Outlook for selected CESEE countries and Russia

CESEE-6: fighting back from the pandemic roller coaster – recovery to take hold only from mid-2021 onward; Russia poised for recovery amid exceptionally large risks[1, 2]

At 4.0%, economic growth in the CESEE-6 countries[3] will show a moderate economic recovery in 2021, which will increase to 4.8% in 2022, before returning to 3.9% in 2023. Overall, the recovery will be rather evenly spread across countries, with Romania and Hungary exhibiting somewhat stronger growth dynamics, and Czechia and Bulgaria finding themselves bottom of the league in 2021. Along with reviving external demand, private consumption will be first to recover in mid-2021, once lockdown measures end. Investments will follow suit and strengthen further in 2022, supported by EU funds. Exports will rebound strongly in 2021 and 2022, reflecting strong external demand. Imports will strengthen with some delay on the back of reviving domestic demand. Over the projection horizon, we expect a roughly neutral contribution of net exports. The slump in 2020, which was less severe compared to that observed in the euro area, resulted in a notable positive growth differential (+3 percentage points) during the recession. We do not expect to see a positive growth margin in 2021, but the growth differential will re-emerge in 2022, and widen in 2023 (+0.7 and +1.8 percentage points, respectively). One year into the pandemic, our projections continue to be surrounded by a high degree of uncertainty, with the balance of risks being tilted to the downside, depending on pandemic developments.

The impact of the coronavirus pandemic on Russia has, so far, been less severe than anticipated. We have revised our economic forecast from last fall upward to reflect the increase of oil prices and price expectations,[4] projecting Russia's GDP to grow almost 3% this year and next, before declining to about 2% in 2023. Significant uncertainties surround the outlook. Russia and the rest of the world may struggle longer with the coronavirus, oil markets remain sensitive, and as with many other economies, Russia's incipient recovery is fragile.

[1] *Cutoff date for data underlying this outlook: March 24, 2021. The projections for the CESEE-6 countries were prepared by the OeNB, those for Russia by the Bank of Finland in cooperation with the OeNB. In our projections, we assume economic developments in the euro area as set out in the March 2021 ECB staff Macroeconomic Projection Exercise (MPE), according to which real annual GDP growth in the euro area is projected to amount to 4.0% in 2021, 4.1% in 2022, and 2.1% in 2023.*

[2] *Compiled by Julia Wörz, with input from Katharina Allinger, Stephan Barisitz, Melanie Koch, Mathias Lahnsteiner, Thomas Reininger, Tomáš Slačík and Zoltan Walko.*

[3] *CESEE-6: Bulgaria, Croatia, Czechia, Hungary, Poland, Romania.*

[4] *Forecast oil prices based on the average for oil futures contracts for the ten days preceding March 16, 2021, yield the following oil prices per barrel: USD 65 in 2021, USD 61 in 2022, and USD 58 in 2023.*

Table 1

OeNB-BOFIT GDP projections for 2021 to 2023 compared with the IMF forecast

	Eurostat/ Rosstat	OeNB-BOFIT projections April 2021			IMF WEO forecast April 2021		
	2020	2021	2022	2023	2021	2022	2023
	Year-on-year growth in %						
CESEE-6	**–3.9**	**4.0**	**4.8**	**3.9**	**4.3**	**4.7**	**3.9**
Bulgaria	–3.8	3.2	4.1	3.0	4.4	4.4	3.9
Croatia	–7.7	4.2	4.9	3.1	4.7	5.0	4.2
Czechia	–5.6	3.0	3.9	2.9	4.2	4.3	3.7
Hungary	–5.1	4.7	5.2	3.1	4.3	5.9	3.8
Poland	–2.7	3.9	5.2	4.4	3.5	4.5	4.0
Romania	–3.7	4.9	4.5	4.3	6.0	4.8	3.8
Russia	–3.1	2.7	3.1	2.0	3.8	3.8	2.1

Source: IMF World Economic Outlook (WEO) of April 2021, Rosstat, OeNB-BOFIT projections.

1 CESEE-6: private consumption picks up in 2021, and gross fixed capital formation will boost GDP growth further in 2022

While we do not expect COVID-19-related restrictions to be eased significantly in the first half of 2021, we base our projections on the assumption that progress with vaccinations over the next couple of weeks will help avoid further widespread lockdowns during the summer months and thereafter. In economic terms, we expect economic activity to accelerate markedly from the third quarter onward.

This will translate into an average (GDP-weighted) growth rate of 4% in 2021, mainly driven by private consumption growth. The recovery will strengthen further in 2022. CESEE-6 growth will peak at 4.8% on average, backed by a strong revival in gross fixed capital formation and carry-over effects from 2021. Romania is the only country whose GDP growth will peak in 2021 already, given investment spending fueled by EU funds from the 2014 to 2020 multiannual financial framework (MFF) and a base effect following the weak harvest in 2020. In 2023, we expect annual GDP growth in the CESEE-6 to return to almost 4%, mostly thanks to the continued strong performance of the Polish economy.

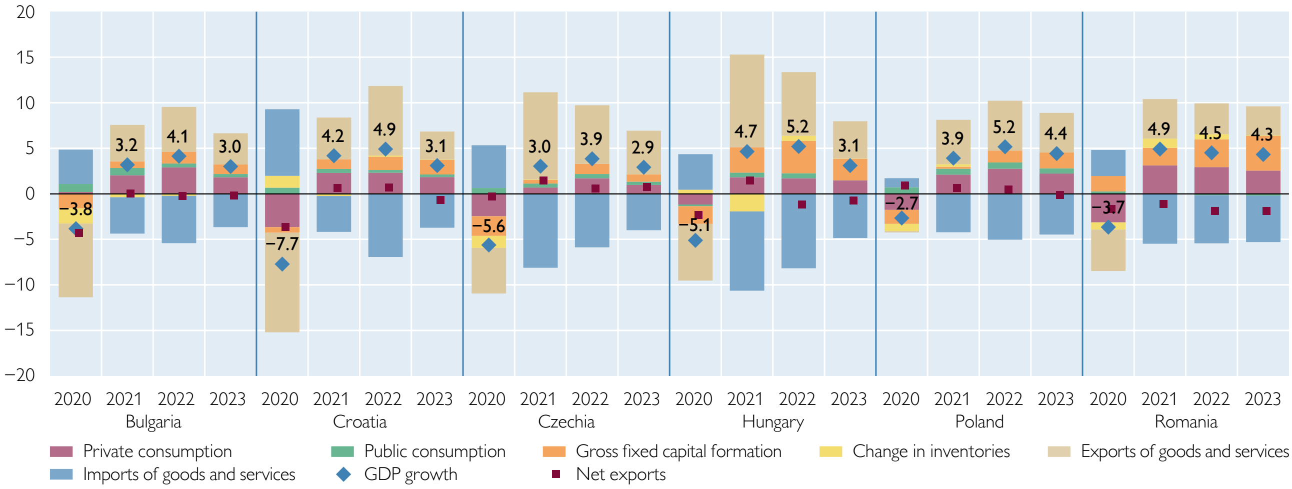
Throughout the projection horizon, the differences in the individual economies' growth performance are not overly large. Overall, Czechia and Bulgaria are expected to show somewhat weaker growth dynamics. By contrast, Hungary (in 2021 and 2022), Poland (in 2022 and 2023) and Romania (in 2021 and 2023) will be the growth engines in the region. Poland and Romania will attain pre-crisis GDP levels by end-2021 already; all other economies will reach their 2019 GDP levels in the course of 2022.

The sizable growth differential of the CESEE-6 region vis-à-vis the euro area (of +3 percentage points) that was observed in the recession year 2020 will vanish in 2021, but – unlike in 2010 after the recession triggered by the financial crisis – the differential will not turn negative. A positive growth margin will re-emerge in 2022 and 2023, and sustain the convergence process, albeit to varying degrees across countries.

Chart 1

CESEE-6: GDP and GDP components

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



Source: Eurostat, OeNB.

Note: Realized data for 2020, projections for 2021 to 2023.

Private consumption will lead the recovery

Private consumption will recover ground in the second half of 2021 and post full-year growth of 3.5% on average in the CESEE-6, after –3.5% in 2020. In all countries, governments made strong use of wage support, worker retention schemes and tax deferrals (or outright tax reductions/exemptions) to soften the impact of the crisis on households and corporates. The EU's SURE program further supported labor markets. Saving rates have gone up and the expected easing of COVID-19 restrictions will release pent-up demand. Wage growth is assessed to be robust overall over the projection horizon, even though increases will considerably fall short of the high rates seen before the pandemic. While minimum wages will increase in nominal terms in many countries, this will not always translate into real increases, given that inflation is expected to pick up. In line with a sustained recovery of contact-intensive service sectors, private consumption growth is projected to accelerate further and peak at 4.3% in 2022, before returning to 3.4% in 2023.

Public consumption will continue to expand robustly by around 2.4% in both 2021 and 2022, even though no further impetus can be expected from public sector wages, with Croatia, Poland and Romania having announced wage freezes and partial cuts. In most countries, the fiscal stance will remain supportive in both years, encompassing allowances and tax reliefs that often benefit families and younger people and support housing demand. Elections in Bulgaria (2021) and Hungary (spring 2022) will most likely trigger (or have already triggered) some extra spending in these two countries. Some gradual consolidation is expected for Croatia and Romania, whereby governments in both countries will make as much use of their fiscal space as possible. Only in Czechia will we observe a more restrictive fiscal stance, as most fiscal stabilization measures will be discontinued in the course of 2021. Furthermore, the marked decline in labor taxation will only have a limited effect, as households are expected to save a large share of the extra income (for country-specific details, see section 2). In 2023, public consumption growth will slow in all countries of the region, averaging 1.5% per annum.

Investments will pick up from 2022 onward, backed by EU funds

While gross fixed capital formation will recover in 2021, not least due to a strong base effect, both pandemic-related uncertainty and capacity utilization that is still somewhat low will weigh on investment dynamics in 2021. Overall, gross fixed capital formation will expand by almost 4% in the region. A notable boost of annual growth to above 8% is only expected to be seen in 2022, building on the availability of funds from the 2021 to 2027 MFF and the NextGenerationEU (NGEU) recovery instrument from mid-2021 onward. EU funds will strongly support high investment rates over the entire projection horizon. We expect that in particular Bulgaria and Croatia are among the largest recipients of MFF and NGEU funds. Romania also ranks among the main beneficiaries depending on its absorption rate. While support from EU funds will be strong in Hungary, it will not exceed the already high funding of previous years. Besides a short-term fiscal stimulus, NGEU funds also offer the potential to boost productivity, and thus long-term growth, through investments in strategically important areas, such as infrastructure, digitalization and the greening of the economy.

With demand conditions improving over the projection horizon, gross fixed capital formation growth will accelerate further in 2023, reaching almost 9%. Credit guarantee schemes will support growth of credit to corporates in addition to further policy measures, with the latter often related to housing and construction (green renovations in Bulgaria; housing subsidy program, infrastructure investment and earthquake reconstruction in Croatia; tax cuts and home subsidies in Hungary; SME support in Poland and the IMM Invest program in Romania). The phasing-out of loan moratoria will partially run counter to these supportive measures, and credit growth developments in individual countries will strongly depend on pre-pandemic corporate debt levels.

External demand provides continued support to growth over projection horizon

Following a rather moderate decline in exports in 2020 (of 5.4% on average in the region), exports will rebound by 9.6% in 2021, thus showing a revival in line with our assumption about euro area import growth. The region's integration into global value chains has proven to be a factor of resilience during the pandemic. Especially in Czechia and Hungary, the rebound in the automotive industry – coupled with ongoing new investments, e.g. in battery production in Hungary – will lead to double-digit export growth in 2021. Vigorous external demand will clearly outweigh deteriorating nominal price competitiveness in Bulgaria, Croatia and Poland. In all other countries, productivity is expected to grow in sync with wages. In contrast to the strongly diverging export performance during the downturn, export growth will be somewhat more homogeneous across countries in 2021 (ranging from 6.5% in Bulgaria to 11.6% in Czechia). In 2022, export growth will soften somewhat in all countries except Poland and Croatia (where we do not expect a full recovery of the tourism industry in 2021 already). Region-wide export growth will amount to 8.5% in 2022 and 6.3% in 2023.

Imports will also rebound notably, with their growth reaching 9.2% in 2021, softening slightly to 8.9% in 2022, and edging down to 7.2% in 2023. Import growth will be fueled by both recovering domestic demand and the strong export-import nexus due to the region's integration into international production networks. The recovery in imports that was initially somewhat weaker compared with export growth will thus result in a small positive contribution of net exports to overall GDP growth in 2021 (+0.5 percentage points). The more sustained demand for imports along with firming domestic demand in 2022 and 2023 will result in a slightly negative growth contribution (–0.2 and –0.4 percentage points, respectively).

Risks to CESEE-6 projections continue to be on the downside

The major risk to our projections continues to be grounded in the further development of the pandemic; much will in particular depend on the race between new virus strains and vaccination progress. In light of the generally slow progress in the vaccine rollout, risks are currently tilted to the downside, as a delay in the full opening-up of the economy cannot be ruled out at the current juncture. Vice versa, a sudden, unexpected boost in vaccine production or availability in Europe cannot be ruled out either, but for 2021 we assess this upside risk to be smaller than the downside risks. Over the projection horizon, these risks will become more balanced.

A second downside risk relates to the economic fallout from the crisis. So far, mitigation measures have prevented widespread bankruptcies and an increase in nonperforming loans. Thus, while liquidity risks have been well addressed, solvency risks will become visible only over the projection horizon. Given rather strong leverage in the banking sector, it remains to be seen to what extent existing and newly adopted/extended guarantee programs will succeed in addressing these risks. These programs further encompass the risk of adversely affecting public debt, which potentially restricts the policy space going forward. While we do not see an imminent risk arising from developments in public debt levels in the region, especially as long as the escape clause of the Stability and Growth Pact is activated, some indirect risks may prevail in individual cases, with regard to financial market access, and related to the euro area accession process in the case of Croatia.

A further downside risk might stem from the multispeed recovery across the globe and a potential monetary policy tightening in the USA leading to spillovers on financial conditions, which might also affect CESEE-6 economies.

The strongly rebounding export sector is also subject to some downside risks: the shortage of silicon chips caused a standstill of conveyor belts in the automotive industry in late January this year. Strong demand coupled with supply bottlenecks may at any time cause disruptions in supply chains and expose the vulnerability of just-in-time production models used by some manufacturers active in the region. As always, economic growth in the CESEE-6 depends largely on the economic growth of its trading partners. Therefore, should the world economy, and in particular the euro area, grow at a faster or slower pace than that we assumed in our baseline scenario, the growth prospects of the CESEE-6 countries would improve or deteriorate accordingly. On the upside, positive spillovers from the Biden Plan would lift our growth projections upward.

Further, political and geopolitical risks have not abated during the pandemic and trade tensions continue to exist despite the political change seen in the USA since our last projections. In political terms, closer cooperation between the new US administration and Europe could potentially aggravate tensions between the EU and Russia. Within the EU, political trenches between the EU and some CESEE-6 countries as well as remaining legal uncertainties over the 2021 to 2027 MFF and the Recovery and Resilience Facility continue to exist at the time of writing, thus potentially weakening the EU's capacity to act both internally and as a global player.

Overall, uncertainty remains higher than before the pandemic and we assess the balance of risks to be on the downside in particular at the start of the projection period, even though we cannot rule out a turn for the better. Risks will become more balanced toward the end of the projection horizon.

2 Projections for Bulgaria, Croatia, Czechia, Hungary, Poland and Romania

Bulgaria: despite severe third wave, consumption heralds recovery

Bulgaria's contraction in real GDP was smaller than expected for 2020. However, given ongoing measures to contain the pandemic worldwide and lower than expected vaccination rates across Europe, a full rebound of the economy will still not happen before 2022, if that soon. Nevertheless, investment and both private and public consumption will support a partial recovery in 2021. Private consumption will have recovered by the second quarter of 2021, and gross fixed capital formation will even gain more momentum in 2022. In 2023, GDP growth will return to 3% on the back of a continued strong positive contribution of gross fixed capital formation. Net exports' contribution will be zero or negative over the entire forecast horizon. While imports will rebound to pre-crisis levels by the end of 2021, exports will take longer to recover.

Based on less restrictive measures and a rising vaccination rate, we expect a gradual increase in private consumption over 2021. As spending opportunities unfold, households will catch up on foregone consumption. The government plans to officially open the tourist season on May 1, 2021, first concentrating on domestic tourism. Additionally, in a general election year, public sector wages, minimum wages, and pensions continue to grow. In January 2021, minimum pensions and wages increased by 19.5% and 6.4%, respectively, with minimum pensions supposed to grow by at least 5% in both 2022 and 2023 year on year. All other pensions are expected to increase by 5% in July 2021. The most important job retention schemes will be in place at least until the end of May.

Gross fixed capital formation is expected to grow considerably over the next years. As planned, investments in health care infrastructure began this year by constructing and renovating emergency care centers. Driven mostly by NGEU funds and the Recovery and Resilience Facility, proposed investments in an "innovative, green, connected, and fair" Bulgaria could strengthen productivity and competitiveness. These investments pose an upside risk for exports that will fully unfold after the projection horizon only. Still, investments in water management and digital agriculture are intended to be completed already by 2023.

Given the European Commission's proposal to introduce digital green certificates, we also expect cross-national tourism to go up already in the summer months of 2021. Downside risks are that the proposal might be dismissed and vaccine rollouts in the largest arrival countries (Germany, Greece, and Romania) might be delayed further. Overall, we do not expect economic activity to reach its pre-crisis trajectory before 2023.

Croatia: slow vaccination rates dampen outlook

After a very sharp year-on-year contraction of –8.1% in 2020, we expect annual GDP to grow by 4.2% in 2021, 4.9% in 2022, and 3.1% in 2023. We thus expect the Croatian economy to reach pre-crisis GDP levels by the end of 2022.

Our projections are to a large extent determined by the outlook for the tourism sector. So far, vaccination campaigns in the EU have progressed slowly and, as we are entering the second quarter, many European countries are again tightening containment measures. The outlook for Croatia's 2021 tourist season is therefore becoming increasingly dim and we assume that it will again fall noticeably short of pre-pandemic seasons. We therefore split the recovery of exports and imports to pre-pandemic levels between 2021 and 2022 and project moderately positive contributions of net exports to overall growth in both years.

Over the entire forecast horizon, growth will be largely driven by domestic demand. Private consumption is projected to grow by around 4% in 2021, supported by government measures, such as the income tax decrease and minimum wage increase effective from January 1, 2021, and the continuation of short-time work schemes. We expect investment to grow by around 4.5% per annum in 2021, and to pick up speed over the forecast horizon. Uncertainty and potentially tightening credit standards amidst rising NPLs and high corporate debt will weigh on private investments, particularly in the short term. However, Croatia is among the countries with the highest allocation of funds in percent of GDP from the EU's MFF and the Recovery and Resilience Facility. These funds, coupled with efforts to improve the business environment, and credit guarantee schemes should support investments.

Public consumption will make mildly positive contributions to growth over the projection horizon. Regarding the broader fiscal stance, Croatia has to balance the need for fiscal support to spur the country's recovery with the need for fiscal prudence in light of high public debt levels and the convergence criteria it has to meet to adopt the euro as planned. A tightening of the overall fiscal stance over the forecast horizon can therefore be expected.

Despite our cautious assumptions regarding the tourist season, the risks to our projections remain to the downside. This is due to the highly uncertain trajectory of the pandemic and the difficult task faced by governments to get both the timing and scale of gradually reducing policy support right.

Czechia: unspectacular recovery from last year's unprecedented plunge in the long shadow of the pandemic

In spite of some improvement in the second half of last year, the Czech economy experienced the deepest dive since the beginning of transformation. As a result of long-tailed aftermaths of the pandemic, we expect the economy to recuperate only gradually over the forecast horizon.

Highly accommodative fiscal and monetary policy will keep mitigating the economic impact of the crisis on domestic demand well into 2021. Nonetheless, the effect will gradually fade away in the medium term. Moreover, in the wake of the discontinuation of government support measures and the (resulting) increase in firms' bankruptcies, unemployment is expected to keep rising for most of the remainder of this year, even though the presumably solid demand for labor in retail and service sectors – once re-opened – will alleviate the situation somewhat.

Before strengthening in the medium run, private consumption will experience but relatively moderate growth this year, subject to various contradicting forces. On the one hand, private spending will benefit from the release of pent-up demand and a likely improvement in consumer sentiment once restrictions start loosening as well as – to some extent – from the tax reduction implemented in January. On the other hand, a more robust revival in consumer spending will be precluded by subdued wage growth, rising unemployment and the phase-out of government support measures. These factors along with rising borrowing costs are projected to act as a brake on growth in households' investment in dwellings. Overall, investment will accelerate gradually over the projection horizon, on the back of strengthening foreign and domestic demand, the receding pandemic as well as the influx of EU (recovery) funds.

On the upside, Czechia's highly export-oriented and pivotal manufacturing industry has not been locked down since the first COVID-19 wave in spring 2020. It has, in fact, benefited from the relative crisis-resilient industrial sector and the broadly upheld functioning of global value chains. However, industrial production – particularly in the key automotive industry – is affected by a global shortage of silicon chips, which is expected to prevail in the first half of the year.

Overall, we thus expect a decent, albeit not exuberant, economic recovery in 2021, which will gain momentum next year and stabilize toward the end of the forecast horizon. This year's economic growth will be driven in a broadly balanced way by both domestic demand and net exports. However, looking further ahead, the contribution of domestic demand to economic expansion is projected to gain importance relative to net exports. With exports gathering steam on the back of more robust external demand, imports will likewise be on the increase again.

Apart from the further development of the pandemic, downside risks to the projections stem mainly from possible (structural) damage to the economy, which will be the more pronounced, the longer the pandemic and the ensuing restrictions and uncertainty drag on.

Hungary: significant economic recovery postponed into the second half of 2021 despite vaccination progress

Hungary's GDP contracted by 5.1% year on year in 2020, hence to a lesser extent than we had expected in our last projections (–6.3%). As a result of the more protracted nature of the crisis, we now expect a notable economic recovery from mid-2021 at the earliest. Consequently, we have revised our growth projections for 2021 down, but have become significantly more optimistic regarding 2022.

We expect macroeconomic policies to remain supportive for growth in 2021 and to gradually abate from the second half of 2022 onward. At the end of 2020, the government raised its budget deficit target for 2021, from the originally planned 2.9% to 6.5% of GDP. Apart from expenditure to mitigate the economic and social impact of the pandemic, the government has recently increased transfers to pensioners and introduced additional support to households (for further details, see the section on developments in selected CESEE countries). The central bank also remains committed to supplying sufficient liquidity, while keeping on fine-tuning its monetary policy instruments.

The adverse impact of the pandemic on private consumption during the first half of 2021 will continue to be mitigated by the government's wage compensation measures as well as the automatic and undifferentiated loan moratorium (in place at least until mid-2021), which has also contributed to the continued strong expansion of credit to households. Various factors are expected to accelerate private consumption growth from the second half of 2021 onward. Households' net financial assets have risen to record highs and we expect pent-up demand to be unleashed once the restrictions are eased. Banks envisage an easing of consumer credit conditions during the first half of the year, in addition to the government measures to underpin households' disposable financial resources mentioned above. Less positively, however, we expect the increase in labor market slack to lead to substantially lower wage growth at least in 2021, as already reflected in the relatively moderate increase in minimum wages (by 4% in February 2021, half of the rate seen in the previous three years).

Despite additional COVID-19-related expenditure, public consumption decreased in 2020. Going forward, we expect it to recover and gain momentum in the run-up to crucial parliamentary elections in spring 2022 – as witnessed ahead of the last two parliamentary elections – especially with the opposition coalition and the ruling government parties being neck and neck in some recent polls.

Gross fixed capital formation suffered from the collapse in demand and the jump in economic uncertainty in 2020. We expect investment activity to recover once pandemic-related restrictions are lifted, economic prospects to brighten up at home and abroad, and capacity utilization to start to climb. While banks continued to modestly tighten corporate credit conditions in the final quarter of 2020 and are expected to continue doing so in the first half of 2021, the various programs of the central bank are expected to support business investments. In addition, nonfinancial corporations have piled up savings at banks since mid-2020, creating a basis for future investments. Household investments should benefit from expanded state support to families and the reduction in the VAT rate for new home sales. Importantly, investments should be aided by the influx of EU funds (including the new MFF and NGEU funds) from the second half of 2021, and public investment activity additionally by the electoral cycle.

We expect export growth to bounce back after the decline in 2020 in line with the economic recovery of Hungary's main trading partners. Also, past and ongoing investments in main export industries and the weaker exchange rate in combination with slowing wage growth should aid exports. Imports will rebound in 2021, though to a somewhat lesser extent than exports, partly due to their smaller contraction in 2020, which leads to a positive contribution of real net exports in 2021. However, as import demand will be fueled by accelerating domestic demand later on, we expect the contribution of real net exports to turn negative in 2022 and 2023.

Poland: 2021 – is the glass half empty or half full?

In Poland, GDP is projected to grow by 3.9% year on year in 2021, following a contraction by 2.7% in 2020. Foreign demand growth will contribute more strongly than domestic demand to total final demand and GDP growth. Exports, having a weight of about 37% in total final demand, shrank by only 0.6% in 2020 and thus contributed substantially to the overperformance of the Polish economy. In 2021, annual exports will expand substantially, namely by about 8.5%, on the back of significant carry-over effects and the fact that goods export-oriented branches, particularly manufacturing, are generally less affected by the pandemic. Domestic demand, which shrank by 3.9% and thus considerably more strongly than foreign demand in 2020, is expected to grow by 3.4%, thus lagging behind growth of foreign demand in 2021. Our projections that the 2021 recovery in domestic demand will not fully offset the previous year's decline rest mainly on subdued fixed investment. In 2022, economic growth is projected to accelerate to 5.2%. While exports will grow at an only marginally higher rate, domestic demand growth will accelerate significantly, to more than 5%, and thus contribute almost as much as foreign demand to overall GDP growth in 2022.

After imports shrank more strongly than exports in 2020 due to domestic demand contraction, the recovery of both exports and domestic demand will lead to strong import growth in 2021. The growth rate of imports is, however, expected to remain below that of exports on account of subdued fixed investment. Thus, there will be a positive contribution of net exports to GDP growth. In 2022, import growth is projected to exceed export growth, given further acceleration of domestic demand, particularly of fixed investment. However, starting from a sizable external surplus, the growth differential is not expected to turn the contribution of net exports to GDP growth into negative territory.

Within domestic demand, the impact of the pandemic will continue to prevail in the first half of 2021, preventing private consumption from growing. However, anti-crisis measures extended into 2021, including wage subsidies, exemptions from social security contributions, support to the self-employed and childcare allowance, will help contain the damage, as will the increase in minimum wages. On the other hand, continued wage freezes and bonus cuts in the public sector will hurt mainly better-off income segments and are likely to have an only marginal adverse impact on consumption. In contrast, the decline of consumer loans reflects not only heightened reluctance to supply credit but also subdued loan demand. In the second half of 2021 and during 2022, post-pandemic private consumption is expected to thrive on the back of pent-up demand and accumulated extra savings, which more than offset economic hysteresis effects, such as still higher unemployment rates and hence also weaker wage growth than before the crisis. Public consumption will continue to grow steadily on account of, inter alia, pandemic-related spending beyond transfers. Fixed investment will be held back by the pandemic in the first half of 2021, as anti-crisis measures extended into 2021, including substantial nonrepayable support from the Polish Development Fund to SMEs, mainly aim at keeping companies afloat. Moreover, less EU funds are available for public investment from the previous MFF in 2021 than in 2020, while new EU funds are not yet available in the first half of the year. In the second half of 2021 and in 2022, both public and corporate sector fixed investment will benefit from an overlap of old and new MFF funding cycles and from the EU's NGEU recovery instrument. In addition, markedly improved foreign and domestic demand will strengthen corporate investment, and residential housing investment will benefit from a crisis-induced higher saving rate and supportive monetary conditions for loan supply. Moreover, both private consumption and fixed investment growth rates in 2022 will be lifted by the favorable base effect.

Romania: investment-led growth during period of gradual fiscal consolidation

After the Romanian economy recovered relatively quickly in the second half of 2020, considerable carry-over effects as well as the agreement on the EU's NGEU recovery instrument triggered an upward revision of our projections. Moreover, as has become evident in the meantime, fiscal consolidation envisaged by the new government will be gradual, with a rather limited impact on growth in 2021. We now project GDP to grow by 4.9% in 2021, before moderating somewhat in 2022 and 2023. With regard to the pandemic, we expect containment measures to remain at least partially in place in the first half of 2021. While there might be even further episodes of tightening, we assume that a full-fledged lockdown hitting also industrial production as seen in spring 2020 can be avoided. With economic developments projected to remain restrained until mid-2021, annual growth is expected to be high in the second quarter due to the low base.

An easing of containment measures – inter alia enabled by progress with vaccinations – will presumably be possible in Romania and in its main trading partner countries toward the end of the second quarter. Hence, we expect the economic recovery to accelerate markedly during summer. Rebounding private consumption, increasing external demand and a further speeding-up of investment activity will contribute to a strong economic recovery in the second half of the year. In addition, after relatively weak agricultural output in 2020, positive production side effects might come from this sector in 2021. Looking beyond 2021, we expect investment-led growth to continue. Growth rates will moderate, however, as the impact of fiscal consolidation will increase in 2022 and 2023.

As soon as restrictions on consumption possibilities are lifted, consumer confidence will rise, and many consumers can resort to savings accumulated during the pandemic to satisfy their backlog demand. After this initial pickup, private consumption will not play a key role in the recovery, as real income advances will be limited by restrictive fiscal and income policies (freezing of public sector wages and pensions as well as small 3.1% minimum wage hike in January 2021). Yet, the 14% pension hike enacted in September 2020 will entail positive carry-over effects into 2021. Moreover, the economic recovery is most likely to positively affect the labor market via declining unemployment and rising wages in many sectors of the economy.

Gross fixed capital formation will be the main growth driver over the forecast horizon. Substantial support will come from the continued influx of funds from the 2014 to 2020 MFF (in particular in 2021) as well as from funds allocated to Romania under the 2021 to 2027 MFF and the NGEU recovery instrument (in particular in 2022 and 2023). Among other things, partially EU-funded highways will be built over the next few years. In this respect, it is worth mentioning that the budget plan for 2021 envisages increasing public investments despite the overall fiscal consolidation strategy. At the same time, there is nonnegligible uncertainty about effective EU fund absorption and the exact timing of investment projects. Moreover, state-guaranteed loans and investment grants for corporates (both of which were introduced in the context of the COVID-19 crisis) will support investment growth.

After exports took a strong hit in 2020 due to temporary disruptions in supply chains and faltering external demand, exports will also recover in 2021 and beyond, in line with our external assumptions. Yet, global semiconductor shortages will dampen automotive production and exports for a while. The contribution of net exports will remain negative, however, as the projected pickup in domestic demand will entail a considerable rise in imports.

3 Russia poised for recovery amid exceptionally large risks

Russia's recovery has been supported by the relaxation of restrictive measures against the coronavirus pandemic from the third quarter of 2020. In contrast to the situation in some other countries, in the winter of 2020/2021 no new tight lockdown was imposed in Russia. The authorities had pushed ahead with a comprehensive fiscal spending stimulus in 2020 (including social support to households, subsidies to firms, and procurements), which continues to have an impact in the first months of 2021.

After returning to positive growth in 2021, the Russian economy should accelerate slightly in 2022, buoyed by the expected increase of Russia's oil production after the OPEC+ agreement expires. Growth will then slow toward the end of the projection period, getting closer to its future long-term trajectory. Global economic growth is expected to remain solid. If Russian government sector spending develops as planned, it should decline slightly in real terms. Structural/institutional reforms that would clearly benefit economic growth – such as cutting corruption, strengthening the rule of law, adjusting the state's economic footprint – are not expected to materialize during the projection period.

Private consumption will recover this year, and in 2023 should reach a level comparable to the peaks of 2014 and 2019. Higher consumption is supported by reviving employment and income growth. Savings set aside during the crisis will possibly support a consumption recovery this year. The same applies to the possible return of Russians to foreign travel. While fixed investment is also expected to recover, its recovery will first be confined by very low use of production capacity and will likely continue to be burdened by lingering economic uncertainty and stubborn investment risks.

Uncertainties are also connected with the expected recovery of Russian energy exports and of tourism in Russia in 2021. However, total export growth should be supported next year by the planned expiration of the OPEC+ agreement on production ceilings. Growth expectations for exports in the coming years are limited by projections for the energy sector, which currently see the level of petroleum product exports remaining largely unchanged and natural gas exports expanding rather moderately.

After plunging in 2020, Russia's total imports are expected to recover partly this year, with the timing of the resurgence of Russian tourism abroad strongly impacting the pace of the recovery. While the revival of imports is supported by higher oil price-induced export earnings (compared to 2020), it may be dampened by the ruble's relatively weak exchange rate (the real exchange rate was down 7% last year from 2019). The real rate is not expected to appreciate, as Russian inflation is moderate and oil prices will probably soon start to slide down gradually. Russia's current account surplus, which shrank to around 2% of GDP last year, is expected to remain solid this year and in the next few years.

Following the government's strong anti-cyclical fiscal stance (resulting in a consolidated budget shortfall of 4% of GDP) in 2020, growth of government spending slowed down in the fall of last year. Last fall's plan to reduce the budget deficit through slight spending cuts in real terms in 2021 and 2022 still holds. Higher oil prices should help trim the deficit, as the prices are expected to exceed those assumed in the government budget plan, which should boost oil tax revenues. Apart from that, there is still ample fiscal room for maneuver, as the level of government debt last year was still below 20% of GDP. Moreover, the state reserve fund (National Wealth Fund) holds liquid assets equivalent to about 8% of GDP.

The balance of risks to economic growth in Russia continues to be tilted to the downside

Of the many risks surrounding the current projections, the biggest is a prolonging of the coronavirus pandemic due to slow vaccination rollouts and (renewed) coronavirus restrictions. Economic recovery in Russia and the world could turn out to be weaker or more hesitant than expected. Any significant weakening of oil prices would press down both private and public sectors of the Russian economy and compress imports. The speed of recovery in oil and gas production from last year's dip is a major factor that will influence the pace of GDP recovery. The government's currently tightened stance as regards budget spending could be relaxed swiftly if the need to provide support arose from, for instance, a weakening economy. Elections, e.g. the upcoming parliamentary poll, may also have an impact here. Renewed geopolitical tensions and sanctions could (further) dampen capital inflows, while once again putting pressure on the ruble and (further) cutting imports. Overall, downside risks are dominating the picture.