

Developments in selected CESEE countries

War in Ukraine disrupts recovery from the pandemic and further heats up prices^{1,2,3}

1 Regional overview

The Russian invasion of Ukraine on February 24, 2022, marked a watershed moment for European post-Cold War history. The economic consequences of the unfolding war for Central, Eastern and Southeastern Europe (CESEE) have been manifold and will evolve further. This text is supposed to give a short overview on macroeconomic conditions in the run-up to the war and shed light on some of the economic ramifications of the conflict for economic developments in CESEE.

Economic activity was recovering from the pandemic's disruptions when the war in Ukraine hit

In the run-up to the events of February 2022, macroeconomic dynamics in CESEE had been generally solid as the region continued to recover from the pandemic-induced disruptions of 2020. The revival was initially driven by dynamic exports and, as time progressed, by capital formation and later by private consumption as well. As a result, annual real GDP growth in 2021 averaged 6.8%, a level last seen 10 years ago (see table 1). Toward the end of the year, economic developments became more heterogenous, however. While short-term growth dynamics in Slovenia and Hungary turned out stronger than expected and the

Table 1

Real GDP growth

	2019	2020	2021	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
Period-on-period change in %									
Slovakia	2.6	-4.4	3.0	9.1	0.4	-1.4	1.9	0.4	0.3
Slovenia	3.3	-4.2	8.1	11.8	-0.2	1.5	2.0	1.3	5.4
Bulgaria	4.0	-4.4	4.2	3.1	1.4	1.8	0.9	0.8	1.0
Croatia	3.5	-8.1	10.2	3.3	4.3	7.4	0.9	1.4	-0.1
Czechia	3.0	-5.8	3.3	6.7	0.8	-0.3	1.4	1.7	0.8
Hungary	4.6	-4.5	7.1	11.5	1.5	1.7	2.2	0.9	2.0
Poland	4.7	-2.5	5.7	7.6	-0.3	1.6	1.8	2.3	1.7
Romania	4.2	-3.8	6.0	4.8	3.9	1.9	1.6	0.4	-0.1
Turkey	0.9	1.8	11.0	16.4	1.2	2.2	1.7	2.8	1.5
Russia	2.2	-2.7	4.7	0.9	0.5	0.3	0.2	0.1	0.4
CESEE average ¹	2.5	-2.3	6.8	6.6	0.9	1.1	1.0	1.2	0.9
Euro area	1.6	-6.4	5.3	12.6	-0.3	-0.1	2.2	2.3	0.3

Source: Eurostat, national statistical offices.

¹ Average weighted with GDP at PPP.

¹ Compiled by Josef Schreiner with input from Katharina Allinger, Stephan Barisitz, Antje Hildebrandt, Mathias Lahnsteiner, Anna Raggl, Thomas Reiningger, Tomáš Slačik and Zoltan Walko.

² Cut-off date: April 13, 2021. This report focuses primarily on data releases and developments from October 2021 up to the cut-off date and covers Slovakia, Slovenia, Bulgaria, Croatia, Czechia, Hungary, Poland, Romania, Turkey and Russia. The countries are ranked according to their level of EU integration (euro area countries, EU member states, EU candidates and potential candidates and non-EU countries). For statistical information on selected economic indicators for CESEE countries not covered in the main text (Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, Serbia and Ukraine), see the statistical annex in this issue.

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

Polish and Turkish economy continued to expand swiftly, economic activity stagnated in Russia and Slovakia and declined slightly in Croatia and Romania.

Growth was firmly based on domestic demand in the second half of 2021

Despite a renewed wave of COVID-19 infections and a subsequent tightening of measures to combat the pandemic in several countries, private consumption was the main pillar of growth in the second half of 2021. Consumer spending was buoyed by pent-up demand and accumulated savings after the lockdowns and a remarkable improvement in the CESEE labor markets. The average unemployment rate in CESEE EU member states declined to 3.9% in February 2022, which was only marginally above the pre-pandemic level. Unemployment rates in Turkey and Russia were even lower than prior to the pandemic. Tight labor supply allowed wage growth to outpace price growth and implied positive real-wage advances in most countries. Faced with rising prices, some consumers possibly also frontloaded planned purchases.

Capital formation was more heterogeneous as financing conditions tightened, capital goods and construction inputs became more expensive and uncertainties around the outlook for the international economy increased. At the same time, stockbuilding contributed notably to growth in several countries as the completion and sale of semifinished industrial goods was still delayed by lingering supply chain issues.

Yet, the improving availability of key inputs had a positive impact on industrial sentiment and industrial activity in the final quarter of 2021 and in the first two months of 2022. This helped to sustain a robust export momentum. Dynamic domestic demand, however, strongly lifted imports so that the external sector on balance hardly contributed to growth.

Highest inflation in more than 15 years

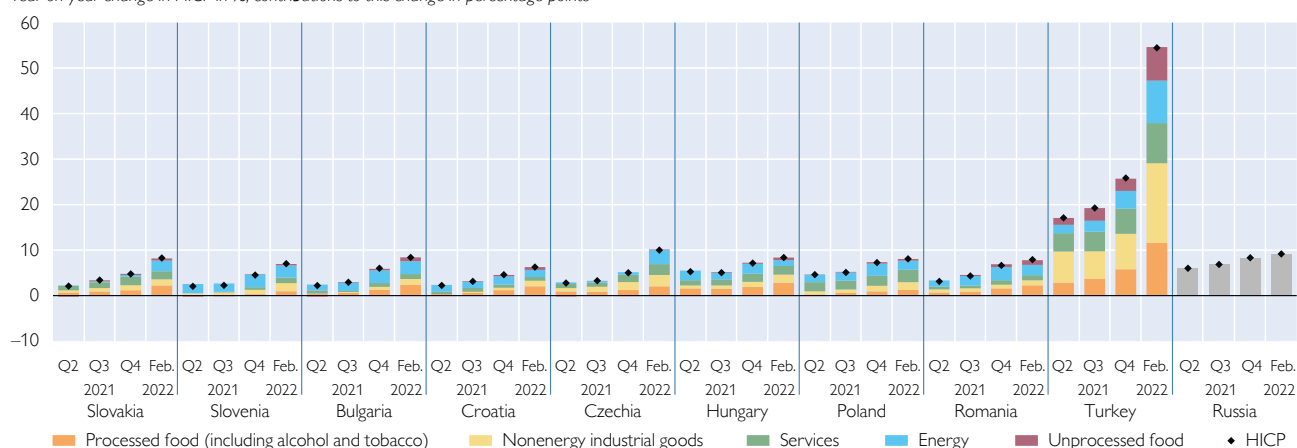
Rising commodity prices, the economic recovery and afterpains from the pandemic lifted inflation in the CESEE countries to its highest level in more than 15 years (see chart 1). Initially mostly propelled by soaring energy prices, price pressures became more broadly based toward the end of the review period: The latest price surge in January and February of 2022 was strongly driven by core inflation (i.e. services, industrial goods and processed food). This development reflected, in part, skyrocketing producer prices fueled by raw material shortages, bottlenecks in the production of certain intermediate goods (e.g. semiconductors), tight international transport capacity (especially in shipping) and higher demand in certain sectors. Many companies probably also used the turn of the year to reset their prices and pass on some of their increased input costs to consumers.

By contrast, the momentum in energy price growth in early 2022 was contained by widespread government intervention to limit price increases for household energy (and in some cases also for food items). These measures ranged from compensatory payments to consumers and companies, to reductions in VAT rates and/or network fees, to direct interventions in the price structure (price cuts or price caps). As these interventions continue, they place an increasing burden on national budgets and the balance sheets of energy suppliers, and they could lead to a renewed price surge once they expire.

Chart 1

HICP inflation and its main drivers

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



Source: Eurostat.

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

Going forward, another important determinant of price dynamics will be the extent to which rising inflation rates and expectations could lead to higher wage demands and thus trigger a price-wage spiral. In Turkey, for example, high inflation has already triggered a rapid increase in government payments for pensions and wages. In the other CESEE countries, several indicators also point to faster wage growth from mid-2021, and nominal wages advanced by some 8% on average in the final quarter of 2021. In general, however, the wage-setting process in CESEE is organized in a much more decentralized manner than e.g. in Austria, thereby reducing the bargaining power of employees. In the CESEE EU member states as a whole, about half of the working population are not subject to any collective bargaining agreements, and for another third, collective agreements are negotiated only at the company level (although there are sometimes marked differences between the individual countries). Moreover, the conflict in Ukraine has probably dented wage expectations in Central Europe, with the crisis adding to supply chain bottlenecks and disruptions to economic activity.

Most CESEE central banks have initiated a remarkable tightening cycle

In any case, CESEE central banks have already responded forcefully to the rise in inflation. Before the outbreak of the war in Ukraine, the Polish central bank had raised its key interest rate in five steps from October, bringing it up from 0.1% to 2.75%. The Czech central bank adjusted its key interest rate in six steps from June 2021, raising it from 0.25% to 4.5%. The Hungarian central bank increased its key interest rate in nine steps from June 2021, i.e. from 0.6% to 3.4%. The Romanian central bank has taken four interest rate steps since October 2021, raising its key rate from 1.25% to 2.5%. The Russian central bank has increased its policy rate in three steps since October 2021, from 6.75% to 9.5% (see chart 2). In addition to raising key interest rates, some monetary policymakers in CESEE have also been tightening their stance by adjusting other interest rates,

by active liquidity management designed to raise money market rates or by withdrawing unconventional monetary policy measures. In several countries, the tightening was reinforced by macroprudential measures (including capital and borrower-based measures) also with a view to preventing real estate markets from overheating. Only the Turkish central bank slashed rates from 19% to 14% between September and December 2021, arguing that inflation was being driven by transitory factors and – in part – by factors beyond the control of monetary policy. The Turkish president Erdoğan strongly supported rate cuts.

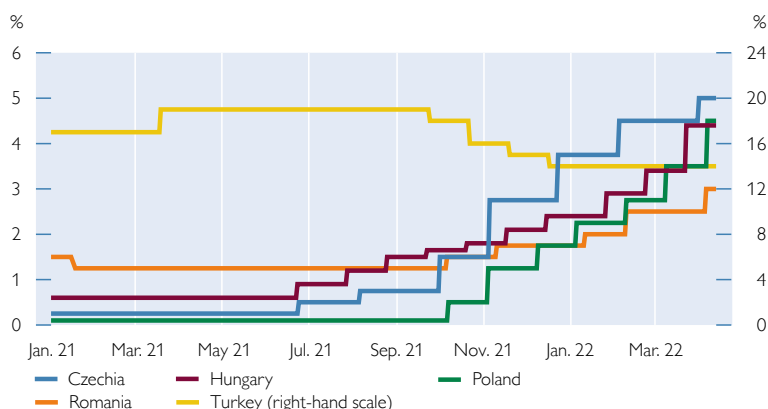
CESEE currencies broadly stable despite growing interest rate differentials

The cycle of monetary easing at a time of widespread (anticipated) global tightening pushed the Turkish lira down and the currency traded at a record level of TRY 20

per EUR in December 2021. The widening interest rate differential against the euro area (and the prospect of further interest rate hikes) had less of an influence on exchange rates in the CESEE EU member states. The Polish złoty, the Hungarian forint and the Romanian leu were relatively stable or even depreciated slightly against the euro in the second half of 2021 (see chart 3). Only since the turn of the year, a cautious upward trend had been observed. Currencies were supported by an increased credibility of the interest rate turnaround and the central bank communication emphasizing the importance of the exchange rate for achieving the inflation target. At the same time, markets assumed a less loose monetary policy in the euro area and the USA. This was reflected, among other things, in higher capital outflows from CESEE bond markets from mid-September 2021. Among the CESEE EU member states, Romania reported the strongest outflows (partly also driven by existing macrofinancial imbalances in the country), followed by Hungary and Poland. Net flows to Czechia fluctuated relatively little in comparison, and the Czech koruna has also been the only currency in the region to fully recover the losses registered in the first COVID-19 wave in spring 2020.

Chart 2

Policy rates in selected CESEE countries

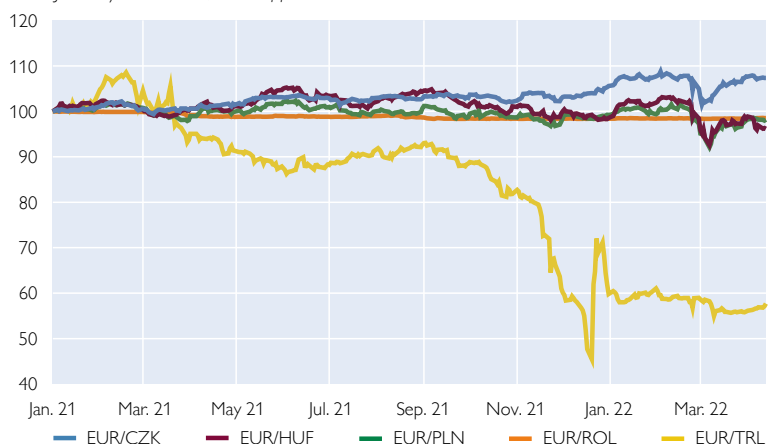


Source: Macrobond.

Chart 3

Exchange rates of selected CESEE currencies vs euro

Index: January 2021 = 100, rise = appreciation



Source: Macrobond.

The invasion of Ukraine: tectonic shift for CESEE

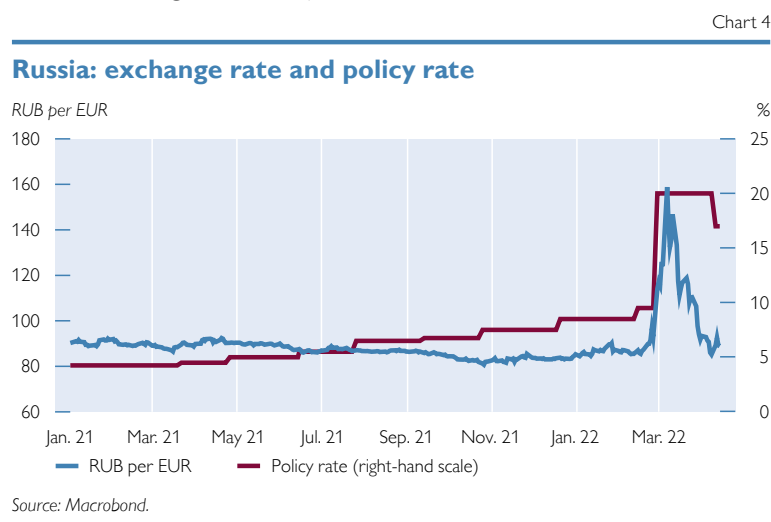
Russia's war of aggression against Ukraine dealt a blow to the international security architecture that had been established after the Cold War. This tectonic shift will drastically alter the political, military and economic situation in Europe in the years to come and has already had profound impacts on the CESEE economies.

Wide-ranging economic sanctions against Russia

In economic terms, Russia was undoubtedly affected the most. Soon after the start of the Russian invasion of Ukraine, a large number of countries, including the EU member states and the USA, imposed sanctions on Russia with the aim of exerting economic pressure to counter the military attack. The sanctions were wide-ranging and targeted Russian individuals, banks (including the central bank) and businesses, monetary exchanges, bank transfers as well as exports from and imports to Russia. From an economic viewpoint, the most important sanctions include (1) the cutting off of major Russian banks from SWIFT (although there is still limited accessibility to ensure the continued ability to pay for gas shipments), (2) asset freezes on some 60% of the Russian central bank's international reserves, (3) restrictions on the import of Russian fossil fuels and/or a commitment to reduce the dependency on these imports in Western countries, (4) export controls focused on restricting Russian access to a range of items, including high-tech components. In addition, a self-imposed disentangling of commercial ties with Russia took place by a multitude of international companies to avoid reputational and/or (sanction-related) legal risks.

Market turbulences on the heels of the invasion did not persist

The sanctions hit the Russian economy very swiftly: The Russian ruble depreciated by some 40% against the US dollar within the first week after the invasion (see chart 4) and Russian equity prices declined by one-third on February 24 alone (shortly before equity trading was suspended altogether). To stabilize markets, the central bank hiked its policy rate from 9.5% to 20%, and Russian authorities introduced several measures targeted at the foreign exchange market (including an obligation imposed on Russian exporters to sell 80% of their foreign currency revenues, the introduction of a commission fee on foreign currency purchases and restrictions on the transfer of foreign currency to other countries). Since then, chaos on Russian markets has largely subsided. The official exchange rate of the ruble recovered most of the losses and the currency traded close to its pre-war level by mid-April 2022 on the Moscow Exchange. However, off the Moscow Exchange it traded at a lower value according to financial analysts' reports. Russian equities recovered somewhat from their trough after trading was resumed in late March and Russians returned much of the cash to their bank accounts.



Following the stabilization, the Russian central bank again reduced the key interest rate to 17% in early April 2022, arguing that the balance of risks related to accelerated consumer price growth, a decline in economic activity and financial stability has shifted. It also highlighted that the latest weekly inflation data showed a deceleration of price growth and that capital control measures were containing financial stability risks.

Real economy seems to have handled the shock reasonably well – at least for the time being

First available evidence on real economic impacts of the sanctioning regime paints a mixed picture. General economic activity seems to have held up well in March. According to the OECD's weekly GDP tracker, Russia's output in the last week of March was broadly comparable to readings for the second half of 2021. According to the Kiel Trade Indicator of the Institute for the World Economy, Russian exports declined by 5% in March compared to the previous months (imports: -9.7%) and container freight traffic has already slumped by half. Many foreign firms have pulled out, cutting the supply of goods, while a weaker currency and sanctions have made imports more expensive. Prices have therefore gone up quite a bit.

The full impact of sanctions will only unfold in the weeks to come

Sanctions, however, might become more biting over time. First, Russian consumers might reduce spending as inflation cuts deeper into purchasing power and uncertainty increases as the war drags on. This is what happened when Russia invaded the Crimea in 2014. A spending tracker produced by Sberbank already suggests quite a sharp deceleration of spending in recent weeks. Spending growth declined from around 25% year on year in the first week of March (reflecting stockpiling of goods such as home appliances, electronics, furniture and computers before inflation gets out of hand or certain goods become altogether unavailable) to around 6% in the first week of April 2022. Second, a lack of imports from the West will inevitably weigh on Russia's industry once existing stocks of Western inputs have been depleted or spare parts are no longer available. Third, Russia is inching closer to a default as foreign banks declined to process about USD 650 million of dollar payments on its bonds in early April. Russia offered to pay in ruble instead, but neither of the two bonds in question allowed such a settlement. S&P has already declared a "selective default" on the two notes, even though the 30-day grace period has not expired yet.

Russian oil sales set to decline noticeably?

The fourth and most important factor relates to Russia's exports of fossil fuel. Despite the imposed sanctions, Russia was still selling substantial quantities of oil and gas to foreign buyers during the past weeks. This provided a valuable stream of foreign currency that upheld the ruble's external value and bolstered the current account.

Yet, the sale of energy commodities might decline noticeably going forward. Most of the oil that has left Russia in recent weeks was bought and paid for before the war started. Worries about sanctions and bad publicity as well as logistical difficulties (as cautious banks cut credit, ship owners struggled to obtain insurance and freight costs soared) have prompted many Western buyers to pause purchases.

Big players in the energy sector are boycotting Russian oil altogether (e.g. Shell and BP) and globally operating shippers are winding down operations in Russia (e.g. Maersk and MSC).

According to the commodity data provider Kpler, seaborne exports of crude oil from Russia averaged 4.6 million barrels per day in March, in line with export volumes in December, January and February. In the first week of April, volumes averaged 1.1 million barrels a day. This is well in line with estimates by the International Energy Agency that suggest that the supply of Russian oil will exceed demand by about 3 million barrels per day in April (other estimates are even higher, i.e. demand of 4.8 million barrels per day versus a total Russian oil supply of around 10 million barrels per day).

As these barrels fail to sell, Russia's Urals crude is trading at an increasing discount: At the cut-off date, Urals crude sold for some USD 35 below Brent crude (see chart 5). The large discount is also a clear indication that non-Western countries are not yet prepared to up their purchases of Russian oil and that the decisive Western sanctioning is constraining the willingness and/or ability to actively profit from price dislocations. This applies to large Chinese energy companies, in particular. The reluctance on the part of China, however, might in part also be related to transport and technical issues: Whereas tanker shipment from Russia to Europe usually takes three or four days, to Asia it takes 40 days. Furthermore, most refineries are optimized to operate with certain types of crude and switching to a Russian type from a different type takes time and money.

CESEE economies will suffer setbacks too

As far as the other CESEE countries are concerned, the outlook prior to the war included a somewhat weaker though still solid GDP expansion in 2022, as economic constraints from the COVID-19 pandemic (including on value chains) were expected to ease and the beginning disbursement of EU funding (with resources from overlapping financial frameworks and the NGEU reconstruction fund) was expected to support investment and construction activity. With the war in Ukraine, the situation has clearly deteriorated. The main transmission channels of this shock relate to higher energy and commodity prices, trade spillovers from a contracting Russian economy and an impaired availability of selected products and general confidence effects resulting from this toxic mixture.

Rising commodity prices are set to heat up inflation even further

Persistently high inflation and the imminent further push to energy, commodity and food prices will lead to losses in purchasing power, and the accompanying tightening of monetary policy will translate into increasingly tighter financing conditions. As mentioned above, inflation in the CESEE

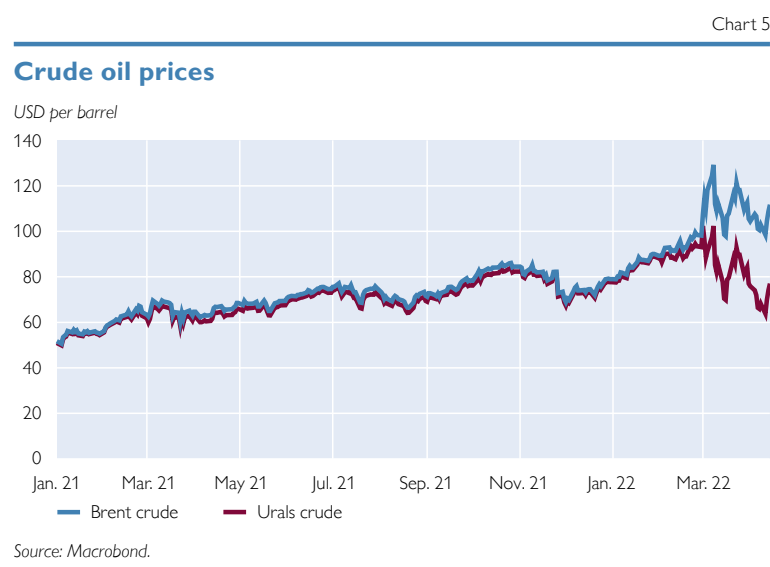
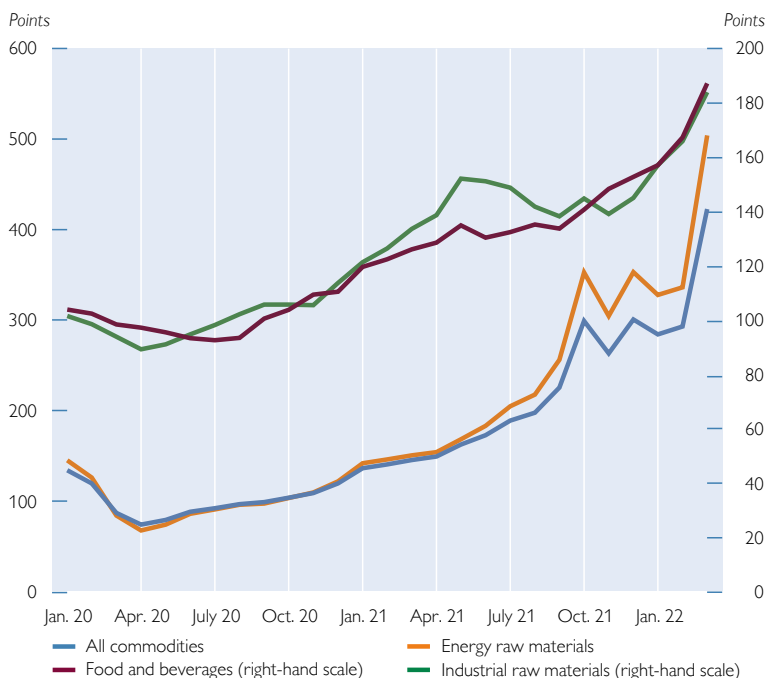


Chart 6

HWI commodity price index



Source: Hamburgisches WeltWirtschaftsinstitut (I-HWWI).

region already reached historically high levels in February, with price growth averaging more than 8% in the CESEE EU member states and as much as 54.4% in Turkey. In March, the HWI commodity price index advanced by 44.4% month on month, with crude oil prices up by 23.4%, coal prices up by 58% and gas prices up by 78% (see chart 6). The FAO Food Price Index went up by 12.6% compared to its February reading, reflecting new all-time highs in the prices for vegetable oils, cereals and meat, while those for sugar and dairy products also rose significantly.

The pass-through of spiraling world market prices on CESEE consumer price inflation will be enhanced, on the one hand, by the relatively large weight of energy and especially food items in CESEE consumption baskets and, on the other hand, by recent currency movements. The moderate upward trend of Central European currencies

came to an end and spillovers from the war in Ukraine cost CESEE currencies quite a bit of their external value against the euro (and, even more so, against the US dollar) in the first days after the invasion. By mid-April, regional currencies had recovered some of their initial losses but generally failed to return to their pre-war levels. Geopolitical risk premiums could continue to weigh on currencies in the weeks to come.

Central banks step up their hiking cycles

Against this backdrop, CESEE central banks have sped up their hiking cycles: Since February 24, policy rates have been raised by 100 basis points to 4.4% in Hungary, by 175 basis points to 4.5% in Poland, by 50 basis points to 5% in Czechia and by 50 basis points to 3% in Romania. The Romanian central bank resumed its government bond purchases in early March to sustain liquidity and to reduce market tension. The Croatian national bank announced two foreign currency market interventions since the start of the war to stabilize the exchange rate of the kuna vis-à-vis the euro. Both the Czech and Polish national banks also reported market interventions in early March and communicated that they stand ready to intervene if they deem exchange rates to be fluctuating excessively. On March 28, the ECB announced that it had agreed to a precautionary swap line of over EUR 10 billion with the Polish national bank, which expires on January 15, 2023. Moreover, it extended the bilateral, temporary repo line (up to EUR 4 billion) with the central bank of Hungary, which was due to expire at the end of March 2022.

War is a major deglobalization event

Economically, the Russian invasion of Ukraine constitutes a major deglobalization event that poses a serious threat to complex value chains due to Russia's important role as an upstream supplier of energy products. This alone impacts on the outlook for the tightly integrated CESEE economies. According to the Kiel Trade Indicator by the Institute for the World Economy, world trade declined by 2.8% in March, month on month. The WTO revised its projection for world trade growth in 2022 to 3% from previously 4.7%.

The trade-related fallout from the expected recession in Russia (and the associated reduction of import demand) alone, however, appears to be limited. The Vienna Institute for International Economic Studies (wiiw), for example, estimated that even in a scenario where Russian demand falls by 10%, imports by 30% and exports by 13%, the negative impact on GDP growth in the other CESEE countries via the trade channel would be -0.3% at most. This scenario, however, does not take into account potential adverse effects on growth and demand from rising costs of energy and raw materials, value chain disruptions or from disruptions in the supply of critical inputs⁴. Especially a stop of energy deliveries from Russia to the CESEE economies would impact negatively on economic activity in the region.

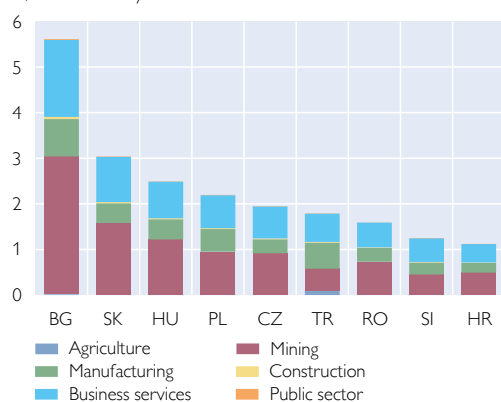
Dependence on Russian inputs above EU average in CESEE

On the import side, the CESEE countries – in a European comparison – show an above-average dependence on Russian inputs for their production. Data from the OECD's Trade in Value-Added database (referring to the year 2018) show that Russia's share in value-added in final demand ranged between 5.7% in Bulgaria and 1.2% in Croatia (EU-27: 1%). Russia's contribution to final demand in CESEE was strongly related to the Russian energy sector and mostly originated from Russian mining and business services (see chart 7). These two categories include, most

Chart 7

Russia's share in value-added in final demand, 2018

%, broken down by individual source industries in Russia

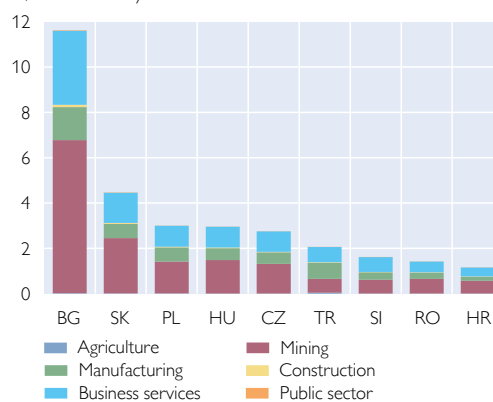


Source: OECD TiVA database, OeNB.

Chart 8

Russia's share in value-added in gross exports, 2018

%, broken down by individual source industries in Russia



Source: OECD TiVA database, OeNB.

⁴ For the OeNB's most recent forecast, please consult *Outlook for selected CESEE countries and Russia* in this issue of *Focus on European Economic Integration*.

prominently, energy-producing products, wholesale and retail trade of fuels, transport via pipelines and warehousing/support activities for transportation. Among the other categories, only manufacturing – and within manufacturing especially coke and refined petroleum products – contributed a notable share.

Russia's share in value-added in gross exports is even higher and ranged from 11.9% for Bulgarian exports to 1.2% for Croatian exports (EU-27: 1.4%). Again, Russia's contribution to gross exports mostly came from the Russian mining industry (especially from energy-producing goods). The respective contributions of business services and manufacturing were somewhat less important (see chart 8).

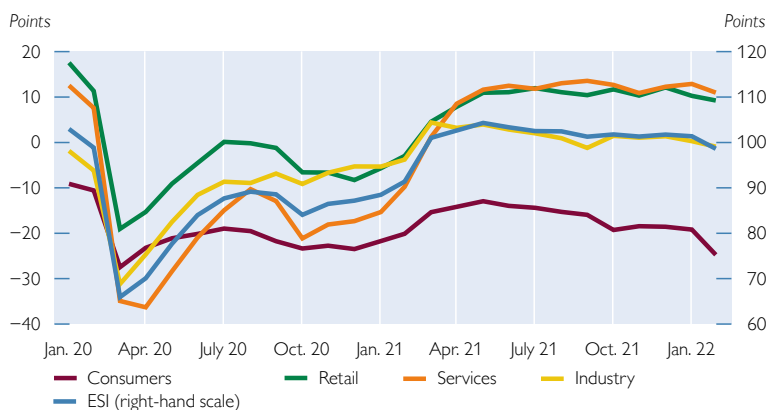
Russia supplies several critical inputs

While those figures – especially aside from items directly related to the Russian energy sector – do not look particularly impressive, it needs to be borne in mind that the significance of an input for an economy is not strictly measured by its contribution to gross value-added. A lack of so-called “risky” products may cause interruptions in production lines, even if missing parts are minor in terms of their value-added. A prominent case in point are semiconductors – their shortage shut down whole production facilities during the COVID-19 pandemic. Knock-on effects of lower (or even zero) imports of key inputs from Russia are therefore difficult to estimate but could potentially be severe.

“Risky” products supplied by Russia include palladium, a precious metal that is embedded in engine exhausts to reduce emissions. Here, shortages have already led to price hikes and could quickly translate into supply chain issues especially for the automotive industry. Russia also accounts for large chunks of the EU's total imports of nickel and aluminum. Disruptions in the trade flows in these areas could therefore severely impact the steel, manufacturing and construction industries. Furthermore, farmers across Europe rely heavily on imported fertilizers from Russia (and Belarus). Some 50% of the world's semiconductor-grade neon, critical for the lasers used to make chips, came from two Ukrainian companies that have halted their operations. The stoppage casts a cloud over the worldwide output of microchips, already in short supply after the pandemic had driven up demand for cell phones, laptops and cars.

Chart 9

Economic sentiment indicator and subcomponents



Source: European Commission.

Economic sentiment remains remarkably stable so far

The challenging geopolitical situation in the very heart of the CESEE region, surging prices across the board, potential supply (chain) disruptions in vital areas and constantly evolving risks have been increasing uncertainty.

Against this backdrop – and somewhat astonishingly – economic sentiment in CESEE has so far deteriorated only moderately. The European Commission's economic sentiment indicator (ESI) on average declined by some 3 points between February and March 2022,

with the largest reductions being reported for Bulgaria, Czechia and Turkey (see chart 9). At the height of the first COVID-19 wave back in April 2020, the ESI had declined by full 37 points. Consumers are currently worrying the most. Consumer sentiment declined by an average 5.6 points, with Czechia and Hungary reporting declines in the double digits. In addition to general economic fears, consumers were increasingly concerned about a deterioration in their own finances, certainly reflecting the loss of purchasing power due to current and expected future inflation. According to survey data, the level of inflation expected by consumers spiked in March, reaching historically high levels in many cases.

Sentiment was more resilient in services and in the retail sector amid expectations of a stronger rebound after the ongoing easing of COVID-19 restrictions. The deterioration in the industrial sector was also rather contained. Purchasing managers' indexes declined somewhat but remained in expansionary territory, at least in Czechia and Poland in March. The indicator on industrial sentiment within the ESI framework retreated by an average of 1.2 points, which is a moderate decline compared to the composite ESI. This was somewhat unexpected as the energy-intensive industrial sector suffers particularly from high electricity and gas prices and would have to bear the main economic burden of any gas rationing. Furthermore, industry surveys also reveal that supplier's delivery times have again increased quite a bit in March (after several months of decline) pointing to recurring supply chain issues. This development, however, could also reflect renewed supply chain blockages due to China's zero-COVID policy.

CESEE takes in millions of Ukrainian refugees within only a few weeks

Over the last weeks, CESEE countries have done a remarkable job in taking in refugees after the outbreak of the war. The figures are staggering: More than 4 million Ukrainian refugees have arrived in neighboring countries since the start of the invasion (some 2.7 million in Poland, 710,000 in Romania, 440,000 in Hungary and 320,000 in Slovakia). The EU has activated its Temporary Protection Directive, which stipulates that all refugees from Ukraine will be granted a temporary residence permit in the EU without the need to apply for asylum and will be granted unrestricted labor market access. While housing and accommodating such large numbers of people in such a short time constitutes a major challenge, the inflow of people will undoubtedly also generate additional demand and public expenditure. This should cushion the ramifications of the war on economic activity in receiving countries at least to some extent. Depending on several factors (ultimate number of refugees, duration of stay, age profile, availability for the labor market, educational attainment and/or professional skills, shortfall of seasonal workers from Ukraine due to the war), refugees may also provide some relief for the CESEE region's tight labor markets.

Ukraine: economy operating under war conditions

Before Russia's war against Ukraine started, the Ukrainian economy had reached a notable degree of stability: progress had been made in rebuilding international reserves, improving the fiscal and external positions, and the banking sector had become more solid during the last few years. After some setbacks, Ukraine had again made progress on the reform agenda ahead of the conclusion of the first review under the latest IMF Stand-By Agreement (SBA) in November 2021, and further reform steps were envisaged under the program.

In light of the urgent balance of payments needs and the severe constraints that the war has imposed on the country's capacity to implement reforms subject to conditionality under the SBA, the Ukrainian authorities requested financial assistance under the IMF's Rapid Financing Instrument (RFI). The disbursement of about USD 1.4 billion was approved by the IMF Executive Board on March 9, 2022. The SBA was canceled. Additional financing was announced (and partly already disbursed) by the EU, EBRD, EIB and the World Bank. Narodowy Bank Polski provided the National Bank of Ukraine (NBU) with a USD/UAH currency swap line in an amount of up to USD 1 billion. In early April, the IMF Executive Board approved the establishment of an administered account for Ukraine, providing donors with a secure vehicle for directing financial assistance to Ukraine. Backed by international financial assistance, Ukraine's international reserves slightly rose to USD 28 billion in March, while Ukraine continued to service and repay its foreign currency-denominated public debt. Yet, pressures on international reserves and public finances will remain very high.

The IMF projects a GDP contraction of 35% this year. Regions affected directly by the war (at end-March 2022) produced about 50% of GDP when including Kyiv and about 30% when excluding Kyiv. GDP losses are only a small part of total economic losses due to the war, however. At end-March, the Ukrainian ministry of economy stated that total losses due to the war amounted to USD 565 billion (including loss of infrastructure, GDP losses, losses incurred by the civilian population, losses of enterprises and organizations, losses of FDI in the Ukrainian economy and losses of the state budget).

The banking sector, as part of the critical infrastructure, has adapted to the war conditions. Bank branches have been kept open, ATMs have been replenished as far as possible and cashless payments have continued to work. In contrast to previous crises, there have been no bank runs, which is related to limits on cash withdrawals as well as security risks associated with holding cash outside banks and difficulties in exchanging hryvnia abroad (in contrast to the possibility of withdrawing money abroad using ATM/credit cards). Reportedly, several banks voluntarily agreed on repayment holidays. The foreign exchange market switched to operating under significant restrictions imposed by martial law. In areas occupied by Russia, according to the NBU, the occupation forces have taken actions to limit the circulation of cash and cashless hryvnia and to introduce the Russian ruble.

Despite efforts within the agricultural sector to continue working, there is certainly a risk that agricultural output will be constrained this year, particularly in those parts that are most affected by the war. The blockage of main export routes (Ukrainian black sea ports) by Russian forces further aggravates the overall difficult situation. The nearby port of Constanța (Romania) may serve as an alternative export route, but poor railway connections act as a bottleneck.

Western Balkans⁵: some recovery from the COVID-19 pandemic but war in Ukraine brings new economic challenges

Since March 2020, the COVID-19 pandemic has strongly affected the EU candidates and potential candidates (CPCs) of the Western Balkans, with high per capita fatality rates in Bosnia and Herzegovina, Montenegro and North Macedonia. Currently, the latest wave of infections seems to be receding in the region; however, the number of tests has also decreased significantly, and COVID-19-related restrictions have been phased out. Vaccination rates have reached 40% (North Macedonia) to 50% (Serbia) and remain lowest in Bosnia and Herzegovina at less than 30%. Risks related to the pandemic, however, have recently been surpassed in significance by the impact of the war in Ukraine on the Western Balkan economies.⁶

After sharp contractions in 2020, CPC economies expanded in 2021 with full-year growth being weakest in North Macedonia at 4% (year on year) and strongest in Montenegro at 12.4% (year on year). Growth had returned to positive territory in all CPCs in the second quarter of 2021 (chart B1). Except for Montenegro, growth in the third and fourth quarter decelerated somewhat compared to the second quarter but remained positive in all CPCs. The slowdown is partially due to a base effect, i.e. the easing of COVID-19-related restrictions and initial economic recovery in the second half of 2020. In the second half of the year, private consumption growth weakened compared to the first half of 2021 (except for Montenegro) but remained an important pillar of growth in all countries. With the lifting of COVID-19 containment measures, pent-up demand and continuously improving consumer confidence bolstered private consumption throughout 2021. Private consumption also strengthened on the back of crisis support measures as well as increased remittances. For example, in North Macedonia, remittances returned to pre-crisis levels in 2021 and, according to the National Bank of the Republic of North Macedonia, about two-thirds of remittances are used to finance private consumption. Serbia, having experienced a rather mild economic shock in 2020, also recovered strongly in 2021; in the second half of the year, this recovery was driven by solid private consumption and investment growth, which had already cushioned the contraction and contributed to overall GDP growth in the first half of 2021. In North Macedonia, investment was an important pillar of growth throughout 2021, similar to the situation in other CPCs.

The development of public consumption is mixed when comparing the second half with the first half of 2021: In Albania and Kosovo, public consumption growth visibly decelerated while, in Serbia, it strongly increased, which could have been related to the general elections that took place in early April 2022. Overall, however, public consumption only adds little to economic growth in the region.

In Kosovo and Montenegro, net exports significantly contributed to a strong rebound in growth in the third quarter of 2021. Among its peers in the region, Montenegro had been hit worst by the pandemic in 2022, while growth in 2021 was partially bolstered by policy measures to mitigate the effect of the pandemic as well as infection control and most importantly the re-opening of tourism in 2021. In Kosovo, the easing of travel restrictions led to exceptionally strong summer travel by Kosovans living abroad and – like in Montenegro – a strong recovery of services exports.

In the second half of 2021, the year-on-year increase of exports of goods and services slowed down (somewhat) compared to the second quarter of 2021 in Albania, North Macedonia and Serbia and accelerated (somewhat) in Kosovo, Montenegro and Bosnia and Herzegovina. Goods exports recovered against the background of economic recovery in EU trading partners; services exports were mainly driven by the effect of easing restrictions on

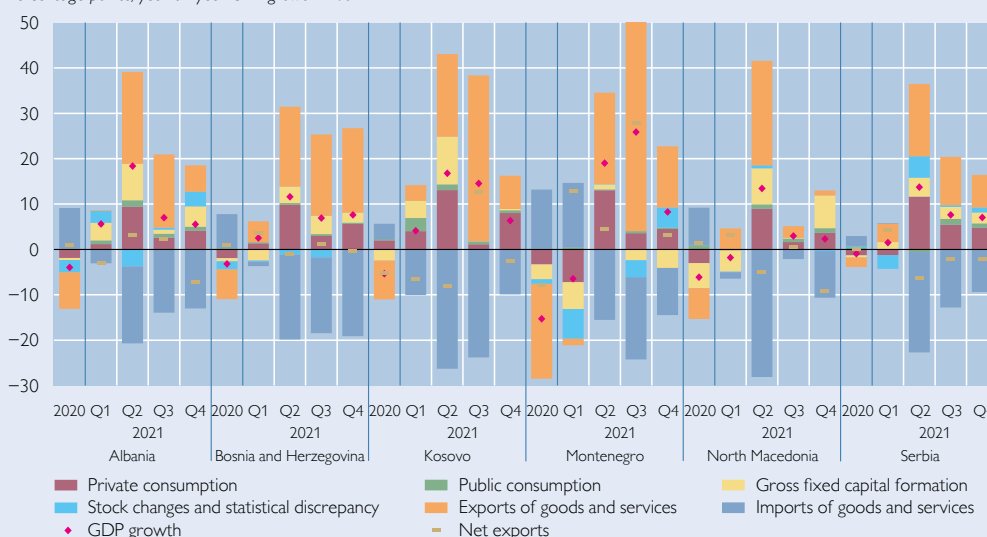
⁵ The Western Balkans comprise Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia. The designation “Kosovo” is used without prejudice to positions on status and in line with UNSC 1244 and the opinion on the Kosovo Declaration of Independence.

⁶ Although we focus on economic developments in the Western Balkans over the second half of 2021 in this box, we will also mention exposure to the Russia-Ukraine war and the various channels where appropriate.

Chart B1

GDP growth and growth contributions in the Western Balkans

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



Source: Eurostat, wiw, national statistical institutes.

Note: Gross capital formation for Bosnia and Herzegovina, North Macedonia, Kosovo.

tourism. Recovery, however, was not uninterrupted. Supply chain disruptions affected exports of the automotive industry in North Macedonia. Kosovo's main ferro-nickel producer and exporter had to close production due to power disruptions. Against the background of rebounding private consumption and increasing domestic demand, the negative contribution of imports to growth was 10 percentage points or more in the CPC economies. Except for Montenegro, strong imports kept net exports (slightly) negative in the fourth quarter of 2021. In Serbia, this was the case in the third quarter as well.

The Western Balkans' trade exposure to Russia, Ukraine and Belarus is of limited scope (chart B2), with Serbia reporting the highest share of imports from Russia and the highest share of exports to Russia. However, Bosnia and Herzegovina, North Macedonia and Serbia are highly dependent on Russian gas deliveries, which account for about two-thirds of all gas imports to these countries. Nearly 30% of Albania's imports of fertilizers and 22% of cereals come from Russia. Serbia imports even more than half of its fertilizers from Russia. On the export side, Russia is also an essential market for Montenegro's non-metallic mineral items and for Bosnia and Herzegovina's pharmaceutical exports. Montenegro is to a large extent dependent on tourism and in particular on tourists from Russia. In 2021, tourists from Ukraine also played an important role.

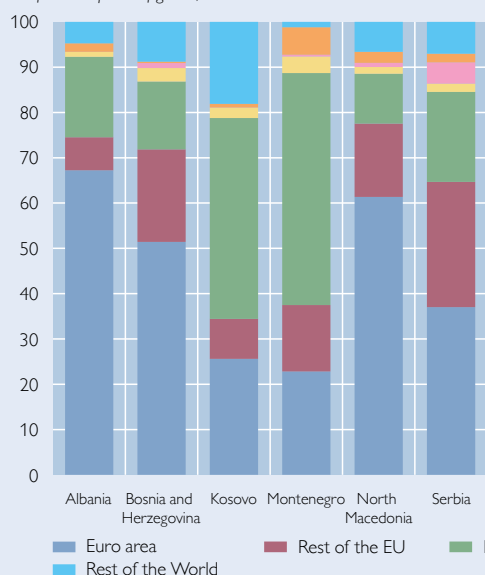
Against the background of the economic recovery, labor market figures improved in Western Balkan CPCs. Unemployment rates returned to or were even below pre-pandemic levels in the second half of 2021 in all countries. For Bosnia and Herzegovina as well as North Macedonia, unemployment also fell because of lower labor force participation – which was also attributable to emigration in both countries. In Montenegro, decreases in unemployment were mainly due to short-term and seasonal employment. In Serbia, by contrast, the employment rate reached a historical high at 50% in the third quarter of 2021 and the labor force participation rate also increased. In Albania an increase in the minimum wage from ALL 30,000 to ALL 32,000 per month entered into force as of January 2022. In North Macedonia, the minimum wage was increased by 18.5% as of February 2022.

Current account deficits narrowed in 2021 compared to 2020 in Albania, Montenegro and Serbia, largely due to higher surpluses in the balance of services. The improvement was most striking in Montenegro, where the surplus of the service balance almost increased fivefold in

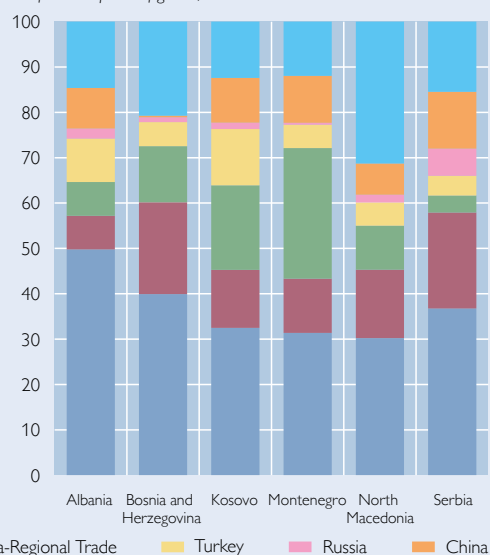
Chart B2

Export shares of Western Balkan CPCs

% of total exports of goods, 2020

**Import shares of Western Balkan CPCs**

% of total imports of goods, 2020



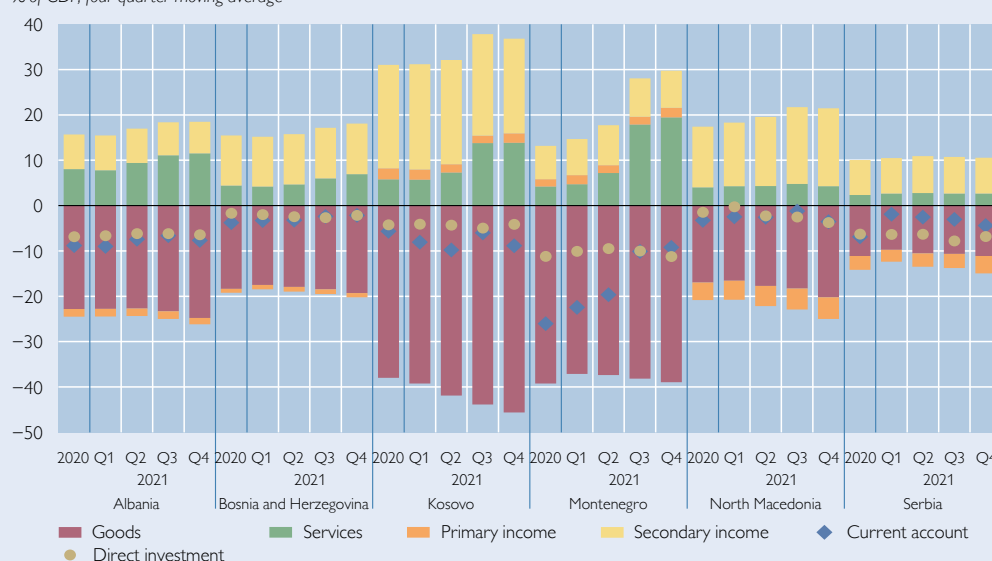
Source: wiw.

the second half of 2021. In Kosovo the current account balance deteriorated due to a widening of the trade deficit but also because of lower remittances, which play a significant role in the external position of Kosovo (remittances amount to more than 20% of GDP). However, in most other CPCs, secondary income increased. Foreign direct investment remained almost unchanged

Chart B3

Current account balances and FDI

% of GDP, four-quarter moving average

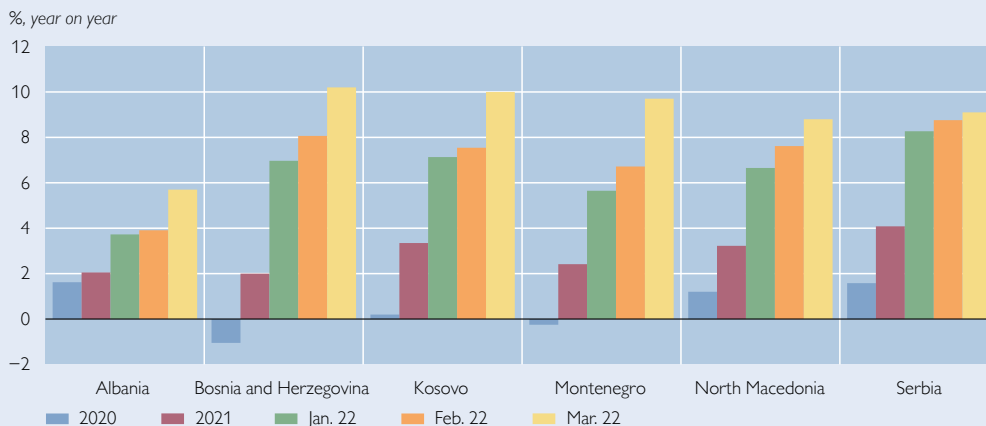


Source: National central banks, national statistical offices.

Note: A positive (negative) value in the category of direct investments indicates that net acquisition of assets is higher (lower) than net incurrence of liabilities.

Chart B4

The same picture everywhere: strong rise in inflation



in 2021 compared to 2020 and covered a large part of the current account deficit. The significant financing gap of 2020 was also closed in Montenegro.

Foreign direct investment from Russia only plays a role in Montenegro, Serbia and Bosnia and Herzegovina. In Montenegro, it amounted to 10.9% of total stocks of inward FDI in 2020; for Serbia, this share is 5.7% and for Bosnia and Herzegovina it is 4%. Although these shares are still quite low, FDI from Russia plays a larger role in Serbia and Montenegro than FDI from the UK and the US combined.

Inflationary pressure in the Western Balkans accelerated toward the end of 2021 and has significantly intensified due to the war in Ukraine (chart B4). The inflation targets in Albania (target of 3%) and in Serbia (upper inflation target of 4.5%) were overshoot by far over the last months. In all countries, the surge in inflation is being fueled by energy and food price increases. In some countries, continuing supply chain problems play a role. Food and transport prices accelerated, in particular affecting the purchasing power of poorer households. In some countries, energy tariffs are regulated. Serbia, for example, has kept energy tariffs unchanged despite rising energy costs.

In Albania and Serbia – the only Western Balkan economies with flexible exchange rate regimes – depreciation pressures have been evident since the start of the war in Ukraine. The National Bank of Serbia intensified interventions, also in an effort to stabilize inflation, and the exchange rate has remained more or less stable. After initial losses, the Albanian lek gained ground thereafter and stood at 120.20 against the euro. Thus, the currency was almost as strong as during its December 2007 high. To address rising inflationary pressure, central banks in the region started to raise their key interest rates: The Bank of Albania increased its key interest rate by 50 basis points to 1% on March 23, 2022, the National Bank of Serbia by 50 basis points to 1.5% on April 7, 2022, and the National Bank of the Republic of North Macedonia raised its interest rate on central bank bills by 25 basis points to 1.5% in mid-April 2022. Responding to increased demand for euro cash due to elevated uncertainty related to the war in Ukraine, both the National Bank of Serbia and the National Bank of the Republic of North Macedonia introduced measures to increase consumers' confidence in the continued availability of foreign currency cash.

Since our last reporting, credit growth (in nominal terms) for corporates and households has accelerated in the CPCs (with the exception of North Macedonia) though at a very uneven pace. In Kosovo, credit increased by an average of roughly 15% year on year in the period from September 2021 to February 2022 (March 2021 to August 2021: 11% year on year, on average), in Albania, by almost 10% year on year (compared to less than 6% in the previous period). In most CPCs, credit to households grew more dynamically than corporate loans; however, the growth of credit to households weakened in North Macedonia and Serbia. Throughout 2021, the share of loans denominated in foreign currency remained stable in the four CPCs that retain a currency of their own but remains rather high at 49% in Albania, 48% in Bosnia and Herzegovina, 41% in North Macedonia and 61% in Serbia. Deposit substitution showed a similar pattern with relatively high but stable rates in the four CPCs.

Nonperforming loans (NPLs) remained more or less stable or decreased over the second half of 2021 compared to the first half in all countries with the exception of Montenegro. The decline was strongest in Albania. In Montenegro NPLs increased from 5.7% at the end of the first half of 2021 to 6.2% at the end of 2021. The percentage of loans under moratoria was substantially lower in 2021 than in 2020; by the end of 2021, the percentage of loans under moratoria was very small. Only in Bosnia and Herzegovina, Montenegro and North Macedonia, some residual loan moratoria or restructuring agreements were still in place at the end of 2021. These residual COVID-19-related debt-relief measures are primarily targeted at vulnerable individuals. In Montenegro, for example, loan restructuring measures were offered to people who lost their employment, suffered wage reductions of more than 10% or did not receive net wage payments for more than three months. Stage 2 loans increased in 2020 and there is some indication that they increased further until the end of 2021. For Albania, the IMF Article IV consultation report from December 2021 estimates that NPLs could increase by more than 15% due to the COVID-19 pandemic.

Following a significant increase in 2020, budget deficits in all Western Balkan CPCs stood at 6% or lower in 2021. North Macedonia and Albania recorded the highest deficits, at 6% of GDP, followed by Serbia at 5% of GDP. Montenegro reduced its deficit by more than 8 percentage points and recorded a deficit of 3% of GDP in 2021. Kosovo's budget was balanced with a surplus of less than 1% largely due to a 29% increase in tax revenues. The debt-to-GDP ratio decreased significantly in Montenegro, by around 20 percentage points to an estimated 85% of GDP, which is, however, still well above Montenegro's fiscal rule of 60% of GDP. In Albania, the country with the second highest debt-to-GDP ratio, the figure increased by 2 percentage points to 78% in 2021. Although tax revenues increased in Albania, the government also raised subsidies to state-owned energy providers in the last quarter of 2021. Contingent liabilities of state-owned enterprises are one of the major risks for sovereign debt sustainability in Albania. Debt-to-GDP increased slightly in North Macedonia and Serbia and remained more or less unchanged in Kosovo and Bosnia and Herzegovina.

North Macedonia asked for a two-year Precautionary and Liquidity Line with the IMF in mid-April 2022. This tool is meant to support countries with sound policies and economic fundamentals in case of external shocks. The IMF is now in the process of deciding on the request. In Serbia, the first review of the IMF Policy Coordination Instrument (approved in June 2021) – a tool to anchor economic policy without drawing on financial resources – was successfully completed in December 2021; the second review is expected for end-June 2022. With respect to EU enlargement, not much has happened since our last reporting. Albania and North Macedonia are still waiting for the opening of accession negotiations, a decision that has been stalled for several years now.

2 Slovakia: brittle economic recovery amid supply shocks and lofty prices

The recovery of the Slovak economy lost steam in the second half of 2021. GDP growth was rather lackluster, averaging just above 1% and thus pushing the figure for 2021 as a whole to 3%. By the end of the year, real output thus still lagged behind the pre-pandemic level reached in 2019 by about 1.5%. The growth structure changed in the second half of the year 2021 as foreign demand weakened. Hence, contrary to the beginning of 2021, in the six months to December, economic growth was determined by domestic demand while net exports were a significant drag. Among the domestic demand components, it was predominantly the buildup of inventories that provided the most significant contribution to growth. This was brought about mainly by supply chain disruptions, in particular missing semiconductors in the crucial automotive industry, which hindered the completion, sale and export of cars and other industrial goods. Also household consumption contributed quite decisively to the rise in domestic demand despite (selective) lockdowns and other restrictive anti-pandemic measures toward year-end resulting from record-high COVID-19 infections. Private consumption has benefited inter alia from rising wages in a tight labor market. While fixed investment accelerated in the final quarter of 2021, its overall contribution to GDP growth in the second half of the year remained moderate, not least due to significant increases in prices of industrial goods and construction input materials. Rising prices along with the spreading Omicron COVID-19 variant were some of the key factors that overshadowed foreign demand as well. Yet, net exports were also hampered on the supply side as a result of the supply chain frictions mentioned above. Accelerating inflation as well as supply chain disruptions have not only persisted since the beginning of 2022, but they have deepened and aggravated in the wake of the war in Ukraine. These factors will thus have continued exercising a detrimental impact on private consumption, investment and net exports also in the first months of 2022. In contrast, public consumption is likely to have received a boost on the back of heightened expenditures induced by the war, particularly those for helping refugees arriving in Slovakia.

Despite the pandemic, the situation on the labor market has improved since mid-2021 as a falling unemployment rate and slightly rising employment suggest. Nonetheless, the Slovak economy suffers from a skill mismatch and thus a lack of skilled labor. This does not only translate into rising wages but is reflected also in a record-high number of vacancies, on the one hand, and a persistently high long-term unemployment rate – one of the highest in the EU – on the other. Headline inflation rose sharply in the review period and came in at 8.3% in February 2022, the highest reading in more than 20 years. This towering inflation rate was broadly based, driven by soaring prices of almost all components, particularly services, industrial goods, processed food but, especially since the start of this year, also swelling energy prices. The Russian invasion of Ukraine and the ensuing sanctions as well as economic disturbances will further exacerbate inflation pressure. On the back of fiscal response measures to the coronavirus crisis worth 3.8% of GDP that had been budgeted for 2021, the general government deficit amounted to 6.2% of GDP. Consequently, public debt is projected to have gone up from 48.1% of GDP in 2019 to about 63.1% of GDP in 2021.

Table 2

Main economic indicators: Slovakia

	2019	2020	2021	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	2.6	-4.4	3.0	-2.0	-1.8	0.2	9.6	1.3	1.4
Private consumption	2.7	-1.3	1.2	0.8	-2.3	-5.5	5.0	2.5	2.7
Public consumption	4.6	0.9	1.9	1.4	3.2	-1.7	8.1	-1.0	2.1
Gross fixed capital formation	6.7	-11.6	0.6	-8.1	-14.8	-9.3	5.6	-1.9	6.0
Exports of goods and services	0.8	-7.3	10.2	0.9	0.9	10.8	39.3	-3.0	1.6
Imports of goods and services	2.1	-8.2	11.2	-5.7	0.3	6.0	39.2	3.5	3.5
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	3.8	-5.2	3.8	-7.8	-2.3	-4.4	9.3	6.8	3.1
Net exports of goods and services	-1.2	0.9	-0.8	5.7	0.5	4.5	0.2	-5.3	-1.7
Exports of goods and services	0.8	-6.7	8.7	0.8	0.8	10.2	28.2	-2.5	1.5
Imports of goods and services	-2.0	7.6	-9.5	4.9	-0.3	-5.7	-28.0	-2.8	-3.2
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	5.2	6.4	2.1	2.5	5.3	0.9	-1.3	4.4	4.6
Unit labor costs in manufacturing (nominal, per hour)	5.6	4.2	-4.2	-5.0	-5.3	-9.9	-19.0	8.7	5.9
Labor productivity in manufacturing (real, per hour)	1.3	1.2	10.0	7.6	9.5	10.5	23.3	1.6	7.0
Labor costs in manufacturing (nominal, per hour)	6.8	4.9	6.1	2.3	3.7	-0.5	-0.1	10.5	13.3
Producer price index (PPI) in industry	1.8	-0.5	6.8	-1.3	-1.0	-0.8	4.3	9.3	14.5
Consumer price index (here: HICP)	2.8	2.0	2.8	1.5	1.6	1.0	2.1	3.4	4.8
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	5.8	6.8	6.9	7.3	7.0	7.2	7.0	6.8	6.6
Employment rate (%, 15–64 years)	68.4	67.5	69.5	67.5	67.8	67.9	68.8	70.3	70.8
Key interest rate per annum (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Nominal year-on-year change in the period-end stock in %</i>									
Loans to the domestic nonbank private sector ¹	6.8	6.8	6.8	5.0	4.5	4.8	4.2	5.2	7.3
of which: loans to households	8.0	8.0	8.0	6.5	6.1	6.0	7.2	8.0	8.8
loans to nonbank corporations	4.4	4.4	4.4	2.1	1.4	2.5	-1.8	-0.2	4.3
<i>%</i>									
Share of foreign currency loans in total loans to the nonbank private sector	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Return on assets (banking sector)	0.8	0.5	0.7	0.5	0.5	0.5	0.8	0.8	0.7
Tier 1 capital ratio (banking sector)	16.6	18.1	18.3	18.0	18.1	18.8	19.2	18.8	18.3
NPL ratio (banking sector)	2.8	2.3	1.9	2.5	2.3	2.2	2.1	1.9	1.9
<i>% of GDP</i>									
General government revenues	39.4	39.9	40.7	..	..	..	..	..	..
General government expenditures	40.7	45.3	46.8	..	..	..	..	..	..
General government balance	-1.3	-5.5	-6.2	..	..	..	..	..	..
Primary balance	-0.1	-4.2	-5.0	..	..	..	..	..	..
Gross public debt	48.1	59.7	63.1	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	53.8	54.5	53.2	..	..	..	..	..	..
Debt of households and NPISHs ² (nonconsolidated)	43.7	47.2	48.5	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Goods balance	-1.2	1.1	-0.1	4.2	2.5	4.0	-0.3	-2.5	-0.9
Services balance	1.3	1.2	0.8	2.0	0.2	0.7	0.7	1.5	0.4
Primary income	-2.3	-1.2	-1.7	-1.2	-1.6	-0.4	-1.8	-1.6	-2.9
Secondary income	-1.1	-1.0	-1.0	-1.1	0.0	-1.9	-1.0	-0.8	-0.4
Current account balance	-3.4	0.1	-2.0	3.9	1.0	2.4	-2.4	-3.4	-3.8
Capital account balance	0.7	1.1	1.4	0.6	2.0	0.9	3.7	0.2	0.8
Foreign direct investment (net) ³	-2.3	2.1	0.3	7.1	-0.7	3.0	-1.0	-1.3	0.7
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	112.7	120.5	137.0	121.0	120.5	119.0	117.6	118.6	137.0
Gross official reserves (excluding gold)	5.3	6.6	8.7	7.0	6.6	8.4	8.1	8.8	8.7
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	0.7	0.9	1.1	1.0	0.9	1.2	1.1	1.2	1.1
<i>EUR million, period total</i>									
GDP at current prices	94,048	92,079	97,123	24,578	24,325	21,819	24,078	25,637	25,589

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

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

- = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

3 Slovenia: GDP rebound overshadowed by accelerating inflation

Slovenia's GDP rebounded sharply and grew by 8.1% in 2021. Although year-on-year dynamics eased somewhat during the second half of the year, seasonally adjusted month-on-month growth signaled strengthening dynamics. GDP growth relied heavily on the acceleration of private consumption, which was attributable to a base effect, expansion of employment and by accelerating household credit growth. At the same time, consumer confidence improved only modestly, and real average wage growth decelerated due to both, accelerating inflation and slowing nominal wage dynamics. Gross fixed capital formation expanded at a double-digit rate as well during the second half of 2021, supported by public investments, high industrial capacity utilization and a rebound in corporate credit growth. Strong domestic demand fueled imports, which led to a negative contribution of net real exports despite double-digit export growth.

Slovenia's budget deficit amounted to 5.2% of GDP in 2021, down from 7.8% in 2020. Fiscal developments benefited from the strong cyclical rebound. At the same time, expenditures in 2021 continued to be adversely affected by investment spending and government measures designed to mitigate the effects of the pandemic. For 2022, the government targets a reduction in the budget deficit as expenditures are expected to decline, while revenues will continue to benefit from economic growth. According to Slovenia's independent fiscal council, however, planned expenditures pose a structural risk for public finances and violate fiscal rules, as they raise the concern of inefficient use of budget funds and open room for nontransparent spending in the election year 2022. Moreover, the fiscal council has warned that discretionary measures adopted during, but not related to, the pandemic will worsen public finances by around 2% of GDP per year in the future.

HICP inflation accelerated from around 2.1% in August 2021 to 7% by February 2022 and thus exceeded the euro area average from December 2021. Inflation excluding energy and unprocessed food prices rose from less than 1% to 4.7% during the reporting period. In order to mitigate the effect of rising energy prices on households and businesses, parliament adopted an aid package of around 0.4% of 2021 GDP. The package includes an energy voucher scheme for households and aid for most-affected businesses. In addition, network fees for electricity and excise duties on heating oil, petrol and natural gas were lowered for February-April 2022, while the government has also introduced a cap on retail fuel prices.

The banking sector was recently hit by negative news. In early February 2022, parliament passed a law which introduced a retroactive cap on exchange rate movements for CHF loans signed between June 28, 2004, and December 31, 2010, including those that have been paid off. According to estimates from the banking sector, the implementation of the law would cause them a loss of almost 60% of their combined after-tax profit in 2021. Following constitutional complaints, the constitutional court in mid-March 2022 suspended the implementation of the law until a final decision has been reached.

At the beginning of March 2022, following the ECB's and the Single Resolution Board's decision to close Sberbank Europe AG, Sberbank's Slovene subsidiary was taken over by Slovenia's biggest lender, NLB. The institution was the ninth-largest bank in Slovenia with a market share of nearly 4% in 2020 (in terms of total assets).

Table 3

Main economic indicators: Slovenia

	2019	2020	2021	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	3.3	-4.2	8.1	-1.4	-3.1	1.5	16.1	5.0	10.4
Private consumption	4.8	-6.6	11.6	1.4	-11.1	-0.8	17.9	7.2	22.8
Public consumption	2.0	4.2	3.9	5.0	3.5	1.2	4.4	3.2	7.0
Gross fixed capital formation	5.5	-8.2	12.3	-5.7	-2.7	8.0	20.4	10.5	11.0
Exports of goods and services	4.5	-8.7	13.2	-8.9	-0.7	1.6	30.5	11.6	12.1
Imports of goods and services	4.7	-9.6	17.4	-12.2	-0.8	1.2	36.1	19.1	16.8
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	3.0	-4.2	9.8	-3.2	-3.1	1.0	16.9	8.7	12.7
Net exports of goods and services	0.3	-0.1	-1.6	1.8	0.0	0.5	-0.8	-3.7	-2.3
Exports of goods and services	3.8	-7.3	10.3	-7.4	-0.6	1.3	22.0	8.7	9.8
Imports of goods and services	-3.6	7.2	-11.9	9.2	0.6	-0.9	-22.8	-12.4	-12.2
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	4.2	7.7	-1.3	3.0	9.0	3.9	-5.4	3.2	-5.8
Unit labor costs in manufacturing (nominal, per hour)	0.1	8.1	-2.8	5.4	3.0	3.3	-15.7	3.8	-1.2
Labor productivity in manufacturing (real, per hour)	4.0	-4.5	9.7	-3.1	-1.2	3.1	23.8	3.1	10.6
Labor costs in manufacturing (nominal, per hour)	4.0	3.1	6.8	2.2	1.8	6.5	4.4	7.0	9.2
Producer price index (PPI) in industry	0.6	-0.3	5.5	-0.3	-0.2	1.1	3.6	7.5	9.9
Consumer price index (here: HICP)	1.7	-0.3	2.0	-0.6	-0.9	-0.6	2.1	2.3	4.5
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	4.5	5.0	4.8	5.2	5.1	5.7	4.4	4.5	4.5
Employment rate (%, 15–64 years)	71.9	70.9	71.5	70.8	71.1	68.1	71.9	73.4	72.4
Key interest rate per annum (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Nominal year-on-year change in the period-end stock in %</i>									
Loans to the domestic nonbank private sector ¹	4.3	4.3	4.3	0.1	-1.0	-1.9	0.9	2.2	5.6
of which: loans to households	5.8	5.8	5.8	1.2	0.1	0.8	2.9	3.6	5.0
loans to nonbank corporations	2.8	2.8	2.8	-1.0	-2.2	-4.5	-1.1	0.7	6.2
<i>%</i>									
Share of foreign currency loans in total loans to the nonbank private sector	1.7	1.4	1.1	1.5	1.4	1.3	1.2	1.2	1.1
Return on assets (banking sector)	1.3	1.0	1.1	1.2	1.0	0.8	1.0	1.0	1.1
Tier 1 capital ratio (banking sector)	17.8	16.7	16.8	18.2	16.7	16.5	17.0	17.0	16.8
NPL ratio (banking sector)	2.2	1.9	0.8	1.8	1.9	1.8	1.0	0.9	0.8
<i>% of GDP</i>									
General government revenues	43.8	43.5	43.9	..	..	..	..	..	..
General government expenditures	43.3	51.3	49.1	..	..	..	..	..	..
General government balance	0.4	-7.8	-5.2	..	..	..	..	..	..
Primary balance	2.2	-6.2	-3.9	..	..	..	..	..	..
Gross public debt	65.6	79.8	74.7	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	48.0	47.8	46.0	..	..	..	..	..	..
Debt of households and NPISHs ² (nonconsolidated)	26.9	27.8	26.5	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Goods balance	2.7	5.0	1.0	5.7	4.3	4.6	1.6	-0.3	-1.3
Services balance	6.0	4.3	4.6	4.6	4.3	4.3	3.8	5.3	5.0
Primary income	-1.7	-0.9	-1.3	-3.0	0.1	-0.9	-1.0	-1.5	-1.7
Secondary income	-1.1	-1.0	-1.0	-0.8	-0.8	-1.6	-0.8	-0.7	-0.9
Current account balance	6.0	7.4	3.3	6.5	7.8	6.5	3.6	2.8	1.0
Capital account balance	-0.4	-0.5	0.1	-0.2	-1.1	1.2	-0.1	0.7	-1.4
Foreign direct investment (net) ³	-1.6	0.6	-1.0	-1.8	4.4	-1.6	-4.0	-2.0	3.4
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	91.5	101.9	97.0	101.2	101.9	106.4	101.6	103.2	97.0
Gross official reserves (excluding gold)	1.6	1.9	3.5	1.8	1.9	2.0	2.0	3.4	3.5
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	0.3	0.3	0.5	0.3	0.3	0.4	0.3	0.5	0.5
<i>EUR million, period total</i>									
GDP at current prices	48,397	46,918	52,020	12,308	12,275	11,667	13,027	13,359	13,967

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

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

- = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

4 Bulgaria: economic growth disappointed in 2021, and strong energy dependence on Russia and high inflation pose challenges

After soaring COVID-19 infection numbers in fall 2021, the new year also started with a surge in infections, driven by the spread of the Omicron variant. The level of vaccine hesitancy remains high and the vaccination rate in Bulgaria – at 30% – is still the lowest in all EU countries. Whether the recently started campaign on the benefits of vaccinations will be successful remains to be seen.

Bulgaria went through a difficult political year in 2021: After two failed attempts to form a government, the country held its third round of general elections that year on November 14, 2021. A new four-party coalition government under Prime Minister Kiril Petkov was approved by parliament in December.

In spite of high political uncertainty and high infection numbers in fall, GDP growth recovered to 4.2% in 2021. Not only a strong second quarter, but also a dynamic second half of the year – with private consumption as the main driver – supported the recovery. However, the recovery fell somewhat short of expectations, with declines in investments dragging on growth.

HICP inflation started to pick up in the fourth quarter of 2021 and continued its rise in 2022: Inflation hit a new high in February with 8.4%, predominantly driven by energy prices. In order to tackle the impact of rising energy prices, a freeze on utility prices for households and compensations for businesses were established in end-2021. Despite the newly emerging energy crisis triggered by the war in Ukraine, only the latter had been extended beyond March. At the same time, the Bulgarian energy and water regulatory commission has recently approved increases in the price of natural gas, following sharp price increases on the world market and a restriction on withdrawing gas from the national storage facility that has been imposed to secure reserves in preparation for a worsening energy crisis.

The war in Ukraine is strongly affecting Bulgaria. With 77% of natural gas imports coming from Russia, Bulgaria is highly dependent on Russian gas. Also, the country's sole oil refinery, which covers more than 60% of its domestic demand, is owned by Russia's Lukoil. In order to improve energy security, the state-owned gas operator launched procurement procedures to expand the underground gas storage facility Chiren. This is part of the country's energy strategy, together with the modernization of the distribution infrastructure and the construction of a connection to the liquified natural gas terminal in Alexandroupolis (Greece), in which Bulgaria holds a 20% share. The war is likely also to weigh on the upcoming summer tourism season: with a shortfall of Russian and Ukrainian tourists and the geographical proximity to the war, a recovery of tourism is likely to be further postponed.

Because of political uncertainty until end-2021, the budget for 2022 was only approved in February 2022. A budget deficit of 4.1% of GDP is expected. The budget foresees sizable infrastructure investments, as well as spending increases in the areas of education, health and social protection. Pensions, minimum wages as well as social benefits have been raised by the new government, but if inflation remains elevated these might barely translate into real gains. Adding to the stimuli created by the expansionary budget, also the access to the NextGenerationEU funds will fuel the country's investments. On April 7, 2022, the European Commission endorsed Bulgaria's national recovery and resilience plan, unlocking a total of EUR 6.3 billion in grants.

The Bulgarian government continues to plan for euro adoption by 1 January 2024.

Table 4

Main economic indicators: Bulgaria

	2019	2020	2021	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	4.0	-4.4	4.2	-2.9	-4.1	0.2	6.5	3.9	5.6
Private consumption	6.0	-0.4	8.0	4.1	-1.5	5.4	9.3	8.3	8.7
Public consumption	2.0	8.3	4.0	7.4	10.8	6.2	1.4	6.3	2.7
Gross fixed capital formation	4.5	0.6	-11.0	4.5	6.9	-6.1	-4.8	-14.5	-15.5
Exports of goods and services	4.0	-12.1	9.9	-16.3	-12.4	-2.0	22.0	7.9	13.8
Imports of goods and services	5.2	-5.4	12.2	-7.6	0.3	4.6	21.8	12.5	10.9
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	4.7	0.1	5.2	4.2	3.1	3.9	6.4	6.0	4.5
Net exports of goods and services	-0.7	-4.4	-1.1	-6.9	-7.2	-4.2	0.2	-1.7	0.9
Exports of goods and services	2.6	-7.7	5.5	-11.3	-7.0	-1.3	11.5	4.4	6.7
Imports of goods and services	-3.3	3.3	-6.5	4.4	-0.2	-2.9	-11.3	-6.1	-5.8
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	3.1	9.4	5.4	8.3	11.2	5.9	3.0	7.9	5.0
Unit labor costs in manufacturing (nominal, per hour)	6.6	-0.1	0.9	-5.7	-4.8	-5.2	-4.5	7.7	6.9
Labor productivity in manufacturing (real, per hour)	4.9	5.2	6.0	3.6	8.7	3.7	6.6	7.4	6.3
Labor costs in manufacturing (nominal, per hour)	11.9	4.9	7.3	-2.2	3.5	-1.7	1.8	15.6	13.6
Producer price index (PPI) in industry	3.0	-2.0	15.5	-2.8	-2.1	3.6	12.1	17.4	28.9
Consumer price index (here: HICP)	2.5	1.2	2.8	0.6	0.3	0.2	2.2	2.9	6.0
EUR per 1 BGN, + = BGN appreciation	0.0	0.0	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)	4.3	5.2	5.3	4.9	5.3	6.4	5.7	4.6	4.6
Employment rate (%, 15–64 years)	70.1	68.5	68.2	69.6	68.8	66.9	67.8	69.5	68.5
Key interest rate per annum (%) ¹	..	..	..	..	..	..	..	..	..
BGN per 1 EUR	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
<i>Nominal year-on-year change in the period-end stock in %</i>									
Loans to the domestic nonbank private sector ²	9.4	9.4	9.4	5.8	4.3	4.6	6.3	7.5	8.6
of which: loans to households	9.5	9.5	9.5	7.5	6.6	7.1	10.4	11.8	13.4
loans to nonbank corporations	9.3	9.3	9.3	4.7	2.9	3.0	3.7	4.8	5.5
<i>%</i>									
Share of foreign currency loans in total loans to the non-bank private sector	33.2	31.9	29.3	31.6	31.9	31.6	30.9	30.2	29.3
Return on assets (banking sector)	1.5	0.7	1.1	0.8	0.7	1.1	1.0	1.1	1.1
Tier 1 capital ratio (banking sector)	19.5	22.1	22.0	22.3	22.1	21.9	22.3	21.8	22.0
NPL ratio (banking sector)	4.2	4.3	3.7	4.9	4.3	4.1	4.0	3.8	3.7
<i>% of GDP</i>									
General government revenues	38.4	38.1	39.0	..	..	..	..	..	..
General government expenditures	36.3	42.0	43.1	..	..	..	..	..	..
General government balance	2.1	-4.0	-4.1	..	..	..	..	..	..
Primary balance	2.7	-3.4	-3.6	..	..	..	..	..	..
Gross public debt	20.0	24.7	25.1	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	78.5	78.9	72.6	..	..	..	..	..	..
Debt of households and NPISHs ³ (nonconsolidated)	23.0	24.4	24.9	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Goods balance	-4.7	-3.2	-4.9	-2.5	-5.3	-3.7	-4.0	-3.6	-7.5
Services balance	7.9	5.0	6.6	5.9	3.9	5.4	6.7	9.1	5.1
Primary income	-4.2	-3.4	-3.3	-3.9	-2.6	-3.7	-3.4	-2.1	-4.0
Secondary income	2.9	1.4	1.1	0.5	-0.4	2.2	1.9	1.1	-0.4
Current account balance	1.8	-0.3	-0.4	0.0	-4.4	0.3	1.3	4.5	-6.8
Capital account balance	1.4	1.5	0.7	1.5	1.3	1.6	1.4	0.6	-0.4
Foreign direct investment (net) ⁴	-2.0	-3.4	-1.7	-8.5	-0.3	-1.5	-1.9	-1.9	-1.4
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	61.3	64.6	61.8	65.0	64.6	63.1	62.5	63.3	61.8
Gross official reserves (excluding gold)	37.5	47.0	47.9	47.4	47.0	43.3	43.6	46.5	47.9
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	7.4	10.4	9.2	10.2	10.4	9.4	8.9	9.3	9.2
<i>EUR million, period total</i>									
GDP at current prices	61,558	61,331	67,872	16,681	17,274	13,813	15,941	18,475	19,643

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

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

- = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

5 Croatia: excellent recovery momentum in 2021, but murky outlook

Croatia's GDP expanded by 12.4% year on year in the second half of 2021, leading to GDP growth of 10.2% for the full year. Recovery momentum was dynamic, with real GDP surpassing its 2019 level. Strong contributions to growth in the second half of 2021 came from household consumption and net exports, while gross fixed investments made a smaller but positive contribution; changes in inventories made a large negative contribution. On the output side, all sectors expanded, with particularly high growth in the largest sector, wholesale and retail trade, but also strong growth in the ICT sector and in professional, scientific and technical activities. The tourism industry, a vital factor for Croatia's economy, did well in 2021, with tourist arrivals in the peak summer season noticeably above 2019 levels. This contributed to a recovery in the service trade balance compared to 2020 and thus a current account surplus of 3.4% of GDP in 2021.

GDP growth was supported by the fiscal and monetary policy stance. During the second half of 2021, the government largely wound down its job preservation support, but given accelerating inflation, temporary caps on fuel retail prices were implemented at the end of 2021. The government budget deficit was 4.1% of GDP in 2021, roughly as projected. Government debt declined from 87.3% of GDP to 82.3%, as GDP growth surpassed the growth of debt. Croatia's external debt decreased from 79.9% of GDP at end-2020 to 78% of GDP at end-2021. During the second half of 2021, the Croatian National Bank (HNB) did not have to conduct foreign exchange interventions to maintain the exchange rate of the kuna vis-à-vis the euro, and international reserves continued to grow. The precautionary swap line with the ECB expired at the end of March 2022.

The Croatian banking system's profitability improved, with return on assets increasing from 0.6% in 2020 to 1.2% in 2021. The improvement was mostly due to lower net provisions. The tier 1 capital ratio of the banking system stood at the high level of 25.1% at end-2021. The NPL ratio declined mildly throughout 2021 and was 4.3% at end-2021; however, the share of loans with elevated credit risk (IFRS 9 "Stage 2") remained high. The European Systemic Risk Board issued a warning regarding residential real estate dynamics at the end of 2021.

Croatia has accelerated its preparations for its targeted euro adoption on January 1, 2023. In late March 2022, the Croatian government announced that all commitments made under the ERM II Action Plan had been completed. If Croatia will get the green light for euro adoption in 2023 will become clear in mid-2022. Croatian HICP inflation has accelerated quickly to 6.3% in February 2022, shifting the focus of attention for the Convergence Reports to inflation.

Inflation is also an issue for Croatia's private sector, creating uncertainty and eroding spending power. In February 2022, the Croatian government passed a large package (HRK 4.8 billion; about 1.1% of GDP) with measures to mitigate the impacts of inflation. These measures include several VAT rate cuts, energy price regulations and targeted subsidies for households and sectors.

The ongoing war in Ukraine is worsening the outlook for inflation and, generally, economic growth. So far, an immediate policy response has been necessary in financial markets, with the HNB intervening twice to stabilize the kuna, providing liquidity to banks via its regular operations and resolving Sberbank d.d. by sale after assessment by the Single Resolution Board (SRB) that the bank was failing or likely to fail. Further policy action may become necessary, depending on the extent of energy price surges or even energy shortages, supply chain disruptions and weaker economic growth in important trading partners.

Table 5

Main economic indicators: Croatia

	2019	2020	2021	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	3.5	-8.1	10.2	-10.1	-7.4	-0.6	16.4	15.1	9.7
Private consumption	4.1	-5.3	10.0	-6.5	-3.7	-0.2	17.9	15.8	7.6
Public consumption	3.3	4.1	3.1	5.6	2.9	-5.8	8.5	-4.5	14.4
Gross fixed capital formation	9.8	-6.1	7.6	-4.2	-3.8	5.0	18.1	7.6	0.8
Exports of goods and services	6.8	-22.7	33.3	-31.1	-7.2	-1.0	43.0	48.8	31.7
Imports of goods and services	6.5	-12.3	14.7	-12.0	-5.5	-0.7	32.2	13.9	16.4
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	3.4	-2.8	3.4	5.5	-6.9	0.8	16.6	-6.7	4.7
Net exports of goods and services	0.1	-5.3	6.8	-17.2	-0.2	0.0	0.5	20.6	4.3
Exports of goods and services	3.4	-11.5	14.0	-22.8	-3.0	-0.3	15.2	26.9	12.9
Imports of goods and services	-3.3	6.3	-7.2	5.5	2.8	0.4	-14.7	-6.3	-8.5
<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 manufacturing (nominal, per hour)	11.4	2.5	-0.7	1.1	-2.6	-3.0	-7.4	2.9	5.2
Labor productivity in manufacturing (real, per hour)	-7.2	-2.4	4.0	-1.6	2.9	4.9	9.6	2.2	-0.4
Labor costs in manufacturing (nominal, per hour)	3.6	-0.1	3.3	-0.5	0.3	1.7	1.5	5.1	4.7
Producer price index (PPI) in industry	0.8	-3.2	11.7	-4.2	-2.9	0.9	8.0	13.1	24.6
Consumer price index (here: HICP)	0.8	0.0	2.7	-0.5	-0.2	0.7	2.2	3.1	4.6
EUR per 1 HRK, + = HRK appreciation	0.0	-1.6	0.1	-1.8	-1.6	-1.1	0.7	0.4	0.6
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	6.7	7.6	7.6	7.5	9.2	10.0	7.9	6.3	6.3
Employment rate (%, 15–64 years)	62.1	62.0	63.4	63.0	61.5	61.4	63.6	64.6	64.1
Key interest rate per annum (%)	..	..	..	..	..	..	..	..	..
HRK per 1 EUR	7.4	7.5	7.5	7.5	7.6	7.6	7.5	7.5	7.5
<i>Nominal year-on-year change in the period-end stock in %</i>									
Loans to the domestic nonbank private sector ¹	3.4	3.4	3.4	3.0	2.8	1.3	2.4	2.8	2.4
of which: loans to households	6.7	6.7	6.7	3.2	1.6	1.9	3.7	4.5	4.1
loans to nonbank corporations	-1.3	-1.3	-1.3	2.8	4.8	0.4	0.5	0.2	-0.1
%									
Share of foreign currency loans in total loans to the nonbank private sector	51.5	52.0	52.2	51.1	52.0	52.1	51.8	51.5	52.2
Return on assets (banking sector)	1.4	0.6	1.2	0.7	0.6	0.9	1.1	1.1	1.2
Tier 1 capital ratio (banking sector)	24.0	25.0	25.1	24.3	25.0	24.6	25.0	25.2	25.1
NPL ratio (banking sector)	5.5	5.4	4.3	5.5	5.4	5.3	5.1	4.7	4.3
%									
General government revenues	46.3	47.2	47.2	..	..	..	..	..	..
General government expenditures	46.0	54.5	51.2	..	..	..	..	..	..
General government balance	0.3	-7.4	-4.1	..	..	..	..	..	..
Primary balance	2.5	-5.4	-2.4	..	..	..	..	..	..
Gross public debt	71.1	87.3	82.3	..	..	..	..	..	..
%									
Debt of nonfinancial corporations (nonconsolidated)	84.5	93.5	83.8	..	..	..	..	..	..
Debt of households and NPISHs ² (nonconsolidated)	33.7	37.6	34.4	..	..	..	..	..	..
%									
<i>% of GDP (based on EUR), period total</i>									
Goods balance	-18.8	-17.3	-18.1	-15.9	-16.8	-20.4	-18.8	-17.2	-16.6
Services balance	18.5	10.6	17.2	26.6	5.0	3.4	9.6	41.6	8.7
Primary income	-0.1	2.3	0.3	0.3	5.3	1.1	-0.2	-0.8	1.4
Secondary income	3.4	4.4	4.0	3.9	4.7	5.9	3.7	3.5	3.4
Current account balance	3.0	-0.1	3.4	14.9	-1.8	-10.0	-5.7	27.0	-3.1
Capital account balance	1.6	2.1	2.4	1.8	2.7	2.1	2.5	2.1	2.9
Foreign direct investment (net) ³	-6.1	-1.3	-5.0	-1.7	0.5	-3.5	-2.7	-7.4	-5.6
%									
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	72.2	79.9	78.0	79.9	79.9	86.9	84.4	80.0	78.0
Gross official reserves (excluding gold)	33.3	37.8	43.7	35.6	37.8	42.2	41.1	44.0	43.7
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	7.8	9.3	9.8	8.8	9.3	10.3	9.7	10.2	9.8
<i>EUR million, period total</i>									
GDP at current prices	55,577	50,192	57,216	13,463	12,622	12,331	14,037	16,415	14,434

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

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

- = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

6 Czechia: fragile recovery set back by a new war-induced shock

Czechia was faced with two large waves of COVID-19 infections in fall 2021 and in early 2022. Despite the massive spread of the virus, anti-pandemic measures and restrictions were not significantly tightened. On the contrary, most of them have been removed since the new government took office mid-December 2021. As a result, the harm to the Czech economy has been contained compared to previous waves. Real GDP thus saw a steady though not exuberant recovery and nearly reached its pre-pandemic level by the end of 2021. The economy expanded by nearly 3.5% year on year in the second half of 2021 and the year as a whole. The lion's share of growth was again, quite untypically, attributable to the buildup of inventories. This was due to persisting disruptions to supply chains which strongly affected the highly industrialized Czech economy, particularly its automotive industry. Unfinished products were thus produced on stock to be finished upon arrival of the missing components. Private consumption provided the second-most important contribution to growth in the six months to December, to a large extent owing to the low base caused by lockdowns a year earlier. Household consumption also benefited from pent-up demand and savings as well as rising nominal disposable income on the back of labor market tightening. Fixed capital formation was subdued, dampened by production and supply chain disruptions, elevated raw material and input prices as well as still muted external demand. The latter, in combination with stockpiling and the relatively strong domestic demand, caused net exports to make a deeply negative contribution to growth. Despite some easing of the chip shortages, bottlenecks in global supply chains have continued since the start of 2022. Moreover, the Russian invasion of Ukraine has exacerbated the situation by creating new interruptions of supplies and further ballooning inflation.

A lower surplus in goods trade and a higher primary income deficit on the back of revived outflow of dividends, caused a current account deficit in the second half of 2021, bringing the full-year balance into slightly negative territory.

The general government deficit came in at 5.9% of GDP in 2021. Despite expenditures significantly exceeding revenues owing to high pandemic-related expenses, the abolition of the “super gross wage” and relatively moderate economic growth, the deficit turned out significantly smaller than had been mandated by the parliament. Public debt increased to 41.9% of GDP in 2021. Thanks to government support schemes, the harm of the economic downturn remained contained in the labor market. Moreover, driven by strengthening demand for labor, the unemployment rate declined from its pandemic peak (3.4%) in March 2021 to 2.1% by year-end and has increased only marginally since.

Inflation has sped up dramatically since late summer and reached 10% in February, well above the target set by the Czech National Bank (CNB) ($2\% \pm 1$ percentage point). Both consumer and producer price inflation have reached levels unseen since the beginning of transition. The mounting inflation pressure has been broadly based as persistently high core inflation has received a further boost by soaring energy and administered prices. Core inflation has echoed a substantial discrepancy between excess demand fostered by fiscal support measures, robust wage growth and, until recently, loose monetary policy, on the one hand, and rather constrained supplies, on the other. The war in Ukraine will exacerbate price pressures but the monetary policy response has been vigorous. Since the CNB started its tightening cycle last summer it has continued its hawkish stance: In only seven steps – some of them unprecedentedly large – it raised the key interest rate from 0.25% in June 2021 to 5% effective from April 1, 2022.

Table 6

Main economic indicators: Czechia

	2019	2020	2021	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	3.0	-5.8	3.3	-5.7	-5.3	-2.6	9.3	3.2	3.7
Private consumption	2.7	-6.8	4.4	-5.1	-9.8	-6.2	8.7	5.9	9.4
Public consumption	2.5	3.4	3.0	0.4	7.0	0.4	1.7	7.2	2.6
Gross fixed capital formation	5.9	-7.5	0.6	-9.0	-11.3	-4.1	4.5	0.8	0.9
Exports of goods and services	1.5	-6.9	5.1	-4.6	3.5	2.6	32.2	-3.2	-5.2
Imports of goods and services	1.5	-6.9	11.5	-6.5	-0.7	4.1	33.4	8.2	4.5
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	3.0	-5.3	7.1	-6.7	-8.4	-1.8	8.8	10.5	10.7
Net exports of goods and services	0.0	-0.5	-3.8	1.0	3.0	-0.8	0.6	-7.3	-7.1
Exports of goods and services	1.1	-5.1	3.6	-3.2	2.6	1.9	19.9	-2.2	-4.0
Imports of goods and services	-1.1	4.7	-7.4	4.2	0.5	-2.7	-19.4	-5.1	-3.1
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	4.3	7.7	2.3	6.4	10.2	3.4	1.5	4.2	0.3
Unit labor costs in manufacturing (nominal, per hour)	9.1	2.3	-2.5	-1.7	-5.4	-5.2	-14.6	5.5	5.8
Labor productivity in manufacturing (real, per hour)	-0.8	2.7	6.7	3.8	11.5	8.1	18.4	1.5	0.9
Labor costs in manufacturing (nominal, per hour)	8.2	4.7	4.5	2.0	5.4	2.5	1.1	7.1	6.8
Producer price index (PPI) in industry	1.7	0.6	6.2	0.1	1.1	2.3	3.3	8.1	11.0
Consumer price index (here: HICP)	2.6	3.3	3.3	3.5	2.7	2.2	2.8	3.3	5.0
EUR per 1 CZK, + = CZK appreciation	-0.1	-3.0	3.2	-2.8	-4.1	-1.7	5.6	3.8	5.1
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	2.1	2.6	2.9	2.9	3.1	3.4	3.1	2.8	2.3
Employment rate (%, 15–64 years)	75.1	74.4	74.4	74.4	74.3	73.6	73.7	75.0	75.3
Key interest rate per annum (%)	1.9	0.8	0.9	0.3	0.3	0.3	0.3	0.7	2.4
CZK per 1 EUR	25.7	26.5	25.6	26.5	26.7	26.1	25.6	25.5	25.4
<i>Nominal year-on-year change in the period-end stock in %</i>									
Loans to the domestic nonbank private sector ¹	5.0	5.0	5.0	3.5	3.0	2.6	4.4	6.3	9.7
of which: loans to households	6.1	6.1	6.1	6.3	6.5	6.9	8.1	9.1	9.9
loans to nonbank corporations	3.8	3.8	3.8	0.1	-1.3	-2.7	-0.3	2.8	9.4
%									
Share of foreign currency loans in total loans to the non-bank private sector	14.5	14.6	14.6	16.1	14.6	14.8	13.5	14.1	14.6
Return on assets (banking sector)	1.2	0.6	0.8	0.6	0.6	0.5	0.7	0.8	0.8
Tier 1 capital ratio (banking sector)	20.8	23.6	22.8	22.6	23.6	23.4	23.9	23.2	22.8
NPL ratio (banking sector)	2.4	2.6	2.3	2.2	2.6	2.6	2.6	2.5	2.3
%									
General government revenues	41.4	41.6	40.5	..	..	..	..	..	..
General government expenditures	41.1	47.3	46.4	..	..	..	..	..	..
General government balance	0.3	-5.8	-5.9	..	..	..	..	..	..
Primary balance	1.0	-4.9	-5.2	..	..	..	..	..	..
Gross public debt	30.1	37.7	41.9	..	..	..	..	..	..
%									
Debt of nonfinancial corporations (nonconsolidated)	55.1	56.4	53.2	..	..	..	..	..	..
Debt of households and NPISHs ² (nonconsolidated)	31.7	34.1	35.6	..	..	..	..	..	..
%									
<i>% of GDP (based on EUR), period total</i>									
Goods balance	4.1	5.0	1.2	5.4	7.3	6.6	2.7	-2.0	-1.7
Services balance	1.8	1.8	1.8	2.1	0.6	1.7	2.1	1.9	1.6
Primary income	-5.0	-2.7	-3.3	-1.0	-6.7	-1.9	-3.6	-4.7	-2.9
Secondary income	-0.6	-0.5	-0.5	-0.7	-0.1	-1.6	0.2	-0.5	-0.2
Current account balance	0.3	3.6	-0.9	5.8	1.2	4.8	1.3	-5.3	-3.3
Capital account balance	0.4	1.3	1.6	1.3	0.8	-0.1	1.6	2.4	2.1
Foreign direct investment (net) ³	-2.4	-1.3	-0.1	1.5	-4.4	2.4	-2.1	-0.7	0.3
%									
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	76.5	76.1	75.3	73.6	76.1	76.7	73.7	73.8	75.3
Gross official reserves (excluding gold)	59.0	62.7	64.0	61.5	62.7	64.7	62.2	62.8	64.0
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	10.4	11.7	11.0	11.5	11.7	12.0	11.1	11.0	11.0
<i>EUR million, period total</i>									
GDP at current prices	225,579	215,272	238,824	55,130	56,823	53,249	60,103	61,752	63,721

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

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

7 Hungary: economy bounced back in 2021 but inflation is soaring

Economic growth bounced back to 7.1% year on year in 2021. Both domestic consumption and investment growth accelerated in the second half of 2021, though the latter only did so because of a weak base. Economic expansion was underpinned by the strengthening of economic sentiment, improving export prospects, rising capacity utilization in industry, improving consumer confidence, fiscal measures (e.g. pension hike, investment spending, regional development outlays) and prospects for more fiscal support in the 2022 budget. But the sharp acceleration of inflation started to eat into real wages even though nominal wages were growing at a double-digit rate; the negative effect on consumption was mitigated by healthy employment growth. The strengthening of domestic demand was accompanied by a negative contribution of net exports to growth in the second half of 2021.

Hungary's budget deficit amounted to 6.8% of GDP in 2021, down from 7.8% in 2020. The deficit was particularly driven up during the last quarter of 2021 as, for example, extra pension payments were paid out. In mid-December 2021, the government decided to indefinitely postpone investment projects worth nearly 2% of GDP to increase fiscal reserves and lower the 2022 budget deficit target from 5.9% to 4.9% of GDP. At the same time, the 2022 budget foresees substantial expenditure increases and tax cuts, while rising energy prices (with household energy price caps having been in place for years), expected losses of the central bank (which need to be covered by the budget) and higher debt-servicing costs will add to the expected budget deficit. In mid-February 2022, the European Court of Justice confirmed the validity of the "rule of law" mechanism for the suspension of EU funds. Since no progress on this issue seems to have been achieved in negotiations with the EU Commission, the approval of funds to Hungary under the Recovery and Resilience Facility (RRF) is still pending.

Inflation kept accelerating and reached 8.4% in February 2022. Inflation excluding energy and unprocessed food prices also accelerated from 4.1% in August 2021 to 7.8% in February 2022. In response, the Hungarian central bank (MNB) continued its rate hiking cycle into 2022. Between September 2021 and March 2022, it raised the base rate in monthly steps from 1.65% to 4.4% to anchor medium-term inflation expectations. To stabilize short-term financial market developments, starting in late November 2021, it decoupled the interest rate on its one-week deposit facility from the base rate. This "operative" policy rate reached 6.15% in early April 2022 in reaction to the forint temporarily falling to historic lows as a result of the war in Ukraine. In order to additionally tighten monetary conditions, MNB also gradually phased out its quantitative easing programs.

In late December 2021, the government fixed the interest rate on households' mortgage loans at their end-October 2021 level for the first half of 2022. The measure will cost banks an estimated 3.7% of 2021 consolidated after-tax profit and may limit the contractionary effect of the central bank's rate hikes. On the other hand, the government has introduced temporary price caps on selected fuel and basic food prices, which – together with the long-standing fixation of household energy prices – MNB estimates to have taken around 4.2 percentage points off the headline inflation rate in March 2022.

Following the ECB's and the SRB's decision to shut down Sberbank Europe AG, MNB revoked the operating license of the Hungarian Sberbank subsidiary, ordered its winding-up and provided the deposit insurance fund with a short-term bridge loan and a repo deal. According to data at end-2020, Sberbank accounted for around 1% of total assets and 1.2% of total deposits of the banking sector.

Table 7

Main economic indicators: Hungary

	2019	2020	2021	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	4.6	-4.5	7.1	-4.1	-2.7	-1.9	17.8	6.2	7.1
Private consumption	5.0	-1.2	4.6	-1.5	-2.5	-5.5	9.5	6.5	8.0
Public consumption	4.3	-0.9	3.7	-0.3	-1.4	7.5	3.0	3.6	1.1
Gross fixed capital formation	12.8	-7.0	5.9	-13.4	1.6	-3.0	9.3	11.5	3.2
Exports of goods and services	5.4	-6.1	10.3	-3.9	3.4	5.6	36.1	2.8	2.6
Imports of goods and services	8.2	-4.0	8.7	-4.8	2.3	2.5	26.7	7.0	2.0
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	6.5	-2.6	5.7	-4.8	-3.7	-4.8	11.6	9.2	6.6
Net exports of goods and services	-2.0	-1.8	1.4	0.7	0.9	2.7	6.3	-3.0	0.5
Exports of goods and services	4.5	-5.0	8.1	-3.1	2.6	4.8	25.7	2.2	2.1
Imports of goods and services	-6.5	3.1	-6.7	3.8	-1.7	-2.0	-19.4	-5.3	-1.6
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	3.4	6.7	4.0	5.8	5.7	9.2	-2.5	4.5	5.2
Unit labor costs in manufacturing (nominal, per hour)	7.8	7.6	-0.2	2.7	-0.1	-0.6	-15.5	7.5	10.6
Labor productivity in manufacturing (real, per hour)	4.3	-0.2	5.9	2.4	6.1	4.7	20.8	0.4	0.4
Labor costs in manufacturing (nominal, per hour)	12.5	6.8	6.4	5.2	6.0	4.0	2.1	8.0	11.1
Producer price index (PPI) in industry	2.2	4.3	13.5	4.0	6.1	8.0	10.9	14.4	20.7
Consumer price index (here: HICP)	3.4	3.4	5.2	3.8	2.9	3.3	5.3	5.0	7.1
EUR per 1 HUF, + = HUF appreciation	-2.0	-7.4	-2.0	-7.2	-7.9	-6.1	-0.8	-0.1	-1.0
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	3.5	4.3	4.1	4.5	4.2	4.5	4.1	3.9	3.7
Employment rate (%, 15–64 years)	70.1	69.7	73.1	70.2	70.2	71.8	72.8	73.6	74.1
Key interest rate per annum (%)	0.9	0.8	1.1	0.6	0.6	0.6	0.6	1.3	2.0
HUF per 1 EUR	325.2	351.2	358.5	353.6	360.5	361.0	354.7	353.9	364.3
<i>Nominal year-on-year change in the period-end stock in %</i>									
Loans to the domestic nonbank private sector ¹	12.5	12.5	12.5	10.3	11.0	8.7	10.5	11.6	12.0
of which: loans to households	15.5	15.5	15.5	14.9	14.1	13.4	15.5	16.1	15.0
loans to nonbank corporations	10.4	10.4	10.4	7.1	8.8	5.4	6.8	8.3	9.8
%									
Share of foreign currency loans in total loans to the non-bank private sector	23.8	22.3	20.3	23.4	22.3	21.9	20.0	20.3	20.3
Return on assets (banking sector)	1.2	0.4	1.0	0.5	0.4	1.1	1.3	1.2	1.0
Tier 1 capital ratio (banking sector)	16.4	17.4	17.1	15.8	17.4	17.3	17.2	16.6	17.1
NPL ratio (banking sector)	2.6	2.4	1.7	2.8	2.4	2.3	2.2	1.8	1.7
%									
<i>% of GDP</i>									
General government revenues	43.9	43.4	41.1	..	..	..	..	..	..
General government expenditures	46.0	51.2	47.9	..	..	..	..	..	..
General government balance	-2.1	-7.8	-6.8	..	..	..	..	..	..
Primary balance	0.1	-5.5	-4.5	..	..	..	..	..	..
Gross public debt	65.5	79.6	76.8	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	62.7	67.6	72.2	..	..	..	..	..	..
Debt of households and NPISHs ² (nonconsolidated)	18.2	20.0	20.1	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Goods balance	-2.5	-0.9	-2.5	-0.2	0.0	3.7	-1.3	-6.0	-4.9
Services balance	4.9	3.0	3.2	4.1	2.2	2.1	3.6	4.2	2.9
Primary income	-2.5	-2.6	-3.2	-2.8	-2.5	-4.0	-2.9	-3.3	-2.9
Secondary income	-0.5	-0.6	-0.6	-0.2	-0.3	-0.8	-0.7	-0.3	-0.7
Current account balance	-0.7	-1.1	-3.1	0.9	-0.5	1.2	-1.3	-5.4	-5.7
Capital account balance	1.8	2.0	2.5	2.1	2.1	2.0	1.6	1.8	4.3
Foreign direct investment (net) ³	-0.7	-1.7	-1.4	-1.7	0.5	-0.1	0.3	-1.8	-3.5
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	72.6	80.1	82.3	80.1	80.1	85.9	83.2	85.5	82.3
Gross official reserves (excluding gold)	18.5	23.4	21.7	22.0	23.4	20.2	18.2	22.6	21.7
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	2.8	3.6	3.2	3.4	3.6	3.1	2.8	3.4	3.2
<i>EUR million, period total</i>									
GDP at current prices	145,983	137,300	154,121	35,099	38,334	32,121	38,838	39,813	43,349

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

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

- = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

8 Poland: further rate hikes to ensure credibility and avoid second-round effects

Poland's GDP grew by 5.7% in 2021 as year-on-year growth remained high in the second half of 2021 when quarter-on-quarter growth averaged 2%, far above average quarter-on-quarter growth in the two years before the pandemic. While both domestic and foreign demand contributed substantially to growth throughout the year, domestic demand grew at a faster pace, causing import growth to outpace export growth. Thus, 2021 saw a negative contribution of net exports to annual GDP growth that increased up to the fourth quarter. Correspondingly, the surplus in the goods and services balance melted down considerably to 2.1% in the fourth quarter of 2021, almost exclusively due to the trade balance, and in parallel, the current account surplus turned into a deficit of 2.9% of GDP. The capital account surplus (thanks to EU funds) declined somewhat, while net FDI inflows rose in full-year terms. Within domestic demand, both private consumption and gross fixed capital formation showed strong average growth in the second half of 2021. In addition, the accelerated buildup of inventory lifted growth substantially. These developments reflected demand that had been pent up because of the pandemic, rising employment and substantially improved consumer and business confidence. Already in late 2021, however, the military buildup by the Russian leadership and the intensifying tensions started to affect consumer and business confidence indicators in Poland. The especially strong real growth of retail sales in early 2022 may have been related not only to base effects but also to precautionary motives. At the same time, real wage growth slowed down moderately in the review period.

In manufacturing, nominal unit labor cost (ULC) in Poland was unchanged in the second half of 2021 against the previous year, while nominal ULC was slightly higher in the euro area. The exchange rate further enhanced Poland's external competitiveness, as the złoty's value in euro was lower than a year earlier in that period. Thereafter, the złoty depreciated against the euro by about 4.5% in March in the wake of Russia's invasion of Ukraine.

According to HICP (and national CPI) definition, annual headline inflation rose from 4.1% (4.4%) in June to 8.0% (8.6%) in December and further to 10.2% (11.0%) in March. In parallel, core inflation increased from 3.1% (3.5%) in June to 7.5% (6.9%) in March, also markedly accelerating in month-on-month terms in early 2022. Services continued to be the main inflation driver within core inflation. The Polish central bank's Monetary Policy Council (MPC), pursuing a CPI inflation target of $2.5\% \pm 1$ percentage point, hiked its main policy rate in monthly steps from October to April, bringing it to 4.5%, having kept it at 0.1% during the pandemic. In mid-November 2021, the MPC conducted its last outright purchases of government(-guaranteed) debt securities in the secondary market for the time being. In April 2022, the MPC stated that its recent rate hike served to reduce the persisting risk of inflation running above the target in the medium term and to curb inflation expectations. Further decisions would depend on incoming information, including the impact of the Russian military aggression against Ukraine. The MPC will take all necessary actions to ensure macroeconomic and financial stability and it may intervene in the foreign exchange market, in particular to limit fluctuations of the złoty inconsistent with the direction of monetary policy.

Regarding fiscal policy, the general government deficit declined from 6.9% of GDP in 2020 to 1.9% in 2021, benefiting from higher nominal growth. General government debt declined from 57.1% of GDP in 2020 to 53.8% of GDP in 2021.

Table 8

Main economic indicators: Poland

	2019	2020	2021	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	4.7	-2.5	5.7	-1.7	-2.6	-1.2	10.8	5.6	7.7
Private consumption	3.9	-2.9	6.0	0.3	-3.0	-0.2	13.2	4.6	7.7
Public consumption	6.5	4.9	1.1	3.6	8.2	1.1	2.7	1.4	-0.3
Gross fixed capital formation	6.1	-9.0	7.9	-7.0	-15.3	1.3	5.2	9.1	12.3
Exports of goods and services	5.2	0.1	12.0	2.2	8.2	6.8	29.0	8.6	6.7
Imports of goods and services	3.0	-1.2	17.4	0.7	8.5	10.8	34.4	14.9	13.1
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	3.5	-3.2	7.6	-2.6	-2.8	0.3	11.3	8.3	10.4
Net exports of goods and services	1.3	0.7	-1.9	0.8	0.3	-1.6	-0.3	-2.7	-2.7
Exports of goods and services	2.9	0.1	6.7	1.2	4.2	4.0	15.3	4.9	3.8
Imports of goods and services	-1.6	0.6	-8.6	-0.4	-3.9	-5.5	-15.6	-7.6	-6.5
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	2.4	6.3	1.9	4.3	7.1	7.4	-0.9	1.5	-0.2
Unit labor costs in manufacturing (nominal, per hour)	4.2	4.9	-4.6	-1.1	-0.8	-4.1	-13.0	0.6	-0.7
Labor productivity in manufacturing (real, per hour)	2.4	1.6	12.9	4.9	7.2	10.2	23.0	9.2	10.2
Labor costs in manufacturing (nominal, per hour)	6.7	6.2	8.0	3.7	6.4	5.7	7.1	9.8	9.4
Producer price index (PPI) in industry	1.4	-0.5	8.1	-1.1	-0.1	2.6	6.6	9.6	13.6
Consumer price index (here: HICP)	2.1	3.7	5.2	3.7	3.6	3.9	4.6	5.1	7.3
EUR per 1 PLN, + = PLN appreciation	-0.9	-3.3	-2.6	-2.7	-4.9	-4.9	-0.6	-2.8	-2.4
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	3.4	3.2	3.4	3.3	3.2	4.1	3.6	3.1	2.9
Employment rate (%, 15–64 years)	68.2	68.7	70.3	69.0	69.4	69.2	70.0	71.0	71.0
Key interest rate per annum (%)	1.5	0.5	0.3	0.1	0.1	0.1	0.1	0.1	1.1
PLN per 1 EUR	4.3	4.4	4.6	4.4	4.5	4.5	4.5	4.6	4.6
<i>Nominal year-on-year change in the period-end stock in %</i>									
Loans to the domestic nonbank private sector ¹	5.0	5.0	5.0	-0.8	-1.2	-2.2	0.3	2.6	5.1
of which: loans to households	5.6	5.6	5.6	2.1	1.6	1.3	3.0	4.0	4.3
loans to nonbank corporations	4.1	4.1	4.1	-5.6	-6.0	-8.0	-4.4	-0.1	6.5
%									
Share of foreign currency loans in total loans to the non-bank private sector	19.2	19.6	17.5	19.6	19.6	19.3	18.1	18.0	17.5
Return on assets (banking sector)	0.7	0.0	0.4	0.4	0.0	0.4	0.5	0.5	0.4
Tier 1 capital ratio (banking sector)	17.0	18.5	17.3	18.5	18.5	18.6	18.5	18.0	17.3
NPL ratio (banking sector)	6.6	7.0	5.7	7.0	7.0	6.7	6.5	6.3	5.7
%									
<i>% of GDP</i>									
General government revenues	41.0	41.3	42.3	..	..	..	..	..	..
General government expenditures	41.8	48.2	44.2	..	..	..	..	..	..
General government balance	-0.7	-6.9	-1.9	..	..	..	..	..	..
Primary balance	0.6	-5.6	-0.8	..	..	..	..	..	..
Gross public debt	45.6	57.1	53.8	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	44.5	44.7	43.3	..	..	..	..	..	..
Debt of households and NPISHs ² (nonconsolidated)	34.7	33.9	32.4	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Goods balance	0.3	2.4	-0.1	2.4	3.3	2.1	1.6	-1.5	-2.0
Services balance	4.5	4.4	4.6	4.3	4.0	4.9	5.0	4.6	4.1
Primary income	-4.0	-3.5	-4.5	-4.6	-4.1	-3.5	-5.1	-5.3	-3.9
Secondary income	-0.3	-0.3	-0.7	-0.2	-0.7	-1.0	-0.5	-0.2	-1.0
Current account balance	0.5	2.9	-0.6	1.9	2.5	2.5	1.0	-2.4	-2.9
Capital account balance	2.0	2.3	1.6	1.4	3.3	0.6	2.2	2.0	1.6
Foreign direct investment (net) ³	-1.9	-2.1	-3.7	-1.7	-0.6	-6.0	-1.8	-5.4	-1.8
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	59.2	58.4	56.2	57.2	58.4	59.0	57.2	57.4	56.2
Gross official reserves (excluding gold)	19.6	21.8	23.6	20.3	21.8	23.7	22.7	24.1	23.6
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	4.6	5.3	5.0	5.0	5.3	5.7	5.1	5.3	5.0
<i>EUR million, period total</i>									
GDP at current prices	533,674	523,576	569,951	131,573	144,956	129,210	136,237	141,798	162,706

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

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

- = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

9 Romania: growth weakens as inflation rises markedly, twin deficits persist

Romania's GDP grew by 6% in 2021 after shrinking by 3.8% in 2020. Yet, after a steady and relatively quick economic recovery in the first half of 2021, year-on-year GDP growth decelerated markedly in the second half of the year. A noticeable deterioration in quarter-on-quarter growth was also seen from the third to the final quarter of 2021.

After showing strong growth in the third quarter, agricultural production contracted in the final quarter of 2021. Moreover, the growth contribution coming from changes in inventories turned negative in the final quarter. Private consumption, the main growth pillar since mid-2020, remained vivid in the third quarter, largely due to the release of pent-up demand and self-consumption of agricultural products. However, as households' purchasing power was more and more eroded by rising inflation and as some COVID-19 restrictions were tightened again, private consumption growth lost momentum in quarter-on-quarter terms in the final quarter. Even though domestic credit growth accelerated in the second half of 2021 on the back of state guarantee programs, gross fixed capital formation contracted in the same period (in terms of both year-on-year and quarter-quarter growth). Though the export-oriented automotive sector was still constrained by supply chain bottlenecks, net exports delivered a slightly smaller negative contribution to growth in the second half of the year.

Nevertheless, the current account deficit did not improve and hence ended up at 7% of GDP for the full-year 2021. Compared to 2020, also the net borrowing position from the current and capital account deteriorated markedly, though the capital account surplus rose slightly. Net FDI inflows increased somewhat in 2021 and accounted for 63% of this position (compared to 43% in 2020). In contrast to the first half of 2021, unit labor costs in the manufacturing sector rose considerably in the second half of the year. At the same time, the Romanian leu weakened only slightly vis-à-vis the euro.

The general government budget deficit amounted to 6.7% of GDP in cash terms in 2021 (i.e. 7.1% of GDP in ESA terms). The general government budget plan for 2022 was based on a GDP forecast of 4.6% and envisages a deficit of 5.8% of GDP in cash terms (i.e. 6.2% of GDP in ESA terms). Public wages and compensations were frozen at the end-2021 level for all state employees except for those working in social assistance, healthcare and education. Within the framework of the excessive deficit procedure, Romania should put an end to the excessive deficit situation by 2024 at the latest and gradually reduce its deficit until then. It is worth noting that the European Commission disbursed EUR 1.8 billion to Romania in pre-financing at end-2021 (equivalent to 13% of the country's grant allocation under the Recovery and Resilience Facility). Against the background of rising energy prices, the government introduced a support scheme (including price caps for electricity and natural gas as well as subsidies) mainly for households and small companies in November 2021. The scheme was modified earlier this year and extended until end-March 2023.

Inflation moved further away from the National Bank of Romania's (NBR) upper bound of the inflation target variation band of $2.5\% \pm 1$ percentage point. Headline consumer price inflation reached 7.9% in February, while core inflation went up to 5.7%. From November 2021, the NBR hiked its key policy rate to 3% – in four steps by a total of 150 basis points.

Table 9

Main economic indicators: Romania

	2019	2020	2021	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	4.2	-3.8	6.0	-5.4	-1.5	-0.1	15.4	6.9	2.4
Private consumption	3.8	-4.8	7.6	-4.2	-6.1	0.9	11.7	9.0	9.4
Public consumption	8.0	1.5	5.3	-2.6	1.2	-4.3	2.1	-2.4	12.5
Gross fixed capital formation	12.7	4.4	2.5	3.2	3.5	11.3	12.9	-1.3	-6.0
Exports of goods and services	4.6	-9.3	12.8	-5.0	-1.5	1.0	41.7	7.2	7.8
Imports of goods and services	8.8	-5.9	15.0	-3.8	1.7	3.1	42.0	11.2	8.2
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	5.8	-2.3	7.3	-4.7	0.3	3.0	15.1	8.7	3.3
Net exports of goods and services	-1.6	-1.5	-1.4	-1.0	-1.7	-2.2	-2.2	-1.4	-0.4
Exports of goods and services	2.2	-3.8	4.7	-2.5	-1.1	0.3	13.2	2.9	3.0
Imports of goods and services	-3.9	2.3	-6.1	1.5	-0.6	-2.5	-15.3	-4.3	-3.4
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	6.5	4.5	-9.1	7.1	3.3	-5.7	-13.7	-10.6	-6.2
Unit labor costs in manufacturing (nominal, per hour)	13.3	7.6	4.2	3.2	1.8	0.5	-4.9	9.3	12.6
Labor productivity in manufacturing (real, per hour)	-0.8	0.4	3.1	1.8	6.8	5.4	11.6	0.3	-4.0
Labor costs in manufacturing (nominal, per hour)	12.5	8.0	7.5	5.1	8.7	5.9	6.1	9.6	8.1
Producer price index (PPI) in industry	4.0	0.0	14.9	-0.8	-0.5	2.3	10.1	16.4	30.8
Consumer price index (here: HICP)	3.9	2.3	4.1	2.4	1.8	2.3	3.1	4.3	6.6
EUR per 1 RON, + = RON appreciation	-1.9	-1.9	-1.7	-2.3	-2.1	-1.7	-1.7	-1.8	-1.6
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	4.0	5.2	5.6	5.4	5.4	6.1	5.1	5.3	5.9
Employment rate (%, 15–64 years)	65.8	65.6	61.9	66.0	65.8	60.8	62.4	62.3	62.1
Key interest rate per annum (%)	2.5	1.9	1.4	1.6	1.5	1.3	1.3	1.3	1.6
RON per 1 EUR	4.7	4.8	4.9	4.8	4.9	4.9	4.9	4.9	4.9
<i>Nominal year-on-year change in the period-end stock in %</i>									
Loans to the domestic nonbank private sector ¹	5.5	5.5	5.5	3.2	4.8	6.2	10.6	12.7	14.2
of which: loans to households	6.7	6.7	6.7	4.8	4.2	4.6	7.5	8.8	9.3
loans to nonbank corporations	4.2	4.2	4.2	1.4	5.5	7.9	14.3	17.3	19.8
<i>%</i>									
Share of foreign currency loans in total loans to the non-bank private sector	32.4	30.5	27.6	31.4	30.5	29.9	28.9	28.4	27.6
Return on assets (banking sector)	1.4	1.0	1.4	1.2	1.0	1.3	1.4	1.5	1.4
Tier 1 capital ratio (banking sector)	20.1	23.2	19.8	20.8	23.2	22.7	22.1	21.4	19.8
NPL ratio (banking sector)	4.1	3.8	3.4	4.1	3.8	3.9	3.8	3.7	3.4
<i>% of GDP</i>									
General government revenues	31.9	32.7	32.8	..	..	..	..	..	..
General government expenditures	36.2	42.0	39.9	..	..	..	..	..	..
General government balance	-4.3	-9.3	-7.1	..	..	..	..	..	..
Primary balance	-3.2	-7.9	-5.7	..	..	..	..	..	..
Gross public debt	35.3	47.2	48.8	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	32.2	33.2	32.4	..	..	..	..	..	..
Debt of households and NPISHs ² (nonconsolidated)	15.3	16.1	15.7	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Goods balance	-8.0	-8.7	-9.6	-7.9	-8.0	-10.9	-9.3	-9.5	-9.3
Services balance	3.9	4.3	4.0	4.2	3.8	4.6	3.8	3.6	4.1
Primary income	-1.4	-1.6	-1.7	-3.5	-1.5	0.3	-3.1	-2.8	-1.1
Secondary income	0.7	0.9	0.4	0.8	1.1	0.1	0.6	0.8	0.2
Current account balance	-4.9	-5.0	-7.0	-6.4	-4.7	-5.9	-8.0	-7.8	-6.2
Capital account balance	1.3	1.9	2.2	1.0	2.4	1.1	1.4	1.5	4.2
Foreign direct investment (net) ³	-2.2	-1.3	-3.0	-1.1	-1.9	-4.5	-2.8	-4.2	-1.3
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	49.1	58.0	56.1	54.1	58.0	56.2	56.3	56.9	56.1
Gross official reserves (excluding gold)	14.7	17.1	16.9	14.9	17.1	16.2	16.1	17.5	16.9
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	4.0	4.9	4.3	4.3	4.9	4.7	4.4	4.7	4.3
<i>EUR million, period total</i>									
GDP at current prices	223,085	218,706	239,991	58,911	67,395	46,743	55,871	65,172	72,205

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

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

10 Turkey: unorthodox policies show strong impact on exchange rate and inflation

In 2021, Turkey's GDP growth accelerated strongly to 11%. Year-on-year growth was high in the second half of 2021, when quarter-on-quarter growth averaged more than 2%, considerably above the average in the two years before the pandemic. Published figures show that both domestic demand (excluding inventory change) and foreign demand contributed substantially to growth in the second half of 2021, and that export growth outpaced import growth, implying a substantial growth contribution of net exports. These contributions add up to year-on-year GDP growth of about 15% in the second half of 2021, as opposed to published GDP growth of about 8% in that period. The implied large negative contribution of inventory change relates mainly to the inventory of nonmonetary gold, the import of which declined sharply due to regulatory measures. Nonmonetary gold imports form part of imports so that their decline helps explain low import growth rates and strong net exports, while the counterpart of (gold-related) inventory changes does not enter published domestic demand. Goods and services trade was almost balanced in full-year 2021 but slightly positive in the second half of 2021, and the current account deficit came in below 2% of GDP in full-year 2021 and roughly balanced in the second half of 2021. The improvement on a year earlier resulted almost exclusively from the decline of gold imports. Net FDI inflows remained meager at close to 1% of GDP. Domestic demand growth in the review period stemmed almost only from private consumption, while fixed investment even shrank despite the support provided by state bank credit. In late 2021 and early 2022, consumer and confidence indicators clearly deteriorated in the wake of the military buildup by the Russian leadership.

Official foreign currency reserves declined by 7% in EUR terms and by 12% in USD terms from end-August 2021 to end-February 2022 when they covered 2.7 months of imports and exceeded the scheduled off-balance and public sector's on-balance net drains due in three months only moderately. These off-balance sheet liabilities consist primarily in foreign currency swaps that have been incurred to a large extent vis-à-vis domestic commercial banks. The latter have been prohibited to enter swaps abroad for closing their open foreign currency position since 2018. Annual headline inflation accelerated moderately until November. After the Turkish central bank cut the key interest rate by 1 percentage point to 18% in September, further decreases amounted to 2 percentage points in October and 1 percentage point each in November and December so that the key rate stood at 14% during the first quarter of 2022, implying a large, negative real key rate. Reserve requirements, however, were tightened in early November 2021. In response to this unorthodox interest rate policy and accompanying statements by the Turkish president, the lira depreciated sharply from mid-November to mid-December by about 43% in EUR terms. This led to an immediate jump in inflation, resulting in annual figures of 61.1% (headline) and 51.8% (core) in March 2022. Authorities reacted by introducing measures, like budget-financed exchange rate-linked deposit schemes, to boost "liraization" and decrease both nonmonetary gold deposits and foreign exchange deposits and, hence, central bank's contingent foreign exchange liabilities. In addition, since January 1, exporters have been obliged to convert 25% of their foreign exchange earnings into lira. So far, these policies have been partially successful, causing the lira to re-appreciate somewhat and stabilize at about lira 16 per euro.

Table 10

Main economic indicators: Turkey

	2019	2020	2021	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	0.9	1.8	11.0	6.3	6.2	7.3	21.9	7.5	9.1
Private consumption	1.5	3.2	15.1	8.5	7.9	7.0	23.3	9.1	21.3
Public consumption	4.1	2.2	2.1	2.0	3.7	-0.1	3.2	7.9	-1.9
Gross fixed capital formation	-12.4	7.2	6.4	22.6	11.7	12.4	20.8	-1.9	-0.8
Exports of goods and services	4.6	-14.8	24.9	-21.4	0.5	3.9	60.9	25.5	20.7
Imports of goods and services	-5.4	7.6	2.0	16.4	3.0	-1.0	19.9	-8.9	2.6
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	-2.1	4.0	10.9	10.4	8.1	7.2	19.9	6.0	11.9
Net exports of goods and services	2.5	-5.7	5.1	-9.6	-0.7	1.2	7.1	7.4	4.3
Exports of goods and services	1.2	-4.0	5.6	-5.9	0.1	1.0	11.5	5.3	5.0
Imports of goods and services	1.3	-1.8	-0.5	-3.7	-0.8	0.2	-4.4	2.2	-0.7
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	..	..	..	..	..	..	..	..	..
Unit labor costs in manufacturing (nominal, per hour)	21.9	10.0	19.1	3.6	7.0	9.0	13.2	29.2	26.7
Labor productivity in manufacturing (real, per hour)	1.7	8.3	-0.3	7.0	8.2	4.4	-6.9	-1.1	3.1
Labor costs in manufacturing (nominal, per hour)	23.8	18.9	19.0	10.8	15.8	13.8	5.4	27.8	30.6
Producer price index (PPI) in industry	17.6	12.2	43.9	11.4	22.2	28.2	38.8	44.8	60.6
Consumer price index (here: HICP)	15.2	12.3	19.6	11.8	13.5	15.6	17.1	19.2	25.9
EUR per 1 TRY, + = TRY appreciation	-10.4	-21.0	-23.2	-25.5	-31.8	-24.3	-25.2	-15.9	-26.4
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	14.0	13.4	12.2	13.4	13.0	13.8	12.0	11.9	11.2
Employment rate (%, 15–64 years)	50.3	47.5	50.3	48.8	47.7	48.0	49.7	51.6	51.7
Key interest rate per annum (%)	20.6	10.2	17.8	8.4	12.5	17.3	19.0	18.9	15.9
TRY per 1 EUR	6.4	8.0	10.5	8.5	9.4	8.9	10.1	10.1	12.8
<i>Nominal year-on-year change in the period-end stock in %</i>									
Loans to the domestic nonbank private sector ¹	11.0	36.3	36.1	41.3	36.3	31.9	20.7	14.5	36.1
of which: loans to households	15.9	40.1	20.4	48.4	40.1	35.4	24.9	15.9	20.4
loans to nonbank corporations	9.5	35.0	41.9	39.1	35.0	31.3	20.1	14.7	41.9
<i>%</i>									
Share of foreign currency loans in total loans to the nonbank private sector	35.2	30.9	38.1	32.0	30.9	32.4	32.7	32.2	38.1
Return on assets (banking sector)	1.1	1.0	1.3	1.2	1.0	1.0	1.0	1.1	1.3
Tier 1 capital ratio (banking sector)	13.9	14.1	13.2	14.5	14.1	13.4	13.2	12.9	13.2
NPL ratio (banking sector)	5.7	4.4	3.4	4.4	4.4	4.1	3.9	3.8	3.4
<i>% of GDP</i>									
General government revenues	..	..	..	..	..	..	..	..	..
General government expenditures	..	..	..	..	..	..	..	..	..
General government balance	-4.4	-4.7	-3.6	..	..	..	..	..	..
Primary balance	..	..	..	..	..	..	..	..	..
Gross public debt	32.6	39.7	39.1	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	..	..	..	..	..	..	..	..	..
Debt of households and NPISHs ¹ (nonconsolidated)	..	..	..	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Goods balance	-2.2	-5.3	-3.6	-5.7	-4.4	-3.7	-3.4	-3.2	-4.2
Services balance	4.5	1.6	3.3	2.0	1.9	1.2	1.9	5.4	4.0
Primary income	-1.7	-1.3	-1.5	-0.9	-1.2	-1.6	-1.9	-1.2	-1.3
Secondary income	0.1	0.0	0.1	0.2	0.1	0.1	0.2	0.1	0.0
Current account balance	0.7	-5.0	-1.7	-4.3	-3.7	-4.0	-3.2	1.2	-1.5
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment (net) ²	-0.8	-0.6	-0.9	-0.5	-0.6	-0.7	-0.7	-1.5	-0.8
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	52.3	51.3	51.7	50.1	51.3	53.8	53.1	53.3	51.7
Gross official reserves (excluding gold)	10.3	6.5	9.4	5.0	6.5	6.5	7.5	10.7	9.4
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	4.1	2.4	3.2	1.9	2.4	2.4	2.7	3.8	3.2
<i>EUR million, period total</i>									
GDP at current prices	678,772	625,264	683,223	167,165	162,128	155,985	156,492	190,618	180,128

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

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

- = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).

11 Russia: heading from strong recovery to strong recession triggered by Ukraine war and sanctions

Russia's GDP growth in 2021 of 4.7% more than offset the COVID-19-related shrinkage of 2020. Brisk growth in 2021 was driven by private consumption and fixed investment. Russia's economy in 2021 and early 2022 continued to benefit from the oil price upswing, helped by the global recovery and the OPEC+ agreement. Thus, the average Urals price rose by almost two-thirds to USD 69 per barrel in 2021 against 2020, and by even more in January to February 2022 (year on year). The jobless rate declined below the pre-pandemic level to 4.2% (ILO methodology) in December 2021 – the lowest post-Soviet level ever attained.

But Russia's invasion of Ukraine that started on February 24, 2022, and the unprecedented package of Western punitive sanctions that followed profoundly changed the playing field. Western sanctions include the freezing of assets of the Bank of Russia (CBR) and of some large Russian banks located in EU/G7 countries, the prohibition of funding in EU/G7 financial markets for the Russian sovereign, the CBR and several large Russian banks, the exclusion of some Russian banks (though not the largest, Sberbank, and the third-largest, Gazprombank) from the international payment system SWIFT, and additional export controls (on top of already existing controls) for high-tech products and aircraft parts and components. The G7 further decided to strip Russia of its "most favored nation" status in trade with G7 members. The USA furthermore imposed an embargo on purchases of oil, gas and gold, and the EU on purchases of coal from Russia. The freezing of almost half (about USD 300 billion) of the CBR's international reserves (a total of USD 643 billion or 38% of GDP in mid-February 2022) – the part that had been placed in Western countries' jurisdictions – is a particularly remarkable and unprecedented step.

In response, the CBR more than doubled its key rate to 20.0% on February 28 after it had already raised it in the previous six months (in four steps totaling a raise from 3% to 9.5%). Moreover, exporters were instructed to exchange 80% of their foreign currency proceeds into ruble, and some other capital controls were installed (e.g. retail foreign currency purchase surcharges). The CBR also intervened with the unfrozen part of its reserves, which, together with foreign currency refinancing and asset valuation changes, contributed to a decline of its unfrozen reserves by USD 39 billion (about 12%). The Moscow Exchange was closed for a couple of weeks, then opened again in late March, although a "temporary" ban was imposed on foreign firms and nonresidents selling Russian assets and/or repatriating proceeds. The ruble – no longer fully convertible – lost almost half of its value against the US dollar and the euro from mid-February to mid-March, then regained most of the lost terrain. In the course of April, it came close to the level prior to the invasion. In early April, the key policy rate was lowered by 300 basis points to 17%.

CPI inflation, which previously had been pushed by strong domestic demand and structural bottlenecks, grew from 7.4% in September 2021 to 9.2% in February 2022, and further accelerated to 16.7% in March (the highest level seen since 2015). Apart from the (limited) devaluation, the sharp rise is also due to supply chain disruptions and consumers' temporary hamster purchases of food and durables. The government invoked its own anti-inflation measures, including export restrictions on some commodities and products (e.g. sugar, grain, fertilizers).

In mid-March, the CBR stated that the Russian economy has entered a phase of far-reaching “structural transformation” toward more self-reliance and less dependence on Western imports, which will also modify the domestic price structure. Despite economic woes, GDP is estimated (Refinitiv Datastream, OECD) to have expanded by 5% to 6% in the first quarter of 2022.

In 2021, the federal budget had produced a surplus of 0.8% of GDP, buoyed by the recovery of the oil price. Fiscal surpluses continued in January and February 2022. As of end-January 2022, the assets of the National Welfare Fund – most of which constitute Russia’s now partially frozen international reserves – came to USD 175 billion. In reaction to the sanctions, the authorities have announced stepped-up social assistance payments, pension adjustments, tax breaks and financial support for enterprises. That said, a substantial anticyclical fiscal stimulus is reportedly not planned. The oil price rise contributed to boosting the country’s current account surplus to 6.9% of GDP in 2021. The first quarter of 2022 delivered another substantial current account surplus. Despite the partial freeze of reserves, debt service has so far been upheld.

Banks’ NPL ratio slightly declined over 2021 to 15.1% at end-2021. Following the imposition of massive Western sanctions, the CBR provided extensive regulatory lenience for the measurement of banks’ assets and encouraged banks to grant temporary credit holidays for distressed borrowers. In mid-March, the authorities introduced a credit subsidy program. While fully up-to-date monthly data are not yet available, mass bank runs following the plunge of the ruble have so far not materialized, possibly due to the sharp upward key rate adjustment which pushed up deposit rates, albeit rising inflation may soon put more pressure on banks.

Table 11

Main economic indicators: Russia

	2019	2020	2021	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	2.2	-2.7	4.7	-3.3	-1.3	-0.3	10.5	4.0	5.0
Private consumption	3.8	-7.3	9.5	-7.2	-4.9	-2.1	27.2	9.5	7.1
Public consumption	2.4	1.9	1.5	2.1	2.1	1.2	2.6	1.3	1.1
Gross fixed capital formation	1.0	-4.6	6.8	-9.0	-1.9	1.8	12.2	8.2	5.2
Exports of goods and services	0.7	-4.1	3.5	-7.9	-6.2	-0.6	-1.1	8.7	7.1
Imports of goods and services	3.1	-11.9	16.9	-19.9	-5.0	0.0	32.2	19.2	17.7
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	3.0	-4.7	7.4	-6.4	-1.0	-0.3	17.1	6.0	7.1
Net exports of goods and services	-0.5	1.7	-2.7	2.9	-0.4	-0.2	-6.9	-1.8	-2.4
Exports of goods and services	0.2	-1.1	0.9	-2.0	-1.6	-0.2	-0.3	2.1	1.7
Imports of goods and services	-0.7	2.9	-3.7	4.9	1.2	0.0	-6.5	-3.9	-4.1
<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 manufacturing (nominal, per hour)	3.9	7.6	4.3	8.7	5.6	7.3	1.0	4.2	5.1
Labor productivity in manufacturing (real, per hour)	3.7	-1.4	6.2	-2.8	0.3	0.0	10.7	6.8	7.3
Labor costs in manufacturing (nominal, per hour)	7.8	5.9	10.9	5.6	5.9	7.3	11.9	11.3	12.8
Producer price index (PPI) in industry	2.3	-3.7	24.6	-1.9	1.7	10.6	31.2	28.2	28.3
Consumer price index (here: HICP)	4.6	3.4	6.7	3.6	4.5	5.5	6.0	6.9	8.3
EUR per 1 RUB, + = RUB appreciation	2.2	-12.3	-5.3	-16.8	-22.4	-17.9	-11.0	-0.3	9.3
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	4.6	5.8	4.8	6.3	6.1	5.6	5.0	4.4	4.3
Employment rate (%, 15–64 years)	..	..	..	..	..	..	..	..	..
Key interest rate per annum (%)	7.3	5.0	5.7	4.3	4.3	4.3	5.0	6.3	7.5
RUB per 1 EUR	72.5	82.6	87.2	86.3	90.9	89.7	89.5	86.6	83.1
<i>Nominal year-on-year change in the period-end stock in %</i>									
Loans to the domestic nonbank private sector ¹	10.6	10.6	10.6	9.9	9.6	9.4	12.7	13.9	15.3
of which: loans to households	19.0	19.0	19.0	12.9	12.9	13.5	20.3	20.7	22.1
loans to nonbank corporations	7.1	7.1	7.1	8.5	8.0	7.5	9.3	10.8	12.2
<i>%</i>									
Share of foreign currency loans in total loans to the non-bank private sector	11.8	12.6	10.8	13.3	12.6	12.3	10.8	10.8	10.8
Return on assets (banking sector)	2.2	1.9	2.4	1.8	1.9	2.4	2.5	2.6	2.4
Tier 1 capital ratio (banking sector)	9.2	9.7	9.6	10.4	9.7	10.8	10.3	9.8	9.6
NPL ratio (banking sector)	17.0	17.1	15.1	17.4	17.1	17.0	16.2	15.8	15.1
<i>% of GDP</i>									
General government revenues	36.0	35.6	36.7	..	..	..	..	..	..
General government expenditures	34.1	39.6	35.9	..	..	..	..	..	..
General government balance	1.9	-4.0	0.8	..	..	..	..	..	..
Primary balance	..	..	..	..	..	..	..	..	..
Gross public debt	12.4	17.6	16.0	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	..	..	..	..	..	..	..	..	..
Debt of households and NPISHs ² (nonconsolidated)	..	..	..	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Goods balance	9.8	6.3	10.7	5.0	6.1	7.9	9.3	11.6	12.8
Services balance	-2.2	-1.1	-1.1	-1.0	-1.3	-0.8	-0.9	-1.4	-1.1
Primary income	-3.2	-2.3	-2.4	-2.5	-2.8	-0.4	-4.0	-2.2	-2.7
Secondary income	-0.6	-0.4	-0.3	-0.4	-0.4	-0.5	-0.1	-0.3	-0.2
Current account balance	3.8	2.5	6.9	1.1	1.7	6.2	4.2	7.6	8.7
Capital account balance	0.0	0.0	0.0	0.0	-0.1	0.1	-0.1	0.0	0.0
Foreign direct investment (net) ³	-0.6	-0.2	1.4	-1.4	-0.2	0.9	0.8	0.9	2.8
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	29.4	30.0	28.2	29.1	30.0	31.5	30.6	30.8	28.2
Gross official reserves (excluding gold)	26.1	28.7	29.1	27.5	28.7	30.3	29.6	30.3	29.1
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	15.0	16.8	16.4	16.3	16.8	17.5	16.6	16.8	16.4
<i>EUR million, period total</i>									
GDP at current prices	1,515,749	1,298,180	1,509,221	321,684	342,021	301,956	345,451	395,248	466,566

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

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

- = net accumulation of assets smaller than net accumulation of liabilities (net inflow of capital).