

# CE/SEE Watch: Fiscal consolidation vs anti-inflationary measures

From late 2021 governments in CE/SEE have been introducing varied measures to soften the hit from rising prices (energy and food in particular). While this slows fiscal consolidation, it should not lead to its reversal. However, as more measures are introduced, it is crucial that they are mostly targeted and temporary in order not to increase fiscal risks but also not to undermine the adjustments of the demand to the shifts in prices. With that, we share the views recently expressed also by the IMF.

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As Europe prepares for more and possibly very severe disruptions to energy supplies, the concerns about the economic outlook keep increasing. However, this occurs also amid still no relief on the inflation side. Even though in CE/SEE some countries are probably reaching this year's peak, CPI may reach new highs next year amid regulatory energy price hikes (Poland) while for all those countries the path to lower inflation will be a long and slow one.

This results in ongoing activity not just on the monetary policy side (where possible) but also from the governments. The pandemic has marked a shift here, also taking into account the challenges that a policy of austerity brought after the financial crisis. With that, there is an ongoing policy focus on protecting the economies, households in particular, from current challenges with a broad approval for emergency spending.

The fiscal constraints remain, however, with some countries not able to finance broad programs to shield the economy while too extensive easing may also be a dangerous game that will come to the foreground at a later stage. For now, we see fiscal risks in the CE/SEE region as limited and definitely not in the focus and expect that the energy supply challenges will slow but not reverse the fiscal consolidation path.

While we already tracked the governments' antiinflationary measures in a previous note in April ([CE/SEE Watch: Governments intensify interventions to limit price increases](#)), with this update on the measures we take a look at the fiscal impact of the actions and selected country specifics.

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## Overview of antiinflationary measures applied in CE/SEE directly related to energy and food

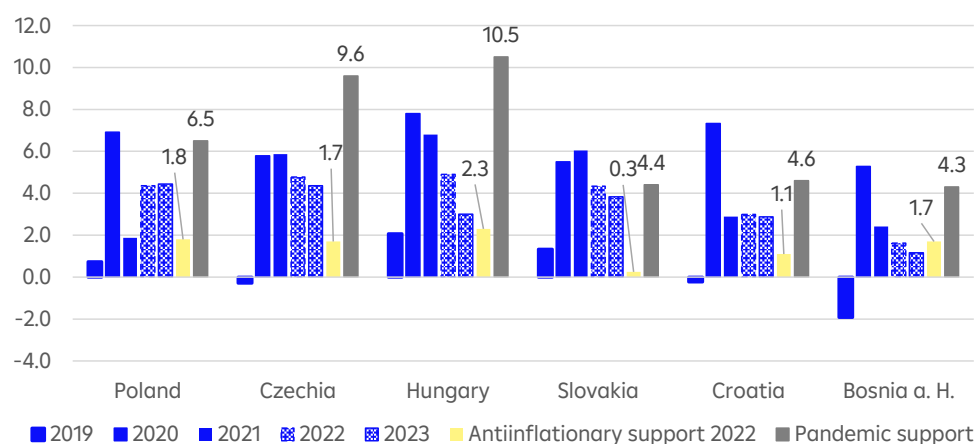
Type of measure	Countries
Fuel: price cap	Croatia, Hungary
Fuel: tax cut	Poland, Czechia, Serbia, Croatia, Bosnia and Herzegovina*
Electricity/energy: price cap/regulated prices	Poland, Hungary**, Slovakia, Romania, Albania, Serbia, Croatia, Bosnia and Herzegovina*
Electricity/energy: tax cut	Poland, Austria, Croatia
Food: price cap on key items	Hungary, Serbia
Food: tax cut	Poland, Croatia, Bosnia and Herzegovina*
Fertilisers: tax cut	Poland, Serbia, Croatia
Agriculture: subsidies	Poland, Kosovo, Croatia

\*measures in Bosnia a.H. still not implemented (expected in September)

\*\*electricity price cap for HH since 2015 but has recently been limited

Source: RBI/ Raiffeisen Research

## Fiscal deficits (realised and forecasted by RBI) vs antipandemic and antiinflationary support (% GDP)



Pandemic support size based on IMF database (above the line measures) available at: <https://www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19>

\*2022 support for Poland with the assumption of extension to full year)

\*\*Measures in Bosnia a.H. expected to be approved in September

Source: Refinitiv, IMF, RBI/Raiffeisen Research

As visible in the graph above, the anti-inflationary shields are significant for some countries, exceeding 1% of GDP but still not comparable to the direct support provided during the pandemic. On top of measures related directly to the energy and food prices (as listed in the table above), the current support is enhanced by other actions like child benefits (Czechia, Austria), higher pensions (half of the recently announced support package in Czechia) or the loan holidays introduced in Poland.

What is key about the implemented measures is that in most countries they focus on the most vulnerable groups which spend a larger portion of their income on increasingly expensive energy and food. This seems the most reasonable solution as too broad measures may have countereffects via providing additional demand impulse and thus make it more difficult to contain inflation in a durable manner. That said **Poland** is the one exception where measures are mostly broad-based rather than focused on vulnerable

groups. For that reason, it is also the only country in CE/SEE where we project higher fiscal deficits in 2022 and 2023 compared to last year. The ratio at 4.4% GDP for both years does not seem very high in regional comparison (in CE especially) as 2021 brought a significant reduction in deficit spurred by fast recovery. Nevertheless, it is still a most pronounced change toward a more expansive fiscal approach which also adds to challenges in taming inflation. Worth noting here is the political context as Poland faces Parliamentary elections in 2023 which also poses risks of an even more expansive approach in the near future. On the other hand, the political motivations do not seem to accelerate anti-inflationary support in **Bosnia and Herzegovina** where measures were announced in early 2022 but have still not been introduced amid political stand-offs (we expect them to be approved in September).

In **Czechia**, the government came up with a sizeable support package (approx. 1.7% of GDP) lately to help ease the price burden carried by households. Crucial is to make the help accessible as data show only a fraction of households eligible for government support actually uses it so far.

In **Hungary** on the other hand, amid new measures aimed to consolidate public finances, one of the recently announced changes was the limit to the freezing of electricity prices for households which had been in place since 2015. After the change, from September 2022, above average gas and electricity consumption should be payed at market price.

As mentioned the breadth of the measures risks making the fight against inflation less effective. It gives additional funds to sustain the demand for energy (also that imported from Russia) rather than inducing a decline in dependency and a cut in demand for fossil fuels. Meanwhile, direct compensation while still boosting the overall demand may actually direct it elsewhere (to new energy sources or prompt a reduction in demand for energy while leaving the household with funds that can be spent on other goods/ services ).

With that in mind, it is important for the measures to be limited in scale and duration to soften the shock but not distort the price setting and the adjustment in demand, as has been underlined also by a recent [working paper from the IMF](#). The paper focuses on the impact of the rise in energy prices on households in Europe. It also looks at the distribution of the impact on the poor vs rich households, confirming the often larger burden on the low-income households compared to high-income. With that, the IMF also underlined the importance of the measures being directed toward the vulnerable, rather than in a broad manner.

The still-unfolding economic slowdown and challenges related to energy supplies, high inflation, and war in Ukraine keep the focus now more on dealing with those issues rather than on accelerating the post-pandemic fiscal tightening. While we do not forecast a reversal in the fiscal consolidation path, the elevated expenses on anti-inflationary or other anticrisis measures should be targeted at the most vulnerable, as well as combined with a more prudent approach in other areas of public finances. This is crucial in order not to raise vulnerability to any increase in fiscal scrutiny which is very likely to return once the current challenges are addressed.

Over the next several years, we project a gradual downward path of fiscal deficits in terms of GDP. That being said fiscal consolidation remains necessary to keep the budgets on a sustainable path in the long run. In our view, the consolidation effort should focus especially on the structural deficit in order to make sure that the economy generates enough to finance (quasi-)mandatory fiscal expenditure and operating costs.

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