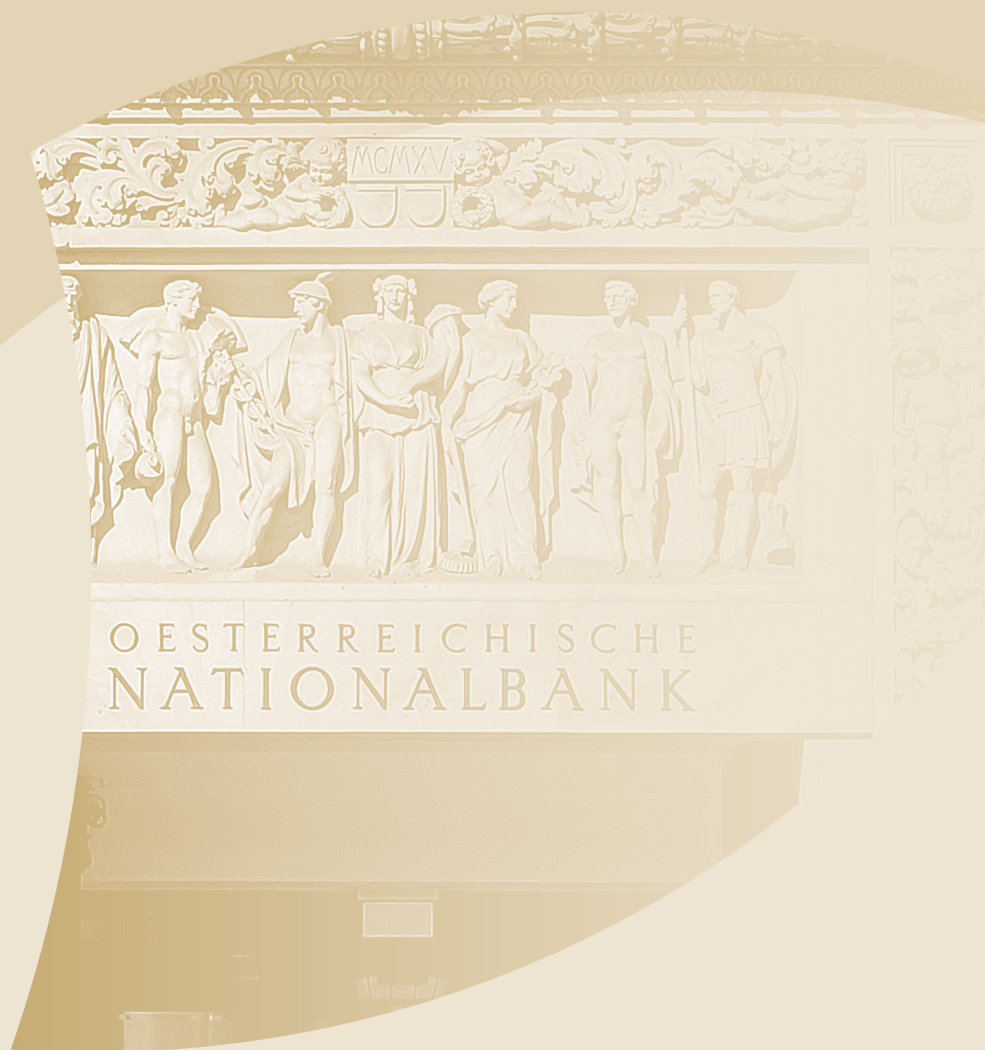


# OeNB REPORTS



# Contents

## **Economic trends**

### **Economic trends in CESEE EU member states**

*Compiled by Josef Schreiner*

### **Economic trends in EU candidate countries**

*Compiled by Tomáš Slačik*

### **Economic trends in Russia**

*Compiled by Stephan Barisitz*

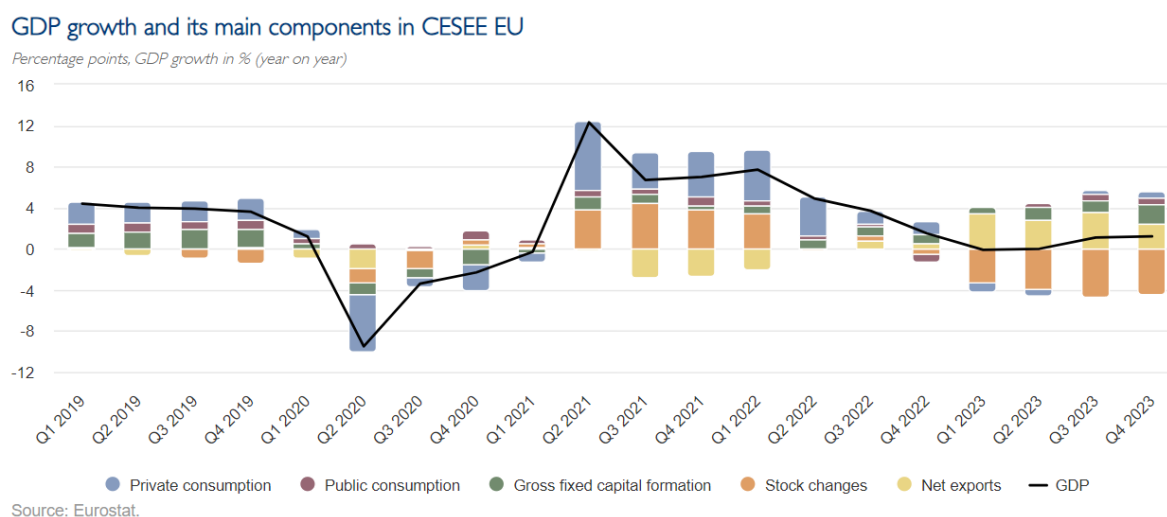
# I Economic trends in CESEE EU member states<sup>1,2,3</sup>

## Inflation is getting back on track amid a protracted economic recovery

### I Regional overview

Russia's invasion of Ukraine remains the single most important event for general economic developments in the EU member states of Central, Eastern and Southeastern Europe (CESEE). The Russian attack on Ukraine triggered high uncertainty and sent inflation through the roof to reach levels last seen in the 1990s. The starting conditions for 2023 were therefore extremely challenging. Yet, the CESEE EU members have dealt with these challenges rather successfully and engineered a soft landing. Inflation has come down substantially and sustainably, without exerting an overtly excessive burden on economic growth and the labor market. Yet economic growth remained muted and was a far cry from the dynamism seen in earlier years and from what one would expect based on CESEE's growth potential.

Chart 1



### Inventory cycle is weighing on growth

Output growth was dragged down strongly by a depletion of stocks. These stocks had been built up over the pandemic, when supply chains were clogged, companies hoarded vital inputs and occasionally found it difficult to sell certain finished (or semifinished) products on international markets. Souring sentiment, uncertainty, weakening international demand and rising energy bills after the start of the war in Ukraine were responded to by gradually reducing existing inventories. This weighed on production, especially in industry, and possibly helped to push the sector into recession. Surveys suggest that the industrial sector had largely gotten rid of its excessive stocks by early 2024. This, however, does not necessarily imply that the inventory cycle has already started to turn, as retail trade is still reporting overly full warehouses.

<sup>1</sup> Compiled by Josef Schreiner with input from Katharina Allinger, Mathias Lahnsteiner, Thomas Reiningger, Thomas Scheiber, Tomáš Slačik and Zoltan Walko.  
<sup>2</sup> Cut-off date: April 17, 2024. This chapter focuses primarily on data releases and developments from October 2023 up to the cut-off date and covers Croatia, Slovakia, Slovenia, Bulgaria, Czechia, Hungary, Poland and Romania. The countries are ordered according to their level of EU integration (euro area countries and EU member states).  
<sup>3</sup> All growth rates in the text refer to year-on-year changes unless otherwise stated.

## **Exports suffer from weak international demand and adverse developments of price competitiveness**

The weakness of industry in CESEE EU is also a reflection of the countries' strong integration in international supply networks and the geographic structure of their trade partners. Export volumes have been contracting since spring 2023, with especially strong reductions in the third quarter of 2023. On the one hand, this was related to weak world trade in general and to the meager economic performance of Germany – a country central to CESEE's growth model – in particular.

On the other hand, the price competitiveness of the CESEE EU member states has also considerably worsened since the beginning of the inflation wave. On the back of positive inflation differentials between the CESEE countries and important trading partner countries (especially the euro area), real effective exchange rates trended up strongly. In early 2024, the Czech koruna and the Polish zloty, for example, traded some 20% above their real effective value of early 2021. Developments in manufacturing unit labor costs (ULC) were also deeply unfavorable. Declining labor productivity (amid contracting manufacturing output) coupled with strongly rising labor costs pushed up ULC growth over the whole of 2023. These dynamics were stronger than in the euro area and pushed up ULC-deflated effective exchange rates throughout most the region.

## **Imports have declined even more**

The overall growth contribution of the external sector, however, remained positive, as depressed domestic demand weighed down import growth to levels even lower than export growth.

## **Private consumption is gradually recovering, but remains rather weak overall**

Besides stock changes, especially private consumption dragged down domestic demand. At an average growth rate of only 0.8% in the second half of 2023, consumer spending expanded only very moderately and, in any case, significantly more slowly than the long-term average. On a positive note, however, in the first half of 2023, consumer spending had still contracted. The recovery in the second half of 2023 was based on several factors: (1) rising purchasing power, as wages expanded swiftly and inflation came down noticeably, (2) improving consumer sentiment, with especially notable improvements in labor market and inflation expectations and (3) a very resilient labor market, considering the economic slowdown. To provide a few numbers: Average real wage growth turned positive and reached more than 6% annually in the fourth quarter of 2023. This was a level largely comparable to the readings of the pre-pandemic period. The average unemployment rate in February 2024 stood at 4.3%. This was lower than before the outbreak of the war in Ukraine and in line with the all-time low reported in late 2019. A broader measure of the labor market slack – i.e. the share of persons with an unmet need for employment in the extended labor force – even beat its end-2019 record-low reading. Labor market resilience is also underlined by employment rates often close to or at historical highs (and in most cases also notably above employment rates in the euro area) and by ongoing labor market shortages that refuse to moderate despite the economic slack and strong wage demands.

## **Investment stands out as the most important driver of growth in domestic demand**

Investments performed far better than consumption and contributed strongly to GDP growth in the CESEE EU member states. Their positive contribution even increased in the course of 2023. This momentum was fueled by public investments in infrastructure, energy and defense and was supported by regular inflows of EU money from two overlapping multiannual financial frameworks as well as from payouts from the Recovery and Resilience Facility. The fourth quarter

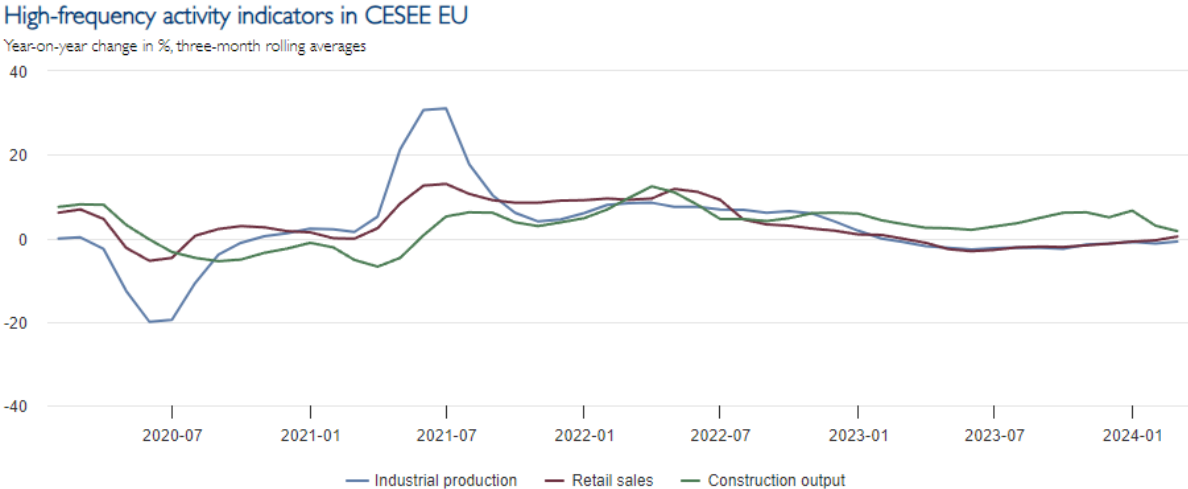
of 2023 witnessed the largest disbursement of funds from the facility yet, amounting to a total of nearly EUR 8 billion for CESEE.

A breakdown of capital formation by asset type showed ongoing healthy investment in machinery and equipment (including weapon systems) and a recovery of construction investment. Within construction, it was other buildings and structures that drove the uptick, while investment in dwellings contracted in most countries of the region. The European Commission’s business and consumer survey shows that – despite tighter financing conditions and a more difficult situation in terms of demand – planned investment spending in the manufacturing sector is still rather solid and, in most cases, higher than in the five years preceding the COVID-19 pandemic. This strength, however, reflects efforts toward rationalization at the expense of replacement and extensions.

**High-frequency activity and sentiment indicators point to a further tentative recovery**

Readily available high-frequency activity indicators support the picture of an ongoing, though somewhat tentative recovery. Industrial production and retail sales’ growth remained weak in a longer-term perspective but have slowly and continuously improved over the past months. In February 2024, industry kept stuck in recession, but retail sales again expanded moderately for the first time in over a year. As far as construction is concerned, a noticeable kink in production growth was observed in early 2024, reducing the impetus of construction for the broader economy.

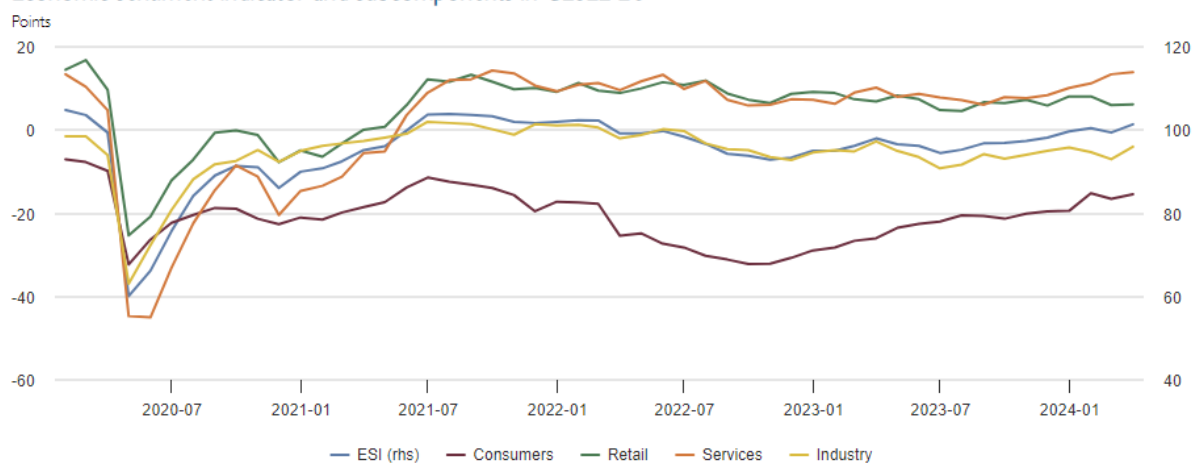
Chart 2



Source: Eurostat.

Sentiment indicators have also improved since the summer of 2023. In March 2024, the economic sentiment indicator of the European Commission even met its long-term average. It was buoyed in particular by brightening consumer and services sentiment. Sentiment among consumers benefited from disinflation and respondents’ more favorable evaluation of the current and future general economic environment and their personal financial situation. Sentiment in the services sector, brightened on account of better than expected demand conditions. Also, industrial sentiment trended up moderately based on improving production expectations. Readings of the purchasing managers’ index (PMI), however, remain well below the 50-points threshold that would indicate an economic expansion. This weakness partly also reflects structural factors, including the post-pandemic shift in consumption back toward services and a general uncertainty amid intensified fragmentation and current geopolitical turbulences.

Economic sentiment indicator and subcomponents in CESEE EU



Source: European Commission.

### The inflation wave seems to have finally broken

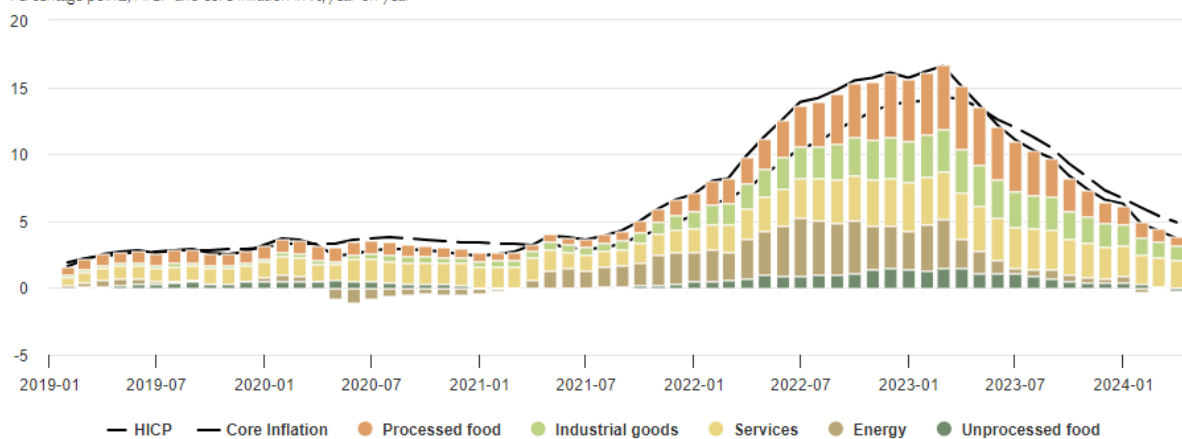
The average inflation rate in CESEE fell to 3.7% in March 2024 – the lowest level recorded since July 2021 – compared with almost 17% at the beginning of 2023. The observed downward movement was strongly influenced by lower price pressures from energy and food. In the first three months of 2024, energy prices even contributed negatively to inflation, which had not been the case for three years. European energy markets stabilized after the disruptions of 2022 amid a redirection of energy demand away from Russian energy carriers, an expansion of renewable energies and a mild winter that left large parts of gas storages untouched. Food price inflation benefited from a good harvest in 2023, from Ukraine’s ability to export more grain thanks to a naval corridor in the Black Sea and land exports via Romania as well as from cheaper input prices (fuel, energy, fertilizer). Base effects were also at play in both areas.

The disinflationary process, however, was much broader based and encompassed large parts of the consumption basket. In March 2024, some 80% of all items within the HICP recorded falling inflation rates. These downward trends were based on (1) weaker cyclical demand pressures and inflation expectations supporting the restrictive monetary policy stance, (2) declining producer and commodity prices that were slowly feeding through the price chain, (3) a general reduction in upstream price pressures and the fading of external supply shocks<sup>4</sup> as well as (4) generally more benign import price developments.

<sup>4</sup> The war in Gaza has not yet caused any lasting disruptions to supply chains: shipping costs (as e.g. measured by the Baltic Dry Index) only increased temporarily and global supply chain pressures (as e.g. measured by the Global Supply Chain Pressure Index provided by the Fed New York) remained below their long-term averages throughout the review period.

### Inflation in CESEE EU

Percentage points; HICP and core inflation in %, year on year



Source: Eurostat.

### Prices for services remain elevated

Nevertheless, core inflation remained above headline inflation throughout the observation period and stood at 4.9% in February 2024. This was related to comparatively high price rises in services, a sector in which pricing is heavily dependent on wage trends. The share of inflation that was accounted for by services rose from a fifth at the beginning of 2023 to more than half in March 2024. A decomposition of quarterly national accounts data shows that – while profits contributed less or in some cases negatively – the contribution of labor costs to the annual change in the gross value added deflator remained substantial and roughly unchanged over the second half of 2023.

### Inflation targets are being met again in many countries

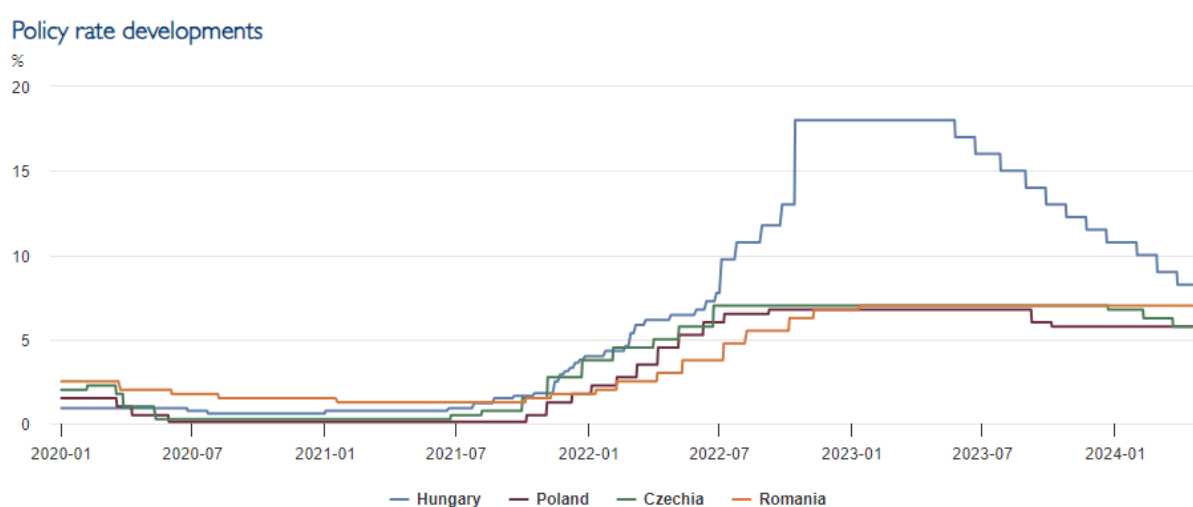
At the country level, all countries saw a strong decline in price growth. In several cases, inflation was converging to respective targets in early 2024. In Hungary, inflation stood at 3.6% in March 2024 (CPI), which was already within the range around the country's inflation target ( $3\% \pm 1$  percentage point). In Czechia, inflation came in at 2% (CPI) in March 2024 and therefore reached its target ( $2\% \pm 1$  percentage point). In Poland, inflation even undercut its target ( $2.5\% \pm 1$  percentage point) with 2% in March 2024 (CPI). Among the inflation-targeting countries with independent monetary policy, only Romania failed to bring inflation close to its target ( $2.5\% \pm 1$  percentage point) as CPI inflation stood at 6.6% in March 2024. Among the CESEE euro area members, price growth proved rather sticky in the first three months of 2024 in Croatia (4.9% in March) and Slovenia (3.4% in March) but converged toward the target in Slovakia (2.4% in March). Inflation was on a clear downward trend in Bulgaria and reached 3.1% in March 2024.

Looking forward, central banks do not necessarily see a continuation of the swift, and in many ways unexpected, strong disinflationary trend. While the cyclical momentum of the economy will likely remain muted over the short term, base effects will reverse over the course of 2024 and imported inflation could rise again, either because of exchange rate swings or because of a resurgence of supply chain problems. Moreover, tight labor markets could push up wage demands and consumption, pinning down core inflation at higher levels. Some questions also remain with regards to the continuation of government interventions in food and/or energy prices that are still in place in several countries.

## Monetary easing progresses at a reduced pace

These considerations informed monetary policy decisions in the inflation-targeting countries in the review period, so that Poland and Romania did not cut their rates (any further). The Hungarian central bank set further steps and lowered its policy rate in six installments from 13% in October 2023 to 8.25% in April 2024, as disinflation has been stronger than expected and external and domestic demand pressures have remained persistently low. Magyar Nemzeti Bank (MNB), however, slowed the pace of easing in March, as risk premiums on Hungarian assets have risen. A relaxation was also implemented in Czechia, where the key interest rate was reduced from 7% in October 2023 to 5.75% in April 2024. In its latest statement, the Czech central bank remarked that it considers it necessary to persist with tight monetary policy and to continue to approach further rate cuts with caution.

Chart 5

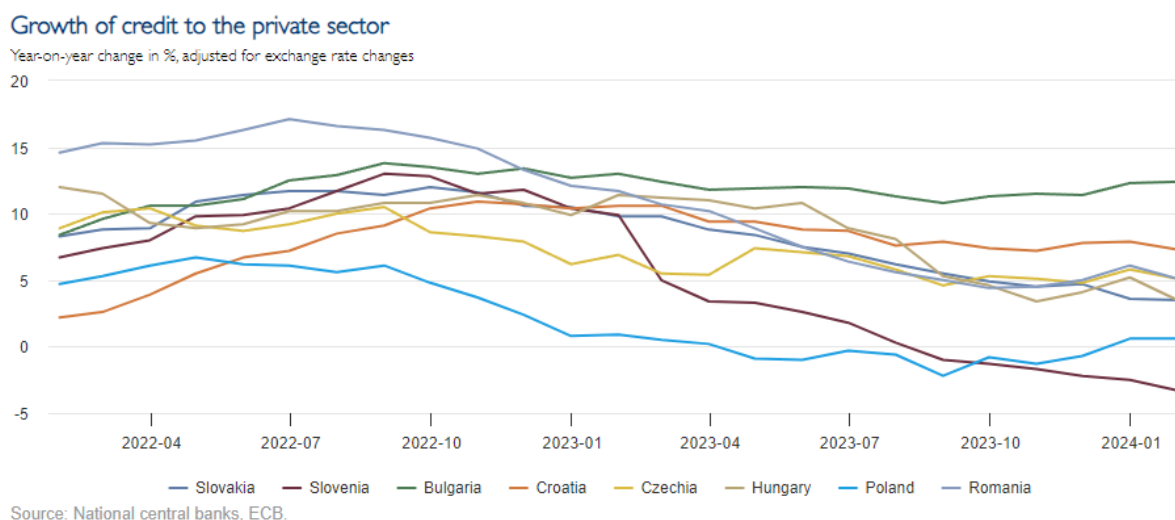


## Generally healthy banking sectors have not yet accelerated lending

The fall in inflation and the associated stepwise reductions in policy rates did not provide a boost to credit markets yet. In fact, credit dynamics remained rather lackluster throughout most of the region, with companies in many instances being even more hesitant than households to take on new credit. Surveys for the second half of 2023 reveal that credit supply conditions remained tight across the board and that credit demand was robust only for short-term operations (e.g. for working capital, debt restructuring and consumer credit), while credit take-up for longer-term operations (e.g. fixed investment and housing) was weaker. This possibly reflected ongoing uncertainty in the banking sector despite ample corporate and retail funding, high capitalization and a largely positive development of asset quality. Throughout 2023, private sector deposits exceeded private sector claims by a large margin in all countries but Slovakia; tier 1 capital ratios frequently remained at levels of about or above 20% and nonperforming loans (NPLs) trended further down. By the end of 2023, nonperforming loan ratios reached their lowest level since the great financial crisis in many countries (e.g. in Czechia, Bulgaria, Romania, Croatia and Slovenia). Moreover, the share of so-called “stage 2” loans, for which banks are less certain of credit quality, also declined in some countries compared to a year earlier (e.g. in Czechia, Hungary, Romania and Slovakia).



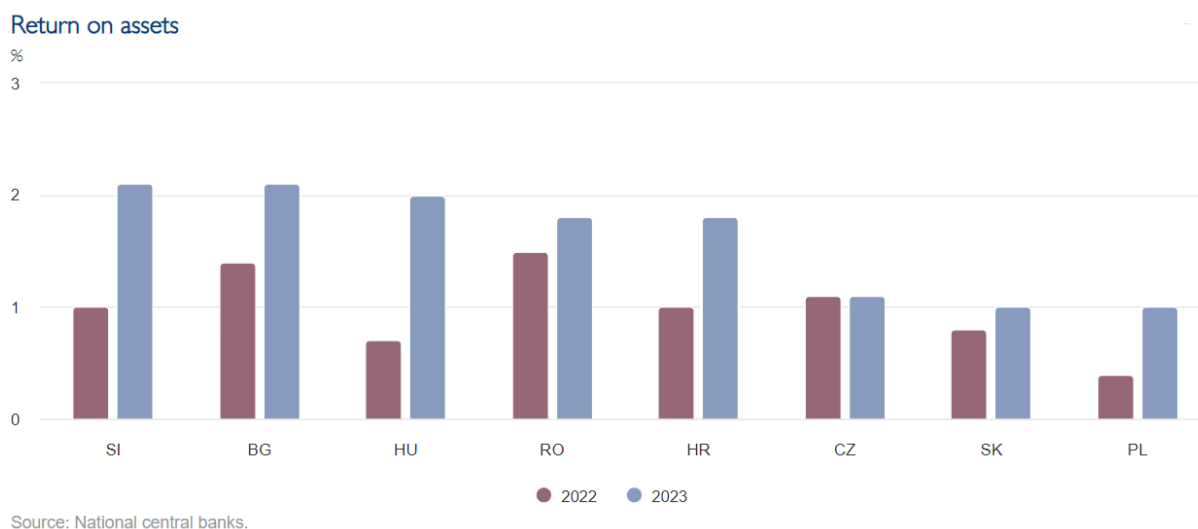
Chart 6



### Banking sector profits at a record high

Banking sector profitability also developed very favorably. A strong rise in lending rates coupled with a weaker transmission of monetary policy signals to deposit rates sent bank's net interest margins up, and improving asset quality allowed for some release of provisioning. Against this background, the average return on assets in the CESEE region increased to 1.6% at the end of 2023, a figure last observed 15 years ago.

Chart 7

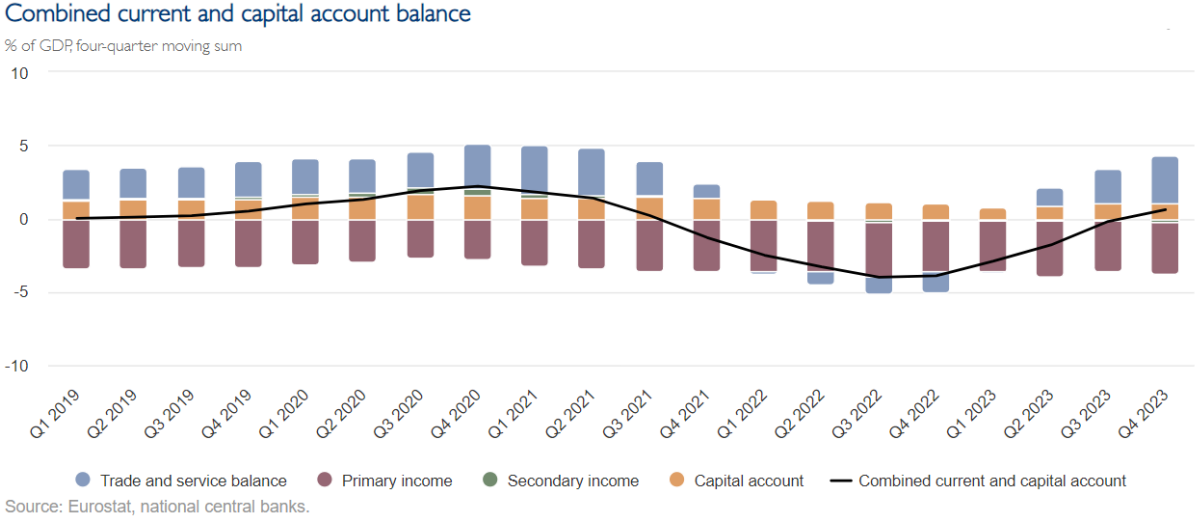


### External accounts swing into surplus

In 2023, the combined current and capital account balance in the CESEE EU member states turned into surplus for the first time since the pandemic disrupted global trade. For the regional aggregate, the surplus reached 0.6% of GDP in 2023, up from -3.9% of GDP a year earlier. This remarkable improvement was driven predominantly by the trade balance, which was propelled by (1) positive terms-of-trade effects on the back of lower prices for energy imports, (2) a generally lower energy consumption and (3) a certain decline in nonenergy imports amidst the economic downturn. Among the other components of the external accounts no major changes were reported for the second half of 2023 (and throughout full-year 2023), with large negative

contributions from primary income (mainly repatriated FDI earnings amid generally sound corporate profits) and notably positive contributions from the capital account (mainly from inflows of EU funds).

Chart 8



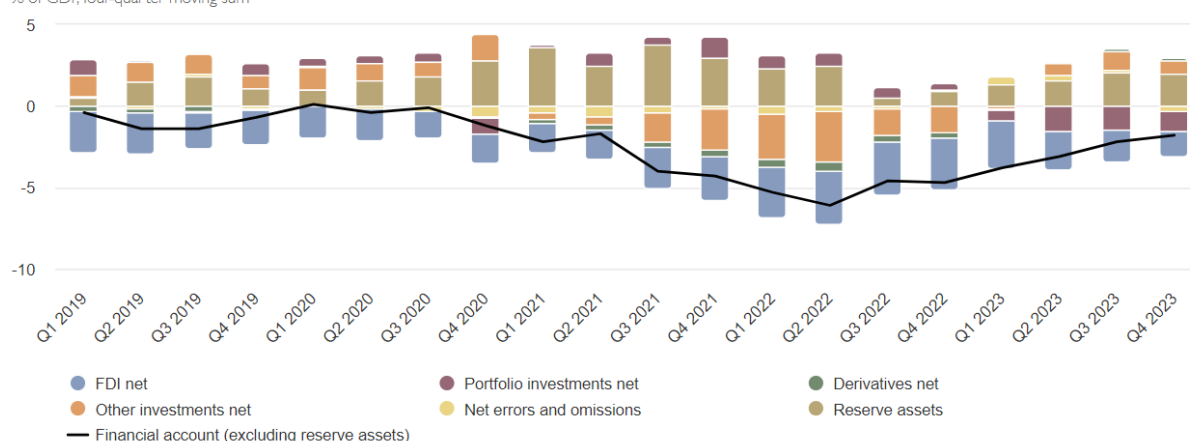
At the country level, the picture was very much comparable: combined current and capital account balances moved close to or remained in surplus. The major exception from this pattern was Romania, where the trade balance not only did not improve, but the overall current account balance remained deep in the red.

At same time, capital kept on flowing into Romania. FDI inflows covered around a third of the deficit and the country was among the largest recipients of portfolio (government debt) investments in CESEE. The financial account for the broader CESEE region showed FDI inflows of 1.6% of GDP in 2023 (down from 3.2% of GDP in 2022), portfolio inflows of 1.2% of GDP in 2023 (up from an outflow of 0.4% of GDP in 2022) and outflows of other investments of 0.8% of GDP in 2023 (down from an inflow of 1.6% of GDP in 2022). Those capital flows partly reflected the changes in the international interest rate environment. The narrowing interest rate differential between CESEE countries and the euro area made cross-border financing via intercompany loans (recorded under FDI), loans and trade credits (both recorded under other investments) less attractive. At the same time, healthy investor appetite and rising budgetary financing needs boosted debt portfolio liabilities.

Chart 9

### Financial account

% of GDP, four-quarter moving sum



Note: Positive values indicate a net outflow, negative values indicate a net inflow of capital (vice versa for reserves). Source: Eurostat, national central banks.

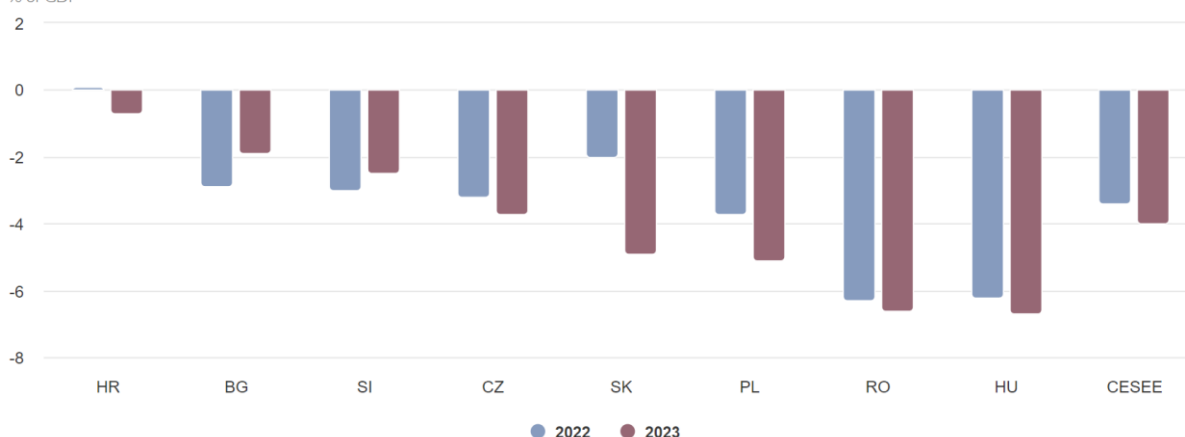
### Public finances often moved farther away from the Maastricht targets

General government budget deficits mostly increased in the CESEE region. Though revenues kept flowing in – they were up by 0.6 percentage points of GDP on average, owing mostly to higher capital revenues –, expenditure was on an upward path too (+1.2 percentage points of GDP). Interest expenditure grew noticeably as higher rates were slowly feeding through into the debt stock. But spending in the region also increased on the back of higher social benefits and subsidies, reflecting measures to control inflation, the electoral cycle and, to some extent, the working of automatic stabilizers. A clear increase was also recorded in governments’ gross fixed capital formation. This uptick was not only supported by EU co-financing requirements, but military spending increased as well. According to NATO data, outlays for defense increased by close to EUR 20 billion in 2023, of which Poland contributed roughly three-quarters.

Chart 10

### General government deficits

% of GDP



Source: Eurostat.

At the time of writing, Romania was the only CESEE country subject to an excessive deficit procedure. Through the lens of the Maastricht criteria, 2023 brought the following developments: All countries but Croatia, Bulgaria and Slovenia reported a public deficit of above 3% of GDP in 2023. Deficits even increased to above 5% of GDP in Poland and to even above 6% of GDP in Romania and Hungary. The debt criterion was less of a problem, as (1) CESEE countries have historically recorded rather low debt levels compared to their Western European peers, also in terms of the 60% of GDP threshold and as (2) inflation and associated high nominal GDP growth reduced debt levels. In the region, only Hungary, Slovenia and Croatia reported government debt above 60% of GDP. However, in the latter two countries, debt levels fell most strongly year on year. For the region on average, the debt stock declined from 54% of GDP in 2022 to 53.4% of GDP in 2024.

## 2 Croatia: top of the EU league in economic growth and inflation

In 2023, economic developments in Croatia were somewhat exceptional in a cross-country comparison. Croatia recorded one of the highest GDP growth rates in the EU in 2023, but also one of the highest HICP inflation rates as of March 2024. Regarding house price developments, Croatia reported the third-highest annual growth rate among EU countries in 2023. The comparatively weaker transmission of monetary policy likely played a role in these developments.

Croatian GDP grew by 2.8% year on year in 2023, after growth accelerated to 3.6% in the second half of the year. On the output side, the largest contributions to annual growth came from taxes, followed by contributions from the sectors of wholesale and retail trade, financial activities and professional, scientific and technical activities. Only the industrial sector made a negative contribution to annual growth. On the expenditure side, household consumption and net exports made the largest positive contributions. Gross fixed capital formation also made a positive, albeit smaller contribution. Its growth accelerated in the second half of the year. Only changes in inventories contributed negatively to the annual growth rate.

Regarding private consumption, growth picked up in the second half of the year and was supported by a resilient labor market. The unemployment rate was 6.4% in December 2023, mildly higher than in mid-2023, but lower than at end-2022. The employment rate continued to increase to new highs, reaching 66.5% at end-2023. While annual HICP inflation remained relatively high in Croatia (4.9% year on year in March), wage growth outpaced inflation. Gross wages increased by roughly 6% in real terms in 2023. Wage developments are certainly one factor to watch when it comes to the inflationary process. The Croatian central bank's latest projections predict HICP inflation at 3.5% for 2024 and 2.4% in 2025.

Private consumption was also supported by continued strong lending to households with growth around 8% year on year. Growth of general-purpose cash loans accelerated markedly. During the second half of 2023, lending dynamics slowed further in the corporate segment, likely due to high financing costs. The banking sector continued to profit from higher interest rates. Its return on assets reached 1.8%, the highest level in more than 20 years. The sharp increase was mostly due to interest income. The NPL ratio declined mildly to 2.6% at end-2023. The Tier 1 capital ratio stood at an elevated level of 23%. The decline by 1.2 percentage points compared to end-2022 was largely due to dividend payments in the first half of the year.

The fiscal deficit remained under control and was 0.7% of GDP in 2023. Government debt stood at 63% of GDP, more than 5 percentage points lower than a year ago. In 2023, all three major rating agencies updated the outlook for Croatia's sovereign rating to "positive."

The current account recorded a surplus of 1.1% of GDP in 2023. The deficit of the goods balance was lower than in 2022, while the services balance surplus remained broadly unchanged. The latter was supported by another strong tourist season. The capital account surplus was 2.9% of GDP. Croatia remained among the leading countries in terms of the absorption of Recovery and Resilience funds. By mid-April the European Commission had disbursed four payments amounting to EUR 3.7 billion (1.1% of GDP, 63% of total allocated grants). The absorption of financial means from the Cohesion Fund is, however, progressing very slowly relative to other EU countries.

2024 is another politically important year for Croatia, due to parliamentary, EU and presidential elections. Parliamentary elections were held on April 17, 2024. The electoral campaign was short and intensified after President Milanović announced his ambitions to become prime minister for

the largest opposition party. In the end, the ruling Croatian Democratic Union (HDZ) lost some seats compared to the elections in 2020 but remained the strongest party. Still, the results of upcoming coalition talks are highly uncertain.

**Table 1: Main economic indicators: Croatia****Main economic indicators: Croatia**

	2021	2022	2023	Q1 23	Q2 23	Q3 23	Q4 23
<i>Year-on-year change of the period total in %</i>							
GDP at constant prices	13.8	6.3	2.8	1.6	2.6	2.7	4.3
Private consumption	10.6	6.7	3.0	2.0	2.2	2.8	5.0
Public consumption	3.0	2.7	2.8	2.6	6.8	2.1	0.2
Gross fixed capital formation	6.6	0.1	4.2	0.7	4.2	6.1	6.0
Exports of goods and services	32.7	27.0	-2.9	9.8	-0.7	-8.5	-4.4
Imports of goods and services	17.3	26.5	-5.3	0.7	-1.6	-12.1	-7.1
<i>Contribution to GDP growth in percentage points</i>							
Domestic demand	8.6	6.8	1.1	-2.0	1.9	2.2	1.8
Net exports of goods and services	5.2	-0.5	1.7	3.6	0.7	0.6	2.5
Exports of goods and services	13.6	13.4	-1.7	4.2	-0.4	-7.0	-2.3
Imports of goods and services	-8.4	-13.9	3.5	-0.6	1.1	7.6	4.7
<i>Year-on-year change of the period average in %</i>							
Unit labor costs in the whole economy (nominal, per person)	..	..	..	..	..	..	..
Unit labor costs in manufacturing (nominal, per hour)	-1.6	6.8	10.6	9.8	8.4	9.7	14.5
Labor productivity in manufacturing (real, per hour)	4.7	1.0	3.1	-0.1	5.0	4.6	2.7
Labor costs in manufacturing (nominal, per hour)	3.1	7.9	14.0	9.7	13.9	14.8	17.6
Producer price index (PPI) in industry	11.7	25.8	0.7	9.2	-0.7	-3.1	-2.6
Consumer price index (here: CPI)	2.7	10.7	8.4	11.6	8.5	8.0	5.9
EUR per 1 HRK, + = HRK appreciation	0.1	-0.1	..	..	..	..	..
<i>Period average levels</i>							
Unemployment rate (ILO definition, %, 15–64 years)	7.6	7.1	6.2	7.4	5.7	5.6	6.0
Employment rate (% , 15–64 years)	63.4	65.0	65.7	64.6	66.0	65.8	66.5
Key interest rate per annum (%)	..	..	..	..	..	..	..
HRK per 1 EUR	7.5	7.5	..	..	..	..	..
<i>Nominal year-on-year change in period-end stock in %</i>							
Loans to the domestic nonbank private sector <sup>1</sup>	2.4	10.4	7.9	9.4	8.7	7.4	7.9
<b>of which:</b>							
loans to households	4.1	5.3	9.4	5.8	6.1	7.7	9.4
loans to nonbank corporations	-0.1	18.6	5.9	14.9	12.5	7.0	5.9
Share of foreign currency loans in total loans to the nonbank private sector	52.2	58.1	0.4	0.2	0.4	0.6	0.4
Return on assets (banking sector)	1.2	1.0	1.8	1.6	1.9	1.9	1.8
Tier 1 capital ratio (banking sector)	25.4	24.2	23.0	23.0	22.6	22.7	23.0
NPL ratio (banking sector)	4.3	3.0	2.6	3.2	3.0	2.7	2.6
<i>% of GDP</i>							
General government revenues	46.1	45.0	46.7				
General government expenditures	48.6	44.9	47.4				
General government balance	-2.5	0.1	-0.7				
Primary balance	-1.0	1.5	1.0				
Gross public debt	78.1	68.2	63.0				
<i>% of GDP</i>							
Debt of nonfinancial corporations (nonconsolidated)	82.7	77.1	73.1				
Debt of households and NPISHs <sup>3</sup> (nonconsolidated)	34.0	30.7	30.1				
<i>% of GDP (based on EUR), period total</i>							
Goods balance	-19.5	-26.7	-22.8	-27.3	-25.6	-19.8	-19.7
Services balance	16.8	20.5	20.8	7.0	18.4	42.5	9.4
Primary income	0.0	0.2	0.1	1.3	0.1	-1.7	1.2
Secondary income	3.6	3.1	3.0	2.7	3.2	2.7	3.5
Current account balance	1.0	-2.8	1.1	-16.3	-3.8	23.7	-5.7
Capital account balance	2.4	2.5	2.9	2.8	3.7	2.0	3.2
Foreign direct investment (net) <sup>3</sup>	-5.1	-5.4	-1.9	-3.5	-1.1	-3.7	0.8
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>							
Gross external debt	76.5	72.9	84.4	81.1	78.6	84.0	84.4
Gross official reserves (excluding gold)	42.7	40.8	3.6	4.2	3.7	3.6	3.6
<i>Months of imports of goods and services</i>							
Gross official reserves (excluding gold)	9.8	7.5	0.8	0.8	0.7	0.7	0.8
<i>EUR million, period total</i>							
GDP at current prices	58,476	67,998	75,855	16,162	18,840	22,122	18,731

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

<sup>1</sup> Foreign currency component at constant exchange rates.

<sup>2</sup> Nonprofit institutions serving households.

<sup>3</sup> + = 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 Slovakia: navigating tight labor markets and fiscal urgency

In the second half of 2023, the Slovak economy showed mixed signals of recovery and ongoing challenges. It continued to expand at a similar, rather moderate pace as in the first six months of the year. In the whole of 2023, real GDP thus grew by 1.1%. While this was a noticeable slowdown of the growth pace compared to 2022, a worse outcome was avoided thanks to a strong fiscal stimulus<sup>5</sup>. More specifically, amid negative real wage growth in the first three quarters of 2023 and depleted pandemic-era savings, the government's increase in social spending and measures to counteract the impact of elevated energy prices helped mitigate the decline in households' real disposable income. Consequently, while these measures contained the contraction of private consumption, they boosted government spending, particularly in the second half of the year. Gross fixed capital formation was the brightest spot among domestic demand components in 2023. Especially the final quarter saw a massive increase in investment activity as a result of the last opportunity to exploit EU funds from the previous programming period. The central and particularly local governments invested primarily in infrastructure projects and transportation. Yet firms too, facing shortages of (skilled) labor, increased their investment in machinery and equipment, i.e. automation. Amid weak (foreign and domestic) demand and relaxed supply chain frictions, changes in inventories put a massive drag on growth (−5.6 percentage points in 2023). In contrast, net exports made a key growth contribution in 2023. This was despite an annual contraction of exports which suffered from subdued foreign demand. Lately, this trend has also reached the automotive industry, the crucial workhorse of the Slovak economy and its exports. However, weak domestic demand led to an even stronger decline in imports.

To a certain extent, the labor market keeps defying the not-so-exuberant growth performance of the Slovak economy. Labor supply has been continuously widening, facilitated by a rising number of employed foreigners and an increasing participation rate. The latter is due, among other things, to previously inactive segments of the labor force, such as older individuals and those who previously believed they could not find work, now re-entering the labor market. Nonetheless, despite the influx of this labor, the tension in the labor market and shortage of skilled labor remain high. As a result, the unemployment rate has reached new historical lows, continuing its downward trend, which has persisted since early 2013 with one significant breather during the pandemic. After two years of contracting real wages, households purchasing power started expanding again toward end-2023 as nominal wage growth outpaced inflation. Annual growth in wages was particularly pronounced in the public sector owing to one-off bonuses.

Since its peak in February 2023 at levels unseen since mid-2000, inflation has been continuously heading downward. Aided by a base effect, the drop in inflation accelerated with the turn of the year. As a result, with the most recent reading of 2.7% in March 2024, inflation in Slovakia is approaching the ECB's price stability target fast. The easing of headline inflation has been driven by most categories, in particular food, energy and other commodities. Yet, given weak consumer demand and high interest rates, core inflation has mimicked the steep downward path of headline inflation.

The general government deficit increased significantly to 4.9% of GDP in 2023 after 2% of GDP a year earlier. The rise was driven particularly by temporary energy support measures such as energy price caps, a permanent increase in social spending as well as higher expenditures owed to

---

<sup>5</sup> According to the IMF's Article IV Consultation published in March 2024 the headline deficit in combination with EU-financed public investment brought about a fiscal impulse of 5.2 percentage points.



inflation indexation. The fact that the fiscal outcome ended up better than budgeted (−6.4% of GDP) should not mask Slovakia’s urgent need to bring public finances back on a sustainable path. The government debt stood at 56% of GDP by end-2023. However, Slovakia’s independent fiscal watchdog, the Council for Budget Responsibility (RRZ), keeps issuing serious warnings, including the message that in the absence of consolidation measures, public debt could exceed the Maastricht criterion of 60% of GDP already next year. While the government stresses that consolidation will not come at the expense of the achieved social standard, a significant consolidation plan is due to be presented (to foreign investors) by mid-year.

**Table 2: Main economic indicators: Slovakia****Main economic indicators: Slovakia**

	2021	2022	2023	Q1 23	Q2 23	Q3 23	Q4 23
	<i>Year-on-year change of the period total in %</i>						
GDP at constant prices	4.8	1.8	1.1	0.5	1.5	1.1	1.3
Private consumption	2.6	5.5	-2.5	-2.2	-3.6	-1.8	-2.3
Public consumption	4.2	-4.2	-0.5	-5.8	-2.2	2.9	2.0
Gross fixed capital formation	3.5	4.5	9.6	5.7	12.4	2.8	15.9
Exports of goods and services	10.5	3.0	-1.3	-3.7	-0.8	0.1	-0.9
Imports of goods and services	11.7	4.2	-7.4	-12.3	-8.0	-4.0	-5.6
	<i>Contribution to GDP growth in percentage points</i>						
Domestic demand	5.7	2.9	-5.3	-9.0	-6.1	-3.2	-3.4
Net exports of goods and services	-0.9	-1.2	6.4	9.5	7.6	4.3	4.8
Exports of goods and services	8.9	2.8	-1.3	-3.5	-0.8	-0.4	-0.8
Imports of goods and services	-9.8	-3.9	7.8	13.1	8.4	4.7	5.6
	<i>Year-on-year change of the period average in %</i>						
Unit labor costs in the whole economy (nominal, per person)	1.3	5.9	8.2	8.4	7.8	6.9	9.5
Unit labor costs in manufacturing (nominal, per hour)	-3.3	10.7	6.2	10.1	4.9	7.3	3.4
Labor productivity in manufacturing (real, per hour)	9.3	-1.8	1.6	-1.8	2.4	1.3	4.4
Labor costs in manufacturing (nominal, per hour)	6.3	8.5	8.1	8.1	7.4	8.7	8.0
Producer price index (PPI) in industry	6.8	27.8	9.2	20.1	9.4	4.0	3.2
Consumer price index (here: HICP)	2.8	12.1	11.0	15.1	12.5	9.6	7.1
EUR per 1 SKK, + = SKK appreciation	..	..	..	..	..	..	..
	<i>Period average levels</i>						
Unemployment rate (ILO definition, %, 15–64 years)	6.9	6.2	6.0	6.3	5.8	6.0	5.7
Employment rate (% , 15–64 years)	69.5	71.4	72.0	71.3	72.0	71.9	72.7
Key interest rate per annum (%)	0.0	0.6	3.8	2.9	3.7	4.2	4.5
SKK per 1 EUR	..	..	..	..	..	..	..
	<i>Nominal year-on-year change in period-end stock in %</i>						
Loans to the domestic nonbank private sector <sup>1</sup>	7.3	10.5	3.6	8.8	7.0	4.9	3.6
<b>of which:</b>							
loans to households	8.8	10.3	4.1	8.4	6.4	4.9	4.1
loans to nonbank corporations	4.3	10.8	2.5	9.6	8.3	5.0	2.5
Share of foreign currency loans in total loans to the nonbank private sector	0.1	0.1	0.0	0.1	0.0	0.0	0.0
Return on assets (banking sector)	0.7	0.8	1.0	0.8	1.0	1.0	1.0
Tier 1 capital ratio (banking sector)	18.5	18.1	19.0	18.1	18.1	18.5	19.0
NPL ratio (banking sector)	1.9	1.7	1.8	1.7	1.8	1.9	1.8
	<i>% of GDP</i>						
General government revenues	40.2	40.2	43.0				
General government expenditures	45.3	42.3	47.9				
General government balance	-5.2	-2.0	-4.9				
Primary balance	-4.0	-1.1	-3.7				
Gross public debt	61.1	57.8	56.0				
	<i>% of GDP</i>						
Debt of nonfinancial corporations (nonconsolidated)	52.7	51.9	46.8				
Debt of households and NPISHs <sup>3</sup> (nonconsolidated)	47.0	47.1	44.3				
	<i>% of GDP (based on EUR), period total</i>						
Goods balance	-0.5	-6.0	1.3	0.6	3.2	1.8	-0.4
Services balance	0.5	0.3	0.5	0.9	0.7	0.3	0.1
Primary income	-1.5	-1.7	-2.6	-2.6	-2.2	-2.6	-3.0
Secondary income	-1.0	-0.8	-0.8	-1.2	-0.7	-0.9	-0.4
Current account balance	-2.5	-8.2	-1.6	-2.3	1.0	-1.4	-3.6
Capital account balance	1.3	1.2	1.1	-0.8	0.5	0.6	3.7
Foreign direct investment (net) <sup>3</sup>	0.3	-2.1	-0.1	3.0	-1.8	2.8	-4.0
	<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>						
Gross external debt	132.7	103.1	96.5	101.5	100.0	99.6	96.5
Gross official reserves (excluding gold)	6.8	7.2	8.4	8.5	8.2	7.9	8.4
	<i>Months of imports of goods and services</i>						
Gross official reserves (excluding gold)	0.9	0.8	1.1	1.0	1.0	1.0	1.1
	<i>EUR million, period total</i>						
GDP at current prices	100,256	109,645	122,156	27,610	30,343	32,181	32,023

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

<sup>1</sup> Foreign currency component at constant exchange rates.

<sup>2</sup> Nonprofit institutions serving households.

<sup>3</sup> + = 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 Slovenia: soft landing but fiscal risks remain

In 2023, Slovenia's GDP grew by 1.6% year on year (down from 2.5% in 2022), experiencing some acceleration from the first to the second half of the year. Gross fixed capital formation remained the most vigorous demand component and the biggest contributor to the overall GDP growth rate in the second half of the year. Construction activity in particular was very buoyant, supported by public sector investments including those financed with EU funds and those in connection with reconstruction works after the devastating floods in early August 2023. By contrast, the contraction of investments in machinery and nontransport equipment deepened in the second half of 2023. This was in line with the continued decline in industrial capacity utilization, worsening export order book levels, tight monetary conditions, accelerating decline in corporate credit and global economic uncertainties. Also, private consumption growth weakened during the second half of 2023, although signs of some improvement appeared in the final quarter. Poor consumer confidence and weak household credit growth (in particular for house purchase) seem to have suppressed consumption, despite the acceleration of real average wage growth to nearly 5%. At the same time, government consumption accelerated, likely supported by expenditures for post-flood reconstruction. Year-on-year export growth weakened sharply and turned negative in the second half of 2023. Although imports contracted even more, their (further) deterioration compared to the first half of 2023 was smaller than that of exports, resulting in a notable decline in the (positive) contribution of net real exports to the overall GDP growth rate.

The general government budget deficit amounted to 2.5% of GDP in 2023, down from 3.0% in 2022. The decline was caused by the budgets of local governments and the social security fund reaching a small surplus, while the deficit of the central government increased modestly, mainly due to substantial public investments, higher labor costs, the weakening of economic activity and government measures to mitigate the impact of high inflation and severe floods. For 2024, the government is targeting a general government budget deficit of 3.8% of GDP. However, since the 2023 deficit turned out lower than the planned 4.5% of GDP, the fiscal council has warned against the implementation of discretionary measures in the course of 2024 that could have a lasting negative impact on the fiscal position. According to the council, renewed demands for public sector wage increases represent a further risk for fiscal sustainability, if not accompanied by a systematic public sector wage reform and an increase in public sector efficiency.

Gradual disinflation continued during the reference period and HICP inflation fell to 3.4% year on year in March 2024. Disinflation was primarily driven by energy and unprocessed food prices. Both base effects and the decline in global commodity prices toward the end of 2023 and in early 2024 played a role. At the same time, core inflation decelerated substantially as well, mainly on account of processed food and nonenergy industrial goods prices. Despite moderation, services price inflation has been notably higher than the overall inflation rate since the last quarter of 2023, which may be related to the comparably stronger growth in unit labor costs in major segments of the services sectors during 2023.

Slovenia's combined current and capital account turned around in 2023 and registered a surplus of 4.2% of GDP. The improvement came mostly from the goods balance, which benefited from favorable terms-of-trade developments and weak domestic demand and registered a minor

surplus. Despite the appreciation of the ULC-based real effective exchange rate, Slovenia's market share in total EU-27 imports continued to increase in 2023. The services balance showed a big surplus, comparable to 2022, and also the primary and secondary income balance and the capital account posted a smaller combined deficit than in 2022.

Owing to the improvement in net interest income, banking sector profitability improved notably in 2023, with return on assets doubling to 2.1%. This helped bolster the capital base, leading to an increase in the capital adequacy ratio (tier 1) to 16.9% by the third quarter of 2023. Despite the economic turbulences of the past few years (COVID-19 and energy crisis) the share of nonperforming exposures remained at historic lows.

**Table 3: Main economic indicators: Slovenia****Main economic indicators: Slovenia**

	2021	2022	2023	Q1 23	Q2 23	Q3 23	Q4 23
<i>Year-on-year change of the period total in %</i>							
GDP at constant prices	8.2	2.5	1.6	1.1	1.7	1.3	2.2
Private consumption	10.3	3.6	1.3	3.4	0.5	0.3	1.2
Public consumption	6.1	-0.5	2.4	-1.0	3.2	2.4	4.8
Gross fixed capital formation	12.6	3.5	9.5	7.7	11.2	9.9	9.1
Exports of goods and services	14.5	7.2	-2.0	4.0	-0.4	-8.6	-2.3
Imports of goods and services	17.8	9.0	-5.1	-0.4	-5.0	-10.6	-4.0
<i>Contribution to GDP growth in percentage points</i>							
Domestic demand	9.2	3.5	-1.2	-2.7	-2.6	-0.3	0.7
Net exports of goods and services	-1.0	-1.0	2.8	3.9	4.3	1.6	1.6
Exports of goods and services	11.3	6.0	-1.9	3.7	-0.3	-8.2	-2.3
Imports of goods and services	-12.2	-7.0	4.7	0.2	4.6	9.7	3.9
<i>Year-on-year change of the period average in %</i>							
Unit labor costs in the whole economy (nominal, per person)	1.0	5.2	11.5	13.4	13.2	10.7	8.5
Unit labor costs in manufacturing (nominal, per hour)	-3.0	2.3	15.4	12.6	14.5	20.6	14.1
Labor productivity in manufacturing (real, per hour)	9.9	5.1	-5.1	-4.3	-0.8	-14.1	-1.0
Labor costs in manufacturing (nominal, per hour)	6.8	7.4	9.5	7.7	13.5	3.6	13.0
Producer price index (PPI) in industry	5.5	19.6	6.3	15.5	7.1	2.3	0.3
Consumer price index (here: HICP)	2.0	9.3	7.2	9.9	7.9	6.3	5.0
EUR per 1 SIT, + = SIT appreciation	..	..	..	..	..	..	..
<i>Period average levels</i>							
Unemployment rate (ILO definition, %, 15–64 years)	4.8	4.0	3.6	3.7	3.5	3.9	3.4
Employment rate (%, 15–64 years)	71.5	73.1	72.5	71.5	73.1	72.6	72.8
Key interest rate per annum (%)	0.0	0.6	3.8	2.9	3.7	4.2	4.5
SIT per 1 EUR	..	..	..	..	..	..	..
<i>Nominal year-on-year change in period-end stock in %</i>							
Loans to the domestic nonbank private sector <sup>1</sup>	5.6	10.4	-2.5	3.4	1.8	-1.3	-2.5
<b>of which:</b>							
loans to households	5.0	7.5	3.5	6.0	4.0	3.2	3.5
loans to nonbank corporations	6.2	13.4	-8.5	0.7	-0.4	-5.7	-8.5
Share of foreign currency loans in total loans to the nonbank private sector	1.1	0.8	0.7	0.8	0.8	0.7	0.7
Return on assets (banking sector)	1.1	1.0	2.1	1.0	1.8	1.9	2.1
Tier 1 capital ratio (banking sector, consolidated)	16.9	16.2	..	16.7	16.6	16.9	..
NPL ratio (banking sector)	0.8	0.7	0.6	0.7	0.7	0.7	0.6
<i>% of GDP</i>							
General government revenues	44.9	44.1	44.2				
General government expenditures	49.5	47.2	46.7				
General government balance	-4.6	-3.0	-2.5				
Primary balance	-3.4	-2.0	-1.3				
Gross public debt	74.4	72.3	69.2				
<i>% of GDP</i>							
Debt of nonfinancial corporations (nonconsolidated)	46.0	45.6	41.1				
Debt of households and NPISHs <sup>3</sup> (nonconsolidated)	26.3	25.9	24.3				
<i>% of GDP (based on EUR), period total</i>							
Goods balance	1.7	-4.0	0.7	0.2	3.0	-0.2	-0.2
Services balance	4.7	6.3	6.1	5.8	6.1	6.4	6.1
Primary income	-1.7	-1.7	-1.4	-1.2	-1.0	-1.7	-1.6
Secondary income	-0.9	-0.9	-1.0	-1.0	-1.4	-1.1	-0.4
Current account balance	3.8	-0.4	4.5	3.8	6.8	3.4	3.9
Capital account balance	0.1	-0.5	-0.3	-0.6	-0.2	0.1	-0.4
Foreign direct investment (net) <sup>3</sup>	-0.8	-2.1	-0.8	-2.6	-1.6	0.4	0.3
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>							
Gross external debt	97.2	91.0	91.8	93.7	92.6	93.2	91.8
Gross official reserves (excluding gold)	3.5	3.4	3.1	3.4	3.3	3.3	3.1
<i>Months of imports of goods and services</i>							
Gross official reserves (excluding gold)	0.5	0.4	0.5	0.5	0.5	0.5	0.5
<i>EUR million, period total</i>							
GDP at current prices	52,279	57,038	63,090	14,402	16,073	16,158	16,457

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

<sup>1</sup> Foreign currency component at constant exchange rates.

<sup>2</sup> Nonprofit institutions serving households.

<sup>3</sup> + = 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 Bulgaria: sticky inflation and political instability may postpone euro adoption

Real GDP growth slowed to 1.5% in the third quarter and accelerated to 1.8% in the fourth quarter of 2023. While private consumption slowed down to 3.2% in the fourth quarter of 2023 and public consumption stagnated, gross fixed capital formation recovered significantly from negative growth rates in the first half of 2023. As a result, domestic demand contributed  $-1.1$  percentage points to growth in the third and  $+0.5$  percentage points in the fourth quarter of 2023, thereby recovering from the strong contraction in the first half of 2023. Exports continued to decline in the second half of the year, but as imports declined even more, net exports of goods and services delivered a large positive contribution to economic growth in the second half of the year.

Monetary tightening in the euro area has been transmitted relatively slowly to interest rates in Bulgaria. Hence, credit demand remained strong and supported domestic demand. In the last quarter of 2023, loans to nonfinancial corporations grew by 9.9% and loans to households by 15.9%. The latter financed the ongoing housing boom and new car purchases. House price growth at 10.1% in the final quarter of 2023 continued to outpace consumer prices.

Looking ahead, gross fixed capital formation will partly depend on the implementation of projects under the Recovery and Resilience Facility. The submission of related plans was subject to further delays and they were only tentatively approved by the European Commission at the end of 2023.

Moreover, weak external demand will continue to weigh on growth in 2024. Industrial production continued to decline in the early months of 2024, and manufacturing sentiment remains below average. Meanwhile, declining inflation, rising real gross wages, relatively low unemployment and labor shortages have strengthened household purchasing power. Recent improvements in consumer sentiment point to stronger private consumption in 2024. Yet, youth unemployment increased substantially to 16.2% in February 2024. Recent economic forecasts<sup>6</sup> predict moderate growth of the Bulgarian economy in 2024, in the range of 1.9% to 2.7%. Economic activity could improve in 2025 if the external environment turns more favorable, when real GDP growth is expected to reach 2.5% to 2.9%.

Headline inflation decelerated gradually from 6.4% in September 2023 to 3.1% in March 2024. Disinflation was driven by all main components, except rather sticky services prices. Food and services inflation remained the largest contributors to headline inflation, accounting for a combined share of 75% in March. Month-on-month rates of change suggest that significant price pressures remain in the pipeline for food and services. Further, the decline in energy prices came to a halt in February.

Moreover, labor cost pressures may prove to be sticky, as labor shortages persist in the dynamic industrial and services sectors of the economy. Rising compensation per employee and only modest gains in productivity growth per employee pushed up unit labor costs for the economy by 9.7% in the final quarter of 2023.

Looking ahead, indicators of selling price expectations suggest that a majority of entrepreneurs in the construction, services and retail trade sectors still expect to increase their selling prices this year.

---

<sup>6</sup> See *Consensus Forecasts, European Commission, IMF and wiiw*.

According to the latest inflation forecasts<sup>7</sup>, headline inflation is expected to decline to range from 3.4% to 4.0% in 2024 and from 2.7% to 3.1% in 2025. Core inflation is projected to decelerate more moderately, driven by second-round effects from input prices and a gradual moderation in wages. Upward risks are associated to stronger consumer demand, rising unit labor costs amid labor shortages and geopolitical events.

The current account was largely balanced in 2023 (−0.3% of GDP). The trade deficit fell to 3.9% of GDP. The decline in real exports of goods was almost entirely due to repairs at the Kozloduy nuclear power plant and at one of the largest metallurgical plants, as well as due to the ban on exports of refined products from Russian crude oil. The surplus in the services balance widened to 7.1% of GDP due to ICT- and tourism-related services. The number of foreign visits has returned to pre-pandemic levels. The net inflow of foreign direct investment increased to 3.3% of GDP in 2023, comprising mostly reinvested earnings in the banking sector.

Fiscal policy supported the recovery from the pandemic but contributed to the inflation surge. The IMF concluded in its Article IV statement from March 2024 that this year's fiscal policy in Bulgaria needs to strike a balance between supporting disinflation and not jeopardizing the recovery.<sup>8</sup> Reducing inflation is important for Bulgaria, as its accession to the euro area, which is planned for 2025, could fail due to the inflation criterion. However, meeting the inflation criterion is only a matter of time. On the other hand, ongoing political instability in the country is likely to pose a greater hurdle. The scheduled change of prime minister did not take place at the end of March; instead, there will now be the sixth snap election in four years – it will take place at the same time as the European elections on June 9, 2024.

---

<sup>7</sup> See *Consensus Forecasts*, European Commission, IMF and wiiw.

<sup>8</sup> In addition, the IMF recommends fiscal and structural reforms to promote productivity and income convergence and to sustainably increase social spending, while supporting the green transition, investing in infrastructure and human capital, and strengthening governance and the fight against corruption.

**Table 4: Main economic indicators: Bulgaria****Main economic indicators: Bulgaria**

	2021	2022	2023	Q1 23	Q2 23	Q3 23	Q4 23
<i>Year-on-year change of the period total in %</i>							
GDP at constant prices	7.7	3.9	1.8	2.2	1.9	1.5	1.8
Private consumption	8.5	3.8	5.4	4.7	9.5	4.8	3.2
Public consumption	0.4	5.5	-0.4	3.4	-5.8	0.3	0.6
Gross fixed capital formation	-8.3	6.5	3.3	-6.5	-1.7	12.6	5.2
Exports of goods and services	11.2	11.6	-1.9	-0.1	-2.4	-2.8	-1.9
Imports of goods and services	10.7	15.0	-6.3	-3.4	-10.4	-6.8	-4.3
<i>Contribution to GDP growth in percentage points</i>							
Domestic demand	7.2	5.7	-1.2	-0.3	-4.1	-1.1	0.5
Net exports of goods and services	0.4	-1.8	3.0	2.5	6.0	2.6	1.4
Exports of goods and services	6.3	7.1	-1.3	0.3	-1.6	-2.0	-1.6
Imports of goods and services	-5.8	-8.9	4.3	2.2	7.6	4.6	3.0
<i>Year-on-year change of the period average in %</i>							
Unit labor costs in the whole economy (nominal, per person)	3.8	9.1	12.7	18.7	10.7	11.1	9.7
Unit labor costs in manufacturing (nominal, per hour)	-0.2	2.0	20.9	19.1	27.4	19.0	18.8
Labor productivity in manufacturing (real, per hour)	7.0	15.5	-3.3	-0.2	-5.7	-2.1	-5.0
Labor costs in manufacturing (nominal, per hour)	7.0	17.8	16.9	18.8	20.1	16.6	12.8
Producer price index (PPI) in industry	15.5	38.3	-8.4	9.1	-7.3	-19.7	-15.5
Consumer price index (here: HICP)	2.8	13.0	8.6	13.4	8.8	7.2	5.5
EUR per 1 BGN, + = BGN appreciation	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Period average levels</i>							
Unemployment rate (ILO definition, %, 15–64 years)	5.3	4.2	4.4	4.5	4.7	4.1	4.3
Employment rate (%, 15–64 years)	68.2	70.7	70.7	70.4	70.3	71.5	70.5
Key interest rate per annum (%) <sup>1</sup>	..	..	..	..	..	..	..
BGN per 1 EUR	2.0	2.0	2.0	2.0	2.0	2.0	2.0
<i>Nominal year-on-year change in period-end stock in %</i>							
Loans to the domestic nonbank private sector <sup>2</sup>	8.6	12.7	12.3	11.8	11.9	11.3	12.3
<b>of which:</b>							
loans to households	13.4	14.6	15.9	14.6	14.0	14.0	15.9
loans to nonbank corporations	5.5	11.4	9.9	10.0	10.4	9.5	9.9
Share of foreign currency loans in total loans to the nonbank private sector	29.3	26.2	23.8	25.5	25.3	24.7	23.8
Return on assets (banking sector)	1.1	1.4	2.1	2.0	2.1	2.2	2.1
Tier 1 capital ratio (banking sector)	22.0	20.5	20.5	20.3	20.2	20.7	20.5
NPL ratio (banking sector)	3.7	2.8	2.1	2.5	2.4	2.4	2.1
<i>% of GDP</i>							
General government revenues	37.7	38.5	37.9				
General government expenditures	41.7	41.4	39.8				
General government balance	-4.0	-2.9	-1.9				
Primary balance	-3.5	-2.5	-1.5				
Gross public debt	23.9	22.6	23.1				
<i>% of GDP</i>							
Debt of nonfinancial corporations (nonconsolidated)	68.8	59.5	55.7				
Debt of households and NPISHs <sup>3</sup> (nonconsolidated)	23.8	22.5	23.7				
<i>% of GDP (based on EUR), period total</i>							
Goods balance	-4.1	-5.7	-3.9	-3.3	-2.2	-2.9	-6.6
Services balance	5.7	6.2	7.1	5.7	7.0	10.3	5.4
Primary income	-4.7	-2.8	-5.0	-4.8	-3.6	-6.7	-4.7
Secondary income	1.2	1.7	1.5	0.5	1.7	0.7	2.8
Current account balance	-1.8	-0.6	-0.3	-2.0	2.8	1.5	-3.1
Capital account balance	0.7	1.0	1.6	1.1	2.3	1.3	1.6
Foreign direct investment (net) <sup>4</sup>	-1.8	-2.3	-3.3	-8.5	0.8	-5.2	-0.8
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>							
Gross external debt	58.0	51.8	48.3	50.5	47.9	47.2	48.3
Gross official reserves (excluding gold)	45.7	42.2	42.0	40.0	36.1	37.7	42.0
<i>Months of imports of goods and services</i>							
Gross official reserves (excluding gold)	9.2	7.6	8.7	7.4	7.0	7.6	8.7
<i>EUR million, period total</i>							
GDP at current prices	71,060	85,801	93,948	20,711	21,947	24,781	26,510

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

<sup>1</sup> Not available in a currency board regime.

<sup>2</sup> Foreign currency component at constant exchange rates.

<sup>3</sup> Nonprofit institutions serving households.

<sup>4</sup> + = 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: contracting economy and easing inflation

After real annual GDP growth had turned negative in the second quarter of 2023, the economy continued contracting in the second half of the year. Despite a moderate turnaround in the final quarter, the Czech economy experienced an overall contraction of 0.3% for the year 2023. Consequently, real output of the Czech economy at the end of 2023 was still below the pre-pandemic level in 2019. While domestic demand exerted a massive drag on the economy, net exports counteracted. Owing to households' declining purchasing power and higher savings, private consumption continued to contract significantly. By the fourth quarter of 2023, it had been shrinking for seven consecutive quarters in real terms. On a positive note, the declining pace of contraction suggests a gradual return of consumer confidence, mainly on the back of rising real disposable income as inflation fades. Public consumption remained a stalwart driver of the economy in the second half of 2023, indicating, inter alia, higher expenses in health care and education following the arrival of Ukrainian war refugees. Gross fixed capital formation proved increasingly robust throughout 2023, reflecting possibly a strengthening investment environment supported by flows from EU funds from the previous programming period. Net exports made the single most significant positive contribution to growth as subdued foreign demand was offset by an even weaker domestic appetite for imports. In greater detail, the decline in exports of goods and services came to a halt in the second half of 2023 while imports observed a pronounced contraction for most of 2023. Despite firms maintaining high inventory levels due to fears of a potential return of supply chain disturbances, changes in inventories put a strong drag on economic growth indicating a reduction in firms' stockpiling activities.

Czechia's current account witnessed a remarkable turnaround, swinging from its largest deficit in 2022 (6.1% of GDP) in over a quarter-century to a modest surplus in 2023 (0.4% of GDP). While the services balance stayed stable, the reversal in the current account balance was propelled primarily by a notable goods balance rebound, predominantly ascribable to a steep decline in the import bill. The latter was driven by a combination of factors, including reduced energy import prices, lower energy consumption as well as a general decline in nonenergy imports amid the economic downturn. While the primary income kept navigating in deeply negative territory, the deficit shrank noticeably on the back of a lower, though fluctuating, outflow of dividends. Consequently, the reduction in the negative primary income balance also contributed to the improvement in the current account.

Despite the economic malaise and mounting signs of easing – inter alia a marked slowdown in nominal wage growth since the second quarter of 2023 – the labor market in Czechia stays tight. Hence, a slight increase in 2023 notwithstanding, the unemployment rate remains among the lowest in the EU. At the same time, employment rose somewhat in the second half of 2023.

Annual consumer price inflation has kept continuously falling since its peak in January 2023 (except for October 2023). A base effect made the disinflation pace accelerate sharply at the beginning of 2024 so that the HICP inflation rate dropped to 2.2% in March. Headline inflation thus plunged into the central bank's tolerance band ( $2\% \pm 1\text{ pp}$ )<sup>9</sup> for the first time since July 2021 while core inflation plummeted in parallel. The composition of disinflation was broad-based amid lower costs of imports and faded domestic inflationary pressures. Particularly food, energy and administered prices provided significant contributions to the inflation decline. In response to falling inflation, the CNB began to ease its monetary policy in December 2023. It has reduced its

---

<sup>9</sup> The Czech National Bank (CNB) targets the consumer price index (CPI) rather than the HICP. The main difference between the two indices stems from different approaches to imputed rent. The CPI dropped to 2% in February and March.

key policy rate in three stages since, from 7% – where it had stayed since August 2022 – to the current 5.75%.

The general government deficit in 2023 came in nearly CZK 72 billion lower than in 2022 and also somewhat lower than had been budgeted. Due to subdued economic growth, the deficit as a share of GDP slightly surpassed the envisaged 3.6% of GDP. The fiscal impulse was slightly expansionary. The better than planned balance (in absolute terms) was owed to the fact that revenue growth outpaced the one in expenditures by about 7%. This is ascribable to, inter alia, high corporate income tax collections bolstered by taxation of firms' windfall profits, dividends from the state-owned energy company CEZ as well as inflows from EU funds (especially from the Recovery and Resilience Facility). Gross public debt decreased slightly in 2023. On the back of a fiscal consolidation package, the deficit should narrow to just above 2% of GDP in 2024. On the flipside, the fiscal austerity measures will have a significant negative impact on economic growth.

**Table 5: Main economic indicators: Czechia****Main economic indicators: Czechia**

	2021	2022	2023	Q1 23	Q2 23	Q3 23	Q4 23
	<i>Year-on-year change of the period total in %</i>						
GDP at constant prices	3.6	2.4	-0.3	0.1	-0.6	-0.9	0.2
Private consumption	4.1	-0.6	-3.1	-5.5	-4.3	-2.4	-0.4
Public consumption	1.4	0.3	3.5	3.0	3.4	3.7	3.9
Gross fixed capital formation	0.8	3.0	4.0	-0.1	3.8	4.9	6.7
Exports of goods and services	6.9	7.2	2.8	7.7	3.5	-1.2	1.1
Imports of goods and services	13.3	6.3	-0.7	3.9	-0.2	-2.0	-4.1
	<i>Contribution to GDP growth in percentage points</i>						
Domestic demand	7.2	1.5	-2.9	-2.9	-3.4	-1.6	-3.8
Net exports of goods and services	-3.6	0.9	2.6	3.0	2.8	0.7	4.0
Exports of goods and services	4.8	5.3	2.1	6.0	2.6	-0.9	0.9
Imports of goods and services	-8.4	-4.4	0.5	-3.0	0.2	1.6	3.1
	<i>Year-on-year change of the period average in %</i>						
Unit labor costs in the whole economy (nominal, per person)	1.8	5.1	8.2	9.7	9.0	8.2	6.1
Unit labor costs in manufacturing (nominal, per hour)	2.2	1.0	8.8	10.7	7.4	10.1	7.3
Labor productivity in manufacturing (real, per hour)	0.9	4.2	-1.1	-2.4	0.6	-1.3	-1.4
Labor costs in manufacturing (nominal, per hour)	3.4	5.3	7.6	8.0	8.1	8.6	5.8
Producer price index (PPI) in industry	6.2	18.6	2.8	11.3	1.7	-1.1	-0.5
Consumer price index (here: HICP)	3.3	14.8	12.0	18.0	12.6	9.5	8.4
EUR per 1 CZK, + = CZK appreciation	3.2	4.4	2.3	3.6	4.5	1.9	-0.5
	<i>Period average levels</i>						
Unemployment rate (ILO definition, %, 15–64 years)	2.9	2.3	2.7	2.7	2.6	2.7	2.6
Employment rate (% , 15–64 years)	74.4	75.5	75.1	74.5	75.2	75.3	75.4
Key interest rate per annum (%)	0.9	5.9	7.0	7.0	7.0	7.0	7.0
CZK per 1 EUR	25.6	24.6	24.0	23.8	23.6	24.1	24.5
	<i>Nominal year-on-year change in period-end stock in %</i>						
Loans to the domestic nonbank private sector <sup>1</sup>	9.7	6.2	5.8	5.4	6.8	5.3	5.8
<b>of which:</b>							
loans to households	9.9	4.8	4.7	3.6	5.1	4.8	4.7
loans to nonbank corporations	9.4	8.3	7.4	7.9	9.0	6.1	7.4
Share of foreign currency loans in total loans to the nonbank private sector	14.6	19.4	22.2	20.3	20.7	21.6	22.2
Return on assets (banking sector)	0.8	1.1	1.1	0.9	1.1	1.1	1.1
Tier 1 capital ratio (banking sector)	22.8	21.5	21.7	21.8	22.0	21.8	21.7
NPL ratio (banking sector)	2.3	1.9	1.6	1.8	1.8	1.7	1.6
	<i>% of GDP</i>						
General government revenues	41.4	41.4	41.7				
General government expenditures	46.5	44.6	45.4				
General government balance	-5.1	-3.2	-3.7				
Primary balance	-4.3	-2.1	-2.4				
Gross public debt	42.0	44.2	44.0				
	<i>% of GDP</i>						
Debt of nonfinancial corporations (nonconsolidated)	53.6	51.3	46.9				
Debt of households and NPISHs <sup>3</sup> (nonconsolidated)	35.7	33.3	30.9				
	<i>% of GDP (based on EUR), period total</i>						
Goods balance	1.1	-1.5	4.0	4.7	4.5	2.0	4.7
Services balance	1.7	1.3	1.3	1.5	1.4	1.5	0.8
Primary income	-5.1	-5.5	-4.3	-2.9	-6.7	-2.8	-4.7
Secondary income	-0.5	-0.5	-0.5	-1.1	-0.2	-0.6	-0.2
Current account balance	-2.8	-6.1	0.4	2.1	-1.1	0.0	0.6
Capital account balance	1.7	0.1	1.2	0.7	2.7	0.2	1.1
Foreign direct investment (net) <sup>3</sup>	-0.5	-2.5	-0.2	-2.1	-0.4	1.9	-0.5
	<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>						
Gross external debt	76.3	66.8	61.1	64.5	62.6	60.6	61.1
Gross official reserves (excluding gold)	64.1	47.3	43.3	45.1	43.6	42.8	43.3
	<i>Months of imports of goods and services</i>						
Gross official reserves (excluding gold)	11.0	7.6	7.8	7.3	7.3	7.5	7.8
	<i>EUR million, period total</i>						
GDP at current prices	238,361	276,318	305,943	72,188	78,661	77,301	77,794

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

<sup>1</sup> Foreign currency component at constant exchange rates.

<sup>2</sup> Nonprofit institutions serving households.

<sup>3</sup> + = 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: first signs of recovery after small GDP contraction

Although economic growth was much less negative during the second half of 2023 than during the first half, GDP contracted by 0.9% year on year in 2023 as a whole. Similarly, to the first half-year, gross fixed capital formation was the biggest drag on growth. Construction investments, especially dwellings, continued to contract heavily (albeit less than during the first six months of the year). The growth rate of investments in machinery and equipment also turned negative during the second half of 2023. The worsening export situation, comparatively low capacity utilization and worsening economic confidence in most sectors of the economy (despite some improvement toward the end of the year) seem to have depressed investment activity. This was also reflected in the continued weakness of lending to corporates. The decline in household consumption moderated in the second half of 2023, in line with the improvement in real wage developments on the back of sharply falling inflation. Also consumer confidence improved. Export growth continued to deteriorate in the second half of 2023, mainly due to weakening exports to the euro area. Since weak domestic demand caused a sharp drop in imports, the contribution of net real exports remained large.

The budget deficit of the general government reached 6.7% of GDP in 2023. Hence, the deficit was higher than in 2022 (6.2% of GDP) and also exceeded the most recent government forecasts. The substantial overshooting of the target was mainly attributable to weaker than expected indirect tax revenues as a result of contracting domestic consumption, higher than planned pension expenditure (in line with legal obligations to compensate for inflation) and high interest expenditure. For 2024, the government in early March 2024 raised its deficit target from 2.9% of GDP to 4.5% of GDP. The deficit is planned to fall to 3.7% of GDP in 2025 and to 2.9% of GDP in 2026.

Since its peak in January 2023 at 26.2%, HICP inflation has gradually declined to reach 3.6% in March 2024. The slowdown was primarily driven by energy and unprocessed food prices, including base effects and the decrease in global commodity prices during the last quarter of 2023 and early 2024. Core inflation decreased as well, though to a smaller extent, and amounted to 4.5% in March 2024. Within core inflation, price pressures are still most visible in the services segment, which is in line with comparatively strong growth in unit labor costs in various services industries. The decline in core inflation has been supported by weak private consumption, tight and only cautiously easing monetary conditions and government measures to promote competition in the retail sector (e.g. price monitoring system, mandatory discounts).

In response to falling inflation, MNB continued to ease policy during the reference period by regular monthly cuts of 75–100 basis points in the base rate (which had again become the main policy rate in September 2023). However, various factors continued to impede monetary transmission (e.g. caps on deposit and loan interest rates), “voluntary” lowering of the interest premium (over the interbank rate) to zero on new corporate loans concluded between February 1 and April 30, 2024, for a period of six months. The mandatory caps on large deposits and on SME loans were discontinued at end-March 2024. At the same time, MNB has increasingly complained about being exposed to permanent pressure for bigger rate cuts and also criticized other suggestions for an artificial easing of monetary conditions (e.g. a government proposal to replace

the interbank rate by the – substantially lower – T-bill yield as the reference rate for corporate loans).

Weak domestic demand and moderating global energy prices, causing a favorable terms-of-trade effect, have also led to a marked improvement in the country's external balance. The combined current and capital account registered a small surplus in 2023, following a sizable deficit in 2022. This was helped by a sharp improvement in the goods (and services) balance, while the combined balance of primary and secondary income and the capital account deteriorated. The EU Commission's decisions in mid-December 2023 and early March 2024 to unfreeze about EUR 13 billion in cohesion funds has also been supportive for the country's external financing position, while the rest of total available EU funds (around EUR 32 billion in grants and loans) remain frozen until Hungary fulfills the necessary conditions. Moreover, in mid-March 2024, the European Parliament decided to sue the Commission for the unfreezing.

**Table 6: Main economic indicators: Hungary****Main economic indicators: Hungary**

	2021	2022	2023	Q1 23	Q2 23	Q3 23	Q4 23
	<i>Year-on-year change of the period total in %</i>						
GDP at constant prices	7.1	4.6	-0.9	-0.9	-2.4	-0.4	0.0
Private consumption	4.6	7.1	-2.0	-3.5	-3.3	-1.9	0.6
Public consumption	1.8	2.9	1.2	-2.9	3.2	5.1	-0.4
Gross fixed capital formation	5.7	1.4	-7.4	-3.6	-10.7	-10.7	-2.8
Exports of goods and services	8.3	11.4	0.9	7.9	2.1	-1.8	-4.1
Imports of goods and services	7.3	10.8	-4.3	3.2	-4.7	-6.8	-8.4
	<i>Contribution to GDP growth in percentage points</i>						
Domestic demand	6.2	4.1	-5.8	-5.0	-8.7	-5.2	-4.3
Net exports of goods and services	0.9	0.5	4.9	4.1	6.4	4.9	4.3
Exports of goods and services	6.5	9.1	0.8	8.0	1.8	-1.7	-3.8
Imports of goods and services	-5.6	-8.6	4.0	-3.9	4.6	6.5	8.0
	<i>Year-on-year change of the period average in %</i>						
Unit labor costs in the whole economy (nominal, per person)	2.3	13.6	15.1	11.8	19.9	15.0	14.4
Unit labor costs in manufacturing (nominal, per hour)	0.6	8.0	22.4	25.5	24.3	21.7	19.0
Labor productivity in manufacturing (real, per hour)	5.6	4.1	-3.4	-3.6	-2.7	-3.5	-3.8
Labor costs in manufacturing (nominal, per hour)	6.9	12.4	18.2	21.0	20.9	17.4	14.5
Producer price index (PPI) in industry	13.5	33.4	7.2	27.2	10.2	-1.7	-6.9
Consumer price index (here: HICP)	5.2	15.3	17.0	25.9	22.1	14.6	7.6
EUR per 1 HUF, + = HUF appreciation	-2.0	-8.4	2.5	-6.2	3.6	5.2	7.5
	<i>Period average levels</i>						
Unemployment rate (ILO definition, %, 15–64 years)	4.1	3.7	4.2	4.1	3.9	4.1	4.5
Employment rate (%, 15–64 years)	73.1	74.4	74.8	74.3	74.7	75.0	75.0
Key interest rate per annum (%)	1.1	8.0	12.8	13.0	13.0	13.0	12.0
HUF per 1 EUR	358.5	391.3	381.9	388.7	372.6	383.6	382.1
	<i>Nominal year-on-year change in period-end stock in %</i>						
Loans to the domestic nonbank private sector <sup>1</sup>	12.1	9.9	5.2	11.0	8.9	4.6	5.2
<b>of which:</b>							
loans to households	14.9	6.3	2.3	6.8	4.6	2.4	2.3
loans to nonbank corporations	9.9	12.6	7.2	14.0	12.0	6.2	7.2
Share of foreign currency loans in total loans to the nonbank private sector	20.3	23.3	25.9	23.7	24.1	25.8	25.9
Return on assets (banking sector)	0.9	0.7	2.0	1.3	1.9	2.1	2.0
Tier 1 capital ratio (banking sector)	18.1	17.5	17.0	16.3	16.7	17.2	17.0
NPL ratio (banking sector)	1.6	2.0	1.8	2.0	2.0	2.0	1.8
	<i>% of GDP</i>						
General government revenues	41.2	42.6	42.4				
General government expenditures	48.4	48.8	49.1				
General government balance	-7.2	-6.2	-6.7				
Primary balance	-4.9	-3.4	-2.0				
Gross public debt	76.7	73.9	73.5				
	<i>% of GDP</i>						
Debt of nonfinancial corporations (nonconsolidated)	78.3	81.9	74.5				
Debt of households and NPISHs <sup>3</sup> (nonconsolidated)	20.5	18.3	16.8				
	<i>% of GDP (based on EUR), period total</i>						
Goods balance	-2.9	-9.1	0.1	-1.9	2.0	0.6	-0.4
Services balance	3.1	4.7	5.0	5.1	4.9	5.9	4.2
Primary income	-3.4	-3.0	-3.6	-2.8	-3.8	-4.2	-3.5
Secondary income	-1.1	-1.0	-1.3	-1.4	-1.2	-1.3	-1.3
Current account balance	-4.3	-8.4	0.2	-1.0	1.9	0.9	-1.0
Capital account balance	2.5	2.1	1.0	1.1	1.2	0.9	0.8
Foreign direct investment (net) <sup>3</sup>	-2.4	-3.0	-1.3	6.0	1.6	-3.8	-6.9
	<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>						
Gross external debt	87.0	92.2	85.4	97.5	95.5	88.1	85.4
Gross official reserves (excluding gold)	21.8	19.9	18.2	20.1	19.4	18.4	18.2
	<i>Months of imports of goods and services</i>						
Gross official reserves (excluding gold)	3.3	2.5	2.9	2.5	2.6	2.6	2.9
	<i>EUR million, period total</i>						
GDP at current prices	153,958	168,089	196,622	39,939	50,085	50,739	55,858

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

<sup>1</sup> Foreign currency component at constant exchange rates.

<sup>2</sup> Nonprofit institutions serving households.

<sup>3</sup> + = 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: zloty appreciation helped inflation return to target while key rate remained unchanged

In 2023, annual GDP almost stagnated at 0.2% year on year. Annual growth rates turned positive in the second half, reaching 1.5% in the fourth quarter. The quarter-on-quarter pattern showed strong 1.1% growth in the third quarter but zero growth in the second and fourth quarter. This unstable GDP growth resulted from even more volatile private consumption, with another quarter-on-quarter contraction in the fourth quarter that translated into quasi-stagnation year on year. In contrast, gross fixed capital formation grew strongly throughout the year both quarter on quarter and year on year. Both real exports and even more so real imports contracted sharply in the second and third quarter and recovered in the fourth one in quarter-on-quarter terms. In the case of real imports, the recovery was not sufficiently strong to render positive year-on-year growth in the fourth quarter. The growth drivers toward year-end were fixed investment, expanding real exports and contracting real imports, while inventory change rendered a sizable negative contribution to growth.

The stagnation of private consumption in the fourth quarter likely still reflected the decline of both real wage sum and real gross retirement pensions in preceding quarters. Yet, on the back of disinflation, these real income indicators substantially increased in tandem with consumer confidence, boding well for a sustained recovery. Fixed investment continued to rely on both corporate and public investment, with the former benefiting from the broadening of profitability in the enterprise sector and the latter from EU funds, while residential investment continued to shrink. The lower number of dwellings under construction mirrored the nominal decline of housing loans.

Corresponding to the sizable positive contribution of net exports to annual growth, the surplus of the goods and services balance increased strongly from a year earlier to more than 6% of GDP in 2023. The combined current and capital account surplus rose to almost 2% of GDP. Net FDI inflows declined but continued to be substantial at about 2% of GDP.

Both in the full-year 2023 and in the final quarter, nominal ULC of manufacturing gross value added were far higher than a year earlier, as labor cost increases outpaced the productivity rise that resulted mainly from the shrinking of labor input measured in hours worked. The ULC increase exceeded the euro area ULC rise substantially in full-year 2023. Also, the zloty's nominal value in euro was higher than a year earlier from the second to the fourth quarter; in real (ULC-deflated) terms the zloty was stronger by roughly 10% in each quarter of 2023. After further monthly nominal appreciation in early 2024, the zloty settled at 4.31 zloty for one euro at end-March.

According to HICP (and national CPI) definition, annual headline inflation declined from 12.5% (13.1%) in the second quarter to 6.3% (6.4%) in the fourth and stood at 2.7% (2.0%) in March 2024, while core inflation came down from 12.5% (11.6%) in the second quarter to 4.2% (4.6%) in March. Within the core HICP, nonenergy industrial goods inflation stood at 1.7% in March, while the annual change of the manufacturing producer price index continued to be negative. The Monetary Policy Council (MPC), pursuing a CPI inflation target of 2.5%  $\pm$  1 percentage point, has maintained its main policy rate at 5.75% since early October 2023. In early April, the MPC decided to keep interest rates unchanged, pointing at substantial uncertainty related to fiscal and regulatory policies and to the pace of recovery, coupled with demand pressure stimulated by wage growth over the medium term.

The general government deficit rose to 5.1% of GDP in 2023 but is projected by the European Commission to decline to 4.6% of GDP in 2024, helped by declining budgetary costs related to high energy prices and by the recovery-driven rise of revenues. The expenditure-to-GDP ratio will remain high due to defense spending and higher spending for public salaries, pensions and families with children. General government debt is expected to rise to about 54% of GDP at end-2024, from 49.6% of GDP at end-2023.



**Table 7: Main economic indicators: Poland****Main economic indicators: Poland**

	2021	2022	2023	Q1 23	Q2 23	Q3 23	Q4 23
	<i>Year-on-year change of the period total in %</i>						
GDP at constant prices	6.9	5.3	0.2	-0.9	-1.1	0.8	1.5
Private consumption	6.1	5.3	-1.0	-2.7	-3.1	1.3	0.4
Public consumption	5.0	0.3	2.9	-0.3	1.6	3.7	5.9
Gross fixed capital formation	1.2	4.9	8.4	6.3	9.4	6.7	10.0
Exports of goods and services	12.3	6.7	-1.9	3.3	-3.4	-10.6	2.9
Imports of goods and services	16.1	6.8	-8.3	-2.7	-6.9	-20.4	-3.1
	<i>Contribution to GDP growth in percentage points</i>						
Domestic demand	8.0	5.1	-3.7	-4.6	-3.2	-5.1	-2.1
Net exports of goods and services	-1.1	0.2	3.9	3.8	2.1	5.9	3.7
Exports of goods and services	6.5	3.9	-1.2	2.2	-2.1	-6.6	1.5
Imports of goods and services	-7.6	-3.7	5.1	1.6	4.2	12.6	2.1
	<i>Year-on-year change of the period average in %</i>						
Unit labor costs in the whole economy (nominal, per person)	0.3	7.8	13.4	15.6	15.1	10.9	11.9
Unit labor costs in manufacturing (nominal, per hour)	-4.6	2.4	11.5	11.9	11.6	12.3	10.3
Labor productivity in manufacturing (real, per hour)	12.9	8.2	-0.3	-1.4	-0.3	-0.5	0.9
Labor costs in manufacturing (nominal, per hour)	8.0	10.9	11.2	10.3	11.2	11.8	11.3
Producer price index (PPI) in industry	8.1	23.8	4.1	18.9	5.0	-2.2	-5.1
Consumer price index (here: HICP)	5.2	13.2	10.9	16.1	12.5	9.2	6.3
EUR per 1 PLN, + = PLN appreciation	-2.7	-2.6	3.2	-1.8	2.5	5.4	7.0
	<i>Period average levels</i>						
Unemployment rate (ILO definition, %, 15–64 years)	3.4	3.0	2.9	3.0	2.6	2.8	3.1
Employment rate (% , 15–64 years)	70.3	71.4	72.3	72.0	72.1	72.3	72.7
Key interest rate per annum (%)	0.3	5.3	6.5	6.8	6.8	6.6	5.8
PLN per 1 EUR	4.6	4.7	4.5	4.7	4.5	4.5	4.4
	<i>Nominal year-on-year change in period-end stock in %</i>						
Loans to the domestic nonbank private sector <sup>1</sup>	5.0	0.8	0.6	0.2	-0.3	-0.8	0.6
<b>of which:</b>							
loans to households	4.2	-4.7	-1.9	-5.4	-4.5	-3.1	-1.9
loans to nonbank corporations	6.5	10.8	4.3	9.9	6.5	2.8	4.3
Share of foreign currency loans in total loans to the nonbank private sector	17.5	18.5	16.6	18.6	17.7	18.5	16.6
Return on assets (banking sector)	0.2	0.4	1.0	1.3	1.1	1.0	1.0
Tier 1 capital ratio (banking sector)	17.4	18.6	19.9	18.8	20.1	20.4	19.9
NPL ratio (banking sector)	5.8	5.5	5.4	5.4	5.6	5.7	5.4
	<i>% of GDP</i>						
General government revenues	42.3	40.2	41.6				
General government expenditures	44.1	43.9	46.7				
General government balance	-1.8	-3.7	-5.1				
Primary balance	-0.7	-2.2	-3.0				
Gross public debt	53.6	49.3	49.6				
	<i>% of GDP</i>						
Debt of nonfinancial corporations (nonconsolidated)	43.2	40.8	38.8				
Debt of households and NPISHs <sup>3</sup> (nonconsolidated)	32.0	26.5	24.8				
	<i>% of GDP (based on EUR), period total</i>						
Goods balance	-1.3	-3.7	0.8	1.5	1.4	0.4	0.1
Services balance	4.6	5.6	5.3	5.5	5.7	5.4	4.7
Primary income	-4.5	-3.9	-4.2	-4.1	-5.8	-4.3	-2.9
Secondary income	-0.1	-0.3	-0.3	-0.1	-0.6	-0.5	-0.2
Current account balance	-1.3	-2.4	1.6	2.8	0.8	1.0	1.8
Capital account balance	0.7	0.5	0.2	-2.6	1.0	1.5	0.6
Foreign direct investment (net) <sup>3</sup>	-3.8	-3.7	-2.2	-5.4	-1.5	-3.6	1.0
	<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>						
Gross external debt	56.0	52.9	51.6	52.7	53.4	51.5	51.6
Gross official reserves (excluding gold)	23.4	22.0	20.5	21.2	21.6	20.9	20.5
	<i>Months of imports of goods and services</i>						
Gross official reserves (excluding gold)	5.2	4.3	4.8	4.2	4.5	4.6	4.8
	<i>EUR million, period total</i>						
GDP at current prices	576,150	654,208	749,201	169,901	180,030	187,903	211,368

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

<sup>1</sup> Foreign currency component at constant exchange rates.

<sup>2</sup> Nonprofit institutions serving households.

<sup>3</sup> + = 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: mounting fiscal challenges and slow disinflation

Year-on-year GDP growth in Romania remained positive in the second half of 2023 bringing the full-year figure to 2.1%. Domestic demand continued to drive economic activity, whereas exports declined in the second half of the year amid weak external demand.

Gross fixed capital formation confirmed its role as the key growth driver. It was supported by EU-funded investment in public infrastructure as well as investment in machinery and equipment. Domestic credit to corporates grew by about 10% year on year in the second half of 2023 and despite a slight deceleration in nominal terms, growth became positive in real (CPI-adjusted) terms. EU fund flows under the multiannual financial framework 2014–2020 were still substantial in 2023. Under the Recovery and Resilience Facility, the EU disbursed the second payment amounting to about EUR 2.8 billion to Romania at end-September 2023. The request for the third payment was submitted by Romania at end-2023. However, in mid-March, European Commission officials explained that the disbursement is delayed due to the government's failure to fulfill necessary conditions (e.g. fiscal and state-owned-enterprises reforms) and reduce the budget deficit in line with its commitments.

After a slowdown in the third quarter, private consumption growth strengthened in the final quarter of 2023. Real wage growth further accelerated to 9.2% at end-2023, supported by two minimum wage hikes in 2023. However, the unemployment rate ticked up somewhat in the final quarter. At the same time, consumer lending gained some momentum.

While real wage growth backed private consumption, productivity developments were weak. In the manufacturing sector, unit labor costs increased markedly, while the Romanian leu remained broadly unchanged vis-à-vis the euro. The current account deficit remained high in 2023 but declined somewhat compared to 2022 thanks to a reduction in the trade deficit. The combined current and capital account deficit (including EU fund inflows) improved to 4.9% of GDP, 44% of which were financed by net FDI inflows. Debt-creating portfolio and other investment inflows caused the external debt ratio to rise in 2023. At the same time, gross official reserves increased noticeably.

Consumer price inflation declined further to 6.6% in December 2023. Food prices contributed to a large extent to this development due to supply factors and policy measures (the broadening of the list of basic food products subject to the mark-up cap). In the first two months of 2024, headline inflation was again above 7% – mainly due to electricity prices, higher oil prices as well as an increase in excise duties on fuels and tobacco products – but came back to 6.7% in March. Core inflation fell from 8.5% in December 2023 to 8.1% in March 2024. After having hiked its key policy rate to 7% in January 2023, the National Bank of Romania (NBR) has left it unchanged since. The NBR currently projects inflation to fall to 4.7% at end-2024 and to 3.5% at end-2025. Hence, the central bank assumes that inflation will come down to the upper bound of the inflation target variation band of  $2.5\% \pm 1$  percentage point only toward the end of its forecast horizon.

Comparatively robust growth in recent years has to be seen against the background of loose fiscal policy. For 2023, the general government budget deficit target was missed by a wide margin. It amounted to 5.7% of GDP in cash terms compared to the 4.4% of GDP target. In ESA terms, the 2023 budget deficit stood at 6.6% of GDP. Romania has been subject to an excessive deficit procedure since 2020. According to a council recommendation adopted in June 2021, Romania should have reached a deficit of 4.4% of GDP in 2023 and should bring it down further to 2.9% of GDP in 2024. The Romanian fiscal budgetary strategy published at end-2023 shows that the deficit is scheduled to go down gradually to 4.9% of GDP in 2024 and fall below 3% of GDP only

in 2027. It is worth noting that European Commission officials recently warned that the budget deficit could reach 7% of GDP or more this year. Moreover, the IMF expects that the newly enacted pension reform will create large additional fiscal costs of about 1.5% of GDP in the coming years (though reducing spending in the long run).

**Table 8: Main economic indicators: Romania****Main economic indicators: Romania**

	2021	2022	2023	Q1 23	Q2 23	Q3 23	Q4 23
<i>Year-on-year change of the period total in %</i>							
GDP at constant prices	5.7	4.1	2.1	1.0	2.8	3.6	1.0
Private consumption	7.2	5.8	2.9	1.3	5.3	1.5	3.3
Public consumption	1.8	-3.3	2.8	2.5	4.3	8.8	-3.2
Gross fixed capital formation	2.9	5.9	12.0	14.6	15.4	11.3	8.6
Exports of goods and services	12.6	9.7	-2.1	1.8	0.8	-3.4	-6.8
Imports of goods and services	14.8	9.5	-1.8	3.1	1.1	-8.3	-1.8
<i>Contribution to GDP growth in percentage points</i>							
Domestic demand	7.2	4.6	2.1	1.9	3.0	0.9	2.7
Net exports of goods and services	-1.5	-0.5	0.0	-1.0	-0.2	2.7	-1.7
Exports of goods and services	4.6	3.9	-0.9	1.0	0.4	-1.4	-2.6
Imports of goods and services	-6.1	-4.4	0.9	-2.0	-0.6	4.2	1.0
<i>Year-on-year change of the period average in %</i>							
Unit labor costs in the whole economy (nominal, per person)	1.4	8.6	14.5	13.9	14.6	12.8	17.2
Unit labor costs in manufacturing (nominal, per hour)	3.6	11.4	18.8	20.5	21.5	16.5	17.1
Labor productivity in manufacturing (real, per hour)	3.1	1.3	-2.3	-3.3	-3.9	-1.6	-0.6
Labor costs in manufacturing (nominal, per hour)	7.0	12.7	16.1	16.6	16.8	14.7	16.5
Producer price index (PPI) in industry	14.9	43.6	4.6	20.6	7.8	-2.3	-4.8
Consumer price index (here: HICP)	4.1	12.0	9.7	13.0	9.8	9.1	7.4
EUR per 1 RON, + = RON appreciation	-1.7	-0.2	-0.3	0.5	-0.1	-0.7	-1.0
<i>Period average levels</i>							
Unemployment rate (ILO definition, %, 15–64 years)	5.6	5.6	5.6	5.8	5.4	5.4	5.9
Employment rate (% , 15–64 years)	61.9	63.0	63.1	62.9	63.0	63.3	63.0
Key interest rate per annum (%)	1.4	4.3	7.0	7.0	7.0	7.0	7.0
RON per 1 EUR	4.9	4.9	4.9	4.9	4.9	4.9	5.0
<i>Nominal year-on-year change in period-end stock in %</i>							
Loans to the domestic nonbank private sector <sup>1</sup>	14.2	12.1	6.1	10.2	6.4	4.4	6.1
<b>of which:</b>							
loans to households	9.3	4.3	1.2	2.1	0.1	0.1	1.2
loans to nonbank corporations	19.8	20.0	10.4	18.2	12.2	8.4	10.4
Share of foreign currency loans in total loans to the nonbank private sector	27.6	31.1	31.6	32.2	32.1	31.9	31.6
Return on assets (banking sector)	1.4	1.5	1.8	1.9	1.9	1.9	1.8
Tier 1 capital ratio (banking sector)	20.9	20.5	19.6	18.8	19.7	19.2	19.6
NPL ratio (banking sector)	3.4	2.7	2.3	2.7	2.7	2.6	2.3
<i>% of GDP</i>							
General government revenues	32.9	33.9	33.6				
General government expenditures	40.0	40.2	40.2				
General government balance	-7.2	-6.3	-6.6				
Primary balance	-5.6	-4.8	-4.6				
Gross public debt	48.5	47.2	48.8				
<i>% of GDP</i>							
Debt of nonfinancial corporations (nonconsolidated)	33.2	30.6	28.8				
Debt of households and NPISHs <sup>3</sup> (nonconsolidated)	15.7	13.9	12.5				
<i>% of GDP (based on EUR), period total</i>							
Goods balance	-9.6	-11.3	-9.0	-10.2	-8.7	-8.2	-9.1
Services balance	3.9	4.6	4.1	5.9	4.6	3.6	3.0
Primary income	-2.0	-3.0	-2.6	-2.0	-3.1	-3.4	-1.9
Secondary income	0.4	0.5	0.5	0.2	0.5	0.5	0.7
Current account balance	-7.2	-9.2	-7.0	-6.1	-6.8	-7.6	-7.4
Capital account balance	2.2	2.5	2.1	0.8	1.8	3.4	2.1
Foreign direct investment (net) <sup>3</sup>	-3.7	-3.1	-2.0	-3.5	-0.8	-3.1	-1.1
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>							
Gross external debt	56.5	50.9	52.3	51.8	51.8	52.2	52.3
Gross official reserves (excluding gold)	16.8	16.4	18.5	18.1	17.7	19.0	18.5
<i>Months of imports of goods and services</i>							
Gross official reserves (excluding gold)	4.3	3.9	5.1	4.4	4.4	5.0	5.1
<i>EUR million, period total</i>							
GDP at current prices	241,443	284,279	322,988	64,293	75,415	87,801	95,479

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

<sup>1</sup> Foreign currency component at constant exchange rates.

<sup>2</sup> Nonprofit institutions serving households.

<sup>3</sup> + = 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).

## 2 Economic trends in EU candidate countries<sup>10,11</sup>

### I Western Balkans: no time for rest as new challenges lie ahead

#### Economic growth rebounded cautiously in the second half of 2023

After a marked slowdown in economic activity observed in the Western Balkan (WB) countries<sup>12</sup> in 2022, real GDP growth continued to decelerate in 2023 on the back of elevated inflation, tightened financing conditions and weak external demand. While economic performance was subdued particularly in the first six months of the year, signs of a gradual rebound emerged during the latter half of 2023, especially in the region's largest economy, i.e. Serbia, where the GDP growth rate more than tripled between the first and the second half of the year (table 9). GDP-weighted real economic growth in the region thus averaged 2.5% in 2023, ranging from 1% in North Macedonia to 6% in Montenegro. Despite the overall rather lackluster economic activity, there is also a “glass-half-full” interpretation of the economic trends recorded in 2023: Since economic growth in all WB countries exceeded that of the EU (0.4%) real convergence resumed after a setback in 2022. However, the clouded macroeconomic environment in the EU, which accounts for 35% to 80% of exports for the small and mostly open Western Balkan economies, has weakened foreign demand, thus hindering more robust growth.

Table 9

Real GDP growth									
	2021	2022	2023	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23
	Annual real change in %								
Albania	8.9	4.9	3.4	4.9	4.4	2.8	3.3	3.8	3.8
Bosnia and Herzegovina <sup>1</sup>	7.3	3.8	1.6	2.8	2.0	1.7	1.2	1.9	1.7
Kosovo	10.7	4.3	3.3	4.3	4.8	3.9	2.4	3.1	4.0
Montenegro	13.0	6.4	6.0	3.1	5.0	4.7	5.4	7.1	6.1
North Macedonia	4.5	2.2	1.0	1.8	1.5	1.4	0.9	1.0	0.9
Serbia	7.7	2.5	2.5	1.2	0.8	0.9	1.6	3.6	3.8
WB average <sup>2</sup>	7.9	3.4	2.5	2.4	2.1	1.7	1.9	3.2	3.2

<sup>1</sup> Expenditure-side data.

<sup>2</sup> Average weighted with GDP at PPP.

Source: Eurostat.

#### Robust domestic demand but uneven net exports

On the expenditure side, economic growth in the Western Balkans in 2023 was largely driven by domestic demand, although the performance of different components varied across the region, with each country navigating its unique challenges and growth catalysts. Against the backdrop of buoyant nominal wage growth and easing inflation, private consumption played a critical role in fueling most of the economies in the Western Balkans. Nonetheless, its contribution to economic growth declined in most instances compared to 2022. Household consumption was the main driver of GDP growth, particularly in Kosovo and Montenegro. In Kosovo, consumer spending was buoyed by wage increases, robust credit growth and strong remittance inflows. In

<sup>10</sup> Compiled by Tomáš Slačik with input from Antje Hildebrandt, Melanie Koch, Mathias Lahnsteiner, Nico Petz and Thomas Reininger.

<sup>11</sup> Cut-off date: May 8, 2024.

<sup>12</sup> The Western Balkans comprise the EU candidate countries Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia as well as the potential candidate Kosovo. The designation “Kosovo” is used without prejudice to positions on status and in line with UNSC 1244 and the opinion on the Kosovo Declaration of Independence.

Montenegro, it benefited significantly from a surge in tourism and the influx of affluent migrants, among other factors. As crises-related fiscal measures were gradually phased out, public consumption showed mixed results across the region. Particularly Albania and to a lesser extent Bosnia and Herzegovina saw relatively vigorous increases in public spending. These increases provided a relatively significant contribution to economic growth and – in case of Albania – compensated weakening private consumption. In North Macedonia, government consumption contracted for most of the year in real year-on-year terms but recorded a rather strong increase in the fourth quarter, driven, inter alia, by a notable rise in public sector wages.

Gross fixed capital formation was another key determinant of economic activity in the WB countries, albeit with a very uneven performance across the region. Albania witnessed vigorous investment activities, particularly in the construction sector, and tourism-related developments, driven by strong foreign direct investment inflows. In Kosovo, fixed investment recovered in 2023 and, in Serbia and Montenegro, it continued to expand. North Macedonia experienced a whopping decline in capital formation<sup>13</sup>, reflecting primarily a strong negative contribution of stock changes in 2023, which contrasted with the accelerated buildup of gas and oil reserves during the energy crisis in 2022. Destocking (or slower stockpiling) on the back of the easing energy crisis and fading supply chain frictions brought about (strong) negative contributions to economic growth by stock changes also in other countries, such as Albania and Serbia.

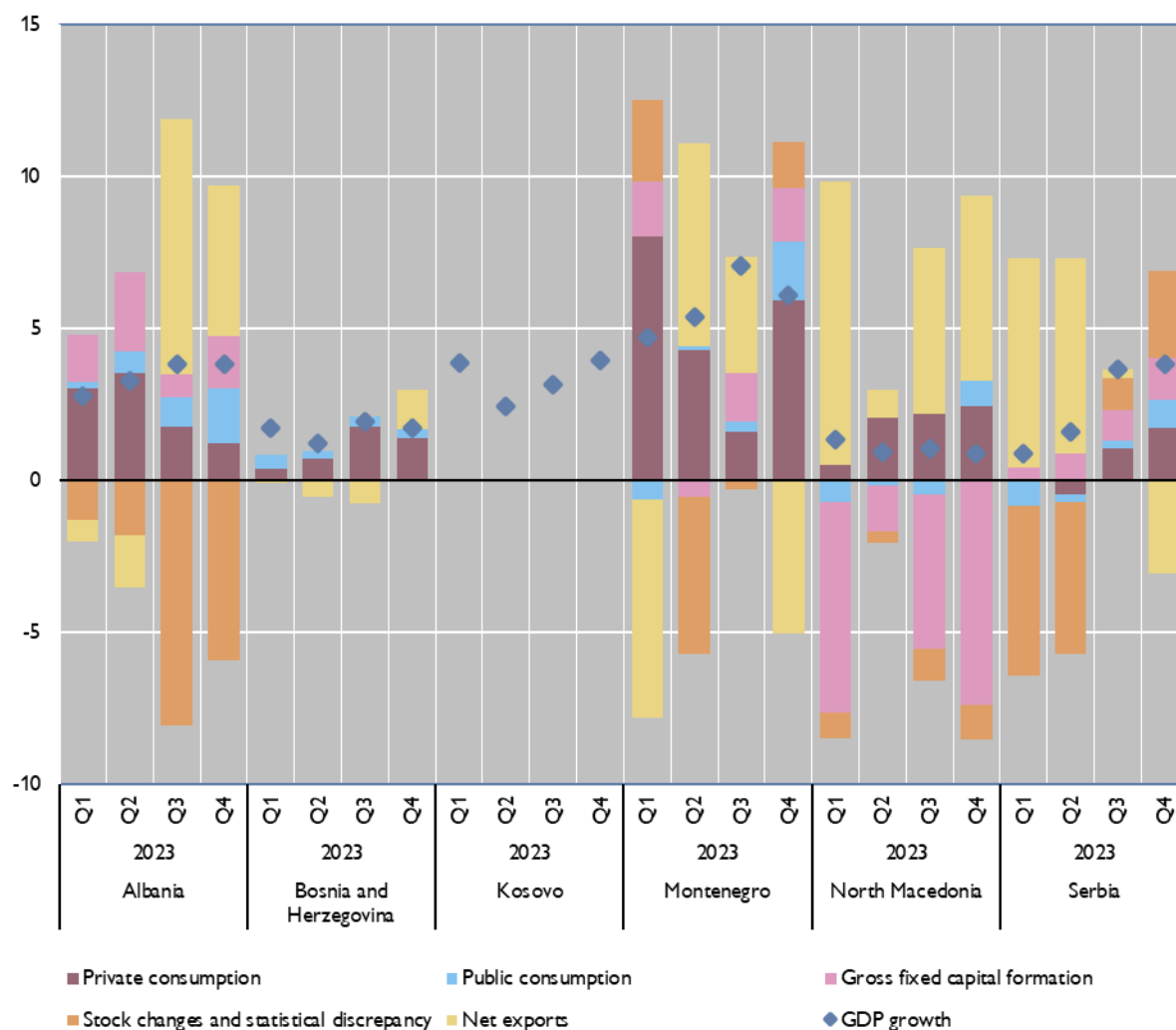
The performance of net exports, too, varied significantly across the region despite common factors in external trade dynamics: Imports declined in several instances in the wake of lower energy imports while exports of goods were hampered by weak external demand. However, weaker merchandise exports were counteracted by a continued robust increase in services exports. Turning to developments in individual countries, import volumes in North Macedonia plunged sharply due to reduced electricity imports and the sizable destocking described before. Consequently, despite a slight decline in exports, net exports ended up contributing a substantial 5.4 percentage points to GDP growth. Similarly, in Serbia, lower imports of energy and raw materials combined with exports benefiting from new production capacities brought about a significantly positive contribution of net exports to economic growth. Albania, too, saw a strong contribution of net exports on account of a large expansion of exports of (tourism) services. While record tourist arrivals boosted exports also in Montenegro, comparably strong increases in imports as well as slumping merchandise exports toward year-end dampened the overall contribution of net exports. In Kosovo and Bosnia and Herzegovina, net exports somewhat dampened GDP growth as increases in imports outpaced export growth.

---

<sup>13</sup> For North Macedonia, data are only available for gross capital formation, i.e. no distinction between gross fixed capital formation and stock changes is possible.

## GDP growth and growth contributions in the Western Balkans

Percentage points, year-on-year GDP growth in %



Source: Eurostat, national statistical offices, wiw.

Note: Growth contributions for Kosovo not available; gross capital formation for North Macedonia.

## External imbalances narrowed

As a result of the developments of exports and imports outlined above, the combined current and capital account deficits as a percentage of GDP shrank across the board. At end-2023, the balances thus ranged between a deficit of  $-11.4\%$  in Montenegro and a slight surplus of  $0.7\%$  in North Macedonia. North Macedonia also recorded the largest improvement in the external accounts compared to 2022 (6.7 percentage points), exclusively driven by the goods trade balance on account of significantly lower gas and oil imports.

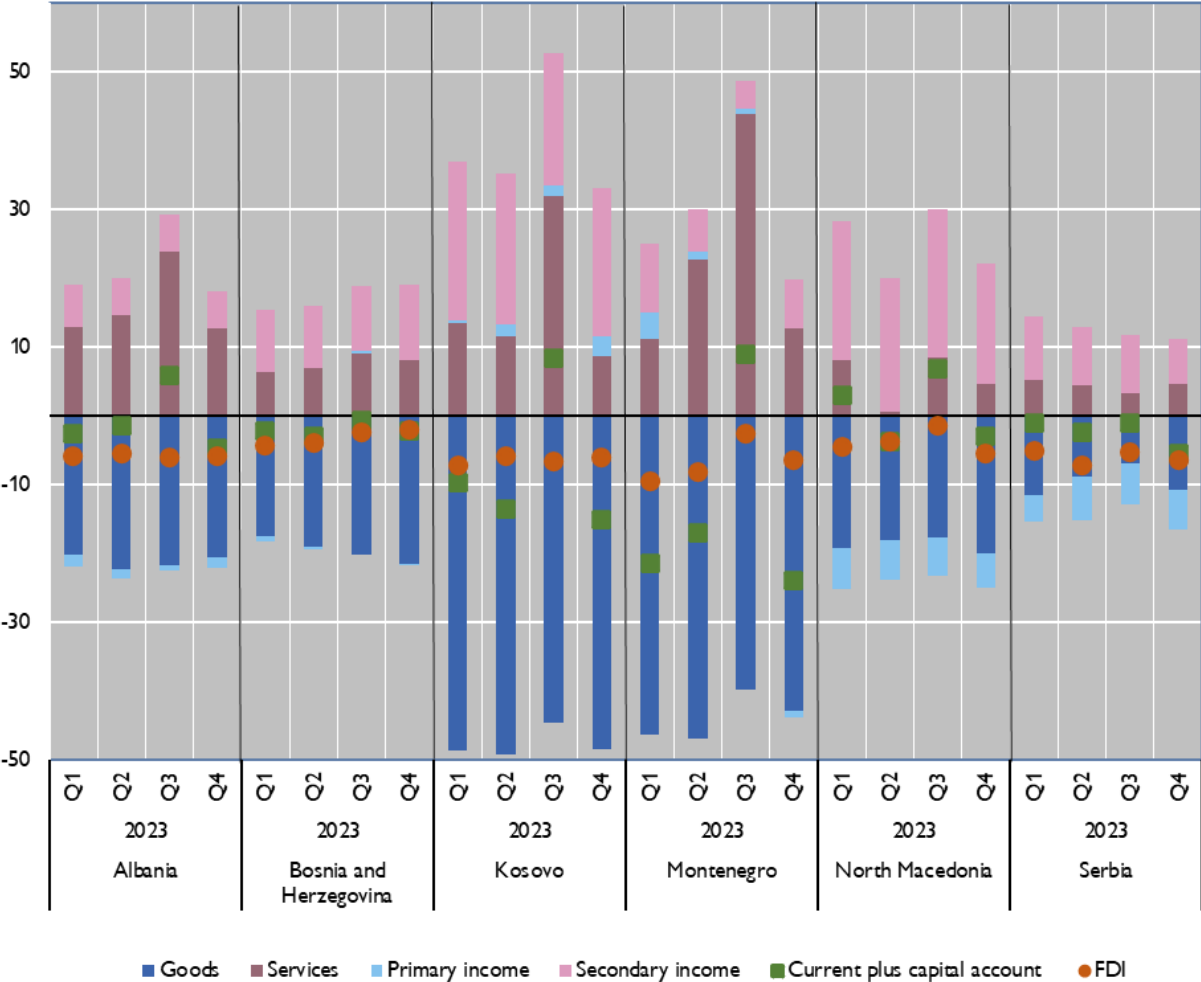
Goods trade deficits declined notably but remained significant across the region, ranging between  $-9.5\%$  of GDP in Serbia and a whopping  $-47.6\%$  of GDP in Montenegro. These figures point toward the need to improve the goods exports base. The improvements in services trade balances arose from robust tourism revenues, an essential driver of exports in most economies, and increasingly also ICT exports. As a result, surpluses in the services trade balance ranged between more than  $4\%$  of GDP in Serbia and nearly  $25\%$  of GDP in Montenegro.

Remittances and FDI inflows remained robust in the region and were crucial sources of financing. In many countries, they remained concentrated in the tourism and real estate sectors. FDI inflows outstripped or – in the case of Kosovo – almost fully covered the financing needs from the combined current and capital accounts. Nonetheless, FDI inflows as a percentage of GDP declined in most countries. In Montenegro, however, FDI inflows saw a dramatic plunge by 7 percentage points compared to 2022. As a consequence, the external financing gap was mirrored in a sizable decline of central bank reserves from more than 32% of GDP at end-2022 to 19.5%<sup>14</sup> a year later. This is the second-lowest reserve level in the region after Kosovo, where central bank reserves amounted to less than 12% of GDP<sup>15</sup>. In the remaining countries, reserves hovered slightly above or – in case of Albania – somewhat short of 30% of national GDP.

Chart 12

**External accounts in the Western Balkan countries**

% of GDP



Source: Eurostat, national statistical offices, wiw.

Note: FDI:

- + = 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).

<sup>14</sup> Excluding gold.

<sup>15</sup> Note that data are only available including gold.



Trends on the demand side were largely echoed on the supply side. Low foreign demand, especially in the EU, poses one of the key challenges in the current economic environment as it brought about lower new orders and production needs. This was reflected in subdued industrial production. After moderate yet positive growth in 2022, industrial production in the region as a whole saw a slight contraction in 2023 despite some acceleration in Serbia. The shrinkage was particularly pronounced in Albania and Bosnia and Herzegovina. Possibly, the feeble industrial production is linked to the strong destocking trend as firms tended to serve the frail demand from existing inventories first. In contrast, services, especially tourism and increasingly ICT, were important determinants of economic growth on the supply side.

### **Continued labor market paradox: cyclical tightening shadowed by persistently high youth unemployment**

Trends in the labor market continued to present a mixed picture, encompassing cyclical improvements on the one hand and sustained structural challenges on the other. Although official labor market statistics may not fully capture the reality due to high levels of informality and limitations in data availability, indicators suggest that the labor market tightened further in 2023. Overall, employment kept rising in the region even though its growth slowed down somewhat on the back of weakened economic performance. Labor force participation also improved in several instances. Similarly, unemployment continued to decline in most countries, thus extending the solid long-lasting downward trend that had only temporarily been interrupted during the pandemic (table 10). At the end of 2023, the unemployment rate varied from just under 10% in Serbia to slightly over 13% in Bosnia and Herzegovina, Montenegro, and North Macedonia.

Nonetheless, although cyclical improvements continued and key labor market indicators in the Western Balkans hovered around historical highs, they still significantly lagged behind their counterparts in the EU. Hence, the still comparably high unemployment levels and low formal employment as well as labor force participation suggest not only persistent structural weaknesses but, in some cases, also a persistently large informal sector. Particularly in Albania the latter amounts to about a third of total employment.

Moreover, labor markets in the region suffer from structural mismatches between labor demand and supply, particularly among young people, with youth unemployment rates ranging from over 20% in Albania to more than 35% in Montenegro. Despite the still comparably high (structural) unemployment rates, there is abundant anecdotal evidence of firms facing labor shortages, especially in sectors such as construction and services. While these bottlenecks are exacerbated by adverse demographic trends and emigration, inflows of workers, e.g. from various Asian countries, offer a degree of alleviation. In this regard, Kosovo is a particularly vivid case in point at the moment. Surveys suggest that following the visa liberalization with the EU in January 2024, there are quite a few in the general population that have strong intentions to leave the country. While these intentions may not be (fully) realized, and immigration of workers, for example from Bangladesh, may partially counteract this trend, there is a risk that labor market bottlenecks could worsen. The ongoing tightening of the labor market has been mirrored in vigorous, double-digit growth of nominal wages in the Western Balkan economies in general and in the booming sectors in particular (table 10). As nominal wage increases have generally outpaced falling inflation rates real wage growth may pose some upside risk to the disinflation process.

Table 10

<b>Labor market</b>									
	2021	2022	2023	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23
<b>Average gross wages – total economy</b>	<i>Annual change in %</i>								
Albania	6.3	8.2	14.0	9.2	10.8	9.2	16.9	16.0	13.7
Bosnia and Herzegovina	4.4	11.7	13.0	13.4	14.4	15.6	14.8	11.4	10.7
Kosovo	3.9	7.6	17.1	..	..	..	..	..	..
Montenegro	1.4	11.3	11.7	11.4	11.8	8.9	12.6	12.5	12.8
North Macedonia	5.7	11.1	15.3	12.0	14.1	13.2	15.4	15.2	17.0
Serbia	9.4	13.8	14.8	14.8	13.4	15.5	15.4	14.2	14.3
<b>Unemployment rate<sup>1</sup></b>	<i>%</i>								
Albania	12.1	11.3	11.2	10.8	11.0	11.4	11.1	11.0	11.2
Bosnia and Herzegovina	17.5	15.5	13.3	14.9	14.4	13.5	13.3	13.7	12.7
Kosovo	20.8	12.6	..	10.8	11.8	11.5	..	..	..
Montenegro	16.9	15.1	13.4	13.4	14.9	15.8	13.5	12.0	12.4
North Macedonia	15.8	14.6	13.2	14.4	14.2	13.4	13.2	12.9	13.2
Serbia	11.4	9.7	9.7	9.3	9.4	10.3	9.9	9.2	9.5

<sup>1</sup> Labor force survey.

Source: Eurostat, Macrobond, national statistical offices, wiw.

## Some improvement of fiscal indicators boosted in part by strong nominal GDP growth

Overall, fiscal developments in the WB region did not see any dramatic developments in 2023. The fiscal balances across the region showed relatively limited variation. The revenue side generally benefited from the moderate economic rebound. In addition, some country-specific idiosyncrasies and nuances also helped, such as robust income tax revenues in Albania, improved tax compliance and formalization in Kosovo or higher than expected indirect taxes and windfall revenues in Montenegro. In these three countries the fiscal outcome was also aided by a substantial underexecution of capital expenditures on the expenditure side (relative to plans envisioned in the budget). As a result, fiscal deficits decreased to 2.2% of GDP in Albania, 0.3% of GDP in Kosovo and most significantly in Montenegro, i.e. by 3 percentage points to 2.3% of GDP. Especially in a country with no autonomous monetary policy like Montenegro a prudent fiscal stance is a key element to (regaining) price stability. Serbia too saw its general government deficit improve further, despite some one-off expenditures on agriculture, pensions and wages. Similarly, Bosnia and Herzegovina achieved a slight fiscal surplus, notwithstanding increased social spending in the Republika Srpska. Conversely, in North Macedonia, the already comparably high budget deficit in 2022 widened further last year, as savings from lower electricity subsidies were partially reallocated to increase public sector wages.

Consequently, compared to 2022, public debt-to-GDP ratios decreased in all economies of the region but North Macedonia. In addition to the improved fiscal balances, the debt ratios also benefited from high nominal GDP growth. Montenegro witnessed the largest drop in the debt burden, i.e. by more than 8.5 percentage points. Within just two years the general government debt-to-GDP ratio declined by 20 percentage points. Nonetheless, the debt level in Montenegro remains the second largest in the region and together with Albania still ranges above 60% of GDP.

On the other side of the spectrum, we see Kosovo and Bosnia and Hercegovina with relatively contained debt levels. In North Macedonia, even though public debt remained broadly unchanged, at 51% its financing is highly reliant on external borrowing which may pose some challenges and risks. Overall, in some cases fiscal vulnerabilities persist, primarily with respect to the high domestic and external refinancing needs and exposure to interest and exchange rate risks. Against this backdrop, restoring fiscal buffers in the vulnerable countries remains a priority, particularly to provide leeway for coping with future shocks.

Table 11

<b>Fiscal policy indicators</b>						
	2021	2022	2023	2021	2022	2023
	<b>General government balance</b>			<b>General government debt</b>		
	<i>End of period, % of GDP</i>					
Albania	-4.6	-3.7	-2.2	74.5	64.6	62.5
Bosnia and Herzegovina	-0.3	-0.4	1.0	33.9	29.3	26.9
Kosovo	-1.3	-0.5	-0.3	21.1	19.7	17.2
Montenegro	-1.9	-5.2	-2.3	82.5	69.5	61.0
North Macedonia	-5.4	-4.5	-4.8	52.0	50.9	51.0
Serbia	-4.1	-3.2	-2.8	57.1	55.6	52.2
Ukraine	-3.4	-16.1	-20.3	49.0	77.8	84.4

Source: European Commission (Ameco), Macrobond, national central banks, wiiw.

### Various risks to disinflation

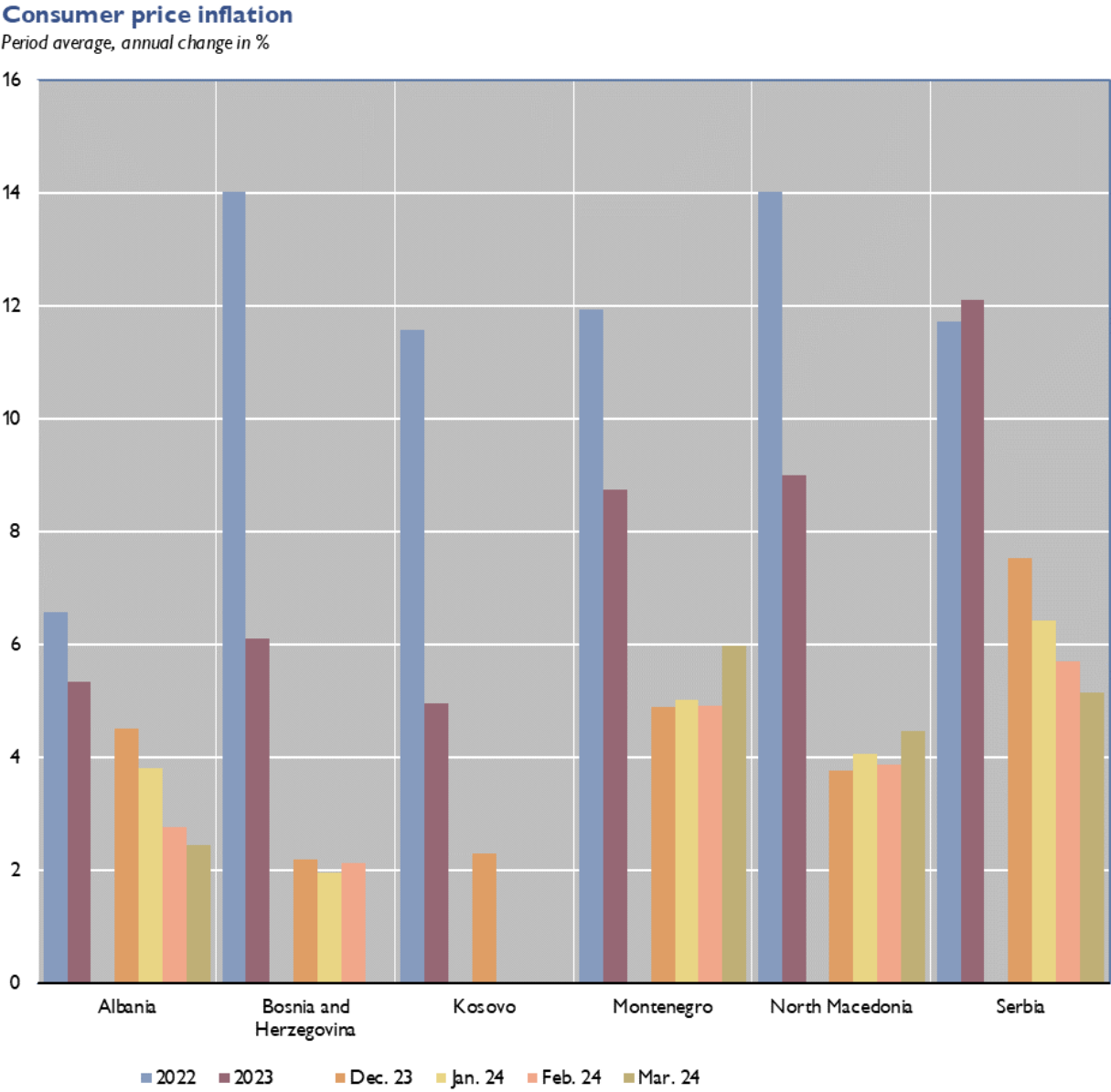
After consumer price inflation had climbed sharply to historical highs in 2022, it eased dramatically in 2023 in all WB countries, except Serbia, where the disinflation process set in with some delay. Annual headline inflation in 2023 averaged between 4.8% in Albania and 12.5% in Serbia, and it continued to decelerate in the early months of 2024. In March 2024, consumer price inflation ranged between 1.9% in Bosnia and Herzegovina and 5.5% in Montenegro. In Serbia, annual inflation stood at 5%. The National Bank of Serbia (NBS) projects inflation to enter its target band ( $3 \pm 1.5\%$ ) by mid-2024 and to continue to decline toward the target midpoint by late 2024. In Albania, on the other hand, which is the other inflation-targeting country in the region, inflation already stood below the target at 2.6% as of February.

Apart from the base effect, the slowdown in inflation has been driven predominantly by weakening global cost-push factors, especially easing food and energy prices. This reflects the fact that these two categories account for a substantial weight in the consumer basket in the WB region, significantly larger than in the euro area. More specifically, food and energy weigh 40% to 50% in the consumption baskets of the WB countries compared to 30% in the euro area. Especially the share of food in the basket is about twice as large as in the euro area. In Montenegro, the disinflation process seems to have stalled or even reversed recently due to rather stubbornly elevated services inflation on the back of vigorous tourism and consumption. Reasons for the delayed disinflation in Serbia are manifold, including, inter alia, dynamic wage growth, tight labor markets, price-setting power in retail as well as the fact that the NBS has maintained a broadly stable exchange rate despite appreciating pressures on the dinar (chart 15). In contrast, the Albanian lek sharply accelerated its appreciation trend and in 2023 alone gained some 11% in value vis-à-vis the euro which certainly helped bring inflation back to the target of the Bank of Albania (BoA). On the flip side, strong appreciation pressures from buoyant financial inflows due to tourism, remittances and FDI have forced the BoA to intensify its interventions. Moreover, the

hastened strengthening of the lek raises doubts about alignment with economic fundamentals and the potential risk of a sudden reversal.

In parallel to headline inflation core inflation too has declined to single digit values (though it should be noted that it is subject to varying country-specific definitions). However, in a majority of the WB countries, core inflation is higher than headline inflation, suggesting some second-round effects of the past cost-push factors that have been passed through. Specifically, the higher inertia of core inflation reflects strong wage growth, to which particularly the more labor-intensive services sector is more susceptible.

Chart 13

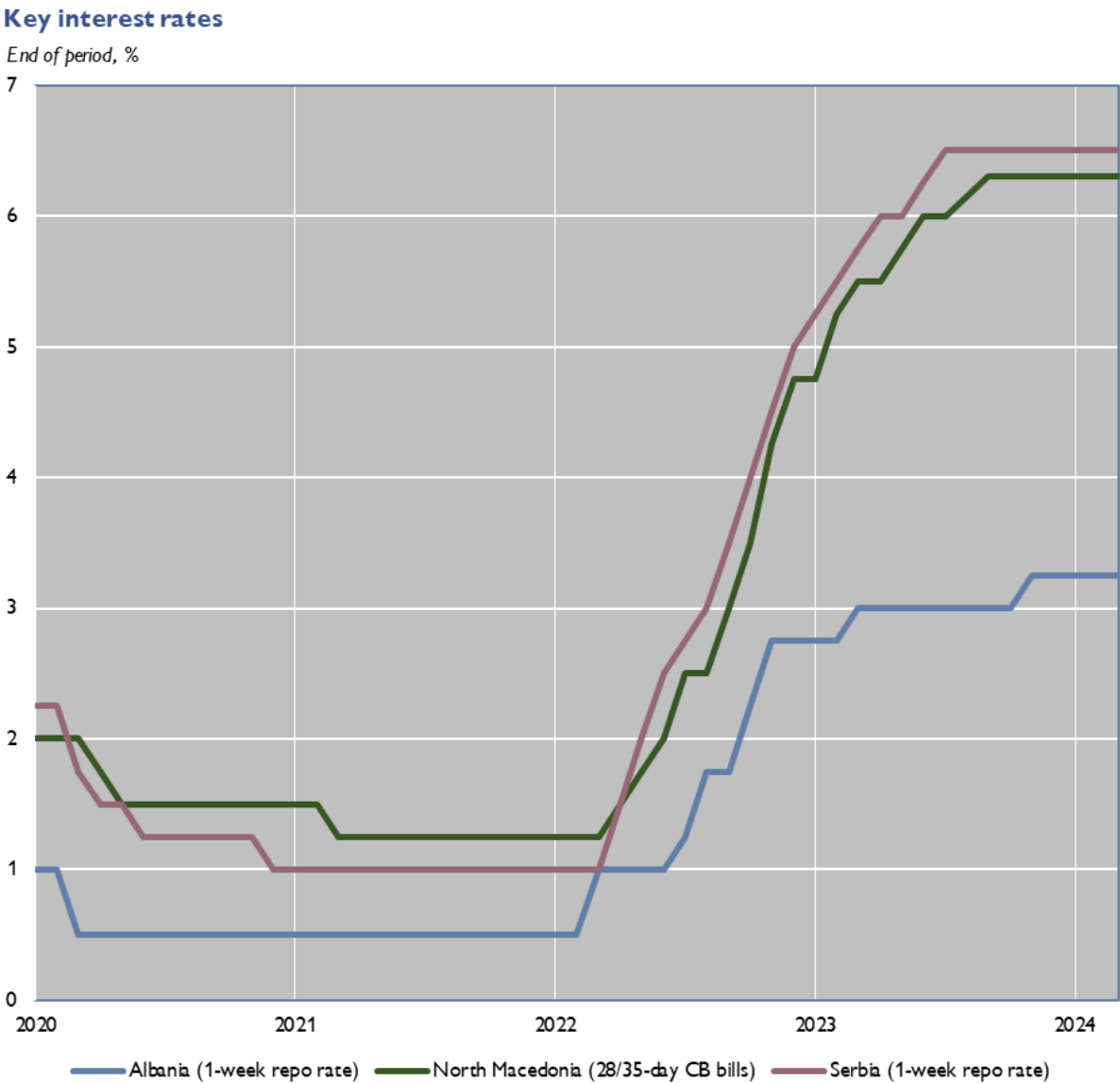


Inflation is expected to gradually decrease to and then plateau at a level of around 2% over the medium-term horizon in Kosovo and Bosnia and Herzegovina. It will hover around the target in Albania and, according to expectations, from mid-2024 also in Serbia. In Montenegro, inflation is projected to remain stickier at 4% to 5% for some time to come, not least in light of domestic wage pressures. The latter pose some risk of a renewed acceleration of inflation, also in North

Macedonia. Nonetheless, all central banks in the region are urged to closely monitor risks arising from persistent geopolitical tensions, potential second-round effects, and in some cases, only hesitantly declining core inflation. They should remain vigilant particularly regarding those inflation expectations that are not yet fully anchored at levels consistent with price stability objectives and to risks related to tight labor markets.

In the three WB countries with autonomous monetary policies, continued tightening of the monetary stance has helped to put inflation on a downward trajectory. After lifting its key policy rate in February, the BoA hiked it one more time, i.e. by 25 basis points to 3.25% in November 2023. After ten previous upward steps between March 2022 and March 2023, the National Bank of the Republic of North Macedonia continued to raise its policy rates four more times (15–25 basis points each) between May and September 2023, bringing it to 6.3%.

Chart 14



Source: National central banks.  
 Note: No policy rate available for Bosnia and Herzegovina, Kosovo and Montenegro due to currency board or unilateral euroization.

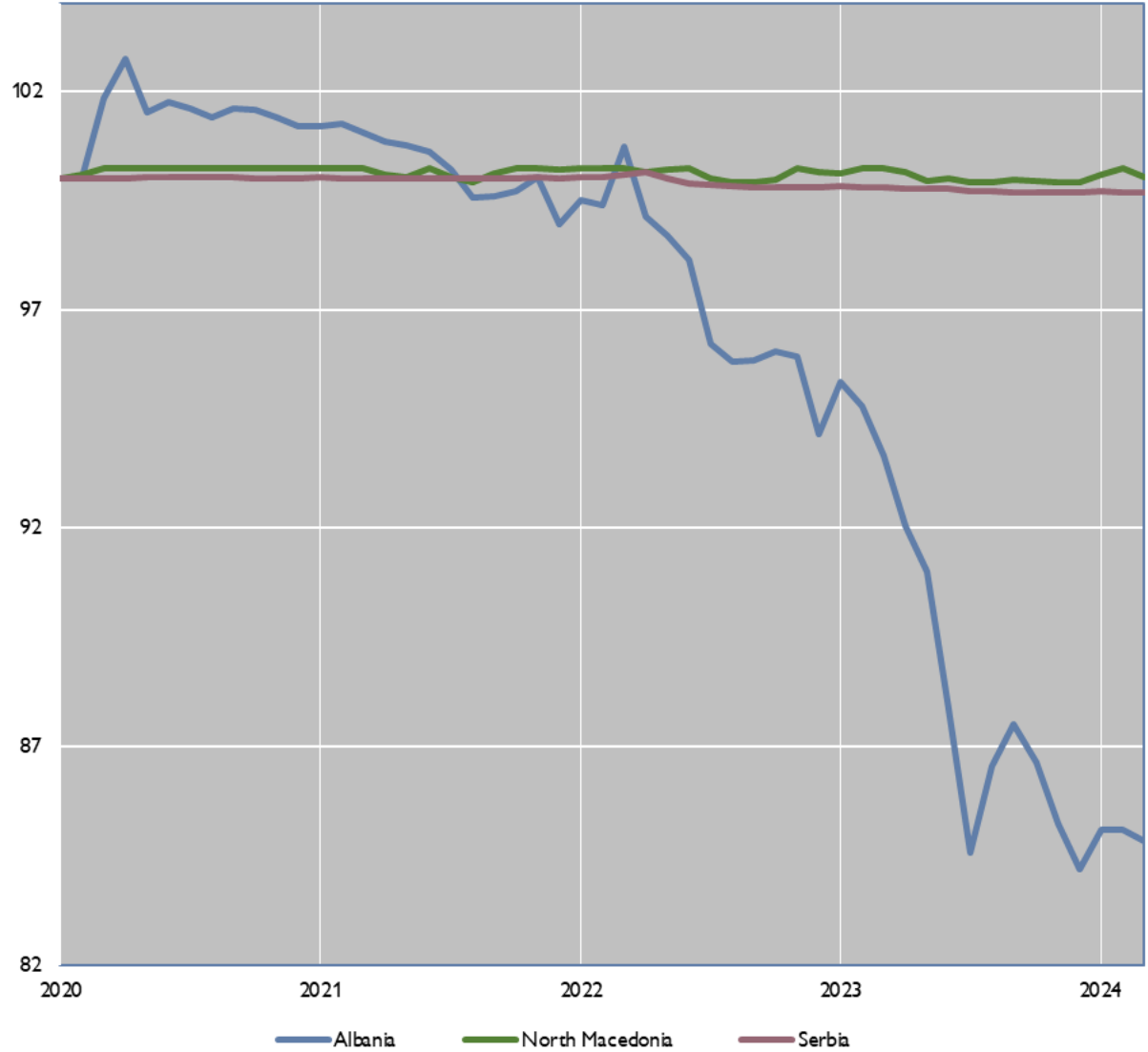
The NBS too, after raising its policy rate 13 months in a row before April 2023, added two more hikes of 25 basis points each in June and July 2023. However, it has to be borne in mind that in Serbia, the effective rate in the market is the one-week weighted average repo rate, which has hovered around 100 basis points below the policy rate. The IMF and the ECB have called upon the NBS to narrow the gap.

Unlike in several Central and Eastern European countries, policy rates in the WB have stayed at their respective peaks of the current tightening cycle so far, and central bank representatives have been cautious in signaling when monetary policy easing will start. Hence, looking ahead, it has been stressed that future monetary policy decisions will depend on the movement of key inflation factors at home and abroad and on the pace of disinflation.

Chart 15

**Exchange rate vis-à-vis the euro**

National currency per EUR (i.e. up/down = depreciation/appreciation), period average, January 2020 = 100



Source: Macrobond.

In addition to the interest rate hikes, some of the aforementioned central banks have also increased their reserve requirements, absorbed excess liquidity and/or employed macroprudential measures to support the monetary tightening and improve efficiency of the transmission mechanism. Moreover, facing partially strong foreign currency (FX) inflows and appreciation pressures, the BoA, the NBS and the National Bank of the Republic of North Macedonia intervened in the FX market to stabilize their respective currencies. In the case of Serbia and North Macedonia this happened in the context of, respectively, a de facto stabilized and a pegged exchange rate regime. These interventions have led to a continued, significant accumulation of international reserves at record levels.

In the three countries without autonomous monetary policy – Bosnia and Herzegovina, Kosovo and Montenegro – the limited tools available, such as minimum reserve requirements and macroprudential measures, have been barely actively employed in the current (dis)inflationary period. Following the recommendation by the IMF to align the remuneration rate on banks' excess reserves with the ECB deposit rate the Central Bank of Bosnia and Herzegovina (CBBH) only marginally increased the remuneration rate in July 2023. In this context, it has to be stressed again that prudent fiscal policy plays a key role in attaining and maintaining price stability in countries without an autonomous monetary policy.

### **Financial sector proves resilient, yet a watchful eye on asset quality is warranted**

The financial sector in the WB countries, largely dominated by foreign-owned banks, has navigated the series of shocks that occurred over the recent years relatively well and remains resilient. In nominal terms, bank lending to the nonbank private sector kept on expanding in all countries but Serbia. However, compared to 2022, nominal credit growth slowed down in 2023 in all countries, except Bosnia and Herzegovina. In Serbia, diminishing credit growth has been owed to tighter monetary policy, stricter credit standards and in some instances macroprudential measures on the supply side. At the same time, demand cooled down in the wake of the economic slowdown. In real terms, credit expansion in 2023 was positive in countries with a more advanced disinflation process, namely Albania, Bosnia and Herzegovina and Kosovo, while it was negative in the remainder of the region. Hence, real credit growth 2023 ranged from almost –13% in Serbia to a vigorous expansion of 8% in Kosovo. In most countries, growth in loans to households, especially mortgages, outpaced that of lending to corporates, as the latter was particularly affected by weaker domestic economic activity and foreign demand. In Serbia, in particular, corporate lending – even in nominal terms – contracted for most of 2023. In contrast, lending to firms rebounded in Bosnia and Herzegovina and also held up quite strongly in Albania due to real estate loans to corporates.

As for the currency decomposition, the share of foreign currency loans in total loans remained broadly stable except for Albania, where it declined significantly. This was brought about by deeply contracting FX lending and – at the same time – by a strong acceleration in growth of lek-denominated loans. Such a trend is ascribable to the sharp narrowing of the interest rate differential between lek- and euro-denominated loans, which turned even negative in case of business loans. As a result, the long-lasting trend of falling attractiveness of foreign currency loans in Albania resumed after some interruption during 2021 and 2022 sparked by higher inflation and Russia's invasion into Ukraine. The share of FX loans in 2023 declined to 44% and was thus roughly 10 percentage points lower than in 2016 and almost 30 percentage points below the levels seen in 2007. With two-thirds of loans denominated in foreign currencies, Serbia remains by far the country with the highest share of FX loans. The authorities continued to promote dinarization by developing local bond markets and stimulating dinar-denominated deposits and loans via

various measures. As a result, the dinarization trend resumed on the deposit side in late 2022, after previously halting due to depreciation fears ignited by the war in Ukraine and elevated inflation. The share of deposits in dinar thus reached a record high by end-2023. In contrast, the dinarization on the loans side has made less progress. The share of dinar-denominated loans, especially corporate loans, went down on account of maturing loans granted under government guarantee schemes and an increase of FX-indexed (particularly investment) loans. Similarly, the National Bank of the Republic of North Macedonia too put in place several measures to boost denarisation, including raising reserve requirements on FX deposits relative to denar deposits. While these measures helped stop or reverse the increasing share of FX-denominated deposits, loan euroization remains a persistent trend. Overall, despite significant advances, currency substitution in some WB countries remains high, posing a tail risk to financial stability and constraining monetary policy transmission. For the time being, however, trust in domestic currencies remains rather stable as data from the OeNB Eurosurvey suggest.

In general, banking sectors in the region remain liquid and well capitalized (table 12) while their profitability keeps on improving, driven by net interest income, higher fees and commissions as well as a further decline in noninterest costs. Despite the challenging global geopolitical environment, rather subdued growth and a series of crises over the last years, asset quality has not deteriorated so far. On the contrary, the share of nonperforming loans (NPL) in total loans continued to decrease in most countries or remained broadly stable in 2023, ranging between 2% in Kosovo and 5% in Montenegro (table 12). However, despite these comparably low levels, in some instances, the benign trend of the NPL ratio is owed mainly to continued high nominal credit growth in the denominator, which somewhat disguises the development of the NPL stock in the numerator. In particular, in Albania and Serbia the NPL stock increased. Moreover, the fact that stage 2 loans – a potential leading indicator of future asset quality changes – increased in North Macedonia and Serbia, calls for continued vigilance, especially in light of the credit, exchange and interest rate risks. While provisioning is mostly appropriate in the region, the most recent NPL monitor by the Vienna Initiative<sup>16</sup> sees a potentially risky combination of a relatively high NPL ratio and low NPL coverage in Albania, Serbia and particularly Montenegro.

In addition to the fragile geopolitical situation and challenging macroeconomic environment, the microeconomic perspective still warrants some caution as well. According to the most recent wave of the OeNB Euro Survey, a range of 11% of interviewed household borrowers in Bosnia and Herzegovina to 21% in North Macedonia report that they will be unlikely or very unlikely to repay their debt over the next 12 months. While these are non-negligible shares, they are significantly lower than what was reported in 2022. Also, the perspective of the banks provides a more relaxed picture than a year ago, although still somewhat mixed. According to the EIB Bank Lending Survey conducted in September 2023<sup>17</sup>, banks expected an improvement in credit quality (i.e. decrease in nonperforming loans) over the next six months in Albania and Kosovo and a broadly unchanged situation in North Macedonia. In contrast, a deterioration in credit quality driven by the corporate segment was expected in Bosnia and Herzegovina, and in both the corporate and the retail segment in Serbia.

---

<sup>16</sup> See the [NPL monitor for the CESEE region, H2 2023](#) by the Vienna Initiative.

<sup>17</sup> See [Central, Eastern and South-Eastern Europe \(CESEE\) Bank Lending Survey Second half of 2023 \(eib.org\)](#).



Table 12

**Banking sector indicators**

	2021	2022	2023	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23	
<b>Bank loans to the domestic nonbank private sector</b>	<i>End of period, annual change in %</i>									
Albania <sup>1</sup>	9.4	8.9	7.7	11.7	8.9	7.0	6.5	5.7	7.7	
Bosnia and Herzegovina <sup>1</sup>	3.3	5.5	7.3	4.0	5.5	4.9	4.8	6.7	7.3	
Kosovo	15.5	16.0	12.9	18.4	16.0	14.8	14.4	13.2	12.9	
Montenegro	3.2	8.7	6.7	8.9	8.7	6.6	5.0	5.1	6.7	
North Macedonia <sup>1</sup>	7.3	8.4	3.8	7.3	8.4	6.0	6.2	6.1	3.8	
Serbia <sup>1</sup>	8.5	5.3	-0.6	7.4	5.3	2.4	-0.1	-0.1	-0.6	
Ukraine <sup>1</sup>	10.9	-10.6	-1.4	-3.3	-10.6	-12.0	-13.3	-8.7	-1.4	
<b>Share of foreign currency loans<sup>2</sup></b>	<i>End of period, %</i>									
Albania	48.8	49.3	44.2	49.6	49.3	49.5	46.7	45.3	44.2	
Bosnia and Herzegovina	9.6	6.6	6.9	7.0	6.6	6.6	6.5	7.0	6.9	
Kosovo	..	..	..	..	..	..	..	..	..	
Montenegro <sup>3</sup>	3.2	3.3	..	4.0	3.3	3.5	3.2	3.3	..	
North Macedonia	40.7	42.6	42.1	42.3	42.6	42.9	43.1	42.7	42.1	
Serbia <sup>4</sup>	62.4	65.7	66.2	65.0	65.7	66.2	66.7	66.8	66.2	
Ukraine	28.6	27.0	25.8	28.1	27.0	26.6	26.1	25.5	25.8	
<b>NPL ratio</b>	%									
Albania	5.7	5.0	4.7	5.1	5.0	5.2	5.2	5.2	4.7	
Bosnia and Herzegovina	5.8	4.5	3.8	4.9	4.5	4.2	4.1	4.0	3.8	
Kosovo	2.3	2.0	2.0	2.1	2.0	2.0	2.0	2.0	2.0	
Montenegro	6.2	5.7	5.0	5.9	5.7	5.6	5.2	5.0	5.0	
North Macedonia	3.2	3.1	2.8	3.3	3.1	3.2	3.1	3.4	2.8	
Serbia	3.6	3.0	3.2	3.2	3.0	3.0	3.2	3.2	3.2	
Ukraine	30.0	38.1	37.4	33.6	38.1	37.9	38.9	37.9	37.4	
<b>Tier 1 capital ratio</b>	%									
Albania	16.9	16.9	17.7	18.1	16.9	17.5	17.7	18.2	17.7	
Bosnia and Herzegovina	18.7	18.7	18.7	18.4	18.7	18.6	18.6	18.3	18.7	
Kosovo <sup>5</sup>	15.3	14.8	15.8	15.8	14.8	16.0	15.3	15.3	15.8	
Montenegro <sup>5</sup>	18.5	19.3	20.3	18.4	19.3	18.9	20.1	20.7	20.3	
North Macedonia	15.8	16.6	17.2	16.3	16.6	16.9	17.1	17.4	17.2	
Serbia	19.7	18.8	19.7	18.2	18.8	19.2	20.6	20.5	19.7	
Ukraine	12.0	13.1	12.2	12.8	13.1	13.4	14.5	14.8	12.2	

Source: National central banks.

<sup>1</sup> Foreign currency component at constant exchange rates.

<sup>2</sup> In total loans to the nonbank private sector. As far as available, including loans indexed to foreign currencies.

<sup>3</sup> Share in total loans to all sectors.

<sup>4</sup> Including securities.

<sup>5</sup> Overall capital adequacy ratio.

## European Commission is striving for renewed enlargement momentum

After decades of enlargement efforts with too little (tangible) progress, enlargement fatigue is noticeable among the negotiating partners, and the credibility of the enlargement process is dwindling.

Partly due to this development, trust in the EU has declined in the WB countries, as shown by the OeNB Euro Survey<sup>18</sup> results. In Albania, more than 70% of all respondents had trust in the EU from 2010–2014 according to the survey, but the share dropped to below 25% in 2022 (no data available for 2023). Positive sentiment toward the EU was highest in Bosnia and Herzegovina in 2021 (56% of the respondents had trust in the EU) and in North Macedonia in 2020 (58%). With shares of 52% (Bosnia and Herzegovina) and 44% (North Macedonia), survey results confirm somewhat diminishing trust in the EU among households in 2023. In Serbia, trust in the EU was always low across all survey waves since 2009. In 2016, the highest level of trust was reached: Almost 33% of the respondents said they had trust in the EU. The share, however, dropped to 24% in 2022 but recovered slightly to around 26% in 2023.

Obviously, the EU enlargement process needs renewed momentum and more credibility and predictability. This need is reinforced particularly by the rising importance of other influential players for the Western Balkans (predominantly China, Russia but also the USA) and by geopolitical shifts induced by Russia's aggressive invasion of Ukraine.

New impetus for the enlargement process was provided by the Enlargement Package<sup>19</sup>, which was adopted in November 2023. The European Commission recommended opening accession negotiations with Moldova as well as with Ukraine and granting candidate status to Georgia. Moreover, the European Commission also recommended opening accession negotiations with Bosnia and Herzegovina once the necessary degree of compliance with the membership criteria has been achieved. In March 2024, the Council decided to open formal accession talks with Bosnia and Herzegovina.

The Enlargement Package 2023 was complemented by the new Growth Plan for the Western Balkans, which is based on four pillars, namely accelerating integration with the EU's single market<sup>20</sup>, implementing a common regional market, boosting fundamental reforms and eventually providing financial support depending on the implementation of reforms. Financial resources allocated to the New Growth Plan amount up to EUR 6 billion with up to EUR 2 billion in grants and up to EUR 4 billion in long-term loans over the 2024–2027 Multiannual Financial Framework period. Each WB country should prepare a Reform Agenda on investment priorities and reforms based on the Economic Reform Programmes. Ultimately, the allocation of funds will depend on progress made by the country. By the end of April 2024, all WB countries had submitted their respective Reform Agendas to the European Commission. These are now being reviewed by the European Commission.

---

<sup>18</sup> For more information refer to [OeNB Euro Survey - Oesterreichische Nationalbank \(OeNB\)](#).

<sup>19</sup> [Strategy and Reports - European Commission \(europa.eu\)](#).

<sup>20</sup> This pillar includes seven priority areas to promote the integration of the Western Balkan countries into the EU single markets, i.e.: free movement of goods, free movement of services and workers, access to the Single Euro Payments Area (SEPA), facilitation of road transportation, integration and decarbonisation of energy markets, a Digital Single Market and integration into industrial supply chains.

## 2 Georgia: economy benefits from the Russian invasion in Ukraine

Following the Russian invasion in Ukraine, Georgia formally applied for EU membership in March 2022. Subsequently, in December 2023, Georgia was granted candidate status by the European Council. As such, we have included it in our regular monitoring. While the invasion of Ukraine caused a significant upswing in the Georgian economy, shifting geoeconomic patterns imply a high uncertainty going forward.

Real GDP growth in Georgia was slightly stronger than expected, at 7.5% in 2023, following double-digit growth rates in 2021 and 2022. Last year's growth is primarily attributed to tourism, trade, construction, financial services and investment. While remittances moderated during the second half of 2023, they still contributed significantly to GDP growth in the last two years. The National Bank of Georgia (NBG) raised concerns about the risk of output consistently exceeding its potential due to the combination of high growth rates of previous years and heightened credit activity. However, it should be noted that credit growth was largely driven by increased business loans. The resulting increase in investment led to a higher output capacity, while minimizing risk of sustained excess demand. Looking ahead, GDP growth is projected to slow down to 5.7% in 2024 and converge toward its potential of 5% in the medium term. The fiscal deficit remained low at 2.4% of GDP, supported by strong economic activity and revenue growth. Public debt remained under the 40% threshold and is expected to stay close to that margin in the medium term.

The current account deficit reached a historic low of 4.3% in 2023, which was partly driven by increased remittances and strong tourism. The Russian invasion triggered large volumes of capital inflows, which persisted throughout 2022 and the first half of 2023, but moderated in the second half. The balance of goods and services amounted to -8.6% of GDP. Total exports increased by 8.2% and total imports increased by 8.6%. Georgia's most important export countries in 2023 were Azerbaijan (14.2% of goods exports), Armenia (12.9%) and Kazakhstan (11.5%). Leading export commodities include cars (34.9%), copper ores and concentrates (8%) and wine (4.3%). Georgia's most important import partners are Türkiye (16.6% of goods imports), United States (12.6%) and Russia (11.3%), with the predominant import goods being cars (20.5%), petroleum products (7.6%) and packaged medicaments (3.5%). In recent years, Georgia has established itself as a regional hub of importing and reselling used cars. From 2022 to 2023, imports and exports of cars increased by 84.5% and 134.8%, respectively.

The labor market in Georgia is characterized by high structural unemployment, shortage of skilled labor, high self-employment (around 30%) and a high share of agricultural workers (around 40%). After the COVID-19 shock, which led to unemployment reaching over 22% in the third quarter of 2021, Georgia's labor market has recovered well, with unemployment declining to below pre-pandemic levels of 15.3% in the last quarter of 2023. However, despite sizable unemployment, the labor market remains tight, causing real wage growth to hit over 15% in 2023. Labor force participation trended downward after 2015, reaching its low at 48.3% in the first quarter of 2021, but has since increased to 54.3% in the final quarter of 2023.

After inflation levels of above 10% in 2021 and 2022, the downward trajectory of headline inflation persisted throughout 2023, reaching 0.4% in the last quarter and averaging 2.5% annually. The strong decline is primarily attributed to lower international commodity prices and an appreciation of the Georgian lari (GEL), while domestic price pressures remain strong. After a period of high inflationary risk, low observed inflation caused the NBG to lower the policy rate by a cumulative 275 basis points from May 2023 to 8.25% in March 2024. According to the NBG,

inflation will remain below its target of 3% at the beginning of this year and it is predicted to stabilize close to the desired rate by the end of the year. The average inflation forecast for 2024 is 2.4%. Following a controversial ruling last summer, the government increased its political influence on the NBG via changes to the organic law of the central bank. These changes raised concerns of limited central bank independence among international institutions.

Overall, the banking sector in Georgia is highly concentrated and well capitalized, as the tier 1 capital ratio increased from 17.1% in 2022 to 19.7% in 2023. Indicators for liquidity and profitability remained sound throughout 2023. Return on assets increased from 3.8% in the fourth quarter of 2022 to 4.1% in fourth quarter of 2023. Dollarization of loans decreased from 56.1% in 2022 to 47% in 2023, while dollarization from deposits decreased from 45% to 44.5%. Macroprudential policies to gradually reduce foreign currency lending are in place, yet financial dollarization remains high.

The IMF sees upcoming challenges for Georgia to include a strengthening of the independence of the central bank, further macroprudential measures to mitigate risk of banking sector concentration and dollarization and improving the quality of education across the country.

**Table 13: Main economic indicators: Georgia****Main economic indicators: Georgia**

	2021	2022	2023	Q1 23	Q2 23	Q3 23	Q4 23
<i>Year-on-year change of the period total in %</i>							
GDP at constant prices	10.6	11.0	7.5	8.2	8.1	7.0	6.9
Private consumption	12.3	-2.8	3.2	-2.5	2.4	1.3	10.2
Public consumption	7.1	-0.8	6.1	-2.7	1.9	9.7	14.9
Gross fixed capital formation	-4.8	9.9	25.0	9.7	5.0	66.7	23.9
Exports of goods and services	23.5	37.4	8.2	38.1	15.6	-2.0	-5.7
Imports of goods and services	8.8	16.9	8.6	19.6	10.6	6.9	0.1
<i>Contribution to GDP growth in percentage points</i>							
Domestic demand	7.1	4.2	8.2	..	..	..	..
Net exports of goods and services	3.6	5.7	-1.0	..	..	..	..
Exports of goods and services	8.5	15.1	4.1	..	..	..	..
Imports of goods and services	-5.0	-9.4	-5.1	..	..	..	..
<i>Year-on-year change of the period average in %</i>							
Unit labor costs in the whole economy (nominal, per person)	..	..	..	..	..	..	..
Unit labor costs in industry (nominal, per person)	..	..	..	..	..	..	..
Labor productivity in industry (real, per person)	..	..	..	..	..	..	..
Average gross earnings in industry (nominal, per person)	..	..	..	..	..	..	..
Producer price index (PPI) in industry	16.7	11.4	-2.9	-1.5	-6.0	-3.1	-0.7
Consumer price index (here: CPI)	9.6	11.9	2.5	7.6	1.6	0.6	0.4
EUR per 1 GEL, + = GEL appreciation	-6.4	24.3	7.6	28.2	23.6	14.6	-0.4
<i>Period average levels</i>							
Unemployment rate (ILO definition, %, 15–64 years)	20.6	17.3	16.4	18.0	16.7	15.6	15.3
Employment rate (% , 15–64 years)	40.4	43.0	44.5	42.6	44.3	45.3	46.0
Key interest rate per annum (%)	9.3	10.9	10.5	11.0	10.7	10.3	9.9
GEL per 1 EUR	3.8	3.1	2.9	2.8	2.8	2.8	2.9
<i>Nominal year-on-year change in period-end stock in %</i>							
Claims on the domestic nonbank private sector of which:	13.0	3.5	16.0	2.8	6.9	12.1	16.0
claims on households	14.9	10.0	15.0	8.8	11.7	12.6	15.0
claims on nonbank corporations	11.0	-3.5	17.2	-4.1	1.4	11.5	17.2
Share of foreign currency loans in total loans to the nonbank private sector	50.8	45.1	44.3	44.3	44.6	44.3	44.3
Return on assets (banking sector)	3.9	3.8	4.1	3.9	4.1	4.3	4.1
Tier 1 capital ratio (banking sector)	15.6	17.1	19.7	17.5	17.6	19.9	19.7
NPL ratio (banking sector)	1.9	1.5	1.5	1.6	1.6	1.6	1.5
<i>% of GDP</i>							
General government revenues	..	..	..	..	..	..	..
General government expenditures	..	..	..	..	..	..	..
General government balance	..	..	..	..	..	..	..
Primary balance	..	..	..	..	..	..	..
Gross public debt	..	..	..	..	..	..	..
<i>% of GDP</i>							
Debt of nonfinancial corporations (nonconsolidated)	..	..	..	..	..	..	..
Debt of households and NPISHs <sup>3</sup> (nonconsolidated)	..	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>							
Goods balance	-20.6	-21.5	-19.8	-21.8	-18.8	-19.4	-19.5
Services balance	3.9	11.5	11.2	10.9	10.8	15.0	8.1
Primary income	-6.4	-7.4	-6.6	-5.7	-8.8	-5.9	-5.9
Secondary income	12.5	12.9	10.8	11.2	10.2	11.1	10.6
Current account balance	-10.5	-4.5	-4.3	-5.3	-6.5	0.9	-6.7
Capital account balance	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Foreign direct investment (net) <sup>2</sup>	-5.1	-7.4	-4.2	-7.0	-6.2	-2.7	-1.8
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>							
Gross external debt	124.6	97.5	76.7	89.4	84.1	78.8	76.7
Gross official reserves (excluding gold)	24.1	20.3	15.9	18.7	17.6	17.8	15.9
<i>Months of imports of goods and services</i>							
Gross official reserves (excluding gold)	4.8	3.7	3.3	3.4	3.3	3.5	3.3
<i>EUR million, period total</i>							
GDP at current prices	15,625	22,652	28,501	6,074	6,957	7,650	7,820

Source: Bloomberg, national statistical offices, national central banks, wiiv, OeNB.

<sup>1</sup> Nonprofit institutions serving households.

<sup>2</sup> + = 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 Moldova: sluggish recovery after war-induced recession<sup>21</sup>

The Republic of Moldova (hereinafter: Moldova) received EU candidate status in June 2022, and the EU bodies formally opened accession negotiations in December 2023. As such, we have included Moldova in our regular monitoring.

Amid EU accession plans and the challenges the war in Ukraine poses on neighboring Moldova, GDP growth was still muted in 2023. After a sharp drop in 2022, GDP dropped further in the first half of 2023 and started to moderately increase only in the second half, also due to a good harvest season. Real GDP remained below 2021 levels at end-2023. Despite wages growing by over 16% in 2023, real wage growth and private consumption are low. Investment is still suppressed. The current account balance is clearly in the negative realm, with a net lending position of more than 11% of GDP in the fourth quarter of 2023.

Thus, while external demand again positively contributed to GDP in 2023, domestic demand still did not recover and had a clear negative contribution. In general, the Moldovan economy relies heavily on trade with its neighbors and the EU. About 60% of all exports went to the EU in 2022, another 15% were exported to (potential) EU candidate countries. Main export goods are agricultural and mineral products, food and beverages as well as machinery. Following a trade agreement in 2016, which envisions full trade liberalization within ten years and already included free trade for most goods, last year, trade liberalization for agricultural exports to the EU was granted until summer 2024. Prior to Russia's invasion of Ukraine, Moldova almost completely depended on Russia for importing gas, which is also essential in electricity production. Financial support from European institutions helped reduce these dependencies in the last two years.

Unemployment stayed low during the last two years. However, employment rates are low as well, especially among women, and between 20% and 30% of people are working in informal employment. Reforms, like for example a civil service salary reform, are planned to make work in these sectors more attractive. The tourism sector employs more than 10% of the labor force but, by the end of 2023, overnight stays had not caught up with pre-pandemic levels yet.

After a yearly inflation rate of more than 30% in the second half of 2022, it has been on a steady decline since then, reaching 3.9% in March 2024. This is in the range of the 5% targeted by the central bank. The key policy rate was gradually reduced from over 21% in summer 2022 to 3.75% in March 2024. Core inflation has exceeded headline inflation since the third quarter of 2023. The exchange rate between the Moldovan leu and euro has remained relatively stable over the last years, showing a slight appreciation of the leu in 2023. This supported the strong upward trend in foreign exchange reserves, already seen over the last five years. In March 2024, reserves were over USD 5.3 billion, which corresponds to more than seven import months. Capital buffers in the banking system are very high, e.g. the capital-to-risk-weighted assets ratio stood at about 30% in the final quarter of 2023. With still high policy rates in 2023, loan growth stayed weak while NPLs remained relatively high.

The government deficit stood at over 5% of GDP in 2023, comparable to the deficit in 2020, and substantially higher than the average in the previous decade. The government supported vulnerable households in the recession and, over the last two winters, by subsidizing high energy prices for example. Financial support especially from the EU and the European Bank for Reconstruction and Development (EBRD) provided significant support to the budget in 2023 and

---

<sup>21</sup> Data are taken from public and official data sources, excluding data from unrecognized Transnistria and regions controlled by Transnistria.

helped alleviate the negative spillover effects of the war. Energy dependency remains a high risk, since Moldova's electricity supply still crucially depends on production in Transnistria and hence Russian gas.

External funding will remain important for Moldova for mastering the challenges imposed by the Russian war of aggression in neighboring Ukraine but also for the ongoing reforms necessary for EU accession. Two major areas of reform remain the control of corruption and the independence of institutions. Still, good reform progress toward accession was made in the last two years, for example in some areas of the judicial framework and in financial services.

**Table 14: Main economic indicators: Moldova****Main economic indicators: Moldova**

	2021	2022	2023	Q1 23	Q2 23	Q3 23	Q4 23
	<i>Year-on-year change of the period total in %</i>						
GDP at constant prices	13.9	-5.0	0.8	-0.9	-0.2	3.4	0.3
Private consumption	17.1	-5.8	-0.4	-0.2	-4.5	0.8	1.8
Public consumption	3.0	3.2	-3.4	-2.3	-2.2	-1.4	-6.7
Gross fixed capital formation	1.9	-6.8	-3.0	-1.9	-7.7	-3.4	1.1
Exports of goods and services	17.5	26.7	5.2	7.9	-5.5	6.5	12.6
Imports of goods and services	21.2	15.9	-3.1	8.4	-11.2	-7.6	-0.6
	<i>Contribution to GDP growth in percentage points</i>						
Domestic demand	21.4	-4.2	-4.2	1.7	-6.8	-5.1	-5.7
Net exports of goods and services	-7.3	-1.1	5.0	-2.8	6.7	8.7	6.2
Exports of goods and services	6.0	9.5	2.5	3.9	-3.0	2.7	5.7
Imports of goods and services	-13.3	-10.6	2.6	-6.8	9.7	6.0	0.5
	<i>Year-on-year change of the period average in %</i>						
Unit labor costs in the whole economy (nominal, per person)	..	..	..	..	..	..	..
Unit labor costs in industry (nominal, per person)	-2.3	20.0	17.2	20.7	25.1	11.4	12.3
Labor productivity in industry (real, per person)	11.0	-3.6	-0.6	-2.3	-7.2	2.3	4.2
Average gross earnings in industry (nominal, per person)	8.7	15.8	16.2	17.9	16.1	14.0	17.0
Producer price index (PPI) in industry	8.4	26.4	13.0	24.6	14.5	10.0	2.9
Consumer price index (here: CPI)	5.1	28.6	14.0	25.1	15.8	9.7	5.3
EUR per 1 MDL, + = MDL appreciation	-5.4	5.2	1.1	1.9	0.6	2.8	-0.1
	<i>Period average levels</i>						
Unemployment rate (ILO definition, %, 15–64 years)	3.3	3.2	4.7	5.7	3.9	4.3	5.0
Employment rate (% 15–64 years)	47.5	48.4	51.8	50.4	52.8	53.0	51.0
Key interest rate per annum (%)	3.7	16.6	10.1	17.7	11.2	6.0	5.3
MDL per 1 EUR	20.9	19.9	19.7	19.7	20.1	19.5	19.4
	<i>Nominal year-on-year change in period-end stock in %</i>						
Claims on the domestic nonbank private sector of which:	21.0	8.8	2.9	5.1	3.2	3.4	2.9
claims on households	39.2	4.4	8.1	-0.5	-1.2	2.8	8.1
claims on nonbank corporations	10.9	12.0	-0.4	9.1	6.4	3.8	-0.4
Share of foreign currency loans in total loans to the nonbank private sector	31.0	35.2	29.9	34.5	33.5	31.7	29.9
Return on assets (banking sector)	2.4	3.4	3.3	4.5	4.0	3.6	3.3
Tier 1 capital ratio (banking sector)	25.2	28.5	29.2	28.0	30.9	30.1	29.2
NPL ratio (banking sector)	6.1	6.4	5.6	6.5	7.1	6.7	5.6
	<i>% of GDP</i>						
General government revenues	32.0	33.3	34.1				
General government expenditures	33.9	36.6	39.2				
General government balance	-1.9	-3.2	-5.2				
Primary balance	..	..	..				
Gross public debt	32.6	35.0	36.0				
	<i>% of GDP</i>						
Debt of nonfinancial corporations (nonconsolidated)	..	..	..				
Debt of households and NPISHs <sup>3</sup> (nonconsolidated)	..	..	..				
	<i>% of GDP (based on EUR), period total</i>						
Goods balance	-30.7	-36.1	-29.6	-35.0	-27.6	-28.7	-27.9
Services balance	3.5	6.3	5.4	7.8	4.8	4.0	5.3
Primary income	2.0	0.4	1.3	1.8	1.7	1.0	0.8
Secondary income	12.9	12.2	11.0	11.3	10.8	11.4	10.5
Current account balance	-12.4	-17.2	-12.0	-14.1	-10.3	-12.3	-11.3
Capital account balance	-0.4	0.2	0.0	0.0	0.0	0.0	0.0
Foreign direct investment (net) <sup>2</sup>	-2.7	-3.7	-2.5	-3.9	-1.5	-2.3	-2.5
	<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>						
Gross external debt	66.8	65.3	62.0	64.0	63.1	62.1	62.0
Gross official reserves (excluding gold)	29.8	30.4	32.3	30.1	30.8	31.0	32.3
	<i>Months of imports of goods and services</i>						
Gross official reserves (excluding gold)	6.2	5.1	6.5	5.1	5.5	5.7	6.5
	<i>EUR million, period total</i>						
GDP at current prices	11,547	13,767	15,277	3,285	3,539	4,153	4,300

Source: Bloomberg, national statistical offices, national central banks, wiiv, OeNB.

<sup>1</sup> Nonprofit institutions serving households.

<sup>2</sup> + = 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 Türkiye: lira depreciation, high inflation and low reserves raise expectations of further rate hikes

Published annual GDP growth amounted to 4.5% in 2023, down from 5.5% in 2022. While private consumption grew at double-digit rates, public consumption registered growth of about 5%. Gross fixed capital formation showed an acceleration of growth to almost 9%, from 1.3% in 2022. By contrast, real exports contracted by almost 3%, after growth of 10% in 2022. However, real imports grew by almost 12%, even more strongly than in 2022, implying a large negative contribution of net exports. Part of the high import growth rate resulted from the increase of nonmonetary gold imports. The sum of growth contributions of all published demand components, which includes the negative contribution of net exports, continues to exceed the published rate of GDP growth by far, suggesting a large negative contribution of inventory change, which, however, was less pronounced than in 2022.

Public consumption and hence domestic demand growth was far more pronounced in the first half of 2023, reflecting both earthquake-related reconstruction and presidential elections. Moreover, seasonally and working day-adjusted data show quarter-on-quarter contraction of both fixed investment and real imports in the fourth quarter of 2023, in contrast to the annual average figures above.

The current account balance showed a deficit of 4.2% of GDP in 2023, which was 1.2 percentage points smaller than in 2022, reflecting the improvement in the goods and services balance. Excluding almost unchanged net imports of nonmonetary gold, the current account deficit amounted to 1.8% of GDP. Net FDI inflows shrank to only 0.4% of GDP and, above all, net other investment inflows financed the remaining deficit.

Official foreign currency (FX) reserves stood at 2.8 import months at end-2023, almost unchanged on a year earlier, but declined to 2.2 import months by end-February 2024. At the same time, the central bank's off-balance net short positions due within one year amounted to 90% of official FX reserves, with about half from FX swaps with domestic banks.

Both annual HICP headline and core inflation remained at a very high level, accelerating from August 2023 to March 2024 to reach 68.6% and 70.9%, respectively, with services inflation rising from 80% to 96.2%. In parallel, the lira depreciated in euro terms, by about 39% year on year, amounting to euro appreciation in lira terms by about 65%, which was comparable to the size of inflation. The Turkish central bank (TCMB) doubled the key rate from 25% at end-August to 50% at end-March, which still implies a large negative real interest rate.

Banks continue to run a negative net FX position on balance, which they close by entering swaps with the central bank by initial FX sale. In parallel, nonfinancial corporations run a negative overall net FX position on balance, with about one-quarter due to overall net domestic FX liabilities (mostly vis-à-vis banks), while the bulk is due to external liabilities. This overall net FX position continued to become less negative during 2023. At the same time, nonfinancial corporations run a positive short-term net FX position on balance, almost entirely reflecting the net domestic FX position (mostly vis-à-vis banks).

The general government fiscal deficit rose strongly to 5.5% of GDP in 2023 from 2.1% in 2022 mainly due to earthquake-related support and reconstruction and partly due to presidential election-related spending. IMF staff forecasts that it will remain close to that level in 2024. General government debt remains below 35% of GDP.

**Table 15: Main economic indicators: Türkiye****Main economic indicators: Türkiye**

	2021	2022	2023	Q1 23	Q2 23	Q3 23	Q4 23
	<i>Year-on-year change of the period total in %</i>						
GDP at constant prices	11.4	5.5	4.5	4.0	3.9	6.1	4.0
Private consumption	15.4	18.9	12.8	16.6	15.3	11.1	9.3
Public consumption	3.0	4.2	5.2	6.0	6.4	7.6	1.7
Gross fixed capital formation	7.2	1.3	8.9	3.8	5.7	14.8	10.7
Exports of goods and services	25.1	9.9	-2.7	-3.4	-9.4	1.2	0.2
Imports of goods and services	1.7	8.6	11.7	13.5	19.7	14.5	2.7
	<i>Contribution to GDP growth in percentage points</i>						
Domestic demand	11.5	12.5	11.7	12.8	12.7	12.0	9.5
Net exports of goods and services	5.3	0.6	-3.4	-3.8	-6.8	-2.9	-0.7
Exports of goods and services	5.7	2.5	-0.7	-0.9	-2.6	0.3	0.1
Imports of goods and services	-0.4	-1.9	-2.7	-2.9	-4.2	-3.2	-0.7
	<i>Year-on-year change of the period average in %</i>						
Unit labor costs in the whole economy (nominal, per person)	..	..	..	..	..	..	..
Unit wage costs in manufacturing (nominal, per hour)	19.0	76.5	102.8	115.1	101.5	97.9	99.7
Labor productivity in manufacturing (real, per hour)	-0.3	-1.7	1.8	-1.2	2.1	2.3	3.7
Gross wages in manufacturing (nominal, per hour)	19.0	74.0	106.5	112.4	105.6	102.4	107.1
Producer price index (PPI) in industry	43.9	128.5	49.9	74.5	44.1	47.1	42.0
Consumer price index (here: HICP)	19.6	72.3	54.0	54.4	40.5	56.4	62.8
EUR per 1 TRY, + = TRY appreciation	-23.4	-39.6	-32.4	-22.7	-26.5	-38.1	-38.0
	<i>Period average levels</i>						
Unemployment rate (ILO definition, %, 15–64 years)	12.2	10.7	9.6	10.6	9.5	9.5	8.8
Employment rate (% 15–64 years)	50.3	52.8	53.8	52.7	53.6	54.5	54.4
Key interest rate per annum (%)	17.8	12.9	18.5	8.8	9.1	20.4	35.8
TRY per 1 EUR	10.5	17.4	25.8	20.3	22.9	29.2	30.7
	<i>Nominal year-on-year change in period-end stock in %</i>						
Loans to the domestic nonbank private sector <sup>1</sup>	11.2	37.5	33.1	40.8	37.3	37.1	33.1
<b>of which:</b>							
loans to households	20.4	55.4	76.6	77.5	81.1	84.0	76.6
loans to nonbank corporations	10.3	36.6	26.8	36.4	31.5	31.0	26.8
Share of foreign currency loans in total loans to the nonbank private sector	38.1	27.7	27.9	25.2	28.5	27.5	27.9
Return on assets (banking sector)	1.3	3.8	3.2	2.8	3.0	3.3	3.2
Tier 1 capital ratio (banking sector)	13.2	15.3	14.7	14.1	13.9	14.3	14.7
NPL ratio (banking sector)	3.4	2.2	1.7	2.0	1.8	1.6	1.7
	<i>% of GDP</i>						
General government revenues	32.2	28.3	28.0				
General government expenditures	33.3	30.4	34.0				
General government balance	-1.1	-2.1	-6.0				
Primary balance	2.1	2.6	-1.7				
Gross public debt	41.7	31.7	32.0				
	<i>% of GDP</i>						
Debt of nonfinancial corporations (nonconsolidated)	..	..	..				
Debt of households and NPISHs <sup>3</sup> (nonconsolidated)	..	..	..				
	<i>% of GDP (based on EUR), period total</i>						
Goods balance	-3.6	-10.0	-8.0	-12.0	-8.2	-7.5	-4.8
Services balance	3.9	5.6	4.8	3.2	4.7	7.0	4.0
Primary income	-1.3	-1.0	-1.0	-1.0	-1.3	-0.9	-0.9
Secondary income	0.1	0.0	0.1	0.0	0.1	0.1	0.0
Current account balance	-0.9	-5.4	-4.2	-9.9	-4.7	-1.4	-1.6
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment (net) <sup>2</sup>	-0.8	-0.9	-0.4	-0.5	-0.4	-0.1	-0.7
	<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>						
Gross external debt	50.4	44.0	39.3	41.8	40.3	40.6	39.3
Gross official reserves (excluding gold)	9.3	9.1	8.3	7.0	6.5	7.8	8.3
	<i>Months of imports of goods and services</i>						
Gross official reserves (excluding gold)	3.2	2.6	2.8	2.0	2.0	2.5	2.8
	<i>EUR million, period total</i>						
GDP at current prices	687,586	852,655	1,007,742	229,098	240,100	263,637	274,907

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

<sup>1</sup> Foreign currency component at constant exchange rates.

<sup>2</sup> + = 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 Ukraine: economy recovers but remains under war-related pressures

Ukraine's economy recovered by 5.3% in 2023 following a GDP contraction of 28.8% in 2022. Remarkably, the recovery clearly exceeded earlier projections by the IMF and the National Bank of Ukraine (NBU). A strong harvest, a comparably stable situation in the energy sector as well as the establishment of export routes enabled better than expected growth. In general, loose fiscal policy supported domestic demand. Investments were underpinned by: defense spending and reconstruction, consumer demand through social programs and military allowances, among other factors. Private sector wage growth also backed private consumption, while the private sector in turn contributed to soaring investment growth. Ukraine's success in creating its self-managed Black Sea corridor after Russia refused to prolong the Black Sea Grain Initiative facilitated the export of grain and other goods. As a result, export contraction slowed down in the final quarter. Obviously, the economy must continue to deal with an immense burden emanating from Russia's aggression. In March 2024, Russia again intensified attacks on Ukraine's energy infrastructure causing blackouts in some regions. Labor supply constraints due to migration and mobilization have been dampening growth. After a new legal package on more wide-ranging mobilization was signed by the president in early April, this effect will likely increase in the course of this year.

Ukraine's budget deficit is very large, reflecting persistently high expenditure needs for defense and social programs and revenue losses due to the economic impact of the war as well as import tax losses from border blockades. The deficit (excluding external grants from revenues) rose to 26.3% of GDP in 2023 from about 25% in 2022 according to IMF estimates. For 2024, the budget deficit is expected to go down to 20% of GDP. To boost tax revenues, the authorities inter alia introduced a one-time 50% tax on bank profits on extraordinary earnings of the year 2023. On the external funding side, the European Council's agreement on the EUR 50 billion Ukraine Facility at the beginning of February was an important step that allows the EU to provide financial support over the period 2024–2027. In April, the USA finally adopted a further military and financial support package worth around EUR 57 billion (including around EUR 7.5 billion in financial support). In addition to acting as a vital source for budget funding, external financial support has enabled Ukraine to avoid a balance-of-payments crisis and to build up its international reserve buffers. In 2023, the deficit in the trade and services balance rose to more than 20% of GDP given war-related constraints on exports and high import demand. Positive income balances (with the secondary income balance including grants from abroad) compensated a large part of the trade deficit. In sum, the current account deficit stood at about 5% of GDP in 2023 following a surplus of similar size a year earlier. As external funding also arrived in the form of loans on a large scale, international reserves recorded a substantial increase in 2023. Yet, external funding delays caused a decline in international reserves in the first two months of 2024. In March, Ukraine finally received ample inflows in the form of bridge financing under the EU facility (EUR 4.5 billion), a further IMF tranche (EUR 0.8 billion) and bilateral support – in sum about EUR 8.3 billion. As a result, international reserves climbed to EUR 40.5 billion covering 5.8 months of future imports at end-March 2024. When approving the latest disbursement, the IMF noted that Ukraine continued to perform strongly in fulfilling the conditionality under the IMF Extended Fund Facility.

The international reserves buffer has given the NBU room for maneuver to balance the FX market. Through FX market interventions, maintaining high real interest rates and adjusting FX controls, the NBU has steered the transition to a managed flexibility of the exchange rate. Since the end of the peg to the USD in early October 2023, the hryvnia has moderately depreciated against the USD (by about 7%). Keeping the FX market under control together with some other factors (good

harvest, lower global energy prices, moratorium on raising some utility tariffs) supported a further considerable disinflation. Monetary financing of the budget deficit stopped at end-2022. Consumer price inflation dropped to 4.3% in February 2024 from 12.8% in mid-2023 and thus reached the NBU's target range of  $5\% \pm 1$  percentage point. Against this background, the NBU lowered its key policy rate stepwise to 14.5% in March 2024 (compared to 25% in mid-2023). In March 2024, inflation amounted to 3.5%.

The NBU's banking sector resilience assessment was completed at end-2023 and revealed capital shortfalls in five banks that have already been mostly addressed according to the IMF. A more detailed and independent asset quality review will follow as soon as conditions allow. Meanwhile, bank lending showed signs of stabilization thanks to government-backed subsidized lending initiatives. At the same time, deposits grew markedly.

**Table 16: Main economic indicators: Ukraine****Main economic indicators: Ukraine**

	2021	2022	2023	Q1 23	Q2 23	Q3 23	Q4 23
<i>Year-on-year change of the period total in %</i>							
GDP at constant prices	3.4	-28.8	5.3	-10.3	19.2	9.6	4.7
Private consumption	6.7	-27.5	6.1	-10.3	17.5	11.9	9.8
Public consumption	0.8	31.4	9.0	13.8	3.7	17.0	4.0
Gross fixed capital formation	9.3	-33.9	52.9	44.8	117.3	58.9	19.5
Exports of goods and services	-8.6	-42.0	-5.4	-22.0	33.0	-9.9	-6.0
Imports of goods and services	14.2	-17.4	8.5	13.9	32.5	3.6	-6.2
<i>Contribution to GDP growth in percentage points</i>							
Domestic demand	10.5	-19.0	11.2	8.1	22.0	14.7	2.6
Net exports of goods and services	-9.3	-9.8	-5.9	-16.7	-5.1	-4.7	1.7
Exports of goods and services	-3.9	-17.1	-1.8	-9.7	9.5	-3.1	-1.7
Imports of goods and services	-5.4	7.3	-4.1	-6.9	-14.6	-1.6	3.4
<i>Year-on-year change of the period average in %</i>							
Unit labor costs in the whole economy (nominal, per person)	..	..	..	..	..	..	..
Unit labor costs in industry (nominal, per person)	12.5	..	..	..	..	..	..
Labor productivity in industry (real, per person)	3.7	..	..	..	..	..	..
Average gross earnings in industry (nominal, per person)	16.8	1.7	21.3	8.0	26.2	25.6	25.7
Producer price index (PPI) in industry	40.5	9.4	..	..	..	..	..
Consumer price index (here: CPI)	9.3	20.0	13.4	24.0	15.3	9.0	5.2
EUR per 1 UAH, + = UAH appreciation	-4.7	-4.9	-14.1	-17.7	-21.6	-11.9	-5.3
<i>Period average levels</i>							
Unemployment rate (ILO definition, %, 15–64 years)	9.9	..	..	..	..	..	..
Employment rate (% 15–64 years)	65.3	..	..	..	..	..	..
Key interest rate per annum (%)	7.5	18.6	22.4	25.0	25.0	22.5	17.0
UAH per 1 EUR	32.3	34.0	39.6	39.2	39.8	39.8	39.3
<i>Nominal year-on-year change in period-end stock in %</i>							
Loans to the domestic nonbank private sector <sup>1</sup>	15.3	14.0	21.8	14.3	18.4	21.3	21.8
<b>of which:</b>							
loans to households	22.1	9.4	23.0	10.1	17.2	22.2	23.0
loans to nonbank corporations	12.2	16.4	21.2	16.5	19.1	20.8	21.2
Share of foreign currency loans in total loans to the nonbank private sector	28.6	27.0	25.8	26.6	26.1	25.5	25.8
Return on assets (banking sector)	4.4	1.4	6.2	6.9	6.5	6.9	6.2
Tier 1 capital ratio (banking sector)	12.0	13.1	12.2	13.4	14.5	14.8	12.2
NPL ratio (banking sector)	30.0	38.1	37.4	37.9	38.9	37.9	37.4
<i>% of GDP</i>							
General government revenues	30.5	41.9	47.5				
General government expenditures	33.9	58.1	67.8				
General government balance	-3.4	-16.1	-20.3				
Primary balance	..	..	..				
Gross public debt	49.0	77.8	84.4				
<i>% of GDP</i>							
Debt of nonfinancial corporations (nonconsolidated)	..	..	..				
Debt of households and NPISHs <sup>3</sup> (nonconsolidated)	..	..	..				
<i>% of GDP (based on EUR), period total</i>							
Goods balance	-3.3	-9.3	-16.1	-15.8	-14.8	-17.9	-15.7
Services balance	2.0	-7.0	-4.8	-9.5	-4.3	-3.6	-3.0
Primary income	-2.9	5.3	2.9	3.6	2.9	1.6	3.7
Secondary income	2.3	16.0	12.8	17.1	15.9	11.0	9.1
Current account balance	-2.0	5.0	-5.2	-4.7	-0.3	-8.7	-5.9
Capital account balance	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Foreign direct investment (net) <sup>4</sup>	-3.7	-0.2	-2.3	-3.1	-3.3	-3.4	-0.2
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>							
Gross external debt	67.2	80.3	88.4	83.4	86.8	88.7	88.4
Gross official reserves (excluding gold)	15.2	16.5	21.2	18.0	21.8	22.4	21.2
<i>Months of imports of goods and services</i>							
Gross official reserves (excluding gold)	4.4	3.8	5.1	4.0	4.8	5.1	5.1
<i>EUR million, period total</i>							
GDP at current prices	170,372	152,925	165,294	34,738	36,760	44,669	49,127

Source: Bloomberg, national statistical offices, national central banks, wiw, OeNB.

<sup>1</sup> Foreign currency component at constant exchange rates.

<sup>2</sup> Nonprofit institutions serving households.

<sup>3</sup> + = 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 Economic trends in Russia<sup>22,23</sup>

### I Russia: war spending boom is driving economic expansion and fueling inflation; sharp key rate adjustment

The growth of the Russian economy accelerated in the second half of 2023, facilitated by substantially rising budgetary outlays, strongly recovering consumer spending and growing capital expenditure that caused the economy to grow above its potential. Hence, the recovery rested on booming war-driven armaments production, rising incomes in the population and dynamic lending. Brisk domestic demand reflected private consumption growing by 6.5% (in real terms) in 2023 as a whole, government consumption expanding by 7% and fixed investment growth accelerating to 8.8%. Inventories accumulated at an even higher rate. While national accounts data for foreign trade are not yet available, net exports doubtlessly shrank in 2023. Overall GDP increased by 3.6% in 2023. Production-wise, manufacturing led the way, growing by 7.5%.

The economy has clearly been showing signs of overheating, which has prompted the Bank of Russia (CBR) to act decisively in recent months. The jobless rate (ILO definition) declined to only 2.7% in January 2024 (a new post-Soviet record low), indicating a very tight labor market, saddled with persisting shortages of skilled staff. Real wages reached record levels, which was one of the driving forces behind the upswing of private consumption; the average real wage of the period January–November 2023 was 7.6% higher than a year ago. Moreover, in the fourth quarter of 2023, for the first time in a decade did real disposable income of the population exceed its previous record level of 2014 by 4%.

Soaring wages, swelling consumer demand, the expansionary fiscal stance, the substantial decline of the ruble (explained below), as well as continuously high inflation expectations pushed up CPI inflation (year on year) from 4.3% in July 2023 to 7.7% in February 2024, before it slightly eased again to 7.5% in March 2024. The monetary authority reacted energetically – if a few months later than it should have, as the CBR itself conceded – with a series of consecutive key rate adjustments in July (+100 basis points to 8.5%), August (+350 basis points to 12%), September (+100 basis points to 13%), late October (+200 basis points to 15%) and mid-December 2023 (+100 basis points to 16%). As a result, this rate (the one-week auction repo rate) reached a level more than twice as high as half a year before. At its policy meetings in mid-February and mid-March 2024, the CBR left the key rate unchanged.

The shrinkage of oil-related budget revenues in the first half of 2023 was reined in in the second half of the year due to the recovery of the Urals oil price after the G7 oil price cap of US 60 per barrel for Russian oil had lost some of its effectiveness. Still the average Urals price in 2023 came to USD 63, which was 17% lower than a year ago. Overall, the shrinkage of oil-related revenues was more than offset by the increase of non-oil revenues, with the largest chunk, VAT and corporate profit tax proceeds, boosted by Russia's economic recovery. Driven by war-related spending, total budget expenditure in 2023 somewhat surpassed planned levels, but the annual federal deficit remained within the government's 2%-of-GDP target and reached 1.9% of GDP. The shortfall was mostly funded by drawing down liquid assets of the National Wealth Fund (NWF) and from domestic borrowing. Overall, the NWF declined from USD 147 billion at end-

---

<sup>22</sup> Compiled by Stephan Barisitz.

<sup>23</sup> Cut-off date: April 17, 2024.

February 2023 to USD 133 billion twelve months later; NWF liquid assets had shrunk from USD 86 billion (4.3% of GDP) to USD 56 billion (2.8% of GDP).

Substantially lower energy export proceeds combined with higher imports cut Russia's current account surplus by no less than 79% in 2023 compared to the previous year, bringing it down to USD 50.2 billion (2.5% of GDP). This deterioration, combined with capital outflows, triggered the ruble's slide by almost one-third against the US dollar and the euro in the first ten months of 2023. The incipient impact of the above key rate hikes, combined with the re-tightening of foreign exchange controls for a number of large exporting firms in mid-October (re-introduction of surrender requirement for export proceeds), caused the ruble to stabilize and slightly rebound again until February 2024 (+4% to +5%). Russia's gross international reserves (of which about USD 300 billion had been frozen by Western jurisdictions in February 2022) grew by USD 21 billion in the six months to end-March 2024, reaching USD 589 billion at this point.

As referred to above, dynamic lending has been one of the factors driving Russia's economic recovery. Corporate credit growth came to 11% in February 2024 (year on year, in real terms and exchange rate-adjusted), while loans to households increased by 18%. Among the latter, (subsidized) mortgage loans continued to grow most swiftly. After a weak patch in 2022, banks' profitability recovered substantially. The sector's net profit came to USD 39 billion in 2023. Yet the sharp key rate adjustment is starting to exert a cooling effect on real corporate lending (which had still grown at a rate of 16% in June 2023), while retail lending is somewhat less affected, given that more than a third of household debtors benefit from some form of state subsidy. That said, the rate hike is rendering these subsidy programs more costly for the government to finance. Fueled by the rate hike, retail deposit growth recovered to 14% in February 2024 (year on year, in real terms and exchange rate-adjusted), while corporate deposits grew much more modestly (+4%). Given the relative stabilization of the sector, regulatory forbearance is gradually being phased out.

**Table 17: Main economic indicators: Russia****Main economic indicators: Russia**

	2021	2022	2023	Q1 23	Q2 23	Q3 23	Q4 23
<i>Year-on-year change of the period total in %</i>							
GDP at constant prices	5.9	-1.2	3.6	-1.6	5.1	5.7	4.9
Private consumption	9.9	-1.1	6.5	-0.7	9.9	9.6	7.2
Public consumption	2.9	3.0	7.0	7.8	7.2	7.1	5.9
Gross fixed capital formation	9.3	6.7	8.8	6.8	12.9	7.7	8.1
Exports of goods and services	3.2	..	..	..	..	..	..
Imports of goods and services	19.1	..	..	..	..	..	..
<i>Contribution to GDP growth in percentage points</i>							
Domestic demand	8.3	0.3	8.2	4.3	10.7	7.6	9.8
Net exports of goods and services	-2.5	..	..	..	..	..	..
Exports of goods and services	1.0	..	..	..	..	..	..
Imports of goods and services	-3.5	..	..	..	..	..	..
<i>Year-on-year change of the period average in %</i>							
Unit labor costs in the whole economy (nominal, per person)	..	..	..	..	..	..	..
Unit labor costs in industry (nominal, per person)	3.3	15.0	14.3	15.6	12.9	12.3	16.4
Labor productivity in industry (real, per person)	7.2	0.0	1.8	-2.4	4.2	3.5	1.8
Average gross earnings in industry (nominal, per person)	10.9	15.2	16.3	12.6	17.6	16.3	18.4
Producer price index (PPI) in industry	24.6	12.8	4.7	-7.1	-5.3	10.2	20.9
Consumer price index (here: CPI)	6.7	13.7	5.9	8.7	2.7	5.1	7.2
EUR per 1 RUB, + = RUB appreciation	-5.3	18.1	-20.1	25.0	-18.9	-40.9	-35.3
<i>Period average levels</i>							
Unemployment rate (ILO definition, %, 15–64 years)	4.8	4.0	3.2	3.5	3.2	3.0	2.9
Employment rate (%, 15–64 years)	..	..	..	..	..	..	..
Key interest rate per annum (%)	5.8	10.7	9.9	7.5	7.5	10.3	14.5
RUB per 1 EUR	87.2	73.9	92.5	78.6	88.7	102.6	99.9
<i>Nominal year-on-year change in period-end stock in %</i>							
Loans to the domestic nonbank private sector <sup>1</sup>	15.3	14.0	21.8	14.3	18.4	21.3	21.8
<b>of which:</b>							
loans to households	22.1	9.4	23.0	10.1	17.2	22.2	23.0
loans to nonbank corporations	12.2	16.4	21.2	16.5	19.1	20.8	21.2
Share of foreign currency loans in total loans to the nonbank private sector	10.8	7.5	8.4	7.8	8.1	8.6	8.4
Return on assets (banking sector)	1.7	0.1	..	2.3	2.2	2.1	..
Tier 1 capital ratio (banking sector)	9.6	10.4	9.6	10.7	9.8	9.6	9.6
NPL ratio (banking sector)	15.1	15.3	12.8	15.0	14.6	13.6	12.8
<i>% of GDP</i>							
General government revenues	35.4	34.2	34.3				
General government expenditures	34.7	35.6	36.6				
General government balance	0.8	-1.4	-2.3				
Primary balance	..	..	..				
Gross public debt	15.4	14.7	15.0				
<i>% of GDP</i>							
Debt of nonfinancial corporations (nonconsolidated)	..	..	..				
Debt of households and NPISHs <sup>3</sup> (nonconsolidated)	..	..	..				
<i>% of GDP (based on EUR), period total</i>							
Goods balance	10.4	13.3	6.0	6.2	5.3	7.0	5.7
Services balance	-1.1	-1.0	-1.7	-1.5	-1.8	-2.0	-1.4
Primary income	-2.3	-1.9	-1.3	-1.1	-1.7	-1.2	-1.4
Secondary income	-0.3	-0.4	-0.5	-0.4	-0.3	-0.4	-0.8
Current account balance	6.7	10.0	2.5	3.1	1.5	3.3	2.1
Capital account balance	0.0	-0.2	-0.1	0.0	0.0	0.0	-0.2
Foreign direct investment (net) <sup>3</sup>	1.4	1.3	1.0	1.8	0.8	0.8	0.8
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>							
Gross external debt	27.3	16.5	15.3	14.4	14.1	15.1	15.3
Gross official reserves (excluding gold)	28.1	19.1	21.5	18.1	18.3	20.1	21.5
<i>Months of imports of goods and services</i>							
Gross official reserves (excluding gold)	16.4	15.0	13.7	14.5	13.4	13.4	13.7
<i>EUR million, period total</i>							
GDP at current prices	1,564,036	2,186,631	1,859,938	460,028	451,689	439,315	508,906

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

<sup>1)</sup> Foreign currency component at constant exchange rates.

<sup>4)</sup> Nonprofit institutions serving households.

<sup>3</sup> + = 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).



© Oesterreichische Nationalbank, 2024. All rights reserved.

Address: Otto-Wagner-Platz 3, 1090 Vienna  
PO Box 61, 1011 Vienna, Austria

Website: [www.oenb.at](http://www.oenb.at)

*May be reproduced for noncommercial, educational and scientific purposes provided that the source is acknowledged.*

*Opinions expressed by the authors do not necessarily reflect the official viewpoint of the Oesterreichische Nationalbank or the Eurosystem.*

Data protection information [www.oenb.at/en/dataprotection](http://www.oenb.at/en/dataprotection)  
ISSN 2960-5075 (online)