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Article

Economic trends in CESEE : stubbornly high inflation despite cooling economy

Economic trends in CESEE

Stubbornly high inflation despite cooling economy[1, 2, 3]

1 Regional overview

Russia's invasion of Ukraine in early 2022 sent shockwaves through the global economy. Together with the effects of past adverse shocks – most notably the pandemic and the associated disruptions of global supply chains – it propelled price growth up to levels not seen for decades. After a period of pronounced economic stress and uncertainty, some of the factors that weighed on the economies of Central, Eastern and Southeastern Europe (CESEE) became less pressing as the year 2022 progressed. Commodity prices have moderated and – while the war continues, and geopolitical tensions remain high – the European economy has started to adapt to the new realities of geoeconomic fragmentation. In some fields, the adjustment has been rather successful (e.g. concerning the redirection of energy demand away from Russian energy sources and regarding general energy-saving efforts). Also supply chains seem to be functional again after China's departure from its zero COVID policy. This is evidenced by lower global shipping costs and more readily available inputs among other factors. By the turn of the year, several signs suggested that the fourth quarter of 2022 may have already marked the bottom of the current economic downturn: (1) Fillips from lower food and energy prices, improved supply chain functioning and bold monetary policy finally put a brake on accelerating inflation rates; (2) the euro area economy showed no signs of contraction, at least not yet; (3) investment activity withstood tougher financing conditions comparatively well; and (4) sentiment improved notably from the troughs of mid-2022, especially among consumers.

CESEE is not yet out of the woods, though. Economic activity continued to weaken in early 2023 (also compared to the euro area) and inflation remains stubbornly high despite the notable cooling of the economy. Adjustments to the measures introduced to shield households from spiraling energy prices have introduced quite some volatility in headline inflation rates. Underlying (core) price pressures are proving sticky, with labor markets very tight throughout the CESEE region. At the same time, the fast rise in policy rates is starting to bite, and rising (global) financial sector risks could – despite generally solid fundamentals – spill over into CESEE banking sectors. Public support amid the energy crisis and rising government financing costs have consumed fiscal space and are limiting fiscal policymakers' ability to respond flexibly to new challenges.

Economic activity weakened throughout the review period

How is all the above reflected in the data? After confidence indicators had already deteriorated significantly from early summer 2022 onward – consumer confidence fell to a lower level than at the height of the COVID-19 pandemic – activity indicators also weakened from fall 2022. Almost all industrial sectors were affected

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

[2] *Cut-off date: April 14, 2023. This report focuses primarily on data releases and developments from October 2022 up to the cut-off date and covers Slovakia, Slovenia, Bulgaria, Croatia, Czechia, Hungary, Poland, Romania, Türkiye and Russia. The countries are ranked according to their level of EU integration (euro area countries, EU member states and non-EU countries).*

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

by the downturn, especially energy-intensive industries and industries that are particularly dependent on raw materials and imported components. Average industrial production growth declined and output in the sector contracted by 1.5% in the CESEE EU member states in February 2023. This was the strongest contraction since the summer of 2020. Retail sales momentum was increasingly driven by daily necessities, while sales of durable goods and fuels weakened. Retail sales in the CESEE EU member states contracted by 0.3% on average in February 2023, a figure comparable to January and February of 2021, a time when lockdown restrictions were still in place in many countries. While activity indicators trended down, sentiment indicators recovered somewhat from autumn 2022 onward. This is particularly true for consumer sentiment, but industrial sentiment brightened as well.

Output contracted in the CESEE EU member states in Q4 2022

In terms of actual GDP figures, this means that – amid quite some volatility in quarterly growth readings – economic momentum decelerated notably in the second half of 2022. Average growth in the CESEE EU member states turned negative in the fourth quarter of 2022 (with Czechia and Hungary meeting the criteria for a technical recession), and growth in Türkiye halved compared to the first half of 2022 (see table 1). The Russian economy, however, rebounded from its strong contraction in the second quarter of 2022.

Private consumption almost completely disappeared as a central pillar of growth

In the second half of 2022, the economic momentum in the CESEE EU member states rested primarily on investment, whose growth weakened only slightly, and on net exports. At the same time, private consumption noticeably failed to support growth in many countries (see chart 1).

Gross fixed capital formation advanced by close to 5% on average in the region during the second half of 2022 and was especially buoyant in Slovakia, Croatia and

Table 1

Real GDP growth

	2020	2021	2022	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22
	Period-on-period change in %										
Slovakia	–3.4	3.0	1.7	–1.4	1.9	0.3	0.4	0.3	0.3	0.3	0.3
Slovenia	–4.3	8.2	5.4	1.7	2.0	2.9	3.4	1.0	0.8	–1.3	0.8
Bulgaria	–4.0	7.6	3.4	2.7	1.3	1.9	1.5	0.4	0.7	0.6	0.6
Croatia	–8.6	13.1	6.3	7.2	0.5	2.4	2.1	2.4	1.3	–0.5	0.9
Czechia	–5.5	3.6	2.5	–0.5	1.4	1.7	0.8	0.6	0.3	–0.3	–0.4
Hungary	–4.5	7.2	4.6	1.1	2.3	1.6	2.5	1.3	0.7	–0.7	–0.4
Poland	–2.0	6.8	4.9	2.6	2.2	2.1	1.7	4.2	–2.2	1.1	–2.4
Romania	–3.7	5.9	4.8	2.0	1.8	0.8	0.6	1.3	1.2	1.2	1.0
Türkiye	1.9	11.3	5.6	2.6	2.0	2.7	1.6	0.7	1.9	–0.1	0.9
Russia	–2.7	5.6	–2.1	0.7	1.6	0.6	0.9	0.2	–4.6	0.5	0.5
CESEE average[1]	–2.0	7.8	2.2	1.6	1.8	1.5	1.3	1.1	–1.4	0.4	0.2
Euro area	–6.1	5.3	3.5	0.0	2.0	2.3	0.6	0.6	0.9	0.4	0.0

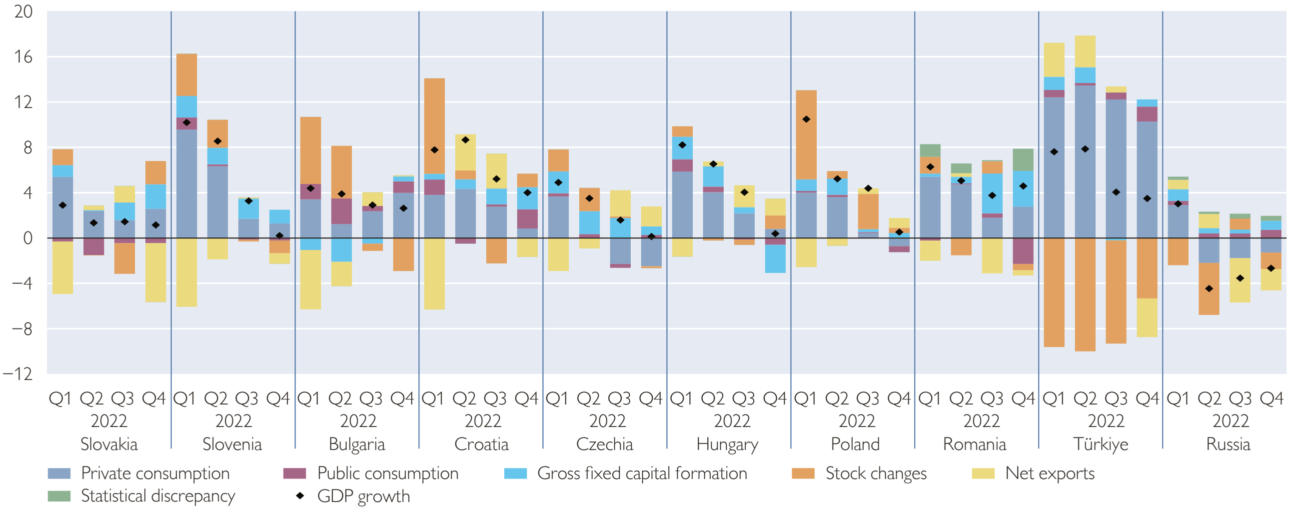
Source: Eurostat, national statistical offices.

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

Chart 1

GDP growth and its main components

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



Source: Eurostat, national statistical offices.

Romania. While nominal financing conditions tightened notably throughout CESEE, real interest rates remained firmly in negative territory, and high profitability provided sources for internal financing. Capital formation was also supported by the beginning utilization of funds under the Recovery and Resilience Facility (RRF), above-average capacity utilization and/or efforts to save (increasingly scarce) labor in several countries. Stock changes, however, weighed on GDP as the high inventories that were built up in 2021 and early 2022 (mostly related to supply chain issues) were slowly being depleted.

Although net exports slowed down toward the end of 2022, they often made a positive contribution to growth – for the first time since late 2020. Real exports increased more strongly than real imports. This in part reflected the unclogging of supply chains amid order backlogs from the past and stronger than expected demand from Western Europe. Exchange rate weakness (for example in Hungary), the strong tourist season (for example in Croatia), consumption restraint and/or lower energy imports due to high world market prices and/or energy-saving measures also played a role. In 2022, natural gas demand declined notably in almost all CESEE EU member states, most strongly so in Romania and Croatia (–14% and –19%, respectively, compared to the 2019–2021 average). In addition, CESEE countries used 4% to 17% less electricity in 2022 than in 2021, with Slovakia and Romania leading the way.

In the review period, poor economic confidence, weakening loan growth and losses in purchasing power in the wake of strong inflation had a growing impact on consumer spending in the CESEE EU member states. By the fourth quarter of 2022, private consumption growth had declined to only 0.5% on average (and was even negative in Czechia and Poland), delivering a moderate contribution to GDP growth at best. The central pillar of growth over the first half of 2022 has thus almost completely disappeared.

Labor market tightness persists

Consumer demand would likely have been even weaker were it not for remaining cushions of pandemic savings (estimated to amount to at least 1% of GDP in most countries) and the still very strong labor markets of the region. Despite weak growth, the average unemployment rate in the CESEE EU member states (at 3.7% in February 2023) currently stands only slightly above the historic lows recorded at the end of 2019. This means that there is practically full employment. A broader measure of the labor market slack – i.e. the share of persons with an unmet need for employment in the extended labor force – even beat its end-2019 reading by a full 0.7 percentage points. At 6% in the fourth quarter of 2022, it reached the lowest level since the start of the time series in 2009. And while employment growth has lost steam recently, trends in employment rates and activity rates were also favorable, with both rising to close to or even above historical heights in the final quarter of 2022.

Earthquakes weighed on activity in Türkiye

In Türkiye, the earthquakes of February 6, 2023, weighed on activity and pushed already weakening industrial output into contraction. Retail sale growth held up better, partly thanks to strong pay hikes at the beginning of this year (including a minimum wage increase of 55% and a 30% increase in civil servant wages) and aided by a favorable base effect after the confidence shock from the lira exchange rate crisis in November to December 2021. GDP growth in the second half of 2022 was based on a robust contribution of private consumption while both investments and net exports weakened.

Russian economy is weathering Western sanctions rather well

While growth readings were volatile in the CESEE region and the economic momentum generally decelerated, the Russian economy improved steadily from its mid-2022 trough. After the first shock of international economic sanctions had been digested, quarter-on-quarter growth came in at 0.5% in the third and fourth quarter, limiting the annual GDP contraction to –2.1% for the whole year. Russian GDP dynamics benefited from higher (war-related) government spending and

Chart 2

Russia: exchange rate and policy rate

Source: Macrobond.

from substantially higher prices for energy. Notwithstanding international sanctions, the country managed to bring substantial quantities of its energy carriers to the world market, in part by redirecting crude oil exports from sanctioning to nonsanctioning countries. With sanctions severely curtailing imports from Western economies, the current account surplus rose to more than 10% of GDP in 2022.

The price cap for Russian oil and the European Union's import ban increased the price discount of Russian oil vis-à-vis oil from other origins from late 2022 onward. This weighed on the ruble's external value and the currency fell back to its pre-invasion level against the euro in late March 2023 (see chart 2). Inflation spiked at 17.8% in April 2022 but came back to 11% in February 2023. After reducing its key rate to 7.5% in mid-September 2022, the Bank of Russia (CBR) has so far left it at this level.

Inflation in CESEE EU stabilizes at a high level amid considerable volatility

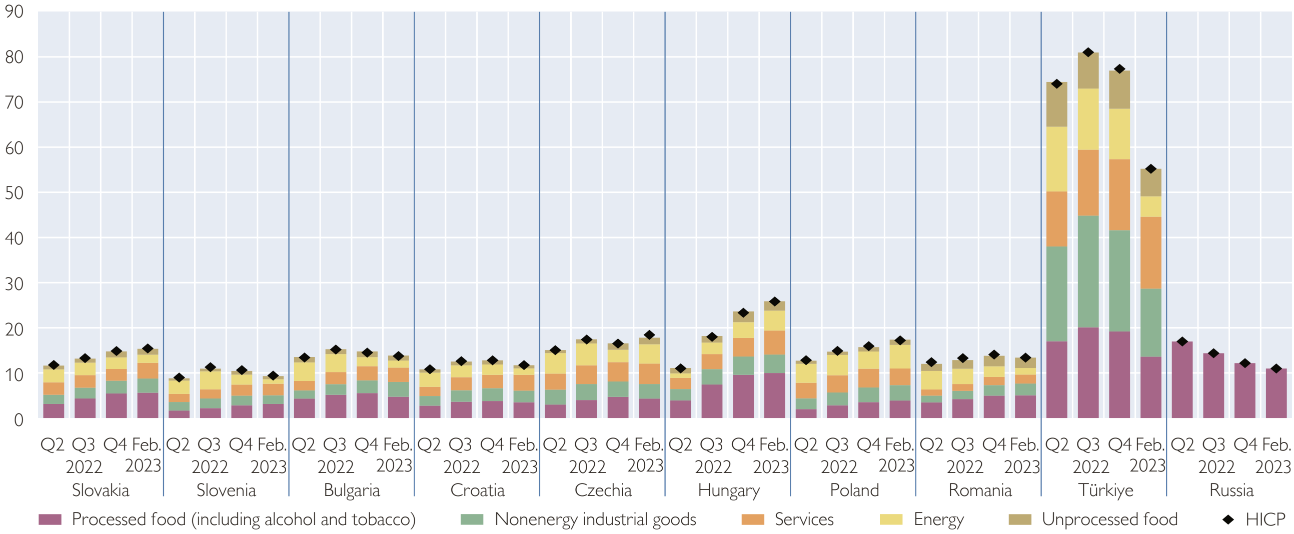
The strong increase in annual inflation rates that characterized much of 2022 seems to have come to an end in the CESEE EU member states as well, and inflation recently stabilized at a high level amid considerable volatility (see chart 3). Energy prices in particular had a disinflationary effect, reflecting lower world market prices and country-specific relief packages for household energy. In December 2022, the average inflation rate in the CESEE EU member states declined to 16%, which marked the first decrease in two years. From May 2022, it became evident, at a disaggregated level, that the share of items with rising inflation rates in the overall consumption basket was declining – from a high level – both in terms of their number and their aggregate weight in the basket. Inflation is therefore currently less broadly based than it was in spring 2022.

However, price dynamics in the region have not yet embarked on a stable und sustainable downward trend. Core inflation, for instance, remained very high and

Chart 3

HICP inflation and its main drivers

Percentage points, contribution to year-on-year change in HICP; HICP in %



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

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

kept on increasing in several countries of the region. This reflected lagged effects of the pass-through of producer price spikes to consumer bills, an expansion of profit margins in some sectors as well as rising (labor-intensive) services prices. The latter could suggest a stronger translation of wage costs into the general price level amid tight labor markets. Nominal wage growth had already accelerated to around 11% on average in the fourth quarter of 2022. However, the risk of a wage-price spiral is mitigated to some extent by the low unionization in CESEE EU member states and easing inflation expectations. Surveys among consumers show that inflation expectations recently converged back to the values reported in 2018. Inflation expectations in industry, retail and services came down as well but have not yet returned to their pre-pandemic levels.

Moreover, aid packages to shield households from spiraling prices (mostly energy prices) had to be adjusted in several instances as they negatively impacted national budgets and/or the balance sheets of energy suppliers. This once again boosted (regulated) energy prices, and the average inflation rate in the CESEE EU member states again edged up to 16.9% by February 2023. Hungary, for instance, abandoned its fuel price caps and increased its regulated prices for household energy; Czechia introduced a price cap to replace its (subsidized) energy-saving tariff; and Poland removed tax breaks on fuel and energy. Going forward, further adjustments cannot be ruled out, at least in some countries, as the prices for household energy are not yet aligned with world market prices and/or as tax rates (especially for food and energy) have not yet returned to pre-pandemic levels. However, statistical effects as the war-related price spikes of early 2022 drop out of the base should also contribute to some easing of price pressures going forward.

Tightening cycles near an end

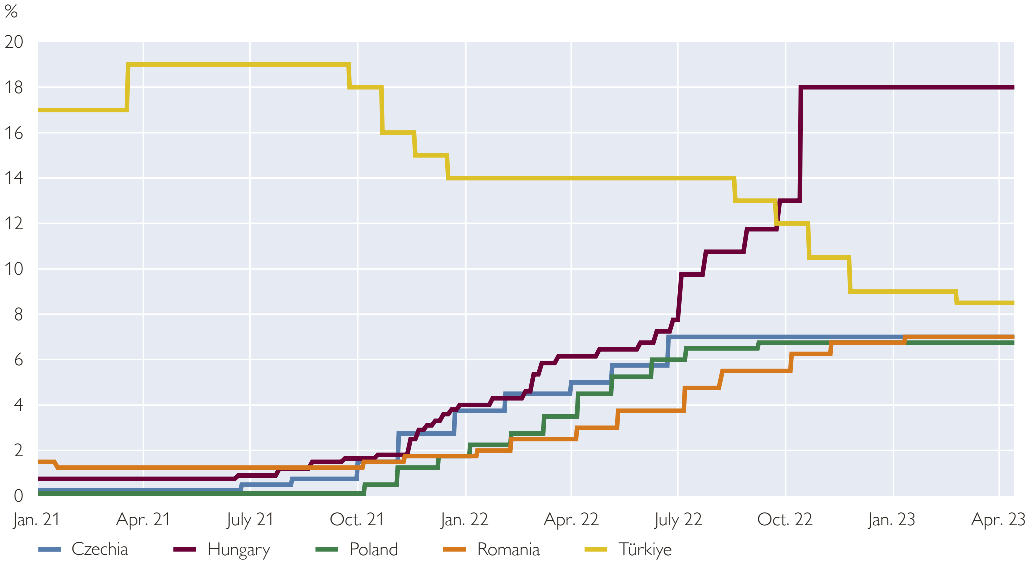
Against the backdrop of inflation stabilizing at a high level, the incipient economic slowdown and the already far-reaching tightening of monetary policy, most central banks in the region refrained from further interest rate hikes in the review period (see chart 4). For example, the last rate hike in Poland dates back to September 2022, and the last rate hike in Czechia was in June 2022, even further in the past. The Hungarian central bank (MNB) has also refrained from taking a further interest rate step since October 2022. However, this was preceded by strong monetary tightening in reaction to a depreciation of the forint: After the MNB had hiked its operational policy rate by 125 basis points to 13% in late September 2022 and communicated the end of its hiking cycle, the forint came under pressure and depreciated to its lowest value against the euro (430 HUF per EUR) on October 13, 2022. The following day, MNB called an emergency meeting in which it made several adjustments to its rate tool kit and hiked its operational policy rate to 18%. The policy rate has since stayed at this level – the highest since 1998.

The interest rate ceiling may also have been reached in Romania, after the central bank hiked its policy rate by a moderate 25 basis points to 7% at the beginning of January 2023. Forward rate agreements for the abovementioned countries indicate that market expectations are broadly in line with current market rates. In Hungary, even some unwinding of the emergency rate step of October 2022 is expected in the course of the year.

In Türkiye, both headline and core inflation decelerated from their peaks (at 85% and 79%, respectively, in October 2022) to 55% and 57%, respectively, in

Chart 4

Policy rates in selected CESEE countries



Source: Macrobond.

February 2023. In parallel, the Turkish central bank (TCMB) delivered policy rate cuts by 150 basis points each in October and November (to 9%) and another one in February to 8.5%, implying a large negative real key rate. Against this background and despite regulatory measures to foster a "liraization" of banks' assets and liabilities, the lira depreciated against the euro by 30% in nominal terms since January 2022 (see chart 5).

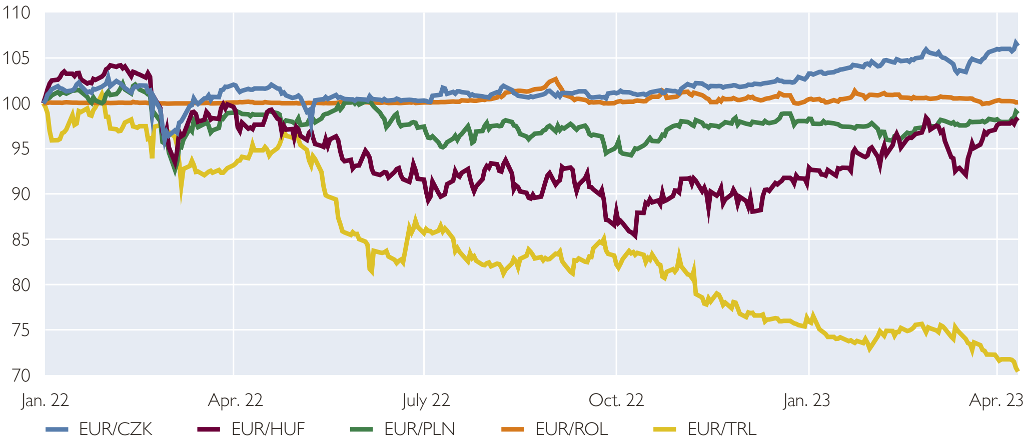
Most currencies have recovered to levels seen prior to the invasion of Ukraine

Unlike in Türkiye, monetary conditions in CESEE EU member states with independent monetary policies have probably already reached the restrictive range and should have a significantly dampening effect on prices going forward. Real (ex ante) interest rates have turned positive in recent months and the large interest rate differential to the euro area – together with a more supportive risk environment, e.g. with respect to energy markets – supported regional currencies. This applies not least to Hungary, where the forint has recovered significantly from its crash in October 2022, currently trading around 2% below its early 2022 value. The recovery was also supported by positive political news concerning long-standing issues between Hungary and the European Commission. The development of the forint compares to a depreciation by 2% of the Polish złoty, a largely stable development of the Romanian leu and an appreciation of the Czech koruna by 6%. The latter, however, was buoyed by exchange rate interventions carried out by the Czech National Bank (CNB), which depleted its foreign currency reserves by some 10 percentage points of GDP in the second half of 2022. The central bank has ample firepower given the large foreign currency reserves it amassed during the intervention-floor policy several years ago.

Chart 5

Exchange rates of selected CESEE countries vs. euro

Index: January 2022 = 100, rise = appreciation



Source: Macrobond.

Currencies only temporarily affected by international financial market turbulences

The most recent global financial sector turbulences following troubles at Silicon Valley Bank and Credit Suisse had only a temporary impact on CESEE foreign exchange markets. The Czech koruna lost 2.5% and the Hungarian forint 6% of value against the euro in mid-March, but both currencies recovered quite quickly. Global financial sector uncertainty currently also does not seem to be leading to an early exit from tight monetary policy. Prior to the events of mid-March, the narrative (and the market assessment) was that interest rates in CESEE EU member states would not continue to rise and that some interest rate hikes would possibly be reversed in the nearer future (e.g. the emergency hike in Hungary). Recent rate decisions, however, have set a somewhat more hawkish tone. The central banks of the region emphasized that policy adjustments will be data driven and that there is no predetermined path as to when the rates will be brought back to lower levels. CNB policymakers have explicitly noted that they "consider the market expectations regarding the timing of the first decrease in CNB rates to be premature." Regardless of upcoming rate decisions, ongoing significant declines in equity prices of European banks could lead to tighter lending standards. Periods of bank stress usually raise the costs of capital and thereby constrain their ability to lend.

Banking sector momentum has weakened

Surveys like the European Investment Bank's CESEE Bank Lending Survey already suggest that credit supply conditions have deteriorated significantly over the last six months. A weak local market outlook (related to the war in Ukraine, high inflation and the general economic slowdown) is cited as the most important reason for this development. All credit segments have been affected by tighter credit standards, though the tightening has been particularly strong in the mortgage market. While credit demand has been more resilient than supply, it is increasingly being driven by short-term demand for working capital and debt restructuring. At the same time, geopolitical uncertainty and the weak economic outlook are negatively influencing long-term fixed investments and consumer confidence. Among households, housing market prospects as well as non-housing-related consumption expenditures are expected to drag down demand further.

This increasingly restrictive situation in CESEE banking sectors is not yet fully reflected in credit market data and banks' balance sheets. Credit dynamics in the CESEE region decelerated in the review period, reflecting a slowdown in new lending due to higher interest rates, more early repayments than in previous years and declining volumes in housing transactions. The weakening, however, was not observed evenly across countries and sectors. Credit growth rates, for example, remained broadly stable in Croatia, Bulgaria and Hungary amid some deceleration in growth of credit to households and largely unabated corporate sector credit dynamics. By contrast, corporate loan growth weighed heavily on credit market developments in Slovenia, Czechia, Poland and Romania.

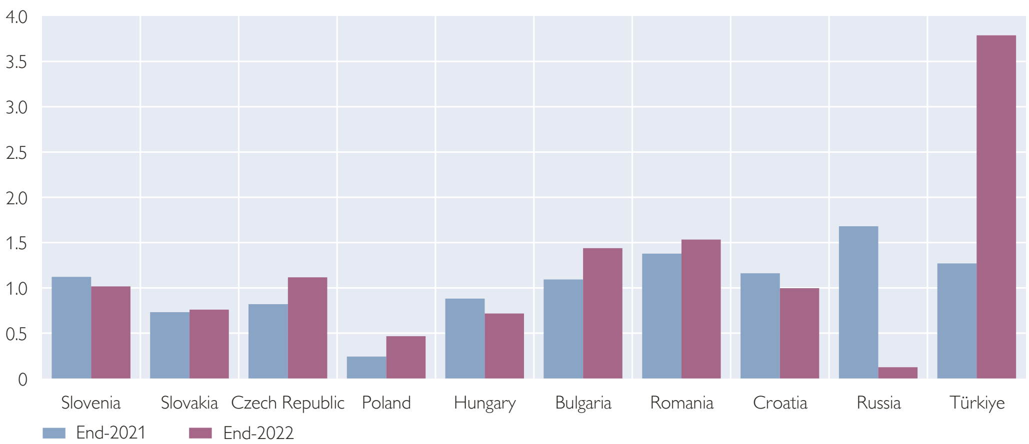
Yet banks' results and balance sheets have remained sound

Profitability was bolstered by higher net interest income and remained at around the levels observed in 2021 (see chart 6) – despite partly higher (personnel) expenses and provisioning. Credit quality also improved across CESEE and non-performing loan (NPL) ratios even reached multiannual lows in some countries. Pockets of vulnerabilities exist, however. While NPL ratios are at a historic low, the share of so-called "stage 2" loans, for which banks are less certain of credit quality, is well above NPLs and increasing in several cases (e.g. Czechia, Croatia and Hungary). Furthermore, fast rising interest rates already exposed some banks with large fixed-income assets (see the example of Silicon Valley Bank in the US). Should the need arise, for instance due to funding shocks generated by changing market sentiment, these assets would have to be sold at a loss. Such unrealized losses, often associated with sovereign assets held to maturity, are significant for a number of countries, but high capital adequacy ratios provide a buffer.

Chart 6

Banking sector profitability

Return on assets (ROA) in %



Source: IMF, national central banks, OeNB.

Note: Data based on annual after-tax profits.

In Türkiye, the supervisory authority has required since mid-2022 that corporations are only granted access to new lira loans if their foreign exchange holdings (including gold) remain below a low ceiling. Moreover, to contain lira loan growth, the central bank has introduced and gradually raised reserve requirement ratios and securities maintenance ratios on selected commercial lira loans, plus additional ratios for banks with high loan growth or relatively high loan interest rates. Despite these measures, growth of credit to the private sector remained well in the double digits. Banking sector profitability increased amid higher operating income and asset growth was reflected in lower NPL ratios.

Even Russia's banking sector reported a moderate profit in 2022

In Russia, banks continue to do business in a regime of regulatory lenience, aided by subsidized lending programs related to strategic enterprises, SMEs and households. This kept the expansion of credit to the private sector broadly stable in the review period. The banking sector reported a very modest overall profit of about USD 3 billion in full-year 2022 (which is less than one-tenth of the figure of 2021), after offsetting the loss from the first half of 2022 incurred on the back of sharply rising provisions and foreign exchange transactions.

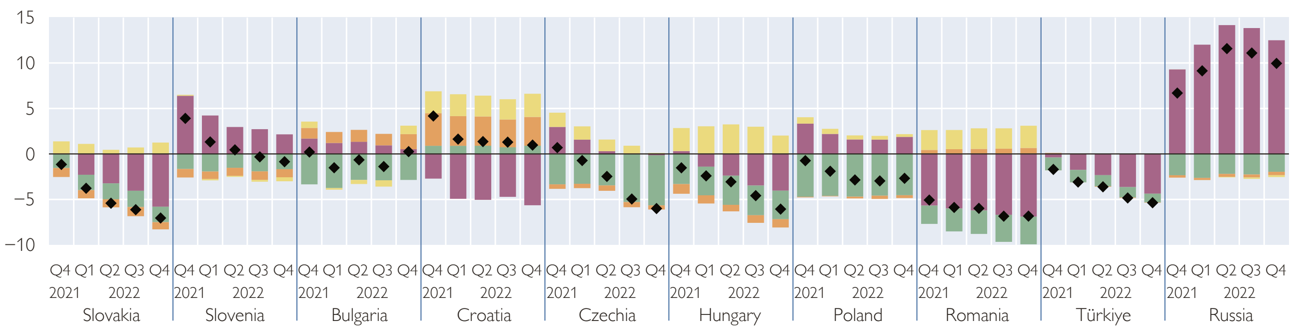
External balances slid further into deficit amid terms-of-trade effects

The war in Ukraine and the ensuing spike in energy prices had a visible impact on CESEE countries' external balances. The terms-of-trade shock amid slowing international momentum had a negative impact on trade balances. This effect was compounded by currency weakness in several instances. Depreciation increased the price for (largely demand-inelastic and usually US dollar-invoiced) energy imports further, while offsetting the negative impact of rising labor costs on competitiveness only to some degree. By the fourth quarter of 2022, combined current and capital account balances deteriorated by between –1.8 percentage points of GDP in Romania and –6.7 percentage points of GDP in Czechia (four-quarter moving sums compared to Q4 2021, see chart 7). Only Bulgaria reported a stable external balance. Against this background, current account balances slipped deeper into deficit in all countries but Croatia and Bulgaria. In some cases, they even approached the unsustainable levels seen ahead of and during the global financial crisis.

Chart 7

Combined current and capital account balance

% of GDP, four-quarter moving sum



Source: Eurostat, IMF, national central banks.

Sufficient financing for covering external deficits

Other investment and foreign direct investment inflows (FDI), which in some cases declined, while accelerating in others, were sufficient to cover large parts of the current account shortfalls over the past four quarters. Part of the strengths of FDI inflows was related to companies exploiting the interest rate differential between CESEE countries and the euro area by increasing intercompany loans. Portfolio flows remained volatile, however. The war, tighter financial conditions around the globe, increased risk aversion and certainly also widening external imbalances have been accompanied by a deterioration in market sentiment toward some CESEE economies. Data on high-frequency portfolio flows show that solid inflows since November 2022 stalled in mid-February 2023, with modest outflows through March, mirroring the fever curve of global banking stress. Government bond yields came down somewhat from their October 2022 peaks, but spreads over German bonds remain clearly elevated in a longer-term perspective.

Inflation is boosting government revenues and lowering debt ratios

High bond yields are not only a function of perceived higher risks, they also reflect high inflation and a generally higher interest rate environment amid monetary tightening. Higher financing costs, of course, weigh on government expenditure. Government expenditure also went up as many CESEE governments were trying to fight the energy crisis by transferring money to households and/or offering support with rising energy bills. This is particularly true in countries that face elections this year (Slovakia, Bulgaria, Poland and Türkiye) or next (Romania). Legacies from pandemic-related stimuli and/or spending related to refugees from Ukraine further fueled spending in some countries.

At the same time, the unexpectedly strong rising price level also boosted tax receipts and – through higher nominal GDP – reduced public debt ratios.

The above factors translated into somewhat lower headline deficits across most of the region, with the exceptions of Poland and Türkiye. Deficit ratios, however, remained elevated, with only Croatia and Slovakia staying below the 3% of GDP target. Debt ratios were lower than a year earlier and hovered between 39.4% of GDP (Türkiye) and 73.3% of GDP (Hungary). Only Bulgaria (22.9% of GDP) and Russia (15.1% of GDP) reported lower government debt levels in 2022. Concerning public finances in Russia, the general government balance reverted from a small surplus in 2021 to a deficit of 1.4% of GDP in 2022. This reflected rising budgetary support for strategic enterprises, SMEs as well as households, expanding arms production, and sharply declining imports and thus import taxes due to Western trade restrictions.

2 Slovakia: one-eyed among the blind? The economy grows dull but scrapes past a recession

Slovakia's lackluster economic performance continued in the second half of 2022, in which GDP growth declined to just above 1%. As a result, real GDP expansion in full-year 2022 nearly halved compared to the hesitant post-pandemic recovery in 2021. The country, however, avoided recession, unlike some regional peers. Economic growth was driven by domestic demand. In contrast, the negative contribution of net exports to real growth in 2022 nearly doubled. This was brought about not only by weakened foreign demand but also by disruptions in the global supply chains – despite some easing since the summer. The latter was epitomized by a significant contraction of car production. In contrast, domestic demand developments somewhat defied the economic odds. Though private consumption growth did slow down noticeably in the second half of the year owing to high and accelerating inflation, it still benefited from savings accumulated during the pandemic and thus contributed more than 2 percentage points to real GDP growth. The mirror image was a steep decline in households' saving rate throughout 2022. Despite rising prices of inputs, cooling foreign demand, a high level of uncertainty and a mediocre absorption of EU funds, investment growth even accelerated in the second half of 2022. In contrast, despite (relatively small) energy support measures, government consumption continued its contraction in the six months to December largely owing to the base effect as pandemic-related support measures boosted public consumption in 2021. Interestingly, while accumulation of inventories made a neutral contribution to GDP growth in 2022 overall, the quarterly contribution fluctuated strongly, echoing the development of supply chain disruptions.

Labor market indicators have come close to their pre-pandemic levels over the last months. Following a moderate but continuous decline until July 2022, the unemployment rate has remained broadly stable since. Employment, in contrast, has kept on rising, although only marginally as demand for labor has weakened amid elevated uncertainty. Foreign workers, particularly refugees from Ukraine, have continued to fill vacant jobs and thus helped mitigate the notorious skill mismatch and lack of (skilled) labor. Nominal wages saw a significant increase, predominantly in the public sector, mainly owing to a previously bargained one-off bonus. Yet, while labor cost increases have outpaced productivity growth, nominal wage growth did not keep up with rising costs of living. Headline inflation continuously headed upward and came in at 15.4% in February 2022. While soaring food and energy prices seem to have peaked in November 2022, core inflation continued climbing to more than 15% most recently. Hence, despite a reduction in the VAT rate for selected goods and services, price hikes have been bloated by nearly all components, most notably food and services.

The general government deficit came in at 2% of GDP in 2022. The reduction compared to 2021 was driven by stronger economic growth, higher tax revenues (not least on the back of high inflation) and lower pandemic-related expenditures. However, these positive factors were counteracted by government expenditures related to the war in Ukraine and measures to compensate firms and households for galloping prices. After the government did not survive the no-confidence vote in the parliament in December 2022, it remains in office with a limited care-taking mandate since snap elections have only been scheduled for end-September 2023. This unusually long run-up has some uncommon consequences such as a power shift toward the parliament, which may also bear some risks.

Table 2

Main economic indicators: Slovakia

	2020	2021	2022	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22
	Year-on-year change of the period total in %								
GDP at constant prices	–3.4	3.0	1.7	1.4	1.3	2.9	1.3	1.4	1.1
Private consumption	–1.2	1.7	5.1	3.0	3.1	9.3	4.2	2.8	4.5
Public consumption	–0.6	4.2	–3.2	1.0	3.9	–1.4	–7.1	–2.1	–2.0
Gross fixed capital formation	–10.8	0.2	6.5	–1.8	5.3	6.4	0.5	8.2	9.8
Exports of goods and services	–6.4	10.6	1.0	–2.0	2.2	–5.8	–0.9	8.8	2.6
Imports of goods and services	–8.2	12.1	3.0	4.4	4.5	–1.5	–1.4	6.9	8.0
	Contribution to GDP growth in percentage points								
Domestic demand	–5.0	4.1	3.6	6.6	3.4	7.5	0.9	0.0	6.3
Net exports of goods and services	1.6	–1.0	–1.9	–5.3	–2.1	–4.6	0.4	1.5	–5.2
Exports of goods and services	–5.8	9.0	0.9	–1.6	1.7	–5.8	–0.9	6.9	2.5
Imports of goods and services	7.5	–10.1	–2.8	–3.7	–3.8	1.2	1.3	–5.4	–7.7
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	5.6	2.7	6.6	4.4	5.5	5.4	6.8	8.8	5.6
Unit labor costs in manufacturing (nominal, per hour)	1.5	–3.0	8.6	10.2	7.7	10.2	11.1	3.6	10.1
Labor productivity in manufacturing (real, per hour)	2.6	9.9	–0.9	1.5	6.4	0.5	–0.2	2.4	–5.7
Labor costs in manufacturing (nominal, per hour)	3.6	7.3	7.6	11.9	14.7	10.8	10.9	6.1	3.8
Producer price index (PPI) in industry	–0.5	6.8	27.8	9.3	14.5	24.4	30.6	31.0	25.0
Consumer price index (here: HICP)	2.0	2.8	12.1	3.4	4.8	8.5	11.8	13.3	14.9
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.8	6.9	6.2	6.8	6.6	6.4	6.2	6.1	6.1
Employment rate (%, 15–64 years)	67.5	69.5	71.4	70.3	70.8	70.6	71.4	71.6	71.8
Key interest rate per annum (%)	0.0	0.0	0.6	0.0	0.0	0.0	0.0	0.5	1.8
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	4.5	7.3	10.5	5.2	7.3	8.9	11.7	12.0	10.5
of which: loans to households	6.1	8.8	10.3	8.0	8.8	10.5	11.3	11.1	10.3
loans to nonbank corporations	1.4	4.3	10.8	–0.2	4.3	5.5	12.6	13.9	10.8
	%								
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	0.0	0.1
Return on assets (banking sector)	0.5	0.7	0.8	0.8	0.7	0.5	0.7	0.7	0.8
Tier 1 capital ratio (banking sector)	18.1	18.3	18.0	18.8	18.3	18.1	17.8	17.8	18.0
NPL ratio (banking sector)	2.3	1.9	1.7	1.9	1.9	1.9	1.9	1.8	1.7
	% of GDP								
General government revenues	39.4	40.1	40.2	..	..	..	..	..	..
General government expenditures	44.7	45.6	42.3	..	..	..	..	..	..
General government balance	–5.4	–5.4	–2.0	..	..	..	..	..	..
Primary balance	–4.1	–4.4	–1.1	..	..	..	..	..	..
Gross public debt	58.9	61.0	57.8	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	54.5	52.7	51.2	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	46.6	47.9	48.0	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	1.1	–0.5	–6.2	–2.6	–1.6	–6.7	–4.3	–4.8	–8.9
Services balance	1.0	0.6	0.4	1.2	0.2	0.5	0.1	0.2	0.6
Primary income	–0.8	–1.5	–1.7	–1.4	–2.7	–0.9	–1.9	–1.6	–2.3
Secondary income	–0.7	–1.0	–0.8	–0.8	–0.4	–1.5	–0.9	–1.2	0.4
Current account balance	0.6	–2.5	–8.3	–3.6	–4.5	–8.6	–6.9	–7.4	–10.2
Capital account balance	0.8	1.3	1.3	0.2	0.7	–0.1	1.0	1.1	2.8
Foreign direct investment (net)[3]	2.6	0.3	–2.2	–1.2	0.7	–1.7	–2.2	–3.0	–1.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	119.6	135.0	105.0	116.9	135.0	141.5	129.6	111.6	105.0
Gross official reserves (excluding gold)	6.5	7.0	9.0	7.1	7.0	8.8	9.6	9.3	9.0
	Months of imports of goods and services								
Gross official reserves (excluding gold)	0.9	0.9	1.0	1.0	0.9	1.1	1.2	1.1	1.0
	EUR million, period total								
GDP at current prices	93,414	98,523	107,730	26,025	25,935	24,076	26,807	28,504	28,344

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

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

3 Slovenia: inflation moderates as consumption loses steam and energy prices decline

GDP growth slowed to 5.4% in 2022. The economy lost lots of steam in the second half of the year, with the growth rate dropping from 10.2% in the first half to 0.2% in the second half of 2022. The deceleration was most pronounced for household consumption, which was hit by the erosion of consumer confidence, slowing employment growth and the continued contraction of real wages, which was only partially cushioned by a decline in households' saving rate and in their net financial assets. Government consumption slipped into contraction during the second half of 2022, mainly as containment measures related to COVID-19 were scaled back. By contrast, investment growth held up well, mostly owing to construction activity. Though housing construction growth slowed considerably, non-housing construction growth accelerated. Investment in machinery and equipment weakened along with the deterioration of economic sentiment, worsening export prospects and falling capacity utilization rates. With import dynamics slowing more than exports, the negative contribution of net real exports diminished in the second half of 2022.

The budget deficit amounted to 3% of GDP in 2022, down from 4.6% recorded in 2021. This improvement was supported by a strong rise in revenues, which were aided by corporate tax proceeds and VAT revenues. At the same time, budget expenditures decreased owing to a fall in current transfers as support measures related to COVID-19 were gradually phased out.

For 2023, the government plans a budget deficit of 5.3% of GDP. The widening of the deficit is mainly related to increased spending on measures to mitigate the impact of the energy and cost-of-living crisis, but in part also due to increased public sector wages and pension outlays. The Fiscal Council has noted that less than 20% of the adopted measures to ease the cost-of-living crisis represent targeted measures. It has also criticized that, excluding crisis mitigation measures, budget expenditure growth is expected to be the highest ever. It also warned that the government will likely have to revise the 2023 budget later in the year, as some expenditure items have been underestimated. In fact, in late March 2023, the government announced a proposed revision of the 2023 budget, cutting both expenditures and the deficit, stating that fewer measures were needed to mitigate the impact of higher energy costs than previously anticipated.

HICP inflation hovered around 10% and 11% between September and December 2022, before falling back to 9.4% by February 2023. The decline in early 2023 was caused mainly by the prices for energy (and, to a smaller extent, unprocessed food), which partly reflected favorable international energy price developments and government measures to mitigate the impact of rising energy prices. By contrast, core inflation edged somewhat higher on the back of accelerating price increases for processed food and services.

The combined current and capital account recorded a deficit during the second half of 2022 as the surplus on the goods and services balance continued to evaporate while the combined deficit on the other items increased modestly. The worsening of the goods and services balance resulted largely from the deterioration of the terms of trade.

Banking sector profitability worsened modestly in 2022. Operating income improved on the back of intensified lending activity and an improvement in the interest margin, but banks created some additional provisions (despite a modest improvement in the quality of the credit portfolio).

Table 3

Main economic indicators: Slovenia

	2020	2021	2022	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22
	Year-on-year change of the period total in %								
GDP at constant prices	–4.3	8.2	5.4	5.1	10.5	10.2	8.6	3.3	0.2
Private consumption	–6.9	9.5	8.9	5.8	21.2	20.0	12.9	3.2	2.4
Public consumption	4.1	5.8	0.9	5.4	8.3	4.8	0.8	–0.6	–1.0
Gross fixed capital formation	–7.9	13.7	7.8	11.8	13.2	9.4	7.3	8.7	5.9
Exports of goods and services	–8.6	14.5	6.5	12.6	13.8	8.2	9.3	11.9	–2.5
Imports of goods and services	–9.6	17.6	9.8	19.5	18.1	17.2	12.6	12.6	–1.5
	Contribution to GDP growth in percentage points								
Domestic demand	–4.3	9.0	7.5	8.3	12.3	16.3	10.4	3.2	1.2
Net exports of goods and services	0.0	–0.8	–2.1	–3.2	–1.8	–6.1	–1.9	0.1	–0.9
Exports of goods and services	–7.2	11.3	5.4	9.5	11.1	6.9	7.8	9.7	–2.1
Imports of goods and services	7.2	–12.0	–7.5	–12.7	–12.9	–13.0	–9.7	–9.6	1.1
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	7.6	0.9	1.1	5.0	–4.3	–5.1	–2.3	4.2	8.7
Unit labor costs in manufacturing (nominal, per hour)	6.8	–3.0	2.0	3.9	–0.9	–3.0	2.7	–1.2	9.6
Labor productivity in manufacturing (real, per hour)	–3.3	9.9	5.3	2.9	10.4	9.7	6.6	5.1	–0.2
Labor costs in manufacturing (nominal, per hour)	3.2	6.8	7.3	6.9	9.3	6.4	9.5	3.9	9.4
Producer price index (PPI) in industry	–0.3	5.5	19.6	7.5	9.9	15.6	21.7	21.2	19.9
Consumer price index (here: HICP)	–0.3	2.0	9.3	2.3	4.5	6.3	9.0	11.3	10.6
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	5.0	4.8	4.0	4.5	4.5	4.3	4.2	4.0	3.4
Employment rate (%, 15–64 years)	70.9	71.5	73.1	73.4	72.4	72.5	73.1	73.9	73.0
Key interest rate per annum (%)	0.0	0.0	0.6	0.0	0.0	0.0	0.0	0.5	1.8
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	–1.0	5.6	10.4	2.2	5.6	8.0	10.4	12.8	10.4
of which: loans to households	0.1	5.0	7.5	3.6	5.0	6.7	7.9	8.2	7.5
loans to nonbank corporations	–2.2	6.2	13.4	0.7	6.2	9.4	13.2	17.6	13.4
	%								
Share of foreign currency loans in total loans to the nonbank private sector	1.4	1.1	0.8	1.2	1.1	1.0	1.0	0.9	0.8
Return on assets (banking sector)	1.0	1.1	1.0	1.0	1.1	0.7	0.8	0.5	1.0
Tier 1 capital ratio (banking sector)	16.7	16.9	15.9	17.0	16.9	15.7	15.7	15.5	15.9
NPL ratio (banking sector)	1.9	0.8	0.7	0.9	0.8	0.9	0.8	0.8	0.7
	% of GDP								
General government revenues	43.7	44.9	42.5	..	..	..	..	..	..
General government expenditures	51.4	49.5	45.5	..	..	..	..	..	..
General government balance	–7.7	–4.6	–3.0	..	..	..	..	..	..
Primary balance	–6.1	–3.4	–1.9	..	..	..	..	..	..
Gross public debt	79.6	74.5	69.9	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	47.8	46.1	43.1	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	27.8	26.4	25.1	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	5.0	1.7	–3.9	0.5	–1.1	–4.1	–4.1	–2.6	–4.9
Services balance	4.4	4.7	6.1	5.4	4.9	4.5	6.0	7.3	6.3
Primary income	–0.8	–1.7	–1.7	–1.1	–2.2	–1.2	–1.6	–2.6	–1.2
Secondary income	–1.0	–0.9	–0.9	–0.7	–0.9	–1.0	–1.0	–0.9	–0.7
Current account balance	7.6	3.8	–0.4	4.1	0.7	–1.9	–0.6	1.2	–0.5
Capital account balance	–0.5	0.1	–0.4	0.3	–0.1	–0.3	–0.3	–0.1	–1.0
Foreign direct investment (net)[3]	0.6	–0.8	–2.1	–1.3	3.8	–2.7	–1.8	–2.0	–1.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	102.1	97.3	88.0	103.1	97.3	96.2	92.8	90.5	88.0
Gross official reserves (excluding gold)	1.9	3.5	3.3	3.4	3.5	3.5	3.5	3.5	3.3
	Months of imports of goods and services								
Gross official reserves (excluding gold)	0.3	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.4
	EUR million, period total								
GDP at current prices	47,021	52,208	58,989	13,483	14,009	13,313	15,017	15,309	15,349

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

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

4 Bulgaria risks stagflation after fifth inconclusive election

HICP inflation in Bulgaria increased substantially from fall 2021, peaking at 15.6% in September 2022, with a strong contribution from energy and food price inflation. The pass-through of higher costs affected transport and restaurant services first, but toward the end of the year, inflation also spread to other services, in line with increasing unit labor costs. Subsequently, the HICP inflation rate moderated to 13.7% in February 2023 because of the downward trend in international energy commodity prices. Headline inflation will decelerate in late 2023 but remain high on average in 2023 (between 7% and 10%), as high producer prices, limited supply and labor shortages will continue to weigh on consumer prices in the short run. Against the backdrop of strong wage increases and pro-inflationary fiscal policies, core inflation came in at 10.9% in February 2023 and it is expected to even accelerate in 2023 and to remain high in 2024, dominating headline inflation dynamics.

The interplay of wages and prices also influences economic activity. Despite high inflation, real GDP continued to expand by 3.4% in 2022, supported by robust growth in exports and by wage and social transfer increases that compensated consumers for losses in purchasing power. Private and public consumption as well as the buildup of inventories contributed positively to real GDP growth over the year, while net exports and gross fixed capital investment contributed negatively.

Quarterly data reveal a pronounced cycle of inventories, and stock changes started to dampen GDP growth in the second half of 2022. The cycle was driven by disruptions of global supply chains that changed the incentives for firms to maintain stocks of commodities, raw materials and finished products.

The downward trend in fixed capital investment that started in 2021 persisted in 2022. Rising prices of investment goods and political stalemate that delayed the disbursement of NextGenerationEU (NGEU) funds and, more recently, higher interest rates, have been suppressing new investment. However, fixed capital formation started to add to GDP growth in the final quarter of 2022.

The global energy crisis disrupted the recovery in Bulgaria. While industrial production started to shrink in the second half of 2022, the labor market is lagging behind the cycle. Real GDP is expected to slow down considerably in 2023 in line with weak external demand and rising borrowing costs. GDP estimates range between 0.4% and 2.5%.

The snap general election on April 2, 2023, the fifth in two years, produced yet another highly fragmented parliament with little chance to form a regular government. If the political parties cannot form a temporary technocratic cabinet with a specific agenda, then Kremlin-friendly President Radev will continue ruling through caretaker governments until the next snap vote, which is likely to be held together with the local elections in autumn. Bulgaria's prolonged political deadlock has already forced the country to delay its target date for adopting the euro until 2025. The uncertainty has also hampered Bulgaria's ability to harness EU post-pandemic recovery funds by delaying significant reforms and infrastructure investments and in turn slowing down economic convergence.

In the absence of a formal 2023 budget bill, the generous support measures for households and firms are still in force. They are mostly untargeted and distorting price signals – and they are increasingly jeopardizing the path to sound public finances. While the debt-to-GDP ratio is low, spending pressures related to aging, health and education, as well as infrastructure and the green transition, are mounting. Moreover, rising interest rates and sovereign spreads and the short tenor of public debt have increased the public debt interest burden.

Table 4

Main economic indicators: Bulgaria

	2020	2021	2022	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22
	Year-on-year change of the period total in %								
GDP at constant prices	–4.0	7.6	3.4	8.6	10.2	4.4	3.9	2.9	2.6
Private consumption	–0.6	8.8	4.8	9.8	8.9	5.5	2.1	4.2	6.8
Public consumption	8.3	0.4	6.5	2.9	2.3	6.6	11.6	3.8	4.5
Gross fixed capital formation	0.6	–8.3	–4.3	–11.9	–13.0	–7.4	–11.0	–3.3	2.4
Exports of goods and services	–10.4	11.0	8.3	9.6	9.4	4.8	8.9	9.7	9.4
Imports of goods and services	–4.3	10.9	10.5	13.0	3.9	12.3	12.3	9.2	8.5
	Contribution to GDP growth in percentage points								
Domestic demand	0.1	7.4	4.6	10.2	7.3	9.6	6.1	1.7	2.5
Net exports of goods and services	–4.0	0.2	–1.2	–1.6	2.9	–5.2	–2.2	1.2	0.1
Exports of goods and services	–6.6	6.2	5.1	5.4	5.1	3.9	6.0	5.9	4.4
Imports of goods and services	2.6	–5.9	–6.3	–7.0	–2.1	–9.1	–8.2	–4.7	–4.3
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	8.9	3.8	15.6	5.0	2.3	10.3	17.9	16.1	18.8
Unit labor costs in manufacturing (nominal, per hour)	1.6	–1.9	3.8	4.7	3.1	3.0	–1.6	4.5	9.1
Labor productivity in manufacturing (real, per hour)	3.7	8.8	13.6	10.5	9.3	14.5	17.2	13.6	9.5
Labor costs in manufacturing (nominal, per hour)	5.2	7.0	17.9	15.7	12.7	17.9	15.4	18.8	19.5
Producer price index (PPI) in industry	–2.0	15.5	38.3	17.4	28.9	33.9	40.2	50.2	28.8
Consumer price index (here: HICP)	1.2	2.8	13.0	2.9	6.0	8.9	13.4	15.2	14.5
EUR per 1 BGN, + = BGN appreciation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	5.2	5.3	4.3	4.6	4.6	5.0	4.7	3.7	3.9
Employment rate (%, 15–64 years)	68.5	68.2	70.4	69.5	68.5	68.4	69.8	71.9	71.5
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
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[2]	4.3	8.6	12.7	7.5	8.6	10.6	12.5	13.5	12.7
of which: loans to households	6.6	13.4	14.6	11.8	13.4	14.1	14.7	15.2	14.6
loans to nonbank corporations	2.9	5.5	11.4	4.8	5.5	8.4	10.9	12.2	11.4
	%								
Share of foreign currency loans in total loans to the nonbank private sector	31.9	29.3	26.2	30.2	29.3	29.0	28.4	27.3	26.2
Return on assets (banking sector)	0.7	1.1	1.4	1.1	1.1	1.6	1.5	1.4	1.4
Tier 1 capital ratio (banking sector)	22.1	22.0	20.5	21.8	22.0	21.4	20.7	20.1	20.5
NPL ratio (banking sector)	4.3	3.7	2.8	3.8	3.7	3.3	3.1	3.1	2.8
	% of GDP								
General government revenues	37.7	37.7	38.5	..	..	..	..	..	..
General government expenditures	41.5	41.5	41.3	..	..	..	..	..	..
General government balance	–3.8	–3.8	–2.8	..	..	..	..	..	..
Primary balance	–3.3	–3.3	–2.3	..	..	..	..	..	..
Gross public debt	24.5	24.5	22.9	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	77.1	69.3	60.2	..	..	..	..	..	..
Debt of households and NPISHs[3] (nonconsolidated)	24.3	23.8	22.8	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	–3.2	–4.1	–5.8	–2.9	–6.4	–5.8	–3.8	–5.4	–7.8
Services balance	5.1	5.7	6.3	7.9	4.5	5.4	6.4	8.4	4.8
Primary income	–3.5	–3.3	–2.9	–4.2	–3.2	–4.8	0.4	–4.1	–3.0
Secondary income	1.6	1.2	1.7	1.8	0.9	1.0	1.5	1.5	2.3
Current account balance	0.0	–0.5	–0.7	2.5	–4.1	–4.2	4.6	0.4	–3.6
Capital account balance	1.4	0.7	0.9	0.6	–0.4	–2.3	0.0	–0.4	5.3
Foreign direct investment (net)[4]	–4.5	–1.4	–2.4	–2.2	0.9	–7.0	2.7	–2.7	–3.0
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	63.8	58.4	52.5	60.5	58.4	56.0	54.0	54.5	52.5
Gross official reserves (excluding gold)	46.8	45.7	42.8	44.9	45.7	41.6	40.3	42.9	42.8
	Months of imports of goods and services								
Gross official reserves (excluding gold)	10.4	9.2	7.6	9.3	9.2	8.0	7.4	7.6	7.6
	EUR million, period total								
GDP at current prices	61,639	71,077	84,561	19,515	20,518	17,248	20,075	22,987	24,251

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

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

5 Croatia: smooth transition into the euro area amid slowing growth

On January 1, 2023, Croatia joined the Schengen Area and the euro area. The euro changeover went smoothly and on January 15, euro banknotes and coins became the sole legal tender in Croatia. Survey data from the Eurobarometer show that most Croatian citizens found it easy to switch to the euro, which is unsurprising given previously high levels of euroization. However, 38% continued to think that euro introduction was not good for Croatia. Moreover, most people thought that euro adoption would lead to higher inflation. From a macroeconomic point of view, euro adoption has removed the previously elevated currency risks stemming from financial asset and liability euroization. This has reduced macroeconomic imbalances in Croatia.

At the same time, the geopolitical and economic environment remains challenging. Croatia's impressive post-pandemic economic expansion has gradually weakened. GDP growth decelerated notably to 4.6% year on year in the second half of 2022 (6.3% for the full-year 2022). Private consumption growth slowed in the second half of the year, while growth of gross fixed capital formation accelerated strongly. Both components made roughly similar contributions to GDP growth. A relatively strong positive contribution came from changes in inventories. Net exports made a negative contribution in the second half of 2022 as the surplus in the services balance could not keep up with rising deficits in the goods balance. On the output side, all sectors except manufacturing expanded in the second half of the year.

CPI inflation was 11.7% year on year in February 2023 – the strongest contributions came from services and processed food items, while tax changes had a dampening effect. During 2022, the government passed two large policy packages to mitigate the effects of higher inflation (worth roughly 6% of 2021 GDP). On April 1, 2023, another policy package worth EUR 1.7 billion (around 2.5% of 2022 GDP) entered into force. The lion's share (EUR 1.2 billion) has been allocated to energy price caps, the remainder to various measures to support the most vulnerable citizens and to subsidies. To help finance the packages, the government introduced a tax on excess corporate profits generated in 2022, which will bring in roughly 0.3% of GDP in additional revenues according to estimates by the Ministry of Finance.

Croatia's public sector gross debt in euro has remained roughly unchanged compared to a year ago. However, in relative terms, indebtedness continued to decline to 70% of GDP, helped by strong economic growth. With these debt levels, Croatia broadly mirrors the EU average, while it has the third-highest public debt level among the CESEE EU member states. The budget deficit for 2022 came in at 1.6% of GDP and is expected to increase to 2.3% of GDP in 2023.

The Croatian National Bank announced an increase in the countercyclical capital buffer from 0.5% to 1% from December 31, 2023. It noted that cyclical risks are increasing due to continued strong growth of residential real estate prices, robust mortgage lending activity and very high growth of corporate lending. The latter slowed down somewhat in the second half of 2022. The banking sector's return on assets was 1% in 2022, 0.3 percentage points lower than in 2021. This was due to lower net operating income. Banks' tier 1 capital ratio declined from 25.4% to 24% between end-2021 and end-2022, mainly due to unrealized losses from bond valuations and an increase in risk-weighted assets. The NPL ratio continued to decrease to 3% at end-2022, while the share of stage 2 loans increased in the second half of 2022.

Table 5

Main economic indicators: Croatia

	2020	2021	2022	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22
	Year-on-year change of the period total in %								
GDP at constant prices	–8.6	13.1	6.3	16.7	12.2	7.8	8.7	5.2	4.0
Private consumption	–5.1	9.9	5.1	15.8	7.5	6.2	7.5	5.4	1.3
Public consumption	4.3	3.0	3.0	–4.5	14.3	5.8	–2.2	1.3	6.8
Gross fixed capital formation	–5.0	4.7	5.8	0.7	–5.0	2.0	3.9	8.0	9.6
Exports of goods and services	–23.3	36.4	25.4	53.0	34.4	27.8	40.3	23.3	14.2
Imports of goods and services	–12.4	17.6	25.0	19.8	20.1	29.5	26.5	30.5	14.6
	Contribution to GDP growth in percentage points								
Domestic demand	–3.1	6.5	6.5	–3.0	8.8	14.1	5.5	2.1	5.7
Net exports of goods and services	–5.4	6.6	–0.2	19.7	3.4	–6.3	3.2	3.1	–1.7
Exports of goods and services	–11.8	15.1	13.0	28.7	13.7	9.4	17.2	17.7	6.8
Imports of goods and services	6.3	–8.5	–13.2	–9.0	–10.2	–15.7	–14.0	–14.6	–8.5
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	..	..	..	..	..	..	..	..	..
Unit labor costs in manufacturing (nominal, per hour)	2.4	–0.9	6.9	3.5	5.3	4.1	8.3	7.3	8.1
Labor productivity in manufacturing (real, per hour)	–2.5	4.7	0.9	1.8	0.7	4.6	–0.2	1.2	–1.8
Labor costs in manufacturing (nominal, per hour)	–0.4	3.9	7.9	5.4	6.0	9.0	8.1	8.6	6.2
Producer price index (PPI) in industry	–3.2	11.7	25.8	13.1	24.6	25.1	32.5	30.2	15.6
Consumer price index (here: HICP)	0.0	2.7	10.7	3.1	4.6	6.4	10.8	12.6	12.8
EUR per 1 HRK, + = HRK appreciation	–1.6	0.1	–0.1	0.4	0.6	0.4	–0.1	–0.3	–0.3
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	7.6	7.6	7.1	6.3	6.3	7.2	7.4	6.8	6.8
Employment rate (%, 15–64 years)	62.0	63.4	65.0	64.6	64.1	64.2	64.9	65.1	65.6
Key interest rate per annum (%)	..	..	..	..	..	..	..	..	..
HRK per 1 EUR	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	2.8	2.4	10.4	2.8	2.4	3.9	7.2	10.4	10.4
of which: loans to households	1.6	4.1	5.3	4.5	4.1	4.0	5.1	4.9	5.3
loans to nonbank corporations	4.8	-0.1	18.6	0.2	-0.1	3.6	10.4	19.5	18.6
	%								
Share of foreign currency loans in total loans to the nonbank private sector	52.0	52.2	58.1	51.5	52.2	52.1	52.5	55.1	58.1
Return on assets (banking sector)	0.6	1.2	1.0	1.1	1.2	1.2	1.2	1.3	1.0
Tier 1 capital ratio (banking sector)	25.0	25.4	24.0	25.2	25.4	25.2	24.6	23.5	24.0
NPL ratio (banking sector)	5.4	4.3	3.0	4.7	4.3	4.2	3.8	3.3	3.0
	% of GDP								
General government revenues	46.7	46.0	45.7	..	..	..	..	..	..
General government expenditures	54.0	48.5	47.2	..	..	..	..	..	..
General government balance	–7.3	–2.6	–1.6	..	..	..	..	..	..
Primary balance	–5.3	–1.0	–0.3	..	..	..	..	..	..
Gross public debt	87.0	78.4	70.0	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	12.4	11.0	10.1	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	5.0	4.5	4.1	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	–17.6	–19.6	–26.7	–18.5	–20.7	–29.0	–27.0	–25.8	–25.4
Services balance	10.5	16.9	21.0	41.6	8.3	4.7	17.4	46.3	10.5
Primary income	2.5	0.9	0.9	–0.8	2.8	1.6	0.3	–1.1	3.1
Secondary income	4.0	3.6	3.2	3.3	3.0	3.4	3.1	2.8	3.5
Current account balance	–0.5	1.8	–1.6	25.6	–6.6	–19.2	–6.2	22.1	–8.3
Capital account balance	2.1	2.4	2.6	2.2	2.8	2.1	2.1	2.0	4.0
Foreign direct investment (net)[3]	–1.4	–4.8	–5.6	–7.1	–4.7	–6.8	–4.0	–5.0	–6.7
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	79.6	76.8	74.0	79.8	76.8	80.2	79.8	75.0	73.5
Gross official reserves (excluding gold)	37.6	42.9	41.5	43.6	42.9	40.1	40.4	40.4	41.2
	Months of imports of goods and services								
Gross official reserves (excluding gold)	9.3	9.8	7.6	10.3	9.8	8.6	8.1	7.6	7.6
	EUR million, period total								
GDP at current prices	50,427	58,269	67,393	16,412	14,823	14,368	16,854	18,922	17,249

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

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

6 Czechia: economy navigating troubled waters; technical recession amid eye-catching imbalances

Czechia's economic growth and its structure changed dramatically in H2 2022. Facing weak domestic demand but relatively sturdy net exports and fixed capital formation, real GDP growth experienced a sharp slowdown to 0.8%, after expanding by more than 4% in the first six months of the year. In fact, the economy entered a technical recession. Moreover, the composition of growth drivers changed dramatically. Whereas domestic demand had contributed positively and net exports negatively to growth for more than two years, the roles reversed in the review period. GDP growth was mainly driven by net exports. In contrast, domestic demand provided an increasingly negative contribution to GDP dynamics. This was brought about predominantly by weakened household consumption. Its previously vigorous expansion on the back of pandemic savings and resilient nominal disposable income was replaced by a severe contraction in H2 2022 as high inflation, tightened monetary policy and elevated uncertainty started to bite. While the largest drop was recorded in purchases of durable goods, expenditures on food decreased significantly too. Public consumption made a slightly negative contribution to growth in H2 2022, despite higher defense spending, expenses related to Ukrainian refugees and growing public sector wages and pensions. The expansion of fixed investment and its contribution to GDP growth were relatively robust.

The balance of goods and services turned negative in H2 2022, to a large extent owing to high import prices of energy commodities. This, in combination with a rather high primary income deficit on the back of outflowing dividends, brought about an unusually deep current account deficit (6.1% of GDP in 2022). The general government deficit came in at 3.6% of GDP in 2022, while public debt increased to more than 44% of GDP. Public finances were burdened by permanent tax reductions implemented during the pandemic, expenditures related to the war in Ukraine and incoming refugees as well as by the support to households and firms troubled by strong price increases. These factors notwithstanding, the fiscal outcome was not only significantly better than the Treasury had expected but the deficit was also much smaller than in the previous two years. However, important challenges for public finances remain, e.g. relating to demographics and the pension system. The economic slowdown notwithstanding, the labor market remains rather tight. Despite a very moderate increase, the unemployment rate has stayed contained, hovering at or below 2.5%.

Strong and broad-based price growth accelerated almost continuously throughout 2022 with only a slight breather toward the end of the year owing to some easing in the price pressure of both energy and nonenergy imports. These echoed not only the relaxation on the energy markets but also some easing of the frictions in global supply chains as well as a steadily appreciating koruna. HICP inflation thus averaged just short of 15% in 2022. Yet it accelerated again in January 2023 (19.1%) as a result of electricity prices rising to the government price cap after the energy savings tariff was discontinued. In February, both headline and core inflation eased somewhat, inter alia due to some slowdown of service price growth and imputed rents. The CNB has kept its key interest rate unchanged at 7% since June 2022 as the composition of the CNB board shifted to a more dovish stance. In the new makeup a majority of CNB board members prefer rate stability while putting more emphasis on the strong exchange rate to rein in inflation. The CNB expects headline inflation to drop to single-digit levels in H2 2023 and to reach the 2% target in H1 2024.

Table 6

Main economic indicators: Czechia

	2020	2021	2022	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22
	Year-on-year change of the period total in %								
GDP at constant prices	–5.5	3.6	2.5	3.5	3.6	4.9	3.5	1.6	0.1
Private consumption	–7.2	4.1	–0.9	4.8	8.4	8.3	–0.1	–5.0	–5.5
Public consumption	4.2	1.4	0.6	5.1	0.6	1.3	1.7	–1.6	1.1
Gross fixed capital formation	–6.0	0.8	6.2	1.6	0.7	8.0	7.9	6.8	2.7
Exports of goods and services	–8.0	6.9	5.7	–1.7	–3.4	1.2	1.6	11.1	9.3
Imports of goods and services	–8.2	13.3	5.7	9.8	6.1	5.4	3.0	7.5	6.9
	Contribution to GDP growth in percentage points								
Domestic demand	–5.1	7.1	2.3	10.7	10.3	7.8	4.4	–0.7	–1.6
Net exports of goods and services	–0.4	–3.6	0.2	–7.2	–6.7	–2.9	–0.9	2.3	1.8
Exports of goods and services	–5.9	4.8	4.1	–1.1	–2.7	1.0	1.3	7.2	6.6
Imports of goods and services	5.6	–8.4	–4.0	–6.1	–4.0	–3.9	–2.1	–4.9	–4.9
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	7.2	1.8	4.8	3.8	1.3	4.2	2.9	4.6	7.4
Unit labor costs in manufacturing (nominal, per hour)	2.9	–2.6	4.5	5.1	5.7	7.0	7.6	0.7	3.2
Labor productivity in manufacturing (real, per hour)	4.5	4.7	1.8	–0.1	–0.7	–0.4	–0.3	5.5	2.6
Labor costs in manufacturing (nominal, per hour)	7.1	2.4	6.5	4.9	4.9	6.6	7.2	6.2	5.9
Producer price index (PPI) in industry	0.6	6.2	18.6	8.1	11.0	16.4	21.3	20.6	16.2
Consumer price index (here: HICP)	3.3	3.3	14.8	3.3	5.0	10.2	15.0	17.4	16.5
EUR per 1 CZK, + = CZK appreciation	–3.0	3.2	4.4	3.8	5.1	5.8	4.1	3.7	4.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	2.6	2.9	2.4	2.8	2.3	2.5	2.4	2.3	2.3
Employment rate (%, 15–64 years)	74.4	74.4	75.5	75.0	75.3	75.0	75.2	75.8	75.8
Key interest rate per annum (%)	0.8	0.9	5.9	0.7	2.4	4.2	5.6	7.0	7.0
CZK per 1 EUR	26.5	25.6	24.6	25.5	25.4	24.6	24.6	24.6	24.4
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	3.0	9.7	6.2	6.3	9.7	10.4	9.2	8.6	6.2
of which: loans to households	6.5	9.9	4.8	9.1	9.9	10.3	8.3	6.5	4.8
loans to nonbank corporations	–1.3	9.4	8.3	2.8	9.4	10.5	10.5	11.6	8.3
	%								
Share of foreign currency loans in total loans to the nonbank private sector	14.6	14.6	19.4	14.1	14.6	15.6	17.3	19.4	19.4
Return on assets (banking sector)	0.6	0.8	1.1	0.8	0.8	1.0	1.2	1.2	1.1
Tier 1 capital ratio (banking sector)	23.6	22.8	21.6	23.2	22.8	21.7	20.9	21.1	21.6
NPL ratio (banking sector)	2.6	2.3	1.9	2.5	2.3	2.2	2.0	1.9	1.9
	% of GDP								
General government revenues	41.5	41.4	41.0	..	..	..	..	..	..
General government expenditures	47.2	46.5	44.6	..	..	..	..	..	..
General government balance	–5.8	–5.1	–3.6	..	..	..	..	..	..
Primary balance	–4.9	–4.3	–2.4	..	..	..	..	..	..
Gross public debt	37.7	42.0	44.1	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	56.1	53.4	51.5	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	34.0	35.7	33.2	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	4.9	1.2	–1.5	–2.0	–1.7	0.4	–2.2	–2.9	–0.9
Services balance	1.8	1.8	1.3	1.9	1.6	1.6	1.8	1.6	0.3
Primary income	–4.2	–3.3	–5.5	–4.7	–2.9	–1.9	–4.3	–11.2	–4.2
Secondary income	–0.5	–0.5	–0.5	–0.5	–0.2	–1.3	–0.4	–0.4	0.1
Current account balance	2.0	–0.9	–6.1	–5.3	–3.3	–1.2	–5.0	–12.9	–4.7
Capital account balance	1.2	1.6	0.1	2.4	2.1	–0.3	0.9	0.8	–1.0
Foreign direct investment (net)[3]	–2.6	–0.1	–2.5	–0.7	0.3	–1.1	–1.9	–1.8	–5.1
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	76.3	75.5	66.8	73.8	75.5	77.5	72.9	67.3	66.8
Gross official reserves (excluding gold)	62.5	64.1	47.2	62.8	64.1	62.9	57.7	50.8	47.2
	Months of imports of goods and services								
Gross official reserves (excluding gold)	11.9	11.0	7.6	11.0	11.0	10.7	9.6	8.2	7.6
	EUR million, period total								
GDP at current prices	215,824	238,361	276,659	61,848	63,500	62,484	68,948	71,573	73,653

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

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

7 Hungary: tight monetary policy, weakening consumption and global raw material prices to reduce inflation substantially

In H2 2022, Hungary's GDP growth slowed substantially and reached a meager 0.4% in the fourth quarter, pushing Hungary into a technical recession. The weakening was most pronounced for investments, as increasing interest rates, deteriorating economic sentiment, falling capacity utilization rates, worsening export expectations and the delay of public investment projects as part of the government's fiscal consolidation efforts cooled activity. Household consumption also weakened substantially amid slowing employment growth, falling real wages and sharply worsening consumer confidence. Slowing domestic demand and the acceleration of export growth (exceeding import growth) benefited net real exports, which delivered a positive growth contribution during H2 2022.

The budget deficit declined to 6.2% of GDP in 2022, as revenues were supported by strong economic growth and windfall taxes. Expenditure growth was slowed by the postponement of public investment projects and operational savings to accommodate bigger outlays for the utility bill protection scheme. At the end of 2022, the government modified its 2023 budget deficit target from 3.5% to 3.9% of GDP. This mainly reflected the substantial increase in the cost of the various energy subsidy schemes, but pension outlays, interest expenditure and fiscal reserves were also set markedly higher than in the original budget.

In mid-December 2022, the European Commission and the Council of the EU approved Hungary's recovery and resilience plan (RRP) and the Partnership Agreement with Hungary for 2021–2027. At the same time, the Council decided to withhold EUR 6.3 billion of structural funds until Hungary takes additional measures to safeguard the rule of law. Later on, the Commission specified that it would not disburse any of the EUR 22 billion in cohesion funds until some horizontal enabling conditions are met. These issues mainly concern judicial independence, the so-called "child protection" law and serious risks to academic freedom and the right to asylum. Hungary has pledged to implement the necessary legal requirements but lengthy negotiations with the Commission are ongoing.

Inflation continued to accelerate during the reporting period and presumably peaked at 26.2% in January 2023, before easing to 25.8% in February 2023. However, the decline in February was primarily driven by energy and unprocessed food prices, while core inflation edged up further and price pressures remained broad-based. Increasing fuel shortages forced the government to abandon the price cap on automotive fuels in early December 2022. By contrast, the price cap on selected basic food items was extended until end-April 2023, and the government has indicated that the price cap will remain in place until inflation slows significantly. Nevertheless, food price inflation in Hungary kept on rising during the reporting period and has been the highest in the EU since August 2022.

The MNB maintained its strict policy stance. To additionally absorb banking sector liquidity, it restarted regular auctions of 1-week discount bonds and longer-term deposits from late January 2023 and announced a doubling of the mandatory reserve rate to 10% as of April along with abolishing interest on the first 2.5% of the reserve base. The tight monetary policy together with the MNB's provision of foreign currency to cover FX liquidity needs in connection with energy imports and news about the approval of Hungary's Partnership Agreement and RRP supported the forint between mid-December 2022 and mid-March 2023, when it temporarily came under pressure following the outbreak of global banking sector risks (Silicon Valley Bank, Credit Suisse).

Table 7

Main economic indicators: Hungary

	2020	2021	2022	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22
	Year-on-year change of the period total in %								
GDP at constant prices	–4.5	7.2	4.6	6.3	7.6	8.2	6.5	4.0	0.4
Private consumption	–1.2	4.6	6.4	6.5	7.7	11.6	8.4	4.7	1.7
Public consumption	–0.5	1.7	0.8	2.9	–3.1	4.3	2.5	–0.6	–2.9
Gross fixed capital formation	–7.1	6.5	1.2	13.3	1.5	10.9	6.1	1.2	–9.0
Exports of goods and services	–6.1	8.8	11.8	2.3	0.5	9.1	9.9	16.4	12.1
Imports of goods and services	–3.9	7.7	11.1	5.6	1.3	10.9	9.5	13.7	10.2
	Contribution to GDP growth in percentage points								
Domestic demand	–2.6	6.2	3.9	8.8	8.1	9.9	6.1	2.1	–1.1
Net exports of goods and services	–2.0	1.0	0.7	–2.5	–0.5	–1.6	0.4	1.9	1.5
Exports of goods and services	–5.0	6.9	9.5	1.8	0.4	8.3	8.1	12.5	9.0
Imports of goods and services	3.1	–5.9	–8.8	–4.3	–1.0	–9.9	–7.7	–10.5	–7.5
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	6.8	2.6	11.8	3.3	2.6	12.5	6.7	12.1	15.9
Unit labor costs in manufacturing (nominal, per hour)	8.4	0.1	8.0	9.3	11.2	6.9	7.5	4.9	12.2
Labor productivity in manufacturing (real, per hour)	–0.2	5.9	3.8	0.2	0.5	4.0	2.6	7.2	1.8
Labor costs in manufacturing (nominal, per hour)	7.4	6.8	12.1	9.5	11.7	11.2	10.3	12.4	14.2
Producer price index (PPI) in industry	4.3	13.5	33.4	14.4	20.7	23.4	32.0	41.2	36.9
Consumer price index (here: HICP)	3.4	5.2	15.3	5.0	7.1	8.3	11.0	18.0	23.3
EUR per 1 HUF, + = HUF appreciation	–7.4	–2.0	–8.3	–0.1	–1.0	–0.9	–7.9	–12.3	–11.3
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	4.3	4.1	3.7	3.9	3.7	3.8	3.2	3.7	3.9
Employment rate (%, 15–64 years)	69.7	73.1	74.4	73.6	74.1	74.0	74.3	74.6	74.5
Key interest rate per annum (%)	0.8	1.1	8.0	1.3	2.0	3.1	5.3	10.6	13.0
HUF per 1 EUR	351.2	358.5	390.9	353.9	364.3	364.1	385.3	403.5	410.9
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	11.0	12.1	9.9	11.6	12.1	9.3	10.2	10.8	9.9
of which: loans to households	14.1	14.9	6.3	16.0	14.9	11.0	8.9	7.6	6.3
loans to nonbank corporations	8.8	9.9	12.6	8.3	9.9	7.9	11.3	13.3	12.6
	%								
Share of foreign currency loans in total loans to the nonbank private sector	22.3	20.3	23.3	20.3	20.3	21.3	22.3	23.6	23.3
Return on assets (banking sector)	0.4	0.9	0.7	1.2	0.9	1.1	0.6	0.7	0.7
Tier 1 capital ratio (banking sector)	17.4	18.1	16.7	16.6	18.1	17.3	16.7	16.2	16.7
NPL ratio (banking sector)	2.4	1.6	2.0	1.8	1.6	1.6	1.9	2.0	2.0
	% of GDP								
General government revenues	43.6	41.2	41.6	..	..	..	..	..	..
General government expenditures	51.1	48.3	47.8	..	..	..	..	..	..
General government balance	–7.5	–7.1	–6.2	..	..	..	..	..	..
Primary balance	–5.2	–4.8	–3.4	..	..	..	..	..	..
Gross public debt	79.3	76.6	73.3	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	68.6	75.8	79.3	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	20.1	20.4	18.1	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	–1.0	–2.9	–8.8	–5.4	–5.8	–7.4	–6.9	–11.3	–9.3
Services balance	2.9	3.2	4.7	4.2	2.7	4.3	4.9	5.7	4.1
Primary income	–2.6	–3.3	–3.1	–3.6	–3.6	–2.1	–3.4	–3.8	–3.1
Secondary income	–0.5	–1.1	–0.9	–0.7	–0.7	–0.6	–1.0	–1.1	–0.9
Current account balance	–1.1	–4.1	–8.1	–5.5	–7.4	–5.7	–6.4	–10.5	–9.3
Capital account balance	2.0	2.5	2.0	1.9	4.2	4.3	2.6	1.0	0.6
Foreign direct investment (net)[3]	–1.7	–1.9	–2.3	–2.4	–5.2	4.4	–2.7	–8.2	–1.9
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	81.1	84.7	88.2	87.9	84.7	85.6	83.7	85.0	88.2
Gross official reserves (excluding gold)	23.3	21.7	19.8	22.8	21.7	19.8	19.6	20.1	19.8
	Months of imports of goods and services								
Gross official reserves (excluding gold)	3.6	3.3	2.5	3.4	3.3	2.9	2.7	2.6	2.5
	EUR million, period total								
GDP at current prices	137,723	154,098	169,726	39,852	44,449	37,627	42,129	43,176	46,794

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

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

8 Poland: sharp slowdown of growth in the wake of weaker consumption

GDP growth amounted to about 5% in full-year 2022 but declined continuously from 10.5% in the first quarter to about 0.5% in the fourth quarter. In quarter-on-quarter terms, GDP rebounded in the third quarter following a contraction after Russia had escalated its war against Ukraine, but it contracted again by 2.4% in the fourth quarter. Foreign demand contributed more to GDP growth than domestic demand, whether including or excluding the contribution from inventory change. This was true both in year-on-year and quarter-on-quarter terms in the second half and particularly in the fourth quarter, even though its contribution also declined in the fourth quarter. Nevertheless, the parallel slowdown of real imports in the wake of weaker domestic demand was sufficiently strong to lead to a positive contribution of net exports to GDP growth throughout the second half of 2022. Correspondingly, in that period, the surplus of the goods and services balance in balance of payment terms was higher than a year earlier, even though in full-year terms it declined from 3.3% to 1.9% of GDP. With the primary balance deficit roughly unchanged at 4.5%, the combined current and capital account deficit came in at 2.7% of GDP in 2022, still fully covered by net FDI inflows of 4% of GDP. The weakening of domestic demand in the second half of 2022 primarily reflected private consumption, as consumer confidence deteriorated and both real wages and real pension payments declined. In contrast, the slowdown of gross fixed capital formation was less pronounced. While industrial confidence, too, was moderately weaker in the second half and capacity utilization declined, other factors including sales profitability, the share of profitable enterprises and corporate liquidity continued to support business investment. Residential investment (measured by the number of dwellings under construction) and housing loans were lower than a year earlier in the second half of 2022.

In the second half of 2022, nominal unit labor costs (ULC) of manufacturing gross value added were higher than a year earlier and their increase exceeded that in the euro area by about 6.5 percentage points, while the złoty's nominal value in euro was weaker by about 3%. Thus, in real (ULC-deflated) terms, the złoty was stronger by about 3.5%. According to HICP (and national CPI) definition, annual headline inflation stood at almost 16% (17.3%) in the final quarter and at 17.2% (18.4%) in February 2023, while core inflation stood at 13.2% (11.3%) and at 13.6% (12.0%), respectively. Within core HICP inflation, nonenergy industrial goods inflation stood below average at 10.3% in February. The Monetary Policy Council (MPC), pursuing a CPI inflation target of 2.5% ± 1 percentage points, has maintained its main policy rate at 6.75% since its hike in September 2022. In early April 2023, the MPC stated that the earlier strong monetary policy tightening will lead to a gradual decline in inflation toward the target and that this disinflation would be faster if supported by an appreciation of the złoty, which, in the MPC's assessment, would be consistent with the fundamentals of the Polish economy.

Regarding fiscal policy, the 2022 general government deficit rose to 3.7% of GDP and, according to the European Commission staff forecast in November, it will increase further to 5.5% in 2023. Despite increased military expenditure and spending on support for displaced persons from Ukraine, the deficit rise resulted primarily from a decline in the revenue-to-GDP ratio induced by anti-inflationary tax policy. The general government debt ratio declined from 53.6% of GDP at end-2021 to 49.1% at end-2022.

Table 8

Main economic indicators: Poland

	2020	2021	2022	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22
	Year-on-year change of the period total in %								
GDP at constant prices	–2.0	6.8	4.9	7.4	9.4	10.5	5.2	4.4	0.5
Private consumption	–3.4	6.3	3.0	4.6	8.3	6.5	6.3	0.7	–1.4
Public consumption	4.9	5.0	–0.3	5.0	5.7	0.8	1.1	0.5	–2.6
Gross fixed capital formation	–2.3	2.1	4.5	5.8	5.7	7.1	9.1	1.6	2.6
Exports of goods and services	–1.1	12.5	4.5	8.0	7.3	4.5	5.2	6.8	1.7
Imports of goods and services	–2.4	16.1	5.5	13.4	12.4	9.5	7.0	6.0	0.1
	Contribution to GDP growth in percentage points								
Domestic demand	–2.6	7.9	5.2	9.5	11.4	13.0	5.9	3.9	–0.3
Net exports of goods and services	0.6	–1.0	–0.4	–2.2	–2.0	–2.6	–0.7	0.5	0.9
Exports of goods and services	–0.6	6.6	2.6	4.3	3.9	3.0	3.3	3.8	0.8
Imports of goods and services	1.2	–7.6	–3.0	–6.5	–5.9	–5.5	–4.0	–3.3	0.1
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	7.5	–0.8	9.8	–2.6	–1.6	1.7	10.6	13.9	13.3
Unit labor costs in manufacturing (nominal, per hour)	4.7	–4.6	1.8	0.9	–0.8	–1.6	2.1	2.6	4.3
Labor productivity in manufacturing (real, per hour)	1.9	12.9	8.7	8.8	10.3	12.7	9.7	9.0	4.1
Labor costs in manufacturing (nominal, per hour)	6.2	8.0	10.8	9.8	9.4	10.9	12.1	11.7	8.6
Producer price index (PPI) in industry	–0.5	8.1	23.7	9.6	13.6	18.5	25.3	27.5	23.7
Consumer price index (here: HICP)	3.7	5.2	13.2	5.1	7.3	9.0	12.8	14.9	15.9
EUR per 1 PLN, + = PLN appreciation	–3.3	–2.6	–2.6	–2.8	–2.4	–1.6	–2.5	–3.8	–2.3
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	3.2	3.4	3.0	3.1	2.9	3.2	2.7	3.0	2.9
Employment rate (%, 15–64 years)	68.7	70.3	71.4	71.0	71.0	71.0	71.4	71.2	71.8
Key interest rate per annum (%)	0.5	0.3	5.3	0.1	1.1	2.7	5.1	6.5	6.8
PLN per 1 EUR	4.4	4.6	4.7	4.6	4.6	4.6	4.6	4.7	4.7
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	–1.2	5.0	0.8	2.6	5.0	6.1	6.1	4.8	0.8
of which: loans to households	1.6	4.2	–4.7	4.0	4.2	3.1	0.4	–2.5	–4.7
loans to nonbank corporations	–6.0	6.5	10.8	–0.1	6.5	11.7	16.9	18.5	10.8
	%								
Share of foreign currency loans in total loans to the nonbank private sector	19.6	17.5	18.5	18.0	17.5	17.6	17.7	19.0	18.5
Return on assets (banking sector)	0.0	0.2	0.5	0.5	0.2	1.0	0.8	0.3	0.5
Tier 1 capital ratio (banking sector)	18.5	17.4	17.6	18.0	17.4	16.7	17.0	16.4	17.6
NPL ratio (banking sector)	7.0	5.8	5.4	6.3	5.8	5.7	5.6	5.7	5.4
	% of GDP								
General government revenues	41.3	42.3	39.8	..	..	..	..	..	..
General government expenditures	48.2	44.1	43.5	..	..	..	..	..	..
General government balance	–6.9	–1.8	–3.7	..	..	..	..	..	..
Primary balance	–5.6	–0.7	–2.1	..	..	..	..	..	..
Gross public debt	57.2	53.6	49.1	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	44.9	43.4	0.0	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	33.7	32.1	0.0	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	1.3	–1.3	–3.7	–2.7	–3.6	–4.2	–3.6	–4.0	–3.1
Services balance	4.4	4.7	5.6	4.6	4.2	5.2	6.6	5.8	4.9
Primary income	–3.8	–4.7	–4.5	–5.5	–3.1	–4.7	–5.5	–5.0	–3.1
Secondary income	0.5	–0.1	–0.3	0.2	–0.3	–0.3	–0.4	–0.4	–0.1
Current account balance	2.4	–1.4	–3.0	–3.5	–2.7	–4.1	–3.0	–3.7	–1.4
Capital account balance	1.4	0.7	0.3	1.0	0.8	–0.5	0.5	0.8	0.3
Foreign direct investment (net)[3]	–2.4	–4.1	–4.0	–5.9	–2.9	–7.7	–3.1	–4.4	–1.3
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	58.5	56.2	53.0	57.1	56.2	55.1	54.9	53.9	53.0
Gross official reserves (excluding gold)	21.7	23.4	22.0	23.8	23.4	21.8	22.0	22.5	22.0
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.5	5.2	4.3	5.5	5.2	4.6	4.5	4.4	4.3
	EUR million, period total								
GDP at current prices	526,034	574,543	654,275	145,387	161,418	149,585	155,613	164,229	184,849

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

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

9 Romania: economic activity stays resilient, but current account deficit widens further

Despite a challenging external environment, Romania's economic activity remained resilient in the second half of 2022, bringing full-year GDP growth to 4.8%. Seasonally adjusted quarter-on-quarter growth was stable in the third quarter and decelerated only mildly in the final quarter of the year.

In the second half of 2022, gross fixed capital formation became the most important growth driver supported by partly EU-funded public investments. Alongside, construction output showed double-digit growth. It is also worth mentioning that substantial investments in the areas of electromobility, electricity storage facilities and solar panels have been launched or announced recently. While domestic credit growth slowed down, it was still positive in real terms within the segment of nonbank corporations, but considerably below the inflation rate in the household segment. Private consumption continued to expand, even though real wage growth remained negative in the second half of 2022 and the unemployment rate edged up in the final quarter. Consumer demand benefited from the energy capping scheme (that was extended until March 2025) and the mild winter that limited utility bills. Net exports contributed negatively to GDP growth in second half of 2022, but the negative contribution decreased in the final quarter. Industrial production continued to shrink in the second half of 2022, as particularly energy-intensive sectors (such as metals and chemistry) were hit by high energy costs. Yet, supply chain bottlenecks in the automotive industry have eased. Meanwhile, unit labor costs in the manufacturing sector grew considerably and the Romanian leu tended to appreciate slightly against the euro in the second half of 2022.

Consumer price inflation stood at 16.4% at end-2022 and came down to 15.5% in February 2023. Remarkably, the National Bank of Romania's (NBR) estimates that the annual inflation rate would have been about 11 percentage points higher without the energy price capping scheme at end-2022. While headline inflation rate started to decline, core inflation was still rising and reached 15% in February 2023. Against this background, the NBR hiked its key policy rate further to 7% in January 2023, and then left it unchanged at the subsequent two board meetings. The NBR currently projects inflation to go down to 7% at end-2023 and to 4.2% at end-2024. Hence, the central bank assumes that inflation will remain above the upper bound of the inflation target variation band of 2.5% ± 1 percentage point until the end of its forecast horizon. After the general government budget deficit fell to still high 6.2% of GDP in ESA 2010 terms, the budget plan for 2023 envisages a further gradual decline of the budget deficit to 4.4%. Within the framework of the excessive deficit procedure, Romania should put an end to the excessive deficit situation by 2024.

The current account deficit widened to 9.3% of GDP in 2022, compared to 7.2% of GDP in 2021 and 8.2% recorded in the four quarters up to mid-2022. Looking at the full-year comparison, the widening of the deficit was driven by the goods balance and the primary income balance (mainly related to outflows of reinvested earnings and dividends). In the fourth quarter, both items tentatively improved compared to the third quarter. Also, the capital account surplus rose in the fourth quarter thanks to increasing EU fund inflows. Nevertheless, the net borrowing position from current and capital accounts remained clearly negative in the fourth quarter as well as over the whole year (6.8% of GDP). Net FDI inflows stayed at an elevated level and covered half of this position in 2022.

Table 9

Main economic indicators: Romania

	2020	2021	2022	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22
	Year-on-year change of the period total in %								
GDP at constant prices	–3.7	5.9	4.8	6.7	2.4	6.3	5.1	3.8	4.6
Private consumption	–3.7	8.0	5.6	9.4	9.8	7.1	7.8	2.8	5.1
Public consumption	0.6	2.0	–3.2	–2.0	4.7	–2.4	0.1	2.6	–7.0
Gross fixed capital formation	1.4	2.0	8.8	–1.8	–6.5	1.4	2.7	11.4	16.2
Exports of goods and services	–9.4	12.8	8.0	7.2	7.9	8.6	9.5	12.9	1.7
Imports of goods and services	–5.8	15.4	9.8	11.5	8.4	10.4	7.0	18.2	3.3
	Contribution to GDP growth in percentage points								
Domestic demand	–2.2	7.3	5.5	7.5	3.1	6.9	3.9	6.8	3.1
Net exports of goods and services	–1.5	–1.5	–0.8	–2.1	–0.5	–1.8	0.3	–3.1	–0.5
Exports of goods and services	–3.8	4.6	3.5	2.5	2.8	4.7	4.3	4.2	0.5
Imports of goods and services	2.3	–6.2	–4.3	–4.6	–3.3	–6.5	–4.0	–7.3	–0.9
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	5.5	–2.0	5.6	–3.1	–0.1	3.4	3.5	8.2	8.8
Unit labor costs in manufacturing (nominal, per hour)	7.7	3.9	14.5	9.1	12.4	11.7	15.1	13.8	17.1
Labor productivity in manufacturing (real, per hour)	0.4	3.1	–1.6	0.3	–4.0	–0.1	–2.5	–0.6	–2.9
Labor costs in manufacturing (nominal, per hour)	8.1	7.1	12.7	9.4	7.9	11.6	12.2	13.1	13.7
Producer price index (PPI) in industry	0.0	14.9	44.7	16.4	30.8	46.2	47.3	50.5	36.2
Consumer price index (here: HICP)	2.3	4.1	12.0	4.3	6.6	8.2	12.4	13.3	14.1
EUR per 1 RON, + = RON appreciation	–1.9	–1.7	–0.2	–1.8	–1.6	–1.4	–0.4	0.4	0.6
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	5.2	5.6	5.6	5.3	5.9	6.0	5.3	5.4	5.8
Employment rate (%, 15–64 years)	65.6	61.9	63.0	62.3	62.1	62.4	63.5	63.4	62.8
Key interest rate per annum (%)	1.9	1.4	4.3	1.3	1.6	2.3	3.4	5.1	6.5
RON per 1 EUR	4.8	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	4.8	14.2	12.0	12.7	14.2	15.2	17.1	15.7	12.0
of which: loans to households	4.2	9.3	4.3	8.8	9.3	9.3	8.6	6.3	4.3
loans to nonbank corporations	5.5	19.8	20.0	17.3	19.8	21.7	26.4	25.7	20.0
	%								
Share of foreign currency loans in total loans to the nonbank private sector	30.5	27.6	31.2	28.4	27.6	27.3	28.0	29.4	31.2
Return on assets (banking sector)	1.0	1.4	1.5	1.5	1.4	1.2	1.5	1.5	1.5
Tier 1 capital ratio (banking sector)	23.2	20.9	18.8	21.4	20.9	19.0	18.9	18.8	18.8
NPL ratio (banking sector)	3.8	3.4	2.7	3.7	3.4	3.3	3.0	2.8	2.7
	% of GDP								
General government revenues	32.3	32.7	33.5	..	..	..	..	..	..
General government expenditures	41.5	39.8	39.7	..	..	..	..	..	..
General government balance	–9.2	–7.1	–6.2	..	..	..	..	..	..
Primary balance	–8.0	–6.0	–5.0	..	..	..	..	..	..
Gross public debt	46.9	48.6	47.3	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	33.0	33.1	30.9	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	16.0	15.7	13.8	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	–8.6	–9.6	–11.3	–9.4	–9.2	–12.2	–11.4	–11.7	–10.2
Services balance	4.3	3.9	4.4	3.5	4.0	4.4	5.0	4.1	4.1
Primary income	–1.5	–2.0	–3.0	–2.7	–1.8	–2.2	–3.7	–4.0	–2.1
Secondary income	0.9	0.4	0.7	0.8	0.3	0.4	0.7	0.8	0.6
Current account balance	–4.9	–7.2	–9.3	–7.8	–6.6	–9.5	–9.4	–10.7	–7.6
Capital account balance	1.9	2.2	2.4	1.5	4.1	1.0	2.1	1.5	4.5
Foreign direct investment (net)[3]	–1.3	–3.7	–3.4	–4.1	–3.5	–5.3	–2.3	–3.9	–2.5
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	57.6	56.6	49.8	56.7	56.6	54.7	52.6	50.4	49.8
Gross official reserves (excluding gold)	17.0	16.8	16.3	17.5	16.8	16.1	16.1	16.0	16.3
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.9	4.3	4.0	4.7	4.3	4.1	4.0	3.9	4.0
	EUR million, period total								
GDP at current prices	220,325	241,099	286,526	65,854	72,934	54,572	67,066	79,062	85,825

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

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

10 Türkiye: fragile economy hit by earthquake as country awaits election outcome

GDP growth amounted to 5.6% in 2022, declining from almost 8% in the first half to less than 4% in the second half of the year. The main driving force was private consumption, followed by real exports, while gross fixed capital formation almost stagnated in the second half of the year. Real export growth turned negative in the fourth quarter. By contrast, real import growth was far lower than that of real exports in the first three quarters, but it stood at about 10% in the fourth quarter so that net exports' contribution to GDP turned negative. However, the sum of growth contributions of all published demand components amounted to GDP growth of about 14% in 2022, far above the published rate. The difference could stem from a very large negative contribution of inventory change, for which no figures are published, and from an underreporting of real imports. Balance-of-payments import growth (in USD) was considerably higher, possibly reflecting not only higher energy import prices. It outpaced export growth by far so that both goods and services deficit and current account deficit widened by 4 percentage points year on year, reaching about 4.5% and 5.5%, respectively, of GDP in 2022. Net FDI inflows remained at close to 1% of GDP and, together with net other investment inflows, financed portfolio investment outflows and part of the current account deficit. Net errors and omissions amounted to 3% of GDP, financing the other part and preventing gross official reserves from declining sharply relative to GDP. At the same time, off-balance sheet net short positions due within one year amounted to about 100% of official FX reserves, with about half from FX swaps with domestic banks and the other half from swaps with Arabian and Asian central banks. Most recently, Saudi Arabia joined this list of creditors.

Both headline and core inflation decelerated from their peaks of 85% and 79%, respectively, in October to 55% and 57%, respectively, in February. In parallel, the Turkish central bank (TCMB) delivered policy rate cuts by 150 basis points each in October and November (to 9%) and another one in February to 8.5%, implying a large negative real key rate. While the lira depreciated by 10% in nominal terms against the euro from August to February, it appreciated by about 11% in real (CPI-deflated) terms. Lira stabilization without interest rate hikes resulted (1) from the continuous requirement for exporters to sell part of their FX revenues to the central bank, (2) from government financing and guarantees for new exchange rate-linked lira deposits stemming from converted FX deposits and (3) from regulatory measures to foster "liraization" of banks' assets and liabilities. Initially, reserve requirement ratios and requirements to hold lira (government) securities depended inversely on a bank's share of converted deposits in its total FX deposits. From 2023, required securities maintenance depended inversely on a bank's compliance (or overcompliance) with the new 60% target share of lira deposits. As a result, in the second half of 2022, the correction of banks' negative on-balance sheet net FX position continued, lowering their need for entering swaps with the central bank by selling FX initially (given the ban on contracting foreign swap partners). In parallel, nonfinancial corporations reduced their overall negative on-balance sheet net FX position further and their positive short-term on-balance net FX position rose moderately again.

The general government fiscal deficit increased to 3.5% of GDP in 2022, up from 1.1% of GDP in 2021. In the wake of the earthquake and related to upcoming elections, the deficit will likely rise further.

Table 10

Main economic indicators: Türkiye

	2020	2021	2022	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22
	Year-on-year change of the period total in %								
GDP at constant prices	1.9	11.3	5.6	7.9	9.6	7.6	7.9	4.1	3.5
Private consumption	3.3	15.3	19.6	9.4	20.5	20.7	22.3	20.3	16.0
Public consumption	2.5	2.6	5.1	8.0	1.3	4.5	1.6	4.6	9.0
Gross fixed capital formation	7.4	7.4	2.8	–1.3	2.1	4.5	5.3	–0.9	2.6
Exports of goods and services	–14.4	24.9	9.1	25.9	21.6	14.3	16.4	12.4	–3.2
Imports of goods and services	6.7	2.4	7.9	–8.7	3.2	2.2	5.8	11.9	10.2
	Contribution to GDP growth in percentage points								
Domestic demand	4.1	11.4	13.4	6.3	12.7	14.2	15.1	12.6	12.2
Net exports of goods and services	–5.4	5.0	0.5	7.4	4.4	3.0	2.8	0.5	–3.4
Exports of goods and services	–3.8	5.6	2.3	5.3	5.2	3.5	4.1	3.0	–0.9
Imports of goods and services	–1.6	–0.6	–1.8	2.1	–0.8	–0.5	–1.3	–2.5	–2.5
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	..	..	..	..	..	..	..	..	..
Unit labor costs in manufacturing (nominal, per hour)	10.0	19.1	74.3	29.2	26.7	48.4	53.8	93.7	100.0
Labor productivity in manufacturing (real, per hour)	8.3	–0.2	–0.5	–1.1	3.3	2.1	2.6	–1.0	–5.2
Labor costs in manufacturing (nominal, per hour)	18.9	19.1	73.8	27.8	30.9	51.4	57.8	91.9	89.7
Producer price index (PPI) in industry	12.2	43.9	128.5	44.8	60.6	104.7	131.0	146.7	127.7
Consumer price index (here: HICP)	12.3	19.6	72.3	19.2	25.9	54.8	74.1	81.0	77.3
EUR per 1 TRY, + = TRY appreciation	–21.0	–23.2	–39.8	–15.9	–26.4	–43.1	–39.8	–44.3	–32.8
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	13.4	12.2	10.7	11.9	11.2	11.8	10.4	10.3	10.3
Employment rate (%, 15–64 years)	47.5	50.3	52.8	51.6	51.7	50.8	53.0	53.5	54.0
Key interest rate per annum (%)	10.2	17.8	12.9	18.9	15.9	14.0	14.0	13.4	10.2
TRY per 1 EUR	8.0	10.5	17.4	10.1	12.8	15.7	16.8	18.1	19.0
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	4.3	8.6	12.7	14.5	36.1	45.1	60.4	68.7	56.3
of which: loans to households	6.6	13.4	14.6	15.9	20.4	22.7	37.5	42.0	55.4
loans to nonbank corporations	2.9	5.5	11.4	14.7	41.9	52.4	67.4	77.5	56.8
	%								
Share of foreign currency loans in total loans to the nonbank private sector	30.9	38.1	27.7	32.2	38.1	37.0	33.9	31.1	27.7
Return on assets (banking sector)	1.0	1.3	3.8	1.1	1.3	2.6	3.3	3.5	3.8
Tier 1 capital ratio (banking sector)	14.1	13.2	15.3	12.9	13.2	15.4	13.6	14.4	15.3
NPL ratio (banking sector)	4.4	3.4	2.2	3.8	3.4	3.0	2.7	2.4	2.2
	% of GDP								
General government revenues	31.2	31.4	32.1	..	..	..	..	..	..
General government expenditures	35.9	32.5	35.6	..	..	..	..	..	..
General government balance	–4.7	–1.1	–3.5	..	..	..	..	..	..
Primary balance	–1.6	2.1	–0.8	..	..	..	..	..	..
Gross public debt	39.7	41.8	39.4	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	..	..	..	..	..	..	..	..	..
Debt of households and NPISHs[1] (nonconsolidated)	..	..	..	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	–5.3	–3.6	–10.0	–3.2	–4.2	–11.8	–9.0	–11.4	–8.4
Services balance	1.6	3.2	5.7	5.3	3.9	3.5	5.3	8.4	4.8
Primary income	–1.3	–1.4	–0.9	–1.1	–1.2	–1.3	–1.2	–0.9	–0.6
Secondary income	0.0	0.1	0.0	0.1	0.1	–0.2	–0.1	0.0	0.1
Current account balance	–5.0	–1.7	–5.4	1.1	–1.4	–9.9	–5.1	–3.8	–4.1
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]	–0.6	–0.8	–0.9	–1.4	–0.6	–0.4	–1.8	–0.7	–0.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	51.3	50.8	44.0	53.0	50.8	51.6	51.1	51.0	44.0
Gross official reserves (excluding gold)	6.5	9.3	9.1	10.7	9.3	8.3	7.5	8.9	9.1
	Months of imports of goods and services								
Gross official reserves (excluding gold)	2.4	3.2	2.6	3.8	3.2	2.6	2.2	2.5	2.6
	EUR million, period total								
GDP at current prices	625,392	687,929	853,070	191,802	182,302	160,450	203,933	236,083	252,605

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

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

11 Russia: high oil revenues keep recession relatively mild despite severe Western sanctions

High energy prices, a successful rechanneling of oil exports to nonsanctioning countries and competent fiscal and monetary management have helped cushion the effects of major Western sanctions in response to Russia's invasion of Ukraine. The EU oil and oil products embargo against Russia and the G7 oil price cap for Russian deliveries to third countries, however, created further challenges from December 2022 (EU oil embargo, G7 oil price cap) and February 2023 (EU oil products embargo) onward.

Russia's GDP contracted by 2.1% in 2022. Driving forces of the drop in economic activity were the decline of private consumption (–1.4%) and the substantial shrinkage of inventories (following a major buildup in the previous year). On the other hand, economic activity was supported by government consumption (+2.8%) and fixed investment (+3.3%, notably boosted by public investment in transportation infrastructure, enterprise restructuring and increased arms production).

Partly supported by continuing capital controls, the ruble's exchange rate remained relatively high until November (around RUB 60 per USD), before losing about 20% of its value in late 2022 and early 2023. This downward slide was largely caused by the declining Urals oil price (from USD 67 per barrel in November 2022 to USD 50 in January–February 2023), which was mostly triggered by the abovementioned new EU and US oil sanctions. As of late March 2023, the ruble had fallen back to its pre-invasion level (of around RUB 76–77 per USD). Inflation continued to decline to 11% in February 2023 (year on year). After reducing its key rate to 7.5% in mid-September 2022, the CBR has so far left it at this level.

The unemployment rate reached a new post-Soviet record low of 3.7% (ILO definition) in January 2023. This i.a. reflects a very tight labor market, after hundreds of thousands left Russia following the start of the Ukraine invasion and the mobilization wave a few months later. Although the average Urals oil price was higher in 2022 than in 2021, the general government balance reverted from a small surplus in 2021 to a deficit of 1.4% of GDP in 2022, on the back of rising budgetary support for strategic enterprises, households and arms production as well as of sharply declining imports and thus import taxes due to Western trade restrictions. The deficit was financed to a larger degree on the domestic debt market, and to a smaller degree by drawing down on the National Wealth Fund. Russia's low government debt (end-2022: 15.1% of GDP) still provides the authorities with sufficient leeway to take recourse to domestic deficit financing.

The abovementioned substantial dip of the Urals oil price in January–February 2023, combined with (one-off) technical effects of the move to a single tax account system as well as brought-forward VAT refunds, triggered a sharp widening of the budget deficit in those two months. Western oil-related sanctions will likely render the budgetary situation more difficult in 2023. High energy export prices until November 2022 and sharply contracting imports in the wake of sanctions triggered a record current account surplus of 10.2% of GDP in 2022. In the second half-year of 2022, the banking sector managed to offset its initial sanctions-triggered loss and achieve a very modest overall profit of about USD 3 billion in full-year 2022, which is, however, less than one-tenth of the corresponding figure of 2021.

Table 11

Main economic indicators: Russia

	2020	2021	2022	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22
	Year-on-year change of the period total in %								
GDP at constant prices	–2.7	5.6	–2.1	5.0	5.8	3.0	–4.5	–3.5	–2.7
Private consumption	–5.9	9.9	–1.4	9.8	7.8	5.6	–4.4	–3.6	–2.7
Public consumption	1.9	2.9	2.8	2.6	2.4	1.9	2.3	2.4	4.7
Gross fixed capital formation	–4.0	9.1	3.3	11.3	5.9	7.4	2.7	1.8	3.0
Exports of goods and services	–4.2	3.3	–13.9	8.5	6.8	3.6	–15.8	–26.6	–14.6
Imports of goods and services	–11.9	19.1	–15.0	21.6	19.8	1.4	–27.6	–20.5	–11.2
	Contribution to GDP growth in percentage points								
Domestic demand	–3.5	8.2	–1.4	7.0	7.7	1.9	–5.9	–0.1	–1.2
Net exports of goods and services	1.1	–2.5	–1.1	–1.3	–1.6	0.8	1.2	–3.9	–1.9
Exports of goods and services	–1.3	1.0	–4.2	2.5	1.9	1.1	–4.8	–8.1	–4.1
Imports of goods and services	2.4	–3.5	3.1	–3.8	–3.5	–0.3	6.0	4.2	2.2
	Year-on-year change of period average in %								
Unit labor costs in the whole economy (nominal, per person)	..	..	..	..	..	..	..	..	..
Unit labor costs in manufacturing (nominal, per hour)	7.6	3.3	16.5	3.3	4.4	12.0	14.8	18.8	20.5
Labor productivity in manufacturing (real, per hour)	–1.4	7.2	–1.2	7.7	8.1	4.8	–3.3	–2.1	–3.7
Labor costs in manufacturing (nominal, per hour)	5.9	10.9	15.2	11.3	12.8	17.7	11.0	16.4	16.0
Producer price index (PPI) in industry	–3.7	24.6	12.8	28.2	28.3	25.6	21.4	5.2	–1.2
Consumer price index (here: HICP)	3.4	6.7	13.7	6.9	8.3	11.5	16.9	14.4	12.2
EUR per 1 RUB, + = RUB appreciation	–12.3	–5.3	18.1	–0.3	9.3	–8.7	24.3	42.7	28.6
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	5.8	4.8	3.9	4.4	4.3	4.2	3.9	3.9	3.8
Employment rate (%, 15–64 years)	..	..	..	..	..	..	..	..	..
Key interest rate per annum (%)	5.0	5.7	10.6	6.3	7.5	12.7	13.9	8.3	7.5
RUB per 1 EUR	82.6	87.2	73.9	86.6	83.1	98.3	72.0	60.7	64.6
	Nominal year-on-year change in period-end stock in %								
Loans to the domestic nonbank private sector[1]	9.6	15.3	14.0	13.9	15.3	15.6	11.7	12.1	14.0
of which: loans to households	12.9	22.1	9.4	20.7	22.1	20.3	12.2	10.2	9.4
loans to nonbank corporations	8.0	12.2	16.4	10.8	12.2	13.3	11.4	13.0	16.4
	%								
Share of foreign currency loans in total loans to the non-bank private sector	12.6	10.8	7.5	10.8	10.8	11.2	7.3	6.7	7.5
Return on assets (banking sector)	1.9	2.4	0.2	2.6	2.4	–0.8	–2.4	–0.9	0.2
Tier 1 capital ratio (banking sector)	9.7	9.6	10.4	9.8	9.6	..	..	10.6	10.4
NPL ratio (banking sector)	17.1	15.1	15.3	15.8	15.1	..	..	15.9	15.3
	% of GDP								
General government revenues	35.5	35.6	34.6	..	..	..	..	..	..
General government expenditures	39.5	34.8	36.0	..	..	..	..	..	..
General government balance	–4.0	0.8	–1.4	..	..	..	..	..	..
Primary balance	..	..	..	..	..	..	..	..	..
Gross public debt	17.6	15.5	15.1	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	..	..	..	..	..	..	..	..	..
Debt of households and NPISHs[2] (nonconsolidated)	..	..	..	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Goods balance	6.3	10.4	13.5	11.3	12.4	20.0	17.4	11.4	8.7
Services balance	–1.1	–1.1	–1.0	–1.4	–1.1	–0.9	–0.6	–1.1	–1.2
Primary income	–2.3	–2.3	–2.0	–2.2	–2.6	–2.0	–2.0	–2.4	–1.5
Secondary income	–0.4	–0.3	–0.4	–0.3	–0.2	–0.3	–0.5	–0.3	–0.3
Current account balance	2.4	6.7	10.2	7.4	8.5	16.8	14.3	7.6	5.6
Capital account balance	0.0	0.0	–0.2	0.0	0.0	0.0	–0.2	–0.3	–0.2
Foreign direct investment (net)[3]	–0.2	1.4	1.3	0.9	2.7	0.2	2.2	1.6	0.9
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	29.9	27.4	16.5	30.1	27.4	25.4	26.1	22.3	16.5
Gross official reserves (excluding gold)	28.6	28.2	19.3	29.5	28.2	25.9	24.4	21.5	19.3
	Months of imports of goods and services								
Gross official reserves (excluding gold)	16.8	16.4	15.0	16.7	16.4	15.0	15.9	15.6	15.0
	EUR million, period total								
GDP at current prices	1,301,316	1,558,582	2,162,355	408,332	482,544	370,340	507,680	630,437	653,898

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

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

Box 1

Ukraine: economy has been hit hard but continues to function due to increasing international financial support

Ukraine's GDP collapsed by roughly 30% in 2022, because of Russia's war of aggression, which has affected the economy via the destruction of production capacities and infrastructure, flight movements within the country and abroad, and through a severe restriction of export opportunities. In particular, much of the export through Black Sea ports has ceased, with the exception of the possibility of exporting agricultural goods under the Black Sea Grain Initiative through some ports remaining under Ukrainian control. Massive Russian attacks on civilian and energy infrastructure since the fall of 2022 have led to power shortages and interrupted the economic recovery from the shock of the first phase of the full-scale war. After GDP grew 9% quarter on quarter in the third quarter of 2022, it shrank again by 4.7% quarter on quarter in the fourth quarter. The liberation of parts of the country from Russian occupation in autumn and resuming business activity as well as rebuilding probably helped contain the renewed GDP drop. The situation in the energy sector started to improve in early 2023.

The trade deficit (goods and services) of USD 25.9 billion in 2022 was almost 10 times higher than in 2021 (USD 2.7 billion), as the slump in exports by far exceeded the decline in imports. Services imports were fueled by expenses of Ukrainians who went abroad due to the war. Yet, as the secondary income balance (as a result of grants and humanitarian aid from abroad) and the primary income balance (as a result of largely stable remittances inflows and sharply falling investment income outflows) improved strongly, there was a current account surplus of USD 8.0 billion.

The deep war-driven recession hit labor demand hard: According to a survey, 36% of those who had a job before the start of the war were unemployed in February 2023. The war, together with the resulting currency devaluation, also caused the inflation rate to rise to 26.6% at end-2022 from about 10% before the full-scale war began. Yet, inflation trended down to 24.9% in February 2023. The National Bank of Ukraine has left its key policy rate stable since the hike to 25% in early June last year. The peg vis-à-vis the USD remained unchanged after the 25% devaluation in July 2022.

The budget deficit increased to 16.7% of GDP in 2022 but would have been by about 10 percentage points higher when excluding grants (primarily from the US) from revenues. Restraining the deficit at lower levels would have resulted in an even deeper economic slump. This deficit widening without the consequence of much stronger inflation acceleration was only possible due to international financial assistance in the amount of USD 32 billion, which financed 60% of the deficit (excluding grants), while bond sales to the central bank (monetary financing) contributed 25% and other bond issues domestically 15%.

For the year 2023, international financial assistance was scheduled to reach more than USD 40 billion, including support from the G7 and other countries, the EU and the IMF. A four-year USD 15.6 billion Extended Fund Facility was approved by the IMF Executive Board at end-March 2023 and is playing a key role in anchoring policies. Monetary financing ceased this year, and the Ukrainian authorities took measures to revive the domestic bond market. Thanks to improving international financial support inflows, Ukraine's international reserves rose to USD 31.9 billion at end-March 2023 from USD 22.3 billion at end-July 2022 (i.e. the lowest level recorded in 2022). Central bank interventions to support the hryvnia stood at a high level at end-2022 but have decreased since then. In parallel, the spread between the cash market rate and the official exchange rate narrowed, partly also reflecting policy measures.