Executive summary

The CESEE region experienced a growth rate of 1.5% in Q2 2023, exceeding that of the EU, which remained stagnant during the same period. However, this seemingly positive result conceals several important nuances.

First, significant variations were observed across individual countries and sub-regions within CESEE. The EU-CEE countries performed at below expectations, mainly due to the recession in Germany. Conversely, the Western Balkan countries exceeded expectations, benefiting from tourism, remittances and foreign direct investment. The CIS countries and Ukraine also did better than anticipated, as they adapted to the new reality.

Secondly, in many of these countries, growth was driven by a decline in imports – primarily on account of the strong base effects resulting from the high level of imports seen the previous year, when energy concerns led to stockpiling. This effect is temporary and will lead to a slowdown in future growth.

Thirdly, despite the overall solid GDP growth in the region, living conditions deteriorated for many, and poverty indicators increased. Real wages remain at significantly below their level of a year and a half ago, and an increasing number of people are struggling to afford to have decent meals.

Inflation generally exceeded expectations, driven not only by global energy and food prices, but also by corporate profits, price increases in other sectors and, in some cases, rising wages. While inflation has started to moderate, the process is slow and it will remain high for some time.

Monetary policy has been restrictive throughout 2023. Although some central banks have ceased their rate hikes, and a few have initiated easing cycles, monetary conditions are expected to remain tight in 2024.

The fiscal authorities in CESEE have faced higher borrowing costs, but have managed to provide some support packages for their citizens and businesses. This has partly been achieved due to inflation's positive impact on public revenue – and, in certain cases, to EU funds. However, as the packages are phased out, so fiscal support is anticipated to decline.

The energy situation has improved since last year, with reduced gas dependence and diversified sources. Nonetheless, the region may face challenges in a severe winter, and there has been only limited progress in reducing fossil fuel dependence and investing in renewable energy for the long term.

Looking ahead, the region appears to be moving toward a new equilibrium, the main features of which will be lower growth and higher inflation. Growth expectations for 2024 and 2025 have been revised downward owing to the global economic slowdown, a weak EU economy, sustained inflation, tight monetary conditions and less fiscal support. Inflation is expected to remain elevated; also, given the complexity of its drivers – which extend beyond global energy prices – there is no prospect of a return to the 2% target any time soon.

COUNTRY SUMMARIES

ALBANIA

Economic growth will accelerate to 3.5% this year, and a similar pace is expected over the medium term, owing to favourable external and domestic demand. A bumper tourist season has greased the wheels of the economy. Strong services exports and buoyant remittance inflows have pushed the current account deficit to unprecedentedly low levels, while FDI inflows have also performed strongly. Consumer prices will surge by a relatively modest 5%, but an inflation rate in double digits for staple foodstuffs is eating into the income of the most vulnerable groups.

BELARUS

In 2023, Belarus's economy has performed considerably better than expected. While this largely reflects recovery from a low base, there have also been signs of adjustment to the effects of Western sanctions. With Russia's assistance, Belarus has remodelled some logistical export chains. The authorities have maintained an accommodative policy stance, combining fiscal stimulus with monetary easing. We expect GDP to grow by 3.0% in 2023, and then to moderate to 2.2% and 2.5% in 2024 and 2025, respectively.

BOSNIA AND HERZEGOVINA

The year started with rather slow economic growth, as a result of a decline in household consumption and net exports. Inflation has been falling, despite the inability of the central bank to influence interest rates under the currency board arrangement. Political tensions are again on the rise, as one part of the country, Republika Srpska, has ceased to heed the decisions of the international official who oversees peace in the country. On a positive note, the country's new government has been making some progress in meeting the conditions set by the EU for progress towards EU accession, and the country's S&P sovereign rating was upgraded in August 2023 in recognition of its economic resilience.

BULGARIA

Economic slowdown became more pronounced over the course of the year, and industry actually plunged into a deep recession. Export performance was dismal against the background of shrinking demand in Western Europe. A new government took office in May, supported by the two main political parties. Its foundations are shaky, however, as the parties have not signed a coalition agreement. Economic weakness will persist: GDP will grow by 1.0% in 2023 and by 1.5% and 2.5% in 2024 and 2025, respectively.

CROATIA

Croatia's accession to the euro area and the EU's border-free Schengen zone boosted tourism in 2023. The country's full EU integration will also provide a fillip to trade and investment in the long term. EU-related funds were already supporting investment activity in the country in 2022, and have continued to do so this year. Nevertheless, persistently high levels of inflation have put real incomes, external demand and investment sentiment under pressure, which is why we have maintained our growth forecast for 2023 of 2.5%.

CZECHIA

There are not too many reasons to be optimistic about the economic performance of Czechia in 2023. The economy will remain stagnant (0.1%) and inflation high (11%). With prices rising steeply, household consumption is dragging growth downward, as are declining inventories. Following a period of surprising resilience, industry is also losing steam. The dim outlook for Germany is further weakening Czechia's prospects. A mild recovery can be expected in 2024, helped by inflation falling back.

ESTONIA

The Estonian economy performed at below the EU-CEE average in H1, and GDP is now expected to decline by 1.3% in 2023 as a whole, as the aftermath of severe inflation, major supply issues and interest rate hikes unfolds. With shrinking domestic and foreign demand, the outlook for recovery will largely be determined by the country's success in gaining a share of new markets, the resurgence of foreign direct investment and the revival of Estonian firms' competitiveness. Economic growth is expected to gain ground slowly but steadily from next year onwards, with GDP growth forecast to be 1.7% in 2024 and 3.0% in 2025.

HUNGARY

Hungary has slipped into recession, with private consumption and investment contracting in H1 2023. Net exports mitigated the decline. The economy may soon see a slight recovery, but the annual growth rate will remain at below zero. Only a modest recovery is expected in 2024 and 2025. Growth would receive a fillip from EU transfers and a strong recovery of the main export markets, but neither of those things is currently on the horizon. Fiscal consolidation and continued high interest rates may slow the pace of recovery. Inflation will likely fall to below 10% later in 2023 and slowly sink further over the next two years.

KAZAKHSTAN

In H1 2023, the Kazakh economy recorded GDP growth that was among the highest of all CESEE countries – 5.1% – driven by investment and private consumption. We expect economic performance to slow in H2 2023, but growth for the full year will still exceed our previous forecast by 0.2 percentage points (pp), reaching 4.7%. Monetary policy loosening will remain cautious in light of the slow disinflation. Booming imports, fuelled by strong demand and declining exports (amid global oil prices that are lower than in 2022) lead to a higher current account deficit forecast for 2023 and 2024. In 2024-2025 we expect economic growth of around 4%.

KOSOVO

Economic growth for 2023 will be around 3.2% and will be driven by domestic demand. Consumer price inflation has fallen substantially, though there is still upward pressure from food prices and energy costs. The uneasy dialogue with Serbia and the sanctions imposed by the EU are having repercussions for the economy, with a slowing of trade relations and EU investment.

LATVIA

Whereas in 2022 economic activity remained quite lively right up to the end of the year, in 2023 the effects of dwindling external demand and reluctant household consumption are dampening GDP growth. Inflation is declining significantly, so that real incomes are again increasing in H2. While public investment has been expanding this year, enterprises are in the process of running down their stocks. Given the still rather tight labour market, the unemployment rate will fall slightly in 2023 – and even more so in the coming two years. Assuming that the EU economy finds its way back on track next year, we expect a subdued revival in Latvia's GDP growth, to 1.8% in 2024 and 2.3% in 2025.

LITHUANIA

The economy performed worse than expected in H1 2023, and we do not foresee any significant upswing before the end of the year. Since inflation has been declining considerably, real income will pick up again in H2 2023; this will support household consumption – after four consecutive quarters of decline. However, it is only in 2024 that the rise in real incomes will gain momentum. Despite the stagnation, the labour market remains robust. Private investment activity is declining, since external demand is in the doldrums, while the government has considerably raised infrastructure investment. We expect real GDP to decline by 0.1% in 2023; this will be followed by a modest upswing to 1.7% in 2024 and then 2.4% in 2025.

MOLDOVA

After two years of decline, GDP will finally recover in H2 2023. The harvest will be better than last year, and that will have a positive impact on incomes, exports and the food industry. Sharp disinflation will help consumption recover. The future prospects look even brighter, as Moldova has managed to switch its trade flows, including energy supplies, from Russia to the West. The country can rely on multinational institutions to finance its fiscal and current account deficits.

MONTENEGRO

Montenegro’s economy performed exceptionally well in H1 2023, growing by 6.5%. The economy is still feeling the positive effects of last year’s social reform, which is boosting household consumption. Moreover, there has been a strong tourist season, as well as vibrant investment in hotel facilities and energy infrastructure. The potential formation of a new governing coalition offers hope of a stable political environment. We have upgraded our previous GDP growth forecast for 2023 to 4.5%.

NORTH MACEDONIA

As expected, the economy slowed in Q2, owing to high inflation, restrictive monetary policy and limited foreign direct investment. Driven by company profits, inflation remained very high: the government has reinstated price controls on food products in an effort to tame it (though we do not believe the effects will last long). The GDP forecast for 2023 has been kept unchanged at 1.6%, but our forecast for 2024 has been revised downward to 2%, on account of the cloudier outlook for the EU economy.

POLAND

Restrictive monetary policy has pushed the economy into a minor recession that is directly linked to suppressed real wages and the liquidation of excessive inventories. The recent (6 September) cut in the policy interest rate is expected to prevent further deterioration on the real side. In effect, GDP in 2023 is likely to stay flat – and then to resume its moderate expansion in 2024. At the same time, disinflation will progress naturally. Public deficit spending remains high, but the public debt levels are not a serious threat to fiscal stability.

ROMANIA

Romania will suffer a significant economic growth slowdown to 2.5% in 2023, but – helped along by EU funds and a good harvest – its growth will still be above that of most of its peers. Inflation fell to single digits in August, but real incomes are proving slow to recover. The current account deficit has shrunk due to lower imports of goods and higher exports of services. High fiscal deficits jeopardise the country’s access to EU funds, but no harsh stabilisation measures will be necessary to keep most of the funds flowing. The rising political risks moderate our growth expectations for the election year of 2024.

RUSSIA

Low oil prices and a strong rebound of imports have resulted in the rouble depreciating by about 30% since the beginning of the year, prompting drastic monetary policy tightening. Nevertheless, the economy is continuing to recover on the strength of domestic demand, with military procurement boosting industrial production and construction, and a tight labour market pushing up wages and consumption. This year, growth is projected to exceed 2%, to be followed by a mild deceleration in 2024-2025. A growing addiction to fiscal military stimulus and increased technological backwardness together increase the risk of stagnation (or even outright crisis) once the war is over.

SERBIA

The economy grew solidly in Q2, but this is likely to be short lived. Inflation is showing signs of moderating, but is still among the highest in the CESEE region. The central bank is likely to keep interest rates unchanged for the rest of the year, while fiscal policy will probably become less restrictive. We are revising our GDP growth forecast for 2023 upwards to 1.5%, but for 2024 and 2025 downwards, due to the expected lower global growth.

SLOVAKIA

In H1 2023, Slovak GDP grew by 1.3% – far better than expected. On the one hand, the important automotive sector supported export growth; on the other, the persistently high inflation deterred household consumption and dragged down GDP growth. Major uncertainties prevail and could dampen future growth.

SLOVENIA

The reconstruction efforts following the floods in August – the worst in decades – will require several billion euro and will take years to complete, boosting government spending. Growth in 2023 will be subdued, at an estimated 1.3%, as private consumption has slowed significantly. Inflation will be high, but is showing clear signs of decreasing. Industrial output will shrink, as manufacturers face reduced foreign demand. The growth in exports will stall, but imports will fall, leading to a positive current account balance. The labour market is very tight, with the unemployment rate at historically low levels.

TURKEY

In the first half of 2023, Turkey faced a challenge of unbalanced economic growth, fuelled primarily by strong household consumption. While this uptick provided a boost to the economy, it also created a delicate balancing act for the Turkish authorities. If they maintain their dedication to monetary stability, the opportunity exists to gradually rein in inflation over the coming years; however, that would come at the cost of economic slowdown. That said, the possibility of policy reversals in the future, once external financing becomes more stable or the budget deficit levels out, brings an element of uncertainty.

UKRAINE

In Q2 2023, Ukraine's real GDP grew by 19.5% year on year, reflecting both the base effect and the resilience of the economy. Exports of agricultural and food products have been growing, despite Russia's withdrawal from the Black Sea Grain Initiative. Inflation has slowed more than expected, on the back of falling food and fuel prices. Given the greater-than-anticipated resilience of the economy, our GDP growth forecast for 2023 has been revised upwards. However, as the war is likely to be more protracted than we had initially hoped, growth in 2024-2025 will be lower than previously forecast. Most risks to the forecast continue to be on the downside.

Keywords: CESEE, Central and Eastern Europe, economic forecast, Western Balkans, Visegrád group, CIS, Ukraine, Russia, Turkey, euro area, EU, convergence, Russia-Ukraine war, Russia sanctions, commodity prices, inflation, energy crisis, gas, renewable energy, electricity, monetary and fiscal policy, EU funds, purchasing power, poverty, real wages, remittances, FDI, imports, external debt, interest rates, banking sector, credit, impact on Austria, macroeconomic forecasting

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