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A Time of Moderate Expectations

Economic Analysis and Outlook for Central, East and Southeast Europe

The Vienna Institute for International Economic Studies
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A Time of Moderate Expectations

LEON PODKAMINER
SÁNDOR RICHTER
AMAT ADAROV
VASILY ASTROV
SERKAN ÇIÇEK
MARIO HOLZNER

et al. (including Rumen Dobrinsky, Vladimir Gligorov, Doris Hanzl-Weiss, Peter Havlik, Gábor Hunya, Sebastian Leitner, Isilda Mara, Olga Pindyuk and Hermine Vidovic)

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The statistical data until 2014 presented in this Report are as of 20 February 2015, forecasts as of March 2015. Most data are taken from the wiiw Databases. Direct access is available at: http://data.wiiw.ac.at/.

ABBREVIATIONS

AL	Albania
BY	Belarus
BA	Bosnia and Herzegovina
BG	Bulgaria
CZ	Czech Republic
EE	Estonia
HR	Croatia
HU	Hungary
KZ	Kazakhstan
XK	Kosovo
LT	Lithuania
LV	Latvia
ME	Montenegro
MK	Macedonia
PL	Poland
RO	Romania
RS	Serbia
RU	Russia
SI	Slovenia
SK	Slovakia
TR	Turkey
UA	Ukraine

ALL	Albanian lek
BAM	convertible mark of Bosnia and Herzegovina
BGN	Bulgarian lev
BYR	Belarusian rouble
CZK	Czech koruna
EUR	euro
HRK	Croatian kuna
HUF	Hungarian forint
KZT	Kazakh tenge
LTL	Lithuanian litas
MKD	Macedonian denar
PLN	Polish zloty
RON	Romanian leu
RSD	Serbian dinar
RUB	Russian rouble
TRY	Turkish lira
UAH	Ukrainian hryvnia
USD	US dollar

BOP	balance of payments
CEE	Central and Eastern Europe
CESEE	Central, East and Southeast Europe
CIS	Commonwealth of Independent States
CIS-STAT	Interstate Statistical Committee of the Commonwealth of Independent States
CPI	consumer price index
EA	Euro area 19 countries
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
ER	exchange rate
ESA'95	European system of national and regional accounts
EU	European Union
FDI	Foreign Direct Investment
FISIM	Financial Intermediation Services, Indirectly Measured
GDP	Gross Domestic Product
ICP	International Comparison Project
IMF	International Monetary Fund
LFS	Labour Force Survey
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne (Statistical classification of economic activities in the European Community)
NACE Rev. 1	first revision of the original NACE (1970)
NACE Rev. 2	revised classification, introduced in 2008
NB	National Bank
NC	national currency
NMS	new EU Member States
OECD	Organisation for Economic Co-operation and Development
OMS	old EU Member States
pp	percentage points
PPI	producer price index
PPP	Purchasing Power Parity
SEE	Southeast Europe
SME	small- and medium-sized enterprise
SNA	System of National Accounts
SPE	Special Purpose Entity
TCB	Turkish Central Bank
VAT	value added tax
WBC	Western Balkan countries
WIFO	Austrian Institute of Economic Research
wiiw	The Vienna Institute for International Economic Studies

.	not available (in tables)
bn	billion
mn	million
p.a.	per annum

Executive summary

Contrary to expectations, near-stagnation has continued in the euro area. Certain forecasts for 2015 repeatedly suggest some moderate improvement, while others do not envisage any meaningful measure of acceleration. Extraordinary measures announced by the euro area authorities that have already been factored in remain inconsequential. Furthermore, the drop in energy carrier prices and a slight depreciation of the euro do not seem to have helped very much either. The euro area – and hence the EU as a whole – has been seized by secular stagnation. The current misfortune, although triggered by the impact of the global economic crisis, has much deeper roots. The growth slowdown in Europe can be attributed to policy reorientation that started back in the mid-1970s.

In all likelihood, growth in CESEE will follow the unimpressive growth pattern displayed by the euro area. The longer-term convergence of income levels in those countries can no longer be expected to be as rapid as was assumed a decade or so ago.

The current performance of the CESEE economies is also only moderately satisfactory. Growth in the period 2015-2017 is not going to deviate substantially from the pace recorded in 2014. On the other hand, most of the countries in the region are also expected to evade the dangers of runaway inflation, fiscal deficits or excessive foreign borrowing that often plagued them in the past.

Depressed aggregate domestic demand has been the major factor behind anaemic growth. This is evidenced by disinflation (or even mildly deflationary tendencies) across much of the region, as well as the persistence of fairly high unemployment.

There is some evidence of a 'race to the bottom' in terms of wage setting. While wage moderation strengthens profitability and external competitiveness, it also weakens disposable household incomes and thus slows down growth in domestic demand. Apparently, there is a trade-off between improvements in the trade balance and more rapid growth in domestic demand. Overall, GDP growth is being held 'on a short leash'.

Growth in public gross fixed capital formation (GFCF) may be supporting economic growth, especially in those new EU Member States (NMS) that have access to EU funds. However, a proper tangible rebound in private-sector GFCF is still lacking. Weak private-sector GFCF cannot be attributed to a 'profit squeeze' in the corporate sector. On the contrary, the corporate sector has been doing very well, at least in those NMS, for which relevant data are available.

The corporate sector as a whole still tends to lend rather than borrow. The means available to the corporate sector appear to be plentiful at present – but the sector still prefers to lick its wounds inflicted by former excessive borrowing or extend loans (primarily to the public sector) rather than to invest productively.

Loans are stagnant even in those instances where interest rates are relatively low. With a few exceptions (largely on the region's periphery) the stocks of loans to the non-financial corporate sector increased marginally at best in 2014. This may reflect firms' pessimistic assessment of future growth in demand, increased 'liquidity preference' or the relative abundance of the means at their disposal.

Non-performing loans are linked to a high share of borrowing in foreign currencies. The recent strengthening of the Swiss franc will bear some negative consequences for those firms and households that borrowed heavily in that currency in the past. Thus far, the shares of non-performing loans in total loans extended to households and the non-financial corporate sector have not changed perceptibly. However, there does seem to be a positive link between the share of non-performing loans and the share of loans denominated in (or indexed to) foreign currencies. A rise in the share of non-performing loans is likely.

New evidence supports the claim that the countries with floating exchange rates fare better in the medium-to-long term. They tend to avoid irreversible currency overvaluation, whereas the countries with fixed exchange rates do not quite avert it. It is argued, however, that despite the rigidity of the exchange rates, overvaluation can be avoided - at least in the medium term.

All the CESEE countries run up fiscal deficits. Over the past few years, Belarus used to be an exception. Recent European Commission projections, however, envisage fiscal deficits in all NMS in 2015 as well. Current account deficits are still depressed. Net national lending in the NMS tends to be positive. This is a consequence of current savings in the private sector in the NMS generally running ahead of gross capital formation in that sector.

On average output growth across the NMS will become more uniform in 2015 – albeit not any faster. Some acceleration in marginal growth is to be expected in the biennium 2016-2017. Unemployment in the NMS will recede only gradually. Low inflation will prevail in 2015, but it will gradually return to more normal levels in 2016. Under sustained – albeit rather anaemic – growth, the current account balances will deteriorate (although they will still remain comparatively low).

Growth is hardly accelerating in the (current and potential) EU candidate countries either. Output in those countries is not expected to grow faster than in the NMS. Turkey, Macedonia and Kosovo may fare slightly better than the rest of the group. However, with the exception of Turkey, those countries seem to have put high inflation behind them. Nonetheless, their unemployment figures continue to be dismal (less so only in Turkey). They will also run high (or even very high) current account deficits.

Most of the successor states to the Soviet Union will perform rather badly in 2015. Ukraine's output will continue its free fall as many of the country's industrial centres have since become battlefields. The decline in world market prices for energy carriers will negatively affect both Kazakhstan and Russia, with real output in the latter country dropping sharply. The same fate will befall Belarus: a country that relies heavily on exports to Russia and Ukraine. However, assuming a peaceful resolution to the Ukrainian conflict in 2015, it is expected that all the successor states will resume moderate growth in 2016 or 2017.

COUNTRY SUMMARIES

BULGARIA

Economic activity in Bulgaria remained sluggish throughout most of 2014; weak GDP growth is likely to continue in 2015, driven mainly by household consumption and net exports. Some acceleration of economic activity might be expected over the period 2016-2017 on account of improving external conditions. The newly elected government that lacks strong political backing faces the challenge of implementing an ambitious reform agenda in a weak economic environment.

CROATIA

In Croatia GDP fell for the sixth consecutive year; however, the country is likely to return to a slightly positive growth path in 2015. Household consumption remains subdued owing to high and persistent unemployment and continued deleveraging. Economic recovery will hinge primarily on external demand, and a revival in investment activities following increased absorption of EU funds. Fiscal consolidation and an overly indebted enterprise sector are the key obstacles to more robust growth.

CZECH REPUBLIC

The Czech economy has finally recovered from the effects of fiscal consolidation. Given the relatively low level of debt burden in both the government and private sectors and the 'growth-friendly' monetary and fiscal policies, recovery over the period 2015-2017 seems assured. Acceleration of growth, however, may only be gradual as fixed investment is unlikely to expand at a markedly high rate. Doubts have recently been voiced about the country's foreign trade performance in the years to come.

ESTONIA

Given sluggish external demand, economic growth in 2015 compared to the previous year is not expected to accelerate. However, an increase in earnings and thus household consumption will keep the economy afloat, which is projected to grow by 2% in 2015. From 2016 onwards, we expect an investment revival and positive developments in terms of exports.

HUNGARY

Even though Hungary has left recession behind, it has not yet embarked on a sustainable growth path. The strong external stimulus to growth lent by the EU helped to resuscitate private investment and employment. However, with the stimulus from the EU cohesion policy weakening as of the current year, it is expected that other private (domestic and external) factors will drive recovery; however, the conditions conducive to that happening are far from favourable. Medium-term growth is unlikely to reach more than 2% in the biennium 2016-2017.

LATVIA

Prospects for the Latvian economy in 2015 have gradually deteriorated over the past few months. The major devaluation of the Russian rouble and the Russian economic slump will drag down the volume of Latvian exports. Entrepreneurs will thus be reluctant to expand their investment activities - at least not before 2016. It is expected, however, that household consumption will keep the Latvian economy buoyant, increasing by 2.1% in 2015 before a revival in external demand sets in and revitalises economic activity overall.

LITHUANIA

The setback in the neighbouring countries to the east, which hit exporters hard last year, will continue and economic growth will decelerate in 2015. Both public and private investments will increase at a slow rate, while household spending will secure a rise in employment; the net result will be 2.4% growth in real terms in 2015. An upward trend in economic activity driven by exports and investment is to be expected in the years thereafter.

POLAND

Driven by a major increase in gross capital formation, the Polish economy has entered a phase of moderately faster growth, which is likely to extend into 2016. In the medium term some deterioration of external balances can be expected. The outcome of the elections to be held in 2015 is still uncertain. Should the present liberal-conservative coalition lose to the nationalist-populist opposition, the economic and social policy may take an unpredictable track.

ROMANIA

Expanding private consumption and a good harvest softened the economic slowdown generated by an investment slump. Further slowdown is expected in 2015, should there be no major turnaround in terms of investments. Increased political and economic stability will benefit longer-term economic growth, yielding an increase of some 3%.

SLOVAKIA

Domestic demand replaced exports as the main engine of growth in 2014. This pattern will be maintained in the years to come. A major contributory factor is a number of substantial social measures taken by the government in the run-up to parliamentary elections. Stronger household consumption will also encourage import growth. Exports will remain sluggish in 2015, as low growth will prevail in the euro area and regional uncertainties persist. Growth should pick up thereafter, although risks will remain.

SLOVENIA

The Slovene economy returned to growth in 2014 after two years of contraction. The rebound has been driven by rising external demand and a revival in investment activities supported by EU funds. GDP growth in 2015 and 2016 will weaken once again on account of lower investments. Exports and the gradual recovery of household consumption will remain the main engines of growth.

* * *

ALBANIA

GDP growth is expected to increase progressively over the next three years; increasing by 2% in 2015, 2.2% in 2016 and 2.4% in 2017. The economy might benefit from a resolute reform in the energy sector and growth in gross fixed capital formation stemming mainly from foreign direct investment in energy infrastructure. Nonetheless, with government and household consumption failing to thrive, the country's economy still begrudges the growth rates achieved in 2010 and earlier years.

MACEDONIA

Growth has been speeding up, yet is bound to flatten somewhat in the current year as well as in the medium term. This is primarily due to a slowdown in public investments and growing concern over political stability. Additional risks are linked to the crisis in Greece, despite their not being easy to forecast. Nonetheless, barring major economic improvements in the region, growth should settle down at around 3%.

MONTENEGRO

Growth in the previous year fell short of expectations: probably not more than 1.3%. It can be attributed to slower growth in exports. The government plans to increase investments in infrastructure and will continue to rely on foreign investments in the tourist sector. Over the current year and in the medium term, growth should accelerate up to as much as 3%. Efforts are being made to join NATO and step up the pace of negotiations with the EU.

SERBIA

The economy slid into recession in 2014. It is expected at best to stagnate over the current year. This is mostly due to the fiscal consolidation measures being planned, as well as to stagnating exports. In the medium term, the government expects recovery that will be driven for the most part by public and foreign investments. It also anticipates support from a three-year IMF programme that was approved at the end of February. Recovery should pick up speed, increasing to about 2% by 2017.

TURKEY

Thanks to the continuing rise in foreign demand and with the help of major government transfers, the Turkish economy is likely to have grown by 3% in 2014. In 2015, we expect GDP to expand by 3.3% owing to the ongoing depreciation of the lira, a rise in transfer expenditures and a slight easing in monetary policy. Growth should even improve in 2016 and 2017 on account of probable cuts in the policy rate, continued government-induced consumption and investment, as well as improvements in net exports.

* * *

BOSNIA AND HERZEGOVINA

The economy suffered a downturn in the aftermath of the disastrous floods in the spring of 2014. That notwithstanding, the GDP recorded a modest increase for the year as a whole. Looking ahead, a strong rebound is anticipated, which may ultimately prove too optimistic an expectation. In the medium term, additional foreign investments and improved absorption of EU funds should contribute to an acceleration of growth. Political risks are on the decline: a trend that should nudge the EU integration process forward.

KOSOVO

The growth outlook for Kosovo had to be revised downwards slightly owing to a longer than expected political stalemate besetting the formation of a new government as well as an exodus of the younger members of the population. However, while the level of economic activity is still extremely low in Kosovo, its dynamics are more promising. GDP growth in both 2014 and 2015 is expected to hover around 4%, mainly on account of strong household consumption fuelled by pre-election public wage increases and a rise in remittances.

* * *

BELARUS

The Belarusian economy has been hit hard by the indirect impact of the recent plunge in oil prices. Thanks to a modest upturn in the second and third quarters, GDP growth for 2014 as a whole remained positive. Faced with severe balance of payments constraints, the authorities have had to accept a sharp depreciation of the exchange rate. The repercussions of the ongoing adjustments will probably result in an unwelcome economic contraction in 2015. Some measure of growth might return in 2016 and 2017.

KAZAKHSTAN

The drop in global oil prices and depreciation of the Russian rouble has led to deterioration in Kazakhstan's economic outlook. In 2015, growth will slow down to 2%, the lowest level since 2009. In the biennium 2016-2017, GDP growth will revive, rising to 3.5% and 4.5%, respectively. The National Bank is likely to embark on a gradual devaluation of the tenge vis-à-vis the US dollar; estimates hint at a figure of by about 15% by the end of 2015. A new economic policy known as *Nurly Zhol* is expected to boost investment in the country over the medium term.

RUSSIAN FEDERATION

Russia was in the direst straits even before the Ukraine crisis erupted on a grand scale. Current sanctions have deterred investments still further, instigated capital flight and boosted inflation. The slump in oil prices and the related collapse of the rouble have inflicted additional pain. Assuming that the sanctions and oil prices remain at their current levels, the wiiw baseline scenario reckons with a 4% drop in GDP in 2015, followed by weak recovery resulting from a gradual revival in government-sponsored investment.

UKRAINE

In 2015, the ongoing military conflict in the Donbas region, the erosion of incomes on account of galloping inflation and the unrelenting collapse of trade and investment will plunge the economy into deep recession for the second year running. Dismal growth prospects, an ever-weakening currency and massive fiscal deficits on the back of huge expenditures on defence will put the sustainability of public debt in jeopardy. A recovery can hardly be expected before 2017, the all-essential pre-requirement being a lasting peace settlement.

Keywords: Central and East European new EU Member States, Southeast Europe, Balkans, Russia, Ukraine, Kazakhstan, Turkey, economic forecasts, secular stagnation, functional distribution of income, wage-led growth, investment, deflation, sectoral financial balances, deleveraging, exchange rates, beta convergence

JEL classification: C33, C50, E12, E20, E29, E65, E66, F02, F34, F62, G01, G18, O52, P24, P27, P33, P52

Table 1 / OVERVIEW 2013-2014 AND OUTLOOK 2015-2017

	GDP real change in % against prev. year					Consumer prices change in % against prev. year					Unemployment (LFS) rate in %, annual average					Current account in % of GDP				
			Forecast					Forecast					Forecast					Forecast		
	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017
NMS-11																				
Bulgaria	1.1	1.6	1.5	1.9	2.3	0.4	-1.6	0.0	1.0	1.5	12.9	11.5	11.0	10.5	9.5	3.0	1.9	1.2	0.7	-0.4
Croatia	-0.9	-0.6	0.3	1.1	1.5	2.3	0.2	0.4	0.5	1.0	17.2	17.3	17.5	16.5	16.0	0.8	0.5	0.2	0.1	0.0
Czech Republic	-0.7	2.0	2.3	2.4	2.4	1.3	0.4	0.4	1.5	1.5	7.0	6.4	6.0	5.8	5.8	-1.4	0.3	-1.0	-1.2	-1.5
Estonia	1.6	1.8	2.0	2.5	3.1	3.2	0.5	0.8	2.2	3.0	8.6	7.4	6.6	6.1	5.8	-1.1	-0.9	-1.5	-2.2	-2.3
Hungary	1.5	3.5	2.3	2.0	2.0	1.7	0.0	1.5	2.5	3.0	10.2	7.7	7.5	7.3	7.2	4.1	4.4	3.8	3.4	3.0
Latvia	4.2	2.5	2.1	2.8	2.8	0.0	0.7	0.8	2.2	2.8	11.9	10.9	10.2	9.6	9.2	-2.3	-3.0	-3.2	-3.5	-3.3
Lithuania	3.3	3.0	2.4	2.9	3.2	1.2	0.2	0.6	1.8	2.5	11.8	11.0	10.5	9.8	9.2	1.6	-0.5	-0.8	-0.9	-1.0
Poland	1.7	3.3	3.5	3.2	3.2	0.8	0.1	0.3	1.5	2.0	10.3	10.0	10.0	9.5	9.0	-1.3	-1.3	-2.0	-2.5	-3.0
Romania	3.4	2.9	2.5	3.0	3.0	3.2	1.4	2.0	3.0	3.0	7.3	7.0	6.8	6.7	6.5	-0.8	-0.5	-0.6	-0.8	-1.0
Slovakia	1.4	2.4	2.5	2.7	3.0	1.5	-0.1	0.4	1.4	1.7	14.2	13.4	13.0	12.5	12.0	1.8	0.7	0.6	0.3	0.4
Slovenia	-1.0	2.5	1.7	1.8	2.0	1.9	0.4	0.5	0.5	1.0	10.1	10.0	9.0	8.5	8.0	5.6	5.9	5.3	4.9	4.2
NMS-11[1)]	*1.5*	*2.7*	*2.7*	*2.7*	*2.8*	*1.5*	*0.3*	*0.7*	*1.8*	*2.1*	*10.0*	*9.4*	*9.2*	*8.8*	*8.4*	*0.0*	*0.1*	*-0.5*	*-0.9*	*-1.2*
EA-19[2)]	*-0.5*	*0.8*	*1.3*	*1.9*	.	*1.4*	*0.4*	*-0.1*	*1.3*	.	*12.0*	*11.6*	*11.2*	*10.6*	.	*2.4*	*2.8*	*3.2*	*3.0*	.
EU-28[2)]	*0.0*	*1.3*	*1.7*	*2.1*	.	*1.5*	*0.6*	*0.2*	*1.4*	.	*10.8*	*10.2*	*9.8*	*9.3*	.	*1.4*	*1.6*	*1.9*	*1.9*	.
Candidate countries																				
Albania	1.4	1.5	2.0	2.2	2.4	1.9	1.6	1.5	1.7	1.7	15.6	18.0	17.5	17.5	17.5	-10.6	-13.5	-13.6	-13.7	-13.7
Macedonia	2.7	3.5	3.5	2.9	2.6	2.8	-0.3	1.5	2.0	2.0	29.0	28.0	27.0	27.0	26.0	-1.8	-2.0	-4.0	-4.0	-4.0
Montenegro	3.3	1.3	2.3	2.6	2.9	2.2	-0.7	1.0	2.0	2.0	19.5	19.0	19.0	19.0	19.0	-14.6	-20.0	-15.0	-15.0	-15.0
Serbia	2.6	-2.0	-0.5	1.0	1.4	7.8	2.9	3.0	3.0	3.0	22.1	17.6	17.0	17.0	17.0	-6.1	-5.9	-6.0	-6.0	-6.0
Turkey	4.1	3.0	3.3	3.5	3.5	7.5	8.9	7.1	6.3	5.7	9.7	9.9	10.5	10.0	9.5	-7.9	-5.8	-5.5	-5.2	-5.2
Potential candidate countries																				
Bosnia and Herzegovina	2.5	0.5	1.6	2.1	2.4	0.2	-0.9	1.0	2.0	3.0	27.5	27.5	26.8	26.5	25.4	-5.9	-9.0	-8.0	-8.0	-8.0
Kosovo	3.4	4.5	3.6	2.9	3.8	1.8	0.4	1.0	1.0	2.0	30.0	30.0	29.0	29.0	28.0	-6.4	-7.1	-7.6	-9.0	-7.7
Belarus[3)]	1.0	1.6	-2.0	1.3	2.0	18.3	18.1	25.0	25.0	18.0	0.5	0.5	0.5	0.5	0.5	-10.4	-5.1	-3.8	-2.7	-2.5
Kazakhstan	6.0	4.3	2.0	3.5	4.5	5.8	6.7	7.5	6.0	5.0	5.2	5.1	5.0	5.0	5.0	0.5	1.5	-4.0	-1.6	0.2
Russia	1.3	0.6	-3.9	1.9	2.0	6.8	7.8	11.0	8.0	6.0	5.5	5.2	5.3	5.3	5.3	1.6	3.0	3.1	3.2	3.1
Ukraine[4)]	0.0	-7.0	-5.0	0.0	1.8	-0.3	12.1	24.0	9.0	6.0	7.2	9.0	11.0	12.0	12.0	-8.8	-4.0	-1.9	-1.8	-1.7

Note: LFS: Labour Force Survey. NMS: The New EU Member States. EA: Euro area 19 countries.
1) wiiw estimate. - 2) Current account data include transactions within the region (sum over individual countries). - 3) Unemployment rate by registration. - 4) From 2014 excluding the occupied territories of Crimea and Sevastopol.
Source: wiiw (March 2015), Eurostat. Forecasts by wiiw and European Commission for EU and euro area (Winter Report, February 2015).

A time of moderate expectations

BY LEON PODKAMINER*

INTERNATIONAL ENVIRONMENT: THE EURO AREA SEIZED BY SECULAR STAGNATION

Im Westen nichts Neues[1]: Contrary to earlier expectations, global output growth (excluding the euro area) slowed down slightly in 2014 to (an anticipated) 3.6% (from an unimpressive 3.7% in 2013). Correspondingly, the rest-of the-world's imports from the euro area grew by 2.3% in 2014 (down from 2.9% in 2013). Global growth (again excluding the euro area) is expected[2] to accelerate in 2015 and 2016 to 4% and 4.2%, respectively (still less than previously assumed), with external demand for euro-area exports increasing by 3.4% and 4.9%, respectively. This (probably modest) rebound in external demand for euro-area exports may add somewhat to the expected GDP growth rates whose point forecasts are estimated at 1,3% in 2015 and 1.9% in 2016 (up from 0.8% in 2014). Those forecasts, however, cannot be considered precise in any way as their 'confidence bounds' are quite wide. All in all, the euro area remains a depressed region. In 2015, growth in all other advanced economies (except Japan) is expected to outstrip the euro area by some 2 percentage points. Euro-area imports (including the intra-euro area imports) are set to rise in 2015 and 2016 – greater than the figure of 3.3% recorded in 2014. This also suggests that exports to the euro area by both the transition countries and the NMS (including those that have not yet joined the euro area) might perform slightly better in 2015 than in 2014, and in 2016 better than in 2015.

'Extraordinary measures' taken by the euro-area authorities remain inconsequential. Downward revisions for the euro area (and for its three largest economies) indicate that the impact of the 'extraordinary' policies announced by the European authorities is generally expected to be negligible, at best. The policies in question include Mr Juncker's investment initiative and the European Central Bank's resolve to run a proper Quantitative Easing programme on a massive scale. Markets and professional forecasters alike have factored in both policies. There is good reason to believe that in those particular instances 'the market sentiment is right' and that - given the circumstances - neither policy can do much good, at least in the foreseeable future[3]. It is possible that the above initiatives do not inspire much confidence owing to the fact that fiscal consolidation programmes are still in force that envision further cuts in the budget deficit for the euro-area countries in the biennium 2015-2016. However, if either initiative is to have an impact, fiscal policy must be more relaxed. In more recent analyses, other leading international economic institutions have also scaled down their forecasts of

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1 The German title of E.M. Remarque's famous novel about the Great War 1914-1918 (the English title being *All Quiet on the Western Front*), which describes the intra-European 'war of attrition' over that period.

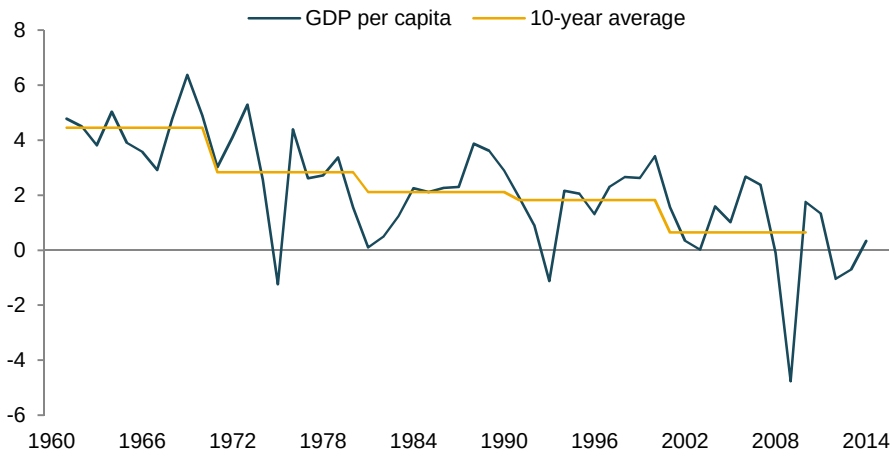
2 Source: ECB, Eurosystem Staff Macroeconomic Projections for the Euro Area, Dec. 2014.

3 See the special section I to this report: 'President Juncker's EUR 315 billion initiative: an investment plan for Europe'.

output growth – both globally and for the major countries and groups of countries (although as a rule, they tend to exclude the USA). The IMF World Economic Outlook Update (released on the 19 January 2015) is a case in point. Massive downward revisions are only to be expected in the major oil-exporting countries (including Russia and Kazakhstan, of course). But it is worth adding that the revisions do not affect the differentials between the growth rates forecast for the euro area compared to other advanced economies. A drop in world market prices for energy carriers (which recent forecasts have factored in) would fail to improve the outlook for the euro area substantially. Moreover, the anticipated (and duly factored in) depreciation of the euro vis-à-vis the dollar does not seem to matter - as far as performance in the euro area as a whole is concerned.

The euro area – and thus the EU as a whole – has been seized by secular stagnation. It is commonly believed that the current stagnation was triggered by the global financial crisis of 2008. Moreover, it is believed that the crisis released forces that have since prevented the resumption of rapid growth, which allegedly characterised the earlier decades. Opinion on current stagnation differs on many counts. There seems to be the common belief that 'monetary factors' (such as those pertaining to the 'zero lower band') are crucially co-responsible for the post-2008 predicament. All opinions tend to emphasise the need for 'difficult, but uncontroversial reforms' (i.e. further structural reforms on the supply side) as the prime means of ending stagnation[4]. However, the current stagnation seems to represent the latest stage in the longer-term – truly secular – development, and it is not necessarily an outcome of a massive stroke of bad luck (or an 'exogenous shock' hitting an otherwise smoothly functioning world economy). Since the mid-1970s, growth in the area (which subsequently morphed into the euro area) has been slowing down and at the same time it is becoming increasingly unstable (Figure 1). Interestingly enough, the slowdown in output growth seems to have had nothing to do with labour-productivity trends. Over the period 1975-2008, real GDP per employed person in the euro area grew quite steadily at about 1.6% per annum.

Figure 1 / Euro area (12 original members) – per capita GDP growth rate (%), 1960-2014



Source: Own calculations based on AMECO database.

[4] See, for example, the extensive presentation of the opinions on secular stagnation held by prominent economists collected in a recent VOX volume edited by Teulings and Baldwin (2014).

The secular slowdown in growth in the euro area can be attributed to the process of policy reorientation that started in the first half of the 1970s. Progress towards policy-directed liberalisation (internal as well as external) was just one aspect of the new post-1975 paradigm. Since the end of the era of full-employment, the wage share has been following a downward trend. This is not an exclusively market-driven development. Policy has been very actively supporting a 'secular trend towards wage moderation'. Under such conditions, growth in private consumption has been slowing down in secular terms as well; at the same time, it has become more volatile. The rising profit (non-wage) shares (as well as profitability), however, have not transformed into higher domestic investment. The latter has dipped sharply and exhibited violent ups and downs. Simultaneously, fiscal policy has also undergone a creeping change in direction evidenced by a gradual slowdown of growth in public consumption, a growing burden of indirect taxation and a reduction in the burden imposed by corporate taxation. In addition, unlike the United States or the United Kingdom, the euro-area authorities are pursuing an impossible goal of achieving fiscal balance (or even securing some measure of permanent surplus). All in all, the reasons for continuing secular economic stagnation in the euro area are not cloaked in mystery [5].

In all likelihood, growth in the CESEE countries that are associated, one way or another, with the European Union will follow the unimpressive growth pattern displayed by the euro area. This is a natural consequence of those countries' growing integration into the EU. Integration (be it material [through trade, finance and production networks] or 'immaterial' [through the adoption of the 'common policies' elaborated in Brussels or Frankfurt]) is likely to determine the fates of the CESEE countries – and not only in the long term. In fact, current developments in the NMS also seem to be increasingly affected by those tendencies that have long characterised the 'old' EU. To some extent, the same applies to most candidate countries from the Balkans. Although growth in the NMS is certain to be more rapid than in the 'old' member states (also on account of the sizeable net transfers still emanating 'from Brussels'), current longer-term estimates suggest a drawn-out process of income convergence with the more developed EU member states. Furthermore, that 'convergence' is by no means assured across the board.[6] This claim is supported formally by the results of an analysis of income convergence over the past two decades (see Box 1).

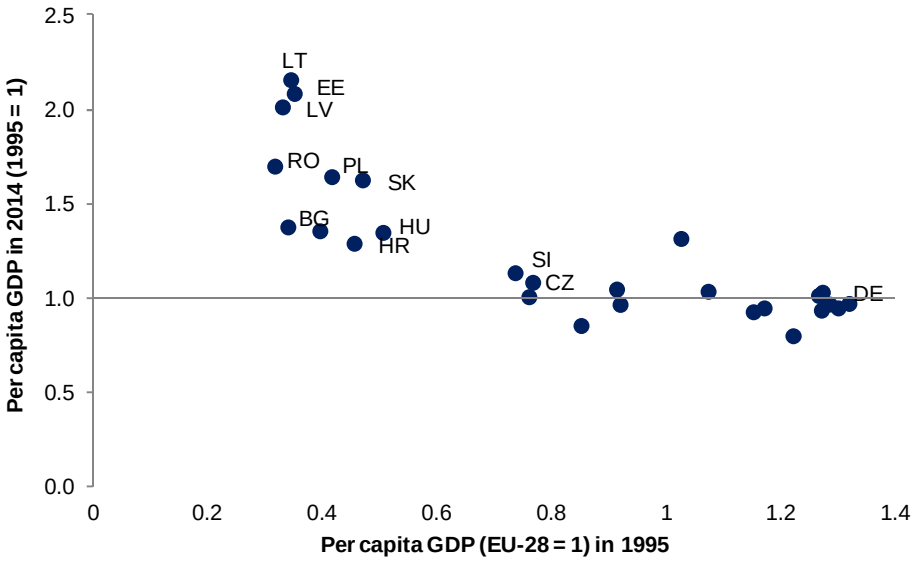
[5] For an extensive analysis of macroeconomic determinants of the euro area's secular stagnation see L. Podkaminer: 'The Euro Area Secular Stagnation and What Can Be Done about It: A Post-Keynesian View'. *Real World Economics Review*, No. 70, (Feb. 2015).

[6] Until 2008 optimism prevailed concerning the Southern European 'cohesion countries' (and Italy) quickly catching up with the developed EU core. Since then, their divergence rather than their convergence is to be observed.

BOX 1 / THE LONGER-TERM GROWTH PATTERN: EVIDENCE OF BETA-CONVERGENCE

There is some evidence of growth across the EU member states (including the NMS) being consistent with the so-called beta-convergence hypothesis. According to this hypothesis (first theoretically derived from Robert Solow's neo-classical growth model) in the longer term countries' growth rates are negatively correlated with their income levels. Roughly speaking, the higher the income achieved, the slower its further growth.

Figure 2 / The longer-term growth pattern: evidence of beta-convergence



Source: Own calculations based on AMECO database.

The scatter plot in Box Figure 2 illustrates this regularity for all individual EU countries (excluding Malta and Luxemburg, but including Turkey). The change in per capita GDP (at current purchasing power parities) of individual countries compared to the average for the EU as a whole (28 countries) is measured along the vertical axis. The change in question is defined as Y_{2014}/Y_{1995}, where Y_{1995} and Y_{2014} are the p.c. levels of PPP GDP in 1995 and 2014 respectively (vs. the average p.c. PPP GDP levels for the EU-28). The initial p.c. income level (i.e. Y_{1995}) is measured along the horizontal axis.

Evidently, the lower-income countries (primarily NMS and Turkey) have performed strongly compared to the 'average', while the medium-income countries (including Slovenia and the Czech Republic) did not. Finally, some of the high-income countries have lost compared to the 'average' (which is consistent with the Solow's growth model – as well as with common sense).

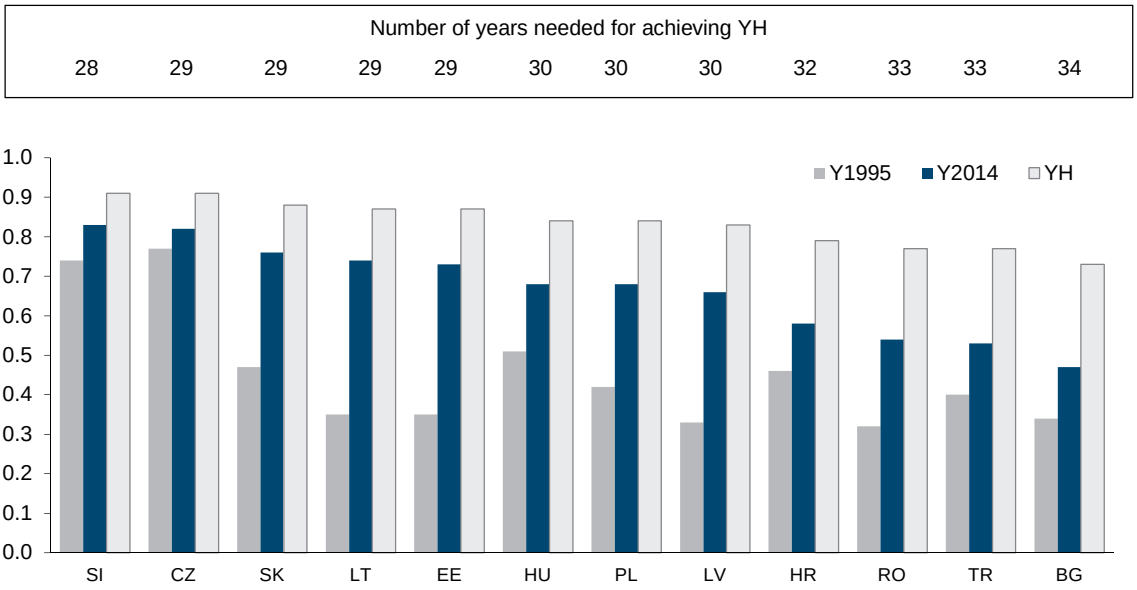
A regression function fitted to the data from the Box Figure 2 has the following logarithmic form:

$$\text{Log}(Y_{2014}/Y_{1995}) = a + c\ \text{Log}(Y_{1995})$$

The estimated regression coefficient 'c' (-0.404) implies the 'annual speed of convergence' equal -2.6% (For details see ANNEX 1). This estimate indicates that convergence in the EU has been somewhat faster than the 2 per cent 'customarily' (on average) revealed for other regions and/or time periods. Using the above formula specified with beta equals -2.6%, one can calculate the number of years needed for individual NMS (and Turkey) to halve the distance from the average p.c. GDP for the EU-28 (see Box Figure 3). It appears that halving the current 'distance from the average' can be expected to take about 30 years or more (in the case of the poorer countries).

Figure 3 / Per capita GDP at PPP (EU-28=1)

In 1995, 2014 and the GDP level at which the distance from the average for EU-28 is halved (YH), and the number of years needed for achieving YH.



Source: Own calculations based on AMECO database.

Not all is quiet on the Eastern front. A final settlement of the Ukrainian conflict is hard to foresee. In the meantime, the conflict has a major impact on Ukraine and – to a lesser extent – on Russia and Belarus. Sanctions imposed on Russia have had some negative impact on the country's economic performance. The conflict has also hurt – indirectly – some NMS (primarily the Baltic countries) - not solely on account of the drop in Russian demand for imports in general. The Russian counter-sanctions (in the form of embargos on specific goods) affect some NMS export specialities (such as foodstuffs). All in all, the Ukraine conflict, though bitterly painful for Ukraine itself, continues to be of minor economic importance for most of the CESEE economies.[7] For Russia (as well as Belarus and Kazakhstan), it is the slump in oil prices that has had a devastating effect on the economy.

[7] wiiw Autumn 2014 Forecast Report contains detailed quantitative assessment of economic impacts of the Ukraine conflict for the CESEE.

INSUFFICIENCY OF DOMESTIC DEMAND: THE MAIN FACTOR BEHIND RECENT DEVELOPMENTS IN THE NMS

Growth in 2015-2017 is not going to deviate substantially from the pace recorded in 2014. As can be seen from Table 1 GDP growth rates calculated for the 11 NMS for 2014 and 2015-2016 are essentially the same. Moreover, GDP forecasts for the candidate countries also display remarkable stability. Understandably, forecasts for Russia and Ukraine are less stable. In itself the stability in question as forecast could be seen as a positive development. However, it must be conceded that those growth rates are rather modest. Growth at the rates forecast still yields a comparatively high level of unemployment (Table 1). It should also be noted that the differential between the average growth rates in the NMS and euro area is expected to decline systematically. This is hardly a positive development because the convergence in growth rates (NMS compared to the euro area) undermines any prospects of convergence in the levels of GDP. (Worse still, even convergence of CESEE income levels with the euro-area average level would not be a truly satisfactory outcome. Were the euro area to lose out to the rest of the world, the CESEE countries would be losing out to the rest of the world as well).

Depressed aggregate demand has been a factor behind anaemic growth. In 2014 the vast majority of CESEE countries experienced moderate deflationary tendencies coming after a period of relatively marked disinflation in the biennium 2012-2013 (see Table 1). The 2014 inflation rate in the NMS was even lower than that in the euro area. Both were positive – but rather symbolic in nature. In both cases, weakness in aggregate demand (and in the demand for consumer goods and services, in particular) must have been an important reason for the unusually strong 'price moderation'. Weak aggregate demand tends to accompany 'wage moderation' and stable or falling unit-labour costs. Inflation is now forecast to return gradually to normal (i.e. 'desirable') levels (around 2 per cent) by 2016. However, in most cases, inflation in 2015 is expected to remain very low indeed, indicating continuing slack in aggregate demand[8]. Of course, this may not apply to the notorious inflationary outliers (Turkey, Belarus, Russia and Ukraine) where the cost-push considerations (for example, in relation to steep currency depreciations) may prevail over the consequences of inadequate aggregate demand. The expectation of high and rising inflation may feed on itself too, by prompting precautionary purchases. In Ukraine, these factors may be combined with a reduction in aggregate supply, caused by the destruction of some of its productive capacity (and disrupting production, exchange and payments).

The drop in oil prices has not had a significant impact on disinflation (and deflation). A drop in (and very low) inflation is not necessarily an outcome of lower oil prices. In a number of CESEE countries, disinflation was quite marked in 2013 - prior to the fall in international prices for crude oil and other energy carriers. Of course, the decline in energy carrier prices in the second half of 2014 is likely to affect overall inflation in 2015. Feeding the lower energy prices into the final inflation index will take time, while not necessarily being complete[9].

Moderate deflation may have supported growth to a certain degree. Major extensive and rapid ('galloping') deflation is believed to have the potential to deepen recession because, under such conditions, households might tend to postpone purchases of certain consumer items in expectation of their prices dropping still more. However a moderate (and largely unexpected) deflation of the type

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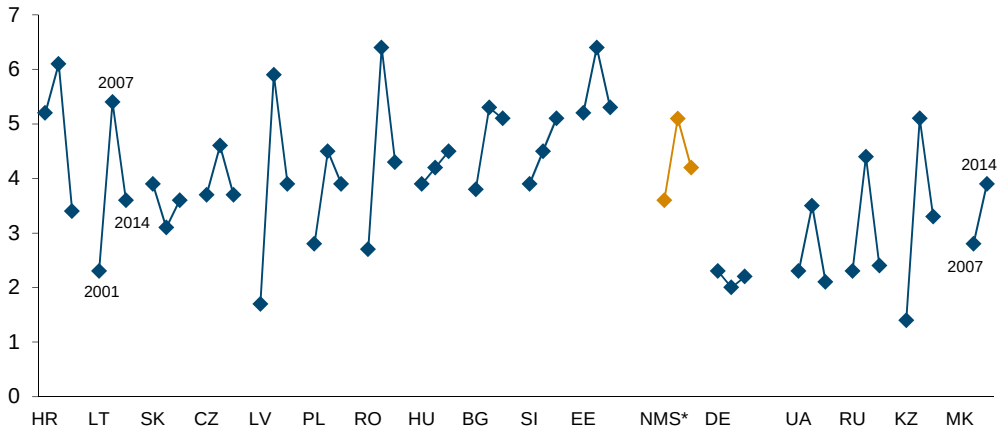
[8] Conceptually, inflation could be 'explained', at least partly, by reference to the size of the 'output gap' or to the level of the economy's 'underutilised production capacities'. The practical issue here is that the measurement of either the 'gap' or the 'capacity utilisation rate' lacks firm methodological foundations. The European Commission publishes some estimates of the 'gap' – also for the NMS. But these do not correlate with actual inflation.

[9] See the special section II to this report: Energy prices, inflation and growth in the CESEE countries.

recently observed might have a rather positive impact on consumer demand. Nominal wages and social benefits tend to adjust, even if not fully, to moderately rising consumer prices, while they adjust fairly sluggishly to cost-of-living indices - if at all. Nominal wages and social benefits, however, do not appear to be adjusting to occasionally *falling* consumer prices and cost-of-living indices. It follows that mild deflation could increase the real purchasing power of wages and social benefits, thereby supporting some growth in aggregate demand. The return to 'inflationary normalcy' in the period 2016-2017 would eliminate additional 'unexpected' gains in terms of the purchasing power of wages and other regular income[10].

Growth in public gross fixed capital formation (GFCF) may be encouraging overall growth. Public sector GFCF in the NMS is consistently higher than in Germany, for example (Figures 4 & 5). This is obviously related to: (i) the badly needed upgrading of physical infrastructure in those countries; and (ii) the availability of EU funds directed towards such upgrading programmes. In 2015, public infrastructural investment co-financed by the EU under the 2007-2014 framework may still be quite high. It is less certain whether the new projects to be realised under the current multi-year framework can guarantee a sufficiently large volume of public GFCF in 2016. There is also some uncertainty about the relationship between the volume of private GFCF and that of public GFCF. The notion that high public investment tends to be associated with high private investment suggests that public policy (on investment) is actually pro-cyclical. The comparatively high levels of public investment in the NMS in the period around 2007-2008 (just at a time when private investment also peaked) support the notion that public and private investments tend to 'complement' each other. However, on closer scrutiny the data available indicate that the correlation between the annual growth rates of public and private GFCF was not statistically significant in any of the NMS, at least not after 2009 (see Annex 3: *Public and private investment in the NMS: casual companions*).

Figure 4 / GDP shares of public gross fixed capital formation, 2001, 2007, 2014 in %

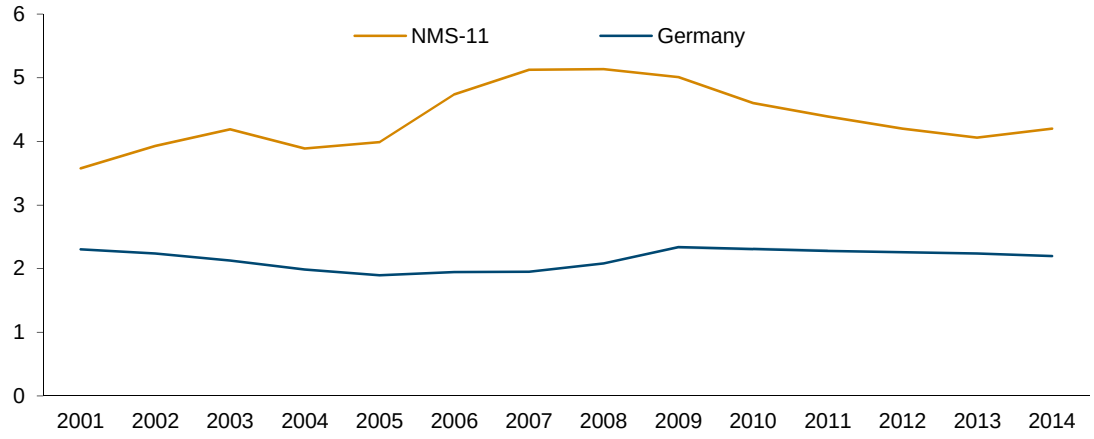


Remark: *NMS average, unweighted, UA, RU, KZ, MK data 2014 refer to 2012.
Source: National statistics and AMECO database.

[10] Mild deflation in producer prices may be less advantageous to producers as it might depress the value of their sales and profits, thereby interfering not only with current operations but also with the servicing of debts. Sharp deflation may also imply unduly high levels of *real* interest rates on loans. That way a prolonged and meaningful deflation in producer prices may limit a firm's ability and willingness to engage in the investment of fixed assets.

Outside the NMS, public GFCF is quite low. In 2007, public GFCF also peaked in Ukraine, Russia and Kazakhstan. However, the share of public GFCF in GDP in those countries is consistently lower than in the NMS. Most probably the same holds true for the remaining CESEE countries for which data on public GFCF are not available. Of course, the infrastructural needs of those countries are much higher than the needs of the NMS[11]. The apparent failure of the governments of non-EU CESEE countries to do much to meet those needs may be due to various factors. In the countries in the Western Balkans, the reasons may be related to the lack of proper expertise and the marked political fragmentation of the region, as well as to budgetary constraints (as in Ukraine). The reasons for the apparently low level of public GFCF in Russia and Kazakhstan are less obvious. The EU membership of the NMS may have had a positive impact on public GFCF, not only by providing some co-financing of infrastructural investment, but also by imposing some infrastructural standards (such as those relating to transportation and environmental protection).

Figure 5 / GDP share of public gross fixed capital formation, 2001-2014
The NMS and Germany

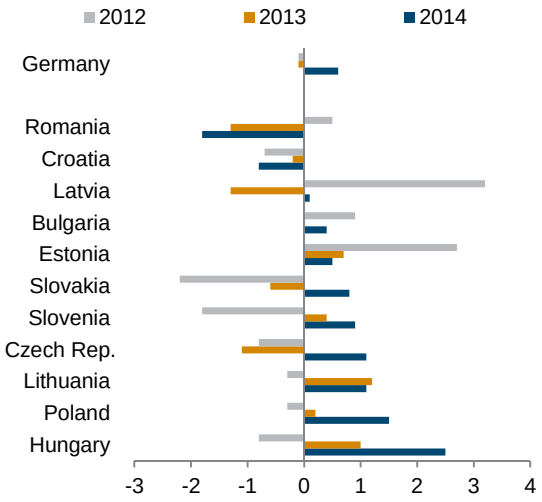


Source: AMECO database.

In the NMS, private GFCF is likely to rebound from the current depressed levels. According to provisional AMECO data, in 2014 GFCF in the private sector (with corporate and households lumped together) increased quite significantly in some NMS (while performing weakly or even contracting in others). Private sector GFCF has been quite volatile everywhere (except Estonia). This is borne out by Figure 4 which, based on AMECO data, shows estimates of the contribution of private sector GFCF to GDP growth in the period 2012-2014. On the whole, 2014 'looks better' than 2013 and much better than 2012 (although that does not apply to Romania and Croatia).

[11] The EBRD Transition Reports routinely document the levels of infrastructural backwardness of the non-EU CESEE.

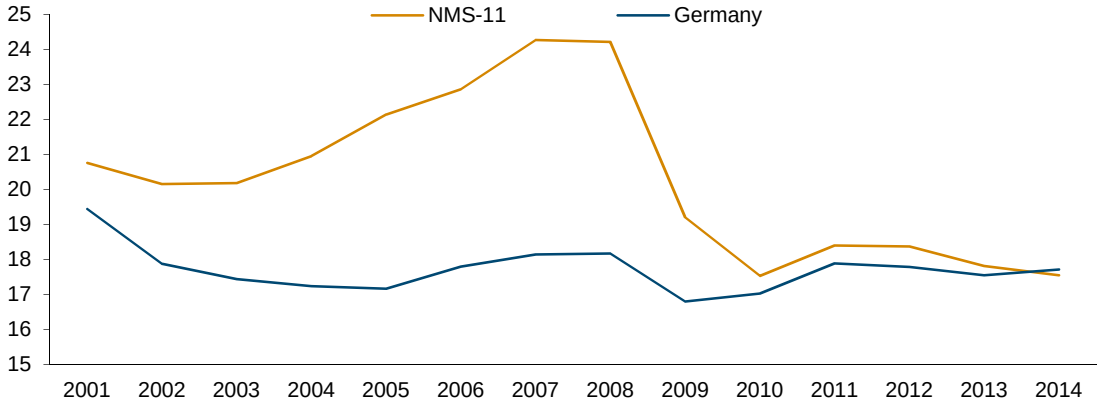
Figure 6 / Contribution (percentage points) of private sector gross fixed capital formation to GDP growth



Source: AMECO

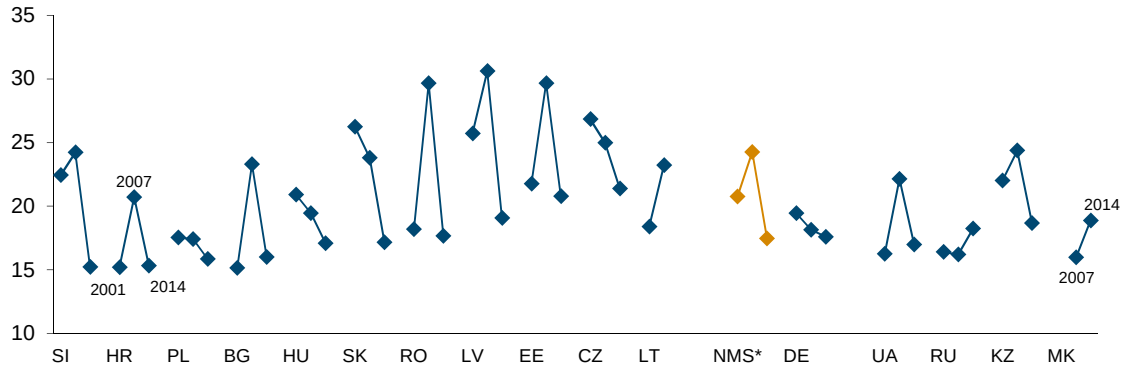
A real rebound in private sector GFCF, however, has yet to come. As can be seen in Figures 7-8, the share of private sector GFCF in GDP at present falls short not only of the levels recorded for 2007 (which were clearly overinflated owing to the unsustainable real estate booms in the Baltic countries, for example), but it also falls short of the levels recorded in the early noughties – prior to the boom (which started around 2004 when the NMS joined the EU only to crash in 2007-2008). At present, the share of private GFCF in GDP matches the levels recorded in Germany at the close of the 1990s. Clearly, a GFCF share of 20% might have been suitable for Germany given its level of development at the time. That self-same level, however, cannot suffice for countries whose level of development is even now far lower than that of Germany in 2000. Unfortunately, the expected (moderate) accretion in overall GFCF in most NMS in tandem with a probable gentle rise in the share of private GFCF in GDP expected for 2015 will lend only modest impetus to aggregate demand growth. The otherwise unimpressive share of private GFCF in GDP in Ukraine and Russia is very likely to plummet in 2015. A further decline might also be expected in Kazakhstan.

Figure 7 / Share of private sector gross fixed capital formation in GDP



Source: Own calculations based on AMECO database.

Figure 8 / Share of private gross fixed capital formation in GDP, 2001, 2007, 2014

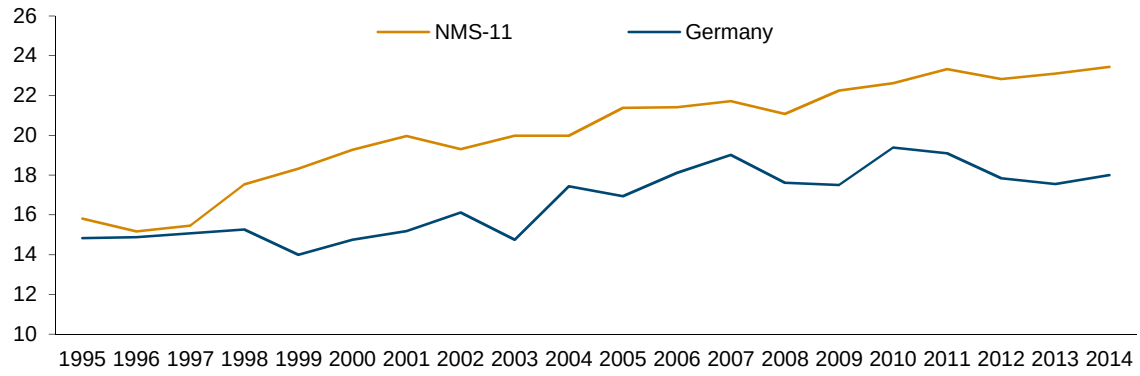


Remark: *NMS average, unweighted, UA, RU, KZ, MK data 2014 refer to 2012.
Source: National statistics and AMECO database.

INVESTMENT: UNCONSTRAINED BY THE AVAILABILITY OF FUNDS

Weak private GFCF is unlikely to follow a 'profit squeeze' in the corporate sector. Corporate sector gross disposable income rises much more rapidly than household disposable income: the corporate sector share in private gross disposable income has been on the rise since the late 1990s (Figures 9-10). This tendency (much more pronounced in the NMS than in Germany) not only reflects the trend towards the suppression of wages: a policy pursued by most of the NMS and Germany, as well as by the majority of euro-area countries. (The Balkan countries, for which comparable statistics are patchy, most probably follow this trend as well). Furthermore, the trend in question may also be positively reinforced by the ongoing changes in social policy (such as downsizing entitlements and cutting pensions), as well as by the changes in fiscal systems (progressive reduction of tax rates on corporate income combined with unchanged or higher tax rates on labour income). All in all, the net returns on capital stock in most NMS have not declined as compared to the early 2000s[12].

Figure 9 / Share of the corporate sector in private gross disposable income, in %

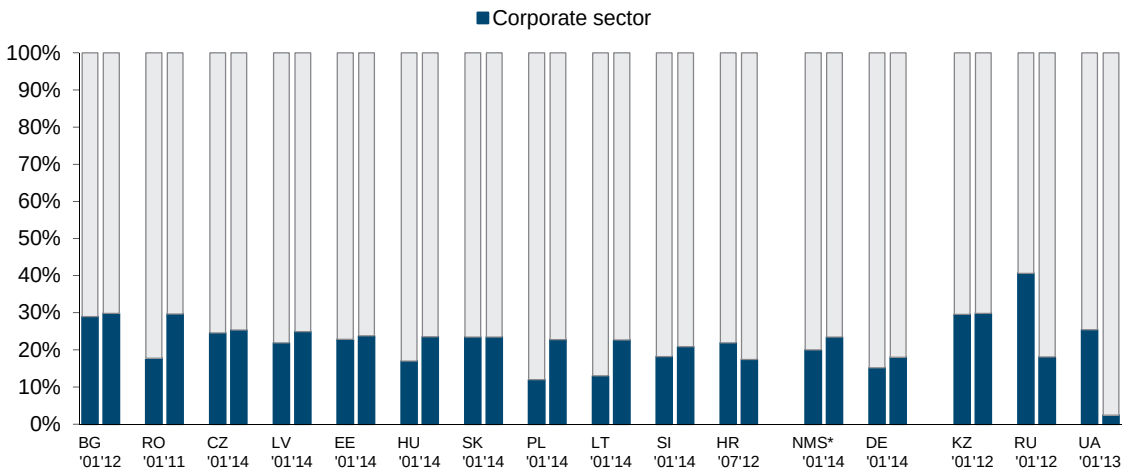


Source: AMECO database.

[12] The AMECO (estimated) net returns/net capital stock ratios for 2014 were lower than their averages for the period 2000-2003 in Bulgaria, Estonia and Slovenia (by 30.5%, 25.3% and 23.3%, respectively). In Hungary, the Czech Republic, Lithuania, Latvia, Slovakia, Poland and Romania the ratio increased by 5.5%, 10.4%, 22%, 27%, 37.6%, 49.7% and 89.1%, respectively. In Croatia the ratio remained almost unchanged (falling by 0.4%); in Germany it rose by 9.2%.

The question arises whether profits have been suppressed in Russia and Ukraine. According to official statistics, the share of the corporate sector in private gross disposable income in Russia dropped by more than half over the period 2001 - 2012. An even sharper contraction is reported for Ukraine. These figures do not inspire any confidence (especially in respect of Ukraine). In all probability, the concept of 'disposable income' as generally understood is interpreted differently in Ukraine and Russia[13].

Figure 10 / Share of the corporate sector in private gross disposable income, in %



Source: National statistics and AMECO database.

The NMS corporate sectors as a whole still tend to lend rather than borrow. A normal (and desirable) situation obtains when the corporate sector is a net borrower and the household sector is a net lender. The financial balance of the private sector as a whole should then be roughly balanced (or rather show a modest surplus, equivalent to net borrowing (typically positive) by the public sector (corrected for net lending abroad)). Such a pattern was not uncommon before 2004 (see the entries for Poland and Romania in 2001 in Table 2, for example). In 2007 (and around that time) most NMS displayed a highly abnormal pattern – with both companies and households borrowing heavily (eventually abroad). Of course, it was part and parcel of the bubble ballooning at the time that eventually burst around 2008.The post-2009 developments are also abnormal. Either they show that both households and firms are net lenders (as in Slovenia, for example, since 2012) or they point to households once again being net borrowers, while companies are net lenders (as in the case of Latvia, Lithuania and Poland).

The NMS corporate sector appears to dispose of plentiful financial means at present. Insufficiency of current financial means that the corporate sector as a whole has at its disposal does not seem to prevent the recovery of gross fixed capital formation. Of course, it must be recalled that some firms (be they financial or non-financial) may be net lenders, while others are net borrowers. Some may have surpluses of cash (and other liquid financial assets), while others may not. Finally, some may have incurred large debts against others (or vis-à-vis foreign parties). In particular, some non-financial firms

[13] Perhaps the statistics on disposable income in the two countries allow somehow for the cross-border flight of income earned by 'oligarchs'.

currently acting as net lenders may still be indebted to banks, for example. Depressed private GFCF in face of positive net lending by firms could thus reflect the inability and/or unwillingness of firms to increase their (possibly excessive) indebtedness. It is quite possible that firms in the Baltic countries, Romania, Bulgaria and Slovenia have not yet reduced the burden imposed by the excessive debts that they incurred during the runaway investment boom that ultimately collapsed in the period 2007-2009. That diagnosis need not apply so much to the other NMS that did not participate in the boom (Poland and the Czech Republic, in particular). The fact that the corporate sectors in those countries (as well as in Germany) are net lenders may reflect more the expectation that overall demand would continue to be weak. An expected weakness of that kind is likely to encourage savings, paying back debts and loaning currently available financial means. It may well deter financing the expansion of their own fixed productive assets.

Table 2 / Net lending by corporate and household sectors (in per cent of GDP)

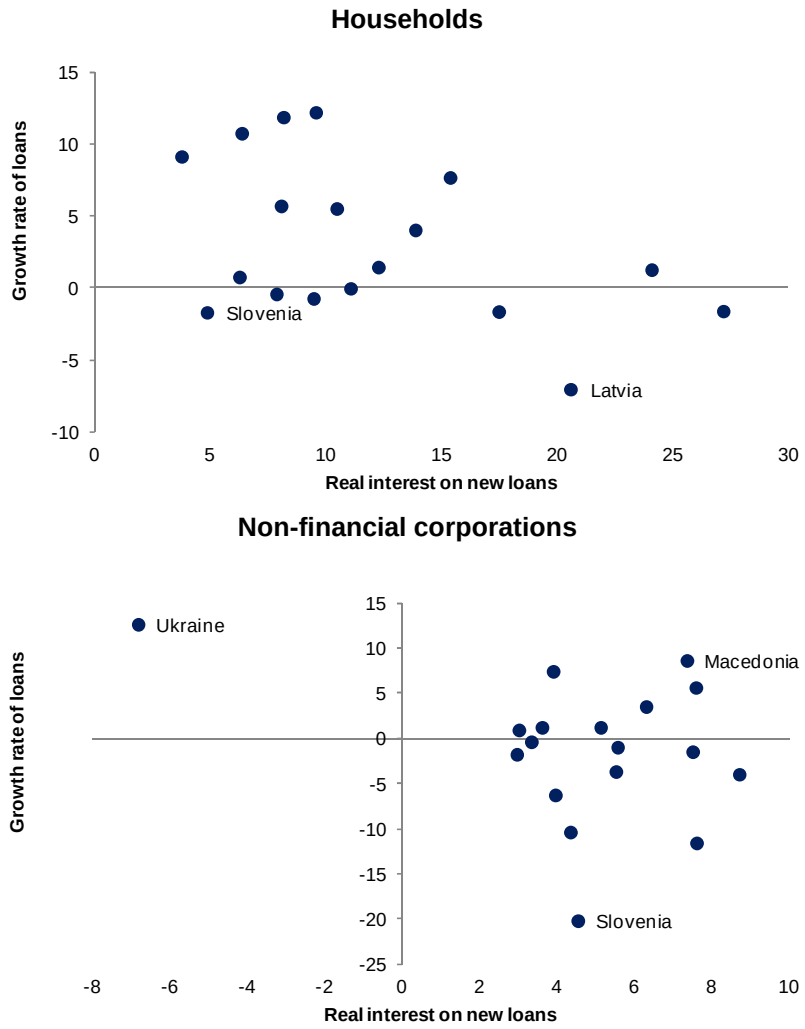
Net lending (+) or net borrowing (-): corporations and households, % GDP

	2001 Corporations	2001 Households	2007 Corporations	2007 Households	2014 Corporations	2014 Households
Bulgaria	6.4	-12.4	-14.0	-12.8	5.4[a]	-4.8
Czech Republic	-0.8	2.3	-4.9	1.5	1.0	1.7
Estonia	-4.1	-0.7	-9.4	-7.5	-0.2	0.5
Croatia	-4.7[c]	2.7[c]	-3.6	-1.5	0.2[a]	4.0[a]
Latvia	-2.9	-3.0	-10.7	-8.1	7.3	-5.4
Lithuania	-1.5	0.3	-7.5	-4.8	8.2[b]	-2.5[b]
Hungary	-3.4	2.1	-2.5	1.1	6.7	3.2
Poland	-3.4	6.3	-2.9	-0.3	6.5	-3.0
Romania	-21.0	19.3	-9.8	-0.6	9.5[d]	-7.7[d]
Slovenia	-1.5	4.4	-8.6	4.6	4.8	5.9
Slovakia	-0.8	0.1	-2.0	-1.2	5.1	-0.3
Germany	-1.9	4.5	1.3	5.4	2.5	4.9

a: 2012, b: 2013, c: 2002, d: 2011.
Source: AMECO.

Loans to firms are stagnating even in those instances where interest rates are relatively low. With a few exceptions (largely on the region's periphery) the stocks of loans to the non-financial corporate sector declined in 2014 (or at best increased only marginally). It was only outside the NMS that the stocks of loans to households rose more palpably. In 7 out of 11 NMS, the stocks of loans to households contracted. (Only in Slovakia and Poland did the stocks of loans to households increase visibly – by 12 % and 5.4%, respectively). In contrast, the stocks of loans to households have been rising strongly in all non-EU CESEE countries, very much irrespective of the prevailing interest rates on new loans. To some extent, the rising stocks of loans do not yet reflect an increase in new loans, but rather the impact of depreciation suffered by domestic currencies (viz. Russia and Ukraine) that inflated the value of loans denominated in foreign currencies.

Figure 11 / Real interest rates on new loans and growth rates of loan stocks, CESEE, 2014, %, end of period



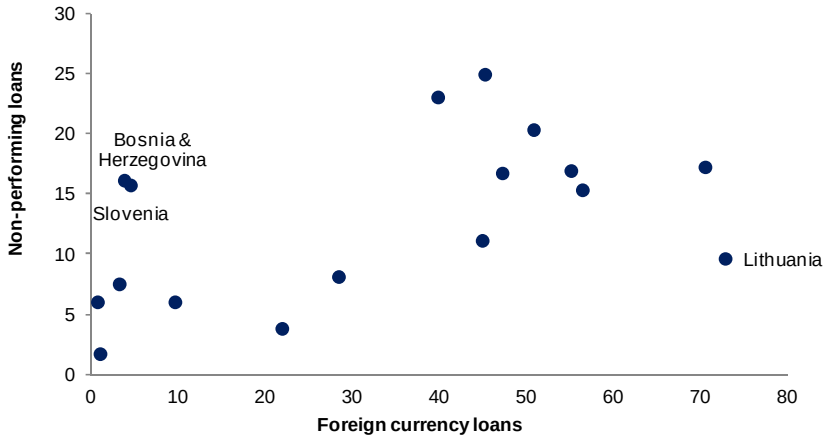
Source: National bank statistics, wiiw own calculations.

The reluctance of households to indebt themselves seems quite understandable, given the comparatively high levels of interest rates on loans they could draw from banks. However, the interest rates charged to corporate borrowers seem quite moderate (around 5% per annum) in most cases. The fact that low real interest rates do not seem to stimulate borrowing may reflect many different developments, starting with the non-financial firms' pessimistic assessment of future demand trends, increased 'liquidity preferences' or simply the abundance of the financial means at their disposal. (In actual fact, the bank deposits of both non-financial corporations and households increased massively in 2014 (excluding Bulgaria, Latvia and Slovakia).

Non-performing loans are linked to a high share of borrowing in foreign currencies. The recent strengthening of the Swiss franc will bear some negative repercussions for the firms and households that borrowed heavily in that currency in the past. Thus far, the share of non-performing loans in total loans extended to households and non-financial corporate sectors has not changed perceptibly compared to the levels reported at end-September 2014 (or end-2013). Interestingly enough, there

seems to be a positive link between the share of non-performing loans and the share of loans denominated in (or indexed to) foreign currencies (See Figure 12), with a few understandable exceptions (Russia and members of the euro area) where a high share of foreign-denominated loans tends to be associated with a high share of non-performing loans. This regularity is relatively simple to explain. Primarily, borrowing large amounts in foreign currencies tracks the high differentials between domestic and foreign interest rates. However, should domestic monetary policy – for whatever reason – maintain domestic interest rates at rather high levels, it is likely to suppress GDP growth. In effect, such a policy may result in domestic disposable income growing at a speed that might not guarantee ability to service that debt.

Figure 12 / Share of foreign currency and non-performing loans in total non-financial private sector loans, CESEE, 2014, %, end of period



Definition of non-performing loans: Loans that are more than 90 days overdue, (also classified as substandard (C), doubtful (D) and loss (E)).
Source: National bank statistics, wiiw own calculations.

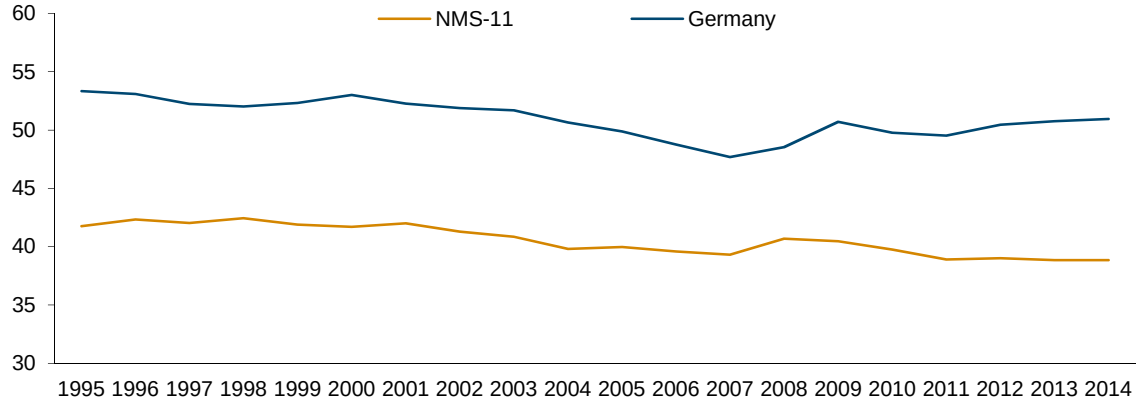
GROWTH: WAGE-LED RATHER THAN PROFIT-LED

The presence of a 'race to the bottom' in wage setting is visible. Until 2002, the average (weighted) share of employee compensation in GDP (which lumps together gross wages earned by employees and non-wage labour costs incurred by the employers) calculated for 11 NMS hovered around the 41% mark (see Figures 13, 14). Since then, the share has been dipping downwards, briefly touching the 40% mark in 2008 and 2009. For 2014, the provisional estimate for the average compensation share (based on AMECO data) is as low as 38.7%[14]. The same trend is undoubtedly prevalent outside the NMS. This is evident in the case of Macedonia where the compensation share has declined from 47% in 1997 to less than 35% in 2014. It should be noted that even in countries where the reported compensation shares seem to have increased in recent years (viz. Bulgaria), the shares are still much lower than in Germany.

[14] The data on compensation shares in the MNS are probably strongly affected by the ongoing structural change. Thereby the share of agriculture in total employment has been falling very fast (e.g. in Romania from 45% in 2000 to 31% in 2010, or in Bulgaria from 24% to 19% respectively). Very likely the change in question is combined with a change in occupational status. The former 'self-employed' are becoming 'wage earners'. Without that change, the drop in the average compensation shares reported would have been much more pronounced.

The compensation share's tendency to decline over the longer term is characteristic of the euro area as well. It is most visible in Germany where the compensation share contracted by close to 5 percentage points between 1995 and 2008. That radical fall in the German wage share (recently interrupted) has secured the country's extraordinarily strong position in external trade[15]. Actually, all euro – area countries are trying to emulate the German wage-share pattern - or else they will lose out in terms of foreign trade. The NMS – especially those countries that have adopted the euro – cannot but face the same choice. Neither alternative is terribly attractive in the long (or even medium) term. Not allowing the wage share to fall ultimately contributes to a growing external trade imbalance and an accumulation of foreign debt, which sooner or later will call for painful adjustments to domestic absorption. On the other hand, attempts to keep up with the wage-and-productivity developments in Germany limits the risks of widening external imbalances; however, it also more or less guarantees that domestic demand remains anaemic - as has been the case in Germany itself[16].

Figure 13 / Share of employee compensation in GDP, in %



Source: AMECO database.

The former Yugoslav republics display high employee-compensation shares. The GDP compensation shares were recently quite high in both Bosnia-Herzegovina and Serbia. The share used to be high in Macedonia, although it has been falling recently. Despite a slight diminution, the employee-compensation share is still pretty high in Slovenia. It has been quite high (and is even rising) in Croatia. All the countries listed above are heirs to socialist Yugoslavia. The Yugoslav system of labour-managed firms differed from systems developed elsewhere in the region. In the Yugoslav system, the employees had some say in 'their' firms' affairs. Permanence of the relatively high GDP compensation shares may have been one element inherited from the past. A reluctant embrace of full-scale privatisation (and continuing opposition to the sell-out of national property to foreigners) may have been a second factor. Of course, high and rising labour shares are not enough to support strong growth. Other conditions have

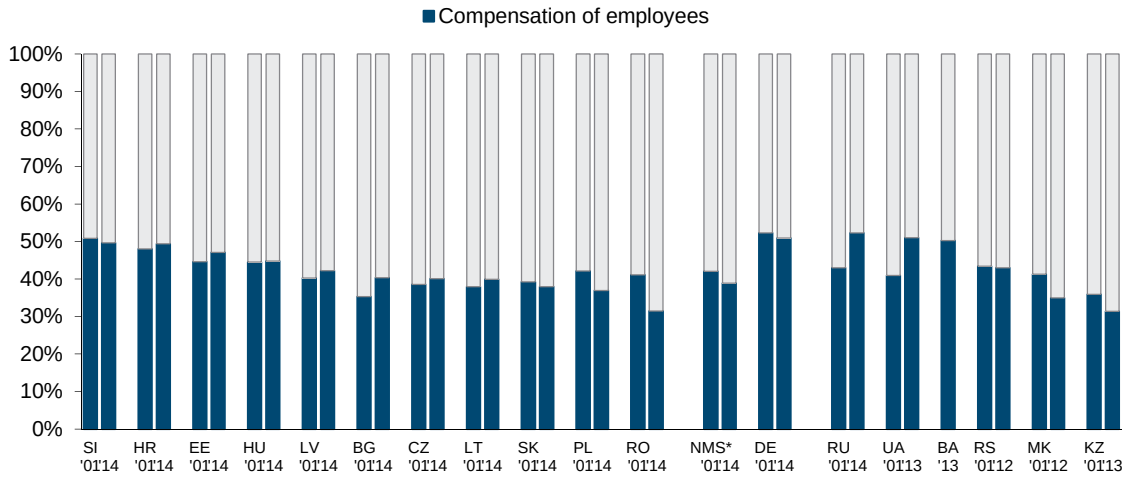
[15] Depression of wages and unit labour costs expressed in domestic currencies is only one (albeit very important) factor behind the improved external competitiveness. Other factors include the movements in nominal (and real) exchange rates which could increase (or reduce) the advantages of domestic wage moderation. Finally, it is quite clear that countries where domestic demand is depressed are likely to be successful on the external front (because of the lower demand for imports).

[16] See e.g. Bibow, J. (2013), Germany and the Euroland Crisis: The Making of a Vulnerable Haven, Levy Economics Institute, Working Paper No. 767 and Laski, K. and L. Podkaminer (2012), 'The basic paradigms of EU economic policy-making need to be changed', Cambridge Journal of Economics, Vol. 36, pp.253-271.

also to be met. The macroeconomic policy must be competent, while the business class must be bent on seeking profits through market competition rather than through rent-seeking behaviour linked to corruption and market-distorting public policies.

Compensation shares are rising in Russia and Ukraine, yet dropping in Kazakhstan. The general trend for the GDP compensation share to decline is perceptible in Kazakhstan. The statistics for Russia and Ukraine, however, suggest a rise in those shares – at least as compared to 2001. If the statistics are correct, this could reflect a change in the position of labour vis-à-vis their employers. In both cases, the public authorities may have become less tolerant of the early post-transition custom of employers' delaying the payment of wages to their workers (or their complete and utter failure to pay wages due).

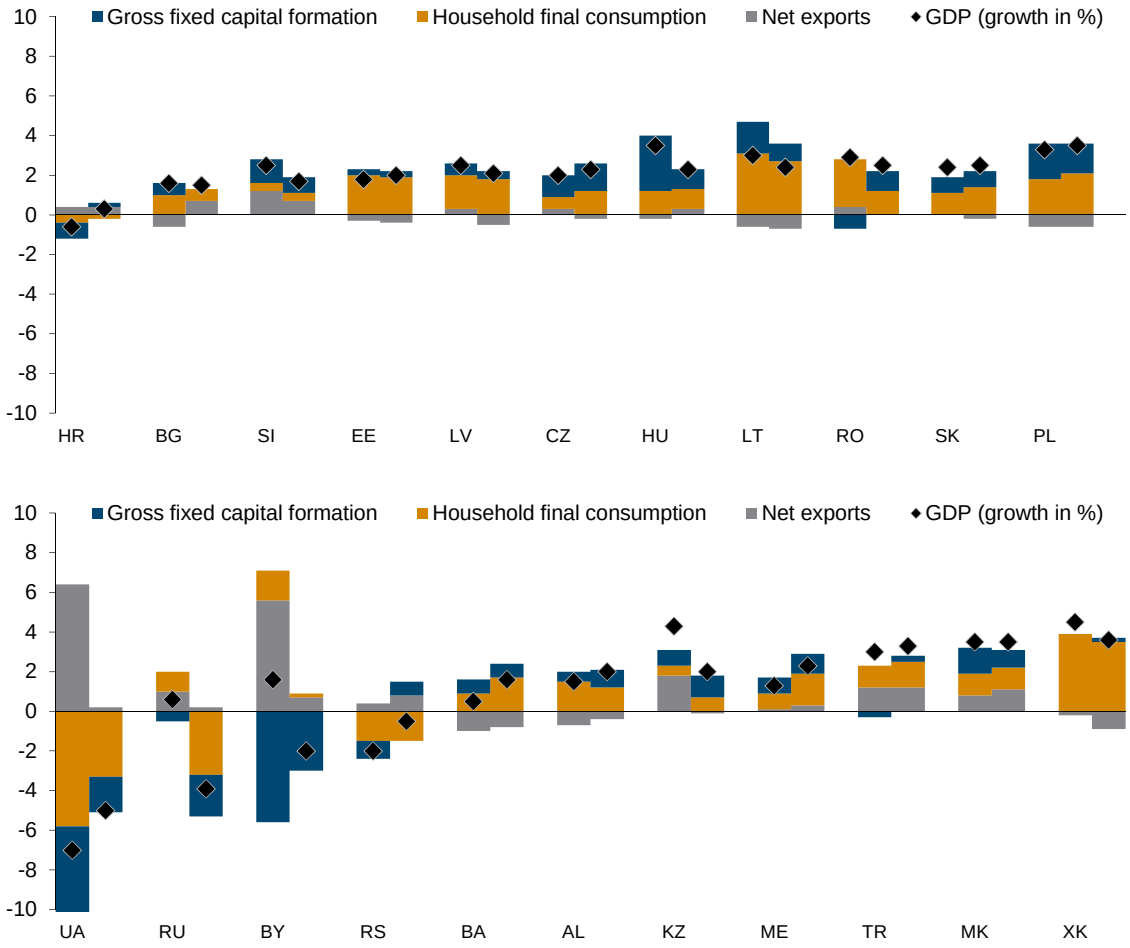
Figure 14 / GDP compensation shares, in %



Source: National statistics and AMECO database.

There is a trade-off between improvements in the trade balance and more rapid growth in domestic demand. This trade-off can be detected in all NMS, except the Czech Republic. The correlation between the percentage-point contributions to the annual GDP growth rates of domestic demand and the trade balance ranges between minus 0.57 and minus 0.98 for the period 2004-2014 (whereas it equals +0.042 for the Czech Republic). The negative correlation coefficients are highly significant, while the correlation coefficient for the Czech Republic (which is close to zero) is statistically insignificant. For the more recent period (2008-2014), all correlation coefficients are negative (in the Czech Republic as well). Most of them have moved closer to minus 1, indicating a strengthening of the trade-off in the post-crisis period. 8 out of the 11 correlation coefficients for the period 2008-2014 are highly significant, whereas only two (including the Czech Republic) are statistically insignificant at conventional levels. One implication of this regularity is that overall GDP growth is restricted. Stronger growth in domestic demand worsens trade performance - and hence GDP growth. Stronger performance in foreign trade appears to require stagnating domestic demand (primarily in household consumption, of which wage incomes are the main determinant) – and consequently lower GDP growth as well.

Figure 15 / GDP growth in 2014-2015 and contribution of individual demand components in percentage points



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

EXCHANGE RATE REGIMES DO MATTER

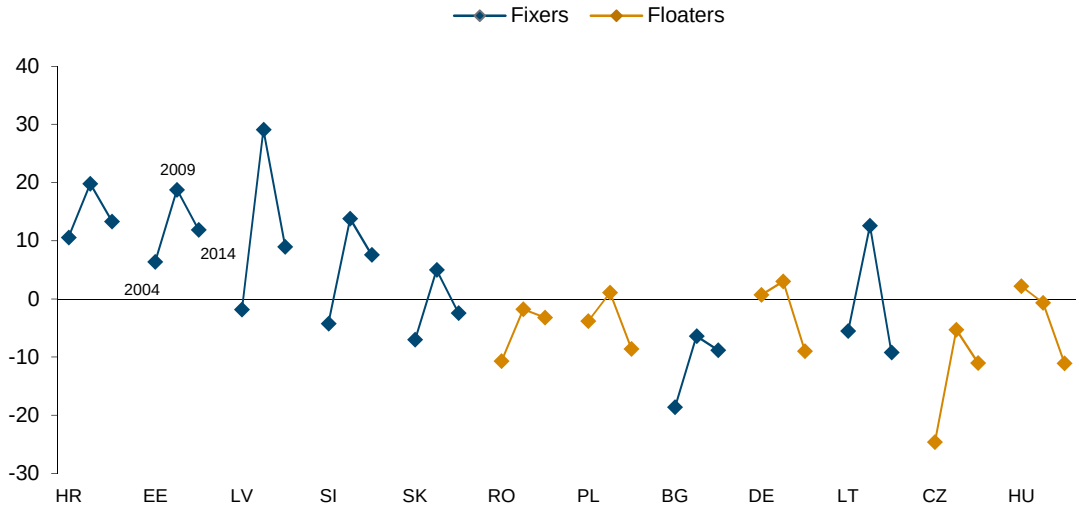
The countries with floating exchange rates have avoided currency overvaluation; the countries with fixed exchange rates have not been quite so successful. Many are the indications that a country's foreign trade performance depends primarily on developments in terms of foreign and domestic output. (Exports depend primarily on the strength of foreign output growth and imports on the strength of domestic output growth). Nonetheless, it is widely believed that currency overvaluation or undervaluation also has a certain (auxiliary) role to play, with overvaluation damaging the trade balance and undervaluation having the opposite effect. Figure 16 reports estimates of the levels of overvaluation in the NMS (and Germany) for selected years. The estimates were derived from applying a simple method that the wiiw elaborated a couple of years ago (see Annex 2 for details[17]). It appears that the countries with floating exchange rates (the Czech Republic, Hungary, Poland and Romania) tend to

[17] Annex Table 1 reports the estimates of the overvaluation levels for all years from 2000 through 2014.

display longer spells of alternating over- and under-valuation. Interestingly enough, in 2009 Hungary, Romania and Poland abruptly reduced their rather high levels of overvaluation. Quite quickly, those three countries entered a period of undervaluation (which they have since retained). There is little doubt that this may have helped to limit recession in 2009 and thereafter (or escape it altogether, as in the case of Poland). In the Czech Republic the same adjustment was delayed somewhat (and it was not quite as market-driven as in the remaining floaters because it was only set in motion once the Czech National Bank had decided to intervene and weaken the national currency). By way of contrast, the adjustments in most countries with fixed exchange rates (including the euro area) were greatly delayed and less pronounced (if at all). In the ultimate analysis, overvaluation has not been wholly eliminated in Croatia, Estonia, Latvia and Slovenia. Given the fact that the three latter countries cannot devalue any more (they have since switched to the euro), they will either adjust by repressing domestic prices (and domestic output) – as has already been the case in Slovenia – or, more likely, they will march full title into another major crisis (Estonia, Latvia and Croatia) incurred by their ever weakening trade performance and a renewed accumulation of foreign indebtedness.

Despite the rigidity of the exchange rate regime, it is also possible to avert overvaluation in the medium term. Bulgaria is a case in point. The case of Lithuania may offer more grounds for optimism: despite the rigidity of its exchange rate regime vis-à-vis the euro, the country has managed to recover while avoiding overvaluation. This happy coincidence may perhaps be attributable to features peculiar to Lithuania (such as a very narrow range of manufacturing activities centred on the processing of crude oil and a somewhat larger share of trade with partners outside the euro area). Finally, in Slovakia the country's membership in the euro area has not yielded overvaluation either. This may be due to the successful structural changes that the country has undergone (thanks to the pronounced development of FDI-based manufacturing). The very fact that Slovak wages are extremely repressed may have also helped (as in the case of Germany, for that matter).

Figure 16 / Percentage levels of overvaluation (positive) or undervaluation (negative) of NMS currencies vis-à-vis the euro, 2004, 2009, 2014

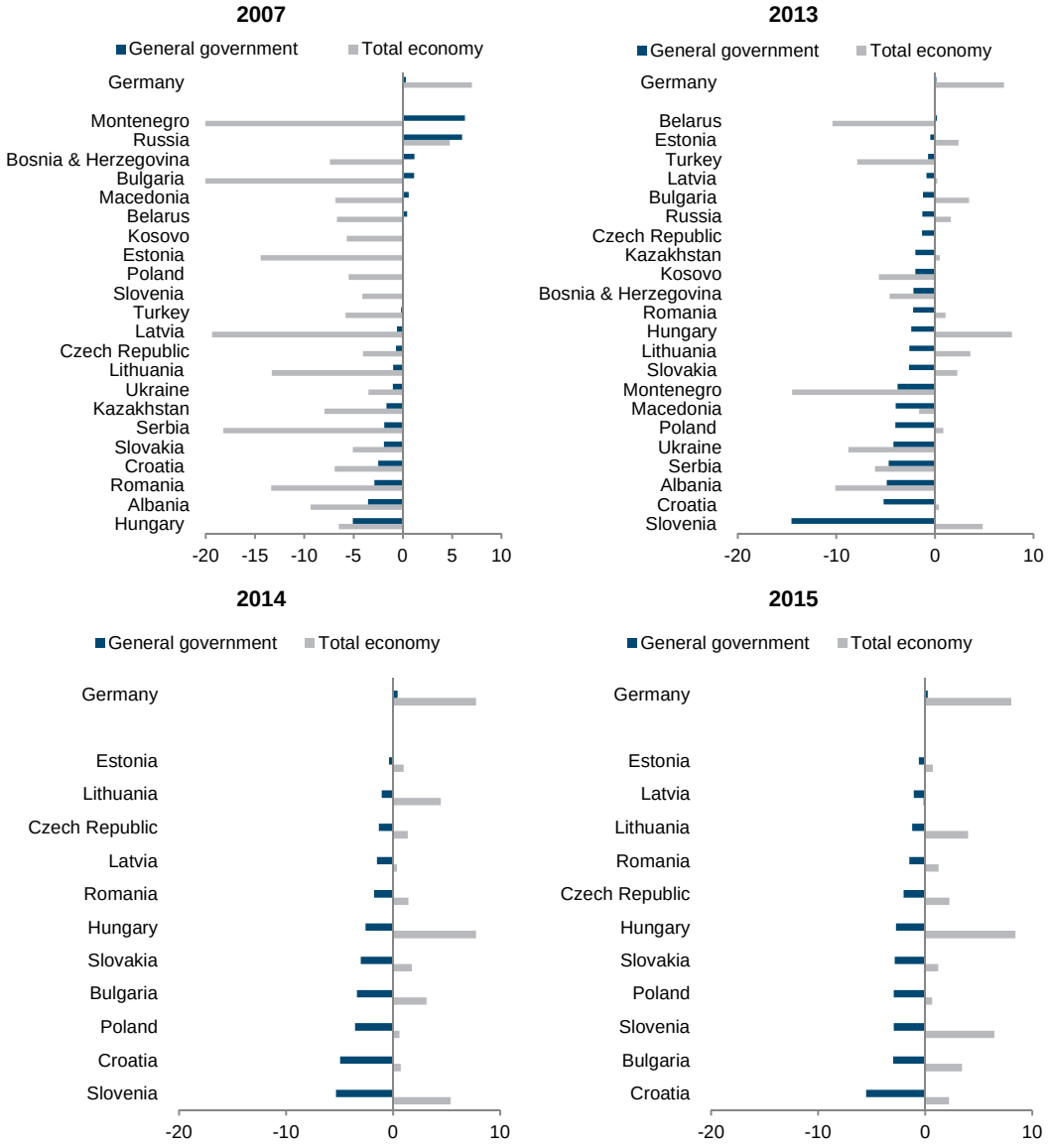


Source: Own calculations.

FISCAL DEFICITS AND NET LENDING ABROAD ABSORB EXCESSIVE PRIVATE SAVINGS IN THE NMS

All of the NMS are expected to run up fiscal deficits. This is borne out by the recent European Commission projections (see Figure 17). Generally, the deficits are quite low though. Only in Bulgaria and Croatia do the deficit/GDP levels cross the 3% mark. However, this still leaves the Bulgarian public debt/GDP level very low (around 30% by 2016). In contrast, the Croatian public debt/GDP level is expected to rise still more, approaching the 90% mark in 2016. In other countries with high public debt levels (Hungary and Slovenia), the expectation is that GDP growth will help reduce the debt/GDP ratios in the coming years.

Figure 17 / Net lending (+) or net borrowing (-), 2007, 2013, 2014, 2015 in % of GDP



Remark: 2007 Montenegro: -39.6, Bulgaria: -26.3.
Source: wiiw Annual Database incorporating national and AMECO statistics, own calculations.

Current account deficits are still depressed, but net national lending tends to be positive. In 2007 (close to the peak of the boom) all CESEE countries (excluding Russia) ran current account deficits: most excessively so by historical standards. Although at the time national net foreign borrowing was slightly lower than the current account deficits (on account of positive capital transfers), it is quite obvious that the private sector had embarked on excessive net borrowing (see Figure 17). The data for 2013 (and the European Commission's projections for 2014-2015) indicate that at present the CESEE countries – and primarily their private sectors - tend to act as net lenders rather than net borrowers vis-à-vis the rest of the world. In 2013 only a few (peripheral) countries continued to be net borrowers from the rest of the world: Ukraine, Turkey, Serbia, Kosovo, Montenegro, Bosnia and Herzegovina, Albania and Belarus. Others tend to be net lenders. This is particularly visible in the case of Hungary and Slovenia, both of which are running up large current account surpluses (Table 1). These surpluses - mainly unspent disposable income in the private sector – represent private sector payments to foreign creditors: i.e. cross-border deleveraging. While suppressing domestic demand and overall GDP growth, that deleverage also limits the risks inherent in too high a level of foreign debt. It may be observed that 'Germany is different'. German net lending to the rest of the world (essentially equal to its current account surplus) is consistently huge, as is its private sector net lending (or excess of savings in that sector over domestic investment in fixed assets). Much of the German net lending must have funded the excessive private sector borrowing in the NMS in the past.

OUTLOOK FOR 2015-2017: *ALL (RELATIVELY) QUIET IN THE EAST*

Those CESEE countries that are associated in one way or another with the European Union seem to have been adapting to the stagnationist tendencies that have long been a characteristic feature of the 'old' EU. The process of income convergence with the more developed EU will be slower than was commonly assumed only a decade ago. Furthermore, medium-term economic growth in most of the CESEE countries is likely to be moderate – primarily on account of the insufficiency in aggregate domestic demand and the ongoing changes in the functional distribution of income.

On average, output growth across the NMS will become more uniform in 2015 – yet no faster. Some marginal acceleration of growth can be expected in the biennium 2016-2017. Unemployment will recede only gradually. Low inflation will prevail in 2015, but will gradually return to more normal levels in 2016. Under conditions of sustained, albeit rather anaemic growth, the current account balances will deteriorate (although they will still remain quite low).

Growth is hardly accelerating in the EU current (and potential) candidate countries either. Output growth in those countries is not expected to outstrip that of the NMS. Turkey (as well as Macedonia and Kosovo) may perform slightly better than the rest of the group. However, with the exception of Turkey, those countries seem to have put high inflation behind them. Nonetheless, their unemployment figures are still dismal (less so only in Turkey). They will also run up high (or even very high) current account deficits.

Most of the successor states to the Soviet Union will perform rather badly in 2015. Ukraine's output will continue its free fall as many of the country's industrial centres have become battlefields. The decline in world market prices for energy carriers will affect both Kazakhstan and Russia negatively, with real output in the latter country plummeting. The same fate will befall Belarus: a country that relies heavily on exports to Russia and Ukraine. However, assuming a peaceful resolution to the Ukrainian conflict in 2015, it is expected that all the successor states will resume moderate growth in 2016 or 2017.

Annexes to the overview

ANNEX 1. THE LONGER-TERM GROWTH PATTERN: EVIDENCE OF BETA-CONVERGENCE

The regression function fitted to the data from the Box Figure 2 has the following logarithmic form[1]:

$$\text{Log}(Y_{2014}/Y_{1995}) = a + c\ \text{Log}(Y_{1995})$$

The estimated regression coefficient 'c' (-0.404) is properly negative and highly significant (its approximate standard error equals 0.09 and the t-value is -4.5). The regression's adjusted R-squared is 0.763. c= -0.404 implies the 'annual speed of convergence' ('beta') equal to -2.6%. (-0.026 = [Log (1-0.404)]/20)*. This estimate indicates that convergence in the EU has been somewhat faster than that implied by the 2 per cent 'customarily' (on average) revealed for other regions and/or time periods. In our case the intercept ('a' parameter) turns out to be very small (and insignificant in statistical terms). Interestingly enough, adding the dummy variable for the NMS does not improve things. The regression coefficient for that dummy turns out to be tiny and insignificant (which could suggest that being a NMS does not necessarily yield a meaningful advantage as far as convergence is concerned).

[1]This is the basic form used in innumerable studies on beta-convergence (see e.g. M. Abreu, H. de Groot and R. Florax, (2005), 'A Meta-Analysis of Beta Convergence: The Legendary Two-Percent', *Tinbergen Institute Discussion Paper,* 05-0001/3.

*The standard error of this 'yearly beta' equals, approximately, 0.75%

ANNEX 2. ASSESSING THE LEVELS OF CURRENCY OVERVALUATION

Over time, dozens of definitions of the term 'currency over- and/or under-valuation' have been proposed. As for its proper definition and measurement, the jury is still out[1]. The most popular method (and one that is relatively easy to implement) could hinge on the comparison of a country's exchange rate (ER) with its purchasing power parity (PPP). A PPP/ER ratio (otherwise known as the price level) less than 100% would indicate currency undervaluation. Conversely, a ratio larger than 100% would suggest overvaluation. Of course, this approach neglects the essential intuition, namely that a country's level of over- or under-valuation should be somehow related to its foreign trade performance (and indirectly to overall GDP growth). Empirically, the link between foreign trade performance and price levels (as described above) does not really exist. Very many countries with price levels far in excess of 100% (such as Switzerland, Japan or Norway) perform excellently in terms of their foreign trade, while just as many (if not most) countries with very low price levels are notorious for their weak foreign-trade performance. However, a strong, firm and stable (over time) regularity obtains that links a country's price levels to its overall level of development[2]. That (non-linear) regularity is shown to possess some desirable properties. Positions shifting away from that regularity tend to lessen over time – by virtue of a combination of changes in both price and GDP levels. It appears that undervaluation tends to be conducive to faster growth (convergence in the case of poorer countries), whereas overvaluation tends to retard growth. The regularity in question can be estimated econometrically and then used to calculate the hypothetical price levels consistent with the long-term regularity and individual countries' relative

GDP levels. Annex Table 1 shows the impact of applying that approach to 11 NMS and Germany over the period 2000-2014[3].

Table 3 / Percentage levels of overvaluation (positive) or undervaluation (negative) of NMS currencies vs. euro 2000-2014

	Bulgaria	Czech R.	Estonia	Croatia	Latvia	Lithuania	Hungary	Poland	Romania	Slovenia	Slovakia	Germany
2000	-21.4	-29.7	10.6	9.1	17.0	4.8	-10.3	6.7	-6.4	0.3	-15.9	2.5
2001	-18.4	-27.4	15.7	11.3	15.4	3.1	-9.5	20.2	-7.3	2.4	-18.8	4.1
2002	-19.9	-18.7	12.0	11.3	8.0	1.0	-3.6	12.1	-8.5	0.6	-17.9	4.8
2003	-20.4	-24.7	8.6	10.3	-1.1	-6.5	-3.3	-0.6	-9.9	1.5	-11.8	2.5
2004	-18.6	-24.6	6.4	10.6	-1.8	-5.5	2.2	-3.8	-10.7	-4.2	-7.0	0.7
2005	-16.6	-19.6	5.4	13.4	0.1	-2.8	5.8	8.6	8.8	-4.2	-7.3	-2.3
2006	-14.3	-15.6	6.9	16.5	5.9	-0.8	2.4	13.0	11.4	-2.1	-6.1	-2.3
2007	-12.7	-16.6	8.9	11.3	16.9	-0.2	11.9	13.3	19.7	0.7	-3.0	-2.9
2008	-10.0	1.0	12.7	14.2	25.6	6.7	12.0	25.8	10.5	2.8	1.3	-1.9
2009	-6.4	-5.3	18.8	19.8	29.1	12.6	-0.7	1.1	-1.8	13.8	5.0	3.0
2010	-6.9	0.2	15.6	24.8	20.4	2.9	-0.9	2.4	-3.2	14.0	1.2	-5.0
2011	-9.2	-0.5	11.4	20.0	17.1	-0.9	-3.5	-1.6	-1.4	12.7	1.3	-9.2
2012	-9.1	-3.8	11.0	14.8	14.4	-5.6	-5.4	-5.0	-7.7	9.5	0.8	-9.7
2013	-6.6	-4.5	13.0	14.2	11.1	-6.6	-6.2	-6.3	-3.6	10.5	0.3	-9.4
2014	-8.8	-11.0	11.9	13.3	9.0	-9.2	-11.1	-8.6	-3.2	7.6	-2.4	-9.0

The negative entries in Annex Table 3 represent undervaluation, the positive entries overvaluation. Zero represents 'equilibrium': i.e. an absence of both over- and under-valuation. For example the -21.4 for Bulgaria in 2000 means that in that year the Bulgarian price level (vis-à-vis the European Union as a whole) was too low by 21.4%. That level actually equalled 31.76% whereas the calculated 'equilibrium' price level was 40.43%. The price level of 40.43% of the EU average would have implied a 21.4% rise in Bulgarian prices or appreciation of the Bulgarian nominal exchange rate by (approximately) 21.4% (from 1.9558 BGN/EUR to 1.536 BGN/EUR) - or a proper combination of higher domestic prices and nominal appreciation.

[1]See e.g. Schnatz, B. (2011), 'Global imbalances and the pretence of knowing fundamental equilibrium exchange rates', *Pacific Economic Review*, Vol. 16, No. 5, pp. 604-615.

[2]See Podkaminer, L.: 'Real Convergence and the Price Levels: Long-Term Tendencies vs. Short-Term Performance in the Enlarged European Union', *Metroeconomica*, vol. 61 (2010), pp. 640-664.

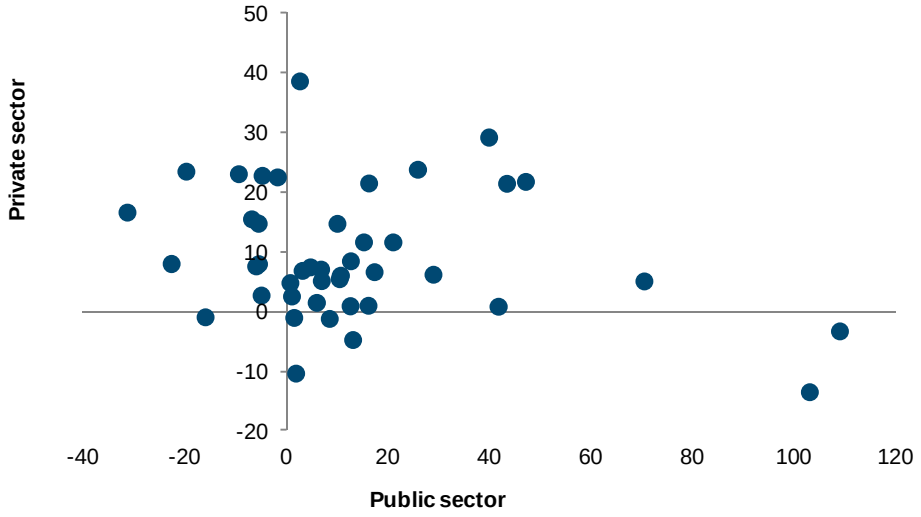
[3]The function fitted econometrically is Log(P) = bY+C where Log is the natural logarithm, P is the price level, Y is the p.c. GDP level and b, C are parameters to estimate. 540 observations were taken into account (pooled data on Y and P for all EU countries, except Luxemburg and Malta, but including Turkey), for the period 1995-2014. The estimates for b and C are 0.011047 and 3.382825 (with standard errors 0.0002 and 0.017), respectively. The equation's adjusted R-squared equals 0.8722.

ANNEX 3. PUBLIC AND PRIVATE INVESTMENT IN THE NMS: CASUAL COMPANIONS

Consciously pursued, public investment policy could be an essential feature of the overall macroeconomic stabilisation efforts. Rapid growth in private investment – normally a symptom of a cyclical expansion - would justify relatively slow growth in public investment – or even its decline. Conversely, falling private investment – normally a symptom of recession – ought to be offset by rising public investment.

A stabilising public investment policy suggests the existence of a **negative** correlation between the growth rates of private and public GFCF. The available data on private and public GFCF in the NMS[18] permit the calculation of such correlation coefficients for various periods in a country's recent past. Annex Figure 18 shows the scatter plot of growth rates of public GFCF as distinct from private GFCF for the years prior to the EU accession of the majority of the NMS. During that period both private and public GFCF had tended to rise steeply – for most of the time. That trend reflected the conditions governing recovery from the deep 'transitional recession-cum-depression' of the early 1990s. After extraordinary cuts in both private and public investments recorded during the early transition years, it was natural for both types of GFCF to recover. Of course, there is little evidence of a negative correlation between the two types of GFCF. In actual fact, Annex Figure 18 suggests that there was no correlation in that period. The correlation coefficient for the data from Fig. 1 equals 0.07. Although slightly positive, it is statistically insignificant: the probability of the correlation coefficient equalling zero is 0.54 (see Annex Table 3, column 1).

Figure 18/ GFCF growth rates, pooled NMS, 1999-2004



Source: National and Eurostat statistics, wiiw own calculations.

[18] Eurostat's AMECO database reports values (at current prices) of private and public GFCF for the EU member states, as well as the overall GFCF price deflators. Quite certainly, the price deflators for private and public GFCF need not be the same. Estimates of real growth rates of private and public GFCF (on which the present analysis is based) were derived by means of overall GFCF. These estimates are not the best possible approximations to the true figures, but perhaps the best approximations possible.

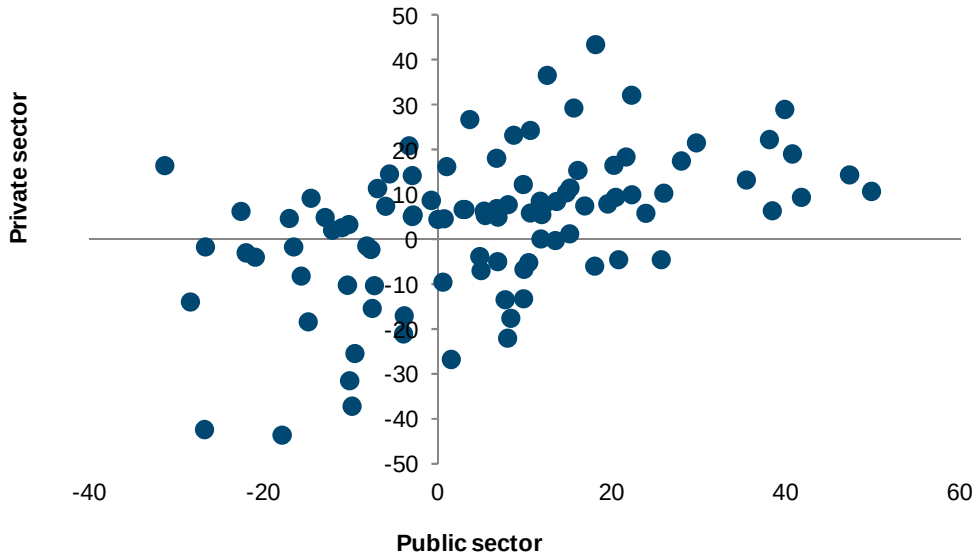
Country-wise, the correlations between rates of growth of private and public GFCF were all statistically insignificant (except for Hungary and the Czech Republic) and predominantly positive (see Annex Table 3, column 1). For Hungary and the Czech Republic, the correlations were statistically significant, large – and negative. That may be seen as evidence of an early attempt at countercyclical public policies. Interestingly enough, the correlation in question is also positive (although statistically insignificant) for Germany. Since Germany did not really suffer from the 'transitional recession' on the scale experienced by the NMS, that particular finding casts doubt on the quality of Germany's macroeconomic policy over that period.

The period 2004-2014 can be roughly divided into two discrete sub-periods. The first sub-period following in the wake of accession to the EU can be generally characterised as the 'boom years'. In most instances the 'boom' came to an end in 2008 (or a year earlier in the Baltic countries). The second sub-period (2009-2014) can be characterised as the years of recession that since 2011 or thereabouts have been followed by mild recovery.

The fact that the NMS economies went through various stages of the business cycle from 2004 onwards suggests that (on applying the hypothesis on the proper conduct of the stabilising macro policy) the data might reveal as expected the presence of a negative correlation between growth rates of private and public GFCF.

Annex Fig. 2, however, does not really substantiate that assumption.

Figure 19 / GFCF growth rates, pooled NMS, 2004-2013



Source: National and Eurostat statistics, wiiw own calculations.

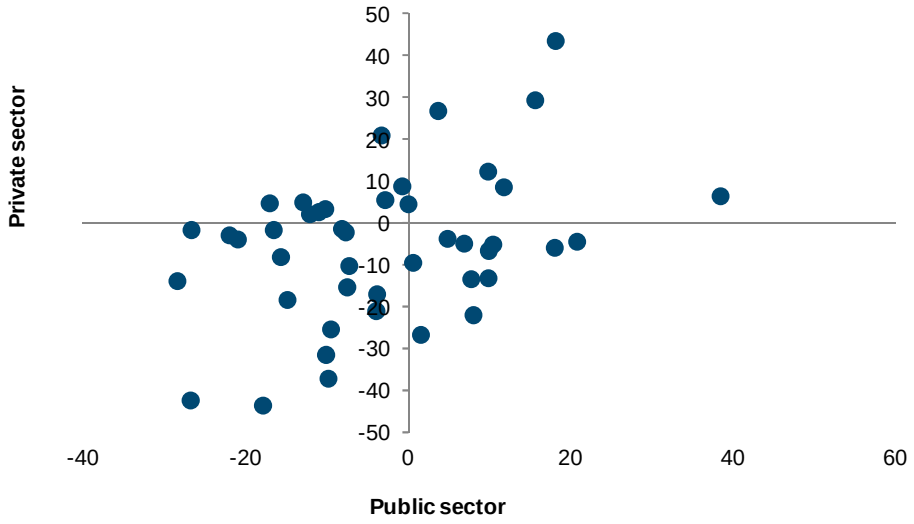
If anything, Annex Figure 19 suggests that for all (pooled) NMS, the correlation between the growth rates of private and public investment is positive. Actually, the correlation coefficient for the data from Annex Fig. 19 is not only high and positive (0.43) – but also highly significant in statistical terms (see Annex Table 4, column 2).

Country-wise, all the correlation coefficients remain insignificant (and predominantly positive) over the whole period, the exceptions being Latvia and Lithuania. The hypothesis that the growth rates of private and public investment are completely uncorrelated cannot be rejected for all countries (except Latvia and Lithuania). For those two countries, however, the correlations are not only highly significant in statistical terms, but also high and positive (see Annex Table 4, column 2). Clearly, public investment policy in both countries seems to have been pro-cyclical rather than stabilising, whereas on the whole that same policy seems to have been neither stabilising nor destabilising in the remaining NMS and Germany.

The final period worth examining is the period 2009-2014. Once again, during those years the NMS suffered periods of recession followed by recovery. However, as Annex Figure 20 and Annex Table 4 (col.3) make clear, it is difficult to detect any evidence of counter-cyclicality in public investment. Annex Figure 20 suggests the opposite. Country-wise, the correlations are positive throughout (except for Poland and the Czech Republic, as well as Germany); however, even for those latter three countries, the correlation coefficients are statistically insignificant.

Absence of a clearly strong (and positive) correlation between *contemporaneous* changes in private and public investment need not necessarily mean that private investment does not respond positively to public investment – albeit with a certain time lag. In other words, it seems likely that it takes some time for the rise in public spending to yield acceleration in private investment.

Figure 20 / GFCF growth rates, pooled NMS, 2009-2013



Source: National and Eurostat statistics, wiiw own calculations.

Another policy-relevant question worth asking relates to the potential role of EU transfers (earmarked for investment purposes) in supporting public GFCF in individual countries. Authoritative data on such transfers are not easy to come by. The available data on the net financial position of NMS compared to the EU budget[19] suggest that Lithuania, Latvia and Estonia are among the top net beneficiaries,

[19] See wiiw Forecast Report, Autumn 2014, p.14.

whereas Slovakia and Slovenia feature among the 'losers'. In all probability, the transfers supporting GFCF (mostly via the public sector) must have been much larger in the Baltic countries than in Slovakia and Slovenia. However, public GFCF in the latter two countries has been performing quite well (with GFCF in 2014 surpassing the 2008 level by 24% and 7%, respectively), whereas the public GFCF in the three Baltic countries is still trailing far behind the 2008 level - by 19.8%, 31.6% and 9.6%, respectively.

Table 4 / Correlation between growth rates of private and public GFCF

	1996-2004	2004-2014	2009-2014
11 NMS (pooled)	0.0689 (*0.543*)	**0.426*** (*0.001*)	**0.302*** (*0.014*)
Bulgaria	0.332 (*0.383*)	0.382 (*0.246*)	0.213 (*0.685*)
Czech Republic	**-0.705*** (*0.034*)	-0.363 (*0.272*)	-0.477 (*0.272*)
Estonia	0.371 (*0.327*)	0.489 (*0.127*)	0.476 (*0.340*)
Croatia		0.341 (*0.305*)	0.320 (*0.536*)
Latvia	-0.049 (*0.900*)	**0.629*** (*0.038*)	0.694 (*0.126*)
Lithuania	-0.004 (*0.993*)	**0.635*** (*0.035*)	0.566 (*0.242*)
Hungary	**-0.664*** (*0.050*)	-0.333 (*0.317*)	0.056 (*0.915*)
Poland	-0.310 (*0.417*)	0.142 (*0.677*)	-0.507(*0.305*)
Romania	0.227 (*0.557*)	0.513 (*0.107*)	0.488 (*0.326*)
Slovenia	0.034 (*0.931*)	0.442 (*0.173*)	0.196 (*0.710*)
Slovakia	0.587 (*0.097*)	0.235 (*0.487*)	0.122 (*0.818*)
Germany	0.327 (*0.390*)	-0.092 (*0.787*)	-0.440 (*0.384*)

Source: Own calculations based on AMECO data. P-values (probabilities that the correlation is zero) are in brackets.
(* denotes significance at a 5% level).

Special Section I: President Juncker's EUR 315 billion initiative: an investment plan for Europe

SÁNDOR RICHTER

THE RATIONALE BEHIND THE INITIATIVE

Although both GDP and private consumption in the EU-28 Member States have re-attained their pre-crisis (2007) levels, total investment is still 15% below the volume recorded in 2007. Growth remains sluggish and unemployment high. The investment plan for Europe that the newly elected President of the EU Commission Jean-Claude Juncker announced at the end of 2014 is designed to remedy that very problem.[20] In fact, the financial institutions and corporations dispose of sufficient liquidity, which, however, is not being put to productive use. Within the context of the European Investment Bank (EIB), a new European Fund for Strategic Investments (EFSI) is taking shape. Its mission is to generate EUR 315 billion additional investment over the period 2015-2017 by making better use of public money and so attract private investors. The potential of the initiative is such that it is expected to add EUR 330-410 billion to the EU GDP and create 1-1.3 million new jobs. The growth-generating effect envisioned has three strands: (a) mobilising investment finance without creating new public debt; (b) supporting investment in infrastructure, education, research and innovation; and (c) removing sector-specific and other financial and non-financial barriers to investment.[21]

ITS MODUS OPERANDI

On establishing the EFSI, a guarantee of EUR 16 billion will be appropriated under the EU budget. The EIB will commit EUR 5 billion. Member States will have the opportunity to contribute and pay capital into the Fund. Those capital contributions will not be counted for the deficit and debt criterion of the Member State concerned.[22] The EU guarantee will be backed up by existing EU funds from the existing margins of flexibility within the EU budget (EUR 2 billion), the Connecting Europe Facility (EUR 3.3 billion) and the Horizon 2020 programme (EUR 2.7 billion) – yielding a total amount of EUR 8 billion. With an initial combined contribution of EUR 21 billion the Commission hopes to generate massive additional finance, of which EUR 240 billion will be directed towards large, long-term strategic investments and EUR 75 billion towards investments by small- and medium-sized firms with up to 3,000 employees.[23]

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[20] COM (2014) 903 final, p. 4.

[21] European Commission, http://ec.europa.eu/priorities/jobs-growth-investment/plan/documents/index_en.htm, Factsheets 1 and 2

[22] P. Manasse, The EU new fiscal flexibility guidelines: An assessment, http://www.voxeu.org/article/eu-new-fiscal-flexibility-guidelines-assessment

[23] European Commission, http://ec.europa.eu/priorities/jobs-growth-investment/plan/documents/index_en.htm, Factsheet 2

The role of the EFSI is to mobilise that additional private financing; the Commission hopes to attain a multiplier effect of 1:15 overall in real investment, thanks to the EFSI offering an initial risk-bearing capacity that provides extra financing. The calculation is as follows: for every initial EUR 1 of risk-protection by the EFSI, EUR 3 of extra financing can be provided to a project in the form of sub-ordinated debt. On the assumption that this establishes a safety buffer for that particular project, private investors are expected to invest in the senior tranches of the same project. Drawing on the experience of the EIB and the European Commission, allowance has been made for EUR 1 of subordinated debt catalysing EUR 5 in total investment: EUR 1 in subordinated debt topped by EUR 4 in senior debt. This means that for every EUR 1 of risk protection guaranteed by the Fund, EUR 15 of private investment are generated in the real economy: an amount which would not have otherwise materialised. The Commission speaks of this 1:15 multiplier effect as a prudent average, based on historical experience from EU programmes and the EIB[24].

The Commission listed a few characteristic projects that could well benefit from the EFSI.[25]

› Construction and rehabilitation of public buildings aimed at improving their energy efficiency that are currently on hold for want of funding.

› Transport links between EU countries that are facing delays owing to high upfront project costs.

› Open-access research infrastructure in countries that are currently in need of financing to avoid delays in implementation.

› Upgrading school facilities in countries that are facing implementation challenges and a lack of funding.

› Investment in water infrastructure, including waste water treatment plants and water supply facilities, that are hampered by a lack of financing.

› Other projects supporting, for example, the expansion and upgrading of: freight and passenger capacities at ports and airports; dedicated rail-links between important airports and urban centres; environmental projects in the area of maritime transport; alternative fuel-infrastructure along major roads; and third-generation bio-refineries.

[24] European Commission, http://ec.europa.eu/priorities/jobs-growth-investment/plan/documents/index_en.htm, Factsheet 2.

[25] European Commission, http://ec.europa.eu/priorities/jobs-growth-investment/plan/documents/index_en.htm, Factsheet 3.

BOX 2 / SOME LARGE PROJECTS FROM THE TENTATIVE LIST OF THE SPECIAL TASK FORCE TO BE IMPLEMENTED IN THE NEW MEMBER STATES

Bulgaria: Blagoevgrad-Sandanski, motorway EUR 0.9 billion
Croatia: Railway Hrvatski Leskovac-Karlovac, EUR 0.4 billion
Czech Republic: Mirosovice-Kyvalka motorway, EUR 0.5 billion
Estonia: Transforming the oil shale sector, EUR 5 billion
Hungary: Rainwater harvesting in urban areas to reduce flood risk, EUR 1 billion
Latvia: Riga northern transport corridor, EUR 1.5 billion
Lithuania: Road safety and security measures, EUR 1.4 billion
Poland: Express motorway S7 section Koszwaly-Kazmierzowo, EUR 3.6 billion
Romania: Port of Constanta improvements, EUR 1.2 billion
Slovakia: Motorway D3, EUR 1.5 billion
Slovenia: Broadband network for Slovenia EUR 0.5 billion

Note: The costs indicated in euro are total investment costs, i.e. they also contain cost elements that will fall due beyond the Juncker initiative's three-year time horizon (2015-2017).
Source: http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/project-list_part-3_en.pdf

DOUBTS AND OPEN QUESTIONS

At first sight, the initiative and its plan to generate in three years EUR 315 billion private investment using EUR 21 billion public money seems truly impressive. On closer scrutiny, however, doubts arise. It is not clear what will happen to the public funds amounting to EUR 180 billion that are disbursed annually in the context of the traditional EU budget, of which at least half, using a very conservative estimate, is currently used to fund both public and private investment. Reading the above list of typical projects from the new EFSI, one cannot but ask where the essential difference lies between the new EFSI and the traditional developmental pillar of the EU budget: the European Structural and Investment Funds (ESIF)[26]. The Commission claims that EFSI and ESIF have distinctly different purposes that are implemented via distinctly different financial instruments. Whereas the new EFSI will focus on attracting private investors in economically viable projects, the bulk of the long- established ESIF comprises grants. The Commission cites a hypothetical example: building a toll road in an industrial centre might well attract investors and could thus be more easily funded through the EFSI. On the other hand, building a toll-free road in a rural area would probably not attract private investors and the project would thus be better funded under the EU budget (drawing on the ESIF). That notwithstanding, the Commission has been encouraging Member States at least to double the use of the new financial instruments so as to crowd out grant-type financing. This hints at the Commission acknowledging the dangers inherent in supporting highly inefficient investments, such as building roads that lead from nowhere to nowhere, if cost-effectiveness does not play an eminently crucial role in the ultimate decision to fund a project.[27]

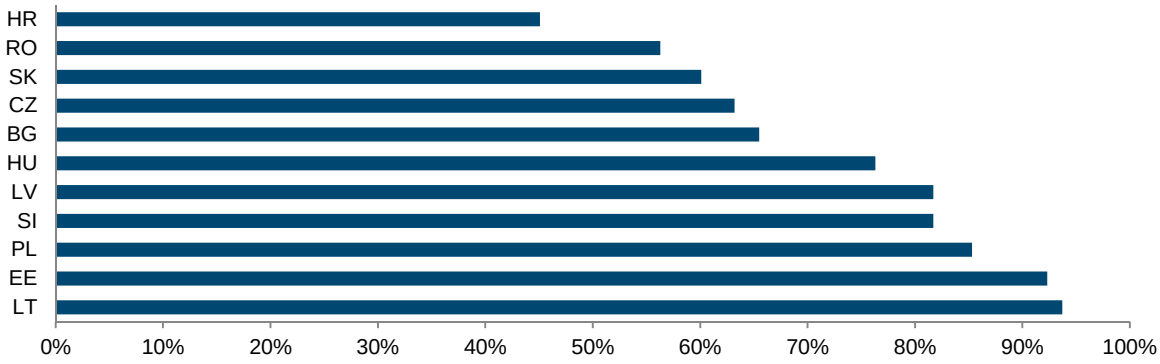
The question thus arises about the need to draw up a new investment plan, if massive reserves are apparently tucked away in the traditional EU budget. If we base our calculations on the 15-fold leverage

[26] ESIF includes the European Regional Development Fund, the European Social Fund, the Cohesion Fund, European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund.

[27] European Commission, The European Fund for Strategic Investments (EFSI), Questions and Answers, p. 17; http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/efsi_qa_en.pdf

that the Juncker initiative reckons with and assume a conservative back-of-the-envelope figure of EUR 90 billion (equal to half of total annual expenditures from the EU budget) for the traditional EU budget investment expenditures, one could possibly generate each year new private sector investment in the order of EUR 1,350 billion (EUR 90 billion X 15). If we consider this calculation even halfway realistic, one of the most urgent tasks should be the reform of the current EU budget and its transformation in keeping with the new EFSI guidelines. Indeed, whatever happens, a move in that direction would seem expedient.

Figure 21 / Absorption rates of EU cohesion policy-related resources under the 2007-2014 Multiannual Financial Framework, at the end of 2014



Note: 2015 is the final year for drawing resources from the 2007-2014 Multiannual Financial Framework (except for Croatia, where the final year is 2016).
Source: European Commission;
https://cohesiondata.ec.europa.eu/EU-Cohesion-Funding/Bar-chart-Funds-Absorption-Rate-Cohesion-Policy-20/g67v-zjyr

NEW MEMBER STATES: INSUFFICIENT INVESTMENT A PROBLEM, ADEQUATE EU SUPPORT A SOLUTION

In common with the highly developed core of the EU, the new Member States (NMS) suffer from an insufficient level of investment. Nevertheless, as beneficiaries of the EU cohesion policy, the NMS have to cope with the absorption of the ample cohesion policy transfers available to them. For several NMS, it would seem illusory to believe that they will be able to expend to the full all the cohesion policy-related resources provided under the 2007-2013 Multiannual Financial Framework, whose disbursement period will close at the end of the current year (see Figure 21). Given the remarkable similarity of the typical projects under the current ESIF and the new EFSI, it is questionable whether the new line of finance can be appropriately utilised. There is also every risk of projects that failed with good reason to meet the requirements of the established cohesion policy framework being recycled and re-submitted for consideration under the new line of financing. As for the new initiative, speed is of the essence; however, it should be appreciated that, apart from obvious bureaucratic exaggerations, the current protracted decision-making process to which cohesion policy projects are subjected is a response to painful instances of mismanagement and corruption in the past. Whether the new initiative will be able to engender business investment is an open question. However, a resolute shift to EU-sponsored, yet market-based financing from the currently predominantly grant-based financing will be a change that serves the longer-term interest of the NMS, as it will filter out unviable, prestige-driven projects tainted by corruption.

Special Section II: Energy prices, inflation and growth in the CESEE countries

AMAT ADAROV, VASILY ASTROV AND SERKAN CICEK[28]

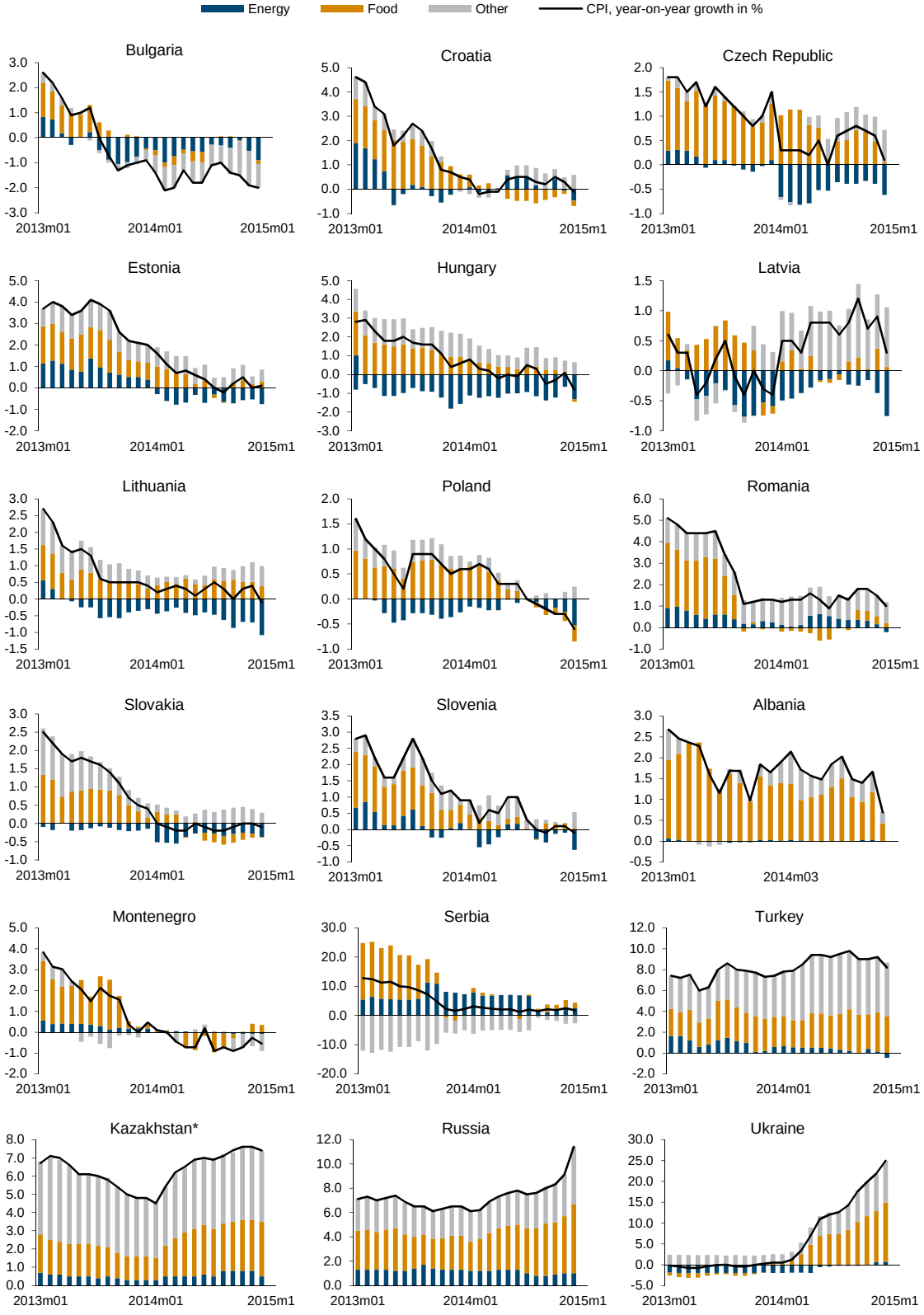
Food and energy reduce inflation in the new EU member states and the Western Balkans …

By and large, inflationary pressures in the majority of the new EU member states (NMS) and countries in the Western Balkans have been subsiding over the past two years (Figure 22). A number of countries – notably Bulgaria and Bosnia and Herzegovina, as well as Slovakia, Macedonia and Montenegro, for example – have been even recording outright deflation on an annual basis over prolonged periods of time. Poland also entered the deflation mode during the final months of 2014. It may come as no surprise that inflationary pressures are weak in an environment displaying generally unimpressive economic growth; those pressures are also weak in Western Europe. However, a more nuanced analysis of individual inflation components suggests that the main drivers of the recent disinflation lie elsewhere. Apart from Bulgaria and a few countries in the Western Balkans, core inflation (which corresponds to the 'other' inflation component in Figure 22) has remained positive and generally unchanged almost everywhere in the region; this would seem to suggest that the recent disinflation trend has been a reflection not so much of weakening aggregate demand, but rather of other factors.

One important factor has been the drop in energy prices, whose contribution to headline inflation has been negative in nearly all NMS. However, their correlation to the recent dramatic decline in the world oil prices (which dropped by almost half in US dollar terms) that only started in mid-2014 appears to be weak. Most NMS had already been recording declines in energy prices well before then, although in some cases (such as in the Czech Republic, Latvia and Poland) the recent oil price decline has clearly reinforced those trends. The reason for the weak correlation to be observed between global oil prices and domestic energy prices is straightforward. Oil prices have only (at best) an immediate impact on the retail prices of motor fuel/gasoline, whereas for other energy-related expenditures, such as utility bills for heating and electricity, which tend to assume greater weight in the consumer basket than transportation costs, the link to world oil prices is much weaker; various 'mark-ups', network costs, electricity generation mix and, most importantly, administrative tariff regulation play a far greater role in terms of price formation. A case in point is Hungary where the negative contribution of energy tariff cuts – part of the Orban-style 'unorthodox' economic policies – to the consumer price index (CPI) has been particularly pronounced over the past two years, dragging inflation down by up to 2 percentage points (in year-on-year terms). However, not only in Hungary have energy tariff declines kept inflation down; the same holds true for nearly all the other NMS as well.

[28] The authors would like to thank Vladimir Gligorov, Peter Havlik, Mario Holzner and Robert Stehrer for their valuable comments and suggestions on this chapter.

Figure 22 / CPI growth and contribution of components, 2013-2015, in percentage points



Notes: For the NMS, MK, ME, RS and TR: Harmonized Index of Consumer Prices (HICP); for other CESEE countries: Consumer Price Index (CPI). Energy component for Kazakhstan includes all kinds of transport costs.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Another factor behind the recent disinflation has been the dynamics of food prices. However, their contribution to inflation – though declining – has in many cases remained positive. Interestingly enough, this even applies to countries such as Latvia and Lithuania, both of which trade extensively with Russia and whose food exports to that country have suffered on account of the import embargo imposed in August 2014. However, as both countries are relatively small producers, they have been able to redirect their exports to markets elsewhere. By contrast, the marked turnaround in the dynamics of food prices in Poland – a much larger producer, whose food industry also has relatively strong ties with the Russian market – may well reflect the impact of the Russian embargo and the corresponding steep increase in domestic food supplies.

… while prices in the Commonwealth of Independent States are fuelled by currency depreciation

In countries on the periphery of the CESEE region – Russia, Ukraine, Kazakhstan and Turkey – inflation dynamics have exhibited very different patterns from those prevailing in both the NMS and the countries in the Western Balkans. In all of the peripheral countries (except Ukraine), both headline and core inflation have been historically high – not least a reflection of their more vibrant domestic demand as compared to the NMS, for example. However, the speed-up in inflation starting from the second half of 2014, particularly in Russia and Ukraine, had little to do with demand factors; it was primarily due to major currency depreciations riding on the back of the geopolitical conflict and, in the case of Russia, the decline in the world oil prices, the country's main export item, as well. The broad-based increase in the prices of both food and non-food items, many of which are imported, reflects the magnitude of the pass-through of the nominal exchange rate depreciation into CPI, which thus far has been only partly offset by import substitution. On top of all that, in the case of Russia the food import embargo imposed in August 2014 has also played a role, as reduced food supplies have contributed to price increases.

Interestingly, currency depreciation has eroded any benefits that local consumers might have gained from the recent decline in world oil prices. In fact, in both Russia and Ukraine gasoline prices, for example, have even risen in national currency terms (albeit not as much as prices for food or pharmaceuticals). The forthcoming hikes in regulated tariffs for natural gas and heating – primarily in Ukraine, where they are part of the IMF-required austerity package – will fuel still further the already high inflationary pressures.

OIL PRICES AND INFLATION

There have been dramatic changes in global oil prices over the past decade. Since oil prices fell by nearly 50 percent in the second half of 2014 and are likely to remain at a low level or rise only mildly in 2015, domestic inflation rates – already very low in most CESEE countries – are expected to decelerate further in 2015 owing to this dramatic supply-side shock. Since oil is an important input in parts of the economy, for instance in industrial activities and transportation, any change in oil prices will affect production costs – and thus have an impact on inflation. Thus, whenever oil prices rise or fall, inflation should follow in the same direction, although the relationship between oil prices and inflation has weakened over time.[29]

[29] For details please see Blanchard and Gali (2007), Hamilton and Herrera (2004), Hooker (2002) and de Gregorio et al. (2007).

Inflation likely to respond asymmetrically to oil price changes

Theoretically, firms tend to increase prices swiftly whenever production costs rise; however, they are reluctant to lower prices instantly when the costs fall. Hence, depending on competition conditions, prices are assumed to be sticky downward in the short term. In order to measure the impact of the recent oil price plunge on domestic inflation rates in the CESEE region, the following regression equation has been employed in respect of 12 countries:[30]

$$\pi_{t,j} = \alpha_0 + \sum_{i=1}^{12} \alpha_1 \pi_{t-i,j} + \delta_1 y_{t,j}^{d} + \theta_1 e_{t,j} + \beta_1^{0/+/-} o_{t,j}^{0/+/-} + \varepsilon_{t,j} \quad (1)$$

Domestic inflation (π_t) is regressed on its own lags (π_{t-i}), the output gap (y_t^d), changes in the exchange rate (e_t) and oil price changes ($o_t^{0/+/-}$) covering the period January 2000 - December 2014.[31]

On considering the overall effect of changes in oil prices (both positive and negative) on domestic inflation, the findings suggest that they have positive effects on domestic inflation as was expected in 10 CESEE countries, except Romania and Slovakia. Slovenia has the highest coefficient indicating that a 1% change in the USD oil price will cause domestic inflation to change by 0.018 percentage points (pp) in that country. In other words, a 50% decline in oil prices as experienced recently may reduce domestic inflation there by 0.92 pp. The average oil price pass-through coefficient is 0.0105 for the 10 other CESEE countries; this means that a 50% change in oil prices may lead to a change in domestic inflation rates in the order of 0.52 pp on average.

Surprisingly, negative oil price changes have an impact on inflation more often than positive changes

When only positive changes in oil prices are taken into account, the findings show that the coefficients are significant for just half of the countries under investigation, yet the values of the coefficients are relatively higher than the coefficients of overall changes in oil prices for each country. For example, in Estonia that has the highest coefficient among the countries investigated, a 50% increase in oil prices might have an impact on domestic inflation of 1.6 pp. On average, the pass-through coefficient in Bulgaria, Croatia, the Czech Republic, Estonia, Poland and Slovenia is 0.0203, while Hungary, Latvia, Lithuania, Romania, Slovakia and Turkey display no statistically significant relationship between oil price increases and inflation.

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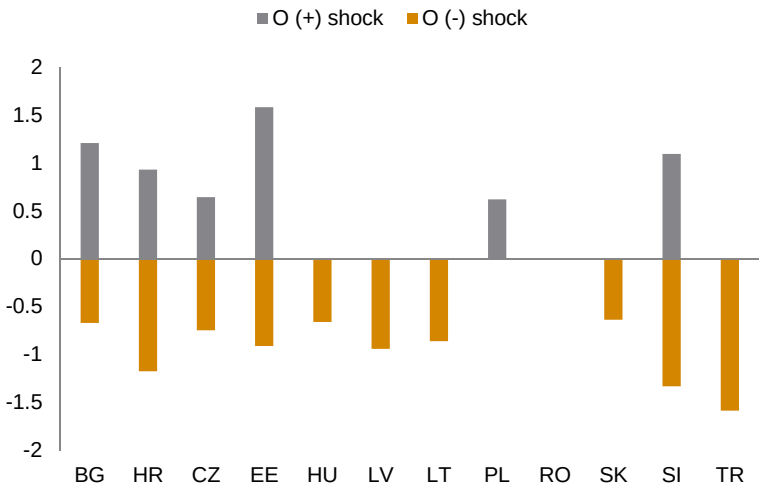
30 These countries are Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia and Turkey. For the other countries in the region, either there is a lack of data or time series are not long enough.

31 The inflation rate is calculated with the seasonally adjusted and log-differenced consumer price index (CPI). The output gap is defined as the deviation of the industrial production index (log) from its Hodrick-Prescott trend. Changes in exchange rates are calculated by log-differencing the USD exchange rates. Changes in oil prices are in US dollar terms and indicate three different measures: (i) Changes in oil prices [(o_t^0) = Calculated by log-differencing the oil prices]; (ii) Positive shocks in oil prices [(o_t^+) = a positive oil price shock is computed as the above zero percentage change of the oil price in month t from its preceding 3-month maximum (specified in log-differences)]; and (iii) Negative shocks in oil prices [(o_t^-) = a negative oil price shock is computed as the below zero percentage change of the oil price in month t from its preceding 3-month minimum (specified in log-differences)]. Price indices, exchange rates and industrial production indices are obtained from the wiiw monthly database, while Brent oil prices are taken from the Eurostat database.

Not surprisingly, negative changes in oil prices are found to have an inflation-reducing effect, except in Poland and Romania where the coefficients are insignificant. The coefficients range between 0.0317 and 0.0127 for Turkey and Slovakia, respectively. This finding implies that a 50% decrease in oil prices might lead to a 1.6 pp fall in inflation in Turkey and a 0.64 pp decrease in Slovakia. On average, the dampening effect of a 50% decrease in the US dollar oil price on domestic inflation would be in the order of 1 pp in the CESEE region, all other things being equal. Figure 23 shows both the effect of a 50% increase and decrease in oil prices on domestic inflation rates across the countries under investigation. It should be stressed that the findings should be treated with caution as they are past correlations that may not necessarily have pronounced forecasting properties.

Figure 23 / The effect of a 50% positive and negative change in oil prices on domestic inflation in selected CESEE countries



Note: 'o(+) shock' is a 50% positive change in the US dollar oil price; 'o(-) shock' is a 50% negative change in the US dollar oil price.
Source: Own calculations

Contrary to theory, it can be seen that negative changes in the oil price have more impact on domestic inflation than positive changes. One explanation for this might be that monetary policy responses to positive and negative oil price shocks are asymmetric: the former are typically stronger in order to counteract inflationary pressures.[32]

OIL PRICES AND ECONOMIC GROWTH

Recent oil price developments have also become an important factor shaping expectations of a more rapid recovery of global economic growth. Economic growth is expected to receive additional stimulus via consumption and investment in oil-importing economies, whereas oil exporters will have to go through a phase of growth deceleration. The latest episode in the decline of oil prices has been

[32] Bernanke et al. (1997) demonstrate that economic downturns following positive oil price shocks may take place because authorities respond by tightening monetary policy. The more active the central bank is in combating inflation, the lower the oil price pass-through when the price of oil increases.

especially noteworthy since, unlike during the crisis in 2008—2009, while it has undoubtedly been caused in part by weaknesses in global demand, it is strongly driven by supply-side conditions, which might trigger significant macroeconomic spillovers. Various channels through which oil prices may affect real economic activity have been identified in the literature:

› Supply side: A decline in oil prices will decrease the costs of production in general by easing energy and transportation costs. In addition, industries reliant on petroleum inputs, such as chemicals, plastics and agriculture, will also benefit. In the longer term, sustained oil price changes induce the reallocation of productive factors between energy-intensive and less energy-intensive sectors of an economy.

› Demand side: A boost lent to real disposable household incomes by lower energy costs, as well as lower costs of production and wider corporate profit margins, may encourage consumption and investment spending by households and businesses.

› Terms of trade: Oil price swings will prompt a global redistribution of wealth from oil exporters to oil importers, along with balance-of-payments adjustments.

› Indirect channels: Oil price developments may also manifest themselves in the medium to long term via cross-country macroeconomic spillovers through trade and financial linkages, and remittances. For example, the terms-of-trade effect will generate a second-round impact as lower revenues will dampen demand from oil-exporting economies, thereby negatively affecting their trading partners, and, vice versa, oil importers will generate extra demand globally.

The overall expected positive effects of oil price declines may be inhibited by concurrent excess volatility of oil prices and uncertainty about its future trajectory, which could well discourage investment and consumption of durable goods sensitive to macroeconomic uncertainties in general. In addition, policy responses to oil price shocks may trigger further macroeconomic adjustments - something rather relevant nowadays as low oil prices induce additional downward pressures on the already low level of inflation prevailing in Europe, while monetary conditions are still extremely easy. Finally, negative and positive oil price shocks of comparable magnitude have been found to produce asymmetric effects attributable to nominal/real price and wage rigidities and adjustment costs associated with the reallocation of productive factors between sectors.[33] It is therefore difficult to predict the magnitude of a net boost to global growth attributable to a decline in oil prices, whereas it is generally agreed that the effect is more likely to be positive, albeit with rather different outcomes for oil importers and oil exporters. Thus, according to the estimates of the IMF and the World Bank, the drop in oil prices observed in the second half of 2014 might add approximately 0.3-0.7 pp to global economic growth in the medium term.[34]

High energy intensity in the CESEE countries paired with cyclical co-movements of oil prices and GDP

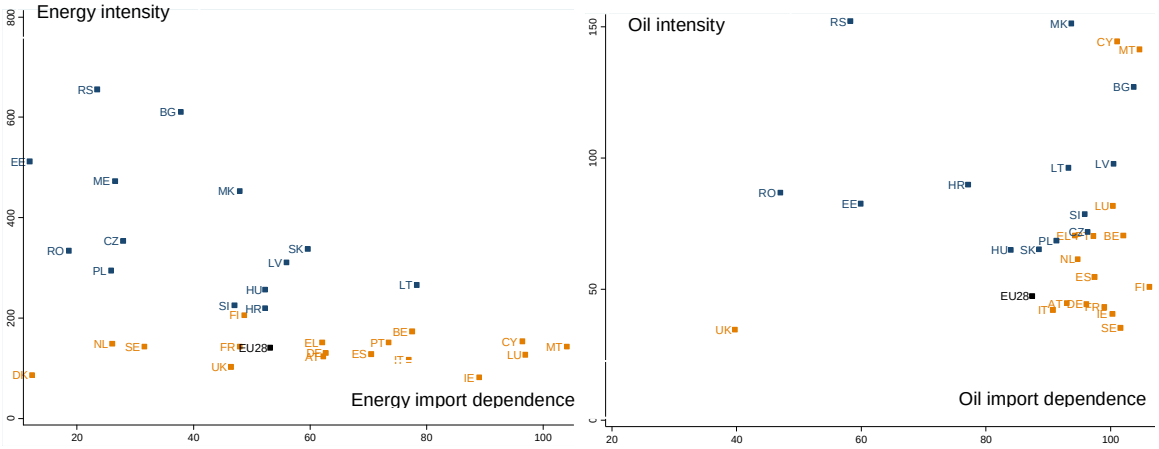
The CESEE economies are characterised by considerably higher energy and oil intensity relative to the EU average, at least when GDP is measured at market prices (Figure 24). On the other hand, the extent

[33] For more discussion and empirical evidence on the effects of oil prices see, e.g. Bernanke, Watson and Gertler (1997), Blanchard and Galí (2008), Blanchard and Riggi (2013), Hunt, Isard and Laxton (2001), Hamilton (2003, 2009), Jimenez-Rodrıguez and Sanchez (2005), Kilian (2009), and Kilian and Vigfusson (2011).

[34] IMF World Economic Outlook Update (January 2015); World Bank Global Economic Prospects (January 2015)

to which an economy relies on imports to meet its energy needs varies significantly across the sample, with particularly high energy import dependence ratios (>50%) in Lithuania, Slovakia, Latvia, Croatia, and Hungary, signifying their greater exposure to developments in the global energy market. Yet, most of the European economies are heavily dependent on petroleum imports.

Figure 24 / Exposure of European economies to energy and oil price shocks, 2013



Note: Vertical axis: energy (oil – right panel) intensity, measured as gross inland consumption of energy (oil) divided by GDP (kg of oil equivalent per 1000 EUR of GDP at 2005 market prices). Horizontal axis: energy (oil – right panel) dependence, measured as net energy (oil) imports divided by the sum of gross inland energy (oil) consumption plus bunkers.
Source: Eurostat, own calculations

The long-term dynamics of oil prices tends to follow the global economic cycle and that of the CESEE countries (Figure 25). However, identifying the extent to which co-movement of business cycles can be attributed to the impact of oil prices on economic activity is by no means a trivial task. In the case of the CESEE region, it is also inhibited by a comparatively short time-dimension of macroeconomic series available for emerging economies. Yet, to shed at least some light on the issue, a parsimonious 4-lag bivariate model is estimated with adjustments to control for asymmetric effects of oil price shocks based on quarterly data spanning the period 2000-2014:[35]

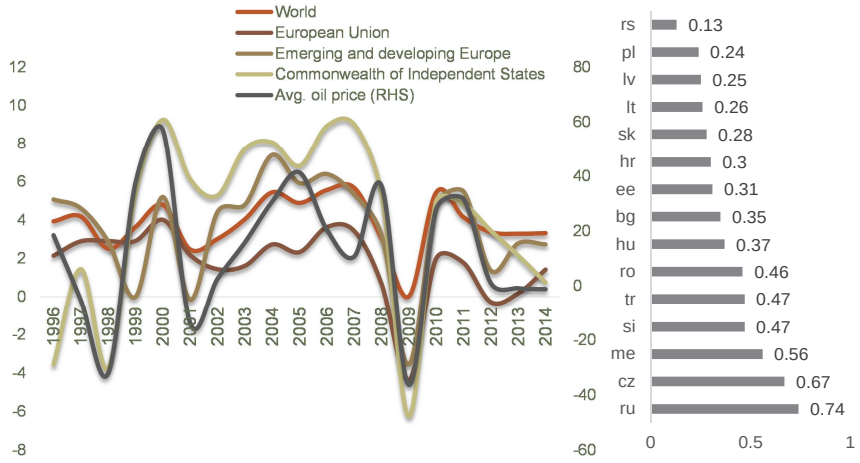
$$\Delta \ln(y_t) = \alpha + \sum_{j=1}^{4} [\beta_j \Delta \ln(y_{t-j})] + \sum_{k=1}^{4} [\gamma_k o^{+}_{t-k} + \mu_k o^{-}_{t-k}] + \mathbf{\Theta C}_t + \varepsilon_t$$

where $\Delta \ln(y_t)$ is real GDP in log-differenced form, $\mathbf{C}_t$ is the vector of dummy variables, controlling for the crisis episode of 2009, o^{+}_{t-k} and o^{+}_{t-k} are indicators of positive and negative oil price shocks, respectively, measured based on the Brent crude oil price as 'net oil price changes' inspired by Hamilton (2003, 2009). Specifically, a positive oil price shock is calculated as the greater of zero and the percentage difference of the current oil price from its previous four-quarter peak (specified in log-differences). Likewise, if a decline in oil price updates its 4-quarter minimum, it is regarded as a negative

[35] The data are obtained from Eurostat, wiiw database, and national statistical agencies. The nominal Brent oil price converted to national currencies is used to measure oil price shocks. Real GDP growth rates data are seasonally adjusted via TRAMO-SEATS. The model is estimated separately for each of the 14 economies in the CESEE sample, for which sufficiently long data are available, including BG, HR, CZ, EE, HU, LV, LT, MK, PL, RO, RU, RS, SK, SI. The equation is augmented by dummy variables controlling for the business cycle to avoid spurious regression attributable to mere co-movement of the oil price cycle and business cycles, as evidenced in Figure 25.

oil price shock and computed as a percentage change from the 4-quarter minimum value, and zero otherwise.

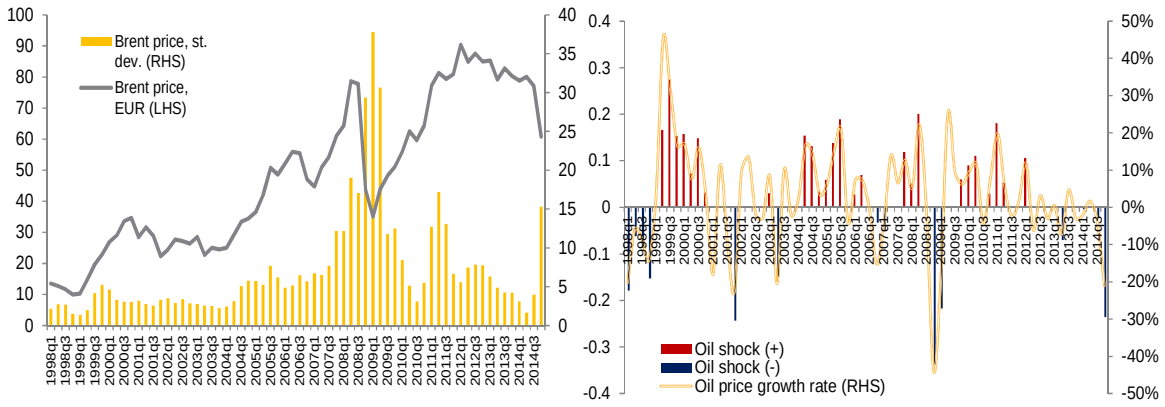
Figure 25 / Oil price and business cycle, 1997-2014



Note: Left panel; annual real GDP growth rates and annual growth of average oil price (simple average of three spot prices: Dated Brent, West Texas Intermediate, and the Dubai Fateh, USD per barrel). Right panel: pairwise correlation between the annual oil price growth rate and real GDP growth rates of CESEE economies over the period 1997-2014
Source: IMF WEO, own calculations.

Such a threshold-based approach permits the capture of only major swings in oil prices (Figure 26), which are likely to have a more profound effect on the macroeconomic environment than transitory fluctuations, and has been widely used in the related literature. While the number of positive shocks is relatively large, episodes of oil price drops are less common in recent history. Taking this into account, as well as the short data-span and the simple specification, the regression results should be interpreted with great caution (the dynamic responses of output growth rates to oil shocks for the CESEE economies for which significant effects were found are presented in Figure 27).

Figure 26 / Dynamics of oil prices, 1998Q1-2014Q4



Note: Nominal Brent oil price (EUR) and its standard deviation over rolling 12-month periods (left panel). Incidence of oil price shocks measured as changes in oil price, positive and negative net oil price changes over 4-quarter periods (right panel).
Source: Eurostat, own calculations

Figure 27 / Dynamic response of economic growth to net oil price shocks in selected CESEE economies, 1998Q1-2014Q4

Note: Dynamic responses of real GDP growth rates to 1 pp positive ('o+ shock') and negative ('o- shock') net oil price shocks for CESEE economies with significant effects. Responses over 4 quarters after shock, taking into account the statistical significance of estimates. For the remaining economies in the CESEE sample neither positive nor negative shocks are found to be significant.
Source: Own calculations based on data from Eurostat, national statistical agencies and wiiw database.

Historical data suggest a strong, asymmetric reaction of GDP growth to a drop in oil prices

For most economies in the sample, positive oil price shocks are found to be insignificant. However, for those countries found to exhibit a strong reaction to oil price hikes (Hungary, Lithuania, Latvia and Serbia), the impact on economic activity is negative, with the magnitudes implying a reduction in the real GDP growth rate of approximately 0.04-0.13 pp in response to a sustained percentage-point increase in the oil-price level above the historical 4-quarter maximum, manifesting as fast as over 2-3 quarters.

Negative oil price shocks are found to exert an especially deep impact on the economies of Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, and Slovakia, confirming the hypothesis of asymmetric effects of oil price increases versus declines in growth. Notably, the pass-through dynamics of negative oil price shocks on real economic activity for the majority of the countries affected is rather similar, culminating in the third quarter after a shock. The estimated magnitudes of the effect, however, seem to be very high, ranging from 0.03 for Bulgaria to 0.14 for Estonia.[36] Nevertheless, even taking into account the methodological limitations, the estimates may point to the significance of negative oil price shocks for the CESEE region. Whereas the recently observed decline in oil prices might be driven more by supply-side factors than by the weakness of demand emanating from commodity importers (and therefore historical parallels may not be relevant), estimation results suggest that a permanent drop in oil prices by 50% may contribute up to 1.7 percentage points to the real GDP growth rate in the CESEE region.

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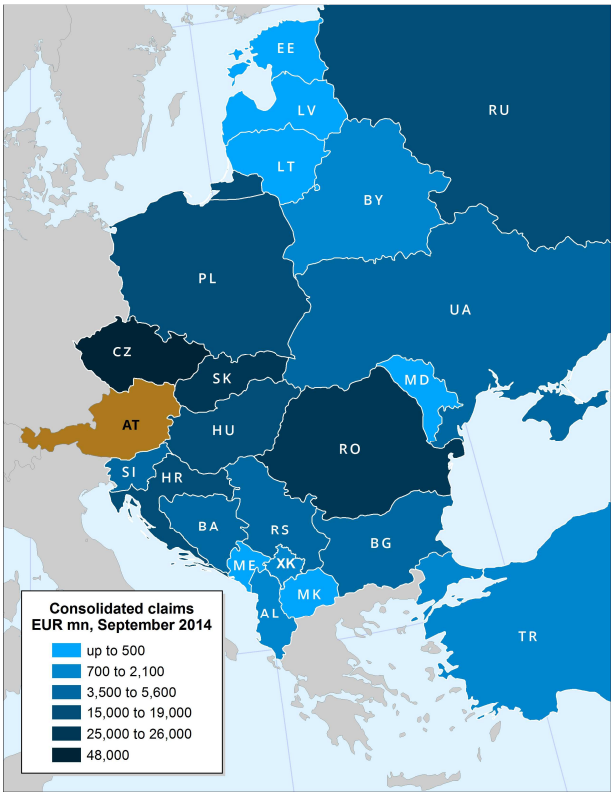
[36] This could be the consequence of a short time dimension of the data along with the episodes of economic downturn/recovery not fully accounted for by the business cycle dummy variables, and calls for a more elaborate identification strategy.

Special Section III: Austrian banks in the countries of Central, East and Southeast Europe (CESEE)

MARIO HOLZNER[37]

Although the Austrian banking sector has gone through a fairly stringent clean sweep process in recent years, Austrian banks still rank among the leading foreign banks operating in the CESEE countries. They are particularly strong in the neighbouring countries to the east of Austria, as well as in the Balkans. Notably, the Erste Bank and Raiffeisen Bank International are market leaders in the Czech Republic, Slovakia, Romania and Albania; they rank second in Hungary, Bosnia and Herzegovina and Kosovo. They also come third in terms of market shares in Slovakia and Croatia.

Figure 28 / Austrian banks' exposure to risk in the CESEE countries



Note: Data are collected on an ultimate-risk basis. For Bulgaria, data stem from June 2014. For Albania, Belarus, Kosovo, Russia and Ukraine Raiffeisen assets only, December 2013.
Source: BIS, RBI, own calculations using USD/EUR exchange rate as of 30 September 2014.

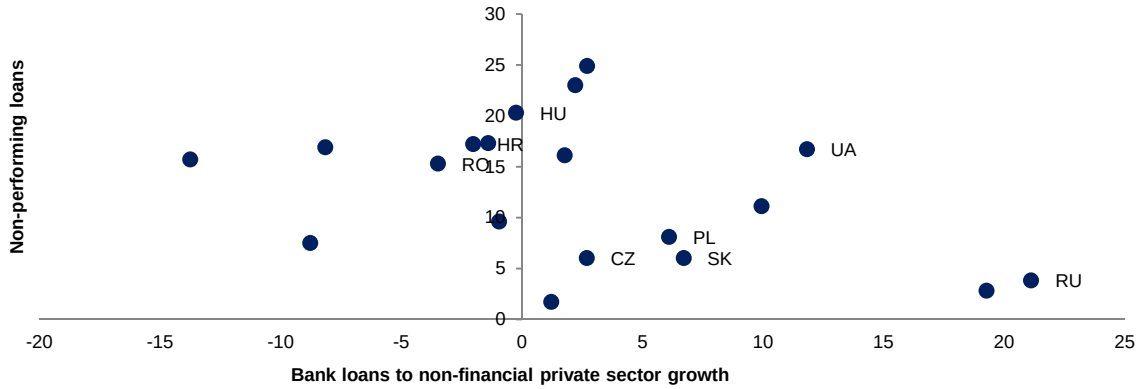
[37] The author wants to thank Hermine Vidovic, Vladimir Gligorov, Peter Havlik, Olga Pindyuk and Vasily Astrov for valuable comments.

In terms of nominal assets, the most important Austrian banking markets in the CESEE countries as of September 2014 (see Figure 28 and Table 5 in the Annex) were the Czech Republic (EUR 48.1 billion), Slovakia (EUR 26.4 billion), Romania (EUR 25.6 billion) and Croatia (EUR 19.1 billion). Overall, the amounts outstanding in the 11 new EU Member States (NMS) come to almost EUR 160 billion or about half of Austria's GDP. Thus, more than 80% of all Austrian CESEE assets are concentrated in the NMS. The markets in the Western Balkans are only of minor significance. Russia and Ukraine, however, take on appreciable significance - especially where Raiffeisen Bank International is concerned. In December 2013, Raiffeisen recorded assets of some EUR 15 billion euro in Russia and EUR 4 billion in Ukraine.

Austrian exposure to diverse CESEE banking markets is strong, with Russia as the cash cow to date

Hitherto, the banking markets in both the Balkans and Hungary[38] were most worrisome owing to a combination of high shares of non-performing loans (NPLs) (and foreign currency denominated loans) and low or even negative growth in loans to the private sector (see Figure 29). In actual fact, in 2014 the core markets, the Czech Republic and Slovakia (about 40% of the Austrian CESEE claims) performed quite well, with low NPL levels and stable growth in loans. Until recently, the increase in loans to firms and households even reached double digits in Ukraine and Russia, where Raiffeisen has accrued a large chunk of its profits thus far. However, the recent collapse in oil prices and the war in Ukraine have led to a massive depreciation of the Russian rouble and the Ukrainian hryvnia, with a corresponding decline in the value of banking assets (expressed in euros) in both countries. Furthermore, the financial sanctions that the EU imposed on Russia in August 2014 (including a ban on extending credits with a maturity in excess of 30 days to the leading Russian state-owned energy companies and banks) meant that Austrian banks had to forego their profit. The prospects for the banking market in both economies in 2015 and beyond appear rather bleak at present: one of the reasons for Moody's Investors Service having downgraded Raiffeisen's long-term debt rating to Baa2 from Baa1 on 18 February 2015.

Figure 29 / Share of NPLs in total loans and growth in bank loans to the private sector, CESEE 2014



Note: Growth of loans refers to the percentage change in the stock of loans in December 2014 against December 2013. The share of NPLs refers to the situation in December 2014 or the latest available month.
Source: National central banks, own calculations.

[38] The Hungarian banking sector was also suffering from the high bank taxes imposed by Prime Minister Viktor Orban's government.

Raiffeisen's substantial exposure to risk in Russia

The above heading notwithstanding, Austria's Raiffeisen is not the largest foreign lender in Russia. French (EUR 34.6 billion), Italian (EUR 21.6 billion) and US (EUR 19.7 billion) banks are far more exposed (see Table 6 in the Annex). Banks from those countries – including Italy's UniCredit, which operates in Russia via its Austrian subsidiary, Bank Austria, - have in fact massively increased their positions since the outbreak of the global financial crisis in 2008. Moreover, French and Italian banks, as well as Austria's Raiffeisen, have appreciably increased their exposure to risk in Russia as compared to late 2012 when GDP growth in Russia had already started to decelerate. By way of contrast, the German and Swiss banks in particular reduced their exposure quite notably during that very same period. Overall, it can be said that Austrian engagement in the Russian banking market is not the strongest in nominal terms; however, if a comparison is drawn to the smaller country's GDP, Raiffeisen's Russian assets are equivalent to almost 5% of Austria's GDP in 2014.

Involvement in Ukraine is less, but also risky

Although Raiffeisen's assets in Ukraine are less than a third of its Russian exposure, Raiffeisen's associate, Bank Aval, is the largest foreign lender in Ukraine (see Table 7 in the Annex). Once again it is the Italian and French banks that have comparable outstanding amounts in Ukraine. In fact, over recent years almost all foreign banks in Ukraine have substantially reduced their balance sheets since back in 2012 Ukraine was already getting bogged down in economic stagnation and the business environment for foreign banks was getting palpably worse. The marked reduction of Austrian exposure to Ukraine is mostly due to the Erste Bank having sold its Ukrainian branch in 2013. Taken together, the Austrian banks' exposure to risk in the two major crisis countries, Russia and Ukraine, are equivalent to some 6% of Austria's GDP and amount to about 10% of the Austrian banks' total engagement in the CESEE countries (not including assets held by Bank Austria in both countries that are statistically captured as Italian exposure). While this clearly represents a substantial risk for Austria, and especially for the Austrian Raiffeisen cooperative sector, it has to be noted that almost half of the Austrian banking activities in the CESEE countries are located in some of Europe's most stable economies, such as the Czech Republic, Slovakia and Poland, where GDP growth in the years to come is expected to range from 2.5% to 3.5%. Compared to the euro area, this yields a growth differential of about 1.5 percentage points. Hence, Austrian exposure in the CESEE countries can be seen to be both risky and profitable, depending on the country (and time-period) of activity.

Extent of the balance-sheet scale-back depends on political developments in the region

In general, the Austrian banking business model would appear to contain an element of structural risk as documented by the country's long history of bank failures. Unfortunately, information on current risks is incomplete. However, those risks are most likely related to the NPLs that are going to increase significantly in both Russia and Ukraine, in particular on foreign currency loans. By the end of the previous year, the share of foreign currency denominated loans in the banking sector's assets was as high as 47% in Ukraine and 22% in Russia. The fact that on 20 February 2015 Moody's downgraded Russia's sovereign rating to Ba1 from Baa3, with a negative outlook, is further evidence of a worsening business climate in that part of the CESEE region. Furthermore, in the wake of deteriorating relations between Russia and the EU financial (counter-) sanctions will most likely be even more stringent (such as the exclusion of Russian banks from SWIFT or the introduction of capital controls in retaliation).

Certainly, Raiffeisen will be mooting an exit strategy for both Ukraine and Russia. However, a pertinent case in point is UniCredit's Bank Austria experience in Kazakhstan, which ended rather badly. In 2007, Bank Austria bought the Kazakh ATF bank for EUR 1.6 billion. Following the outbreak of the global financial crisis , the bank got into deep trouble on account of the NPLs on its books . Ultimately in 2013, Bank Austria was left no option but to sell its shares in ATF at a fraction of the amount it bought them for. Currently, Raiffeisen is officially planning to scale back its problematic units in Russia, Ukraine and Hungary, as well as sell its branches in Poland and Slovenia, the aim being to achieve a core capital ratio of 12% by the end of 2017. Whether this will be sufficient depends to a large extent on a swift resolution to the Ukraine-Russia conflict and subsequent economic recovery in both countries.

ANNEX TABLES

Table 5 / Consolidated foreign claims of Austrian banks in the CESEE countries – ultimate-risk basis, September 2014

	EUR mn	% of total	% of CESEE	% of AT'14 GDP
CESEE total	**194,139**	**60.3**	**100.0**	**58.9**
Bulgaria	3,621 [1)]	1.1	1.9	1.1
Croatia	19,137	5.9	9.9	5.8
Czech Republic	48,142	15.0	24.8	14.6
Estonia	40	0.0	0.0	0.0
Hungary	14,999	4.7	7.7	4.6
Latvia	51	0.0	0.0	0.0
Lithuania	150	0.0	0.1	0.0
Poland	16,121	5.0	8.3	4.9
Romania	25,567	7.9	13.2	7.8
Slovakia	26,367	8.2	13.6	8.0
Slovenia	5,638	1.8	2.9	1.7
NMS-11	**159,834**	**49.7**	**82.3**	**48.5**
Albania	2,084 [2)]	0.6	1.1	0.6
Bosnia and Herzegovina	3,458	1.1	1.8	1.0
Kosovo	699 [2)]	0.2	0.4	0.2
Macedonia	281	0.1	0.1	0.1
Montenegro	451	0.1	0.2	0.1
Serbia	4,400	1.4	2.3	1.3
Turkey	1,265	0.4	0.7	0.4
EU candidates (incl.pot.)	**12,637**	**3.9**	**6.5**	**3.8**
Armenia	10 [3)]	0.0	0.0	0.0
Azerbaijan	72	0.0	0.0	0.0
Belarus	1,446 [2)]	0.4	0.7	0.4
Georgia	2 [4)]	0.0	0.0	0.0
Kazakhstan	148 [1)]	0.0	0.1	0.0
Moldova	109	0.0	0.1	0.0
Russia	15,555 [2)]	4.8	8.0	4.7
Tajikistan	0	0.0	0.0	0.0
Turkmenistan	0	0.0	0.0	0.0
Ukraine	4,327 [2)]	1.3	2.2	1.3
Uzbekistan	0	0.0	0.0	0.0
CIS (incl. former)	**21,668**	**6.7**	**11.2**	**6.6**

Note: 1) June 2014; 2) Raiffeisen assets only, December 2013; 3) June 2013; 4) September 2013.
Source: BIS, RBI, AMECO, own calculations using USD/EUR exchange rate as of 30 September 2014.

Table 6 / Consolidated foreign claims of international banks in Russia – ultimate-risk basis

	Sept. 2008 EUR mn	Sept. 2012 EUR mn	Sept. 2014 EUR mn	% change 2014/2008	% change 2014/2012
French banks	21,806	31,030	34,570	58.5	11.4
Italian banks	17,698	17,802	21,593	22.0	21.3
US banks	9,465	20,079	19,706	108.2	-1.9
Austrian banks	15,370	13,190	15,555 [1)]	1.2	17.9
Japanese banks	9,695	10,691	13,242	36.6	23.9
German banks	30,664	20,453	12,657	-58.7	-38.1
British banks	7,923	15,755	11,874	49.9	-24.6
Dutch banks	14,341	10,414	11,582	-19.2	11.2
Swedish banks	6,936	11,701	6,958	0.3	-40.5
Swiss banks	12,360	8,168	5,345 [2)]	-56.8	-34.6
Spanish banks	2,182	771	810	-62.9	5.0
Indian banks	931	742	490	-47.4	-33.9
Belgian banks	7,543	3,166	487	-93.5	-84.6
Turkish banks	234	229	390	66.7	70.3
Canadian banks	423	314	300	-29.0	-4.3
Greek banks	1,153	356	247	-78.6	-30.7
Portuguese banks	631	80	186	-70.5	132.1

Note: 1) Raiffeisen assets only, December 2013; 2) September 2013.
Source: BIS, RBI, own calculations using end of September USD/EUR exchange rates.

Table 7 / Consolidated foreign claims of international banks in Ukraine – ultimate-risk basis

	Sept. 2008 EUR mn	Sept. 2012 EUR mn	Sept. 2014 EUR mn	% change 2014/2008	% change 2014/2012
Austrian banks	10,010	5,821	4,327 [1)]	-56.8	-25.7
Italian banks	3,353	4,758	3,892 [2)]	16.1	-18.2
French banks	6,750	2,926	1,318 [3)]	-80.5	-54.9
Greek banks	769	1,379	884	15.0	-35.9
US banks	896	948	865	-3.4	-8.7
German banks	3,571	1,177	808	-77.4	-31.4
Swiss banks	4,627	1,159	538 [4)]	-88.4	-53.5
British banks	542	315	438	-19.2	38.9
Swedish banks	4,004	908	81	-98.0	-91.1
Belgian banks	524	47	79	-84.9	69.6
Japanese banks	538	276	57	-89.4	-79.4
Portuguese banks	122	33	28	-77.3	-15.2
Spanish banks	49	16	5	-90.3	-70.9
Indian banks	47	19	4	-91.6	-78.8

Note: 1) Raiffeisen assets only, December 2013; 2) June 2014; 3) BNP assets only, December 2014; 4) September 2013.
Source: BIS, RBI, BNP, own calculations using end of September USD/EUR exchange rates.

Country reports

Table 8 / Bulgaria: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	7,396	7,348	7,306	7,265	7,260	7,250	7,230	7,200
Gross domestic product, BGN mn, nom. [3]	71,904	78,434	80,044	80,282	81,500	82,700	85,100	88,400
annual change in % (real) [3]	0.7	2.0	0.5	1.1	1.6	1.5	1.9	2.3
GDP/capita (EUR at exchange rate)	5,000	5,500	5,600	5,700	5,700	5,800	6,000	6,300
GDP/capita (EUR at PPP)	11,200	12,200	12,400	12,300	12,600	.	.	.
Consumption of households, BGN mn, nom. [3]	45,533	48,470	52,140	49,863	49,700	.	.	.
annual change in % (real) [3]	0.4	1.9	3.8	-2.3	1.6	1.0	2.5	2.5
Gross fixed capital form., BGN mn, nom. [3]	16,431	16,685	17,246	17,108	16,300	.	.	.
annual change in % (real) [3]	-18.3	-6.6	4.2	-0.1	3.0	0.0	3.0	5.0
Gross industrial production [4]								
annual change in % (real)	2.1	5.8	-0.3	-0.1	1.9	2.0	4.0	5.0
Gross agricultural production								
annual change in % (real)	-6.0	-2.5	-10.0	14.2	-5.0	.	.	.
Construction industry [5]								
annual change in % (real)	-14.9	-12.8	-0.7	-5.3	3.3	.	.	.
Employed persons, LFS, th, average [6]	3,053	2,950	2,934	2,935	2,981	3,010	3,040	3,070
annual change in %	-6.2	-3.4	-1.1	0.0	1.6	1.0	1.0	1.0
Unemployed persons, LFS, th, average [6]	348	372	410	436	385	370	360	320
Unemployment rate, LFS, in %, average [6]	10.2	11.2	12.3	12.9	11.5	11.0	10.5	9.5
Reg. unemployment rate, in %, end of period	9.2	10.4	11.4	11.8	10.7	.	.	.
Average monthly gross wages, BGN	648.1	685.8	731.1	775.1	827.8	.	.	.
annual change in % (real, gross)	3.9	1.5	3.5	5.1	8.3	.	.	.
Consumer prices (HICP), % p.a.	3.0	3.4	2.4	0.4	-1.6	0.0	1.0	1.5
Producer prices in industry, % p.a.	8.5	9.2	4.4	-1.5	-1.2	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	34.1	32.6	34.7	37.1	38.0	.	.	.
Expenditures	37.4	34.7	35.2	38.3	43.0	.	.	.
Net lending (+) / net borrowing (-)	-3.2	-2.0	-0.5	-1.2	-5.0	-3.0	-2.5	-2.0
Public debt, EU-def., % of GDP	15.9	15.7	18.0	18.3	23.1	25.7	27.5	28.5
Central bank policy rate, % p.a., end of period [7]	0.18	0.22	0.03	0.02	0.02	.	.	.
Current account, EUR mn [8]	-534	33	-454	1,215	800	500	300	-200
Current account, % of GDP [8]	-1.5	0.1	-1.1	3.0	1.9	1.2	0.7	-0.4
Export of goods, BOP, EUR mn [8]	15,562	20,265	20,771	21,208	21,250	21,500	22,000	22,800
annual change in %	33.0	30.2	2.5	.	0.2	1.2	2.3	3.6
Import of goods, BOP, EUR mn [8]	18,326	22,421	24,231	24,099	24,350	24,800	25,500	26,700
annual change in %	15.4	22.3	8.1	.	1.0	1.8	2.8	4.7
Exports of services, BOP, EUR mn [8]	5,012	5,354	5,696	6,860	7,400	7,600	7,800	8,100
annual change in %	2.0	6.8	6.4	.	7.9	2.7	2.6	3.8
Imports of services, BOP, EUR mn [8]	3,143	3,037	3,426	4,124	4,500	4,700	4,800	5,000
annual change in %	-13.1	-3.4	12.8	.	9.1	4.4	2.1	4.2
FDI inflow (liabilities), EUR mn [8]	1,152	1,330	1,142	1,353	1,450	1,500	1,600	1,800
FDI outflow (assets), EUR mn [8]	174	117	270	266	300	.	.	.
Gross reserves of NB excl. gold, EUR mn	11,612	11,788	13,935	13,303	15,276	.	.	.
Gross external debt, EUR mn	37,026	36,295	37,714	36,924	38,800	.	.	.
Gross external debt, % of GDP	100.7	90.5	92.1	90.0	93.1	.	.	.
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
Purchasing power parity BGN/EUR	0.8680	0.8780	0.8817	0.8982	0.8921	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census February 2011. - 3) According to ESA 2010. - 4) Enterprises with 10 and more employees. - 5) All enterprises in public sector, private enterprises with 5 and more employees. - 6) From 2012 according to census February 2011. - 7) Base interest rate. This is a reference rate based on the average interbank LEONIA rate of previous month (Bulgaria has a currency board). - 8) From 2013 BOP 6th edition, 5th edition before.
Source: wiiw Databases incorporating Eurostat and national statistics.

BULGARIA: New government's reform ambitions to face reality check

RUMEN DOBRINSKY

Economic activity in Bulgaria remained sluggish throughout most of 2014; weak GDP growth is likely to continue in 2015, driven mainly by household consumption and net exports. Some acceleration of economic activity might be expected over the period 2016-2017 on account of improving external conditions. The newly elected government that lacks strong political backing faces the challenge of implementing an ambitious reform agenda in a weak economic environment.

The early elections held in October 2014 did not produce clear-cut winners and a new, rather broad coalition government was formed with the participation of four centrist and centre-right parties. The most remarkable outcome, however, was that these elections brought back Boyko Borisov as Prime Minister – the first time anyone returned to the top political position in post-communist Bulgaria. To his credit, Mr. Borisov manoeuvred rather skilfully through the post-election horse trading phase and managed to mobilise a coalition around him. It only remains to be seen whether it will be able to survive for long in Bulgaria's turbulent and unstable political environment.

Another novelty in Bulgaria's political life was the fact that the new government came forth rather fast with a comprehensive and detailed programme which envisages a wider-ranging reform agenda, covering many important spheres of economic and social life. As regards the economy, the programme puts the emphasis on innovation, new technologies and export-oriented competitiveness, which would be supported by a better business environment and an efficient public administration. Other important areas of targeted reforms include the pension system, the health care system and the judiciary.

While there is nothing novel in the stated objective and desirable outcomes, what is striking is the overambitious range of detailed measures that the government has included in its wish-list: the programme contains 423 specific objectives and 1,155 measures in 21 different spheres. Some analysts estimated that if the government serves its full term in office, it will have to implement at least one measure per working day during this term – something that appears highly unlikely even if regarded purely in its technical aspect. In any case, a key challenge for the government will be to ensure lasting political support for the declared reform agenda by a rather heterogeneous political coalition with divergent political orientation and objectives. Another key challenge for the authorities will be to invigorate economic activity and growth so as to ensure a broader political support for the envisaged reforms.

Bulgaria's economic performance has been anaemic during the past several years and there are no indications of a possible notable upturn in the short run. Annual GDP growth in 2014 was marginally higher than in 2012 and 2013 and not much different from that in the EU as a whole. The catch-up process which was quite perceptible in the previous decade has all but petered out since the global financial turmoil of 2008/2009.

2014 was also marked by visible deflation, which was among the most pronounced in the EU. Bulgaria's deflation, however, does not appear to be domestically driven but rather imported. An important piece of evidence to this effect is the fact that domestic demand (both private consumption and gross fixed capital formation) grew in 2014 and made a positive contribution to GDP growth. There were also positive developments in the labour market in 2014: employment registered a modest upturn after several years of contraction. Hence one does not observe the typical signs of a vicious deflationary spiral (shrinking domestic demand exerting a downward pressure on prices and contributing to output contraction, labour shedding and further weakening of demand). Rather, being a small economy, dips in international prices are being transmitted through the channels of external trade.

On the supply side, it was the sectors of manufacturing and construction that contributed to the positive GDP growth in 2014. The external environment was not particularly favourable and net trade made a negative contribution to GDP growth. Bulgaria did suffer casualties related to the economic downturn in Russia and the conflict in Ukraine: in nominal terms exports to Russia in 2014 dropped by almost 10% from their 2013 level while exports to Ukraine dived by more than half. Positive growth was only registered in exports to the EU which supported the modest upturn in manufacturing.

The saga of the Corporate Commercial Bank failure ended with the closure of the bank and the initiation of a bankruptcy procedure. The Bulgarian National Bank postponed this decision until after the October elections in the expectation of a possible bailout by the newly elected government, something that did not materialise. The irony is that while there was no formal government bailout, the closure of CCB had serious implications for public finances due to the legal obligation to guarantee deposits of up to EUR 100,000 in accordance with the EU rules. As the Deposit Insurance Fund was not sufficiently endowed with resources to repay the full amount of CCB deposits, the government extended to the Fund, through an amendment in the 2014 budget, a 5.5-year loan amounting to BGN 2 billion (slightly more than EUR 1 billion) at an annual rate of 2.95%.[39] Repayments started at the beginning of December and within one month after the start of these operations, some BGN 3.25 billion of the estimated BGN 3.6 billion eligible for repayment were in fact restituted to their title holders.

In any case, there was no contagion from the CCB failure which remained strictly limited to that specific bank. Moreover, the overwhelming share of the repaid guaranteed deposits never left the banking system at all – they were just transferred to other banks. Overall, apart from the failed CCB, the Bulgarian banking system remains financially sound and has continued operating without interruptions. However, it is not clear yet what the fate of the asset side of the CCB balance sheet will be as the bankruptcy litigation (which has not started yet) hints at possible lengthy legal battles ahead.

[39] Earlier in the year, BNB had argued that a speedy government bailout to keep the bank afloat would ultimately cost the public sector less. However, by that time, the previous government resigned and the parliament was dissolved so this option could not be acted upon.

Bulgaria's fiscal balance deteriorated considerably in 2014. In addition to the CCB intervention, the fiscal outturn was negatively affected by the deflationary trends (e.g. the falling oil prices resulted in lower excise revenue); for the year as a whole, fiscal revenue was some BGN 1 billion below the target. In November, the newly elected parliament voted amendments to the 2014 budget equivalent to a significant increase in the cash deficit, de facto legitimising the expected outturn (BGN 3 billion or some 3.7% of GDP). Given the large-scale deposit insurance commitments that the government took in 2014, the accrual deficit for the year is expected to be significantly higher.

One somewhat striking feature of Bulgaria's recent economic performance (which continued in 2014 as well) has been the persistent robust rise in real wages, by far surpassing productivity growth. In this divergent dynamics, Bulgaria is a clear outlier not only in Central and Eastern Europe but also within the EU. The recent deflationary trend is undoubtedly an important component in this equation; the low absolute level of nominal wages (by far the lowest in the EU) is probably another. However, the most important factor is probably a built-in inertia in the wage formation mechanisms, offsetting by and large its association with productivity. In 2013-2014 these effects were reinforced by some policy moves such as the increase in minimum wages as well as wage rises in the public sector. So far, there are no indications of competitiveness losses related to these developments.

In the final days of December, the parliament approved the 2015 budget under a rather conservative macroeconomic framework: GDP growth of 0.8% in 2015 and a cash deficit of 3% of GDP. However, the pessimistic growth assumption seems to be more an ex ante precautionary justification of possible overspending in the year. While there is no ground to expect a robust recovery, the recent short-term indicators suggest that in 2015 the real economy could probably fare better than these assumptions.

The short-term outlook for the Bulgarian economy has deteriorated only marginally from the autumn of 2014. Thus the current expectations are that in 2015 GDP will grow by some 1.5%, a rate similar to that registered in 2014 thanks to a modest support both from private consumption (the 2015 budget envisages two consecutive hikes in the minimum wage) and net exports. Lower oil prices should also have a beneficial effect on Bulgaria's real economic performance. The expected further upturn in the sectors of manufacturing and construction should allow for modest improvements in the labour market as well. Given the current external environment, inflation is likely to stay close to zero while the current account balance will probably remain in the positive territory.

No major changes in this pattern of economic performance can be expected in 2016 and 2017. Nevertheless, if there will be an overall amelioration in economic conditions in Europe in these years, as envisaged in the most recent EU Economic Forecast, chances are that there will also be a further gradual improvement in Bulgaria's economic performance with GDP growth figures of around 2%, also slightly below the autumn 2014 forecast.

Table 9 / Croatia: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	4,296	4,283	4,269	4,254	4,250	4,250	4,250	4,250
Gross domestic product, HRK mn, nom. [3]	328,041	332,587	330,456	330,135	328,890	331,200	336,500	345,000
annual change in % (real) [3]	-1.7	-0.3	-2.2	-0.9	-0.6	0.3	1.1	1.5
GDP/capita (EUR at exchange rate)	10,500	10,400	10,300	10,200	10,100	10,100	10,200	10,300
GDP/capita (EUR at PPP)	14,900	15,400	15,700	15,800	15,800	.	.	.
Consumption of households, HRK mn, nom. [3]	190,237	195,325	195,623	196,885	196,140	.	.	.
annual change in % (real) [3]	-1.5	0.3	-3.0	-1.3	-0.6	-0.3	0.5	0.6
Gross fixed capital form., HRK mn, nom. [3]	69,784	67,471	64,820	63,732	61,320	.	.	.
annual change in % (real) [3]	-15.2	-2.7	-3.3	-1.0	-4.0	1.0	3.0	4.0
Gross industrial production [4]								
annual change in % (real)	-1.4	-1.2	-5.5	-1.8	1.2	2.0	2.5	2.5
Gross agricultural production								
annual change in % (real)	-8.2	-1.0	-9.9	5.2	0.8	.	.	.
Construction output [4]								
annual change in % (real)	-15.8	-8.5	-11.1	-4.1	-7.0	.	.	.
Employed persons, LFS, th, average [5]	1,541	1,493	1,446	1,390	1,550	1,550	1,560	1,570
annual change in %	-4.0	-3.2	-3.1	-3.9	.	0.0	0.5	0.5
Unemployed persons, LFS, th, average [5]	206	232	272	288	325	.	.	.
Unemployment rate, LFS, in %, average [5]	11.8	13.5	15.9	17.2	17.3	17.5	16.5	16.0
Unemployment rate, reg., in %, end of period	18.8	18.7	21.1	21.6	19.6	19.0	18.0	17.0
Average monthly gross wages, HRK	7,679	7,796	7,875	7,939	7,945	.	.	.
annual change in % (real, gross)	-1.5	-0.8	-2.3	-1.4	0.3	.	.	.
Average monthly net wages, HRK	5,343	5,441	5,478	5,515	5,520	.	.	.
annual change in % (real, net)	-0.5	-0.4	-2.6	-1.5	0.3	.	.	.
Consumer prices (HICP), % p.a.	1.1	2.2	3.4	2.3	0.2	0.4	0.5	1.0
Producer prices in industry, % p.a. [6]	4.3	7.0	5.4	-0.2	-2.6	0.0	1.0	1.0
General governm.budget, EU-def., % of GDP								
Revenues	40.8	40.6	41.3	41.8	42.5	.	.	.
Expenditures	46.8	48.2	46.9	47.0	47.5	.	.	.
Net lending (+) / net borrowing (-)	-6.0	-7.7	-5.6	-5.2	-5.0	-5.5	-5.6	-4.0
Public debt, EU-def., % of GDP	52.8	59.9	64.4	75.7	81.0	84.0	87.0	89.0
Central bank policy rate, % p.a., end of period [7]	9.0	7.0	7.0	7.0	7.0	.	.	.
Current account, EUR mn [8]	-503	-360	-61	341	200	100	50	0
Current account, % of GDP	-1.1	-0.8	-0.1	0.8	0.5	0.2	0.1	0.0
Exports of goods, BOP, EUR mn [8]	8,058	8,742	8,673	8,923	9,900	10,600	11,300	12,100
annual change in %	22.2	8.5	-0.8	2.9	10.9	7.0	7.0	7.0
Imports of goods, BOP, EUR mn [8]	13,980	15,124	14,970	15,512	16,180	16,800	17,500	18,400
annual change in %	-0.5	8.2	-1.0	3.6	4.3	4.0	4.0	5.0
Exports of services, BOP, EUR mn [8]	8,928	9,358	9,636	9,824	10,020	10,200	10,400	10,700
annual change in %	-0.6	4.8	3.0	2.0	2.0	2.0	2.0	2.5
Imports of services, BOP, EUR mn [8]	3,167	3,169	3,120	3,032	2,970	3,000	3,100	3,200
annual change in %	-0.6	0.1	-1.5	-2.8	-2.0	2.0	3.0	3.0
FDI inflow (liabilities), EUR mn [8]	1,069	1,036	1,134	741	2,700	.	.	.
FDI outflow (assets), EUR mn [8]	125	-169	-63	-118	1,900	.	.	.
Gross reserves of NB excl. gold, EUR mn	10,660	11,195	11,236	12,908	12,687	.	.	.
Gross external debt, EUR mn [8]	46,908	46,397	45,276	45,920	46,500	.	.	.
Gross external debt, % of GDP	104.2	103.7	103.0	105.3	107.9	.	.	.
Average exchange rate HRK/EUR	7.2862	7.4342	7.5173	7.5735	7.6300	7.73	7.79	7.86
Purchasing power parity HRK/EUR	5.1340	5.0537	4.9167	4.9168	4.8984	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census April 2011. - 3) According to ESA'10. - 4) Enterprises with 20 and more employees. - 5) From 2014 according to census April 2011. - 6) 2010 domestic output prices. - 7) Discount rate of NB. - 8) BOP 6th edition.
Source: wiiw Databases incorporating national statistics. Forecasts by

CROATIA: Hope for a reversal of the negative growth trend

HERMINE VIDOVIC

In Croatia GDP fell for the sixth consecutive year; however, the country is likely to return to a slightly positive growth path in 2015. Household consumption remains subdued owing to high and persistent unemployment and continued deleveraging. Economic recovery will hinge primarily on external demand, and a revival in investment activities following increased absorption of EU funds. Fiscal consolidation and an overly indebted enterprise sector are the key obstacles to more robust growth.

Croatia's economy continued to shrink for the sixth consecutive year, with GDP contracting by 0.6% in 2014. Gross fixed capital formation and private consumption declined further and government consumption, after showing an upward trend in 2013, fell again in 2014. Only foreign demand contributed positively to GDP growth. The continued drop in investment has been felt particularly in construction, also reporting a decline for the sixth year in a row. After five years of contraction, industrial production showed first signs of recovery, up by 1.2%. Manufacturing grew by 3%, with above-average output growth registered, among others, for the production of leather, wearing apparel, pharmaceuticals and rubber and plastic products. Labour productivity in industry continued to increase due to further layoffs.

The labour market situation remained weak with employment declining by 2% in the first three quarters of 2014 according to the Pension Insurance Institute. In December registered unemployment stood at 19.6%, 3 percentage points lower than in 2013. The reason behind this was mainly of an administrative nature: a high number of persons were deleted from the registers because of non-compliance with the legal provisions. In November the LFS-based unemployment rate stood at close to 17%, youth unemployment at a disastrous 46%, representing the third highest rate in the EU after Spain and Greece. After years of decline both real gross and net wages grew only modestly in 2014.

Since Croatia's accession to the EU in July 2013, trade data have been subject to several revisions following the adoption of the Eurostat methodology in data compilation.[40] Based on customs statistics, goods exports and imports measured in euro terms increased by 8% and 4%, respectively, in the first eleven months of 2014. As a result, the trade deficit declined by EUR 450 million compared to the same period in 2013. Sales expanded both to the EU and CEFTA countries, by about 11% each. A breakdown

[40] Since Croatia's accession to the EU, data on foreign trade in goods are acquired from two different sources: Intrastat for the trade in goods between EU Member States, and the Single Administrative Document for trade in goods with non-EU countries (Extrastat).

by commodity groups shows that wearing apparel, textiles, motor vehicles, and rubber and plastic products reported the strongest growth while exports of ships shrank by almost half. Data on services trade available for the first three quarters of 2014 indicate a modest export increase (tourism and transport in particular) and a contraction of imports, leading to a rise in the services trade surplus compared to a year earlier. For 2014 as a whole wiiw expects the current account to end up with a surplus (EUR 200 million), slightly lower than in 2013. As regards FDI, both inflows and outflows were exceptionally high in the first three quarters of 2014, suggesting that the large transactions were actually round-tripping (a Croatian company sending FDI funds to its subsidiary abroad and then channelling it back).

The general government deficit reached an estimated 5% of GDP in 2014. Revenues performed better than anticipated mainly due to an increased inflow of excises and VAT, while expenditures remained stagnant. The general government debt is estimated to have reached about 81% of the GDP. The 2015 budget is based on an (optimistic) 0.5% GDP growth and envisages the general government deficit to narrow to 3.8% of the GDP, mainly through expenditure cuts. As of 1 January 2015, the Croatian Health Fund has been excluded from the state budget (though some expenses remain in the budget), making comparisons with previous years difficult. Given that 2015 is an election year, there is a high uncertainty on whether fiscal discipline can be maintained.[41] In February 2015 a new Eurobond issue of at least EUR 1 billion will be launched for the financing of a EUR 700 million euro-linked T-bill.

Croatian households are heavily affected by the decision of the Swiss National Bank to abandon the peg of the franc to the euro. About 60,000 persons have loans in Swiss francs, primarily for housing (38% of the total amount of such loans). The stock of Swiss franc loans amounts to about HRK 27 billion or EUR 3.9 billion. In response to the decision of the Swiss National Bank the Croatian parliament decided to fix the exchange rate of the franc for the next 12 months at 6.39 kuna, corresponding to the level prior to the lifting of the cap on the franc. The costs of this decision will have to be borne by the banks. The government announced that talks with the National Bank and commercial banks should follow to find longer-term solutions. Prime Minister Milanovic has also announced the possibility of converting the loans into local currency following the Hungarian example. The Croatian National Bank warned that a conversion of all currency-indexed housing loans to kuna would imply a reduction of the foreign exchange reserves by EUR 7.8 billion; excluding debts denominated in euro, the reserves would drop by EUR 3.2 billion.

At the beginning of February 2015 the Croatian government announced an agreement with municipalities, banks, telecommunication providers and public and private companies to write off debts of the country's poorest citizens. To qualify for the write-off, the applicants' debts must not exceed HRK 35,000 (EUR 4,800), the monthly income of a single person must be less than HRK 1,250 (EUR 170) over the last three months and the banking account must have been blocked for more than 12 months. Applicants are not allowed to have any property or savings.

At the end of September 2014 the ratio of non-performing loans to total loans was at 17.2% (up from 15.7% in December 2013). Out of the loans provided to the corporate sector (in particular construction

[41] The European Commission, in its Winter Forecast 2015, expects the general government deficit to stand at 5.5% in 2015.

and real estate), 30% were categorised as non-performing; the share of non-performing loans in total household loans was 12%.

In January 2015 Kolinda Grabar Kitarovic, the candidate of the main opposition party HDZ, was elected new president of Croatia, replacing incumbent president Ivo Josipovic. This result may also be interpreted as a signal for the upcoming parliamentary elections to be held by the end of 2015 or at the beginning of 2016.

As for the years to come, wiiw has slightly revised upwards the forecast for Croatia's GDP growth for 2015 from stagnation to a 0.3% increase which should be primarily backed by exports. More pronounced growth of more than 1% is expected in 2016 and 2017, driven by external demand as well as by investments fuelled by increased absorption of EU funds. Household consumption will remain suppressed due to high and persistent unemployment and continued private sector deleveraging. Uncertainties remain on whether fiscal discipline can be maintained given that 2015 is an election year.

Table 10 / Czech Republic: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	10,474	10,496	10,511	10,514	10,534	10,534	10,534	10,534
Gross domestic product, CZK bn, nom. [3]	3,954	4,022	4,048	4,086	4,190	4,300	4,470	4,650
annual change in % (real) [3]	2.3	2.0	-0.8	-0.7	2.0	2.3	2.4	2.4
GDP/capita (EUR at exchange rate)	14,900	15,600	15,300	15,000	14,400	.	.	.
GDP/capita (EUR at PPP)	20,600	21,400	21,800	21,600	22,100	.	.	.
Consumption of households, CZK bn, nom. [3]	1,920	1,957	1,970	1,999	2,030	2,090	2,170	2,260
annual change in % (real) [3]	1.0	0.3	-1.8	0.4	1.2	2.4	2.5	2.5
Gross fixed capital form., CZK bn, nom. [3]	1,066	1,069	1,055	1,019	1,070	1,130	1,210	1,290
annual change in % (real) [3]	1.3	1.1	-2.9	-4.4	4.5	5.5	5.5	5.0
Gross industrial production								
annual change in % (real)	8.6	5.9	-0.9	0.0	4.8	4.5	5.0	4.5
Gross agricultural production								
annual change in % (real)	-7.0	8.6	-5.8	6.9	7.3	.	.	.
Construction industry								
annual change in % (real)	-7.4	-3.6	-7.7	-6.6	2.2	.	.	.
Employed persons, LFS, th, average [4]	4,885	4,904	4,890	4,937	4,960	4,970	4,980	4,990
annual change in %	-1.0	0.4	0.4	1.0	0.5	0.3	0.2	0.2
Unemployed persons, LFS, th, average [4]	384	354	367	369	340	.	.	.
Unemployment rate, LFS, in %, average [4]	7.3	6.7	7.0	7.0	6.4	6.0	5.8	5.8
Reg. unemployment rate, in %, end of period [5]	9.6	8.6	9.4	8.2	7.7	6.8	6.4	6.2
Average monthly gross wages, CZK	23,864	24,455	25,067	25,078	25,680	.	.	.
annual change in % (real, gross)	0.7	0.6	-0.8	-1.3	2.0	3.0	2.5	2.5
Consumer prices (HICP), % p.a.	1.2	2.2	3.5	1.3	0.4	0.4	1.5	1.5
Producer prices in industry, % p.a.	0.1	3.7	2.3	0.7	1.3	1.0	1.3	1.5
General governm. budget, EU-def., % of GDP								
Revenues	38.6	39.6	39.8	40.7	40.3	.	.	.
Expenditures	43.0	42.5	43.8	42.0	41.7	.	.	.
Net lending (+) / net borrowing (-)	-4.4	-2.9	-4.0	-1.3	-1.5	-1.5	-2.0	-1.5
Public debt, EU-def., % of GDP	38.2	41.0	45.5	45.7	45.0	44.8	44.5	44.3
Central bank policy rate, % p.a., end of period [6]	0.75	0.75	0.05	0.05	0.05	0.05	0.5	1.5
Current account, EUR mn [7]	-5,708	-3,466	-2,518	-2,171	462	-1,560	-1,940	-2,580
Current account, % of GDP	-3.7	-2.1	-1.6	-1.4	0.3	-1.0	-1.2	-1.5
Exports of goods, BOP, EUR mn [7]	86,836	99,123	104,336	103,230	110,019	116,000	122,000	127,000
annual change in %	20.0	14.1	5.3	-1.1	6.6	5.0	5.0	4.5
Imports of goods, BOP, EUR mn [7]	85,283	96,048	99,413	96,912	101,417	106,000	112,000	118,000
annual change in %	22.0	12.6	3.5	-2.5	4.6	5.0	6.0	5.5
Exports of services, BOP, EUR mn [7]	16,577	17,923	18,863	17,919	17,999	19,000	19,000	19,000
annual change in %	12.3	8.1	5.2	-5.0	0.4	3.0	2.0	2.0
Imports of services, BOP, EUR mn [7]	13,479	14,614	15,776	15,275	16,222	17,000	18,000	19,000
annual change in %	15.6	8.4	8.0	-3.2	6.2	4.0	3.0	3.0
FDI inflow (liabilities), EUR mn [7]	7,707	3,025	7,348	5,250	3,580	.	.	.
FDI outflow (assets), EUR mn [7]	3,945	1,161	2,531	3,053	-1,198	.	.	.
Gross reserves of NB excl. gold, EUR mn	31,357	30,675	33,550	40,459	44,610	.	.	.
Gross external debt, EUR mn [7]	86,371	89,627	96,826	99,294	102,200	.	.	.
Gross external debt, % of GDP	55.2	54.8	60.2	63.1	67.2	.	.	.
Average exchange rate CZK/EUR	25.28	24.59	25.15	25.98	27.54	27.60	27.60	27.00
Purchasing power parity CZK/EUR	18.30	17.90	17.71	17.98	17.96	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) From 2012 according to census March 2011. - 5) From 2013 available job applicants 15-64 in % of working age population 15-64, all available job applicants in % of labour force before. - 6) Two-week repo rate. - 7) BOP 6th edition.
Source: wiiw Databases incorporating Eurostat and national statistics.

THE CZECH REPUBLIC: Second dip left behind

LEON PODKAMINER

The Czech economy has finally recovered from the effects of fiscal consolidation. Given the relatively low level of debt burden in both the government and private sectors and the 'growth-friendly' monetary and fiscal policies, recovery over the period 2015-2017 seems assured. Acceleration of growth, however, may only be gradual as fixed investment is unlikely to expand at a markedly high rate. Doubts have recently been voiced about the country's foreign trade performance in the years to come.

The moderate recovery that had started in the last quarter of 2013 continued steadily throughout 2014. Still the 2014 real GDP fell short of the 2008 level. Growth in household consumption accelerated in 2014 and there was a substantial turnaround in gross fixed capital formation: from a strong decline to strong growth. Despite this the current volume of GFCF is still about 16% below the level recorded in 2008. Inventories, which had decreased strongly throughout much of 2013, showed a considerable increase in the second and third quarter of 2014. The contribution of rising inventories to GDP growth in 2014 equalled, approximately, 0.3 percentage points. In the second quarter of 2014 foreign trade (in goods and services) stopped contributing to GDP growth positively. In the whole of 2014 the volume of exports rose by an estimated 8% while that of imports by 8.8%. The overall contribution of foreign trade to GDP growth in 2014 was minus 0.2 percentage points, thereby disappointing the earlier official expectations.

The changing orientation of the fiscal policy seems to be playing an important role in the strengthening of consumption growth – and partly also of fixed capital formation. After five years of fiscal consolidation (2010-2013) the public sector deficit/GDP ratio had been suppressed from 5.8% to about 1.5%. Public debt to GDP was increasing anyway, largely due to the suppressed GDP development. The deficit ratio is projected (by the Finance Ministry) to rebound to close to 2% in 2015, and public consumption to rise by about 2%, slightly more than in 2014. The wage bill for the public administration sector is to be increased in 2015.[42] Most importantly, government spending on gross fixed capital formation has been planned to jump strongly (after still contracting, by 12%, in 2013). Higher public investment spending is complementing investment spending financed out of the unutilised means still available until the end of 2015 under the EU programmes for 2007-2013. The fiscal relaxation underway – while clearly supporting GDP growth[43] – is nonetheless expected to further suppress the public debt/GDP ratio in 2015.

[42] In addition, the official minimum monthly wage is to rise in 2015, from an equivalent of approximately 310 to 334 euro.

[43] According to the Finance Ministry, the fiscal effort (the increase in GDP shares of the general government *structural* balance) has become negative (-1 percentage point) in 2014 – meaning actual relaxation of the fiscal policy. Nearly as much is envisioned for 2015. (During the fiscal consolidation period 2010-2013 the fiscal effort was positive, averaging 1.1 pp per year.)

The extremely relaxed monetary policy will remain unchanged in the near future. The very low policy interest rate (two-week repo rate) of 0.05%, in force since early November 2012, has not induced any inflationary tendency. Actually, the consumer price index is quite close to zero now – and is not expected to rise in 2015 (especially given the continuing suppression of fuel prices). Low policy interest rates have had little impact on commercial lending rates. The volume of lending to the domestic private non-financial sector has been contracting and the volume of lending to the household sector has been rising very slowly (primarily on account of housing loans). In 2014 the stocks of loans to households and non-financial corporations rose 4% and 0.9% respectively. At the same time the corporate sector's deposits increased by 7.9% and households' by 6.1%. The private (non-financial) sector's deposits exceed the stock of the loans extended to the sector by over 33%. The shares of non-performing loans have been low and falling (or at worst stable) at 6% recently.

The commercial banks seem quite resilient to unfavourable shocks – not only on account of their clients' borrowing and depositing habits, but also due to the banks' high capital adequacy and the relatively low shares of their domestic assets denominated in foreign currencies. All in all, the private sector's saving propensities remain high, which could be a rational attitude given the deflationary risks and fresh memories of the recent recession.

The strategy of targeting a 'competitive' exchange rate level (while at the same time formally sticking to inflation targeting) has so far proven to be a success.[44] Although the strategy has not visibly accelerated the return of inflation to the desirable level (which was the 'official' justification of the strategy) it may have been beneficial with respect to foreign trade developments (and in particular for the restriction of price-competitive imports) recorded in the fourth quarter of 2013 and the first quarter of 2014.

The most recent trade developments suggest that the impact of the enforced devaluation of the Czech koruna could be temporary and limited. As already mentioned, in real terms imports grew faster than exports in 2014. This is likely to continue in 2015 because of higher expected growth in domestic demand and lacking an improvement in the business climate in the euro area. Of course some deterioration in the trade surplus is not disquieting in itself – even if one takes into account that the country's primary income balance (primarily representing net payments to the foreign owners of Czech assets) is consistently negative – and rather large.

When all is said and done, the verdict on the near-term prospects of the Czech economy is positive. The economy has finally recovered after a period of disrupting fiscal consolidation. Given the relatively low levels of debt burden of the government and the private sector (both corporate and households) and growth-friendly monetary and fiscal policies, further recovery in 2015-2017 seems assured. But the growth speed-up of around two and a half per cent may be gradual as fixed investment (especially in housing) is unlikely to expand further at a high rate. It will take more time before investment enters a path of fast and sustained growth. Moreover, there are doubts now – hopefully transient – about the performance of foreign trade in the coming years.

[44] The strategy was inaugurated in early November 2013. So far it has 'cost' the National Bank some EUR 7.5 billion, initially placed on the foreign exchange market. No further interventions have followed: the participants of the foreign exchange markets do not seem to doubt the CNB resolve to keep the CZK/EUR rate above 27.

ESTONIA: Growth remains below potential

SEBASTIAN LEITNER

Given the sluggish external demand, economic growth in 2015 compared to the previous year is not expected to accelerate. However, an increase in earnings and thus household consumption will keep the economy afloat, which is projected to grow by 2% in 2015. From 2016 onwards, we expect an investment revival and positive developments in terms of exports.

The dampening effect of the Russian embargo on European Union exports of food products in 2014 was less severe than expected for the Estonian economy; nevertheless it slowed down export growth. However, the recession of the neighbouring economy and the depreciation of the Russian rouble will have a more severe impact on Estonian exports and transit trade in 2015. By contrast, economic activity is accelerating in Sweden, Estonia's most important trading partner, while the northern neighbour Finland will move out of a four-year recessionary period only in 2016.

On account of the sluggish external demand, industrial production has developed at a slow pace, increasing below productivity growth. Thus the investment activity of the enterprise sector will remain subdued also throughout 2015 – idle capacity prevails in the manufacturing sector. Moreover, the government refrains from giving the economy an additional stimulus and plans to keep public investments at the level of 2014 in real terms.

The budget plan of the Estonian government for 2015 foresees the budget deficit to remain stable at 0.5% of GDP. From January 2015 onwards the flat personal income tax rate was reduced from 21% to 20%, the support for children was doubled and public pensions were raised by about 6%. The average old-age pension thus amounts to EUR 374 this year. Commenting on the draft budgetary plans of the Estonian government, the European Commission again pointed out that the high tax wedge for low-income earners should be reduced in order to ease job creation for this group of the work force. However, the cut in income and unemployment tax enacted in the budget plan of 2015 are not targeted at low-wage earners.

Towards the end of last year the unemployment rate fell below 7% of the workforce. The increase in employment still taking place in 2014 has come to an end. Demographic developments will result in a slight decrease of the workforce in the coming years. However, unemployment rates will continue to fall throughout the period 2015 to 2017.

Table 11 / Estonia: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	1,331	1,327	1,323	1,318	1,310	1,305	1,300	1,295
Gross domestic product, EUR mn, nom. [3]	14,709	16,404	17,637	18,739	19,200	19,700	20,600	21,900
annual change in % (real) [3]	2.5	8.3	4.7	1.6	1.8	2.0	2.5	3.1
GDP/capita (EUR at exchange rate)	11,000	12,400	13,300	14,200	14,700	15,100	15,800	16,900
GDP/capita (EUR at PPP)	16,100	17,700	18,700	19,200	19,800	.	.	.
Consumption of households, EUR mn, nom. [3]	7,480	8,054	8,759	9,373	9,790	.	.	.
annual change in % (real) [3]	-1.6	2.3	5.1	3.8	3.9	3.7	3.5	3.3
Gross fixed capital form., EUR mn, nom. [3]	3,125	4,226	4,759	5,118	5,030	.	.	.
annual change in % (real) [3]	-2.6	33.0	10.4	2.5	1.0	1.0	4.0	5.0
Gross industrial production								
annual change in % (real)	23.6	19.9	1.0	2.9	2.0	3.0	4.0	6.0
Gross agricultural production								
annual change in % (real)	-4.0	9.7	5.6	4.7	1.8	.	.	.
Construction industry								
annual change in % (real)	-8.5	27.3	16.5	0.8	-4.5	.	.	.
Employed persons, LFS, th, average [4]	570.9	609.1	614.9	621.3	625.0	625	620	615
annual change in %	-4.2	6.7	1.9	1.0	0.6	0.0	-0.8	-0.8
Unemployed persons, LFS, th, average [4]	115.9	86.8	68.5	58.7	50.0	44	40	38
Unemployment rate, LFS, in %, average [4]	16.9	12.5	10.0	8.6	7.4	6.6	6.1	5.8
Reg. unemployment rate, in %, end of period	10.2	7.4	6.2	5.3	4.3	.	.	.
Average monthly gross wages, EUR	792	839	887	949	1,000	.	.	.
annual change in % (real, gross)	-1.8	0.9	1.7	4.1	5.5	.	.	.
Average monthly net wages, EUR	637	672	706	757	798	.	.	.
annual change in % (real, net)	-2.9	0.5	1.1	4.3	5.5	.	.	.
Consumer prices (HICP), % p.a.	2.7	5.1	4.2	3.2	0.5	0.8	2.2	3.0
Producer prices in industry, % p.a.	3.2	4.2	2.6	7.3	-2.7	.	.	.
General governm. budget, EU-def., % of GDP								
Revenues	40.6	39.1	39.5	38.4	38.2	38.5	38.2	38.0
Expenditures	40.4	38.0	39.7	38.9	38.7	39.0	38.5	38.3
Net lending (+) / net borrowing (-)	0.2	1.0	-0.3	-0.5	-0.5	-0.5	-0.3	-0.3
Public debt, EU-def., % of GDP	6.5	6.0	9.7	10.1	10.0	9.7	9.4	9.0
Central bank policy rate, % p.a., end of period [5]	0.92	1.00	0.75	0.25	0.05	.	.	.
Current account, EUR mn [6]	266	223	-439	-211	-166	-300	-450	-500
Current account, % of GDP	1.8	1.4	-2.5	-1.1	-0.9	-1.5	-2.2	-2.3
Exports of goods, BOP, EUR mn [6]	7,482	10,384	11,104	11,387	11,422	11,400	12,000	12,700
annual change in %	41.3	38.8	6.9	2.6	0.3	-0.2	5.3	5.8
Imports of goods, BOP, EUR mn [6]	7,886	10,735	12,283	12,341	12,428	12,600	13,200	14,000
annual change in %	31.0	36.1	14.4	0.5	0.7	1.4	4.8	6.1
Exports of services, BOP, EUR mn [6]	3,567	4,040	4,486	4,745	5,050	5,250	5,560	5,850
annual change in %	7.9	13.3	11.0	5.8	6.4	4.0	5.9	5.2
Imports of services, BOP, EUR mn [6]	2,225	2,734	3,131	3,520	3,584	3,660	3,780	3,930
annual change in %	18.4	22.9	14.5	12.4	1.8	2.1	3.3	4.0
FDI inflow (liabilities), EUR mn [6]	1,936	818	1,394	672	1,114	.	.	.
FDI outflow (assets), EUR mn [6]	923	-951	996	538	575	.	.	.
Gross reserves of NB excl. gold, EUR mn [7]	1,904	150	218	222	352	.	.	.
Gross external debt, EUR mn [6]	16,492	16,721	17,966	17,515	19,100	.	.	.
Gross external debt, % of GDP	112.1	101.9	101.9	93.5	99.5	.	.	.
Purchasing power parity EUR/EUR	0.6871	0.6967	0.7136	0.7398	0.7388	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) From 2012 according to census March 2011. - 5) From 2011 official refinancing operation rates for euro area (ECB), TALIBOR one-month interbank offered rate before (Estonia had a currency board). - 6) BOP 6th edition. - 7) From January 2011 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.
Source: wiiw Databases incorporating Eurostat and national statistics.

The shortage of skilled workforce will keep wages growing at a remarkable pace also in 2015 and the following year, particularly in the services sectors. The slow increase in consumer prices will lift net earnings of households by more than 6% in real terms this year. The drop in energy prices resulted in a deflationary period in the second half of 2014. We expect prices to strengthen in the second half of 2015.

Household consumption will remain the most important driver of GDP growth in the coming two years. From 2016 onwards we expect the external environment of the Estonian economy to improve. With a revival in the price of crude oil the Russian economy should gain momentum and thus lift also the prospects for Finland. Recovering external demand will result in an upswing in investments in the Estonian manufacturing sector. Moreover, public investments will increase thereupon with the availability of new co-financing from EU funds for the period 2014-2020. We therefore expect GDP growth to remain somewhat sluggish with 2% in 2015. For 2016 and 2017 we forecast an upswing to 2.5% and 3.1%, respectively, a slight downward revision compared to our autumn forecast.

Table 12 / Hungary: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	10,000	9,948	9,920	9,894	9,850	9,830	9,810	9,800
Gross domestic product, HUF bn, nom. [3]	26,946	28,035	28,549	29,846	31,570	33,000	34,500	36,200
annual change in % (real) [3]	0.8	1.8	-1.5	1.5	3.5	2.3	2.0	2.0
GDP/capita (EUR at exchange rate)	9,800	10,100	9,900	10,200	10,400	.	.	.
GDP/capita (EUR at PPP)	16,400	17,100	17,300	17,600	18,400	.	.	.
Consumption of households, HUF bn, nom. [3]	13,679	14,292	14,880	15,254	15,960	.	.	
annual change in % (real) [3]	-2.8	0.8	-2.0	0.1	2.4	2.0	1.4	1.4
Gross fixed capital form., HUF bn, nom. [3]	5,492	5,552	5,458	5,949	6,930	.	.	
annual change in % (real) [3]	-9.5	-2.2	-4.2	5.2	14.0	5.0	3.0	3.5
Gross industrial production								
annual change in % (real)	10.5	5.6	-1.8	1.1	7.5	6.0	5.0	4.0
Gross agricultural production								
annual change in % (real)	-11.1	11.1	-10.0	12.2	9.2	.	.	.
Construction industry								
annual change in % (real)	-10.4	-8.0	-6.7	8.5	14.3	5.0	3.0	3.0
Employed persons, LFS, th, average [4]	3,781	3,812	3,827	3,893	4,101	4,120	4,140	4,150
annual change in %	0.0	0.8	1.8	1.7	5.3	0.5	0.5	0.2
Unemployed persons, LFS, th, average [4]	475	468	473	441	343	.	.	.
Unemployment rate, LFS, in %, average [4]	11.2	10.9	11.0	10.2	7.7	7.5	7.3	7.2
Reg. unemployment rate, in %, end of period	13.3	12.4	12.8	9.3	8.9	.	.	
Average monthly gross wages, HUF [5]	202,525	213,094	223,060	230,664	237,100	.	.	.
annual change in % (real, gross)	-3.4	1.3	-0.9	1.7	3.0	.	.	.
Average monthly net wages, HUF [5]	132,604	141,151	144,085	151,085	155,300	.	.	.
annual change in % (real, net)	1.8	2.4	-3.4	3.1	3.0	.	.	.
Consumer prices (HICP), % p.a.	4.7	3.9	5.7	1.7	0.0	1.5	2.5	3.0
Producer prices in industry, % p.a.	4.0	4.1	4.1	0.6	-0.4	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	45.2	44.4	46.4	47.3	48.0	.	.	.
Expenditures	49.7	49.9	48.7	49.7	50.2	.	.	.
Net lending (+) / net borrowing (-)	-4.5	-5.5	-2.3	-2.4	-2.2	-2.8	-2.9	-2.9
Public debt, EU-def., % of GDP	80.9	81.0	78.5	77.3	77.3	77.5	77.0	76.8
Central bank policy rate, % p.a., end of period [6]	5.75	7.00	5.75	3.00	2.10	.	.	.
Current account, EUR mn [7]	274	754	1,873	4,162	4,495	4,000	3,700	3,500
Current account, % of GDP	0.3	0.8	1.9	4.1	4.4	3.8	3.4	3.0
Exports of goods, BOP, EUR mn [7]	66,130	71,793	70,299	72,409	76,527	81,700	87,400	92,600
annual change in %	16.4	8.6	-2.1	3.0	5.7	6.8	7.0	6.0
Imports of goods, BOP, EUR mn [7]	63,514	68,868	67,261	68,822	73,384	78,500	83,600	88,600
annual change in %	17.2	8.4	-2.3	2.3	6.6	7.0	6.5	6.0
Exports of services, BOP, EUR mn [7]	14,650	16,039	16,125	16,788	17,452	18,500	19,400	20,200
annual change in %	10.1	9.5	0.5	4.1	4.0	6.0	5.0	4.0
Imports of services, BOP, EUR mn [7]	12,005	12,752	12,327	12,751	12,875	13,400	13,800	14,200
annual change in %	-1.0	6.2	-3.3	3.4	1.0	4.0	3.0	3.0
FDI inflow (liabilities), EUR mn [7]	1,358	4,430	4,366	4,063	3,040	.	.	.
FDI outflow (assets), EUR mn [7]	597	3,458	2,345	3,689	2,695	.	.	.
Gross reserves of NB, excl. gold, EUR mn	33,667	37,242	33,757	33,696	34,481	.	.	.
Gross external debt, EUR mn [7]	140,558	135,351	127,230	119,148	120,000	.	.	.
Gross external debt, % of GDP	143.7	134.9	128.9	118.5	117.6	.	.	.
Average exchange rate HUF/EUR	275.48	279.37	289.25	296.87	308.71	315	315	315
Purchasing power parity HUF/EUR	164.54	164.39	166.35	171.01	173.74	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2011 according to census October 2011. - 3) Accoding to ESA 2010. - 4) From 2012 according to census 2011. - 5) Enterprises with 5 and more employees. - 6) Base rate (two-week NB bill). - 7) BOP 6th edition.
Source: wiiw Databases incorporating Eurostat and national statistics.

HUNGARY: The growth engine kicked in – what next?

SÁNDOR RICHTER

Even though Hungary has left recession behind, it has not yet embarked on a sustainable growth path. The strong external stimulus to growth lent by the EU helped to resuscitate private investment and employment. With the stimulus from the EU cohesion policy weakening as of the current year, it is expected that other private (domestic and external) factors will drive recovery; however, the conditions conducive to that happening are far from favourable. Medium-term growth is unlikely to reach more than 2% in the biennium 2016-2017.

According to preliminary data the Hungarian GDP may have expanded by 3.5% in 2014, the best result since 2006. Does this impressive performance mark the beginning of a new era, characterised by stronger and more sustainable economic growth, or is 2014 to be seen as an anomaly within a lasting low-growth period characterised by meagre investment propensity, unsolved structural problems in public finance and spreading pauperisation[45] of wide strata of the population?

Without any doubt, one-off factors played a very important role in the improvement of the growth performance last year. Cohesion policy related payments from the EU budget steeply increased over 2013 and 2014, reaching a climax at about 6% of the GDP last year. This huge injection into aggregate demand was reflected in the strong upturn in investment (over 14%) and, indirectly, in elevated household consumption relative to the previous year as well. It may have contributed to higher fiscal revenues by over 2 percentage points of the GDP, i.e. without these transfers the fiscal deficit may have attained more than 4% of GDP, surpassing the 3% threshold prescribed in the Stability and Growth Pact. Another one-off effect is that 2014 was a super-election year (general, EU parliament and municipal elections) with the consequence of long-pending large investment projects being completed to impress the electorate. Household consumption may have increased by more than 2% last year, an important expansion after several years of negative or only marginal positive growth. The upturn in household consumption was triggered by an exceptionally strong, 5.3% increase in employment and a 3% expansion of real net wages last year. The former was related to the mentioned investment boom as well as to a substantial enlargement of public workfare programmes and that part of migration abroad which is registered as domestic employment. Real wages may have grown partly unplanned, due to stronger than expected disinflation. Retail trade turnover increased by more than 5%.

[45] http://www.ksh.hu/docs/eng/xstadat/xstadat_annual/i_zhc013.html

What remains of all these growth-fostering effects for this year? 2015 is the last year of payments from the 2007-2013 Multiannual Financial Framework of the EU. A complete disbursement of outstanding resources would ensure a magnitude of inflows similar to that registered last year. However, often the difficult projects remain to be completed in the very last stage. Hungary is one of the most problematic Member States in terms of deficient projects; there are problems with transparency, reliability of data supply and public procurement.[46] This makes it likely that the contribution of EU transfers to economic growth will lag behind the peak attained last year. The 5% increase in employment cannot be repeated this year as investment growth has been decelerating since the summer of 2014. Inflation is making a comeback this year, even if it remains low. That means that no surprise effect in real wages can be expected as in the previous year. To partly counterbalance these effects, household consumption may be fostered this year through more disposable income of those households where monthly amortisation of mortgage loans will be diminished. This is due to a law compelling banks to compensate their clients for arbitrary modifications of interest rates charged and too high a margin between bid and ask rates for currency conversion applied in the case of foreign exchange loans for households in the past years.

Thus, one-off factors will wane this year as drivers of growth. This leaves the traditional growth engines of the Hungarian economy, FDI and foreign trade. FDI inflow data must be split into two parts. On the one hand, there is a substantial inflow for the recapitalisation of ailing foreign-owned banks by their mother companies: from 2008 to end of 2014 the accumulated inflow to this purpose amounted to EUR 5 billion.[47] On the other hand, in the non-financial business sector the FDI outflow has been surpassing the inflow for two years.[48] With regard to the outstanding role foreign-owned enterprises play in the modernisation of industrial capacities and services, employment and exports, this has become one of the crucial obstacles to attaining a higher growth path of the economy. Foreign trade, i.e. net export, had made an important contribution to GDP growth from the 2009 crisis up to 2013. This contribution diminished already in 2013 and is assumed to have turned negative in 2014. With less import for investment and consumption and lower import value of energy due to falling prices, net export may again positively contribute to GDP growth this year, even if less than in the pre-2013 years.

While the fiscal balance safely remained below 3% of GDP in 2014, the public debt to GDP ratio most probably stayed at the level of the previous year. Though the main figures hint at a consolidated fiscal stance, the critical state of affairs in public health, education, culture and local governments coupled with the persisting existence of growth-constraining sector-specific taxes point to outstanding structural reforms.

An enhancement of financial transmission would be of critical importance for improving Hungary's growth performance. Recent data show that, except for the SME segment where the Credit for Growth Programme, a preferential credit line subsidised by the central bank, brought about positive changes, the stock of loans presumably declined further in 2014. The financial sector has become a battlefield in the past five years. An exceptionally high bank tax and a financial transaction tax, together with other smaller charges, have become the main pillar of fiscal consolidation. Squeezing the banks had also the purpose to diminish the foreign presence in the sector. In early 2015 this goal seems to have been

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[46] B. Jávor, 'Veszélyben vannak a regionális pénzek?', http://javorbenedek.blog.hu/2014/12/29/veszelyben_vannak_a_regionalis_penzek

[47] National Bank of Hungary, 'Fizetési Mérleg Jelentés', January 2015.

[48] Világgazdaság Online, www.vg.hu/gazdasag/menekul-a-toke-magyarorszagrol-441127 and National Bank of Hungary, 'Fizetési Mérleg Jelentés', January 2015.

achieved with the state having bought MKB and the Budapest Bank and having agreed with Erste Bank to purchase a 15% participation in that bank. The Russian-owned Sberbank may also go over to Hungarian state ownership. The further faith of majority state-owned banks is unclear. Both lasting state ownership and early reprivatisation to Hungarian owners are possible, both solutions bearing the danger of immediate political interference, a guarantee of inefficiency under the current political constellation in Hungary. Nevertheless, in its most recent information on this issue the government declared its intention to reprivatise the banks concerned within three years.

This year foreign exchange mortgage loans of households will be converted into forint-denominated loans. The conversion will take place at the daily rate of 7 November 2014 (256 HUF/CHF and 309 HUF/EUR). This is much more favourable for the banks (and worse for the households involved) than the conversion rate of 180 HUF/CHF and 250 HUF/EUR applied in a 2011 campaign designed for the richest segment of the forex debtors. Still the compensation of clients for arbitrary interest rate changes and too high a margin between bid and ask rates will cost the banks an equivalent of 2% of GDP, and in this context forex debtor households come off better. The average monthly amortisation of the involved households' loans is assumed to shrink by 20% to 30% after being converted into Hungarian forint. All in all, the exit of forex mortgage loans (their value corresponds to 10% of the GDP) is a painful but necessary step to defuse a dangerous time bomb.

On 9 February 2015 the Hungarian government announced a U-turn in its policy towards the financial sector. In a Memorandum of Understanding with the EBRD the government promised to cut the rate of the bank tax (projected on the balance sheets of individual banks) from the current 0.53% to 0.31% in 2016 and to 0.21% in 2017. From 2019 the tax rate is planned to be adjusted to EU norms. The tax amounts to HUF 144 billion this year, and delivers about 0.9% of total fiscal revenues (all special taxes combined about 5.5%)[49]. It remains to be seen whether this turn in policy will hold (originally the government had announced to phase out the tax by 2014 and that promise was broken). The change, if realised, may help the revitalisation of the ailing financial intermediation, but it also raises the necessity to find an alternative source of revenues for the budget to make up for the losses due to the elimination of the bank tax.

Summarising, though Hungary has left behind recession, it has not entered a sustainable growth path yet. The strong external stimulus to growth received from the EU in the last one and a half years helped reanimate, to some extent, private investment and employment in the business sector. The growth-enhancing impact of these one-off effects made us to revise upwards our forecast for 2014. Once this extraordinary addition to domestic demand gets weaker from this year onwards, other, private domestic and external factors should carry on the recovery. It is doubtful whether this will occur. FDI inflows have ebbed out and financial transmission is yet far from fulfilling its due role in the economy, to mention only the two most important obstacles to sustained recovery. In addition to these, there are the evergreen issues of the past five years: the uncertainty of the legal environment, the extreme centralisation of government decisions and cronyism, pointless confrontations with the EU and the United States, the Prime Minister's attraction to Putin's Russia and dubious autocratic regimes such as that in Azerbaijan. In these circumstances, economic growth is assumed to reach not more than 2% in the medium run, leaving the hope for catching up with the core EU countries or the Visegrad peers frustrated.

[49] Own calculation based on Portfolio, 'Orbán megint megigérte a különadók csökkentését', 15 January 2014.

Table 13 / Latvia: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	2,098	2,060	2,034	2,013	2,005	1,995	1,987	1,979
Gross domestic product, EUR-LVL mn, nom. [3]	18,166	20,297	22,043	23,222	24,000	24,700	26,000	27,500
annual change in % (real) [3]	-2.9	5.0	4.8	4.2	2.5	2.1	2.8	2.8
GDP/capita (EUR at exchange rate)	8,600	9,800	10,900	11,600	12,000	12,400	13,100	13,900
GDP/capita (EUR at PPP)	13,400	15,000	16,300	17,200	17,800	.	.	.
Consumption of households, EUR-LVL mn, nom. [3]	11,421	12,457	13,226	14,119	14,620	.	.	.
annual change in % (real) [3]	3.3	2.8	2.7	6.1	2.8	2.9	3.2	3.4
Gross fixed capital form., EUR-LVL mn, nom. [3]	3,469	4,494	5,548	5,401	5,770	.	.	.
annual change in % (real) [3]	-20.0	24.2	14.5	-5.2	2.7	1.9	3.0	4.0
Gross industrial production [4]								
annual change in % (real)	14.9	9.0	6.1	-0.8	-1.1	1.0	3.0	4.0
Gross agricultural production								
annual change in % (real)	-2.4	2.8	17.3	1.5	-1.0	.	.	.
Construction industry								
annual change in % (real)	-23.4	12.5	13.5	8.3	7.8	.	.	.
Employed persons, LFS, th, average [5]	940.9	970.5	875.6	893.9	885.0	885	880	875
annual change in %	-4.3	3.1	1.6	2.1	-1.0	0.0	-0.6	-0.6
Unemployed persons, LFS, th, average [5]	216.1	176.4	155.1	120.4	108.3	100	90	90
Unemployment rate, LFS, in %, average [5]	18.7	15.4	15.0	11.9	10.9	10.2	9.6	9.2
Reg. unemployment rate, in %, end of period [5]	14.3	11.5	10.5	9.5	8.5	.	.	.
Average monthly gross wages, EUR-LVL	633.2	660.2	684.4	715.7	766.0	.	.	.
annual change in % (real, gross)	-2.4	-0.1	1.4	4.6	6.4	.	.	.
Average monthly net wages, EUR-LVL	449.6	469.5	488.0	515.4	558.0	.	.	.
annual change in % (real, net)	-6.5	0.1	1.6	5.6	7.6	.	.	.
Consumer prices (HICP), % p.a.	-1.2	4.2	2.3	0.0	0.7	0.8	2.2	2.8
Producer prices in industry, % p.a.	2.4	7.7	4.1	1.7	0.4	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	36.0	35.5	35.8	34.8	34.5	33.9	33.5	33.1
Expenditures	44.2	38.9	36.6	35.7	36.1	35.2	34.7	34.0
Net lending (+) / net borrowing (-)	-8.2	-3.4	-0.8	-0.9	-1.6	-1.3	-1.2	-0.9
Public debt, EU-def., % of GDP	46.8	42.7	40.9	38.2	40.2	36.1	35.0	34.0
Central bank policy rate, % p.a., end of period [6]	3.50	3.50	2.50	0.25	0.05	.	.	.
Current account, EUR mn [7]	420	-572	-718	-543	-711	-800	-900	-900
Current account, % of GDP	2.3	-2.8	-3.2	-2.3	-3.0	-3.2	-3.5	-3.3
Exports of goods, BOP, EUR mn [7]	6,657	8,300	9,645	9,810	10,115	10,200	10,500	10,900
annual change in %	32.8	24.7	16.2	1.7	3.1	0.8	2.9	3.8
Imports of goods, BOP, EUR mn [7]	8,145	10,743	12,208	12,351	12,551	12,600	13,100	13,700
annual change in %	24.6	31.9	13.6	1.2	1.6	0.4	4.0	4.6
Exports of services, BOP, EUR mn [7]	3,050	3,471	3,768	3,900	3,807	3,770	3,960	4,110
annual change in %	-3.3	13.8	8.6	3.5	-2.4	-1.0	5.0	3.8
Imports of services, BOP, EUR mn [7]	1,749	1,991	2,145	2,127	2,082	2,060	2,130	2,210
annual change in %	1.5	13.8	7.7	-0.8	-2.1	-1.1	3.4	3.8
FDI inflow (liabilities), EUR mn [7]	331	1,075	840	743	340	.	.	.
FDI outflow (assets), EUR mn [7]	57	75	127	373	100	.	.	.
Gross reserves of NB excl. gold, EUR mn [8]	5,472	4,666	5,412	5,565	2,446	.	.	.
Gross external debt, EUR mn [7]	30,119	29,603	30,254	30,501	34,200	.	.	.
Gross external debt, % of GDP	167.2	146.6	136.2	131.1	142.5	.	.	.
Average exchange rate EUR-LVL/EUR	1.0084	1.0050	0.9922	0.9981	1.0000	1.0000	1.0000	1.0000
Purchasing power parity EUR-LVL/EUR	0.6441	0.6566	0.6629	0.6692	0.6707	.	.	.

Note: Latvia has introduced the Euro from 1 January 2014. Up to and including 2013 all time series in LVL as well as the exchange rates and PPP rates have been divided for statistical purposes by the conversion factor 0.702804 (LVL per EUR) to achieve euro-fixed series (EUR-LVL).
1) Preliminary and wiiw estimates. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) Enterprises with 20 and more employees. - 5) From 2012 according to census March 2011. - 6) From 2014 official refinancing operation rate for euro area (ECB), refinancing rate of National Bank before. - 7) BOP 6th edition. - 8) From January 2014 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.
Source: wiiw Databases incorporating Eurostat and national statistics.

LATVIA: Headwind from the east

SEBASTIAN LEITNER

Prospects for the Latvian economy in 2015 have gradually deteriorated over the past few months. The major devaluation of the Russian rouble and the Russian economic slump will drag down the volume of Latvian exports. Entrepreneurs will thus be reluctant to expand their investment activities – at least not before 2016. It is expected, however, that household consumption will keep the Latvian economy buoyant, increasing by 2.1% in 2015 before a revival in external demand sets in and revitalises economic activity overall.

Throughout 2014 the growth of export volumes declined not least due to the Russian embargo on food products. Although trade with western markets is developing at a good pace, in 2015 the setback of Russian demand will result at best in stagnation of overall Latvian exports. The expected decline in transit trade will also hit the transport and wholesale trade sectors.

In line with exports also industrial production decreased for the second year in a row in 2014. A substantial upswing is not to be expected in 2015 either, although positive growth might be accomplished. Liepajas metalurgs, the largest producer in the Latvian steel sector, which became insolvent and was taken over by the Ukrainian KVV group last year, resumed production in mid-February 2015. In total the plans envisage the reinstatement of about 1,300 employees.

In the light of unsatisfying business prospects, confidence indicators in the industrial and construction sectors are on the decline. Accordingly, in the second half of last year growth in fixed capital investments declined and will remain almost stagnant in 2015. The same applies to public investments, which are planned to be reduced slightly as a share in GDP, from about 3.8% of GDP last year to 3.6% in 2015. The availability of fresh EU funds will result in public as well as private investments growing more swiftly in 2016 and thereafter.

The budget deficit is scheduled to be reduced slightly and is likely to amount to 1.3% of GDP in 2015. From January 2015 onwards the flat income tax rate was cut from 24% to 23%, while the minimum wage was increased by 12.5% to EUR 360. A further cut of the income tax rate of one percentage point and an increase in tax allowances for low-income earners and families are envisaged for 2016.

The significant decrease of energy prices resulted in consumer prices remaining stagnant in 2014 and even declining in January 2015. However, with prices in services rising by about 4% and oil prices unlikely to fall further, we expect consumer price inflation to increase slightly in 2015.

Households benefited from low inflation and strongly rising wage incomes in 2014. As a result, net incomes expanded remarkably, by 7.6%. For this year we expect wage growth to slow down slightly to 6.5% and continue to grow at a high pace, by some 6%, in 2016 as well.

Already in 2014 the number of employed declined by 1% although the unemployment figures were decreasing gradually. Towards the end of 2015 we expect the unemployment rate to fall below 10% for the first time after the outbreak of the economic crisis in 2008. Demographic developments, reinforced by negative net migration, will however result in a decline in the labour force by more than 1% annually in the years ahead.

Considering the strong increase in net wages, the growth in household consumption, at slightly below 3% in real terms, remained relatively restrained last year. The economic and political instability in Russia results in precautionary savings of Latvian households. Also in the coming two years they will prefer to lower their debt burden, although household consumption will remain the most important driver of growth of the Latvian economy.

In the light of the severity of the Russian economic downturn we had to lower the growth forecast for 2015 from 2.7% to 2.1%. Expecting exports and thus also industrial production to revive on account of increased external demand both from eastern and western neighbours, we forecast an upswing in overall economic activity to 2.8% both in 2016 and 2017.

LITHUANIA: Weathering the Russian slump

SEBASTIAN LEITNER

The setback in the neighbouring countries to the east, which hit exporters hard last year, will continue and economic growth will decelerate in 2015. Both public and private investments will increase at a slow rate, while household spending will secure a rise in employment; the net result will be 2.4% GDP growth in real terms in 2015. An upward trend in economic activity driven by exports and investment is to be expected in the years thereafter.

Lithuania is the EU member with the strongest trade linkages not only with Russia, but also other CIS countries. Nevertheless, the structure of exports is composed of a high share of transit goods. Only about 5% of the exported goods of Lithuanian origin are destined for Russia. Thus, the recession in Russia, Belarus and Ukraine will obviously cause losses both for Lithuanian producers and particularly entrepreneurs in the transport and wholesale sectors; however, the general impact should remain bearable for the Lithuanian economy, since trade with the western partners evolves at a good pace.

Nevertheless, entrepreneurs in the manufacturing and transport sectors will reduce their investments in view of the meagre prospects. Moreover, the budget plan for 2015 foresees a reduction of public investments this year. Only the construction of dwellings will continue to increase given the ongoing growth in household income; moreover, the stock in mortgage loans started to increase gradually again last year.

The growth of economic activity by 3% last year resulted in employment expanding by more than 1%; still the figure for 2014 is about 10% below the level of 2007. Although return migration is increasing and negative net migration declining, the demographic developments will lead to a decrease of the labour force in the years to come. As the number of jobs in both the private and public sector will grow thanks to the pace of economic activity in Lithuania, the unemployment rate will further decline, though at a slower rate than before, to 10.5% in 2015 and below 10% in 2016.

The overall growth of net wages by more than 4% in real terms last year was particularly driven by shortages for highly skilled workers in the services sectors and the increase of the minimum wage. This development will continue to drive household consumption. The government has announced to increase the minimum wage, which was lifted last time in October 2014, by another 7% to EUR 320 in July 2015 and to raise in addition the income of low-earning public servants. The strongest hike in expenditures in the budget 2015 is earmarked for defence. The budget deficit will continue to decline, yet less than expected by the government due to lower revenue growth, to 1.4% of GDP.

Table 14 / Lithuania: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	3,097	3,028	2,988	2,958	2,928	2,900	2,875	2,860
Gross domestic product, EUR-LTL mn, nom. [3]	28,001	31,247	33,314	34,956	36,100	37,200	39,000	41,300
annual change in % (real) [3]	1.6	6.1	3.8	3.3	3.0	2.4	2.9	3.2
GDP/capita (EUR at exchange rate)	9,000	10,300	11,200	11,800	12,300	12,800	13,600	14,400
GDP/capita (EUR at PPP)	15,300	17,100	18,500	19,300	20,200	.	.	.
Consumption of households, EUR-LTL mn, nom. [3]	17,882	19,471	20,786	21,873	23,010	.	.	.
annual change in % (real) [3]	-3.4	4.6	3.6	4.2	5.0	4.3	4.0	3.8
Gross fixed capital form., EUR-LTL mn, nom. [3]	4,736	5,761	5,777	6,360	6,590	.	.	.
annual change in % (real) [3]	1.4	19.4	-1.6	7.0	9.0	5.0	7.0	8.0
Gross industrial production (sales)								
annual change in % (real)	6.4	6.4	3.7	3.4	-0.1	1.0	3.0	5.0
Gross agricultural production								
annual change in % (real)	-7.2	10.3	14.2	-1.8	3.9	.	.	.
Construction industry								
annual change in % (real)	-7.3	22.1	-7.3	11.5	16.9	.	.	.
Employed persons, LFS, th, average [4]	1,344	1,371	1,276	1,293	1,310	1,320	1,328	1,330
annual change in %	-5.1	2.0	1.8	1.3	1.3	0.8	0.6	0.2
Unemployed persons, LFS, th, average [4]	291	249	197	173	162	155	144	135
Unemployment rate, LFS, in %, average [4]	17.8	15.4	13.4	11.8	11.0	10.5	9.8	9.2
Reg. unemployment rate, in %, end of period [4][5]	14.4	11.0	11.4	11.1	9.3	.	.	.
Average monthly gross wages, EUR-LTL [6]	576	593	615	646	676	.	.	.
annual change in % (real, gross)	-4.6	-1.2	0.7	4.0	4.5	.	.	.
Average monthly net wages, EUR-LTL [6]	450	462	478	501	523	.	.	.
annual change in % (real, net)	-4.3	-1.3	0.5	3.8	4.3	.	.	.
Consumer prices (HICP), % p.a.	1.2	4.1	3.2	1.2	0.2	0.6	1.8	2.5
Producer prices in industry, % p.a.	10.3	13.9	5.0	-2.4	-4.9	.	.	.
General goverm.budget, EU-def., % of GDP								
Revenues	35.4	33.5	33.0	32.8	33.8	33.5	33.2	33.0
Expenditures	42.3	42.5	36.1	35.5	35.4	34.9	34.2	33.8
Net lending (+) / net borrowing (-)	-6.9	-9.0	-3.2	-2.6	-1.6	-1.4	-1.0	-0.8
Public debt, EU-def., % of GDP	36.3	37.3	39.9	39.0	41.0	42.0	40.0	38.0
Central bank policy rate, % p.a., end of period [7]	1.07	1.24	0.52	0.27	0.12	.	.	.
Current account, EUR mn [8]	-92	-1,203	-397	560	-191	-300	-350	-400
Current account, % of GDP	-0.3	-3.8	-1.2	1.6	-0.5	-0.8	-0.9	-1.0
Exports of goods, BOP, EUR mn [8]	14,891	19,422	22,427	23,998	23,772	24,070	25,030	26,780
annual change in %	34.7	30.4	15.5	7.0	-0.9	1.3	4.0	7.0
Imports of goods, BOP, EUR mn [8]	16,539	21,487	23,530	24,918	25,243	25,920	27,090	28,850
annual change in %	35.3	29.9	9.5	5.9	1.3	2.7	4.5	6.5
Exports of services, BOP, EUR mn [8]	3,423	4,033	4,793	5,390	5,857	6,580	7,440	8,480
annual change in %	16.7	17.8	18.8	12.5	8.7	12.3	13.1	14.0
Imports of services, BOP, EUR mn [8]	2,301	2,766	3,404	4,033	4,317	4,970	5,640	6,490
annual change in %	3.7	20.2	23.1	18.5	7.0	15.1	13.5	15.1
FDI inflow (liabilities), EUR mn [8]	653	1,095	454	532	-373	.	.	.
FDI outflow (assets), EUR mn [8]	46	94	215	322	-29	.	.	.
Gross reserves of NB excl. gold, EUR mn	4,788	6,120	6,203	5,705	6,991	.	.	.
Gross external debt, EUR mn [8]	24,015	25,041	25,921	24,395	25,200	.	.	.
Gross external debt, % of GDP	85.8	80.1	77.8	69.8	69.8	.	.	.
Average exchange rate EUR-LTL/EUR	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
Purchasing power parity EUR-LTL/EUR	0.5913	0.6036	0.6029	0.6132	0.6112	.	.	.

Note: Lithuania has introduced the Euro from 1 January 2015. Up to and including 2014 all time series in LTL as well as the exchange rates and PPP rates have been divided for statistical purporses by the conversion factor 3.4528 (LTL per EUR) to achieve euro-fixed series (EUR-LTL).
1) Preliminary and wiiw estimates. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) From 2012 according to census March 2011. - 5) In % of working age population. - 6) Including earnings of sole proprietors. - 7) VILIBOR one-month interbank offered rate (Lithuania had a currency board until Euro introduction). - 8) BOP 6th edition.
Source: wiiw Databases incorporating Eurostat and national statistics.

The political and economic instability in the eastern neighbourhood will result in households raising the level of precautionary savings. Nevertheless, apart from increasing wage incomes, the purchasing power of households is still propped up by remittances from the Lithuanian diaspora amounting to about 4% of GDP. Thus private consumption is expected to continue rising by more than 4% in real terms in both 2015 and 2016.

Overall, due to weaker external demand we had to revise the growth forecast for Lithuania downwards. In 2015 we expect GDP to expand by 2.4%, driven by still vibrant household consumption, while investment growth will dwindle. In 2016 and 2017 an upswing to 2.9% and 3.2% is likely, conditional on economic growth in the eastern neighbourhood and the euro area gaining momentum and public investment activity being pushed by the availability of EU funds.

Table 15 / Poland: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016	2017
						Forecast		
Population, th pers., average [2]	38,184	38,534	38,536	38,514	38,530	38,525	38,500	38,550
Gross domestic product, PLN bn, nom. [3]	1,437	1,554	1,616	1,662	1,720	1,790	1,870	1,970
annual change in % (real) [3]	3.7	4.8	1.8	1.7	3.3	3.5	3.2	3.2
GDP/capita (EUR at exchange rate)	9,400	9,800	10,000	10,300	10,700	.	.	.
GDP/capita (EUR at PPP)	15,800	16,600	17,300	17,800	18,500	.	.	.
Consumption of households, PLN bn, nom. [3]	870.4	939.7	979.4	997.7	1,030.0	1070.0	1120.0	1180.0
annual change in % (real) [3]	2.5	3.0	1.0	1.1	3.0	3.5	3.5	3.5
Gross fixed capital form., PLN bn, nom. [3]	284.8	315.6	314.0	312.8	340.0	360	390	420
annual change in % (real) [3]	-0.4	9.3	-1.5	0.9	9.4	8.0	7.0	6.0
Gross industrial production (sales) [4]								
annual change in % (real)	11.1	6.7	1.2	2.3	3.4	4.5	5.0	4.0
Gross agricultural production								
annual change in % (real)	-3.2	0.1	1.2	0.5	5.2	.	.	.
Construction industry [4]								
annual change in % (real)	3.9	15.3	-5.3	-10.2	4.3	.	.	.
Employed persons, LFS, th, average [5]	15,961	16,131	15,591	15,568	15,724	15,800	15,880	15,930
annual change in % [5]	0.6	1.1	0.2	-0.1	1.0	0.5	0.5	0.3
Unemployed persons, LFS, th, average [5]	1,699	1,723	1,749	1,793	1,747	1,760	1,670	1,580
Unemployment rate, LFS, in %, average [5]	9.6	9.7	10.1	10.3	10.0	10.0	9.5	9.0
Reg. unemployment rate, in %, end of period	12.4	12.5	13.4	13.4	11.5	10.5	10.0	10.0
Average monthly gross wages, PLN	3,224	3,404	3,530	3,659	3,790	3,930	4,130	4,380
annual change in % (real, gross)	1.4	1.4	0.1	2.8	3.7	3.5	3.5	4.0
Consumer prices (HICP), % p.a.	2.7	3.9	3.7	0.8	0.1	0.3	1.5	2.0
Producer prices in industry, % p.a.	1.8	7.3	3.3	-1.2	-1.3	-1.5	0.0	1.5
General governm.budget, EU-def., % of GDP								
Revenues	38.2	39.0	39.1	38.2	38.2	38.6	38.3	39.0
Expenditures	45.9	43.9	42.9	42.2	41.6	41.5	41.1	41.5
Net lending (+) / net borrowing (-)	-7.6	-4.9	-3.7	-4.0	-3.4	-2.9	-2.8	-2.5
Public debt, EU-def., % of GDP	53.6	54.8	54.4	55.7	49.1	50.2	50.1	50.0
Central bank policy rate, % p.a., end of period [6]	3.5	4.5	4.3	2.5	2.0	1.8	2.0	2.0
Current account, EUR mn [7][8]	-19,587	-19,390	-13,699	-5,251	-5,337	-8,600	-11,300	-14,100
Current account, % of GDP	-5.4	-5.1	-3.5	-1.3	-1.3	-2.0	-2.5	-3.0
Exports of goods, BOP, EUR mn [7]	117,931	132,237	140,813	148,872	157,698	168,700	178,800	187,700
annual change in %	23.8	12.1	6.5	5.7	5.9	7.0	6.0	5.0
Imports of goods, BOP, EUR mn [7]	128,325	144,683	147,959	148,237	157,734	169,600	181,500	192,400
annual change in %	25.1	12.7	2.3	0.2	6.4	7.5	7.0	6.0
Exports of services, BOP, EUR mn [7]	26,688	29,330	32,020	33,794	34,359	35,000	36,100	38,400
annual change in %	18.9	9.9	9.2	5.5	1.7	2.0	3.0	6.5
Imports of services, BOP, EUR mn [7]	23,247	24,146	25,812	25,775	27,212	27,800	28,600	30,500
annual change in %	33.6	3.9	6.9	-0.1	5.6	2.0	3.0	6.5
FDI inflow (liabilities), EUR mn [7][8]	12,769	13,274	5,636	71	10,379	.	.	.
FDI outflow (assets), EUR mn [7][8]	7,254	3,173	446	-2,772	4,461	.	.	.
Gross reserves of NB excl. gold, EUR mn	66,253	71,028	78,403	74,257	79,379	.	.	.
Gross external debt, EUR mn [7]	238,421	250,248	278,037	277,495	300,000	.	.	.
Gross external debt, % of GDP	66.3	66.4	72.0	70.1	73.0	.	.	.
Average exchange rate PLN/EUR	3.9947	4.1206	4.1847	4.1975	4.1843	4.15	4.12	4.20
Purchasing power parity PLN/EUR	2.3872	2.4242	2.4199	2.4288	2.4187	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2011 according to census March 2011. - 3) According to ESA 2010. - 4) Enterprises with 10 and more employees. - 5) From 2012 according to census March 2011. - 6) Reference rate (7-day open market operation rate). -
7) BOP 6th edition. - 8) Including Special Purpose Entities (SPEs).
Source: wiiw Databases incorporating Eurostat and national statistics.

POLAND: Fast recovery of investment

LEON PODKAMINER

Driven by a major increase in investment, the Polish economy has entered a phase of moderately faster growth, which is likely to extend into 2016. In the medium term some deterioration of external balances can be expected. The outcome of the elections to be held in 2015 is still uncertain. Should the present liberal-conservative coalition lose to the nationalist-populist opposition, the economic and social policy may take an unpredictable track.

GDP grew by an estimated 3.3% in 2014. Both household and public consumption increased by about 3%. In contrast, gross fixed capital formation rose by more than 9%. Most probably part of that acceleration was due to the speeding-up of EU co-financed spending. In the first three quarters of 2014 investment outlays taking the form of an increase in the stocks of buildings and structures rose by close to 15% while those into machinery and equipment (other than means of transport) by 13%. Investment in the stock of machinery and equipment accounts for the bulk (over 46%) of total investment outlays. Investment outlays in manufacturing (accounting for a third of the total) rose by about 14%. Outlays in the transportation and storage sector rose by more than 20%. Most likely the increased investment into this sector has only been possible due to the support by transfers from EU funds. The infrastructural sectors (water supply, land transportation, etc.) also feature very prominently in the recent statistics on the estimated value of newly started investment projects.

In real terms growth of exports of goods and non-factor services (estimated at 5.5%) fell short of the growth in imports (estimated at 7%) in 2014. All of a sudden foreign trade became a major drag on overall GDP growth. After 13 consecutive quarters featuring positive (and generally large) contributions of foreign trade to GDP growth, in the second quarter of 2014 that contribution became negative. In 2014 the contribution of trade to GDP growth was about -0.6 percentage points (down from plus 1.4 p.p. in 2013).

A (still mild) deflation in industrial producer prices has been running for over two years now. Its recent acceleration (in the second half of 2014) may have been additionally strengthened by falling prices of energy carriers. Consumer price inflation has also been very close to zero for a long time and is still falling, across a wide spectrum of goods and services. Since mid-year 2014 the CPI has turned negative. This development (long unanticipated and ignored at the central bank) has had some positive aspects. With nominal wage rates following their ‘natural’ upward trends the unplanned disinflation (turning into mild deflation) has been a source of additional gains in the purchasing power of wage incomes.

The inflation target of the National Bank of Poland (CPI of 2.5% with 1 percentage point tolerance band) has been missed by a wide margin. To some extent this has been the outcome of the monetary policy which continues – for hardly understandable reasons – a fairly restrictive course. The NBP policy interest rate of 2.5% had been maintained, amid deflationary tendencies, for a year and a half before being reduced to 2%.[50] That may have affected the levels of interest rates charged by banks on their loans to the non-financial corporate sector and to households. Nonetheless, in real terms the interest rate on new loans to households is still in excess of 10%, on average, and close to 4% for corporate clients (virtually the same as a year ago). Commercial banks were much quicker in lowering the interest rates on clients' new deposits, though. Not surprisingly, the stocks of loans to both households and the non-financial corporate sector remain essentially flat or falling (and that despite the fact that the weight of the loans denominated in Swiss francs has increased)[51]. But, despite rather unattractive deposit rates, the private non-financial sectors have been increasing their bank deposits (denominated in domestic currency) very strongly.

While the high real interest rates on loans have not precluded the rise in capital formation (still financed primarily out of plentiful own resources, not by loans), high interest rates are unwelcome for another reason. They may have had something to do with the continuing strength of the Polish currency. For a long time this has not be harming the performance of foreign trade. But the recent foreign trade developments seem to indicate that without some currency depreciation it may be hard to square positive trade developments with an acceleration of growth of domestic demand. The risk to foreign trade – and to the economy at large – following too strong a currency may finally induce those in charge of Poland's monetary policy to move the interest rates closer to those prevailing internationally. Before that change materialises, the Polish monetary policy course exposes the economy to serious risks.

The less positive trade performance in 2014 seems to be the first consequence of the impending currency overvaluation (and indirectly probably of too high interest rates). It is unlikely to improve in the coming months especially because of the importance of Russia and Ukraine to Poland's exporters.

The outcomes of the next parliamentary elections (autumn 2015) are also hardly predictable now. If the elections are decisively won by the Law and Justice Party (of former Prime Minister Jaroslaw Kaczynski), the course of policy (including on economic matters) may change radically.[52] The direction of that change cannot be predicted with any certainty. Barring extraordinary changes in the external and internal circumstances, Poland's development in 2015-2017 can be expected to be driven, as in 2014, by expanding domestic demand. We still expect an average GDP growth rate of about 3.5%. The investment push which is an essential aspect of this development has been triggered by both external (EU-funds) and internal (largely cyclical) economic impulses. These positive impulses were much weaker during the less dynamic years 2012-2013.

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[50] On 9 October 2014.

[51] Loans denominated in (or indexed to) foreign currencies accounted (at end-2014) for about 27% of the total for the non-financial corporate and household sectors. The shares of such loans in the totals have been quite stable for a couple of years. The recent strengthening of the Swiss currency, though certainly unpleasant to many firms and (primarily well-to-do) households, has not yet perceptibly affected the shares of non-performing loans. At end-2014 the share of such loans stood at 6.5% for households and at 11.2% for the non-financial corporate sector. (These levels are lower than recorded one year earlier.)

[52] Prime Minister Ewa Kopacz tries to continue the muddling-through tactics of her predecessor, Donald Tusk. Apparently, she lacks the latter's skills. Her reign so far is hard to consider a success.

Romania: Investment slump and consumption boom

GÁBOR HUNYA

Expanding private consumption and a good harvest softened the economic slowdown generated by an investment slump. Further slowdown is expected in 2015, should there be no major turnaround in terms of investments. Increased political and economic stability will benefit longer-term economic growth, yielding an increase of some 3%.

GDP growth fell back in 2014 as compared to a very strong previous year but the country was still among the good performers in the EU. Private consumption boomed due to expanding real wages supported by both nominal wage expansion and subdued inflation. Investments, both public and private, declined as part of fiscal austerity on the one hand and due to further credit squeeze on the other. Exports continued their upward trend ahead of imports but the contribution of net exports to economic growth shrank compared to previous years. The forecast for annual GDP growth in 2015-2017 ranges between 2.5% and 3.0% depending on the robustness of the likely turn-around in investments and on harvest results. We take a conservative stance for 2015 in both respects.

Fiscal policy can at least in part be blamed for the investment slump. The deficit reduction was especially harsh in 2014 (amounting to 1.4% of GDP, cash-based) which is to be eased to 0.13% of GDP in 2015. The budget for 2015 aims at achieving a deficit of 1.45% of GDP (ESA 2010 based) following about 2% in 2014. The 2015 budget law stipulates significantly higher spending on investments than the previous year while total expenditures should be lower by economising on staff. Also revenues should contract as a result of a 5 percentage points cut in the social security contribution introduced last November. The aim of the measure is to lower wage costs and thereby increase the competitiveness of enterprises. Personal income tax revenues should increase, nevertheless, due to higher minimum wages and wage adjustments in the public sector.

The 2015 deficit target is based on Romania's Medium-Term Objective (MTO), an obligation under the preventive arm of the EU Stability and Growth Pact and the IMF precautionary stand-by agreement to reach a 1% structural deficit this year. In this context, Romania has one of the most disciplined fiscal policies in the EU especially in view of the country's modest public debt of less than 40% of GDP. One can hardly find proper arguments to defend intense austerity when economic growth is below 3% mainly as a result of contracting public investment. During the negotiations with the IMF in early February, Finance Minister Valcov tried in vain to postpone the MTO in order to gain more room for increasing public investment without cutting the public sector wage bill. The IMF mission ended without an agreement only because of differing opinions on gas price liberalisation for households and the streamlining of a metallurgy plant. The agreement stays valid, nevertheless, and the next mission is due in April this year.

Table 16 / Romania: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	20,247	20,148	20,058	19,981	19,930	19,880	19,830	19,780
Gross domestic product, RON bn, nom. [3]	533.9	565.1	596.7	637.6	662.0	700	740	780
annual change in % (real) [3]	-0.8	1.1	0.6	3.4	2.9	2.5	3.0	3.0
GDP/capita (EUR at exchange rate)	6,300	6,600	6,700	7,200	7,500	.	.	.
GDP/capita (EUR at PPP)	12,600	13,100	13,800	14,100	14,700	.	.	.
Consumption of households, RON bn, nom. [3]	331.5	347.7	366.6	384.1	403.0	.	.	.
annual change in % (real) [3]	1.0	1.0	0.8	1.1	4.0	2.0	3.0	3.0
Gross fixed capital formation, RON bn, nom. [3]	138.5	153.0	164.1	151.6	150.0	.	.	.
annual change in % (real) [3]	-2.4	2.9	0.1	-7.9	-3.0	4.0	4.0	4.0
Gross industrial production [4]								
annual change in % (real)	5.5	7.4	2.4	7.8	6.1	4.0	5.0	5.0
Gross agricultural production								
annual change in % (real)	1.0	8.9	-21.9	24.5	1.4	.	.	.
Construction industry [4]								
annual change in % (real)	-13.2	2.8	1.2	-0.4	-6.7	.	.	.
Employed persons, LFS, th, average [5]	9,239	9,138	9,263	9,247	8,600	8,620	8,640	8,670
annual change in %	0.0	-1.1	1.4	-0.2	0.6	0.2	0.2	0.3
Unemployed persons, LFS, th, average [5]	725	730	701	730	650	.	.	.
Unemployment rate, LFS, in %, average [5]	7.3	7.4	7.0	7.3	7.0	6.8	6.7	6.5
Reg. unemployment rate, in %, end of period	7.0	5.2	5.5	5.7	5.2	.	.	.
Average monthly gross wages, RON	1,902	1,980	2,063	2,163	2,278	.	.	.
annual change in % (real, gross)	-2.8	-1.6	0.8	0.8	4.2	.	.	.
Average monthly net wages, RON	1,391	1,444	1,507	1,579	1,661	.	.	.
annual change in % (real, net)	-3.7	-1.9	1.0	0.8	4.1	.	.	.
Consumer prices (HICP), % p.a.	6.1	5.8	3.4	3.2	1.4	2.0	3.0	3.0
Producer prices in industry, % p.a.	4.4	7.1	5.3	2.0	-0.2	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	33.0	33.7	33.4	32.9	32.7	.	.	.
Expenditures	39.6	39.2	36.4	35.2	34.7	.	.	.
Net lending (+) / net borrowing (-)	-6.6	-5.5	-3.0	-2.2	-2.0	-2.0	-2.0	-2.0
Public debt, EU-def., % of GDP	29.9	34.2	37.3	38.0	39.0	39.0	39.0	38.0
Central bank policy rate, % p.a., end of period [6]	6.25	6.00	5.25	4.00	2.75	.	.	.
Current account, EUR mn [7]	-5,788	-6,186	-6,060	-1,170	-696	-1,000	-1,400	-1,700
Current account, % of GDP	-4.6	-4.6	-4.5	-0.8	-0.5	-0.6	-0.8	-1.0
Exports of goods, BOP, EUR mn [7]	32,714	40,102	39,855	43,905	46,637	49,100	52,300	54,800
annual change in %	35.8	22.6	-0.6	10.2	6.2	5.3	6.5	4.8
Imports of goods, BOP, EUR mn [7]	41,683	49,063	48,779	49,339	52,154	55,000	58,600	61,600
annual change in %	27.4	17.7	-0.6	1.1	5.7	5.5	6.5	5.1
Exports of services, BOP, EUR mn [7]	7,828	8,685	9,866	13,431	15,050	16,300	17,400	18,600
annual change in %	-7.6	10.9	13.6	36.1	12.1	8.0	7.0	7.0
Imports of services, BOP, EUR mn [7]	6,335	7,031	7,392	8,733	9,181	9,700	10,300	10,900
annual change in %	-15.7	11.0	5.1	18.1	5.1	6.0	6.0	6.0
FDI inflow (liabilities), EUR mn [7]	2,441	1,745	2,181	2,891	2,737	2,500	3,000	3,000
FDI outflow (assets), EUR mn [7]	184	19	-175	-24	280	.	.	.
Gross reserves of NB excl. gold, EUR mn	32,606	33,166	31,206	32,525	32,216	.	.	.
Gross external debt, EUR mn [7]	93,624	99,926	100,857	98,069	94,259	.	.	.
Gross external debt, % of GDP	73.9	75.0	75.4	68.0	63.3	.	.	.
Average exchange rate RON/EUR	4.2122	4.2391	4.4593	4.4190	4.4437	4.46	4.46	4.50
Purchasing power parity RON/EUR	2.0873	2.1469	2.1575	2.2590	2.2666	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census October 2011. - 3) According to ESA 2010. - 4) Enterprises with 4 and more employees. - 5) From 2014 according to census October 2011. - 6) One-week repo rate. - 7) BOP 6th edition.
Source: wiiw Databases incorporating Eurostat and national statistics.

Cumbersome public procurement has been one of the main causes of Romania's inability to benefit from EU structural funds. At the end of 2014 the rate of utilisation of the structural and cohesion funds reached only 52% and Prime Minister Ponta announced the government's goal to achieve 75-80% in 2015. This means that about one quarter of the amount allocated for the 2007-2013 financing period will be lost for the country. Institutional capacity is still inadequate to manage large infrastructure projects. In addition, procedures are often blocked as civil servants avoid passing decisions in fear of ex-post investigations for breaching public interest which is a side-effect of the current anti-corruption campaign.

Success in fighting corruption has been verified by the European Commission. The anti-corruption agency (DNA) investigates against scores of former and current high public officials and business persons inter alia for influence peddling, bribe taking/giving and using bribe money for party financing. If the political and economic life gets finally cleansed, conditions for doing business would improve. Some of the allegations of prosecutors might be exaggerated, however. In a most controversial case the court sentenced two ex-ministers and several foreign consultants for espionage and treason related to planned privatisations which never took place. There may also be a touch of political bias: last year investigations targeted mainly politicians in or around former socialist-led governments, while the supporters of former President Basescu are the more recent targets.

Monetary policy has been easing for more than a year now. In view of falling inflation the National Bank of Romania (BNR) cut the monetary policy rate in several steps, from 4% in December 2013 to 2.25% in February 2015. In addition, minimum reserve requirements have been lowered and the spread for the permanent deposit facility reduced. Money market rates have been even lower than the BNR policy rate. Although commercial interest rates subsided both in nominal and in real terms, lending has not increased. Commercial banks used the new liquidity to return credits to parent banks while some of the funds returned as equity (FDI) to increase the capital adequacy ratio. Banks have also taken steps to work out non-performing loans by writing them off or selling them at a discount, and have converted some foreign currency loans into domestic RON. As a result, the banking sector's exposure to non-performing loans declined. While the banks suffered losses (EUR 800 million in January-November 2014) the soundness of the banking system increased, at least until the Swiss franc crisis starting in January 2015.

Loans denominated in Swiss francs amounted to RON 9.8 billion (EUR 2.2 billion) at the end of November, 4.3% of total lending affecting about 75,000 borrowers. A few thousand of them marched to the government building demanding an overall relief of the increased instalments. The National Bank's perception is that a conversion at an exchange rate other than the market rate is unconstitutional because it affects commercial banks' capital, and that of the shareholders. BNR and the Romanian Banking Association (ARB) agreed that there were a multitude of specific individual situations thus there was no generally applicable solution. They want to avoid moral hazard but encourage banks to find case-by-case reliefs. The six banks most affected have lowered interest rates and offered credit restructuring schemes to the customers involved.[53] The government plans to provide tax credits for borrowers who agree with banks to extend the term of their loans by two years.

[53] Of the total 75,000 persons that have CHF-denominated loans, 32% are Bancpost (subsidiary of Eurobank, Greece) clients, 24% are clients of Volksbank, 20% of Piraeus Bank, 11% of Raiffeisen, 7% of Banca Romaneasca (subsidiary of the National Bank of Greece) and 2% of OTP Bank. A conversion of the CHF credits into RON at the historical rate would generate RON 5.7 billion in losses (0.8% of GDP), and the conversion of all credits in foreign currency at the historical rate of the moment they were granted would generate RON 9.8 billion in losses (1.4% of GDP).

Further external shocks have had very limited effect on Romania. Trade dependence on Russia and on energy imports is small, thus neither the sanctions nor the oil price slump have changed the economic growth path. Export performance has been shaped by the booming automotive sector and also underpinned by exceptionally high grain and electricity sales. Mild weather played a positive role, hydropower stations could work at full capacity.[54] In addition, energy-intensive industries have suffered downsizing in the past few years. A decisive part of Romanian manufacturing is now anchored in European value chains and can grow ahead of its main trading partners. But the inflow of FDI is weak and despite some minor new manufacturing projects, export capacities do not increase as rapidly as earlier.

Low inflation rates have not led to deflation but moderated expectations. Nominal wages were raised at the beginning of 2014 and further increases followed in the public sector during the year. The resulting rapid real wage growth supported the acceleration of private demand. The pace of consumption growth will most probably decelerate in 2015 as wages will be less dynamic except in the case of minimal wage earners while on-farm consumption will decline. Inflation may pick up somewhat unless a bumper harvest is achieved. The labour market usually reacts only moderately to the business cycle; some modest decrease of unemployment (from the current 7% to 6.5%) is expected under the present economic growth scenario in the coming years.

Political uncertainty has decreased following the presidential elections in November 2014. The new president Klaus Iohannis comes from the opposition of the present government, but he does his work in a more conciliatory manner than his predecessor. His constitutional power is important in appointing the leaders of higher courts and secret services, especially at a time of heated anti-corruption allegations that have discredited a major part of the political and business leaders. Thus moral integrity and mediating power of the president is all the more in demand. He can also be the driving force of constitutional amendments aiming, among other things, at streamlining elected bodies and decentralising administration which may increase the efficiency of public institutions.

The governing socialists have been weakened by internal fights since they lost the presidential elections while the opposition liberals see a chance to join forces and demand early elections. This seems rather unlikely to succeed for the time being. The longer-term economic agenda of the socialist-led government includes further fostering of private consumption including a reduction of the VAT rate from 24% to 20% in 2016. For that to happen, they will need more room for fiscal manoeuvre which can only be granted if Romania graduates from IMF tutorship. Assuming full government responsibility for economic policy may be beneficial for the country, provided they do not slip back to excessive spending as before. EU regulations may now provide the necessary and adequate safeguard. Based on increased economic and political stability and improved governance, Romania would be able to grow ahead of its NMS peers and even faster than indicated in the present forecast of 2.5% to 3%, even more than 3% in terms of real GDP.

[54] In 2014, in the structure of electricity production the share of hydropower was 29%; coal accounted for 28%, nuclear power plants for 18%, hydrocarbons for 12%, wind for 9%, and solar power and biomass for 4%. There has been an important shift to renewable energy in recent years.

SLOVAKIA: Domestic demand driving growth

DORIS HANZL-WEISS

Domestic demand replaced exports as the main engine of growth in 2014. This pattern will be maintained in the years to come. A major contributory factor is a number of substantial social measures taken by the government in the run-up to parliamentary elections. Stronger household consumption will also encourage import growth. Exports will remain sluggish in 2015, as low growth will prevail in the euro area and regional uncertainties persist. Growth should pick up thereafter, although risks will remain.

GDP growth in Slovakia reached 2.4% in 2014. While in the past net exports were the main drivers of growth it is now domestic demand. Household consumption recovered after five years of stagnation and grew by about 2.3% in the first three quarters thanks to improving conditions on the labour market and rising real wages. There was deflation in 2014 (-0.1% on annual average). Government consumption rose by nearly 5% as did investment. The latter showed an exceptionally improving trend over the first three quarters. On the other hand, export and import growth slowed down significantly during the year. Goods exports to Slovakia's main export partner Germany grew by 7% (January to November), exports to its second most important export partner, the Czech Republic, dropped by 5%. Exports to other markets, such as Russia or China, dropped by as much as 19% and 15%, respectively.

With regard to sectoral trends, industrial production increased by 3.6% in 2014 – the smallest increase since 2009. The automotive industry, which is the largest sector of the Slovak economy and has led growth in the recent years, lost momentum in the second half of 2014: it even declined from August. Overall, it grew just by 2.4%. While the record number of 980,000 cars produced in 2013 was probably not reached in 2014, two of the main car manufacturers, PSA Peugeot-Citroën and KIA Motors, still reported production increases. The major sectors contributing to growth were basic metals and fabricated metal products, and electrical engineering, followed only on third place by the automotive sector. The construction sector still did not recover in 2014 and declined again by 4% – the sixth year in a row. Value added of services continued growing.

On the labour market, trends were fairly favourable in 2014: Employment rose by about 1% and the unemployment rate (LFS) fell from 14.2% to about 13.4%. Still, this figure is quite high and the situation is aggravated by high long-term and youth unemployment – both represent a major problem in Slovakia. Regional disparities are wide, with low unemployment rates prevailing in the capital Bratislava, but high ones in the central and eastern part of the country. Unemployment among the Roma minority, mainly located in the east, is very high as well.

Table 17 / Slovakia: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	5,391	5,398	5,408	5,413	5,420	5,430	5,440	5,450
Gross domestic product, EUR mn, nom. [3]	67,204	70,160	72,185	73,593	75,300	77,500	80,700	84,500
annual change in % (real) [3]	4.8	2.7	1.6	1.4	2.4	2.5	2.7	3.0
GDP/capita (EUR at exchange rate)	12,500	13,000	13,300	13,600	13,900	13,900	14,800	15,500
GDP/capita (EUR at PPP)	18,600	19,200	19,700	20,000	20,600	.	.	.
Consumption of households, EUR mn, nom. [3]	38,354	39,583	40,770	40,995	41,800	43,000	44,800	46,800
annual change in % (real) [3]	0.1	-0.7	-0.5	-0.8	2.0	2.5	2.7	2.7
Gross fixed capital form., EUR mn, nom. [3]	14,910	16,946	15,393	15,045	15,600	16,300	17,300	18,400
annual change in % (real) [3]	7.2	12.7	-9.3	-2.7	4.0	4.0	4.5	4.5
Gross industrial production								
annual change in % (real)	8.2	5.3	7.9	4.9	3.6	3.0	4.0	4.0
Gross agricultural production								
annual change in % (real)	-8.2	8.7	-5.7	6.7	0.9	.	.	.
Construction industry								
annual change in % (real)	-4.6	-1.8	-12.6	-5.2	-4.2	.	.	.
Employed persons, LFS, th, average [4]	2,318	2,351	2,329	2,329	2,352	2360	2380	2400
annual change in %	-2.1	1.5	0.6	0.0	1.0	0.5	0.7	0.7
Unemployed persons, LFS, th, average [4]	389	368	378	386	365	.	.	.
Unemployment rate, LFS, in %, average [4]	14.4	13.5	14.0	14.2	13.4	13.0	12.5	12.0
Reg. unemployment rate, in %, end of period	12.5	13.6	14.4	13.5	12.3	12.0	11.5	11.0
Average monthly gross wages, EUR	769	786	805	824	840	.	.	.
annual change in % (real, gross)	2.2	-1.6	-1.2	1.0	4.5	.	.	.
Consumer prices (HICP), % p.a.	0.7	4.1	3.7	1.5	-0.1	0.4	1.4	1.7
Producer prices in industry, % p.a.	0.4	4.5	1.9	-1.0	-3.5	1.0	1.5	2.0
General governm.budget, EU-def., % of GDP								
Revenues	34.5	36.4	36.0	38.4	38.0	.	.	.
Expenditures	42.0	40.6	40.2	41.0	40.9	.	.	.
Net lending (+) / net borrowing (-)	-7.5	-4.1	-4.2	-2.6	-3.0	-2.8	-2.6	-2.3
Public debt, EU-def., % of GDP	41.1	43.5	52.1	54.6	54.1	54.9	55.2	55.0
Central bank policy rate, % p.a., end of period [5]	1.00	1.00	0.75	0.25	0.05	.	.	.
Current account, EUR mn [6]	-3,184	-3,497	684	1,341	530	460	250	350
Current account, % of GDP	-4.7	-5.0	0.9	1.8	0.7	0.6	0.3	0.4
Exports of goods, BOP, EUR mn [6]	46,501	54,673	60,159	62,815	63,500	64,000	65,000	68,000
annual change in %	21.3	17.6	10.0	4.4	1.1	1.1	2.2	4.8
Imports of goods, BOP, EUR mn [6]	46,581	54,709	57,653	59,384	59,600	60,000	62,000	65,000
annual change in %	22.3	17.4	5.4	3.0	0.4	1.5	2.8	4.9
Exports of services, BOP, EUR mn [6]	4,836	5,228	6,049	7,197	6,500	6,800	7,300	7,800
annual change in %	2.1	8.1	15.7	19.0	-9.7	5.0	7.0	7.0
Imports of services, BOP, EUR mn [6]	5,488	5,498	5,628	6,612	6,300	6,600	7,300	8,000
annual change in %	-2.7	0.2	2.4	17.5	-4.7	5.0	10.0	10.0
FDI inflow (liabilities), EUR mn [6]	1,561	3,961	1,356	1,610	1,200	.	.	.
FDI outflow (assets), EUR mn [6]	939	1,962	-958	847	1,000	.	.	.
Gross reserves of NB excl. gold, EUR mn	541	659	620	670	1,165	.	.	.
Gross external debt, EUR mn	49,262	52,934	53,755	59,684	66,500	.	.	.
Gross external debt, % of GDP	73.3	75.4	74.5	81.1	88.3	.	.	.
Purchasing power parity EUR/EUR	0.6691	0.6758	0.6776	0.6794	0.6748	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census May 2011. - 3) According to ESA 2010. - 4) From 2012 data according to census May 2011. - 5) Official refinancing operation rates for euro area (ECB). - 6) BOP 6th edition.
Source: wiiw Databases incorporating Eurostat and national statistics.

The Slovak budget deficit and debt to GDP ratio for the year 2013 decreased slightly thanks to revisions in GDP data (but increased due to ESA 10 implementation in 2014), thus reaching -2.6% and 54.6% of GDP in 2013. This is important as Slovakia introduced a 'Fiscal Responsibility Act' in 2011 which incorporates certain thresholds for the debt level and sanctions if surpassed. Thus, the debt to GDP level fell again below the '55%-threshold'. This, together with a pre-election period (the next parliamentary elections are to take place in 2016) and the end of the drawing of structural funds for the period 2007-2013 (absorption of EU funds has been the third lowest and payments will finish at the end of 2015), seems to have spurred the spending mood in 2014/15: The government announced a set of social measures which include free rail transport for students and pensioners since November 2014. The 2015 budget stipulates an increase in salaries of teachers and public and state administration employees, support for kindergartens and new rules for health insurance for low-income employees. At the beginning of 2015, the minimum wage was raised by 8% to EUR 380; also, the introduction of a minimum pension of EUR 270 is planned in 2015. Further on, the government, owner of the Slovak gas utility SPP since 2014, promised to cut household gas prices by a double-digit number until 2016. Considering these measures, the official 2015 budget deficit target of 2.5% seems unrealistic, while the debt to GDP level should remain at about 55% in the coming years.

The Slovak banking sector is in good shape, as confirmed by the ECB's comprehensive assessment of banks which took place in October 2014 (consisting of an asset quality review and stress tests of banks). Slovakia's three largest banks were included: Slovenská sporiteľňa (Erste Bank), Všeobecná úverová banka (Intesa), and Tatra banka (Raiffeisen). On 4 November 2014, the Single Supervisory Mechanism became effective and the ECB has now direct oversight in Slovakia over the above three banks as well as over Československá obchodná banka (KBC), ČSOB Stavebná sporiteľňa and Sberbank Slovensko, as their parent groups are deemed significant. A specific feature of Slovakia is its high growth of loans to households (10% annually between 2009 and 2013), which is among the highest in the EU, and which even accelerated further to 12% in the third quarter of 2014. As a precautionary measure, the Slovak National Bank issued a recommendation in October 2014 which specified conditions under which retail loans are given (e.g. checking of customers, more prudency requirements). Growth of loans to non-financial corporations is lower but also picked up and reached close to 4% in the third quarter of 2014. Here it was primarily loans to state-owned enterprises that surged.

Domestic demand replaced exports as the main engine of growth in 2014, and this pattern will be maintained in 2015 as well. As 2015 is a pre-election year, government spending will be more favourable and contribute to rising household income (e.g. minimum wages, pensions). Stronger household consumption will in turn encourage import growth. Export growth will remain sluggish as low growth will prevail in the euro area and regional uncertainties (Russia, Ukraine) will persist. The economic sentiment indicator has been quite stable since July 2014; in January 2015 it was six points higher than a year earlier. While confidence in the construction sector has increased most since July, confidence in services has registered the strongest relative decline. Other components of the economic sentiment indicator – confidence in industry, in retail trade and consumer confidence – remained at their previous level. For the coming two years we have marginally increased our growth forecast (+0.1pp due to better forecasts for Slovakia's main trading partner Germany); household consumption will again be the main driving force. Prospects for export growth are more favourable for 2016 and 2017. Still, downward risks remain as regional tensions (Russia, Ukraine) persist and certain risks within the euro area prevail (Greece). On the other hand, upward risks may bring faster export growth as oil prices are low and the weak euro may encourage exports to countries outside the European Union. However, previously promising markets (Russia, China) saw decreasing market shares last year. Thus our forecast for 2015 remains at 2.5% for this year and lies at 2.7% for 2016 and 3% for 2017.

Table 18 / Slovenia: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	2,049	2,053	2,057	2,060	2,061	2,061	2,061	2,061
Gross domestic product, EUR mn, nom. [3]	36,220	36,868	36,006	36,144	37,190	38,010	38,890	40,060
annual change in % (real) [3]	1.2	0.6	-2.6	-1.0	2.5	1.7	1.8	2.0
GDP/capita (EUR at exchange rate)	17,700	18,000	17,500	17,500	18,000	18,400	18,900	19,400
GDP/capita (EUR at PPP)	21,000	21,600	21,800	21,800	22,400	.	.	.
Consumption of households, EUR mn, nom. [3]	19,960	20,299	19,981	19,301	19,530	.	.	.
annual change in % (real) [3]	1.0	0.0	-2.9	-4.0	0.8	0.8	1.0	1.0
Gross fixed capital form., EUR mn, nom. [3]	7,694	7,445	6,927	7,127	7,580	.	.	
annual change in % (real) [3]	-13.7	-4.6	-8.9	1.9	6.0	4.0	4.5	3.5
Gross industrial production								
annual change in % (real)	7.2	1.3	-1.1	-0.9	2.2	2.5	3.0	3.0
Gross agricultural production								
annual change in % (real)	0.1	0.6	-11.0	-3.3	8.8	.	.	.
Construction industry [4]								
annual change in % (real)	-16.9	-24.9	-16.9	-2.4	19.4	.	.	.
Employed persons, LFS, th, average	966	936	924	906	920	930	940	960
annual change in %	-1.5	-3.1	-1.3	-1.9	1.5	1.5	1.5	2.0
Unemployed persons, LFS, th, average	75	83	90	102	102	.	.	
Unemployment rate, LFS, in %, average	7.3	8.2	8.9	10.1	10.0	9.0	8.5	8.0
Unemployment rate, reg., in %, end of period	11.8	12.1	13.0	13.5	13.0	12.5	11.5	10.0
Average monthly gross wages, EUR	1,495	1,525	1,525	1,523	1,540	.	.	.
annual change in % (real, gross)	2.1	0.2	-2.4	-2.0	0.7	.	.	.
Average monthly net wages, EUR	967	987	991	997	1,005	.	.	.
annual change in % (real, net)	2.1	0.3	-2.1	-1.2	0.4	.	.	.
Consumer prices (HICP), % p.a.	2.1	2.1	2.8	1.9	0.4	0.5	0.5	1.0
Producer prices in industry, % p.a.	2.0	4.6	0.9	0.0	-0.7	0.5	1.0	1.0
General governm.budget, EU-def., % of GDP								
Revenues	43.6	43.6	44.4	45.2	45.3	.	.	.
Expenditures	49.2	49.8	48.1	59.7	50.6	.	.	.
Net lending (+) / net borrowing (-)	-5.7	-6.2	-3.7	-14.6	-5.3	-3.5	-3.0	-3.0
Public debt, EU-def., % of GDP	37.9	46.2	53.4	70.4	82.2	83.0	84.0	82.0
Central bank policy rate, % p.a., end of period [5]	1.00	1.00	0.75	0.25	0.05	.	.	.
Current account, EUR mn [6]	-30	83	954	2,026	2,187	2,000	1,900	1,700
Current account, % of GDP	-0.1	0.2	2.6	5.6	5.9	5.3	4.9	4.2
Exports of goods, BOP, EUR mn [6]	18,630	21,042	21,256	21,692	23,100	24,400	25,900	27,700
annual change in %	14.4	12.9	1.0	2.1	6.5	5.5	6.0	7.0
Imports of goods, BOP, EUR mn [6]	19,348	21,979	21,292	20,929	21,770	22,900	24,300	26,000
annual change in %	15.8	13.6	-3.1	-1.7	4.0	5.0	6.0	7.0
Exports of services, BOP, EUR mn [6]	4,655	4,906	5,107	5,308	5,517	5,800	6,100	6,500
annual change in %	5.7	5.4	4.1	3.9	3.9	5.0	5.0	6.0
Imports of services, BOP, EUR mn [6]	3,444	3,500	3,596	3,552	3,809	4,100	4,400	4,700
annual change in %	4.6	1.6	2.7	-1.2	7.2	7.0	7.0	7.0
FDI inflow (liabilities), EUR mn [6]	230	637	28	64	1,117	.	.	.
FDI outflow (assets), EUR mn [6]	138	-4	-439	4	-2	.	.	.
Gross reserves of NB excl. gold, EUR mn	695	642	593	580	736	.	.	.
Gross external debt, EUR mn [6]	40,838	40,292	41,503	40,205	44,399	.	.	.
Gross external debt, % of GDP	112.8	109.3	115.3	111.2	119.4	.	.	.
Purchasing power parity EUR/EUR	0.8412	0.8315	0.8030	0.8056	0.8039	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2011 according to register-based census 2011. - 3) According to ESA'10. - 4) Enterprises with 20 and more employees and output of some non-construction enterprises. - 5) Official refinancing operation rates for euro area (ECB). - 6) BOP 6th edition.
Source: wiiw Databases incorporating Eurostat and national statistics.

SLOVENIA: Finally a rebound after years of contraction

HERMINE VIDOVIC

Slovenia's economy returned to growth in 2014 after two years of contraction. The rebound has been driven by rising external demand and a revival in investment activities supported by EU funds. GDP growth in 2015 and 2016 will weaken once again on account of lower investments. Exports and the gradual recovery of household consumption will remain the main engines of growth.

After two years of recession, Slovenia's GDP grew by an unexpected 2.5% in 2014 backed by external demand and a rise in gross fixed capital formation (up by 6%). Household consumption increased for the first time since 2010, while government consumption continued to fall for the fourth consecutive year. Rising investment, co-financed by EU funds, translated into a strong increase in construction activities after years of steep decline, particularly in local infrastructure. By contrast, investments in machinery and equipment have further contracted. Industrial production recovered after two years of contraction, with output of manufacturing up by 4.2%. Above-average output increases were reported for car production (12.5%), production of electrical equipment (12%) and production of computers (11%). Employment – particularly in the private services sector – grew in line with economic recovery, increasing by 1.5% based on Labour Force Survey data, and was mainly due to rising temporary employment; the unemployment rate remained almost stagnant at close to 10%. After two years of decline real wages started to grow moderately, but less than labour productivity. In January 2015 the consumer confidence indicator was 8 percentage points above the 2014 average; this was mainly due to a more optimistic outlook for unemployment, the improved economic situation in the country and the improved financial situation of households, and the suitability for savings over the next 12 months.

In external trade, goods exports rose by 6.5% and imports by 4% in 2014, resulting in a significantly higher trade surplus than in 2013. The increase in exports was mainly the result of rising exports to EU countries, particularly to Croatia, Italy, Austria and France. Deliveries to non-EU countries remained stagnant. Car exports and exports of pharmaceutical products grew the most. The surplus in services trade remained almost unchanged compared to 2013. Services imports were high with respect to 'other business services', out of which 'technical, trade-related and other business services' (25.5%) grew the most. The deficit in primary income has more than doubled due to a strong rise in expenditures, in particular higher net outflows of capital income, which could not be offset by rising income from labour (from an increased number of labour migrants abroad). Overall, the current account closed with a surplus of EUR 2.2 billion in 2014, i.e. EUR 160 million more than in 2013.

The inflow of FDI gained momentum in 2014 owing primarily to the sale of state-owned companies, and rose to an estimated EUR 1.1 billion. Slovenia's gross foreign debt amounted to EUR 45 billion by the end of 2014 and was EUR 4.7 billion higher than at the end of 2013. This increase is mainly attributable to government borrowing by selling bonds.

The general government deficit was narrowing in 2014 owing to rising revenues in line with the economic recovery, but also due to one-off revenues (inflow from concession fees for the mobile telephony radio spectrum) and higher inflows from the EU budget. Expenditures rose on interest payments, one-off factors related to banking recapitalisation and the government's approval to repay deposit holders of Ljubljanska Banka. The 2014 general government deficit is estimated at 5.3%, which is somewhat higher than anticipated. The budget revision for 2015, adopted by the Slovenian government in January, still has to be approved by the parliament. The draft document is based on (an optimistic) 2% GDP growth and anticipates a 2.89% general government deficit for 2015, which considers the recommendations of the European Commission and the commitments made in the 2014 Stability Programme. Revenues will be slightly below the originally planned ones due to the non-implementation of the Real Property Tax, while expenditures will be higher owing to rising interest payments and pension transfers. In addition, investment spending should be raised by 30% as compared to a year earlier. Measures, introduced in 2014, to reduce the public sector's wage bill will be prolonged. The revised budget is relying partly (15.5% of expenditures) on the remaining drawings of EU funds from the 2007-2013 financial period.

The privatisation of state-owned enterprises approved by the previous government in 2013 has been subject to controversial debates over the recent months. Both advocates of and opponents to privatisation (economists, academics, and public figures) have launched petitions either to accelerate or to (partly) stop the privatisation process. Both the prime minister – initially very critical of privatisation – and the minister of finance took a very clear position in favour of privatisation in order to maintain Slovenia's credibility abroad. So far out of the 15 enterprises earmarked for privatisation in 2013, only three have been sold. The privatisation process of the biggest companies, Telekom Slovenije and Nova Kreditna Banka Maribor (NKBM), should be completed by March 2015, but sales may be delayed since the bidders have requested additional information about possible legal liabilities of the two companies.

In 2014 further measures were undertaken to stabilise the banking system. The recapitalisation of Abanka, the third largest bank worth EUR 243 million, together with a transfer of non-performing assets (EUR 1.1 billion) to the Slovenian asset management company (BAMC) were completed in October. In December 2014 Banka Celje was recapitalised with EUR 190 million and became a fully state-owned bank; a merger with Abanka is planned for 2016. Overall, liquidity risks have eased, funding costs have decreased and the three major state-owned banks have returned to profit since the beginning of 2014.[55] During the first eleven months of 2014 bank lending fell both to private households and the non-financial corporate sector, in the latter case reflecting the continued deleveraging process; lending to the government has been rising. Loans in Swiss francs amounted to about EUR 750 million in November 2014, the bulk being household loans. Following the lifting of the cap on the Swiss franc in relation to the euro, the Slovenian minister of finance stated that the government would not take any action over loans denominated in Swiss francs.

wiiw has made a slight upward revision (plus 0.2 percentage points) with respect to Slovenia's GDP forecasts for the coming years owing to higher than earlier assumed export growth. Accordingly, GDP will continue to grow during the forecast period 2015-2017 by (only) up to 2%, a somewhat slower pace than in 2014 due to a weakening of investments. Exports and the gradual recovery of household consumption following an improvement in the labour market situation will remain the key drivers of growth. Government consumption will remain subdued because of fiscal consolidation. The continuation of reforms including the privatisation of state-owned enterprises will be crucial to support sustainable growth.

[55] European Commission (2014), Slovenia – Review of progress on policy measures relevant for the correction of macroeconomic imbalances, Brussels, December, p. 9.

ALBANIA: New energy for the economy

ISILDA MARA

GDP growth is expected to increase progressively over the next three years, rising by 2% in 2015, 2.2% in 2016 and 2.4% in 2017. The economy might benefit from a resolute reform in the energy sector and growth in gross fixed capital formation stemming mainly from foreign direct investment in energy infrastructure. Nonetheless, with government and household consumption failing to thrive, the country's economy still begrudges the growth rates achieved in 2010 and earlier years.

The energy sector has been at a high risk of collapse for several years, recording a considerable increase in annual losses between 2010 and 2013, from 30% up to 45% of the total energy available for consumption. The last quarter of 2014 was characterised by a firm battle of the government against the abuses in the electricity system. The related campaign poured into the budget an additional EUR 49 million in revenues and a further EUR 37 million from reduced losses in the network. In this line, the government has drafted a new law that, if approved by the parliament, will give the state-owned distribution operator the authority to sequester assets of households and businesses with a debt above a ceiling of EUR 1,000 and 14,000 respectively. Another event which opens up the possibility for further and radical reforms in the energy system is the recent deal with the CEZ group to pay to the Czech energy giant, as the former owner of the Albanian electricity distribution company, an amount of EUR 95 million as compensation for the earlier revoked licence.

In 2014 general government budget revenues increased, in lek terms, by 9.2% nominally on an annual basis while expenditures, after declining severely in the first half of 2014, recovered during the second half of the year and recorded an increase of about 8.5%. Capital expenditure was cut by 7.5% compared to the previous year. In 2015, government capital expenditures in infrastructure are planned to account for 53% of the budget, mainly to be invested in new roads and the improvement of existing ones and their safety. The increase in the corporate income tax and the progressive taxation of income started in 2014 may heal the finances of the government but at the same time may reduce business activity and curb demand. Therefore, in 2015 revenues are expected to increase by 7% while expenditures are planned to rise only moderately, by 2%, suggesting that fiscal austerity measures will still prevail over expansionary ones. Most probably the floods that hit the country in early February 2015, apart from causing damage to the agricultural sector, will absorb some public funds for reconstruction, contributing to further investments in roads, bridges, and infrastructure in those particular areas which are in emergency need. Local elections in the early summer might contribute to a further increase in government expenditure. Hence the planned austerity measures might actually be softened.

Table 19 / Albania: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016	2017
						Forecast		
Population, th pers., average [2]	2,913	2,905	2,900	2,897	2,894	2,890	2,885	2,880
Gross domestic product, ALL bn, nom. [3]	1,240	1,301	1,335	1,365	1,400	1,450	1,510	1,570
annual change in % (real) [3]	3.7	2.5	1.6	1.4	1.5	2.0	2.2	2.4
GDP/capita (EUR at exchange rate)	3,100	3,200	3,300	3,400	3,500	3600	3700	3800
GDP/capita (EUR at PPP)	7,100	7,300	7,400	7,500	7,700	.	.	.
Consumption of households, ALL bn, nom. [3]	962	1,012	1,035	1,069	1,110	.	.	.
annual change in % (real) [3]	1.7	1.8	0.7	1.8	1.9	1.5	1.6	1.9
Gross fixed capital form., ALL bn, nom. [3]	352	382	345	354	360	.	.	.
annual change in % (real) [3]	-8.5	5.9	-11.3	1.2	2.0	3.6	4.0	4.4
Gross industrial production								
annual change in % (real)	36.2	19.0	15.7	28.4	7.6	9.0	10.0	13.0
Gross agricultural production								
annual change in % (real)	6.2	4.8	5.8	1.0	2.0	.	.	.
Construction output total								
annual change in % (real)	-13.3	-1.1	-11.4	-13.0	0.2	.	.	.
Employed persons, LFS, th [4]	1,167	1,160	1,117	992	1,022	1,070	1,090	1,100
annual change in %	0.6	.	-3.7	-11.2	3.0	4.7	1.9	0.9
Unemployed persons, LFS, th [4]	191	189	173	184	206	194	190	190
Unemployment rate, LFS, in % [4]	14.0	14.0	13.4	15.6	18.0	17.5	17.5	17.5
Reg. unemployment rate, in %, end of period [2]	13.8	13.1	12.8	13.4	13.5	13.5	13.0	13.0
Average monthly gross wages, ALL	34,767	36,482	37,305	40,860	41,600	42,800	44,100	45,400
annual change in % (real, gross)	-7.0	1.5	0.2	7.4	0.2	1.3	1.3	1.3
Consumer prices, % p.a.	3.6	3.4	2.0	1.9	1.6	1.5	1.7	1.7
Producer prices in industry, % p.a.	0.3	2.6	1.1	-0.5	0.3	1.0	1.0	1.0
General governm.budget, nat.def., % of GDP								
Revenues	26.2	25.4	24.7	24.0	26.2	28	28	29
Expenditures	29.3	28.9	28.2	28.9	31.3	32	31	31
Deficit (-) / surplus (+)	-3.1	-3.5	-3.4	-4.9	-5.2	-4.0	-3.0	-2.0
Public debt, nat.def., % of GDP	57.7	59.4	62.0	70.2	70.6	72.0	72.0	71.0
Central bank policy rate, % p.a., end of period [5]	5.00	4.75	4.00	3.00	2.25	2.25	2.00	2.00
Current account, EUR mn [6]	-1,019	-1,225	-978	-1,035	-1,350	-1,400	-1,450	-1,500
Current account, % of GDP	-11.3	-13.2	-10.2	-10.6	-13.5	-13.6	-13.7	-13.7
Exports of goods, BOP, EUR mn [6]	1,172	1,406	1,526	1,063	1,100	1,200	1,300	1,400
annual change in %	56.1	20.0	8.5	.	3.5	9.1	8.3	7.7
Imports of goods, BOP, EUR mn [6]	3,254	3,647	3,525	2,956	3,200	3,400	3,600	3,800
annual change in %	6.5	12.1	-3.4	.	8.3	6.3	5.9	5.6
Exports of services, BOP, EUR mn [6]	1,751	1,747	1,673	2,349	2,100	2,250	2,350	2,500
annual change in %	-1.2	-0.2	-4.2	.	-10.6	7.1	4.4	6.4
Imports of services, BOP, EUR mn [6]	1,519	1,612	1,460	2,192	1,900	2,050	2,200	2,300
annual change in %	-4.9	6.2	-9.5	.	-13.3	7.9	7.3	4.5
FDI inflow (liabilities), EUR mn [6]	793	630	666	945	800	900	950	1,000
FDI outflow (assets), EUR mn [6]	5	21	18	22	80	90	80	100
Gross reserves of NB excl. gold, EUR mn	1,851	1,851	1,909	1,971	2,142	.	.	.
Gross external debt, EUR mn [6]	4,100	4,958	5,513	6,177	6,750	.	.	.
Gross external debt, % of GDP	45.6	53.5	57.4	63.5	67.5	.	.	.
Average exchange rate ALL/EUR	137.79	140.33	139.04	140.26	139.97	141	143	143
Purchasing power parity ALL/EUR	59.88	61.45	62.53	62.74	63.03	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census October 2011. - 3) According to ESA'10 (FISIM reallocated to industries etc). - 4) Until 2011 survey once a year, quarterly thereafter. From 2011 according to census October 2011. - 5) One-week repo rate. - 6) From 2013 based on BOP 6th edition, 5th edition before.
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

The weak performance of exports in 2014, which shrank by 6.2% (from a volume of EUR 3.4 billion down to 3.2 billion year on year), compared to a less than 1% contraction of imports (from EUR 5.15 billion down to 5.10 billion year on year) widened the trade deficit by another 9% (rising from EUR 1.7 billion to 1.9 billion, year on year). According to customs statistics, exports of textiles, clothing and footwear grew the most, by 24%, followed by chemical and plastic products (up 17%), and wood and paper articles (up 15%). Conversely, exports of mineral fuels and electricity, which used to be the largest export group in 2013, suffered a sharp decline of 14%. The unexpected drop is a result of the drastic decline in oil prices on international markets which caused a reduction in Albanian crude oil revenues. Also in 2015, persistent low international oil prices will have a negative impact on exports of oil and on the investments in this sector. Bankers Petroleum, the country's main oil producer, has already drastically reduced production due to the oil price fall.

The signals concerning external demand are blurred. Some of the main trading and investment partners such as Italy and Greece are expected to achieve higher economic growth rates in the years to come. However, that recovery is still uncertain and may not necessarily exert an immediate positive impact on the Albanian economy via the export channel or a return of the level of remittance revenues to that prior to the international financial crisis (6% of GDP in 2013 vs. 16% in 2006).

From November 2013 to November 2014, the credit market almost stagnated, expanding by less than 1% on an annual basis, from 39.6% to 40.1% as a share of GDP. In the same period, new loans showed a better performance: they increased by 24% and their share in GDP rose from 14.3% to 16.8%. New loans to businesses increased by 29% whereas loans to households rose by a mere 1%. As opposed to previous years, new loans were taken predominantly in local currencies. The share of new business loans in lek rose by 4 percentage points, up from 44% in November 2013. By contrast, the share of new business loans in euro lost 15 percentage points, down from 52% in November 2013. A similar pattern was observed for household loans, experiencing an increase of 12% for loans in lek versus a decline of 16% for loans in euro. The shift in the preference towards loans in local currency may have been due to the closing gap of interest rates applied to local versus foreign currency.

The government's attempt to reduce non-performing loans and foster weak credit growth by paying arrears to private companies does not seem to be very successful. The payment of arrears has assisted a number of firms in being removed from the blacklist of the banks but meanwhile some others have moved in. The level of non-performing loans has remained high, which is a symptom of a credit portfolio not that well-structured, of weak economic performance, consumer demand, investments from corporate, small and medium-sized enterprises as well as weak liquidity of the market. It is expected that credit growth will continue to remain low not only because of low demand. Banks persist in their reluctance to lend to private businesses, hesitating to soften credit conditions as long as the level of non-performing loans remains as high as 24.9% of total loans (third quarter of 2014).

A high level of non-performing loans puts into question the role that the banking sector and the central bank can play in incentivising other sectors of the economy. Apart from this, the newly elected central bank governor Gent Sejko has to cope with a low inflation rate of 1.3% in January 2015, far below the target of 3%, as well as to introduce new monetary tools dealing with deflationary risks. A further cut in the key interest rate to an unprecedentedly low rate of less than 2% is not unlikely.

The last quarter of 2014 economic sentiment indicator, a combination of businesses' and consumers' confidence in the economy, sends favourable signals as concerns the construction, services and trade sectors but rather discomforting ones with regard to the industry sector and consumer confidence. In particular, the construction sector, which had been languishing for four consecutive years, demonstrated the first signs of recovery in 2014 and will experience further progress in the first quarter of 2015. By contrast, consumer confidence worsened because of unbalanced spending, income and purchases. Besides, the confidence of consumers has been eroded by pessimistic expectations as concerns unemployment, the financial situation and the increased cost of living.

As of 2015 we expect a number of public, private and joint public-private investments to start or make progress in the next four years. This February the new manager of the Trans Adriatic Pipeline (TAP) consortium, Ian Bradshaw, confirmed the start of the TAP construction by early June 2015 if the expropriation of land owners runs smoothly. This project will give a boost to the inflow of FDI to Albania. The initiation of the construction of the TAP pipeline is going to be one of the biggest foreign direct investments in Albania so far, EUR 1.2 billion out of a total investment volume of EUR 32 billion. For 2015 an investment of EUR 64 millions in infrastructure and 3,000 new jobs are expected. Thus, the boosting effect on the economy is expected to materialise only in the medium term. Further investments which are expected to boost especially the energy sector and also the export of electricity is the construction of a hydropower plant at the Devoll river by the Norwegian company Statkraft. This investment is to increase electricity production by about 17% from 2018 onwards. In addition, for 2015 the Norwegian company agreed to invest EUR 70 million in infrastructure, mainly roads in the area of Devoll. Another vital investment to be launched in 2015 is the road bypass of the city of Vlora, funded by the European Union (EUR 17 million), the European Bank for Reconstruction and Development and the European Investment Bank (EUR 18 million each).

Overall, the credit market will continue to record sluggish growth. Exports of crude oil are expected to suffer due to low international oil prices, and further investments in this sector will be postponed. Under austerity measures more substantial growth will be delayed. Nevertheless, the improvement in business expectations and investment growth are important steps towards economic recovery. On these grounds we have revised our earlier forecasts upwards, to 2% in 2015, 2.2% in 2016 and 2.4% in 2017.

MACEDONIA: Growth and instability

VLADIMIR GLIGOROV

Growth has been speeding up, yet is bound to flatten somewhat in the current year as well as in the medium term. This is primarily due to a slowdown in public investments and growing concern over political stability. Additional risks are linked to the crisis in Greece, despite their not being easy to forecast. Nonetheless, barring major economic improvements in the region, growth should settle down at around 3%.

Growth in 2014 has turned out better than expected due to both increased consumption and investment. It should slow down gradually in the medium term because of a deceleration of public investment in particular. Also, a possible increase in political instability will impact negatively on economic prospects.

Unlike most other countries in the Balkans, the Macedonian government has had enough room to pursue a cautiously expansionary economic policy, with an initial hike in wages in 2009 and a continuous flow of public investments. In addition, it has accelerated various structural reforms in order to accommodate foreign investments in particular. The latter have not been as plentiful as hoped for, but did not dry out as in some neighbouring countries. With this policy mix, growth has been supported and the record for the past five years as well as for the last and in all probability this year has been better than in most of the other transition countries.

The policy mix was accommodative and will remain so. Monetary policy has been especially accommodative, with the policy rate declining to just above 3%, which is low given the central bank's traditional concern over the stability of the exchange rate. There is scope for continued monetary relaxation, given deflationary tendencies, but this is unlikely to happen. Also, fiscal policy has been accommodative, especially given the traditional commitment to balanced budget policies. Again, some fiscal tightening with decreased public investments can be expected.

As in most other countries in the region, which import practically all oil and gas that they use, the fall in oil prices will be very supportive of the trade balance and also of domestic consumption. It will also relax the foreign borrowing requirements, which are significant due to a relatively large foreign debt. The energy bill is large in Macedonia as in most other less developed countries in the Balkans, so the positive effect of the fall of energy prices will be larger than in more developed countries.

Table 20 / Macedonia: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., mid-year	2,055	2,059	2,061	2,064	2,075	2080	2085	2090
Gross domestic product, MKD mn, nom. [2]	437,296	464,187	466,703	499,559	515,500	541,700	569,000	595,000
annual change in % (real) [2]	3.4	2.3	-0.5	2.7	3.5	3.5	2.9	2.6
GDP/capita (EUR at exchange rate)	3,500	3,700	3,700	3,900	4,000	4,200	4,400	4,600
GDP/capita (EUR at PPP)	8,900	9,100	9,200	9,500	9,900	.	.	.
Consumption of households, MKD mn, nom. [2)3)]	330344	343080	344852	359204	363500	.	.	.
annual change in % (real) [2]	3.8	-5.4	1.2	2.1	1.5	1.5	1.5	2.0
Gross fixed capital form., MKD mn, nom. [2]	100851	109219	109071	117382	121500	.	.	.
annual change in % (real) [2]	-4.0	13.3	6.5	4.8	5.5	4.0	4.0	4.0
Gross industrial production [4]								
annual change in % (real)	-4.9	6.9	-2.7	3.2	4.8	5.0	5.0	5.2
Gross agricultural production [5]								
annual change in % (real)	8.2	-0.4	-5.6	5.0	3.0	3.0	3.0	3.0
Construction output, hours worked								
annual change in % (real)	15.2	28.1	8.3	43.2	-5.0	5.0	5.0	5.0
Employed persons, LFS, th, average	637.9	645.1	650.6	678.8	689.0	700	710	720
annual change in %	1.3	1.1	0.8	4.3	1.5	1.5	1.0	1.0
Unemployed persons, LFS, th, average	300.4	295.0	292.5	277.2	268.0	260	260	250
Unemployment rate, LFS, in %, average	32.0	31.4	31.0	29.0	28.0	27	27	26
Reg. unemployment rate, in %, end of period	.	.	.	.	.	.	.	.
Average monthly gross wages, MKD	30,225	30,602	30,669	31,025	31,100	31900	32900	33900
annual change in % (real, gross)	-0.6	-2.6	-3.0	-1.6	0.5	1.0	1.0	1.0
Average monthly net wages, MKD	20,553	20,847	20,902	21,145	21,200	21700	22400	23100
annual change in % (real, net)	1.4	-2.4	-2.9	-1.6	0.6	1.0	1.0	1.0
Consumer prices, % p.a.	1.6	3.9	3.3	2.8	-0.3	1.5	2.0	2.0
Producer prices in industry, % p.a. [6]	8.7	11.9	1.4	-1.4	-1.9	1.0	2.0	2.0
General governm. budget, nat.def., % of GDP								
Revenues	32.4	31.7	32.1	30.2	31.0	31.0	31.0	.
Expenditures	34.8	34.2	36.0	34.2	35.0	34.0	32.0	.
Deficit (-) / surplus (+)	-2.4	-2.6	-3.9	-4.0	-4.0	-3.0	-2.0	-2.0
Public debt, nat.def., % of GDP	34.6	32.0	38.3	40.4	46.0	46.0	46.0	46.0
Central bank policy rate, %, p.a., end of period [7]	4.11	4.00	3.73	3.25	3.25	3.25	3.25	3.50
Current account, EUR mn [8]	-144	-189	-224	-147	-170	-350	-370	-390
Current account, % of GDP	-2.0	-2.5	-2.9	-1.8	-2.0	-4.0	-4.0	-4.0
Exports of goods, BOP, EUR mn [8]	1,981	2,396	2,307	2,370	2,725	2,920	3,100	3,260
annual change in %	46.7	21.0	-3.7	2.7	15.0	7.0	6.0	5.0
Imports of goods, BOP, EUR mn [8]	3,513	4,301	4,315	4,228	4,650	4,880	5,120	5,380
annual change in %	13.6	22.4	0.3	-2.0	10.0	5.0	5.0	5.0
Exports of services, BOP, EUR mn [8]	747	1,045	1,067	1,140	1,254	1,354	1,435	1,507
annual change in %	-5.7	39.8	2.1	6.8	10.0	8.0	6.0	5.0
Imports of services, BOP, EUR mn [8]	616	686	757	779	896	941	988	1,037
annual change in %	4.8	11.4	10.5	2.9	15.0	5.0	5.0	5.0
FDI inflow (liabilities), EUR mn [8]	229	370	261	306	200	300	300	300
FDI outflow (assets), EUR mn [8]	72.0	25.7	143.7	42.0	-50.0	0	0	0
Gross reserves of NB, excl. gold, EUR mn	1,483	1,802	1,918	1,803	2,221	2,200	2,300	2,400
Gross external debt, EUR mn [8]	4,106	4,847	5,172	5,220	6,500	6,600	6,700	6,800
Gross external debt, % of GDP	57.8	64.2	68.2	64.3	77.7	.	.	.
Average exchange rate MKD/EUR	61.52	61.53	61.53	61.58	61.62	61.50	61.50	61.50
Purchasing power parity MKD/EUR	23.83	24.84	24.60	25.39	25.16	.	.	.

1) Preliminary and wiiw estimates. - 2) According to ESA'10. 2014 estimated by wiiw. - 3) Including NPISHs. - 4) Enterprises with 10 and more employees. - 5) 2013 and 2014 wiiw estimates. - 6) Until 2010 domestic output prices. - 7) Central Bank bills (28-days). - 8) BOP 6th edition.
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

The situation in the labour market continues to improve, which is exceptionally important because the unemployment rate has been very high for a very long time now. With continued recovery, even though at moderate growth rates, employment should continue to increase, which will certainly contribute to social stability.

Political stability, however, is another matter. There have been several early elections during the crisis period, all of which were won by the government coalition. Still, the long duration of the same governing coalition is fuelling dissatisfaction in the public and with the opposition. This is neither extraordinary nor cause for undue concern. The government, however, seems to be taking the growing assertiveness of the opposition as a threat not only to its power but to the well-being of the state, which may prove additionally destabilising.

In summary, short-term prospects are for continued recovery, partly supported by the decline in oil prices and by continued growth of investment. For 2015 we expect GDP to grow by 3.5%, the same rate as in 2014. In the medium term, some growth moderation can be expected due to a slowdown in public investments and a possible flare-up of political uncertainty. The growth trend will centre somewhere below 3%. The current forecast does not differ substantially from the previous one, though 2014 turned out to be better in terms of GDP growth than forecasted.

Table 21 / Montenegro: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., mid-year [2]	619	621	620	621	623	625	625	625
Gross domestic product, EUR mn, nom.	3,104	3,234	3,149	3,327	3,400	3,500	3,700	3,900
annual change in % (real)	2.5	3.2	-2.5	3.3	1.3	2.3	2.6	2.9
GDP/capita (EUR at exchange rate)	5,000	5,200	5,100	5,400	5,500	.	.	.
GDP/capita (EUR at PPP)	10,200	10,600	10,400	10,700	10,900	.	.	.
Consumption of households, EUR mn, nom.	2,551	2,667	2,632	2,712	2,800	.	.	.
annual change in % (real)	2.0	1.9	-3.2	1.1	1.0	2.0	2.0	2.0
Gross fixed capital form., EUR mn, nom.	655	596	584	639	680	.	.	.
annual change in % (real)	-18.5	-10.3	-3.3	8.8	4.0	5.0	5.0	4.0
Gross industrial production [3]								
annual change in % (real)	17.5	-10.3	-7.0	10.7	-11.4	3.0	5.0	5.0
Net agricultural production								
annual change in % (real)	-1.7	9.5	-12.7	5.0	3.0	2.0	3.0	2.0
Construction output [4]								
annual change in % (real)	-7.4	15.8	-11.9	1.2	5.0	5.0	5.0	5.0
Employed persons, LFS, th, average [5]	208	195	200	202	210	210	210	210
annual change in %	-2.2	.	2.4	1.0	4.0	2.0	1.0	1.0
Unemployed persons, LFS, th, average [5]	51	48	49	49	49	.	.	.
Unemployment rate, LFS, in %, average [5]	19.6	19.7	19.7	19.5	19.0	19.0	19.0	19.0
Reg. unemployment rate, %, average	16.5	15.9	15.3	15.8	16.5	16.0	15.0	15.0
Average monthly gross wages, EUR	715	722	727	726	723	.	.	.
annual change in % (real, gross)	10.6	-2.1	-3.3	-2.7	0.3	1.0	1.0	1.0
Average monthly net wages, EUR	479	484	487	479	477	.	.	.
annual change in % (real, net)	2.9	-2.0	-3.3	-3.8	0.3	1.0	1.0	1.0
Consumer prices, % p.a.	0.5	3.5	4.1	2.2	-0.7	1.0	2.0	2.0
Producer prices in industry, % p.a. [6]	-0.9	3.2	1.9	1.6	0.1	1.0	2.0	3.0
General governm.budget, nat.def., % of GDP								
Revenues	42.3	39.7	35.8	37.4	37.0	37.0	38.0	38.0
Expenditures	47.2	43.4	42.4	41.1	39.0	40.0	40.0	40.0
Deficit (-) / surplus (+)	-4.9	-3.7	-6.6	-3.8	-2.0	-3.0	-2.0	-2.0
Public debt, nat.def., % of GDP	40.9	46.0	54.0	56.3	59.0	58.0	58.0	58.0
Central bank policy rate, % p.a., end of period [7]	8.98	9.06	8.83	8.68	8.50	8.0	8.0	8.0
Current account, EUR mn	-710	-573	-588	-487	-680	-525	-555	-585
Current account, % of GDP	-22.9	-17.7	-18.7	-14.6	-20.0	-15.0	-15.0	-15.0
Exports of goods, BOP, EUR mn	357	477	392	396	370	380	400	420
annual change in %	20.4	33.6	-17.8	1.0	-6.5	5.0	5.0	5.0
Imports of goods, BOP, EUR mn	1,624	1,783	1,781	1,724	1,730	1,790	1,860	1,930
annual change in %	0.4	9.8	-0.1	-3.2	0.3	4.0	4.0	4.0
Exports of services, BOP, EUR mn	801	906	998	994	1,090	1,070	1,120	1,180
annual change in %	9.5	13.1	10.1	-0.3	9.6	5.0	5.0	5.0
Imports of services, BOP, EUR mn	337	317	385	341	400	340	360	380
annual change in %	1.8	-5.9	21.6	-11.5	17.2	3.0	5.0	5.0
FDI inflow (liabilities), EUR mn	574	401	482	337	350	390	430	470
FDI outflow (assets), EUR mn	22	12	21	13	20	20	20	20
Gross reserves of NB, excl. gold, EUR mn [8]	165	171	187	197	200	210	220	230
Gross external public debt, EUR mn	912	1,064	1,295	1,433	1,530	1,700	1,800	1,900
Gross external public debt, % of GDP	29.4	32.9	41.1	43.1	45.0	45.0	45.0	45.0
Purchasing power parity EUR/EUR	0.4927	0.4904	0.4893	0.4993	0.5007	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census April 2011. - 3) Excluding small enterprises in private sector and arms industry. From 2011 NACE Rev. 2. - 4) Gross value added. From 2011 NACE Rev. 2. - 5) From 2011 according to census April 2011. - 6) Domestic output prices. - 7) Average weighted lending interest rate of commercial banks (Montenegro uses the euro as national currency). - 8) Data refer to reserve requirements of Central Bank.
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

MONTENEGRO: Public and foreign investments driving growth improvement

VLADIMIR GLIGOROV

Growth in the previous year fell short of expectations: it was probably not more than 1.3%. It can be attributed to slower growth in exports. The government plans to increase investments in infrastructure and will continue to rely on foreign investments in the tourist sector. Over the current year and in the medium term, growth should accelerate up to as much as 3%. Efforts are being made to join NATO and step up the pace of negotiations with the EU.

Growth should accelerate this year to more than 2% and should improve further to close to 3% in the medium term. This should be mainly due to the ambitious plan for public investments and continued growth in the export of services. Public and foreign debts are increasingly constraining, but are manageable.

Last year growth slowed down to about 1.3% with the decline of industrial production, mainly because of the reduction of production of energy. Manufacturing is anyway a small part of the economy. Services have increased, though not as much as expected due to the bad beginning of the summer season. Interestingly enough, and in opposition to most forecasts, Russian tourists and their spending continued to increase in spite the worsening situation in Russia and the political rift between the two countries due to Montenegro's solidarity with the EU sanctions.

The government has drafted a programme of reforms for the period 2015-2017. The centre piece of those is infrastructure projects. The key is the highway to the north, which makes a lot of sense in terms of internal connection within the state and also as connecting this coastal and mountainous country with the Balkan hinterland. Foreign investments, mainly in tourism, continue to be important and high inflows are pencilled in. Last year's FDI was around 10% of GDP and similar or higher numbers are expected in the medium term.

The labour market has improved with more people employed and less unemployed. Nevertheless, the unemployment rate continues to be quite high at close to 19%. Still, Montenegro continues to be a recipient of seasonal labour from the neighbouring countries. There is no doubt that public investment projects will be beneficial to the construction industry, which started to recover last year, but it is not clear how much a boost to domestic as opposed to foreign labour it will have.

A structural characteristic of Montenegro is a high current account deficit fuelled and financed by foreign direct and portfolio investments. Export of goods covers imports by about 20% only and as much as 70% when services are included. So, foreign financing is crucial for sustained consumption and for the financing of the foreign debt. There is some lingering worry about the health of the banking sector, which was almost bankrupted at the beginning of the crisis.

Overall, managing this small country is no small problem. So far, social and public stability have been maintained, even though the past five years have seen growth that is on average close to stagnation. Also, the process of EU integration, though quite slow, contributes to domestic and regional stability. The government hopes to join NATO as soon as possible for the same reason.

Overall, this year should see some improvement and some acceleration of growth can be expected in the medium term. Improved regional prospects should also be helpful. The forecast is not substantially different from the last one expect for the more disappointing GDP growth last year.

SERBIA: Fiscal consolidation starts

VLADIMIR GLIGOROV

The economy slid into recession in 2014. It is expected at best to stagnate over the current year. This is mostly due to the fiscal consolidation measures being planned, as well as to stagnating exports. In the medium term, the government expects recovery that will be driven for the most part by public and foreign investments. It also anticipates support from a three-year IMF programme that was approved at the end of February. Recovery should pick up speed, increasing to about 2% by 2017.

Growth will be at best flat this year if investments, including public ones, start to increase. Over the medium term, growth should accelerate to around or somewhat above 1%. Policies aim at stabilising the public debt to GDP ratio and at reforming the public sector.

Last year saw a decline of GDP by about 2%, a decline of industrial production by over 5%, and almost stagnant exports. Practically all elements of demand receded, with investments down by more than 4%. Labour force surveys, however, show growth of employment, both formal and informal. This is in all probability a statistical effect, though it is not clear due to what precisely.

Fiscal consolidation and the reform of the public sector dominate the policy agenda. This year's budget marks the beginning of a protracted process of fiscal consolidation. At the end of last year, public debt stood just above 70% of GDP. The government target is to stabilise it at a level of 80% in three years; then it should start a long-term decline. Given that the assumptions about GDP growth for the next three years are not ambitious, possible overshooting could stop at 85% of GDP. It will take about a decade to bring it down to 45%, which is the ceiling imposed by the law on fiscal responsibility. That means that not only in the medium term, but even in the long term the contribution to growth from public spending will be small or nonexistent.

Private consumption cannot be relied on to provide much of a boost to the economy, however. In the past five or so years, real wages have been stagnant at best. They have now been cut by 10%, nominally, in the public sector, and pensions were cut too, though not that much. Having in mind that significant lay-offs are planned in the public sector, consumption will be subdued.

Table 22 / Serbia: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th. pers., mid-year [2]	7,291	7,234	7,199	7,164	7,070	7,040	7,010	7,000
Gross domestic product, RSD bn, nom. [3]	3,067	3,408	3,584	3,876	3,900	4,000	4,200	4,400
annual change in % (real) [3]	0.6	1.4	-1.0	2.6	-2.0	-0.5	1.0	1.4
GDP/capita (EUR at exchange rate)	4,100	4,600	4,400	4,800	4,700	.	.	.
GDP/capita (EUR at PPP)	9,000	9,500	9,700	9,900	9,900	.	.	.
Consumption of households, RSD bn, nom. [3]	2,366	2,596	2,728	2,886	2,900	.	.	.
annual change in % (real) [3]	-0.6	0.9	-2.1	-0.4	-2.0	-2.0	0.0	0.0
Gross fixed capital form., RSD bn, nom. [3]	570	627	759	668	650	.	.	.
annual change in % (real) [3]	-6.5	4.6	13.2	-12.0	-5.0	4.0	4.0	5.0
Gross industrial production [4]								
annual change in % (real)	1.2	2.5	-2.2	5.3	-6.8	5.0	5.0	5.0
Gross agricultural production								
annual change in % (real)	-0.6	0.9	-17.3	21.7	2.0	8.0	5.0	5.0
Construction output [5]								
annual change in % (real)	-2.4	5.9	-9.8	11.1	-4.0	5.0	5.0	5.0
Employed persons, LFS, th, average [6]	2,396	2,253	2,228	2,311	2,442	2,500	2,500	2,500
annual change in %	-8.4	-6.0	-1.1	3.7	5.7	1.0	1.0	1.0
Unemployed persons, LFS, th, average [6]	569	671	701	656	535	.	.	.
Unemployment rate, LFS, in %, average [6]	19.2	23.0	23.9	22.1	17.6	17	17	17
Reg. unemployment rate, in %, end of period	26.7	27.6	28.2	28.2	28.0	28	28	28
Average monthly gross wages, RSD	47,450	52,733	57,430	60,708	61,426	.	.	.
annual change in % (real, gross)	0.6	0.1	1.0	-1.9	-0.9	0.0	1.0	1.0
Average monthly net wages, RSD	34,142	37,976	41,377	43,932	44,530	.	.	.
annual change in % (real, net)	0.7	0.2	1.1	-1.5	-1.5	0.0	1.0	1.0
Consumer prices, % p.a.	6.8	11.0	7.8	7.8	2.9	3.0	3.0	3.0
Producer prices in industry, % p.a.	13.7	12.7	6.8	2.7	1.3	2.0	2.0	2.0
General governm.budget, nat.def., % of GDP								
Revenues	39.9	38.2	39.2	37.9	40.0	40.0	40.0	40.0
Expenditures	44.4	42.9	45.3	42.5	47.0	45.0	44.0	43.0
Deficit (-) / surplus (+)	-4.5	-4.7	-6.1	-4.7	-7.0	-5.0	-4.0	-3.0
Public debt, nat.def., % of GDP	41.8	45.4	56.2	59.6	70.0	75.0	80.0	85.0
Central bank policy rate, % p.a., end of period [7]	11.50	9.75	11.25	9.50	8.00	7.0	6.0	6.0
Current account, EUR mn [8]	.	.	-3,640	-2,092	-1,950	-1,950	-2,100	-1,900
Current account, % of GDP	.	.	-11.5	-6.1	-5.9	-6.0	-6.0	-6.0
Exports of goods, BOP, EUR mn [8]	.	.	8,394	10,540	10,700	11,000	11,600	12,200
annual change in %	.	.	.	25.6	1.5	3.0	5.0	5.0
Imports of goods, BOP, EUR mn [8]	.	.	14,028	14,693	14,800	15,100	15,600	16,200
annual change in %	.	.	.	4.7	0.7	2.0	3.0	4.0
Exports of services, BOP, EUR mn [8]	.	.	3,104	3,423	3,800	4,000	4,200	4,400
annual change in %	.	.	.	10.3	11.0	5.0	5.0	5.0
Imports of services, BOP, EUR mn [8]	.	.	2,965	3,103	3,300	3,500	3,700	3,900
annual change in %	.	.	.	4.7	6.3	5.0	5.0	5.0
FDI inflow (liabilities), EUR mn [8]	.	.	926	1,485	1,550	700	1,000	1,000
FDI outflow (assets), EUR mn [8]	.	.	257	257	300	100	100	100
Gross reserves of NB, excl. gold, EUR mn	9,555	11,497	10,295	10,734	9,800	9,500	9,500	9,500
Gross external debt, EUR mn	23,786	24,125	25,721	25,842	27,000	28,000	29,000	30,000
Gross external debt, % of GDP	79.9	72.2	81.2	75.4	81.2	87	87	87
Average exchange rate RSD/EUR	103.04	101.95	113.13	113.14	117.25	124	126	128
Purchasing power parity RSD/EUR	46.73	49.57	51.46	54.39	55.50	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2011 according to census October 2011. - 3) According to ESA 2010. - 4) Excluding arms industry. - 5) According to gross value added. - 6) Survey in April and October. - 7) Two-week repo rate. - 8) BOP 6th edition.
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

That requires investments, which have been declining year after year. They are now below 18% of GDP and a rather fast increase would be needed for them to make a difference to the growth of GDP in the medium run. Public investments could be increased by as much as 2% or even 3% of GDP, but the efficiency of their implementation has been very low in the past. One indication is that the economy experienced hardly any boost from the post-flood recovery in the second half of last year. There are clearly institutional obstacles to an effective planning and implementation of public investment projects.

Private investments are still not recovering and foreign investments are also not pouring in. The most recent estimate for 2014 is FDI of about EUR 1.2 billion. Given that domestic private investments as well as public ones are rather sluggish and cannot be expected to increase a lot this year or over the medium term, foreign investments are certainly crucial. The government is looking to sell a steel-mill and also the state-owned telecommunication company with the expectation that the new private owners will invest in these and related businesses. All that does not suggest that an investment boom is around the corner, and as a consequence a strong recovery of GDP growth.

The country is enjoying a period of political stability due to the strong support for the majority party in the current coalition government. Also, no regional or wider international discords are expected in the near future or in the next few years. The government and most of the public understand the connection between regional stability and economic development. Also, the government is committed to EU integration, though the process is slow. Finally and most importantly, normalisation with Kosovo is proceeding, which helps both politically and in economic terms.

The discontinuation of the South Stream project was a disappointment, but not a big surprise. On the other hand, the drop in oil prices will benefit the trade balance if not necessarily the domestic consumption. The former effect may be huge if oil prices stay as low as they are now. The latter is countervailed by the depreciation of the Serbian dinar especially in relation to the US dollar. The forecast for the exchange rate calls for further depreciation because the central bank has hardly an alternative instrument to spur price growth. The end of last year saw prices actually falling, which is rather a new phenomenon for this country that has been used to inflation rates close to double digits.

On a minor point, loans in Swiss francs are not as massive as in some other countries, so financially it is the strengthening of the euro vis-à-vis the dinar that may have negative consequences for the non-performing loans in the banking sector. In any case, credits are scarce and demand is low anyway. Most publicly owned or strongly influenced banks have failed and there is some consideration to selling off the remaining big one, Komercijalna banka. Also, the state-owned insurance company, Dunav osiguranje, is probably going to be privatised. Still, a backlog of bad loans will weigh on the banking sector for some time.

Thus, this year's growth is going to be flat at best (with a point estimate of -0.5% GDP growth), while the medium-term prospect is for some recovery (1% and 1.4% growth for 2016 and 2017, respectively), though not much of an acceleration can be expected as of now. The current forecast does not differ substantially from the previous one. The fall of 2014 GDP has been larger than anticipated by 1 percentage point due mostly to the disappointing performance of exports.

Table 23 / Turkey: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average	73,142	74,224	75,176	76,148	77,700	78,700	79,600	80,600
						.	.	.
Gross domestic product, TRY bn, nom.	1,099	1,298	1,417	1,565	1,740	1,930	2,120	2,320
annual change in % (real)	9.2	8.8	2.1	4.1	3.0	3.3	3.5	3.5
GDP/capita (EUR at exchange rate)	7,500	7,500	8,100	8,100	7,700	7,200	8,100	8,500
GDP/capita (EUR at PPP)	12,200	13,300	13,700	14,100	14,300	.	.	.
Consumption of households, TRY bn, nom.	788	924	994	1,109	1,220	1,330	1,460	1,590
annual change in % (real)	6.7	7.7	-0.5	5.1	1.5	1.9	3.2	3.2
Gross fixed capital form., TRY bn, nom.	208	283	287	318	340	370	400	430
annual change in % (real)	30.5	18.0	-2.7	4.2	-1.5	1.5	1.2	1.2
Gross industrial production								
annual change in % (real)	12.8	10.0	2.4	3.0	3.6	4.0	3.8	3.8
Gross agricultural production [2]								
annual change in % (real)	2.4	6.1	3.1	3.5	-0.7	3.4	3.5	3.5
Construction industry								
annual change in % (real)	18.6	11.4	0.7	7.5	2.0	4.0	5.0	5.0
Employed persons, LFS, th, average	22,593	24,100	24,820	25,520	25,950	26,300	26,700	27,200
annual change in %	6.2	6.7	3.0	2.8	1.7	1.4	1.7	1.7
Unemployed persons, LFS, th, average	3,048	2,616	2,517	2,750	2,850	.	.	.
Unemployment rate, LFS, in %, average	11.9	9.8	9.2	9.7	9.9	10.5	10.0	9.5
Reg. unemployment rate, in %, end of period	.	.	.	.	.	.	.	.
Average monthly gross wages, TRY	.	.	.	.	.	.	.	.
annual change in % (real, gross)	.	.	.	.	.	.	.	.
Consumer prices (HICP), % p.a.	8.6	6.5	9.0	7.5	8.9	7.1	6.3	5.7
Producer prices in industry, % p.a. [3]	6.2	12.3	6.1	5.7	10.1	7.1	5.9	5.2
General governm. budget, nat.def., % of GDP								
Revenues	35.5	36.4	37.8	40.0	39.6	40.0	39.0	40.0
Expenditures	38.5	36.8	38.9	40.7	40.4	43.0	40.5	41.0
Net lending (+) / net borrowing (-)	-3.0	-0.4	-1.0	-0.7	-0.8	-3.0	-1.5	-1.0
Public debt, EU-def., % of GDP	42.3	39.1	36.2	36.2	35.0	40.0	40.0	40.0
Central bank policy rate, % p.a., end of period [4]	6.50	5.75	5.50	4.50	8.25	7.50	7.00	6.50
Current account, EUR mn	-34,215	-53,891	-37,043	-48,683	-34,520	-34,000	-33,000	-35,000
Current account, % of GDP	-6.2	-9.7	-6.0	-7.9	-5.8	-5.5	-5.2	-5.2
Exports of goods, BOP, EUR mn	91,292	103,086	127,126	123,036	128,745	135,000	142,000	149,000
annual change in %	16.1	12.9	23.3	-3.2	4.6	4.8	5.0	5.0
Imports of goods, BOP, EUR mn	133,962	166,978	178,003	183,236	176,915	174,000	176,000	180,000
annual change in %	39.3	24.6	6.6	2.9	-3.4	-1.5	1.0	2.0
Exports of services, BOP, EUR mn	27,776	29,427	34,260	35,674	38,037	41,000	44,000	48,000
annual change in %	9.1	5.9	16.4	4.1	6.6	8.0	8.0	8.0
Imports of services, BOP, EUR mn	15,033	15,051	16,280	17,995	18,661	19,000	20,000	21,000
annual change in %	21.8	0.1	8.2	10.5	3.7	3.0	4.0	4.0
FDI inflow (liabilities), EUR mn	6,803	11,581	9,708	9,554	9,145	10,000	10,000	10,000
FDI outflow (assets), EUR mn	1,108	1,710	3,142	2,336	5,016	3,000	3,000	3,000
Gross reserves of NB excl. gold, EUR mn	60,404	60,531	75,749	80,435	88,058	.	.	.
Gross external debt, EUR mn	218,415	234,679	255,937	281,444	348,000	367,000	385,000	409,000
Gross external debt, % of GDP	39.7	42.3	41.8	45.6	58.1	59.0	60.0	60.0
Average exchange rate TRY/EUR	2.00	2.34	2.31	2.53	2.91	3.10	3.30	3.40
Purchasing power parity TRY/EUR	1.23	1.31	1.37	1.46	1.57	.	.	.

1) Preliminary and wiiw estimates. - 2) According to gross value added. - 3) Domestic output prices. - 4) One-week repo rate.
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

TURKEY: On a government-supported steady-state growth path

SERKAN ÇIÇEK

Thanks to the continuing rise in foreign demand and with the help of major government transfers, the Turkish economy is likely to have grown by 3% in 2014. In 2015, we expect GDP to expand by 3.3% owing to the ongoing depreciation of the lira, a rise in transfer expenditures and a slight easing in monetary policy. Growth should even improve in 2016 and 2017 on account of probable cuts in the policy rate, continued government-induced consumption and investment, as well as improvements in net exports.

GDP growth has been following a new steady-state equilibrium which is around 3-4% since 2011 due to a novel policy mix. Household final consumption has not risen as fast as GDP in the first three quarters of 2014, because of both additional restrictions on domestic credits imposed by the Banking Regulation Agency and declining real wages owing to a rise in the inflation rate. Government final consumption expenditure contributed much more than household consumption due to election-induced spending (elections were held in March and August of 2014). Both the credit growth target of the Central Bank of Turkey (CBRT) and the ongoing depreciation process of the domestic currency suppressed private investments while massive government-led infrastructure projects such as a third airport in Istanbul, the Channel Istanbul and the third bridge across the Bosporus became the main drivers of public investments. Net exports have been increasing thanks to the depreciation of the lira. We therefore expect an annual GDP growth of 3% for 2014. For 2015 we expect government expenditures and net exports to be again the main drivers of economic growth - depending on ongoing government-led infrastructure projects, rising current transfer expenditures and depreciation of the domestic currency. In the years thereafter, policy rate cuts and growing investment will help to increase the growth of GDP, supplementing exchange rate developments.

The central government budget deficit remained slightly above the targets in the course of the year 2014. On the expenditure side, an escalation in primary expenditures plays a more important role than the rise in interest expenditures. Among primary expenditures, the growth rate of current transfers was higher than public expenditure and public investment induced by the elections in 2014. On the revenue side, consumption-based taxes showed a limited rise while non-consumption-based taxes surged in 2014. We forecast the general government budget deficit as a share of GDP to rise in 2015 ahead of the forthcoming parliamentary elections, which will be held in the summer of 2015, and then to gradually decline in the following years.

Although global oil prices had fallen sharply by the end of 2014, the inflation rate decreased only to 8.2% at the end of the year, while the CBRT target was 5%. In the first months of 2015, annual inflation dropped to 7.2%. Even though it seems that the year-end inflation expectations follow the year-end inflation forecast of the CBRT (6.1% in 2015), we forecast relatively higher inflation rates than the CBRT because of the ongoing depreciation of the domestic currency. With global oil prices remaining flat or rising only slightly, our forecast for consumer price inflation in 2015-2017 is a deceleration from 6.8% to 5.5%, respectively, due to a loose monetary policy.

Monetary policy is still under pressure over interest rates. They had been loosened between May and July 2014 by cutting the one-week repo rate by a cumulative 175bp in order to help silence politicians who have been pressuring the CBRT to ease their policy. After a flat period in the second half of 2014, the CBRT has cut its policy rate by 50bp to 7.75% in the first Monetary Policy Committee (MPC) meeting of 2015. Although this cut still seems insufficient for the politicians, we expect the CBRT to keep the policy rate at this level or 25bp less in 2015 until inflation prospects improve which indicates a tight monetary policy stance. Since our inflation expectations are higher than the forecasts of the CBRT for 2016 and 2017, we forecast the policy rates to fall to 7.0% and 6.5%, respectively.

Private sector loans denominated in Swiss francs amounted to USD 760 million at the end of November 2014, less than half a per cent of total private sector borrowing (USD 214 billion). Furthermore, 95% of the franc loans are long-term loans. On the other hand, the shares of USD- and EUR-denominated private sector loans are 59% and 33% of the total private sector debt, respectively. Moreover, Turkey's external debt stock, which is slightly higher than half of GDP, has been on an upward trend since 2010 and the share of short-term external debt in total external debt increased from 20% to 33% over the past couple of years. Although we do not expect an adverse effect for the Turkish economy regarding Swiss franc loans, it is clear that the ongoing depreciation process will increase the gross external debt to GDP ratio in the years to come. In our forecasts, we expect that gross external debt as a percentage of GDP will be 59% in 2015 and 60% in the two subsequent years.

The Turkish lira has weakened sharply against the US dollar in the last couple of weeks. On 11 February 2015, the lira reached an all-time low against the US dollar, ending the day at 2.50 lira per US dollar. The Turkish lira lost 8.2% against the dollar within one month and this was 12% weaker than the level observed on the same day of the previous year. The reasons behind the fragility of the exchange rate are the expected interest rate hikes by the US Fed, the chronically large deficit of the current account, an increasing share of the short-term external debt stock, the pressure of the government regarding a reduction of the interest rates and political interventions in the banking sector due to the ongoing clash between Prime Minister Erdogan and his opponent Gulen.[56] Since the domestic currency has already depreciated at the beginning of the year, we forecast a further mild depreciation against the US dollar over the rest of the year.

[56] The clash between Erdogan and the Gulen movement became clearly evident after the corruption scandal (the sons of three cabinet ministers were detained as part of a probe investigation) in mid-December 2013. Erdogan blamed Gulen, calling it a coup attempt carried out by Gulen and his followers. Later on, Erdogan intensified his attacks on Gulen's supporters or institutions such as Bank Asya whose shareholders have close relations with the Gulen movement. On 3 February 2015, the Savings Deposit Insurance Fund (TMSF) took over management control of 63% of Bank Asya's privileged shares, citing violations of banking regulations on transparency in organisational and partnership structure.

The 12-month rolling cumulative current account deficit recorded a downward trend in 2014. While it stood at USD 64 billion in January 2014, it ended the year with USD 46 billion, amounting to more than 5.8% of GDP according to our forecast. The trade deficits also narrowed by 17.5% in December 2014 as compared to the same month of the previous year. The main drivers behind the decline in the trade deficit, and therefore the current account deficit, are the depreciation of the domestic currency, the recovery of the euro area and the decline in oil prices. Since Turkish exports are more sensitive to exchange rate developments because of the labour intensity of its export products, we expect further substantial increases in exports. The depreciation of the Turkish lira against the US dollar will further contribute to net exports by boosting exports and lowering imports. Since the euro had depreciated already before the Turkish lira, we do not forecast substantial changes in exports regarding the TRY/EUR rate. Assuming flat or only slightly higher oil prices in 2015, we forecast the current account deficit to be -5.5% in 2015 and -5.2% in both 2016 and 2017.

Industrial production increased by 3.6% on average in 2014; this value seems to be the new longer-term growth rate since the end of 2011 when the current policy mix had started to be effective. Although there are some uncertainties concerning the interest rate development, a number of positive trends have the potential to increase industrial production in the years to come. Falling oil prices are one of the cost-saving factors for companies while expectations of positive growth in the euro area and depreciation of the domestic currency might act as revenue-producing factors. With the assumption of slightly higher domestic demand levels for the foreseeable future, we forecast industrial production trend growth to range between 4.0% and 3.8% over the years 2015 to 2017.

Gross fixed capital formation fell by 1.4% in the first three quarters of 2014, as opposed to 2013 when it grew at an average rate of 4.2%. Although construction activity financed by both the private and the public sector registered positive growth, the reduction in public and private investment in machinery and equipment dominated the development of gross fixed capital formation in the first three quarters. As mentioned above, the massive government-led infrastructure projects will clearly be important drivers of Turkey's construction activities ahead of the parliamentary elections and stimulate future investments of the private sector. We therefore expect gross fixed capital formation to grow by 1.5% in 2015 and by 1.2% in the two years thereafter. Overall GDP is forecast to expand by 3.3% in 2015 and 3.5% in both 2016 and 2017 with the support of government-induced stronger consumption and investment as well as improving net exports due to depreciation.

Table 24 / Bosnia and Herzegovina: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., mid-year	3,843	3,840	3,836	3,832	3,832	3,832	3,832	3,832
Gross domestic product, BAM mn, nom. [2]	24,879	25,772	25,734	26,282	26,180	26,900	28,000	29,500
annual change in % (real) [2]	0.8	1.0	-1.2	2.5	0.5	1.6	2.1	2.4
GDP/capita (EUR at exchange rate)	3,300	3,400	3,400	3,500	3,500	3,600	3,700	3,900
GDP/capita (EUR at PPP)	6,700	7,000	7,100	7,200	7,300	.	.	.
Consumption of households, BAM mn, nom. [2]	21,294	21,927	22,338	22,573	22,590	.	.	.
annual change in % (real) [2]	0.1	-0.1	-0.8	0.3	1.0	2.0	2.0	2.0
Gross fixed capital form., BAM mn, nom. [2]	4,299	4,800	4,783	4,703	4,850	.	.	
annual change in % (real) [2]	-11.1	7.3	1.1	-1.2	4.0	4.0	5.0	5.0
Gross industrial production								
annual change in % (real)	4.3	2.4	-3.9	5.2	0.2	5.0	5.0	5.0
Gross agricultural production								
annual change in % (real) [3]	-6.1	1.7	-8.9	5.0	0.0	5.0	5.0	3.0
Construction output total								
annual change in % (real)	-14.3	-5.6	-3.1	-2.3	6.0	5.0	5.0	5.0
Employed persons, LFS, th, April	842.8	816.0	813.7	821.6	812.0	820	830	850
annual change in %	-1.9	-3.2	-0.3	1.0	-1.2	1.0	1.0	2.0
Employees total, reg., th, average	695.8	691.0	686.9	686.1	703.0	710	720	730
annual change in %	-0.8	-0.7	-0.6	-0.1	2.5	1.0	1.4	1.4
Unemployed persons, LFS, th, April	315.1	310.9	316.6	311.5	308.0	300	300	290
Unemployment rate, LFS, in %, April	27.2	27.6	28.0	27.5	27.5	26.8	26.5	25.4
Reg. unemployment rate, in %, end of period	42.8	43.9	44.6	44.5	43.0	43.0	43.0	42.0
Average monthly gross wages, BAM	1,217	1,271	1,290	1,291	1,292	.	.	.
annual change in % (real, gross)	-1.0	0.7	-0.5	-0.1	1.0	1.0	1.0	1.0
Average monthly net wages, BAM	798	816	826	827	832	.	.	.
annual change in % (real, net)	-1.0	-1.4	-0.7	-0.1	1.5	1.0	1.0	2.0
Consumer prices, % p.a.	2.1	3.7	2.0	0.2	-0.9	1.0	2.0	3.0
Producer prices in industry, % p.a. [4]	1.0	5.5	0.3	-1.8	-0.5	1.0	2.0	3.0
General governm.budget, nat.def., % of GDP								
Revenues	43.7	44.1	44.5	43.7	44.0	44.0	44.0	44.0
Expenditures	46.1	45.3	46.6	45.9	46.5	46.0	46.0	46.0
Deficit (-) / surplus (+)	-2.5	-1.3	-2.0	-2.2	-2.5	-2.0	-2.0	-2.0
Public debt, nat.def., % of GDP [5]	39.1	40.8	44.6	42.5	46.0	46.0	46.0	46.0
Central bank policy rate, % p.a., end of period [6]	.	.	.	.	.	.	.	.
Current account, EUR mn [7]	-783.0	-1,269.7	-1,214.9	-797.4	-1,200.0	-1,100	-1,150	-1,200
Current account, % of GDP [7]	-6.2	-9.6	-9.2	-5.9	-9.0	-8.0	-8.0	-8.0
Exports of goods, BOP, EUR mn [7]	2,189.1	2,625.2	2,574.8	2,798.8	3,020.0	3,300	3,600	3,900
annual change in %	33.2	19.9	-1.9	8.7	7.9	10.0	8.0	8.0
Imports of goods, BOP, EUR mn [7]	6,089.8	6,892.5	6,892.7	6,787.8	7,330.0	7,700	8,100	8,500
annual change in %	8.3	13.2	0.0	-1.5	8.0	5.0	5.0	5.0
Exports of services, BOP, EUR mn [7]	1,513.3	1,479.8	1,486.7	1,506.8	1,480.0	1,500	1,600	1,700
annual change in %	5.9	-2.2	0.5	1.3	-1.8	4.0	5.0	5.0
Imports of services, BOP, EUR mn [7]	411.1	398.8	385.2	364.6	400.0	400	400	400
annual change in %	-10.2	-3.0	-3.4	-5.3	9.7	5.0	5.0	5.0
FDI inflow, EUR mn [7]	331.0	340.4	261.4	241.0	400.0	400	400	400
FDI outflow, EUR mn [7]	58.8	-4.1	1.1	16.3	0.0	0	0	0
Gross reserves of NB excl. gold, EUR mn	3,268	3,207	3,246	3,530	3,700	4,000	4,000	4,000
Gross external public debt, EUR mn [7]	3,215	3,406	3,659	3,788	4,200	4,300	4,400	4,500
Gross external public debt, % of GDP	25.3	25.8	27.8	28.2	31.4	31.3	30.7	29.8
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.96	1.96	1.96
Purchasing power parity BAM/EUR	0.9676	0.9604	0.9419	0.9520	0.9380	.	.	.

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (FISIM not yet reallocated to industries). - 3) Based on UN-FAO data, from 2013 wiiw estimate. - 4) 2010 domestic output prices. - 5) Based on IMF data. - 6) Bosnia and Herzegovina has a currency board. There is no policy rate and even no money market rate available. - 7) Converted from national currency with average exchange rate. BOP 6th edition.
Source: wiiw Databases incorporating national statistics and IMF.

BOSNIA AND HERZEGOVINA: A glimmer of hope

VLADIMIR GLIGOROV

The economy suffered a downturn in the aftermath of the disastrous floods in the spring of 2014. That notwithstanding, the GDP recorded a modest increase for the year as a whole. Looking ahead, a strong rebound is anticipated, which may ultimately prove too optimistic an expectation. In the medium term, additional foreign investments and improved absorption of EU funds should contribute to an acceleration of growth. Political risks are on the decline: a trend that should nudge the EU integration process forward.

Growth stalled last year due to the floods in the spring. Still, exports held up and reconstruction investments helped in the second half of the year. Most forecasts see a strong rebound this year, but that may be too optimistic. In the medium run, however, growth should accelerate to about 2.5% per year.

The economy is characterised by running significant and persistent current account deficits. Those are mostly reflections of low coverage (about 40%) of imports by exports of goods and services. However, there is a trade surplus in services and steady growth of exports of goods. The latter indicates some increase in industrial production, though all of that will take time to make a real difference in the structure of the economy.

The data on foreign debt are not reliable. It is probably around 70% of GDP, but does not tend to increase even though current account deficits continue to be quite large. That may be because there are still significant official transfers, i.e. aid of one kind or another. Bosnia and Herzegovina is not using the EU IPA funds because it has been failing to make progress on the fulfilment of conditions, notably those that have to do with human rights and other institutional changes. But, other bilateral aid is coming in and there is also a continuous inflow of foreign investments. All of that refers mostly to the Federation rather than to the smaller entity of Republika Srpska. The latter is also in a notably worse economic position due to relative isolation and mismanagement.

The debate in the public is dominated by the concern with fiscal sustainability. There is no completely reliable figure of the state of public debt due, in part, to the fiscal activities of the local governments and municipalities. Though foreign public debt is well recorded, information on domestic public debt is not reliable. In any case, due to the relatively low interest rate on the public debt, the issue of sustainability does not really arise. This may not apply to Republika Srpska, which seems to have been resorting to deficit financing much more than the other entity, the Federation. Still, given the level of public spending, which is very high, and the sources of public revenues, which are again mostly connected with

government employment, there is clearly a need to consider public sector reforms on all levels, i.e. in the entities, the cantons, and municipalities – and also the central government, as it is not delivering much for the money it is spending.

The country is an example of how an economy can struggle when the institutional set-up is dysfunctional. There is a slow social movement to initiate changes which has found some response in the latest general elections last year. There is a new coalition at the level of the central government that has adopted a type of road map for EU integration. This is one precondition for increased EU financial and political support. Also, the regional context, and the improved relations with Serbia in particular, is more supportive of integrative policies inside Bosnia and Herzegovina than it was the case until quite recently. With the economy being somewhat resilient and with growth slowly accelerating, there are some chances that the country may start to turn the corner.

In summary, the risks for this year are cautiously on the upside, if investments in post-floods recovery are managed efficiently. GDP growth in 2015 might reach as much as 1.6%. In the medium term, growth should accelerate, though not dramatically. Finally, there is a more positive political atmosphere that may start to underpin the positive developments in the economy. The forecast does not differ substantially from the previous one, though the risks are probably on the upside given the slightly better than forecasted outcome of the last year.

KOSOVO: The exodus of young people from a poor country

MARIO HOLZNER

The growth outlook for Kosovo had to be revised downwards slightly owing to a longer than expected political stalemate besetting the formation of a new government as well as an exodus of the younger members of the population. However, while the level of economic activity is still extremely low in Kosovo, its dynamics are more promising. GDP growth in both 2014 and 2015 is expected to hover around 4%, mainly on account of strong household consumption fuelled by pre-election public wage increases and a rise in remittances.

Over the recent months tens of thousands have fled Kosovo (a small country of some 1.8 million inhabitants) via Serbia and crossed illegally the EU border with Hungary, heading for Germany, Austria or even further. Among them are many young families from smaller towns who lack prospects for a decent life due to high risk vulnerability, deep poverty and mass unemployment. There is hardly any public social security system existent in Kosovo. The average monthly net wage makes only about 450 euro. However, many do not have a job at all. The overall unemployment rate is at around 30%, while the youth unemployment rate hits some 55%. Moreover, many discouraged workers have stopped looking for work and contribute to a large hidden unemployment. Kosovo has the youngest population and the highest fertility rate in Europe. Although the economy experiences (by European standards) quite high growth rates, these are not high enough to absorb the younger generations that push into the labour market. The country generally lacks productive capacities. There are hardly any larger companies operating in Kosovo.

However, as these features of a developing economy have been present for a very long time the question arises why exactly the exodus started this winter. Travel restrictions for Kosovars going to Serbia have been relaxed back in 2012. One contributing factor may have been widespread disappointment with the recent formation of the government which took several months as the former Prime Minister Hashim Thaci (with the help of formal tricks, rather) did everything to make an alternative coalition government without the involvement of his PDK party impossible. Finally Isa Mustafa, from the second largest party LDK, became the new prime minister. Mr. Thaci now acts as the foreign minister. Especially younger people who had hoped for more political change were disappointed and the Kosovo capital Prishtina has seen several violent anti-government demonstrations more recently.

While clearly the level of economic activity is still very low in Kosovo, the dynamics are more promising. The average GDP growth rate in recent years has been close to 4%, and probably even higher in 2014. During that year's parliamentary election campaign public wages were increased strongly and that has fuelled domestic consumption. This is also reflected in rising imports. However, exports were growing quite strongly as well, by double-digit rates as suggested by customs data for 2014. Remittances in the first three quarters of 2014 were increasing at a similar pace and may have reached up to EUR 700 million for the whole year, about 12.5% of GDP.

Table 25 / Kosovo: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average	1,775	1,799	1,816	1,821	1,838	1,855	1,872	1,890
Gross domestic product, EUR mn, nom. [2]	4,402	4,815	5,059	5,327	5,600	5,900	6,100	6,500
annual change in % (real) [2]	3.3	4.4	2.8	3.4	4.5	3.6	2.9	3.8
GDP/capita (EUR at exchange rate)	2500	2700	2800	2900	3000	.	.	.
GDP/capita (EUR at PPP)	5900	6200	6500	6700	6900	.	.	.
Consumption of households, EUR mn, nom. [2]	3,768	4,142	4,458	4,652	4,900	.	.	.
annual change in % (real) [2]	3.5	3.5	2.9	2.0	4.5	4.0	3.5	4.0
Gross fixed capital form., EUR mn, nom. [2]	1,301	1,476	1,317	1,323	1,300	.	.	.
annual change in % (real) [2]	11.0	8.1	-13.6	-0.2	0.0	1.0	1.5	3.0
Gross industrial production [3]								
annual change in % (real)	1.8	-5.7	-3.3	0.0	10.0	5.0	6.0	8.0
Gross agricultural production [3]								
annual change in % (real)	1.4	0.2	9.9	2.0	6.0	4.0	5.0	6.0
Construction output [3]								
annual change in % (real)	-9.7	18.0	3.0	0.6	3.0	5.0	4.0	5.0
Unemployment rate, LFS, in %, average [4]	45.1	44.8	30.9	30.0	30.0	29.0	29.0	28.0
Reg. unemployed persons, th, end of period	335	325	260	268	274	.	.	.
Average monthly net wages, EUR	286	348	354	356	416	.	.	.
annual change in % (real, net)	12.3	13.4	-0.8	-1.2	16.4	10.0	0.0	2.0
Consumer prices, % p.a.	3.5	7.3	2.5	1.8	0.4	1.0	1.0	2.0
Producer prices in industry, % p.a.	4.7	5.7	1.7	2.5	-0.6	.	.	.
General governm.budget, nat.def., % of GDP [5]								
Revenues	25.9	27.2	27.3	35.0	35.0	36.0	37.0	37.0
Expenditures	27.7	28.3	28.6	37.0	37.0	37.0	37.0	38.0
Deficit (-) / surplus (+)	-1.8	-1.1	-1.2	-2.0	-2.0	-1.0	0.0	-1.0
Public debt, nat.def., % of GDP	5.9	5.3	8.1	8.9	10.7	11.2	10.8	11.1
Central bank policy rate, % p.a., end of period [6]	14.3	13.9	12.9	11.1	10.0	.	.	.
Current account, EUR mn [7]	-516	-658	-380	-339	-400	-450	-550	-500
Current account, % of GDP	-11.7	-13.7	-7.5	-6.4	-7.1	-7.6	-9.0	-7.7
Exports of goods, BOP, EUR mn [7]	299	317	282	291	320	330	350	390
annual change in %	73.5	5.8	-10.9	3.4	9.8	3.1	6.1	11.4
Imports of goods, BOP, EUR mn [7]	2,041	2,364	2,332	2,287	2,380	2,470	2,570	2,720
annual change in %	12.2	15.8	-1.3	-1.9	4.1	3.8	4.0	5.8
Exports of services, BOP, EUR mn [7]	574	625	641	633	700	730	770	850
annual change in %	10.1	8.9	2.5	-1.3	10.7	4.3	5.5	10.4
Imports of services, BOP, EUR mn [7]	398	369	317	320	330	340	350	390
annual change in %	35.5	-7.3	-14.0	1.0	3.0	3.0	2.9	11.4
FDI inflow (liabilities), EUR mn [7]	369	384	229	280	170	200	300	400
FDI inflow (assets), EUR mn [7]	37	5	16	30	20	40	50	60
Gross reserves of NB excl. gold, EUR mn	634	575	840	799	850	.	.	.
Gross external debt, EUR mn	1,361	1,428	1,517	1,596	1,736	.	.	.
Gross external debt, % of GDP	30.9	29.7	30.0	30.0	31.0	.	.	.
Purchasing power parity EUR/EUR	0.4170	0.4350	0.4280	0.4380	0.4390	.	.	.

1) Preliminary and wiiw estimates. - 2) According to ESA 2010. - 3) According to gross value added data. - 4) From 2012 new improved sample survey based on census 2011, not comparable with previous years. - 5) National definition based on ESA 2010. - 6) Average weighted lending interest rate (Kosovo uses the euro as national currency). - 7) BOP 6th edition.
Source: National statistics and IMF. Forecasts by wiiw.

Investment fared less well. By November 2014 public capital expenditures were slashed by a third as compared to the same period a year earlier. Also foreign direct investment decreased by 45% over the first three quarters of 2014, year on year – a major reason being the almost six months that passed between the elections in early June 2014 and the formation of the government in mid-December. It can be expected that the new government will gradually increase public investment in infrastructure to earlier levels and this should also be associated with more FDI in the medium term.

The sluggish public and foreign investment activity in 2014 was partly outweighed by strongly increasing private domestic investment. Over the whole year new loans to the economy soared by more than 30% on an annual basis. New investment loans to non-financial corporations increased by 36%. New household mortgage loans increased by 28% (new household consumer loans by as much as 49%). However, the depth of financial intermediation is still rather low. Total new loans made up less than 20% of GDP. Effective interest rates are still high but falling. Overall interest rates on loans dropped continuously from close to 12% in January 2014 to about 9% in December. New long-run business investment and household mortgage loans' effective interest is at around 8%. A further reduction in the interest level should also contribute to improved investment conditions in 2015 and the years thereafter.

Signals for the future external supply of remittances are mixed. Germany, the main host country of Kosovo migrants, is expected by the European Commission to register a GDP growth rate of 1.5% in 2015, the same as in 2014. However, the recent winter forecast was revised upwards as compared to the earlier autumn forecast. For Switzerland, the second most important host country, the forecasts were revised sharply downwards after the sudden appreciation of the Swiss franc in mid-January. The KOF Swiss Economic Institute expects slightly negative GDP growth in 2015 and stagnation in 2016. Earlier forecasts expected growth rates of around 2%. On the other hand, remittances from Switzerland could experience a boost due to the 20% appreciation of the Swiss franc. Also a higher number of Kosovars living outside the country after the current emigration wave might contribute to rising remittances. However, the net effect of these contrary developments might be positive at first and later on fading away or even negative as regards the amount of remittances fuelling for instance the Kosovo construction sector but also consumption in the years to come.

The new government's budget plan for 2015 foresees a strong increase in tax revenues and another major boost in wages and salaries outlays while capital expenditures are assumed to decrease further. While this will obviously continue to fuel household consumption growth, gross fixed capital formation will be further depressed. Overall this should lead to a tightening effect of the public sector with regard to aggregate demand. Given the wage increases and the likely increases in remittances, private households should consume substantially more than last year. However, uncertainties regarding the extent of the exodus of Kosovars might point to a somewhat slower growth of household consumption as compared to a year earlier. Given the soaring credit development, private firms could contribute to a slight increase in gross fixed capital formation in 2015. In terms of exports it will be difficult to repeat the strong increase in 2014. Overall we expect a GDP growth rate of 3.6% for the year 2015. As compared to the autumn forecast we had to revise both the year 2014 and 2015 growth estimates slightly downwards due to the longer than expected political stalemate regarding the formation of the new government and associated postponed public investment decisions as well as because of the population exodus.

Growth in 2016 will probably be less than 3% given that no more public wage increases are planned and public investment will only slowly recover. However, 2017 might again see economic growth rates of close to 4% once the much needed public and foreign investment projects mostly in transport and energy infrastructure will hopefully materialise.

Table 26 / Belarus: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	9,491	9,473	9,465	9,466	9,475	9,490	9,510	9,530
Gross domestic product, BYR bn, nom.	164,476	297,158	530,356	649,111	778,456	953,600	1,207,400	1,453,500
annual change in % (real)	7.7	5.5	1.7	1.0	1.6	-2.0	1.3	2.0
GDP/capita (EUR at exchange rate)	4,300	3,900	5,200	5,800	6,200	.	.	.
GDP/capita (EUR at PPP)	11,700	12,500	13,200	13,500	13,800	.	.	.
Consumption of households, BYR bn, nom.	88,470	139,955	244,863	318,332	386,900	.	.	.
annual change in % (real)	9.5	2.3	10.8	10.9	3.0	0.5	2.0	3.0
Gross fixed capital form., BYR bn, nom.	64,698	113,230	178,455	244,296	245,000	.	.	.
annual change in % (real)	17.5	13.9	-11.3	9.6	-15.0	-8.0	0.0	2.0
Gross industrial production								
annual change in % (real)	11.7	9.1	5.8	-4.9	1.9	-2.0	1.0	3.0
Gross agricultural production								
annual change in % (real)	2.5	6.6	6.6	-4.2	3.1	.	.	.
Construction industry								
annual change in % (real)	12.9	6.7	-8.6	4.6	-5.3	.	.	.
Reg. employment, th, average	4,666	4,655	4,577	4,546	4,500	4,470	4,470	4,500
annual change in %	0.5	-0.2	-1.7	-0.7	-1.0	-0.7	0.0	0.7
Reg. unemployed persons, th, end of period	33.1	28.2	24.9	21.0	22.5	.	.	
Reg. unemployment rate, in %, end of period	0.7	0.6	0.5	0.5	0.5	0.5	0.5	0.5
Average monthly gross wages, ths BYR	1,217	1,900	3,676	5,061	5,995	.	.	.
annual change in % (real, gross)	15.0	1.9	21.5	16.4	0.3	.	.	.
Consumer prices, % p.a.	7.8	53.2	59.2	18.3	18.1	25.0	25.0	18.0
Producer prices in industry, % p.a. [3]	13.6	71.4	76.0	13.6	12.8	.	.	.
General governm.budget, nat. def., % of GDP								
Revenues	41.5	38.7	38.5	40.3	39.0	.	.	.
Expenditures	43.3	35.9	37.7	40.1	39.5	.	.	.
Net lending (+) / net borrowing (-)	-1.8	2.8	0.8	0.2	-0.5	-2.0	-2.0	-1.0
Public debt, EU-def., % of GDP	39.5	45.9	38.5	37.0	35.1	.	.	.
Central bank policy rate, % p.a., end of period [4]	10.5	45.0	30.0	23.5	20.0	.	.	.
Current account, EUR mn [5]	-6,187	-3,518	-1,446	-5,702	-3,000	-2,000	-1,500	-1,500
Current account, % of GDP	-15.1	-9.5	-2.9	-10.4	-5.1	-3.8	-2.7	-2.5
Exports of goods, BOP, EUR mn [5]	18,311	28,499	35,391	27,701	27,800	27,000	28,000	29,000
annual change in %	26.3	55.6	24.2	-21.7	0.4	-2.9	3.7	3.6
Imports of goods, BOP, EUR mn [5]	25,251	30,913	34,952	31,183	29,500	28,000	28,500	29,500
annual change in %	29.5	22.4	13.1	-10.8	-5.4	-5.1	1.8	3.5
Exports of services, BOP, EUR mn [5]	3,583	3,906	4,901	5,700	5,900	5,800	5,900	6,000
annual change in %	37.1	9.0	25.5	16.3	3.5	-1.7	1.7	1.7
Imports of services, BOP, EUR mn [5]	2,247	2,334	3,140	3,957	4,200	4,000	4,100	4,200
annual change in %	43.9	3.9	34.5	26.0	6.1	-4.8	2.5	2.4
FDI inflow (liabilities), EUR mn [5]	1,041	2,787	1,137	1,703	1,500	.	.	.
FDI outflow (assets), EUR mn [5]	38	87	121	199	80	.	.	.
Gross reserves of NB, excl. gold, EUR mn	2,591	4,648	4,390	3,589	2,820	.	.	.
Gross external debt, EUR mn [5]	21,449	26,305	25,518	28,555	33,000	.	.	.
Gross external debt, % of GDP	52.2	71.3	51.9	52.1	56.0	.	.	.
Average exchange rate BYR/EUR	4,007	8,051	10,778	11,834	13,220	18,000	22,000	24,000
Purchasing power parity BYR/EUR	1,476	2,512	4,253	5,085	5,937	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census October 2009. - 3) Domestic output prices. -
4) Refinancing rate of NB. - 5) BOP 6th edition.
Source: wiiw Databases incorporating Eurostat and national statistics.

BELARUS: External shocks impose a painful macroeconomic adjustment

RUMEN DOBRINSKY

The Belarusian economy has been hit hard by the indirect impact of the recent plunge in oil prices. Thanks to a modest upturn in the second and third quarters, GDP growth for 2014 as a whole remained positive. Faced with severe balance of payments constraints, the authorities have had to accept a sharp exchange rate depreciation. The repercussions of the ongoing adjustments will probably result in an unwelcome economic contraction in 2015. Some measure of growth might return in 2016 and 2017.

Despite falling below the expectations of the authorities, a modest recovery was under way through much of 2014. However, with the unexpectedly sharp fall in oil prices towards the end of 2014 and their strong negative effect on Russia – Belarus' key trading partner and donor – the external economic environment was becoming increasingly harsh. In December it became clear that a painful macroeconomic adjustment was unavoidable.

Understanding such effects on a non-oil-producing country like Belarus requires looking into their sources and mechanisms. There were two main such channels – real and financial – through which the Belarusian economy has been affected. The channel of transmitting real effects is associated with the strong ties to the Russian economy, which is Belarus' main export market. The weakening of the Russian economy resulting from the drop in oil prices led to a shrinking demand for Belarusian exports in the final months of 2014. In addition, Russia started introducing trade protection measures, with a further negative impact on Belarusian exports. Some of these measures were justified by Russia as aiming to prevent the re-export from Belarus of goods originating in the EU that are banned for import in Russia. In any case, a number of these measures were rather controversial, given the Eurasian Customs Union of which both Belarus and Russia are members, and provoked political tensions between the two countries. On top of that, Belarus suffered significant export losses due to the crisis in Ukraine, which is also among Belarus' main markets.

Additional external shocks originating in Russia were transmitted through financial channels. Thus, the sharp depreciation of the Russian rouble which accompanied the fall in oil prices resulted in financial losses for Belarus in bilateral rouble-denominated trade in the final months of 2014. This prompted the Belarusian authorities to request renegotiating trade deals with Russia and their revaluation in US dollars. This, in turn, was another source of tensions between the two countries. In addition, the Russian rouble depreciation implied competitiveness losses for a number of local manufacturers due to

the emergence of attractive import opportunities from Russia. The surge in consumer imports from Russia contributed to the deterioration of the external balances in November-December.

Another financial blow to the Belarusian economy is due to the reduction in foreign exchange revenue resulting from the plunge in oil prices at the end of 2014. Despite not being an oil producer, Belarus re-exports considerable quantities of oil imported from Russia at preferential prices. These arrangements, regulated through a framework of bilateral agreements, are equivalent to hefty implicit financial transfers from Russia. Although their value has been progressively declining in recent years, they still represent a significant balance of payments support (de facto Russian subsidy) to Belarus. However, the fall in oil prices in late 2014 translates directly into a drop in the foreign exchange and fiscal revenues related to these transactions.

The combined effect of these shocks resulted in shrinking foreign exchange revenues and led to escalating balance of payments tensions, generating strong downward pressure on the exchange rate. This was reinforced by contagion from Russia where the rouble was under a severe attack. All this provoked panic purchases on the Belarusian foreign exchange market as well as withdrawals of forex deposits in December. Faced with this situation, the authorities intervened with a set of rush – and eclectic – policy measures. On 20 December 2014, the National Bank introduced a combination of quasi capital controls in the form of increased (to 50%) mandatory sales of foreign exchange revenue by exporters and a 30% levy on the purchase of foreign exchange on the currency markets (in effect, a dual exchange rate system implying an artificial 30% margin between the 'buy' and 'sell' rates). At the same time it raised its short-term lending rate to commercial banks from 24% to 50%. Restrictions on the expansion of commercial banks' credit activity as well as widespread price controls on the retail market were also put into effect. On top of that, the authorities introduced extra levies on the exports of key export commodities such as oil and potash, a measure seeking to support both the fiscal balance and the balance of payments.

The main objective of these measures was probably to avoid an outright currency depreciation (which would be a repeat of a similar episode in 2011) and its implications as well as to dampen somewhat the immediate effect of the shocks on the population at large. There was also a political backlash of the worsening economic situation: at the end of December, President Lukashenko carried out a far-reaching overhaul of the government, including a changeover at the Prime Minster level. The Head of the National Bank was also replaced.

However, the in-built inconsistency of some of the December measures soon became much too evident to be ignored. The most controversial among those measures – the dual exchange rate – gave immediate though short-lived re-birth to a street black foreign exchange market, as had also happened during a previous similar episode in 2011. The dual exchange rate in combination with price controls also created plenty of black or grey market arbitrage opportunities for a number of economic agents while establishing a highly uneven playing field for many among them. In the event, some of the palliative measures did not last for long and the authorities gradually started lifting or modifying them soon.

Already in January 2015, the foreign exchange levy was first reduced and then completely eliminated. This was equivalent to the de facto recognition of a depreciation of the Belarusian rouble by some 30%. As of 9 January, the National Bank switched, in its policy mix, to a reference basket of currencies

(consisting of the euro, the US dollar and the Russian rouble) instead of the US dollar alone. Also in January, the National Bank raised its basic refinancing rate from 20% to 25% but reduced the short-term lending rate from 50% to 40%. As of 1 February all restrictions on the commercial banks' credit activity were lifted. In February, price controls were also loosened somewhat (mostly on imported goods) but as of the moment of writing a number of restrictions on locally produced goods still remain in force. These controls are clearly not consistent with the recognition of the exchange rate depreciation and sooner or later they will have to be removed. Anecdotal evidence suggests that prices not subject to controls were rapidly adjusting upwards already at the beginning of 2015.

Obviously, there will be deep and lasting repercussions of the macroeconomic turbulence that occurred at the turn of the year. Importantly, this was probably the beginning of an adjustment towards a more stable macroeconomic equilibrium that seemed inevitable anyway but which the authorities had been trying to delay as much as possible, at least until after the 2015 presidential elections. In recent years, by resorting to all possible sources of external funding, Belarus was attempting to support a level of the exchange rate which was inconsistent with the balance of payments fundamentals. The December 2014 crisis – triggered by the drying-up of some of these sources – was a clear sign that this policy course was no longer sustainable.

While the currency crisis overshadowed other developments, Belarusian economic performance in 2014 was lacklustre anyway. GDP growth for the year as a whole was just half of what the authorities had targeted ex ante. Public sector finances experienced mounting problems, with public revenue (which is directly associated with the level of oil prices) also falling below targets. In the second half of the year, the government had to abandon a number of public investment projects resulting in a sharp drop in gross fixed capital formation for the year as a whole. On average, private consumption was on the rise in 2014 (reflecting the pre-election policy stance of the authorities), but at a much lower rate than during the previous two years.

Both manufacturing and agriculture registered a modest upturn in 2014 as a whole and there was a period when they received an extra boost due to increased Russian import demand related to the EU and Russian (counter) sanctions but these effects were soon offset by the negative shocks of the last quarter. Recent anecdotal evidence suggests that, faced with financial problems, large firms are shedding labour. However, in the absence of reliable LFS statistics it is difficult to gauge the labour market effects of the crisis. The one star performer in 2014 was the sector of potash ('Belaruskali' being one of the largest producers in the world), which registered record-high levels of output and exports of potash fertilisers.

As long as world oil prices remain at the lows recorded at the turn of 2014/2015 Belarus will remain under negative external pressure exerted through the real and financial transmission channels outlined above. As of the moment of writing there are no signs of a reversal and these factors are likely to prevail in the short run. Thus the main challenges that Belarusian policy-makers will be facing in 2015 will continue to include tight conditions on the key Russian market, contracting export revenues, and continuing balance of payments and fiscal constraints. In the current circumstance, the Eurasian Economic Union that entered into effect in January 2015 has so far not lived up to the expectation of providing a further boost to trade and economic ties between its members.

While the current account deficit dropped considerably in 2014, the balance of payments will remain a major source of policy concern in 2015 when Belarus is facing considerable foreign debt service payments (estimated at about USD 4 billion). In the current environment, its borrowing conditions on the international financial markets have deteriorated and the authorities will need to consider carefully whether they will go ahead with the envisaged Eurobond issue in 2015. In its approaches to international capital markets, Belarus may try to capitalise on the recent Minsk summit on Ukraine, but the prospects for that are not clear yet. On the other hand, it will probably be difficult for Belarus to raise from its traditional donor, Russia, external funding at levels comparable to those of previous years. Thus, the macroeconomic adjustment that started already in December 2014 is likely to deepen further in 2015.

The combined effect of these factors can be expected to curb both domestic demand and economic activity. By and large, the economy of Belarus seems to be embarking on a downward trend and will probably enter a recession in 2015. The authorities will probably seek to avoid at any cost a contraction in personal consumption – something that may be politically damaging in the eve of the presidential elections (expected in the autumn of 2015). However, preventing the erosion of real incomes in the current economic environment will be challenging. Given the fiscal constraints, public investment is likely to be further curtailed. A revision of the 2015 government budget seems all but inevitable given the fact that it was adopted under a very different macroeconomic framework. In the face of the continuing fiscal problems, the authorities announced a new privatisation programme in an attempt to support cash revenue. However, the fiscal balance in 2015 will probably be in the negative territory.

The National Bank has signalled additional tightening of its monetary stance in an attempt to prevent further depreciation of the exchange rate. This, together with the continuing price controls, will seek to prevent inflation from catching up with the nominal exchange rate depreciation, hence engineering a real exchange rate depreciation consistent with the macroeconomic adjustment. However, the carryover inflationary push will remain to be felt also in the years after 2015.

Given the recent developments, the outlook for the Belarusian economy has deteriorated considerably compared to the autumn of 2014. Overall, the repercussions of the ongoing adjustment will probably result in an unwelcome economic contraction of some 2% in 2015. Economic performance in 2016-2017 will depend both on the future dynamics of the external environment and on the sustainability of the macroeconomic adjustment. The current forecast assumes a modest improvement in the external environment in these years as well as a relatively tight macroeconomic policy stance. However, GDP growth of more than 1-2% is highly unlikely.

KAZAKHSTAN: Waiting for devaluation

OLGA PINDYUK

The drop in global oil prices and the depreciation of the Russian rouble has led to deterioration in Kazakhstan's economic outlook. In 2015, growth will slow down to 2%, the lowest level since 2009. In the biennium 2016-2017, GDP growth will revive, rising to 3.5% and 4.5%, respectively. The National Bank is likely to embark on a gradual devaluation of the tenge vis-à-vis the US dollar, by about 15% by the end of 2015. A new economic policy known as *Nurly Zhol* is expected to boost investment in the country over the medium term.

At the end of 2014, the main risks to Kazakhstan's economy became reality: the world oil prices plummeted and the Russian rouble depreciated by more than 50%. Developments in the Kazakhstani oil sector, the backbone of the country's economy, have profound effects on the whole economy, in particular on exports – as oil accounts for more than 70% of merchandise exports. Depreciation of the Russian rouble causes an additional loss of competitiveness of Kazakh exporters, in particular in the agricultural sector, as both Russia and Kazakhstan are major wheat exporters. As a result, we forecast that merchandise exports will fall by about 25% in USD terms in 2015.

An effective revaluation of the tenge also negatively affects domestic manufacturers who have to compete with cheaper imports from Russia (in particular with imported food, petroleum products, cars, construction materials). Early February 2015, the National Chamber of Entrepreneurs of Kazakhstan submitted a request to the government to impose an embargo on imports of these products from Russia. If this drastic measure is to be taken, this will be yet one more sign of the inefficiency of the customs union between the two countries (and Belarus).

Regardless of whether the embargo will be introduced, pressures to devalue the national currency have been mounting. Economic agents have fresh memories of the surprise 19% devaluation in February 2014; therefore they have very low trust in the government's promises of keeping a stable exchange rate. The widespread anticipation of devaluation has caused an increased dollarisation of the economy: the share of foreign exchange deposits in the total deposits stock increased to 55.6% by the end of 2014 (up by 18 percentage points as compared with December 2013). Simultaneously, due to the lack of tenge liquidity, banks have virtually stopped issuing loans denominated in tenge. Investment decisions are being put on hold under the increased uncertainty about the timing and scale of the devaluation.

Table 27 / Kazakhstan: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	16,322	16,557	16,791	17,035	17,289	17,400	17,550	17,700
Gross domestic product, KZT bn, nom. [3]	21,816	27,572	30,347	35,275	38,033	40,700	45,100	49,300
annual change in % (real) [3]	7.3	7.5	5.0	6.0	4.3	2.0	3.5	4.5
GDP/capita (EUR at exchange rate)	6,800	8,200	9,400	10,200	9,200	9,900	11,100	12,400
GDP/capita (EUR at PPP)	13,600	15,600	16,800	17,400	18,000	.	.	.
Consumption of households, KZT bn, nom. [3]	9,721	11,569	13,623	17,535	18,900	20,600	22,500	24,600
annual change in % (real) [3]	11.8	10.9	11.0	12.6	1.0	1.5	3.0	4.0
Gross fixed capital form., KZT bn, nom. [3]	5,307	5,772	6,761	7,473	8,400	7,900	9,000	9,900
annual change in % (real) [3]	3.8	3.9	9.1	4.9	4.0	5.0	5.0	7.0
Gross industrial production								
annual change in % (real)	9.6	3.8	0.7	2.5	0.2	2.0	3.0	6.0
Gross agricultural production								
annual change in % (real)	-11.7	26.8	-17.8	11.7	0.8	4.0	5.0	5.0
Construction industry								
annual change in % (real)	2.4	2.8	3.1	3.5	4.1	7.0	8.0	8.0
Employed persons, LFS, th, average [4]	8,114	8,302	8,507	8,571	8,642	8,730	8,820	8,910
annual change in %	2.7	1.1	1.0	0.7	0.8	1.0	1.0	1.0
Unemployed persons, LFS, th, average [4]	497	473	475	471	460	.	.	.
Unemployment rate, LFS, in %, average [4]	5.8	5.4	5.3	5.2	5.1	5.0	5.0	5.0
Reg. unemployment rate, in %, end of period	0.4	0.4	0.4	0.3	0.4	.	.	.
Average monthly gross wages, KZT [5]	77,611	90,028	101,263	109,141	120,455	.	.	.
annual change in % (real, gross)	7.6	7.1	7.0	1.9	3.9	.	.	.
Consumer prices (HICP), % p.a.	7.1	8.3	5.2	5.8	6.7	7.5	6.0	5.0
Producer prices in industry, % p.a.	25.2	27.2	3.5	-0.3	9.5	-10.0	8.0	3.0
General governm.budget, nat.def., % of GDP								
Revenues	19.7	19.5	19.2	18.1	19.2	.	.	.
Expenditures	22.1	21.5	22.1	20.1	22.1	.	.	.
Deficit (-) / surplus (+)	-2.4	-2.1	-2.9	-2.0	-2.9	-2.5	-2.5	-2.0
Public debt, nat.def., % of GDP	14.8	12.3	13.0	12.9	15.2	16.0	17.0	18.0
Central bank policy rate, % p.a., end of period [6]	7.0	7.5	5.5	5.5	5.5	.	.	.
Current account, EUR mn [7]	1,044	7,325	816	844	2,377	-6,800	-3,200	500
Current account in % of GDP	0.9	5.4	0.5	0.5	1.5	-4.0	-1.6	0.2
Exports of goods, BOP, EUR mn [7]	46,231	61,198	67,629	64,435	59,909	54,300	62,500	75,500
annual growth rate in %	46.8	32.4	10.5	-4.7	-7.0	-9.4	15.1	20.8
Imports of goods, BOP, EUR mn [7]	24,769	28,985	37,954	38,244	32,880	35,700	39,300	44,600
annual growth rate in %	19.4	17.0	30.9	0.8	-14.0	8.6	10.1	13.5
Exports of services, BOP, EUR mn [7]	3,102	3,116	3,757	3,854	4,277	5,500	6,100	6,700
annual growth rate in %	5.4	0.5	20.6	2.6	11.0	28.6	10.9	9.8
Imports of services, BOP, EUR mn [7]	8,561	7,882	9,941	9,049	9,137	11,400	12,500	13,900
annual growth rate in %	18.4	-7.9	26.1	-9.0	1.0	24.8	9.6	11.2
FDI inflow (liabilities), EUR mn [7]	5,615	9,885	10,618	7,514	7,150	7,300	8,100	8,900
FDI outflow (assets), EUR mn [7]	2,855	3,719	1,394	1,437	527	1,400	1,600	2,400
Gross reserves of NB excl. gold, EUR mn	19,044	19,477	16,665	13,940	17,682	.	.	.
Gross external debt, EUR mn [7]	89,259	96,951	103,150	109,037	118,500	.	.	.
Gross external debt, % of GDP	80.1	71.8	65.1	62.5	74.2	.	.	.
Average exchange rate KZT/EUR	195.67	204.11	191.67	202.09	238.10	237	231	225
Purchasing power parity KZT/EUR [8]	98.37	106.61	107.78	118.76	122.03	.	.	.

Note: Gross industrial production and producer prices refer to NACE Rev. 2 (including E - Water supply, sewerage, waste management and remediation activities).
1) Preliminary and wiiw estimates. - 2) According to census March 2009. - 3) From 2011 according to SNA'08 (SNA'93 before) and FISIM reallocated to industries. - 4) From 3rd quarter 2011 according to census March 2009, wiiw estimates for growth in 2011 and 2012. - 5) Excluding small enterprises, engaged in entrepreneurial activity. - 6) Refinancing rate of NB. - 7) Converted from USD and based on BOP 6th edition. - 8) wiiw estimates based on the 2011 International Comparison Project benchmark.
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

The government has announced that it wants to avoid any sharp movements of the USD/KZT exchange rate and has introduced several measures to fight dollarisation and mitigate devaluation pressures. In December 2014, the National Bank strongly recommended commercial banks to decrease maximum interest rates on deposits denominated in US dollar from 4% to 3% (and most of the banks immediately followed the recommendation). In February 2015, the President addressed domestic companies with foreign exchange revenues with the request to exchange them (partly) into tenge; as many companies in the country belong to a quasi-state sector, this request can be regarded more as an order for them. Third, the National Bank has announced that it is going to provide commercial banks with additional tenge liquidity.

But it appears that devaluation of the tenge is inevitable anyway as its expectations are not likely to fade away any time soon. We expect that this time devaluation will be more protracted; by the end of 2015, the tenge will weaken by about 15% with respect to the US dollar. Plans announced by the National Bank to switch to inflation targeting in the medium run also signal that it will aim at greater exchange rate fluctuations.

In addition to the unfavourable global demand developments, the restart of production in the Kashagan oil field is likely to take place only in 2017. The cost of the Kashagan oil field project, already the world's most expensive one, is set to rise by nearly USD 4 billion as the companies developing it are forced to replace 200 km of leaking pipelines. Thus during the forecast period oil production will not rise significantly, and it will be primarily demand factors that will determine the commodity's export dynamics – as world oil prices are assumed to gradually pick up in 2016-2017, Kazakhstan's oil export will grow moderately.

Imports of goods will also decrease in 2015, but not as dramatically as exports – probably by some 10% in USD terms according to our forecast – as increased investment will call for more import of machinery and equipment even if the tenge is devalued. The current account will go into the red in 2015. In 2016-2017, imports will restore their growth though at a somewhat slower pace than exports – and the current account will slowly improve and return into positive territory in 2017.

In light of these developments we have made a downward revision of our forecast for the country's GDP: in 2015, growth will slow down to 2%, the lowest level since 2009; in 2016-2017, GDP growth will gradually revive to 3.5% and 4.5%, respectively.

In response to the slowing growth, in November 2014, President Nazarbayev announced a new economic policy called *Nurly Zhol* (Path to the Future) aimed at boosting investment in the country. Under this policy, an additional USD 3 billion (around 1.4% of GDP) will be transferred annually from the National Oil Fund during 2015-2017 to finance the development of the country's infrastructure[57] and credit facilities for small and medium-sized enterprises. In February 2015, President Nazarbayev requested to additionally include some short-term anti-crisis measures in the Path to the Future programme, such as support to the domestic agricultural and machine-building sectors, protection of the domestic market against imports, etc. He also requested government spending in 2015 to be cut by 10%

[57] The Path to the Future programme envisages the development not only of the transportation and logistics infrastructure (highways, railways and airlines) – which is of high importance for the landlocked country with the ninth largest territory in the world – but also of industrial, energy, housing and education infrastructure.

(not affecting social expenditures[58]) – apparently aiming at assuring fiscal sustainability and macro stability under the expected loss of fiscal revenues from the oil sector. Regardless of the request, the budget deficit is likely to remain at 2-2.5% during the forecast period.

While it is difficult to assess the short-term measures yet as they have not been described in detail, the infrastructure projects are likely to give a boost to the economy only in the medium term. They will also make economic growth more investment-driven. Government financing has already accounted for a significant portion of gross fixed capital investment (about 20% in 2014), and the share is likely to rise under the lack of access to long-term bank credit for many companies as banks are still struggling to cleanse their balance sheets and secure long-term funding. In 2014, loans on capital expenditures accounted for a mere 6% of total loans issued to corporate clients, and the volume of such loans was 19% lower than a year earlier.

[58] Expenditures on healthcare, education and social security accounted for about 48% of total government spending in 2014.

RUSSIAN FEDERATION: From stagnation to recession and back

PETER HAVLIK

Russia was in the direst straits even before the Ukraine crisis erupted on a grand scale. Current sanctions have deterred investments still further, instigated capital flight and boosted inflation. The oil price slump and the related collapse of the rouble have inflicted additional pain. Assuming that the sanctions and oil prices remain at their current levels, the wiiw baseline scenario reckons with a 4% drop in GDP in 2015, followed by weak recovery resulting from a gradual revival in government-sponsored investment.

Russian economic growth stayed just above zero in 2014. This reflects a modest expansion of industrial production (1.7%) and agricultural output (3%) and a drop in construction (-5%). Household consumption grew by less than 2% and real wages even declined owing to accelerated inflation. Fixed capital investment dropped by 2.5%, already reflecting the increased risks owing to heightened geopolitical tensions. The growth contribution of real net exports remained positive with imports declining more than exports, not least due to sluggish domestic demand, sanctions and the weakened rouble. In nominal terms, both the trade and current account surpluses widened, the latter exceeding 3% of GDP, while net capital outflows surged above EUR 100 billion. FDI inflows and foreign exchange reserves dropped; the rouble exchange rate sharply depreciated in line with falling oil prices towards the end of the year.[59]

In these circumstances – and with the dramatically changed geopolitical situation – the long overdue 'new growth model' has become even more urgent. Lasting vulnerabilities owing to the excessive reliance on energy export revenues (still 65% of goods exports in 2014 yet only 60% in the last quarter of that year) came once more out in the open. Exports dropped by more than 5% in nominal USD terms while imports declined by 10% in 2014. The trade turnover with the EU contracted by 8%, in particular with Finland, Poland, France, Spain, Slovakia and the United Kingdom. Trade with Ukraine was cut by nearly 30% and many important technological linkages, not only in defence-related sectors, seem to be irreparably broken. In this situation of elevated risks and generally worsened conditions of external trade and financing, which are unlikely to change soon, the already existing broadly acknowledged obstacles to investments – the poor investment climate and reform stalemate – will be extremely difficult to overcome. The repeatedly underlined necessity to improve the institutional, administrative and infrastructure prerequisites for investments in order to support growth, to restructure, modernise and diversify the economy has become more challenging under the changed geopolitical climate with spiralling sanctions and recently also reduced energy export revenues.

[59] Early 2015, all three major rating agencies subsequently downgraded Russia's credit rating. The loss of the investment grade by S&P is probably justified, while Moody's downgrade from 20 February to Ba1, mentioning endangered servicing of sovereign debt, is not. As of September 2014, the total external debt to GDP ratio amounted to 33%, debt service to GDP just to 8%. At the beginning of 2015, total external debt dropped below USD 600 billion (of which USD 171 billion were owed by banks and USD 376 billion by other sectors). Government debt (including the Central Bank) amounted to just USD 52 billion. Total debt service due in 2015 amounts to some USD 130 billion according to the Central Bank of Russia.

Table 28 / Russia: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	142,861	142,961	143,202	143,507	144,000	144,000	144,000	144,000
Gross domestic product, RUB bn, nom.	46,309	55,967	62,147	66,194	70,976	77,500	82,800	89,300
annual change in % (real)	4.5	4.3	3.4	1.3	0.6	-3.9	1.9	2.0
GDP/capita (EUR at exchange rate)	8,000	9,600	10,900	10,900	9,800	.	.	.
GDP/capita (EUR at PPP)	15,600	17,000	18,400	18,800	18,700	.	.	.
Consumption of households, RUB bn, nom.	23,618	27,193	31,019	34,672	38,099	.	.	.
annual change in % (real)	5.5	6.8	7.8	5.0	1.9	-6.0	2.0	2.5
Gross fixed capital form., RUB bn, nom.	10,014	11,950	13,639	14,487	14,690	.	.	.
annual change in % (real)	5.9	9.1	6.6	1.4	-2.5	-10.0	5.0	3.0
Gross industrial production [3]								
annual change in % (real)	7.3	5.0	3.4	0.4	1.7	1.0	3.0	3.0
Gross agricultural production								
annual change in % (real)	-11.3	23.0	-4.8	5.8	3.7	.	.	.
Construction output								
annual change in % (real)	5.0	5.1	2.5	0.1	-4.5	-10.0	5.0	5.0
Employed persons, LFS, th, average [2]	69,934	70,857	71,545	71,391	71,524	71,000	71,500	72,000
annual change in %	0.8	1.3	1.0	-0.2	0.2	-0.7	0.7	0.7
Unemployed persons, LFS, th, average [2]	5,544	4,922	4,131	4,138	3,889	4,000	4,000	4,000
Unemployment rate, LFS, in %, average [2]	7.3	6.5	5.5	5.5	5.2	5.3	5.3	5.3
Reg. unemployment rate, in %, end of period [2]	2.1	1.7	1.4	1.2	1.2	.	.	.
Average monthly gross wages, RUB	20,952	23,369	26,629	29,960	32,000	34,000	.	.
annual change in % (real, gross)	5.2	2.8	8.4	5.2	-1.0	-4.5	.	.
Consumer prices, % p.a.	6.9	8.5	5.1	6.8	7.8	11.0	8.0	6.0
Producer prices in industry, % p.a. [4]	14.9	17.3	6.8	3.4	6.1	6.0	5.0	5.0
General governm.budget, nat.def., % of GDP								
Revenues	34.6	37.3	37.2	36.9	37.2	.	.	.
Expenditures	38.0	35.7	36.7	38.2	38.3	.	.	.
Deficit (-) / surplus (+)	-3.4	1.5	0.4	-1.3	-1.2	-3.0	-5.0	-2.0
Public debt, nat.def., % of GDP [5]	8.4	9.0	10.0	10.5	11.8	15.0	15.0	13.0
Central bank policy rate, % p.a., end of period [6]	7.75	8.00	8.25	5.50	17.00	10.0	.	.
Current account, EUR mn [7]	50,853	69,855	55,452	25,701	42,665	30,000	35,000	40,000
Current account, % of GDP	4.4	5.1	3.6	1.6	3.0	3.1	3.2	3.1
Exports of goods, BOP, EUR mn [7]	296,041	370,131	410,300	393,911	371,423	320,000	330,000	350,000
annual change in %	38.8	25.0	10.9	-4.0	-5.7	-13.8	3.1	6.1
Imports of goods, BOP, EUR mn [7]	185,221	228,764	261,202	256,951	231,763	200,000	220,000	240,000
annual change in %	40.3	23.5	14.2	-1.6	-9.8	-13.7	10.0	9.1
Exports of services, BOP, EUR mn [7]	37,062	41,680	48,495	52,787	50,115	45,000	47,000	50,000
annual change in %	12.7	12.5	16.4	8.8	-5.1	-10.2	4.4	6.4
Imports of services, BOP, EUR mn [7]	56,753	65,706	84,736	96,657	91,200	80,000	80,000	85,000
annual change in %	24.7	15.8	29.0	14.1	-5.6	-12.3	0.0	6.3
FDI inflow (liabilities), EUR mn [7]	32,545	39,557	39,353	53,187	20,000	20,000	30,000	50,000
FDI outflow (assets), EUR mn [7]	39,668	48,008	37,980	65,275	45,000	50,000	60,000	50,000
Gross reserves of CB, excl. gold, EUR mn [8]	335,251	350,786	367,323	341,787	279,383	.	.	.
Gross external debt, EUR mn [7]	369,219	416,416	480,440	530,481	493,528	.	.	.
Gross external debt, % of GDP	32.1	30.4	30.9	33.9	35.1	.	.	.
Exchange rate RUB/EUR, average	40.3	40.9	39.9	42.3	50.5	80.0	75.0	70.0
Purchasing power parity RUB/EUR [9]	20.7	23.1	23.6	24.5	26.4	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census October 2010. - 3) Excluding small enterprises. - 4) Domestic output prices. - 5) wiiw estimate. - 6) From 2013 one-week repo rate, refinancing rate before. - 7) Converted from USD and based on BOP 6th edition. - 8) Including part of resources of the Reserve Fund and the National Wealth Fund of the Russian Federation. - 9) wiiw estimates based on the 2011 International Comparison Project benchmark.
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

Facing the acute prospect of a severe economic recession, the government rushed to work out urgent 'anti-crisis measures'.[60] The current plan is to spend immediately up to RUB 2400 billion (3.3% of GDP or more than EUR 30 billion) on a bank recapitalisation scheme, on financing import substitution programmes, inflation-adjusted indexation of pensions and family welfare benefits, on agricultural and interest rate subsidies, credit guarantees, etc. About half of the envisaged spending will be used for supporting the banks (RUB 1000 billion); the recapitalisation will be financed from last year's budget revenues which were originally assigned to the Deposit Insurance Agency. Additional budget expenditure will thus amount to just RUB 300 billion, another RUB 550 billion will be withdrawn from the National Welfare Fund, and RUB 160 billion will be raised by the issue of new government bonds. The revised government budget for 2015 will reckon with cutting most expenditures by 10% (except defence outlays, social benefits, agricultural subsidies and meeting international obligations), thus saving about RUB 2000 billion. In the medium run, annual government spending should be cut by at least 5% in real terms in order to balance the budget by 2017 given the expected lower (energy) export revenues.

Apart from spending cuts, the government reiterates once more the necessity to launch structural reforms in order to diversify the economy and stimulate economic growth in the medium run (this mantra has been repeated for years, so far without any apparent results). The current plan mentions again conditions for the growth of private investments (including improvements in the doing business climate), using industrial policy instruments for import substitution, export support and SME development schemes, attracting 'substantial amounts' of FDI, promotion of innovation developments, etc. There is an (incomplete) list of some 200 strategic enterprises that will enjoy government support (companies with foreign participation may face obstacles in receiving support). Besides, several huge investment projects will receive financing totalling RUB 500 billion from the National Welfare Fund (e.g. construction of the Yamal LNG plant, the third Moscow Ring Road, modernisation of the BAM and Transsib railways, preparations for the 2018 Football World Cup, a Space Launch Centre and, last but not least, the construction of the Kerch Bridge to Crimea). A number of additional individual measures and their financing should be specified in the coming weeks.

Obviously, the official expectation is that both low energy prices and a 'difficult geopolitical environment' are here to stay for some time. Under these assumptions, both the government and the Central Bank of Russia elaborated several scenarios of economic growth, depending on the expected oil price developments and sanctions regime. More optimistic assumptions (regarding oil prices) currently appear less likely and the respective forecast scenarios worked out last year are already obsolete.[61] Neither is the oil price expected to return to its previous level (USD 98/bbl on average in 2014) nor will sanctions be rapidly abolished (although the latter factor impacts GDP forecasts much less).

All these factors require another substantial downward revision of the GDP growth forecasts.[62] Household consumption (which used to be the main engine of growth until recently) is expected to shrink

[60] See RF Government decree No 98 from 27 January 2015 (www.kommersant.ru/Doc/2655295). Already last year the government intended to tap resources accumulated in the National Welfare Fund (at that time RUB 3100 billion or nearly 5% of GDP) in order to compensate effects of Western financial sanctions – see *Vedomosti*, 15 September 2014.

[61] For example, the CBR reckoned in its 'baseline scenario' from November 2014 with an oil price of USD 95/bbl by mid-2015 and sanctions lasting until end-2017. GDP growth would be positive in 2015 unless the oil price drops below USD 90/bbl (www.cbr.ru from 11 November 2014).

[62] In October 2014 wiiw still expected GDP growth close to 2% in both 2015 and 2016.This corresponded more or less to the baseline scenario published at that time by the Central Bank of Russia (see http://www.cbr.ru, 12 September 2014).

in real terms owing to the spike of inflation. Also government consumption will drop owing to necessary spending cuts. Despite the announced additional financing, gross fixed investments are expected to drop sharply in 2015 as the necessary project preparations will take time. Moreover, we doubt the efficiency of state-sponsored industrial policies and stay generally sceptical towards re-launched reform declarations. We are especially sceptical with respect to the success of 'new' FDI, austerity, import substitution and innovation strategies and believe that without (now apparently abandoned or at least much more difficult) cooperation and integration with the EU economic growth will remain more or less flat in the foreseeable future. An inward-looking development strategy, even under the working assumption that the current financial and trade sanctions will be eventually lifted, will hardly yield the envisaged modernisation results (admittedly, low energy prices over a sustained long period might support the necessary reform pressure on economic diversification). Furthermore, the contribution of net exports to GDP growth is expected to become negative again (as has been the case already for nearly a decade with the exception of the crisis years 2009 and 2014). Given the prospects for stagnating (real) exports in the medium run, and assuming only a one-off downward adjustment of imports in 2014/2015, the present sizeable trade and current account surpluses may eventually diminish.

Weaker economic growth notwithstanding, the labour market remains strained with employment nearly flat and unemployment declining (the LFS rate of unemployment was just 5% in 2014). Sectoral and regional labour market shortages persist (e.g. in retail trade and construction), especially in big cities such as Moscow and St. Petersburg, but so do also huge efficiency reserves. The shadow side of the tight labour market – sizeable employment of migrant (both legal and illegal) workers and the related social, political, nationalist tensions with even racist sentiments – are posing a number of difficult challenges to the authorities. According to some estimates there have been more than 10 million migrant workers in Russia, the majority of them from the former Soviet republics.[63] The new challenge – though probably less complicated owing to cultural similarity – will be the labour market integration of (mostly qualified) Russian-speaking Ukrainian refugees who may ease the labour market shortages and replace some migrant workers from Central Asia.

Apart from the sharply worsened investment climate, it has been the missing progress in diversification and modernisation that has been the main obstacle to a revival of economic growth. The conflict over Ukraine (which may be frozen with a ceasefire but not fully resolved) and ever more assertive domestic and external policies represent an even more serious modernisation bottleneck. Nevertheless, and despite rising tensions, Russia succeeded as planned in launching the Eurasian Economic Union (EEU) on the basis of the Customs Union with Belarus and Kazakhstan in January 2015. Besides the free trade area in goods (with some important exceptions such as energy), the agreement envisages also the free movement of labour, capital and services among participating countries (Armenia already joined the EEU in January 2015 and Kyrgyzstan is expected to join in mid-2015 as well). In theory, coordinated economic policies among EEU members will use 'Maastricht-like' indicators such as limits on budget deficit, government debt, inflation and interest rates. Needless to say, Russian policies towards Ukraine and the unilateral (without consent of other EEU partners) imposition of import restrictions elevated the conflict potential in EEU integration. The current recession affecting all EEU member states and trade disruptions due to unilateral Russian actions have not been instrumental to the smooth functioning of the EEU either.

[63] According to latest reports, migrant workers (and their remittances) started to decline owing to less attractive conditions (a combination of additional bureaucratic obstacles and rouble depreciation).

Summing up, Russia is currently facing a recession (GDP will drop by about 4% in 2015) and prospects for sustainable recovery have markedly deteriorated. Apart from lasting Western sanctions – which result in a sharply deteriorating investment climate, higher risks and capital outflows – it is especially the collapse of the oil price and accelerated rouble depreciation which cause the most economic damage. Even barring a further escalation of the conflict, modernisation ambitions will doubtlessly suffer also in the medium and long run due to lower FDI inflows and reduced imports of advanced technologies – despite efforts to mobilise additional domestic resources. Initial hopes that more serious damage to relations with the EU and other neighbours of Russia could be avoided have not materialised so far. Still, the resolution of the conflict at the negotiation table – where topics may include the implementation of the EU's Association Agreements with Georgia, Moldova, and Ukraine, as well as the cooperation between the EEA and the EU – remains preferable to further escalation.[64] In any case, the serious and probably lasting damage to Russian external relations with Ukraine and the West will be very difficult to repair, hindering the future development of the post-Soviet space.

[64] The full implementation of the AA/DCFTA between the EU and Ukraine was delayed until end-2015 according to the trilateral agreement between Russia, Ukraine and the EU from 16 September – see http://europa.eu/rapid/press-release_STATEMENT-14-280_en.htm.

Table 29 / Ukraine: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average	45,871	45,706	45,593	45,490	43,001	42,950	42,920	42,900
Gross domestic product, UAH bn, nom. [2]	1,121	1,349	1,459	1,505	1,511	1,780	1,940	2,090
annual change in % (real) [2]	4.1	5.4	0.2	0.0	-7.0	-5.0	0.0	1.8
GDP/capita (EUR at exchange rate)	2,300	2,700	3,100	3,100	2,200	.	.	.
GDP/capita (EUR at PPP)	5,600	6,500	6,700	6,700	6,400	.	.	.
Consumption of households, UAH bn, nom. [2]	718	906	1,002	1,100	1,135	.	.	.
annual change in % (real) [2]	7.0	15.7	8.4	7.7	-8.0	-4.5	-0.5	2.0
Gross fixed capital form., UAH bn, nom. [2]	202	248	283	273	239	.	.	.
annual change in % (real) [2]	3.4	6.5	3.3	-6.5	-25.0	-10.0	-5.0	5.0
Gross industrial production [3]								
annual change in % (real)	11.2	8.0	-0.5	-4.3	-10.7	-6.0	0.0	3.0
Gross agricultural production								
annual change in % (real)	-1.5	19.9	-4.5	13.7	2.8	.	.	.
Construction output [4]								
annual change in % (real)	-5.4	18.6	-8.3	-14.5	-21.7	.	.	.
Employed persons, LFS, th, average	20,266	20,324	20,354	20,404	18,300	17,800	17,600	17,600
annual change in %	0.4	0.3	0.1	0.2	-5.3	-2.7	-1.1	0.0
Unemployed persons, LFS, th, average	1,786	1,733	1,657	1,577	1,800	2,200	2,400	2,400
Unemployment rate, LFS, in %, average	8.1	7.9	7.5	7.2	9.0	11.0	12.0	12.0
Reg. unemployment rate, in %, end of period [5]	2.0	1.8	1.8	1.8	1.7	.	.	.
Average monthly gross wages, UAH [6]	2,239	2,633	3,026	3,265	3,476	.	.	.
annual change in % (real, gross)	9.7	8.9	14.3	8.2	-5.8	.	.	.
annual change in % (real, net)	10.2	8.7	14.4	8.2	-6.5	.	.	.
Consumer prices, % p.a.	9.4	8.0	0.6	-0.3	12.1	24.0	9.0	6.0
Producer prices in industry, % p.a. [7]	20.9	19.0	3.7	-0.1	17.1	20.0	10.0	5.0
General governm.budget, nat.def., % of GDP								
Revenues	28.1	29.5	30.5	29.4	30.2	.	.	.
Expenditures	33.8	31.2	34.0	33.6	34.9	.	.	.
Deficit (-) / surplus (+) [8]	-5.8	-1.7	-3.5	-4.2	-4.8	-5.5	-5.0	-5.0
Public debt, nat.def., % of GDP	38.6	35.1	35.3	38.8	72.8	115.0	125.0	121.0
Central bank policy rate, % p.a., end of period [9]	7.75	7.75	7.50	6.50	14.00	.	.	.
Current account, EUR mn [10]	-2,272	-7,351	-11,153	-12,441	-3,800	-1,000	-1,000	-1,000
Current account, % of GDP	-2.1	-6.0	-7.9	-8.8	-4.0	-1.9	-1.8	-1.7
Exports of goods, BOP, EUR mn [10]	35,636	44,812	50,127	44,518	42,300	42,300	43,100	44,000
annual change in %	33.9	25.7	11.9	-11.2	-5.0	0.0	2.0	2.0
Imports of goods, BOP, EUR mn [10]	42,866	57,764	67,124	61,185	47,700	44,400	44,400	45,300
annual change in %	40.8	34.8	16.2	-8.8	-22.0	-7.0	0.0	2.0
Exports of services, BOP, EUR mn [10]	13,808	15,278	17,186	17,032	11,070	10,000	10,000	10,500
annual change in %	28.9	10.6	12.5	-0.9	-35.0	-10.0	0.0	5.0
Imports of services, BOP, EUR mn [10]	9,577	9,613	11,351	12,141	9,710	8,700	8,700	9,100
annual change in %	15.6	0.4	18.1	7.0	-20.0	-10.0	0.0	5.0
FDI inflow (liabilities), EUR mn [10]	4,860	5,177	6,360	3,396	300	300	1,000	1,500
FDI outflow (assets), EUR mn [10]	521	138	762	324	300	300	300	500
Gross reserves of NB excl. gold, EUR mn	25,096	23,593	17,186	13,592	5,429	.	.	.
Gross external debt, EUR mn [10]	88,363	97,940	102,120	102,852	104,000	.	.	.
Gross external debt, % of GDP	83.1	80.5	71.9	72.5	108.2	.	.	.
Average exchange rate UAH/EUR	10.533	11.092	10.271	10.612	15.716	33.0	34.0	35.0
Purchasing power parity UAH/EUR [11]	4.328	4.561	4.748	4.923	5.485	.	.	.

Note: From 2014 data and forecasts excluding the occupied territories of Crimea and Sevastopol.
1) Preliminary and wiiw estimates. - 2) According to SNA'08. - 3) From 2011 according to NACE Rev. 2 including E (water supply, sewerage, waste management, remediation). - 4) From 2011 according to NACE Rev. 2. - 5) In % of working age population. - 6) Enterprises with 10 and more employees. - 7) Domestic output prices. From 2013 according to NACE Rev. 2. - 8) Without transfers to Naftohaz and costs of bank recapitalisation. - 9) Discount rate of NB. - 10) Converted from USD and based on BOP 6th edition. - 11) wiiw estimates based on the 2011 International Comparison Project benchmark.
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

UKRAINE: From illiquidity to insolvency

VASILY ASTROV

In 2015, the ongoing military conflict in the Donbas region, the erosion of incomes on account of galloping inflation and the unrelenting collapse of trade and investment will plunge the economy into deep recession for the second year running. Dismal growth prospects, an ever-weakening currency and massive fiscal deficits on the back of huge expenditures on defence will put the sustainability of public debt in jeopardy. A recovery can hardly be expected before 2017, the all-essential pre-requirement being a lasting peace settlement.

According to preliminary estimates, in the fourth quarter of 2014 Ukraine's GDP contracted by 15.2% (year on year). For the first time, the GDP figure does not cover the eastern areas of Donbas which are controlled by the separatist rebels; including those would certainly show an even deeper recession, since the war has destroyed a large part of the local production and transport capacities. According to official (certainly incomplete) statistics, in 2014 industrial production dropped by more than 30% in Donetsk and more than 40% in Luhansk, accounting for the bulk of the 11% decline in Ukraine as a whole. Coal mining and the metals industry – both heavily concentrated in war-torn areas – were hit particularly hard: by 31% and 15%, respectively, while machine-building, whose main export market is Russia, also reported a strong 21% decline. Apart from the weakening growth dynamics in Russia and the falling rouble, machine-building also suffered from the disruption of existing links in military-related production cooperation because of the export bans imposed by both countries, as well as Russia's import-substitution efforts. All in all, exports to Russia, which used to account for a quarter of Ukraine's exports in previous years, plummeted by a dramatic 35% in US dollar terms in 2014. Exports to the European Union increased by 12% but could not offset the decline in exports to Russia and the rest of the world.

The military conflict in Donbas has obviously had a detrimental effect on the investment climate as well; fixed investments plunged by an estimated 25% last year. Strong capital flight was the main reason behind the free fall of the hryvnia, which lost half of its value against the US dollar. Currency depreciation and energy tariff hikes fuelled consumer price inflation, which climbed to 25% by the end of the year and eroded the purchasing power of households: on average, net wages dropped by 6.5% in real terms. At the same time, credits to households fell by 16% (after adjusting for the valuation effect of forex-denominated loans) amidst strong deposit outflows and the overall gloomy economic prospects. All this weighed heavily on the consumer demand: retail trade turnover – a proxy for private consumption – fell by 8.6% last year. On a positive note, the combined effect of currency depreciation and falling domestic demand contributed to a sharp drop in imports of goods and services by 27% in US dollar terms – much more than that of exports (-20%), resulting in vastly improved trade and current accounts and a strongly positive contribution of real net exports to GDP growth.

The National Bank of Ukraine (NBU) has been trying to limit the scope of the currency depreciation, which is jeopardising both the financial stability and the sustainability of public debt, more than half of which is denominated in foreign currency. However, the choice of instruments at NBU's disposal is very limited: official reserves are already at a critically low level of 1.5 months of imports, interest rate hikes hardly provide an incentive to invest in a war-torn country, while the imposed administrative measures (such as the 75% surrender requirement for export proceeds) have only resulted in the emergence of a vast 'shadow' market for foreign exchange.[65] Therefore, Ukraine continues to be critically dependent on foreign emergency assistance, the bulk of it coming from the IMF.

So far, Ukraine has received USD 4.6 billion as part of the USD 17 billion stand-by financial package agreed with the IMF in spring 2014 (as well as a total of another USD 4.5 billion in other multilateral and bilateral loans and credit guarantees, such as from the World Bank, the EBRD, the EU, the US and Japan). Upon its inception, the IMF programme implicitly assumed that the country's balance-of-payments (and fiscal) problems were those of liquidity rather than solvency: economic recovery and currency stabilisation were expected to enable external debt repayment in the longer run. This assumption – arguably justified at that time – looks now increasingly unrealistic, as economic recovery is not in sight, the hryvnia is likely to depreciate even more, while high defence spending continues to hamper budget consolidation. Rising concerns over public debt sustainability are also pushing the yields on government bonds to double-digit levels (the yields on hryvnia-denominated bonds are of course even higher) – much higher than the GDP growth rate in US dollar terms (which is negative), thus contributing towards the debt to GDP ratio rising still further and sovereign default potentially becoming a 'self-fulfilling prophecy'. The newly announced staff-level agreement (still to be approved by the IMF executive board) over a new four-year USD 17.5 billion worth Extended Fund Facility (EFF) is recognition of the solvency problems the country is facing. The new lending package will replace the previous stand-by arrangement and is only USD 5 billion larger in volume than the funds outstanding in the framework of the previous programme. It does not fully cover Ukraine's extra financing needs which are estimated at some USD 10-15 billion, and thus puts pressure on private creditors (such as Franklin Templeton, the largest single holder of Ukrainian eurobonds) to participate in debt relief and/or restructuring.

Following the latest IMF recommendations, the draft government budget for 2015 targets a deficit of 4.1% of GDP. If attained, this would represent a modest reduction compared to last year (4.8%). However, both figures exclude important quasi-fiscal expenditure items, such as subsidies to the state-owned energy company Naftohaz and the costs of bank recapitalisation. The Naftohaz deficit alone reportedly accounted for some 7% of GDP, as strong depreciation inflated the gas import bill in hryvnia terms, which was only partially offset by the 60% hike in domestic gas tariffs for households enacted in mid-2014. This year, the import gas price for Ukraine should decline thanks to the recent drop in the oil price, to which it is contractually linked. Nevertheless, further tariff hikes for households – reportedly by 280% for gas and 66% for heating – are on the government agenda this year, and are indeed a key requirement of the IMF. The wisdom of front-loaded tariff hikes is however questionable, unless they are accompanied by parallel efforts aimed at promoting energy-saving measures, such as subsidising the installation of heating metres.[66]

[65] As of 5 February 2015, the exchange rates were finally unified, resulting in another massive depreciation, while the (largely symbolical) NBU discount rate was raised by another 5.5 p.p., to 19.5% p.a. All in all, during the year prior to the time of finalising this report (25 February 2015), the hryvnia lost around three-quarters of its value: from 8 to 32 UAH/USD.

[66] Although the government is planning to allocate 0.7% of GDP in direct heating subsidies to the poor to offset the impact of tariff hikes, this will hardly contribute towards improving energy efficiency.

Quasi-fiscal deficits apart, the 2015 budget is probably unrealistic as it heavily relies on a projected growth of revenues by 26% in nominal terms – roughly in line with inflation, and despite the severe economic recession. The government reckons that tax collection should benefit from the newly enacted comprehensive tax reform: as of January 2015, the tax system has been streamlined and the number of taxes reduced from 22 to 9, while a drastic lowering of social security contributions and a generous tax amnesty are hoped to encourage the 'de-shadowing' of the economy. In addition, government revenues should be boosted by the newly imposed temporary 5-10% surcharge on all imports (excluding energy and pharmaceuticals), although this might be in violation of WTO rules. On the expenditure side, the 2015 budget envisages some austerity measures, such as cuts in the number of public employees in law enforcement agencies and a 'freeze' of the minimum wage until December 2015, implying a further erosion of real incomes by high inflation. However, their austerity impact will be offset by increased military spending. According to the government, the so-called 'anti-terrorist operation' in Donbas costs USD 5-10 million per day. Extrapolated for the whole year, this would sum up to some USD 2-4 billion, or 2-4% of GDP (obviously, the costs can be easily higher if the fighting escalates further). While the effectiveness of the Ukrainian army on the battlefield is far from being impressive, high military spending – mirrored in the statistics by the growth of public consumption – provides at least some growth stimulus in an otherwise strongly recessionary environment.

The snap parliamentary elections in October 2014 initiated by President Poroshenko brought a surprise success for the rival party of Prime Minister Arseniy Yatsenyuk and allowed him to retain his post. With the new-old constitution enhancing the powers of the parliament and the prime minister re-installed once again, the current power structure resembles the earlier fragile Yuschenko-Tymoshenko 'ruling tandem'. The strong election performance of the relatively 'hawkish' party of Mr Yatsenyuk has been a factor behind the recent escalation of the war in Donbas. On the other hand, the arbitrariness of borders controlled by pro-Russian separatists (one-third of Donbas' territory and half of its population) by the time of signing of the first Minsk ceasefire agreement in September 2014 has been probably even more important. Coupled with strong pro-Russian sentiments in some other Donbas territories, which are now under Kyiv's control but were part of the two self-proclaimed 'peoples' republics' back in summer 2014, a military counter-offensive by the rebels appeared to be only a question of time.

Economic prospects remain crucially dependent on a lasting peace settlement of the Donbas conflict, and any recovery can be hardly expected before 2017. Whether the peace settlement will be secured by the so-called Minsk-II ceasefire agreement signed on 12 February 2015 remains to be seen; by the time of finalising this report this was not the case, and separatists were gradually gaining control over new territories. Among other things, the ongoing war deters the inflow of foreign investments which are badly needed to modernise the economy and finance the implementation of the newly signed (but suspended until January 2016) Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU. In addition, high military spending is 'crowding out' other essential payments, such as public sector wages and pensions, and contributes to the progressing impoverishment of large segments of the population. It is also unlikely that Ukraine's exports sector will be able to take advantage of the highly competitive exchange rate, given that part of the production and transportation capacities are physically destroyed, trade with Russia remains severely curtailed, while an increase in manufacturing exports to the EU is conditional on improved competitiveness, including the costly implementation of EU standards envisaged in the DCFTA agreement – both possible only in the medium and longer run. Important exceptions to this may be agriculture and parts of the food processing industry, which are largely located outside the conflict zone and have been able to benefit to some extent from the newly granted market access for their products by the EU.

Appendix

Table 30 / Central and East European new EU Member States (NMS-11): an overview of economic fundamentals, 2014

	Bulgaria	Croatia	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	*NMS-11* [1]	*EU-28* [2]
GDP in EUR at exchange rates, EUR bn	41.7	43.1	152.2	19.2	102.3	24.0	36.1	411.1	149.0	75.3	37.2	*1,091*	*13,930*
GDP in EUR at PPP, EUR bn	91.4	67.1	233.3	26.0	181.7	35.8	59.1	711.1	292.1	111.6	46.3	*1,855*	*13,930*
GDP in EUR at PPP, EU-28=100	0.7	0.5	1.7	0.2	1.3	0.3	0.4	5.1	2.1	0.8	0.3	*13.3*	*100.0*
GDP in EUR at PPP, per capita	12,600	15,800	22,100	19,800	18,400	17,800	20,200	18,500	14,700	20,600	22,400	*17,800*	*27,300*
GDP in EUR at PPP per capita, EU-28=100	46	58	81	73	67	65	74	68	54	75	82	*65*	*100*
GDP at constant prices, 1990=100	137.2	105.0	145.8	156.7	132.2	120.0	131.5	209.4 [3]	146.5	178.7	154.6	*171.2*	*148.6*
GDP at constant prices, 2007=100	106.4	89.2	102.4	97.0	100.1	94.9	104.1	123.8	108.2	113.5	95.8	*110.8*	*101.3*
Industrial production real, 2007=100 [4]	90.1	83.9	101.3	113.3	102.5	103.3	109.5	125.3	128.8	129.3	92.0	*115.1*	*93.4*
Population, thousands, average	7,260	4,250	10,534	1,310	9,850	2,005	2,928	38,530	19,930	5,420	2,061	*104,078*	*509,583*
Employed persons, LFS, thousands, average	2,981	1,550	4,960	625	4,101	885	1,310	15,724	8,600	2,352	920	*44,007*	*217,516*
Unemployment rate, LFS, in %	11.5	17.3	6.4	7.4	7.7	10.9	11.0	10.0	7.0	13.4	10.0	*9.4*	*10.2*
General gov. revenues, EU-def., in % of GDP	38.0	42.5	40.3	38.2	48.0	34.5	33.8	38.2	32.7	38.0	45.3	*38.8*	*45.2*
General gov. expenditures, EU-def., in % of GDP	43.0	47.5	41.7	38.7	50.2	36.1	35.4	41.6	34.7	40.9	50.6	*41.6*	*48.1*
General gov. balance, EU-def., in % of GDP	-5.0	-5.0	-1.5	-0.5	-2.2	-1.6	-1.6	-3.4	-2.0	-3.0	-5.3	*-2.8*	*-3.0*
Public debt, EU def., in % of GDP	23.1	81.0	45.0	10.0	77.3	40.2	41.0	49.1	39.0	54.1	82.2	*50.4*	*88.4*
Price level, EU-27=100 (PPP/exch. rate)	46	64	65	74	56	67	61	58	51	67	80	*59*	*100*
Compensation per employee, monthly, in EUR [5]	564	1,421	1,207	1,406	993	1,082	1,038	1,038	666	1,273	2,071	*1,012*	*3,034*
Compensation per employee, monthly, EU-28=100	18.6	46.8	39.8	46.4	32.7	35.7	34.2	34.2	22.0	42.0	68.3	*33.4*	*100.0*
Exports of goods in % of GDP	51.0	23.0	72.3	59.5	74.8	42.1	65.9	38.4	31.3	84.3	62.1	*50.8* [6]	*31.5* [6]
Imports of goods in % of GDP	58.4	37.5	66.6	64.7	71.8	52.3	69.9	38.4	35.0	79.2	58.5	*51.0* [6]	*30.3* [6]
Exports of services in % of GDP	17.8	23.2	11.8	26.3	17.1	15.9	16.2	8.4	10.1	8.6	14.8	*11.8* [6]	*11.6* [6]
Imports of services in % of GDP	10.8	6.9	10.7	18.7	12.6	8.7	12.0	6.6	6.2	8.4	10.2	*8.5* [6]	*9.9* [6]
Current account in % of GDP	1.9	0.5	0.3	-0.9	4.4	-3.0	-0.5	-1.3	-0.5	0.7	5.9	*0.1* [6]	*1.6* [6]
FDI stock per capita in EUR, 2013	5,288	5,546	9,383	11,564	7,918	5,781	4,210	4,099	3,076	7,877	5,205	*5,290*	*9,209*

Note: NMS-11: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia. PPP: Purchasing power parity.
1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) 1989=100, which in the Polish case is the appropriate reference year. - 4) EU-28 working-day adjusted. - 5) Gross wages plus indirect labour costs, according to national account concept. - 6) Data for NMS-11 and EU-28 include transactions within the region (sum over individual countries).
Source: wiiw Annual Database, Eurostat, AMECO.

Table 31 / Southeast Europe and selected CIS countries: an overview of economic fundamentals, 2014

	Albania	Macedonia	Monte-negro	Serbia	Turkey	Bosnia - Herzegovina	Kosovo	Belarus	Kazakhstan	Russia	Ukraine [1]	*NMS-11* [2]	*EU-28* [3]
GDP in EUR at exchange rates, EUR bn	10.0	8.4	3.4	33.3	598.7	13.4	5.6	58.9	159.7	1,406.6	96.1	*1,091*	*13,930*
GDP in EUR at PPP, EUR bn	22.2	20.5	6.8	70.3	1,109.0	27.9	12.8	131.1	311.7	2,689.5	275.5	*1,855*	*13,930*
GDP in EUR at PPP, EU-28=100	0.2	0.1	0.05	0.5	8.0	0.2	0.1	0.9	2.2	19.3	2.0	*13.3*	*100.0*
GDP in EUR at PPP, per capita	7,700	9,900	10,900	9,900	14,300	7,300	6,900	13,800	18,000	18,700	6,400	*17,800*	*27,300*
GDP in EUR at PPP per capita, EU-28=100	28	36	40	36	52	27	25	51	66	68	23	*65*	*100*
GDP at constant prices, 1990=100	211.6	132.1	.	.	249.6	.	.	198.8	191.8	118.4	64.5	*171.2*	*148.6*
GDP at constant prices, 2007=100	123.6	117.6	108.8	103.6	124.6	106.4	132.8	130.9	140.0	111.5	88.7	*110.8*	*101.3*
Industrial production real, 2007=100 [4]	324.4	102.7	63.8	88.4	121.8	111.6	165.6	134.8	124.0	108.5	75.6	*115.1*	*93.4*
Population, thousands, average	2,894	2,075	623	7,070	77,700	3,832	1,838	9,475	17,289	144,000	43,001	*104,078*	*509,583*
Employed persons, LFS, thousands, average	1,022	689	210	2,442	25,950	812	338	4,500	8,642	71,524	18,300	*44,007*	*217,516*
Unemployment rate, LFS, in %	18.0	28.0	19.0	17.6	9.9	27.5	30.0	0.5	5.1	5.2	9.0	*9.4*	*10.2*
General gov. revenues, nat. def., in % of GDP	26.2	31.0	37.0	40.0	39.6	44.0	35.0	39.0	19.2	37.2	30.2	*38.8* [5]	*45.2* [5]
General gov. expenditures, nat. def., in % of GDP	31.3	35.0	39.0	47.0	40.4	46.5	37.0	39.5	22.1	38.3	34.9	*41.6* [5]	*48.1* [5]
General gov. balance, nat. def., in % of GDP	-5.2	-4.0	-2.0	-7.0	-0.8	-2.5	-2.0	-0.5	-2.9	-1.2	-4.8	*-2.8* [5]	*-3.0* [5]
Public debt, nat. def., in % of GDP	70.6	46.0	59.0	70.0	35.0	46.0	10.7	35.1	15.2	11.8	72.8	*50.4* [5]	*88.4* [5]
Price level, EU-28=100 (PPP/exch. rate)	45	41	50	47	54	48	44	45	51	52	35	*59*	*100*
Average gross monthly wages, EUR at exchange rate	297	505	723	524	630 [6]	661	450 [7]	454	506	634	221	*1,012* [6]	*3,034* [6]
Average gross monthly wages, EU-28=100	9.8	16.6	23.8	17.3	20.8 [6]	21.8	14.8	14.9	16.7	20.9	7.3	*33.4* [6]	*100.0* [6]
Exports of goods in % of GDP	11.0	32.6	10.9	32.2	21.5	22.6	5.7	47.2	37.5	26.4	44.0	*50.8* [8]	*31.5* [8]
Imports of goods in % of GDP	32.0	55.6	50.9	44.5	29.6	54.8	42.5	50.1	20.6	16.5	49.6	*51.0* [8]	*30.3* [8]
Exports of services in % of GDP	21.0	15.0	32.1	11.4	6.4	11.1	12.5	10.0	2.7	3.6	11.5	*11.8* [8]	*11.6* [8]
Imports of services in % of GDP	19.0	10.7	11.8	9.9	3.1	3.0	5.9	7.1	5.7	6.5	10.1	*8.5* [8]	*9.9* [8]
Current account in % of GDP	-13.5	-2.0	-20.0	-5.9	-5.8	-9.0	-7.1	-5.1	1.5	3.0	-4.0	*0.1* [8]	*1.6* [8]
FDI stock per capita in EUR, 2013	986	1,927	6,012	2,970	1,376	1,474	1,524	1,285	5,287	2,870	1,260	*5,290*	*9,209*

Note: NMS-11: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia. PPP: Purchasing power parity, wiiw estimates for Belarus, Kazakhstan, Russia and Ukraine; IMF for Kosovo.
1) Exluding the occupied territories of Crimea and Sevastopol. - 2) wiiw estimates. - 3) wiiw estimates and Eurostat. - 4) EU-28 working-day adjusted. - 5) EU definition: expenditures and revenues according to ESA 2010, excessive deficit procedure. - 6) Gross wages plus indirect labour costs, according to national account concept. - 7) Average net monthly wages. - 8) Data for NMS-11 and EU-28 include transactions within the region.
Source: wiiw Annual Database, Eurostat, AMECO.

Table 32 / GDP per capita at current PPPs (EUR), from 2014 at constant PPPs and population

	1991	1995	2000	2005	2009	2010	2011	2012	2013	2014	2015	2016 Forecast	2017
Bulgaria	4,400	5,100	5,600	8,300	10,800	11,200	12,200	12,400	12,300	12,600	12,800	13,000	13,300
Croatia	6,700	6,900	9,500	13,400	15,000	14,900	15,400	15,700	15,800	15,800	15,800	16,000	16,200
Czech Republic	8,800	11,600	14,100	18,600	20,300	20,600	21,400	21,800	21,600	22,100	22,600	23,100	23,700
Estonia	5,400	5,300	8,600	13,800	15,200	16,100	17,700	18,700	19,200	19,800	20,200	20,700	21,300
Hungary	6,800	7,600	10,500	14,400	15,600	16,400	17,100	17,300	17,600	18,400	18,800	19,200	19,600
Latvia	6,400	5,000	7,000	11,800	12,900	13,400	15,000	16,300	17,200	17,800	18,200	18,700	19,200
Lithuania	7,100	5,200	7,500	12,300	13,700	15,300	17,100	18,500	19,300	20,200	20,700	21,300	22,000
Poland	4,500	6,200	9,100	11,500	14,400	15,800	16,600	17,300	17,800	18,500	19,100	19,700	20,300
Romania	4,000	4,800	5,000	8,000	11,900	12,600	13,100	13,800	14,100	14,700	15,100	15,600	16,100
Slovakia	5,800	7,100	9,700	13,900	17,400	18,600	19,200	19,700	20,000	20,600	21,100	21,700	22,400
Slovenia	8,500	11,100	15,500	20,000	20,700	21,000	21,600	21,800	21,800	22,400	22,800	23,200	23,700
NMS-11	5,400	6,600	8,700	12,000	14,600	15,500	16,300	16,900	17,200	17,800	18,300	18,800	19,300
Albania	1,400	2,000	3,500	5,200	7,000	7,100	7,300	7,400	7,500	7,700	7,900	8,100	8,300
Macedonia	4,300	4,000	5,400	6,900	8,500	8,900	9,100	9,200	9,500	9,900	10,200	10,500	10,800
Montenegro	.	.	5,600	6,900	9,900	10,200	10,600	10,400	10,700	10,900	11,200	11,500	11,800
Serbia	.	.	4,900	7,400	8,900	9,000	9,500	9,700	9,900	9,900	9,900	10,000	10,100
Turkey	3,700	4,300	7,600	9,100	10,900	12,200	13,300	13,700	14,100	14,300	14,800	15,300	15,800
Bosnia & Herzeg.	.	.	3,900	5,200	6,400	6,700	7,000	7,100	7,200	7,300	7,400	7,600	7,800
Kosovo	.	.	.	5,100	5,700	5,900	6,200	6,500	6,700	6,900	7,100	7,300	7,600
Belarus	3,900	3,200	5,000	8,100	10,600	11,700	12,500	13,200	13,500	13,800	13,500	13,700	14,000
Kazakhstan	5,200	3,800	3,700	7,300	11,300	13,600	15,600	16,800	17,400	18,000	18,400	19,000	19,900
Russia	7,100	4,700	5,900	9,900	14,500	15,600	17,000	18,400	18,800	18,700	18,000	18,300	18,700
Ukraine	3,700	2,400	3,100	4,800	4,700	5,600	6,500	6,700	6,700	6,400	6,100	6,100	6,200
Austria	19,000	19,900	25,700	29,000	30,600	31,900	33,200	34,200	34,000	34,200	34,600	35,100	35,800
Germany	18,900	19,300	23,100	26,900	27,900	30,200	31,800	32,500	32,600	33,000	33,400	34,000	34,700
Greece	12,900	12,800	16,600	21,000	22,900	22,100	20,100	19,600	19,300	19,400	20,000	20,700	21,100
Ireland	12,900	15,400	25,600	33,700	31,200	32,700	33,900	34,300	34,500	36,100	37,400	38,800	39,600
Italy	17,600	18,400	23,200	24,700	25,500	26,300	26,800	26,900	26,500	26,400	26,600	26,900	27,400
Portugal	10,900	11,500	15,500	18,500	19,700	20,600	20,300	20,200	21,000	21,200	21,500	21,900	22,300
Spain	13,300	13,800	19,000	23,300	24,700	24,700	24,700	24,900	25,000	25,300	25,700	26,300	26,800
United States	22,400	24,100	31,600	37,000	35,300	36,900	37,500	39,100	40,000	40,900	42,200	43,600	44,500
EU-28 average	14,100	15,100	19,600	23,200	24,300	25,300	26,000	26,500	26,600	27,300	27,700	28,300	28,900

European Union (28) average = 100

	1991	1995	2000	2005	2009	2010	2011	2012	2013	2014	2015	2016	2017
Bulgaria	31	34	29	36	44	44	47	47	46	46	46	46	46
Croatia	48	46	48	58	62	59	59	59	59	58	57	57	56
Czech Republic	62	77	72	80	84	81	82	82	81	81	82	82	82
Estonia	38	35	44	59	63	64	68	71	72	73	73	73	74
Hungary	48	50	54	62	64	65	66	65	66	67	68	68	68
Latvia	45	33	36	51	53	53	58	62	65	65	66	66	66
Lithuania	50	34	38	53	56	60	66	70	73	74	75	75	76
Poland	32	41	46	50	59	62	64	65	67	68	69	70	70
Romania	28	32	26	34	49	50	50	52	53	54	55	55	56
Slovakia	41	47	49	60	72	74	74	74	75	75	76	77	78
Slovenia	60	74	79	86	85	83	83	82	82	82	82	82	82
NMS-11	38	44	44	52	60	61	63	64	65	65	66	66	67
Albania	10	13	18	22	29	28	28	28	28	28	29	29	29
Macedonia	30	26	28	30	35	35	35	35	36	36	37	37	37
Montenegro	.	.	29	30	41	40	41	39	40	40	40	41	41
Serbia	.	.	25	32	37	36	37	37	37	36	36	35	35
Turkey	26	28	39	39	45	48	51	52	53	52	53	54	55
Bosnia & Herzeg.	.	.	20	22	26	26	27	27	27	27	27	27	27
Kosovo	.	.	.	22	23	23	24	25	25	25	26	26	26
Belarus	.	21	26	35	44	46	48	50	51	51	49	48	48
Kazakhstan	.	25	19	31	47	54	60	63	65	66	66	67	69
Russia	50	31	30	43	60	62	65	69	71	68	65	65	65
Ukraine	26	16	16	21	19	22	25	25	25	23	22	22	21
Austria	135	132	131	125	126	126	128	129	128	125	125	124	124
Germany	134	128	118	116	115	119	122	123	123	121	121	120	120
Greece	91	85	85	91	94	87	77	74	73	71	72	73	73
Ireland	91	102	131	145	128	129	130	129	130	132	135	137	137
Italy	125	122	118	106	105	104	103	102	100	97	96	95	95
Portugal	77	76	79	80	81	81	78	76	79	78	78	77	77
Spain	94	91	97	100	102	98	95	94	94	93	93	93	93
USA	159	160	161	159	145	146	144	148	150	150	152	154	154
EU-28 average	100	100	100	100	100	100	100	100	100	100	100	100	100

Sources: wiiw Annual Database incorporating national and Eurostat statistics, wiiw estimates, Eurostat, EC - Autumn Report 2014.

Table 33 / Indicators of macro-competitiveness, 2010-2017, EUR based, annual averages

	2010	2011	2012	2013	2014	2015	2016 Forecast	2017
Bulgaria								
Producer price index, 2010=100	100.0	109.2	114.0	112.2	110.9	110.9	112.0	113.7
Consumer price index, 2010=100	100.0	103.4	105.9	106.3	104.6	104.6	105.6	107.2
GDP deflator, 2010=100	100.0	107.0	108.6	107.8	107.7	107.7	108.7	110.4
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.0	100.3	100.0	98.9	96.8	96.6	96.2	96.2
Real ER (PPI-based), 2010=100	100.0	103.7	105.3	103.8	104.4	103.4	103.0	103.0
PPP, NC/EUR	0.8680	0.8780	0.8817	0.8982	0.8921	0.88	0.88	0.88
Price level, EU28 = 100	44	45	45	46	46	45	45	45
Average monthly gross wages, EUR (ER)	331	351	374	396	423	430	440	470
Average monthly gross wages, EUR (PPP)	747	781	829	863	928	950	990	1,030
GDP per employed person, 2010=100	100.0	105.5	106.6	107.8	107.4	108.26	109.11	110.81
Unit labour costs, ER adj., 2010=100	100.0	100.3	105.8	110.9	118.9	119.7	123.0	126.7
Unit labour costs, PPP adj., Austria=100	25.6	25.5	26.1	27.1	28.4	28.3	28.4	29.6
Croatia								
Producer price index, 2010=100	100.0	107.0	112.8	112.5	109.6	110.7	111.8	113.0
Consumer price index, 2010=100	100.0	102.2	105.6	108.1	108.3	108.8	109.3	110.4
GDP deflator, 2010=100	100.0	101.7	103.3	104.2	104.4	104.8	105.3	106.4
Exchange rate (ER), NC/EUR	7.286	7.434	7.517	7.574	7.630	7.73	7.79	7.86
ER, nominal, 2010=100	100.0	102.0	103.2	103.9	104.7	106.1	106.9	107.9
Real ER (CPI-based), 2010=100	100.0	97.2	96.8	96.8	95.8	94.7	93.2	91.9
Real ER (PPI-based), 2010=100	100.0	99.6	101.0	100.1	98.6	97.3	96.2	94.9
PPP, NC/EUR	5.134	5.054	4.917	4.917	4.898	4.87	4.83	4.80
Price level, EU28 = 100	70	68	65	65	64	63	62	61
Average monthly gross wages, EUR (ER)	1,054	1,049	1,048	1,048	1,041	1,030	1,030	1,040
Average monthly gross wages, EUR (PPP)	1,496	1,543	1,602	1,615	1,622	1,630	1,660	1,700
GDP per employed person, 2010=100	100.0	103.0	104.0	107.1	95.5	95.80	96.22	97.02
Unit labour costs, ER adj., 2010=100	100.0	96.6	95.6	92.9	103.5	101.9	101.7	101.5
Unit labour costs, PPP adj., Austria=100	53.2	51.2	49.2	47.2	51.5	50.1	49.3	48.9
Czech Republic								
Producer price index, 2010=100	100.0	103.7	106.1	106.8	108.2	109.4	110.9	112.3
Consumer price index, 2010=100	100.0	102.2	105.8	107.2	107.7	108.1	109.7	111.3
GDP deflator, 2010=100	100.0	99.8	101.2	102.9	103.5	103.8	105.4	107.0
Exchange rate (ER), NC/EUR	25.28	24.59	25.15	25.98	27.54	27.60	27.60	27.00
ER nominal, 2010=100	100.0	97.3	99.5	102.8	108.9	109.2	109.2	106.8
Real ER (CPI-based), 2010=100	100.0	101.9	100.5	97.1	91.5	91.5	91.6	93.6
Real ER (PPI-based), 2010=100	100.0	101.3	98.6	96.2	93.6	93.5	93.4	95.3
PPP, NC/EUR	18.30	17.90	17.71	17.98	17.96	17.8	17.9	17.9
Price level, EU28 = 100	72	73	70	69	65	65	65	66
Average monthly gross wages, EUR (ER)	944	995	997	965	930	960	1,000	1,060
Average monthly gross wages, EUR (PPP)	1,304	1,366	1,416	1,395	1,430	1,480	1,540	1,600
GDP per employed person, 2010=100	100.0	101.6	101.0	99.4	100.9	103.01	105.27	107.59
Unit labour costs, ER adj., 2010=100	100.0	103.7	104.5	102.9	97.9	98.4	100.3	104.3
Unit labour costs, PPP adj., Austria=100	44.7	46.2	45.1	43.9	40.8	40.7	41.0	42.1
Estonia								
Producer price index, 2010=100	100.0	104.2	107.0	114.7	111.6	112.3	114.5	118.1
Consumer price index, 2010=100	100.0	105.1	109.5	113.1	113.6	114.5	117.0	119.6
GDP deflator, 2010=100	100.0	103.0	105.8	110.6	111.1	111.8	114.0	117.6
Real ER (CPI-based), 2010=100	100.0	101.9	103.5	105.3	105.2	105.8	106.6	107.4
Real ER (PPI-based), 2010=100	100.0	99.0	98.8	106.1	105.1	104.7	105.3	107.0
PPP, NC/EUR	0.6871	0.6967	0.7136	0.7398	0.7388	0.74	0.74	0.75
Price level, EU28 = 100	69	70	71	74	74	74	74	75
Average monthly gross wages, EUR (ER)	792	839	887	949	1,000	1,040	1,090	1,150
Average monthly gross wages, EUR (PPP)	1,153	1,204	1,243	1,283	1,354	1,410	1,470	1,530
GDP per employed person, 2010=100	100.0	101.5	105.2	105.8	107.3	109.45	112.94	117.60
Unit labour costs, ER adj., 2010=100	100.0	104.3	106.4	113.2	117.6	119.9	121.8	123.4
Unit labour costs, PPP adj., Austria=100	44.3	46.0	45.5	47.8	48.7	48.9	49.2	49.3

(Table 33 ctd.)

(Table 33 ctd.)

	2010	2011	2012	2013	2014	2015	2016 Forecast	2017
Hungary								
Producer price index, 2010=100	100.0	104.1	108.4	109.1	108.6	111.0	113.8	117.0
Consumer price index, 2010=100	100.0	103.9	109.8	111.7	111.7	113.4	116.2	119.7
GDP deflator, 2010=100	100.0	102.2	105.6	108.8	111.2	113.6	116.4	119.8
Exchange rate (ER), NC/EUR	275.5	279.4	289.3	296.9	308.7	315	315	315
ER, nominal 2010=100	100.0	101.4	105.0	107.8	112.1	114.3	114.3	114.3
Real ER (CPI-based), 2010=100	100.0	99.4	98.8	96.5	92.3	91.6	92.6	94.0
Real ER (PPI-based), 2010=100	100.0	97.5	95.4	93.6	91.3	90.5	91.5	92.7
PPP, NC/EUR	164.5	164.4	166.4	171.0	173.7	175.8	177.7	180.1
Price level, EU28 = 100	60	59	58	58	56	56	56	57
Average monthly gross wages, EUR (ER)	735	763	771	777	768	780	810	850
Average monthly gross wages, EUR (PPP)	1,231	1,296	1,341	1,349	1,365	1,400	1,440	1,480
GDP per employed person, 2010=100	100.0	101.0	99.1	98.9	97.2	98.96	100.45	102.21
Unit labour costs, ER adj., 2010=100	100.0	102.7	105.9	106.8	107.5	107.1	109.7	112.6
Unit labour costs, PPP adj., Austria=100	35.5	36.4	36.4	36.2	35.7	35.1	35.6	36.3
Latvia								
Producer price index, 2010=100	100.0	107.7	112.1	114.0	114.4	115.4	118.1	121.5
Consumer price index, 2010=100	100.0	104.2	106.6	106.6	107.4	108.2	110.6	113.7
GDP deflator, 2010=100	100.0	106.4	110.2	111.4	112.4	113.2	116.0	119.3
Real ER (CPI-based), 2010=100	100.0	101.4	102.4	100.3	100.2	100.8	101.6	102.9
Real ER (PPI-based), 2010=100	100.0	102.7	105.3	106.5	108.7	108.5	109.5	111.0
PPP, NC/EUR	0.6441	0.6566	0.6629	0.6692	0.6707	0.67	0.68	0.69
Price level, EU28 = 100	64	65	67	67	67	67	68	69
Average monthly gross wages, EUR (ER)	628	657	690	717	766	790	830	880
Average monthly gross wages, EUR (PPP)	983	1,005	1,032	1,069	1,142	1,180	1,230	1,280
GDP per employed person, 2010=100	100.0	101.8	118.3	120.8	125.0	127.41	131.56	136.22
Unit labour costs, ER adj., 2010=100	100.0	102.8	92.9	94.6	97.6	98.7	100.5	102.9
Unit labour costs, PPP adj., Austria=100	43.9	44.9	39.4	39.6	40.0	39.9	40.2	40.8
Lithuania								
Producer price index, 2010=100	100.0	113.9	119.6	116.7	110.9	111.6	113.7	116.7
Consumer price index, 2010=100	100.0	104.1	107.4	108.7	108.9	109.6	111.6	114.3
GDP deflator, 2010=100	100.0	105.2	108.0	109.7	110.0	110.7	112.8	115.7
Real ER (CPI-based), 2010=100	100.0	101.0	101.5	101.2	100.9	101.3	101.6	102.7
Real ER (PPI-based), 2010=100	100.0	108.2	110.5	107.9	104.5	104.1	104.6	105.7
PPP, NC/EUR	0.5913	0.6036	0.6029	0.6132	0.6112	0.61	0.61	0.62
Price level, EU28 = 100	59	60	60	61	61	61	61	62
Average monthly gross wages, EUR (ER)	576	593	615	646	676	710	750	800
Average monthly gross wages, EUR (PPP)	974	982	1,020	1,054	1,106	1,170	1,230	1,290
GDP per employed person, 2010=100	100.0	104.0	116.1	118.3	120.2	122.37	125.25	129.09
Unit labour costs, ER adj., 2010=100	100.0	98.9	92.0	94.9	97.7	100.8	104.0	107.6
Unit labour costs, PPP adj., Austria=100	34.2	33.7	30.4	31.0	31.3	31.8	32.5	33.3
Poland								
Producer price index, 2010=100	100.0	107.3	110.8	109.4	108.0	106.4	106.4	108.0
Consumer price index, 2010=100	100.0	103.9	107.7	108.6	108.7	109.0	110.6	112.8
GDP deflator, 2010=100	100.0	103.2	105.5	106.7	106.9	107.5	108.8	111.1
Exchange rate (ER), NC/EUR	3.995	4.121	4.185	4.198	4.184	4.15	4.12	4.20
ER, nominal, 2010=100	100.0	103.2	104.8	105.1	104.7	103.9	103.1	105.1
Real ER (CPI-based), 2010=100	100.0	97.7	97.2	96.2	96.0	96.9	97.7	96.3
Real ER (PPI-based), 2010=100	100.0	98.8	97.7	96.3	97.1	95.5	94.8	93.0
PPP, PLN/EUR	2.387	2.424	2.420	2.429	2.419	2.41	2.40	2.42
Price level, EU28 = 100	60	59	58	58	58	58	58	58
Average monthly gross wages, EUR (ER)	807	826	844	872	906	950	1,000	1,040
Average monthly gross wages, EUR (PPP)	1,351	1,404	1,459	1,507	1,567	1,630	1,720	1,810
GDP per employed person, 2010=100	100.0	103.7	109.1	111.1	113.6	117.04	120.26	123.70
Unit labour costs, ER adj., 2010=100	100.0	98.7	95.8	97.2	98.7	100.3	103.3	104.5
Unit labour costs, PPP adj., Austria=100	44.8	44.1	41.5	41.5	41.4	41.6	42.1	42.2

(Table 33 ctd.)

(Table 33 ctd.)

	2010	2011	2012	2013	2014	2015	2016 Forecast	2017
Romania								
Producer price index, 2010=100	100.0	107.1	112.7	115.0	114.7	118.4	121.5	124.3
Consumer price index, 2010=100	100.0	105.8	109.4	112.9	114.5	116.7	120.2	123.9
GDP deflator, 2010=100	100.0	104.7	109.9	113.6	114.6	118.2	121.3	124.2
Exchange rate (ER), NC/EUR	4.212	4.239	4.459	4.419	4.444	4.46	4.46	4.50
ER, nominal, 2010=100	100.0	100.6	105.9	104.9	105.5	105.9	105.9	106.8
Real ER (CPI-based), 2010=100	100.0	102.0	97.7	100.2	100.4	101.9	103.5	104.1
Real ER (PPI-based), 2010=100	100.0	101.0	98.3	101.3	102.4	104.2	105.5	105.4
PPP, NC/EUR	2.087	2.147	2.158	2.259	2.267	2.32	2.34	2.36
Price level, EU28 = 100	50	51	48	51	51	52	53	53
Average monthly gross wages, EUR (ER)	452	467	463	489	510	530	560	590
Average monthly gross wages, EUR (PPP)	911	922	956	958	1,010	1,020	1,070	1,130
GDP per employed person, 2010=100	100.0	102.2	101.4	105.1	116.3	118.89	122.01	125.47
Unit labour costs, ER adj., 2010=100	100.0	101.2	101.0	103.2	97.6	99.0	102.2	104.3
Unit labour costs, PPP adj., Austria=100	34.2	34.4	33.3	33.6	31.0	31.1	31.7	32.1
Slovakia								
Producer price index, 2010=100	100.0	104.5	106.5	105.4	101.7	102.1	103.5	105.3
Consumer price index, 2010=100	100.0	104.1	108.0	109.6	109.4	110.5	112.2	114.4
GDP deflator, 2010=100	100.0	101.6	102.9	103.5	103.4	103.8	105.3	107.0
Real ER (CPI-based), 2010=100	100.0	101.0	102.0	102.0	101.3	102.1	102.2	102.7
Real ER (PPI-based), 2010=100	100.0	99.3	98.4	97.5	95.7	95.2	95.2	95.4
PPP NC/ EUR	0.6691	0.6758	0.6776	0.6794	0.6748	0.67	0.67	0.67
Price level, EU28 = 100	67	68	68	68	67	67	67	67
Average monthly gross wages, EUR (ER)	769	786	805	824	840	870	910	950
Average monthly gross wages, EUR (PPP)	1,149	1,163	1,188	1,213	1,245	1,300	1,360	1,410
GDP per employed person, 2010=100	100.0	101.2	103.8	105.3	106.8	108.97	111.04	113.45
Unit labour costs, ER adj., 2010=100	100.0	101.0	100.8	101.8	102.3	103.8	106.6	108.9
Unit labour costs, PPP adj., Austria=100	37.2	37.4	36.2	36.1	35.5	35.6	36.1	36.5
Slovenia								
Producer price index, 2010=100	100.0	104.6	105.5	105.5	104.8	105.3	105.8	106.9
Consumer price index, 2010=100	100.0	102.1	105.0	107.0	107.4	107.9	109.0	110.1
GDP deflator, 2010=100	100.0	101.2	101.5	102.9	103.3	103.8	104.3	105.4
Real ER (CPI-based), 2010=100	100.0	99.0	99.2	99.6	99.4	99.7	99.3	98.8
Real ER (PPI-based), 2010=100	100.0	99.3	97.4	97.5	98.7	98.2	97.3	96.8
PPP, NC/EUR	0.8412	0.8315	0.8030	0.8056	0.8039	0.80	0.79	0.79
Price level, EU28 = 100	84	83	80	81	80	80	79	79
Average monthly gross wages, EUR (ER)	1,495	1,525	1,525	1,523	1,540	1,560	1,590	1,620
Average monthly gross wages, EUR (PPP)	1,777	1,834	1,900	1,891	1,916	1,950	2,010	2,050
GDP per employed person, 2010=100	100.0	103.8	102.4	103.4	104.4	105.08	105.88	105.62
Unit labour costs, ER adj., 2010=100	100.0	98.2	99.6	98.5	98.7	99.3	100.5	102.6
Unit labour costs, PPP adj., Austria=100	70.2	68.7	67.6	66.0	64.8	64.3	64.4	65.1
Albania								
Producer price index, 2010=100	100.0	102.6	103.8	103.3	103.6	104.6	105.7	106.7
Consumer price index, 2010=100	100.0	103.4	105.5	107.6	109.3	111.0	112.9	114.8
GDP deflator, 2010=100	100.0	102.3	103.4	104.2	105.3	106.9	109.0	110.6
Exchange rate (ER), NC/EUR	137.8	140.3	139.0	140.3	140.0	141.0	143.0	143.0
ER, nominal, 2010=100	100.0	101.8	100.9	101.8	101.6	102.3	103.8	103.8
Real ER (CPI-based), 2010=100	100.0	98.5	98.8	98.4	99.6	100.2	99.1	99.3
Real ER (PPI-based), 2010=100	100.0	95.7	95.0	93.8	96.0	95.3	93.6	93.2
PPP, NC/EUR	59.88	61.45	62.53	62.74	63.03	63.4	63.7	63.7
Price level, EU28 = 100	43	44	45	45	45	45	45	45
Average monthly gross wages, EUR (ER)	252	260	268	291	297	300	310	320
Average monthly gross wages, EUR (PPP)	581	594	597	651	660	680	700	720
GDP per employed person, 2010=100	100.0	103.2	108.9	124.3	122.5	119.34	119.73	121.50
Unit labour costs, ER adj., 2010=100	100.0	99.9	97.6	92.9	96.1	101.0	102.5	104.7
Unit labour costs, PPP adj., Austria=100	29.8	29.6	28.1	26.4	26.8	27.4	27.9	28.1

(Table 33 ctd.)

(Table 33 ctd.)

	2010	2011	2012	2013	2014	2015	2016 Forecast	2017
Macedonia								
Producer price index, 2010=100	100.0	111.9	113.5	111.9	109.7	110.8	113.0	115.3
Consumer price index, 2010=100	100.0	103.9	107.3	110.3	110.0	111.7	113.9	116.2
GDP deflator, 2010=100	100.0	103.7	104.8	109.3	108.9	110.6	112.9	115.1
Exchange rate (ER), NC/EUR	61.52	61.53	61.53	61.58	61.62	61.5	61.5	61.5
ER, nominal, 2010=100	100.0	100.0	100.0	100.1	100.2	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.0	100.8	101.4	102.6	101.7	103.2	103.8	104.3
Real ER (PPI-based), 2010=100	100.0	106.2	104.8	103.3	103.1	103.3	103.9	104.5
PPP, NC/EUR	23.83	24.84	24.60	25.39	25.16	25.3	25.5	25.6
Price level, EU28 = 100	39	40	40	41	41	41	41	42
Average monthly gross wages, EUR (ER)	491	497	498	504	505	520	540	560
Average monthly gross wages, EUR (PPP)	1,268	1,232	1,246	1,222	1,236	1,270	1,300	1,350
GDP per employed person, 2010=100	100.0	101.2	99.9	98.2	100.2	102.06	103.53	104.76
Unit labour costs, ER adj., 2010=100	100.0	100.0	101.6	104.4	102.5	103.8	105.8	108.7
Unit labour costs, PPP adj., Austria=100	35.8	35.6	35.1	35.6	34.3	34.2	34.6	35.1
Montenegro								
Producer price index, 2010=100	100.0	103.2	105.1	106.8	106.9	108.0	110.2	113.5
Consumer price index, 2010=100	100.0	103.5	107.7	110.1	109.3	110.4	112.6	114.9
GDP deflator, 2010=100	100.0	100.9	100.8	103.1	104.0	104.7	107.8	110.5
Real ER (CPI-based), 2010=100	100.0	100.4	101.8	102.5	101.2	102.0	102.6	103.1
Real ER (PPI-based), 2010=100	100.0	98.0	97.1	98.8	100.7	95.6	96.6	97.0
PPP, NC/EUR	0.4927	0.4904	0.4893	0.4993	0.5007	0.50	0.51	0.51
Price level, EU28 = 100	49	49	49	50	50	50	51	51
Average monthly gross wages, EUR (ER)	715	722	727	726	723	740	770	800
Average monthly gross wages, EUR (PPP)	1,451	1,472	1,486	1,454	1,444	1,480	1,520	1,560
GDP per employed person, 2010=100	100.0	110.0	104.7	107.2	104.4	107.30	109.31	112.66
Unit labour costs, ER adj., 2010=100	100.0	91.8	97.1	94.7	96.9	96.5	98.5	99.3
Unit labour costs, PPP adj., Austria=100	49.5	45.3	46.4	44.7	44.8	44.0	44.5	44.4
Serbia								
Producer price index, 2010=100	100.0	112.7	120.4	123.6	125.2	127.7	130.3	132.9
Consumer price index, 2010=100	100.0	111.0	119.7	129.0	132.7	136.7	140.8	145.0
GDP deflator, 2010=100	100.0	109.6	116.4	122.7	126.0	129.9	135.0	139.5
Exchange rate (ER), NC/EUR	103.04	101.95	113.13	113.14	117.25	124	126	128
ER, nominal, 2010=100	100.0	98.9	109.8	109.8	113.8	120.3	122.3	124.2
Real ER (CPI-based), 2010=100	100.0	108.8	103.0	109.4	108.0	105.0	104.9	104.8
Real ER (PPI-based), 2010=100	100.0	108.2	101.3	104.1	103.6	98.9	97.9	96.9
PPP, NC/EUR	46.73	49.57	51.46	54.39	55.50	56.6	58.1	59.1
Price level, EU28 = 100	45	49	45	48	47	46	46	46
Average monthly gross wages, EUR (ER)	460	517	508	537	524	500	510	510
Average monthly gross wages, EUR (PPP)	1,015	1,064	1,116	1,116	1,107	1,090	1,100	1,110
GDP per employed person, 2010=100	100.0	107.8	107.9	106.8	99.0	96.24	97.20	98.56
Unit labour costs, ER adj., 2010=100	100.0	104.2	102.1	109.1	114.9	112.8	113.2	113.2
Unit labour costs, PPP adj., Austria=100	35.2	36.5	34.8	36.7	37.8	36.6	36.6	35.7
Bosnia and Herzegovina								
Producer price index, 2010=100	100.0	105.5	105.8	104.0	103.4	104.4	106.5	109.7
Consumer price index, 2010=100	100.0	103.7	105.8	106.0	105.0	106.1	108.2	111.5
GDP deflator, 2010=100	100.0	102.6	103.7	103.4	102.5	103.6	105.6	108.7
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.0	100.6	99.9	98.7	97.2	98.0	98.6	100.1
Real ER (PPI-based), 2010=100	100.0	100.2	97.8	96.1	97.4	97.4	98.0	99.4
PPP, NC/EUR	0.9676	0.9604	0.9419	0.9520	0.9380	0.94	0.94	0.96
Price level, EU28 = 100	49	49	48	49	48	48	48	49
Average monthly gross wages, EUR (ER)	622	650	660	660	661	680	710	740
Average monthly gross wages, EUR (PPP)	1,257	1,323	1,370	1,356	1,377	1,420	1,460	1,510
GDP per employed person, 2010=100	100.0	104.3	103.3	104.8	106.6	107.39	108.07	108.07
Unit labour costs, ER adj., 2010=100	100.0	100.2	102.6	101.2	99.6	101.8	105.0	110.3
Unit labour costs, PPP adj., Austria=100	42.7	42.6	42.4	41.2	39.8	40.1	41.2	42.5

(Table 33 ctd.)

(Table 33 ctd.)

	2010	2011	2012	2013	2014	2015	2016 Forecast	2017
Kosovo								
Producer price index, 2010=100	100.0	105.7	107.5	110.2	109.5	111.4	111.9	114.9
Consumer price index, 2010=100	100.0	107.3	110.0	112.0	112.4	113.5	114.7	117.0
GDP deflator, 2010=100	100.0	104.8	107.1	109.0	109.1	111.0	111.5	114.5
Real ER (CPI-based), 2010=100	100.0	104.1	103.9	104.2	104.1	104.9	104.5	105.0
Real ER (PPI-based), 2010=100	100.0	100.4	99.3	101.9	103.1	103.9	102.9	104.1
PPP, NC/EUR	0.4170	0.4350	0.4280	0.4380	0.4390	0.44	0.44	0.44
Price level, EU28 = 100	42	44	43	44	44	44	44	44
Average monthly gross wages, EUR (ER)	286	348	354	356	416	440	460	490
Average monthly gross wages, EUR (PPP)	686	800	827	813	948	1,000	1,050	1,110
GDP per employed person, 2010=100	100.0	107.1	102.0	94.4	95.9	96.79	96.79	97.44
Unit labour costs, ER adj., 2010=100	100.0	113.6	121.3	131.8	151.7	158.9	166.2	175.8
Unit labour costs, PPP adj., Austria=100	16.3	18.5	19.2	20.5	23.2	23.9	24.8	25.9
Belarus								
Producer price index, 2010=100	100.0	171.4	301.7	342.7	386.6	483.2	603.9	712.8
Consumer price index, 2010=100	100.0	153.2	243.9	288.5	340.8	425.9	532.4	665.5
GDP deflator, 2010=100	100.0	171.3	300.5	364.2	429.9	537.3	671.6	792.7
Exchange rate (ER), NC/EUR	4,007	8,051	10,778	11,834	13,220	18,000	22,000	24,000
ER, nominal, 2010=100	100.0	200.9	269.0	295.4	330.0	449.3	549.1	599.0
Real ER (CPI-based), 2010=100	100.0	74.0	85.7	90.9	95.6	87.6	88.4	99.7
Real ER (PPI-based), 2010=100	100.0	81.0	103.6	107.3	110.3	100.3	101.1	107.8
PPP, NC/EUR	1476	2512	4253	5085	5937	7347.9	9057.3	10531.6
Price level, EU28 = 100	37	31	39	43	45	41	41	44
Average monthly gross wages, EUR (ER)	304	236	341	428	454	420	440	520
Average monthly gross wages, EUR (PPP)	825	756	864	995	1,010	1,030	1,060	1,170
GDP per employed person, 2010=100	100.0	105.8	109.4	111.2	114.2	112.63	114.09	115.60
Unit labour costs, ER adj., 2010=100	100.0	73.4	102.6	126.6	130.8	122.3	125.9	146.7
Unit labour costs, PPP adj., Austria=100	26.6	19.5	26.4	32.2	32.6	30.2	30.9	35.6
Kazakhstan								
Producer price index, 2010=100	100.0	127.2	131.7	131.3	143.7	129.4	139.7	143.9
Consumer price index, 2010=100	100.0	108.3	113.9	120.5	128.6	138.3	146.6	153.9
GDP deflator, 2010=100	100.0	117.8	123.6	135.6	140.2	147.1	157.4	164.7
Exchange rate (ER), NC/EUR	195.7	204.1	191.7	202.1	238.1	237	231	225
ER, nominal, 2010=100	100.0	104.3	98.0	103.3	121.7	121.1	118.1	115.0
Real ER (CPI-based), 2010=100	100.0	100.7	109.9	108.7	97.9	105.5	113.1	120.1
Real ER (PPI-based), 2010=100	100.0	115.8	124.2	117.5	111.2	99.6	108.8	113.4
PPP, NC/EUR	98.4	106.6	107.8	118.8	122.0	126.8	133.8	137.9
Price level, EU28 = 100	50	52	56	59	51	53	58	61
Average monthly gross wages, EUR (ER)	397	441	528	540	506	550	620	700
Average monthly gross wages, EUR (PPP)	789	844	940	919	987	1,040	1,070	1,140
GDP per employed person, 2010=100	100.0	104.9	107.4	112.9	116.8	117.91	120.80	124.96
Unit labour costs, ER adj., 2010=100	100.0	106.0	124.1	120.6	109.2	118.6	129.7	140.5
Unit labour costs, PPP adj., Austria=100	30.4	32.1	36.4	35.0	31.0	33.0	35.9	38.8
Russia								
Producer price index, 2010=100	100.0	117.3	125.3	129.5	137.4	145.7	153.0	160.6
Consumer price index, 2010=100	100.0	108.5	114.1	121.8	131.3	145.7	157.4	166.8
GDP deflator, 2010=100	100.0	115.9	124.5	130.9	139.5	158.5	166.2	175.7
Exchange rate (ER), NC/EUR	40.27	40.87	39.94	42.27	50.46	80	75	70
ER, nominal, 2010=100	100.0	101.5	99.2	105.0	125.3	198.7	186.2	173.8
Real ER (CPI-based), 2010=100	100.0	103.7	108.7	108.0	97.0	67.8	77.0	86.2
Real ER (PPI-based), 2010=100	100.0	109.8	116.7	114.1	103.3	68.4	75.5	83.7
PPP, NC/EUR	20.74	23.07	23.56	24.53	26.39	29.7	30.7	32.0
Price level, EU28 = 100	52	56	59	58	52	37	41	46
Average monthly gross wages, EUR (ER)	520	572	667	709	634	420	490	570
Average monthly gross wages, EUR (PPP)	1,010	1,013	1,130	1,221	1,213	1,120	1,200	1,250
GDP per employed person, 2010=100	100.0	102.9	105.4	107.0	107.4	103.99	105.23	106.59
Unit labour costs, ER adj., 2010=100	100.0	106.8	121.6	127.4	113.5	77.1	89.6	102.9
Unit labour costs, PPP adj., Austria=100	34.1	36.3	40.1	41.5	36.2	24.4	27.9	31.7

(Table 33 ctd.)

(Table 33 ctd.)

	2010	2011	2012	2013	2014	2015	2016 Forecast	2017
Ukraine								
Producer price index, 2010=100	100.0	119.0	123.4	123.3	144.4	173.2	190.6	200.1
Consumer price index, 2010=100	100.0	108.0	108.6	108.3	121.4	150.6	164.1	174.0
GDP deflator, 2010=100	100.0	114.2	123.3	127.2	142.5	176.8	192.7	203.9
Exchange rate (ER), NC/EUR	10.53	11.09	10.27	10.61	15.72	33.0	34.0	35.0
ER, nominal, 2010=100	100.0	105.3	97.5	100.8	149.2	313.3	322.8	332.3
Real ER (CPI-based), 2010=100	100.0	99.5	105.3	100.1	75.4	44.4	46.3	47.0
Real ER (PPI-based), 2010=100	100.0	107.3	116.9	113.1	91.1	51.6	54.3	54.5
PPP, NC/EUR	4.328	4.561	4.748	4.923	5.485	6.73	7.24	7.55
Price level, EU28 = 100	41	41	46	46	35	20	21	22
Average monthly gross wages, EUR (ER)	213	237	295	308	221	130	130	140
Average monthly gross wages, EUR (PPP)	517	577	637	663	634	620	620	650
GDP per employed person, 2010=100	100.0	105.1	105.1	104.9	104.8	102.36	103.45	105.44
Unit labour costs, ER adj., 2010=100	100.0	106.2	131.8	137.9	99.3	57.9	60.3	62.2
Unit labour costs, PPP adj., Austria=100	34.8	36.9	44.4	45.8	32.4	19.2	18.8	19.7
Austria								
Producer price index, 2010=100	100.0	104.0	104.9	104.0	102.9	104.7	106.2	107.7
Consumer price index, 2010=100	100.0	103.3	105.8	107.9	109.6	111.3	113.0	114.9
GDP deflator, 2010=100	100.0	101.8	103.7	105.2	107.1	109.0	110.5	112.1
Real ER (CPI-based), 2010=100	100.0	100.2	100.0	100.5	101.5	102.8	103.0	103.1
Real ER (PPI-based), 2010=100	100.0	98.8	96.9	96.2	96.9	97.6	97.6	97.6
PPP, NC/EUR	1.104	1.104	1.099	1.114	1.122	1.131	1.131	1.130
Price level, EU28 = 100	110	110	110	111	112	113	113	113
Average monthly gross wages, EUR	3,107	3,178	3,272	3,333	3,383	3,430	3,490	3,540
Average monthly gross wages, EUR (PPP)	2,815	2,880	2,977	2,991	3,015	3,033	3,087	3,132
GDP per employed person, 2010=100	100.0	101.9	101.8	102.3	101.8	101.81	102.51	102.92
Unit labour costs, ER adj., 2010=100	100.0	100.4	103.5	104.8	106.9	108.4	109.6	110.7
Unit labour costs, PPP 2010 adjusted	0.57	0.58	0.59	0.60	0.61	0.62	0.63	0.63

Notes:
Benchmark PPP results for 2011 were applied (published by Eurostat , OECD and CIS Stat in December 2013).
Employment data and related indicators (e.g. Unit labour costs) may be affected by the new population census data - mostly from 2012 (HR, RO from 2014, AL, ME, KZ from 2011).
Unit labour costs are defined as average gross wages per employee relative to labour productivitiy (real GDP per employed person, LFS). For level comparisons, labour productivity is converted with the PPP rate 2010 (PPP adjusted).
PPP rates have been taken from Eurostat based on the benchmark results 2011. Missing data have been extrapolated by wiiw with GDP deflators. Kazakhstan, Russia and Ukraine are estimated by wiiw using the OECD and CIS PPP benchmark results 2011.
Real exchange rates: Increasing values mean real appreciation.
ER = Exchange Rate, PPP = Purchasing Power Parity, Price level: PPP/ ER.

Sources: wiiw Annual Database incorporating national and Eurostat statistics; WIFO; OECD and CIS for purchasing power parities, 2011 benchmark year, December 2013. wiiw estimates and forecasts.

Table 34 / Indicators of macro-competitiveness, 2010-2017, annual changes in %

	2010	2011	2012	2013	2014	2015	2016 Forecast	2017	2010-14 average
Bulgaria									
GDP deflator	1.2	7.0	1.6	-0.8	-0.1	0.0	1.0	1.5	1.7
Real ER (CPI-based)	0.9	0.3	-0.3	-1.1	-2.1	-0.2	-0.4	0.0	-0.5
Real ER (PPI-based)	5.3	3.7	1.5	-1.4	0.6	-1.0	-0.4	0.0	1.9
Average gross wages, real (PPI based)	-1.9	-3.1	2.1	7.7	8.1	1.5	2.6	3.0	2.5
Average gross wages, real (CPI based)	3.3	2.3	4.1	5.6	8.5	1.5	2.5	3.1	4.8
Average gross wages, EUR (ER)	6.4	5.8	6.6	6.0	6.8	1.6	2.3	6.8	6.3
Employed persons (LFS)	-6.2	-3.4	-1.1	0.0	1.6	1.0	1.0	1.0	-1.8
GDP per empl. person, NC at 2010 ref. pr.	7.3	5.5	1.6	1.1	-0.4	0.8	0.8	1.6	3.0
Unit labour costs, ER (EUR) adjusted	-0.8	0.3	4.9	4.8	7.2	0.7	2.8	3.0	3.2
Croatia									
GDP deflator	0.8	1.7	1.6	0.9	0.2	0.4	0.5	1.0	1.0
Exchange rate (ER), EUR/NC	0.7	-2.0	-1.1	-0.7	-0.7	-1.3	-0.8	-0.9	-0.8
Real ER (CPI-based)	-0.2	-2.8	-0.4	0.1	-1.1	-1.1	-1.7	-1.4	-0.9
Real ER (PPI-based)	2.0	-0.4	1.4	-0.9	-1.5	-1.3	-1.2	-1.4	0.1
Average gross wages, real (PPI based)	-4.5	-5.1	-4.2	1.1	2.7	-0.9	0.0	0.6	-2.1
Average gross wages, real (CPI based)	-1.5	-0.7	-2.3	-1.5	-0.1	-0.3	0.5	0.6	-1.2
Average gross wages, EUR (ER)	0.3	-0.5	-0.1	0.1	-0.7	-1.1	0.0	1.0	-0.2
Employed persons (LFS)	-4.0	-3.2	-3.1	-3.9	-1.4	0.0	0.6	0.6	-3.1
GDP per empl. person, NC at 2010 ref. pr.	2.4	3.0	1.0	3.0	0.8	0.3	0.4	0.8	2.0
Unit labour costs, ER (EUR) adjusted	-2.0	-3.4	-1.1	-2.9	-1.5	-1.5	-0.2	-0.1	-2.2
Czech Republic									
GDP deflator	-1.4	-0.2	1.4	1.7	0.5	0.3	1.5	1.6	0.4
Exchange rate (ER), EUR/NC	4.6	2.8	-2.2	-3.2	-5.7	-0.2	0.0	2.2	-0.8
Real ER (CPI-based)	3.6	1.9	-1.4	-3.4	-5.8	0.0	0.1	2.2	-1.1
Real ER (PPI-based)	1.6	1.3	-2.7	-2.5	-2.7	-0.1	-0.1	2.0	-1.0
Average gross wages, real (PPI based)	2.1	-1.2	0.2	-0.6	1.1	1.7	2.8	2.7	0.3
Average gross wages, real (CPI based)	1.1	0.3	-1.0	-1.3	2.0	2.4	2.6	2.5	0.2
Average gross wages, EUR (ER)	6.9	5.4	0.2	-3.2	-3.7	3.2	4.2	6.0	1.0
Employed persons (LFS)	-1.0	0.4	0.4	1.0	0.5	0.2	0.2	0.2	0.2
GDP per empl. person, NC at 2010 ref. pr.	3.3	1.6	-1.2	-1.7	1.5	2.1	2.2	2.2	0.7
Unit labour costs, ER (EUR) adjusted	3.4	3.7	1.4	-1.5	-4.8	0.5	1.9	4.0	0.4
Estonia									
GDP deflator	1.5	3.0	2.7	4.5	0.5	0.6	2.0	3.1	2.4
Real ER (CPI-based)	0.6	1.9	1.5	1.7	-0.1	0.6	0.8	0.7	1.1
Real ER (PPI-based)	0.2	-1.0	-0.2	7.4	-0.9	-0.4	0.6	1.6	1.0
Average gross wages, real (PPI based)	-2.0	1.6	3.0	-0.2	8.3	3.4	2.7	2.3	2.1
Average gross wages, real (CPI based)	-1.6	0.8	1.4	3.6	4.9	3.2	2.6	3.2	1.8
Average gross wages, EUR (ER)	1.1	5.9	5.7	7.0	5.4	4.0	4.8	5.5	5.0
Employed persons (LFS)	-4.2	6.7	1.9	1.0	0.6	0.0	-0.8	-0.8	1.2
GDP per empl. person, NC at 2010 ref. pr.	6.9	1.5	2.7	0.6	1.4	2.0	3.2	4.1	2.6
Unit labour costs, ER (EUR) adjusted	-5.5	4.3	2.9	6.4	3.9	1.9	1.6	1.3	2.3
Hungary									
GDP deflator	2.1	2.2	3.4	3.0	2.2	2.2	2.5	2.9	2.6
Exchange rate (ER), EUR/NC	1.8	-1.4	-3.4	-2.6	-3.8	-2.0	0.0	0.0	-1.9
Real ER (CPI-based)	4.4	-0.6	-0.6	-2.4	-4.3	-0.7	1.1	1.5	-0.7
Real ER (PPI-based)	2.7	-2.5	-2.2	-1.9	-2.5	-0.9	1.1	1.3	-1.3
Average gross wages, real (PPI based)	-2.5	1.0	0.5	2.8	3.2	1.3	1.4	1.5	1.0
Average gross wages, real (CPI based)	-3.2	1.2	-0.9	1.7	2.8	2.0	1.4	1.4	0.3
Average gross wages, EUR (ER)	3.1	3.8	1.1	0.8	-1.2	1.6	3.8	4.9	1.5
Employed persons (LFS)	0.0	0.8	1.8	1.7	5.3	0.5	0.5	0.2	1.9
GDP per empl. person, NC at 2010 ref. pr.	0.8	1.0	-3.2	-0.2	-1.7	1.8	1.5	1.8	-0.7
Unit labour costs, ER (EUR) adjusted	2.3	2.7	4.5	0.9	0.6	-0.3	2.4	2.6	2.2
Latvia									
GDP deflator	-1.0	6.4	3.6	1.1	0.8	0.8	2.4	2.9	2.2
Real ER (CPI-based)	-3.6	1.4	0.9	-2.1	0.0	0.6	0.8	1.3	-0.7
Real ER (PPI-based)	-1.0	2.7	2.6	1.2	2.0	-0.2	1.0	1.4	1.5
Average gross wages, real (PPI based)	-5.7	-3.2	-0.4	2.9	6.6	2.3	2.6	3.0	-0.1
Average gross wages, real (CPI based)	-2.3	0.0	1.3	4.6	6.3	2.3	2.8	3.1	1.9
Average gross wages, EUR (ER)	-3.9	4.6	5.0	3.9	6.8	3.1	5.1	6.0	3.2
Employed persons (LFS)	-4.3	3.1	1.6	2.1	-1.0	0.0	-0.6	-0.6	0.3
GDP per empl. person, NC at 2010 ref. pr.	1.5	1.8	3.2	2.1	3.5	1.9	3.3	3.5	2.4
Unit labour costs, ER (EUR) adjusted	-5.3	2.8	1.8	1.8	3.2	1.2	1.8	2.4	0.8

(Table 34 ctd.)

(Table 34 ctd.)

	2010	2011	2012	2013	2014	2015	2016 Forecast	2017	2010-14 average
Lithuania									
GDP deflator	2.3	5.2	2.7	1.6	0.3	0.6	1.9	2.6	2.4
Real ER (CPI-based)	-0.9	1.0	0.5	-0.3	-0.3	0.4	0.4	1.0	0.0
Real ER (PPI-based)	7.1	8.2	2.1	-2.3	-3.2	-0.4	0.5	1.1	2.3
Average gross wages, real (PPI based)	-12.4	-9.7	-1.1	7.7	10.0	4.4	3.7	3.9	-1.5
Average gross wages, real (CPI based)	-4.4	-1.2	0.6	3.9	4.3	4.4	3.8	4.1	0.6
Average gross wages, EUR (ER)	-3.3	2.9	3.8	5.1	4.6	5.0	5.6	6.7	2.6
Employed persons (LFS)	-5.1	2.0	1.8	1.3	1.3	0.8	0.6	0.2	0.2
GDP per empl. person, NC at 2010 ref. pr.	7.1	4.0	2.0	1.9	1.6	1.8	2.4	3.1	3.3
Unit labour costs, ER (EUR) adjusted	-9.7	-1.1	1.8	3.1	2.9	3.2	3.2	3.5	-0.7
Poland									
GDP deflator	1.8	3.2	2.2	1.2	0.2	0.6	1.2	2.1	1.7
Exchange rate (ER), EUR/NC	8.3	-3.1	-1.5	-0.3	0.3	0.8	0.7	-1.9	0.7
Real ER (CPI-based)	9.0	-2.3	-0.6	-1.0	-0.2	0.9	0.8	-1.4	0.9
Real ER (PPI-based)	7.1	-1.2	-1.1	-1.4	0.8	-1.7	-0.7	-1.9	0.8
Average gross wages, real (PPI based)	2.1	-1.6	0.4	4.9	4.9	5.3	5.1	4.5	2.1
Average gross wages, real (CPI based)	1.2	1.6	0.1	2.8	3.5	3.4	3.5	4.0	1.8
Average gross wages, EUR (ER)	12.6	2.3	2.1	3.3	3.9	4.9	5.3	4.0	4.8
Employed persons (LFS)	0.6	1.1	0.2	-0.1	1.0	0.5	0.5	0.3	0.5
GDP per empl. person, NC at 2010 ref. pr.	3.1	3.7	1.6	1.8	2.3	3.0	2.8	2.9	2.5
Unit labour costs, ER (EUR) adjusted	9.2	-1.3	0.6	1.5	1.6	1.5	3.0	1.1	2.3
Romania									
GDP deflator	5.4	4.7	4.9	3.4	0.9	3.2	2.6	2.3	3.9
Exchange rate (ER), EUR/NC	0.7	-0.6	-4.9	0.9	-0.6	-0.4	0.0	-0.9	-0.9
Real ER (CPI-based)	4.6	2.0	-4.3	2.6	0.3	1.4	1.6	0.6	1.0
Real ER (PPI-based)	2.0	1.0	-2.7	3.0	1.1	1.8	1.2	-0.1	0.9
Average gross wages, real (PPI based)	-1.2	-2.8	-1.0	2.8	5.5	0.9	3.2	3.6	0.6
Average gross wages, real (CPI based)	-2.8	-1.6	0.8	1.6	3.9	2.0	2.8	2.9	0.3
Average gross wages, EUR (ER)	3.8	3.4	-1.0	5.8	4.2	3.9	5.7	5.4	3.2
Employed persons (LFS)	0.0	-1.1	1.4	-0.2	0.6	0.2	0.2	0.3	0.1
GDP per empl. person, NC at 2010 ref. pr.	-0.8	2.2	-0.7	3.6	2.3	2.2	2.6	2.8	1.3
Unit labour costs, ER (EUR) adjusted	4.6	1.2	-0.2	2.2	1.9	1.4	3.2	2.1	1.9
Slovakia									
GDP deflator	0.5	1.6	1.3	0.5	-0.1	0.4	1.4	1.7	0.8
Real ER (CPI-based)	-1.4	1.0	1.1	0.0	-0.6	0.8	0.1	0.5	0.0
Real ER (PPI-based)	-2.5	-0.7	-0.9	-0.9	-1.8	-0.6	0.0	0.2	-1.4
Average gross wages, real (PPI based)	2.9	-2.2	0.5	3.4	5.7	3.2	3.2	2.7	2.0
Average gross wages, real (CPI based)	2.6	-1.8	-1.3	0.9	2.0	2.5	3.1	2.3	0.5
Average gross wages, EUR (ER)	3.3	2.2	2.4	2.4	1.9	3.6	4.6	4.4	2.4
Employed persons (LFS)	-2.1	1.5	0.6	0.0	1.0	0.3	0.8	0.8	0.2
GDP per empl. person, NC at 2010 ref. pr.	7.0	1.2	1.0	1.4	1.4	2.0	1.9	2.2	2.4
Unit labour costs, ER (EUR) adjusted	-3.5	1.0	1.4	0.9	0.5	1.5	2.6	2.2	0.1
Slovenia									
GDP deflator	-1.1	1.2	0.3	1.4	0.4	0.5	0.5	1.0	0.4
Real ER (CPI-based)	0.0	-1.0	0.2	0.4	-0.2	0.3	-0.4	-0.5	-0.1
Real ER (PPI-based)	-1.0	-0.7	-1.9	0.1	1.1	-0.5	-0.9	-0.5	-0.5
Average gross wages, real (PPI based)	1.9	-2.5	-0.8	-0.2	1.8	0.8	1.4	0.9	0.0
Average gross wages, real (CPI based)	1.8	-0.1	-2.7	-2.0	0.7	0.8	0.9	0.9	-0.5
Average gross wages, EUR (ER)	3.9	2.0	0.1	-0.2	1.1	1.3	1.9	1.9	1.4
Employed persons (LFS)	-1.5	-3.1	-1.3	-1.9	1.5	1.1	1.1	2.1	-1.3
GDP per empl. person, NC at 2010 ref. pr.	2.8	3.8	-1.3	1.0	1.0	0.6	0.8	-0.3	1.4
Unit labour costs, ER (EUR) adjusted	1.1	-1.8	1.4	-1.1	0.1	0.7	1.2	2.1	-0.1
Albania									
GDP deflator	4.5	2.3	1.0	0.8	1.1	1.5	1.9	1.5	1.9
Exchange rate (ER), EUR/NC	-4.2	-1.8	0.9	-0.9	0.2	-0.7	-1.4	0.0	-1.2
Real ER (CPI-based)	-2.8	-1.5	0.3	-0.4	1.3	0.6	-1.1	0.2	-0.6
Real ER (PPI-based)	-6.7	-4.3	-0.7	-1.3	2.4	-0.7	-1.8	-0.5	-2.2
Average gross wages, real (PPI based)	-3.9	2.2	1.1	10.1	1.5	2.1	2.2	2.6	2.1
Average gross wages, real (CPI based)	-7.0	1.5	0.2	7.4	0.2	1.6	1.5	1.9	0.4
Average gross wages, EUR (ER)	-7.6	3.0	3.2	8.6	2.0	0.9	3.3	3.2	1.7
Employed persons (LFS)	0.6	-0.6	-3.7	-11.2	3.0	4.7	1.9	0.9	-2.5
GDP per empl. person, NC at 2010 ref. pr.	3.1	3.2	5.6	14.2	-1.5	-2.6	0.3	1.5	4.8
Unit labour costs, ER (EUR) adjusted	-10.4	-0.1	-2.2	-4.9	3.6	5.1	1.5	2.1	-2.9

(Table 34 ctd.)

(Table 34 ctd.)

	2010	2011	2012	2013	2014	2015	2016 Forecast	2017	2010-14 average
Macedonia									
GDP deflator	2.0	3.7	1.0	4.3	-0.3	1.5	2.1	1.9	2.1
Exchange rate (ER), EUR/NC	-0.4	0.0	0.0	-0.1	-0.1	0.2	0.0	0.0	-0.1
Real ER (CPI-based)	-0.9	0.8	0.6	1.2	-0.9	1.5	0.6	0.5	0.2
Real ER (PPI-based)	5.1	6.2	-1.4	-1.4	-0.2	0.2	0.6	0.5	1.6
Average gross wages, real (PPI based)	-7.1	-9.5	-1.2	2.6	2.2	1.9	1.4	1.9	-2.7
Average gross wages, real (CPI based)	-0.6	-2.5	-3.0	-1.6	0.5	1.4	1.4	1.9	-1.4
Average gross wages, EUR (ER)	0.6	1.2	0.2	1.1	0.2	3.0	3.8	3.7	0.7
Employed persons (LFS)	1.3	1.1	0.8	4.3	1.5	1.6	1.4	1.4	1.8
GDP per empl. person, NC at 2010 ref. pr.	2.1	1.2	-1.3	-1.6	2.0	1.9	1.4	1.2	0.4
Unit labour costs, ER (EUR) adjusted	-1.4	0.0	1.5	2.8	-1.8	1.2	2.0	2.7	0.2
Montenegro									
GDP deflator	1.6	0.9	-0.1	2.2	0.9	0.6	3.0	2.4	1.1
Real ER (CPI-based)	-1.5	0.4	1.4	0.7	-1.2	0.8	0.6	0.5	-0.1
Real ER (PPI-based)	-3.8	-2.0	-0.9	1.7	1.9	-5.0	1.0	0.4	-0.6
Average gross wages, real (PPI based)	12.2	-2.1	-1.2	-1.7	-0.5	1.3	2.0	0.9	1.2
Average gross wages, real (CPI based)	10.6	-2.4	-3.3	-2.3	0.3	1.3	2.0	1.9	0.5
Average gross wages, EUR (ER)	11.2	1.0	0.7	-0.1	-0.4	2.4	4.1	3.9	2.4
Employed persons (LFS)	-2.2	0.8	2.4	1.0	4.0	0.0	0.0	0.0	1.2
GDP per empl. person, NC at 2010 ref. pr.	4.8	2.4	-4.8	2.4	-2.6	2.8	1.9	3.1	0.4
Unit labour costs, ER (EUR) adjusted	6.1	-1.4	5.8	-2.4	2.3	-0.4	2.1	0.8	2.0
Serbia									
GDP deflator	5.9	9.6	6.3	5.4	2.7	3.1	4.0	3.3	5.9
Exchange rate (ER), EUR/NC	-8.8	1.1	-9.9	0.0	-3.5	-5.4	-1.6	-1.6	-4.3
Real ER (CPI-based)	-4.6	8.8	-5.4	6.2	-1.2	-2.8	0.0	-0.1	0.6
Real ER (PPI-based)	0.6	8.2	-6.4	2.8	-0.5	-4.5	-1.0	-1.1	0.8
Average gross wages, real (PPI based)	-5.5	-1.4	2.0	2.9	-0.1	-1.0	1.0	1.0	-0.5
Average gross wages, real (CPI based)	0.6	0.1	1.0	-1.9	-1.7	-2.0	0.0	0.0	-0.4
Average gross wages, EUR (ER)	-2.0	12.3	-1.9	5.7	-2.4	-4.6	2.0	0.0	2.2
Employed persons (LFS)	-8.4	-6.0	-1.1	3.7	5.7	2.4	0.0	0.0	-1.4
GDP per empl. person, NC at 2010 ref. pr.	9.8	7.8	0.1	-1.1	-7.3	-2.8	1.0	1.4	1.7
Unit labour costs, ER (EUR) adjusted	-10.8	4.2	-1.9	6.8	5.3	-1.8	0.4	0.0	0.5
Bosnia and Herzegovina									
GDP deflator	1.5	2.6	1.1	-0.3	-0.9	1.1	1.9	2.9	0.8
Real ER (CPI-based)	0.0	0.6	-0.6	-1.3	-1.4	0.8	0.6	1.5	-0.6
Real ER (PPI-based)	-2.0	0.2	-2.4	-1.7	1.3	0.0	0.6	1.5	-0.9
Average gross wages, real (PPI based)	0.1	-1.0	1.2	1.9	0.6	1.9	1.7	2.0	0.6
Average gross wages, real (CPI based)	-1.0	0.7	-0.5	-0.1	1.0	1.9	1.7	2.0	0.0
Average gross wages, EUR (ER)	1.1	4.5	1.5	0.1	0.1	2.9	4.4	4.2	1.4
Employed persons (LFS)	-1.9	-3.2	-0.3	1.0	-1.2	1.0	1.2	2.4	-1.1
GDP per empl. person, NC at 2010 ref. pr.	2.8	4.3	-0.9	1.5	1.7	0.7	0.6	0.0	1.8
Unit labour costs, ER (EUR) adjusted	-1.7	0.2	2.4	-1.4	-1.6	2.2	3.1	5.1	-0.4
Kosovo									
GDP deflator	4.7	4.8	2.2	1.8	0.1	1.7	0.5	2.7	2.7
Real ER (CPI-based)	1.4	4.1	-0.1	0.3	-0.1	0.8	-0.4	0.5	1.1
Real ER (PPI-based)	1.7	0.4	-1.1	2.6	1.2	0.7	-0.9	1.1	1.0
Average net wages, real (PPI based)	10.9	15.1	0.0	-1.9	17.6	4.0	4.1	3.8	8.1
Average net wages, real (CPI based)	12.3	13.4	-0.8	-1.2	16.4	4.7	3.5	4.4	7.8
Average net wages, EUR (ER)	16.2	21.7	1.7	0.6	16.9	5.8	4.5	6.5	11.1
Employed persons (LFS)	-2.5	-2.6	8.0	11.7	3.4	2.9	2.8	2.7	3.5
GDP per empl. person, NC at 2010 ref. pr.	6.0	7.1	-4.8	-7.4	1.5	1.0	0.0	0.7	0.3
Unit labour costs, ER (EUR) adjusted	9.6	13.6	6.8	8.6	15.1	4.8	4.5	5.8	10.7
Belarus									
GDP deflator	11.1	71.3	75.5	21.2	18.0	25.0	25.0	18.0	36.7
Exchange rate (ER), EUR/NC	-0.6	-50.2	-25.3	-8.9	-10.5	-26.6	-18.2	-8.3	-21.3
Real ER (CPI-based)	5.0	-26.0	15.8	6.1	5.1	-8.4	0.9	12.9	0.1
Real ER (PPI-based)	9.7	-19.0	27.9	3.6	2.8	-9.1	0.9	6.6	3.9
Average gross wages, real (PPI based)	9.2	-8.9	9.9	21.2	5.0	0.5	2.0	9.1	6.8
Average gross wages, real (CPI based)	15.0	1.9	21.5	16.4	0.3	0.5	2.0	3.0	10.7
Average gross wages, EUR (ER)	23.3	-22.3	44.5	25.4	6.0	-7.4	4.8	18.2	13.0
Employment registered	0.5	-0.2	-1.7	-0.7	-1.0	-0.7	0.0	0.7	-0.6
GDP per empl. person, NC at 2010 ref. pr.	7.2	5.8	3.4	1.7	2.6	-1.3	1.3	1.3	4.1
Unit labour costs, ER (EUR) adjusted	15.0	-26.6	39.8	23.3	3.3	-6.5	3.0	16.5	8.5

(Table 34 ctd.)

(Table 34 ctd.)

	2010	2011	2012	2013	2014	2015	2016 Forecast	2017	2010-14 average
Kazakhstan									
GDP deflator	19.6	17.8	4.9	9.7	3.4	4.9	7.1	4.6	10.9
Exchange rate (ER), EUR/NC	5.1	-4.1	6.5	-5.2	-15.1	0.5	2.6	2.7	-2.9
Real ER (CPI-based)	-4.9	4.3	9.1	-1.1	-9.9	7.8	7.3	6.2	-0.7
Real ER (PPI-based)	10.3	0.7	7.2	-5.3	-5.4	-10.5	9.3	4.2	1.3
Average gross wages, real (PPI based)	-7.9	-8.8	8.7	8.1	0.8	21.2	1.1	6.0	-0.1
Average gross wages, real (CPI based)	7.6	7.1	6.9	1.9	3.4	1.5	3.0	4.0	5.4
Average gross wages, EUR (ER)	21.2	11.2	19.8	2.2	-6.3	8.7	12.7	12.9	9.1
Employed persons (LFS)	2.7	1.1	1.0	0.7	0.8	1.0	1.0	1.0	1.3
GDP per empl. person, NC at 2010 ref. pr.	4.5	6.1	3.9	5.2	3.4	1.0	2.4	3.4	4.6
Unit labour costs, ER (EUR) adjusted	16.0	4.8	15.3	-2.8	-9.4	8.6	9.3	8.4	4.3
Russia									
GDP deflator	14.2	15.9	7.4	5.2	6.6	13.6	4.8	5.7	9.8
Exchange rate (ER), EUR/NC	9.6	-1.5	2.3	-5.5	-16.2	-36.9	6.7	7.1	-2.6
Real ER (CPI-based)	14.7	3.7	4.8	-0.6	-10.2	-30.1	13.6	11.9	2.2
Real ER (PPI-based)	22.2	9.8	6.3	-2.2	-9.5	-33.8	10.5	10.8	4.8
Average gross wages, real (PPI based)	-2.2	-4.9	6.7	8.8	0.7	-1.6	4.9	3.5	1.7
Average gross wages, real (CPI based)	5.2	2.8	8.4	5.4	-0.9	-6.0	2.0	2.5	4.1
Average gross wages, EUR (ER)	23.2	9.9	16.6	6.3	-10.5	-33.8	16.7	16.3	8.5
Employed persons (LFS)	0.8	1.3	1.0	-0.2	0.2	-0.7	0.7	0.7	0.6
GDP per empl. person, NC at 2010 ref. pr.	3.7	2.9	2.4	1.5	0.4	-3.2	1.2	1.3	2.2
Unit labour costs, ER (EUR) adjusted	18.8	6.8	13.8	4.8	-10.9	-32.0	16.1	14.9	6.2
Ukraine									
GDP deflator	13.7	14.2	8.0	3.1	12.1	24.0	9.0	5.8	10.1
Exchange rate (ER), EUR/NC	3.2	-5.0	8.0	-3.2	-32.5	-52.4	-2.9	-2.9	-7.1
Real ER (CPI-based)	10.6	-0.5	5.8	-4.9	-24.7	-41.1	4.3	1.4	-3.6
Real ER (PPI-based)	21.1	7.3	8.9	-3.2	-19.5	-43.4	5.3	0.5	2.0
Average gross wages, real (PPI based)	-0.7	-1.2	10.8	8.0	-9.1	-0.3	-1.4	3.1	1.3
Average gross wages, real (CPI based)	9.7	8.9	14.3	8.2	-5.0	-3.5	-0.5	2.1	7.0
Average gross wages, EUR (ER)	23.8	11.7	24.1	4.4	-28.1	-41.2	0.0	7.7	5.2
Employed persons (LFS)	0.4	0.3	0.1	0.2	-10.3	-2.7	-1.1	0.0	-1.9
GDP per empl. person, NC at 2010 ref. pr.	3.7	5.1	0.0	-0.2	-0.2	-2.3	1.1	1.9	1.7
Unit labour costs, ER (EUR) adjusted	19.4	6.2	24.1	4.6	-28.0	-41.7	4.1	3.1	3.5
Austria									
GDP deflator	0.9	1.8	1.9	1.4	1.8	1.8	1.4	1.5	1.6
Real ER (CPI-based)	-0.2	0.2	-0.2	0.5	1.0	1.3	0.2	0.1	0.3
Real ER (PPI-based)	-0.2	-1.2	-1.9	-0.8	0.7	0.8	0.0	0.0	-0.7
Average gross wages, real (PPI based)	-1.6	-1.7	2.1	2.8	2.6	-0.4	0.4	0.0	0.8
Average gross wages, real (CPI based)	-0.8	-1.0	0.5	-0.1	-0.1	-0.1	0.1	-0.2	-0.3
Average gross wages, EUR (ER)	1.1	2.3	3.0	1.9	1.5	1.4	1.7	1.4	1.9
Employed persons (LFS)	0.5	1.2	1.0	-0.2	0.9	0.4	0.5	0.9	0.6
GDP per empl. person, NC at 2010 ref. pr.	1.4	1.9	-0.1	0.5	-0.5	0.0	0.7	0.4	0.6
Unit labour costs, ER (EUR) adjusted	-0.3	0.4	3.1	1.3	2.0	1.4	1.1	1.0	1.3

NC = national currency (including euro-fixed series for euro area countries - EE, LV, LT, SK, SI, AT). ER = Exchange Rate, PPI = Producer price index, CPI = Consumer price index. Positive growth of real exchange rates means real apprecaition. Employment data and related indicators (e.g. Unit labour costs) may be affected by the new population census data - mostly from 2012 (HR, RO from 2014, AL, ME, KZ from 2011). Where available comparable growth rates are applied.
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