Outlook for selected CESEE countries

CESEE-6 economic growth loses speed but remains robust, Russia returns to lower economic growth[1,2]

Following solid GDP growth of above 4% in 2018, economic expansion in the CESEE-6 countries[3] is predicted to slow down to 3.6% in 2019 and further to 3.3% in 2020 and 3.1% in 2021. Hungary and Poland will be the growth leaders over the projection horizon but – as in all other CESEE-6 countries – economic growth will lose steam toward the end of the forecast period. Generally, domestic demand will become weaker (but remain robust), which is strongly linked to bottlenecks in the labor market and a lower inflow of EU funds in some cases. In 2019 and 2020, export growth will gain speed compared to 2018, in line with our assumptions on euro area import growth, while CESEE-6 import growth will stay more or less unchanged. The growth differential vis-à-vis the euro area is expected to amount to 2.5 percentage points in 2019 (the same as in 2018) and to moderate to 1.6 percentage points by 2021. Current risks to economic growth are tilted downward and remain elevated.

For Russia[4] we expect economic growth to slow down to 1.4% in 2019 and to pick up somewhat thereafter. Tax measures and slightly higher inflation are dampening household consumption. So far, there have been no signs of recovery in private investment activity, while the launch of major government investments in infrastructure projects in 2020 and 2021 should somewhat boost the pace of economic

Table 1

OeNB-BOFIT GDP projections for 2019 to 2021 compared with the IMF forecast

	Eurostat/ Rosstat	OeNB-BOFIT projections April 2019			IMF WEO forecast April 2019		
	2018	2019	2020	2021	2019	2020	2021
	Year-on-year growth in %						
CESEE-6	**4.4**	**3.6**	**3.3**	**3.1**	**3.4**	**3.0**	**2.7**
Bulgaria	3.3	3.3	3.3	3.1	3.3	3.0	2.8
Croatia	2.6	2.5	2.7	2.6	2.6	2.5	2.4
Czech Republic	2.9	2.8	2.6	2.7	2.9	2.7	2.5
Hungary	5.0	3.7	3.2	3.4	3.6	2.7	2.4
Poland	5.1	4.2	3.9	3.3	3.8	3.1	2.8
Romania	4.2	3.0	2.8	2.8	3.1	3.0	3.0
Russia	2.3	1.4	1.7	1.6	1.6	1.7	1.7

Source: OeNB-BOFIT April 2019 projections, IMF World Economic Outlook (WEO) of April 2019, Eurostat, Rosstat.

Note: 2018 figures are seasonally adjusted data.

[1] *Cutoff date for data underlying this outlook: March 25, 2019. The projections for the CESEE-6 countries were prepared by the OeNB, those for Russia were prepared by the Bank of Finland in cooperation with the OeNB. All projections are based on the assumptions of the March 2019 ECB staff Macroeconomic Projection Exercise (MPE) for the euro area. The MPE forecasts real annual GDP growth in the euro area of 1% in 2019, 1.6% in 2020 and 1.5% in 2021 and import growth of 3.7% in 2019, 4.1% in 2020 and 3.5% in 2021.*

[2] *Compiled by Antje Hildebrandt, with input from Katharina Allinger, Stephan Barisitz, Markus Eller, Martin Feldkircher, Thomas Reininger, Tomáš Slačík and Zoltan Walko.*

[3] *CESEE-6: Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania.*

[4] *The oil price assumption used by the Bank of Finland corresponds to Urals futures price quotes (USD/barrel), with March 6, 2019, as our baseline. We expect Urals oil to remain fairly close to its current price level (of above USD 60 per barrel) and to slightly level off over the three-year forecast period.*

expansion, particularly in 2020. Moreover, net exports will continue to be an important growth driver in 2019. Overall risks appear to be, by and large, balanced.

1 OeNB CESEE-6 forecast: weaker domestic demand across the region

Following solid GDP growth of 4.4% in 2018, economic expansion in the CESEE-6 countries is predicted to slow down to 3.6% in 2019 and further to 3.3% in 2021 and 3.1% in 2021. Domestic demand is expected to moderate somewhat in all CESEE-6 countries. The growth contribution of net exports, by contrast, will improve in line with more or less unchanged average import growth and the assumption of stronger external demand in the euro area.

Monetary policy expected to be overall accommodative

We assume that the overall accommodative monetary policy stance will continue in 2019 and 2020. Despite a recent slight pickup of inflation in some CESEE-6 countries, a no-change policy is the most likely scenario in most but not all countries. The central bank of Hungary recently tightened its monetary policy by raising the deposit facility rate. In light of (still) favorable financing conditions in all CESEE-6 countries, lending activity has been growing very strongly, in particular lending to the household sector. Noticeably, in Croatia, the growth of lending to the corporate sector eventually turned slightly positive in January 2019 after a prolonged period of negative growth figures.

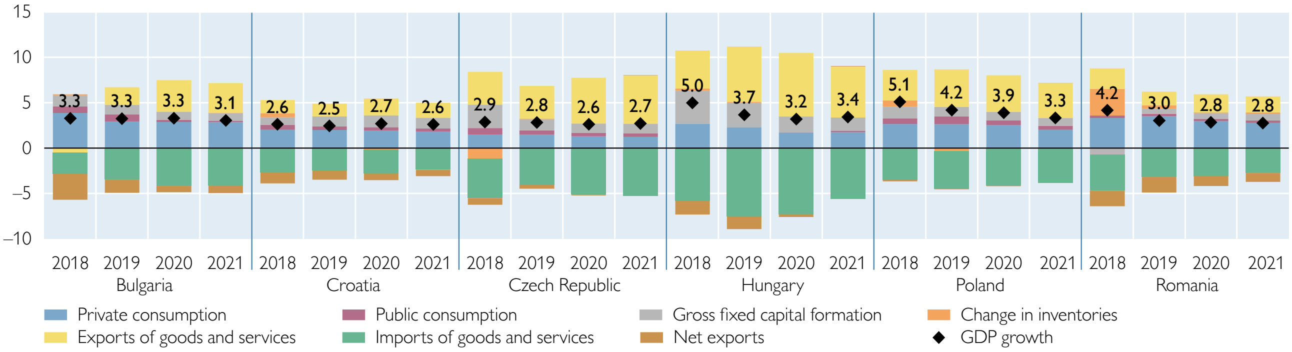
Fiscal policy in the CESEE-6 region shows a more diverse pattern

For one group of CESEE-6 countries – Bulgaria, the Czech Republic and Poland – we expect a looser fiscal policy stance in 2019 compared to 2018. In the Czech Republic, higher public expenses are, inter alia, linked to an exceptionally high increase of pensions, while in Poland, upcoming parliamentary elections in autumn 2019 are expected to push up public spending. Following years of fiscal surpluses, Bulgaria has decided to move to a more expansionary fiscal policy and is expected to record a fiscal deficit in 2019. Consolidation needs in Croatia, Hungary and Romania, by contrast, require more restrictive fiscal measures to bring the budget deficit in line with EU rules. For Hungary, we expect a more expansionary fiscal track only toward the end of our projection horizon, given that parliamentary and presidential elections are upcoming in 2022.

Chart 1

CESEE-6: GDP growth and contributions from 2019 to 2021

GDP contributions in percentage points, year-on-year GDP growth in %



Source: Eurostat, OeNB.

Note: Realized data for 2018, projections for 2019 to 2021.

Some moderation of private consumption growth expected

In this environment, we expect private consumption growth to remain strong but to moderate continuously over the projection horizon in all CESEE-6 countries. Generally, consumer mood remains optimistic. Real wages still have room to increase but to a lesser extent than in previous years, and job creation will reach its limits, particularly in the Czech Republic and Hungary, as the labor stock is close to being exhausted. Additionally, inflation has been lowering real disposable income in some countries. Currently, Hungary and Romania have the highest inflation rates (3.2% and 4%, respectively, in February 2019). On the other hand, private consumption has been supported by buoyant credit growth (in particular of consumer loans) across the region.

Public consumption growth shows a less uniform pattern

For several CESEE-6 countries, we expect a moderation in public consumption in 2019 compared to 2018, which reflects consolidation efforts (Croatia, Hungary) or a somewhat less expansionary stance (Czech Republic). In Bulgaria and Poland, public consumption growth is expected to accelerate strongly in 2019, driven by the public sector wage increases in the former and upcoming elections in the latter country. In 2020 and 2021, the growth rates of public consumption will moderate in all CESEE-6 countries, except in Hungary, according to our projections.

Investment activity will slow down over the projection horizon

Despite slowing down, gross fixed capital formation will remain strong, largely due to inflows of EU funds, high capacity utilization rates and capital-to-labor substitution needs in light of mounting labor shortages. However, a lower use of EU funds (e.g. strong frontloading in Hungary), less favorable growth prospects for the main trading partners and, eventually, some base effects will hamper gross fixed capital formation growth over the projection horizon. Croatia's investment activity, by contrast, is expected to benefit from a higher absorption of EU funds. From 2021 onward, the EU's new multiannual financial framework for 2021–2027 will be in place, and we expect much lower inflows of EU funds in the final year of our forecast period.

Export growth will gain speed in 2019 and 2020

In 2019 and 2020, export growth will gain speed in line with our assumption on euro area import growth. Only in the Czech Republic and in Romania will export growth weaken compared to 2018; the reasons for the decline are country-specific: capacity constraints and rising unit labor costs in the former case, weak export performance seen at the end of 2018 in the latter. As euro area import growth will soften in 2021, we forecast a similar pattern for most CESEE-6 countries.

In most of the CESEE-6 countries import growth will slow down in 2019 compared to 2018. Exceptions are Poland and Hungary, where import growth will only moderate from 2020 onward. Overall, the growth contribution of net exports will improve in all countries over the projection horizon (or stay more or less unchanged as in Poland).

CESEE-6: downside risks intensify

The risks to the CESEE-6 economic outlook stem both from external and internal developments and are tilted downward. The modalities of Brexit are still unknown, global politics have caused a high level of uncertainty, and the economic downturn of the euro area has set in more strongly than expected some months ago.

As in our forecast of autumn 2018, we still consider an intensification of trade conflicts between the U.S.A. and its main trading partners as an acute downside risk to our outlook. Several CESEE-6 countries are small, open economies, and trade tensions between large trading countries would adversely spill over to the CESEE-6.

Apart from protectionist measures, unforeseeable events affecting primarily the automobile sector – such as new emission standards or a potential inability to keep up with new technologies – could become severely harmful to the growth projections for most CESEE-6 countries. Additionally, the possibility of adverse weather conditions (e.g. droughts) poses a downside tail risk to growth in particular in countries with a large agricultural sector, such as Poland and Romania.

At the EU level, the unresolved issues related to Brexit remain an important downside risk. Negative implications of Brexit could affect the CESEE-6 through the trade channel, financial stability implications and the EU budget. In addition, regardless of the future situation of the U.K., structural changes in the next EU budget are likely to have adverse consequences for the CESEE-6 countries, especially for those that heavily rely on flows of funds from the EU (such as Hungary and Poland).

As always, the economic performance of the euro area represents a major source of external risk. The outlook for the euro area, and, importantly, also for Germany, has clouded over since our last forecast. Another downside risk emanating from the euro area relates to the fiscal outlook in Italy.

Our CESEE-6 forecast is also subject to downward risks stemming from the region itself. Most prominently, the phenomenon of severer than expected labor shortages across all CESEE-6 countries and all sectors and its implications for price competitiveness represent an important factor in our risk assessment. Additionally, rising inflationary pressure associated with higher wages and strong demand could drag down real disposable income. In this context, stronger than anticipated monetary tightening due to elevated inflationary pressure is considered as a downward risk to our forecast.

Apart from economic risks, we consider political developments in some CESEE-6 countries as a downside risk to our projections. Tensions with the EU over compliance with EU laws could result in sanctions by the EU against some CESEE-6 EU Member States (for example in the form of lower flow of EU funds). Additionally, the political environment in some CESEE-6 countries could be harmful to overall confidence among foreign investors.

In terms of upside risks, a higher absorption of EU funds than currently assumed could boost investment activity more strongly than expected. Furthermore, an upward revision of euro area growth would push up CESEE-6 growth beyond current expectations. Finally, a constructive Brexit solution would lower economic uncertainty to a large extent.

2 Projections for Bulgaria, Croatia, the Czech Republic, Hungary, Poland and Romania

Bulgaria: steady economic growth supported by recovery in exports

Annual real GDP growth in 2018 turned out slightly weaker in Bulgaria than we had expected in our autumn 2018 forecast. The main reason for this is a stronger than expected slowdown in exports, as Bulgaria's most important trading partners (Germany, Italy and Turkey) all have experienced a stronger economic slowdown than foreseen. Over the forecasting horizon, we expect the economy to move sideward, anticipating GDP growth rates of slightly more than 3% per year.

A recovery of exports this year has already been backed by the favorable trend reversal seen in the last quarter of 2018 and by a projected acceleration of euro area imports. At the same time, a potentially prolonged recession in Turkey could put a drag on export growth in 2019. In view of the economic acceleration projected for the euro area in 2020, we thus expect exports to be stronger in 2020 than in 2019, before moderating again somewhat in 2021. Bulgarian imports should follow a similar path, but import growth rates will remain contained because of moderating domestic demand. On balance, the negative growth contribution of net exports is expected to shrink over the forecasting horizon.

Domestic demand components are expected to lose some steam compared to 2018. One notable exception is public consumption. After a small general government balance surplus in 2018, the medium-term budgetary forecast of the government, which was updated and fed into the adopted State Budget Law in October 2018, foresees a small deficit in 2019 (–0.5% of GDP) and surpluses of 0.5% and 0.6% of GDP in 2020 and 2021, respectively. The slight fiscal expansion in 2019 is being driven mainly by a strong annual increase in (EU co-financed and national) capital expenditure, subsidies, staff costs and social assistance benefits, reflecting the government's priority of implementing investment projects and increasing public sector wages (by 10% in 2019).

Private consumption could benefit from expansionary fiscal policies in 2019. However, it is rather unlikely that it will be possible to keep up the outstanding growth rates seen in 2018, given that the last quarter of 2018 already brought a marked deceleration amid deteriorating consumer sentiment, increased income inequality and curbed real wage growth. Slower wage growth could also alleviate inflationary pressure; the Bulgarian National Bank (in its February 2019 forecast) projects a moderation of the annual HICP inflation rate to just above 2% until the end of 2020.

Investment growth is also expected to lose some momentum compared to 2018, because of a high base level and increasing skill shortages in the labor market, among other reasons. Bank lending to the private sector might possibly be constrained in the wake of the comprehensive assessment of the six largest Bulgarian banks in the first half of 2019 and pending gradual macroprudential tightening (with the activation of the countercyclical capital buffer, set at 0.5% as from October 2019 and 1% as from April 2020). On the other hand, investment should remain robust in 2019 and 2020 thanks to still low interest rates, considerable EU funding and confidence-feeding effects caused by Bulgaria's efforts to join ERM II and the banking union.

Croatia: external demand lower, investment growth picks up

For Croatia, we expect the weakness in external demand that kept GDP growth below our expectations for the full year of 2018 to persist in 2019. We have therefore lowered our GDP forecast for 2019 to 2.5% year on year. With a better outlook for growth and trade in the euro area and accelerated EU fund absorption in 2020, we see growth temporarily returning to 2.7%, before starting to decline toward levels more consistent with potential growth in 2021.

Private consumption will remain the main growth driver in 2019, helped by several government measures effective from January 1, 2019, e.g. favorable changes in income tax brackets, lower VAT rates on a set of additional products and an increase of the minimum wage, as well as favorable labor market developments. Government measures will likely continue to support private consumption over the next years as a reduction in the VAT rate by 1 percentage point is already planned for 2020. The unemployment rate should continue its decline, and wages are expected to rise. Overall, we project a moderate decline in private consumption growth to 3.1% in 2021.

Overall, we expect the government to maintain the prudent fiscal stance it has shown over the past years, in particular in light of the plans announced by the Croatian authorities to join ERM II in 2020. Fiscal prudence and reducing the economy's external debt have paid off: the European Commission recently reclassified Croatia as facing "imbalances" instead of "excessive imbalances" and Standard and Poor's upgraded Croatia's sovereign rating to investment grade in March 2019.

Gross fixed capital formation growth accelerated in 2018 at rates beyond our previous forecast. Accordingly, we have revised the current forecast upward for the entire period, projecting an accelerated pace of EU fund absorption and positive effects from the resolution of the Agrokor crisis. Investment growth is expected to peak in 2020, at around 6%.

The negative contribution of net exports doubled in 2018 compared to 2017, largely due to a disappointing export performance. Domestic developments, in particular related to the shipbuilding sector, will lead to a renewed acceleration of export growth in 2019 and 2020, which is also in line with our assumption for euro area import growth. However, the recovery of export growth will be gradual given that the situation of Uljanik, a large shipbuilding company, will take time to be resolved. We expect import growth to outpace export growth in the entire forecast period, yielding a substantial negative contribution to growth from net exports over the entire forecast horizon.

Czech Republic: economic expansion moderates in line with labor market constraints and monetary policy tightening

The expansion of the Czech economy continued in 2018 and will ease slightly over the forecasting horizon to below 3%. Strong domestic demand on the back of fairly robust private consumption and investment will offset the drag coming from net exports, before the contribution of net external demand will become neutral in the medium term.

Private consumption is projected to expand at a rather rapid, though slowing pace, mirroring rises in wages and other components of households' disposable income. In particular, the historically unprecedented hike in pensions in January (about 7% increase of the average monthly pension) is likely to provide an extraordinary boost to private consumption as pensioners typically have a higher propensity to consume.

Fast growth in employee compensation as well as rising social transfers and other nonwage expenses will continue to spur government consumption. However, its expansion is projected to lose momentum in real terms as the growth of the deflator will outpace the increase in nominal expenditures.

Private investment activity is expected to benefit from still relatively solid external demand and a tight labor market, which incentivizes firms to improve labor efficiency by investing into automation and labor-saving technologies. Improving the drawdown of EU funds will continue to benefit public gross fixed capital formation. However, these positive forces will be counteracted to some extent by a (possibly faster than expected) tightening of monetary policy, weaker external demand and some base effects. As a result, investment in 2019 is projected to grow at less than half the pace seen last year, and it is likely to moderate further thereafter.

A more pronounced expansion in exports will be held back, particularly in the short term, by slower growth in foreign demand and a tight labor market because labor shortages will increasingly constrain production capacities. On the other hand, strong increases in wages coupled with slowing growth in foreign prices will worsen the Czech terms of trade. Sustained robust growth in domestic demand, later reinforced by strengthening export growth, will give rise to a comparably vigorous expansion of imports. Against this background, net exports will again make a negative contribution to GDP growth this year before their impact on economic expansion will become zero toward the end of the projection horizon.

The projection has been revised somewhat downward, particularly due to a weaker contribution of net exports to GDP growth. This reflects noticeable downward revisions of external demand and a deterioration in domestic producers' price competitiveness. Moreover, the now weaker projection for foreign demand in the euro area is likely to have a bigger negative impact on gross fixed capital formation. Last but not least, the koruna has not appreciated to the extent assumed by the markets and the Czech National Bank. Against this background, the central bank has signaled that a faster tightening of its monetary policy stance is rather likely. This, in turn, will slow down the expansion in private consumption and investment to a larger extent than previously assumed.

Hungary: further fiscal boost to slow the slowdown

The Hungarian economy grew by 5% in 2018, a rate clearly above that anticipated in our last forecast (4.3%). Private consumption and investments grew faster than we had anticipated; thus the contribution of domestic demand surprised on the upside. Export growth, by contrast, was lower than predicted in our forecast, leading to a worse than expected growth contribution of net real exports. Due to stronger than expected credit growth and new information on additional economic policy measures, and despite labor shortages, we now expect GDP to grow more strongly, i.e. by 3.7% in 2019 and 3.2% in 2020, before temporarily edging up to 3.4% in 2021.

Concerning new economic policy measures, the government's "Family Protection Plan," which is expected to be implemented from mid-2019, will likely have a positive impact on economic growth already from the second half of 2019 onward. Private consumption is set to benefit most from these financial support measures for families, but should also be supported by consumer confidence, which will remain strong despite some weakening since mid-2018, and high wage growth. Shortages of skilled labor and the prospect of cuts in employers' social security contribution tax rate if real wage growth exceeds certain thresholds will keep wage growth elevated but mostly aligned with productivity growth. By contrast, employment gains should slow as labor reserves are getting exhausted. The modest acceleration in 2021 is due to some elements of the Family Protection Plan which will not become effective until then as well as measures ahead of crucial parliamentary elections in spring 2022.

Some elements of the Family Protection Plan will be support investment activity, as will the central bank's new "Funding for Growth Scheme Fix." As a result, we expect investment activity to remain an important pillar of growth but to slow down over the forecast horizon.

On the one hand, capacity utilization increased further in the second half of 2018 and remained close to record highs at the beginning of 2019, while the tight labor market has benefited capital-for-labor substitution. Economic sentiment remains elevated despite a minor weakening in the second half of 2018. The growth of credit to the corporate sector picked up substantially in the second half of 2018 and should continue to be supported by favorable lending conditions in the short term. Housing construction is expected to benefit from the further extension of housing subsidies under the Family Protection Plan (on top of an extension which took effect in December 2018).

On the other hand, lending conditions are expected to become less supportive of growth over the medium-term, while the disbursement of EU funds should slow already in 2019 and more markedly in 2020 and 2021. The extension of the reduced VAT rate on new housing until 2023 (for projects with a building permit issued already in November 2018) should limit previously expected positive anticipatory effects in 2019 but should lift activity in the medium term, compared to previous assumptions.

We expect a temporary acceleration of public consumption during the first half of 2019 ahead of the elections to the European Parliament (May 2019) and municipal elections (autumn 2019), but the need to comply with EU budget rules should lead to some correction thereafter. We expect public spending to increase again in 2021, ahead of the 2022 parliamentary elections.

Export growth should roughly follow demand developments in major export markets and hence accelerate in 2019 and – to a smaller extent – in 2020, before slowing down toward the end of the forecast horizon. The excess of import growth over export growth should gradually contract as the expansion of domestic demand decelerates. We therefore expect the negative contribution of net real exports to have gradually disappeared by 2021.

Poland: lower investment growth will dampen GDP growth in 2019 and 2020

Annual GDP growth in Poland will moderate to 4.2% year on year in 2019 compared to growth of above 5% in 2018, with growth drivers shifting from domestic demand toward exports. In 2020, economic growth will continue to decelerate moderately (to 3.9%), reflecting a continued weakening of domestic demand.

Public consumption growth will increase considerably in 2019, an election year, as public sector wages will rise after years of freezes and the government is planning to introduce subsidies for local bus transport. For 2020, we expect some post-election fiscal tightening at the beginning of the year. Private consumption growth will remain nearly stable in 2019 and 2020. On the one hand, the fading growth impact of earlier significant measures (increase of child benefits, higher tax rate thresholds, official minimum wage rate hikes), the lowering of the retirement age and higher consumer price inflation will exert a dampening effect. On the other hand, private consumption growth will be stimulated by the increase of public sector wages, several measures adopted by the government that become effective in 2019 (widening of family benefits to include higher income segments, an additional one-off pension payment and the exemption of young people under 26 from income tax as well as an increase in tax-deductible expenses) and low interest rates.

Overall, we expect gross fixed capital formation growth to decline in 2019 and 2020, as the rise in public investments is forecast to decelerate markedly due to a weaker inflow of EU funds, while residential investment will not rise more strongly than hitherto despite strong household income growth and low interest rates. Business fixed investment will continue to benefit from robust domestic and stronger foreign demand growth, high capacity utilization and a favorable financing situation with respect to both own funds (profitability, accumulated deposits) and external funds (low interest rates, and, in particular for publicly owned companies, EU funds). Increasingly relevant shortages on the labor market will probably have an ambiguous effect: they are likely to prevent complementary investment in the short term and to enhance labor-substituting investment in the medium to long term.

Export growth in 2019 and 2020 will reflect, on the one hand, an expected acceleration of euro area import demand, in particular from Germany. On the other hand, the forecast decline of import demand from the world outside the euro area in 2019 as well as the anticipated rise of manufacturing unit labor costs, which is expected to outpace the rise of unit labor costs in its main trading partners, will hold back export growth.

Against this background, import growth will accelerate to about 8% in 2019 and 2020, which will be roughly in line with export growth, as weaker domestic demand growth is assumed to largely offset the effects of the relatively strong rise in unit labor costs. Hence, the contribution of net exports to GDP growth will be close to zero in both years.

Romania: economy slows, but private consumption remains up

We expect economic growth in Romania to decelerate further, to 3.0% in 2019 and to 2.8% in the following two years. Although we have revised our forecast somewhat downward, we still see downside risks to our projection. These include a stronger than anticipated negative impact of recent policy measures (sectoral taxes which might still be amended) and the unpredictability of future economic policies, which reduces investor confidence and the availability of financing. More specifically, the provision of credit will very likely be curtailed markedly due to a tax on banks' assets. Depending on the final design of this tax, this will affect investments and consumption. Moreover, after changes in inventories delivered a strong contribution to overall GDP growth in 2018, a negative impact on overall growth cannot be excluded in the coming years.

Economic policy has remained supportive of private consumption: At the beginning of the year, the minimum wage was raised by 10%. Furthermore, a minimum wage (higher than the general minimum wage) for employees with higher education and one-year work experience was introduced. Moreover, pensions will be hiked up in September 2019, and public wages are set to rise as laid down in the unified wage law enacted in 2018. On top of these policy measures, private sector wages are under pressure from tight labor market conditions. Hence, we expect private consumption to remain the key growth driver. Retail sales data for January 2019 confirmed the ongoing expansion of private consumption. The growth of public consumption will probably continue in 2019 and 2020, when presidential and parliamentary elections will be held, despite limited scope given a budget deficit of slightly below 3% in 2018 and despite EU recommendations under the significant deviation procedure to correct a deviation from the medium-term objective.

As regards gross fixed capital formation, we expect the positive trend in quarter-on-quarter growth rates recorded since mid-2018 to continue, resulting in a moderate investment recovery. Further investments in the automotive industry are on the table, and the absorption of EU structural and investment funds may improve and provide some support to investment activity. In the construction sector, favorable developments might be seen in the nonresidential segment, as some projects are in the pipeline (for example office buildings, commercial and logistics facilities).

After a weakening export performance in the course of 2018, we expect 2019 export growth to come in below the figures seen in the last few years. Yet, the launch of new car models produced in Romania should support a moderate export revival. In line with our external assumptions, export growth is expected to pick up somewhat in 2020. We expect import growth to surpass export growth, but to decelerate over the forecast horizon as domestic demand will gradually slow down. Hence, the negative growth contribution of net exports will diminish.

3 Russia: modest growth continues

In Russia, economic growth accelerated to 2.3% in 2018 on the back of rising oil prices coupled with a depreciation of the ruble.

Lower economic growth is expected to return in 2019, though.[5] The hike in value-added taxes (from 18% to 20% in January 2019) and a mild pickup in the inflation rate are dampening growth in household consumption. Moreover, there are still no signs of a real recovery in private fixed investments, which implies that net exports will remain an important growth driver in 2019. The launch of major government investments in infrastructure projects in 2020 and 2021 should slightly boost the pace of economic expansion, particularly in 2020. However, we expect Russia's economic growth to settle at around 1.5% (which corresponds to the potential growth rate) annually thereafter.

Continued low public sector wage growth, an expected leveling-off of the household borrowing spree (given some prudential tightening measures of the Central Bank of Russia), and the impact of the 2 percentage point VAT hike are likely to dampen private consumption growth, particularly in the current year. After that, some modest consumption recovery should set in. Given our oil price assumption, the general government budget should deliver sizeable surpluses throughout the forecast period because of the current fiscal rule (surplus revenues must be transferred to the National Welfare Fund if the Urals oil price exceeds USD 41 per barrel) and provided that expenditures will drop on account of the gradual increase of the retirement age.

Recent figures on construction activity suggest that projected fixed investment data may have to be adjusted upward. Russia's current major projects (Power of Siberia pipeline to China, Nord Stream II and Turkish Stream) as well as the giant natural gas liquefaction plants and shipping terminal on the Yamal Peninsula, West Siberia (Yamal LNG, a Belt & Road project strongly supported by China) could provide a boost to 2019 investment expansion. Meanwhile, major government-sponsored new national priority projects for 2019 to 2024 (incorporating the new goals set by the Russian president) are likely to get started and impact capital formation only in 2020 and 2021. Notwithstanding state-directed measures, the overall business environment will continue to suffer from a range of uncertainties and structural shortcomings specific to the Russian economy.

It is unlikely that the vibrant export expansion seen in the last two years will continue. While there will be strong growth in liquefied natural gas (LNG) exports and probably also in pipeline gas exports next year, growth can be expected to essentially plateau out thereafter. With respect to oil production and exports, observers assess it as unlikely that Russia has any significant additional available

[5] *Besides the oil price assumption, we assume for this forecast that the authorities will continue to pursue their current economic policies geared to safeguarding macroeconomic stability and strengthening economic independence. Economic independence implies favoring domestic products and services over imports, including import substitution policies. Additionally, we assume that there will be no major shifts in EU-Russia and U.S.A.-Russia relations; current sanctions and countersanctions regimes are expected to remain in place.*

capacity at the moment. Given weak increases of domestic demand, we expect import growth to continue to slow down slightly. The trend in import volumes will also depend on import prices, which, in turn, will be influenced by the ruble's exchange rate. While the effect of net exports on GDP growth during the forecast period should be positive, its impact will likely become marginal toward the end of the period.

Risks to the Russian forecast are overall balanced

Due to the floating exchange rate and adherence to its fiscal rule, Russia's economic performance has become less dependent on oil price movements. However, major changes in the oil price remain hugely important because of their impact on the ruble exchange rate, financial markets, inflation, costs of investment funding and net exports. Western sanctions had negative economic effects, particularly on Russian financial markets. Over our forecast period, the U.S.A. could launch a renewed series of sanctions, and the EU might consider a new wave of restrictive measures. Yet, the impact of such measures would likely be weakened by a consequent devaluation of the exchange rate, which would, in turn, boost the oil price in ruble and, eventually, budget revenues and cut Russia's import growth further.

While our assumptions about fixed investment growth are quite cautious, it cannot be ruled out that some of Russia's major pipeline and infrastructure projects may provide a larger than expected boost to overall capital formation in 2019 and the coming years. The largest source of uncertainty relates to net exports. While a further surge in volumes of the country's biggest export commodities is unlikely, the opening up of new energy routes to China and rapid growth in the export of certain metal industry goods could hold positive surprises in store.