Economic trends in CESEE

Unexpected resilience to the war in Ukraine but economic cooling is visible on the horizon[1, 2, 3]

1 Regional overview

It has now been more than eight months since Russia invaded Ukraine on February 24, 2022. This has already profoundly altered the political, economic and security situation in Europe. While the outlines of a new equilibrium have yet to emerge, a return to the status quo is becoming more and more inconceivable.

War as a turning point for the European economy

In the medium term, the war could spark substantial structural shifts in the world economy. The decoupling from the Russian economy will impact trade and global value chains. Russia was – at least before the war – the 11th-largest economy worldwide in terms of GDP at current USD and an important provider of energy and other commodities. Trends toward fragmentation in world trade will amplify. Those trends have been around for some time already and made renewed headlines during the Trump administration and later during the COVID-19 pandemic, when governments around the globe discussed possibilities of near-shoring and strategic autonomy. Russia's invasion of Ukraine will also fragment the world monetary system as the weaponization of finance threatens to erode the US dollar's role as the world's dominant currency. The fragmentation of world trade and of the world monetary system could pave the way for two economic blocs – one aligned with the US and the other with China –, putting a brake on the free flow of goods, capital and ideas that characterized much of the past decades. In any case, basing a growth model on a deep economic integration of authoritarian regimes needs serious reconsideration. For Europe and the economies of Central, Eastern and Southeastern Europe (CESEE), this reconsideration implies an end to relying on Russian energy on the one hand. On the other hand, it implies the need to reduce the central importance of China for European value chains – both in terms of final demand for European produce and as a provider of important inputs.

All these considerations have direct implications for the highly open CESEE economies that based their economic success on an ever-deeper integration into the world economy over the past three decades, guided by liberal principles of openness and international exchange. Aside from basic economic parameters, the political narrative across the EU has also changed profoundly. Political discussions in the years to come will strongly revolve around defense capabilities, decarbonizing the economy and Western unity but also around the reach of great powers on infrastructure development, investments and political players in certain parts of CESEE. Yet, CESEE countries are in many ways also driving forces behind the coordinated European response to the war in Ukraine. This will likely give them a bigger say in

[1] *Compiled by Josef Schreiner with input from Katharina Allinger, Stephan Barisitz, Mathias Lahnsteiner, Thomas Reininger, Thomas Scheiber, Tomáš Slačík and Zoltan Walko.*

[2] *Cut-off date: October 14, 2022. This report focuses primarily on data releases and developments from April 2022 up to the cut-off date and covers Slovakia, Slovenia, Bulgaria, Croatia, Czechia, Hungary, Poland, Romania, Türkiye and Russia. The countries are ranked according to their level of EU integration (euro area countries, EU member states and non-EU countries).*

[3] *All growth rates in the text refer to year-on-year changes unless otherwise stated.*

European decision-making in the future, shifting some political leverage from the West to the East. Finally, geopolitical and security considerations will without doubt gain more influence on economic decision-making in the years to come.

Invasion brought about several unexpected consequences

In the short term, it has once again become apparent that the course and the consequences of a war are largely unpredictable. Many things in and surrounding the war turned out differently than initially expected. Most importantly, Ukraine still exists as an independent country. Since late summer, the tide has been turning even more in favor of the Ukrainian troops: The Russian army had to stop its advances, retreated from several strategically important positions and ceased control over large swaths of land. Yet, the politics and the rhetoric off the battlefield keep on escalating.

Russian economy initially proved largely resilient to sanctions

The initial resilience of the Russian economy came as a surprise. The international sanctioning regime imposed on the country as a response to the invasion caused little more than a short-lived stir in Russian markets. A mix of clever macrofinancial management, a positive terms-of-trade shock and large gaps in the sanction packages kept the Russian economy largely afloat until early summer.

After depreciating by some 40% against the US dollar within the first week after the invasion, the Russian ruble recovered rather quickly. It was buoyed by a huge hike in the Russian key policy rate (from 9.5% to 20%), several measures targeted at the foreign exchange market (including the obligation of exporters to sell large parts of foreign exchange receipts) and a large current account surplus. Russia's current account surplus swelled to a whopping 16.3% of GDP in the first half of 2022, as (1) energy exports from Russia remained largely unsanctioned during the review period – at least on the part of the EU –, (2) energy prices rose strongly, (3) Russia managed to increase commodity exports to some big emerging markets (i.e. China and India) and (4) Russian imports plummeted due to Western trade restrictions. As a result, the ruble was 20% more expensive than prior to the invasion in early October 2022, and capital controls could be eased (see chart 1).

Chart 1

Russia: exchange rate and policy rate

Source: Macrobond.

The ruble's recovery and subdued domestic demand brought back consumer price growth from its peak of 17.8% in April to 14.3% in September and allowed Russia's central bank to reduce its policy rates to 7.5% in mid-September, back to its level of November 2021.

Yet, the war and the sanctions did impair growth: In the second quarter of 2022, the Russian economy shrank by 4.1% year on year. However, the economic contraction two years earlier, i.e. at the height of the COVID-19 pandemic, was way more severe (–7.4% year on year). Especially private consumption suffered from weak sentiment, high inflation, tightening financing conditions and broader economic uncertainty. At the same time, gross fixed investment held up comparatively well and net exports presumably contributed strongly to economic dynamics. Furthermore, budgetary balances are increasingly burdened by a combination of ruble appreciation, declining import tax revenues and a sizable spending increase; and the fiscal surplus has already narrowed substantially in recent months. Sanctions will start to bite more strongly in the medium term, as more and more sectors of the Russian economy are running out of vital Western supplies and as sanctions are set to become more binding in the coming months (e.g. with respect to the planned EU embargo on Russian tanker-transported oil from late 2022 onward).

Most other CESEE countries are weathering the storm reasonably well too

In the face of the biggest geopolitical disruption in Europe since the second world war, most other CESEE economies did surprisingly well. Growth moderated somewhat throughout the first half of the year but remained by and large solid in most countries. Second quarter readings – i.e. for the first full quarter after the start of the war – even beat expectations in several cases (see table 1).

Pandemic-related legacies, such as pent-up demand and abundant deposits, mobility normalization, substantial corporate financial surpluses as well as tight labor markets, shielded CESEE countries from some of the effects of faltering external demand, of deteriorating sentiment and of energy market disruptions on output growth (see chart 2).

Table 1

Real GDP growth

	2019	2020	2021	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
	Period-on-period change in %								
Slovakia	2.6	–4.4	3.0	–1.4	1.8	0.4	0.4	0.4	0.5
Slovenia	3.5	–4.3	8.2	1.6	1.9	1.4	5.2	0.7	0.8
Bulgaria	4.0	–4.4	4.2	1.7	1.0	1.0	1.2	0.9	0.8
Croatia	3.5	–8.1	10.2	5.9	1.0	1.8	1.1	2.8	2.0
Czechia	3.0	–5.5	3.5	–0.5	1.4	1.7	0.8	0.6	0.5
Hungary	4.9	–4.5	7.1	1.2	2.6	1.1	2.3	1.8	1.1
Poland	4.7	–2.2	5.9	1.4	2.0	2.6	1.8	2.5	–2.1
Romania	4.2	–3.8	6.0	1.1	3.2	–2.9	1.0	5.1	2.1
Türkiye	0.8	1.9	11.4	2.6	2.0	2.7	1.6	0.7	2.1
Russia	2.2	–2.7	4.7	1.6	2.6	–0.9	0.5	–0.3	–1.9
CESEE average[1]	2.5	–2.2	6.9	1.7	2.3	0.6	1.1	0.8	–0.4
Euro area	1.6	–6.1	5.2	–0.1	2.0	2.2	0.5	0.7	0.8

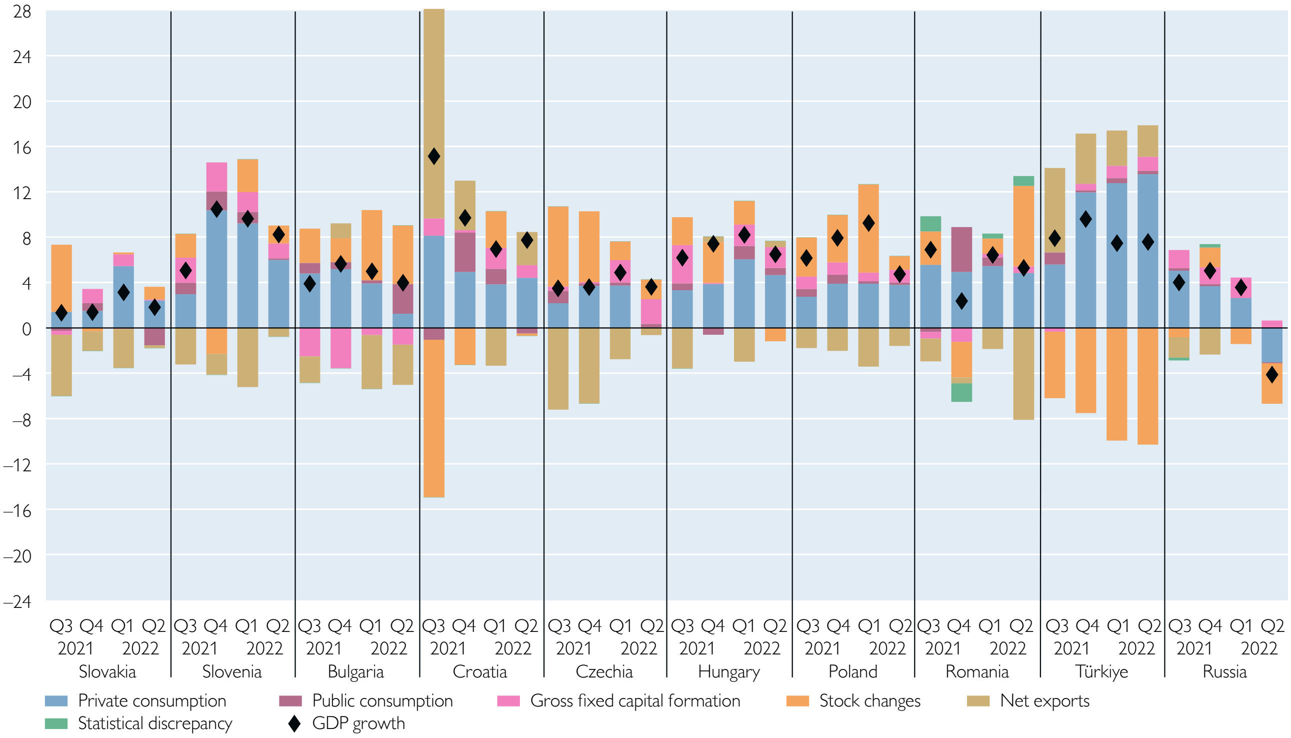
Source: Eurostat, national statistical offices.

[1] *Average weighted with GDP at PPP.*

Chart 2

GDP growth and its main components

Percentage points, GDP growth in % (year on year)



Source: Eurostat, national statistical offices.

Labor markets performed better than in the pre-pandemic period

Labor market developments deserve special attention. Labor markets not only fully recovered from the lockdown-induced disruptions of 2020 and 2021, but they performed better than in the pre-pandemic period in many ways. The average unemployment rate in the CESEE EU member states declined to 3.6% in August 2022, on a par with the December 2019 reading. A broader measure of the labor market slack – i.e. the share of persons with an unmet need for employment[4] in the extended labor force – even beat its end-2019 reading by a full 0.4 percentage points. At 6.3% in the second quarter of 2022, it reached the lowest level since the start of the time series in 2009. At the same time, trends in employment rates and activity rates were also favorable, with both rising to close to or even above historical heights in the second quarter of 2022.

Labor markets are again becoming very tight, and companies are reporting rising labor shortages, especially in services but also in manufacturing and construction. Thus, problems with insufficient labor supply amid skill mismatches and labor market bottlenecks, which have plagued CESEE labor markets for many years, again came to the fore and resulted in robust nominal wage growth. Despite deteriorating economic sentiment and a dim outlook, wage growth accelerated to an

[4] *This includes unemployed and underemployed persons, persons available for the labor market but not seeking employment, as well as persons seeking employment but not available for the labor market.*

average of 9.3% in the second quarter of 2022, with Bulgaria, Hungary, Poland and Romania reporting wage advances firmly in the double digits.

Fixed capital formation still strong, but inventory cycle is turning

Private consumption was the main pillar of output dynamics, but fixed capital formation also contributed positively to growth in many countries. While nominal financing conditions tightened notably throughout CESEE, real interest rates remained firmly in the negative and high profitability provided sources for internal financing. Investments were channeled mainly into new machinery, as capacity utilization stood some 3 percentage points above its long-term average and possibly also in an effort to save (increasingly scarce) labor. At the same time, the inventory cycle turned. Throughout most of the pandemic, inventories were built up as lingering supply chain issues delayed the completion and sale of semifinished industrial goods and companies stocked up on vital supplies whenever they were available on international markets. As supply chain pressures started to ease in spring, stock changes only moderately lifted growth in mid-2022, if at all. In Poland, for example, stock changes were solely responsible for the marked slowdown in annual output growth observed in the second quarter.

Unclogging of supply chains and currency depreciation sustain export growth

The unclogging of supply chains amid order backlogs from the past and currency depreciation helped sustain export growth despite the incipient moderation in global economic momentum. Real export growth accelerated modestly from the first to the second quarter of this year throughout the region, especially in countries with strong tourist arrivals. In Türkiye and Croatia, for example, tourist arrivals in the second quarter of 2022 were about twice as high as in the previous year. At the same time, import growth continued unabated, reflecting robust domestic demand. On balance, the external sector's contribution to real GDP growth improved somewhat in the second quarter of 2022. However, it only lifted growth notably in Croatia and Türkiye.

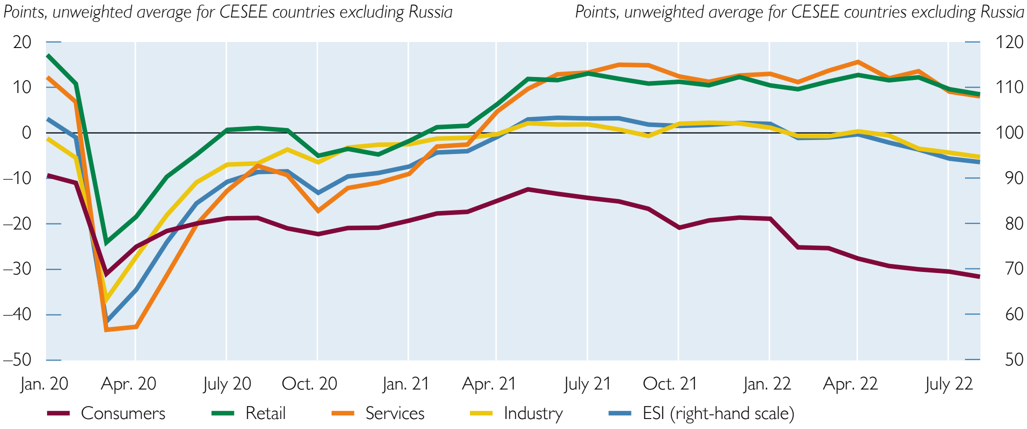
Resilience to the fallout from the war is gradually weakening

Looking forward, high-frequency data signal that resilience to the fallouts from the war in Ukraine is gradually weakening.[5] Industrial production growth has been declining steadily since spring 2022. In July, it reached its lowest point so far this year at an average of 5.5% in the CESEE EU member states (3.1% in Türkiye). Almost all manufacturing sectors have been affected by the downturn recently, especially the export-oriented industries that depend on raw materials and imported components and industries with a high dependence on fossil energy carriers. This trend is expected to continue, as forward-looking surveys in CESEE fell to new lows in September 2022. In Poland, Czechia and Türkiye, for example, purchasing managers' indices moderated to levels last seen at the height of the COVID-19 pandemic in spring 2020. The decline was driven by weaker order intake, higher input prices and deteriorating future output expectations, while supplier delivery times again

[5] *For the OeNB's most recent forecast, please consult Outlook for selected CESEE countries and Russia in this issue of Focus on European Economic Integration.*

Chart 3

Economic sentiment indicator and subcomponents



Source: European Commission.

embarked on an upward path. The accumulated order backlog, by contrast, has largely returned to pre-pandemic levels.

Consumer sentiment has also been declining over the past months, reflecting rising economic uncertainty amid strong inflation and the associated downward pressure on real wages and purchasing power. While overall economic sentiment as measured by the European Commission's economic sentiment indicator declined by an average of 8.6 points between January and September 2022, consumer sentiment was lower by a full 13 points (see chart 3). Consumer sentiment in September 2022 was even weaker than at the height of the COVID-19 pandemic in March 2020. This stands in stark contrast to the rather moderate deterioration in retail and services sentiment (–3.8 and –4.6 points, respectively).

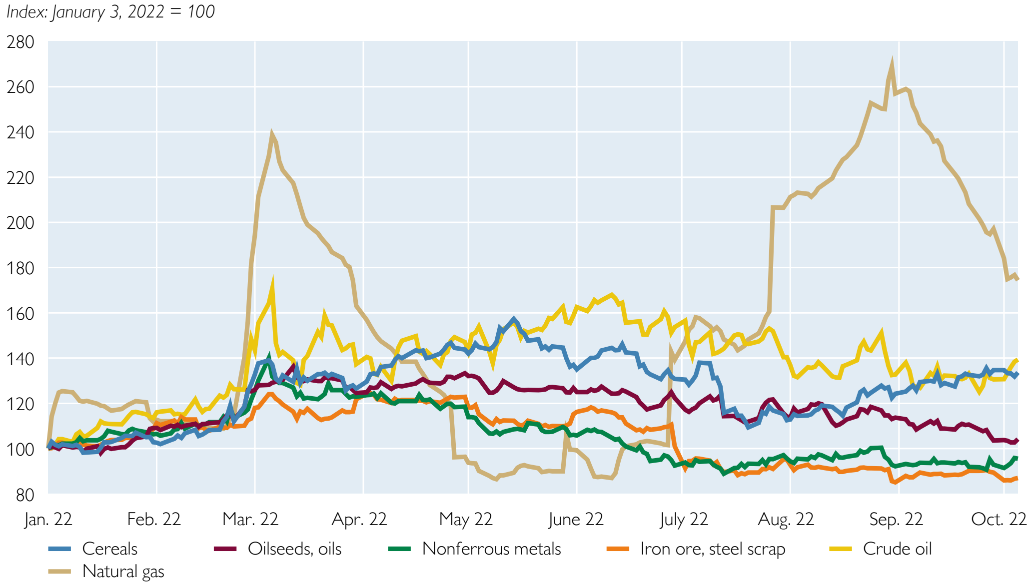
Annual retail sales growth in September 2022 was only a third of its January 2022 reading and amounted to an average of 4.3% in the CESEE EU member states and 2.8% in Türkiye. This represents the worst performance since early-2021, a time when pandemic restrictions were in full force. Retail sales growth is increasingly driven by daily necessities, while sales of durable goods and fuels are weakening. At the same time, the pent-up demand created by the pandemic now appears to have been used up.

War is disrupting international commodity markets

While – as mentioned above – some events triggered by the war did not turn out as expected, some other events unfortunately did. This applies in particular to the amount of human suffering and the humanitarian crisis that unfolded after February's events. On the economic front, the war tore Ukraine's economy into pieces (see box 1) and sent shock waves across the global economy. The latter applies in particular to oil, gas and food markets, where Russia and/or Ukraine were important suppliers to the global economy in the past. Prices skyrocketed and, in many instances, reached historically high levels against a combination of reduced supplies, efforts to isolate Russia from the world markets, constant saber rattling and the associated high uncertainty. Undoubtedly, commodity supplies were used as a strategic weapon to test the West's resolve in its support for Ukraine and to impose a heavy toll on Europe's political system and economy if it chooses to stand with Ukraine.

Chart 4

Price developments for selected commodities



Source: Hamburg Institute of International Economics (HWWI).

Commodity price developments can serve as a kind of fever curve, mirroring the heat of the conflict. After notable increases already in 2021, prices increased at an unparalleled pace across different segments between the beginning of the year and early March 2022: iron +25%, oilseeds +30%, cereals and nonferrous metals +40%, crude oil +70% and gas +240% (see chart 4). Markets, however, stabilized to some extent after it became clear that Russia lost the battle of Kiev and had to retreat from its maximalist goals for the war. Since July 2022, prices embarked on a broader downward trend. By early October, oil seeds and nonferrous metals traded at about their January prices, and iron was even some 10% cheaper. Cereals and crude oil prices remained somewhat elevated, however, and were up by 30% and 40% against January 2022.

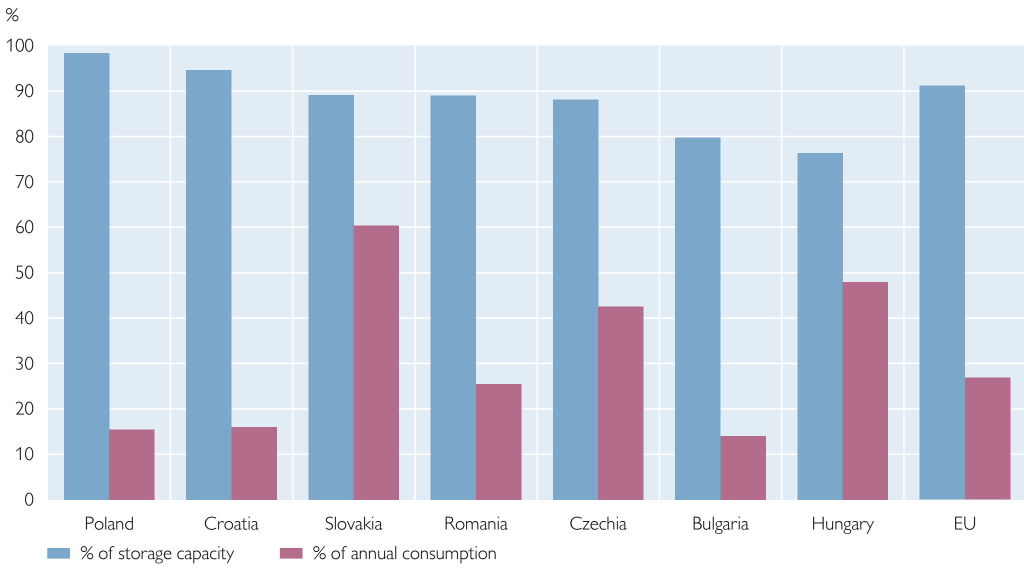
Gas prices are especially volatile and CESEE countries increasingly renounce Russian gas

Gas and – linked via the merit order system – electricity price developments remained very volatile. After prices quickly came back to their levels from early 2022, price dynamics accelerated markedly from July onward, as gas supplies from Russia became increasingly unreliable and erratic. Some CESEE countries were cut off from Russian gas altogether (Bulgaria, Poland), and Russia also stopped its gas deliveries to Europe via the important Nord Stream 1 pipeline. After gas prices peaked at an astronomically high level in late August 2022, they once again collapsed from an index value of 270 to about 170 in the subsequent weeks. This not only underlines the unpredictability in today's energy markets, it is possibly also a sign of an increasingly successful decoupling of European economies from Russian energy carriers.

By October 9, 2022, CESEE EU member states – which historically showed a high dependence on Russian gas – managed to fill between 76% (Hungary) and 98% (Poland) of their available gas storage capacities for winter, mostly well ahead

Chart 5

Gas storage in selected CESEE countries



Source: AGSI.

Note: Reference date = October 9, 2022.

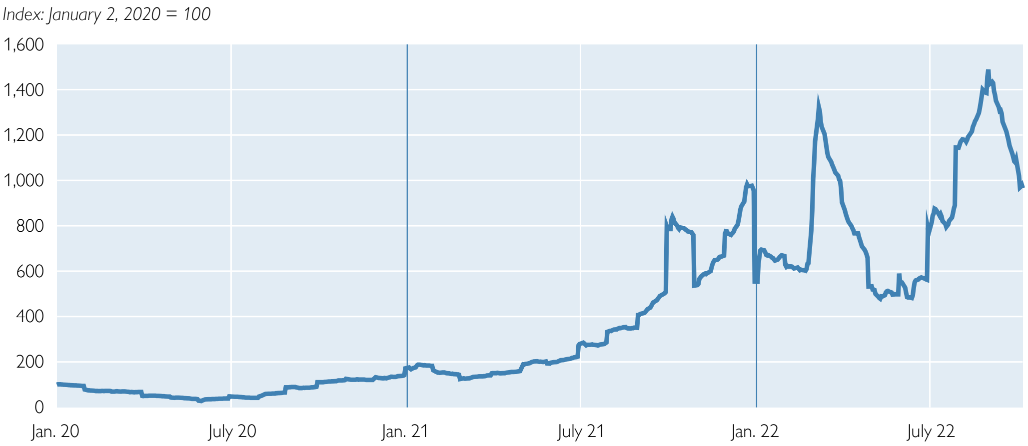
of their targets. This translates to gas storages covering between 15% (Bulgaria, Croatia, Poland) and 60% (Slovakia) of annual gas consumption (see chart 5). This is on average higher than the coverage in Western European countries. Furthermore, those lagging behind within CESEE are countries with access to the sea and can therefore be more easily supplied with liquefied natural gas (LNG). Croatia, for instance, opened a large LNG terminal in 2021, allowing even exports of gas to Hungary. CESEE countries also managed to reduce total gas demand by quite a bit: In the first nine months of the year 2022, Bulgaria, Czechia, Poland and Romania cut gas consumption by around 10% compared to 2019–21 averages; Hungary and Slovenia achieved a 5% reduction. Only Croatia and Slovenia reported an increase in gas demand in the year to date (by 8% and 4%, respectively). However, also in those two countries, gas demand has embarked on a downward trend more recently, and gas consumption was reduced by 10% in Slovenia and 28% in Croatia in September 2022 vis-à-vis the 2019–21 average.

Gas prices started to increase already long before the war

The turbulences on international energy and commodity markets are often cited as evidence for the sanctions being more harmful to Western economies than to the Russian economy. This, however, is based on an incomplete reading of the facts and the data. When it comes to gas, for example, gas deliveries never were subject to EU sanctions, and gas prices started rising already long before Russia's invasion of Ukraine (see chart 6). By mid-February 2022, gas prices were already six times as high as at the beginning of 2020 (i.e. pre-pandemic). During this time, Russia – the most important supplier of gas to Europe – did not use its free capacities to

Chart 6

European gas prices



Source: Hamburg Institute of International Economics (HWWI).

counter price increases. This not only ran contrary to earlier years' practice but also to usual business-oriented behavior, suggesting misuse of market power and political motivations. It led to unusually low levels of gas storage, uncertainty and further price increases. Moreover, already before the war, Russian gas export companies held much smaller storage volumes in the EU than at the same time in previous years. Effectively, Russia gave up its role as a "reliable supplier" of gas already quite a long time before the start of the war and not just in response to any international economic sanctions due to its attack. Gas imports from Russia plunged over the course of 2022 from some 2,500 million cubic meters per week in March to a mere 500 million cubic meters per week in early October 2022. In 2021, on average around 3,000 million cubic meters of Russian gas reached Europe every week. Imports via Nord Stream and Yamal stopped completely, while some minor quantities have reached Europe via Turkstream and Ukraine transit in recent weeks (around 250 million cubic meters per week each).

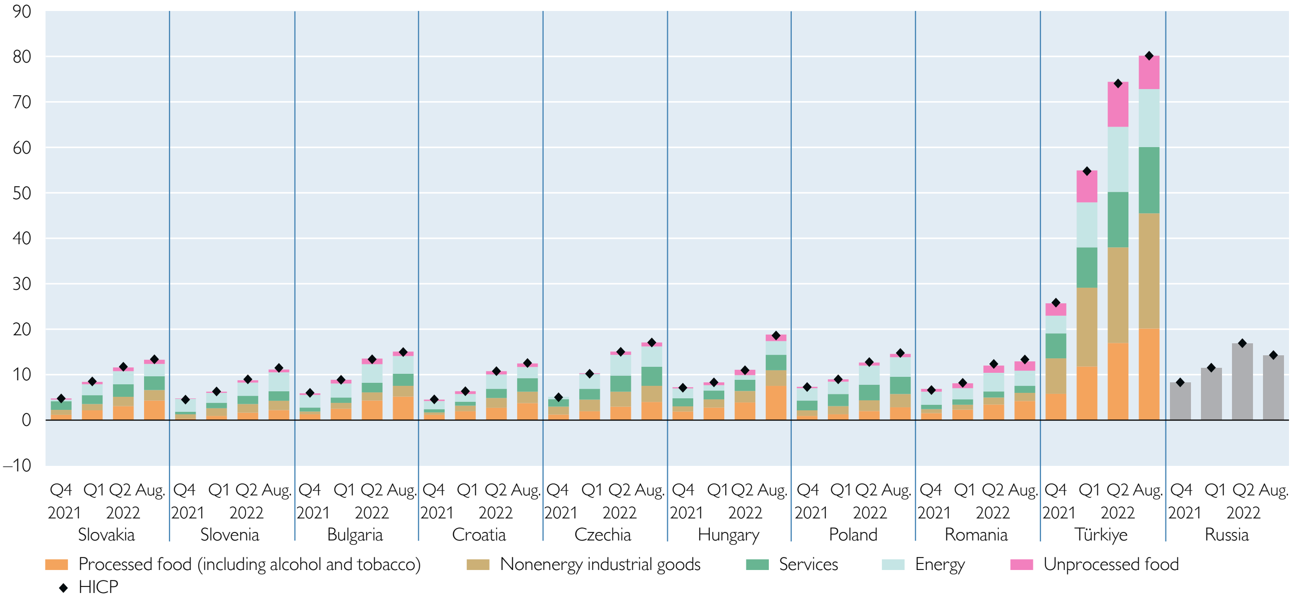
Inflation reaches new heights, but lower energy prices have recently dampened the increase

Inflation has continued to rise inexorably in recent months. In August 2022, it averaged 15% in the CESEE EU member states and a whopping 80.1% in Türkiye, once again hitting new heights (see chart 7). At the same time, however, price increases seem to have moderated somewhat at least over the summer months, i.e. July and August. Despite currency weakness in several countries, lower world market prices for crude oil and country-specific relief packages for household energy exerted some dampening impact on energy prices. A certain stabilization was also observed in the development of prices for unprocessed food. As a flip side, however, price pressure in the core components remained very high and contributed increasingly strongly to inflation.

Chart 7

HICP inflation and its main drivers

Year-on-year change in HICP in %; contribution to this change in percentage points



Source: Eurostat, The Vienna Institute for International Economic Studies.

Note: CPI data for Russia. No breakdown according to COICOP available.

Some further push of HICP inflation might well be in the offing

Concerning the future path of inflation, two opposing trends are currently at work. At a disaggregated level, it can be observed that the share of items with rising inflation rates in the overall consumption basket has been declining somewhat since May 2022 (albeit from a very high level). Therefore, price increases have become less broad-based. It remains to be seen to what extent this trend will persist, however. In any case, three countries – Czechia, Slovenia and Croatia – already reported a moderate decline in inflation in August 2022.

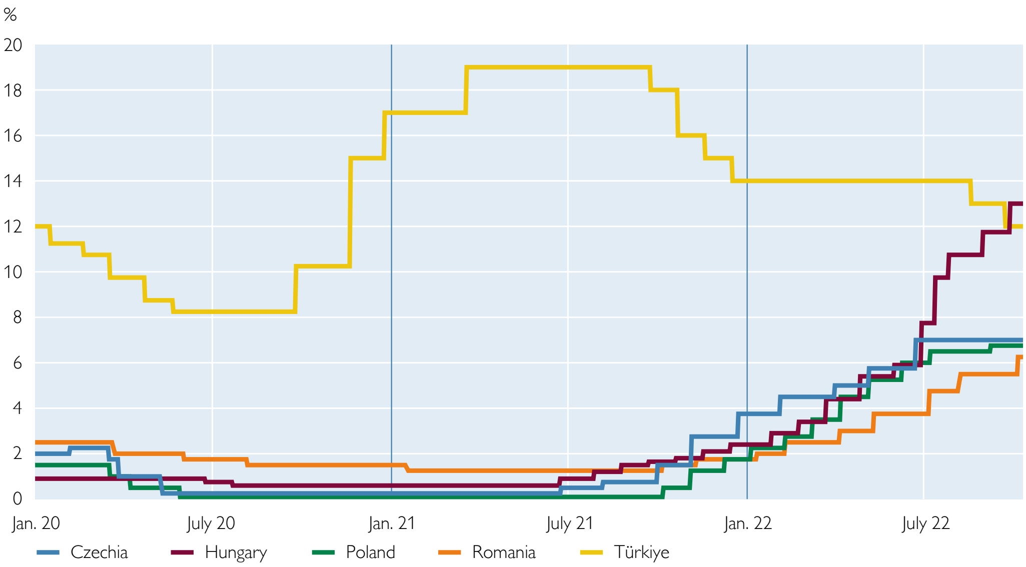
Inflation expectations have moderated recently as well. Surveys among consumers on the expected price trends over the next 12 months indicated record price expectations in spring 2022. Yet, over the review period, the situation eased notably. By September 2022, survey responses converged to the values reported in summer 2021. Similar trends were observed for industry, retail and services, but price expectations in those sectors remained far above pre-war levels.

At the same time, however, there may well be further inflationary pushes ahead in the coming months. This is directly related, above all, to the fact that wholesale gas and electricity price increases are reflected in household price structures and hence in the HICP, only with a certain time lag. In Hungary, for example, recent increases in regulated prices for household energy have already added more than 2 percentage points to August's inflation (propelling Hungarian inflation to the highest level among CESEE EU member states).

Furthermore, pressures upstream the price chain remain strong. In August 2022, producer prices for the domestic market increased by 45.7% on average in the CESEE EU member states and by 144.6% in Türkiye, with the upward trend

Chart 8

Policy rates in selected CESEE countries



Source: Macrobond.

largely unabated. Within the producer price index, the energy component showed the strongest price rises, followed by consumer goods (the component most closely linked to consumer prices). At the same time, inflation in intermediate and capital goods has moderated recently.

Monetary policy has been tightened significantly

Skyrocketing inflation and the associated risks of second-round effects, as well as the lingering danger of an unanchoring of inflation expectations, have prompted central banks in the CESEE region to tighten their monetary policy significantly and notably earlier than most advanced economies. Since the start of the tightening cycle in mid-2021, central banks in the following CESEE countries have increased their policy rate: Hungary from 0.6% to 13%, Czechia from 0.25% to 7%, Poland from 0.1% to 6.75% and Romania from 1.25% to 6.25% (see chart 8).

Further rate hikes have to be weighed against the incipient economic slowdown

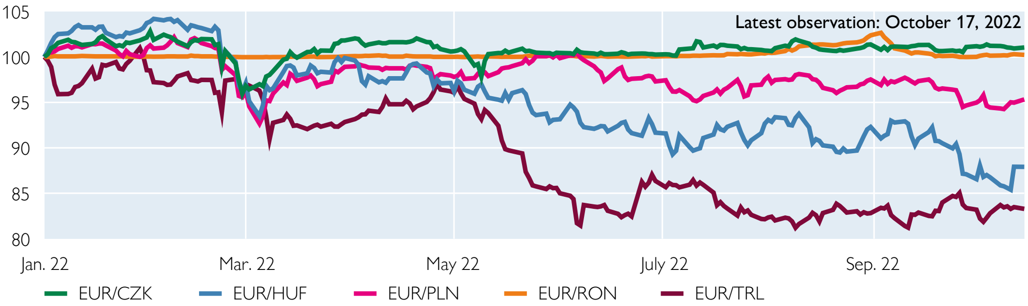
Throughout the review period, however, the environment for monetary policy has become increasingly challenging, as any further interest rate moves have to be weighed against the incipient economic slowdown. In its most recent decision from October 2022, the Polish central bank has already refrained from raising rates further. The Czech National Bank (CNB) kept rates unchained in two subsequent sessions in August and September 2022. If high inflation, pressure on the foreign exchange markets or an unexpectedly strong further tightening of monetary policy by the Fed and the ECB make further interest rate steps necessary, these could possibly be lower overall than in the past.

In contrast to Poland and Czechia, the Hungarian central bank (MNB) has recently even accelerated the pace of monetary policy tightening. The key interest rate and the interest rate for one-week deposits were combined in June 2022 and have since been raised from 5.9% to 13%. In addition to the interest rate hikes, further measures

Chart 9

Exchange rates of selected CESEE currencies vs. euro

January 3, 2022 = 100, rise = appreciation



Source: Macrobond.

were adopted to reduce interbank liquidity (higher reserve ratios, longer-term deposit instrument, regular central bank discount bond auctions) and to increase the effectiveness of the transmission mechanism (daily tenders providing foreign currency liquidity). Those steps were initially meant to put an end to the MNB's tightening cycle, but they did not put an end to the depreciation of the forint: The currency reached an all-time low against the euro on October 13, 2022, at 430 HUF per EUR. The following day, the MNB called an emergency meeting where it decided to hike the upper end of its interest corridor by 950 basis points to 25%, to introduce an overnight deposit tender at 18% and to launch a one-day foreign exchange swap with an interest rate of 17%. For the time being, these measures stabilized the currency, and the forint again reached 418 HUF per EUR on October 17, 2022.

Even after this appreciation, the forint remains the worst performer of the free-floating currencies in the CESEE EU member states. Year to date, it depreciated by 12% against the euro. This compares to a depreciation of 5% of the Polish złoty and a largely stable development of the Romanian leu and the Czech koruna (see chart 9). Especially the latter, however, was buoyed by exchange rate interventions by the Czech National Bank (CNB), which depleted some 6 percentage points of GDP of its foreign currency reserves. The CNB, however, has ample firepower, given the large foreign currency reserves it amassed during the "intervention floor policy" several years ago.

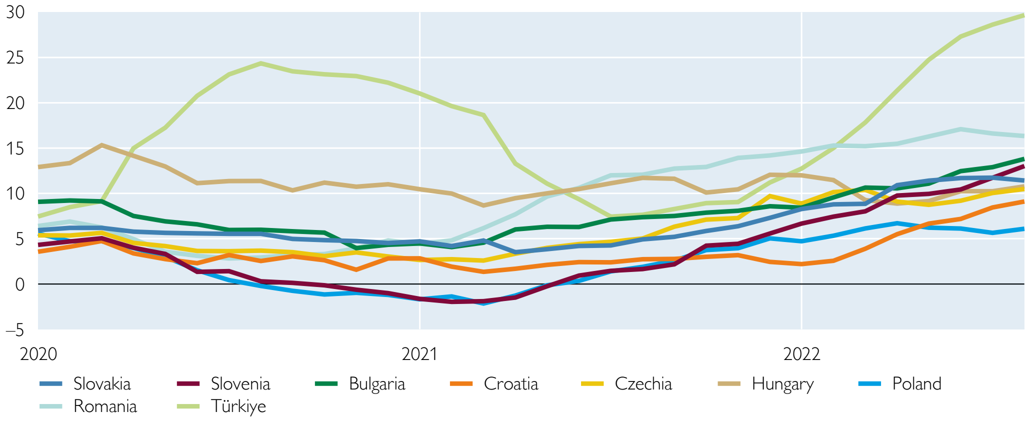
Turkish central bank opts for further rate cuts despite lira weakness and record inflation

The Turkish lira lost substantial value against the euro and traded some 17% below its January 2022 level in early October 2022. This came against the backdrop of an unorthodox monetary policy built around low interest rates. The Turkish central bank (TCMB) had already cut its main policy rate repeatedly in late 2021 and continued to do so in the review period. Despite ongoing currency weakness and massive price increases, the TCMB reduced its policy rate to 12%, shaving off 100 basis points in August and September, respectively. The authorities sought to combat the immediate risks accompanied by low interest rates with liquidity, prudential measures to constrain bank lending and with a series of regulations, including subsidized "foreign-exchange-protected" deposits to encourage households and companies to keep some of their savings in lira. Bank rates in Türkiye subsequently fell and regulatory precautions only slowed the increase in credit to the private sector.

Chart 10

Growth of credit to the private sector

Year-on-year change in %, adjusted for exchange rate changes



Source: National central banks, ECB.

Tightening financing conditions are already somewhat impairing credit growth

In other CESEE countries, rising policy rates were quickly passed through to market interest rates. Average interest rates on bank lending doubled between January 2021 and August 2022 in Czechia, Hungary and Poland and were up by a third in Romania. In the euro area countries Slovakia and Slovenia as well as in Bulgaria and Croatia, dynamics were more muted, but some upward trend has also been observable more recently (especially in rates on short-term loans).

Rising rates – in tandem with increasing uncertainty – have already notably dampened the growth of loans to households in Hungary, Czechia and Poland. In Poland, credit to households started to decline in July 2022 (in annual comparison), which was the first recorded contraction since the start of the time series in 1997. Credit growth to corporates, however, was more resilient to tightening financing conditions due to firms' rising liquidity needs and demand for working capital against the backdrop of rising input prices. For the private sector as a whole, this translated into broadly constant credit growth rates in Czechia, Hungary, Poland and Romania, a moderate increase in Slovakia and a stronger increase in Slovenia, Bulgaria and Croatia in the review period (see chart 10).

Surveys hint to a possible turning point in credit activity

Surveys show that CESEE banks are increasingly signaling a turning point where geopolitical uncertainty and the dim economic outlook are negatively influencing future business expectations. Demand from banks' clients is expected to deteriorate in line with the general economic momentum, and some credit tightening on the supply side could be in the offing as well. Such deterioration of credit supply expectations is widespread across segments but appears more relevant for small to medium-sized enterprises and large corporates. Funding conditions, which were supported by strong corporate and retail funding in the past (CESEE banks are self-funded in most cases), are expected to become less favorable.

Credit quality improved further in the first half of 2022, as nonperforming loans (NPLs) trended down across the region. Furthermore, the drop in NPLs was visible both in the retail and corporate segments, with particularly strong dynamics among the latter (possibly still reflecting some earlier pandemic-related support measures). However, following the incipient cooling of the economy and rising rates, banks are expecting a deterioration of credit quality going forward, significantly affecting both the retail and corporate segments.

Current account balances turn red for the first time in a decade

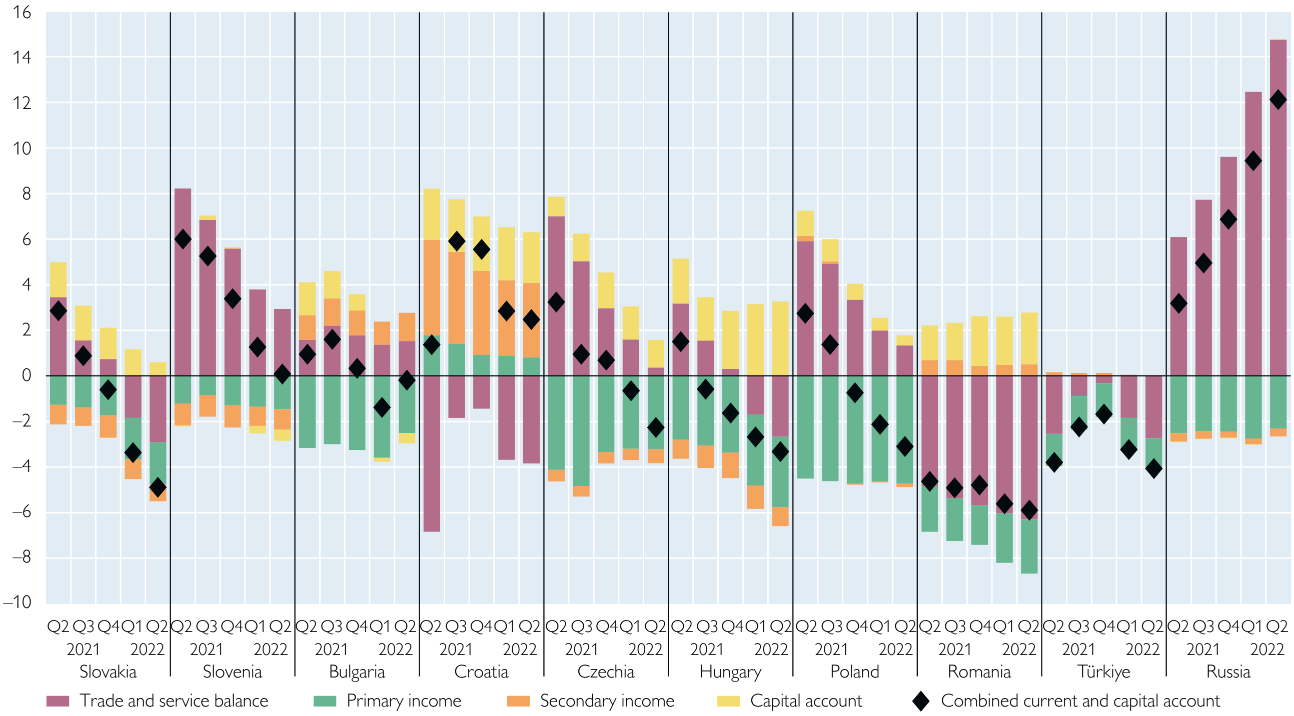
The war in Ukraine and the ensuing spike in energy prices had a visible impact on the CESEE countries' external balances. The terms of trade shock amid cooling international momentum sent trade balances southward. This effect was compounded by currency weakness. Depreciation increased the price for (largely demand-inelastic and usually foreign currency-invoiced) energy imports further, while offsetting the negative impact of rising labor costs on competitiveness only to some degree. By the second quarter of 2022, combined current and capital account balances deteriorated by between –0.3 percentage points of GDP in Türkiye and –7.7 percentage points of GDP in Slovakia (four-quarter moving sums compared to the respective period of the previous year). Only Croatia reported an improvement (1.1 percentage points of GDP), given strong tourism-related services exports (see chart 11). Against this background, current account surpluses disappeared in all countries but Croatia, and the CESEE region's aggregate external balance slipped into deficit for the first time since the European sovereign debt crisis in 2011/2012.

Sufficient foreign direct investment (FDI) and other investment inflows covered large parts of the current account shortfalls over the past four quarters. However,

Chart 11

Combined current and capital account balance

% of GDP, four-quarter moving sum



Source: Eurostat, IMF, national central banks.

tighter financial conditions around the globe and increased risk aversion have recently been accompanied by a deterioration in market conditions in some CESEE economies. Even though the sharp contraction in portfolio inflows at the onset of the war in Ukraine has subsided, nonresidents have been net sellers of securities, especially of bonds. Accordingly, sovereign bond spreads over German bonds have risen in most countries under observation, led by Hungary with a plus of more than 300 basis points within the first nine months of 2022. In Hungary, this was partly related to home-grown problems, such as the temporary halt of EU fund disbursement to the country due to disputes with the European Commission concerning rule of law requirements. In a broader comparison, Romanian spreads widened just as much as Italian spreads did. Polish and Hungarian spreads widened even more.

Box 1

Ukraine: war is hitting the economy hard – continued international support vital

Russia's war of aggression has resulted in loss of life, human suffering and enormous economic losses for Ukraine, inter alia through the massive damage caused to Ukraine's infrastructure and housing stock as well as the displacement of a large number of people inside and outside the country. Real GDP dropped by 37.2% year on year in the second quarter of 2022 after having declined by 15.1% year on year in the first quarter. As exports were hit by the destruction of production capacities and the blockage of important export routes, the trade deficit widened considerably to USD 10.4 billion (for goods and services) in the period from January to July 2022. Yet, due to large surpluses in the income balances (largely thanks to grants received from abroad), the current account balance recorded a surplus. The reopening of seaports under the Black Sea Grain Initiative (agreed until November 19, 2022) helped revive agricultural exports from early August.

At the beginning of June 2022, the National Bank of Ukraine (NBU) decided to raise its key policy rate to 25% from 10%. In addition to containing inflationary trends, this move was aimed at raising the attractiveness of hryvnia assets and reducing the pressure on the foreign exchange market. Yet, after fixing the hryvnia exchange rate vis-à-vis the US dollar at the onset of the war and introducing capital controls, the NBU opted for a devaluation of 25% in July and refixed the official exchange rate at UAH/USD 36.6. The inflation rate rose from 10% at end-2021 to 24.6% in September 2022, reflecting war effects, rising food prices and the devaluation of the Ukrainian hryvnia. News coming from Russia in September implying a further escalation of the war contributed to a temporary increase in foreign currency demand and a widening of the spread between the cash market rate and the official market rate.

After Ukraine's international reserves had declined from USD 27.5 billion at end-February 2022 to USD 22.4 billion at end-July, the downward trend was interrupted in August but resumed in September. At end-September, international reserves amounted to USD 23.9 billion. The development of international reserves has been mainly driven by the timing of international financial support flows (from the EU, the IMF, the USA and other multilateral and bilateral donors), the extent of NBU interventions on the foreign exchange market and repayments made to international lenders such as the IMF. To ease foreign exchange liquidity needs, the Ukrainian authorities reached agreement on a two-year debt freeze with Eurobond holders and official bilateral external creditors (G7 and Paris Club) over summer.

In addition to stabilizing the balance of payments, international assistance in the form of grants and loans plays a vital role in covering an important part of Ukraine's large state budgetary expenditure needs. In the period from March to August 2022, the state budget deficit amounted to about USD 15 billion, and without grants it would have exceeded USD 23 billion (compared to a nominal GDP level of about USD 198 billion in 2021). Until end-September, the NBU covered about USD 10 billion of deficit financing with direct purchases of war bonds. Hence, continued and sufficient international financial support remains vital to limit the extent of monetary financing.

2 Slovakia: economy torn between choked-off recovery and epic inflation

The performance of the Slovak economy was rather lackluster in the first half of 2022, when annual GDP growth averaged some 2.5%. The supportive effect of fading antipandemic measures was counteracted by the Russian invasion in Ukraine and its second-round repercussions, previous and new frictions in the supply chains as well as soaring prices. GDP growth was driven by relatively robust domestic demand, while the negative contribution of net exports more than doubled compared to 2021 as a whole. However, a more granular look at the domestic demand components unveils a rather mixed picture. While private consumption remained strong and served as the most important growth driver in the six months to June, it has been losing steam owing to soaring prices and the depletion of households' pandemic savings. As a result, consumers' confidence has plummeted in parallel with the savings rate, which is approaching its historic lows. Despite expenditures related to the refugees arriving from Ukraine, public consumption contracted sharply in the first half of 2022. This was largely owed to the base effect as pandemic-related support measures were withdrawn. Government consumption thus dragged GDP growth down by almost 1 percentage point in the period under study. Fixed investment remained subdued and contributed only half a percentage point to GDP growth. Investment activity, not least on a government level, has been held back by steeply rising prices of materials and inputs, cooling foreign demand, a high level of uncertainty and lackluster absorption of EU funds. Accumulation of inventories has again been providing a notable contribution to growth this year owing to continued supply chain disruptions that have hindered the completion and sale of industrial goods, particularly cars. In addition to the mentioned supply-side frictions, Slovakia's exports have taken a hard hit as the war has caused significant harm to foreign demand.

The unemployment rate continuously fell while employment kept on rising in the first eight months of 2022. The notorious skills mismatch and lack of (skilled) labor have been somewhat mitigated as refugees from Ukraine have filled many long-vacant jobs, particularly in the trade and services sectors. Nonetheless, the still tight labor market is exerting strong upward pressure on wages. Since a trough of 0.7% in January 2021, headline inflation has been continuously heading upward and came in at 13.4% in August 2022, levels unseen since mid-2000. Towering food and energy prices aside, annual core inflation has most recently climbed to about 12% as well. Hence, the lofty price hikes have been bloated by nearly all components, most notably food, housing, services and skyrocketing energy prices.

After the general government deficit climbed up to 6.2% of GDP in 2021 in the wake of the response measures to the pandemic, a deficit of 4.9% of GDP was approved for 2022. However, despite additional expenditures related to the energy crisis, Slovakia's independent Council for Budget Responsibility currently expects the deficit to come in at 3.5% of GDP. The more positive outcome results particularly from higher tax revenues and social contributions as high inflation has boosted the tax base. Moreover, the lower than expected absorption of EU funds has reduced cofinancing expenditures. Consequently, public debt is projected to decrease by about 1.5 percentage points from just above 63% in 2021. In light of the sustained strong growth of credit to both firms and households, Národná banka Slovenska raised the countercyclical capital buffer rate from 1.0% to 1.5% as of August 2023.

Table 2

Main economic indicators: Slovakia

	2019	2020	2021	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
	Year-on-year change of the period total in %								
GDP at constant prices	2.6	–4.4	3.0	0.2	9.6	1.3	1.4	3.1	1.8
Private consumption	2.7	–1.3	1.2	–5.5	5.0	2.5	2.7	9.3	4.2
Public consumption	4.6	0.9	1.9	–1.7	8.1	–1.0	2.1	–0.4	–7.2
Gross fixed capital formation	6.7	–11.6	0.6	–9.3	5.6	–1.9	6.0	6.4	0.4
Exports of goods and services	0.8	–7.3	10.2	10.8	39.3	–3.0	1.6	–4.5	–0.3
Imports of goods and services	2.1	–8.2	11.2	6.0	39.2	3.5	3.5	–1.3	0.0
	Contribution to GDP growth in percentage points								
Domestic demand	3.8	–5.2	3.8	–5.9	11.9	6.6	3.4	7.5	0.9
Net exports of goods and services	–1.2	0.9	–0.8	4.6	0.4	–5.4	–1.7	–3.4	–0.3
Exports of goods and services	0.8	–6.7	8.7	9.8	28.8	–2.4	1.2	–4.5	–0.3
Imports of goods and services	–2.0	7.6	–9.5	–5.2	–28.5	–3.0	–2.9	1.0	0.0
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	5.2	6.4	2.1	0.9	–1.3	4.4	4.6	5.5	6.3
Unit labor costs in manufacturing (nominal, per hour)	5.6	3.0	–3.1	–9.0	–17.9	9.9	7.2	9.6	12.9
Labor productivity in manufacturing (real, per hour)	1.3	1.1	10.1	10.6	23.5	1.7	7.0	1.0	–1.9
Labor costs in manufacturing (nominal, per hour)	6.8	3.6	7.4	0.7	1.3	11.9	14.7	10.8	10.8
Producer price index (PPI) in industry	1.8	–0.5	6.8	–0.8	4.3	9.3	14.5	24.4	30.6
Consumer price index (here: HICP)	2.8	2.0	2.8	1.0	2.1	3.4	4.8	8.5	11.8
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	5.8	6.8	6.9	7.2	7.0	6.8	6.6	6.4	6.2
Employment rate (%, 15–64 years)	68.4	67.5	69.5	67.9	68.8	70.3	70.8	70.6	71.4
Key interest rate per annum (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	6.8	6.8	6.8	4.8	4.2	5.2	7.3	8.9	11.7
of which: loans to households	8.0	8.0	8.0	6.0	7.2	8.0	8.8	10.5	11.3
loans to nonbank corporations	4.4	4.4	4.4	2.5	–1.8	–0.2	4.3	5.5	12.6
	%								
Share of foreign currency loans in total loans to the nonbank private sector	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Return on assets (banking sector)	0.8	0.5	0.7	0.5	0.8	0.8	0.7	0.5	0.7
Tier 1 capital ratio (banking sector)	16.6	18.1	18.3	18.8	19.2	18.8	18.3	18.1	17.8
NPL ratio (banking sector)	2.8	2.3	1.9	2.2	2.1	1.9	1.9	1.9	1.9
	% of GDP								
General government revenues	39.4	39.9	40.7	..	..	..	..	..	..
General government expenditures	40.7	45.3	46.8	..	..	..	..	..	..
General government balance	–1.3	–5.5	–6.2	..	..	..	..	..	..
Primary balance	–0.1	–4.2	–5.0	..	..	..	..	..	..
Gross public debt	48.1	59.7	63.1	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	53.9	55.2	53.4	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	43.7	47.2	48.5	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	–1.2	1.1	–0.1	4.0	–0.3	–2.5	–0.9	–6.9	–4.1
Services balance	1.3	1.2	0.8	0.7	0.7	1.5	0.4	0.5	0.1
Primary income	–2.3	–1.2	–1.7	–0.4	–1.8	–1.6	–2.9	–0.9	–1.9
Secondary income	–1.1	–0.8	–1.0	–1.9	–1.0	–0.8	–0.4	–1.3	–0.5
Current account balance	–3.4	0.4	–2.0	2.4	–2.4	–3.4	–3.8	–8.7	–6.3
Capital account balance	0.7	0.8	1.4	0.9	3.7	0.2	0.8	0.1	1.3
Foreign direct investment (net)[3]	–2.3	2.1	0.3	3.0	–1.0	–1.3	0.7	–1.8	–2.2
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	112.7	121.4	137.0	119.0	117.6	118.6	137.0	143.5	130.6
Gross official reserves (excluding gold)	5.3	6.6	7.1	6.8	6.5	7.2	7.1	8.9	9.7
	Months of imports of goods and services								
Gross official reserves (excluding gold)	0.7	0.9	0.9	1.0	0.9	1.0	0.9	1.1	1.2
	EUR million, period total								
GDP at current prices	94,048	92,079	97,123	21,819	24,078	25,637	25,589	23,843	26,486

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] *Foreign currency component at constant exchange rates.*
[2] *Nonprofit institutions serving households.*
[3] *+ = net accumulation of assets larger than net accumulation of liabilities (net outflow of capital).*
– = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

3 Slovenia: new government is focusing on short-term issues, long-term reforms not yet addressed

Despite some moderation from the first to the second quarter of 2022, Slovenia's GDP expanded by nearly 9% during the first half of the year. Growth was driven by household consumption, which benefited from an apparently good start of the tourist season, accelerating employment growth, tax relief and rising incomes, although the latter was diminished by the sharp rise in inflation, which also contributed to the worsening of consumer confidence. Investment growth was healthy but slowed significantly from the double-digit rates recorded in 2021. High capacity utilization in industry, sharply negative real interest rates, strong and accelerating growth in loans to companies and households (in particular for house purchase) were supportive factors. On the back of strong domestic demand, imports continued to grow more strongly than exports and the negative contribution of net real exports to the overall GDP growth rate remained at 3 percentage points in the first half of 2022.

Following parliamentary elections in April 2022, a new center-left coalition government took office at the beginning of June. The main priorities of the new government in the short term include measures to address the rise of energy and food prices and to implement an exit strategy from the coronavirus crisis. The government has already implemented various measures to mitigate the impact of global energy price increases for both households and businesses (e.g. various energy price caps, cuts in excise duties and VAT on energy, one-off payment). With respect to rising food prices, the government has launched public price monitoring but has not ruled out more rigorous measures at a later point. As for the medium term, reforms in the areas of healthcare, pensions and the labor market, hikes in wages and pensions, better access to housing, green transition and digital transformation rank high on the government's agenda. The government announced, however, in mid-July 2022, that the start of the implementation of the long-term care reform will be postponed from early 2023 to April 2024 in order to make amendments.

To take into account the changed macroeconomic developments during the first half of 2022, accommodate the recently introduced inflation-alleviating measures and reflect the medium-term policy priorities of the new administration, the government has adopted a supplementary budget for 2022 (increasing revenues more than expenditures). It is also drafting changes to the 2023 state budget and putting together the budget for 2024. According to Slovenia's Fiscal Council, the 2022 budget amendment increases the risk of unnecessary spending and additional revenue should have been used to reduce public debt. The Fiscal Council was also critical about the medium-term budgetary plans of the government (as set out in the coalition agreement), noting the general vagueness in terms of size and timing of measures.

During the reporting period, inflation rose from 7% in February to 11.7% in July before falling back to 11.5% in August. Energy and food prices (processed and unprocessed) rose the most dynamically, but price pressures fed through into the inflation rate of services and industrial goods. Globally rising prices for energy and other raw materials left their footprint on the current account as well. The surplus on the goods and services balance melted to 2.9% of GDP by the second quarter of 2022 (on a four-quarter moving sum basis) as the goods balance turned into a deficit on the back of soaring imports fueled by buoyant domestic demand and worsening terms of trade. Combined with a deterioration in the capital account, net lending to the rest of the world decreased to 0.1% of GDP (from 3.4% at end-2021).

Table 3

Main economic indicators: Slovenia

	2019	2020	2021	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
	Year-on-year change of the period total in %								
GDP at constant prices	3.5	–4.3	8.2	1.6	16.2	5.1	10.5	9.6	8.2
Private consumption	5.3	–6.9	9.5	–2.9	14.2	5.8	21.2	19.3	12.2
Public consumption	1.8	4.1	5.8	3.4	6.0	5.4	8.3	4.5	0.7
Gross fixed capital formation	5.1	–7.9	13.7	8.7	21.5	11.8	13.2	8.6	6.5
Exports of goods and services	4.5	–8.6	14.5	2.4	32.4	12.6	13.8	8.0	7.9
Imports of goods and services	4.7	–9.6	17.6	0.8	35.4	19.5	18.1	16.0	9.7
	Contribution to GDP growth in percentage points								
Domestic demand	3.2	–4.3	9.0	0.2	15.4	8.3	12.3	14.9	9.0
Net exports of goods and services	0.2	0.0	–0.8	1.4	0.9	–3.2	–1.8	–5.2	–0.8
Exports of goods and services	3.8	–7.2	11.3	1.8	23.5	9.5	11.1	6.8	6.6
Imports of goods and services	–3.6	7.2	–12.0	–0.4	–22.7	–12.7	–12.9	–12.1	–7.4
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	4.0	7.6	0.9	6.6	–2.6	5.0	–4.3	–5.0	–2.5
Unit labor costs in manufacturing (nominal, per hour)	0.1	8.1	–2.7	3.3	–15.8	4.0	–0.8	–2.0	2.7
Labor productivity in manufacturing (real, per hour)	3.9	–4.4	9.6	3.1	24.0	2.9	10.2	8.5	6.7
Labor costs in manufacturing (nominal, per hour)	4.0	3.1	6.9	6.5	4.4	7.0	9.3	6.4	9.5
Producer price index (PPI) in industry	0.6	–0.3	5.5	1.1	3.6	7.5	9.9	15.6	21.7
Consumer price index (here: HICP)	1.7	–0.3	2.0	–0.6	2.1	2.3	4.5	6.3	9.0
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	4.5	5.0	4.8	5.7	4.4	4.5	4.5	4.3	4.2
Employment rate (%, 15–64 years)	71.9	70.9	71.5	68.1	71.9	73.4	72.4	72.5	73.1
Key interest rate per annum (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	4.3	4.3	4.3	–1.9	0.9	2.2	5.6	8.0	10.4
of which: loans to households	5.8	5.8	5.8	0.8	2.9	3.6	5.0	6.7	7.9
loans to nonbank corporations	2.8	2.8	2.8	–4.5	–1.1	0.7	6.2	9.4	13.2
	%								
Share of foreign currency loans in total loans to the nonbank private sector	1.7	1.4	1.1	1.3	1.2	1.2	1.1	1.0	1.0
Return on assets (banking sector)	1.3	1.0	1.1	0.8	1.0	1.0	1.1	0.7	0.8
Tier 1 capital ratio (banking sector)	17.8	16.7	16.9	16.5	17.0	17.0	16.9	15.7	15.7
NPL ratio (banking sector)	2.2	1.9	0.8	1.8	1.0	0.9	0.8	0.9	0.8
	% of GDP								
General government revenues	43.8	43.5	43.9	..	..	..	..	..	..
General government expenditures	43.3	51.3	49.1	..	..	..	..	..	..
General government balance	0.4	–7.8	–5.2	..	..	..	..	..	..
Primary balance	2.2	–6.2	–3.9	..	..	..	..	..	..
Gross public debt	65.6	79.8	74.7	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	47.9	47.8	46.1	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	26.8	27.8	26.4	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	2.7	5.0	1.0	4.7	1.6	–0.3	–1.3	–3.4	–4.4
Services balance	6.0	4.2	4.6	4.3	3.8	5.2	4.9	4.7	6.4
Primary income	–1.7	–0.9	–1.3	–0.9	–1.0	–1.5	–1.7	–1.1	–1.5
Secondary income	–1.0	–1.0	–1.0	–1.6	–0.8	–0.7	–0.9	–1.0	–1.0
Current account balance	6.0	7.4	3.3	6.5	3.6	2.7	1.0	–0.9	–0.4
Capital account balance	–0.4	–0.5	0.1	1.2	–0.1	0.7	–1.4	–0.5	–0.7
Foreign direct investment (net)[3]	–1.6	0.6	–1.0	–1.6	–4.0	–2.0	3.3	–2.8	–1.9
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	91.2	101.6	96.7	106.4	101.5	102.8	96.7	96.4	93.0
Gross official reserves (excluding gold)	1.6	1.9	3.5	2.0	2.0	3.4	3.5	3.5	3.5
	Months of imports of goods and services								
Gross official reserves (excluding gold)	0.3	0.3	0.5	0.4	0.3	0.5	0.5	0.5	0.5
	EUR million, period total								
GDP at current prices	48,533	47,021	52,208	11,606	13,110	13,483	14,009	13,290	15,044

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] *Foreign currency component at constant exchange rates.*
[2] *Nonprofit institutions serving households.*
[3] *+ = net accumulation of assets larger than net accumulation of liabilities (net outflow of capital).*
– = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

4 Bulgaria: economy surprised on the upside in the first half of 2022 despite high inflation and political uncertainty

Bulgaria's real GDP grew by 4.5% year on year in the first half of 2022, turning out better than expected, but high-frequency indicators suggest that momentum has declined since then. Private and public consumption and particularly inventories contributed positively to growth, while net exports and investments had a dampening impact.

Private consumption – which added 2.5 percentage points to growth in the first half of 2022 – was fueled by strong demand for durable goods, decreasing unemployment (down to 4.6% by August) and downward-trending deposit growth. Yet, high inflation and falling consumer confidence turned retail sales growth negative from April 2022. Government consumption contributed 1.5 percentage points to growth in the first half of 2022.

Industrial production growth peaked in the first half of 2022, at 17.8%, and manufacturing output expanded by 10.2%. Exports, however, expanded at a lower pace, driving up inventories, which contributed 5.7 percentage points to real GDP growth in the first half of the year. Moreover, mounting import prices kept net exports and the current account in negative territory. Uncertainty regarding energy supplies in the coming months, deteriorating prospects for euro area growth and tighter financing conditions have already translated into a sharp decline of investments. Gross fixed capital formation also suffered from the ongoing political crisis, which has been delaying the second disbursement of the EU's Recovery and Resilience Facility.

HICP inflation increased from 10.5% in March to 15.0% in August 2022, with energy and food prices as main drivers of inflation. Core inflation excluding the volatile components energy, food, alcohol, and tobacco rose by 8.8%.

The stronger than expected rise in inflation is putting downward pressure on real wages, particularly for the group of income-poor households who suffer from even higher inflation due to the high weight of energy and food items in their consumption basket. Moreover, minimum wages are lagging behind inflation because they are traditionally adjusted once a year on January 1. The government's main measures to alleviate rising energy costs for households are regulated prices and an increase of pensions by 10%. Furthermore, firms are currently fully compensated for energy bills above EUR 125/MWh. The interim finance minister warned in September 2022 that Bulgaria's fiscal deficit might escalate to 6.8% of GDP in 2023 unless corrective measures are taken by the next government.

Bulgaria went to the polls on October 2, its fourth parliamentary election in 18 months. The historically low turnout of 30% reflects voters' frustration with political instability. Political observers expect the post-election coalition-building process to drag on because of dissent concerning the fight against corruption and relations with Russia. The next government needs to secure gas supplies at affordable prices and speed up the greening of the economy – as laid out in the Recovery and Resilience Plan. Russia cut Bulgaria off from gas deliveries in April 2022 over its refusal to pay for gas in Russian ruble. According to official sources, Azerbaijan will provide 19% of Bulgaria's gas demand until the end of 2022. A new natural gas pipeline (IGB) started operations on October 3 and has brought some relief. The IGB allows the transfer of natural gas from Greece to Bulgaria and further to Romania, Moldova, Ukraine and even Central Europe – which highlights its geostrategic significance beyond Bulgaria. It will be connected to the new Greek LNG terminal at Alexandropolis, which will start operations in 2023.

Table 4

Main economic indicators: Bulgaria

	2019	2020	2021	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
	Year-on-year change of the period total in %								
GDP at constant prices	4.0	–4.4	4.2	0.2	6.5	3.9	5.6	5.0	4.0
Private consumption	6.0	–0.4	8.0	5.4	9.3	8.3	8.7	6.4	2.1
Public consumption	2.0	8.3	4.0	6.2	1.4	6.3	2.7	1.1	13.1
Gross fixed capital formation	4.5	0.6	–11.0	–6.1	–4.8	–14.5	–15.5	–4.4	–8.1
Exports of goods and services	4.0	–12.1	9.9	–2.0	22.0	7.9	13.8	7.4	10.7
Imports of goods and services	5.2	–5.4	12.2	4.6	21.8	12.5	10.9	14.1	16.6
	Contribution to GDP growth in percentage points								
Domestic demand	4.7	0.1	5.2	4.0	6.4	6.2	4.4	9.8	7.5
Net exports of goods and services	–0.7	–4.4	–1.1	–3.8	0.1	–2.3	1.3	–4.8	–3.5
Exports of goods and services	2.6	–7.7	5.5	–2.0	11.7	4.4	7.2	5.7	7.0
Imports of goods and services	–3.3	3.3	–6.5	–1.8	–11.5	–6.7	–5.9	–10.4	–10.6
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	3.1	9.4	5.4	5.9	3.0	7.9	5.0	11.3	19.6
Unit labor costs in manufacturing (nominal, per hour)	6.6	–0.1	0.9	–5.2	–4.6	7.8	6.6	2.4	–2.5
Labor productivity in manufacturing (real, per hour)	4.8	5.2	6.1	3.7	6.7	7.3	6.4	15.2	18.3
Labor costs in manufacturing (nominal, per hour)	11.9	4.9	7.2	–1.7	1.8	15.6	13.4	18.0	15.4
Producer price index (PPI) in industry	3.0	–2.0	15.5	3.6	12.1	17.4	28.9	33.9	40.2
Consumer price index (here: HICP)	2.5	1.2	2.8	0.2	2.2	2.9	6.0	8.9	13.4
EUR per 1 BGN, + = BGN appreciation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	4.3	5.2	5.3	6.4	5.7	4.6	4.6	5.0	4.7
Employment rate (%, 15–64 years)	70.1	68.5	68.2	66.9	67.8	69.5	68.5	68.4	69.8
Key interest rate per annum (%)[1]	..	..	..	..	..	..	..	..	..
BGN per 1 EUR	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[2]	9.4	9.4	9.4	4.6	6.3	7.5	8.6	10.6	12.5
of which: loans to households	9.5	9.5	9.5	7.1	10.4	11.8	13.4	14.1	14.7
loans to nonbank corporations	9.3	9.3	9.3	3.0	3.7	4.8	5.5	8.4	10.9
	%								
Share of foreign currency loans in total loans to the nonbank private sector	33.2	31.9	29.3	31.6	30.9	30.2	29.3	29.0	28.4
Return on assets (banking sector)	1.5	0.7	1.1	1.1	1.0	1.1	1.1	1.6	1.5
Tier 1 capital ratio (banking sector)	19.5	22.1	22.0	21.9	22.3	21.8	22.0	21.4	20.7
NPL ratio (banking sector)	4.2	4.3	3.7	4.1	4.0	3.8	3.7	3.3	3.1
	% of GDP								
General government revenues	38.4	38.1	39.0	..	..	..	..	..	..
General government expenditures	36.3	42.0	43.1	..	..	..	..	..	..
General government balance	2.1	–4.0	–4.1	..	..	..	..	..	..
Primary balance	2.7	–3.4	–3.6	..	..	..	..	..	..
Gross public debt	20.0	24.7	25.1	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	78.5	77.5	72.5	..	..	..	..	..	..
Debt of households and NPISHs[3] (nonconsolidated)	23.0	24.4	24.9	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	–4.7	–3.2	–4.9	–3.7	–4.0	–3.6	–7.5	–5.4	–3.2
Services balance	7.9	5.0	6.6	5.4	6.7	9.1	5.1	5.4	6.3
Primary income	–4.2	–3.5	–3.3	–3.6	–3.4	–2.1	–4.0	–5.0	0.6
Secondary income	2.9	1.5	1.1	2.2	1.9	1.1	–0.4	1.7	2.6
Current account balance	1.8	–0.1	–0.4	0.3	1.3	4.5	–6.8	–3.3	6.3
Capital account balance	1.4	1.5	0.7	1.6	1.4	0.7	–0.4	–2.4	0.0
Foreign direct investment (net)[4]	–2.0	–4.5	–1.7	–1.5	–1.9	–1.9	–1.4	–7.3	3.3
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	61.3	64.9	61.8	63.1	62.5	63.3	61.8	58.7	55.7
Gross official reserves (excluding gold)	37.5	47.0	47.9	43.3	43.6	46.5	47.9	43.4	41.7
	Months of imports of goods and services								
Gross official reserves (excluding gold)	7.4	10.4	9.2	9.4	8.9	9.3	9.2	8.0	7.5
	EUR million, period total								
GDP at current prices	61,558	61,331	67,872	13,813	15,941	18,475	19,643	16,775	19,921

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] Not available in a currency board regime.
[2] Foreign currency component at constant exchange rates.
[3] Nonprofit institutions serving households.
[4] + = net accumulation of assets larger than net accumulation of liabilities (net outflow of capital).
– = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

5 Croatia: green light for euro adoption and continued strong growth

In terms of international integration, 2022 has been a very important year for Croatia. In July, the country got the green light to join the euro area on January 1, 2023, after it fulfilled all necessary convergence criteria. Euro adoption is widely regarded as a positive step for Croatia, as it will eliminate the currency (mismatch) risks stemming from the high levels of euroization of loans, deposits and external debt. International rating agencies have reacted with several upgrades of Croatia's sovereign ratings. Moreover, at the end of 2021 the Council of the EU concluded that Croatia fulfilled all the necessary conditions to join the Schengen area in 2023. The European Parliament is expected to give its opinion on the matter in autumn. Finally, in January, the OECD Council decided to open accession discussions with Croatia.

These successes come against the backdrop of continued strong growth, despite the challenges posed by the pandemic, war and inflation. GDP expanded by 7.4% year on year in the first half of 2022, maintaining the strong momentum seen in 2021. On the output side, all sectors except arts and recreation expanded, with particularly high growth of the largest sector, wholesale and retail trade. The sector of professional, scientific and technical activities also grew strongly. Looking at the expenditure side, growth in the first half of 2022 was broad-based. The largest contributions came from private consumption growth, followed by net exports. Both exports and imports expanded strongly, partially fueled by a strong tourist season that came close to pre-pandemic records. Gross fixed capital formation also expanded strongly and contributed positively to overall growth.

Amidst accelerating CPI inflation – 12.6% year on year in August – domestic demand was supported by a policy package (EUR 634 million, about 1.1% of 2021 GDP) that entered into force on April 1. It included energy price caps, a VAT reduction on selected products and subsidies for vulnerable sectors and groups, among other measures. In September, the government revealed a second and considerably larger package (EUR 2.8 billion, about 5% of 2021 GDP), which includes one-off payments to several subgroups of the population, electricity price caps and a cap on the price of gas for households and other measures. To finance the package, the government announced that it was sending a proposal to the parliament for a special tax on excessive profits of certain companies. Despite supporting measures, declining unemployment and a strong tourist season, consumer confidence indicators have been dropping throughout 2022 and have almost reached the lows observed at the start of the pandemic.

Croatia's public sector indebtedness remains high, which increases Croatia's vulnerability to rising interest rates. Government borrowing costs already increased during the first half of 2022, particularly at the long end. However, government debt continued to decrease and stood at 77.3% in March 2022 and the state budget deficit for the first six months of 2022 improved relative to 2021. The Croatian government projects a general government deficit of 2.8% of GDP for 2022 – after a slight upward revision of the deficit in May.

Regarding the banking system, a noteworthy development was the fast growth of credit to nonfinancial corporations during the first half of 2022. It was most likely driven by higher financing needs due to higher input prices and an anticipation of rising borrowing costs. Banks' return on assets increased slightly in the first half of 2022 to 1.2%. This was mostly due to lower provisions, which overcompensated a fall in (net) interest income. Banks' tier 1 capital ratio declined a little from a high level and stood at 24.6% in June 2022. The NPL ratio continued to decrease and was reported at 3.8% in June.

Table 5

Main economic indicators: Croatia

	2019	2020	2021	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
	Year-on-year change of the period total in %								
GDP at constant prices	3.5	–8.1	10.2	–0.6	16.4	15.1	9.7	7.0	7.7
Private consumption	4.1	–5.3	10.0	–0.2	17.9	15.8	7.6	6.2	7.5
Public consumption	3.3	4.1	3.1	–5.8	8.5	–4.5	14.4	5.9	–2.2
Gross fixed capital formation	9.8	–6.1	7.6	5.0	18.1	7.6	0.8	7.9	5.0
Exports of goods and services	6.8	–22.7	33.3	–1.0	43.0	48.8	31.7	29.4	41.9
Imports of goods and services	6.5	–12.3	14.7	–0.7	32.2	13.9	16.4	25.0	28.6
	Contribution to GDP growth in percentage points								
Domestic demand	3.4	–2.8	3.4	–0.7	15.9	–5.3	5.3	10.3	4.8
Net exports of goods and services	0.1	–5.3	6.8	0.1	0.6	20.4	4.4	–3.3	2.9
Exports of goods and services	3.4	–11.5	14.0	–0.2	15.3	26.7	12.9	10.2	18.3
Imports of goods and services	–3.3	6.3	–7.2	0.4	–14.7	–6.3	–8.5	–13.6	–15.4
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	..	..	..	..	..	..	..	..	..
Unit labor costs in manufacturing (nominal, per hour)	11.4	2.0	–0.6	–1.5	–8.1	2.9	5.2	4.7	7.4
Labor productivity in manufacturing (real, per hour)	–7.2	–2.4	4.0	4.9	9.6	2.2	–0.4	3.7	1.2
Labor costs in manufacturing (nominal, per hour)	3.6	–0.6	3.5	3.3	0.7	5.1	4.7	8.5	8.6
Producer price index (PPI) in industry	0.8	–3.2	11.7	0.9	8.0	13.1	24.6	25.1	32.5
Consumer price index (here: HICP)	0.8	0.0	2.7	0.7	2.2	3.1	4.6	6.4	10.8
EUR per 1 HRK, + = HRK appreciation	0.0	–1.6	0.1	–1.1	0.7	0.4	0.6	0.4	–0.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.7	7.6	7.6	10.0	7.9	6.3	6.3	7.2	7.4
Employment rate (%, 15–64 years)	62.1	62.0	63.4	61.4	63.6	64.6	64.1	64.2	64.9
Key interest rate per annum (%)	..	..	..	..	..	..	..	..	..
HRK per 1 EUR	7.4	7.5	7.5	7.6	7.5	7.5	7.5	7.5	7.5
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	3.4	3.4	3.4	1.3	2.4	2.8	2.4	3.9	7.2
of which: loans to households	6.7	6.7	6.7	1.9	3.7	4.5	4.1	4.0	5.1
loans to nonbank corporations	–1.3	–1.3	–1.3	0.4	0.5	0.2	–0.1	3.7	10.4
	%								
Share of foreign currency loans in total loans to the nonbank private sector	51.5	52.0	52.2	52.1	51.8	51.5	52.2	52.1	52.5
Return on assets (banking sector)	1.4	0.6	1.2	0.9	1.1	1.1	1.2	1.2	1.2
Tier 1 capital ratio (banking sector)	24.0	25.0	25.4	24.6	25.0	25.2	25.4	25.2	24.6
NPL ratio (banking sector)	5.5	5.4	4.3	5.3	5.1	4.7	4.3	4.2	3.8
	% of GDP								
General government revenues	46.3	47.2	46.4	..	..	..	..	..	..
General government expenditures	46.1	54.5	49.2	..	..	..	..	..	..
General government balance	0.2	–7.3	–2.9	..	..	..	..	..	..
Primary balance	2.4	–5.3	–1.3	..	..	..	..	..	..
Gross public debt	71.1	87.3	79.8	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	84.5	93.5	84.8	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	34.0	37.9	34.8	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	–18.9	–17.6	–18.6	–20.7	–19.0	–17.5	–17.6	–28.8	–26.5
Services balance	18.5	10.6	17.2	3.5	9.6	41.5	8.5	4.1	17.3
Primary income	0.1	2.5	0.9	1.8	0.1	–0.8	2.8	1.5	0.0
Secondary income	3.1	4.1	3.7	5.1	3.3	3.4	3.2	3.4	3.1
Current account balance	2.8	–0.5	3.2	–10.4	–6.0	26.6	–3.1	–19.8	–6.0
Capital account balance	1.6	2.1	2.4	2.1	2.5	2.1	2.9	1.8	2.2
Foreign direct investment (net)[3]	–6.2	–1.4	–4.9	–4.5	–2.8	–7.1	–4.5	–6.5	–4.9
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	72.2	79.9	77.9	87.0	84.5	80.6	77.9	77.3	76.0
Gross official reserves (excluding gold)	33.3	37.8	43.7	42.2	41.2	44.3	43.7	40.8	41.0
	Months of imports of goods and services								
Gross official reserves (excluding gold)	7.8	9.3	9.8	10.3	9.7	10.3	9.8	8.5	8.1
	EUR million, period total								
GDP at current prices	55,577	50,192	57,216	12,331	14,037	16,415	14,434	14,072	16,586

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] Foreign currency component at constant exchange rates.
[2] Nonprofit institutions serving households.
[3] + = net accumulation of assets larger than net accumulation of liabilities (net outflow of capital).
– = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

6 Czechia: domestic demand still defying post-pandemic and war-induced shocks, including inflation

Czechia's GDP expanded by 4.2% in the first half of 2022. Growth was driven by domestic demand, while net exports continued to provide a negative contribution, though this contribution halved compared to 2021. Again, additions to inventories due to persisting disruptions to supply chains were the most powerful driver of economic expansion by far. Unfinished products have thus been produced on stock and are waiting for completion upon arrival of missing components. Household consumption was another important contributor to growth. Apart from a low base in the first half of 2021, it profited from remaining pandemic savings and resilient nominal disposable income on the back of labor market tightness. However, a look at the quarterly profile suggests that accelerated inflation and the resulting tightened monetary policy have started to bite. Private consumption nearly came to a halt in the second quarter of 2022, which is echoed in some of the lowest levels of consumer sentiment in two decades. In contrast, business sentiment remains relatively favorable despite skyrocketing input prices, strongly increased rates on corporate loans and unprecedently high uncertainty. Hence, fixed investment recorded rather solid growth in the first half of 2022 on the back of foreign demand and ongoing automation. In addition, public investment benefited from the absorption of EU funds. Government consumption continued to show rather firm growth too, supported by defense spending, expenditures to cope with Ukrainian refugees and growing public sector wages and pensions.

Owing to lower exports of goods and a wider primary income deficit, the current account deficit deepened significantly, while net foreign direct investment turned markedly negative in the first half of 2022. Gross official reserves declined by more than 6 percentage points of GDP between end-2021 and mid-2022. This was, inter alia, the result of CNB's interventions in favor of the koruna, which got under pressure in the wake of the weaker current account balance, the outbreak of the war and new appointments to CNB's board.

The Czech Ministry of Finance originally projected the general government deficit at CZK 280 billion in 2022, about 4.5% of GDP. Yet, owing to rising costs from surging energy prices and the war, the Czech parliament approved an increase of the annual deficit to CZK 330 billion in October. Public debt is expected to surpass 42% of GDP in 2022, up from 30.1% in 2019, but broadly in line with 2021.

The labor market situation improved somewhat further in the first half of 2022. Despite the influx and quick integration of Ukrainian refugees into the labor market and a recent uptick in unemployment, the jobless rate remains very low both by historical and international standards. Significant shortages of (skilled) labor remain a challenge.

Apart from a marginal decline in August, inflation has been steadily rising since mid-2021 to historical records. Consumer prices increased by more than 17% in September, well above CNB's target (2% ±1 percentage point). Inflation has been broad-based as high core inflation has ballooned further driven by soaring food, energy, fuel but also housing prices. Clearly, the war in Ukraine has exacerbated inflation pressure through various channels. In response to rising inflation, the CNB board continued its tightening cycle: In May and June, it raised the key interest rate further in two steps, by 200 basis points in total, to 7%. In the two subsequent meetings and in a new composition, the board left the rates unchanged.

Table 6

Main economic indicators: Czechia

	2019	2020	2021	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
	Year-on-year change of the period total in %								
GDP at constant prices	3.0	–5.5	3.5	–2.3	9.5	3.5	3.6	4.9	3.6
Private consumption	2.7	–7.2	4.1	–6.2	9.3	4.8	8.5	8.4	0.1
Public consumption	2.5	4.2	1.5	–0.3	0.4	5.4	0.8	1.4	1.5
Gross fixed capital formation	5.9	–6.0	0.7	–3.7	4.2	1.5	0.5	8.2	8.6
Exports of goods and services	1.5	–8.0	6.9	4.0	34.8	–1.7	–3.4	1.1	1.7
Imports of goods and services	1.5	–8.2	13.3	5.6	36.0	9.8	6.1	5.1	2.7
	Contribution to GDP growth in percentage points								
Domestic demand	3.0	–5.1	7.1	–1.6	8.8	10.7	10.3	7.6	4.2
Net exports of goods and services	0.0	–0.4	–3.6	–0.7	0.7	–7.2	–6.7	–2.8	–0.6
Exports of goods and services	1.1	–5.9	4.8	2.9	21.5	–1.1	–2.7	1.0	1.3
Imports of goods and services	–1.1	5.6	–8.4	–3.6	–20.8	–6.1	–4.0	–3.7	–2.0
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	4.3	7.2	1.8	0.4	1.8	3.8	1.2	4.3	2.9
Unit labor costs in manufacturing (nominal, per hour)	9.1	2.9	–2.6	–4.9	–15.0	5.1	5.7	8.1	8.7
Labor productivity in manufacturing (real, per hour)	–0.8	4.5	4.7	5.7	16.1	–0.1	–0.8	–1.2	–1.2
Labor costs in manufacturing (nominal, per hour)	8.2	7.1	2.4	0.5	–1.3	4.9	4.8	6.8	7.4
Producer price index (PPI) in industry	1.7	0.6	6.2	2.3	3.3	8.1	11.0	16.4	21.3
Consumer price index (here: HICP)	2.6	3.3	3.3	2.2	2.8	3.3	5.0	10.2	15.0
EUR per 1 CZK, + = CZK appreciation	–0.1	–3.0	3.2	–1.7	5.6	3.8	5.1	5.8	4.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	2.1	2.6	2.9	3.4	3.1	2.8	2.3	2.5	2.4
Employment rate (%, 15–64 years)	75.1	74.4	74.4	73.6	73.7	75.0	75.3	75.0	75.2
Key interest rate per annum (%)	1.9	0.8	0.9	0.3	0.3	0.7	2.4	4.2	5.6
CZK per 1 EUR	25.7	26.5	25.6	26.1	25.6	25.5	25.4	24.6	24.6
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	5.0	5.0	5.0	2.6	4.4	6.3	9.7	10.4	9.2
of which: loans to households	6.1	6.1	6.1	6.9	8.1	9.1	9.9	10.3	8.3
loans to nonbank corporations	3.8	3.8	3.8	–2.7	–0.3	2.8	9.4	10.5	10.5
	%								
Share of foreign currency loans in total loans to the nonbank private sector	14.5	14.6	14.6	14.8	13.5	14.1	14.6	15.6	17.3
Return on assets (banking sector)	1.2	0.6	0.8	0.5	0.7	0.8	0.8	1.0	1.2
Tier 1 capital ratio (banking sector)	20.8	23.6	22.8	23.4	23.9	23.2	22.8	21.7	20.9
NPL ratio (banking sector)	2.4	2.6	2.3	2.6	2.6	2.5	2.3	2.2	2.0
	% of GDP								
General government revenues	41.4	41.6	40.5	..	..	..	..	..	..
General government expenditures	41.1	47.3	46.4	..	..	..	..	..	..
General government balance	0.3	–5.8	–5.9	..	..	..	..	..	..
Primary balance	1.0	–4.9	–5.2	..	..	..	..	..	..
Gross public debt	30.1	37.7	41.9	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	55.2	55.2	53.4	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	31.7	34.0	35.7	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	4.1	4.9	1.2	6.6	2.7	–2.0	–1.7	0.5	–2.4
Services balance	1.8	1.8	1.8	1.7	2.1	1.9	1.6	1.6	2.1
Primary income	–5.0	–4.2	–3.3	–1.9	–3.6	–4.7	–2.9	–1.5	–3.6
Secondary income	–0.6	–0.5	–0.5	–1.6	0.2	–0.5	–0.2	–1.4	–0.4
Current account balance	0.3	2.0	–0.9	4.8	1.3	–5.3	–3.3	–0.9	–4.3
Capital account balance	0.4	1.2	1.6	–0.1	1.6	2.4	2.1	–0.3	0.7
Foreign direct investment (net)[3]	–2.4	–2.6	–0.1	2.4	–2.1	–0.7	0.3	–1.0	–2.3
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	76.5	76.3	75.5	76.6	73.6	73.8	75.5	76.7	71.9
Gross official reserves (excluding gold)	59.0	62.5	64.1	64.6	62.1	62.8	64.1	62.9	57.8
	Months of imports of goods and services								
Gross official reserves (excluding gold)	10.4	11.9	11.0	12.1	11.1	11.0	11.0	10.7	9.6
	EUR million, period total								
GDP at current prices	225,624	215,824	238,349	53,083	59,957	61,830	63,479	62,420	68,946

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] *Foreign currency component at constant exchange rates.*

[2] *Nonprofit institutions serving households.*

[3] *+ = net accumulation of assets larger than net accumulation of liabilities (net outflow of capital).*
– = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

7 Hungary: stagflation seasoned with a twin-deficit

Hungary's GDP grew by 7.3% in the first half of 2022, but dynamics decelerated from the first to the second quarter. Household consumption was the main driver of growth, benefiting from various fiscal measures (e.g. 13th month pension, tax rebate for families, tax exemption for those under the age of 25, bonuses and wage hikes in the public sector), a generous minimum wage hike and continued employment growth. However, inflation increasingly reduced the real value of incomes, which likely contributed to the sharp worsening of consumer confidence. Investment growth was supported by private sector activity and accelerating investments in machinery and equipment. Driven by domestic demand, import growth outpaced export growth during the first half of 2022, which pushed the contribution of net real exports into negative territory.

Following heavy overspending during the first four months of the year (up until parliamentary elections in April), the government has since then undertaken various policy measures to ensure that the budget deficit targets for 2022 and 2023 (4.9% and 3.5% of GDP, respectively) are met. Initial revenue measures consisted of a temporary windfall profit tax plus hikes of some small taxes on consumption. Together with the delay of public investments and across-the-board cuts in spending by budgetary units, the announced package was worth around 3.7% of expected 2022 GDP. Facing sustained fiscal risks, the government later on introduced substantial limitations on the use of the preferential small business tax and a significant reduction in energy price subsidies for households.

Despite progress in negotiations about the unlocking of EU funds, the European Commission, in mid-September, recommended to the Council of the EU to withhold EUR 7.5 billion in cohesion funds (and all funds under the Recovery and Resilience Facility) until Hungary implements concrete measures to fight corruption by mid-December at the latest.

Inflation rose to 18.6% in August, mainly due to food and energy price increases, but price pressures have also fed through to industrial goods and services. Price caps on staple foods and fuel are still preventing the worst, and households continue to pay substantially less than the market price for electricity and gas even after the tightening of the subsidy scheme from early August. Inflation concerns, coupled with fears of an economic slowdown, a continuously widening deficit in the combined current and capital account amid persistent uncertainty around the future of EU funds, caused recurring currency weakness.

To combat these developments, Magyar Nemzeti Bank (MNB) further hiked the base rate from 4.4% in March 2022 to 13% in September. In addition, it has introduced euro liquidity-providing overnight swaps on a daily basis and has decided to reduce banking sector liquidity further (with effect from October) by raising banks' minimum reserve rate, regularly holding discount bond auctions and introducing a long-term deposit facility for banks. Despite these measures, the forint reached new all-time lows during the first half of October. Thus, the MNB implemented a 5 percentage point hike in its operational rate in mid-October (to 18%), started to provide foreign currency swaps and announced that it would cover foreign currency liquidity needs in connection with energy imports from its reserves.

Higher interest rates have led to a noticeable slowdown in lending to households (in particular for consumption loans). Lending to nonfinancial corporations accelerated during the reporting period despite higher interest rates, worsening economic prospects and the expiry of the MNB's preferential F4G and corporate bond purchase programs.

Table 7

Main economic indicators: Hungary

	2019	2020	2021	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
	Year-on-year change of the period total in %								
GDP at constant prices	4.9	–4.5	7.1	–2.2	17.8	6.2	7.4	8.2	6.5
Private consumption	5.0	–1.2	4.9	–5.0	9.9	6.9	8.0	12.0	9.6
Public consumption	5.8	–0.5	2.0	8.2	0.5	3.2	–2.9	4.8	3.1
Gross fixed capital formation	12.8	–7.1	5.2	–3.3	9.6	11.8	0.2	10.6	6.2
Exports of goods and services	5.4	–6.1	10.3	5.5	36.1	2.8	2.6	5.1	7.6
Imports of goods and services	8.2	–3.9	9.1	2.9	27.2	7.7	2.1	8.4	7.0
	Contribution to GDP growth in percentage points								
Domestic demand	6.8	–2.6	6.0	–4.6	11.9	9.8	7.0	11.2	5.9
Net exports of goods and services	–2.0	–2.0	1.1	2.4	5.8	–3.6	0.5	–3.0	0.6
Exports of goods and services	4.5	–5.0	8.1	4.6	25.8	2.2	2.1	4.8	6.3
Imports of goods and services	–6.5	3.1	–7.0	–2.2	–19.9	–5.8	–1.6	–7.8	–5.7
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	3.1	6.7	2.2	7.9	–3.9	2.8	2.2	12.6	6.6
Unit labor costs in manufacturing (nominal, per hour)	6.3	8.3	0.2	–0.7	–15.8	9.3	11.3	7.1	7.6
Labor productivity in manufacturing (real, per hour)	4.3	–0.2	5.8	4.6	20.6	0.2	0.4	3.8	2.5
Labor costs in manufacturing (nominal, per hour)	10.9	7.4	6.8	3.9	1.5	9.5	11.7	11.2	10.3
Producer price index (PPI) in industry	2.2	4.3	13.5	8.0	10.9	14.4	20.7	23.4	32.0
Consumer price index (here: HICP)	3.4	3.4	5.2	3.3	5.3	5.0	7.1	8.3	11.0
EUR per 1 HUF, + = HUF appreciation	–2.0	–7.4	–2.0	–6.1	–0.8	–0.1	–1.0	–0.9	–7.9
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	3.5	4.3	4.1	4.5	4.1	3.9	3.7	3.8	3.2
Employment rate (%, 15–64 years)	70.1	69.7	73.1	71.8	72.8	73.6	74.1	74.0	74.3
Key interest rate per annum (%)	0.9	0.8	1.1	0.6	0.6	1.3	2.0	3.1	5.3
HUF per 1 EUR	325.2	351.2	358.5	361.0	354.7	353.9	364.3	364.1	385.3
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	12.5	12.5	12.5	8.7	10.5	11.6	12.1	9.3	10.2
of which: loans to households	15.5	15.5	15.5	13.4	15.5	16.0	14.9	11.0	8.9
loans to nonbank corporations	10.4	10.4	10.4	5.4	6.8	8.3	9.9	7.9	11.3
	%								
Share of foreign currency loans in total loans to the nonbank private sector	23.8	22.3	20.3	21.9	20.0	20.3	20.3	21.3	22.3
Return on assets (banking sector)	1.2	0.4	0.9	1.1	1.3	1.2	0.9	1.1	0.6
Tier 1 capital ratio (banking sector)	16.4	17.4	18.1	17.3	17.2	16.6	18.1	17.3	16.7
NPL ratio (banking sector)	2.6	2.4	1.6	2.3	2.2	1.8	1.6	1.6	1.9
	% of GDP								
General government revenues	43.9	43.4	41.1	..	..	..	..	..	..
General government expenditures	46.0	51.2	47.9	..	..	..	..	..	..
General government balance	–2.1	–7.8	–6.8	..	..	..	..	..	..
Primary balance	0.1	–5.5	–4.5	..	..	..	..	..	..
Gross public debt	65.5	79.6	76.8	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	62.8	68.7	76.0	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	18.2	20.1	20.4	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	–2.5	–1.0	–3.0	3.3	–1.7	–6.6	–5.3	–7.0	–6.7
Services balance	4.8	2.9	3.3	2.2	3.6	4.2	2.9	3.2	4.5
Primary income	–2.5	–2.5	–3.4	–2.8	–3.2	–3.7	–3.6	–1.9	–3.1
Secondary income	–0.6	–0.5	–1.1	–1.3	–1.7	–0.7	–0.8	–0.8	–0.9
Current account balance	–0.8	–1.1	–4.2	1.3	–3.0	–6.8	–6.8	–6.5	–6.2
Capital account balance	1.8	2.0	2.6	2.0	1.7	1.9	4.4	4.7	2.2
Foreign direct investment (net)[3]	–0.8	–1.7	–1.8	1.4	–0.5	–2.4	–4.9	3.9	–1.2
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	73.1	81.0	84.6	87.1	84.9	87.5	84.6	86.2	84.3
Gross official reserves (excluding gold)	18.4	23.3	21.8	20.2	18.2	22.7	21.8	19.8	19.7
	Months of imports of goods and services								
Gross official reserves (excluding gold)	2.8	3.6	3.2	3.1	2.8	3.4	3.2	2.9	2.7
	EUR million, period total								
GDP at current prices	146,395	137,683	153,756	31,846	38,778	39,746	43,387	37,914	42,502

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] Foreign currency component at constant exchange rates.
[2] Nonprofit institutions serving households.
[3] + = net accumulation of assets larger than net accumulation of liabilities (net outflow of capital).
– = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

8 Poland: strong growth coupled with policy support against jumping inflation

Poland's GDP growth reached 9.2% year on year in the first quarter of 2022, then sharply declined to 4.7% in the second quarter. Quarter-on-quarter growth amounted to 2.5% in the first quarter, then turned negative to –2.1%. In the first quarter, growth resulted almost exclusively from domestic demand (including a substantial contribution from inventory buildup). In the second quarter, the contribution of domestic demand continued to be more important than that of foreign demand for year-on-year growth, but it was clearly negative for quarter-on-quarter growth due to markedly slower buildup of inventory, which includes semifinished fixed investment. With annual growth of domestic demand outpacing that of foreign demand, import growth exceeded export growth considerably, implying a negative contribution of net exports to GDP growth. In balance of payment terms, the goods and services balance deteriorated in the first half of 2022 compared to a year earlier but remained positive. With the primary balance deficit rising to 5.6% of GDP in the second quarter of 2022, the combined current and capital account deficit came in at 2.6% of GDP, compared to a surplus of 1.7% of GDP a year earlier. It was, however, more than covered by net FDI inflows. Within domestic demand, quarter-on-quarter growth of private consumption even accelerated to 1.7% in the second quarter from 1.2% in the first. Rising employment coupled with nominal wage growth matching inflation more than offset deteriorating consumer confidence.

In contrast, gross fixed capital formation contracted sharply quarter on quarter in the second quarter after expanding at a double-digit rate in the first quarter. Still, annual growth even accelerated in the second quarter, thanks to a favorable base effect. While industrial confidence was moderately weaker in the second quarter than at the end of 2021, factors supporting investment remained strong, e.g. sales profitability, the share of profitable enterprises, corporate liquidity and capacity utilization. Within total fixed investment, residential investment was only marginally higher than a year earlier in the second quarter.

In manufacturing, nominal unit labor costs were slightly higher in the second quarter than a year earlier but the increase was less pronounced than in the euro area, while the złoty's value in euro was weaker by 2.5%. From February to August, the złoty's value in euro depreciated by 3.5%. According to the HICP (and national CPI) definition, inflation rose from 8.1% (8.5%) in February to 14.8% (16.1%) in August. In parallel, core inflation rose from 6.9% (6.7%) to 11.5% (9.9%) in August. Within core HICP, nonenergy industrial goods inflation amounted to 8.7% in August. The Monetary Policy Council (MPC), pursuing a CPI inflation target of 2.5% ± 1 percentage point, hiked its main policy rate from 2.75% to 6.75% in monthly steps from February to September. In September 2022, the MPC stated that its recent hike served to reduce the persisting risk of inflation running above target in the medium term and to curb inflation expectations. The MPC stated that it would take all necessary actions to ensure stability, including above all to reduce the risk of inflation remaining elevated.

In May, the European Commission forecast that Poland's general government deficit would rise from 1.9% of GDP in 2021 to 4.0% in 2022 and 4.4% in 2023, while general government debt would decline from 53.8% of GDP at end-2021 to 50% at end-2023. The deficit increase stems from the decline of the revenue-to-GDP ratio as a result of cuts in indirect tax rates under the "anti-inflationary shield" and direct tax rates, particularly the basic personal income tax rate, under the Polish Deal.

Table 8

Main economic indicators: Poland

	2019	2020	2021	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
	Year-on-year change of the period total in %								
GDP at constant prices	4.7	–2.2	5.9	–1.1	10.9	6.2	7.9	9.2	4.7
Private consumption	3.9	–2.8	6.0	–0.4	13.0	4.7	7.7	6.3	6.6
Public consumption	6.5	4.9	3.4	1.9	3.9	3.6	4.0	1.1	1.3
Gross fixed capital formation	6.1	–4.9	3.8	–1.2	2.8	6.3	5.4	5.2	7.1
Exports of goods and services	5.2	0.0	11.8	6.8	29.4	7.4	6.9	2.4	5.0
Imports of goods and services	3.0	–1.1	15.9	9.2	33.8	12.0	12.0	8.3	8.3
	Contribution to GDP growth in percentage points								
Domestic demand	3.5	–2.7	7.1	–0.5	10.7	8.0	10.0	12.6	6.3
Net exports of goods and services	1.3	0.6	–1.2	–0.7	0.1	–1.8	–2.0	–3.4	–1.6
Exports of goods and services	2.9	0.0	6.6	3.9	15.5	4.1	3.9	1.9	3.4
Imports of goods and services	–1.6	0.6	–7.8	–4.5	–15.4	–5.9	–5.9	–5.3	–5.0
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	2.4	8.0	0.6	5.6	–2.5	–0.8	0.4	2.7	10.7
Unit labor costs in manufacturing (nominal, per hour)	4.3	4.8	–4.6	–4.1	–12.9	0.6	–0.8	–1.2	1.6
Labor productivity in manufacturing (real, per hour)	2.4	1.8	12.9	10.2	22.9	9.2	10.3	12.3	10.3
Labor costs in manufacturing (nominal, per hour)	6.7	6.2	8.0	5.7	7.1	9.8	9.4	10.9	12.1
Producer price index (PPI) in industry	1.4	–0.5	8.1	2.6	6.6	9.6	13.6	18.5	25.3
Consumer price index (here: HICP)	2.1	3.7	5.2	3.9	4.6	5.1	7.3	9.0	12.8
EUR per 1 PLN, + = PLN appreciation	–0.9	–3.3	–2.6	–4.9	–0.6	–2.8	–2.4	–1.6	–2.5
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	3.4	3.2	3.4	4.1	3.6	3.1	2.9	3.2	2.7
Employment rate (%, 15–64 years)	68.2	68.7	70.3	69.2	70.0	71.0	71.0	71.0	71.4
Key interest rate per annum (%)	1.5	0.5	0.3	0.1	0.1	0.1	1.1	2.7	5.1
PLN per 1 EUR	4.3	4.4	4.6	4.5	4.5	4.6	4.6	4.6	4.6
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	5.0	5.0	5.0	–2.2	0.3	2.6	5.0	6.1	6.1
of which: loans to households	5.6	5.6	5.6	1.3	3.0	4.0	4.2	3.1	0.4
loans to nonbank corporations	4.1	4.1	4.1	–8.0	–4.4	–0.1	6.5	11.7	16.9
	%								
Share of foreign currency loans in total loans to the nonbank private sector	19.2	19.6	17.5	19.3	18.1	18.0	17.5	17.6	17.7
Return on assets (banking sector)	0.7	0.0	0.2	0.4	0.5	0.5	0.2	1.0	0.9
Tier 1 capital ratio (banking sector)	17.0	18.5	17.3	18.6	18.6	18.0	17.3	16.6	16.9
NPL ratio (banking sector)	6.6	7.0	5.8	6.7	6.5	6.3	5.8	5.7	5.6
	% of GDP								
General government revenues	41.0	41.3	42.3	..	..	..	..	..	..
General government expenditures	41.8	48.2	44.2	..	..	..	..	..	..
General government balance	–0.7	–6.9	–1.9	..	..	..	..	..	..
Primary balance	0.6	–5.6	–0.8	..	..	..	..	..	..
Gross public debt	45.6	57.1	53.8	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	44.7	44.7	43.5	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	34.7	33.7	32.1	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	–0.8	1.3	–1.3	0.9	0.7	–2.8	–3.5	–4.7	–3.3
Services balance	4.5	4.4	4.7	4.9	5.1	4.6	4.1	4.8	6.1
Primary income	–4.2	–3.8	–4.7	–5.2	–5.3	–5.6	–3.1	–4.8	–5.6
Secondary income	0.2	0.5	–0.1	–0.4	0.2	0.2	–0.3	–0.3	–0.3
Current account balance	–0.2	2.4	–1.4	0.2	0.7	–3.5	–2.7	–5.0	–3.1
Capital account balance	1.5	1.4	0.7	–0.1	1.0	1.0	0.7	–0.5	0.5
Foreign direct investment (net)[3]	–2.0	–2.4	–4.1	–6.1	–1.7	–5.9	–2.8	–7.9	–3.2
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	59.2	58.1	55.8	58.8	56.8	57.1	55.8	55.1	54.8
Gross official reserves (excluding gold)	19.6	21.7	23.5	23.6	22.6	23.9	23.5	21.8	22.1
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.8	5.5	5.2	5.9	5.3	5.5	5.2	4.6	4.5
	EUR million, period total								
GDP at current prices	533,674	526,350	574,131	129,958	137,110	143,563	163,500	148,605	154,836

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] *Foreign currency component at constant exchange rates.*
[2] *Nonprofit institutions serving households.*
[3] *+ = net accumulation of assets larger than net accumulation of liabilities (net outflow of capital).*
– = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

9 Romania: rising inflation, weak fiscal position and increasing current account deficit

Romania's GDP grew by 5.8% year on year in the first half of 2022. With a seasonally adjusted quarter-on-quarter growth rate of 5.1%, GDP expansion was particularly strong in the first quarter of the year. Growth slowed down in the second quarter but stayed relatively brisk.

In the first half of 2022, GDP growth was mainly driven by private consumption and changes in inventories (particularly in the second quarter). Private consumption benefited from the lifting of COVID-19 restrictions and the release of pent-up demand. Due to rising inflation, real wage growth turned negative in April 2022 with nominal wage growth remaining above 10% until mid-2022. The unemployment rate declined from 5.9% in the fourth quarter of 2021 to 5.3% in the second quarter of 2022. After contracting in the second half of 2021, gross fixed capital formation increased again and showed mildly positive year-on-year growth rates. An increase in construction output as well as investment in equipment supported this development. Growth of domestic credit to nonfinancial corporations accelerated noticeably in the first half of 2022. As export growth declined in the second quarter, while import growth picked up, the negative contribution of net exports widened markedly. Industrial production shrank by 2.6% in the second quarter reflecting weakening external demand and supply chain bottlenecks.

Consumer price inflation climbed to 15.3% in August 2022 from 8.2% at end-2021, moving further away from the upper bound of the inflation target variation band of 2.5% ± 1 percentage point as defined by the National Bank of Romania (NBR). Inflationary trends were fueled by electricity, gas, fuels and food items amid supply-side shocks.

The revision of the price capping schemes for electricity and gas prices to a more restrictive form in April led to an increase in the inflation rate in the subsequent months. Nevertheless, the capping scheme continued to have an important disinflationary effect. Without this scheme, inflation would have run about 5 percentage points higher in recent months. In addition to this price capping scheme, social support measures to vulnerable households were implemented (such as one-off payments to recipients of small pensions, vouchers to low-income earners). Moreover, public sector wages were hiked somewhat in August. Romania's fiscal council expects the budget deficit (in cash terms) to reach 7% of GDP in 2022 compared to the 5.8% target stipulated in the budget revision enacted in August. In response to rising inflation, the NBR raised its key policy rate in four steps from 3% in April to 6.25% in early October. According to the current NBR inflation forecast, inflation will decline to 13.9% in the fourth quarter of 2022 and further to 7.5% in the fourth quarter of 2023.

The current account deficit widened markedly in the first half of 2022 and reached 9.5% of GDP, compared to 7% of GDP recorded in the first half of 2021. The widening was caused by a rising trade in goods deficit (due to volume and price effects) and a growing deficit in the primary income balance related to outflows of reinvested earnings and distributed dividends. The net borrowing position from current and capital accounts worsened too (reaching 8% of GDP), as the capital account surplus only increased to a small extent. Net FDI inflows covered less than half of the net borrowing position in the first half of 2022. Meanwhile, unit labor costs in the manufacturing sector rose considerably, while the Romanian leu remained nearly stable vis-à-vis the euro.

Table 9

Main economic indicators: Romania

	2019	2020	2021	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
	Year-on-year change of the period total in %								
GDP at constant prices	4.2	–3.8	6.0	–0.1	15.4	6.9	2.4	6.4	5.3
Private consumption	3.8	–4.8	7.6	0.9	11.7	9.0	9.4	7.2	8.0
Public consumption	8.0	1.5	5.3	–4.3	2.1	–2.4	12.5	5.4	–0.4
Gross fixed capital formation	12.7	4.4	2.5	11.3	12.9	–1.3	–6.0	1.7	2.5
Exports of goods and services	4.6	–9.3	12.8	1.0	41.7	7.2	7.8	8.6	4.9
Imports of goods and services	8.8	–5.9	15.0	3.1	42.0	11.2	8.2	10.8	19.1
	Contribution to GDP growth in percentage points								
Domestic demand	5.8	–2.3	7.3	0.3	16.9	6.0	3.7	7.9	4.2
Net exports of goods and services	–1.6	–1.5	–1.4	–0.7	–2.9	–2.0	–0.5	–1.9	–8.1
Exports of goods and services	2.2	–3.8	4.7	0.2	14.7	2.5	2.7	4.7	2.3
Imports of goods and services	–3.9	2.3	–6.1	–1.0	–17.6	–4.5	–3.3	–6.6	–10.4
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	6.5	4.5	1.3	4.7	–3.4	–0.1	4.2	5.0	5.3
Unit labor costs in manufacturing (nominal, per hour)	13.3	7.6	4.2	0.5	–4.9	9.3	12.6	11.8	15.1
Labor productivity in manufacturing (real, per hour)	–0.8	0.4	3.1	5.4	11.6	0.3	–4.0	–0.1	–2.5
Labor costs in manufacturing (nominal, per hour)	12.5	8.0	7.5	5.9	6.1	9.6	8.1	11.7	12.2
Producer price index (PPI) in industry	4.0	0.0	14.9	2.3	10.1	16.4	30.8	46.2	47.3
Consumer price index (here: HICP)	3.9	2.3	4.1	2.3	3.1	4.3	6.6	8.2	12.4
EUR per 1 RON, + = RON appreciation	–1.9	–1.9	–1.7	–1.7	–1.7	–1.8	–1.6	–1.4	–0.4
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	4.0	5.2	5.6	6.1	5.1	5.3	5.9	6.0	5.3
Employment rate (%, 15–64 years)	65.8	65.6	61.9	60.8	62.4	62.3	62.1	62.4	63.5
Key interest rate per annum (%)	2.5	1.9	1.4	1.3	1.3	1.3	1.6	2.3	3.4
RON per 1 EUR	4.7	4.8	4.9	4.9	4.9	4.9	4.9	4.9	4.9
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	5.5	5.5	5.5	6.2	10.6	12.7	14.2	15.2	17.1
of which: loans to households	6.7	6.7	6.7	4.6	7.5	8.8	9.3	9.3	8.6
loans to nonbank corporations	4.2	4.2	4.2	7.9	14.3	17.3	19.8	21.7	26.4
	%								
Share of foreign currency loans in total loans to the nonbank private sector	32.4	30.5	27.6	29.9	28.9	28.4	27.6	27.3	28.0
Return on assets (banking sector)	1.4	1.0	1.4	1.3	1.4	1.5	1.4	1.2	1.5
Tier 1 capital ratio (banking sector)	20.1	23.2	20.9	22.7	22.1	21.4	20.9	19.0	18.9
NPL ratio (banking sector)	4.1	3.8	3.4	3.9	3.8	3.7	3.4	3.3	3.0
	% of GDP								
General government revenues	31.9	32.7	32.8	..	..	..	..	..	..
General government expenditures	36.2	42.0	39.9	..	..	..	..	..	..
General government balance	–4.3	–9.3	–7.1	..	..	..	..	..	..
Primary balance	–3.2	–7.9	–5.7	..	..	..	..	..	..
Gross public debt	35.3	47.2	48.8	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	32.2	33.3	33.3	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	15.3	16.1	15.8	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	–8.0	–8.7	–9.6	–10.9	–9.3	–9.5	–9.3	–12.1	–11.4
Services balance	3.9	4.3	4.0	4.6	3.8	3.6	4.1	4.3	4.8
Primary income	–1.4	–1.5	–1.7	0.3	–3.1	–2.8	–1.1	–1.9	–3.8
Secondary income	0.7	0.9	0.4	0.1	0.6	0.8	0.2	0.3	0.7
Current account balance	–4.9	–5.0	–7.0	–5.9	–8.0	–7.8	–6.2	–9.4	–9.6
Capital account balance	1.3	1.9	2.2	1.1	1.4	1.5	4.2	0.9	2.1
Foreign direct investment (net)[3]	–2.2	–1.3	–3.0	–4.5	–2.7	–4.2	–1.3	–5.2	–2.4
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	49.1	58.0	56.1	56.3	56.4	57.0	56.1	54.8	52.7
Gross official reserves (excluding gold)	14.7	17.1	16.9	16.3	16.1	17.6	16.9	16.1	16.1
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.0	4.9	4.3	4.7	4.4	4.7	4.3	4.1	4.0
	EUR million, period total								
GDP at current prices	223,085	218,706	239,991	46,743	55,871	65,172	72,205	55,359	67,785

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] *Foreign currency component at constant exchange rates.*
[2] *Nonprofit institutions serving households.*
[3] *+ = net accumulation of assets larger than net accumulation of liabilities (net outflow of capital).*
– = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

10 Türkiye: widening external deficit despite restrictive measures to substitute for interest rate hikes

Published figures show that Türkiye's GDP growth remained strong in the first half of 2022, amounting to more than 7% in both quarters. Quarter-on-quarter growth accelerated from 0.7% in the first quarter to 2.1% in the second. Main driving forces were private consumption and real exports, which both showed double-digit year-on-year growth in both quarters and a strong acceleration of quarter-on-quarter growth in the second quarter. By contrast, published real import growth rates were far smaller so that net exports made a substantial positive contribution to growth. However, the sum of the growth contributions of all published demand components amounted to annual GDP growth of more than 15% in the first half of 2022, far above the published rate. The difference could partly stem from a very large negative contribution of inventory change, for which no figures have been published, or from an underreporting of real imports. The latter argument is supported by very high import growth recorded in the balance of payments (in USD). Import growth outpaced export growth by far so that both the goods and services deficit and the current account deficit widened to about 7% and 8% of GDP, respectively, in the first half of 2022. Net FDI inflows remained at close to 1% of GDP and, together with net other investment inflows, offset portfolio investment outflows. Net errors and omissions amounted to 5% of GDP, limiting the decline of gross official reserves during the first half of 2022 to 3% of GDP. As a result, reserves stood at 2.2 monthly imports in mid-2022 (including gold: 3.8), down from 2.7 (4.6) a year earlier. At the same time, off-balance sheet net short positions due within one year amounted to 120% of official FX reserves, with about half being attributable to FX swaps with domestic banks and the other half to swap agreements with Arabian and Asian central banks.

Inflation accelerated further from February to August, with both the headline rate and the core rate rising markedly to 80% and 75%, respectively. However, the Turkish central bank (TCMB) delivered two policy rate cuts in August and September (to 12%), implying a large negative real key rate. On average, in the first half of 2022, the Turkish lira's value measured in euro was 5% lower than a year earlier (in CPI-deflated terms), as double-digit real depreciation in the fourth quarter of 2021 was followed by double-digit real appreciation in the first half of 2022.

Lira stabilization resulted from measures aimed to substitute for interest rate hikes, including the offer to convert FX or gold deposits to central bank-guaranteed exchange rate-linked lira deposits, higher reserve requirements for banks' FX deposits where only a small share of FX deposits was converted, and an increase of the share of FX revenues that exporters were required to sell to the central bank to 40% in April (from 25% since January 1, 2022). These measures were aimed at increasing lira demand and reducing banks' negative on-balance sheet net FX position so that banks have less need for entering into swaps with the central bank by selling FX initially. As a result, households' FX deposits declined by 20% from end-2021 to mid-2022 and banks' negative on-balance net FX position was lower by 30%. Corporations succeeded in reducing their negative on-balance net FX position inter alia by moderately increasing their FX deposits with domestic banks. However, in mid-2022, the Turkish supervisory authority announced that any corporation will only have access to new lira loans if it has FX holdings (including gold) below a low ceiling. Moreover, to contain lira loan growth, the central bank introduced and gradually raised reserve requirement ratios on selected commercial lira loans and added such ratios for banks with high loan growth or relatively high loan interest rates.

Table 10

Main economic indicators: Türkiye

	2019	2020	2021	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
	Year-on-year change of the period total in %								
GDP at constant prices	0.8	1.9	11.4	7.5	22.2	7.9	9.6	7.5	7.6
Private consumption	1.5	3.3	15.3	7.7	24.2	9.4	20.4	21.3	22.4
Public consumption	3.8	2.5	2.6	–1.8	3.1	8.0	1.4	3.1	2.3
Gross fixed capital formation	–12.5	7.4	7.4	12.1	21.1	–1.3	2.1	4.2	4.7
Exports of goods and services	4.2	–14.4	24.9	3.2	60.0	25.9	21.6	14.8	16.4
Imports of goods and services	–5.0	6.7	2.4	–0.8	20.5	–8.7	3.1	2.2	5.8
	Contribution to GDP growth in percentage points								
Domestic demand	–2.1	4.1	11.4	7.3	20.5	6.3	12.7	14.3	15.1
Net exports of goods and services	2.3	–5.4	5.0	1.0	6.8	7.4	4.4	3.1	2.8
Exports of goods and services	1.1	–3.8	5.6	0.8	11.4	5.3	5.2	3.6	4.1
Imports of goods and services	1.3	–1.6	–0.6	0.2	–4.6	2.1	–0.8	–0.5	–1.3
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	..	..	..	..	..	..	..	..	..
Unit labor costs in manufacturing (nominal, per hour)	21.9	10.0	19.1	9.0	13.1	29.2	26.7	47.8	53.3
Labor productivity in manufacturing (real, per hour)	1.7	8.3	–0.2	4.5	–6.8	–1.1	3.3	2.5	3.1
Labor costs in manufacturing (nominal, per hour)	23.8	18.9	19.1	13.9	5.4	27.8	30.9	51.6	58.0
Producer price index (PPI) in industry	17.6	12.2	43.9	28.2	38.8	44.8	60.6	104.7	131.0
Consumer price index (here: HICP)	15.2	12.3	19.6	15.6	17.1	19.2	25.9	54.8	74.1
EUR per 1 TRY, + = TRY appreciation	–10.4	–21.0	–23.2	–24.3	–25.2	–15.9	–26.4	–43.1	–39.8
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	14.0	13.4	12.2	13.8	12.0	11.9	11.2	11.8	10.4
Employment rate (%, 15–64 years)	50.3	47.5	50.3	48.0	49.7	51.6	51.7	50.8	53.0
Key interest rate per annum (%)	20.6	10.2	17.8	17.3	19.0	18.9	15.9	14.0	14.0
TRY per 1 EUR	6.4	8.0	10.5	8.9	10.1	10.1	12.8	15.7	16.8
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	11.0	36.3	36.1	31.9	20.7	14.5	36.1	45.1	60.4
of which: loans to households	15.9	40.1	20.4	35.4	24.9	15.9	20.4	22.7	37.5
loans to nonbank corporations	9.5	35.0	41.9	31.3	20.1	14.7	41.9	52.4	67.4
	%								
Share of foreign currency loans in total loans to the nonbank private sector	35.2	30.9	38.1	32.4	32.7	32.2	38.1	37.0	33.9
Return on assets (banking sector)	1.1	1.0	1.3	1.0	1.0	1.1	1.3	2.6	3.3
Tier 1 capital ratio (banking sector)	13.9	14.1	13.2	13.4	13.3	12.9	13.2	15.4	13.6
NPL ratio (banking sector)	5.7	4.4	3.4	4.1	3.9	3.8	3.4	3.0	2.7
	% of GDP								
General government revenues	31.0	31.2	30.7	..	..	..	..	..	..
General government expenditures	35.5	35.9	33.4	..	..	..	..	..	..
General government balance	–4.5	–4.7	–2.7	..	..	..	..	..	..
Primary balance	–1.9	–1.6	0.4	..	..	..	..	..	..
Gross public debt	32.7	39.7	42.0	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	..	..	..	..	..	..	..	..	..
Debt of households and NPISHs[1] (nonconsolidated)	..	..	..	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	–2.2	–5.3	–3.6	–3.7	–3.4	–3.2	–4.2	–11.7	–9.1
Services balance	4.5	1.6	3.3	1.2	1.9	5.4	4.0	2.7	4.4
Primary income	–1.7	–1.3	–1.5	–1.6	–1.9	–1.2	–1.3	–1.4	–1.3
Secondary income	0.1	0.0	0.1	0.1	0.3	0.1	0.1	–0.2	–0.1
Current account balance	0.7	–5.0	–1.7	–4.0	–3.1	1.2	–1.4	–10.7	–6.2
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment (net)[2]	–0.9	–0.6	–0.9	–0.7	–0.7	–1.5	–0.7	–0.3	–1.0
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	52.4	51.3	51.4	53.8	53.0	53.1	51.4	52.2	51.4
Gross official reserves (excluding gold)	10.3	6.5	9.3	6.5	7.5	10.7	9.3	8.3	7.5
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.1	2.4	3.2	2.4	2.7	3.8	3.2	2.6	2.2
	EUR million, period total								
GDP at current prices	677,821	625,392	686,913	156,572	157,253	191,802	181,287	159,999	202,875

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] Nonprofit institutions serving households.
[2] + = net accumulation of assets larger than net accumulation of liabilities (net outflow of capital).
– = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

11 Russia: continued war in Ukraine and slide into sanctions-triggered recession

Struck by severe Western sanctions, which were further tightened in the late spring and early summer of 2022, Russia's GDP growth rate turned negative in the second quarter (–4%) and remained so in July and August, which pulled down the growth rate for the first eight months to about –1.5%. After some other Russian banks had already been excluded from the international financial messaging system SWIFT, Russia's largest bank, Sberbank, followed in May. A number of renowned Western firms withdrew or curtailed their activities in the country. Russia has, in turn, been imposing some punitive countermeasures culminating in the suspension of the overwhelming share of its gas deliveries to the EU.

While economic activity in the first quarter was still supported by private consumption and fixed investment, the upsurge of inflation in March and April soon dampened demand. The second quarter brought a slump in private consumption, while fixed investment slowed down, but still expanded. While real export and import figures have so far not been published for 2022, Russian imports have doubtlessly plummeted due to Western trade restrictions, while exports have held up better than expected due to some successful redirecting of oil deliveries to big emerging markets (e.g. China, India, Türkiye). The result was a spike in net exports in the first eight months of 2022. After recouping its initial sharp depreciation against the US dollar in April, the ruble, as of late September, was even 20% more expensive than prior to the invasion, largely due to a combination of high energy prices, the large current account surplus and the authorities' remaining capital controls (even after some easing). The jobless rate reached a post-Soviet low of 3.9% in July and August. The sharp key rate hike in late February as well as the ruble's recovery and subdued demand brought back consumer price growth from its peak of 17.8% in April to 13.7% in September. Declining inflation and inflation expectations allowed the monetary authority to continue to cut its key rate from 17% in early April to 7.5% in mid-September.

Buoyed by further rising oil prices (average Urals price in January to August 2022: USD 82.1 per barrel, i.e. 26% more than in the same period of the previous year), Russia still achieved a fiscal surplus in the first eight months of 2022, but this surplus has narrowed substantially in recent months (to about 0.2% of pro rata GDP in the mentioned period). This narrowing was because of hefty shortfalls recorded in July and August against the backdrop of a combination of ruble appreciation (with oil sales remaining USD-denominated), declining import tax revenue and sizable spending increases. Due to the allocation of substantial saved budgetary means of 2021, the assets of the National Wealth Fund expanded by 8% over the first eight months of 2022 to USD 196.6 billion (or about 9% of GDP).

Banks are currently doing business in a regime of regulatory lenience, flanked by subsidized lending programs. The initially high interest rate level coupled with weak demand and continuing uncertainty, pushed growth of loans to enterprises and households to –3% (year on year, in real terms and exchange rate adjusted) by end-August 2022. In the meantime, deposits of enterprises continued to expand (+9% year on year), while retail deposits strongly declined (–7%). According to the Bank of Russia, Russia's banks lost around RUB 1,500 billion (or about USD 25 billion) in the first half of 2022, which corresponds to about 12% of the sector's regulatory capital as of end-2021. Losses are expected to increase further in the second half of 2022.

Table 11

Main economic indicators: Russia

	2019	2020	2021	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
	Year-on-year change of the period total in %								
GDP at constant prices	2.2	–2.7	4.7	–0.3	10.5	4.0	5.0	3.5	–4.1
Private consumption	3.8	–7.3	9.5	–2.1	27.2	9.5	7.1	4.5	–5.4
Public consumption	2.4	1.9	1.5	1.2	2.6	1.3	1.1	0.0	–0.4
Gross fixed capital formation	1.0	–4.6	6.8	1.8	12.2	8.2	5.2	11.1	3.2
Exports of goods and services	0.7	–4.1	3.5	–0.6	–1.1	8.7	7.1	..	..
Imports of goods and services	3.1	–11.9	16.9	0.0	32.2	19.2	17.7	..	..
	Contribution to GDP growth in percentage points								
Domestic demand	3.0	–4.7	7.4	–0.3	17.1	6.0	7.1	3.0	–6.1
Net exports of goods and services	–0.5	1.7	–2.7	–0.2	–6.9	–1.8	–2.4	..	..
Exports of goods and services	0.2	–1.1	0.9	–0.2	–0.3	2.1	1.7	..	..
Imports of goods and services	–0.7	2.9	–3.7	0.0	–6.5	–3.9	–4.1	..	..
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	..	..	..	..	..	..	..	..	..
Unit labor costs in manufacturing (nominal, per hour)	3.9	7.6	3.2	6.1	–0.4	3.2	4.3	12.0	14.7
Labor productivity in manufacturing (real, per hour)	3.7	–1.4	7.3	1.1	12.3	7.9	8.2	4.8	–3.2
Labor costs in manufacturing (nominal, per hour)	7.8	5.9	10.9	7.3	11.9	11.3	12.8	17.7	11.0
Producer price index (PPI) in industry	2.3	–3.7	24.6	10.6	31.2	28.2	28.3	25.6	21.6
Consumer price index (here: HICP)	4.6	3.4	6.7	5.5	6.0	6.9	8.3	11.5	16.9
EUR per 1 RUB, + = RUB appreciation	2.2	–12.3	–5.3	–17.9	–11.0	–0.3	9.3	–8.7	24.3
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	4.6	5.8	4.8	5.6	5.0	4.4	4.3	4.2	3.9
Employment rate (%, 15–64 years)	..	..	..	..	..	..	..	..	..
Key interest rate per annum (%)	7.3	5.0	5.7	4.3	5.0	6.3	7.5	12.7	13.9
RUB per 1 EUR	72.5	82.6	87.2	89.7	89.5	86.6	83.1	98.3	72.0
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	10.6	10.6	10.6	9.4	12.7	13.9	15.3	15.6	11.7
of which: loans to households	19.0	19.0	19.0	13.5	20.3	20.7	22.1	20.3	12.2
loans to nonbank corporations	7.1	7.1	7.1	7.5	9.3	10.8	12.2	13.3	11.4
	%								
Share of foreign currency loans in total loans to the nonbank private sector	11.8	12.6	10.8	12.3	10.8	10.8	10.8	11.2	7.3
Return on assets (banking sector)	2.2	1.9	2.4	2.4	2.5	2.6	2.4	..	..
Tier 1 capital ratio (banking sector)	9.2	9.7	9.6	10.8	10.3	9.8	9.6	..	..
NPL ratio (banking sector)	17.0	17.1	15.1	17.0	16.2	15.8	15.1	..	..
	% of GDP								
General government revenues	36.0	35.6	36.7	..	..	..	..	..	..
General government expenditures	34.1	39.6	35.9	..	..	..	..	..	..
General government balance	1.9	–4.0	0.8	..	..	..	..	..	..
Primary balance	..	..	..	..	..	..	..	..	..
Gross public debt	12.4	17.6	16.0	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	..	..	..	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	..	..	..	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	9.8	6.3	10.7	7.9	9.3	11.6	12.8	..	..
Services balance	–2.2	–1.1	–1.1	–0.8	–0.9	–1.4	–1.1	..	..
Primary income	–3.2	–2.3	–2.4	–0.4	–4.0	–2.2	–2.7	–2.1	–2.1
Secondary income	–0.6	–0.4	–0.3	–0.5	–0.1	–0.3	–0.2	–0.3	–0.5
Current account balance	3.8	2.5	6.9	6.2	4.2	7.6	8.7	17.7	15.0
Capital account balance	0.0	0.0	0.0	0.1	–0.1	0.0	0.0	0.0	0.1
Foreign direct investment (net)[3]	–0.6	–0.2	1.4	0.9	0.8	0.9	2.8	0.0	1.3
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	29.4	29.9	28.2	31.5	30.6	30.8	28.2	26.2	26.8
Gross official reserves (excluding gold)	26.1	28.7	29.1	30.3	29.6	30.3	29.1	..	..
	Months of imports of goods and services								
Gross official reserves (excluding gold)	15.1	16.8	16.4	17.4	16.6	16.8	16.4	..	..
	EUR million, period total								
GDP at current prices	1.515,749	1.298,180	1.509,221	301,956	345,451	395,248	466,566	352,338	481,607

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] Foreign currency component at constant exchange rates.

[2] Nonprofit institutions serving households.

[3] + = net accumulation of assets larger than net accumulation of liabilities (net outflow of capital).
– = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).