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Marlena Gołębiowska, Bartosz Jóźwik

Year 2023: The State of the Central European Economies

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In 2023, five Central European economies (Estonia, Lithuania, Hungary, Latvia, and the Czech Republic) are expected to end the year in a state of recession, while four (Hungary, Czech Republic, Poland, and Slovakia) are facing double-digit average annual inflation. Furthermore, as many as seven countries in the region are projected to record budget deficits exceeding 3% of GDP. However, economic forecasts for the coming years indicate that the economies of Central Europe will return to a path of economic growth and price stabilization, which may also contribute to the balancing of their public finances.

Deceleration of Economic Growth. The year 2023 brought a significant slowdown in the economic growth of Central European economies. According to forecasts by the European Commission (EC), as many as five countries in this region are expected to end this year in recession, including the three Baltic states. Out of them, the highest predicted GDP decline is faced by Estonia (-2.6%), followed by Lithuania (-0.4%) and Latvia (-0.2%). This is primarily due to decreased demand both in domestic markets and in important external markets (mainly Scandinavia and Germany). Recession is also predicted for Hungary (-0.7%) and the Czech Republic (-0.4). The Polish economy is expected to end 2023 on a positive note (0.4%), but its result remains below the forecasted EU average (0.6%). Economic growth above this average is expected in the southern countries of the Central European region: Slovakia and Slovenia (each 1.3%), Bulgaria (2.0%), Romania (2.2%), and Croatia (2.6%) („Komentarze IEŚ", nr 988). It is worth noting that in the case of the latter, this is not only the best result among the Central European countries but also the second-best in the entire EU (after Malta).

Persistently High Inflation. A significant challenge for the economies of Central Europe in 2023 continued to be inflation („Komentarze IEŚ", nr 914). According to forecasts by the European Commission (EC), the average annual inflation in all of these countries is expected to be higher than the average for the entire EU (6.5%). The highest, double-digit figures are expected to be recorded by the Visegrád Group countries: Hungary (17.2%), Czech Republic (12.2%), Poland (11.1%), and Slovakia (10.8%). The Baltic states are also expected to end 2023 with high inflation, with the highest in Latvia (9.6%), followed by Estonia (9.4%) and Lithuania (8.8%), which is similar to the other Central European countries: Romania (9.8%), Bulgaria (8.8%), Croatia (8.1%), and Slovenia (7.5%).

Restoring the Stability of Public Finances. The stability of the public finance system in Central European countries that are members of the EU is measured by maintaining budget deficits and public debt at levels lower than those specified by the Maastricht criteria: 3% of GDP in terms of deficit and 60% of GDP in terms of debt.

According to Eurostat data, starting from a historically high level of 6.7% of GDP in 2020, the budget deficit in the EU fell to 3.3% in 2022 and is forecasted to reach 3.2% in 2023 („Komentarze IEŚ", nr 916). The ongoing economic expansion in most European Union countries in previous year, particularly the improvement in cyclical components of the budget and discretionary policies, generally favoured the reduction of budget deficits. However, among the eleven Central European countries analysed, as many as seven are expected to have budget deficits in 2023 exceeding the threshold set by the Maastricht criteria: Romania (6.3%), Slovakia (5.7%), Poland and Hungary (both 5.8%), the Czech Republic (3.8%), Slovenia (3.7%), and Latvia (3.2%) („Komentarze IEŚ", nr 939, „Komentarze IEŚ", nr 941). Bulgaria (3%) and Estonia (2.9%) are expected to be on the threshold, while Lithuania (1.6%) is below it. Meanwhile, the smallest budget deficit among the analysed countries is expected in Croatia (0.1%), which, in 2022, was preparing to join the Eurozone on 1st January 2023 („Prace IEŚ", nr 3/2021, „Komentarze IEŚ", nr 320)

Relatively Safe Public Debt. However, the ratio of public debt to GDP in various Central European countries is at a relatively safe level and is much lower than the EU average (83.1%). In 2023, Estonia is expected to lead Central European countries with the lowest level of debt (with public debt at 19.2% of GDP), followed by Bulgaria (23.5%). Lithuania and Latvia are expected to follow (with 37.3% and 41.7%, respectively). Higher debt ratios are expected in the Czech Republic (44.7%), Romania (47.9%), Poland (50.9%), and Slovakia (56.7%). Only three countries are expected to exceed the threshold set by the Maastricht criteria: Croatia (60.8%), Slovenia (69.3%), and Hungary (69.9%).

It is also worth noting that high inflation contributes to the reduction of the public debt-to-GDP ratio. For example, in the EU, the overall debt-to-GDP ratio fell from a historically high level close to 92% at the end of 2020 to 85% in 2022. This significant decrease of 7 percentage points was partly due to the previously mentioned effect of inflation and partly due to the economic recovery after the pandemic.

Low Unemployment. Despite the slowdown in economic activity, the economies of Central Europe are characterized by relatively low unemployment rates. According to forecasts published by the EC in 2023, the lowest rates are expected in the Czech Republic (2.4%), Poland (3.0%), and Slovenia (3.6%). They are followed by Hungary (4.1%), Bulgaria (4.2%), Romania (5.4%), and Slovakia (5.7%). However, higher unemployment rates are expected to be recorded in Croatia (6.5%), Latvia and Lithuania (both 6.8%) („Komentarze IEŚ", nr 887, „Komentarze IEŚ", nr 902), and Estonia (7.0%).

These rates do not cause significant tensions in the labour market and should not contribute to weakening the effective implementation of policies to reduce budget deficits in the coming years. Additionally, in some countries, non-fiscal factors contribute to the reduction of unemployment and ensuring internal balance. These include an aging population, low birth rates, and emigration. For example, long-term trends in the Latvian labour market reveal a decline in population – since 2000, it has decreased by over half a million, which constitutes about one-fifth of the population at the beginning of this period („Komentarze IEŚ", nr 887). In this context, despite a fundamentally stable unemployment rate, the EC draws attention to the growing problem of labour shortages in EU countries.

Conclusions and Forecasts. In 2023, the economies of Central Europe experienced a clear slowdown in economic growth, persistent price increases, and deepening debt. According to forecasts by the European Commission, five countries in the region are expected to end the year in recession, four with double-digit average annual inflation, and seven with a deficit exceeding 3% of GDP.

However, forecasts for the next year provide reasons for cautious optimism. They are based on the assumption that the economic situation will stabilise and inflation will slow down, which will increase the purchasing power of households, thereby boosting consumption. As a result, it is predicted that in 2024, all the economies of Central Europe will return to the path of economic growth. Moreover, forecasts for the next year indicate a reduction in budget deficits in most of the countries of the region under study.

The analysis covers Central European countries that were admitted to the EU after 2004 (i.e., Bulgaria, Croatia, the Czech Republic, Estonia, Lithuania, Latvia, Poland, Romania, Slovakia, Slovenia, and Hungary). Data source: European Commission.