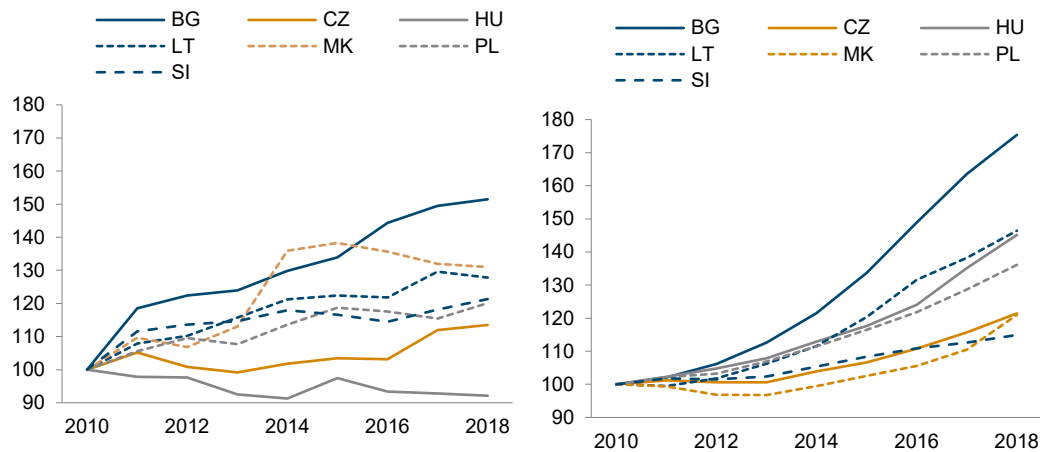
Source: GHS Index Report.

2.7. LABOUR SHORTAGES UNDERLINE THE NEED FOR A NEW GROWTH MODEL

Current demographic developments in CESEE raise fundamental questions about the sustainability of the region's economic model, based as it is on labour-cost advantages and participation in regional production chains. A slowdown in the economic growth of many countries suggests that the low-hanging fruit of economic development has already been picked. As can be seen from Figure 2.18 for selected CESEE countries, growth in labour productivity in manufacturing has been sluggish in recent years. Only Bulgaria – which is characterised by low levels of labour productivity – saw it grow relatively dynamically during 2016-2018; in other countries it basically stagnated (or even fell in Hungary and North Macedonia). In Bulgaria, Hungary, Lithuania and Poland, the growth of wages in manufacturing has significantly outpaced the growth of labour productivity – and this trend can hardly be sustainable in the future. That may limit the role of household consumption as a growth driver.

With a projected decline in the working-age population in the near future, labour shortages are likely to become more acute and subsequently to threaten economic growth. A recent study by Leitner and Stehrer (2019) shows that the hypothetical labour productivity growth rate required to compensate for the loss of working-age population is about 1 percentage point higher than the actual growth rate, suggesting that the current labour productivity growth rate in the EU needs to more than double.

Figure 2.18 / Index of real labour productivity and real wages in manufacturing, 2010=100

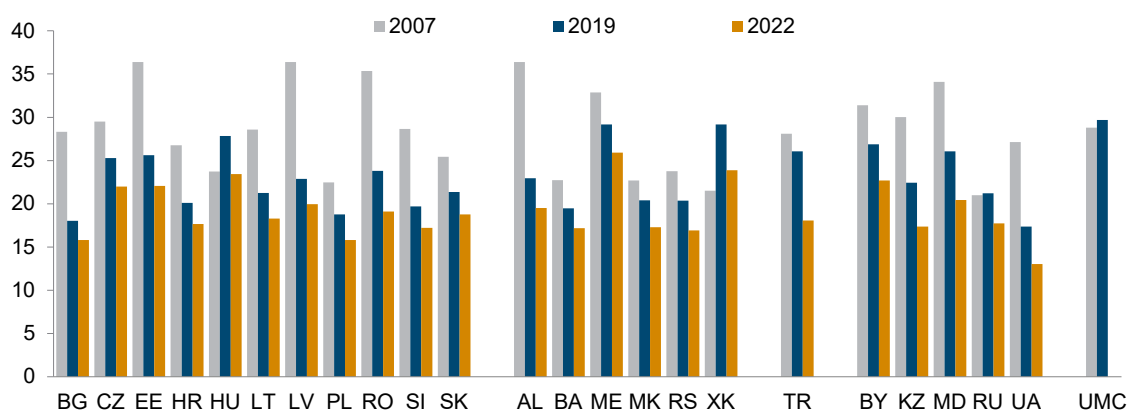


Note: Real labour productivity is calculated as output per employee.

Source: wiiw Annual Database incorporating national and Eurostat statistics. Own calculations.

Figure 2.19 / Gross fixed capital formation

share in % of GDP



Note: UMC refers to upper-middle-income countries.

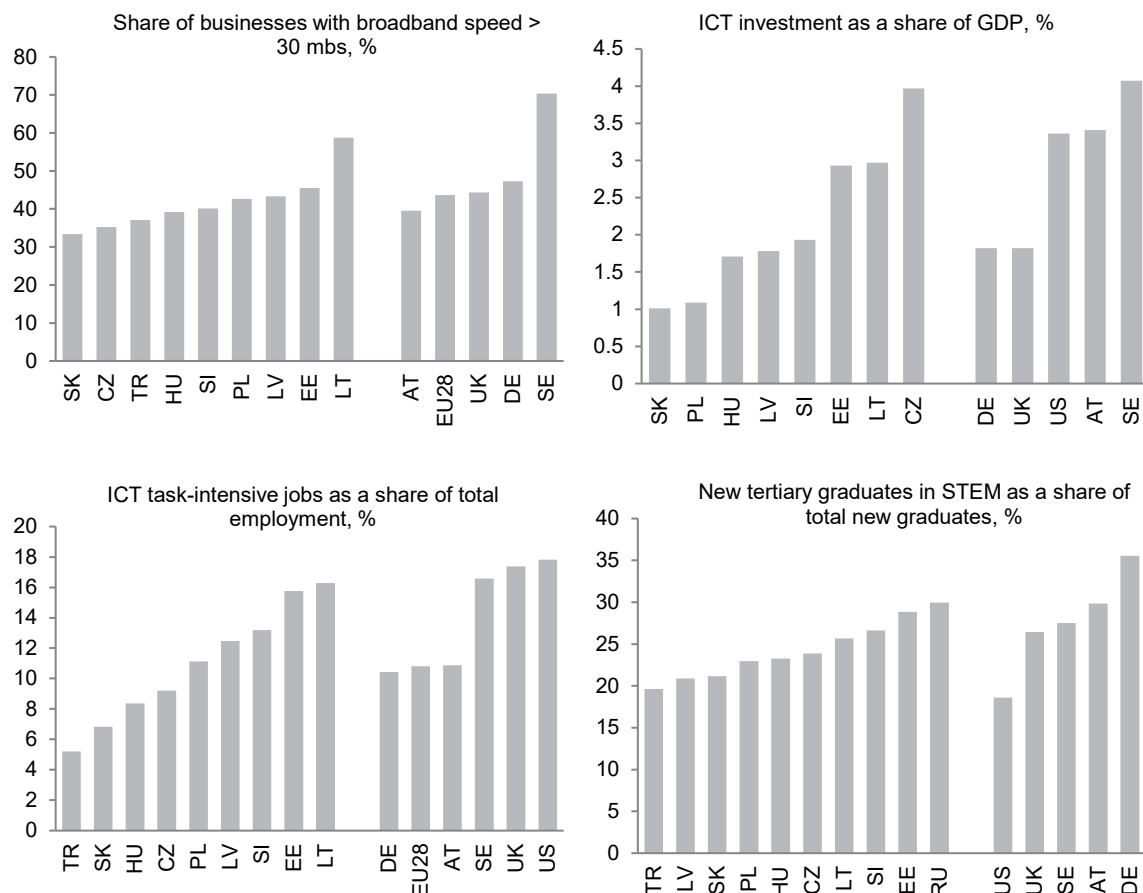
Source: wiiw Annual Database incorporating national and Eurostat statistics, OECD.

The situation is further exacerbated by the relative undercapitalisation of the CESEE region. All other things being equal, unfavourable demographics increase the relative importance of capital deepening, as boosting labour productivity usually requires expanding investment into new capital-intensive technologies, as well as human capital development. Most of the CESEE countries significantly

cut their shares of gross fixed capital formation in GDP after the last global economic crisis – only in Hungary and Kosovo were they higher in 2019 than 2007 (Figure 2.19). During 2020-2022, shares of gross fixed capital in GDP are forecast to decline further in all the countries and to fall below 25% – to as low as 13% in Ukraine and 16% in Bulgaria and Poland. Such levels are significantly lower than the current average in the upper-middle-income economies (about 30%) and most likely are not adequate for technological modernisation of the region.

Digitalisation could ease the pressure on labour reserves and be the next driver of sustained growth in the region. A recent ECB survey of large companies²¹ found that digitalisation is viewed as something that increases productivity, thanks to knowledge-sharing and more efficient production processes. Novak et al. (2018) estimate that about 50% of work activities could be automated using technologies available today – such as industrial robots, distributed ledger technology, 3D printing, the internet of things, artificial intelligence and big data analytics; the greatest potential for automation is to be found in manufacturing, transportation and warehousing, mining, agriculture, accommodation and food services, trade and utilities. Furthermore, Kotian et al. (2018) suggest that investments in ICT in CESEE have a bigger effect on productivity growth than investment in other infrastructure or machinery.

Figure 2.20 / Selected indicators of digital development, 2017



Source: OECD Going Digital Toolkit.

²¹ See ECB (2018).

CESEE countries are believed to have solid foundations for further digitalisation, such as a large STEM (science, technology, engineering and mathematics) and ICT talent pool, relatively high-quality digital infrastructure and broadband coverage, and a milder legacy ‘technology lock-in’ than Western and Northern European countries (Novak et al., 2018). Kirpalani (2012) argues that with the introduction of ICT, Eastern Europe has the potential to leapfrog stages of transition and transform itself into a new knowledge-driven economy, since it can provide the necessary skills or build them relatively easily. Figure 2.20 shows how selected CESEE countries compare with the digital frontrunners Sweden, the US and the UK:²² though the region generally lags behind the leaders with respect to ICT investment, it can claim a relatively high importance of the ICT sector for employment, well-equipped skilled labour and decent broadband infrastructure. The region performs relatively well on average in PISA tests that evaluate pupils’ maths and science scores. Furthermore, the European Digital City Index 2016, for example, ranks Bucharest, Vilnius and Riga as the top three cities in Europe for digital infrastructure, eclipsing major innovation hubs such as London and Amsterdam.

Digitalisation could help CESEE to increase the productivity of its economies by developing more productive service sectors and increasing the servitisation of their production processes.

Growth in the service sector is one of the foundations on which international goods production networks are built – without efficient markets for infrastructure services and business processes, it is impossible to move intermediate inputs across borders and undertake complex coordination of production processes (Pasadilla and Shepherd, 2012). Moreover, a more productive service sector is beneficial not only for those directly connected with it through investment or employment, but also for other parts of the economy that use services inputs intensively or influence productivity of a whole economy through numerous spill-over effects. This could potentially allow the countries to avoid the trap of being stuck in the production part of the (lower) value chain.

New government policies will be needed to harness the benefits of digitalisation. First, growing digitalisation is likely to lead to a significant shift in demand for skills – demand for technology skills, social skills and emotional skills is expected to grow the most. Thus, it is important for CESEE countries to ensure the reskilling of their workers through education policies. Second, it is important to provide incentives for businesses to invest in new technology, and also to ensure that they have the means to finance their investments, in particular through a financial sector that is capable of supporting innovation. Currently R&D spending on aggregate remains very low in CESEE compared to the leaders in Western Europe, Asia and the US, and the situation is unlikely to change without targeted government policies.

2.8. CONCLUSION: CORONAVIRUS UNDERSCORES STRUCTURAL ISSUES FACING CESEE ECONOMIES

In the past three decades, many of the CESEE economies have based their economic models on close integration into regional and global value chains, using their cheap labour forces as a comparative advantage. This strategy allowed them to attract large volumes of FDI to finance investment, and facilitated a rapid process of catch-up with the Western EU members. However, it appears that this model will no longer deliver such big returns. The negative aspects of over-reliance on external demand and cheap labour have become very stark of late, as this chapter has shown.

²² See also Grieveson (2019b).

Currently CESEE economies have to deal with negative external shocks caused by the coronavirus and cyclical weakness in German industry. However, even once these have passed, the region will have to deal with possible long-term issues in globalisation patterns, structural change in the automotive industry and demographic decline. We see two possibilities for the region: either to adjust to a lower trend growth rate (and weak convergence) or to take decisive action to shift to a new growth model. In this chapter we have made some suggestions for how to do the latter.

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