

## 2. CESEE Overview: Recovery beating expectations<sup>1</sup>

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**The economic recovery in Central, East and Southeast Europe (CESEE) identified in our spring and summer Forecasts has strengthened further in recent months.** Current momentum across much of the region is buoyant and has resulted in a number of additional upgrades to our forecasts for 2021 and beyond. This good performance has been built on two important (and linked) foundation stones: the adaptation of the CESEE economies to the pandemic and the increasing reluctance of their governments to impose restrictions. As a result, the pandemic – which remains prevalent in large parts of CESEE – has not exerted anything like the drag on economic growth this year that it did in 2020.

### 2.1. VACCINATION AS A GAME CHANGER<sup>2</sup>

**The recent impact of the pandemic on public health has diverged in the countries of CESEE.**

During the summer, warmer temperatures, the headway made in the vaccination campaigns and the rising levels of natural immunity contained the spread of the virus in many countries of the region, effectively putting an end to the third wave of the pandemic. As a result, in the EU member states from Central and Eastern Europe (EU-CEE), Turkey, Ukraine and Bosnia and Herzegovina, the number of new COVID-19 cases declined in Q3 2021 on a quarterly basis (Figure 2.1). The drop was particularly dramatic in the Visegrád countries, which had been among the worst affected during the third wave in the spring. However, in several Western Balkan countries and in Russia, infections rose, driven by the more contagious – and more deadly – Delta variant. The policy of open borders during the tourist season certainly contributed to the rise, with Montenegro in particular recording nearly 50,000 new cases per million population in Q3.<sup>3</sup>

**This divergence can, to a large extent, be explained by cross-country variations in vaccination rates.** Most of the vaccines administered in CESEE – Pfizer/BioNTech, Moderna, Johnson & Johnson, AstraZeneca and Sputnik V – are effective against the Delta variant. Therefore, it is hardly surprising that the EU-CEE countries and Turkey, which have relatively high rates of vaccination, should also have performed better in terms of new COVID-19 cases (Figure 2.2). Hungary, Czechia, Turkey and Poland have now inoculated more than 50% of their populations, and Lithuania – the CESEE front-runner – has reached the level of Austria (60%). At the opposite end of the spectrum are Ukraine, Bosnia and Herzegovina and Belarus, which have very low vaccination rates and which saw a jump in infections in Q3. Ukraine is an extreme case, having inoculated only 13% of its population (yet it has so far

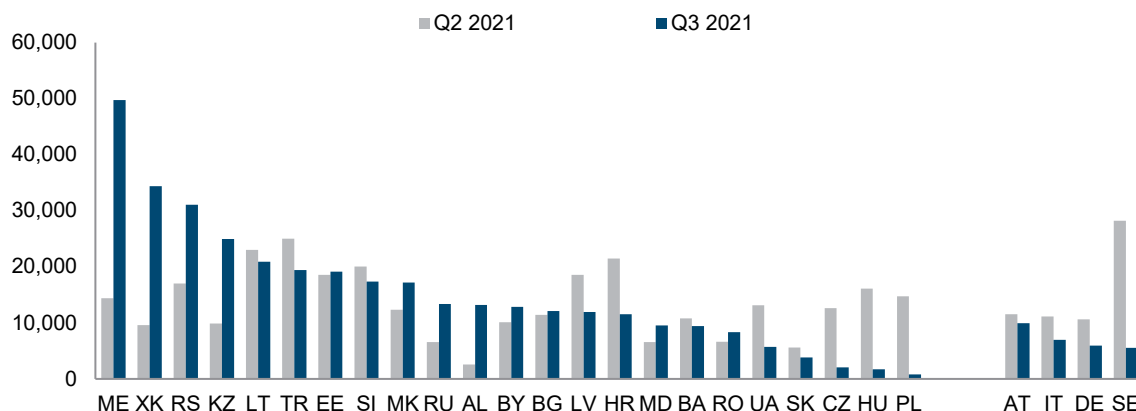
<sup>1</sup> The authors thank Richard Grieveson, Gábor Hunya, Branimir Jovanović, Niko Korpar, Isilda Mara, Sándor Richter and Nina Vujanovic, all wiiw, for valuable comments and suggestions on the first draft.

<sup>2</sup> This section draws partly on O. Pindyuk (2021), Chart of the month: A fourth wave of COVID-19 taking a grip, wiiw Monthly Report No. 9, pp 7-8.

<sup>3</sup> Having said that, the number of cases in the region is likely to be under-reported. In nearly all CESEE countries, the number of COVID-19 tests carried out recently has been several times lower than at the beginning of 2021.

miraculously escaped the worst). On average, at 37%, the vaccination rate in the CESEE region remains rather low.

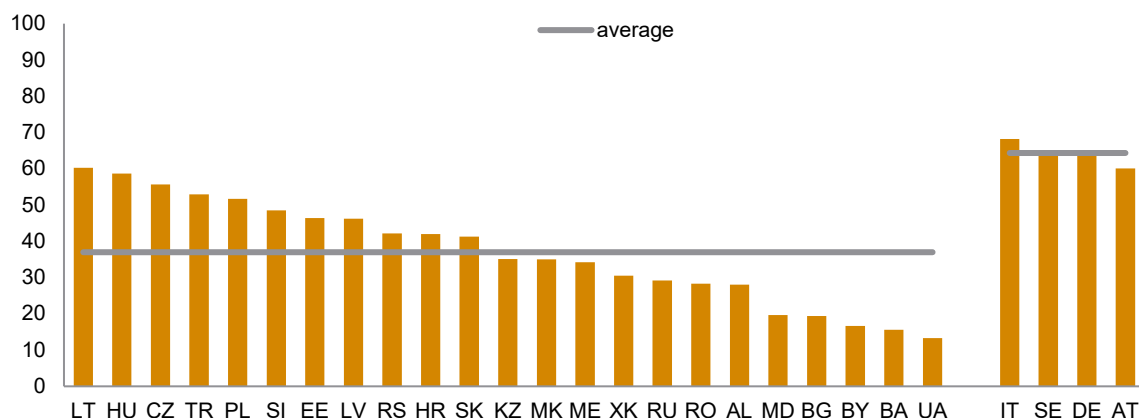
**Figure 2.1 / Number of new COVID-19 cases (per million population)**



Source: Our World in Data, Oxford University.

**Figure 2.2 / Share of population fully vaccinated against COVID-19**

at the end of September 2021, in %



Note: Data refer to 1, 2 or 3 October, except for HU and SK (30 September), BY (26 September) and BA (29 September). Simple averages for country groups.

Source: Our World in Data, Oxford University.

**The low level of vaccination in many CESEE countries can partly be attributed to the slow start and, in some cases, the initial lack of access to the vaccines.** Those CESEE countries that started their vaccination campaigns relatively early, such as Hungary, Slovakia and Serbia (thanks to procurements from Russia and China), are performing at above average in terms of their vaccination levels (Figure 2.2). By contrast, Ukraine, Moldova and Bosnia and Herzegovina lacked access to vaccines for quite some time; it was not until summer 2021 that the large-scale roll-out of vaccinations finally started in those countries, with crucial aid from the EU and other foreign donors.

**But a more important reason is reluctance to have the jab.** Despite the wealth of evidence confirming the safety and effectiveness of the vaccines, inoculation campaigns in many CESEE countries have struggled to raise take-up rates to the level of herd immunity. Russia and Albania are two cases in point: Russia was the first country in the world to register a COVID-19 vaccine, while Albania succeeded early on in procuring the Chinese Sinovac vaccine. Both countries started vaccinating their people early, and yet their vaccination rate is still below 30%. However, a reluctance to have the jab is also common in the more advanced EU-CEE countries.

**The widespread vaccine scepticism in CESEE is fuelled by misinformation, COVID-19 denial and distrust of government.** This last feature strikingly distinguishes the region from many parts of Western Europe, and especially the Nordic countries, where trust in government and institutions has been a key factor behind the success of the vaccination campaigns. The relatively low level of COVID-19 restrictions in CESEE also plays a role. Until such time as tests or proof of vaccination are required for an individual to visit a public place, there will be no great incentive to get vaccinated.

## 2.2. ECONOMIES AND GOVERNMENTS LEARNING TO LIVE WITH THE PANDEMIC

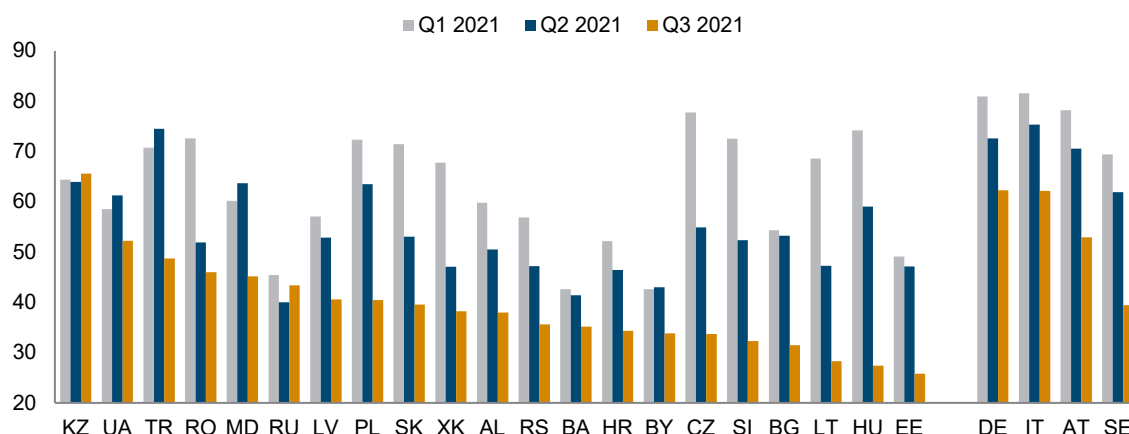
**Over time, the economies of CESEE have shown progressively declining sensitivity towards the pandemic.** Using data on Western European and CESEE economies up to Q1 2021, Jovanović has demonstrated econometrically that the impact of the pandemic (proxied by COVID-19 mortality) on economic growth has weakened considerably over time.<sup>4</sup> The same conclusion was reached with respect to the impact of government restrictions. As the pandemic unfolded, so people and companies adapted their behaviour – for instance, by switching to digital shopping and communication, ordering food in rather than dining out, etc. In this way, they could get on with ‘business as usual’ – even during severe waves of the pandemic.

**The CESEE governments, too, have learned to live with the pandemic and have gradually reduced the range of COVID restrictions...** During the first wave, in spring 2020, all CESEE governments except Belarus imposed lockdowns that were at least as lengthy and strict as in Western Europe. These first lockdowns placed a heavy burden on the economies.<sup>5</sup> However, as the pandemic unfolded, so the appetite for restrictions gradually evaporated. Figure 2.3 shows how the stringency of COVID restrictions – which was still high in most CESEE countries during the second wave in Q1 2021 – has since moderated. In nearly all of the countries (except Kazakhstan), restrictions are now less stringent than, for instance, in Austria.<sup>6</sup>

<sup>4</sup> B. Jovanović (2021), Regional overview, in: Light at the end of the tunnel? Economic forecasts for Eastern Europe for 2021-23, wiiw Monthly Report No. 7-8, pp 18-19.

<sup>5</sup> The rule of thumb is that a one-week strict lockdown during the first wave of the pandemic (in spring-summer 2020) suppressed economic growth on average by 0.5 pp for the whole year.

<sup>6</sup> Having said that, the green pass system in Slovenia is one of the strictest in Europe at the moment.

**Figure 2.3 / Stringency Index**

Note: Q3 2021 data for several countries are available only until the beginning of August.

Source: Blavatnik School of Government, Oxford University.

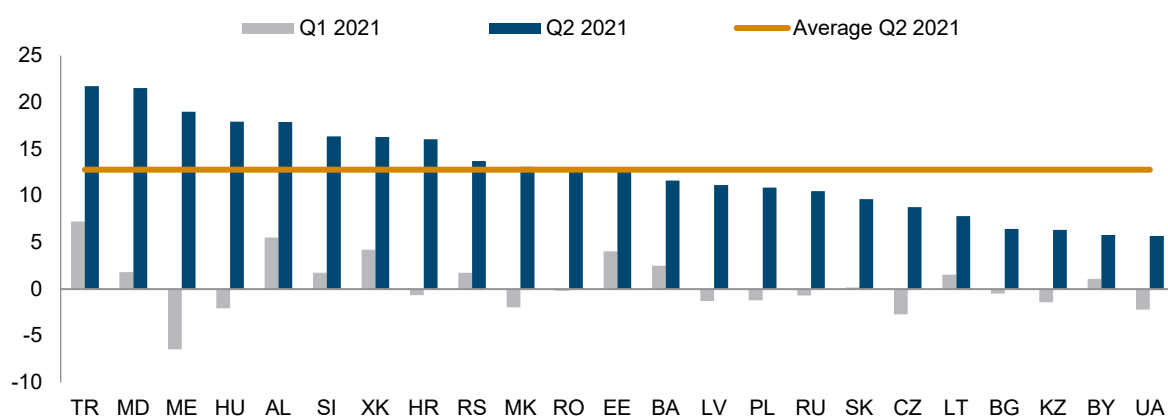
... by increasingly prioritising the economy over public health. The deep recessions recorded by some CESEE countries last year have certainly contributed to this.<sup>7</sup> The switch in priorities also partly reflects the shift in public sentiment, as people were getting increasingly fed up with restrictions, so that they were becoming too costly in the political sense. Another reason, especially in the Western Balkans and the CIS, has been the dwindling fiscal space. The lockdowns were accompanied by massive fiscal support for the sectors and households affected, which led to ballooning government deficits and debt. Finally, in some instances (e.g. the Visegrád countries), the imposition of harsh COVID-19 restrictions was simply no longer needed, in view of the vastly improved pandemic situation.

### 2.3. PRE-PANDEMIC LEVELS OF ACTIVITY LARGELY RESTORED

**The CESEE economies have rebounded strongly – and in many cases now exceed pre-pandemic levels.** On average,<sup>8</sup> real GDP in the region picked up by 12.8% in Q2 2021 (year on year). Many countries recorded double-digit growth rates: up to 22% in Turkey and Moldova (Figure 2.4). Of course, this very high growth should be viewed against the background of the low statistical basis of last year. But in 15 countries of the region, real GDP even outstripped the pre-pandemic level of Q2 2019 (Figure 2.5), suggesting that there has been more to growth than a mere rebound from the pandemic-related slump. In Turkey, the Q2 2019 figure was exceeded by as much as 9.1%; meanwhile, Serbia surpassed it by 6.6%, and Kosovo by 5.7%. On average, regional GDP exceeded the level of Q2 2019 by 1.4%.

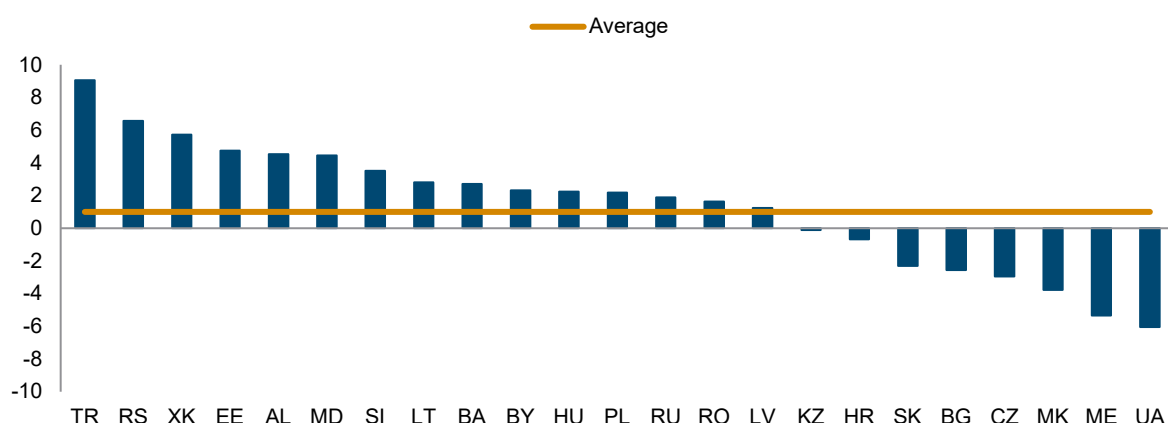
<sup>7</sup> For instance, Montenegro has kept its borders open until the end of the tourist season this year – despite the surge in the number of new cases.

<sup>8</sup> Here and below: unweighted averages.

**Figure 2.4 / Real GDP growth, in %, year on year**

Note: Simple average over all countries.

Source: Eurostat and wiiw Monthly Database.

**Figure 2.5 / Real GDP growth in Q2 2021 versus Q2 2019, in %**

Note: Simple average over all countries.

Source: own calculations based on Eurostat and wiiw Monthly Database.

**The economic recovery in CESEE has been faster than expected, leading us to revise our growth forecasts for 2021 upwards nearly everywhere** (Table 2.1).<sup>9</sup> The biggest revisions since the summer are in Estonia (by 3.6 percentage points (pp)) and Turkey (3.3 pp). With estimated growth of 7.8%, Estonia is one of the star performers in the region. As the digitalisation front-runner even prior to the pandemic, the country has capitalised hugely on this and has attracted large foreign investments. The other star performer is Turkey, whose economy, it is estimated, will grow by 9.1% this year, despite the high starting basis: Turkey was the only CESEE country to avoid recession last year. However, growth in Turkey has largely been driven by a credit boom and may not be sustainable. In contrast to those two countries, the strong estimated revival in Montenegro (8.4%), Moldova (8%) and Croatia (7.2%) can be

<sup>9</sup> Only for North Macedonia and Ukraine have the growth forecasts for this year been revised downwards. In North Macedonia, fiscal policy is arguably overly restrictive and acts as a brake on growth, while in Ukraine the downward revision comes on the back of a disappointing performance by trade and investments. For two other CESEE countries – Slovakia and Belarus – the forecasts have been left unchanged.

entirely explained by the base effect. Foreign tourists – who largely stayed at home during the initial stages of the pandemic – are now pouring into Montenegro and Croatia, while Moldova is benefiting from strong credit expansion and the solid recovery in neighbouring Romania. On the contrary, it is estimated that the economy of Belarus will bounce back by only 2.5% this year – a combined effect of the high statistical basis and the repercussions of the recent political crisis, including Western sanctions.

**Table 2.1 / Real GDP growth forecasts and revisions**

		Forecast, %			Revisions, pp	
		2021	2022	2023	2021	2022
EU-CEE	BG	3.5	3.3	3.2	↑ 0.5	↓ -0.2
	CZ	3.4	3.7	3.6	↑ 0.4	↓ -0.2
	EE	7.8	3.6	3.0	↑ 3.6	↓ -0.9
	HR	7.2	5.0	4.5	↑ 2.1	↓ -0.3
	HU	6.2	4.5	4.0	↑ 1.3	→ 0.0
	LT	4.4	3.7	3.5	↑ 1.4	↓ -0.3
	LV	4.5	4.3	3.4	↑ 1.3	↓ -0.7
	PL	5.3	4.9	4.9	↑ 1.3	↑ 0.4
	RO	6.8	4.3	4.2	↑ 1.6	↓ -0.2
	SI	5.2	4.1	3.3	↑ 1.2	↓ -0.2
	SK	4.0	4.4	3.9	→ 0.0	→ 0.0
Western Balkans	AL	6.4	4.5	4.2	↑ 1.4	↑ 0.1
	BA	3.7	3.1	3.5	↑ 0.8	↓ -0.2
	ME	8.4	4.8	2.4	↑ 1.9	↓ -1.2
	MK	3.5	3.4	3.2	↓ -0.6	→ 0.0
	RS	6.6	4.6	4.5	↑ 0.6	↑ 0.4
	XK	6.0	4.8	4.0	↑ 0.7	↑ 0.1
Turkey	TR	9.1	3.8	3.8	↑ 3.3	↑ 0.4
CIS+UA	BY	2.5	2.0	2.3	→ 0.0	↑ 0.4
	KZ	3.9	4.2	4.4	↑ 0.4	↑ 0.1
	MD	8.0	4.5	4.0	↑ 1.0	→ 0.0
	RU	4.0	3.0	2.8	↑ 0.5	→ 0.0
	UA	3.8	3.6	3.5	↓ -0.5	↑ 0.1

Note: Current forecast and revisions relative to the wiiw July forecast 2021. Colour scale variation from the minimum (red) to the maximum (green).

Source: wiiw.

**It is estimated that the CESEE economy will recover by 5.4% this year – more than the recovery in the euro area (4.8%), its main trading partner** (see Overview Table 1). This is quite a remarkable achievement, and cannot be explained by the effect of the statistical base. Last year, regional GDP contracted by only 2.3%, compared to 6.3% in the euro area. Moreover, the aggregate fiscal (and indeed monetary) response has generally been weaker in CESEE than in the euro area. In our view, the remarkable resilience of the CESEE economies can largely be explained by two factors: (i) the less ambitious approach their governments have taken when it comes to COVID-19 restrictions, and (ii) the structure of their economies, with services – the sector worst affected by the pandemic – generally occupying a lower share of GDP than is the case in the euro area.<sup>10</sup>

<sup>10</sup> Growth in CESEE is obviously heavily driven by the outstanding performance of Turkey, its second-biggest economy. This is largely on account of idiosyncratic factors (for more on that, see below).

Table 2.2 / OVERVIEW 2019-2020 AND OUTLOOK 2021-2023

	GDP					Consumer prices					Unemployment (LFS)				
	real change in % against prev. year					average change in % against prev. year					rate in %, annual average				
	2019	2020	Forecast			2019	2020	Forecast			2019	2020	Forecast		
			2021	2022	2023			2021	2022	2023			2021	2022	2023
BG Bulgaria	3.7	-4.2	3.5	3.3	3.2	2.5	1.2	3.0	2.5	2.0	4.2	5.1	5.5	5.0	5.0
CZ Czechia	3.0	-5.8	3.4	3.7	3.6	2.6	3.3	3.2	2.8	2.2	2.0	2.6	3.3	3.2	2.9
EE Estonia	4.1	-3.0	7.8	3.6	3.0	2.3	-0.6	3.6	3.5	2.4	4.4	6.8	6.5	5.8	4.9
HR Croatia	2.9	-8.0	7.2	5.0	4.5	0.8	0.0	2.2	1.9	1.8	6.6	7.5	8.0	7.4	6.2
HU Hungary	4.6	-5.0	6.2	4.5	4.0	3.4	3.4	4.8	4.2	3.7	3.4	4.3	4.2	3.9	3.8
LT Lithuania	4.3	-0.9	4.4	3.7	3.5	2.2	1.1	3.5	4.0	3.3	6.3	8.5	7.2	6.8	6.2
LV Latvia	2.0	-3.6	4.5	4.3	3.4	2.7	0.1	2.7	3.7	3.2	6.3	8.1	7.6	6.8	6.5
PL Poland	4.7	-2.5	5.3	4.9	4.9	2.1	3.7	4.4	3.3	3.0	3.3	3.2	3.2	3.0	2.9
RO Romania	4.1	-3.9	6.8	4.3	4.2	3.9	2.3	4.2	4.0	3.5	3.9	5.0	5.4	4.8	4.5
SI Slovenia	3.3	-4.2	5.2	4.1	3.3	1.7	-0.3	1.8	1.6	1.5	4.5	5.0	4.7	4.3	4.2
SK Slovakia	2.5	-4.8	4.0	4.4	3.9	2.8	2.0	2.3	2.4	2.0	5.8	6.7	6.8	6.5	6.0
<i>EU-CEE11<sup>1)2)</sup></i>	<i>4.1</i>	<i>-3.8</i>	<i>5.3</i>	<i>4.4</i>	<i>4.2</i>	<i>2.6</i>	<i>2.7</i>	<i>3.9</i>	<i>3.3</i>	<i>2.9</i>	<i>3.8</i>	<i>4.4</i>	<i>4.6</i>	<i>4.2</i>	<i>4.0</i>
<i>EA19<sup>3)</sup></i>	<i>1.5</i>	<i>-6.3</i>	<i>4.8</i>	<i>4.4</i>	<i>2.1</i>	<i>1.2</i>	<i>0.3</i>	<i>2.1</i>	<i>1.6</i>	<i>1.4</i>	<i>7.6</i>	<i>7.9</i>	<i>8.1</i>	<i>7.8</i>	<i>7.3</i>
<i>EU27<sup>3)</sup></i>	<i>1.8</i>	<i>-5.9</i>	<i>4.9</i>	<i>4.5</i>	<i>2.5</i>	<i>1.4</i>	<i>0.7</i>	<i>2.3</i>	<i>1.8</i>	<i>1.6</i>	<i>6.7</i>	<i>7.1</i>	<i>7.3</i>	<i>7.0</i>	<i>6.5</i>
AL Albania	2.1	-4.0	6.4	4.5	4.2	1.4	1.6	2.1	2.5	2.8	11.5	11.7	11.4	11.2	11.0
BA Bosnia and Herzegovina	2.8	-3.2	3.7	3.1	3.5	0.6	-1.1	1.3	1.0	1.2	15.7	15.9	16.9	16.5	15.9
ME Montenegro	4.1	-15.3	8.4	4.8	2.4	0.4	-0.3	1.9	1.3	1.2	15.1	17.9	16.0	15.5	15.3
MK North Macedonia	3.2	-4.5	3.5	3.4	3.2	0.8	1.2	3.0	2.5	2.0	17.3	16.4	16.0	15.5	15.0
RS Serbia	4.2	-1.0	6.6	4.6	4.5	1.7	1.6	3.5	3.0	2.5	10.4	9.0	11.0	10.0	9.0
XK Kosovo	4.8	-5.3	6.0	4.8	4.0	2.7	0.2	2.3	2.5	2.3	25.7	25.9	25.5	25.0	24.5
<i>WB6<sup>1)2)</sup></i>	<i>3.6</i>	<i>-3.1</i>	<i>5.7</i>	<i>4.2</i>	<i>4.0</i>	<i>1.4</i>	<i>0.9</i>	<i>2.7</i>	<i>2.4</i>	<i>2.2</i>	<i>13.4</i>	<i>13.0</i>	<i>13.7</i>	<i>13.2</i>	<i>12.4</i>
TR Turkey	0.9	1.8	9.1	3.8	3.8	15.2	12.3	17.5	12.2	10.0	13.7	13.2	13.1	12.2	11.1
BY Belarus	1.4	-0.9	2.5	2.0	2.3	5.6	5.5	9.0	8.0	7.0	4.2	4.0	4.0	4.1	4.2
KZ Kazakhstan	4.5	-2.5	3.9	4.2	4.4	5.3	6.8	7.9	6.7	5.9	4.8	4.9	4.9	4.8	4.8
MD Moldova	3.7	-7.0	8.0	4.5	4.0	4.8	3.8	4.5	6.0	5.0	5.1	3.8	3.8	3.5	3.0
RU Russia	2.0	-3.0	4.0	3.0	2.8	4.5	3.4	6.2	4.4	3.2	4.6	5.8	5.1	4.8	4.6
UA Ukraine	3.2	-4.0	3.8	3.6	3.5	7.9	2.7	9.3	6.0	5.5	8.2	9.5	9.0	8.0	8.0
<i>CIS4+UA<sup>1)2)</sup></i>	<i>2.4</i>	<i>-3.0</i>	<i>3.9</i>	<i>3.1</i>	<i>3.0</i>	<i>5.0</i>	<i>3.7</i>	<i>6.7</i>	<i>4.9</i>	<i>3.8</i>	<i>5.2</i>	<i>6.2</i>	<i>5.5</i>	<i>5.1</i>	<i>5.0</i>
<i>V4<sup>1)2)</sup></i>	<i>4.2</i>	<i>-3.7</i>	<i>5.0</i>	<i>4.6</i>	<i>4.4</i>	<i>2.4</i>	<i>3.4</i>	<i>4.1</i>	<i>3.3</i>	<i>2.9</i>	<i>3.3</i>	<i>3.5</i>	<i>3.7</i>	<i>3.5</i>	<i>3.4</i>
<i>BALT3<sup>1)2)</sup></i>	<i>3.6</i>	<i>-2.1</i>	<i>5.2</i>	<i>3.8</i>	<i>3.4</i>	<i>2.4</i>	<i>0.4</i>	<i>3.3</i>	<i>3.8</i>	<i>3.1</i>	<i>5.9</i>	<i>8.0</i>	<i>7.2</i>	<i>6.6</i>	<i>6.0</i>
<i>SEE9<sup>1)2)</sup></i>	<i>3.8</i>	<i>-4.1</i>	<i>6.1</i>	<i>4.2</i>	<i>4.1</i>	<i>2.8</i>	<i>1.6</i>	<i>3.5</i>	<i>3.2</i>	<i>2.8</i>	<i>7.4</i>	<i>8.1</i>	<i>8.8</i>	<i>8.2</i>	<i>7.7</i>
<i>CIS3+UA<sup>1)2)</sup></i>	<i>3.5</i>	<i>-3.0</i>	<i>3.7</i>	<i>3.6</i>	<i>3.7</i>	<i>6.5</i>	<i>4.8</i>	<i>8.6</i>	<i>6.6</i>	<i>5.9</i>	<i>6.6</i>	<i>7.2</i>	<i>6.9</i>	<i>6.4</i>	<i>6.4</i>
<i>non-EU12<sup>1)2)</sup></i>	<i>2.0</i>	<i>-1.6</i>	<i>5.5</i>	<i>3.3</i>	<i>3.3</i>	<i>7.7</i>	<i>6.1</i>	<i>9.6</i>	<i>6.9</i>	<i>5.5</i>	<i>7.5</i>	<i>8.0</i>	<i>7.6</i>	<i>7.1</i>	<i>6.8</i>
<i>CESEE23<sup>1)2)</sup></i>	<i>2.6</i>	<i>-2.3</i>	<i>5.4</i>	<i>3.7</i>	<i>3.5</i>	<i>6.2</i>	<i>5.1</i>	<i>8.0</i>	<i>5.8</i>	<i>4.7</i>	<i>6.6</i>	<i>7.1</i>	<i>6.8</i>	<i>6.4</i>	<i>6.1</i>

Table 2.2 / (ctd.)

		Current account					Fiscal balance				
		in % of GDP					in % of GDP				
		2019	2020	Forecast			2019	2020	Forecast		
				2021	2022	2023			2021	2022	2023
BG	Bulgaria	1.9	-0.3	-1.2	-1.5	-1.3	2.1	-3.4	-3.0	-2.5	-2.0
CZ	Czechia	0.3	3.6	2.5	2.4	2.5	0.3	-6.1	-6.5	-5.6	-4.5
EE	Estonia	2.5	-0.3	-3.7	-0.5	-0.2	0.1	-5.0	-4.0	-2.0	-1.0
HR	Croatia	3.1	-0.1	0.6	0.4	-0.3	0.3	-7.4	-4.5	-3.0	-2.5
HU	Hungary	-0.7	-1.6	0.6	0.7	0.9	-2.1	-8.1	-8.0	-5.5	-3.5
LT	Lithuania	3.5	7.4	2.5	2.1	2.0	0.5	-7.4	-6.2	-4.0	-2.5
LV	Latvia	-0.7	2.9	-3.2	-2.6	-2.1	-0.6	-4.5	-8.0	-4.0	-2.0
PL	Poland	0.5	3.5	1.9	2.8	2.6	-0.7	-6.9	-5.5	-4.5	-3.0
RO	Romania	-4.9	-5.0	-5.8	-4.6	-4.0	-4.4	-9.2	-7.0	-6.0	-5.0
SI	Slovenia	6.0	7.4	5.7	5.4	4.8	0.4	-8.3	-7.3	-3.3	-0.8
SK	Slovakia	-3.4	0.1	-0.7	-0.6	-0.5	-1.3	-6.1	-7.1	-5.1	-4.1
EU-CEE11 <sup>1)2)</sup>		-0.3	1.4	0.3	0.8	0.9	-1.0	-7.1	-6.2	-4.8	-3.4
EA19 <sup>3)</sup>		2.9	2.8	2.5	2.5	2.5	-0.6	-7.2	-7.1	-3.4	-2.6
EU27 <sup>3)</sup>		2.9	2.8	2.5	2.5	2.5	-0.5	-6.9	-6.9	-3.2	-2.5
AL	Albania	-7.9	-8.8	-8.5	-7.7	-7.1	-1.9	-6.8	-3.0	-1.5	-1.0
BA	Bosnia and Herzegovina	-2.8	-3.8	-2.3	-2.8	-3.2	1.9	-5.3	-2.0	-0.5	0.2
ME	Montenegro	-14.3	-26.1	-18.3	-16.9	-17.3	-2.0	-11.1	-5.5	-4.0	-3.0
MK	North Macedonia	-3.3	-3.4	-3.5	-4.0	-4.7	-2.2	-8.2	-3.0	-2.0	-1.0
RS	Serbia	-6.9	-4.2	-2.9	-3.0	-3.0	-0.2	-8.1	-3.0	-2.5	-2.0
XK	Kosovo	-5.7	-7.1	-8.4	-8.1	-7.2	-2.9	-7.6	-2.0	-2.0	-1.0
WB6 <sup>1)2)</sup>		-6.2	-5.7	-4.7	-4.6	-4.7	-0.5	-7.5	-2.9	-2.0	-1.4
TR	Turkey	0.9	-5.2	-3.1	-2.9	-2.7	-3.2	-2.8	-3.5	-2.5	-1.5
BY	Belarus	-1.9	-0.4	0.7	0.9	0.5	2.4	-1.7	-2.0	-2.0	-1.0
KZ	Kazakhstan	-4.0	-3.8	-2.9	-2.0	-1.9	-1.8	-4.0	-3.5	-2.6	-2.0
MD	Moldova	-9.3	-7.5	-9.6	-6.9	-5.6	-1.4	-8.5	-6.0	-6.0	-5.0
RU	Russia	3.9	2.4	5.6	5.9	5.7	1.9	-4.0	1.0	1.5	1.5
UA	Ukraine	-2.7	3.4	-0.9	-2.4	-3.0	-2.2	-5.4	-5.0	-3.0	-2.0
CIS4+UA <sup>1)2)</sup>		2.5	1.8	4.0	4.2	4.1	1.3	-4.1	0.0	0.6	0.8
V4 <sup>1)2)</sup>		-0.1	2.5	1.6	2.1	2.0	-0.7	-6.8	-6.2	-4.9	-3.5
BALT3 <sup>1)2)</sup>		2.1	4.2	-0.7	0.1	0.3	0.1	-6.0	-6.1	-3.5	-2.0
SEE9 <sup>1)2)</sup>		-3.3	-3.9	-4.2	-3.6	-3.4	-2.0	-7.8	-5.2	-4.2	-3.5
CIS3+UA <sup>1)2)</sup>		-3.3	-0.6	-1.8	-1.9	-2.1	-1.3	-4.3	-3.9	-2.8	-2.0
non-EU12 <sup>1)2)</sup>		1.7	-0.4	1.7	1.9	1.9	0.1	-3.9	-1.1	-0.4	0.1
CESEE23 <sup>1)2)</sup>		1.0	0.3	1.2	1.5	1.5	-0.3	-5.1	-3.0	-2.0	-1.2

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

3) Forecasts estimated by wiiw.

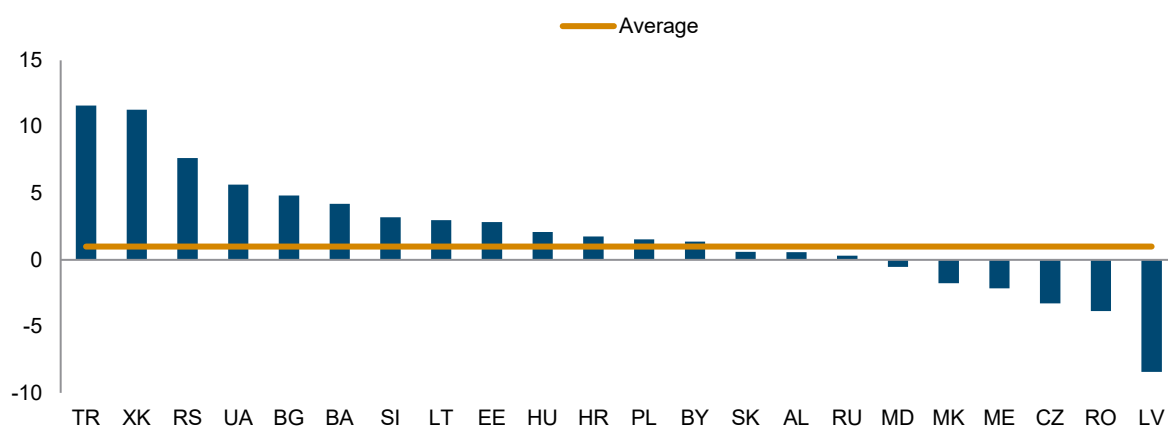
Source: wiiw, Eurostat. Forecasts by wiiw. Cut-off date for historical data and forecasts: 05 October 2021.



## 2.4. THE KEY ROLE OF DOMESTIC DEMAND

**Private consumption has been the main driver of economic recovery.** On average in CESEE, private consumption picked up by 14.5% year on year in Q2, surpassing the level of two years previously by 1.8% (Figure 2.6). It has benefited from the easing of COVID-19 restrictions, the effect of delayed consumption, rising employment and wages, and the release of savings accumulated during the pandemic. In the Western Balkans, it has also been supported by the strong inflow of remittances; and in the CIS, Hungary, Turkey and Kosovo by rapid credit expansion (Figure 2.7, left panel). At the same time, in six CESEE countries – Moldova, North Macedonia, Montenegro, Czechia, Romania and, most notably, Latvia – the pre-pandemic levels of private consumption have not been reached.

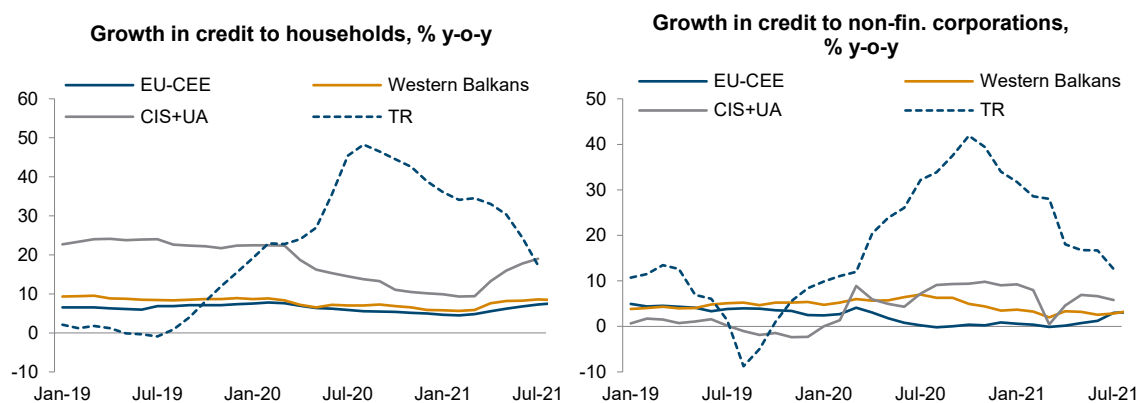
**Figure 2.6 / Real growth in household consumption in Q2 2021 versus Q2 2019, in %**



Note: Simple average over all countries. wiiw estimates for Bosnia and Herzegovina.

Source: own calculations based on Eurostat and wiiw Monthly Database.

**Figure 2.7 / Growth in credit to households and non-financial corporations, in %, year on year**

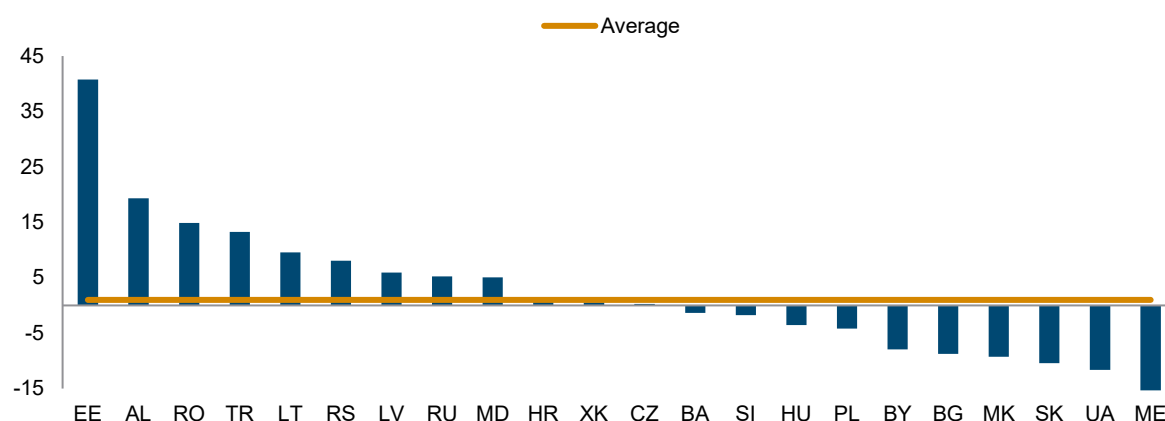


Note: Simple averages for country aggregates.

Source: wiiw Monthly Database incorporating national statistics.

**Fixed capital investment picked up strongly, too, but its dynamics has been very uneven across countries.** In general, investment growth in CESEE has benefited from reduced uncertainties, vastly improved sales, the recovery of foreign direct investment, and, in some cases, further declining real interest rates. On average across the region, gross fixed capital formation (GFCF) rose in Q2 by 17.7% year on year, to surpass the level of two years previously by 2.1% (Figure 2.8). However, the high average figure masks significant country heterogeneity, and is, to a considerable degree, driven by developments in Estonia. GFCF in Estonia skyrocketed by 60% in Q2, coming on top of the 54% increase in Q1, as the country attracted large investment projects in information and communications technology (ICT), biotechnology and a newly opened factory producing COVID-19 tests. Investments also picked up strongly in Albania, Romania, Kosovo and Turkey, but elsewhere their performance has been more mixed. In 13 CESEE countries, the investment slump of last year has not been fully recouped, most notably in Montenegro.

**Figure 2.8 / Real growth in gross fixed capital formation in Q2 2021 versus Q2 2019, in %**



Note: Simple average over all countries. wiiw estimates for Bosnia and Herzegovina.

Source: own calculations based on Eurostat and wiiw Monthly Database. Data for MK and XK refer to gross capital formation.

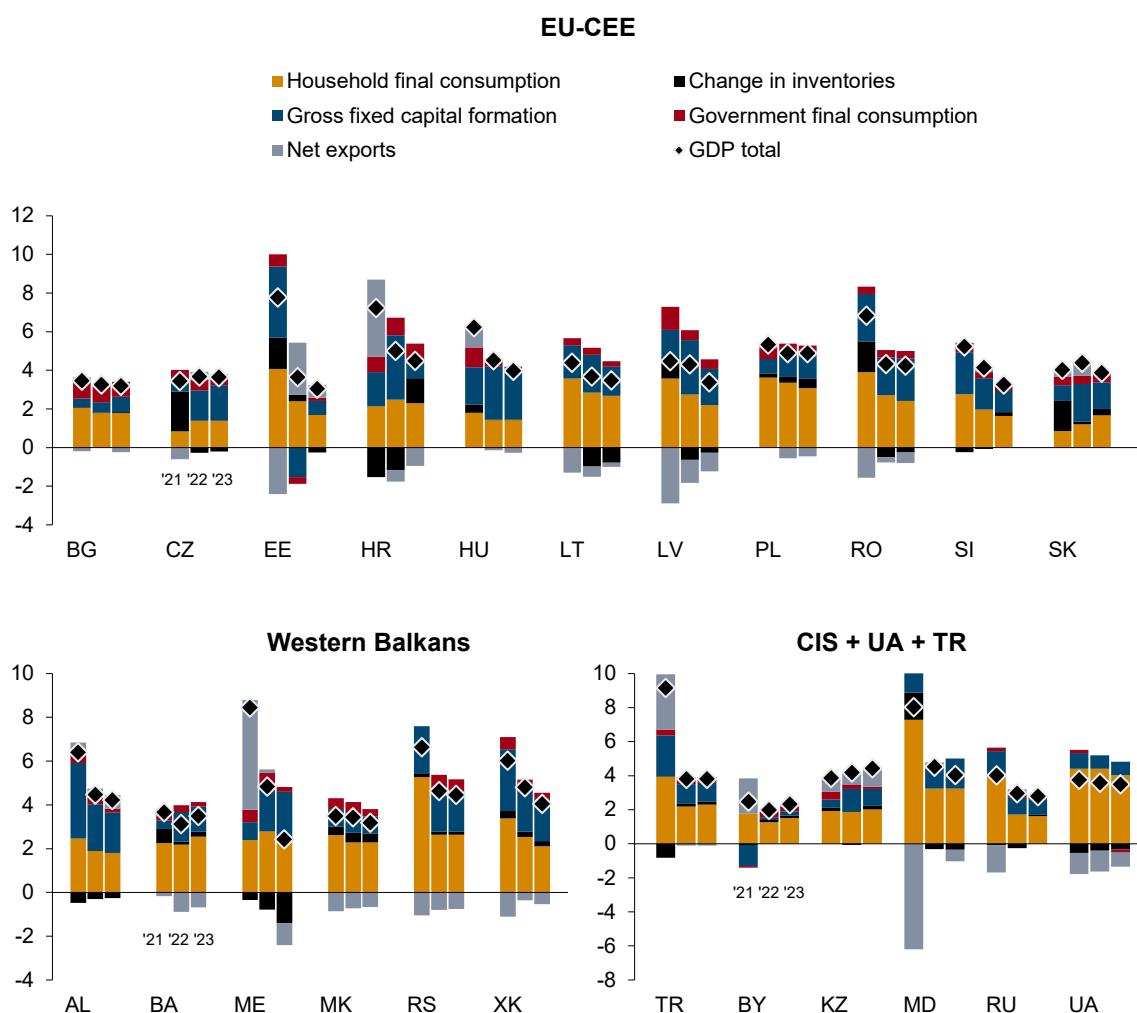
**The exports of CESEE countries have been in recovery mode.** Last year, the value of exports (of goods and services) from many CESEE countries suffered badly on account of the global recession, the disastrous tourist season, plunging energy prices (and restrictive oil production quotas decided by OPEC+) and disruptions in value chains. This last element particularly affected the automotive industry, in which especially the Visegrád countries (but also Slovenia, Serbia and North Macedonia) specialise. The legacy of these disruptions has not yet been fully overcome. This is manifested, for instance, in the persistent (and even increasing) shortages of semiconductor chips – a shortage that affects the production of cars and electronics and causes entire factories to halt their operations temporarily. Nevertheless, by and large the exports of CESEE countries have been in recovery mode, helped by improved demand globally and particularly in the euro area, a strong revival in energy prices and the recovery of cross-border tourism.<sup>11</sup>

<sup>11</sup> Country-specific circumstances play a role, too. For instance, Kosovo appears to have benefited greatly from Brexit, with the bulk of its exports now going to the UK.

Nevertheless, the contribution of net exports to GDP growth is mostly negative. This is demonstrated in Figure 2.9, which shows the estimated contribution of individual final demand components to the headline GDP growth this year. In the vast majority of CESEE countries, growth is being driven primarily by private consumption; in Hungary and Albania by GFCF; and in Czechia and Slovakia by the change in inventories. Only in Croatia and Montenegro is economic recovery primarily driven by net exports, thanks to the rebound in tourism. In 13 CESEE countries, the contribution of net exports to growth is estimated to be negative, with export growth not keeping pace with the rise in imports. This further attests to the primarily domestic-demand nature of recovery in the CESEE region.

**Figure 2.9 / GDP growth forecast for 2021-2023**

and contribution of individual demand components in percentage points



Note: wiiw estimates for Bosnia and Herzegovina.

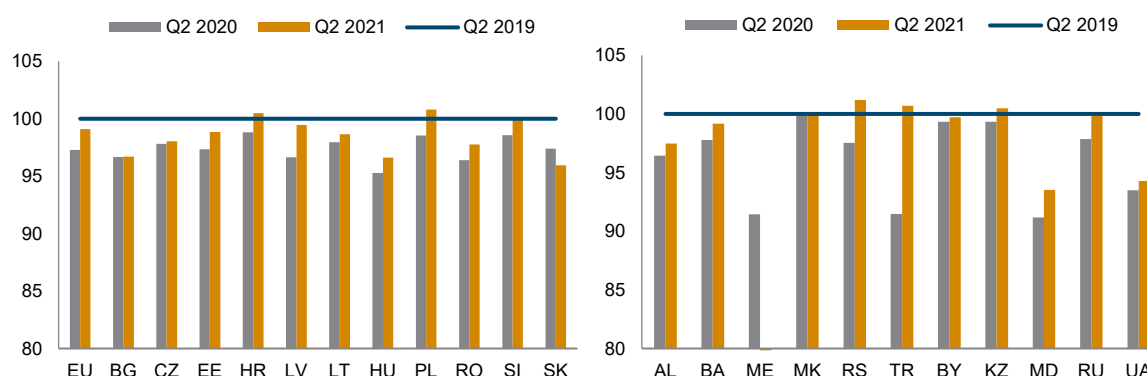
Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculations. Forecasts by wiiw.

## 2.5. RAPID RECOVERY IN LABOUR MARKETS, BUT UNDEREMPLOYMENT STILL AN ISSUE

**The strong economic upswing in CESEE has resulted in labour demand reviving swiftly.** In Croatia, Latvia, Hungary, Poland and Slovenia, the number of employed persons in Q2 2021 reached (or even surpassed) the level of two years previously, according to national accounts statistics. In a number of non-EU countries, this was also the case (Figure 2.10). Either the decline in employment during the first wave of COVID-19 infections was not significant (such as in North Macedonia, Belarus, Kazakhstan and Russia), or a remarkable rebound in labour demand has since occurred (such as in Serbia and Turkey). However, for most CESEE countries, there is still some way to go to overcome last year's slump – most notably in Montenegro, Moldova and Ukraine.

**Figure 2.10 / Employment in CESEE countries**

Q2 2020 and Q2 2021 relative to Q2 2019=100, in %



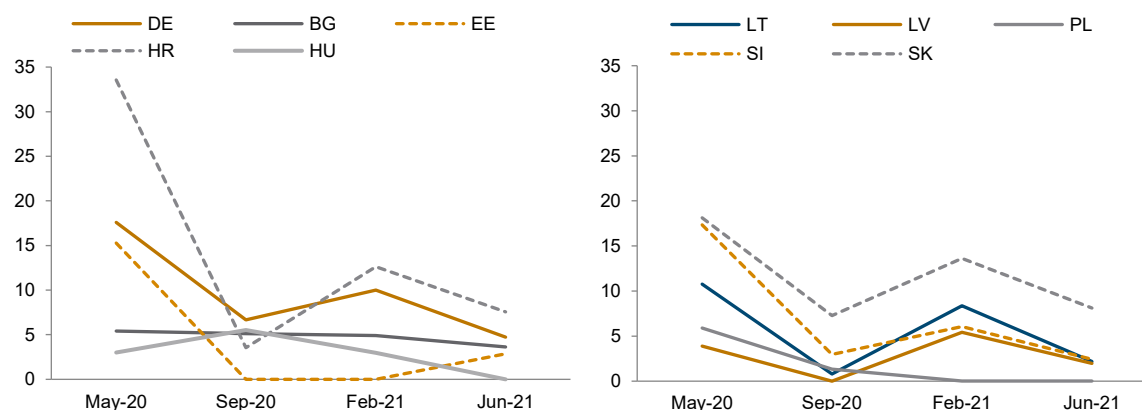
Note: Data for EU-CEE and EU based on national accounts statistics; HU, RO, SK (estimate); WB+TR and CIS4+UA according to Labour Force Survey (LFS) statistics. For BA, the data refer to the number of persons in paid employment. Source: Eurostat and wiiw Annual Database incorporating national statistics.

**Unemployment is returning to the situation it was in before the pandemic, but underemployment remains considerably higher than it was.** Unmet demand for jobs (the so-called labour market slack) comprises – apart from the number of unemployed – a further three elements: (i) the number of part-time workers who are underemployed, (ii) the number of persons who want to work but are not immediately available, and (iii) the number of persons who want to work but are not actively searching for a job. In all EU-CEE countries, bar Poland, the rate of this unmet demand for jobs in Q2 2021 exceeded the level of Q2 2019. And in four EU-CEE countries, it was even higher than a year ago: in Czechia (4.4%), Romania (9%), Slovenia (9.2%) and Latvia (14.1%).

**During the lockdown phases in 2020 and early 2021, job losses were partly averted by the application of various job-retention schemes.** Short-time work, furlough schemes and wage subsidies have been widely used in response to the pandemic. In the EU-CEE countries, the share of employed and self-employed people supported during the first lockdown in May 2020 ranged from 3% in Hungary and Latvia to 15% in Estonia, Slovakia and Slovenia (Figure 2.11). In Croatia, where many people work in tourism, it was as high as 34% of the employed workforce. In February 2021, when lockdowns were generally less stringent, the figure declined to 7% on average in EU-CEE. The

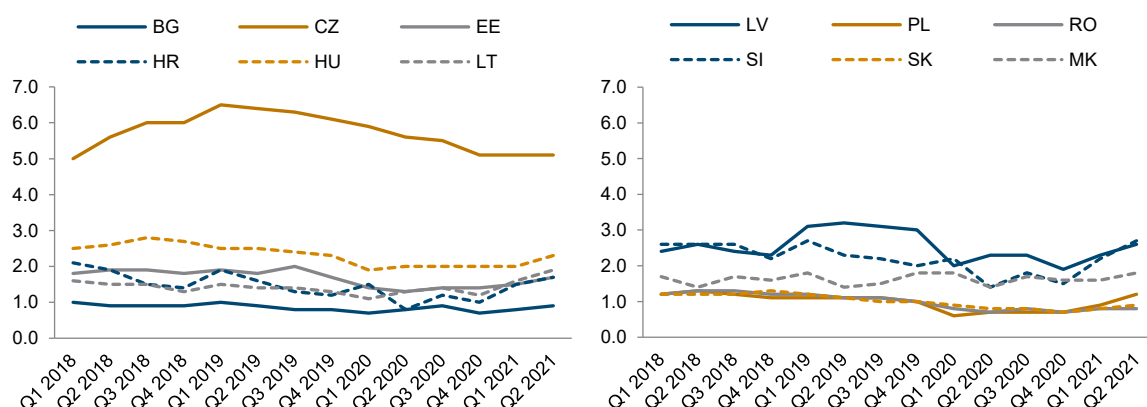
generosity of subsidies has varied greatly by country, with wage replacement ratios low in Poland and Hungary, for example, but relatively high in Croatia, Bulgaria and Slovenia. The Western Balkan countries, too, implemented job-retention schemes. However, the large share of informal employment – estimated to be about 20% in North Macedonia and 35% in Kosovo – meant that fewer firms and (self-)employed people had access to these benefits. In general, we would thus expect a bigger decline in earnings due to the pandemic among low-income households in the grey economy than might be assumed if one looked only at aggregate labour market figures.

**Figure 2.11 / Proportion of jobs supported by government measures, %**



Notes: The data comprise jobs supported by different schemes. Data are available only for selected EU countries.  
Source: Eurostat database.

**Figure 2.12 / Job vacancy rate, in %**



Notes: The job vacancy rate measures the number of total posts that are vacant, divided by the sum (number of occupied posts + number of job vacancies), expressed as a percentage.  
Source: Eurostat database.

**The rapid economic revival resulted in labour markets becoming tighter again – more like pre-pandemic times.** In many countries of the region, job vacancy rates returned to the levels of 2018. As well as most EU-CEE countries (Figure 2.12), Montenegro, Serbia and Russia also recorded an upswing

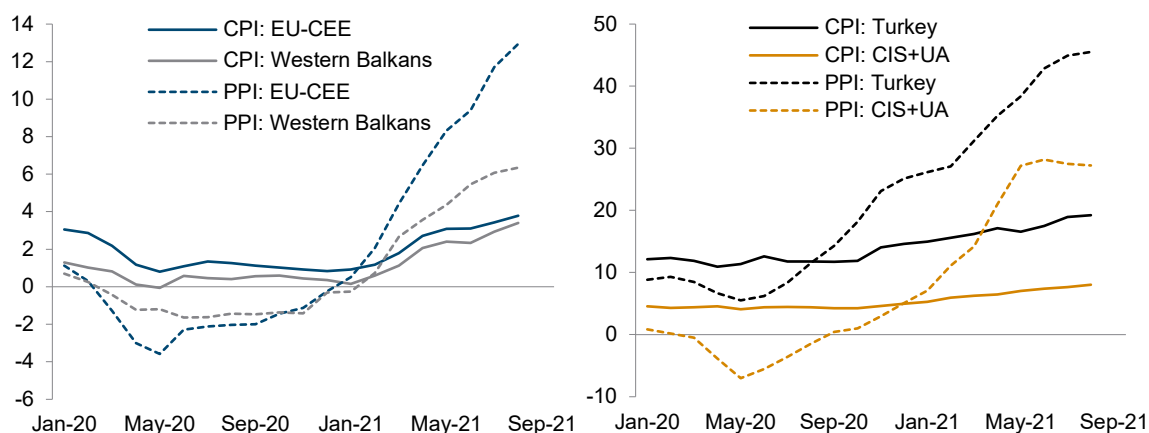
in labour scarcity.<sup>12</sup> While, in many countries, workers who were previously employed in the hospitality sectors (including tourism and transport) are still jobless, there are numerous employers in business services, construction, health care and other public services who are again eagerly searching for labour. This ongoing structural change is resulting in a peculiar combination of strong wage growth and still relatively high underemployment.

## 2.6. IS INFLATION REARING ITS UGLY HEAD?

**Inflationary pressures in CESEE have increased markedly, especially in the non-euro countries.**

In 2020, consumer price inflation (CPI) in several parts of the CESEE region fell to very low levels (with a few countries recording outright deflation), as the demand for many goods and services collapsed and energy prices plummeted to very low levels.<sup>13</sup> But with domestic demand gradually recovering in line with the easing of COVID-19 restrictions, and with supply-side constraints starting to bite, inflation has started to rise again, typically by 3-4 pp (on an annual basis) since the beginning of this year (Figure 2.13). Interestingly, in those countries that use the euro (either as part of the euro area or unilaterally), the increase has been less pronounced than elsewhere. This is because their inflation rates are more aligned with the rate in the euro area (which is lower than in CESEE), and also because the commodity price increase in euro terms over the past year has been relatively less pronounced.

**Figure 2.13 / Consumer and producer price inflation, year on year, in %**



Note: Simple average over all countries. CPI – consumer price inflation; PPI – producer price inflation.

Source: wiiw Monthly Database incorporating national statistics.

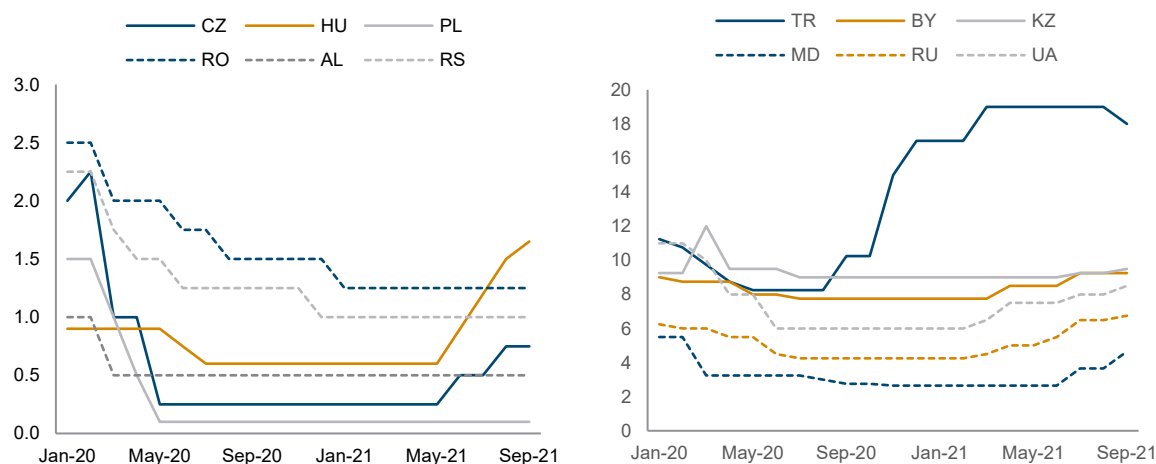
**Many central banks in the region have tightened policy in response.** In many CESEE countries, inflation is now well above the official targets, prompting central banks to intervene. In Czechia, Hungary, Poland, Romania, Russia, Ukraine, Belarus, Kazakhstan and Moldova, the policy rate has already been raised, in some cases markedly (Figure 2.14). In contrast, Serbia and Albania have so far refrained from interest rate hikes; meanwhile, in Turkey, the earlier tightening cycle was abruptly

<sup>12</sup> Due to differences in the applied methodology, job vacancy rates in Montenegro and Russia are not shown in Figure 2.12.

<sup>13</sup> Turkey is a notable exception.

reversed in September. In the other CESEE countries, monetary policy is (effectively) decided by the European Central Bank (ECB), which has largely preserved its ultra-expansive course.

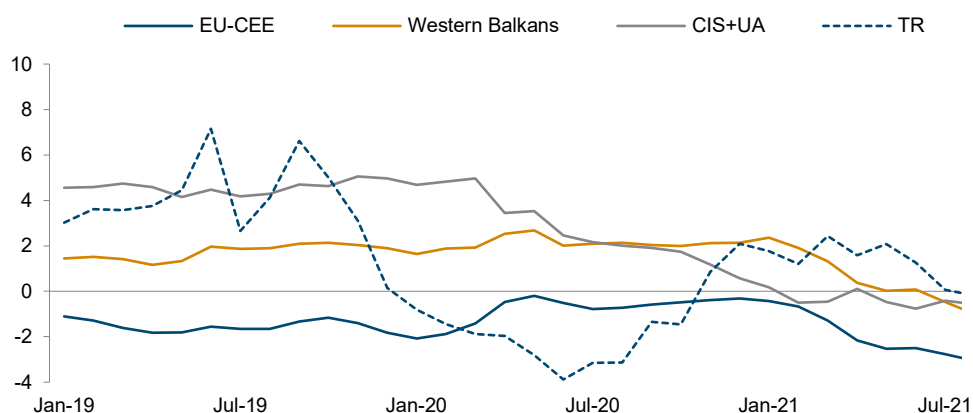
**Figure 2.14 / Central bank nominal policy rate, end of month, in %**



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

**Despite that, real interest rates have declined, probably suggesting more policy tightening to come.** With interest rate hikes generally lagging behind the pick-up in inflation, real interest rates have declined in most CESEE countries (Figure 2.15). As of August 2021, real interest rates were in negative territory in nearly all of these countries, except Montenegro, Kosovo and Kazakhstan. In Poland, Estonia and Lithuania, they were as low as -4.7%. This may suggest that even in the absence of any further increase in inflation, the tightening cycle in many CESEE countries may continue in the months to come (albeit not necessarily in Turkey).

**Figure 2.15 / Real policy rate, CPI deflated, in %**



Note: Simple averages for country aggregates.

Source: wiiw Monthly Database incorporating national statistics.

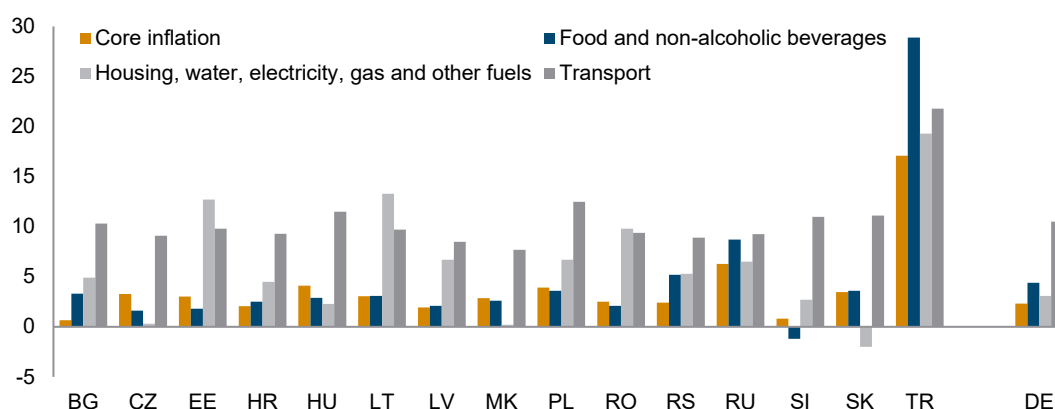
## 2.7. FEW SIGNS OF OVERHEATING – EXCEPT IN PROPERTY MARKETS

**A search for the causes of inflation highlights the outstanding role of energy prices, while core inflation has been subdued.** Figure 2.16 presents the sub-components of the headline consumer price index (CPI) in those CESEE countries for which the respective data are available during the year preceding August 2021. As can be seen, in the EU-CEE countries, it was transportation and, to a lesser extent, utilities that recorded the strongest price increases – both largely reflect rising energy prices. Elsewhere, headline inflation was more broad based, with food prices featuring quite prominently in Russia, Serbia and, particularly, Turkey. By contrast, core inflation has been subdued. In most EU-CEE countries, it stayed at below 4%: only in Russia and Turkey did it approach the headline inflation rate. Given the highly uneven dynamics across the individual CPI sub-components, the recent pick-up in headline inflation may well be a consequence of the adjustments in relative prices, partly unleashed by the COVID-19 shock, rather than inflation in the macroeconomic sense (defined as an increase in the *general price level*).<sup>14</sup>

**The recent spike in inflation has been supply-side driven...** Figure 2.15 shows that producer price inflation (PPI) in the region has been rising far ahead of CPI, with the gap between the two widening over time. This would suggest that supply-side factors (such as the disruptions in value chains) lie behind the recent spike in inflation. In the case of demand-driven inflation (overheating), one would rather expect the opposite: consumer prices rising faster than producer prices. Indeed, our analysis, which draws on a wide range of indicators, suggests that overheating is hardly an issue in most CESEE countries, at least at the aggregate level (see Chapter 3.2). As of Q2 2021, only Turkey and (arguably) Hungary, Serbia and Albania were showing signs of overheating.<sup>15</sup>

**Figure 2.16 / Consumer price inflation sub-components in August 2021**

percentage change year on year



Source: National sources, Eurostat, wiiw.

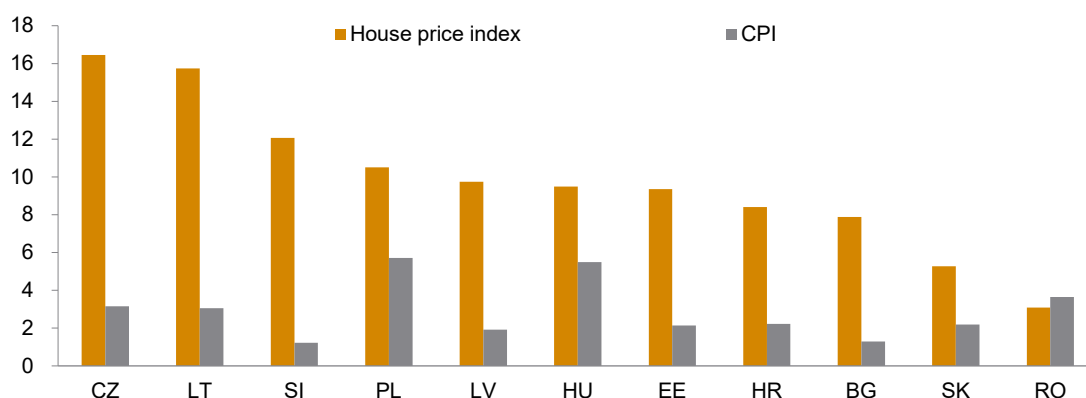
<sup>14</sup> Similar reservations have been voiced when analysing inflation developments on a global scale. Besides, the usual problem of finding the right weights when measuring CPI becomes even greater in the face of big shocks, such as COVID-19. This complicates the interpretation of inflation numbers. See, for instance: <https://adamtooze.substack.com/p/chartbook-42-the-great-inflation>

<sup>15</sup> In Turkey, the wiiw Business Cycle Index (BCI) in Q2 2021 exceeded the level of Q4 2007 – the frequently used benchmark for overheating in the run-up to the global financial crisis – by a wide margin (and Serbia and Albania were very close to it). In Hungary, the BCI also exceeded the level of Q4 2007, but the latter benchmark may not be entirely appropriate in the Hungarian case.



... and is likely to be transitory. The disruptions in value chains are a legacy of the pandemic – as, to some extent, are higher food prices, since the cross-border travel restrictions imposed during the pandemic affected harvesting. With the legacy of the pandemic fading over time, supply-side disruptions will increasingly become less of an issue. Energy prices cannot rise indefinitely, either (although they will probably become much more volatile, as suggested by the current situation with the natural gas prices in Europe). The key question, however, is whether the recent price increases will translate into higher wage demands, potentially setting in motion an upward spiral of rising prices and wages. Such a scenario would be akin to the developments observed in Western Europe in the 1970s (when the oil price shock gave rise to high inflation over a protracted period), although it is unlikely to be repeated in CESEE now.<sup>16</sup> Instead, the current situation is arguably more similar to the one in 2007, when a sharp rise in energy prices proved short-lived, to be followed by a decade or more of (near) price stability.

**Figure 2.17 / House price index and CPI, cumulative change in %, Q1 2020 - Q2 2021**



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

**But monetary policy tightening might cool the booming property markets.** Housing prices in many CESEE countries have been rising rapidly for a number of years now, far outpacing CPI. The main reason has been the ultra-expansionary policy of the ECB, which – directly or indirectly – has had an impact on large parts of the CESEE region.<sup>17</sup> The COVID-19 pandemic has merely reinforced this trend, with many people aspiring to improve their living conditions, and with the price of construction materials soaring in the wake of the pandemic. For instance, in EU-CEE countries housing prices have picked up markedly since the beginning of last year – by up to 16% in Czechia and Lithuania, and almost everywhere faster than CPI (Figure 2.17).<sup>18</sup> The rapid and protracted increases in housing prices may not be sustainable, and that raises concerns about the formation of property-market bubbles. Against

<sup>16</sup> The two main differences are (i) the power of trade unions and (ii) the extent of globalisation. In Western Europe in the 1970s, trade unions were much stronger than in CESEE today, and their wage demands contributed decisively to the price-wage spiral. Besides, there was less competition from China and other Asian economies in the 1970s than is the case today, which made wage demands easier to implement; see, for instance, V. Astrov et al. (2021), How do economies in EU-CEE cope with labour shortages? wiiw Research Report No. 452, February, Chapter 6, pp 59-64.

<sup>17</sup> This essentially solves the 'mystery' of an ever-expanding money supply combined with stable (consumer) prices: most of the extra liquidity ends up in the property market. See also wiiw (2019), Braced for fallout from global slowdown, Economic Analysis and Outlook for Central, East and Southeast Europe, Forecast Report, Autumn, p. 19.

<sup>18</sup> For non-EU CESEE countries, recent data on property prices are not yet available, but anecdotal evidence suggests that trends in many of them have been similar. Idiosyncratic factors, such as the programme of subsidised mortgages in Russia launched in response to the pandemic, have played a role as well.

this background, the ongoing monetary policy tightening in the region might have a welcome cooling effect, given that real estate purchases are mostly financed by credit. In this way, it may well represent the right policy choice, though not necessarily for the right reasons.<sup>19</sup>

## 2.8. MILD SLOWDOWN AHEAD, WITH RISKS TENDING TO BE ON THE DOWNSIDE

**After an estimated 5.4% rebound in 2021, the pace of economic recovery in CESEE will slow in coming years.** Our current projection is that regional growth will slide a little to 3.7% next year and 3.5% in 2023 (see Overview Table 1) – unless the downside risks described below come to pass. Even in the baseline scenario, growth deceleration seems unavoidable, as the effect of the low statistical base of 2020 gradually fades and monetary policy tightening puts the brakes on credit expansion. A sharp slowdown in growth is expected in Turkey, where the current boom is unlikely to be sustained. Within CESEE, the highest growth next year is projected for Croatia (5%) and Poland (4.9%), as well as Montenegro and Kosovo (4.8%).

**The negative labour market effects of any further COVID-19 restrictions will most probably be limited.** Governments have increased their efforts to weather the crisis via public investment, and to protect employees against job loss by using, for example, short-time work schemes until the recovery becomes sustainable. Thus, the medium-term forecast is quite rosy, showing a gradual decline in unemployment rates in EU-CEE towards 4% on average by 2023. A similar development is expected for the CIS, while in Ukraine the unemployment rate could decline to below 8%. In the countries of the Western Balkans, however, employment rates will remain relatively low and unemployment rates high, ranging from 9% in Serbia to 16% in Bosnia and Herzegovina.<sup>20</sup>

**In EU-CEE countries, economic growth will be crucially helped by disbursements from the EU Recovery and Resilience Facility (RRF).**<sup>21</sup> The RRF – worth EUR 723.8bn (in 2020 prices), of which up to EUR 338bn is in the form of grants and up to EUR 385.8bn is in cheap loans – aims at facilitating economic recovery and simultaneously fostering digital and green transition. To be eligible for RRF funding, EU member states need to submit national recovery and resilience plans, outlining the details of the proposed investments.<sup>22</sup> Interestingly, apart from Romania, no EU-CEE country has requested the full amount of the EU funds earmarked.<sup>23</sup> Poland and Slovenia have requested only part of the RRF loans available to them, while all the other countries have not requested any loans at all; Latvia has not even requested the full amount of grants. Besides, approval of the Hungarian and Polish plans is still pending and, given the ongoing political standoff between their governments and the European Commission, the issue is unlikely to be resolved soon.

<sup>19</sup> Within the framework of inflation-targeting regimes, housing prices are not part of the inflation target.

<sup>20</sup> With 24.5% of the active population unemployed, Kosovo is an outlier due to its structurally weak economy.

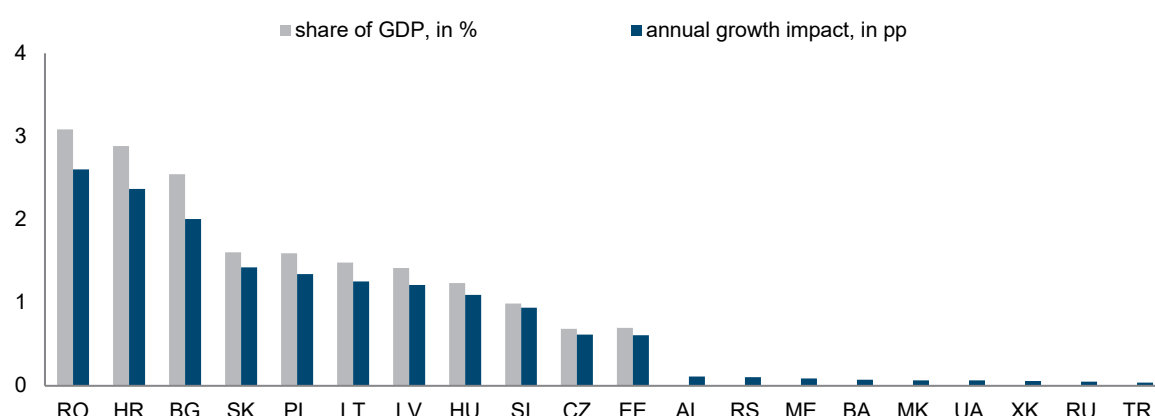
<sup>21</sup> [https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility\\_en](https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility_en) For the Western Balkans, the EU has come up with an Economic and Investment Plan, worth EUR 9bn, to support economic recovery and convergence. Like the RRF, it targets above all investment projects in the areas of digital and green transition. See: [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_20\\_1811](https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1811)

<sup>22</sup> At least 37% of investments proposed in the national recovery and resilience plans is to be spent on green transition, and at least 20% on digitalisation.

<sup>23</sup> Romania may be particularly interested in cheap EU loans, since it typically faces high interest rates on the private markets.

The potential annual RRF transfers are very large, ranging on average from 0.7% of GDP in Czechia and Estonia to 3.1% in Romania (Figure 2.18).<sup>24</sup> However, the RRF's estimated impact on growth will be slightly lower, as part of the funds will leak out in the form of imports, mostly from Western Europe. Besides, the figures in Figure 2.18 represent the upper bound: the actual impact will almost certainly be lower. This is because (i) judging by past experience, the absorption capacity of the recipient countries will likely be far below 100%, and (ii) there will probably be items in the national recovery plans that would have been financed from national budgets anyway – even without RRF funding.<sup>25</sup>

**Figure 2.18 / RRF transfers as a share of GDP and the growth impact of RRF spending**



Notes: Share of GDP based on GDP in 2018. Annual average growth impact for 2021-2026, based on RRF spending in the EU as a whole, and not only in the EU-CEE countries.

Source: own calculations using wiiw multi-country input-output database (MC IOD) and based on Bruegel data: <https://www.bruegel.org/publications/datasets/european-union-countries-recovery-and-resilience-plans/>

**Risks to the above forecasts are mostly on the downside, and include notably (i) particularly unfavourable COVID-19 developments, (ii) premature fiscal consolidation, and (iii) the upcoming monetary tapering in the US (and possibly in the euro area).**

**CESEE is in the grip of a fourth wave of the COVID-19 pandemic, and further waves cannot be ruled out next year and beyond.** As elsewhere in Europe, the number of new infections in CESEE started to rise again in September, signalling the onset of the fourth wave, mostly on account of the Delta variant. Not only is this variant of the virus more contagious than previous variants, but it also significantly increases the risk of hospitalisation, especially among those who are unvaccinated. From this point of view, EU-CEE – and especially the Visegrád countries – are in a much better position than the rest of CESEE: given their relatively high vaccination rates, the burden on their healthcare systems and the pressure on governments to impose restrictions are unlikely to be high. In the Western Balkans and the CIS, the public health situation is likely to be worse; however, for the reasons outlined above, the economic fallout will probably be modest regardless. Still, a worst-case scenario cannot be ruled out, with catastrophic numbers of new infections and deaths potentially forcing governments to act decisively.

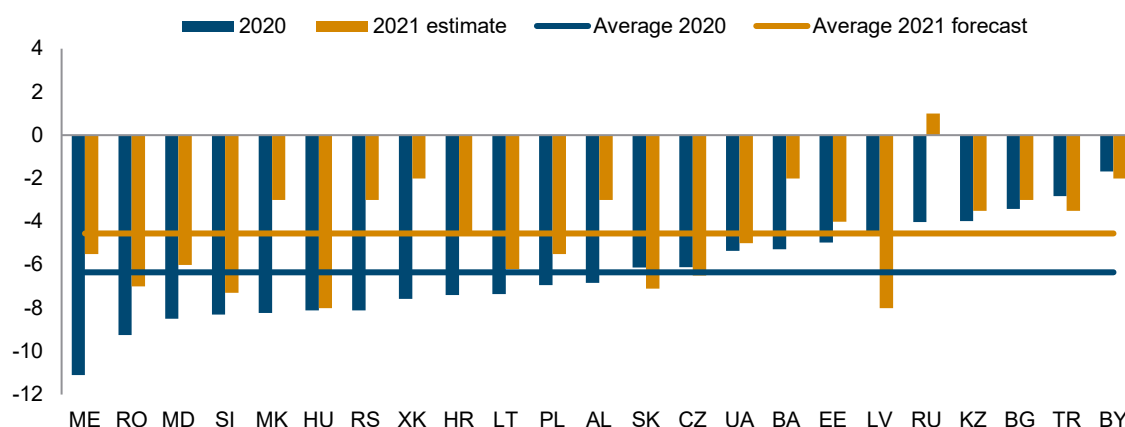
<sup>24</sup> The authors thank Robert Stehrer, wiiw, for providing the estimates presented in Figure 2.18.

<sup>25</sup> But this also means that RRF transfers will allow the budget deficits of recipient countries to be kept in check, without the need to resort to painful austerity measures.

**The risks of premature fiscal consolidation are not negligible either, especially in the Western Balkans and the CIS.**

In 2020, fiscal deficits soared everywhere in CESEE, to a regional average of 6.3% of GDP (Figure 2.19). Economic recessions deprived the governments of a large part of tax revenues, while spending increased dramatically – mostly on account of labour market support measures. This year, thanks to the economic recovery, it is estimated that the deficits will shrink to 4.5% of GDP, on average. Russia will probably even return to a budget surplus, thanks to booming revenue from energy exports, a substantial part of which is appropriated by the state. Nevertheless, in many CESEE countries, public deficits are still rather high – and in Czechia, Slovakia, Latvia, Turkey and Belarus they have even increased this year.<sup>26</sup> Concerns over high fiscal deficits and debts may prompt governments to start consolidating earlier than they should, particularly if they face external headwinds blowing in from the global financial markets.

**Figure 2.19 / Fiscal balance, in % of GDP**



Note: Simple averages over all countries.

Source: Eurostat and wiiw Monthly Database; wiiw forecasts.

**The forthcoming tapering of quantitative easing in the US may have severe repercussions for Turkey and Romania, and possibly for other CESEE countries as well.**

Turkey is currently exhibiting clear signs of overheating, supported by the high growth of credit, and its high short-term external debt rollover needs make it particularly vulnerable to any change of sentiment on the global financial markets. A reorientation of capital flows away from emerging markets – a consequence of the US tapering that is scheduled to start at the end of 2021 – will principally hit countries (such as Turkey) that are heavily reliant on inflows of hot money to finance their external deficits. However, Romania – with its stubbornly high ‘twin deficits’ – may also be affected. That said, unlike Turkey (where balance-of-payments crises have been a recurring feature of economic development), it has largely managed so far to get away with this situation. In other CESEE countries, the related risks should be more manageable, although they will also see capital outflows as a result of tapering and will face higher borrowing costs. Elsewhere, the dependence on volatile capital flows is not that high. Moldova and Bosnia and Herzegovina largely rely on official foreign assistance, while Ukraine depends on cooperation with the International Monetary Fund, which is unlikely to pull the plug on the country – if only for political reasons.

<sup>26</sup> Except for Belarus, in all these countries (as well as in Hungary) the current fiscal stance can be described as procyclical.