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External Sustainability Analysis

Thematic Note to Support In-Depth Reviews

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This paper represents work underpinning in-depth reviews under the Macroeconomic Imbalance Procedure (MIP), work that is still ongoing at time of this paper's publication. On 22 November 2022 in its Alert Mechanism Report (AMR), the Commission concluded that in-depth reviews (IDRs) are warranted for 17 Member States. These in-depth reviews are country-specific, with results due to be published in late Spring 2023. In the AMR the Commission stated that it “*will carry out in-depth thematic assessments on three issues of key relevance at the current juncture. [...] This will inform the country-specific IDRs in the spring package of the European Semester.*”

As a consequence, three thematic notes had been prepared in early 2023, among which “*An in-depth thematic note on external sustainability and balances will look at the reduction in trade balances within a horizontal approach. This note will focus on Cyprus, Greece, Germany, Hungary, Latvia, Lithuania, the Netherlands, Portugal, Romania and Slovakia.*” This note had been discussed at the Economic Policy Committee on 6 March 2023. The content of that note is being reproduced in this paper, adjusted only for minor clerical errors.

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1. INTRODUCTION AND OVERVIEW

This note analyses common factors that are affecting the external flows of selected EU countries, as input to the 2023 In-Depth Reviews under the Macroeconomic Imbalance Procedure. The note aims to provide the analytical basis for the assessment of potential external sector imbalances for Cyprus, Germany, Greece, Hungary, Latvia, Lithuania, the Netherlands, Portugal, Romania and Slovakia. These countries were selected after the first screening for imbalances in the 2023 Alert Mechanism Report, on the basis of the evolution of their external balances. Out of these Member States, Hungary, Latvia, Lithuania, and Slovakia were not considered to experience an imbalance in the 2022 assessment. The note considers the impact of common factors on their external balances, to provide context to the forthcoming In-Depth Reviews under the Macroeconomic Imbalance Procedure. The analysis attempts to be forward-looking and to anticipate the evolution of potential risks by relying on the most recent data and the forecasts, but it also describes important developments starting with the pandemic, as its effects are still relevant, and often makes comparisons with the pre-pandemic period.¹ The analysis provided is not exhaustive. At the time of publication of the In-Depth Reviews, more up to date data will inform the assessments that will be made, and the existence or not of imbalances will take on board developments across countries' economies and additional country-specific factors.

EU countries' external sectors have been strongly affected in recent years by the impact of both the pandemic crisis and, more recently, the sharp increases in energy prices. Since 2020, external sector flows have been subject to two strong shocks: the pandemic and the increase in energy, and other commodity, prices. Understanding the impact of these shocks is important in order to assess the likely risks associated with the external positions of the most affected countries. While for some countries different forces worked in opposite directions, in some cases their effects on Member States' economies were mutually reinforcing or they interacted in complex ways. Given the current global economic dynamics, characterised by a high degree of uncertainty amid geopolitical conflicts, heightened risk aversion, and tightening financial conditions, it is very important to gain more detailed understanding of the external sector developments for the selected Member States in order to better gauge the potentially evolving risks for their external sustainability. This necessitates an analysis of the impact of both the pandemic, to assess whether there are lasting effects, and of the energy and other price increases which have taken place more recently.

The onset of the pandemic strongly affected the external flows of Member States with large cross-country tourism sectors, but also brought with it a reduction in energy prices and changes to sectoral borrowing and lending. The containment measures that were put in place after the outbreak of the pandemic caused a significant drop in the economic activity, especially in contact-intensive services with a strong negative impact on the tourism industry. The ensuing slump in international travel adversely affected the trade balances of several Member States with large cross-border tourism sectors, some of which have large negative net external stock positions. In parallel, however, as the economic activity plunged, the demand for energy, and thus the prices of energy goods also declined. Given that the EU Member States are net importers of energy goods, this had a positive, but mostly mild partial effect on their trade balances. In addition, there were changes to the contributions of different sectors to net lending and borrowing, with the private sector strongly increasing its position, while the position of the government declined markedly as the economic activity fell and measures have been taken to mitigate the consequences of the pandemic and support the economy. As these movements were largely offsetting, the resulting changes in total economy's net positions were mostly contained. However, while the end of the pandemic marked a resumption of

¹ The note mainly relies on the data from Eurostat and AMECO, with the cut-off date on 30 January 2022, and on the Commission's forecast from the Autumn 2022 forecast round.

tourism and an undoing of this temporary effect, the different sectoral positions are relevant to the evolution of demand from 2021 on.

The price increases, especially of energy goods, which started with the recovery and rose dramatically in 2022, have strongly impacted the trade flows of most of the selected countries. With the return of stronger economic activity, energy prices started to rise in 2021 surpassing the pre-pandemic levels by the end of year (by a multiple of three in the case of natural gas), and continuing their growth into 2022, reinforced by the Russian war of aggression against Ukraine. Consequently, the mild positive direct contribution from the energy balance to current accounts in 2020 turned negative and strong for many Member States, especially in 2022, bringing some countries' current accounts into substantial deficits. The strong rise in energy prices broadened to other goods and services. This added to the already evolving price pressures stemming from supply chain disruptions, which emerged as the containment measures limited the supply capacities of both final goods and intermediate inputs. At the same time, demand moved away from (contact-intensive) services and strongly toward goods, driving up their prices.

The change in prices has led to terms of trade changes that have affected trade balances in many countries, while demand has mostly remained strong. The overall growth in export and import prices strengthened in late 2021 and into 2022, exceeding the growth in trade volumes in most countries under consideration. For some Member States the changes in imports and exports deflators largely cancelled out, limiting the change in their terms of trade. For most of countries under consideration, however, the terms of trade crucially shaped the evolution of their trade balances in the most recent quarters, causing, and/or augmenting their declines. A similar picture emerges from the perspective of output and domestic demand: the increase in demand has surpassed the output growth in most of the selected countries, leading to lower trade balances, with the decline being mainly brought about by stronger growth in the deflator of domestic demand as compared to the GDP deflator. In 2022, further decreases in net lending/borrowing positions of the private sectors have either been recorded so far, and/or are forecast, in most cases resulting from lower gross savings of households amid increased costs of living. In parallel, government positions remain supportive of demand in many countries. With the elevated inflation, the monetary authorities tightened their policy stance, leading to higher financing costs that can further burden the flows of net-debtor countries.

Current forecasts are not conducive to improvements of the most of net-debtors' net international investment positions. With current forecasts, which were prepared by the Commission services in autumn², the Net International Investment Positions (NIIP) of the majority of the selected deficit countries are expected to deteriorate. While in some cases the expected worsening should be contained, for some Member States there are risks of accumulating large net liabilities, which would represent a significant economic burden and a potential source of instability in future. While nominal GDP growth should be supportive of the NIIP improvements, higher financing costs amid tightening of monetary policies, are pushing down the primary income balances in most of net-debtor countries. In addition, trade balances were mostly not expected to improve substantially by the end of forecast horizon. Over the more medium-term, the end of capital flows stemming from the European Union's Reform and Recovery Plans, has a downward impact on NIIPs, particularly for countries that are recipients of large flows.

The most recent movements in energy prices suggest that the actual trade flows may turn out to be more favourable for the deficit countries than currently forecast, as a result of the direct impact of energy prices. The current Commission forecast, which underlies the analysis in this note, was prepared in autumn 2022. More recently, however, energy prices have moved down substantially. Thus, the prices of natural gas and electricity are now expected to be considerably below the levels assumed in the current forecast, for this year and the next. Consequently, this would lead to a positive direct impact on the trade and current account balances through a higher balance of trade in energy goods. Such development would be favourable for the deficit countries, while the surpluses of the net lender economies would expand, other things equal. In addition, the pressures from the supply

² https://economy-finance.ec.europa.eu/publications/european-economic-forecast-autumn-2022_en.

disruptions seem to have been receding, as the suppliers' delivery times have been reduced since the mid-2022.

The overall impact on trade balances, both in the short and medium terms is very uncertain.

While the reduction in energy prices has a direct positive impact on trade balances, through trade in energy goods, it is not clear how this would affect other goods and services. In particular, other effects such as rising unit labour costs in some economies could be potentially exerting upward price pressures and driving higher demand overall.³ There is still a considerable uncertainty surrounding the evolution of the overall terms of trade going forward, both in the near and the more medium term. In the savings-investment framework, an improvement to external balances due to lower than forecast energy and possibly other prices, would likely materialise in the form of increased households savings. This is particularly the case if household savings have fallen in anticipation of the energy price shock being a temporary factor, which may also have been facilitated by accumulated savings during the pandemic, or because of limited possibilities of adjusting their energy consumption. Over the medium-term, energy prices may remain higher than their pre-pandemic level, and the response of savings and investments together will determine the impact on the external position of countries.

The countries that are the focus of this note differ in their starting positions, but also in the extent to which their external balances are affected beyond the impact of energy balances.

While some countries' external positions were marked by surpluses in the pre-pandemic period, the outlook for some deficit countries was not very favourable even before the deterioration of their current accounts caused by the latest terms of trade shock. In addition, in half of the selected countries trade balances have worsened beyond the direct impact of the energy balance, as compared to 2020. The same holds true for eight Member States compared to 2019. The longstanding issues of some Member States may persist even if the recent declines in trade balances caused by deteriorating terms of trade are undone completely.

A summary of results by countries is provided in section 5.

³ See the note to the EPC LIME working group "Inflation differentials in Europe and implications for competitiveness: thematic note to support IDRs", February 2023.

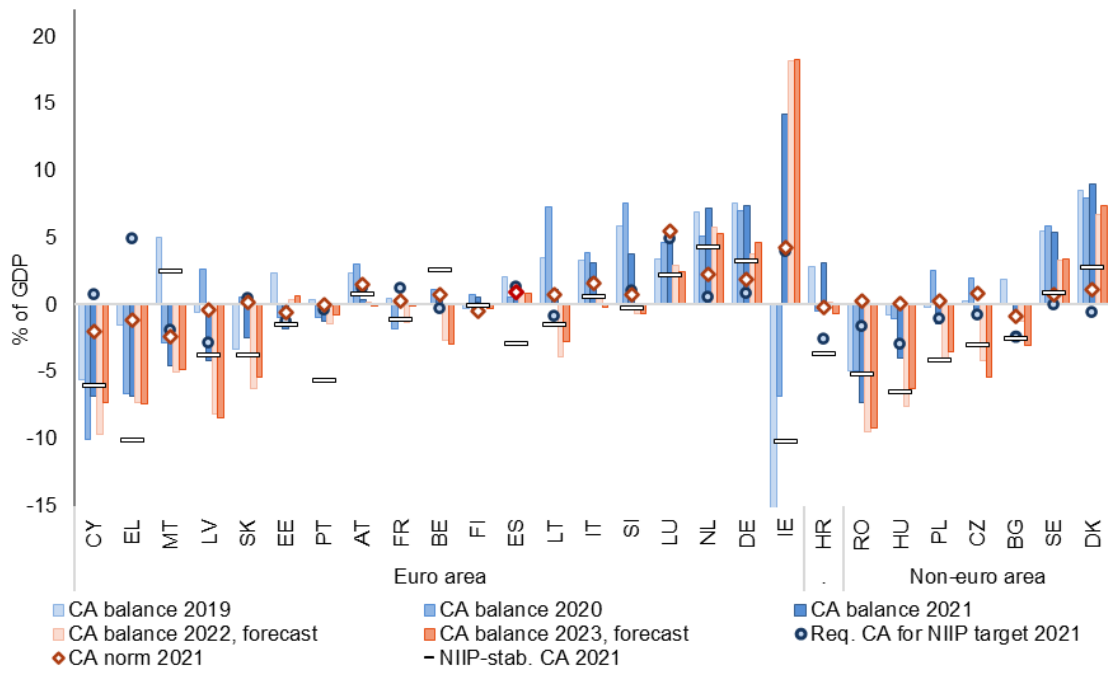
2. COMMON FACTORS BEHIND CURRENT ACCOUNT DEVELOPMENTS

This note analyses both a horizontal context and country-specific developments, starting with a description of the overall context. This section looks at common factors behind current account developments, starting with an overview of the findings in the Alert Mechanism Report (AMR) in subsection 2.1. Sub-section 2.2 then presents the external flows developments for the euro area as a whole. The rest of section 2 discusses horizontally, for the selected Member States, the few common factors behind the recent changes in external flows. These include the changes in energy prices and, more generally, changes in macroeconomic deflators and in terms of trade; continued recovery in international travel; supply chains disruptions; net lending and savings-investment developments by sector, specifically in the context of fiscal support measures in the pandemic and in the energy crisis; and increased global uncertainties and tightening financing conditions. Section 3 comprises country fiches with more country-specific analysis of external flows for the selected Member States. The analysis of flows is put in the context of the existing external stock positions in section 4, which discusses the past evolution of the external stocks, namely the NIIPs and NENDIs, and presents the NIIP projections for the next ten years. Finally, section 5 concludes with a short summary for each country.

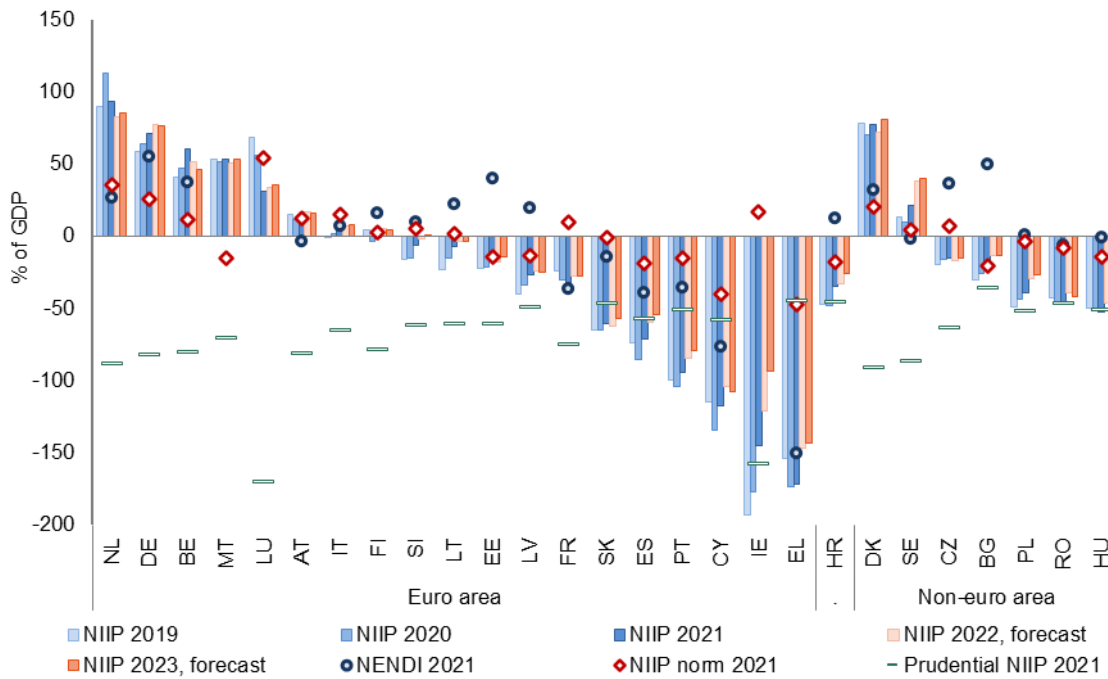
2.1 BACKGROUND FROM THE 2023 ALERT MECHANISM REPORT

As described in the AMR, the current accounts of most Member States displayed small or moderate changes in 2021 (see graph 2.1 a). As discussed in the AMR, these changes often represented a (partial) reversal of the changes recorded in 2020. For countries relying on international tourism as an important source of export revenues, trade balances deteriorated in 2020 as international travel dropped strongly amid pandemic restrictions. Tourism and travel recovered partly in 2021, and further improvements have been recorded in 2022. Largely overlapping with these developments, but working in the opposite direction, have been the changes in the prices of energy goods. They declined in 2020 which positively affected the trade balances of nearly all Member States. However, this has reversed especially since the second half of 2021 as the energy prices started increasing during economic recovery, with the rise accelerating in 2022 after the Russian war of aggression against Ukraine. Furthermore, supply chain disruptions that emerged due to restrictions imposed to contain the pandemic, which lowered the supply capacity, coupled with a shift in demand from (contact-intensive) services toward goods, also impacted the trade balances of EU Member States. The dispersion of the Net International Investment Positions (NIIPs) increased in 2020, but this was partly undone in 2021 as strong nominal GDP growth helped to narrow both negative and positive NIIPs (see graph 2.1 b). Finally, some countries experienced additional changes that seem to have been more country specific. These include a worsening of the trade balances not related to energy or travel balances, which likely indicate resilient domestic demand despite the recent global deceleration, in some cases.

Graph 2.1a: **Current accounts 2019-2022 and the benchmarks**



Graph 2.1b: **Net international investment positions 2019-2022, NENDI and the benchmarks**



Source: Eurostat, AMECO, Commission services calculations.

Among the countries with deeply negative NIIPs, the current accounts in 2021 remained in large deficit in Cyprus, despite some improvement, and in Greece, while for Portugal the external flows developments have been less concerning. Their current accounts in 2021 and (forecast) for 2022 are below their respective current account norms⁴ (graph 2.1 a) and current account levels required to bring their NIIPs above the prudential benchmark over the next ten years. In the case of Cyprus the current account is also below the level required to stabilise the NIIP at the current level.⁵ For Portugal, the situation regarding flows raised fewer concerns, as the 2021 current account was around the level required to reach prudential NIIP over ten years, even if it is slightly below the level required to halve the gap to fundamental NIIP benchmark. Portugal's NIIP is forecast to remain considerably below the prudential benchmark in 2022, with some improvement expected in 2023 (graph 2.1 b).

Hungary, Latvia, Lithuania, Romania and Slovakia recorded a significant worsening in their current accounts in 2021. For all these countries, the outturns in 2021 were below the current account norms, and, with the exception of Lithuania, below the required current account to reach a specific NIIP benchmark. For 2022, current accounts below the NIIP-stabilising levels are forecast. While some of these countries, notably Hungary, Romania, and Slovakia have considerable negative NIIPs (below the MIP indicative threshold of -35% of GDP), their NIIPs excluding non-defaultable instruments (NENDI) are much more favourable (graph 2.1 b) given the comparatively large share of foreign direct investment in their external liabilities. The NIIPs of Latvia and Lithuania are, respectively, moderately and only mildly negative. Their NENDIs are considerably above zero.

In 2021 the longstanding surpluses of Germany and the Netherlands moved close to their pre-pandemic levels after a small decline during the pandemic crisis. While they remain above the levels suggested by their economic fundamentals, more recent data, which is reflected in the forecast, suggest a considerable decline for this year. The forecasts show lower current account balances than in previous years, persisting also into the near future.

Following the short description of the background from the AMR, the rest of the section looks at the details of the more recent evolution, first for the Euro Area and then, starting with the subsection 2.3, horizontally for selected Member States.

2.2 EXTERNAL DEVELOPMENTS FOR THE EURO AREA

The longstanding surplus of the euro area has declined substantially since mid-2021. For the euro area as a whole, the current account surplus declined during the pandemic from 2.3% of GDP in 2019, to 1.6% in 2020, before moving back to its pre-pandemic level of 2.3% of GDP in 2021 (see graph 2.2 a). By the end of 2021, the current account surplus had started to decline after reaching 2.8% of GDP in 2021Q3. The fall accelerated in the first half of 2022, with the surplus falling to 0.6% of GDP by 2022Q2.

The decline in the euro area current account that started in 2021Q3 was mostly due to higher energy prices. The negative euro area balance of trade in energy goods⁶ first narrowed in the pandemic

⁴ Current accounts norms, i.e. current accounts in line with fundamentals, are derived from reduced-form regressions capturing the main determinants of the saving-investment balance, including fundamental determinants, policy factors and global financial conditions. See L. Coutinho et al. (2018), "Methodologies for the assessment of current account benchmarks", European Economy, Discussion Paper 86/2018.

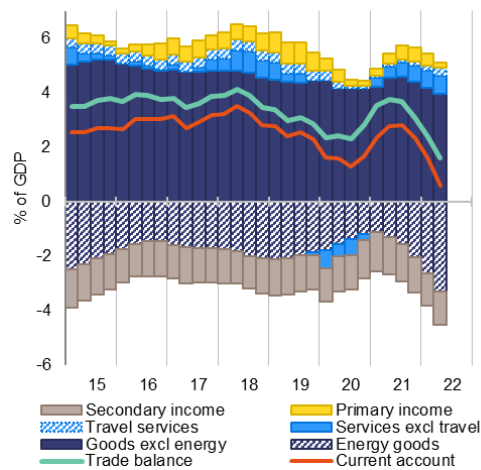
⁵ The NIIP-stabilising current account benchmark is defined as the current account required to stabilise the NIIP at the current level over the next 10 years. The current account required to reach a specific NIIP target is the current account required to reach the prudential threshold over the next 10 years, or to halve the gap to the NIIP in line with fundamentals, whichever is higher. NIIP prudential thresholds are determined from the maximisation of the signal power in predicting a balance of payment crisis, taking into account country-specific information summarised by per-capita income. NIIP in line with fundamentals (NIIP norms) are obtained as the cumulation over time of the values of the current account norms. For the methodology for the computation of NIIP prudential and fundamental benchmarks, see A. Turrini and S. Zeugner (2019), "Benchmarks for Net International Investment Positions", European Economy, Discussion Paper 097/2019.

⁶ The energy balance corresponds to balance of trade in goods under item "3 Mineral fuels, lubricants and related materials" in the Standard International Trade Classification (SITC).

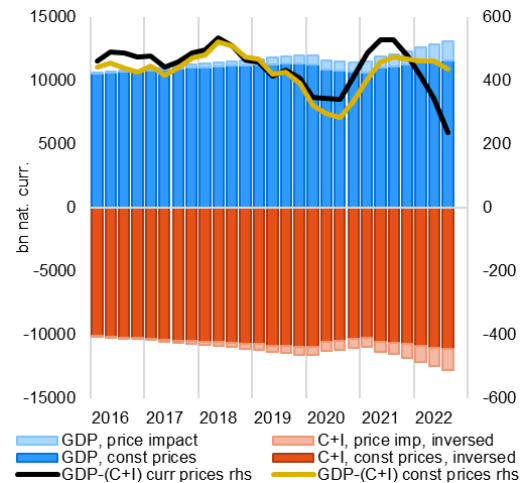
crisis, from -1.9% of GDP in 2019, to -1.1% in 2021Q1, as energy prices fell. With the subsequent increase in prices the deficit widened strongly reaching -3.3% of GDP by 2022Q2. The balance of trade in goods excluding energy was comparatively stable and recorded only a small decline in 2022, for the quarters for which data is currently available. While the euro area as a whole was not as strongly affected by the pandemic-induced slump in international travel as were some individual Member States, its surplus in travel services went from 0.4% of GDP in 2019, to only 0.1% in 2020 and 2021. By 2022Q2, it recovered to 0.3% of GDP. The temporary drop in the balance of trade in services other than travel, which started even before the pandemic, was also undone during 2022. While primary income surplus fell slightly compared to pre-pandemic times, the secondary income account has remained stable.

Graph 2.2: **Euro area external sector developments**

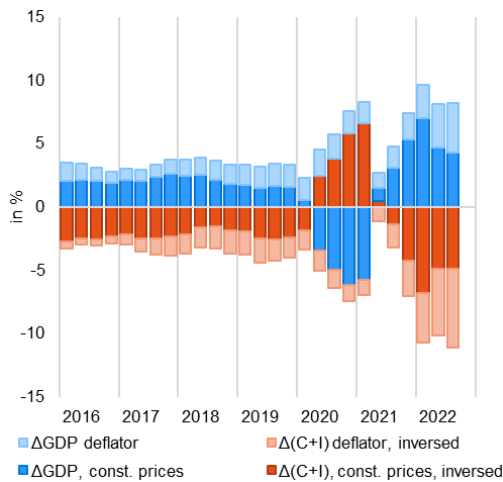
a) Decomposition of current account



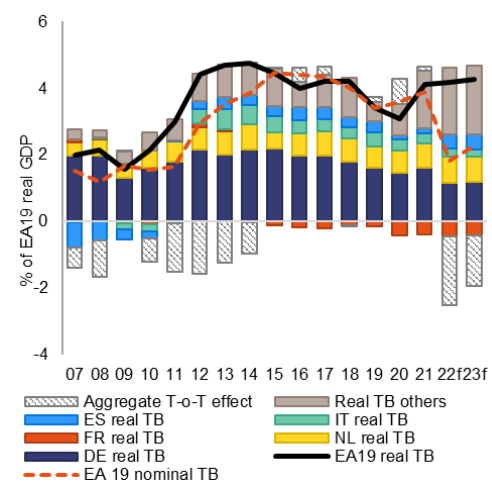
b) Output and domestic absorption



c) Output and domestic absorption growth



d) Trade balance in real terms by countries



Note: 4-quarters moving sums for all quarterly data unless stated differently; graph a: Balance of Payments data; 'Energy goods' corresponds to balance of trade for the SITC3 category; graphs b and c: National Accounts data; graph c: annual growth of 4-quarters moving sums.

Source: Eurostat and Commission services calculations.

The euro area current account evolution after 2021Q3 has largely been shaped by the trade balance, which has been strongly impacted by price changes. The trade balance is equal to the difference between domestic output and domestic demand (absorption), which equals the sum of final consumption expenditure and gross capital formation. During the pandemic, the growth of the GDP deflator slightly outpaced the growth of domestic consumption and investment prices, leading to higher trade balance

measured in current, than in constant prices (graph 2.2 b).⁷ This reversed from 2021Q2, when the domestic consumption and investment deflator started increasing more strongly than the GDP deflator, with the difference becoming more pronounced in the three quarters of 2022 (graph 2.2 c).⁸ As the changes in GDP and domestic demand expressed in constant prices largely cancelled out after 2021Q2, the real trade balance has remained broadly stable since then, with only a small decline having been recorded in 2022Q3.⁹

The euro area trade balance measured in constant prices is forecast to strengthen somewhat for the whole 2022 and to remain stable in 2023. Real domestic demand growth is forecast to outpace real output growth in 2022 and 2023 in some large surplus countries reducing their contribution to the euro area current account surplus (Graph 2.2 d). As several net-debtor countries improved their real trade balance by real demand growth falling short of real GDP growth, they offset the decline in the real trade balance, primarily in Germany, which leads to the stability of the euro area real trade balance going forward.

2.3 DEVELOPMENTS IN THE CURRENT ACCOUNTS OF SELECTED MEMBER STATES

Most of the countries selected for a more detailed analysis recorded current account deficits in 2021 (graph 2.3 a). The exceptions were Germany, the Netherlands, and Lithuania. These three countries, together with Cyprus, Hungary, and Slovakia, had a surplus in trade of goods and services – though a very small one for the latter two countries. All the countries have recorded deficits in trade in energy goods (energy balances), while Cyprus, Greece and to slightly less extent Portugal had visible surpluses in travel services.

Improvements in the current accounts during 2021 have been observed in Cyprus, Germany and the Netherlands (graph 2.3 b). The most substantial improvement over 2020 has been recorded for Cyprus, driven by a strong rebound in travel surplus as compared to 2020, which was stronger than the deterioration in the energy balance and the widening of the primary income deficit. Excluding the energy and travel services, the Cyprus trade balance improved mildly. Germany, and especially the Netherlands, increased their current account surpluses in 2021 to levels close to those before the pandemic, despite worsening energy balances, and with an additional small negative contribution from travel services, as international tourism started to recover.¹⁰ Rest of the selected Member States recorded deteriorations in their current accounts, although only marginal ones in the cases of Greece and Portugal.

The reduction in the current accounts in 2021 was driven by worsening energy balances. Declines in the energy balances in 2021 were the strongest in Lithuania, Hungary and Slovakia. In addition, in Greece, Latvia, and Lithuania, there was a considerable negative contribution from trade in goods excluding energy, slightly reinforced by the negative change in trade in services excluding travel, which also had a strong negative impact on the current accounts. In the case of Greece, this largely offset the positive contribution from the improving travel balance. The increases in the primary income balances for Germany and the Netherlands and the declines for Latvia, Lithuania and Slovakia, in 2021, are largely a reversal of 2020 changes. For Germany and the Netherlands, the pandemic crisis caused declines in investment income credit, which has recovered in 2021. For Latvia, Lithuania and Slovakia there was a decline in debits, which then increased in 2021.

⁷ The trade balance calculated as a difference of output and domestic demand measured in constant prices is also referred to as the real trade balance.

⁸ The greatest contribution to increase in domestic demand came from real consumption growth, followed by the growth in consumption prices. Investment prices grew more strongly than during the pre-pandemic period.

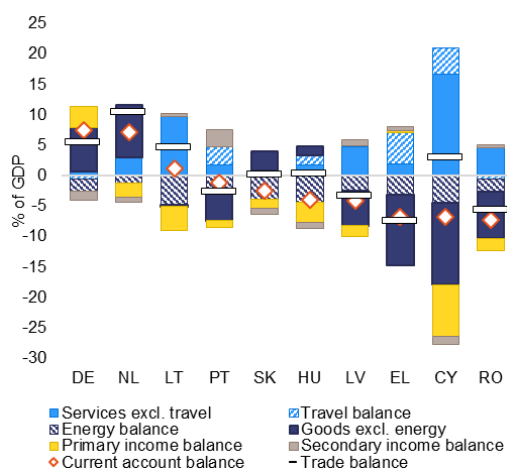
⁹ The same evolution of the trade balances also emerges from the trade flows perspective, which can also be decomposed to changes in volumes and changes in prices. It is worth noting that, following the pandemic-related fall in international trade, the volume of euro area exports and imports of goods exceeded pre-pandemic levels in 2021Q2 and 2021Q3, respectively. The total trade in goods and services took two quarters longer to reach the pre-pandemic volumes.

¹⁰ Before the pandemic both countries had deficits in their travel balances, very small for the Netherlands, but around -1.3% of GDP for Germany. Their travel balances went up in 2020, turning into a small surplus for the Netherlands. This has been reversing since 2021 and into 2022.

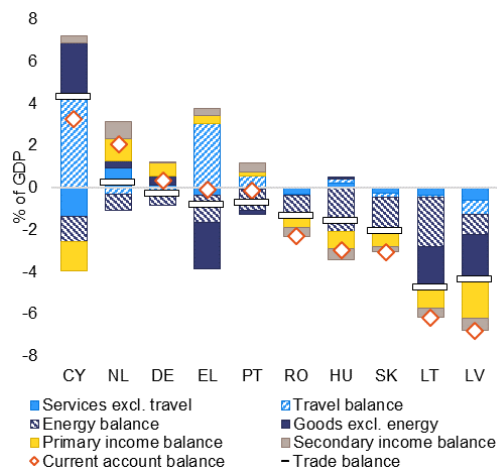
Over the first three quarters of 2022, the current accounts of all the countries declined, with large deficit emerging for some countries (graphs 2.3 c and d). The current accounts of Cyprus and Romania came in below -9% of GDP, while Greece recorded a value of -8.5%. Nearly all countries recorded decreases in their trade balances, largely caused by the lower energy balances. The only exception was Portugal with a remarkably strong increase in the travel balance. The deterioration of the energy balance exceeded the decline from the whole 2021 in all countries except for the Netherlands and Romania. However, the decline of the trade balances has been stronger than the worsening in the energy balance for all countries except for Greece, Hungary, Latvia, and Portugal. The trade balance excluding energy and travel declined in all the selected Member States except for Hungary, Latvia the Netherlands, and Romania.

Graph 2.3: **Decomposition of current account developments**

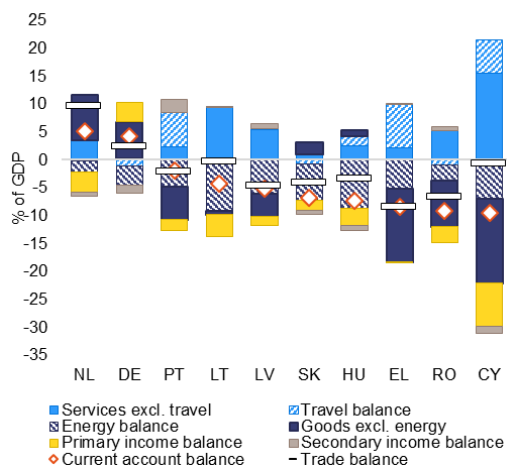
a) Decomposition of current accounts in 2021



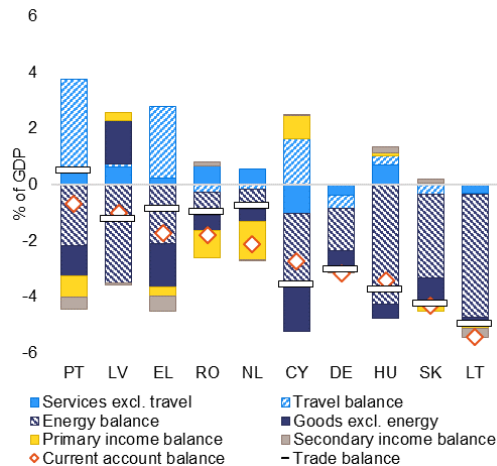
b) Current accounts change from 2020 to 2021



c) Decomposition of current accounts in 2022Q3



d) Current accounts change from 2021 to 2022Q3



Note: graph c: 4-quarters sum of the current accounts (items) in 2022Q3; graph d: the difference in the current account segments between the 4-quarters sum of the current accounts (items) in 2022Q3 and the 4-quarter sum in 2021Q4.

Source: Eurostat and Commission services calculations.

Currently, the outlook for the current account evolutions is not very positive. Over the whole of 2022, current accounts are expected to decline in all the selected countries, with the expected reduction being considerable except in the cases of Greece and Portugal (see graph 2.1 a). Only some mild reversals are forecast for 2023, leaving several Member States with large deficits, beyond the NIIP-stabilising benchmark, implying a potentially negative evolution of net external stocks. More details on the forecasts are presented in country fiches in section 3. It should be noted that these forecasts are based on the Commission autumn 2022 forecast, and energy prices have recorded declines toward the end of 2022. These declines are not taken into account in the figures. As a result, there seems to be an upside risk to the forecast

developments, as lower prices of energy goods should have a direct positive impact on the energy balance, at least partly reversing the declines, some of which have been large. However, as the analysis above shows, especially in some countries, there are more factors underlying the deterioration of the current accounts than what can be attributed to the direct energy price effect. As inflation has broadened to other goods and services, and potentially has led to stronger unit labour cost increases in some Member states, it is difficult to predict the overall impact of the energy price decline on the trade deflators, and, as a result, also on the trade balance excluding energy.¹¹

2.4 OUTPUT AND DOMESTIC DEMAND

In 2021, the nominal growth of domestic absorption, i.e. of consumption and investment, exceeded output growth in all countries under consideration, except Cyprus and the Netherlands (graph 2.4 a). The growth in domestic absorption (measured in current prices), defined as final consumption expenditure and gross capital formation was stronger than the growth of GDP (in current prices), in all countries except Cyprus and the Netherlands. The difference was especially strong in Latvia and Lithuania, leading to substantial declines in their trade balances.¹² In both countries, but especially in Latvia, the trade balance also deteriorated when measured in constant prices. In some cases, most notably for Hungary and Lithuania, contributions of deflators to nominal growth were substantial, and lead to considerable differences in changes of trade balances when measured in current vs. constant prices.

The excess growth of domestic absorption over output intensified further over the first three quarters of 2022 (graph 2.4 b). Over the first three quarters of 2022, domestic demand grew more quickly than output in all countries except Portugal. The difference by which (nominal) absorption growth outpaced (nominal) output growth has been the largest in Hungary, Lithuania and Slovakia. As the nominal growth substantially exceeded the volume change for these countries, the large deterioration in their trade balances can mainly be ascribed to much stronger growth of consumer and investment deflators, relative to growth of the GDP deflator. In constant prices, half of the Member States under consideration recorded higher growth in output than in absorption.

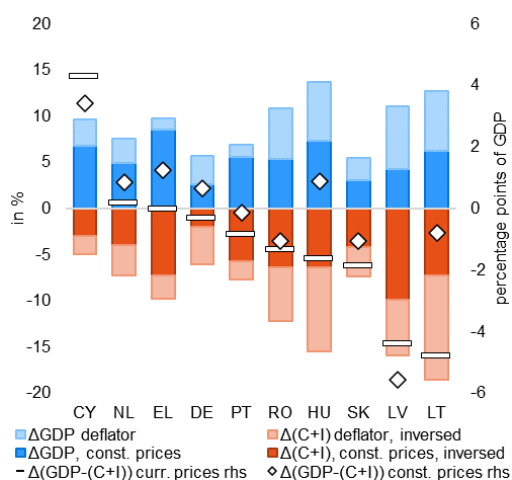
Going forward, some mild improvements in the trade balances are forecast for most of the selected Member States. Nominal output and domestic demand growth in 2023 is largely expected to be driven by price effects (graph 2.4 c), while real changes are forecast to be very small. Measured in current prices, trade balances should slightly improve in half of the countries under consideration. Real trade balance changes are also expected to mostly remain contained. For 2024, forecasts suggest somewhat stronger increases in output and demand measured in constant prices, but the impact of changes in deflators should remain sizeable (graph 2.4 d). In majority of countries, the changes in trade balances projected for 2024, measured in both, constant and current prices, are forecast to be limited, with the exceptions of Latvia, Hungary and the Netherlands, where somewhat stronger increases in (nominal) trade balances are expected.

¹¹ For a detailed analysis of the impact of energy price increases on trade (and other) deflators, please see the note to the EPC LIME working group “Inflation differentials in Europe and implications for competitiveness: thematic note to support IDRs”, February 2023.

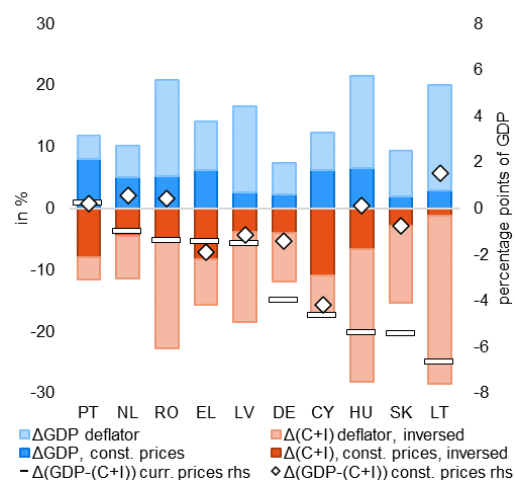
¹² As noted above, the trade balance equals the difference between the output and the domestic demand, i.e. absorption. Thus, stronger growth of domestic demand compared to output growth leads to decline in trade balances. The right-hand scale in graph 2.4 shows the change in trade balance in percentage points of GDP.

Graph 2.4: **Output growth vs. growth in domestic absorption**

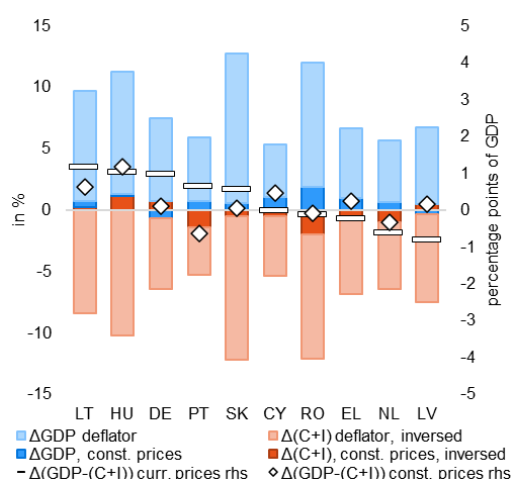
a) Growth in 2021



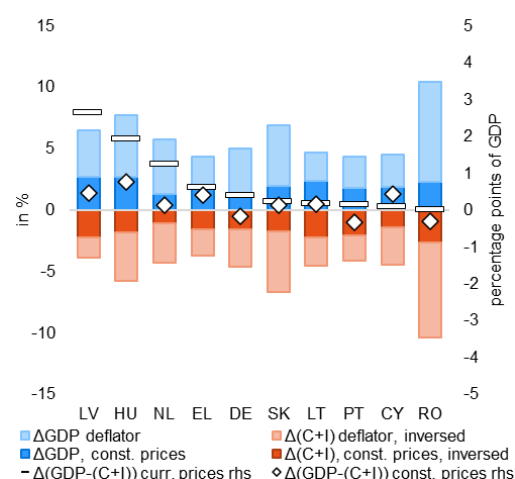
b) Growth in 2022Q1-Q3



c) Growth in 2023 (forecast)



d) Growth in 2024 (forecast)



Notes: graph a: comparison of GDP and domestic absorption (consumption and investment, i.e. C+I) in 2021 with 2020; graph b: comparison of GDP and domestic absorption in the first 3 quarters of 2022 with the same period in 2021; graphs c and d: forecast annual change from a previous year.

Source: Eurostat, AMECO, and Commission services calculations.

2.5 TERMS OF TRADE EFFECTS AND TRADE BALANCES

Over the last year, the terms of trade deteriorated for all countries except Greece and, to some extent, Latvia. As the energy prices increased over the last year, the terms of trade deteriorated, particularly for goods for most countries. This can be seen when comparing data from the last four available quarters to the previous four quarters (graph 2.5 a). The notable exception was Greece, and to a much smaller extent, the terms of trade of goods for Latvia. Changes in the trade balances were roughly correlated with the changes in the terms of trade, as shown in graph 2.5 b, with the trade balances of countries experiencing stronger terms of trade deterioration generally recording stronger declines. In the case of Greece, the trade balance worsened somewhat despite terms of trade improvements.

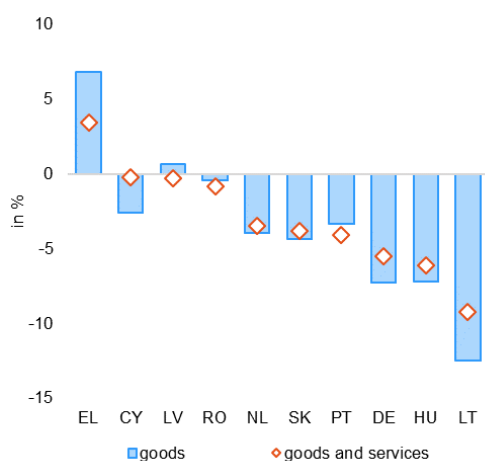
A further, but more limited, deterioration of terms of trade is currently forecast for 2023 for six countries, but recent energy price changes indicate that outcomes may turn out more positive.

While a further deterioration in the terms of trade is expected for Greece, Latvia, Romania, the Netherlands, Hungary and Lithuania, some improvements are forecast for Germany, Portugal and Slovakia, and the terms of trade for Cyprus should remain unchanged. In 2024, all of the selected Member States are expected to

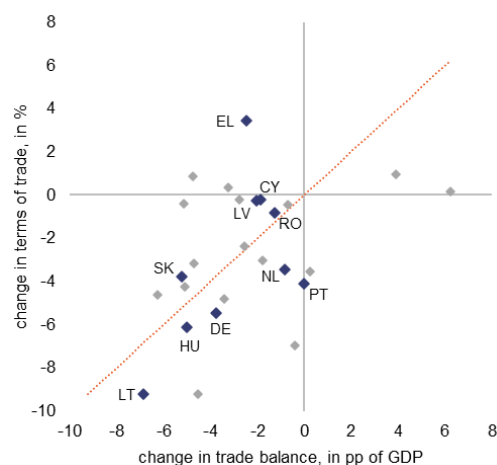
record terms of trade improvements except Cyprus, where the terms of trade are forecast to remain unchanged. However, as the most recent data shows a decline in energy prices below levels expected at the time of the forecast, there may be upside risks to the projections. If the energy prices in 2023 and 2024 come in at more favourable levels, the trade balances, and thus current accounts, should turn out more positive due to, at least, a positive direct impact on the energy balance. The effects beyond the direct impact are difficult to gauge given that the inflation has broadened beyond energy goods, as discussed above.¹³

Graph 2.5: **Terms of trade changes and trade balances**

a) Terms of trade change over 4 quarters in 2022Q3



b) Change in terms of trade and trade balance



Notes: graph a: the annual change in terms of trade for the 4-quarters average up to 2022Q3; graph b: The change in terms of trade for goods and services as in graph a, compared to the annual change in (4q sum of) trade balance up to 2022Q3.

Source: Eurostat and Commission services calculations.

2.6 INTERNATIONAL TOURISM

The recovery in international travel has played an important role in Member States with deeply negative NIIPs, namely Cyprus, Greece, and Portugal. In Cyprus, and particularly in Greece and Portugal, the number of foreign tourists' nights spent at tourist accommodation establishments in 2022 approached the levels recorded before the pandemic¹⁴ (graph 2.6 a). The number of nights spent during the peak summer tourist season were even closer to their 2019 numbers, most notably in Portugal. At the same time, prices of tourism services, as proxied by prices of services related to package holidays and accommodation, grew by more than the overall (harmonised) index of consumer prices (HICP), in Cyprus and much more so in Portugal (graph 2.6 b), likely indicating stronger improvements in the trade balance effects for 2022 as a whole.

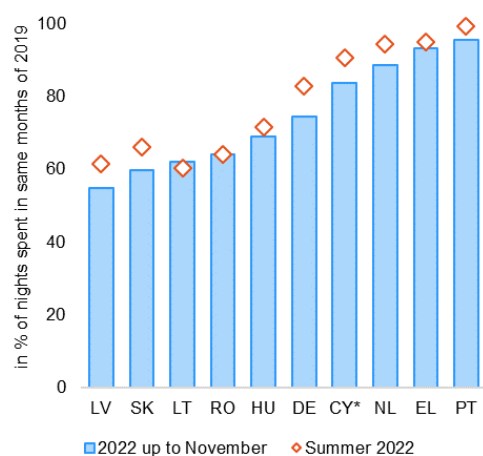
Going forward, further improvements in travel balances of countries with large cross-border tourism sectors can be expected. In the case of Cyprus, there is considerable space to improve and come closer to 2019 level, based on the nights spent over the whole year. The same holds true to somewhat smaller extent for Greece and Portugal. In the cases of Cyprus and Greece, if the demand were to fully recover, stronger increases in prices of tourism services cannot be excluded, potentially leading to the overall stronger positive impact on the trade balances.

¹³ See the note to the EPC LIME working group "Inflation differentials in Europe and implications for competitiveness: thematic note to support IDRs", February 2023

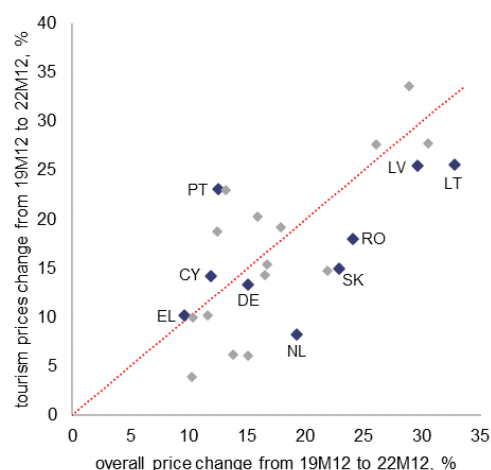
¹⁴ These figures are for the year to November for Greece and Portugal, and for the year to October for Cyprus.

Graph 2.6: **International tourism recovery**

a) Nights spent by foreign tourists, Jan-Nov 2022



b) Change in tourism and consumer prices



Notes: graph a: 'Summer' refers to period from June to September; for countries with *, the overall period considered is until October, graph b: tourism prices are proxied with the subcomponent of the HICP index: 'Services related to package holidays and accommodation'.

Source: Eurostat and Commission services calculations.

2.7 SUPPLY CHAIN DISRUPTIONS

The supply chain disruptions emerged during 2021, affecting international trade flows, and leading to delayed deliveries. The measures introduced to contain the spread of the virus caused frequent, although temporary factory closures, constraining the supply capacities of both final goods and intermediate inputs. There was also a shift in consumer preferences away from (contact-intensive) services¹⁵ toward goods, increasing the demand for the latter and driving up the prices. The shift likely reflected a stronger demand for goods that facilitate working from home during the pandemic. Deliveries were prolonged, with congestion in seaports playing a role. Both export and import flows have likely been adversely affected by these disruptions in most cases, with some sectoral analysis pointing to weaker export performance in industries facing longer supplier delivery times.¹⁶ Still, supply chains have shown flexibility and have adapted relatively quickly including through increased purchases from countries that were, at the time, relatively less affected by the pandemic.¹⁷ As the COVID-19 episode has exposed the vulnerabilities to international spillovers of pandemic containment policies, one of the strategies to increase resilience by some companies could have been to start holding excess inventory,¹⁸ which would have led to temporary increase in imports. On balance, the direction of the impact of the supply chain disruptions on the trade balances is not *a priori* clear, neither for the volumes nor for the price effects.

Despite supply disruptions, the volume of exports and imports of goods for all countries rose in 2021, as international trade rebounded from a strong decline in 2020. The rebound in international trade was accompanied by a substantial increase in export and import prices (graph 2.7 a).¹⁹ The available 2022 data shows that the growth of trade deflators accelerated, accounting for most of the change in nominal exports and imports of goods in all countries except for Cyprus, and to a lesser extent for exports of

¹⁵ The contact-intensive services were partly unavailable.

¹⁶ See T. Schuler et al (2022), "Supply bottlenecks and price pressures in euro area goods trade and tourism", ECB Economic Bulletin, 7/2022.

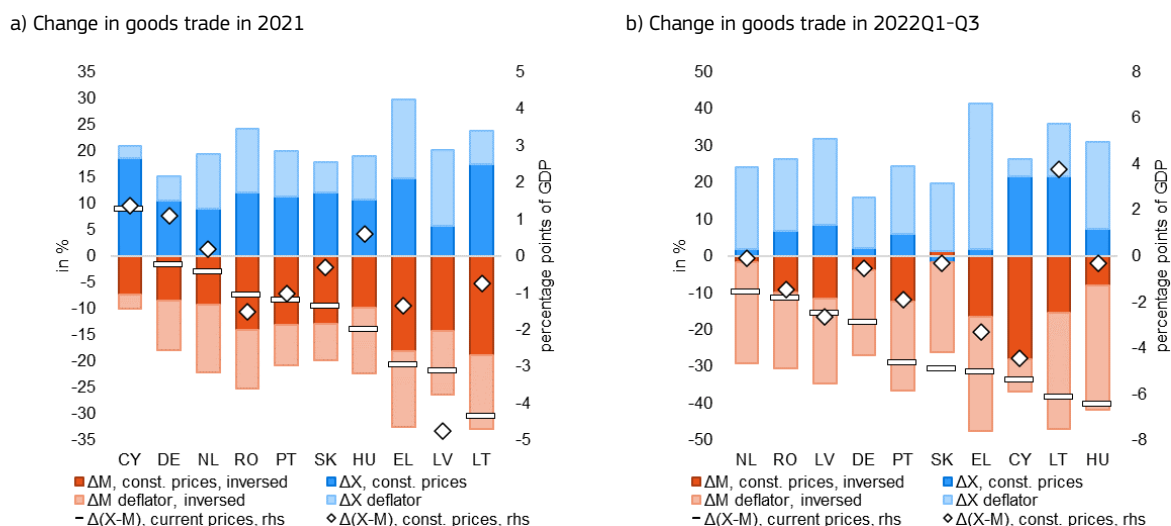
¹⁷ See IMF (2022), "Global trade and value chains during the pandemic", World Economic Outlook, Chapter 4, April 2022.

¹⁸ See D.A. Cerdeiro, and N-J.H. Hansen (2022), "The Stretch of Supply Chains", Finance & Development, June 2022.

¹⁹ As discussed in T. Schuler et al (2022), bottlenecks in supply chains tend to precede pressures on import prices, most notably for intermediate goods.

Lithuania (graph 2.7 b).²⁰ In all the countries except for Slovakia, where a very small decline was observed, both exports and imports also increased when measured in constant prices, even if only slightly in Germany and the Netherlands. Furthermore, in all countries, the volume of exports and imports of goods (4-quarters sums) exceeded the pre-pandemic values already during 2021, and it remained above the 2019 values also in 2022.²¹

Graph 2.7: **Decomposition of change in exports (ΔX) and imports (ΔM) of goods into volume changes and price effects**



Notes: graph a: comparison of exports and imports of goods in 2021 with 2020; graph b: comparison of exports and imports of goods in the first 3 quarters of 2022 with the same period in 2021. Note that the data in the graphs is from the National accounts and there can be discrepancies as compared to the Balance of Payments data. For the selected countries, the deviations are only minor and do not affect conclusions.

Source: National accounts data from Eurostat and Commission services calculations.

After having surpassed the 2019 levels in 2021, the volumes of goods trade have mostly continued growing relatively fast in 2022. The reduced suppliers' delivery times since mid-2022 seem to signal that supply chain bottlenecks have been receding.²² Comparing growth rates in trade flows before and after the pandemic shows that in most countries under analysis, the annual growth in trade flows for goods in 2022 was substantially higher than the average growth recorded in pre-pandemic times (graph 2.8).²³ For all countries, the difference in the growth rates recorded before and after the pandemic crisis is higher when measured in current than in constant prices, which is expected given the considerable increases in trade deflators after mid-2021. The difference has also been higher for imports than for exports.²⁴ Cyprus and Lithuania experienced one of the most noticeable increases in trade flows growth. In particular, Cypriot annual export growth rates moved from slightly below 10% to above 30%, while the ones of imports rose from just above 3% to nearly 19% in constant prices. Similarly, Lithuania moved from annual pre-pandemic export growth rates of around 10% to close to 20% in constant prices. A slightly less pronounced acceleration has been recorded for imports, which rose from just above 7% to nearly 14%. In both countries, when measured in current prices, the growth rates have been significantly higher. Greece experienced the

²⁰ It should be noted that trade in goods represents a relatively small fraction of international trade of Cyprus, amounting to below 20% of exports and around 40% of imports.

²¹ In most countries these levels were reached already in the first half of 2021. The exceptions are exports (i.e. imports) of Cyprus and Germany, which exceeded the 2019 levels only in the fourth (i.e. third) quarter of 2021. Also Portugal surpassed 2019 import levels only in the last quarter of 2021.

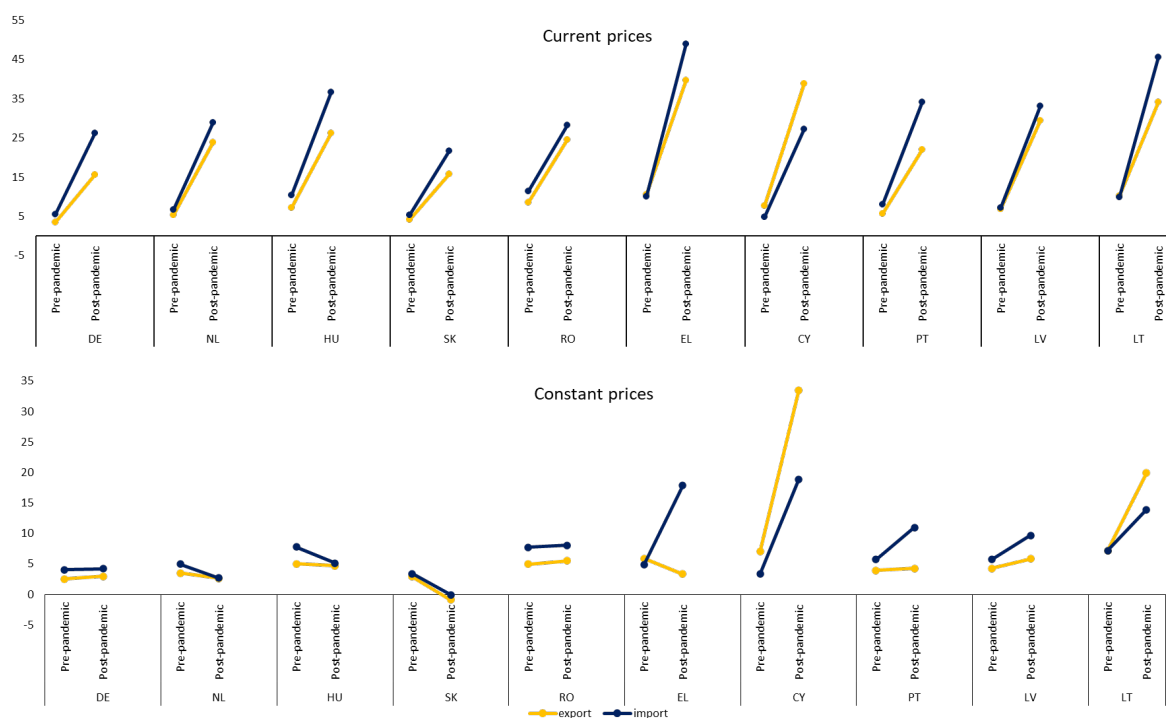
²² See T. Schuler et al (2022).

²³ Pre-pandemic times refers to the average of annual growth rates registered in 2017, 2018 and 2019, while the post-pandemic time period refers to growth of (4-quarters sum of) trade flows from 2021Q3 to 2022Q3. As noted above, by 2021Q3 most of the selected countries' trade flows exceeded the volumes recorded in 2019, with only a few aforementioned exceptions.

²⁴ The only exceptions are Cyprus, where the difference has been higher for exports than for imports both when measured in constant and in current prices, and in Lithuania, where exports registered a more pronounced acceleration compared to pre-pandemic times only when growth is measured in constant prices.

highest increase in annual growth rates of imports measured in current prices, amounting to 50% in 2022Q3, and the second largest in constant prices compared to pre-pandemic times. Unlike most EU countries, however, it recorded a deceleration in the real growth rate of exports. If measured in current prices, the change is positive, suggesting again the especially strong price effect in Greece. Germany, Latvia, Romania and Portugal registered a milder increase in the trade flows annual growth rates but still remarkable both in current and constant prices. The Netherlands, Slovakia, Hungary, on the contrary, recorded deceleration in the annual growth rates of trade flows measured in constant prices, with Slovakia even registering a negative rate in 2022 for the exports. In current prices, these three countries recorded an acceleration in the growth compared to pre-pandemic times both for imports and exports.

Graph 2.8: **Change in trade flows growth rates of goods (annual growth)**



The growth in exports of goods is indicative of the likely changes of export market shares going forward, with Greece, Cyprus and Lithuania likely to be gaining shares and Germany and Slovakia losing them. A country's export market share developments are driven not only by its own export growth, but by how its exports evolve relative to world exports. The data and the discussion of the changes in exports of goods presented above in the context of exposure to supply chain distortions suggest that for exports of goods, and for market shares of exports measured in current prices, Greece, Cyprus and Lithuania are more likely to be gaining shares. Conversely Germany and Slovakia may be losing them. For exports of both goods and services, it is Greece, Portugal and Lithuania that stand out with the highest growth rates in 2022Q3, while total exports are again found to grow more slowly in Germany and Slovakia.²⁵

²⁵ For a more comprehensive discussion, please see the note to the EPC LIME working group "Inflation differentials in Europe and implications for competitiveness: thematic note to support IDRs", February 2023.

2.8 NET LENDING AND BORROWING, AND SAVINGS-INVESTMENT PERSPECTIVE BY SECTORS

From the sectoral perspective, the government remained in deficit in 2021 in all the analysed Member States, with its net borrowing position improving in all cases except Latvia and Slovakia (graph 2.9 a and b). The COVID-19 pandemic has caused a deterioration of the public finances as economic activity slowed down and sizeable fiscal measures were put in place to mitigate the direct economic and social impact on households and firms.²⁶ This was reflected in a strong decline of the net lending/borrowing position of the government sector in 2020 in all EU countries.²⁷ The Member States under consideration implemented temporary COVID-19-related measures close to the EU average of 3.3% of GDP, with the exception of Greece that spent comparatively more, around 7.6% of GDP, and Romania with costs amounting to only 1.6% (graph 2.10). In 2021, all selected countries except for Latvia and Slovakia narrowed their deficits. In most cases, a reduction in emergency spending contributed to their more balanced government positions. Conversely, Germany, Latvia and Slovakia spent more on COVID-related measures in 2021 compared to 2020, contributing to increased deficits in the latter two countries.

As the pandemic crisis eased in 2021, the private sector net position declined in most Member States, leading to lower overall net lending/borrowing in some countries. A decline in private sectors' net lending/borrowing was observed in 2021 in all countries except the Netherlands, representing a partial reversal of the developments from 2020. While the household sector remained a net lender in all countries except Romania and Cyprus, its net position declined everywhere except in Hungary and Latvia. On balance, in 2021, total economy net lending/borrowing declined in Hungary, Latvia, Lithuania, Romania and Slovakia, mainly driven by the corporate sector, with the exception of Romania where the negative contribution came from the household sector.

For 2022 further declines in the overall economies' net lending/borrowing positions are expected for all the selected countries. Governments are forecast to remain net borrowers in all countries but Cyprus (graph 2.9 c), despite continued improvements in government positions except in Latvia and Lithuania (graph 2.9 d). While the cost of COVID-19-related measures has declined strongly, governments introduced new measures to mitigate the effects of the recent energy crisis (graph 2.10).²⁸ With the exceptions of Hungary and Portugal, overall budgetary costs for emergency spending in 2022 still decreased compared to the previous year. A particularly marked reduction is observed for Cyprus, Greece, Slovakia and slightly less for Germany.²⁹ However, as the cost of living has been increasing strongly, the households' net position is expected to decline substantially, either dominating over the increases in other sectors' positions, or sometimes being reinforced by their declines, most notably by those of corporates in Cyprus and Germany, but also in Hungary, Slovakia, and marginally Greece.

²⁶ It should be noted that costs of support measures are not expected to be reflected one-to-one in the worsening government balances, given that the measures provide a positive impulse to the rest of the economy and are therefore likely to yield indirect positive second-round effects on government finances. Similarly, the corresponding decline in government net position need not lead to one-to-one worsening in the total economy's position as net lending/borrowing of other sectors should improve as a consequence of support measures.

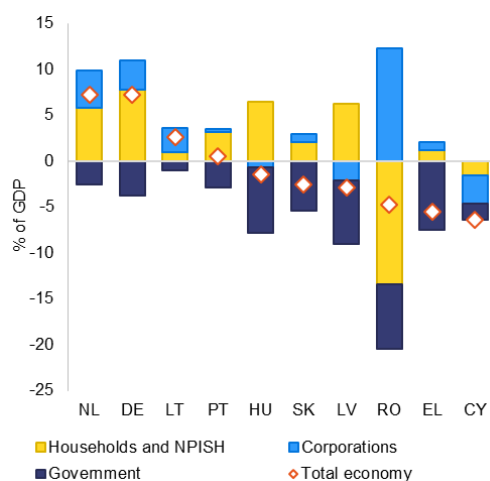
²⁷ See European Commission (2021), "Report from the Commission to the European Parliament, the Council and the European Economic and Social committee Alert Mechanism Report 2022", Brussels, 24.11.2021 COM(2021) 741 final.

²⁸ Note that the budgetary costs of energy-related measures also account for the revenues from (taxes on) windfall profits of energy companies.

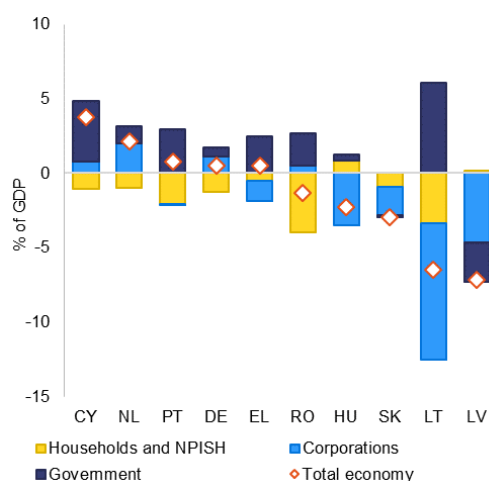
²⁹ For 2023, a general reduction in cost of emergency measures is expected, which become exclusively energy related. The only exceptions are Hungary and the Netherlands, which expect an increase compared to 2022. The cost of energy-related measures in Hungary is the highest, followed by Germany and the Netherlands where these are expected to be twice as high as the EU27 average. Conversely, Cyprus and Slovakia appear to be almost phasing out all support measures.

Graph 2.9: **Net lending and borrowing (NLB) by institutional sectors**

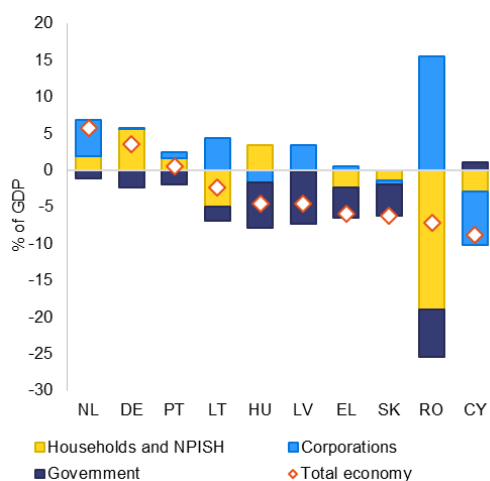
a) NLB by sector in 2021



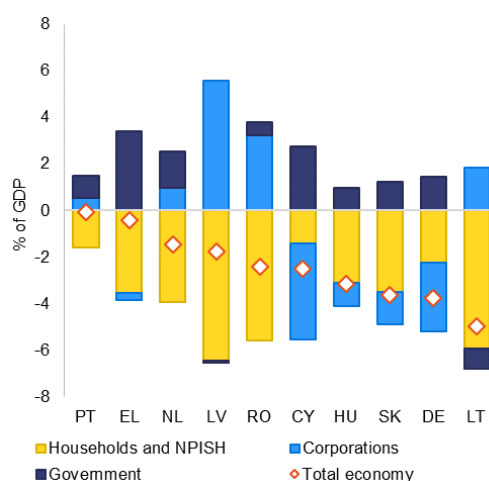
b) NLB change from 2020 to 2021



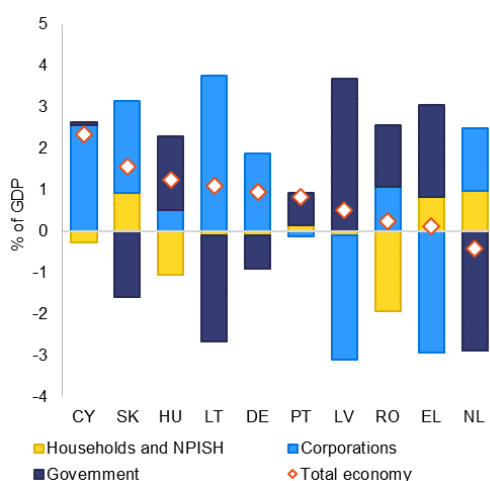
c) NLB by sector in 2022 (forecast)



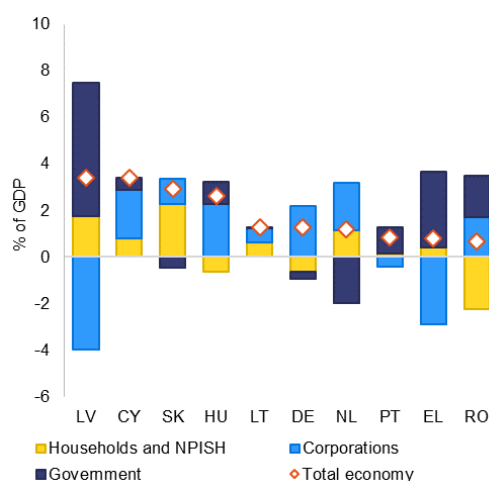
d) NLB change from 2021 to 2022 (forecast)



e) NLB change from 2022 to 2023 (forecast)



f) NLB change from 2022 to 2024 (forecast)

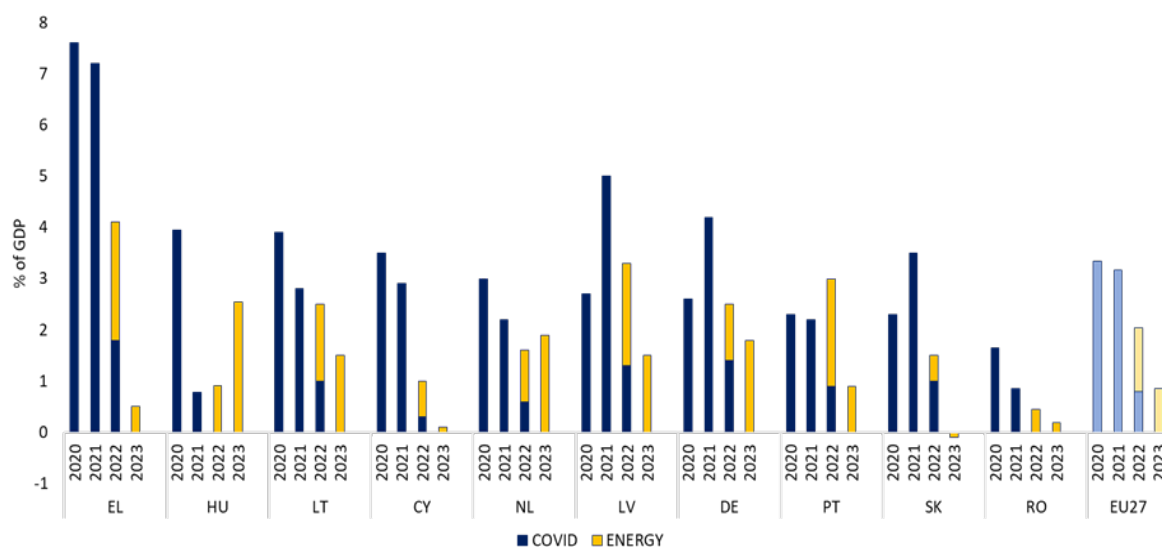


Note: The net lending and borrowing data for households is not available for Romania (except for the forecast), so that here the implied households net position is calculated as a difference between the private sector and corporate net lending and borrowing.

Source: AMECO and Commission services calculations.

Forecasts for 2023 suggest improvements in the net lending and borrowing positions of nearly all countries. The only exception is the Netherlands with a marginal decline compared to 2022 (graph 2.9 e). By 2024, all the selected Member States should record higher positions than in 2022, with the expected increases being stronger in Cyprus, Hungary, Latvia and Slovakia (graph 2.9 f). While the sectoral movements are expected to be very heterogeneous across countries, by 2024 households should improve their positions in all Member States except for Germany, Hungary and Romania. Given the recent declines in energy prices, which are stronger than those expected during the forecast, the improvements in households' positions could potentially be quicker and stronger, if lower energy costs translate into faster reduction in the cost of living.

Graph 2.10: **Fiscal costs of COVID-related and energy crisis measures**

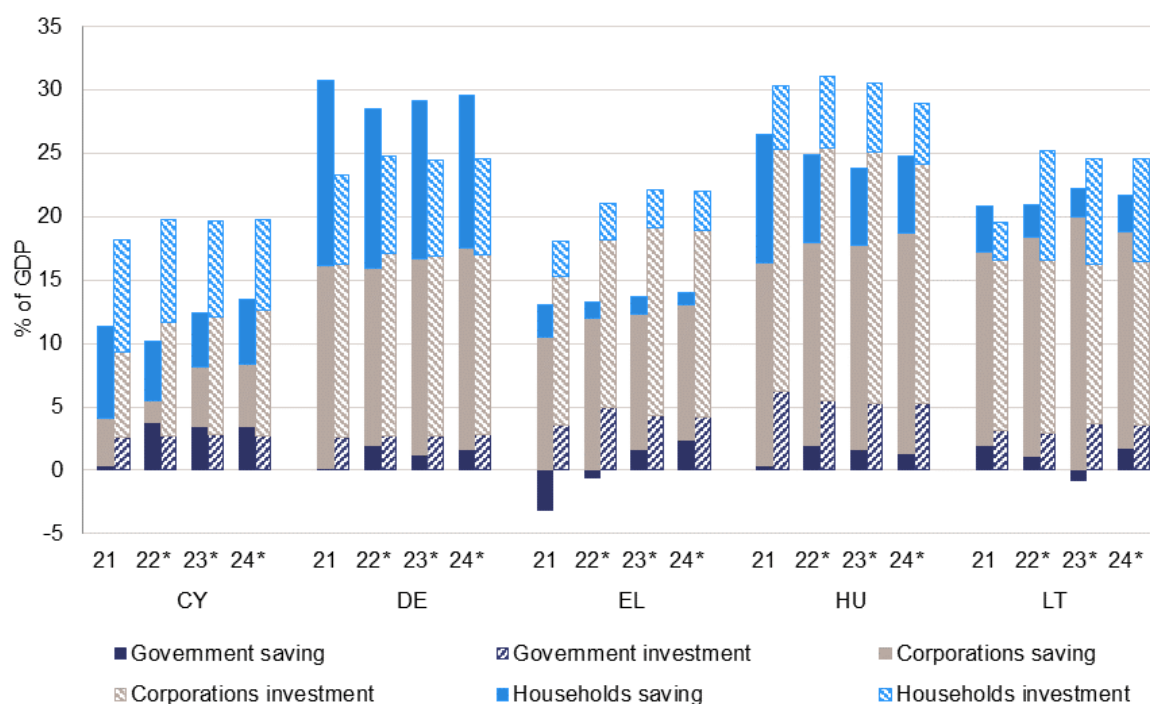


Source: Commission services calculations.

In 2022, investment should exceed the levels recorded in 2021 for a number of countries, with sizeable increases in Greece, Lithuania and Romania. The outlook from the savings-investment perspective shows that investment should increase above its 2021 level for a number of countries. For Greece, Lithuania and Romania the increases are expected to be substantial (graph 2.11 a and b).³⁰ While in Greece it is the corporate sector which is expected to drive the increase, for Lithuania household investment is forecast to rise substantially above the low value recorded in 2021. For Romania, both the government and the corporate sectors are expected to step up their investment. While higher gross capital formation in Greece is projected to move in tandem with higher gross savings, in Lithuania rise in savings will fall short of investment implying lower current account. Conversely, for Romania, the growth of savings should outpace investment growth. In Cyprus, Germany and Slovakia, investment is expected to reach mildly to moderately higher levels than in 2021. In Cyprus, unlike in the other two countries, savings should grow at higher rate thus improving the current account, mainly thanks to the government sector. In all countries, households savings are forecast at noticeably lower levels than in 2021. This may be at least partly reversed in case the aforementioned recent declining trend in energy prices persists and the living costs decline.

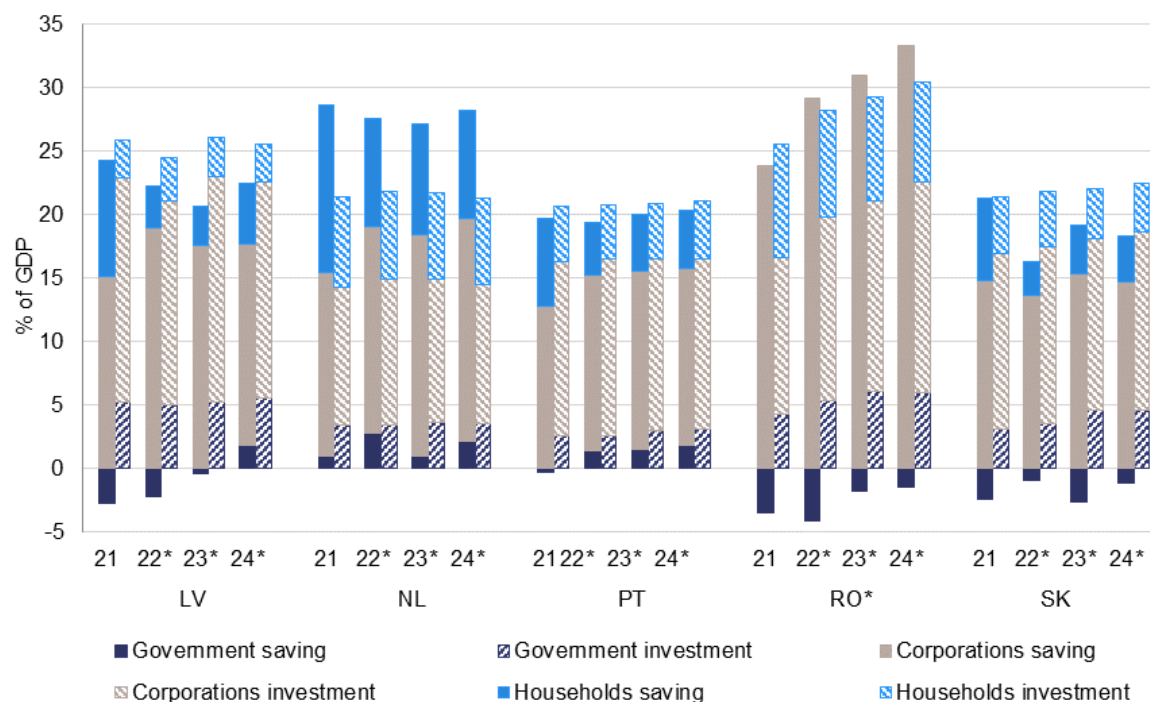
³⁰ Note that for Romania the data on households savings is not available.

Graph 2.11a: **Savings and investments by sector**



Source: AMECO.

Graph 2.11 b: **Savings and investment by sector, continued**



Note: For Romania the data on households savings is not available.

Source: AMECO.

2.9 EXCHANGE RATE DEVELOPMENTS AND EXTERNAL FINANCING RISKS

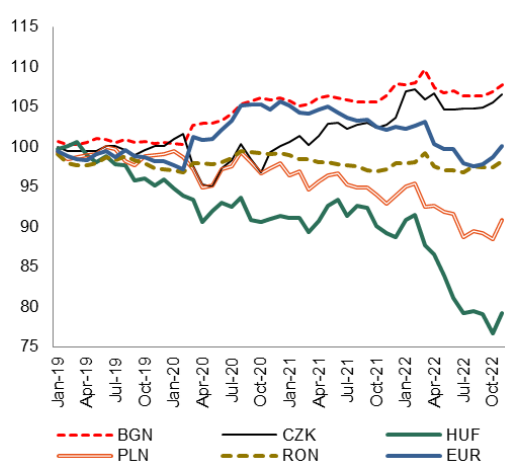
The elevated geopolitical and economic risks have caused notable movements in the exchange rates of the euro and of some non-euro Member States' currencies. Tighter monetary policy in the US and the exposure to economic and geopolitical risks related to war in Ukraine have put both the euro, as well as other Member States' currencies under depreciation pressures vis-à-vis the US dollar as international capital flows sought safe havens. In effective terms, the euro started depreciating in May 2021, with some acceleration visible after March 2022, i.e. after the Russian war of aggression against Ukraine. It has been recording a mild appreciation since September (graph 2.12 a). While Bulgaria operates a euro-anchored currency board, in effective terms its currency had been strongly appreciating until March 2022. The Czech koruna has experienced significant appreciation amid monetary policy tightening and depreciated only mildly in May 2022 to remain stable afterwards. Both currencies started recording a mild appreciation since September 2022. While movements in Romanian leu have been contained, the Polish złoty and, especially, the Hungarian forint have been on a continued depreciating trend. This downward movement turned steeper as the war started, with both currencies depreciating strongly in March 2022, especially the forint, whose value declined by 16% between February and October 2022. Most recently, in November, both currencies recorded a small appreciation in effective terms.

Amid heightened risk aversion in global financial markets, some Member States outside of the euro area may face tighter external borrowing constraints should risk aversion increase further.

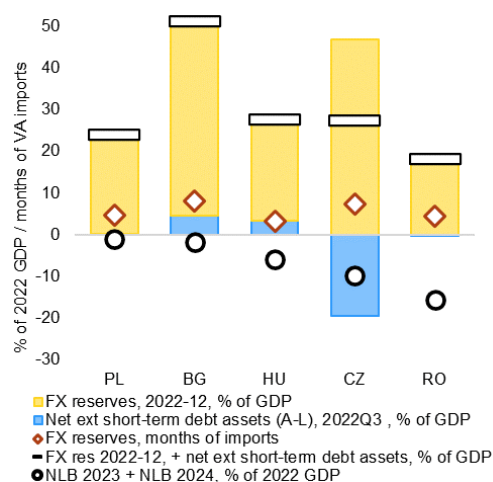
Non-euro area Member States recording substantial current account deficits, and with substantial negative net international investment positions, may face tighter external financing conditions. Given the forecast net lending/borrowing in 2023 and 2024, the net external financing needs are comparatively large in Hungary, Czechia, and especially Romania (in % of forecast 2022 GDP, graph 2.12 b). Risks are mitigated by very high foreign exchange reserves in Czechia, although net external short-term debt assets are deeply negative. The official reserves for Hungary are sizeable at 24.4% of GDP and the net external short term debt assets are positive. However, when measured in months of (forecast 2022) imports of goods and services, the official reserves cover some 3.1 months. This measure is somewhat higher for Romania and equals 4.4 months, reflecting the comparatively lower trade openness. In percent of GDP Romanian reserves amount to 18.5%, which is only slightly above the high net (forecast) financing needs in 2023 and 2024 of around 16% of GDP.

Graph 2.12: Exchange rates and reserves in non-euro area Member States

a) Nominal effective exchange rates, 2018=100



b) Foreign exchange reserves



Notes: graph a: last observation November 2022; graph b: all variables in % of 2022 forecasted GDP, net external short-term debt assets exclude reserve assets.

Source: Commission services calculations for NEER. Eurostat, IMF, AMECO and Commission services calculations for FX reserves graph.

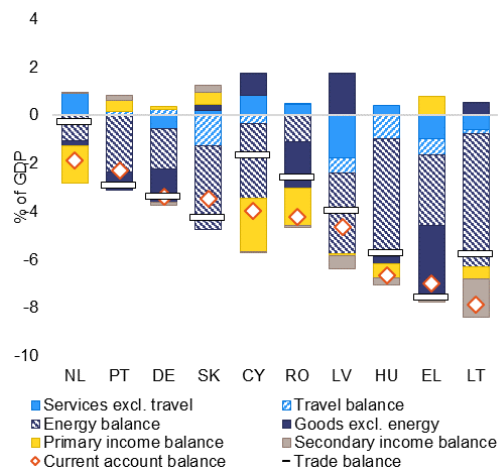
Overall, recent external flows have been strongly affected by the surge in energy prices as well as the ensuing strong terms of trade changes. The impact was negative for all countries under consideration, but the magnitude varied strongly across Member States. The strong, but varying change in the energy balance is clearly visible in comparison of the most recent data to 2019 (graph A1.1 a, in Annex A1).

The current accounts have mainly been shaped by the trade balance development, which in turn were strongly affected by price changes in most, but not all the selected countries. For some Member States changes in real trade balances were close to changes in the nominal trade balances (see graph A1.1 b, for comparison with 2019, from the output vs. domestic demand perspective). Similarly, and related to above, most, but not all countries experienced adverse terms of trade shocks, which were of different magnitudes, also compared to 2019 (graph A1.1 c). Furthermore, while it is likely that supply chain disruptions adversely affected trade flows, and contributed to the price pressures, their impact on the trade balances cannot be easily determined. As the post-pandemic recovery started, volume of trade in goods reached the pre-pandemic values already in the first half of 2021 for most of the observed countries. The total growth in volumes of trade since 2019 varied significantly across Member States, with some recording rather low growth (graph A1.1 d). Finally, a deterioration in external flows is visible from the perspective of sectoral net lending and borrowing, with the government sectors still contributing to larger deficits (2022 forecast) as compared to 2019 due to lower economic activity and the additional costs of support measures aiming at tackling the energy and health crisis (graph A1.1 e). In most countries, the position of households worsened, partly due to recent increase in costs of living.

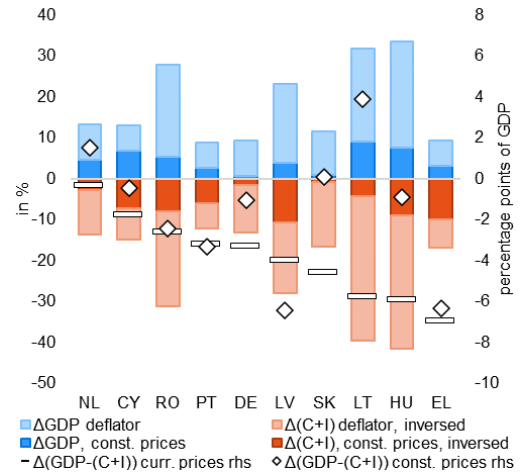
Annex A1: Horizontal comparisons of the most recent data with the pre-pandemic period

Graph A1.1: Comparisons with the pre-pandemic period

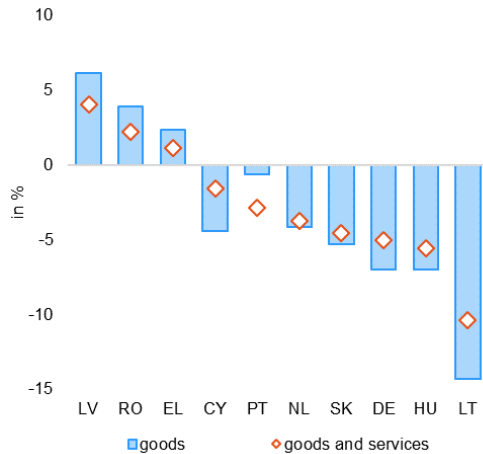
a) Current accounts change from 2019 to 2022Q3



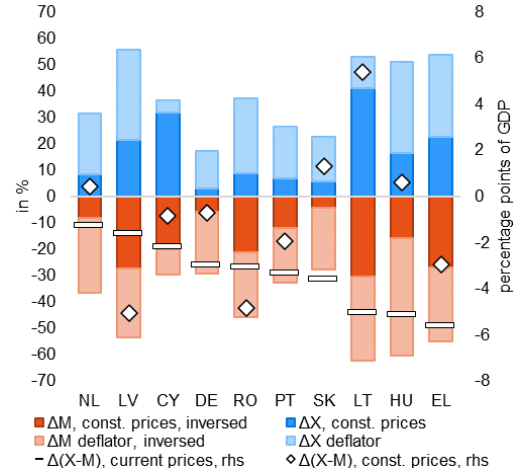
b) Output vs. domestic absorption growth from 2019 to 2022Q3



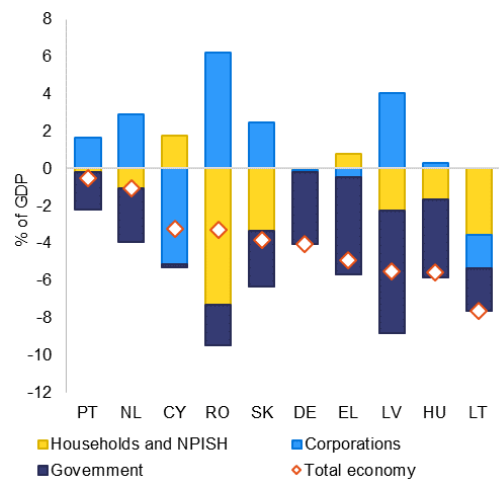
c) Terms of trade change from 2019 to 2022Q3



d) Change in goods trade from 2019 to 2022Q3



e) Change in NLB from 2019 to 2022 (forecast)



Notes: Comparison period is always 2019. The last period is the sum (or average in for deflators and terms of trade) of the last 4 quarter up to 2022Q3. In graph e, 2022 forecast is compared to 2019 values; the 2019 NLB data for households is not available for Romania and the implied households position is calculated as a difference between the total and other sectors' NLB.

Source: Eurostat and Commission services calculations.

3. COUNTRY SPECIFIC ASPECTS

3.1 GREECE

Greece recorded a large current account deficit in 2021, which deepened further in the first three quarters of 2022. Greece recorded a current account balance of -8.5% of GDP in the four quarters up to 2022Q3 and it is now the third largest current account deficit among EU countries (graph 3.1 a). It is below the levels explained by economic fundamentals (the ‘current account norm’) and below other relevant benchmarks, except for the current account level required to stabilise the NIIP over 10 years. It worsened sharply from the -6.8% of GDP recorded in 2021 and from the -1.5% in 2019 (see also graph 2.1 in section 2). The evolution of the current account balance was largely shaped by the dynamics of the balance of trade, which declined from -0.9% of GDP in 2019, to -7.6% in 2021, and to -8.5% in 2022Q3.

Developments in the overall balance of trade mask some recent divergences between the trade in goods and the trade in services. The balance of trade in goods first slightly improved in the pandemic crisis, from -12.5% of GDP in 2019, to -11.2% in 2020. It declined to -14.7% in 2021, with the fall accelerating and the goods balance reaching -18.4% of GDP in 2022Q3. In particular, the energy balance recorded a visible fall, from -2.3% of GDP in 2019, to -3.1% in 2021 and -5.2% in 2022Q3 due to strongly increased energy prices (graph 3.1 b). This went along with the decline in the trade balance for goods excluding energy which fell from -11.6% of GDP in 2021 to -13.1% in 2022Q3 (compared to -10.1% in 2019). By contrast, the recovery of international tourism contributed to a solid increase in the trade balance for services during 2022, which reached 9.9% of GDP in 2022Q3. This is close to pre-pandemic levels, which ranged around 10-11.5% between 2015-2019. As the number of foreign tourists’ nights spent in summer 2022 neared the 2019 levels and was supported by the comparatively strong increase in the prices of tourism services, the travel balance itself increased by 2.9 pp of GDP over a year. The surplus reached 7.7% of GDP in 2022Q3 and was thus slightly below the 2019 level as a share in GDP. Negative contributions to the current account in 2022 came from the worsening secondary and, to less extent, primary income accounts. Combined, they declined by some 0.9 pp of GDP since 2021, and both are now close to balance. The capital account declined a bit, to 1.7% of GDP in 2022Q3, thus still significantly reducing the economy’s net borrowing.

Following a strong decline in trade flows during 2020, exports and imports of goods and services recovered to pre-pandemic values in 2021Q4 and 2021Q3, respectively (graph 3.1 c). The recovery was slower for exports of services.³¹ Expressed in constant prices, the pre-pandemic levels were reached in 2021Q3 for imports and in 2022Q2 for exports. The recent changes of the overall export and import flows have mainly been driven by the price effects (graph 3.1 d). Exports and imports of Greece recorded strong declines in deflators during the 2020 pandemic-crisis (the strongest in the EU). The trade deflators started increasing more strongly in the second half of 2021, with the beginning of the post-pandemic economic recovery. The growth of imports deflator has outpaced the growth of exports deflator in most of 2021 contributing to a deterioration of the trade balance. However, this has reversed starting from 2022Q1. Measured in constant prices, growth of exports outpaced the growth of imports since mid-2021, with the exception of the last quarter, i.e. 2022Q3. Thus, the overall trade balance deterioration observed since 2021Q2 has been less pronounced with trade flows expressed in constant prices.

Overall, recent financial flows are similar to those observed shortly before the pandemic (graph 3.1 e). In the recent years before the pandemic, the financing of the external deficit came mainly in the form of direct investment and portfolio investment equity. In 2020, the importance of debt instruments in financing the external deficit increased. More specifically, the net outflows of portfolio investment debt were more than offset by strong net inflows of debt in the form of other investment, which were related to substantial increases in Greece’s Target2 liabilities. After 2021, and into 2022, the inflows of foreign direct investment started increasing again, and have recently exceeded the longer-term pre-pandemic levels. In addition, net portfolio equity inflows have recently been recorded again.

³¹ Exports of goods reached the pre-pandemic level in 2021Q2 already.

From a sectoral perspective, the net borrowing position of the total economy improved somewhat in 2021, as the government reduced its deficit. The total economy's position went from -6.0% of GDP in 2020 to -5.5% in 2021 (graph 3.1 f). The reduction in the government net borrowing was mildly supported by lower government spending for implementing temporary emergency measures to tackle the health crisis, which declined from 7.6% of GDP in 2020 to 7.2% of GDP in 2021, remaining one of the highest among EU countries. The improvement in the net position of the government has been partly offset by a decline in the net positions of the household and corporate sectors that dropped from 1.7% and 2.3% of GDP in 2020, to 1.2% and 0.9% of GDP in 2021, respectively.

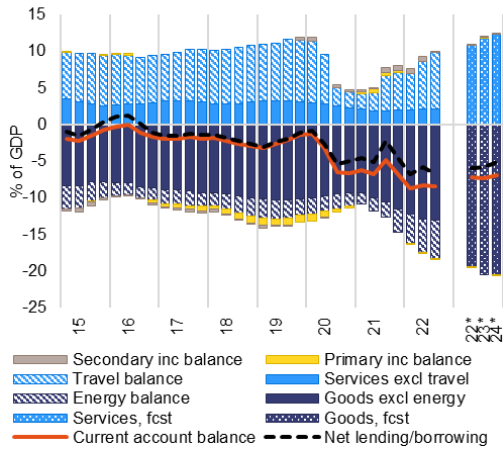
The current account is forecast to decline somewhat in 2022 and 2023. The Commission 2022 autumn forecast for the whole 2022 is currently at -7.3% of GDP, which is above the most recently observed value for 2022Q3. The projection for 2023 is at -7.4% of GDP after which only a small improvement to -6.9% is expected in 2024. These developments are projected to be driven by further declines in the trade balance for goods and mild increases in the trade balance for services. Primary and secondary incomes are expected to remain close to 2022Q3 values, while capital account is forecast to increase noticeably. However, in light of the recent drop in energy prices and the previously assumed energy price developments over the period, the outcome could turn out to be more favourable. From a sectoral perspective, in 2022, the government's net borrowing is expected to continue declining strongly also due to large cut in the budgetary costs of the COVID-19-related measures that exceeds the expected costs of the newly implemented measures to cushion the impact of energy price increases that are estimated at 2.3% of GDP. Further fiscal consolidation is expected in 2023 and 2024. Conversely, households net position is expected to turn negative in 2022 at -2.4% of GDP, to increase to -1.6% in 2023 and to decline only mildly again in 2024. Corporate net lending is forecast to decline in 2022 and to turn mildly negative thereafter. On balance, these trends lead to an expected small decline of the net borrowing of the total economy in 2022 and very slow improvements thereafter. The transfers from the EU budget under the Recovery and Resilience Facility (RRF) and the Multiannual Financial Framework (MFF) represent an important external financing source for Greece, projected at slightly above 3% of GDP on average between 2022 and 2026, and at slightly below 2% thereafter (in net terms).³²

Both savings and investment are expected to rise over the forecast horizon. Savings are projected to increase mostly due to ongoing increases in government savings, while household savings are projected to decline gradually after having peaked during the pandemic period. Conversely, the increase in investment is expected to come mainly from the corporate sector (graph 3.1 g). Investment is forecast at levels significantly above those recorded before the pandemic. However, a decomposition of investment by type shows that the large part of the expected increase is expected to come from strong increases in inventories, over the whole forecast period, following an already substantial increase (in historical comparison) in 2021. Should these increases fall short of the current projections, this would imply lower investment and thus, other things equal, a smaller current account deficit.

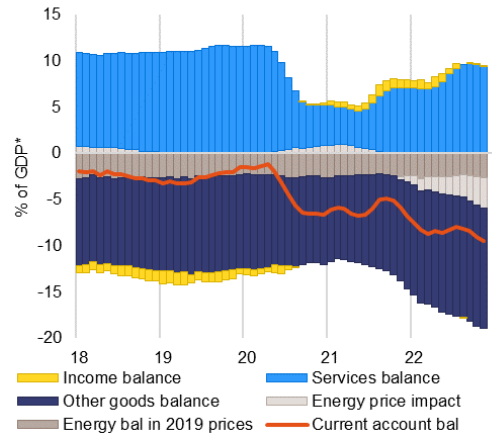
³² These amounts are relevant for the NIIP projections described in the next section.

Graph 3.1: **Selected graphs for Greece**

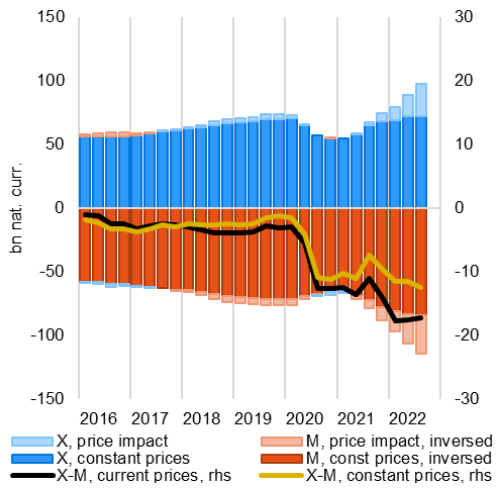
a) Decomposition of current account



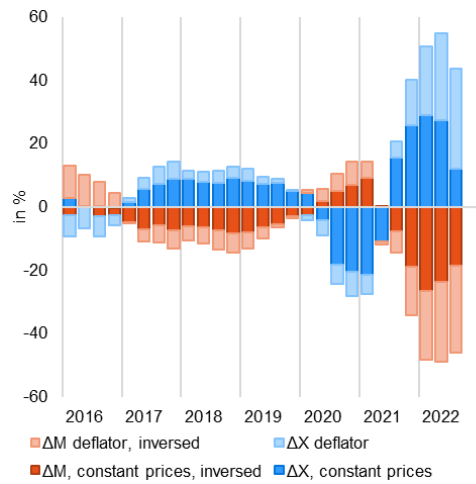
b) Energy price effect



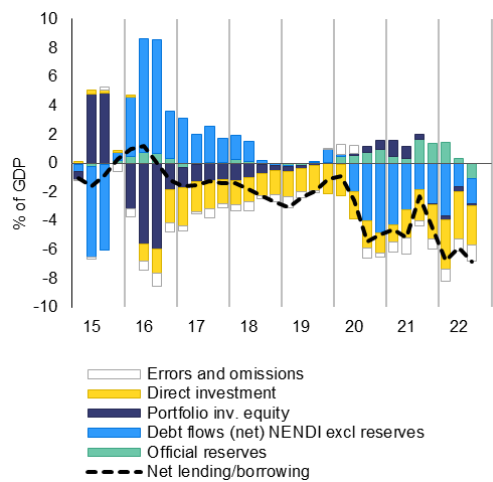
c) Decomposition of exports (X) and imports (M)



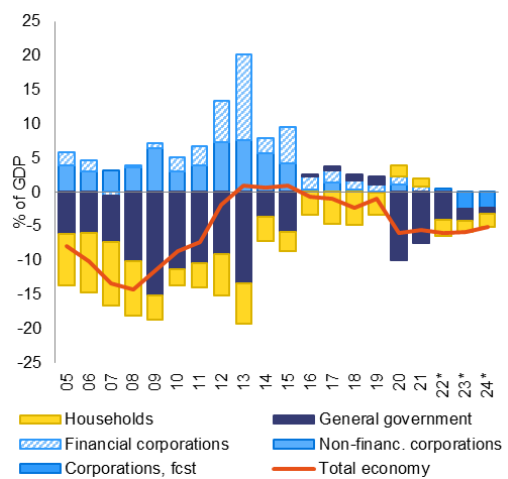
d) Decomposition of exports (X) and imports (M) growth



e) Decomposition of financial account

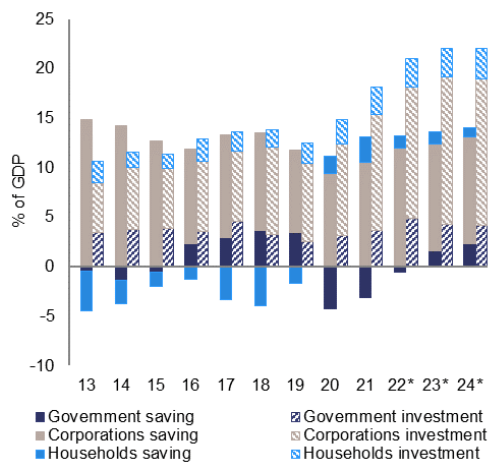


f) Sectoral net lending/borrowing

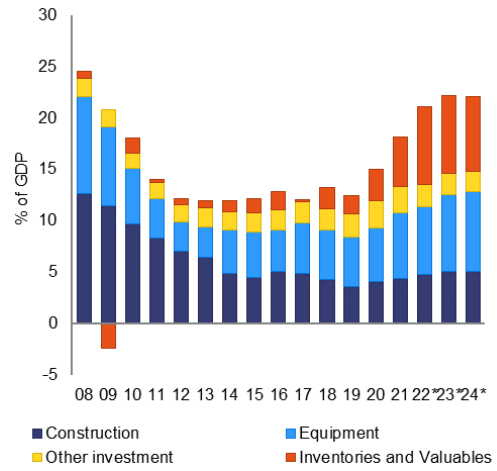


Graph 3.1: **Selected graphs for Greece, continued**

g) Savings and investment by sector



h) Gross capital formation by type



Notes: 4-quarters moving sums for all quarterly data unless stated differently; graph b: 12-months moving sum. GDP* denotes weighted average of year t and t-1 GDP; data up to 2022M11; graphs c and d: National Accounts data; graph d: annual growth of 4-quarters moving sums.

Source: Eurostat, AMECO, Commission services calculations.

3.2 CYPRUS

Cyprus' current account deficit narrowed in 2021, but widened substantially again in 2022, as a result of an increase in trade in goods deficit. The current account deficit increased from -5.6% of GDP in 2019, to -10.1% amid pandemic crisis in 2020. It then narrowed in 2021 to -6.8% of GDP, before increasing to -9.5% in 2022Q3 (4 quarters moving sum, see graph 3.2 a). It is below the levels explained by economic fundamentals (the 'current account norm') and below the other relevant benchmarks. The deficit in trade in goods deteriorated to -22.2% of GDP in 2022Q3 from -18% in 2021, it remained below the pre-pandemic average of -21.2% registered between 2015 and 2019. Conversely, the surplus in trade of services recovered to around pre-pandemic levels, reaching 21.5% of GDP in 2022Q3, from 20.9% of GDP in 2021. In contrast to the pre-pandemic period, when on average the surplus in services was covering the deficit in goods, in 2022Q3, the considerable deterioration of the goods balance led to a deficit in the overall trade balance of -0.7% of GDP in 2022Q3 from a surplus of 2.9% in 2021. A small recovery of the primary income mildly mitigated the current account decline in 2022, as it moved from -8.4% of GDP in 2021, to -7.6% in 2022Q3, albeit remaining in deep negative territory, below the 2016-2019 pre-pandemic levels, which ranged between -2% and -5%. Improvements in both direct investments and portfolio investment incomes contributed to the decline in the primary income deficit during 2022. Secondary income balance remained stable.

While the balance of trade in goods dynamics has been mainly determined by the deterioration of the energy balance and resilient import demand, the balance of trade in services remains in a high positive territory in 2022 mainly on the back of tourism recovery. Being one of the largest among EU countries, the deficit in trade in energy goods worsened from -4.4% of GDP in 2021 to -7.0% of GDP in 2022Q3. In addition, the trade balance of goods excluding energy also slightly declined, equalling -15.2% of GDP in 2022Q3, which is below the -13.5% in 2021, and close to the -16.0% recorded in 2020. Since 2021, the balance of trade in services excluding travel declined by 1 pp of GDP up to 2022Q3, which was more than offset by the travel balance that further improved by 1.6% of GDP. The revenues from tourism in four quarters up to 2022Q3 reached around 83% of the pre-pandemic level, leaving the surplus on the travel balance slightly below the 2019-levels (as a share in GDP). Despite an almost full recovery of tourism, developments in the services balance have become less dependent on tourism. In particular, the share of exports of tourism services in total services decreased from 22.7% on average in the period 2016-2019 to 13.7% in 2022Q3. Shipping export-oriented services also decreased their share compared to the same period. On the contrary, ICT and consulting services have expanded strongly and their share in total exports of services reached 26.6% and 7.3%, in 2022Q3 respectively, up from 18.1% and 2.9%, on average in the period 2016-2019. Financial services continued to expand and their share remained stable over the years at almost 30%.

The recent evolution of trade flows was mainly shaped by the changes in trade volumes. The decline in exports and imports of goods and services during the pandemic crisis in 2020 was relatively shallow and short-lived (graph 3.2 b) as compared to other countries. The magnitude of trade started increasing more strongly after mid-2021, primarily due to increases in export and import volumes (graph 3.2 c). In Cyprus, the terms of trade remained rather stable as the changes in exports and imports prices broadly cancelled out, unlike in most EU countries, which often experienced substantial deteriorations (see section 2).

The deficit in the primary income balance is mainly driven by certain sectors. In particular credit-acquiring companies in Cyprus have been affecting the current account negatively from 2019 onwards, mostly through the payment of interest on their foreign debt. The government has also been a negative contributor through interest payments. Other foreign-owned companies in Cyprus active in the domestic retail trade sector also have a negative impact on the current account, through the repatriation of profits in the form of dividends or retained earnings. Foreign-owned companies in the sectors of manufacturing, shipping, ICT and investment firms, despite their negative contribution in the primary income balance, taking into account the corresponding exports of services of these sectors, contribute positively to the current account.

The current account deficit, after adjustment for the impact of Special Purpose Entities (SPEs), stands at -10.2% of GDP. In the four quarters to 2022Q3, SPEs contributed positively to the current account by 0.7% of GDP, in line with their contribution in recent years, which has mostly been small and fluctuating between -2% and +2% of GDP on average. Regarding the trade flows, 14% of total export and

13% of total imports are attributed to SPEs. SPEs account for 90% of primary income received, and 82% of primary income paid, rendering their segment of the primary income account close to balance. Once SPEs are reclassified as non-residents, the current account is estimated to stand at -10.2% of GDP in 2022Q3.

The financing of external deficit came mainly in the form of direct investment inflows in recent years (graph 3.2 d). Net foreign direct investment inflows in 2020 and 2021 surpassed those recorded in 2019. While both direct investment assets and liabilities declined, the fall in the former was stronger. In the first half of 2022, net inflows have been somewhat smaller. In the second half of 2020 and the beginning of 2021 additional financing was provided by the non-residents buying of portfolio debt instruments, mainly of government debt.³³ Over the same period, large outflows in form of other investment have been recorded, with mainly the private sector reducing its external liabilities. More recently, other investment outflows started narrowing. Net flows of debt in form of portfolio investment switched sign in 2022Q3, turning into net outflows after being an important financing source during the pandemic crisis.

From a sectoral perspective, the net borrowing position of the total economy improved in 2021, mainly due to a narrowing of the government net borrowing. Total net borrowing moved from -10.1% of GDP in 2020 to -6.4% in 2021 but widened substantially again to -9.5% in 2022Q3. The net borrowing position of the government improved gradually between 2021Q1 and 2022Q1, after which the government turned into net lender in 2022Q2. This was partly supported by the gradual reduction of the government spending for COVID-19 temporary emergency measures that went from 3.5% of GDP in 2020 to 2.9% of GDP in 2021 and that it is expected to reach 0.3% in 2022. At the same time, however, the net borrowing position of corporations and households significantly worsened in 2021 and it is expected to continue declining in 2022, to reach -7.3% and -3% of GDP respectively. Developments in the three quarters of 2022 confirm the negative evolution, i.e. increase in the total private sector's net borrowing.³⁴ (graph 3.2 e)

For the year 2022, the current account is forecast to come in slightly below the most recent reading, while it should start to recover gradually in 2023. The current account is projected at -9.7% of GDP in 2022, -7.3% in 2023, and -6.3% in 2024. These developments should be driven by further declines in the balance of trade in goods over the whole forecast horizon. At the same time, balance of trade in services is expected at levels above the most recent outturn. A positive contribution may come from an expected narrowing of the primary income whose trend, however, being a more volatile item, is subject to higher uncertainty. The capital account is forecast to slightly increase and may lend some support to improvement in the overall economy's net borrowing. Moreover, in light of the recent drop in energy prices and the previously assumed energy price developments over the period, the outcome may be more favourable than forecast. From a sectoral perspective, the government net lending position is expected to register a small surplus over the forecast period. Cypriot government is expected to put in place less sizeable fiscal measures in response to the Russian invasion of Ukraine and the ensuing energy crisis, with a budgetary cost of around 0.7% of GDP (one of the lowest among EU countries, see section 2). This helps maintain a positive net position of the government. The total economy net position is forecast to gradually improve from -8.9% of GDP in 2022 to -6.5% of GDP in 2023 and -5.5% of GDP in 2024, in line with the current and capital account projections, supported also by the expected improvements of the net borrowing positions of corporations and households. The overall position of the economy is supported somewhat by the EU transfers under the RRF.

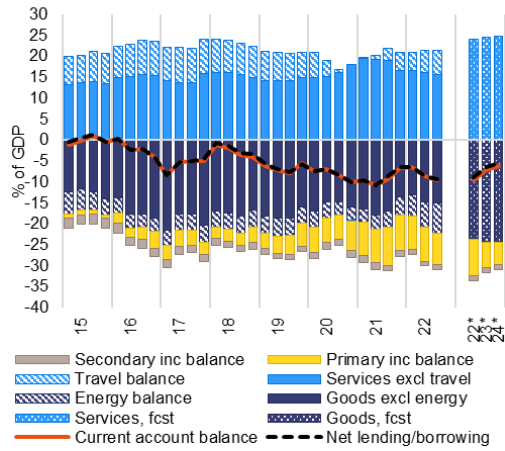
A look at the gross savings and investment by sector shows that the corporate sector savings are expected to play an important role for the current account going forward. The improvement in the current account for 2023 and 2024 is expected to be mostly brought about by a strong increase in corporate savings while investment is expected to remain stable (graph 3.2 f). Conversely, household savings are projected to decline until 2023 partly due to higher living costs, and to increase again in 2024. A decomposition of investment by type shows that a positive contribution to investments is expected to come from a positive change in equipment, while inventories are expected to remain negative over the whole forecast horizon following an already noticeable decline in 2020 (graph 3.2 g and h). Should Cypriot economy not continue reducing its inventories, the investment would be higher than currently projected, which would be consistent with a larger current account deficit, other things equal.

³³ Data on portfolio debt investment flows between 2019Q3 and 2020Q2 is not available.

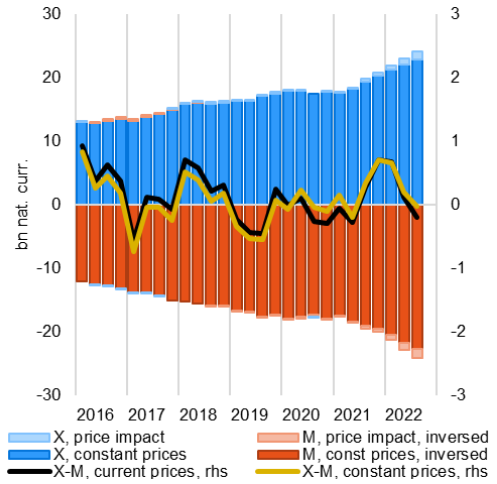
³⁴ Separate data for households and corporations is not available on quarterly basis.

Graph 3.2: **Selected graphs for Cyprus**

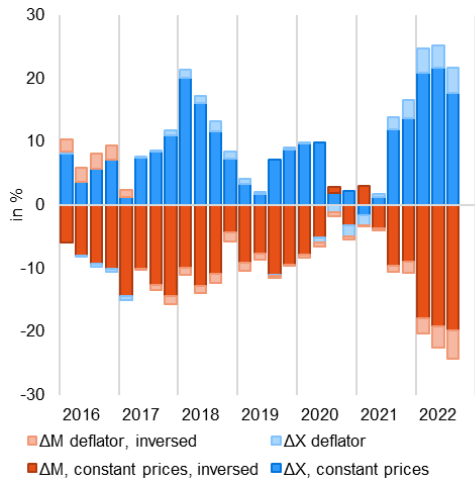
a) Decomposition of current account



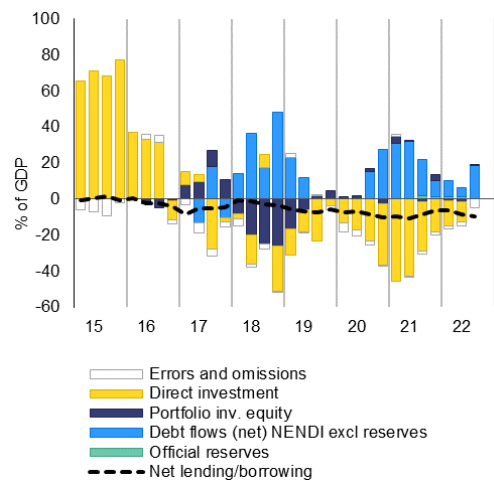
b) Decomposition of exports (X) and imports (M)



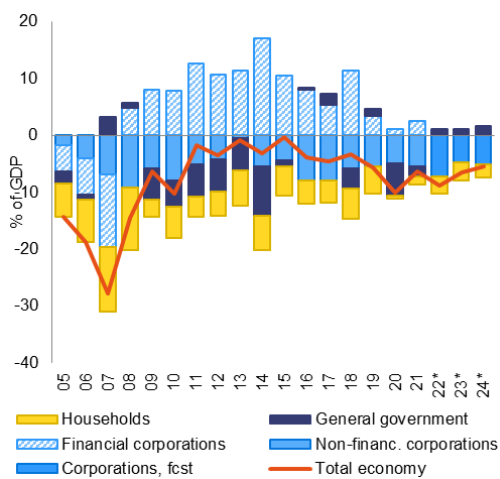
c) Decomposition of exports (X) and imports (M) growth



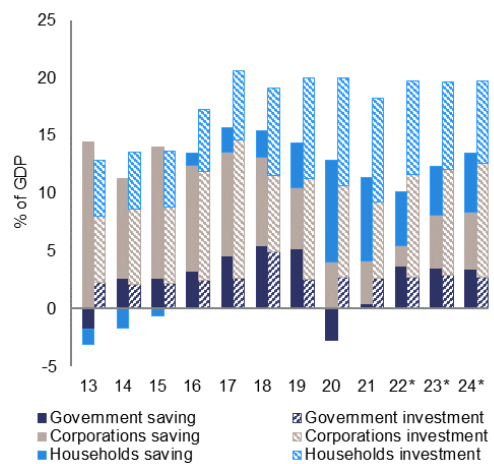
d) Financial account decomposition



e) Sectoral net lending/borrowing

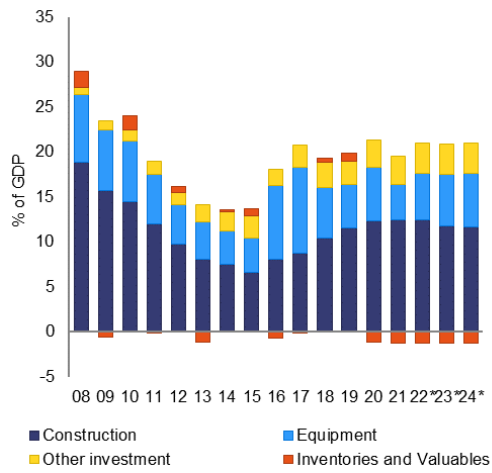


f) Savings and investment by sector



Graph 3.2: **Selected graphs for Cyprus, continued**

g) Gross capital formation by type



Notes: 4-quarters moving sums for all quarterly data unless stated differently; graphs b and c: National Accounts data; graph c: annual growth of 4-quarters moving sums.

Source: Eurostat, AMECO, Commission services calculations.

3.3 PORTUGAL

Portugal's current account posted a mild decline in 2022 driven by exceptionally high prices of energy imports. Its balance reached -1.9% of GDP in the four quarters up to 2022Q3 (see graph 3.3 a). This represents a deterioration from -1.2% of GDP in 2021, -1% in 2020, and a small surplus of 0.4% in 2019. At the same time, economic fundamentals suggest that Portugal should have a balanced current account, as its current account norm equals zero. When adjusted for the negative price effects, mainly reflecting the exceptionally high prices of energy imports, the current account in 2022 is in line with the norm. The current account is around the level required to reach prudential NIIP over ten years, and slightly below the level required to halve the gap to fundamental NIIP benchmark. Still, Portugal's current account is well above the level required to stabilise NIIP over the next 10 years. The balance of trade reached -2.2% of GDP in 2022Q3, which is mildly above the 2021 value of -2.7%, i.e. but still noticeably below the pre-pandemic surplus in 2019 of 0.8% of GDP. The primary income balance fluctuated mildly over the period, moving from -1.4% of GDP in 2020, to -1.2% in 2021 and -1.9% in 2022Q3, thus contributing negatively to the most recent decline in the current account. The secondary income balance increased from 2.3% of GDP in 2020 to 2.7% in 2021, only to drop back to 2.3% by 2022Q3. Similarly, the capital account surplus increased in 2021 to 1.7% of GDP, from 1% in 2020, but declined back to 1% by 2022Q3. This contributed to the recent worsening of the net lending/borrowing of the economy, which turned slightly negative in 2022. On the financing side, the composition of capital flows was mostly stable, with continued net foreign direct investment inflows and portfolio investment outflows. The latter declined over the last two quarters, as net outflows in form of other investment have also been recorded, mainly due to a reduction of the central bank's external liabilities.

Divergent developments in the balance of trade in goods and the balance of trade in services intensified in the first three quarters of 2022. Over that period, the balance of trade in goods worsened by 3.3 pp of GDP, while the balance for services improved by 3.8 pp. The balance of trade in goods dynamics has been largely determined by the energy balance, which worsened from -1.7% of GDP in 2020 to -2.7% in 2021, with the decline accelerating to -4.9% of GDP by 2022Q3. While this development has mostly been caused by the strongly increased energy prices (see graph 3.3 b), the balance of trade in goods excluding energy also declined in the first three quarters of 2022, by 1.1 pp of GDP. For the trade in services, the most important driver has been the recovery of international travel, with the travel balance of Portugal increasing from 2.5% of GDP in 2020, to 3% in 2021, and to 6.3% by 2022Q3, also supported by a comparatively strong increase in tourism services' prices (see graph 2.6 b in section 2). In 2022, the improvement in the travel balance has accounted for almost the entire increase in the trade balance of services.

Measured in constant prices, total exports increased more strongly than imports in the first three quarters of 2022, as compared to the same period in 2021. Exports and imports of Portugal, when measured in current prices, recovered beyond the pre-pandemic levels in 2022Q1 and 2021Q4, respectively (graph 3.3 c). When compared in constant prices, the recovery was somewhat slower, and it took another quarter to exceed its 2019 levels. For exports, this was mainly due to slower recovery in exports of services, most notably tourism, while exports of goods exceeded the 2019 levels already in 2021Q2, both in current and constant prices. In 2022, the contribution of changes in deflators to overall changes in exports, and especially imports, has been sizeable. For imports it was stronger than the contribution of changes in volume over the last two quarters (graph 3.3 d). Consequently, over the recent quarters, the difference between exports and imports, i.e. the trade deficit, improved more strongly when measured in constant prices.

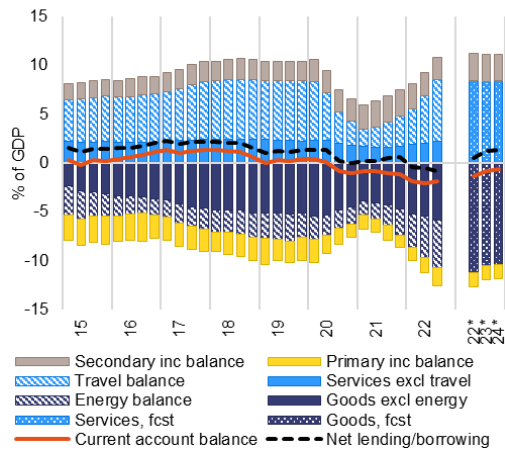
From the sectoral perspective, the net lending/borrowing position of the government has been gradually improving since 2021Q1 (sum of last four quarters, see graph 3.3 e). After the outbreak of the pandemic, as in other Member States, the government net position declined strongly, amid the crisis and the cost of support measures. For Portugal, the government deficit peaked in 2021Q1 at -7% of GDP and has been declining since then, turning into a small surplus in 2022Q2. Conversely, corporations and especially households increased their net positions during the pandemic crisis. In 2021 and into 2022, they continued moving in the opposite direction of the government sector, more than offsetting the effects of fiscal consolidation. On balance, these two trends led to small improvements in the net lending/borrowing of the total economy in 2021. However, this has been reversed since the beginning of 2022, and the net position of Portugal turned negative.

A small further deterioration of the current account is forecast for the whole of 2022. The current account balance is expected to have reached -1.4% of GDP for the whole 2022, with a notable improvement in the second half of the year. A mildly higher balance, driven by a small improvement in the balance of trade in goods, is expected for 2023 and 2024. In light of the recent drop in energy prices and the energy price developments assumed in the current forecast, the actual outcome could be even more favourable. Conversely, the balance of trade in services, as well as the primary and secondary income accounts are projected to be quite stable over the forecast horizon. For the whole of 2022, the government is projected to remain a net borrower, even if its deficit should have shrunk as compared to 2021. This is also due to comparatively high budgetary costs of energy-related measures estimated for 2022, which more than offset a decline in the COVID-related support measures. Supported also by the increased net lending of corporations, the total economy net position is forecast to be positive despite the significant reduction in the net lending of households. For 2023, the total net lending should further increase mainly on the account of the expected continued fiscal consolidation. While a small reduction in government borrowing is expected also in 2024, the overall economy net lending is not forecast to change. The transfers from the EU budget under the RRF and the MFF represent an important external financing source for Portugal, projected at nearly 2% of GDP on average between 2022 and 2026, and to slightly below 1% thereafter (in net terms).³⁵

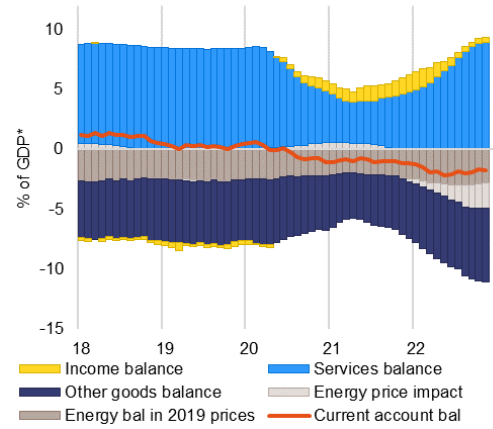
³⁵ These amounts are non-negligible in the context of the NIIP projections described in the next section.

Graph 3.3: **Selected graphs for Portugal**

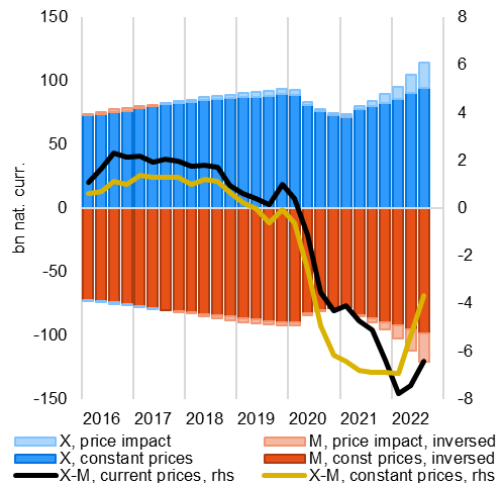
a) Decomposition of current account



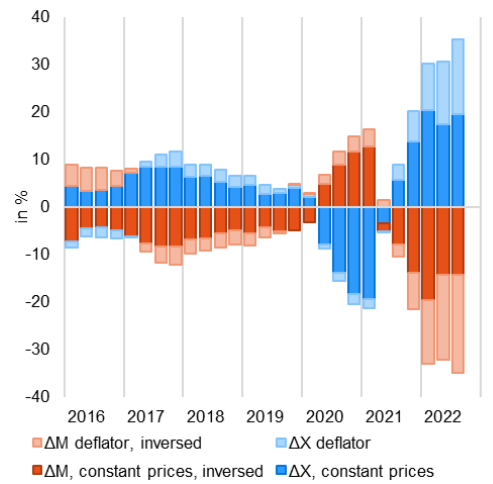
b) Energy price effect



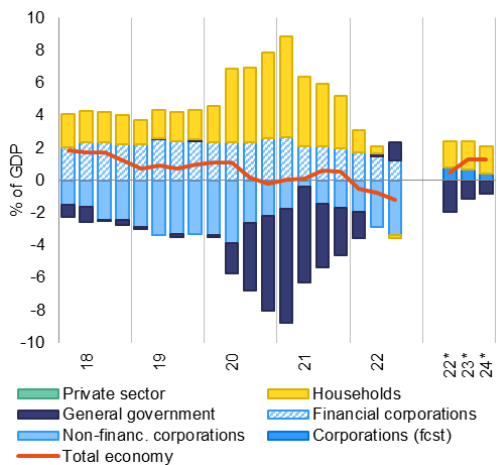
c) Decomposition of exports (X) and imports (M)



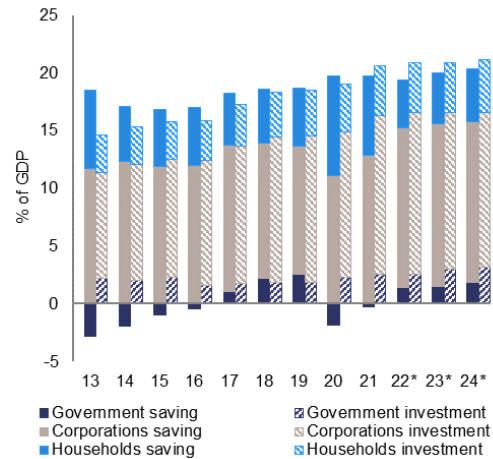
d) Decomposition of exports (X) and imports (M) growth



e) Sectoral net lending/borrowing



f) Savings and investment by sector



Notes: 4-quarters moving sums for all quarterly data unless stated differently; graph b: 12-months moving sum. GDP* denotes weighted average of year t and t-1 GDP; data up to 2022M11; graphs c and d: National Accounts data; graph d: annual growth of 4-quarters moving sums.

Source: Eurostat, AMECO, Commission services calculations.

3.4 ROMANIA

Romania's current account deficit, which has been on a rapidly widening path since 2015, expanded further in 2021 and 2022 so far. The deficit moved from -4.9% of GDP in 2020, and -7.2% in 2021, to -9.1% of GDP in 2022Q3 (sum of the last 4 quarters, see graph 3.4 a). The deterioration continues to be driven mainly by the widening excess of domestic demand over output, namely the rising trade balance deficit, which went from -4.3%, to -5.7% and -6.7% of GDP in 2020, 2021 and 2022Q3, respectively. More specifically, Romania is characterised by a high deficit in trade of goods, and a surplus in trade of services. The balance of trade in goods has been on a continuous declining path for years, and it worsened by an additional 1.4 pp of GDP in 2022 coming to -11% of GDP by the third quarter. Conversely, the services surplus has only been fluctuating mildly over the years and it increased slightly in the first three quarters of 2022 to reach 4.3% of GDP.

Romania's deficit in trade in energy goods is comparatively small and accounts for only a smaller part of its overall trade deficit. Romania's deficit in trade in energy goods has been smaller than the EU average: it equalled -1.2% of GDP in 2020, -2% in 2021, after which it declined to -2.8% of GDP by 2022Q3. This downward trend has mostly been caused by the increasing prices of energy goods (graph 3.4 b). The rest of the current account deterioration has mainly been due to the declining primary income account, which moved from -1.5% of GDP in 2020, to -2% in 2021 and -3% by 2022Q3, largely on the account of higher profits of foreign (direct) investors in Romania. At the same time, secondary income account remained nearly unchanged. The capital account surplus increased mildly, from 1.9% of GDP in 2020 to 2.2% in 2021 and in 2022Q3, cushioning somewhat the decline in the net lending/borrowing position of the economy.

Over the recent quarters, changes in trade deflators contributed to deepening of the trade balance deficit. Romania's trade in goods and services recovered above both the values (trade flows in current prices) and volumes (trade flows in constant prices) observed before the pandemic crisis³⁶, already in the second and third quarters of 2021 (graph 3.4 c). With the ongoing recovery, the contributions of both exports and imports deflators to overall trade changes have been considerably higher than in the past, especially over the most recent quarters (graph 3.4 d). As the growth in imports prices exceeded that of exports prices over the last 4 quarters up to 2022Q3, the deterioration of the trade balance in current prices (i.e. the difference between exports and imports in current prices) was stronger than the corresponding deterioration when the trade flows are measured in constant prices. This represents a reversal as compared to most of the period between 2018 and 2021Q3 when export prices had been increasing more strongly than the imports deflator, mildly mitigating the worsening of the trade balance.

The total economy's net borrowing increased in 2021 despite some improvements in the net position of the government sector. Disaggregating the total net lending/borrowing of the economy by institutional sectors shows the large increase in government borrowing in 2020 resulting from the pandemic crisis, including the expansionary fiscal policy needed to support the economy (graph 3.4 e). However, this did not lead to worsening of the total position as the corporates increased their net lending and the households lowered their net borrowing. Conversely, in 2021, some fiscal consolidation and further increase in corporate net lending were not sufficient to improve the total economy's net position, implying a strong increase in households net borrowing.³⁷

In 2021 and 2022, the government net external borrowing (incurrence of liabilities) declined, and the direct investment inflows increased again. In the few years before the pandemic, financing of external deficit came mostly in form of foreign direct investment, and of portfolio debt (see graph 3.4 f), mainly of the government sector. In 2020, the amounts of portfolio debt raised abroad by the government to meet its financing needs increased substantially, while the direct investment flows declined. In addition, a substantial acquisition of external assets by Romanian residents was recorded, largely by the monetary and financial institutions. In 2021, the government net external borrowing (incurrence of liabilities) declined, and the direct investment inflows increased again. This trend continued also into the first three quarters of 2022.

³⁶ The same holds true also for trade in goods only.

³⁷ The net lending and borrowing data for households is not available (except for the forecast), so that the implied households net position is calculated as a difference between the private sector and corporate net lending and borrowing positions.

Over the same period, Romania continued acquiring additional official reserve assets. The RON remained fairly stable in nominal effective terms³⁸ after very brief tensions and global financial market turbulences at the outset of the pandemic and at the beginning of the war in Ukraine (see graph 2.12 a in section 2). Given the heightened global financial risks and fast-growing current account deficits, tighter external financing constraints cannot be ruled out should the investors' risk aversion (or perception) increase.

Forecasts of external flows add to concerns as the current account is expected to remain deeply negative in coming years. It is forecast to reach -9.5% of GDP for the whole 2022, from -7.2% in 2021, and to improve only marginally over the next two years. The main factor behind the negative forecast developments is the expected further widening of the trade balance deficit for the whole 2022, which is projected to strongly dominate some improvements in the primary income account. However, given that the most recent evolution of energy prices has been more favourable than assumed in the current forecast, there is an upside risk to the above projections. Net lending/borrowing position of the whole economy is expected to decline in 2022, despite some reduction in government deficit and a substantial increase in corporate net lending. The latter is expected to result from strong increases in corporate gross savings, which should noticeably exceed the increases in corporate investment (graph 3.4 h). Despite these improvements, the worsening of the households net position is expected to dominate the changes in the government and corporate sectors. Going forward, the government is projected to mildly increase its gross investment but still to remain on the gradual but slow consolidating path. Overall, only small improvements in the total economy's net lending/borrowing position are expected despite sizeable transfers from the EU under the RRF and the MFF. These are projected at around 2.5% of GDP on average between 2022 and 2026, i.e. to around 1.5% thereafter (in net terms).³⁹

Overall, current forecasts point to considerable external (net) financing needs over the coming years. In the current global economic context of increased uncertainties, the adequacy of the foreign exchange reserves gains on importance. Expressed as a share of GDP, Romania's reserves stood at 18% of GDP in 2022Q3 (graph 3.4 g).⁴⁰ This corresponds to between four and five months of imports, and nearly 200% of the short-term external debt liabilities. Both of these metrics have been on a declining trend over the recent period, but are still at levels normally regarded as sufficient. Net external short-term debt assets are slightly negative. There are, however, large forecast net financing needs going forward, which for 2023 and 2024 (sum of forecast net borrowing for the two years) are projected at close to 16% of (the forecast 2022) GDP.

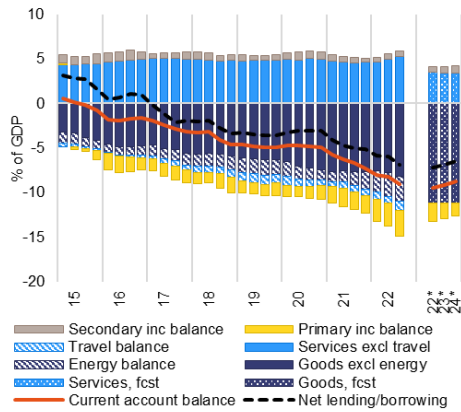
³⁸ The exchange rate stability is important also in view of considerable shares of foreign exchange denominated (mainly euro) government debt, amounting to 46.1% in November 2022, while the shares of foreign exchange denominated loans for household and nonfinancial corporations stood in 2022 at 14.3% and 44.9%, respectively.

³⁹ These amounts are non-negligible in the context of the NIIP projections described in the next section.

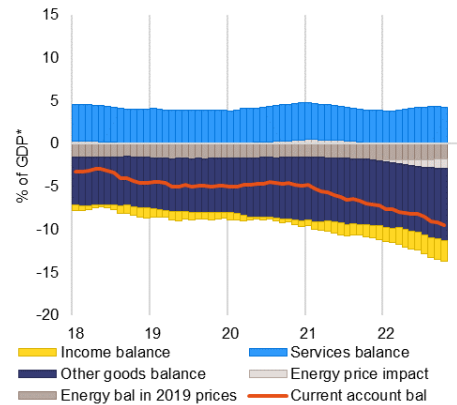
⁴⁰ See also section 2 for a horizontal comparison, using the foreign exchange reserves data from the IMF as of December 2022, which, expressed as a share of the forecast GDP, comes at 18.5% of GDP.

Graph 3.4: **Selected graphs for Romania**

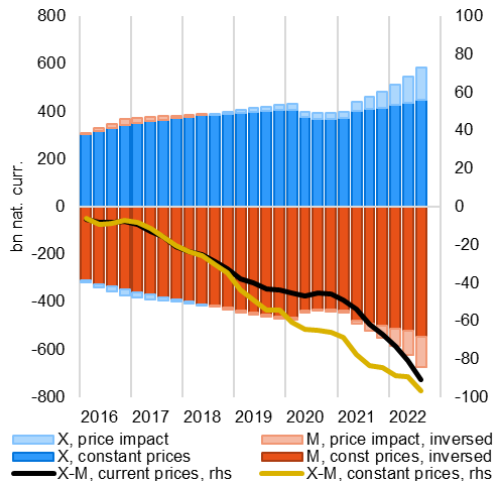
a) Decomposition of current account



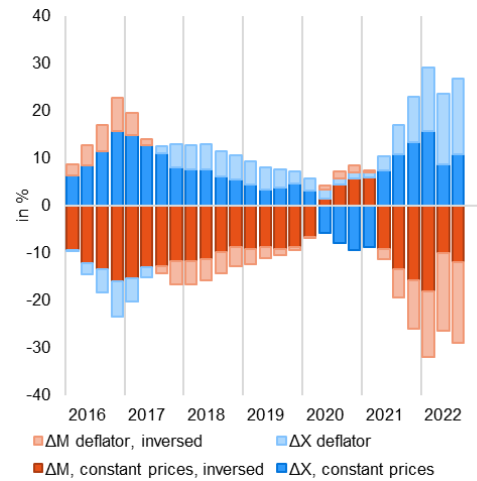
b) Energy price effect



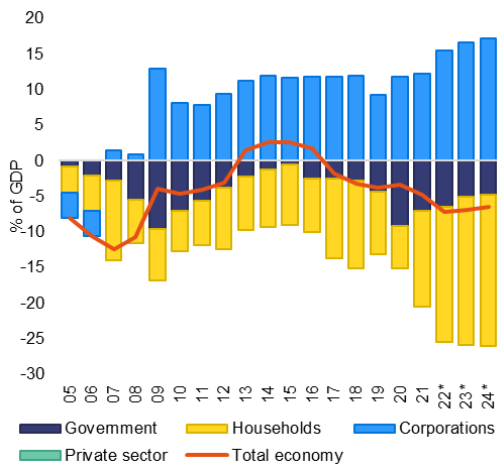
c) Decomposition of exports (X) and imports (M)



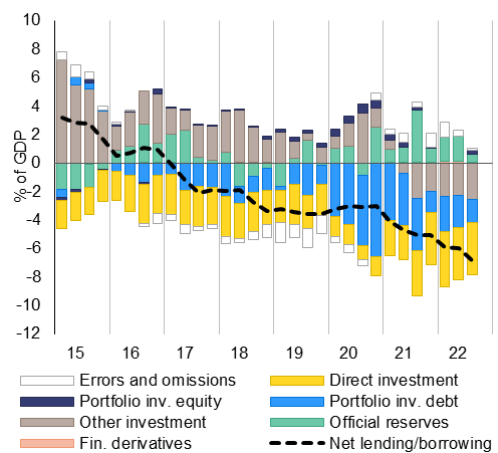
d) Decomposition of exports (X) and imports (M) growth



e) Sectoral net lending/borrowing

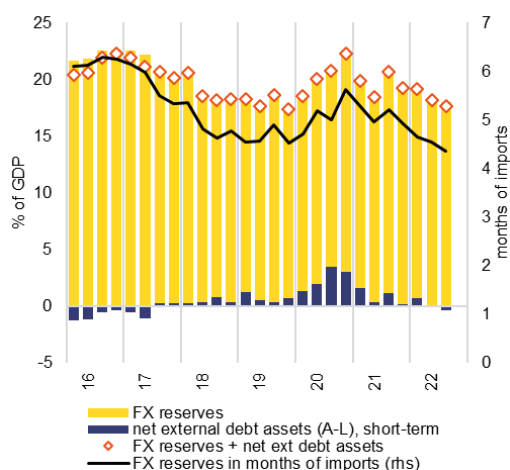


f) Decomposition of financial account

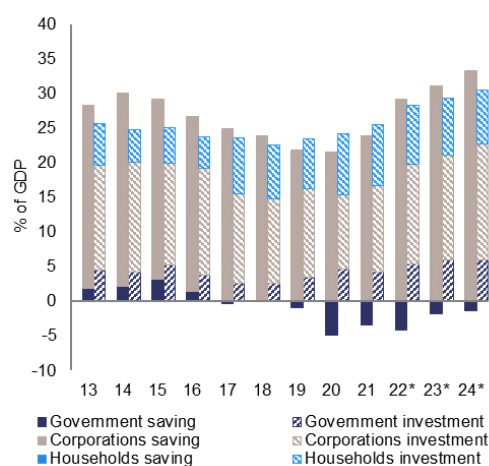


Graph 3.4: **Selected graphs for Romania, continued**

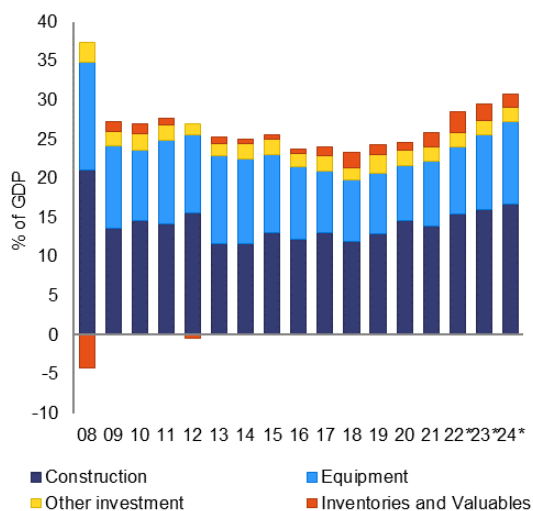
g) FX reserves and short-term net ext. debt



h) Savings and investment by sector



i) Gross capital formation by type



Notes: 4-quarters moving sums for all quarterly data unless stated differently; graph b: 12-months moving sum. GDP* denotes weighted average of year t and t-1 GDP; data up to 2022M10; graphs c and d: National Accounts data; graph d: annual growth of 4-quarters moving sums; graph e: The net lending and borrowing data for households is not available (except for the forecast), so that the implied households net position is calculated as a difference between the private sector's and corporate net lending and borrowing; graph g: if the term structure of assets and liabilities is not available, Commission's estimates are used for specific items; graph h: households savings data is not available.

Source: Eurostat, AMECO, Commission services calculations.

3.5 HUNGARY

Hungary's current account worsened sharply in 2021 and in the first three quarters of 2022. In one of the sharpest current account declines among the EU countries, it moved from -1.1% of GDP in 2020 to -4% in 2021, reaching -7.4% of GDP by 2022Q3 (sum of the last 4 quarters, see graph 3.5 a). It is now below the current account norm and below the required current account to halve the gap to fundamental benchmark over 10 years and the current account required to stabilise the NIIP over the next ten years. However, it is above the current account required to reach the prudential NIIP over 10 years. This dynamic was mainly determined by the balance of trade, which moved from a surplus of 1.9% of GDP in 2020, to 0.3% in 2021, to a deficit of -3.5% in 2022Q3. This is consistent with a comparatively strong deterioration in terms of trade for Hungary over the period, mainly during 2021. Most of the worsening in the balance of trade stems from the deteriorating balance of trade in goods, which went from -1% of GDP, to -3% and -7.7% of GDP in 2020, 2021 and 2022Q3, respectively. Conversely, the balance of trade in services recorded moderate improvements over the period, reaching a surplus of 4.3% of GDP in 2022Q3.

Most of the decline in the balance of trade in goods can be attributed to the energy balance. Hungary's trade deficit in energy goods has been among the largest in the EU: it equalled -2.3% of GDP in 2020, -4.4% in 2021, after which it declined to -8.7% of GDP by 2022Q3. The recent fall is among the strongest in the EU and it was mainly caused by the increase in prices of energy goods (see graph 3.5 b). The surplus of services trade nearly halved after the outbreak of the pandemic, reaching 2.9% of GDP for 2020. Since then, a gradual recovery has been underway, including of travel services' surplus. However, foreign guest overnight stays in 2022 at Hungarian accommodations were still 28% below their 2019 level. Smaller negative contributions to the worsening current account came from the declining primary income account, which moved from -2.4% of GDP in 2020, to -3.2% in 2021 to improve slightly to -3.1% by 2022Q3, largely due to lower compensation of employees. Similar movements have been recorded for the secondary income account, which reached a deficit of -0.9% of GDP in 2022Q3. The capital account surplus increased noticeably, from 2% of GDP in 2020, to 2.6% in 2021 and to 3.3% in 2022Q3, mitigating the decline in the net lending/borrowing of the economy.

Contributions of changes in trade flow deflators to changes in the trade balance have become much more pronounced since the recovery from the pandemic crisis started. Hungary's trade recovered quickly after the pandemic slump (graph 3.5 c), with both exports and imports exceeding the pre-pandemic values already in 2021Q1 (in current prices), i.e. in 2021Q2 (measured in constant prices). As the recovery progressed over the rest of 2021, and especially into 2022, increases in trade were mainly driven by increases in trade deflators (graph 3.5 d). This was more pronounced on the imports side, leading to steep decline in the trade balance. Conversely, when trade flows are measured in constant prices, the difference between exports and imports, while falling after 2021Q2, bottomed in 2022Q1 and has been increasing thereafter.

Net lending/borrowing has been declining since mid-2021, driven by the fall in the private sector's net position. Similarly to other EU countries, the government increased its net borrowing during the pandemic crisis, while the private sector increased net lending. The aggregate position remained positive and relatively stable except for the small short-lived dip in the second quarter of 2020 (graph 3.5 e). After the first quarter of 2021, and into 2022Q3, the government significantly reduced its deficit, more than offsetting the decline in households net lending. However, the aggregate position started to decline, mainly driven by non-financial corporations, which moved from net lending of 2.1% of GDP in 2021Q1, to net borrowing of -3.7% of GDP by 2022Q3.

As Hungary turned into a net borrower, its external deficit has mainly been financed by portfolio debt and other investment. Given the overall economy's net lending position in the years before the pandemic crisis, Hungary's financial account has been characterised by capital outflows. However, net lending had been on the declining trend before the pandemic and came down to 1.1% of GDP in 2019. While it remained positive and relatively stable until 2021Q2, it started to decline thereafter turning negative and reaching -4.2% of GDP by 2022Q3. As for the composition of (net) capital flows, foreign direct investment inflows have been recorded before the pandemic crisis, as well as in the recent years (graph 3.5 f). The capital outflows in the period of surpluses were mainly in the form of other investment and portfolio debt. Over the recent years, the sign of these net flows reversed and they have been contributing to the financing

of the external deficit. Conversely, since the outset of the pandemic crisis, some withdrawal of non-resident investment in portfolio equity has been observed. Over the same period, the amount of foreign exchange reserves increased. The HUF has been on a depreciating trend over the last few years (see graph 2.12 a in section 2). The depreciation has been more substantial following the pandemic shock, but this was followed by a quick recovery and a return to a mild downward trend with some volatility. More recently, however, after the beginning of the Russian invasion of Ukraine, the depreciation accelerated significantly. Given the weaknesses in the currency movements amid heightened global financial risks and high current account deficits, tighter external financing constraints cannot be ruled out should the investors' risk aversion (or perception) increase.

The statistical treatment of Special Purpose Entities (SPEs) does not significantly influence Hungary's current account, but it affects the assessment of the gross external position. Data excluding SPEs shows rising gross external debt. According to the balance of payments from the Hungary's central bank, the current account deficit was 4.2% of GDP in 2021 when including SPEs (i.e. classifying them as residents), while it was 4% when excluding them. Differences are larger for gross external debt, especially when excluding stocks related to foreign direct investments (which are influenced by internal financing choices of multinational companies). With the inclusion of SPEs, this measure of gross external debt fell from 162.4% of GDP at the end of 2019 to 158.8% in 2022Q3. However, excluding SPEs it rose from 53.3% to 66.5%.

The current account is expected to further deteriorate for the whole 2022 before improving in 2023 and 2024. It is forecast to reach -7.6% of GDP in 2022, from -4% in 2021, and to improve close to 2021 level over the next two years. The changes over the forecast horizon are mainly expected to be shaped by the movements in the balance of trade in goods. Income balance, especially the primary income account, is forecast close to levels observed most recently. However, given that the most recent evolution of energy prices has been more favourable than assumed in the current forecast, there is an upside risk to the above projections. Net lending/borrowing position of the whole economy is expected at -4.6% of GDP for the whole 2022, thus somewhat above the most recent value equal to -4.8% in 2022Q3. The government deficit is forecast to remain high at 6.1% of GDP but still lower than in 2021. As the capital account surpluses are forecast to increase going forward, further improvement in net lending/borrowing is projected for 2023 and 2024. The transfers from the EU budget under the RRF and the MFF represent an important external financing source for Hungary, projected to around 2.5% of GDP on average between 2022 and 2026, and to around 1.7% thereafter (in net terms).⁴¹ From the sectoral perspective, the improvement after 2022 is expected to be driven by reduced net borrowing of the corporate sector, while the net lending of households should further decline. While government borrowing is expected to decrease somewhat, the deficit would still remain substantial in 2023 and 2024.

A look at the gross savings and investment by sector shows a strong fall in households savings in 2022 and 2023 amid higher living costs (graph 3.5 h). The deterioration in the current account in 2022 and the subsequent improvement are expected to be mostly brought about by a strong fall in households savings. Following a 2022 increase, investment is expected to decline again over the forecast horizon. As for the type of investment (graph 3.5 i), a jump in 2022 is projected to come mainly from construction, while inventories are expected to decline gradually after an increase in 2021.

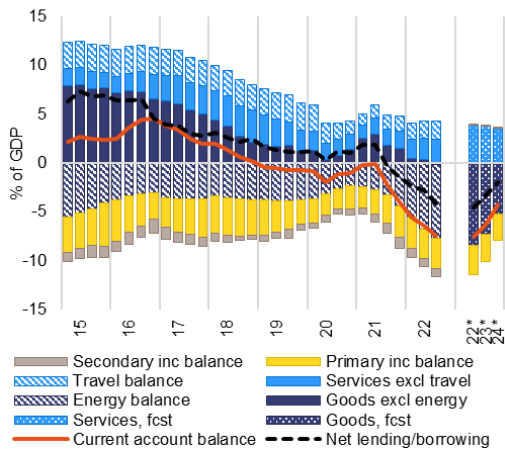
Overall, current forecasts point to narrowing, but still significant current account deficits over the coming years. In a current context of large uncertainties, the adequacy of the foreign exchange reserves becomes more important. Expressed as a share of GDP, Hungary's reserves are solid, at around 23% of GDP in 2022Q3 (graph 3.5 g).⁴² This corresponds to slightly above 120% of the short-term external debt liabilities, and just over three months of imports. Both of these metrics have been on a declining trend over the recent period. Net external short-term debt assets are positive, at around 3% of GDP, but have also been slowly declining.

⁴¹ These amounts are non-negligible in the context of the NIIP projections described in the next section.

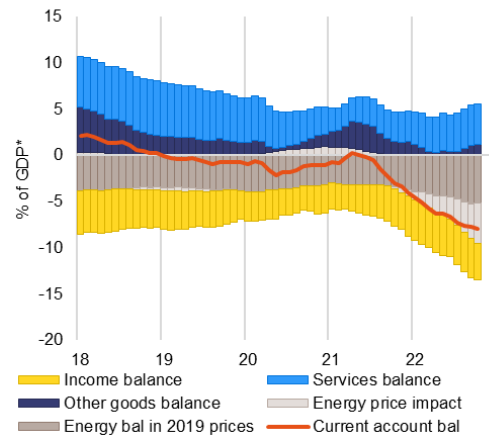
⁴² See also section 2 for a horizontal comparison, using the foreign exchange reserves data from the IMF as of December 2022, which, expressed as a share of the forecast GDP, comes at 24.4% of GDP.

Graph 3.5: **Selected graphs for Hungary**

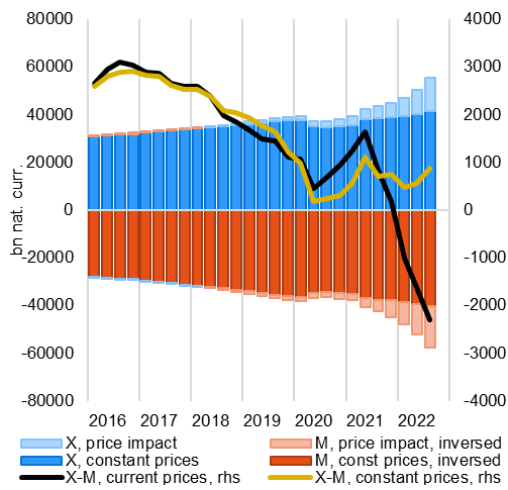
a) Decomposition of current account



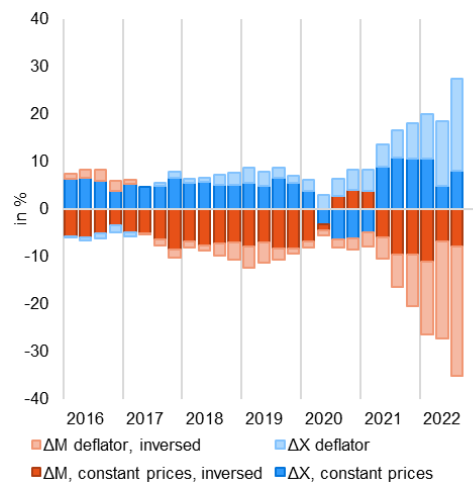
b) Energy price effect



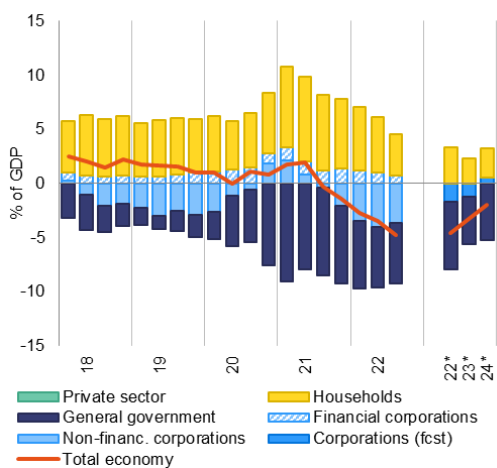
c) Decomposition of exports (X) and imports (M)



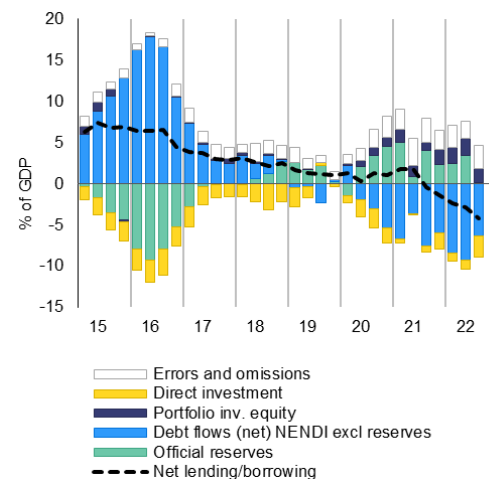
d) Decomposition of exports (X) and imports (M) growth



e) Sectoral net lending/borrowing

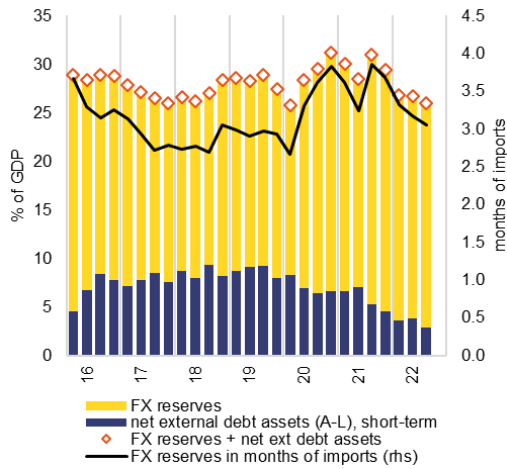


f) Decomposition of financial account

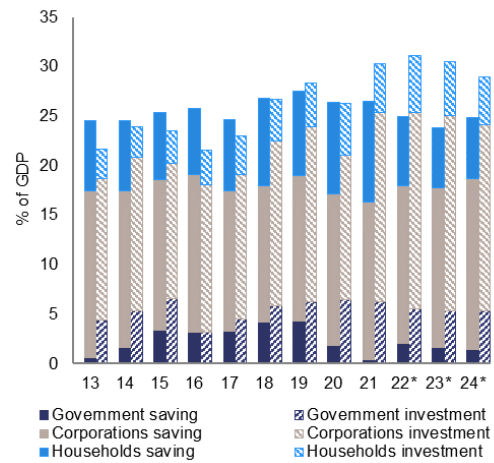


Graph 3.5: **Selected graphs for Hungary, continued**

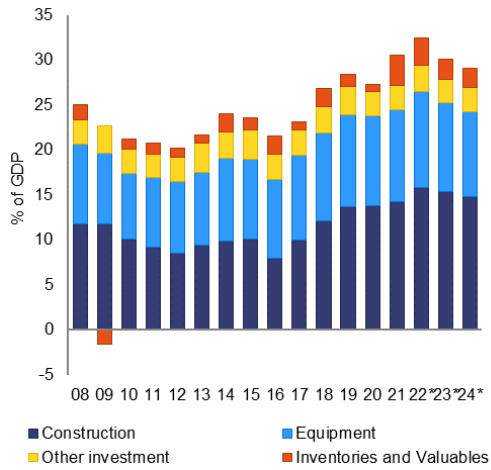
g) FX reserves and short-term net ext. debt



h) Savings and investments by sector



i) Gross capital formation by type



Notes: 4-quarters moving sums for all quarterly data unless stated differently; graph b: 12-months moving sum. GDP* denotes weighted average of year t and t-1 GDP; data up to 2022M10; graphs c and d: National Accounts data; graph d: annual growth of 4-quarters moving sums; graph g: if the term structure of assets and liabilities is not available, Commissions estimates are used for specific items.

Source: Eurostat, AMECO, Commission services calculations.

3.6 LATVIA

Latvia's current account has experienced a significant deterioration since 2021. After having improved during pandemic crisis from -0.6% of GDP in 2019 to a surplus of 2.6% in 2020, it moved to a deficit of -4.2% in 2021, which deepened to -5.2% by 2022Q3 (4 quarters moving sum, graph 3.6 a). It is now below the levels explained by economic fundamentals (the 'current account norm'). This dynamic was mainly determined by a deterioration of the trade balance, which first moved from a small deficit in 2019, to a surplus of 1% of GDP in 2020, before declining strongly to -3.4% in 2021, and -4.7% in 2022Q3. A negative contribution to the worsening current account came from the declining primary income account. It moved from a nearly balanced position in 2020 to -1.5% in 2022Q3, partly due to lower compensation of employees, but mostly to recovery of the direct investment income, both of credit and debit flows, which resulted in lower overall direct investment income balance. The secondary income account has been on a slow declining trend, but remained in the surplus of 1% of GDP in 2022Q3. The same holds true for the capital account, which has been slowly decreasing since 2020, from 1.7% of GDP to 1.1% in 2022Q3.

Most of the worsening in the balance of trade stems from the deteriorating balance of trade in goods, particularly energy. The balance of trade in goods first improved in the pandemic crisis to -5.1% of GDP in 2020, but then fell to -8.2% and -10.2% of GDP in 2021 and 2022Q3, respectively. These dynamics, especially the most recent decline, has been largely determined by the developments of the energy balance. The balance of trade in energy goods first improved to -1.5% of GDP in 2020, but then it reduced to close to pre-pandemic levels, reaching -2.5% in 2021. The decline accelerated strongly more recently with the energy balance reaching -6% of GDP by 2022Q3, mainly due to increased prices (graph 3.6 b). Conversely, surplus of trade in services, while still below the 2019 and 2020 levels, recorded moderate recent improvements, reaching 5.5% of GDP in 2022Q3 from 4.8% in 2021.

The changes of the overall export and import flows in 2022 so far have mainly been driven by changes in trade deflators, but the trade balance was largely determined by the changes in trade volumes. Following the reduction in trade during the pandemic, Latvia's exports and imports recovered to above the pre-pandemic levels by 2021Q2, both in current and constant prices (graph 3.6 c).⁴³ As the recovery moved forward, the contribution of changes in trade deflators to changes in the overall trade flows became increased in significance (graph 3.6 d). More specifically, from the second quarter of 2021, the volume of imports growth outpaced the volume of exports growth, crucially contributing to decline in the trade balance. While the price effects worked in the opposite direction, except in the last observed quarter, only a slight improvement of the terms of trade was observed. Thus, given that the changes in exports and imports prices were largely offsetting, the evolution in the trade balance, calculated as a difference between exports and imports in current prices, largely follows the development of the difference between exports and imports in constant prices.

The net lending/borrowing position of Latvia's economy declined strongly in 2021 and 2022 as the government increased its deficit and non-financial corporations turned into net borrowers (graph 3.6 e). The total economy's net position went from a surplus of 4.3% of GDP in 2020, to -2.8% in 2021, and to -4.1% by 2022Q3. In 2020, the year of the pandemic crisis, households net lending position increased substantially, which went along with a small rise in the net position of the corporate sector. Conversely, government moved into deficit amid crisis, and also due to budgetary costs of COVID-19-related support measures, amounting to around 2.7% of GDP in 2020 (see section 2). On balance, these trends led to a substantial increase in the total economy net lending position that moved from 0.9% in 2019 to 4.3% in 2020. In 2021, Latvia registered a further increase in the borrowing position of the government, to -7% of GDP in 2021, due to substantial additional measures taken to cushion the impact of the pandemic. While government reduced its net borrowing by 2022Q3, private sector's net position declined causing the total economy's net borrowing to expand to -4.1% of GDP. Recent deficits have been primarily financed by foreign direct investment inflows, which held well also in the pandemic crisis. Portfolio debt started flowing in the economy in net terms again in 2022. While capital flows in form of other investment remained small in net terms, Latvia's Target2 position moved deeper in the negative territory during the first eleven months of 2022, to around -27% of (forecast) GDP.

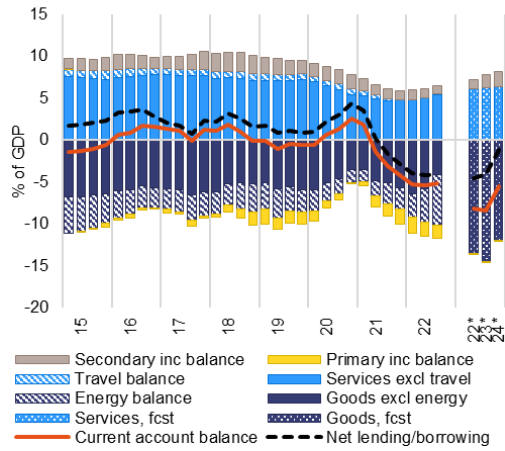
⁴³ If only trade in goods is observed, which could have been more exposed to supply chains frictions, the recovery was even faster on average.

Going forward, the current account is forecast to further deteriorate to below -8% of GDP for 2022 and 2023, and only to improve somewhat in 2024. The expected further deterioration in the current account is mainly driven by a decline of the trade balance for goods that should move from -8.2% of GDP in 2021, to -13.5% in 2022 and to -14.5% in 2023. Primary income deficit is expected to narrow, while the capital account is forecast to significantly increase from 1.4% in 2021 to 2.7% in 2023 and 2024. However, in light of the recent drop in energy prices to levels below those assumed in the current forecast, the current account could turn out to be more favourable than initially projected. From the sectoral perspective, gradual improvements that are forecast for the next two years should result from the declining government net borrowing and households that should turn into net lenders again by 2024. Overall, the net borrowing of the total economy is forecast to reach -4.1% in 2023 and -1.2% in 2024. The overall position is strongly supported by the transfers from the EU budget under the RRF and the MFF, projected at nearly 3% of GDP for the period between 2022 and 2026 on average, i.e. to slightly below 2% thereafter.⁴⁴ A look at the savings and gross investment by sector (graph 3.6 f) shows that the large deterioration in the current account in 2022 is expected to be mostly brought about by a strong fall in households savings likely due to increased cost of living, which should recover only very mildly beyond 2022. Decomposing the gross capital formation by type, however, reveals that comparatively high investment in 2021, as compared to pre-pandemic period, has largely been brought about by a strong increase in inventories. The corresponding increases of only slightly smaller size are projected also for the whole forecasting period. Should only smaller increases in inventories materialise, comparable to those recorded in pre-pandemic period, overall investment would be lower, other things equal, which would be consistent with a smaller forecast current account deficit.

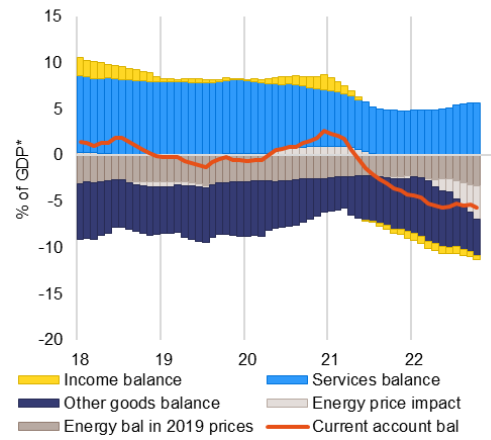
⁴⁴ Those are relevant amounts in the context of the NIIP projections described in the next sections.

Graph 3.6: **Selected graphs for Latvia**

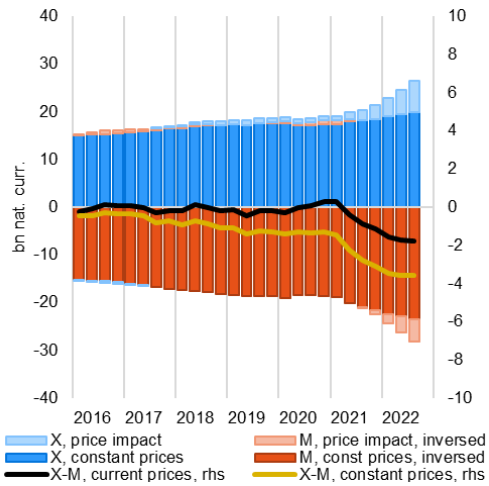
a) Current account decomposition



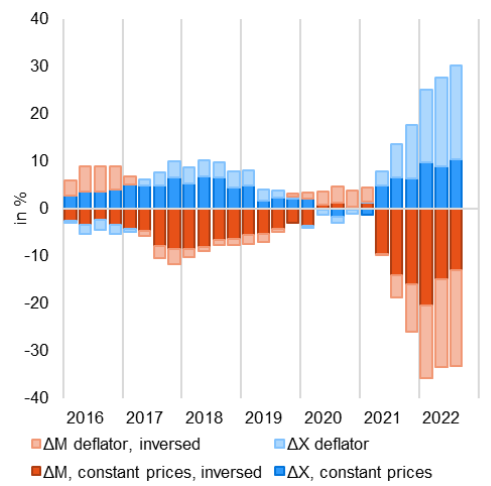
b) Energy price effect



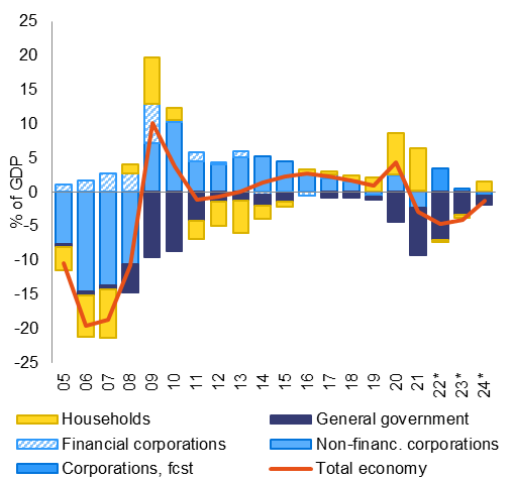
c) Exports and imports, in bn national currency



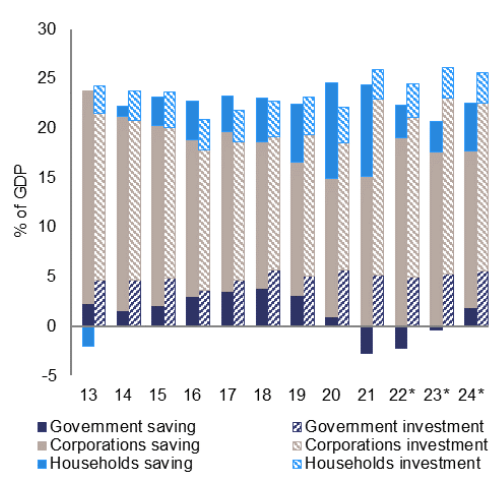
d) Decomposition of exports and imports change, in %



e) Sectoral net lending/borrowing

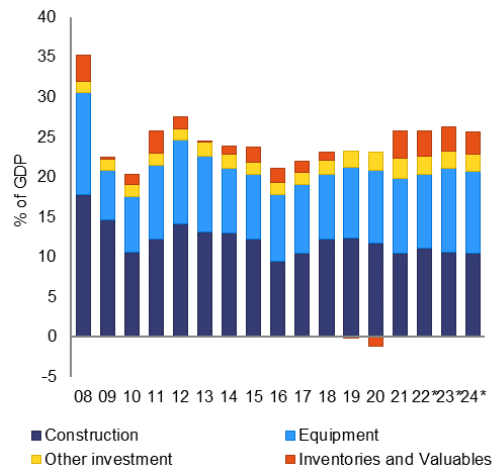


f) Savings and investment by sector



Graph 3.6: **Selected graphs for Latvia, continued**

g) Gross capital formation by type



Notes: 4-quarters moving sums for all quarterly data unless stated differently; graph b: 12-months moving sum. GDP* denotes weighted average of year t and t-1 GDP; data up to 2022M10; graphs c and d: National Accounts data; graph d: annual growth of 4-quarters moving sums.

Source: Eurostat, AMECO, Commission services calculations.

3.7 LITHUANIA

The current account of Lithuania moved into a considerable deficit during the first three quarters of 2022. The current account balance equalled -4.3% of GDP in the four quarters up to 2022Q3 (see graph 3.7 a). This represents a deterioration from a surplus of 1.1% of GDP in 2021 and 7.3% in 2020. While the size of the surplus in the pandemic crisis had been exceptional, in 2019 it was also considerable at 3.5% of GDP. The recent current account deterioration has been substantial compared to the last pre-pandemic year. It is now below the levels explained by economic fundamentals (the ‘current account norm’) and below the other relevant benchmarks, except for the current account to reach the prudential threshold over the next 10 years. The changes have mostly been dictated by the dynamics of the balance of trade, which increased strongly from 5.3% of GDP in 2019 to 9.3% in 2020, but then dropped even more significantly to 4.5% in 2021. The decline accelerated in 2022 and the trade balance turned negative at -0.5% of GDP by the third quarter of 2022. Negative contributions to current account came also from income balances with the deficit in the primary income account widening since mid-2020 to below the pre-pandemic levels⁴⁵, and with the almost continuously declining surplus in the secondary account. In addition, the capital account surplus has been slowly decreasing, contributing to the decline in the net lending/borrowing of the economy, which came at -3.1% of GDP in 2022Q3.

The international trade of Lithuania has been characterised by deficits in the trade in goods and by substantial surpluses in the trade of services. As the balance of trade in services has been comparatively stable over the recent years, with a very mild declining trend since 2019, the 2020 improvement and the subsequent worsening of the balance of trade reflected almost entirely the movements in the balance of trade in goods. This is consistent with the worsening in terms of trade, since the end of 2020, which was the strongest in the EU in terms of goods, and the second strongest for the total trade in goods and services. As in many other Member States, the terms of trade deterioration has been largely driven by energy prices. The deficit in the energy balance of Lithuania was among the largest in the EU before the most recent price surge that started in 2021. Between 2021Q4 and 2022Q3, deficit expanded by 4.5 pp to -9.2% of GDP – currently the largest energy balance deficit in the EU. The deterioration was almost exclusively driven by the change in prices of energy goods (see graph 3.7 b).

More recently, price changes have been playing an increasingly important role for the overall trade flows and the trade balances. Lithuanian exports and imports of goods and services recovered relatively quickly from the decrease of trade in the pandemic crisis, surpassing the 2019 values already in 2021Q2, both in constant and current prices (graph 3.7 c). The changes in volumes of trade have been substantial since the beginning of the recovery in 2021Q2 (graph 3.7 d). However, increases in exports and imports prices over the recent quarters, i.e. their contribution to overall changes in trade flows, have also become more pronounced than in the past. For imports, they exceeded the changes in volume over the last two quarters. The difference between exports and imports measured in constant prices has not fluctuated that much and it slightly grew over the last two quarters. Conversely, in current prices, the difference, i.e. the trade balance, has changed a lot since 2020, moving into deficit in 2022Q3 (four quarters moving sum, NA-based data). Thus, the deterioration in the overall balance of trade has been crucially shaped by the changes in trade deflators. In terms of volumes, the trade balances remained relatively stable and have even moved in the opposite direction most recently.

Developments in the net lending/borrowing from the sectoral perspective were marked by the strong consolidation of the government sector in 2021. The large increase in the net positions of non-financial corporates and households in 2020 led to an increase in the total economy’s net lending, despite government moving into large net borrowing position amid pandemic (see graph 3.7 e).⁴⁶ A change in the opposite direction during 2021 has been almost equally dramatic, as the government consolidated quickly, moving to only a small deficit of -1% of GDP. At the same time, non-financial corporations net lending came down strongly to levels below those observed prior to the pandemic crisis. Finally, households net position remained positive, but small. Overall, net lending for the whole economy declined to 2.6% of GDP. With continued fiscal consolidation, by 2022Q3, the government moved into positive position of 0.9% of GDP,

⁴⁵ Decline in the primary income balance was mostly driven by increased earnings of foreign direct investors in Lithuania.

⁴⁶ The budgetary cost of the COVID-19 related measures amounted to 3.9% of GDP in 2020, as compared to 3.3% of the EU average (see section 2).

while the private sector as a whole turned into net borrower. The total economy net borrowing equalled -2.9% of GDP. The recent deficit has been largely financed by the continued net inflows of foreign direct investment, which exceeded the pre-pandemic values, after a small decline during 2020-21. In net terms, moderate inflows of capital in form of other investment were recorded, changing the sign as compared to 2021. However, this went in parallel with a strong decline in Lithuania's Target2 position over 2022, which remains positive. Some capital outflows in form of portfolio debt investment have recently been recorded.

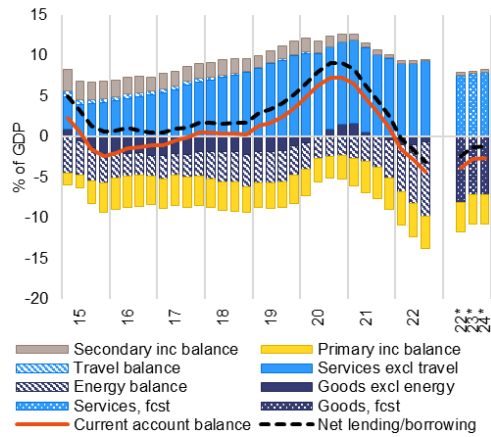
A strong decline in the current account balance is forecast for the whole 2022, leading to a substantial deficit, from a small surplus in 2021. The deficit for the whole 2022 is expected at of -3.9% of GDP. A small improvement is forecast thereafter for 2023, and a marginal one in 2024. Lower current account in 2022 should be driven by a further decline in the balance of trade in goods and services, which is then projected to mildly increase again in 2023, leading to a small current account improvement. However, in light of the recent drop in energy prices to levels below those assumed in the current forecast, the current accounts could turn out to be more favourable than projected. For the whole 2022, government net lending/borrowing is expected to turn negative, with a somewhat larger deficit than in 2021. While corporate net lending is forecast to expand, households should turn into net borrowers, leading to the total economy's net borrowing of -2.4% of GDP. The total economy's position is expected to slightly improve in 2023, amid strong increase in corporate net lending, which should dominate the expected increased government net borrowing. While both of these sectors are forecast to approach a more balanced position in 2024, the total economy's net borrowing should remain largely unchanged. An important contribution to higher net position comes from the EU transfers to Lithuania under the RRF and the MFF. These flows are projected to average around 2% of GDP over the period between 2022 and 2026, i.e. to slightly below 1.5% of GDP thereafter (in net terms).⁴⁷

Current account forecasts for 2022 and beyond are considerably lower than for 2021, which is mainly due to the projected investment growth. Gross investment is forecast to increase strongly over the forecast period, reaching values above the longer-term pre-pandemic levels. At the same time, savings are expected to remain much more stable, also compared to the levels observed before the pandemic crisis (graph 3.7 f). A sectoral view shows that it is the investment of households that drives the aforementioned increase: mainly investment in housing in the first half of 2022, which was driven by the expectation that house prices will further increase in the future. However, following the Russian war of aggression against Ukraine, economic expectations have deteriorated leading to decreased household investments in the second half of 2022. A decomposition of the investment by type (graph 3.7 g) reveals that the forecast assumes strong increases in inventories over the whole forecast period, above those observed in any year over at least the last 15 years. Thus, if households do not turn out to increase their investment as strongly as forecast, with inventories falling short, other things equal, the actual current accounts over the forecast period, especially beyond 2022, may turn out to be lower.

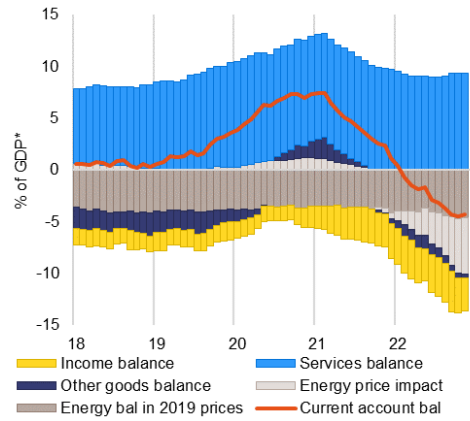
⁴⁷ These are non-negligible amounts in the context of the NIIP projections described below.

Graph 3.7: **Selected graphs for Lithuania**

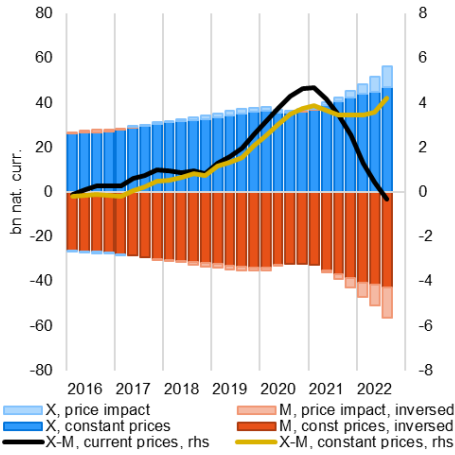
a) Decomposition of current account



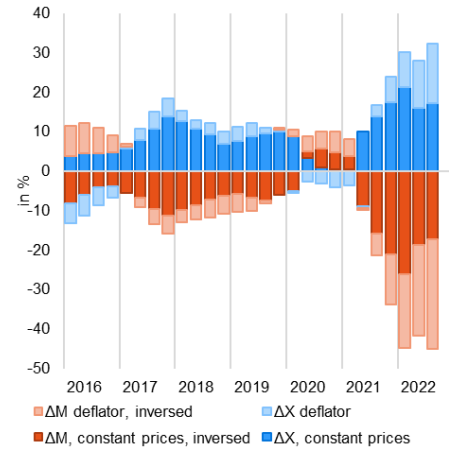
b) Energy price effect



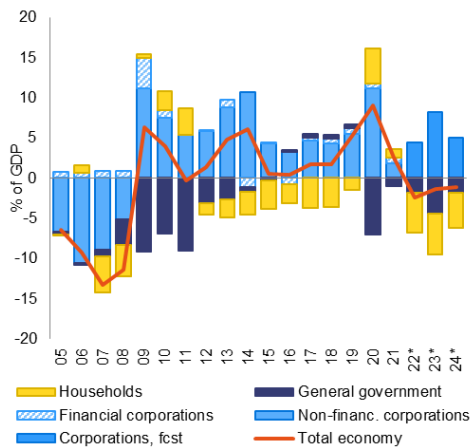
c) Decomposition of exports (X) and imports (M)



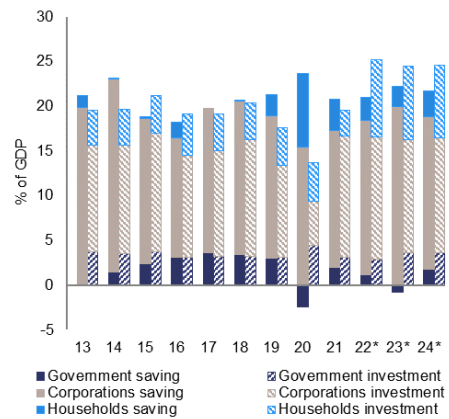
d) Decomposition of exports (X) and imports (M) growth



e) Sectoral net lending/borrowing

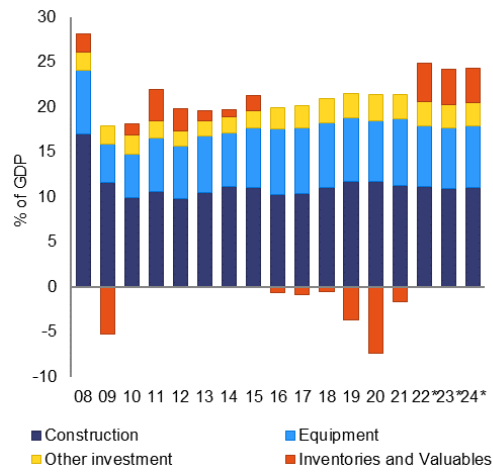


f) Savings and investment by sector



Graph 3.7: **Selected graphs for Lithuania, continued**

g) Gross capital formation by type



Notes: 4-quarters moving sums for all quarterly data unless stated differently; graph b: 12-months moving sum. GDP* denotes weighted average of year t and t-1. GDP; data up to 2022M11; graphs c and d: National Accounts data; graph d: annual growth of 4-quarters moving sums.

Source: Eurostat, AMECO, Commission services calculations.

3.8 SLOVAKIA

Slovakia's current account fell sharply in 2021 and in the first three quarters of 2022 (sum of the last four quarters, see graph 3.8 a). It is below the levels explained by economic fundamentals (the 'current account norm') and most recently below all the other relevant benchmarks. Before the pandemic crisis, Slovakia had been recording moderate deficits, which deepened somewhat in 2019 to -3.3% of GDP. After the improvement to 0.6% in 2020, the current account balance declined to -2.5% of GDP in 2021 and finally to -6.8% in 2022Q3. The fall after 2020 was one of the sharpest among the EU countries, resulting in the most recent current account deficit that noticeably exceeds those from the pre-pandemic years. This was mainly determined by movements of the trade balance, which first went from a small surplus of 0.1% of GDP in 2019, to a surplus of 2.1% in 2020. After returning to only a marginal surplus in 2021, it deteriorated to -4.2% in 2022Q3. These movements have mostly been mirroring the changes in balance of goods, which improved by more than 2 pp to 1.1% of GDP in 2020. It then deteriorated to -0.5% in 2021 and continued to decline in the first three quarters of 2022 to -4.5% of GDP. The balance of trade in services has been declining slowly but consistently since 2019, reaching a small surplus of 0.2% of GDP in 2022Q3, from 1.3% in 2019. These developments are consistent with a comparatively strong deterioration in terms of trade for Slovakia since 2020, that have been more pronounced for goods (see the next paragraph). A negative contribution to the current account comes also from the worsening of the primary income which declined from -0.8% in 2020 to -1.5% in 2021 and to -1.8% in 2022Q3, which is in line with pre-pandemic trends.⁴⁸ The secondary income balance has remained in deficit, but slightly above the pre-pandemic levels. Most recently, the capital account declined to 0.8% of GDP, i.e. around pre-pandemic levels, from 1.3% in 2021.

The balance of trade in goods dynamics has been largely determined by the energy balance. The balance of trade in energy goods worsened from -2.1% of GDP in 2020 to -3.6% in 2021, and with the decline accelerating in 2022 to -6% of GDP. This development has mostly been caused by the soaring energy prices, which have recently been the major driving force in shaping the overall current account movements (see graph 3.8 b). Slovakia is still recording a surplus in the balance of trade in goods excluding energy. While it remained rather stable in 2021, it fell sharply by 1.5 pp to 1.6% of GDP by 2022Q3. The slowly declining balance of trade in services has mainly been driven by the continued deterioration of the travel balance that turned negative in 2020 amid pandemic, and declined further to -0.7% of GDP in 2022Q3.⁴⁹ The balance of trade in services other than travel has been stable at levels slightly above those before the pandemic crisis.

In 2022, the changes of the overall export and import flows have mainly been driven by the changes in deflators. After a strong fall in trade flows during the pandemic crisis, exports and imports of goods and services recovered to, i.e. exceeded, the pre-pandemic values already in 2021Q2 and 2021Q3, respectively (graph 3.8 c). The recovery was mainly driven by the change in volumes of trade, while price changes remained relatively contained until the last quarter of 2021. However, especially in 2022, contributions to changes in trade from the changes in deflators became dominant (graph 3.8 d). The much steeper increases in prices of imported goods and services than of exported was the main factor behind the worsening trade balance. When measured in constant prices, both exports and imports reached the pre-pandemic levels already in the second quarter of 2021. However, they remained rather stagnant thereafter, likely also reflecting the supply chain disruptions.^{50 51} When measured in constant prices, exports and imports

⁴⁸ Slovakia experienced an improvement in the primary income balance during the pandemic crisis as the profits of foreign direct investors in Slovakia declined. While their earnings partly recovered after 2020, they remain below the levels recorded before the crisis. Instead, the recent worsening of the primary income is partly due to smaller compensation of employees, lower balances of other investment income, as well as lower balances on the "other primary income" item.

⁴⁹ While exports of travel services remain at around one third of the pre-pandemic values, the imports recovered to around two thirds of the pre-pandemic levels. By summer 2022, the nights spent by foreign tourists at tourist accommodation establishments reached only 70% of the 2019 nights. In winter and spring, the corresponding share was below 50% on average. In addition, rise in prices of tourism services has been considerably lower than the rise in the overall HICP.

⁵⁰ The same holds true to an even larger extent if only trade in goods is observed.

⁵¹ With the increase in working from home during the pandemic, demand for chips-dependent electronics increased worldwide. At the same time, other factors, such as trade tensions between the US and China, or the extreme drought in Taiwan in 2021 contributed to the decline in chip supply. The excess of demand over supply resulted in supply chains bottlenecks that caused car production to slow in both 2021 and 2022. In Slovakia, many industries began to significantly delay production due to late chip deliveries. Several car companies were forced to limit production. For Slovakia's export-oriented economy with a high share of cars in total exports (on average 25% in 2021), bottlenecks in supply chains are a significant slowing factor of economic growth.

did not change much in 2022. Consequently, the difference, which corresponds to the trade balance, did not deteriorate as much as it did for the flows measured in current prices. Instead, a small improvement has been recorded over the last two quarters (in bn of 2015 euro, graph 3.8 c).

In 2021, Slovakia turned into a net borrower mainly due to declining net lending of non-financial corporations. In 2020, households and corporations net positions increased substantially (graph 3.8 e). These improvements have been just partially offset by the increase in fiscal deficit due to pandemic crisis, including the COVID-19-related spending, which amounted to around 2.3% of GDP (see section 2). On balance, this led to a substantial increase in the total economy's net position that moved from -2.4% in 2019 to 0.4% in 2020. In 2021, Slovakia registered a substantial decline in the borrowing position of the corporate sector, from 2.7% in 2020 to 0.8% in 2021. This was mainly due to lower net lending of non-financial corporations. Net lending of households also declined by some 0.9 pp of GDP. The government position remained roughly stable despite non-negligible increase in the budgetary cost of COVID-19-related measures. As a result, the total economy went from a surplus of 0.4% of GDP in 2020 to -2.6% of GDP in 2021. In the third quarter of 2022, its net position decreased further to -6.2% of GDP. The recent deficit has primarily been financed by net inflows in form of other investment.⁵² In addition, while foreign direct investment started flowing in again in net terms, outflows in form of portfolio investment, both equity and debt, continued.⁵³ In addition to these financial flows, the transfers from the EU budget under the RRF and the MFF are an important source of external finance. These are projected, on average, to around 2.5% of GDP over the period between 2022 and 2026, i.e. to slightly above 1% of GDP thereafter (in net terms).⁵⁴

Going forward, the current account is forecast to further deteriorate to around -6.3% of GDP for the whole 2022, and to slightly recover in 2023 and 2024. The expected deterioration in the current account is mainly driven by a decline of the trade balance for goods that should move from a marginal surplus in 2021, to -4% in 2022, and improve again to around -3.5% of GDP in 2023. The primary income deficit is expected to slightly narrow. However, in light of the recent drop in energy prices and the previously assumed energy price developments over the period, the outcome may be more favourable than forecast. From a sectoral perspective, government net borrowing is expected to go down mildly for the whole 2022, but to increase in 2023 despite projected withdrawal of costly measures related to COVID-19 and the energy crisis. In 2023, households' net position is expected to remain negative while corporations are expected to turn into net lenders. Overall, the net borrowing position of the total economy is forecast to reach -4.7% in 2023 and -3.3% in 2024.

The increase in current account deficit in 2022 is expected to be driven mainly by lower savings of the corporate, and in particular of the households, sectors. At the same time, the government sector is expected to reduce its dissaving, while the overall investment is expected to mildly increase (graph 3.8 f). Some small improvements in the current account beyond 2022 should be driven by recovering private sector savings, in particular by the corporate sector, coupled with a small decline in private sector investment. From the trade perspective, exports in Slovakia are severely hindered by the supply-chain bottlenecks, which are expected to disappear by the end of 2023 as the supply chain is improved and global shortages addressed. Weaker demand in the main export destinations should reduce exports still in 2023, but an improvement in the global economy is expected in 2024. Slovak industrial production is also very energy-intensive and thus affected by high prices: the companies are expected to absorb this shock through substitutions of production, governmental interventions and long-term energy prices declining after 2024. However, given that the most recent evolution of energy prices has been more favourable than assumed in the current forecast, there is an upside risk to the above projections.

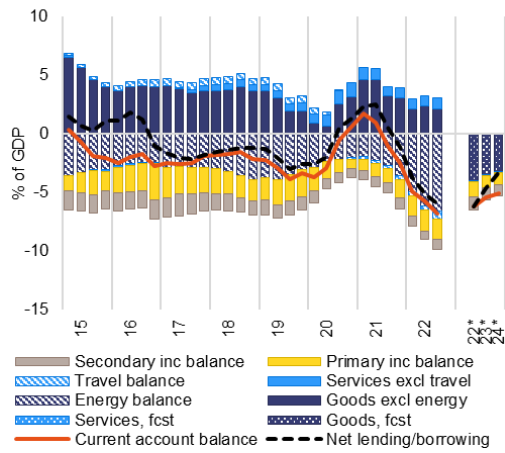
⁵² This went along with Slovakia moving from a positive Target2 position of around 25% of GDP end of 2021, to a negative position of around -15% by November 2022.

⁵³ The composition of financial flows in 2022 resembled the structure in terms of instruments from before the pandemic crisis.

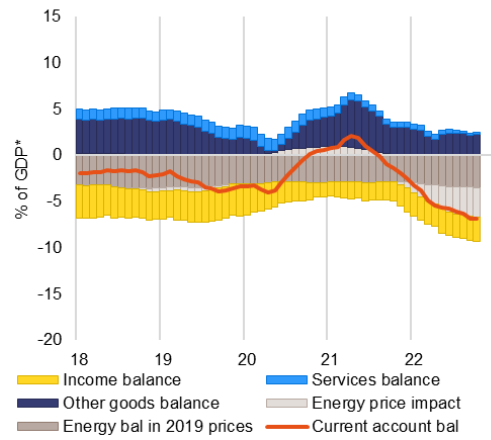
⁵⁴ These are non-negligible amounts in the context of the NIIP projections presented in the next section.

Graph 3.8: **Selected graphs for Slovakia**

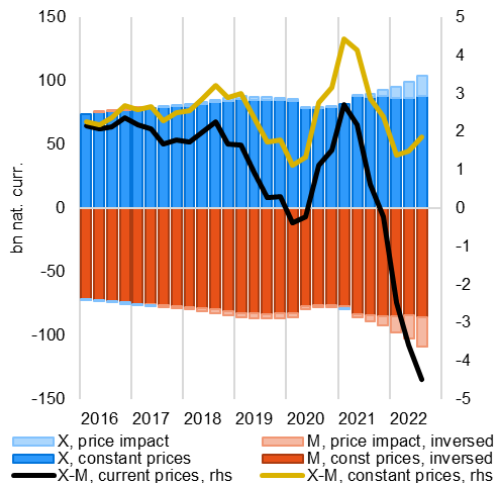
a) Decomposition of current account



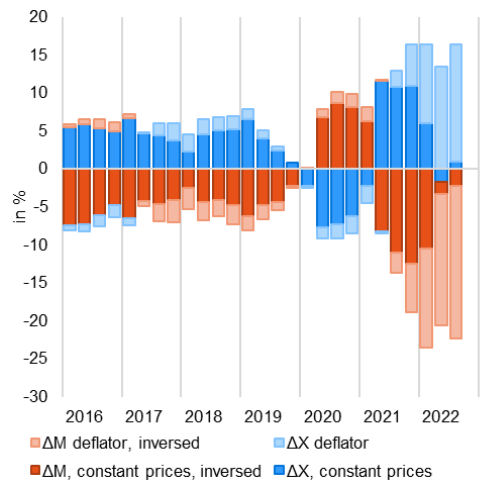
b) Energy price effect



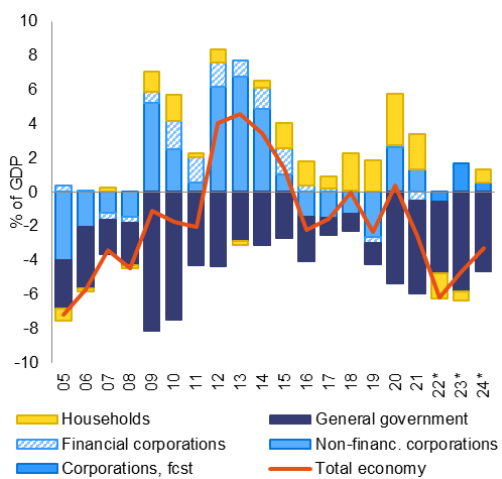
c) Decomposition of exports (X) and imports (M)



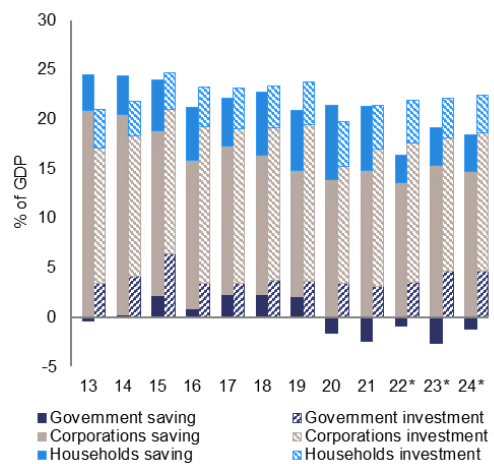
d) Decomposition of exports (X) and imports (M) growth



e) Sectoral net lending/borrowing

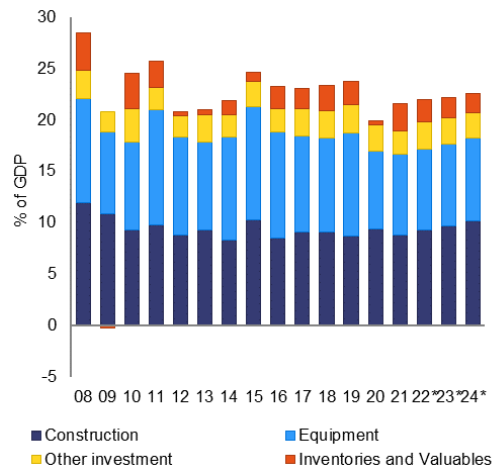


f) Savings and investment by sector



Graph 3.8: **Selected graphs for Slovakia, continued**

g) Gross capital formation by type



Notes: 4-quarters moving sums for all quarterly data unless stated differently; graph b: 12-months moving sum. GDP* denotes weighted average of year t and t-1. GDP; data up to 2022M10; graphs c and d: National Accounts data; graph d: annual growth of 4-quarters moving sums.

Source: Eurostat, AMECO, Commission services calculations.

3.9 GERMANY

Germany recorded a current account balance of 4.2% of GDP in four quarters up to 2022Q3 (sum of last four quarters including 2022Q3, see graph 3.9 a).⁵⁵ This represents a decline from 7.4% of GDP in 2021 and 7% in 2020. While the surplus is below the (annual) values recorded over the last decade, it remains above the levels explained by economic fundamentals (the 'current account norm'). The recent changes have mostly been dictated by the dynamics of the balance of trade, which declined to 2.3% in 2022Q3 from 5.3% in 2021. Balance of trade in goods decreased from 5.3% in 2021 to 3.1% in 2022Q3, while the trade balance for services moved to a deficit of -0.9% of GDP in the first three quarters of 2022, from a balanced position in 2021. This is consistent with a comparatively strong deterioration in terms of trade for Germany over the period. Following a mild decline during the pandemic crisis, primary income surplus returned to the pre-pandemic levels during 2021 and remained there also in 2022 so far.⁵⁶ Secondary incomes remained practically unchanged.

In a longer-term perspective, the trade balance has declined strongly from its peak in 2015, driven by a combination of deteriorating terms of trade and other factors. The trade balance for goods peaked at 8.2% of GDP and for goods and services at 7.6% of GDP in 2015. The decline since has been partly driven by the evolution in terms of trade (1/3 and 1/4 respectively). Other factors that contributed to the declining balance include wage increases leading to stronger domestic demand and a declining price competitiveness and an overall slowing down of global trade dynamics. Other components of the current account balance have remained relatively stable, the primary income balance has averaged 3.3% since 2018, with little fluctuation and the secondary income balance was also stable at around -1.4% of GDP.

The balance of trade in goods dynamics has been mainly, but not only, determined by the energy balance. The latter worsened from -1.2% of GDP in 2020 to -1.9% in 2021, with the decline accelerating in 2022 to -3.4% of GDP in the third quarter. This development has mostly been caused by the soaring energy prices (see graph 3.9 b). Similarly, in 2022 so far also the balance of trade in goods excluding energy is on a declining path reaching 6.6% in 2022Q3 from 7.3% in 2021.⁵⁷ This has been mainly driven by a more marked increase in imports compared to exports due to higher prices. For the declining balance of trade in services, an important negative contribution came from the fall in the travel balance that reached -1.1% of GDP from -0.6% in 2021, mainly due to larger spending of German tourists on travel abroad, although foreign tourists' spending in Germany has also been recovering. While imports of travel services are still at around three quarters of, i.e. 0.6 pp of GDP below the pre-pandemic level, the travel balance in 2022Q3 is higher than in 2019 by some 0.2 pp of GDP. Overall, export market shares declined slightly, from 7.4% in 2019 to 7.3% in 2021, and are expected to have declined further in 2022, mainly due to higher world's export growth.

The recent changes of the overall export and import flows have mainly, but not exclusively, been driven by the price effects. Following a strong decline in trade flows during 2020, exports and imports of goods and services recovered to the pre-pandemic values already in 2021Q3 and 2021Q4, respectively (graph 3.9 c). Some contribution came from the price effects, as the trade deflators started increasing more strongly in the second half of 2021, with the beginning of the post-pandemic economic recovery (graph 3.9 d). The growth of imports deflator has outpaced the growth of exports deflator, including during 2022, thus strongly contributing to decline in German trade surplus, measured in current prices, which started after 2021Q2. Expressed in constant prices, the changes in trade flows were much more contained, with the pre-pandemic levels of trade having been achieved in 2022Q1, both for exports and imports of goods and services.⁵⁸ In particular the growth of exports has been slower for some time, with ongoing restructuring and

⁵⁵ While the Balance of Payments data for the whole 2022 became available very recently from national sources, the note sticks to the same data cut-off date for all countries, relying on the Eurostat data.

⁵⁶ Recovery in primary income balance was driven mainly by the 2021 recovery in earnings on German direct investment abroad, which had declined in the pandemic crisis in 2020.

⁵⁷ The 2021 value represents a partial recovery from the strong decline in the pandemic crisis, to 6.8% of GDP in 2020 from and 8% in 2019.

⁵⁸ Looking only at the international trade in goods, despite exposure to adverse effects of supply chain disruptions (see section 2), the 2019 volume of trade has been reached already in 2021Q4, for exports, i.e. 2021Q3 for imports.

difficulties experienced by (parts of) the manufacturing sector contributing to this.⁵⁹ In the last two quarters, the volume of imports growth outpaced the volume of exports growth, thus augmenting the decline in the trade surplus. Still, the decline in the trade balance, as measured by the difference between exports and imports in constant prices, has been more limited.

In 2022, growth of domestic demand exceeded the output growth both in nominal and real terms.

The decline in the trade surplus can also be interpreted from the perspective of changes in output and domestic absorption (i.e. domestic demand defined as the sum of consumption and investment). By definition, the trade balance equals the difference between output and domestic demand, so that the same trade surplus developments as from the trade perspective are observed (graph 3.9 e). Measured in current prices, domestic demand has been increasing more strongly than output since 2021Q4 (graph 3.9 f). This was largely due to strong increases in both, consumption and investment deflators, which have been especially pronounced over that period. Domestic demand has been holding up better than the output also in constant prices over the last two quarters, with stronger contribution from consumption than from investment.

The net lending position of the total economy increased from 6.7% of GDP in 2020 to 7.2% in 2021 but then fell more strongly in 2022Q3 to 4% of GDP.

The change in the total economy's position reflects divergent, and partly offsetting sectoral developments. The government balance moved into deficit after the outbreak of the pandemic. Its net borrowing position (sum of the last four quarters, see graph 3.9 g) reached the maximum in 2021Q1. It has been gradually improving since then, even though the costs of temporary emergency measures to tackle the health crisis increased from 2.6% of GDP in 2020 to 4.2% of GDP in 2021. Corporate net lending, mainly of non-financial corporations, increased in 2021 from 2% of GDP to 3.2%, but then declined steeply over the first three quarters of 2022 to 0.4% of GDP. Households net lending that rose strongly in 2020, reached its peak in 2021Q1 at 9.9% of GDP, after which they declined to 7.8% in 2021, and to 5.5% of GDP by 2022Q3.

A considerable decline of the current account balance, to 3.7% of GDP, is forecast for the whole 2022.

It is forecast to increase again to 4.6% and 4.9% in 2023 and 2024, respectively. These developments should be driven by a decline in 2022, and then a recovery, in the trade balance in goods and services. Primary and secondary income are expected to remain stable. However, given that the most recent evolution of energy prices has been more favourable than assumed in the current forecast, the surplus may turn out higher than currently projected. From a sectoral perspective, the government net borrowing position is expected to shrink in 2022 as compared to 2020 and 2021. This should partly result from the decline in costs of COVID-19 related measures, which is expected to exceed the costs of new measures introduced to cushion the impact of energy price increase. However, in 2023 the government deficit is forecast to deteriorate again despite the reduction of total costs for temporary measures. Similarly, households and corporates net lending is projected to decline for the whole 2022 from 7.8% to 5.6%, and from 3.2% to 0.2% of GDP, respectively. On balance, these trends lead to an expected decline of the net lending position of the total economy in 2022 followed by gradual increases in 2023 and 2024.

Lower projected current account surpluses are expected to be driven by the domestic demand growing faster than output, mainly due to higher investment than in the previous years.

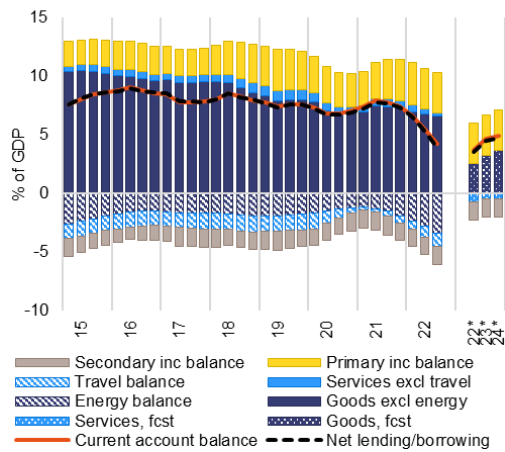
The forecast of gross savings and investment (graph 3.9 h) shows that the former should drop considerably in 2022, but to gradually recover afterwards towards the pre-pandemic levels. The 2022 decline is driven by the corporations, for which a decline should largely be transitory, and households who are expected to save less than in the pandemic years where lack of consumption opportunities resulted in forced savings. Government is forecast to make up for some of the 2020 decline in gross savings also in 2022, but the increase should be halted thereafter. Investment is expected to continue increasing substantially in 2022 (partly driven by the inflation in construction costs), and to remain at comparable levels, which noticeably exceed the longer-term pre-pandemic averages, also in 2023-24. Overall, this should lead to the aforementioned expected substantial current account decline in 2022, followed by a gradual increase. As for the type of investment (graph 3.9 i), a significant contribution is expected to come from a strong positive change in inventories, following an already noticeable increase in inventories during 2021. The forecasted

⁵⁹ Auto manufacturers experienced technical difficulties to meet environmental requirements already in the 2018 and 2019, i.e. before the pandemic. The pandemic disrupted supply chains generally, but particularly deliveries of microchips. Higher energy costs are forcing a scaling down of energy intensive production.

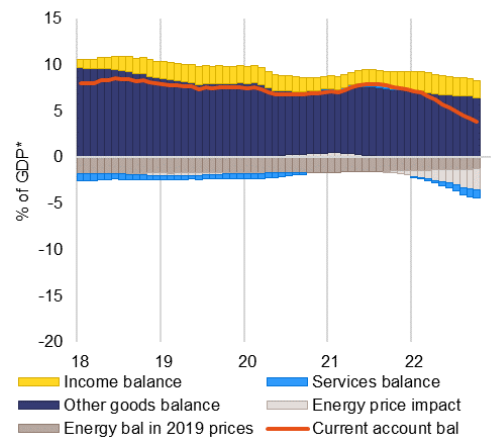
increases exceed the longer-term averages by at least 1.5 pp of GDP. Thus, there seems to be a non-negligible upside risk in the forecast of the current account surplus, should German economy not continue accumulating inventories at the record high pace also beyond 2022.

Graph 3.9: **Selected graphs for Germany**

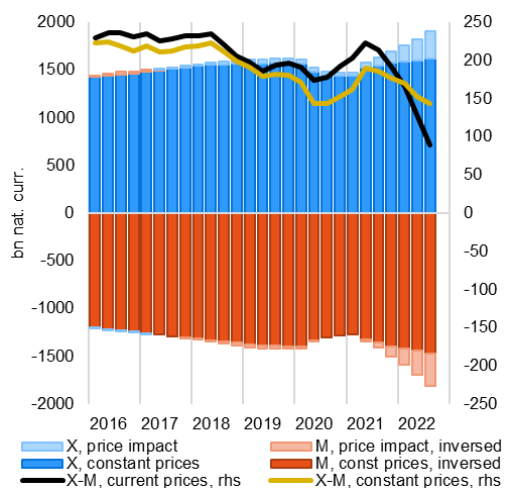
a) Decomposition of current account



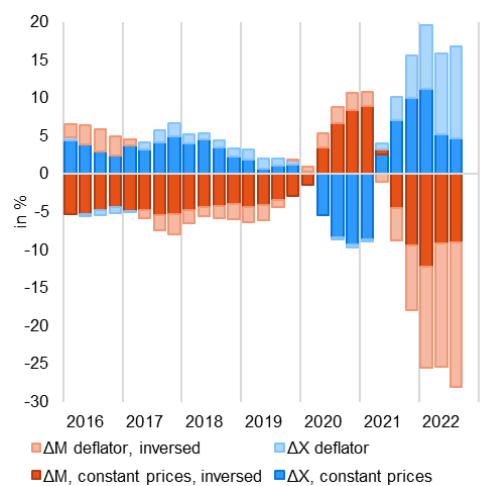
b) Energy price effect



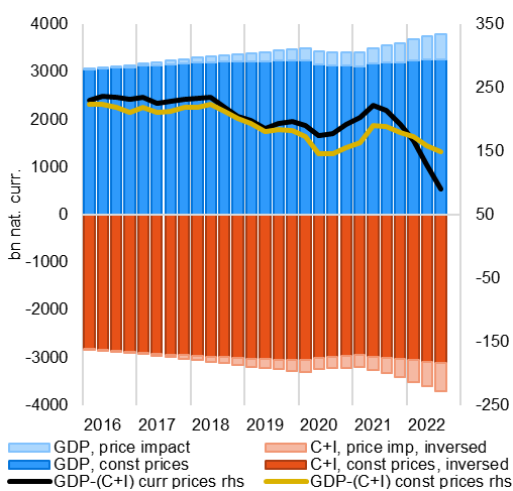
c) Decomposition of exports (X) and imports (M)



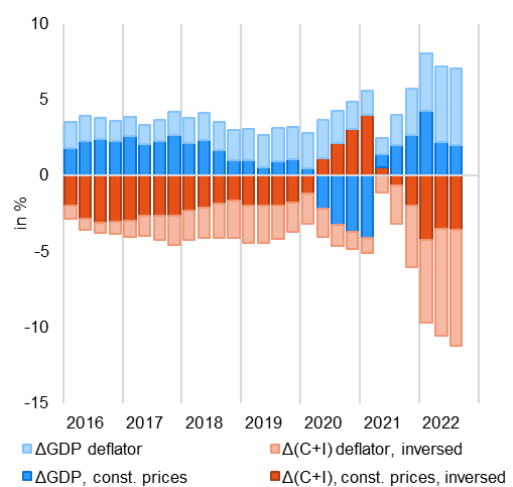
d) Decomposition of exports (X) and imports (M) growth



e) Output and domestic absorption

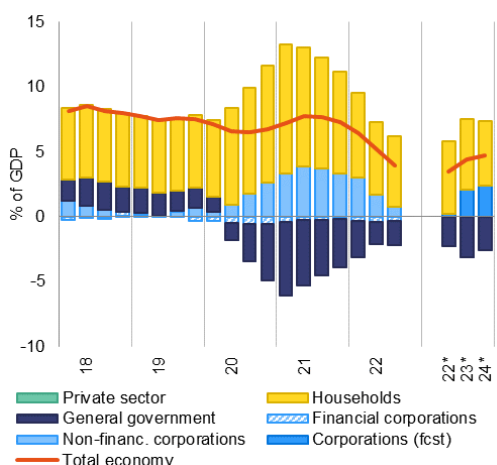


f) Output and domestic absorption growth

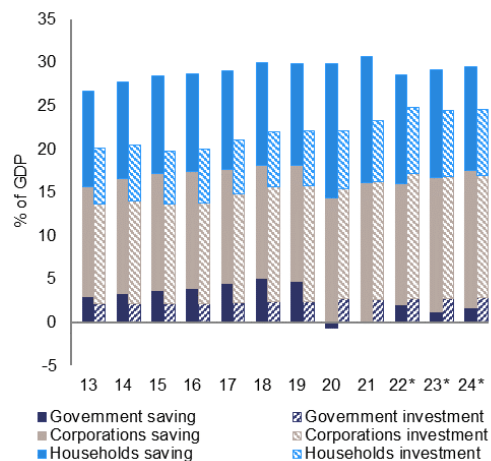


Graph 3.9: **Selected graphs for Germany, continued**

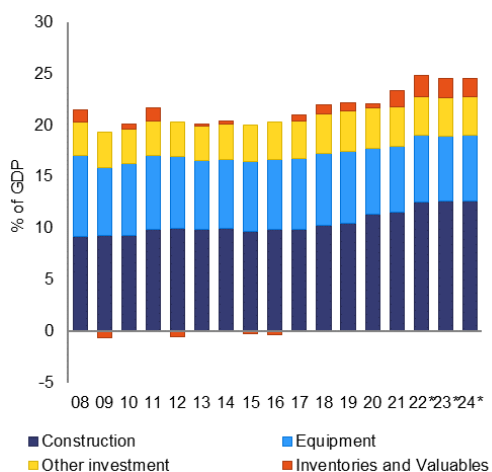
g) Sectoral net lending/borrowing



h) Savings and investment by sector



i) Gross capital formation by type



Notes: 4-quarters moving sums for all quarterly data unless stated differently; graph b: 12-months moving sum. GDP* denotes weighted average of year t and t-1 GDP; data up to 2022M10; graphs c, d, e and f: National Accounts data; graph c: trade balance in constant prices is the difference between X and M in constant prices; graph e: trade balance in constant prices is the difference between the output and demand in constant prices; graph d and f: annual growth of 4-quarters moving sums;

Source: Eurostat, AMECO, Commission services calculations.

3.10 THE NETHERLANDS

Recent adjustments in statistics have led to a downward revision in the Dutch current account balance ranging between 1.2 and 2 percentage points of GDP per year, over the period 2015-2021 (graph 3.10 a).⁶⁰ Research undertaken by Statistics Netherlands showed a structural underestimation of the number of foreign-owned companies in the Netherlands. Over the years, this has led to an overestimation of the current account balance through an underestimation of the corporate earnings disbursed to the rest of the world. In addition, after further analyses made by Statistics Netherlands, many foreign-owned subsidiaries' retained earnings turned out to be larger than initially anticipated, in part due to the frequent inaccurate recording of R&D expenses as operating costs (rather than as retained earnings). These adjustments led to a reduction of the current account surplus relative to GDP ranging between 1.2 and 2 pp.⁶¹

The longstanding current account surplus recently narrowed below the level observed in the pandemic crisis. The longstanding and large Dutch surplus, which amounted to 6.9% of GDP in 2019, declined to 5.1% in 2020 amid pandemic crisis. It then temporarily rebounded to 7.2% in 2021, before falling again to 5% of GDP by 2022Q3 (4 quarters moving sum, see graph 3.10 b).⁶² It persists above the levels explained by economic fundamentals (the 'current account norm') and above the other relevant benchmarks. This development partly resulted from a further deterioration in the trade balance for goods, which has been on a declining trend since 2017 and which reached 6.1% of GDP in 2022Q3 from 7.3% of GDP in 2021. An additional negative contribution to the balance of trade in goods comes from the declining energy balance, which moved to -2% in 2022Q3 from -1.2% of GDP in 2021 due to strongly increased energy prices. At the same time there was a mild improvement in the trade balance for services, which reached 3.3% in 2022Q3 of GDP from 3% in 2021 and it is now at the highest level recorded in the last decade. A negative contribution to the current account came also from the worsening primary income. It declined further by 1.8% of GDP from 2021 to 2022Q3, sparked mainly by increasing earnings of non-residents on their Dutch investment. On the other hand, the capital account exceptionally increased to 10.3% of GDP by 2022Q3, due to the sale of intellectual property by a Dutch business unit of a foreign multinational to a foreign unit of the same multinational. The increase, thus, results from an unusual transaction, recorded in 2022Q2.

The adverse terms of trade shock, resulting from a higher increase in prices of imports than of exports, has put downward pressure on the trade balance. After the fall during the pandemic crisis, the Dutch exports and imports of goods and services recovered to the pre-pandemic levels in the third (measured in current prices) and fourth (in constant prices) quarters of 2021 (graph 3.10 c).⁶³ From 2021Q2 the contribution of changes in trade deflators to changes in the overall trade flows gained in significance (graphs 3.10 d). The changes in exports and imports deflators were largely offsetting for some time, so that the evolution of the trade balance, namely the difference between exports and imports in current prices, largely went in parallel with the development of the difference between exports and imports in constant prices. The latter has been increasing since 2021Q2 given the higher increases in exports than in imports volumes. As the higher growth in import deflator over that of exports deflator became more pronounced in 2022, increase in the trade balance (in current prices) halted and even slightly reversed.

From the sectoral perspective, the evolution of the total net lending has been shaped by the changes in the corporate net lending, given the largely offsetting movements of government and households sectors (graph 3.10 e). The net borrowing position of the total economy increased from 5.1% of GDP in 2020 to 7.3% in 2021, before widening substantially to 15.4% in 2022Q3, due to aforementioned unusual transaction by an MNE (4 quarters moving sum). The net lending/borrowing position of the government has been gradually improving since 2021Q1. This is mostly supported by the gradual reduction

⁶⁰ The revision has been introduced in 2022 and it affected 2015-2021 data.

⁶¹ See Nelisse, R. (2021), "Non-Financial Corporations Split Into Subsectors", CBS Den Haag, September 2021, available at: <https://www.cbs.nl/en-gb/background/2022/38/non-financial-corporations-split-into-subsectors>. See also: <https://www.dnb.nl/en/statistical-news/snb-2022/current-account-surplus-revised-sharply-downwards/#:~:text=According%20to%20DNB%20figures%2C%20the,for%20the%20period%202015%2D2021.>

⁶² Data is based on adjusted figures after the revision made by Statistics Netherlands.

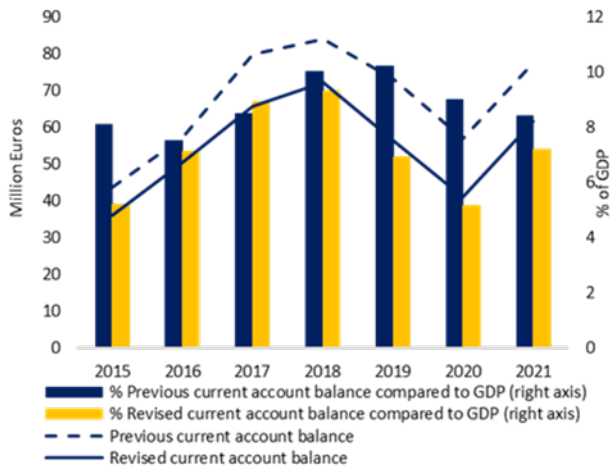
⁶³ Looking at the trade in goods only, the recovery was swifter and the 2019 levels were surpassed already in 2021Q2.

of government spending for COVID-19 temporary emergency measures that declined from 3% of GDP in 2020 to 2.2% of GDP in 2021 and that is expected to reach 0.6% in 2022. The corporate sector's net lending increased in 2021, despite the relocation of Shell to the UK, which contributed roughly 1.4% of GDP to the economy's net lending. The households sector's net lending declined in 2021 and in the first three quarters of 2022.

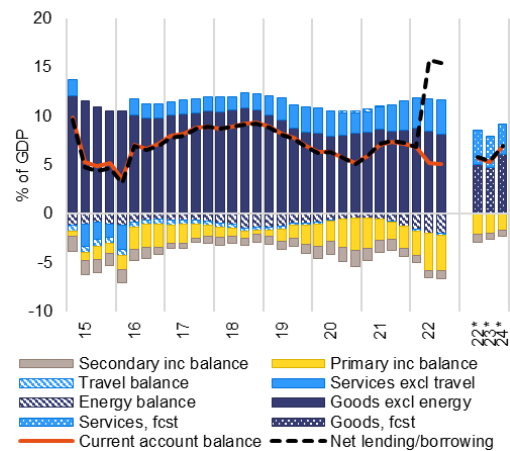
Despite its recent decline, the Dutch current account is still among the largest in the EU, standing at 5% of GDP. It is forecast to reach 5.7% in 2022, slightly decline in 2023 and increase again in 2024 to 7% of GDP. These developments are driven by a further deterioration of the trade balance in goods in 2023 and an expected improvement for 2024. The trade balance for services is projected to remain relatively stable over the forecast period. The primary and secondary income deficits are expected to narrow over the next years, while the capital account should return to nearly balanced values. However, given that the most recent evolution of energy prices has been more favourable than assumed in the current forecast, the surplus may turn out higher than currently projected. From a sectoral perspective, looking separately at savings and gross investment (graph 3.10 f), 2022 is characterised by a strong decline in households savings also driven by higher living costs, especially for the lower income households, while their investment should remain roughly stable. This is the main factor behind the expected decline in households net lending for the whole of 2022. The government is forecast to increase its net borrowing again in 2023 due to additional measures taken to cushion the impact of the energy price increase: In particular, the budgetary cost of these measures is expected to rise from 1% of GDP in 2022 to 1.9% in 2023, which is among the most costly support measures in the EU (see section 2). The decline in the net lending/borrowing position of the government should be partially offset by increases in the net lending by corporations and households. On balance, these trends are expected to generate a decline in the net lending position of the total economy from 7.3% of GDP in 2021, to 5.8% and 5.4% of GDP in 2022 and 2023. An increase to 7% is projected for 2024.

Graph 3.10: **Selected graphs for the Netherlands**

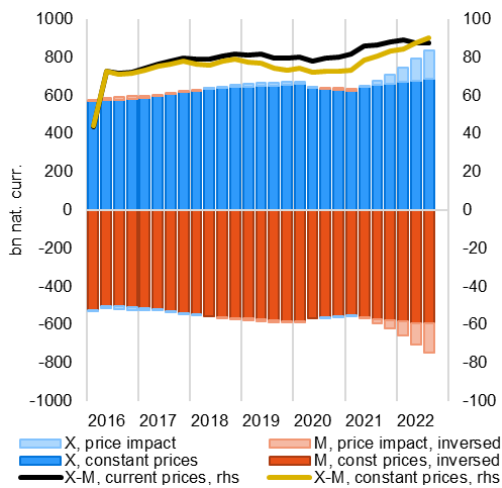
a) Revision of the current account



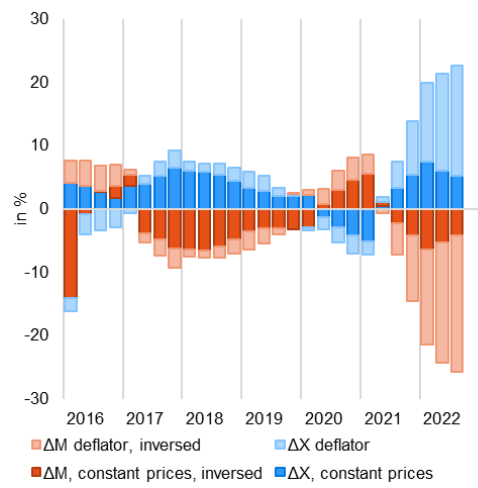
b) Current account decomposition



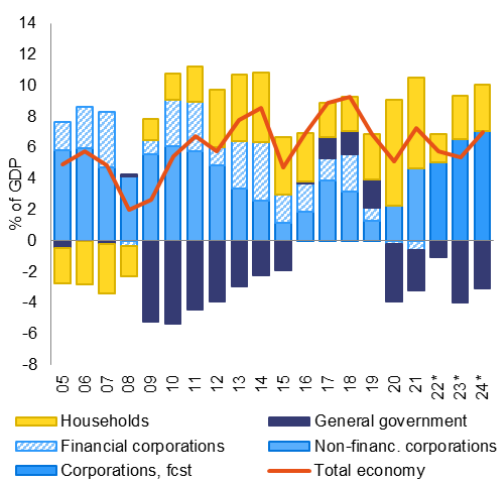
c) Exports and imports, in bn national currency



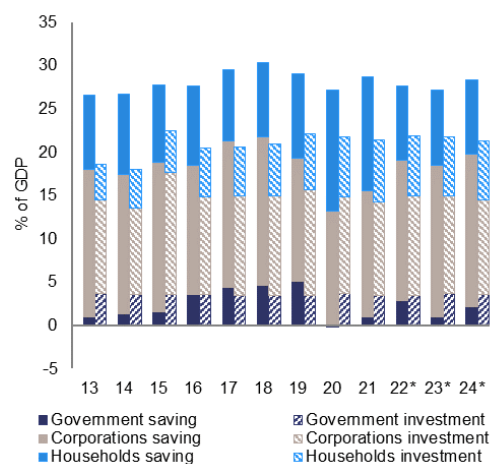
d) Decomposition of exports and imports change, in %



e) Sectoral net lending/borrowing



f) Savings and investment by sector



Notes: 4-quarters moving sums for all quarterly data unless stated differently; graphs c and d: National Accounts data; graph d: annual growth of 4-quarters moving sums.

Source: Eurostat, AMECO, Commission services calculations.

4. EVOLUTIONS OF NET INTERNATIONAL INVESTMENT POSITIONS

Net international investment positions have kept improving in most of selected Member States, but large negative stocks persist in several countries. In 2020, among the countries under consideration, Cyprus, Greece, Portugal, Hungary, and Romania registered a deterioration of their Net International Investment Positions (NIIPs). For the first three countries, which have the largest negative positions (see graph 2.1 b in section 2), the decline was driven mainly by the strong nominal GDP decline amid the pandemic crisis. Some deterioration recorded in Hungary and Romania was mainly due to negative investment income balance and some negative valuation effects. The NIIPs improved in Latvia, Lithuania and, marginally in Slovakia, mainly on account of the net transaction effect (excluding the investment income balance). Conversely, net creditor countries under analysis, namely Germany and Netherlands, remained on an increasing trend even during the first pandemic hit, due to positive transaction effects, as well as strong positive valuation effect in case of the Netherlands. In 2021, as the economic growth resumed, the strong denominator effect working in the opposite direction helped to narrow both negative and positive NIIPs. The exceptions are Germany, where the NIIP continued increasing, and Hungary where it deteriorated also due to negative valuation effects. That pattern has continued into 2022 with NIIP-to-GDP ratios of large net-debtor countries often recording further sizeable improvements.

Box 4.1 NIIP projections

The methodology used for the projections is described in European Commission, 2015, 'Refining the methodology for NIIP-based current account benchmarks', LIME Working Group 17 June 2015; and in European Commission, 2021, 'External sustainability assessment – gauging the impact of the Recovery and Resilience Facility', Note for the attention of the EPC LIME Working Group, 9 September 2021.

The baseline scenario is based on the updated Commission services forecasts for data until 2024, and on the T+10 forecasting exercise as well as debt sustainability monitor for subsequent years. Alternative scenarios are purely illustrative and include assumptions about temporary shocks to the baseline scenario described below.⁶⁴ These shocks are assumed to hit in 2023 and to gradually phase out over five years, with a return to baseline growth and trade balance by 2028.

Scenario 1: Trade balance increases by 3pp of GDP; real GDP growth and GDP deflator growth each increase by 3pp over baseline in 2023.

Scenario 2: Trade balance decreases by 3pp of GDP; real GDP growth and GDP deflator growth each decrease by 3pp over baseline in 2023.

Scenario 3: Trade balance increases by 3pp of GDP; real GDP growth and GDP deflator growth each decrease by 3pp over baseline in 2023.

Scenario 4: Trade balance decreases by 3pp of GDP; real GDP growth and GDP deflator growth each increase by 3pp over baseline in 2023.

The NIIPs of Greece and Cyprus remain in deep negative territory over 2022 despite recent improvements, while the NIIP of Portugal has strengthened substantially. In these countries, the NIIPs are well below both their NIIP norms and prudential thresholds. The NIIP of Greece, the largest negative position among EU countries, declined from -154.1% of GDP in 2019 to -173.8% in 2020 and started improving from 2021Q3, reaching -148.6% in 2022Q3 (see cluster of graphs 4.1 for Greece). These developments largely reflect the increase in stock of liabilities in the form of other investments (as a share in

⁶⁴ Given the huge size of Cyprus gross external assets and liabilities, its NIIP projections are very sensitive to how some of the primary income account items are projected. For this reason, the alternative scenarios for Cyprus make additional assumptions to ensure constant investment income balance over the projection period. This is needed as otherwise the comparatively simple way of extrapolating reinvested earnings may lead to economically non-intuitive NIIP trajectories for different scenarios.

GDP), registered during the pandemic times, while a reduction took place in 2022 (graph 4.1 b). The stock of these liabilities accounted for 85% of the gross liabilities in 2022Q3. On the assets side, an increase in the holdings of portfolio debt was noticeable over the period. Cyprus, starting from a less negative value, registered a slightly more visible improvement in the NIIP. It first declined in the pandemic from -115.4% of GDP in 2019 to -134.5% in 2020, but it then increased strongly to -107.1% by 2022Q3 (see cluster of graphs 4.2 for Cyprus). However, the focus on the net external position masks huge gross amounts of external assets and liabilities. These are at around twentyfold of GDP in 2021, down from nearly thirtyfold of GDP in 2015 (for total liabilities) (graph 4.2 d). The gross positions consisted to the largest extent of direct investment, which equalled 81% and 80% of total assets and liabilities, respectively. Finally, the longer-term improvement of the Portugal's NIIP was briefly interrupted in the pandemic crisis, when it declined from -100% of GDP in 2019 to -104.6% in 2020. However, the improvement resumed quickly and the NIIP reached -86.3% in 2022Q3 (for Portugal, see cluster of graphs 4.3). In gross terms, the improvement after 2020 has been driven by a visible decline in stock of debt liabilities, both of portfolio debt securities and other investment (graph 4.3 d). In all three countries, the nominal growth effect and also the positive valuation effects, account for most of the recent positive change in the NIIP position (see graphs 4.1 c, 4.2 c, 4.3 c).

The NIIP excluding non-defaultable instruments (NENDI) was much more favourable than the total position in Portugal and in Cyprus.⁶⁵ In these countries it came in around -33% of GDP in 2022Q3.

This partly offsets the risks of outflows related to potential abrupt changes in the external market environment.⁶⁶ The difference between NIIP and NENDI for Greece was smaller and NENDI amounted to -126.9% of GDP in 2022Q3 (graphs 4.1 a, 4.2 a, 4.3 a). As for the sectoral composition of the NIIP, in Cyprus and to a lesser extent in Portugal, the worsening during the pandemic times has been mainly driven by an increase in government debt. After 2020, as the economies started to recover, the government's position improved strongly in both countries. In Greece, private sector liabilities increased considerably, far beyond the levels recorded before the pandemic crisis, while the government position improved strongly after 2020.⁶⁷ A small recent decline in the private sector's position was observed also for Portugal.⁶⁸ Other segments, smaller in net terms, remained fairly stable except in Greece which also registered a notable increase in the net position of MFI as compared to pre-pandemic times.

In Cyprus, the NIIP levels largely reflect strong presence of multinational enterprises and of special purpose entities. More specifically, the special purpose entities (SPEs) account for 92% of direct investment assets and 85% of liabilities. It is in particular the financial SPEs which account for the bulk of external assets and liabilities (see graph 4.2 f). Excluding the positions of the SPEs, a considerably different picture of external stocks emerges. The NIIP excluding SPEs stood at -38.8% of GDP in 2022Q3, only slightly above fundamental and prudential benchmarks. In the last four quarters, the improvement in the total NIIP observed mainly follows the improvements in the NIIP excluding the SPEs. Yet, gross external debt of Cyprus excluding SPEs remains relatively high at 239.3% of GDP in 2022Q3. The net foreign direct investment position of the economy changes dramatically if SPEs are excluded, and amounts to -108.5% of GDP in 2022Q3, as compared to -59% with SPEs. The net direct investment position without SPEs has been rather stable in the past, unlike the total position including the SPEs, which has been declining and turning negative in 2020Q3.

The NIIPs of Cyprus, and to a much lesser extent of Greece, are expected to deteriorate by the end of the projection period, while the outlook for Portugal points to an improvement. The baseline projection of the NIIP over the next 10 years (see the Box 4.1 with the explanations of the projections) have a

⁶⁵ NENDI is a subset of the NIIP that abstracts from its pure equity-related components, i.e. foreign direct investment (FDI) equity and equity shares, and from intracompany cross-border FDI debt, and represents the NIIP excluding instruments that cannot be subject to default.

⁶⁶ In Cyprus, until 2020Q1 NENDI has been below the NIIP meaning that their large positive net position in direct investment and other equity was counterbalanced by a large negative net position in portfolio securities and other investment (defaultable instruments). From 2020Q1, this relation reversed with NENDI exceeding the NIIP.

⁶⁷ In Greece, the government debt is largely composed of debt from official creditors at concessional terms and with long maturities, which mitigates Greece's exposure to external shocks or shifts in market sentiment.

⁶⁸ Separate data on private sector for Cyprus is not available. The sum of the sector of monetary and financial institutions and of private sector is stable.

continuously negative slope for Cyprus, with the decline accelerating especially after 2025 (graph 4.2 e). For Greece, some improvement is expected under the baseline assumption until 2024, but at the end of the projection period, in 2032, the NIIP is projected to be below the current level (graph 4.1 e). Conversely, Portugal's NIIP is expected to improve over the next ten years and reach the levels between -50% and -60% of GDP (graph 4.3 e).

Romania and Hungary have more moderately negative NIIPs. They are below what is expected based on country-specific fundamentals but above, even if close to, prudential thresholds. In Romania, the NIIP position slightly deteriorated during the pandemic from -43.4% of GDP in 2019 to -47.1% in 2021 but it recovered fully and significantly improved thereafter, reaching -39.1% of GDP in 2022Q3 (see cluster of graphs 4.4). Similarly, in Hungary, the NIIP deteriorated from -49.8% in 2019 to -53% in 2021 and recovered to -46.2% in 2022Q3. In Romania, the gross liability position consisted to the largest extent of direct investment that remained stable over time and other investments which have been on the declining trend before the pandemic crisis (graph 4.4 d). On the gross assets side, reserve assets are the largest single item. They have been diminishing gradually from 2013 to 2019, but they started growing again in 2020. In Hungary, the gross positions consisted to the largest extent of direct investment, which equalled around 80% of total assets and liabilities (graph 4.5 d). In gross terms, direct investment assets and liabilities both increased noticeably in 2020 and remained stable afterwards. Nominal growth effect and recent valuation effects account for the positive change in the NIIP position, rather than improvements in the savings-investment balance. By contrast, strong negative contributions to the NIIP, more pronounced for Romania than for Hungary, come from negative net transaction and investment income effects (current account developments).

Both countries are characterised by more favourable NENDIs than NIIPs. The NENDIs of two countries are very close to balance, so that their economies are at lower risk of outflows related to potential abrupt changes in the external market environment. The sectoral breakdown of the NIIP indicates that in Hungary the positions of the central bank and the private sector worsened slightly compared to 2019, while that of general government and the MFI sectors improved somewhat (graph 4.5 a). In Romania, the decline during the pandemic times can be attributed to a slight increase in government debt (graph 4.4 a). Similarly to many EU countries, it gradually returned close to pre-pandemic levels.

The NIIP projections show strong worsening for Romania, and a mild decline for Hungary. Under the baseline scenario, Romania's NIIP is expected to deteriorate continuously and quickly over the next ten years (graph 4.4 e), coming down to levels close to -100% of GDP by 2032. For Hungary, the NIIP is projected to first mildly improve to some -45% of GDP in 2026, but then to start declining and to reach levels of close to -60% of GDP by 2032 (graph 4.5 e), i.e. below the current levels.

The NIIPs of Latvia and Lithuania were improving over the last decade, while the one of Slovakia was comparatively stable. In Latvia and Lithuania, the NIIPs are somewhat below the norm but above the prudential thresholds. Latvian NIIP moved from -40.3% of GDP in 2019 to -27.4% in 2021, and then mildly deteriorated in 2022Q3, reaching -28.4% of GDP. Lithuania moved from -23.5% of GDP in 2019 to -7.4% in 2021, and -8.6% in 2022Q3 (see clusters of graphs 4.6 and 4.7 for Latvia and Lithuania, respectively). Since Latvia's and Lithuania's liabilities largely consist of foreign direct investment, their NENDIs are positive at around 20% of GDP. From a sectoral perspective, in Lithuania the overall improvement before 2022 was driven by an increase in the central bank's positive net position (graph 4.7 a). In 2022, the net position of the general government improved noticeably. In Latvia, the improvements reflect the position of MFIs that turned positive and a steady increase in the private sector's position (graph 4.6 a). Slovakia, contrary to most EU countries, improved its NIIP position during the pandemic period from -65.6% in 2019 to -61% in 2021. However, it then started deteriorating again, reaching -66.2% of GDP by 2022Q3 (see cluster of graphs 4.8 for Slovakia). The NIIP remains below the fundamental NIIP and the prudential threshold. In gross terms, foreign direct investment account for a large share of liabilities. Thus, NENDI, at around -21% of GDP, is much more favourable than the NIIP. Slovakia registered a significant recent increase in assets and liabilities in form of other investment (graph 4.8 d). Both started decreasing again over the last two quarters, but in net terms, the negative stock of other investment widened considerably. Related to that, central bank's position has worsened since 2019, while those of the general government and of the private sector improved (graph 4.8 a). In all three countries, the recent contribution from nominal growth to NIIP changes was positive. The deceleration in the NIIP improvement in Latvia and Lithuania has been driven by a combination of declining

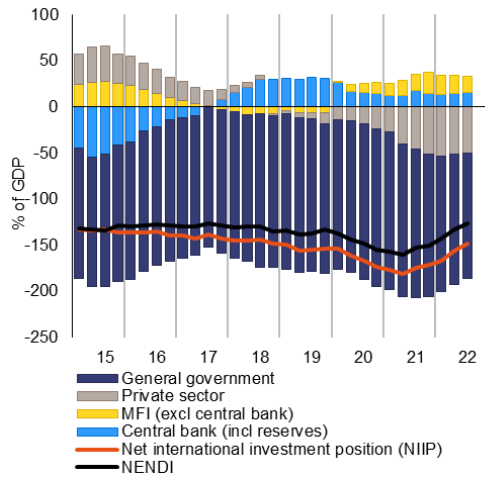
positive net transaction and valuation effects, and of a persistent large negative investment income effect (graphs 4.6 c and 4.7 c). In Slovakia, the most recent deterioration has been driven by large negative valuation effects (graph 4.8 c).

The NIIPs of all three countries are projected to worsen until 2032, but the expected deterioration in Latvia and Lithuania is comparatively mild. Under the baseline scenario, the NIIP of Latvia is projected to first mildly improve up to 2025, and then to worsen to slightly below the indicative MIP threshold of -35% of GDP in 2032 (graph 4.6 e). For Lithuania, the decline is continuous but very mild, with the NIIP reaching levels slightly below -15% of GDP by 2032 (graph 4.7 e). The projection for Slovakia is more negative. Under the baseline scenario, the NIIP should marginally improve by 2024, after which it is expected to decline considerably, reaching levels slightly below -80% of GDP by the end of the projection period (graph 4.8 e).

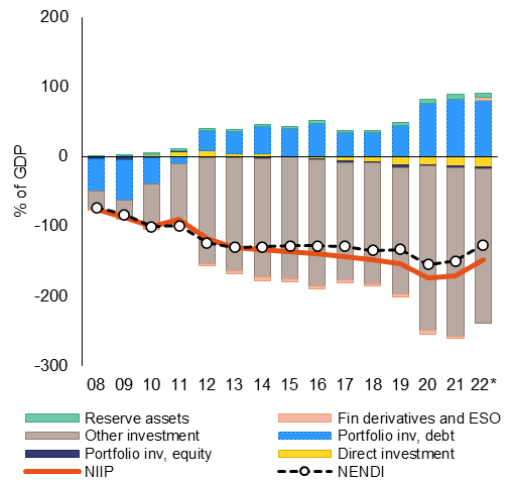
While the NIIP of Germany continued increasing in the last three years, the NIIP of the Netherlands has been declining for the last few quarters. The NIIP in both Germany and the Netherlands remain above the fundamental NIIP and the prudential thresholds. In Germany, it went from 58.5% in 2019 to 74.6% of GDP in 2022Q3, while in the Netherlands it increased from 89.6% in 2019 to 113% in 2020 to decline thereafter and reach 84% in 2022Q3 (see clusters of graphs 4.9 and 4.10 for Germany and the Netherlands, respectively). Substantial positive current account outturns have been making solid positive contributions to their NIIPs (graph 3.9 c and 3.10 c). In addition, Germany recorded strong positive valuation effects over the four quarters until 2022Q3, as opposed to the Netherlands, which experienced substantial negative valuation effects since 2021Q3. The sectoral breakdown of Germany's NIIP shows that the steady increase has been driven by a large rise in private sector net lending position, coupled with the improvements of the government's (negative) position (graph 3.9 a). In the Netherlands, the private sector has a rather stable and large positive position, while government and MFI sectors have negative, but improving NIIPs (graph 3.10 a). The NIIPs of both countries are projected to further increase under the baseline scenario, and to reach values of slightly above 80% of GDP for Germany, i.e. 100% of GDP for the Netherlands, by 2032.

Graph 4.1: NIIP: Greece

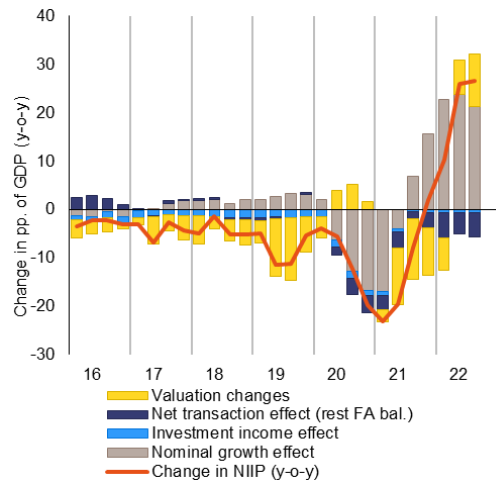
a) NIIP by sector



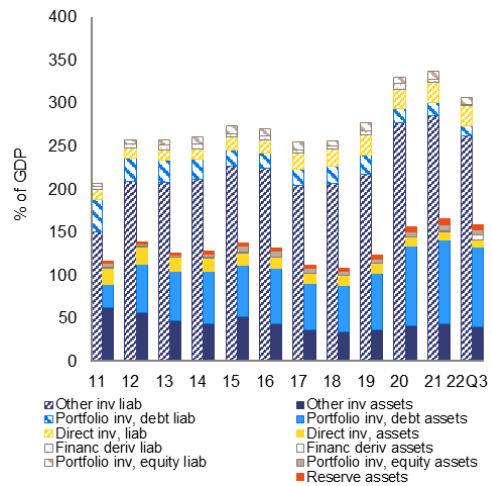
b) NIIP by instrument



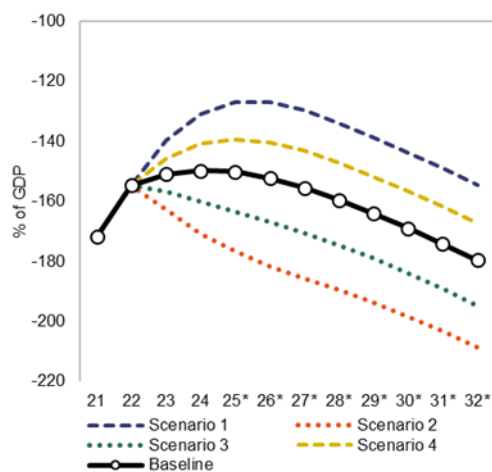
c) Decomposition of the NIIP change



d) IIP, gross components



e) NIIP projection

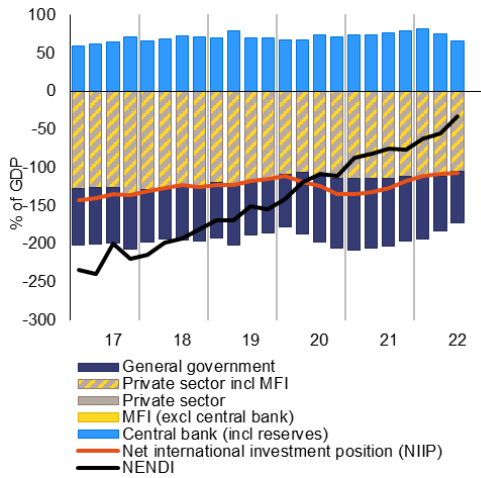


Notes: graph a: 4-quarters moving sums; graph c: (contributions to) annual change of 4-quarters moving sums.

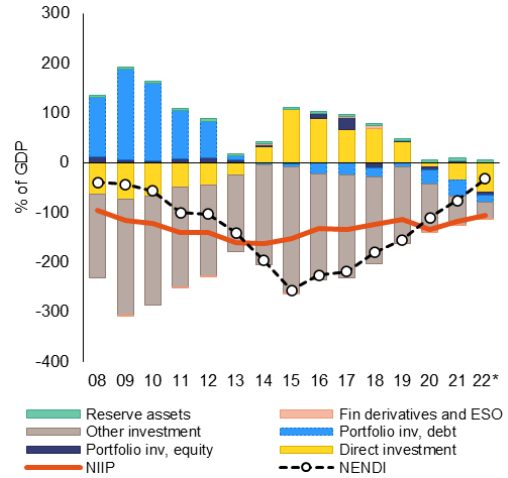
Source: Eurostat, AMECO, Commission services calculations.

Graph 4.2: NIIP: Cyprus

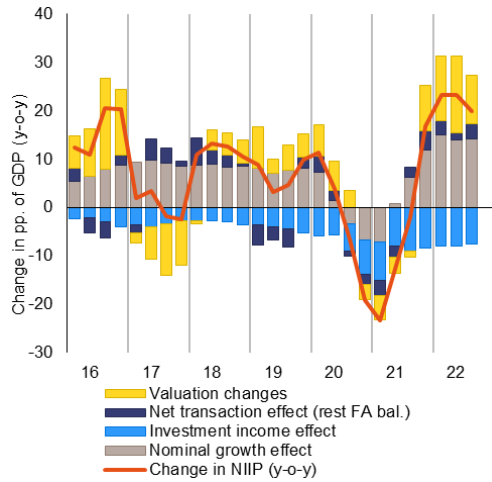
a) NIIP by sector



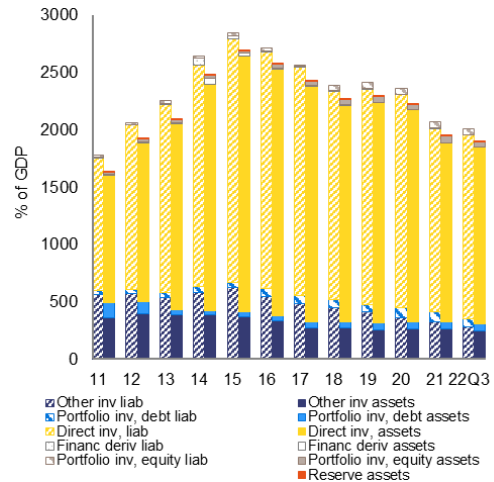
b) NIIP by instrument



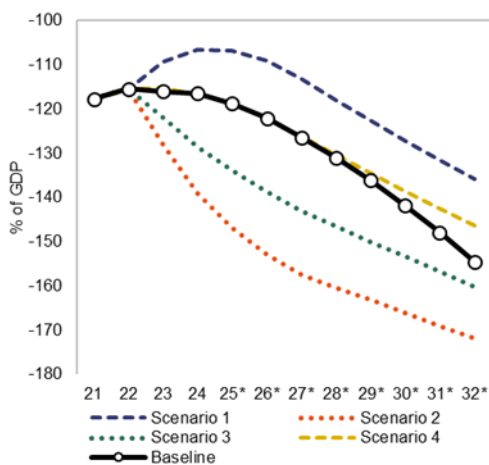
c) Decomposition of the NIIP change



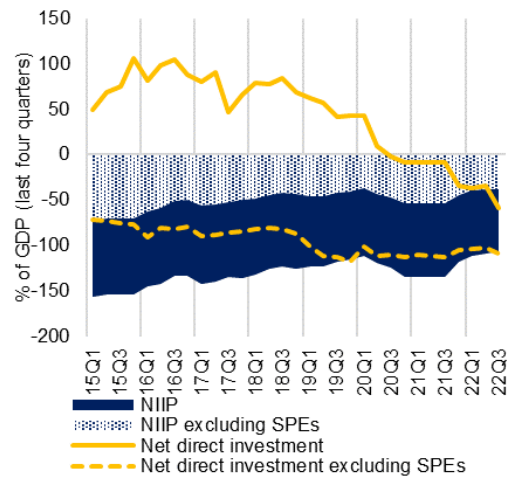
d) IIP, gross components



e) NIIP projection



f) NIIP without SPEs

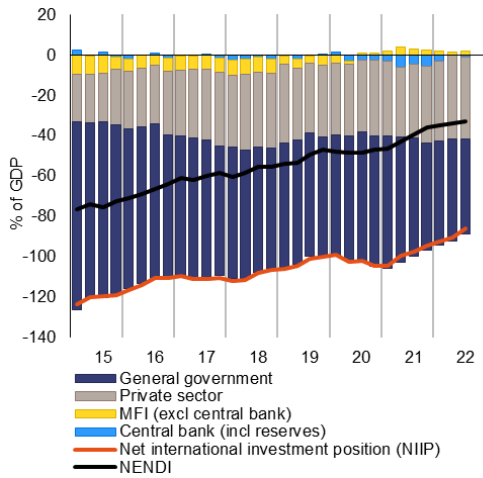


Notes: graphs a and f: 4-quarters moving sums; graph c: (contributions to) annual change of 4-quarters moving sums.

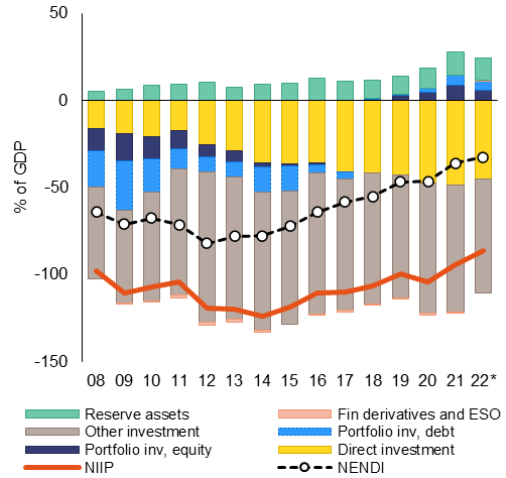
Source: Eurostat, AMECO, the Central Bank of Cyprus (for graph f), and Commission services calculations.

Graph 4.3: NIIP: Portugal

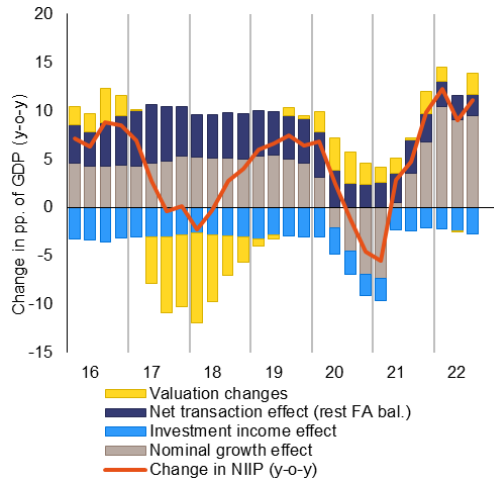
a) NIIP by sector



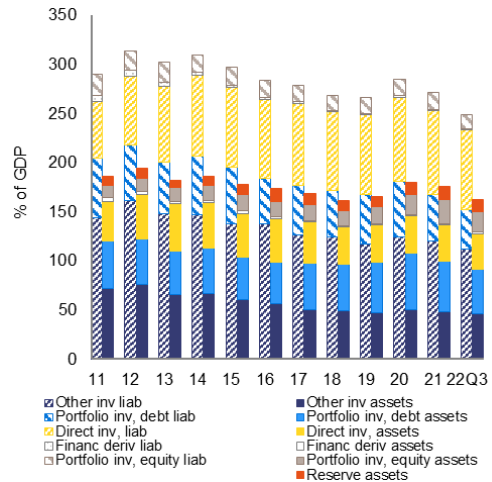
b) NIIP by instrument



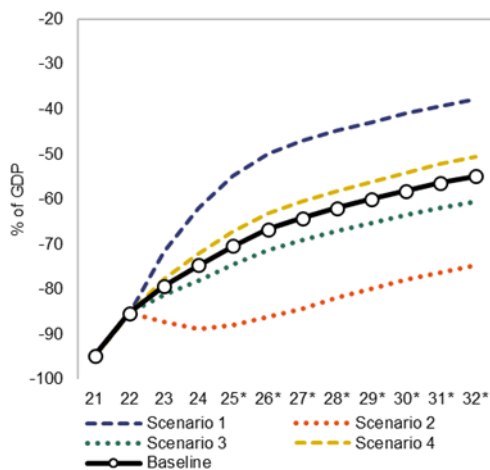
c) Decomposition of the NIIP change



d) IIP, gross components



e) NIIP projection

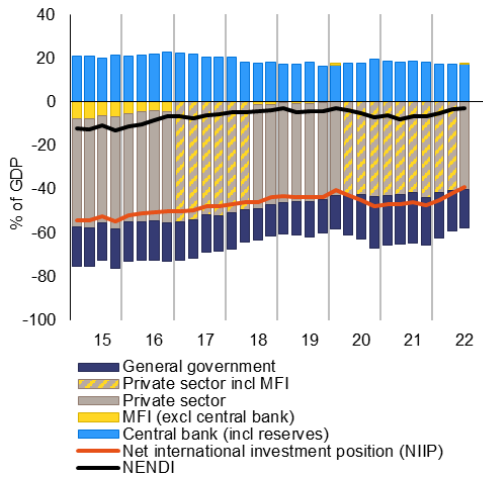


Notes: graph a: 4-quarters moving sums; graph c: (contributions to) annual change of 4-quarters moving sums.

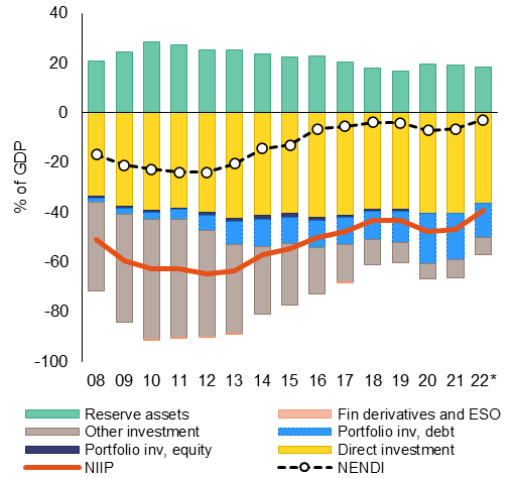
Source: Eurostat, AMECO, Commission services calculations.

Graph 4.4: NIIP: Romania

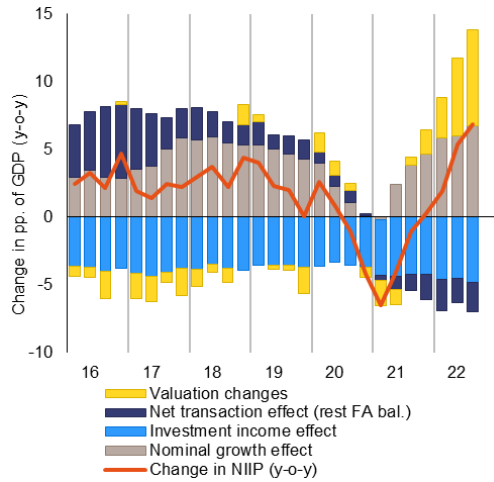
a) NIIP by sector



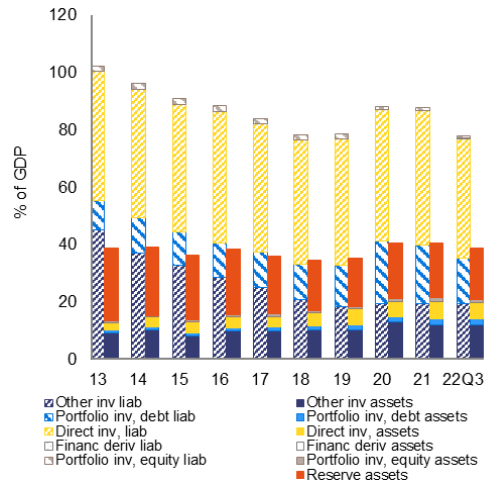
b) NIIP by instrument



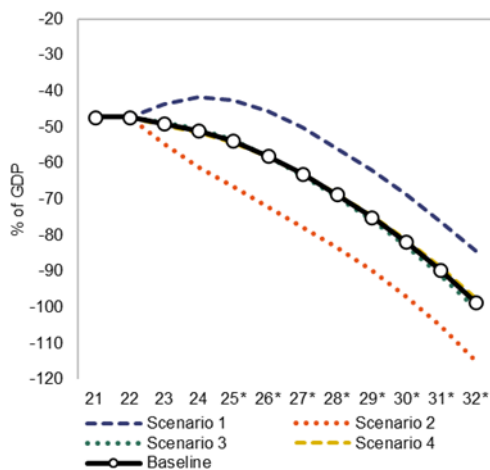
c) Decomposition of the NIIP change



d) IIP, gross components



e) NIIP projection

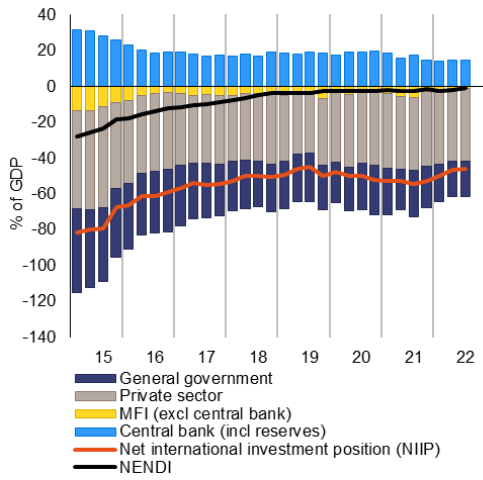


Notes: graph a: 4-quarters moving sums; graph c: (contributions to) annual change of 4-quarters moving sums.

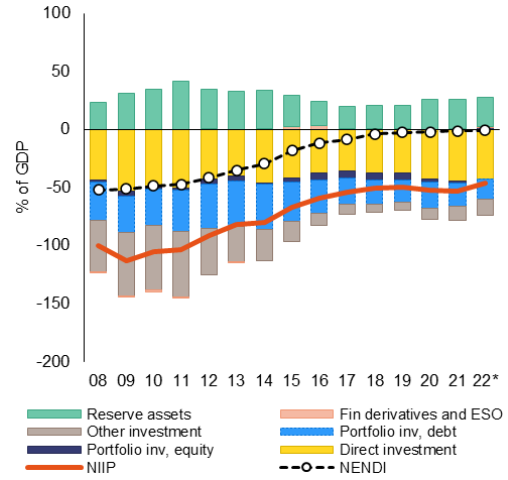
Source: Eurostat, AMECO, Commission services calculations.

Graph 4.5: NIIP: Hungary

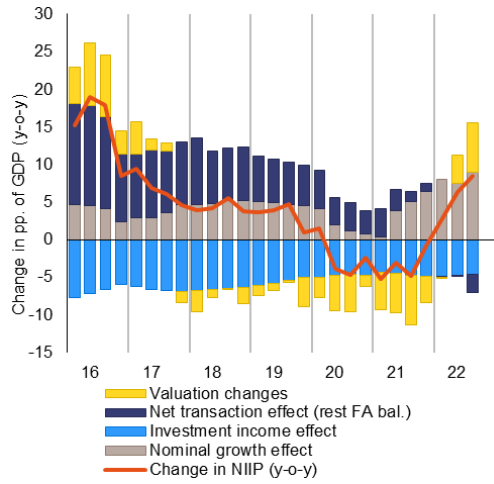
a) NIIP by sector



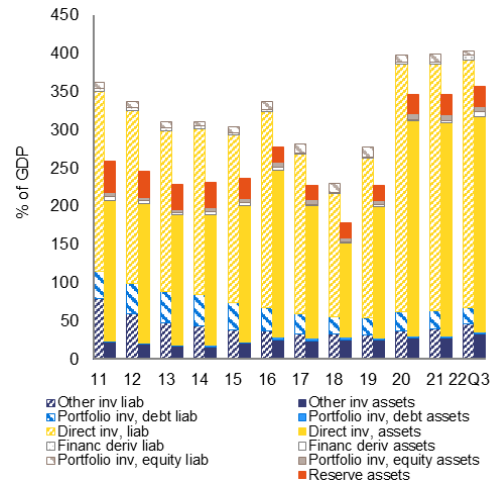
b) NIIP by instrument



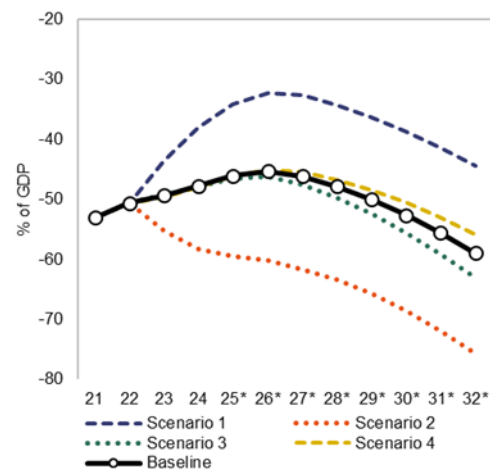
c) Decomposition of the NIIP change



d) IIP, gross components



e) NIIP projection

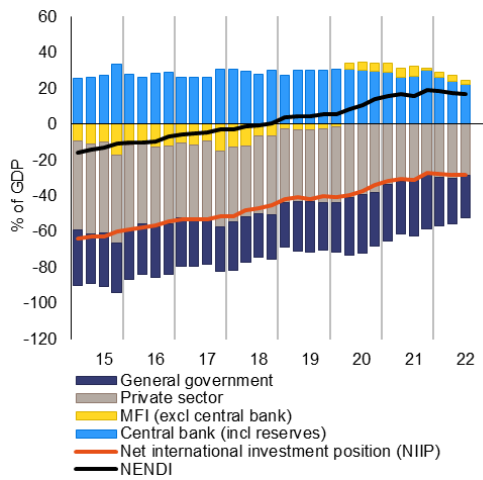


Notes: graph a: 4-quarters moving sums; graph c: (contributions to) annual change of 4-quarters moving sums.

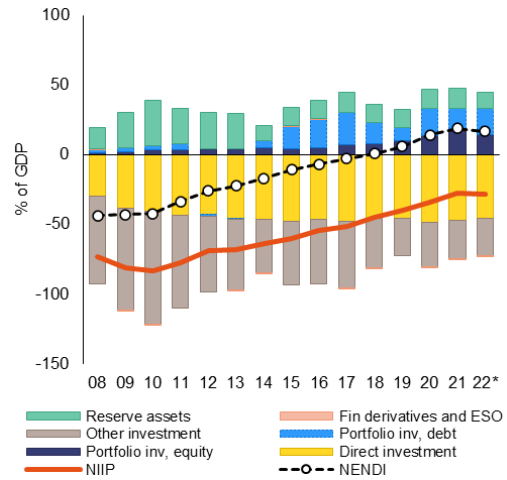
Source: Eurostat, AMECO, Commission services calculations.

Graph 4.6: NIIP: Latvia

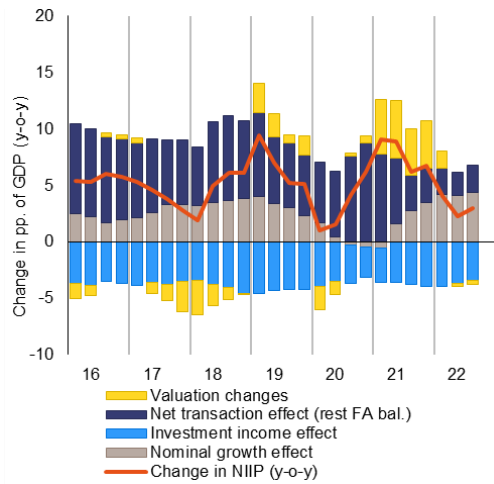
a) NIIP by sector



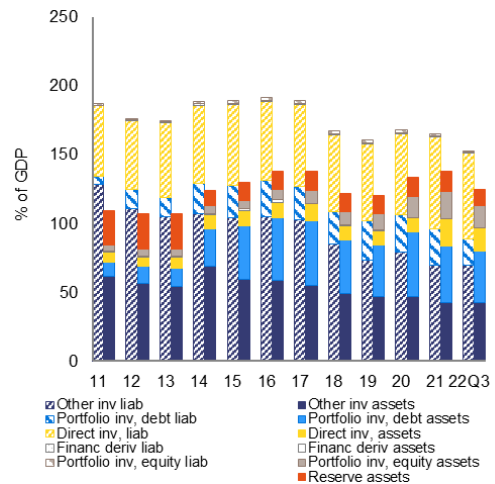
b) NIIP by instrument



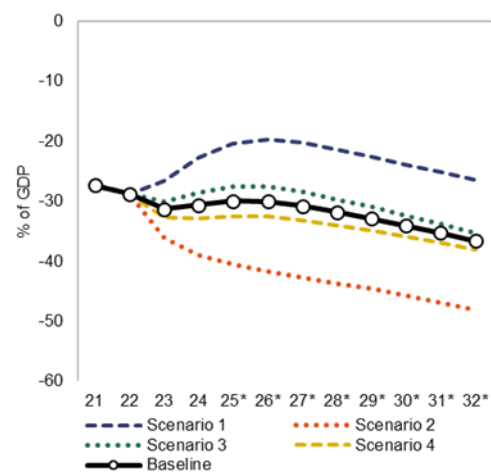
c) Decomposition of the NIIP change



d) IIP, gross components



e) NIIP projection

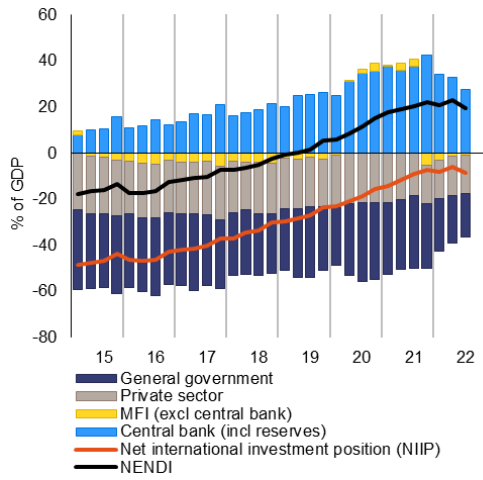


Notes: graph a: 4-quarters moving sums; graph c: (contributions to) annual change of 4-quarters moving sums.

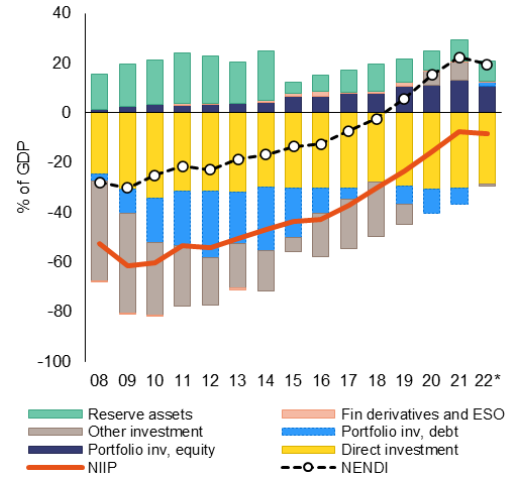
Source: Eurostat, AMECO, Commission services calculations.

Graph 4.7: NIIP: Lithuania

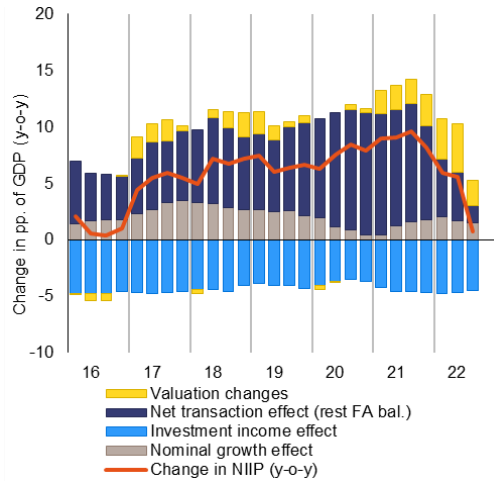
a) NIIP by sector



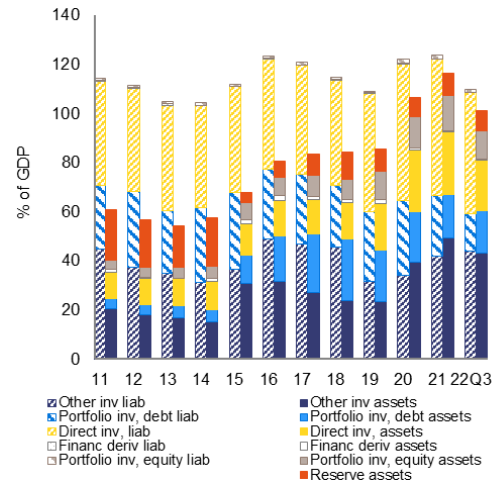
b) NIIP by instrument



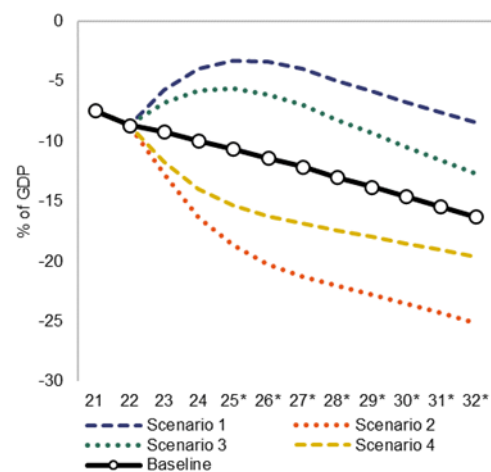
c) Decomposition of the NIIP change



d) IIP, gross components



e) NIIP projection

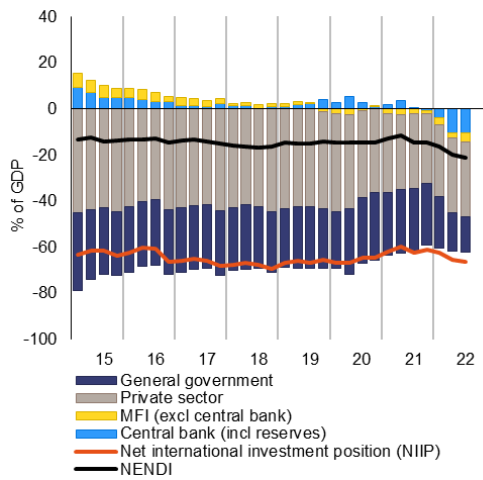


Notes: graph a: 4-quarters moving sums; graph c: (contributions to) annual change of 4-quarters moving sums.

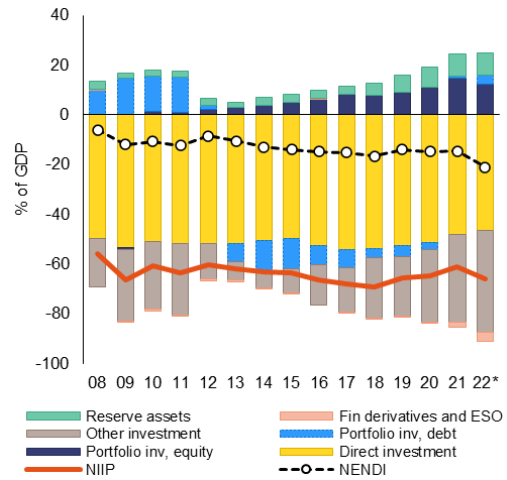
Source: Eurostat, AMECO, Commission services calculations.

Graph 4.8: NIIP: Slovakia

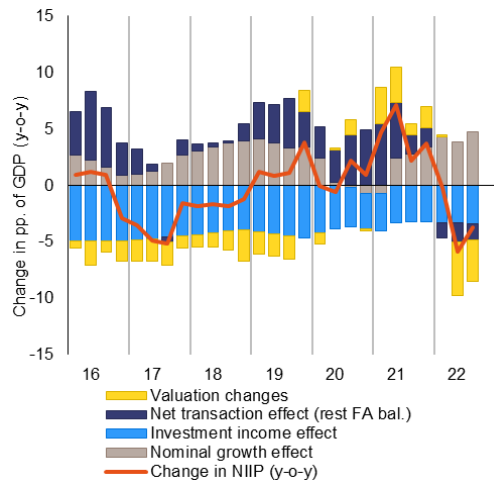
a) NIIP by sector



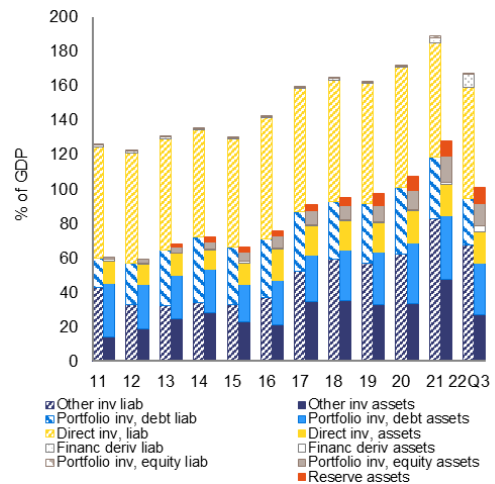
b) NIIP by instrument



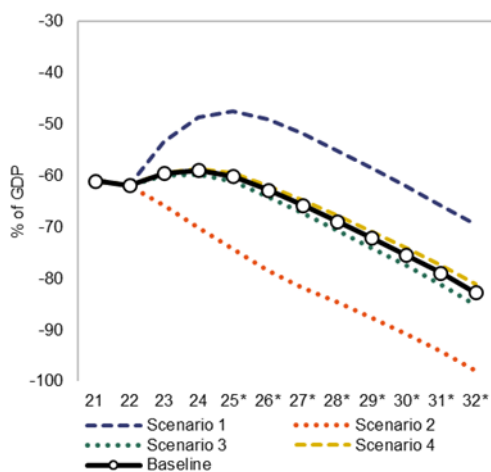
c) Decomposition of the NIIP change



d) IIP, gross components



e) NIIP projection

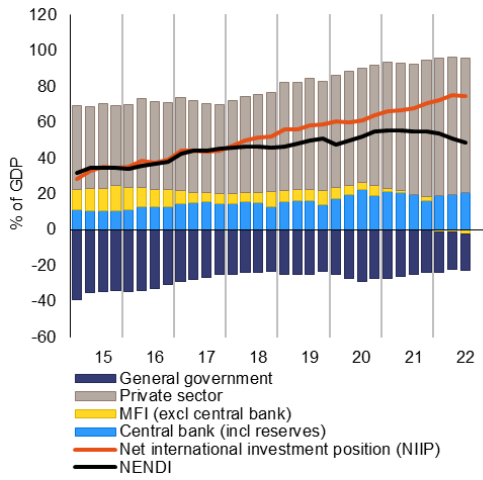


Notes: graph a: 4-quarters moving sums; graph c: (contributions to) annual change of 4-quarters moving sums.

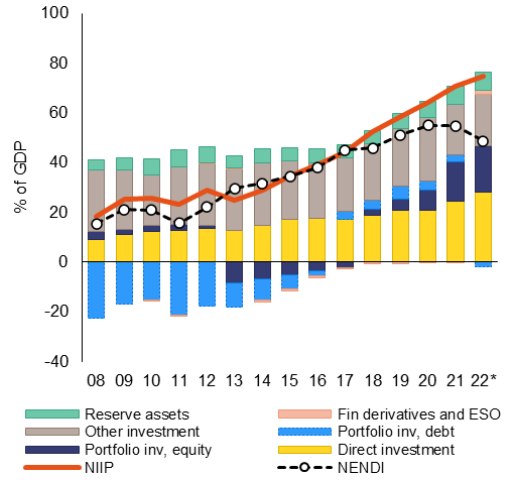
Source: Eurostat, AMECO, Commission services calculations.

Graph 4.9: **NIIP: Germany**

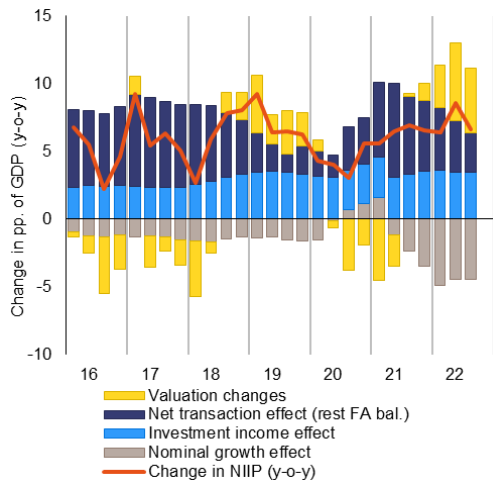
a) NIIP by sector



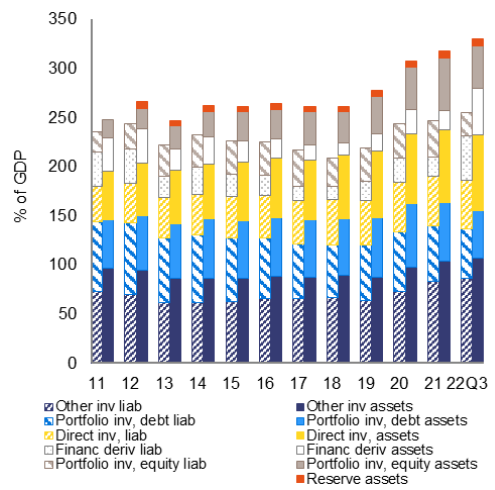
b) NIIP by instrument



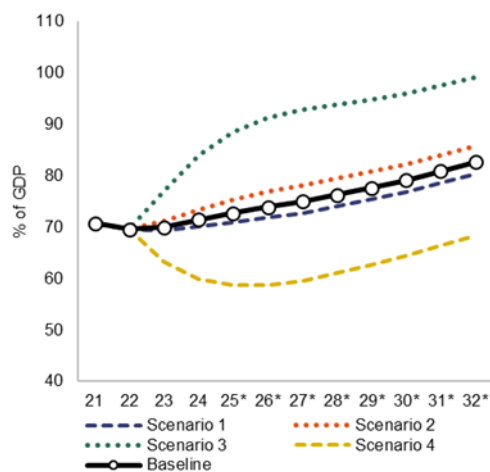
c) Decomposition of the NIIP change



d) IIP, gross components



e) NIIP projection

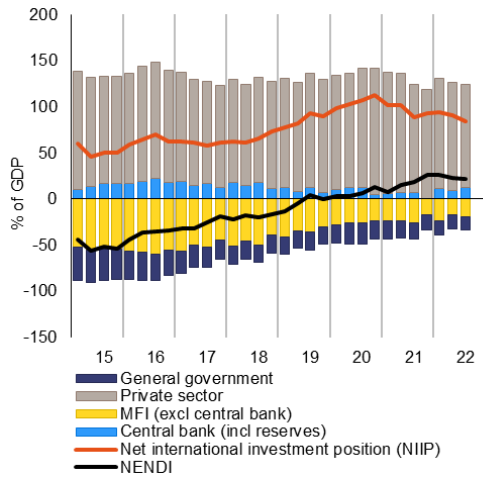


Notes: graph a: 4-quarters moving sums; graph c: (contributions to) annual change of 4-quarters moving sums.

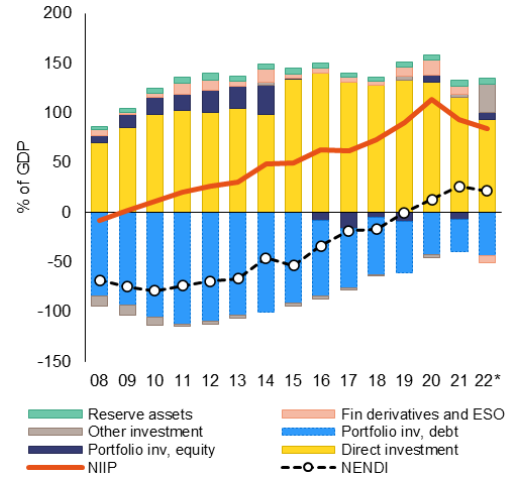
Source: Eurostat, AMECO, Commission services calculations.

Graph 4.10: NIIP: the Netherlands

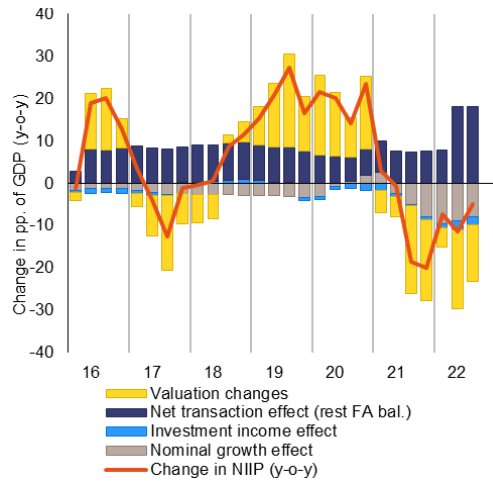
a) NIIP by sector



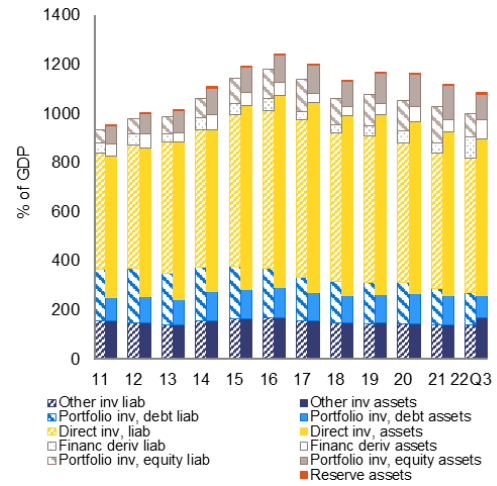
b) NIIP by instrument



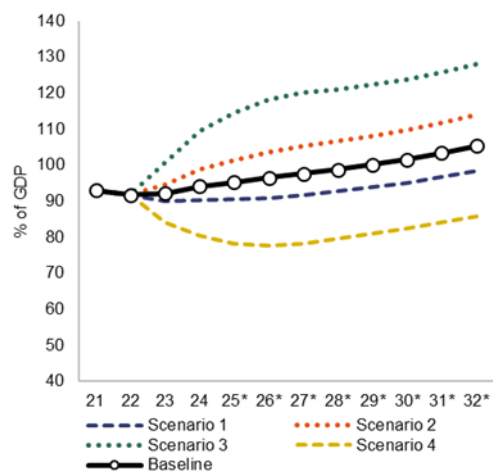
c) Decomposition of the NIIP change



d) IIP, gross components



e) NIIP projection



Notes: graph a: 4-quarters moving sums; graph c: (contributions to) annual change of 4-quarters moving sums.

Source: Eurostat, AMECO, Commission services calculations.

5. SUMMARY BY COUNTRIES

Greece's current account deficit widened further in the first three quarters of 2022 reaching -8.5% of GDP. It is forecast to reach -7.4% in 2023. Overall, this represents a marked deterioration from the -1.5% recorded in 2019. The deterioration in 2022 was mainly caused by higher deficit recorded in the trade balance both in goods excluding energy, and in energy goods. The recent changes of the overall export and import flows have mainly been driven by the price effects with the growth of imports deflator outpacing the growth of exports deflator in most of 2021. However, this trend has reversed starting from 2022Q1 and the trade balance of Greece worsened somewhat despite terms of trade improvements. From a sectoral perspective, government's net borrowing is expected to decline in 2022 and households' net position to turn negative. The Greece's NIIP remains the largest negative position among EU countries despite some recent improvements, mainly on account of positive nominal growth effect. Under the baseline scenario, some improvement is projected until 2024, but at the end of the projection period, in 2032, the NIIP is expected to be below the current level.

Cyprus' current account, after having narrowed in 2021, widened substantially again reaching -9.5% of GDP in the last four quarters until 2022Q3. It is forecast to reach -7.3% in 2023, from -5.6% in 2019. The recent decline was mainly caused by the widening deficit in trade in goods, also including energy, and in the primary income balance. Unlike most EU countries, trade flows were mainly shaped by the changes in trade volumes as the terms of trade for goods and services remained rather stable. A strong presence of the SPEs does not significantly affect the current account balance. The NIIP remains in deep negative territory, despite large improvements recorded over the most recent quarters, and it is expected to continuously deteriorate under the baseline assumption, with the decline accelerating especially after 2025. However, excluding non-defaultable instruments from the NIIP yields a much more favourable picture. Moreover, adjusting for the stock positions of the SPEs leaves the NIIP at much less negative level, slightly above fundamental and prudential benchmarks.

Portugal experienced only a comparatively mild worsening in external flows over recent years, reaching a moderate current account deficit of -1.9% of GDP in 2022Q3. It is forecast to reach -0.8% in 2023, from a small surplus of 0.4% in 2019. The deterioration in the trade balance related to energy price increases since mid-2021 has been comparatively less pronounced and was offset by the recovery in travel balances. The latest observations show small improvements in the trade balance, driven by stronger increases in volumes of exports compared to volumes of imports. The large negative NIIP has already improved to levels considerably above those before the pandemic crisis and amounts to -86.3% in 2022Q3. Current projections suggest a positive trajectory in the baseline scenario, which should bring the NIIP between -50% and -60% of GDP over the next ten years.

Romania's current account, which has been on the downward trend since 2015, accelerated its decline after 2020, to a deficit of -9.1% of GDP in 2022Q3. It is forecast to reach -9.2% in 2023, which represents a marked worsening from -4.9% in 2019. The recent deterioration was mainly caused by a widening trade deficit in goods amid lower energy balances, and by lower primary income, with the negative contribution from the energy segment being smaller than in the most of EU countries. Recently, the contributions of price changes to changes in trade flows have increased. While the price effects largely cancelled out, the growth in import prices still outpaced the growth in export prices somewhat. Net inflows of direct investment, portfolio debt, and other investment have been recorded, along with the net acquisition of reserve assets, while the exchange rate has been stable in effective terms. However, given the substantial net borrowing forecast for the coming years, the NIIP is projected to follow a steep negative trajectory and reach levels of nearly -100% of GDP under the baseline scenario.

The current account balance of **Hungary** underwent a sharp deterioration in 2021 and the first three quarters of 2022, coming down to -7.4% of GDP, below the current account norm and the NIIP stabilising benchmark. It is forecast to reach -6.3% in 2023. Overall, this represents a marked deterioration from -0.8% in 2019. The recent decline was mainly caused by the widening deficit in trade in energy goods, which is among the largest in the EU. While growth in import prices has outpaced the growth in export prices, pulling down the trade balance, when trade flows are measured in constant prices, the balance was more stable, and it recorded some small recent improvements. The depreciating trend of the forint, which has been observed over recent years, accelerated significantly during 2022. The negative NIIP equalled -46.2% of GDP in

2022Q3, while the NENDI was nearly balanced at -1%. However, the NIIP is projected to moderately worsen over the next ten years to levels around -60% of GDP.

The current account balance of **Latvia** recorded the second largest decline since 2020, moving to a deficit of -5.2% of GDP in 2022Q3, mainly on account of lower energy and income account balances. It is forecast to reach -8.4% in 2023, which represents a marked deterioration from -0.6% in 2019. While the contribution of changes in trade deflators to trade flows dynamics became more important recently, the changes in exports and imports prices were largely offsetting. Thus, the deterioration in the trade balance was crucially determined by the changes in volumes of trade, with the growth in volumes of imports surpassing that of exports. The NIIP of Latvia was moderately negative at -28.4% of GDP in 2022Q3, but the NENDI was positive at 16.6%. While the NIIP is projected to worsen under the baseline scenario over the next ten years, the expected deterioration should be mild, leading to a NIIP only slightly below the indicative MIP threshold of -35% of GDP.

Lithuania experienced the largest decline in the current account balance which came at -4.3% of GDP in 2022Q3, from an exceptionally high surplus in 2020, and mostly driven by the decline in the energy balance, the largest among EU countries. It is forecast to reach -2.8% in 2023, considerably below the surplus equal to 3.5% of GDP recorded in 2019. The recent evolution of the balance of trade has been crucially shaped by the strong contributions of the changes in trade deflators. However, in terms of volumes, i.e. with trade flows measured in constant prices, the trade balances have been much more stable and have even recorded some improvements most recently. Lithuania has a relatively strong external stock position, with NIIP coming close to balance most recently, and with a strong NENDI at 19.5% of GDP in 2022Q3. Thus, despite some projected worsening of the NIIP over a longer term, the decline should be very mild, with the NIIP moving only to levels around -15% of GDP.

Slovakia's current account balance worsened sharply since 2020, coming to -6.8% of GDP by 2022Q3. It is forecast to reach -5.4% in 2023, from -3.3% in 2019. The recent decline has been caused mainly by the widening deficit in trade in energy goods. However, especially in 2022, the contributions to changes in trade from changes in deflators became dominant over the contributions from changes in trade volumes. The much steeper increases in prices of imported goods and services than of the exported ones have been the main factor behind the worsening trade balance. When flows are measured in constant prices, the trade balance recorded some small improvements most recently. The outlook is not positive and the negative NIIP of -66.2% of GDP in 2022Q3 is projected to decline considerably, reaching levels slightly below -80% of GDP by the end of the projection period.

Germany's current account surplus moved back up close to pre-pandemic levels in 2021, but declined considerably to 4.2% of GDP in 2022Q3. It is forecast to reach 4.6% in 2023. Overall, this represents a considerable decline from 7.6% in 2019. While lower balance of trade in energy goods contributed to the latest decline, the trade balance excluding energy also decreased considerably in the first three quarters of 2022. A deterioration in terms of trade was an important factor behind the drop in the trade balance through higher growth of import than of export prices. The decline in the trade balance was more contained in real terms. The current account is forecast to remain below the longer-term average as investment is forecast to increase going forward. Projections suggest that the large Germany's NIIP should continue increasing over the next ten years, yet at a slower pace than previously.

The **Netherlands'** current account recently narrowed below the level observed in the pandemic crisis and reached 5% of GDP in 2022Q3, remaining above the levels explained by economic fundamentals and above the other relevant benchmarks. It is forecast to reach 5.3% in 2023, from 6.9% in 2019. The recent decline was mainly caused by the widening deficit in trade in goods excluding energy, and in the energy balance. A mild negative contribution to the current account came also from the worsening primary income. The adverse terms of trade shock, i.e. a higher increase in prices of imports than of exports, has put downward pressure on the trade balance. The Netherlands' NIIP has been declining for the last few quarters but is projected to further increase under the baseline scenario by 2032.

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Open data from the EU

The EU Open Data Portal (<http://data.europa.eu/euodp/en/data>) provides access to datasets from the EU. Data can be downloaded and reused for free, both for commercial and non-commercial purposes.

