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Forecast Report

# Braced for Fallout from Global Slowdown

## Economic Analysis and Outlook for Central, East and Southeast Europe

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The Vienna Institute for International Economic Studies
Wiener Institut für Internationale Wirtschaftsvergleiche

# Braced for Fallout from Global Slowdown

VASILY ASTROV (LEAD AUTHOR)
ALEXANDRA BYKOVA
RICHARD GRIEVESON
GÁBOR HUNYA
OLGA PINDYUK

et al. (including Rumen Dobrinsky, Vladimir Gligorov, Doris Hanzl-Weiss, Sándor Richter, Sebastian Leitner, Isilda Mara, Leon Podkaminer, and Hermine Vidovic)

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# Executive summary

**Global economic growth is at its weakest level since the end of the global financial crisis.** US protectionism (in general, but especially that directed towards China) is weighing heavily on global trade. The uncertainty surrounding Brexit and the latent risk of a repeat of 2018's emerging markets crisis are also keeping businesses and investors cautious. Meanwhile the key central banks, including the ECB, are largely out of ammunition.

**Despite the clear negative signals, we are wary of becoming too pessimistic on the global economy at this stage.** Some recent high-frequency indicators suggest a rebound in business sentiment in key economies. As the US election approaches, President Donald Trump will be keen to keep the economy running at a decent speed, and may well continue to dial down his trade war. At least for the euro area, some kind of moderate bounce-back in economic activity in 2020 is quite realistic.

**Considering the scale of the external slowdown, the resilience of CESEE has so far been impressive.** EU-CEE countries will grow by 3.8% on average this year, almost 3 percentage points higher than the euro area. Growth performance in the Western Balkans and parts of the CIS and Ukraine remains generally solid as well.

**The main factor of resilience remains stubbornly strong domestic demand, reflecting a combination of labour shortage-induced wage increases, loose fiscal policy, rapid credit growth and robust public investment.** Real income is also being supported by weak price growth. Inflation remains at generally subdued levels, despite around half of the countries in the region running negative real interest rates. This reflects lower energy prices, as well as structural factors such as negative demographic trends and the impact of online retail. Even in countries with extremely high inflation rates, such as Ukraine and Turkey, monetary policy is being loosened.

**Our business cycle monitor index has declined compared with the spring, largely owing to negative growth in Turkey.** Across CESEE, the clearest signs of potential overheating are in the labour market, (negative) real interest rates, and property prices. On the other hand, we identify current accounts and fiscal balances as the clearest instances of potential under-heating. In the historical context, no country is really showing strong signs of overheating, but the countries with the most potential for this are Hungary, the Czech Republic and Romania.

**The acute labour shortages of recent years appear to have eased somewhat in many countries.** Job vacancy rates, which indicate unmet labour demand, have recently fallen. This reflects a combination of structural labour market adjustment, stabilisation (or reduction) of labour demand and increased immigration. Despite significant political opposition in most parts of the region, a large number of non-European immigrants have arrived in many CESEE labour markets to fill gaps.

**The increasingly prevalent role of the public sector in investment projects could be an issue further down the line.** Russia, Turkey, Bulgaria and some Visegrád countries have recently witnessed a marked weakening of private investment activity in productive capacity. The investment ratios of around 20% of GDP across most of CESEE are arguably too low to lay the supply-side foundations of sustained long-term catching-up. Particularly problematic are low levels of investment in machinery and equipment. In per capita terms (at PPP), these are far below the levels of advanced countries.

**Some non-EU CESEE countries remain highly successful in attracting large-scale FDI inflows, which is an important pillar of growth for them.** Moldova and several Western Balkan countries (notably Serbia and North Macedonia) have increasingly been establishing themselves as a cheaper alternative to EU-CEE countries, especially when it comes to car production. FDI inflows to the Western Balkan region increased by 28% last year, and this trend largely continued into 2019. In several countries, FDI has primarily been targeting the energy sector, such as the ongoing construction of the Trans-Adriatic gas Pipeline (TAP) and hydropower station in Albania, or the expansion of oil fields in Kazakhstan. In Kosovo, FDI has mainly gone into real estate.

**Despite the impressive degree of resilience to negative external trends thus far, we do not think that CESEE can remain unaffected.** The region's economies are generally quite export reliant, and many are heavily plugged into the German manufacturing core. Countries with particularly high degrees of exposure to Germany and/or where the automotive sector plays a large role in manufacturing – including the Visegrád countries, Romania, North Macedonia and Serbia – are particularly vulnerable. This over-specialisation in automotive production represents a risk for the future.

**We continue to think that the peak of growth in CESEE has passed, and that the outlook is more subdued.** For our Autumn Forecast, we have made several quite substantial downgrades to our growth forecasts, especially for EU-CEE countries in 2020. We expect the effects of a weaker euro area and slower global growth to continue to ripple out through the region in the coming quarters.

**EU-CEE countries will in particular be affected by negative external trends, albeit there may be some moderate relief next year.** Private consumption in EU-CEE will continue to benefit from solid wage growth and generous social policies. Inflows of EU transfers should stay intact at least until the end of the forecasting period.

**In the Western Balkans, the outlook remains decent but underwhelming, and growth will not deliver a particularly high degree of convergence over the forecast period.** The current drivers of rising consumption and investment will likely stay in place, while increased FDI inflows should boost further export capacities. However, geopolitical developments in and surrounding the Western Balkans have not been very encouraging of late. The delay to EU accession in particular may stall the fragile reform momentum in the region.

**In Russia, after a dip this year, growth will pick up somewhat in 2020-2021** due to moderate fiscal relaxation, including increased spending on health care, education and infrastructure projects. However, even with the extra fiscal stimulus, growth will not exceed 2% per year, making Russia the worst performer in the CESEE region. The rest of the CIS region will do better, but its strong economic integration with Russia will cap the growth potential of countries like Belarus.

**The Turkish economy will continue to rebound from the recent crisis, but downside risks remain substantial.** Quarterly growth rates have been positive since the start of 2019, helped by the typically quick adjustment of the economy following the external shock of 2018. We expect real GDP growth to be above 3% in both 2020 and 2021. However, external debt rollover needs remain substantial, making Turkey highly dependent on the mood in global financial markets, and also on good relations with the US. The military operation in northern Syria in October 2019 has introduced a particularly high degree of uncertainty to our forecasts.

**Risks to the forecast for CESEE are significant and are largely tilted to the downside** (see our risk assessment matrix, chapter 3, for full details). Two of the key risks we identified in the Spring Forecast – a major slowdown in the euro area and an intensification of the global trade war – have already materialised. In the high-risk/high-impact cell of the matrix, we now only have the smaller EU budget (which would primarily affect EU-CEE countries, although potentially also the Western Balkans). Otherwise, we are most concerned about the threat of higher US tariffs on EU car exports (medium likelihood, high impact) and a further decline in the quality/independence of institutions (high risk, medium impact).

**We see two key risks emanating from the financial sector for sub-regions of CESEE: rapid consumer credit growth in the CIS and Ukraine, and strong property price increases in EU-CEE.** First, our credit monitor continues to highlight sustained double-digit consumer lending growth in the CIS and Ukraine, at the same time as a deterioration in asset quality across the region, most significantly in Kazakhstan. Meanwhile, years of ultra-loose monetary policy have pushed down mortgage rates across much of the region, leading to the creation of potential bubbles in many EU-CEE property markets. In Hungary, housing prices have increased by 86% over the past five years; in the Czech Republic by 46%; and in most other EU-CEE countries by between 30% and 40%.

## COUNTRY SUMMARIES

### ALBANIA

Growth has been held back by uneven energy supply. Although it will pick up in the next two years, it will remain below its potential. Private and government consumption will continue to support growth, the former underpinned by positive labour market trends, while investment will remain subdued. Outward migration of the young and highly skilled remains a drag on growth potential. Further delays to the start of EU accession negotiations create the risk of backsliding on reforms.

### BELARUS

The Belarusian economy has weakened owing to disruption in gas and oil supplies from Russia. Economic performance in the first half of 2019 was only supported by domestic demand while exports and manufacturing output dropped. The combination of a negative external environment and policy restraint are expected to dominate in the near future as well. The short-term prospects for Belarus have deteriorated and we expect GDP growth to be around 1% in 2019 and slightly higher in the next two years.

### BOSNIA AND HERZEGOVINA

Prospects for growth are more or less where they almost always are; below 3% this year and around that level in the medium run. The political crisis is not all that consequential for the economy, but does represent a barrier to improving international relations. The key sticking point is NATO integration. It is seen as an instrument of stability (as in Montenegro and North Macedonia), but it is opposed by the majority among the Bosnian Serbs. The EU for its part has run out of ideas when it comes to this country.

### BULGARIA

After a strong first quarter, GDP growth slowed down reflecting a worsening domestic and external environment. Cost-push inflationary pressures were partly offset by the weaker domestic demand and inflation stopped rising. Domestic and external demand are expected to weaken further and this will be coupled with continued labour shortages The rate of GDP growth for 2019 as a whole will still be decent, at some 3.5%, but it is expected to slow down in the following years.

### CROATIA

The economy will grow by 2.9% in 2019, an improvement the last year, mainly due to the strengthening of domestic demand (both consumption and investment). Assuming a deterioration of the external environment, domestic demand should remain the main driver of growth in 2020-21. The goal of adopting the euro will be an incentive to continue fiscal consolidation.

### CZECH REPUBLIC

GDP growth has been losing momentum gradually as productive investment starts to decline. Labour resources are nearing depletion, but labour shortages have failed to prompt intensified capital formation. A high dependence on the car industry may become a problem. Signs of recession in Germany are spilling over into Czech manufacturing. Consumption remains the backbone of a subdued output growth. We forecast average growth of around 2.5% in the medium run.

## ESTONIA

Investment activity revived in 2019, following last year's slowdown. Furthermore, external demand continued growing at a higher pace than expected. Household consumption, backed by a considerable rise in employment and real wages, continues to be a strong driver of economic activity. We project GDP to grow at a rate of 3.4% in 2019, followed by a slowdown to 2.7% in 2020 and further to 2.4% in 2021.

## HUNGARY

Hungarian economic growth was strong in the first half of 2019, but the signs of a deceleration are already discernible. In Q2 compared to Q1, investment growth slowed notably, while the external environment deteriorated. From next year, EU transfers will drop by a substantial degree, further weighing on investment. Labour shortages will remain problematic, and put further upward pressure on wages. We expect a significant slowdown of economic growth over the forecast horizon, from 4.3% this year to 3.1% in 2020 and to 2.6% in 2021.

## KAZAKHSTAN

GDP growth will remain robust at 4% in 2019, driven mainly by private consumption, but will slow to around 3.5% in 2020 and 2021, as the stimulating effect of fiscal packages dies out. The current account balance will deteriorate as imports rise on the back of stronger demand for consumer and capital goods. Export growth could decelerate amid an expected economic slowdown in Kazakhstan's main trading partners.

## KOSOVO

Kosovo has been one of the fastest growing economies in the region and is likely to remain so. Growth will be supported by consumption and gross fixed capital formation. The 100% tariff imposed on imports from Serbia and Bosnia and Herzegovina in 2019 is likely to remain in place, and will continue to push up prices. The new government could deliver important domestic reforms, and is also likely to shake up international relations in the Western Balkans region.

## LATVIA

Economic growth has almost halved in comparison to the last two boom years. Investment growth has slowed, although household consumption remains robust. Although abating slightly, exports have grown more strongly than expected so far in 2019. Despite the economic slowdown, the labour market is tightening further with the unemployment rate falling towards 6.5% in 2019. This year, we expect GDP growth to decline to 2.7%, followed by a further slowdown to 2.2% in 2020 and amelioration to 2.4% in 2021.

## LITHUANIA

Growth accelerated again in 2019, underpinned in particular by public and private investment. A further decline in unemployment, a minimum wage hike and a reduction of the effective income tax rate have resulted in rapid increases in the purchasing power of households. External demand has been stronger than expected in 2019 but is likely to abate in the coming two years. For 2019, we estimate real GDP growth of 3.6%, followed by a projected slowdown to 2.4% in 2020 and 2.6% in 2021.

### MOLDOVA

Economic growth should accelerate to about 5% in 2019 on account of booming investments. After correcting for the current overheating, growth is expected to hover at around 4% in the coming years. A resumption of transfers from the IMF and EU will stabilise external financing. The current government coalition of pro-EU and pro-Russian parties has strong external support but may clash on domestic reforms.

### MONTENEGRO

Growth will slow to around 3% in the short run but may accelerate somewhat beyond that, depending primarily on the resumptions of ambitious government investments. Politically, the opposition is yet to find a way to challenge the governing coalition, though the democratic deficit is taking its toll on internal and external credibility. Montenegro is a front-runner in EU integration, though the prospects of accession are not rosy as the EU does not appear to be interested in enlargement any time soon.

### NORTH MACEDONIA

The economy is recovering after its growth came to a halt during the political crisis two years ago. The potential growth rate is around 4%, at least as long as there is large slack in the labour market. Growth should be above 3% this year, and increase further in the medium run. The delayed start to EU accession negotiations could yet have negative repercussions for domestic politics.

### POLAND

Broad-based economic growth has continued. German economic stagnation is not yet affecting foreign trade, but industrial output has started to underperform. A strong rise in gross fixed capital formation primarily reflects larger infrastructural and public sector investments. Household consumption is driven by strongly rising wages and social transfers. Labour shortages have become less acute while moderate inflation is back. The next government may feel obliged to continue the lavish social policies.

### ROMANIA

Economic growth is even stronger than last year, and could reach 4.2% in 2019, driven by household consumption and investment. Monetary and fiscal policy remains loose. Expanding deficits can be easily financed due to abundant international liquidity, albeit at a relatively high cost, constituting a burden for the future. Weaker external demand is already feeding through to industrial production, and will act as a barrier to growth in the future. We expect the interim government to take steps to curtail the fiscal deficit in 2020.

### RUSSIA

Growth in the first half of the year decelerated sharply, largely on account of weaker investment activity and declining net exports. Private consumption remains weak, constrained not least by the tight fiscal policy, although monetary policy has been softened in response to recent disinflation. Even with the planned start of infrastructure projects and increased social spending, it is difficult to see the Russian economy growing above 2% p.a. in the medium term.

### SERBIA

After posting comfortably its strongest real GDP increase for a decade in 2018, the Serbian economy has adjusted back to a more muted growth path, and should expand by just under 3% this year. Growth of 2.5-3% is likely during the rest of the forecast period, with the government set to remain focussed on

FDI-driven investment. Political tensions in the region are rising, but would have to get much worse to constitute a significant downside risk to the economy.

### SLOVAKIA

Slovakia's growth decelerated sharply in the second quarter of 2019 due to declining exports and investments. Growth in the key automotive industry turned negative in June. Growth will slow down in the coming years, with forecasts for this and next year amounting to 2.3% and 2.2%.

### SLOVENIA

After a strong increase in 2018, economic activity slowed in the course of 2019 due to weakening foreign demand. However, thanks to a continued rise in consumption and investments, GDP growth will end up at a fairly robust 2.9% for the year as a whole, with unemployment reaching record lows. In the coming years we expect GDP growth to remain subdued, driven mostly by domestic demand. Banking privatisation has been finally completed after a long lasting process.

### TURKEY

The economy is expanding in quarterly terms, but overall growth is still likely to be negative in 2019. From next year the recovery will firm; we expect the economy to expand by a bit more than 3% in 2020-21. However, while external vulnerabilities are much reduced, the possibility of serious sanctions and volatility in the exchange rate related to the military operation in Northern Syria pose material downside risks to our forecasts.

### UKRAINE

Progress in the peace negotiations with Russia and the reform agenda of the new government sent strong positive signals to investors. If the reforms are implemented the economy will receive a significant boost, though it will likely only be felt in the medium run. During 2019-2021, GDP growth will remain rather moderate at around 3% per annum. The major negative risk to the forecast is inability of the government to shake off the influence of oligarchs.

Keywords: CESEE, economic forecast, Europe, Central and Eastern Europe, Southeast Europe, Western Balkans, new EU Member States, CIS, Russia, Ukraine, Romania, Czech Republic, Hungary, Turkey, Serbia, convergence, business cycle, overheating, external risks, trade war, EU funds, private consumption, credit, investment, exports, FDI, labour markets, unemployment, employment, wage growth, unit labour costs, migration, inflation, savings rate, financial crisis, financial markets, direct lending, leverage, central banks

JEL classification: E20, E31, E32, F15, F21, F22, F32, F51, G21, H60, J20, J30, J61, O47, O52, O57, P24, P27, P33, P52

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**The statistical data until 2018 presented in this Report are as of 15 October 2019, forecasts as of November 2019. Most data are taken from the wiiw Databases. Direct access is available at: http://data.wiiw.ac.at/.**

## wiiw COUNTRY GROUPS

### CESEE23 Central, East and Southeast Europe

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

### EU-CEE11 Central and East European EU members

| | | | |
|---|---|---|---|
| BG | Bulgaria | LV | Latvia |
| CZ | Czech Republic | PL | Poland |
| EE | Estonia | RO | Romania |
| HR | Croatia | SI | Slovenia |
| HU | Hungary | SK | Slovakia |
| LT | Lithuania | | |

| **V4** | **Visegrád countries** | **BALT3** | **Baltic countries** |
|---|---|---|---|
| CZ | Czech Republic | EE | Estonia |
| HU | Hungary | LT | Lithuania |
| PL | Poland | LV | Latvia |
| SK | Slovakia | | |

### SEE9 Southeast Europe

| | | | |
|---|---|---|---|
| AL | Albania | MK | North Macedonia |
| BA | Bosnia and Herzegovina | RO | Romania |
| BG | Bulgaria | RS | Serbia |
| HR | Croatia | XK | Kosovo |
| ME | Montenegro | | |

### non-EU12 non-European Union CESEE countries

| | | | |
|---|---|---|---|
| AL | Albania | MK | North Macedonia |
| BA | Bosnia and Herzegovina | RS | Serbia |
| BY | Belarus | RU | Russia |
| KZ | Kazakhstan | TR | Turkey |
| MD | Moldova | UA | Ukraine |
| ME | Montenegro | XK | Kosovo |

### WB6 Western Balkans

| | | | |
|---|---|---|---|
| AL | Albania | MK | North Macedonia |
| BA | Bosnia and Herzegovina | RS | Serbia |
| ME | Montenegro | XK | Kosovo |

**CIS3+UA** **Commonwealth of Independent States-3 and Ukraine**

| | | | |
|---|---|---|---|
| BY | Belarus | MD | Moldova |
| KZ | Kazakhstan | UA | Ukraine |

**CIS4+UA** **Commonwealth of Independent States-4 and Ukraine**

| | | | |
|---|---|---|---|
| BY | Belarus | RU | Russia |
| KZ | Kazakhstan | UA | Ukraine |
| MD | Moldova | | |

**EU28** **European Union**

| | | | |
|---|---|---|---|
| AT | Austria | IE | Ireland |
| BE | Belgium | IT | Italy |
| BG | Bulgaria | LT | Lithuania |
| CY | Cyprus | LU | Luxembourg |
| CZ | Czech Republic | LV | Latvia |
| DE | Germany | MT | Malta |
| DK | Denmark | NL | Netherlands |
| EE | Estonia | PL | Poland |
| EL | Greece | PT | Portugal |
| ES | Spain | RO | Romania |
| FI | Finland | SE | Sweden |
| FR | France | SI | Slovenia |
| HR | Croatia | SK | Slovakia |
| HU | Hungary | UK | United Kingdom |

**EA19** **Euro area**

| | | | |
|---|---|---|---|
| AT | Austria | LT | Lithuania |
| BE | Belgium | LU | Luxembourg |
| CY | Cyprus | LV | Latvia |
| DE | Germany | MT | Malta |
| EE | Estonia | NL | Netherlands |
| EL | Greece | PT | Portugal |
| ES | Spain | SI | Slovenia |
| FR | France | SK | Slovakia |
| IE | Ireland | UK | United Kingdom |
| IT | Italy | | |

## ABBREVIATIONS

| | |
|---|---|
| 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 |
| MDL | Moldovan leu |
| MKD | North Macedonian denar |
| PLN | Polish zloty |
| RON | Romanian leu |
| RSD | Serbian dinar |
| RUB | Russian rouble |
| TRY | Turkish lira |
| UAH | Ukrainian hryvnia |
| USD | US dollar |

| | |
|---|---|
| AA | association agreement |
| AfD | Alternative für Deutschland |
| BIS | Bank for International Settlements |
| BOP | balance of payments |
| BPM5 | Balance of Payments Manual Fifth Edition |
| BPM6 | Balance of Payments and International Investment Position Manual Sixth Edition |
| BRI | Belt and Road Initiative |
| CE | Central Europe |
| CEF | Connecting Europe Facility |
| CIS | Commonwealth of Independent States |
| CIS-STAT | Interstate Statistical Committee of the Commonwealth of Independent States |
| COSCO | China Ocean Shipping Company |
| CPI | consumer price index |
| CSU | Christian Social Union |
| DCFTA | Deep and Comprehensive Free Trade Area |
| EA | euro area 19 countries |
| EBRD | European Bank for Reconstruction and Development |
| ECB | European Central Bank |
| EFSI | European Fund for Strategic Investment |
| EFTA | European Free Trade Association |
| ER | exchange rate |
| ESA'95 | European system of national and regional accounts, ESA 1995 |
| ESA 2010 | European system of accounts, ESA 2010 |
| ESIF | European Structural Investment Funds |

| | |
|---|---|
| EU | European Union |
| EU15 | European Union – 15 countries |
| FDI | Foreign Direct Investment |
| FISIM | Financial Intermediation Services, Indirectly Measured |
| FW | Free Voters of Bavaria |
| GDP | Gross Domestic Product |
| GNP | Gross National Product |
| GVA | Gross Value Added |
| ICP | International Comparison Project |
| IFR | International Federation of Robotics |
| 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 |
| NPL | non-performing loan |
| OECD | Organisation for Economic Co-operation and Development |
| OICA | Organisation Internationale des Constructeurs d'Automobiles |
| OMS | old EU Member States |
| OPEC | Organization of the Petroleum Exporting Countries |
| PMI | purchasing managers' index |
| pp | percentage points |
| PPI | producer price index |
| PPP | Purchasing Power Parity |
| PPS | purchasing power standard |
| RER | Real exchange rate |
| RIR | Real interest rate |
| SME | small and medium-sized enterprise |
| SNA | System of National Accounts |
| SPE | Special Purpose Entity |
| SPS | sanitary and phytosanitary |
| TEN-T | Trans-European Transport Network |
| VAT | value added tax |
| WBIF | Western Balkan Investment Framework |
| WIFO | Austrian Institute of Economic Research |
| wiiw | The Vienna Institute for International Economic Studies |

| | |
|---|---|
| . | not available (in tables) |
| 2015q1 | first quarter of 2015 |
| 2015h1 | first half of 2015 |
| bn | billion |
| mn | million |
| mom | month-over-month |
| lhs | left-hand side axis/panel |
| p.a. | per annum |
| rhs | right-hand side axis/panel |
| sa | seasonally adjusted |
| saar | seasonally adjusted annualised rate |
| qoq | quarter-over-quarter |
| yoy | year-over-year |

# 1. Global economic outlook

## 1.1. GLOBAL OVERVIEW: TIME TO PANIC?

**by Richard Grieveson**

› **The global economy is slowing, and this year and next will almost certainly be the worst since the global financial crisis. By recent standards, 2020 will also be a subdued year.**

› **Our baseline scenario is that the downturn is unlikely to develop into anything more serious. As the US election approaches, President Donald Trump will be keen to keep the economy running at a decent speed, and may well continue to dial down his trade war.**

› **He will also try to refrain from foreign policy adventures that could push up the oil price. Weaker global growth will also probably act to keep down Brent crude costs. This is positive for growth in most big economies.**

› **We have made a substantial downward revision to our 2019 euro area growth forecast. However, economic growth in the euro area should recover a bit next year, with domestic demand providing some relief from the steep manufacturing downturn.**

› **Major political opposition will stop monetary easing going much further in the euro area, but additional cuts are quite likely in the US. As a result, as the interest rate differential narrows, the euro could recover somewhat against the dollar from current levels.**

› **Over the longer run, a Japan-like scenario for the euro area of low inflation and growth looks quite likely.**

› **For CESEE, it is *not* time to panic. Given the region's high level of exposure to global trade, it cannot expect to emerge from the current downturn unscathed. However, it should continue to show an impressive level of resilience. Sectors exposed to euro area final demand should continue to do quite well, while monetary conditions remain very loose, supporting growth.**

**Table 1.1 / wiiw autumn 2019 forecasts, annual averages**

| | Autumn 2019 | | | Changes since summer | | |
|---|---|---|---|---|---|---|
| | 2019 | 2020 | 2021 | 2019 | 2020 | 2021 |
| Euro area real GDP growth, % | 1.1 | 1.4 | 1.3 | -0.5 | -0.1 | -0.1 |
| USD/EUR exchange rate | 1.13 | 1.12 | 1.12 | 0.01 | 0 | 0 |
| Front-month Brent crude, US$ per bbl | 64 | 61 | 60 | -1 | 0 | 0 |

## 1.2. MACRO TRENDS AND OUTLOOK: GLOBAL GROWTH AT POST-CRISIS LOWS

The global economy is in the midst of a fairly severe slowdown. US protectionism (in general, but especially that directed towards China) is weighing heavily on global trade. The uncertainty surrounding Brexit has negatively impacted investment plans, both in Europe and more widely. Meanwhile the latent risk of a repeat of 2018's emerging markets crisis – then centred on Argentina and Turkey – remains lurking in the background and is keeping businesses and investors wary.

In its most recent World Economic Outlook (WEO), released in October, the International Monetary Fund (IMF) projected global growth at 3% for this year, the lowest level since the global financial crisis. Although the Fund expects a bounce-back to 3.4% next year, this is based on an expected improvement relative to previous forecasts in crisis-hit countries like Turkey, Argentina and Iran. This may well prove too optimistic.

**Figure 1.1 / Real GDP growth, % – China**

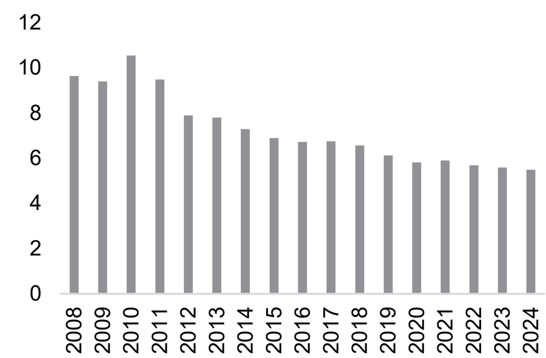
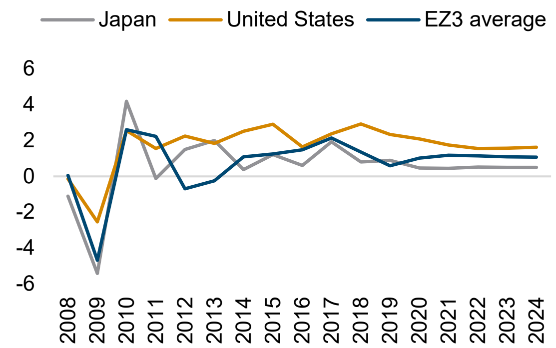



**Figure 1.2 / Real GDP growth, % – US, Japan, Germany, France and Italy**




Note: EZ3 average = simple average of France, Italy and Germany.
Source: IMF WEO.

So far, a great deal of the negative momentum appears to have been confined to the manufacturing sector. The most recent German manufacturing Purchasing Managers' Index (PMI) showed output at 41.7 in September (anything below 50 indicates contraction), its worst reading since the depths of the global financial crisis. Chinese automotive production has fallen by double digit percentages so far in 2019. Even US manufacturing is in contractionary territory.

For a time after the manufacturing downturn started, it appeared that the rest of the global economy was quite resilient. This matters, as the services sector is a much greater share of GDP, even in Germany. However, more recent data for the big global economies suggest that services activity – while still positive – is also slowing.

***How bad will it get?***

While services activity has slowed recently, domestic consumption appears to be holding up quite well in most of the key global economies. Labour markets in China, the US and Germany remain in a healthy state. Interest rates and inflation are both at low levels, and are likely to remain so (see below). Political risk notwithstanding, the oil price is unlikely to rise much from current levels. At least for the euro area, some kind of moderate bounce-back in economic activity in 2020 is quite realistic.

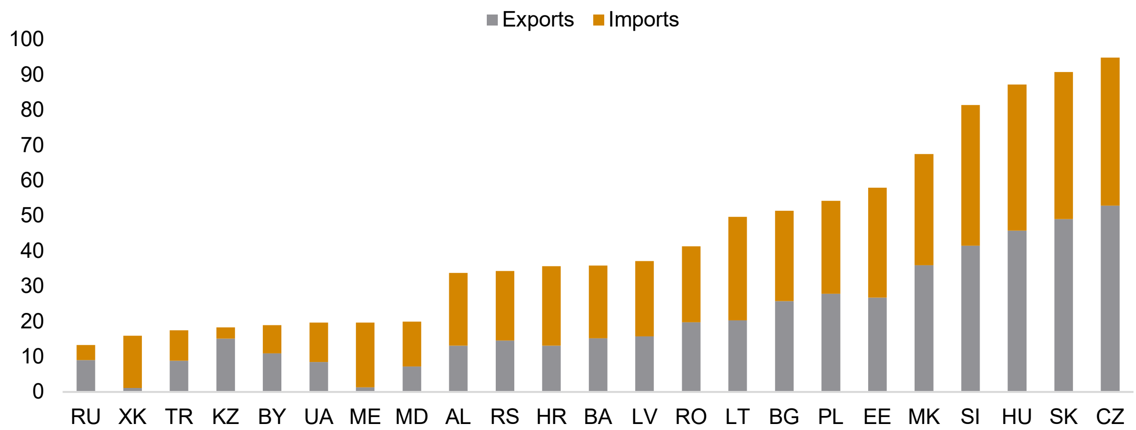
Much depends on what happens with US policy. Donald Trump is up for re-election next year, and will want to make sure the US economy is strong as voting approaches. He will therefore attempt to wind down the trade war somewhat before then (a recent partial deal with China hinted at this direction), and will be wary of conducting foreign policy initiatives that could exert upward pressure on the oil price (this matters in particular for his policy towards Iran). Of course, as with everything related to Mr Trump, there is a high degree of uncertainty surrounding his actions. Nevertheless, his desire for re-election is clear.

***Impact on CESEE***

As we have detailed in previous reports, our region is highly sensitive to global growth. The direct links to Western Europe are significant (Figure 1.3), and we already see a clear blow-back from the downturn in the German manufacturing sector (see chapter 2). Nevertheless, so long as domestic demand in countries like Germany holds up, CESEE will continue to benefit from tailwinds. Western Europe is also an important source of remittances, tourism and foreign investment. Meanwhile those exporters from CESEE for whom Western consumers are the source of final demand will also continue to do well.

CESEE is also exposed, however, to final demand around the world. Many of the region's exporters sell only intermediate goods to Germany, which are then used in the production of goods for which the final demand is in places like China and the US.[1] At least to an extent, it is these firms that are already struggling, for example due to this indirect exposure to the Chinese automotive market. But here as well, if the trade tensions do indeed subside in the run-up to the US election, there should be some relief for CESEE.

**Figure 1.3 / Merchandise trade with the EU-15, % of GDP**




Source: wiiw.

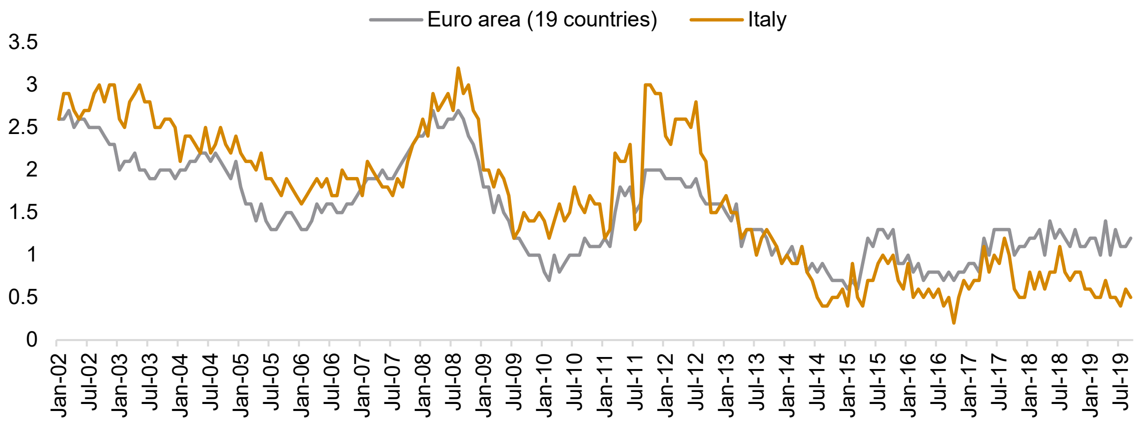
1 https://www.imf.org/en/Publications/CR/Issues/2016/12/31/German-Central-European-Supply-Chain-Cluster-Report-Staff-Report-First-Background-Note-40881

## 1.3. THE POLICY RESPONSE: OUT OF AMMUNITION

Policymakers in the big economies are already trying to respond to this global growth slowdown, but especially in the euro area the burden of response (as has been the case for a decade) is falling heavily on monetary rather than fiscal policy. The European Central Bank (ECB) cut its deposit rate to a new low of -0.5% in September and restarted bond purchases. In the same month, the Fed cut rates by 25 basis points, its second cut since July (which had been the first for a decade).

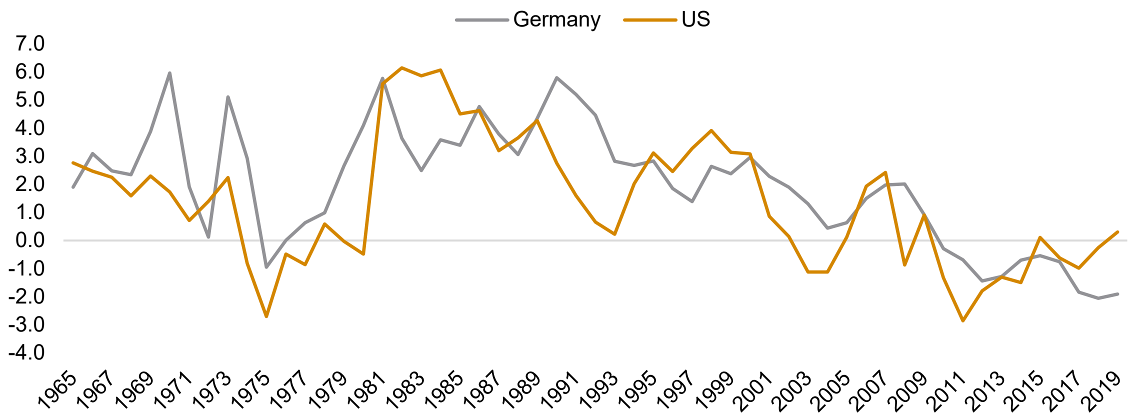
As Figure 1.4 shows, using core inflation (headline excluding energy and unprocessed food), the ECB has not hit its price growth target of just below 2% since 2012. The bank launched quantitative easing (QE) in 2015. Although this may have prevented a larger fall in price growth, it has failed to get core inflation much above 1%. Some of the economies of the euro area, perhaps most worryingly Italy, are edging closer to deflation.

**Figure 1.4 / Harmonised index of consumer prices (HICP); 'core' measure (excluding energy and unprocessed food); % change, year on year**




Source: Eurostat.

**Figure 1.5 / Real short-term interest rate, consumer price index adjusted, %**




Note: 2019 data are wiiw estimates.
Source: OECD.

However, there is little more that monetary policy can do to help, especially in the euro area. As Figure 1.5 shows, even accounting for currently weak inflation, interest rates in both the US and the euro area (but especially the latter) are already at historically very low levels. Since at least the mid-1960s, and in practice probably much longer, German real short-term interest rates have never been as low as they are now (and have been for 5-6 years).

German concerns about ultra-low interest rates have been mocked in the international media. However, worries about the spill-overs from this policy are growing much louder, particularly in the wake of the ECB's latest interest rate cut. In response, a group of former ECB economists (including from countries not considered hawkish, such as France) published a memo criticising the decision.[2] Information leaked to the *Financial Times* suggested significant dissent within the bank's current staff, including among board members, over the recent decision.[3] The banking and insurance industries have long been vocal about the perceived damage that low interest rates and the flattening of the yield curve are doing to their business models.

***Increasing focus on the side effects***

Monetary policy has saved the day in the global economy, and maybe especially in the euro area, over the past decade. However, there is now a serious risk that it is contributing to the next crisis. In reality, the 'mystery' of persistently low inflation is hardly a mystery at all: the extreme levels of global liquidity released by the Fed, ECB and Bank of Japan may have had some impact on consumer price inflation, but the biggest effects can be seen in asset markets, including housing. Between Q1 2014 and Q1 2019, house prices in the euro area rose by 18% according to Eurostat, compared with 4.3% for core inflation over the same period (the ECB launched QE initially in March 2015). For many euro area countries, the rates of increase were much higher, including over one third in Ireland, Latvia and Portugal.

**Figure 1.6 / Shiller P/E ratio**

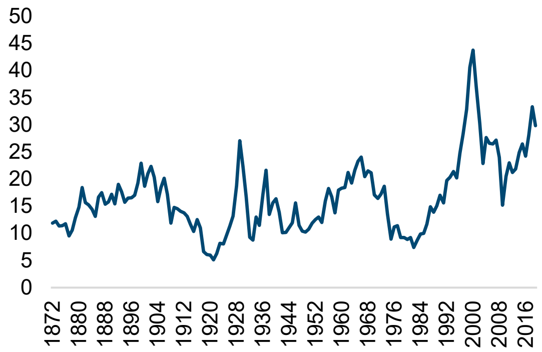



**Figure 1.7 / German 30-year sovereign bond yield, %**


Sources: Investing.com; Shiller.

Evidence of inflation is also clear in other asset markets. In the case of equities, the Shiller price/earnings ratio – which measures how expensive (or cheap) US stocks are, relative to the

2 https://www.ft.com/content/71f90f42-e68f-11e9-b112-9624ec9edc59

3 https://www.ft.com/content/de4a958a-eab3-11e9-a240-3b065ef5fc55

underlying earnings of the companies – is currently close to its second-highest ever level (Figure 1.6). It is well above 1929 levels, and only below the late 1990s, just before the dot-com bubble burst. Meanwhile in the bond market, even more extreme levels have been reached. According to recent data, US$ 16 trillion of bonds around the world currently have a negative yield (for context, this is somewhere between Chinese and US annual GDP). German sovereign debt returns a negative yield out to a 30-year maturity (Figure 1.7).

***Next moves could push the euro a bit higher***

The ECB's own projections, which we roughly agree with, suggest that the bank will not meet its inflation target in the next three years. We have discussed in previous reports why inflation is so low, but in short, the structural factors (including the so-called 'Amazon's Antitrust Paradox',[4] as well as demographic trends[5]) seem to explain a large part of it. As a result, any tightening of monetary policy is highly unlikely during our forecast period. However, given the growing internal and external opposition to further loosening, we see additional cuts as also quite unlikely. As a result, our base case is that in three years the ECB deposit rate will be where it is now.

More likely is further monetary easing from the Fed. Although inflation is higher in the US than in the euro area, and will remain so, inflation expectations are falling. Moreover, the central bank finds itself under sustained pressure from President Trump to further loosen its policy. At least one more rate cut during the current cycle looks highly likely. As a result, the dollar may weaken somewhat against the euro from current levels.

***Turning Japanese? Time to remove the question mark***

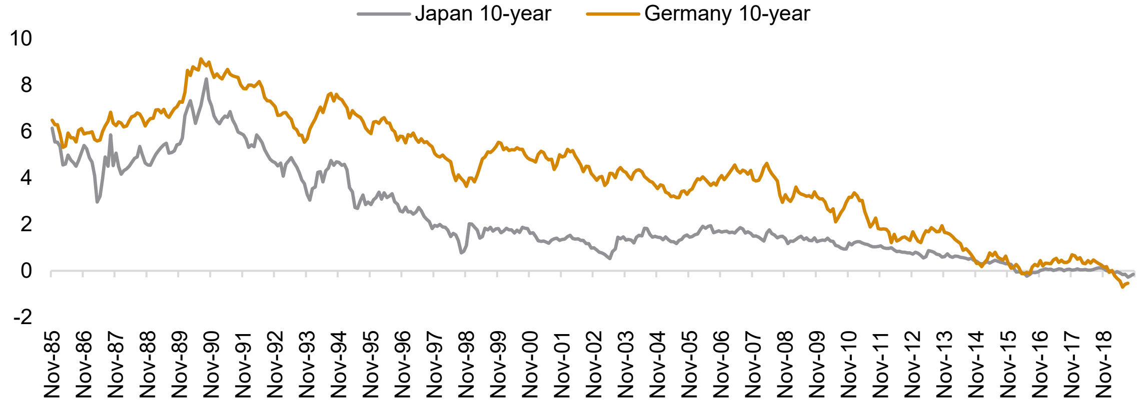
Monetary policy cannot do much more for inflation or growth in the euro area. A strong fiscal stimulus would probably have a bigger impact, but that looks unlikely for political reasons. As a result, the outlook is quite weak. For the euro area specifically, a Japan-like future of low growth, inflation and interest rates over many years appears quite likely. The bond market appears to be pricing this in, reflecting inflation trends (see Figures 1.8 and 1.9).

For CESEE central banks, this means that a continuation of loose monetary policy is highly likely. Even for those central banks with officially inflation-target regimes, the ability to deviate significantly from the course set by the ECB is very limited. Eleven countries in the region already run negative real policy rates (Figure 1.10), including all CESEE EU Member States, except Croatia. During the forecast period, this number is more likely to go up than down.

4 https://www.yalelawjournal.org/note/amazons-antitrust-paradox

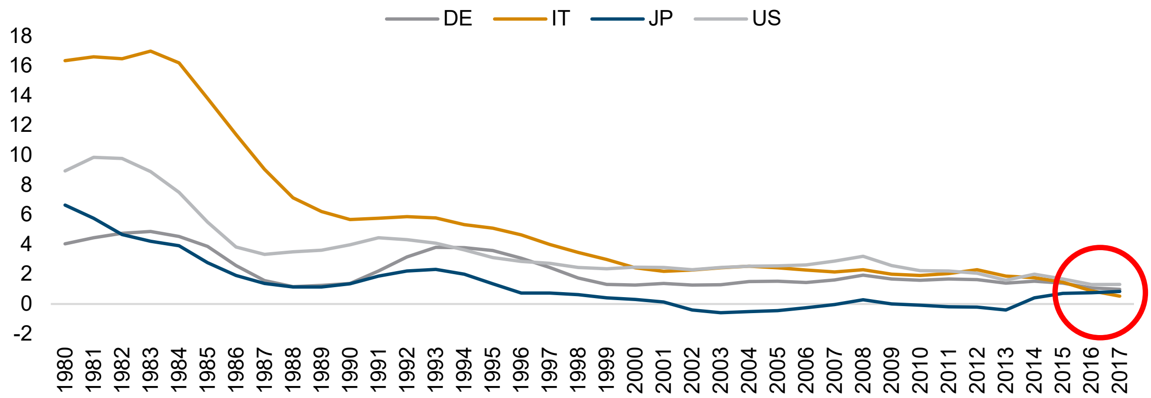
5 https://voxeu.org/article/impact-population-ageing-monetary-policy

**Figure 1.8 / Turning Japanese #1 – sovereign bonds yield, %**



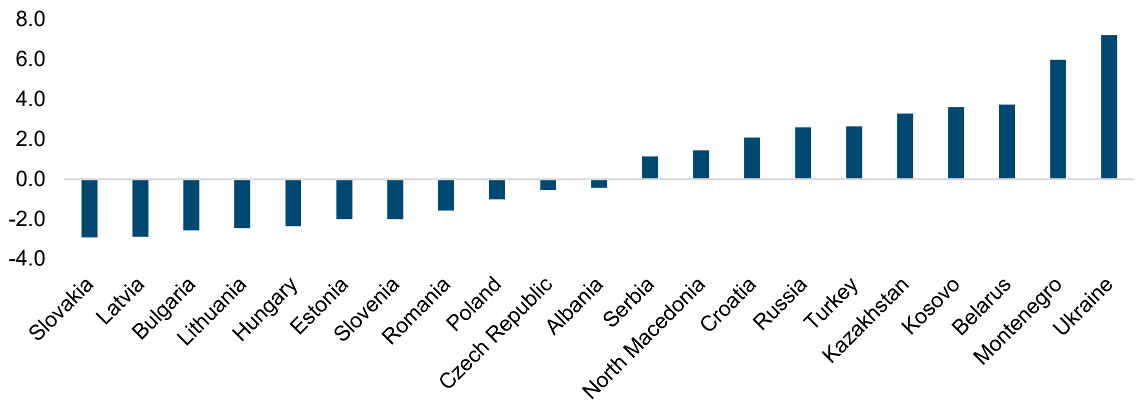

Source: Investing.com.

**Figure 1.9 / Turning Japanese #2 – consumer price inflation, % per year, 5-year moving average**




Source: OECD.

**Figure 1.10 / CESEE real interest rates, consumer price index adjusted, %, August 2019**




Source: wiiw.

# 2. CESEE economic outlook: Braced for fallout from global slowdown

**by Vasily Astrov**[6]

## 2.1. STILL A VERY GOOD YEAR FOR MOST CESEE COUNTRIES …

**Global economic growth has slowed significantly since 2017, but the countries of Central, East and Southeast Europe (CESEE) are withstanding the deterioration in the external environment fairly well.** This applies in particular to the Central and East European EU Member States (EU-CEE). On average, the EU-CEE region has grown by 3.8% this year – nearly 3 percentage points (pp) faster than the euro area, with which it has extensive trade and investment links (Overview Table 2.1). Growth performance in the Western Balkans (WB) and parts of the Commonwealth of Independent States (CIS) and Ukraine remains generally solid as well. Many CESEE countries are now growing faster than the world economy (3% according to the International Monetary Fund[7]), and are thus advancing in relative terms in the global economic context. In six of them – Moldova, Poland, Hungary, Romania, Kosovo and Kazakhstan – real GDP growth should be at least 4% this year.

**The main reason for this is strong domestic demand...** This applies in particular to private consumption, which continues to benefit from tight labour markets and high wage growth, as well as generous social policies in a number of cases. Investment activity remains by and large robust as well, driven to a large extent by public infrastructure projects, mostly financed by the EU and China. Domestic demand is also supported by credit expansion: in the CIS and Ukraine, it benefits above all household consumption; in the more advanced EU-CEE countries – housing investments. However, the pace of credit growth is generally muted. Only in the CIS countries and Ukraine (and arguably in some Western Balkan countries) is it potentially a cause for concern in the medium term.

**… with macroeconomic imbalances being generally held in check.** Many CESEE countries have current account surpluses (or only insignificant deficits), with the dynamics improving in many cases (Overview Table 2.1). A weak external position is a problem mostly confined to the Western Balkan countries, Romania and Moldova. However, external deficits are often being financed by foreign direct investment (FDI), which is good news from the sustainability point of view. Despite lax monetary policy, inflationary pressures remain generally contained as well, and have subsided recently – not least thanks to lower energy prices. In the high-inflation countries of Turkey and Ukraine, inflation has recently been falling as well, enabling a relaxation of monetary policy in both countries (Overview Table 2.1).

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6 The author would like to thank Richard Grieveson, Leon Podkaminer and Hermine Vidovic, all wiiw, for the valuable comments and suggestions on the first draft.

7 IMF (2019).

**Table 2.1 / OVERVIEW 2017-2018 AND OUTLOOK 2019-2021**

| | | GDP real change in % against prev. year | | | | | Consumer prices average change in % against prev. year | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Forecast | | | | | Forecast | | |
| | | 2017 | 2018 | 2019 | 2020 | 2021 | 2017 | 2018 | 2019 | 2020 | 2021 |
| BG | Bulgaria | 3.8 | 3.1 | 3.5 | 2.7 | 2.4 | 1.2 | 2.6 | 3.0 | 2.5 | 2.0 |
| CZ | Czech Republic | 4.4 | 3.0 | 2.5 | 2.4 | 2.6 | 2.4 | 2.0 | 2.5 | 2.1 | 2.1 |
| EE | Estonia | 5.7 | 4.8 | 3.3 | 2.6 | 2.4 | 3.7 | 3.4 | 2.6 | 2.3 | 2.1 |
| HR | Croatia | 2.9 | 2.6 | 2.9 | 2.7 | 2.7 | 1.3 | 1.6 | 1.0 | 1.5 | 1.5 |
| HU | Hungary | 4.3 | 5.1 | 4.3 | 3.1 | 2.6 | 2.4 | 2.9 | 3.5 | 3.2 | 3.0 |
| LT | Lithuania | 4.2 | 3.6 | 3.6 | 2.4 | 2.6 | 3.7 | 2.5 | 2.2 | 1.9 | 2.0 |
| LV | Latvia | 3.8 | 4.6 | 2.8 | 2.2 | 2.4 | 2.9 | 2.6 | 3.0 | 2.3 | 2.4 |
| PL | Poland | 4.9 | 5.1 | 4.4 | 3.5 | 3.3 | 1.6 | 1.2 | 2.0 | 2.7 | 2.5 |
| RO | Romania | 7.1 | 4.0 | 4.2 | 3.3 | 3.0 | 1.1 | 4.1 | 4.0 | 3.5 | 3.5 |
| SI | Slovenia | 4.8 | 4.1 | 2.9 | 2.8 | 2.8 | 1.6 | 1.9 | 1.8 | 1.8 | 2.0 |
| SK | Slovakia | 3.0 | 4.0 | 2.3 | 2.2 | 2.6 | 1.4 | 2.5 | 2.7 | 2.1 | 2.0 |
| | *EU-CEE11 1)2)* | *4.9* | *4.3* | *3.8* | *3.1* | *2.9* | *1.8* | *2.2* | *2.6* | *2.7* | *2.5* |
| | *EA19 3)* | *2.5* | *1.9* | *1.1* | *1.2* | *1.4* | *1.5* | *1.8* | *1.2* | *1.3* | *1.5* |
| | *EU28 3)* | *2.6* | *2.0* | *1.4* | *1.4* | *1.6* | *1.7* | *1.9* | *1.8* | *1.9* | *1.9* |
| AL | Albania | 3.8 | 4.1 | 2.8 | 3.8 | 3.4 | 2.0 | 2.0 | 1.7 | 2.1 | 2.4 |
| BA | Bosnia and Herzegovina | 3.2 | 3.6 | 2.6 | 2.7 | 2.7 | 0.8 | 1.4 | 1.2 | 1.6 | 1.4 |
| ME | Montenegro | 4.7 | 5.1 | 3.1 | 3.0 | 2.1 | 2.4 | 2.6 | 1.5 | 1.8 | 1.9 |
| MK | North Macedonia | 0.2 | 2.7 | 3.3 | 3.4 | 3.4 | 1.4 | 1.5 | 1.4 | 2.4 | 2.5 |
| RS | Serbia | 2.0 | 4.4 | 2.9 | 2.7 | 2.6 | 3.0 | 2.0 | 1.8 | 2.2 | 2.6 |
| XK | Kosovo | 4.2 | 3.8 | 4.2 | 4.0 | 4.3 | 1.5 | 1.1 | 2.7 | 2.5 | 2.5 |
| | *WB6 1)2)* | *2.6* | *4.0* | *3.0* | *3.1* | *2.9* | *2.1* | *1.8* | *1.7* | *2.1* | *2.3* |
| TR | Turkey | 7.5 | 2.8 | -0.7 | 3.1 | 3.3 | 11.1 | 16.3 | 16.5 | 13.0 | 11.2 |
| BY | Belarus | 2.5 | 3.0 | 1.3 | 1.5 | 1.7 | 6.0 | 4.9 | 6.0 | 5.5 | 5.0 |
| KZ | Kazakhstan | 4.1 | 4.1 | 4.0 | 3.5 | 3.5 | 7.4 | 6.0 | 5.3 | 5.0 | 5.0 |
| MD | Moldova | 4.7 | 4.0 | 4.7 | 3.8 | 4.0 | 6.5 | 2.9 | 4.5 | 4.5 | 4.5 |
| RU | Russia | 1.6 | 2.3 | 1.1 | 1.7 | 1.9 | 3.6 | 2.9 | 4.5 | 2.9 | 2.9 |
| UA | Ukraine | 2.5 | 3.3 | 3.3 | 3.1 | 3.3 | 14.4 | 10.9 | 8.0 | 6.0 | 5.0 |
| | *CIS4+UA 1)2)* | *2.0* | *2.6* | *1.6* | *2.0* | *2.2* | *4.9* | *3.9* | *4.9* | *3.4* | *3.4* |
| | *V4 1)2)* | *4.6* | *4.6* | *3.8* | *3.1* | *3.0* | *1.9* | *1.7* | *2.4* | *2.6* | *2.4* |
| | *BALT3 1)2)* | *4.5* | *4.2* | *3.3* | *2.4* | *2.5* | *3.5* | *2.7* | *2.5* | *2.1* | *2.1* |
| | *SEE9 1)2)* | *5.1* | *3.7* | *3.7* | *3.1* | *2.8* | *1.4* | *3.0* | *3.0* | *2.8* | *2.8* |
| | *CIS3+UA 1)2)* | *3.3* | *3.6* | *3.3* | *3.0* | *3.1* | *9.6* | *7.5* | *6.3* | *5.4* | *5.0* |
| | *non-EU12 1)2)* | *3.7* | *2.7* | *1.0* | *2.3* | *2.5* | *6.7* | *7.5* | *8.2* | *6.2* | *5.7* |
| | *CESEE23 1)2)* | *4.1* | *3.2* | *1.8* | *2.6* | *2.7* | *5.3* | *6.0* | *6.6* | *5.2* | *4.7* |

**Table 2.1 / (ctd.)**

| | | Unemployment (LFS) rate in %, annual average | | | | | Current account in % of GDP | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Forecast | | | | | Forecast | | |
| | | 2017 | 2018 | 2019 | 2020 | 2021 | 2017 | 2018 | 2019 | 2020 | 2021 |
| BG | Bulgaria | 6.2 | 5.2 | 4.6 | 4.5 | 4.4 | 3.5 | 5.4 | 6.0 | 4.4 | 3.2 |
| CZ | Czech Republic | 2.9 | 2.2 | 2.0 | 2.0 | 2.0 | 1.6 | 0.3 | 0.4 | 0.3 | 0.2 |
| EE | Estonia | 5.8 | 5.4 | 5.0 | 5.2 | 5.0 | 2.7 | 2.0 | 2.8 | 2.2 | 2.1 |
| HR | Croatia | 11.2 | 8.5 | 6.5 | 6.0 | 5.5 | 3.4 | 1.9 | 0.6 | 0.2 | 0.1 |
| HU | Hungary | 4.2 | 3.7 | 3.5 | 3.5 | 3.5 | 2.3 | -0.5 | -0.1 | -0.1 | -0.1 |
| LT | Lithuania | 7.1 | 6.2 | 5.8 | 5.6 | 5.5 | 0.5 | 0.3 | 0.8 | 0.2 | 0.0 |
| LV | Latvia | 8.7 | 7.4 | 6.5 | 6.3 | 6.0 | 1.0 | -0.7 | -0.2 | -0.5 | -0.6 |
| PL | Poland | 4.9 | 3.9 | 3.7 | 3.4 | 3.4 | 0.1 | -1.0 | -1.0 | -1.2 | -0.9 |
| RO | Romania | 4.9 | 4.2 | 3.8 | 3.7 | 3.7 | -3.2 | -4.6 | -5.2 | -5.0 | -4.9 |
| SI | Slovenia | 6.6 | 5.1 | 4.5 | 4.0 | 4.0 | 6.1 | 5.7 | 4.8 | 4.6 | 4.4 |
| SK | Slovakia | 8.1 | 6.5 | 5.8 | 5.8 | 5.6 | -1.9 | -2.6 | -3.0 | -2.8 | -2.5 |
| | *EU-CEE11 1)2)* | *5.3* | *4.3* | *3.9* | *3.8* | *3.7* | *0.5* | *-0.7* | *-0.8* | *-1.0* | *-0.9* |
| | *EA19 3)* | *9.1* | *8.2* | *7.7* | *7.5* | *7.4* | *3.6* | *3.5* | *2.8* | *2.7* | *2.5* |
| | *EU28 3)* | *7.6* | *6.8* | *6.2* | *6.0* | *6.0* | *2.4* | *2.1* | *1.5* | *1.4* | *1.3* |
| AL | Albania | 13.7 | 12.3 | 11.3 | 11.0 | 10.5 | -7.5 | -6.7 | -7.3 | -6.6 | -6.1 |
| BA | Bosnia and Herzegovina | 20.5 | 18.4 | 15.8 | 15.0 | 14.0 | -4.3 | -3.7 | -4.5 | -4.3 | -4.0 |
| ME | Montenegro | 16.1 | 15.2 | 14.3 | 14.0 | 13.9 | -16.1 | -17.0 | -17.8 | -18.0 | -14.3 |
| MK | North Macedonia | 22.4 | 20.7 | 18.5 | 17.5 | 17.5 | -1.1 | -0.1 | -1.4 | -2.5 | -3.1 |
| RS | Serbia | 13.5 | 12.7 | 11.5 | 10.8 | 10.3 | -5.2 | -5.2 | -6.0 | -5.5 | -5.4 |
| XK | Kosovo | 30.5 | 29.6 | 25.0 | 23.5 | 21.0 | -5.4 | -7.6 | -7.2 | -7.5 | -7.9 |
| | *WB6 1)2)* | *16.9* | *15.7* | *13.8* | *13.2* | *12.6* | *-5.4* | *-5.3* | *-6.1* | *-5.8* | *-5.6* |
| TR | Turkey | 10.9 | 10.9 | 13.5 | 13.4 | 11.5 | -5.5 | -3.4 | -0.2 | -1.6 | -2.3 |
| BY | Belarus | 5.6 | 4.8 | 4.4 | 4.5 | 4.5 | -1.7 | -0.1 | -0.4 | -1.2 | -1.4 |
| KZ | Kazakhstan | 4.9 | 4.9 | 4.8 | 4.8 | 4.8 | -3.1 | -0.2 | -2.4 | -2.0 | -1.9 |
| MD | Moldova | 4.1 | 3.0 | 6.0 | 6.0 | 6.0 | -5.7 | -10.6 | -9.8 | -9.2 | -8.2 |
| RU | Russia | 5.2 | 4.8 | 4.6 | 4.5 | 4.4 | 2.1 | 6.8 | 5.1 | 5.9 | 6.0 |
| UA | Ukraine | 9.5 | 8.8 | 8.4 | 8.1 | 7.8 | -2.2 | -3.3 | -2.6 | -3.0 | -3.5 |
| | *CIS4+UA 1)2)* | *5.9* | *5.4* | *5.2* | *5.1* | *5.0* | *1.2* | *5.3* | *3.6* | *4.2* | *4.3* |
| | *V4 1)2)* | *4.7* | *3.8* | *3.6* | *3.4* | *3.4* | *0.5* | *-0.8* | *-0.8* | *-0.8* | *-0.7* |
| | *BALT3 1)2)* | *7.3* | *6.4* | *5.9* | *5.7* | *5.5* | *1.2* | *0.4* | *1.1* | *0.5* | *0.4* |
| | *SEE9 1)2)* | *9.7* | *8.6* | *7.6* | *7.3* | *7.0* | *-1.9* | *-2.5* | *-3.2* | *-3.3* | *-3.3* |
| | *CIS3+UA 1)2)* | *7.5* | *6.9* | *6.7* | *6.6* | *6.4* | *-2.6* | *-1.5* | *-2.4* | *-2.4* | *-2.6* |
| | *non-EU12 1)2)* | *7.5* | *7.1* | *7.5* | *7.4* | *6.8* | *-1.0* | *2.6* | *2.3* | *2.4* | *2.3* |
| | *CESEE23 1)2)* | *7.0* | *6.4* | *6.6* | *6.5* | *6.1* | *-0.5* | *1.4* | *1.2* | *1.2* | *1.1* |

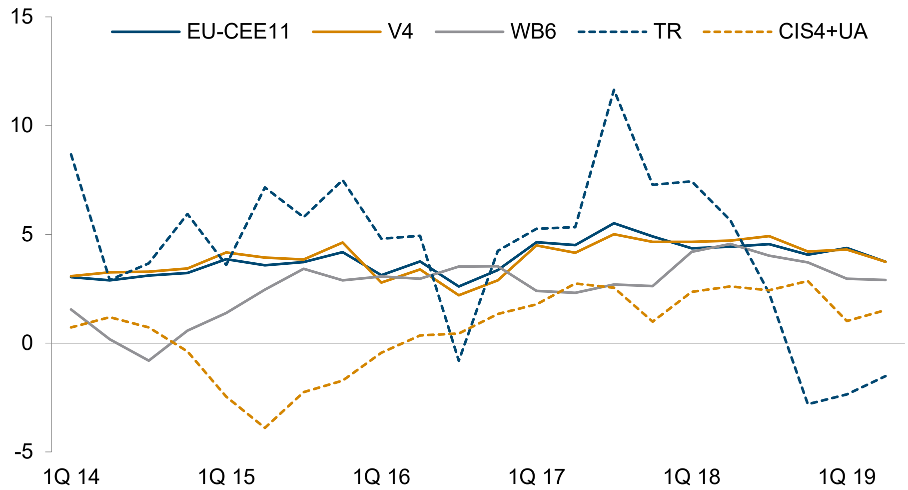
1) wiiw estimates. - 2) Current account data include transactions within the region (sum over individual countries). -
3) Forecasts estimated by wiiw.
Source: wiiw, Eurostat. Forecasts by wiiw (November 2019).

**Only Russia, Belarus and Turkey are displaying weak growth performance.** In Russia, the policy mix is restrictive and is prioritising stability and resilience to Western sanctions over growth; this is also acting as a drag on the pace of expansion in neighbouring Belarus. Both economies have grown by only about 1% this year, partly also because of the decline in oil prices. Turkey, on the other hand, is recovering from the severe financial crisis that erupted last year. After a slump in the second half of 2018, the Turkish economy has lately been in recovery mode (on a quarterly basis), helped by the high tourist inflows and accommodative global liquidity conditions. However, given the high statistical base (the first half of 2018), the economy will not be able to avoid posting full-year negative growth this year.

## 2.2. … BUT THE EXTERNAL ENVIRONMENT IS STARTING TO BITE

**At the same time, and as predicted earlier by wiiw,[8] the peak of the economic boom has already passed.** For the region as a whole, real GDP growth will slow markedly this year, to 1.8% (from 3.2% recorded in 2018). However, this is mostly on account of the sharp deterioration in growth performance in Turkey (Figure 2.1). Outside Turkey, the deceleration has been much milder, and in six countries – Bulgaria, Croatia, Romania, North Macedonia, Kosovo and Moldova – growth has even gained momentum this year.

**Figure 2.1 / Real GDP change against preceding year in %**




Note: EU-CEE11 = the 11 countries of EU-CEE; V4 = the Visegrád countries of the Czech Republic, Hungary, Poland and Slovakia; WB6 = the six countries of the Western Balkans; CIS4 = the four CESEE countries of the CIS (Russia, Belarus, Kazakhstan and Moldova).
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

In EU-CEE, we estimate that growth will have decelerated on average by 0.5 pp this year on the back of a slowdown in the euro area and the specific problems of the automotive industry, which is crucial for the region. In the Visegrád countries, this has already started weighing on the investment mood, although elsewhere in EU-CEE investments have held up well.

In the Western Balkans and the CIS, growth will have slowed by on average 1 pp this year, mostly on account of developments in Serbia and Russia. In Serbia, this is to a large extent a statistical base

8 wiiw (2019a); wiiw (2019c).

effect, since the record harvest of 2018 will not be repeated this year. Besides, the 100% import tariff imposed on Serbian products by Kosovo last year and the temporary shutdown in the crucial Fiat Chrysler plant have been a drag on the pace of economic expansion in Serbia. In Russia, the deceleration in growth is due to the combined effect of export decline on account of lower oil prices and cyclical investment stagnation.

**Compared to the wiiw Summer Forecast,[9] the forecast revisions for 2019 have been largely balanced.** For 10 CESEE countries, the GDP growth forecast has been revised upwards; for eight countries it has been revised downwards; and for five it remains unchanged (Table 2.2). However, in most cases the revisions have not been very significant (apart from Slovakia, Albania and Belarus, where the downward revisions have been of the order of 1 pp or more). Besides, it has to be borne in mind that in summer 2019, wiiw forecasts were mostly revised upwards compared to spring – for many countries, quite substantially. Thus, the current growth estimates for this year are, in many cases, higher than at the beginning of the year, including in such important regional economies as Poland, Hungary, Romania and Ukraine. This demonstrates the surprising resilience of large parts of the CESEE region to external headwinds.

**Table 2.2 / Real GDP forecasts and revisions**

| | | Forecast, % | | | | Revisions, pp | | |
|---|---|---|---|---|---|---|---|---|
| | | 2018 | 2019 | 2020 | 2021 | 2019 | 2020 | 2021 |
| EU-CEE11 | BG | 3.1 | 3.5 | 2.7 | 2.4 | 0.0 | -0.7 | -0.7 |
| | CZ | 3.0 | 2.5 | 2.4 | 2.6 | 0.0 | 0.0 | 0.1 |
| | EE | 4.8 | 3.3 | 2.6 | 2.4 | 0.1 | -0.1 | 0.0 |
| | HR | 2.6 | 2.9 | 2.7 | 2.7 | 0.0 | 0.0 | 0.0 |
| | HU | 5.1 | 4.3 | 3.1 | 2.6 | 0.2 | 0.0 | 0.0 |
| | LT | 3.6 | 3.6 | 2.4 | 2.6 | 0.4 | -0.3 | 0.2 |
| | LV | 4.6 | 2.8 | 2.2 | 2.4 | -0.5 | -0.9 | -0.3 |
| | PL | 5.1 | 4.4 | 3.5 | 3.3 | -0.2 | -0.2 | -0.1 |
| | RO | 4.0 | 4.2 | 3.3 | 3.0 | 0.1 | -0.3 | -0.3 |
| | SI | 4.1 | 2.9 | 2.8 | 2.8 | -0.4 | -0.3 | -0.2 |
| | SK | 4.0 | 2.3 | 2.2 | 2.6 | -1.3 | -0.8 | 0.1 |
| WB6 | AL | 4.1 | 2.8 | 3.8 | 3.4 | -0.9 | 0.1 | -0.1 |
| | BA | 3.6 | 2.6 | 2.7 | 2.7 | -0.1 | -0.1 | -0.1 |
| | ME | 5.1 | 3.1 | 3.0 | 2.1 | 0.0 | 0.0 | 0.0 |
| | MK | 2.7 | 3.3 | 3.4 | 3.4 | 0.2 | 0.0 | 0.0 |
| | RS | 4.4 | 2.9 | 2.7 | 2.6 | 0.0 | 0.0 | 0.0 |
| | XK | 3.8 | 4.2 | 4.0 | 4.3 | 0.1 | -0.1 | 0.3 |
| Turkey | TR | 2.8 | -0.7 | 3.1 | 3.3 | 0.5 | 0.3 | 0.2 |
| CIS4+UA | BY | 3.0 | 1.3 | 1.5 | 1.7 | -1.0 | -0.6 | -0.3 |
| | KZ | 4.1 | 4.0 | 3.5 | 3.5 | 0.4 | 0.3 | 0.3 |
| | MD | 4.0 | 4.7 | 3.8 | 4.0 | 0.7 | 0.3 | 0.6 |
| | RU | 2.3 | 1.1 | 1.7 | 1.9 | -0.2 | 0.0 | 0.0 |
| | UA | 3.3 | 3.3 | 3.1 | 3.3 | 0.6 | 0.1 | -0.2 |

Note: Current forecast and revisions relative to the wiiw Summer Forecast 2019. Colour scale variation from the minimum (red) to the maximum (green).

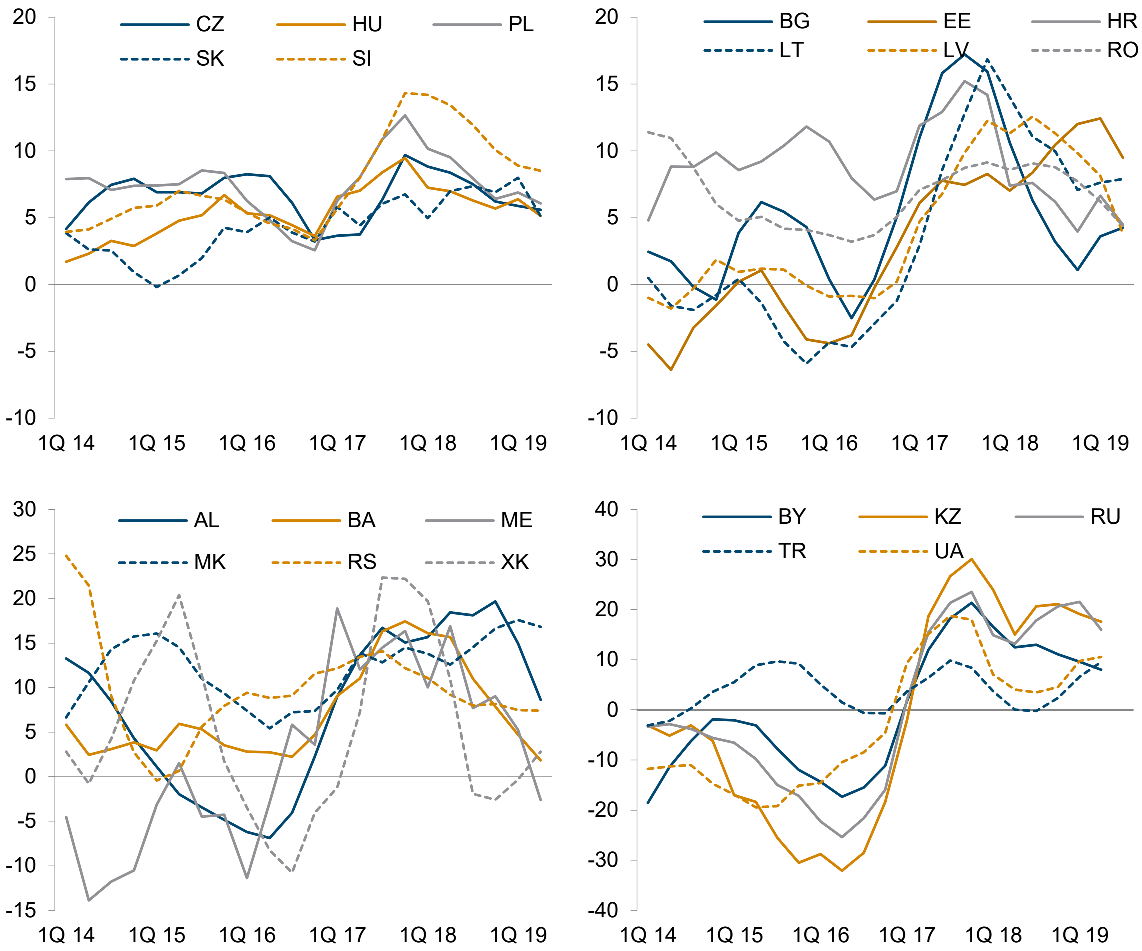
9 wiiw (2019c).

## 2.3. EXPORTS LOSING MOMENTUM

**Stagnation in the German economy has been a drag on the export performance of CESEE countries…** As mentioned in the section 'Global overview', most CESEE countries are small, open economies. This applies in particular to EU-CEE (and some Western Balkan) countries, which have strong trade links with Germany. The German economy has been struggling of late, shaken by the slump in the demand for cars in China, uncertainties surrounding Brexit, and the difficulties faced by the German car industry in adjusting to new emissions standards. Against this background, a weakening of the export performance of CESEE countries was only a matter of time. In the first quarter of 2019, their exports were still holding up surprisingly well;[10] but in the second quarter, the weakness in Germany started increasingly spilling over (Figures 2.2 and 2.3).

**Figure 2.2 / Exports of goods (customs statistics, EUR based), growth in %**

4 quarters moving average



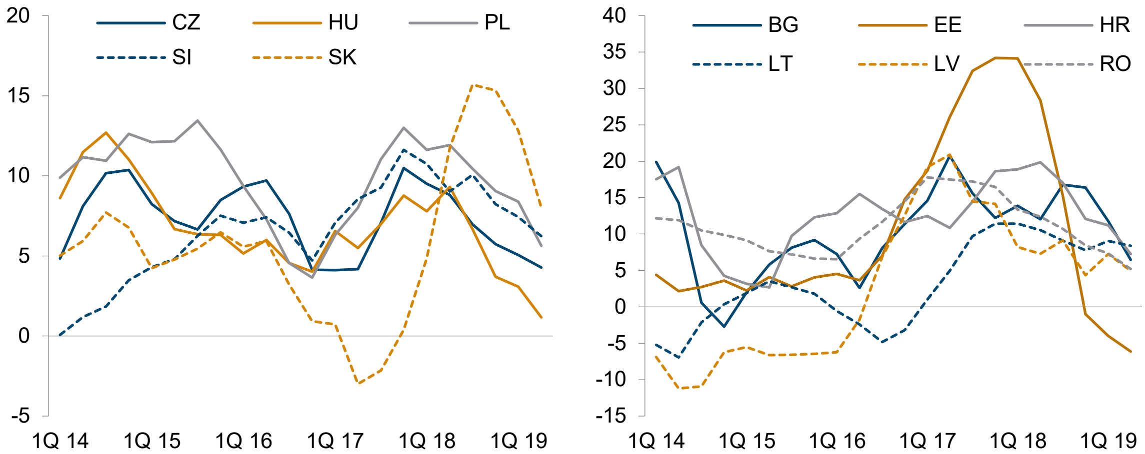

Source: wiiw Monthly Database incorporating national and Eurostat statistics.

10 wiiw (2019c).

**… especially those specialising in the automotive industry.** Car exports have generally performed badly, and have been a major drag on the overall export performance of countries that specialise heavily in the automotive industry, such as the Visegrád countries (but also e.g. North Macedonia). Only in those countries that have recently expanded their car production capacity markedly – such as Slovakia (Land Rover) or Serbia (Fiat Chrysler) – has the downturn in export dynamics been smoothed. All in all, these developments expose the dangers of excessive specialisation in car production – even if such specialisation has served the EU-CEE countries rather well to date. So far as the expansion – and potentially even relocation – of automotive production capacities is concerned, EU-CEE will also face increased competition from other countries, such as Turkey.[11]

**Figure 2.3 / Exports of goods to Germany (customs statistics, EUR based) growth in %**

4 quarters moving average




Source: Comext, own calculations.

**Elsewhere, exports have generally held up better.** In Slovenia, the downward trend in export dynamics has also been pronounced, but the pace of expansion remains higher thanks to pharmaceuticals. In Bulgaria, Lithuania, Kosovo, Turkey and Ukraine, the export momentum has picked up pace recently, albeit for different reasons. In Turkey, exports have been quick to take advantage of the weak lira. Ukraine has increasingly been benefiting from improved access to the EU market. However, in Russia and Kazakhstan, exports have declined on account of lower oil prices, as well as supply constraints in the framework of the OPEC+ deal (Russia) and production disruptions (Kazakhstan). In Belarus, exports have suffered on the back of weak import demand from Russia and interruptions in Russian energy supplies, partly due to pricing disputes. In Albania, they have been constrained by currency appreciation, as well as by weather conditions: a severe drought has affected hydropower generation and exports.

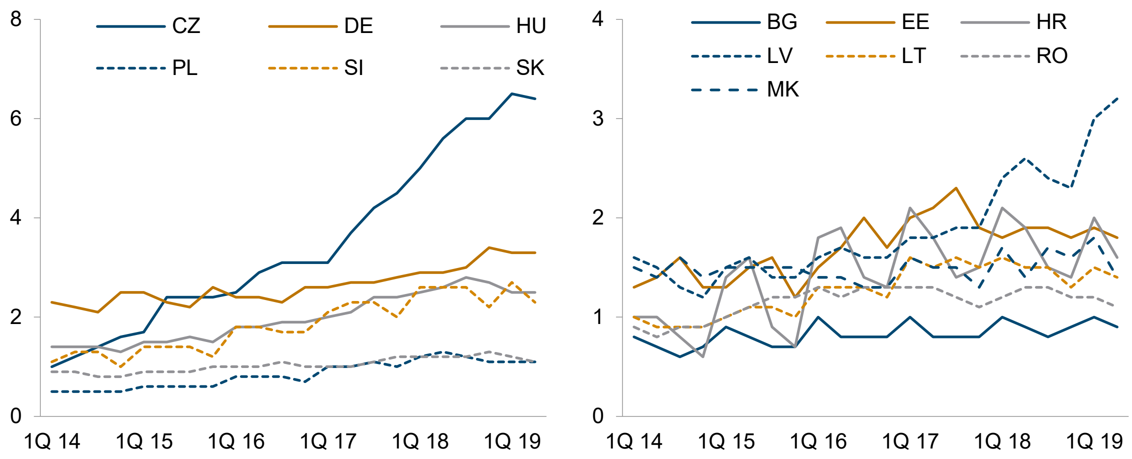
[11] For instance, VW is reportedly planning a big investment in Turkey, with production of some 300,000 cars per year, starting from 2022. However, the final decision has been put on hold for the time being, because of the situation in northern Syria. See https://europe.autonews.com/automakers/vw-postpones-final-decision-turkey-plant

## 2.4. LABOUR SHORTAGES EASE SOMEWHAT

**Over the past few years, large parts of the CESEE region have been characterised by deepening labour shortages.** The main reason for this has been demographic: the long-term trend of secular decline in the working-age population – even in countries where the total population has been on the rise, such as the Czech Republic and Slovenia. This is a combined outcome of low birth rates and, in many cases, outward migration. Rising participation rates and longer working hours could only partly mitigate this trend, resulting in a sharp decline in unemployment in the vast majority of CESEE countries over the past few years (Overview Table 2.1) – albeit starting from a high level in the case of the Western Balkans, where the unemployment rate is still generally in double digits.

**This trend has recently levelled off and has even gone into reverse in some cases,** as can be seen from the recent downturn in job vacancies – more pronounced than mere seasonal dynamics would suggest (Figure 2.4). This can be explained by a combination of factors, such as the structural labour market adjustment, the stabilisation (or reduction) in labour demand, and increased immigration.

**Figure 2.4 / Job vacancy rate in %**




Source: Eurostat.

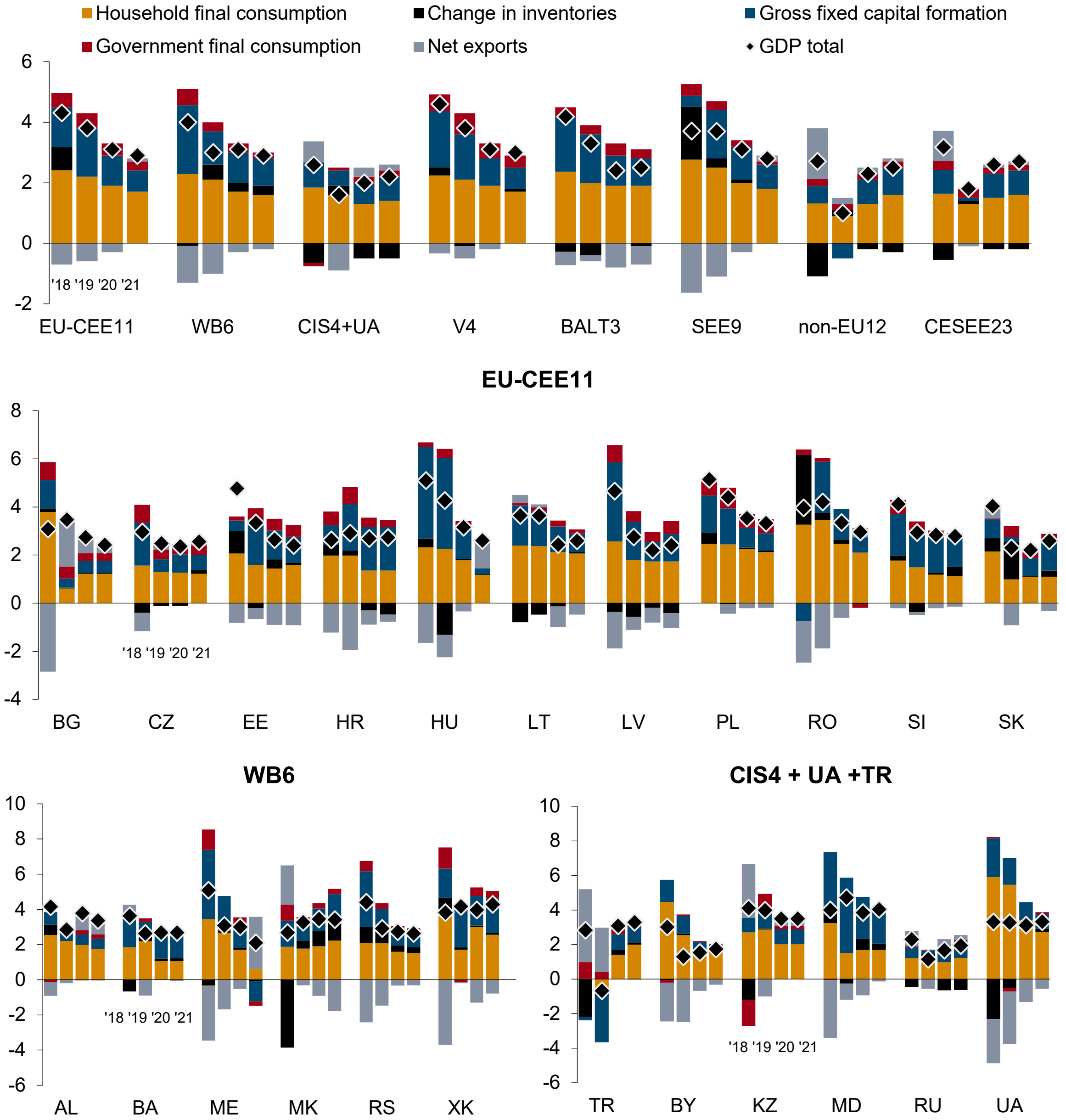
**The easing of labour shortages is, to some extent, a natural outcome of the process of matching supply and demand in the labour market**, which takes time to play out. To the extent that labour shortages for certain occupations have been driven by the inadequate supply of certain skills, one would expect the idle labour force to adjust to that by undertaking (re)training. On the other hand, the labour demand for certain occupations may have declined, as some investment projects for which labour shortages have represented a crucial bottleneck have been abandoned (a case in point is the Czech Republic). The deterioration in the external environment and the expectations of growth slowdown have also reportedly curtailed the demand for labour recently.

**Increased labour immigration appears to have played a role as well.** Despite the strong anti-migrant sentiments prevalent, especially in EU-CEE countries, many of them have recently increased quotas for third-country nationals, and especially for temporary labour migrants. Apart from traditional sources of imported labour, such as Ukraine, the Western Balkans and Belarus (in the Baltic countries), non-European immigration has gained momentum as well: from places such as India (to Hungary and

Croatia, for example), Vietnam and Mongolia (to Hungary), Nepal (to Croatia) and Bangladesh (to Slovenia).

**Figure 2.5 / GDP growth in 2018-2021**

and contribution of individual demand components in percentage points



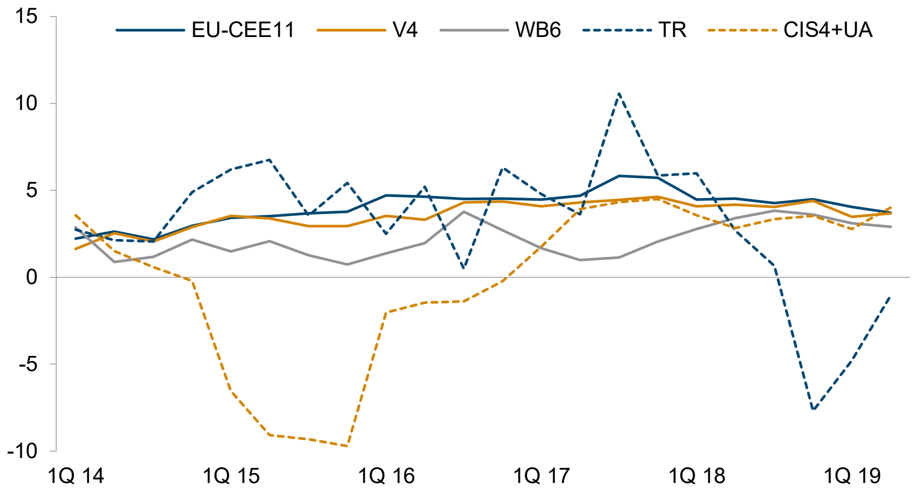

Note: see Figure 2.1 for abbreviations; BALT3 = the three Baltic countries (Estonia, Latvia, Lithuania); SEE9 = the nine countries of Southeast Europe: WB6, Bulgaria, Croatia and Romania; non-EU12 = non-European Union CESEE countries: WB6, CIS4+UA and Turkey.
Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

## 2.5. HOUSEHOLD CONSUMPTION HOLDS UP WELL

**Household consumption continues to be the main driver of growth in the CESEE region.** In 15 countries of the region, we expect it to have been the main growth driver this year (Figure 2.5). The data for the first half of 2019 demonstrate that its dynamics has remained practically unchanged in the Western Balkans, the CIS and Ukraine, and has subsided only slightly in EU-CEE. In these three sub-regions, household consumption continues to grow on average at 3-4% per year (Figure 2.6). Only in crisis-hit Turkey has the dynamics of household consumption been negative since the fourth quarter of last year, albeit with an improving trend recently, as inflation has subsided. However, there is some variation across individual countries. For instance, private consumption has gained momentum in Romania, Kazakhstan and Bosnia and Herzegovina, but has subsided markedly in Bulgaria, Slovakia, Moldova and Kosovo. In those latter countries, growth is primarily driven by components of final demand other than private consumption.

**Figure 2.6 / Household consumption expenditure**

real change against preceding year in %




Source: wiiw Monthly Database incorporating national and Eurostat statistics.

**Private consumption is fuelled by rising wages…** Real wages continue to post solid growth, benefiting from the tight labour market situation and the hikes in the minimum wage in many countries of the region. The latter typically result in disproportionate wage growth in the low-wage segment, thus raising the overall household propensity to consume. Besides, the real purchasing power of households has been strengthened by the recent stabilisation of inflationary pressures, in cases where nominal wage agreements had been concluded in anticipation of higher inflation.

**…and employment.** Employment growth has been helping the rise in private consumption, too. However, in the face of labour shortages, especially in the more advanced EU-CEE countries, the newly created jobs have increasingly been taken up by foreigners. The latter typically have a lower propensity to consume, sending part of their income back home in the form of remittances – and thus supporting consumption growth in e.g. Western Balkans, Moldova and Ukraine. Thus, a greater reliance on foreign workers may be one of the reasons behind the moderate growth in private consumption in countries such as the Czech Republic and Slovakia – despite solid real wage growth.

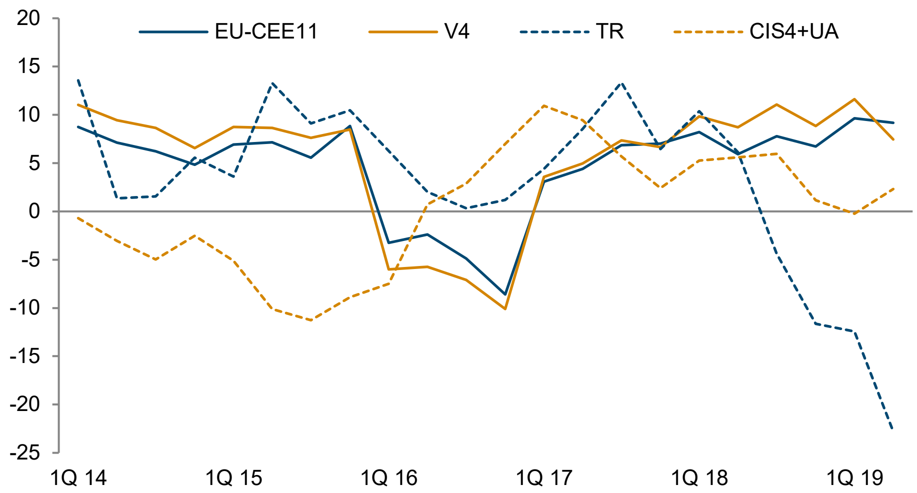
**Consumer credit is an important pillar of private consumption, above all in the CIS, Ukraine and some Western Balkan countries.** In the CIS and Ukraine, consumer credits have been expanding at close to, or in excess of, 20% annually (see section 'Credit monitor'). Although the levels of household indebtedness in these countries are not very high (10-15% of GDP), rapid credit expansion at high interest rates, if sustained over a protracted period, is potentially a cause for concern. This applies, in particular, to Russia, where the real disposable incomes of households are stagnant (not least because of the high burden of debt service), which fuels more credit demand and creates a vicious cycle of rising indebtedness and falling incomes. These concerns have prompted the authorities in Russia, as well as Kazakhstan, to tighten restrictions on household lending over the past few months.

## 2.6. INVESTMENTS INCREASINGLY DRIVEN BY THE PUBLIC SECTOR

**Large parts of the CESEE region – Russia, Turkey, Bulgaria and some Visegrád countries – have witnessed a marked weakening of investment activity recently** (Figure 2.7). This primarily reflects weakening private sector investments, especially in productive capacities. In Turkey, gross fixed capital formation (GFCF) contracted by 18% in the first half of 2019 – a predictable development in times of recession. In Russia, private investments have stagnated, due to the low levels of capacity utilisation and the generally overcast outlook, while the implementation of infrastructure projects has been delayed. In most Visegrád countries (except Hungary) and Bulgaria, pessimistic expectations have weighed heavily on private sector investments as well. Besides, labour shortages have resulted in some of the investment projects being cancelled.

**Figure 2.7 / Gross fixed capital formation**

real change against preceding year in %

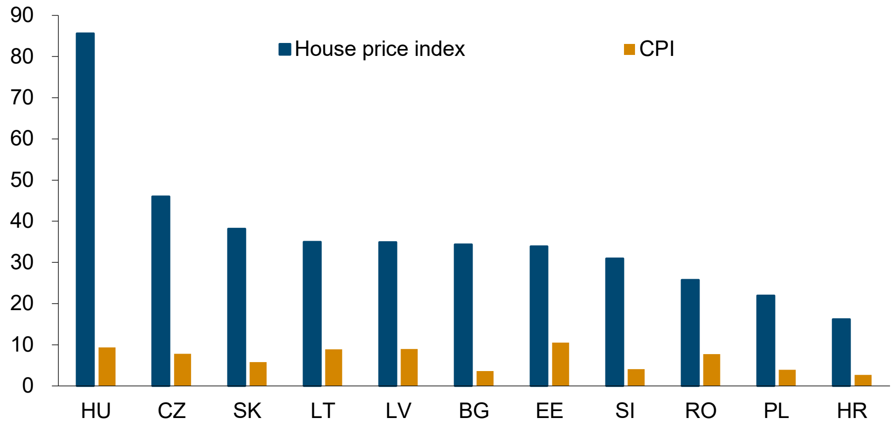



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

**The weakness of investment in productive assets may not bode well for growth and convergence prospects.** The investment ratios of around 20% of GDP typically recorded by most CESEE countries[12] may not be particularly low in international comparison (that is similar to the level in Western Europe). However, unless accompanied by higher productivity (which cannot be taken for granted), they are arguably too low to lay the supply-side foundations of sustained long-term catching-up: for that, much higher investment ratios would be needed.[13] Particularly problematic are low investments in productive capacities such as machinery and equipment: in per capita terms (at Purchasing Power Parity – PPP), these are far below the levels observed in advanced countries.[14] The recent weakening of investment dynamics, if sustained over a prolonged period, may further exacerbate these flaws.

**A large part of private sector investment in CESEE has been channelled to real estate**, fuelled by low interest rates on mortgages. As a result, the construction sector in many countries has been expanding strongly and housing prices have been rising rapidly – much faster than consumer prices (see Figure 2.8 for EU-CEE countries). Many EU-CEE countries have been among the front-runners in the EU when it comes to house price inflation, suggesting the possibility of housing 'bubbles' in some cases. In Hungary, house prices have increased by 86% over the past five years; in the Czech Republic by 46%; and in most other EU-CEE countries by between 30% and 40%. For comparison, the strongest Consumer Price Index (CPI) increase in the region over the same period (in Estonia) has been only 10.5%.

**Figure 2.8 / House price index and CPI, cumulative % change, 2Q 2014 - 2Q 2019**




Source: wiiw Monthly Database incorporating national and Eurostat statistics and Eurostat.

**Elsewhere, investment activity has remained strong, not least thanks to robust FDI inflows.** In four CESEE countries – Estonia, Hungary, Moldova and Kosovo – gross fixed capital formation will be the main growth driver this year (Figure 2.5). Moldova and several Western Balkan countries (notably Serbia and North Macedonia) have increasingly been establishing themselves as a cheaper alternative to EU-CEE countries, especially when it comes to car production. FDI inflows to the Western Balkan

12 Across CESEE, only Turkey and Montenegro recorded much higher investment ratios in 2018, exceeding 30% of GDP in both countries.

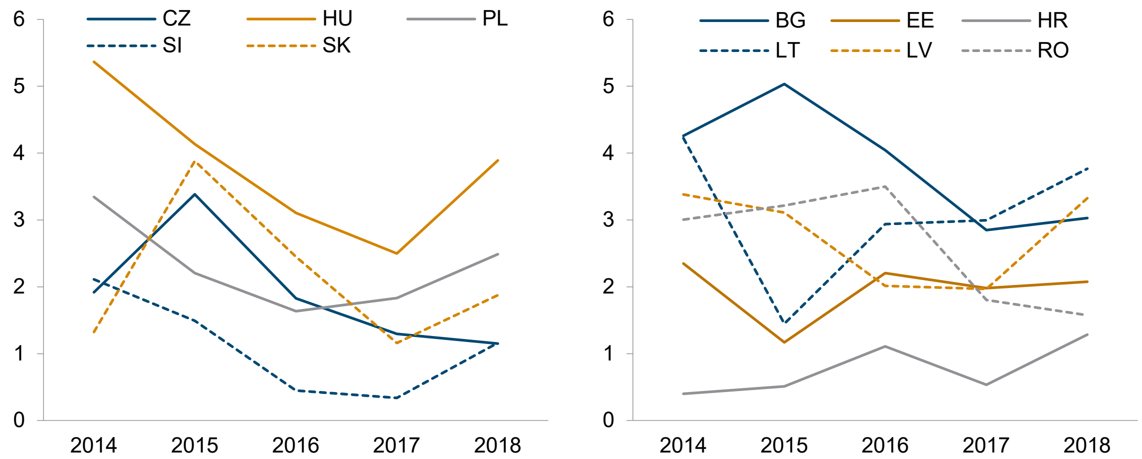
13 Japan and South Korea used to record investment ratios in excess of 30% of GDP, China over 40%, West European countries around 25% over prolonged periods of catching-up.

14 Podkaminer (2019).

region increased by 28% last year, and this trend largely continued into 2019 (wiiw, 2019b). In Moldova, GFCF surged by 20% in the first half of 2019, as the production of car components has been partly relocated to that country from neighbouring Romania for reasons of cost. Despite that, Romania remained an overall attractive destination for FDI – albeit labour-intensive industries, such as textiles and leather recorded divestment because of the wage pressures. In several countries, FDI has primarily been targeting the energy sector, such as the ongoing construction of the Trans-Adriatic gas Pipeline (TAP) and hydropower station in Albania, or the expansion of oil fields in Kazakhstan. In Kosovo, it mainly went into real estate.

**Infrastructure investments performed well, and in Visegrád countries partly offset private investment weakness.** In general, public sector investments in EU-CEE countries have historically strongly correlated with the inflows of EU transfers. The current Multiannual Financial Framework (MFF) for 2014-2020 is now at an advanced stage. This means that, after the usual teething problems, the inflow of EU funds into the EU-CEE countries is now in full swing. Figure 2.9 demonstrates that net inflows of EU funds picked up markedly last year, in some cases – such as in the Czech Republic, Slovakia or Slovenia – after a protracted decline during the preceding years. Those countries were joined by 'slow starters' such as Croatia, which joined the EU only in 2013, and thus could not draw on the previous EU MFF for 2007-2013. Anecdotal evidence suggests that public investments driven by EU transfers have also been strong this year. Among the big infrastructure projects that started this year and that are co-financed by the EU is, for instance, Rail Baltica, a high-speed train project connecting the Baltic countries with the Central European network.

**Figure 2.9 / Net EU transfers, as % of GDP**



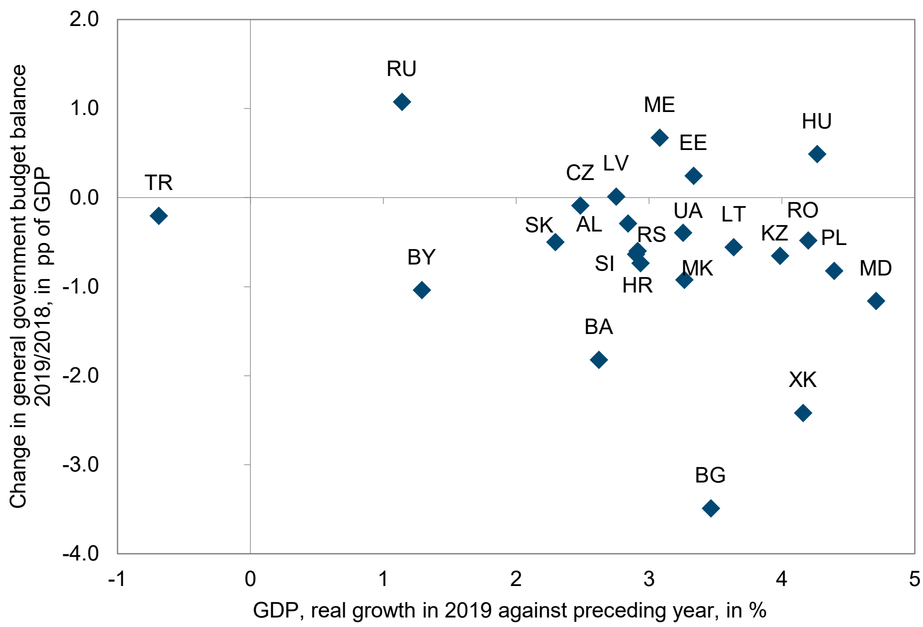

Source: wiiw Annual Database incorporating national and Eurostat statistics, EU Commission.

**In the Western Balkans, infrastructure investments are driven partly by funds from the EU, but especially by the Chinese Belt and Road Initiative (BRI),** as China sees the region as an important transit route. More than half of all BRI funds allocated to the CESEE region (in the form of loans) go to the Western Balkans. However, in Montenegro infrastructure spending has been scaled down this year on the back of fiscal consolidation.

## 2.7. EXPANSIONARY POLICY MIX

**The strength of domestic demand in many CESEE countries is partly due to their pro-growth fiscal policy.** The fiscal stance of a country can be roughly derived by juxtaposing the change in the government budget balance and the country's growth performance (for the reasoning behind this, please see Box 2.1). Using this method, in 18 out of 23 CESEE countries, fiscal policy this year can be classified as clearly expansionary. In many cases, fiscal stimulus takes the form of generous social policy. One example is Poland, which has adopted a large range of social benefits that target various social groups. Another example is Kazakhstan, which hiked the minimum wage by 50% in January, and then the salaries of low-paid public officials by 30% in July of this year.

**Figure 2.10 / Fiscal stance in 2019**




Source: wiiw forecasts.

**Even applicants for accession to the euro area – Croatia and Bulgaria – hardly see a need for fiscal austerity in the current circumstances.** Both countries have ambitions to enter the European Exchange Rate Mechanism 2 (ERM2) soon, possibly even next year, which should pave the way for them to join the euro area two years later. For that, they will need, among other things, to satisfy the formal Maastricht criteria – including the criterion of public debt, which in the case of Croatia is still rather high, at above 70% of GDP (compared to the Maastricht 'threshold' of 60%), though it is gradually declining. In Bulgaria, which has a track record of fiscal prudence, this is less of a problem.[15] However, Bulgaria's current inflation rate of around 3% may potentially violate another Maastricht criterion, which requires that CPI inflation should not exceed the average of the three euro area countries with the lowest

[15] The expected strong deterioration in Bulgaria's fiscal balance this year by 3.5 pp of GDP is due to the one-off effect of a single transaction (acquisition of jet fighters) and may not be indicative of the overall fiscal stance.

inflation rates by more than 1.5 pp. A more restrictive fiscal course would be one way of bringing inflation down (whether that would be wise is another question).[16]

### BOX 2.1 / ASSESSING THE FISCAL STANCE IN CESEE COUNTRIES

A proper assessment of the fiscal stance requires the headline budget balance to be adjusted on account of the 'cyclical' component. For instance, a reduction in the budget deficit accompanied by economic growth may be entirely due to the impact of automatic stabilisers (such as higher tax revenues and reduced spending on unemployment benefits), and is not necessarily a reflection of laxer fiscal policy. For the same reason, the widening of the budget deficit during a recession need not necessarily be indicative of fiscal policy easing, but may be on account of the cyclical downturn in revenues.

Estimating the cyclically adjusted budget balance is no trivial task; it calls for knowledge of the corresponding elasticities of state revenues and expenditures with respect to GDP and an estimate of 'potential GDP'. Those are generally country specific and depend on the particular tax and social welfare system of a country. However, as a first approximation, one can identify two clear-cut cases that correspond to two quadrants in Figure 2.10. A change in the fiscal stance is clearly expansionary if the budget balance deteriorates (or remains unchanged) despite a burgeoning economy (south-east quadrant). Conversely, a change in the fiscal stance is clearly restrictive if the budget balance improves (or remains unchanged) despite a recession (north-west quadrant). In the remaining two quadrants, no unambiguous conclusion can be drawn with respect to the fiscal stance, without entering into deeper analysis. However, the position of a country far from the origin and close to the horizontal axis would strongly suggest that in qualitative terms the fiscal stance is the same as the one observed on the other side of the axis.

**CESEE countries can afford lax fiscal policy, so long as underlying growth fundamentals are reasonably solid and borrowing costs are low.** In most countries, the yields on government bonds have been on a downward trend since the third quarter of 2018, and even turned negative in Slovakia and Slovenia (Figure 2.11). Nearly everywhere, they have been below the nominal growth rates of GDP for a number of years, allowing the economies to 'grow out' of public debt – without a need to resort to painful austerity measures. A case in point is Serbia, which has succeeded in bringing down its public debt since 2015 by about 20 pp of GDP. Declines on a smaller scale could also be observed in other countries where the levels of public debt have been historically high and at times a cause for concern, such as Hungary and Croatia.

**Low borrowing costs are partly due to abundant global liquidity, but also to dovish monetary policy.** This applies not only to the euro area, of which five EU-CEE countries are formally part,[17] but also to CESEE countries which retain some degree of monetary policy autonomy – even if, in practice, they cannot deviate very much from the stance of the European Central Bank (ECB). The policy rates of

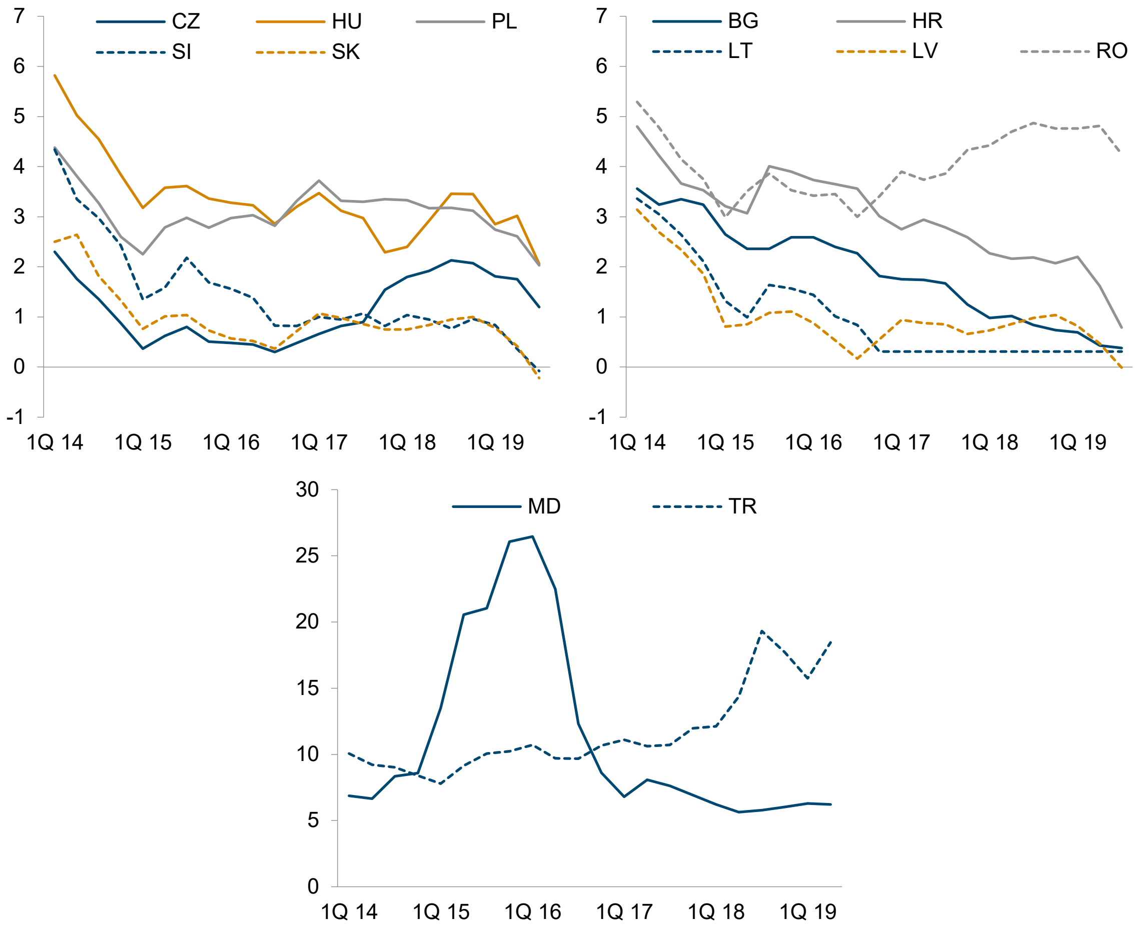
[16] Accession to the euro area requires more than the mere fulfilment of the formal Maastricht criteria on inflation, long-term interest rates, budget deficit, public debt and exchange rate stability; it is also dependent on progress in banking supervision and the institutional environment in general, as well as political factors.

[17] The ultra-loose monetary policy of the ECB has repercussions far beyond the euro area. Montenegro and Kosovo unilaterally use the euro as legal tender, while Bulgaria, Croatia, North Macedonia and Bosnia and Herzegovina peg their currencies to the euro in one way or another.

national central banks are negative in many cases. Even in countries with visible signs of 'overheating', such as Romania and Hungary, national banks have been in no hurry to hike interest rates, clearly prioritising growth over price stability. In any case, the CPI inflation of 3-4% (and subsiding) observed in these countries hardly gives reason for concern.[18] However, in Romania ongoing fiscal expansion runs the risk of the budget deficit surpassing the 'threshold' of 3% of GDP, potentially triggering an EU Excessive Deficit Procedure. In Moldova, fiscal policy should become more restrictive as well under IMF pressure.

**Figure 2.11 / Government bond yields, 10-year maturity**

in domestic currency, % per annum




Source: Eurostat, Investing.com, International Financial Statistics - IFS (IMF).

**Only in Turkey, Russia and Montenegro can the fiscal stance arguably be classified as restrictive.** In Turkey, the budget deficit is projected to widen only marginally this year – despite the cyclical downturn in revenues and suggesting some consolidation effort. In Russia, fiscal surplus will grow further, with the aim of making the economy less vulnerable to Western financial sanctions. Apart from fiscal surpluses, Russia has been accumulating part of the 'windfall' gains from energy exports in its sovereign wealth fund, suggesting that the overall fiscal stance is even more restrictive than implied

18 The only exceptions are Kazakhstan and Moldova, where the acceleration of inflation has prompted monetary policy tightening in recent months.

by Figure 2.10. In Montenegro, concerns over high public indebtedness play a role: since it has no currency of its own, it cannot rely on monetary mechanisms for the purpose of debt service, and its stock of public debt is effectively foreign debt. Spending cuts in Montenegro are falling mostly on public infrastructure projects.

## 2.8. OUTLOOK

**Growth in the CESEE region as a whole is expected to pick up by nearly 1 pp in 2020-2021** (Table 2.1). However, this is entirely due to the anticipated ‘return to normality’ in Turkey, and to a lesser extent in Russia. In EU-CEE, a ‘soft landing’ will likely take place, while in the Western Balkans, CIS and Ukraine growth should remain broadly stable.

**In EU-CEE, the external environment will likely be a drag on growth...** Growth in the euro area is projected to pick up somewhat from the current dip, and will cease to be a drag on EU-CEE exports. At the same time, there are still risks of the US imposing prohibitive import duties on European cars, in which case Hungary and Slovakia (which are particularly dependent on car exports to the US, both directly and indirectly via value-added chains) will be affected the most. A ‘hard Brexit’ (and especially a ‘no-deal Brexit’) may present another negative trade shock for the EU-CEE region – most notably Poland, which has a large trade surplus with the UK.

**… while domestic demand will continue to thrive.** Private consumption in EU-CEE will continue to benefit from solid wage growth and generous social policies. Even Romania, where overheating has long been a feature, should be able to sustain fiscal expansion, so long as financial conditions remain supportive. Inflows of EU transfers should remain intact, at least until the end of the forecasting period. The current MFF formally expires in 2020, and countries should still be able to absorb EU funds for two years after that. Under the next MFF (for 2021-2027), many EU-CEE countries will likely face painful cuts in EU transfers on account of Brexit and the likely shift in EU spending priorities: from EU-CEE towards Southern Europe, and from agriculture towards ‘clean energy’. Besides, the non-compliance with the ‘rule of law’ by some EU-CEE countries, notably Hungary and Poland, may play a role as well. However, the impact of any cuts in EU funding will only be felt from 2023 onwards. Only in Hungary do we expect an abrupt reduction in EU transfers next year, since most of the envisaged funds have already been absorbed.

**In the Western Balkans, growth is expected to settle at around 3% per annum in the coming years.** The current drivers of rising consumption and investment will likely stay in place, while increased FDI inflows should boost further export capacities. However, geopolitical developments in and surrounding the Western Balkans have not been very encouraging recently. The parliamentary victory of hardliners in Kosovo will further complicate the already difficult dialogue with Serbia, and the prohibitive 100% import tariff on goods from Serbia and Bosnia and Herzegovina imposed by Kosovo last year will almost certainly stay in place. North Macedonia has witnessed a major breakthrough recently, when it finally signed an agreement with Greece on the new name for the country. But EU accession talks for this country remain some way off, mainly because of strong opposition from France, which insists on reforming the entire EU enlargement policy. Things look even bleaker for Albania: opposition to the opening of EU accession negotiations with that country is much broader and includes Denmark and the

Netherlands (mostly on security grounds). Taken together, these developments may stall the fragile reform momentum in the region, resulting in EU accession prospects moving even further away.

**In Russia, after a dip this year, growth will pick up somewhat in 2020-2021, due to moderate fiscal relaxation,** including increased spending on health care, education and infrastructure projects. However, even with the extra fiscal stimulus, growth will not exceed 2% per annum, making Russia the worst performer in the CESEE region. Russia's economic prospects are strongly dependent on the geopolitical environment. The recent signs of détente with Ukraine following the change in the Ukrainian leadership earlier this year have been encouraging. However, implementation of the Minsk Agreement – a crucial precondition for easing EU sanctions against Russia – will not be an easy process, mostly because of the strong opposition to it in large parts of Ukrainian society.

**In the CIS countries and Ukraine, the economic dynamics should be broadly stable.** In Belarus, economic activity should revive in line with the rebound in Russia, given the strong – and growing – ties between the two economies. In Kazakhstan and Moldova, fiscal stimulus will continue to play a major role, although in Moldova growth will likely slow from the current very high pace. In both Moldova and Ukraine, the external vulnerabilities remain high, and economic prospects depend on access to IMF funding.

**The Turkish economy is projected to rebound from the recent crisis, although political risks remain high.** On a positive note, the weak lira has restored competitiveness, and the current account is now largely balanced. However, the existing external debt stock still needs to be refinanced, making Turkey highly dependent on the mood of global financial markets – and also on good relations with the US. The latter may be particularly tricky after Turkey started a military operation in northern Syria in October 2019. The baseline scenario at the time of finalising this report is that serious economic sanctions by the US against Turkey will be avoided over the forecasting period – especially if US President Donald Trump is re-elected next year. Nevertheless, the forecast risks for Turkey are by far the highest at the moment in the CESEE region.

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# 3. CESEE risk outlook

## 3.1. CESEE RISK MATRIX

### Table 3.1 / Summary of risks and changes since spring 2019

New risks:

› 'Significant increase in US tariffs on EU automotive exports' (medium likelihood, high impact);

› 'Collapse in one or more inflated asset markets' (low/high).

Deleted risks:

› 'Global trade war/major Chinese slowdown' (rated in the spring as high likelihood/high impact). Both a global trade war and a fairly substantial slowdown in China have already happened.

› 'European Parliament election leads to big gains for anti-EU forces' (high/low). Anti-EU parties did indeed gain seats, but not as many as feared. The impact was, as expected, quite low.

› 'Faster than expected tightening by the ECB' (low/medium). We now think that any tightening, if at all, by the ECB during the forecast period is almost unthinkable, and so this is no longer even a low risk.

Changed risk assessments:

› 'Renewed outbreak of the crisis in the euro area' goes from high to low likelihood (but remains high impact). This move largely reflects the changed make-up of the Italian government.

| | | Impact on CESEE countries* | | |
|---|---|---|---|---|
| | | **High** | **Medium** | **Low** |
| Likelihood | High | Smaller EU budget (only EU countries) | Rule of law and quality/independence of institutions deteriorate further | |
| Likelihood | Medium | Labour shortages stimulate higher investment<br>Significant increase in US tariffs on EU automotive exports | | |
| Likelihood | Low | Formalised core/periphery in EU (only EU countries)<br>Renewed outbreak of EZ crisis<br>Collapse in one or more inflated asset markets<br>German consumption growth roars into life | EM crisis affects more countries in CESEE<br>Hard/no deal Brexit | Improvement in EU-Russia relations |

Note: Red = negative risk, green = positive risk. *Impact on all 23 CESEE countries covered by wiiw unless otherwise stated. Risks related to the forecast period, 2019-2021. When measuring likelihood, high = 30-49% chance, medium = 10-30% chance, low = 1-10% chance.

**Table 3.2 / Positive risks detail**

| Risk | Likelihood | | Impact on CESEE | |
|---|---|---|---|---|
| Labour shortages stimulate virtuous cycle of rising wages and investment | Medium | Many countries in CESEE are facing acute labour shortages, including jobs requiring few skills. It remains unclear how this will go in the long run. Foreign firms in the region, faced with less labour and higher wages, may decide to move production east. However, they have many big incentives to stay, including high sunk costs, a better business environment, proximity to Western Europe, and a higher quality of labour and infrastructure. More broadly, a lack of labour could stimulate higher investment in automation, leading to higher productivity in the services sector as well. | High | Higher investment in productivity-enhancing improvements would lift the region's growth potential, and could increase per capita real GDP growth quite significantly. This could also feasibly improve the pace of convergence. |
| Improved EU-Russia relationship leads to removal of sanctions and increased trade and investment flows between the two | Low | This has become moderately more likely now because of US policy, which has resulted in closer EU ties with countries under pressure from the US, such as Iran and Turkey. However, Russia remains a special case, especially because EU sanctions on it are tied so closely to Minsk II (the terms of which are almost impossible to imagine Russia meeting). Nevertheless, opinion surveys indicate significant positive sentiment towards Russia in many EU countries, including in Germany. | Low | An unwinding of Russia-EU sanctions would matter more for Russia than other countries, but it is unlikely that it would be a game changer for anyone. The reasons that the Russian economy is doing so badly are mostly either structural or because of the weaker oil price of the last few years, not the sanctions. There would be a small positive impact on Russian growth, with spill-overs for other CIS countries. For the rest of CESEE, the impact would be minimal. Most have diverted trade away from Russia since the sanctions were introduced, and would not quickly go back. Many EU investors would remain wary, especially if tensions between Russia and the US remain high. |
| German consumption growth roars into life | Low | The German economy has slowed significantly recently, leading to major downgrades to growth projections by many leading forecasters. Germany's high level of dependence on external trade means it has been particularly badly affected by the US-China trade war. However, many domestic indicators are positive, including in the labour market and wage growth. There remains a (fairly small) chance that Germans will shrug off negative external news, and that higher spending could trigger a virtuous cycle of rising consumption and investment. | High | This would be very positive from the perspective of CESEE. Germany is an important export market for almost every country in the region, as well as a key source of FDI, tourism and remittances for many. |

**Table 3.3 / Negative risks detail**

| Risk | Likelihood | | Impact on CESEE | |
|---|---|---|---|---|
| Renewed outbreak of the euro area crisis | Low | Progress on reforms of the euro area to better insulate it from the next downturn in growth remains painfully slow. In Germany, such reforms tend to be seen as the German taxpayer subsidising profligate Southern Europeans. Some insurance is provided by the expanded role of the ECB in recent years, but over the medium term this may not be enough on its own to prevent a new crisis. | High | In the long run, the euro area needs a banking union and some kind of fiscal sharing to be able to ward off speculative market attacks during downturns. Any break-up of the euro area would badly affect the economies of CESEE, due to high levels of trade, investment and financial integration. |
| Significant increase in US tariffs on EU automotive exports | Medium | This is probably a low likelihood before the next US election, but becomes a higher likelihood thereafter if Donald Trump wins (and so we put it at 'medium' for the whole forecast period). US President Donald Trump has made this specific threat on several occasions. | High | This is a key risk for growth in our region during the forecast period. Most economies in our region are very open in terms of exports/GDP, and many deliver inputs into the German supply chain that go direct to the US. Some of the economies of the region (CZ, HU, SK, RO, MK, RS) are especially reliant on the automotive sector. |
| Rule of law and institutional quality deteriorate further in CESEE countries | High | This is already happening to an extent. In recent years, indicators of institutional and governance quality have declined for some CESEE countries, such as Turkey, Poland and Hungary. Governments in these countries look quite well entrenched, and are popular in most cases, meaning that current trends may well continue. For the EU countries, Brussels has so far shown itself largely unable to take any action. | Medium | Governments can get away with it for a while, but as the example of Turkey shows, an undermining of institutional independence can contribute to a crisis. In the case of Poland and Hungary, there are already signs that it has affected domestic private investment. Lower-quality institutions also threaten long-term growth. |
| EU budget is cut and EU-CEE countries receive significantly less money in the new financing period | High | A smaller post-Brexit EU budget is highly likely. Funding priorities may also change, including a linking of future EU funding to certain benchmarks. There is a growing feeling in some Western European capitals that funding should be tied more closely to indicators such as compliance with EU law. | High | EU-CEE countries receive 2-5 percentage points of GDP per year from the EU, so cuts to the budget would be important for them. |
| 'Rings' of EU integration are formalised and most of EU-CEE is left out | Low | Irritation in some Western European capital with parts of EU-CEE has been growing for some time. This is for three main reasons: a lack of 'solidarity' on the sharing of refugees, threats to institutional independence and the rule of law, and corruption in the use of EU funds. Recent French proposals have suggested 'rings' of integration, which could lead to a more formalised 'core' and 'periphery' in the EU. | High | Any formalisation of 'core' and 'periphery' could have important political and economic consequences, particularly if it affects things like Schengen. Many EU-CEE countries could end up in the outer ring. |

ctd.

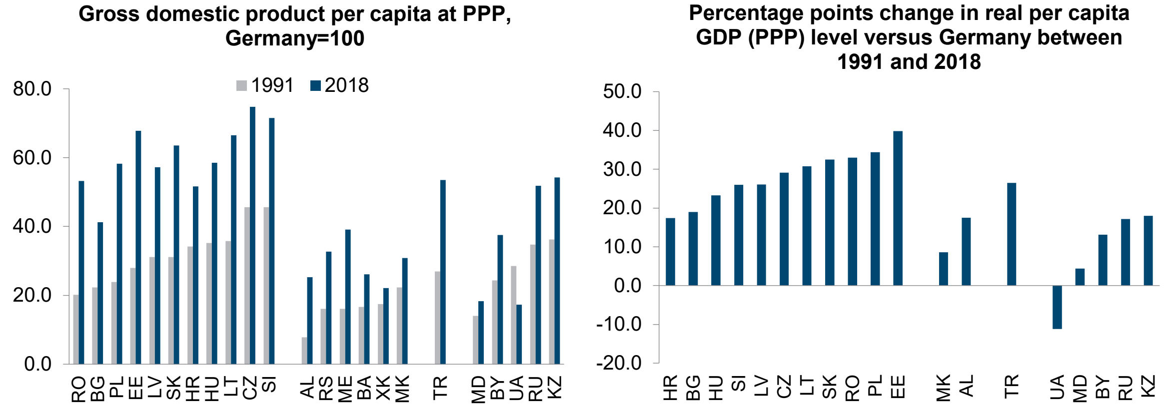
**Table 3.3 / ctd.**

| Risk | Likelihood | | Impact on CESEE | |
|---|---|---|---|---|
| Hard/no-deal Brexit | Low | The likelihood of some kind of deal between the EU-27 and the UK remains quite high. There are major incentives for both sides to avoid a 'hard' Brexit. Moreover, the UK parliament has put in place various measures that make a 'no-deal' Brexit almost impossible. | Medium | The UK and EU-27 economies are heavily intertwined, and London has huge importance for euro area finance. A breakdown of talks and a 'hard' Brexit would likely have quite serious economic and political consequences. The most direct effects would be felt in Western Europe, but the strong linkages between the German economy and CESEE would provide a channel of contagion to our region as well. |
| Emerging markets crisis moves beyond Turkey to affect more countries in the CESEE region | Low | After a decade of ultra-loose monetary policy, levels of global liquidity are at extremely high levels. Investors need yield, and as such there are still lots of dollars and euros willing to finance even high-risk debts in CESEE. In addition, most countries have reduced private debt/GDP since the crisis, including in foreign currency, and generally external vulnerabilities are lower (current account deficits have mostly been cut or have disappeared over the past decade). Turkey seems like a big outlier in our region. | Medium | The impact of the crisis in 2018 on Turkey's currency and bond markets, and then as a follow-through on inflation and the economy, is a big warning sign to the rest of the region. However, the much lower external vulnerability of almost all other CESEE countries provides a lot of insulation. The most exposed are probably those which also tend to borrow in US dollars, specifically Ukraine and Kazakhstan. |
| Collapse in one or more inflated asset markets | Low | Real estate, bond and equity markets across the world, including in much of CESEE, are inflated by historical standards. This reflects a decade of ultra-loose monetary policy. So long as central banks remain in ultra-loose mode (which seems overwhelmingly likely), it is hard to see what will deflate these asset markets. Nevertheless, as 2008-2009 showed, the financial community can be blind to certain risks in the system, which then explode without warning. | High | As the 2008-2009 financial crisis showed, the emergence of stress in the financial system can have wide-ranging effects and can quickly spill over into the real economy. It is true that the role of global central banks has increased markedly since then, which could cushion the impact somewhat, but it is hard to see how a big fall in, for example, house prices would not have a sizeable negative impact on growth. |

# 4. CESEE monitors

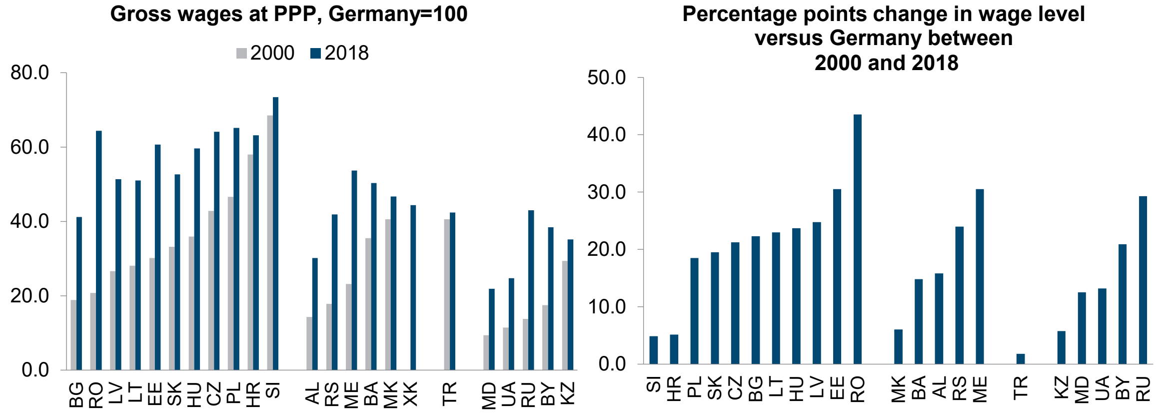
## 4.1. CONVERGENCE MONITOR

### Figure 4.1 / GDP per capita at PPP convergence against Germany




Note: Data 1990 for BA and XK refer to 2000, for ME and RS to 1995.

Source: wiiw Annual Database incorporating national statistics and Eurostat.




Note: Gross wages are based on administrative data. Romanian wages include employers' social security contributions.
Turkey: data 2000 refer to 2003, 2018 wiiw estimate.
Source: wiiw Annual Database incorporating national statistics and Eurostat.

**Table 4.1 / CESEE GDP per capita and gross wages per employee at PPP, 2018**

| | BG | CZ | EE | HR | HU | LT | LV | PL | RO | SI | SK | | EU-CEE11 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GDP per capita | 15,500 | 28,100 | 25,500 | 19,400 | 22,000 | 25,000 | 21,500 | 21,900 | 20,000 | 26,900 | 23,900 | . | 22,000 |
| Gross wages | 13,789 | 21,465 | 20,320 | 21,152 | 19,971 | 17,088 | 17,192 | 21,805 | 21,542 | 24,570 | 17,634 | . | 20,544 |

| | AL | BA | BY | KZ | MD | ME | MK | RS | RU | TR | UA | XK | non-EU12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GDP per capita | 9,500 | 9,800 | 14,100 | 20,400 | 6,900 | 14,700 | 11,600 | 12,300 | 19,500 | 20,100 | 6,500 | 8,300 | 17,300 |
| Gross wages | 10,099 | 16,850 | 12,857 | 11,778 | 7,321 | 17,977 | 15,625 | 14,009 | 14,399 | 14,184 | 8,263 | 14,864 | 13,330 |

Note: Gross wages are based on administrative data. Romanian wages include employers' social security contributions. Turkey 2018 wiiw estimate.
Source: wiiw Annual Database incorporating national statistics and Eurostat.

**Table 4.2 / CESEE GDP per capita and gross wages per employee EUR at ER, 2018**

| | BG | CZ | EE | HR | HU | LT | LV | PL | RO | SI | SK | | EU-CEE11 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GDP per capita | 7,800 | 19,600 | 19,700 | 12,500 | 13,700 | 16,200 | 15,100 | 12,900 | 10,400 | 22,100 | 16,500 | . | 13,400 |
| Gross wages | 6,965 | 14,911 | 15,720 | 13,666 | 12,416 | 11,040 | 12,120 | 12,841 | 11,234 | 20,179 | 12,156 | . | 12,455 |

| | AL | BA | BY | KZ | MD | ME | MK | RS | RU | TR | UA | XK | non-EU12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GDP per capita | 4,500 | 4,900 | 5,300 | 8,300 | 3,600 | 7,500 | 5,200 | 6,100 | 9,600 | 8,000 | 2,600 | 3,700 | 7,800 |
| Gross wages | 4,758 | 8,360 | 4,855 | 4,800 | 3,823 | 9,192 | 6,950 | 6,963 | 7,058 | 5,656 | 3,309 | 6,696 | 6,064 |

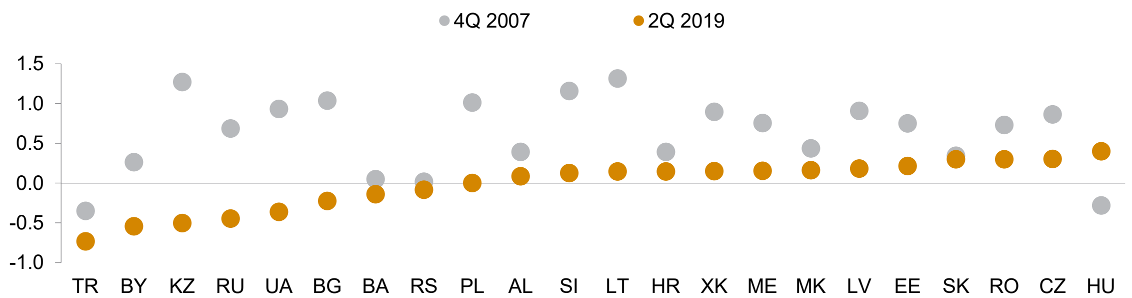
Note: Gross wages are based on administrative data. Romanian wages include employers' social security contributions. Turkey 2018 wiiw estimate.
Source: wiiw Annual Database incorporating national statistics and Eurostat.

## 4.2. BUSINESS CYCLE MONITOR: OVERHEATING STILL VISIBLE IN REGIONAL LABOUR MARKETS

**by Alexandra Bykova**

- For the whole CESEE region the average value of our headline business cycle index dropped slightly, by 0.02 points compared to Spring 2019, dragged down by the recession in Turkey. For the region as a whole, conditions are stable, with no clear signs of under- or overheating relative to the historical period according to the headline index (Figure 4.2).
- In Q2 2019, the business cycle index for nine CESEE economies was below the long-term average, including all countries in the CIS and Ukraine region. For all countries except Hungary, the headline index is below the immediate pre-crisis level, when the region was clearly overheating (see Figure 4.2).
- Hungary, the Czech Republic and Romania had the highest scores for the headline business cycle index in Q2 2019. The highest increases in scores compared with the Spring were observed for Latvia, Croatia and Estonia. Turkey has moved to the bottom of the ranking following a strong decline in the headline score (down by 0.5 relative to Q4 2018 value). Turkey is showing signs of potential underheating for six indicators included in the headline index: real GDP growth, unemployment rate, current account, real exchange rate, private credit and property prices (see Table 4.3). We expect this to change in the coming quarters as the economy recovers.
- Potential labour market overheating persists throughout CESEE, whereas overheating in property prices, real interest rates and external debt now affects less countries than in Spring. We identify potential underheating for fiscal balances in several Visegrád and Western Balkan countries, implying that there is room for fiscal policy to remain expansionary if required to mitigate the deteriorating external environment (see Table 4.3 and Figure 4.3).
- Our Autumn update identifies several country specific risks. In Turkey, bringing high inflation under control is essential for a sustained economic recovery (the most recent data indicate reason for optimism in this regard). Significant real exchange rate appreciation in Ukraine might become challenging for external competitiveness. Negative or zero real interest-rates remain typical for all countries in EU-CEE except Croatia. While property price growth has slightly slowed in Slovenia and Latvia, its acceleration in Hungary is becoming a cause for concern (see Table 4.4).

**Figure 4.2 / Business Cycle Index**




Note: Number of standard deviations from historical mean, average of 11 indicators. Indicators are those in Table 4.3.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

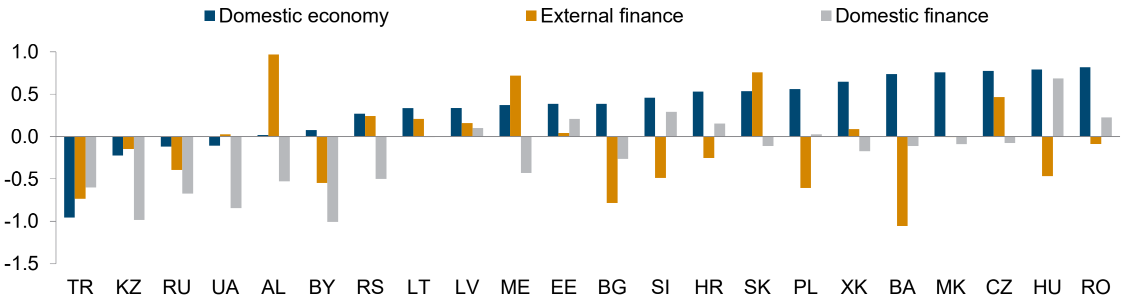
## Table 4.3 / Number of standard deviations from historical mean, 2Q 2019

| | Domestic economy | | | External finance | | | Domestic finance | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Real GDP | Unemployment | CPI | CA | RER | External debt | RIR | Private credit | Broad money | Fiscal balance | Property prices |
| BG | -0.05 | 1.47 | -0.25 | -1.56 | 0.49 | -1.28 | 0.40 | -0.36 | -0.64 | -0.82 | 0.11 |
| CZ | -0.05 | 2.29 | 0.09 | -1.12 | 0.94 | 1.58 | 0.07 | -0.46 | -0.18 | -1.14 | 1.34 |
| EE | 0.12 | 1.23 | -0.18 | -0.85 | 1.43 | -0.44 | 0.93 | -0.39 | -0.37 | 1.04 | -0.16 |
| HR | 0.29 | 1.96 | -0.66 | -0.73 | 0.10 | -0.13 | 0.84 | -0.29 | -0.36 | -1.49 | 2.08 |
| HU | 1.00 | 1.67 | -0.30 | -0.33 | -0.47 | -0.61 | 2.31 | 0.55 | 0.14 | -1.00 | 1.42 |
| LT | -0.08 | 1.17 | -0.08 | -1.16 | 1.21 | 0.58 | 0.78 | -0.41 | -0.24 | -0.42 | 0.24 |
| LV | -0.05 | 1.25 | -0.19 | -0.60 | 0.94 | 0.13 | 0.78 | -0.59 | -0.05 | 0.16 | 0.21 |
| PL | 0.61 | 1.50 | -0.43 | -1.39 | -0.83 | 0.40 | 1.00 | -0.54 | -0.07 | -2.22 | 1.96 |
| RO | 0.11 | 2.81 | -0.47 | -0.19 | 0.02 | -0.09 | 1.29 | -0.45 | -0.83 | 0.31 | 0.80 |
| SI | 0.38 | 1.50 | -0.50 | -1.40 | -0.11 | 0.04 | 1.44 | -0.14 | 0.20 | -1.25 | 1.20 |
| SK | -0.18 | 2.05 | -0.27 | -0.55 | 0.76 | 2.06 | 1.20 | -0.40 | -0.25 | -1.23 | 0.11 |
| AL | -0.60 | 1.51 | -0.86 | -0.59 | 2.52 | 0.97 | 1.47 | -0.83 | -1.31 | -1.45 | |
| BA | -0.01 | 2.46 | -0.23 | -1.11 | -1.75 | -0.31 | 0.82 | -0.38 | -0.40 | -0.50 | |
| ME | 0.36 | 1.37 | -0.62 | 0.03 | 0.79 | 1.33 | 0.64 | -0.35 | -0.68 | -1.33 | |
| MK | 0.23 | 2.41 | -0.37 | -0.84 | -0.53 | 1.36 | 0.83 | -0.51 | -0.28 | -0.05 | -0.45 |
| RS | -0.13 | 1.51 | -0.57 | -0.17 | 0.87 | 0.03 | -0.14 | -0.52 | -0.59 | -1.10 | -0.12 |
| XK | 0.33 | 1.37 | 0.23 | -0.67 | 0.57 | 0.36 | 1.49 | -0.47 | -0.43 | -1.28 | |
| TR | -1.45 | -1.67 | 0.25 | -1.84 | -2.50 | 2.15 | 0.22 | -1.18 | -0.15 | -0.06 | -1.84 |
| BY | -0.80 | 1.69 | -0.67 | -1.22 | -1.22 | 0.80 | -0.51 | -1.17 | -0.91 | -1.44 | |
| KZ | -0.69 | 1.00 | -0.98 | -0.04 | -1.21 | 0.82 | -1.60 | -0.77 | -1.44 | -0.13 | |
| RU | -0.53 | 1.44 | -1.27 | -0.07 | -0.18 | -0.94 | -0.63 | -0.54 | -1.09 | -0.62 | -0.48 |
| UA | 0.12 | -0.08 | -0.36 | 0.45 | -0.81 | 0.43 | -1.45 | -0.65 | -1.05 | -0.23 | |

overheating: > 1 SD above historical average
underheating: > 1 SD below historical average

Notes: Data for unemployment, current account, real interest rate, fiscal balance are inverted (as for these indicators lower values would indicate overheating). Historical mean calculated for 4Q 2000 - 2Q 2019. Calculations are based on four-quarter trailing averages.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

## Figure 4.3 / Sub-components of the Business Cycle Index, 2Q 2019




Note: Number of standard deviations from historical mean, average of indicators in each sub-component. Indicators are those in Table 4.3.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

## Table 4.4 / Over-/under-heating in relation to regional peers, 2Q 2019 (4-q trailing average)

| | Domestic economy | | | External finance | | | Domestic finance | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Real GDP | Unemployment | CPI | CA | RER | External debt | RIR | Private credit | Broad money | Fiscal balance | Property prices |
| | % | % | % yoy | % of GDP | 2015 = 100 | % of GDP | % | % yoy | % yoy | % of GDP | % yoy |
| BG | 3.5 | 4.7 | 3.0 | 7.9 | 99.1 | 59.5 | -2.9 | 6.8 | 9.0 | 1.9 | 6.0 |
| CZ | 2.7 | 2.1 | 2.2 | 0.7 | 107.7 | 79.2 | -0.4 | 6.4 | 5.9 | 0.1 | 9.3 |
| EE | 4.6 | 4.9 | 3.1 | 1.3 | 104.5 | 76.9 | -3.0 | 5.2 | 9.6 | -1.4 | 5.4 |
| HR | 2.9 | 7.4 | 1.2 | -0.3 | 100.6 | 82.7 | 1.8 | 2.5 | 6.4 | -0.6 | 7.3 |
| HU | 5.2 | 3.6 | 3.5 | -1.1 | 98.9 | 79.0 | -2.5 | 10.8 | 9.7 | -2.0 | 14.9 |
| LT | 3.8 | 6.1 | 2.3 | 1.9 | 103.4 | 74.9 | -2.2 | 4.9 | 10.4 | -1.2 | 7.1 |
| LV | 3.7 | 6.8 | 3.0 | -1.1 | 102.4 | 119.6 | -2.9 | -4.7 | 13.7 | -2.5 | 8.4 |
| PL | 4.8 | 3.7 | 1.5 | -0.4 | 96.2 | 61.4 | 0.0 | 6.3 | 9.1 | 0.1 | 7.6 |
| RO | 4.4 | 4.0 | 4.0 | -4.8 | 95.9 | 47.9 | -1.5 | 7.2 | 9.0 | -3.8 | 4.0 |
| SI | 3.6 | 4.6 | 1.8 | 5.3 | 99.4 | 90.9 | -1.8 | 3.4 | 8.2 | 0.5 | 8.3 |
| SK | 3.5 | 6.0 | 2.5 | -2.4 | 100.0 | 109.7 | -2.4 | 8.8 | 6.3 | -0.8 | 6.3 |
| AL | 3.1 | 12.0 | 1.7 | -7.7 | 113.7 | 62.5 | -0.7 | -1.1 | 1.7 | -1.8 | |
| BA | 3.0 | 17.5 | 1.3 | -4.5 | 96.5 | 24.3 | -1.3 | 5.8 | 9.2 | 1.1 | |
| ME | 4.0 | 14.9 | 1.4 | -21.0 | 100.3 | 56.9 | 4.3 | 8.6 | 0.7 | 2.0 | |
| MK | 3.4 | 18.9 | 1.3 | -1.0 | 98.7 | 74.1 | 1.2 | 8.0 | 11.4 | -2.1 | -1.0 |
| RS | 3.3 | 11.7 | 2.3 | -6.4 | 104.9 | 61.7 | 0.7 | 8.7 | 12.2 | 0.3 | 9.4 |
| XK | 4.7 | 28.6 | 2.5 | -6.6 | 99.8 | 29.9 | 3.9 | 11.1 | 7.5 | 2.8 | |
| TR | -1.1 | 12.7 | 19.9 | 0.1 | 68.4 | 59.3 | 3.4 | 12.1 | 23.0 | -3.0 | 4.7 |
| BY | 1.3 | 4.6 | 5.5 | -0.5 | 89.2 | 60.5 | 4.3 | 11.9 | 11.5 | 3.2 | |
| KZ | 4.0 | 4.8 | 5.5 | -0.8 | 71.7 | 89.5 | 3.5 | -0.3 | 1.0 | -1.1 | |
| RU | 1.6 | 4.7 | 4.3 | 6.7 | 100.2 | 28.2 | 3.1 | 12.9 | 10.0 | 4.0 | 5.1 |
| UA | 3.4 | 8.6 | 9.2 | -3.0 | 111.9 | 80.6 | 8.0 | 5.3 | 7.6 | -1.3 | |

potential overheating/instability relative to regional peers — underheating/stability relative to regional peers

Notes: CPI: consumer price index, CA: current account, RER: real exchange rate (EUR) CPI deflated; values more than 100 means appreciation and vice versa; RIR: real interest rate CPI deflated.
For all indicators higher values indicate overheating, except unemployment, current account, real interest rate, and fiscal balance.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

## 4.3. CREDIT MONITOR: HOUSEHOLD DEMAND REMAINS STRONG

**by Olga Pindyuk**

› In the first half of 2019, loans to households increased in all CESEE countries except Latvia and Turkey. In the former, deleveraging has been going on already for 10 years, while the latter has found itself on the brink of a crisis (see Turkey report).

› The market has started to cool slightly compared with December 2018 in many countries, in particular in Belarus, Serbia, Bulgaria and Montenegro. However, despite the slower credit growth in Belarus, we identify this market as still the most vulnerable to potential overheating. In Kazakhstan and Russia we also assess the likelihood of credit bubbles forming as fairly high. In both these countries, credit growth has continued to expand, driven by consumer lending.

› In most of CESEE, loans to non-financial corporations continued to grow in H1 2019, albeit at a much slower pace than household loans. In the Baltic States, Kazakhstan and Ukraine, the stock of corporate loans declined. Hungary maintained double-digit growth of loans to non-financial corporations, as banks benefitted from fiscal stimulus and access to cheap sources of financing. The Western Balkans posted the fastest rate of corporate loan growth in CESEE despite rising real interest rates.

› Montenegro undertook the strongest monetary tightening in real terms in H1 2019, with the real interest rate increasing by 1.7 p.p. compared with December 2018. In EU-CEE, real interest rates remained negative and further declined. Latvia has the lowest real interest rate in the CESEE region and yet a decreasing stock of loans. Slovakia saw the biggest decrease in the real interest rate in H1 2019, and joined countries prone to the highest risks of potential overheating due to negative real interest rates – the Baltic States, Bulgaria, and Hungary.

› The share of non-performing loans has continued to trend downwards in most countries of EU-CEE and the Western Balkans. However, asset quality worsened in all CIS countries in our sample, most significantly in Kazakhstan (by 2 p.p. compared with December 2018).

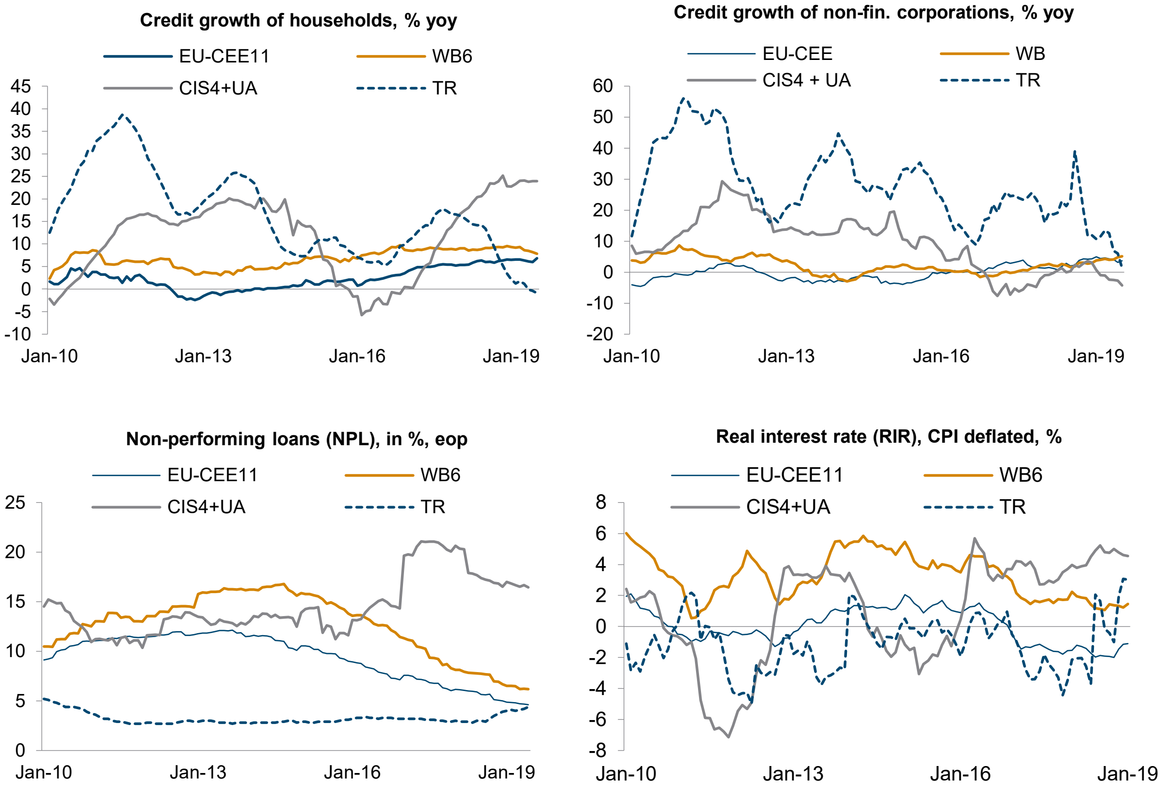
**Table 4.5 / Indicators of financial sector developments, June 2019**

| | AL | BA | BG | BY | CZ | EE | HR | HU | KZ | LT | LV | ME | MK | PL | RO | RS | RU | SI | SK | TR | UA | XK |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Loans to non-fin.corp., % yoy | 2.6 | 4.6 | 4.6 | 8.1 | 3.5 | 4.7 | -2.5 | 14.6 | -11.6 | -3.1 | -2.5 | 1.7 | 6.4 | 4.0 | 6.4 | 8.7 | 6.5 | 0.0 | 4.9 | 6.1 | -3.0 | 10.6 |
| Loans to households, % yoy | 5.5 | 7.4 | 8.1 | 23.7 | 6.7 | 6.6 | 6.1 | 7.6 | 20.7 | 8.0 | -4.6 | 8.9 | 9.9 | 6.0 | 6.9 | 9.2 | 22.8 | 6.1 | 8.5 | -0.4 | 13.5 | 10.4 |
| Real interest rate, CPI defl., % | -0.3 | -0.4 | -2.3 | 4.1 | -0.4 | -2.5 | 2.5 | -2.4 | 3.4 | -2.3 | -3.0 | 5.7 | 1.9 | -0.8 | -1.4 | 1.4 | 2.7 | -1.8 | -2.6 | 7.2 | 7.8 | 3.3 |
| Non-perf. loans (NPL), in %, eop | 11.2 | 8.0 | 7.2 | 5.8 | 2.8 | 0.5 | 9.2 | 4.9 | 9.4 | 2.1 | 5.4 | 4.8 | 5.4 | 6.8 | 4.7 | 5.2 | 5.7 | 4.3 | 2.9 | 4.4 | 50.8 | 2.5 |

potential overheating/instability relative to regional peers — underheating/stability relative to regional peers

Note: The deeper the orange shading, the greater the potential instability/overheating relative to regional peers; the deeper the grey shading, the greater the stability/under-heating.
Source: wiiw Monthly Database incorporating national statistics.

**Figure 4.4 / Indicators of financial sector developments over time**




Note: Simple averages for country aggregates.
Source: wiiw Monthly Database incorporating national statistics.

## 4.4. FDI MONITOR: INFLOWS TO EU-CEE STAGNATE, CATCH-UP IN THE WESTERN BALKANS, DECLINE IN RUSSIA

**by Gábor Hunya**

› Total global FDI inflows fell by 13% in 2018 against the previous year,[19] mainly due to repatriation of accumulated US overseas earnings (negative inflows in Ireland, Switzerland, and a few other countries). This had no visible effect on FDI in CESEE.

› FDI inflows into CESEE fell by around 17% in 2017 (revised data[20]), and by another 13% in 2018. The decline was mainly on account of Russia, where inflows halved in 2018 (Table 4.6). Russia is becoming more and more inward looking, due to the exchange of sanctions with the West and (related) import-substitution policies.

› EU-CEE received about the same amount of FDI in 2018 as in the previous two years. Investments throughout the region were stimulated by robust growth of demand for goods and services, both internally and externally, and also by labour shortages necessitating labour-saving investments. But the main difference compared with 2017 was that inflows in Poland recovered (Figure 4.5).

› FDI inflows were on the whole stable in the other main manufacturing hubs beyond Poland, namely the Czech Republic, Hungary and Romania while they declined in Slovakia. Most of the investments were financed by reinvested earnings in existing foreign subsidiaries, increasing labour productivity. Production sites were closed down only in exceptional cases, mainly in labour-intensive clothing, shoemaking and automotive component production.

› The automotive industry in EU-CEE is not affected by the slowdown in Western Europe yet, as investors initiate technological change to cope with new challenges. Volkswagen and Peugeot have, for example, started assembling e-cars in Slovakia, while four large battery producing factories are under construction or in preparation in Hungary alone.

› The Western Balkans received 28% more FDI in 2018, continuing the upward trend for the third consecutive year. Serbia and North Macedonia have been the main hosts of new projects in industry and export-oriented services. FDI inflows into Turkey recovered in 2018, but the recent postponement of a new VW investment project on account of political instability signals investor perceptions of heightened risks related to political developments.

› Small open economies in EU-CEE and the Western Balkans have been the top receivers of FDI in per capita terms, with Estonia receiving the most even if less than in the previous year (Figure 4.5). Some CIS countries and other large economies such as Russia and Ukraine have generally attracted the least investment relative to their size. As of 2018, the stock of inward FDI in relation to GDP was highest in Montenegro, Kazakhstan and Estonia. The largest increases compared with 2010 took place in Kazakhstan, Serbia and Albania (Figure 4.6), while Turkey and Belarus continued having the lowest exposure to FDI.

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19 In nominal USD terms; UNCTAD World Investment Report 2019.

20 2017 and 2018 data have been revised compared with the *wiiw FDI Report 2019* published in June

› The future may bring less investment into EU-CEE as a consequence of the German slowdown and possible US duties on car imports. The Western Balkans may get some more projects in mining and energy. Future FDI in the CIS is less dependent on global developments, and more on policy measures to make these markets more attractive for foreign investors.

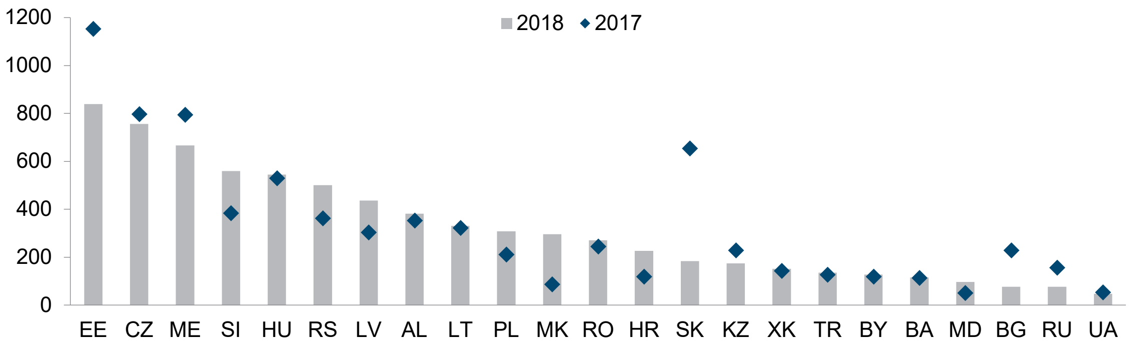
### Table 4.6 / FDI inflow

EUR mn

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|
| EU-CEE11 | 23,564 | 25,603 | 30,255 | 13,447 | 26,428 | 25,412 | 37,509 | 37,384 | 36,943 |
| WB6 | 3,473 | 5,675 | 2,806 | 3,577 | 3,487 | 4,450 | 4,198 | 4,896 | 6,289 |
| TR | 6,861 | 11,576 | 10,341 | 10,212 | 10,039 | 17,372 | 12,603 | 10,220 | 11,009 |
| CIS3+UA | 14,790 | 18,250 | 18,210 | 13,024 | 8,374 | 8,063 | 11,858 | 7,710 | 6,644 |
| RU | 23,875 | 26,476 | 23,483 | 40,196 | 22,037 | 10,664 | 33,568 | 22,990 | 11,222 |
| CESEE23 | 72,563 | 87,580 | 85,095 | 80,456 | 70,365 | 65,960 | 99,737 | 83,200 | 72,107 |

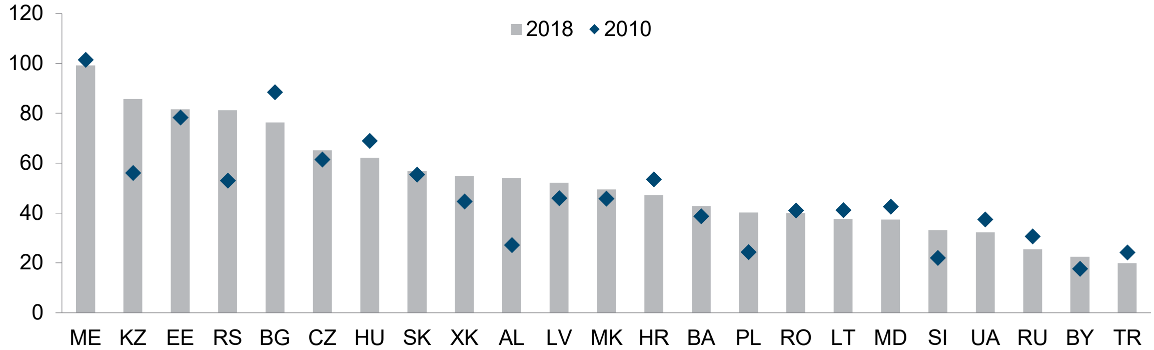
Note: Data are based on Direct Investment Statistics (directional principle) excluding Special Purpose Entities (SPEs).
Source: wiiw FDI Database incorporating national bank statistics.

### Figure 4.5 / FDI inflow per capita, 2017 and 2018, EUR




Note: Data are based on Direct Investment Statistics (directional principle) excluding Special Purpose Entities (SPEs).
Source: wiiw FDI Database incorporating national bank statistics

### Figure 4.6 / FDI inward stock in % of GDP, 2010 and 2018




Note: Data are based on Direct Investment Statistics (directional principle) excluding Special Purpose Entities (SPEs).
Source: wiiw FDI Database incorporating national bank statistics.

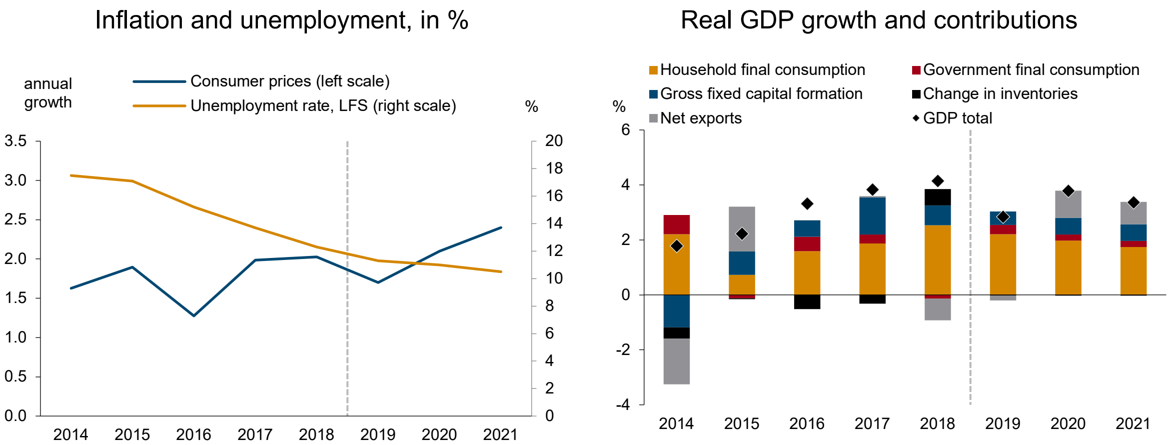
# 5. Country reports


# ALBANIA: Growth will remain below potential

ISILDA MARA

**Growth has been held back by uneven energy supply. Although it will pick up in the next two years, it will remain below its potential. Private and government consumption will continue to support growth, the former underpinned by positive labour market trends, while investment will remain subdued. Outward migration of the young and highly skilled remains a drag on growth potential. Further delays to the start of EU accession negotiations create the risk of backsliding on reforms.**

**Figure 5.1 / Albania: Main macroeconomic indicators**




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

**The European Council last met on October 17-18th, 2019, to take a decision - among others – about starting membership talks with Albania and North Macedonia.** The German parliament voted in support of opening the accession talks with Albania under the conditionality that reforms in the judicial system, the building of institutions – e.g. the Special Anti-corruption Prosecution office (SPAK) - and reforming of electoral law should be implemented by the date negotiations start. The position of France and the Netherlands is a standoff and for the most part, France is pressing into the direction that EU enlargement criteria should be reformed ahead of any other country joining in. Certainly, the opening of accession talks is vital for Albania. The country would benefit by moving forward a number of reforms already launched with the support of the EU as well as by getting access to EU transfers. However, a protracted EU enlargement process - in the foreseeable future - might create downside risks for the ongoing reforms.

**Growth lost vigour and will remain moderate over growing downside risks.** For the first half of 2019, y-o-y, the economy grew by 2.4% thanks to the positive contribution of sectors such as trade, real estate activity and agriculture. Otherwise industry, electricity production and water supply, as well as recreation services, were a drag on growth. In particular, the performance of industry has been in sharp contrast to the previous year, mostly because of the drought which affected electricity production in hydro power stations. Over the last decade the exposure of the economy to extensive drought periods and frequent floods has soared. Droughts have hampered electricity production (the bulk of it coming from hydropower stations) and strengthened the dependence on electricity imports. In the future, these shocks might continue to affect GDP growth, given the importance of this sector for the economy.

**Private and government consumption will continue to support growth.** Private and government consumption increased more than GDP for the first half of 2019, y-o-y. Domestic aggregate demand will continue to be supportive to growth. Signals from the labour market are positive. The pool of employees enlarged by 3.4 % - more than 42,000 new entries have been recorded for Q2.2019, y-o-y. Half of these jobs went to the young age group 15-29, mainly women and those with a tertiary level of education. The unemployment rate sank by 1.1 pp y-o-y, down to 11.5% for Q2/2019. Real gross monthly wages rose above 3% for Q2/2019, y-o-y, and remittances have been on a continuous rise. For some sectors - information and communication as well as trade - nominal wages soared by 11% for Q2/2019, y-o-y. A hike of 8.3% was applied to the minimum wage starting from January 2019. Certainly, rising nominal wages have been driven by tightening labour markets, as outward migration continues to be high (165,000 Albanians, or 6 % of the current population, emigrated over the last decade).

**Credit growth revived and monetary policy will continue to stay loose**. Overall, credit to private non-financial corporations increased by 3.4% until August 2019, y-o-y and the Central Bank kept the key interest rate at 1%. Demand for credit regained momentum thanks to small and medium size enterprises – mainly operating in industry, but also in tourism – whose demand for loans grew respectively by 15% and 11% until August 2019, y-o-y. Credit to households also rose by 5% over the same period. Non-performing loans continued their downward trajectory falling by 2 pp. y-o-y down to 11.2% in July 2019. Importantly, 60% of loans are in foreign currency - predominantly in EUR - hinting that the euroisation of the economy persists in being high, despite the Central Bank announcing a number of measures aiming at de-euroisation.

**Fiscal consolidation might be at risk.** General government budget performance has been below expectations; capital expenditures have been in decline while overall expenditures have been rising and exceeded budget revenues in January – August 2019. As such, fiscal consolidation might stall as long as the general government budget deficit rises.

**Net exports contribution to growth has been positive thanks to an upsurge in services exports which contrasted with falling goods exports.** The tourism sector continued being buoyant and exports of services expanded close to 10% for the first half of 2019, y-o-y. On the contrary, goods exports weakened by 9% over the same period. Further appreciation of domestic currency has negatively affected exports of goods – e.g. LEK appreciated against EUR by 2.2% for January – September 2019, adding to 8.2% appreciation in 2018. Until August 2019, y-o-y, goods exports fell for all groups – both in nominal and real terms – except for agriculture and chemical products. Exports of goods falling into the group of minerals, fuels and electricity suffered the most, while imports in this category hiked owing to protracted drought periods.

**Foreign direct investments kept the upward trend, although overall investments will remain subdued.** FDI inflows for the first half of 2019 soared by 10%, y-o-y. Close to 37% of FDI inflow was thanks to the Trans-Adriatic Pipeline (TAP) and the Norvegian Statkraft investment on Devoll Hydropowers. Since these projects are approaching the final construction phase - in 2019 - their contribution to FDI inflows will be significantly reduced. Meanwhile, over the same period, FDI inflow to the extraction industry rose by 67% meaning that 19% of FDI inflow was absorbed by this sector. Countries such as Italy and Austria more than doubled their FDI inflows to Albania for the first half of 2019 y-o-y and contributed by 10% each. Positive signalling comes also from Shell Upstream operating in Albania. After the clamorous announcement last May 2019 about the discovery of onshore extensive oil reserves, the company is progressing with further appraisal drillings. Bankers' petroleum - owned by Chinese Geo-Jade Petroleum Corporation – owing to favourable heavy oil commodity markets - announced a rise in production of 18% and plans to invest up to $255 million by the end of 2019.

**High potential for renewable resources to fix unstable energy supply, but the progress is slow.** Solar power plants could be a niche sector for Albania because of its high exposure to sunny days. Still, such projects are progressing slowly. In November 2018 the first bid for solar power plant building was awarded to India Power Corporation Ltd Consortium - a conglomerate owned by Kanoria Foundation, a trust entity with headquarters in Kolkata, India. The construction phase is 18 months; still information about its progress is scarce. TAP is approaching the end of its construction phase. By 2020 it will start to deliver gas from Azerbaijan to the EU. Therefore, Albania, and other Western Balkan (WB) countries – e.g. Montenegro, Croatia, Bosnia and Herzegovina – have made joint efforts to get access to TAP through Ionian Adriatic Pipeline (IAP). The latter will be integrated to TAP along the pipeline crossing Albania and will enable the delivery of gas from Azerbaijan to WB. Widening of energy sources will certainly reduce the dependence on hydro energy production and electricity imports, especially for Albania.

**In a nutshell, along the forecasting period, growth is expected to be moderate and below potential, owing also to an unsteady energy supply.** The main drivers of growth will continue to be consumption, tourism and, to a lesser extent, investment in infrastructure projects. Our forecasts will be revised downwards for 2019 – to close to 2.8%. By 2020 growth will accelerate to 3.7%.

## Table 5.1 / Albania: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 January-June | 2019 January-June | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 2,881 | 2,876 | 2,873 | 2,866 | . | . | 2,870 | 2,865 | 2,865 |
| Gross domestic product, ALL bn, nom. | 1,434 | 1,472 | 1,551 | 1,631 | 804 | 825 | 1,700 | 1,800 | 1,900 |
| annual change in % (real) | 2.2 | 3.3 | 3.8 | 4.1 | 4.3 | 2.3 | 2.8 | 3.8 | 3.4 |
| GDP/capita (EUR at PPP) | 8,800 | 8,600 | 9,100 | 9,500 | . | . | . | . | . |
| Consumption of households, ALL bn, nom. | 1,147 | 1,180 | 1,226 | 1,287 | 652 | 680 | . | . | . |
| annual change in % (real) | 0.9 | 2.0 | 2.3 | 3.2 | 3.2 | 2.7 | 2.8 | 2.5 | 2.2 |
| Gross fixed capital form., ALL bn, nom. | 350 | 359 | 381 | 394 | 173 | 175 | . | . | . |
| annual change in % (real) | 3.5 | 2.4 | 5.5 | 2.9 | 2.4 | 0.3 | 2.0 | 2.5 | 2.5 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | -2.1 | -18.0 | -0.6 | 18.5 | 25.4 | -9.1 | -2.0 | 3.0 | 4.0 |
| Gross agricultural production 2) | | | | | | | | | |
| annual change in % (real) | 2.6 | 3.3 | 4.0 | 5.0 | . | . | . | . | . |
| Construction output total | | | | | | | | | |
| annual change in % (real) | 19.4 | 5.1 | 19.6 | 5.6 | 0.8 | 0.9 | . | . | . |
| Employed persons, LFS, th | 1,087 | 1,157 | 1,195 | 1,231 | 1,227 | 1,257 | 1,275 | 1,280 | 1,290 |
| annual change in % | 4.8 | 6.5 | 3.3 | 3.0 | 4.1 | 2.4 | 3.6 | 0.4 | 0.8 |
| Unemployed persons, LFS, th | 224 | 208 | 190 | 173 | 174 | 168 | 160 | 160 | 150 |
| Unemployment rate, LFS, in % | 17.1 | 15.2 | 13.7 | 12.3 | 12.5 | 11.8 | 11.3 | 11.0 | 10.5 |
| Reg. unemployment rate, in %, eop | 12.9 | 8.8 | 7.2 | 5.4 | 6.9 | 6.0 | . | . | . |
| Average monthly gross wages, ALL | 47,900 | 47,522 | 48,967 | 50,589 | 49,769 | 52,088 | 53,800 | 56,600 | 59,100 |
| annual change in % (real, gross) | 3.2 | -2.0 | 1.0 | 1.3 | 1.3 | 3.1 | 4.5 | 3.0 | 2.0 |
| Consumer prices, % p.a. | 1.9 | 1.3 | 2.0 | 2.0 | 2.1 | 1.5 | 1.7 | 2.1 | 2.4 |
| Producer prices in industry, % p.a. | -2.1 | -1.4 | 2.6 | 1.7 | 1.7 | -0.3 | -0.2 | 0.5 | -0.2 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 26.4 | 27.6 | 27.7 | 27.6 | 27.0 | 27 | 27.6 | 28.0 | 28.0 |
| Expenditures | 30.5 | 29.5 | 29.7 | 29.2 | 26.8 | 27.8 | 29.5 | 29.5 | 29.5 |
| Deficit (-) / surplus (+) | -4.1 | -1.8 | -2.0 | -1.6 | 0.2 | -0.4 | -1.9 | -1.5 | -1.5 |
| General gov.gross debt, nat.def., % of GDP | 72.7 | 72.4 | 70.1 | 67.9 | 66.0 | 65.0 | 67.5 | 67.0 | 66.0 |
| Stock of loans of non-fin.private sector, % p.a. | -2.6 | 0.2 | 0.7 | -3.6 | -2.4 | 3.6 | . | . | . |
| Non-performing loans (NPL), in %, eop | 18.2 | 18.3 | 13.2 | 11.1 | 13.3 | 11.2 | . | . | . |
| Central bank policy rate, % p.a., eop 3) | 1.75 | 1.25 | 1.25 | 1.00 | 1.0 | 1.0 | 1.0 | 1.0 | 1.3 |
| Current account, EUR mn | -884 | -812 | -866 | -861 | -347 | -517 | -1,010 | -970 | -940 |
| Current account, % of GDP | -8.6 | -7.6 | -7.5 | -6.7 | -5.6 | -7.8 | -7.3 | -6.6 | -6.1 |
| Exports of goods, BOP, EUR mn | 771 | 714 | 797 | 986 | 496 | 452 | 870 | 930 | 970 |
| annual change in % | -17.2 | -7.4 | 11.7 | 23.7 | 24.7 | -9.0 | -12.0 | 7.0 | 4.2 |
| Imports of goods, BOP, EUR mn | 3,070 | 3,317 | 3,621 | 3,857 | 1,795 | 1,928 | 3,990 | 4,110 | 4,170 |
| annual change in % | -2.5 | 8.0 | 9.2 | 6.5 | 6.8 | 7.4 | 3.5 | 3.0 | 1.5 |
| Exports of services, BOP, EUR mn | 2,028 | 2,396 | 2,856 | 3,073 | 1,370 | 1,492 | 3,260 | 3,460 | 3,590 |
| annual change in % | 7.8 | 18.1 | 19.2 | 7.6 | 7.9 | 8.9 | 6.0 | 6.0 | 3.8 |
| Imports of services, BOP, EUR mn | 1,503 | 1,599 | 1,774 | 1,962 | 856 | 938 | 2,080 | 2,120 | 2,140 |
| annual change in % | -3.5 | 6.4 | 11.0 | 10.6 | 9.0 | 9.6 | 6.0 | 2.0 | 1.0 |
| FDI liabilities, EUR mn | 890 | 943 | 900 | 1,020 | 486 | 535 | 700 | . | . |
| FDI assets, EUR mn | 72 | 6 | -94 | -3 | -22 | 23 | -50 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 2,831 | 2,889 | 2,941 | 3,342 | 2,904 | 3,215 | . | . | . |
| Gross external debt, EUR mn | 7,634 | 7,882 | 7,949 | 8,353 | 8,113 | 8,339 | 8,300 | 8,200 | 8,700 |
| Gross external debt, % of GDP | 74.4 | 73.5 | 68.7 | 65.3 | 63.5 | 60.6 | 60.0 | 56.0 | 56.0 |
| Average exchange rate ALL/EUR | 139.74 | 137.36 | 134.15 | 127.59 | 129.96 | 123.88 | 123.5 | 122.5 | 122.5 |

1) Preliminary. - 2) Based on UN-FAO data, wiiw estimate from 2017. - 3) One-week repo rate.

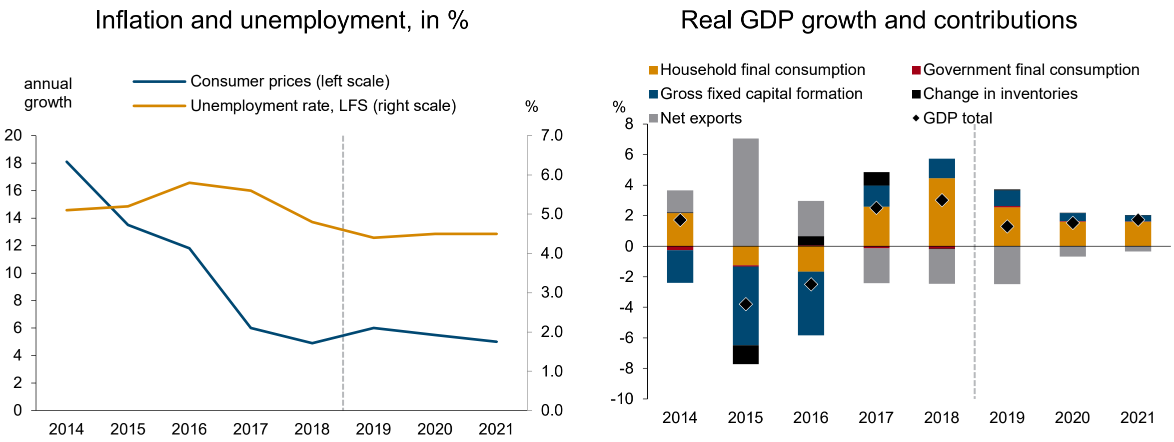
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.


# BELARUS: Economic sluggishness likely to persist

RUMEN DOBRINSKY

**The Belarusian economy has weakened owing to disruption in gas and oil supplies from Russia. Economic performance in the first half of 2019 was only supported by domestic demand while exports and manufacturing output dropped. The combination of a negative external environment and policy restraint are expected to dominate in the near future as well. The short-term prospects for Belarus have deteriorated and we expect GDP growth to be around 1% in 2019 and slightly higher in the next two years.**

**Figure 5.2 / Belarus: Main macroeconomic indicators**




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

**In 2019, Belarus did not manage to embark on a path of steady recovery.** After a meagre 1.3% year on year GDP rise in the first quarter, economic activity actually slowed down with GDP growing by just 0.5% in the second trimester. Such sluggish economic performance – which was below the prevailing ex ante expectations – was due to a combination of negative external factors and a tight macroeconomic policy stance.

**The Belarusian economy was weakened by the disruption in gas supplies from Russia that started in 2018 due to trade disputes which remain unsettled.** Belarus suffered another blow in the spring of 2019 due to the contamination of Russian oil delivered through the Druzhba pipeline which caused a temporary halt of deliveries to Belarus and transit through the country. Given the high share of oil processing in Belarusian manufacturing and exports, this had serious economic repercussions. Weaker import demand for Russia – Belarus's main trading partner – also added adverse effects. As a result, real exports of goods and services (national accounts data) dropped by 3.3% in the first half of the year from the same period of 2018. In current US dollar terms, the exports of goods and services in the first semester were 3.5% below their level of the same period of 2018 while imports were 0.8% down. In statistical terms, net exports made a large negative contribution to GDP growth in this period.

**The manufacturing industry was worst affected by these developments**. In the first quarter of the year gross industrial output grew by just 0.9% year on year and in the second trimester it actually dropped by 0.6% from the same period of 2018. A modest output recovery started in July after normal oil deliveries from Russia resumed along the pipeline, but the damage already caused will affect the outcome for the year as a whole. Other economic sectors were also negatively affected by the disruptions. At the sectoral level, only agriculture fared better with gross agricultural output increasing by 2.8% year on year in January-August thanks to a relatively good harvest.

**On the demand side, economic performance in 2019 was only supported by domestic demand**. Some targeted policy measures supported domestic demand in an attempt to partly offset the negative adverse external shock. In particular, the government continued the policy of raising wage incomes which has been pursued since 2017. In the first half of 2019, average real wages increased by 8.1% from the same period of 2018 while average real disposal income rose by 7%. Thanks to this, private consumption remained relatively strong in 2019: in the first half of the year it grew by 5.9% year on year while real retail sales in January-July grew by 5.2% from the same period of 2018. Gross fixed capital formation was also in positive territory growing by 5.0% year on year in the first semester, partly thanks to the implementation of some public investment projects.

**As regards the labour market, not much change is observable at the macro level**. However, this may be misleading as there is significant churn in the labour market resulting from the ongoing process of the restructuring of large state-owned industrial companies. In the period 2011-2018, the number of employed in industry dropped by 205600 persons, i.e. by 19%. One part of those laid off found employment in the private sector (mostly in services), another part reportedly dropped out of the labour market (i.e. is now registered as ‘inactive’) and only a small portion joined the pool of unemployed. Such labour market dynamics explains the somewhat paradoxical combination of simultaneously declining levels of employment and unemployment as observed in that period. At the same time, recent statistics indicate growing labour shortages: in September the Belarusian Employment Agency reported a record large number of vacancies, 98000. The shortages were most acute in professional occupations such as medical doctors, nurses, drivers, construction workers and cleaners.

**The consolidated general government balance in the first half of 2019 was in large surplus**. This is not something new; the surplus has been on the rise since 2017. Such surpluses suggest a rather tight fiscal policy stance, an assertion that may seem self-contradictory given the proactive fiscal moves mentioned above. In fact, the coexistence of these two features reflects a major restructuring of public expenditure that has been taking place during the last several years. This effort includes two main components: i) gradual reduction of the scale and scope of direct public intervention in the economy involving public finances (such as various forms of subsidies and directed credit); and ii) a strategy of gradual reduction of public debt which in most cases requires the generation of fiscal surpluses. In the case of Belarus, the latter has been coupled with a policy of setting aside a large chunk of dollar denominated hydrocarbons-related fiscal revenue for the servicing of the public debt, most of which is also denominated in foreign currency. This allows the authorities to service the debt without intervening in the forex market. As to the first component of the fiscal restructuring, it has de facto released public funds that could be redirected for preserving the normal levels of financing of other public expenditure items. Presumably, this even allows for a proactive stance in public investment and income policy in the presence of an overall surplus.

**The recent loosening of incomes policy was the one exception within the generally tight macroeconomic policy stance**. Such a loosening takes place through the wage channel: wage rises in the public sector (which is relatively large) initiated by the government are then followed by proportionate increases in other remunerations. In 2019 this translated into rising consumer demand and cost-push inflationary pressure and caused a certain reversal in the process of disinflation that had prevailed in the previous years. Thus the inflation rate for the year as a whole will likely miss the central bank target of 5% (December over December) and is expected to be by some one percentage point higher than that in 2018.

**In 2019, the National Bank of Belarus continued its policy of monetary restraint**. Recently it reconfirmed its commitment to pursue a policy of further disinflation in the country with a target inflation rate of 5% in 2020 and 4% in 2021 and thereafter. The tight monetary stance has been the main anchor for stabilising the exchange rate which, in turn, supported disinflation and macroeconomic stability. However, the overall macroeconomic policy tightness was another deterrent to economic activity in Belarus and added to the negative external factors.

**On the other hand, these policies allowed the central bank to considerably increase its foreign exchange reserves which reached USD 6.84 billion at the end of August.** This, combined with the sizeable fiscal surplus, creates a comfortable cushion for servicing the external debt, most of which is owned by the government. The combination of policies described above made it possible to reduce public external debt by BYN 1.8 billion, i.e by 1.8%, between January and August.

**Economic relations with Russia remain tense due to the ongoing trade disputes**. The most important among them are the disagreement on the price of Russian gas supplies and the implications of the Russian energy tax reform. The so-called Russian 'tax manoeuvre' resulted in a change in the redistribution of import and export duties within the Eurasian Economic Union which results in lower revenue for Belarus. According to local estimates, in 2019 Belarus is expected to lose some USD 400 million directly as a result of this 'tax manoeuvre'. In 2018 and 2019, Belarus benefited from a 2-year transitional customs agreement with Russia according to which Belarus could withhold a portion of the oil export duty revenue for oil transported through Belarus as a cushion for increased gas prices. This agreement generated some USD 500 million annually for the Belarusian budget; however, it is due to be phased out at the end of 2019.

**For months, Belarus has been trying to agree with Russia some new forms of compensation for the 'tax manoeuvre' and the end of the transitional customs agreement**. However, several rounds of negotiations, including at the highest level, did not produce results satisfactory for Belarus. So at this point in time, these changes in the trade relations with Russia can be considered to have the effect of a lasting negative external shock.

**In recent months, the downside risks have increased and the short-term economic prospects have deteriorated further.** In the most likely combination of a negative external environment and continued policy restraint, only domestic demand will be providing an impetus to economic activity. In these circumstances, GDP growth in 2019 can be expected to be around 1% or a little higher. If some of the above restraints are relaxed, growth could accelerate slightly in 2020 and 2021. Sustaining macroeconomic stability seems to have become a lasting policy priority for the Belarusian authorities. Therefore, after a temporary reversal in 2019, disinflation in the country should continue in the next years. Belarus has been managing its external debt rather skilfully and its servicing should not pose problems in the foreseeable future.

## Table 5.2 / Belarus: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 January-June | 2019 January-June | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 9,490 | 9,502 | 9,498 | 9,484 | . | . | 9,470 | 9,450 | 9,430 |
| Gross domestic product, BYN mn, nom. | 89,910 | 94,949 | 105,748 | 121,568 | 55,910 | 60,765 | 130,500 | 139,800 | 149,300 |
| annual change in % (real) | -3.8 | -2.5 | 2.5 | 3.0 | 4.5 | 0.9 | 1.3 | 1.5 | 1.7 |
| GDP/capita (EUR at PPP) | 13,800 | 13,200 | 13,400 | 14,100 | . | . | . | . | . |
| Consumption of households, BYN mn, nom. | 47,006 | 51,122 | 56,843 | 64,684 | 30,600 | 34,314 | . | . | . |
| annual change in % (real) | -2.4 | -3.2 | 4.8 | 8.3 | 9.7 | 5.9 | 4.8 | 3.0 | 3.0 |
| Gross fixed capital form., BYN mn, nom. | 25,763 | 24,155 | 27,662 | 31,461 | 12,780 | 14,739 | . | . | . |
| annual change in % (real) | -15.5 | -14.5 | 5.5 | 4.9 | 11.5 | 5.0 | 4.0 | 2.0 | 1.5 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | -6.6 | -0.4 | 6.1 | 5.7 | 7.8 | 0.1 | 1.5 | 1.5 | 1.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -2.5 | 3.3 | 4.2 | -3.3 | 2.2 | 0.5 | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | -11.3 | -14.8 | -3.7 | 2.2 | 5.4 | 1.3 | . | . | . |
| Employed persons, LFS, th | . | 4,862 | 4,902 | 4,897 | . | . | 4,920 | 4,900 | 4,880 |
| annual change in % | . | . | 0.8 | -0.1 | . | . | 0.5 | -0.4 | -0.4 |
| Unemployed persons, LFS, th | 273 | 302 | 293 | 245 | 250 | 227 | 226 | 231 | 230 |
| Unemployment rate, LFS, in % | 5.2 | 5.8 | 5.6 | 4.8 | 4.9 | 4.4 | 4.4 | 4.5 | 4.5 |
| Reg. unemployment rate, in %, eop | 1.0 | 0.8 | 0.5 | 0.3 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 |
| Average monthly gross wages, BYN | 671.5 | 722.7 | 822.8 | 971.4 | 909 | 1,040 | 1,110 | 1,240 | 1,380 |
| annual change in % (real, gross) | -2.3 | -3.8 | 7.5 | 12.5 | 13.3 | 8.1 | 8.0 | 6.0 | 6.0 |
| Consumer prices, % p.a. | 13.5 | 11.8 | 6.0 | 4.9 | 4.7 | 5.9 | 6.0 | 5.5 | 5.0 |
| Producer prices in industry, % p.a. 2) | 17.2 | 12.0 | 9.8 | 6.8 | 7.1 | 7.1 | 7.0 | 6.5 | 6.0 |
| General governm.budget, nat. def., % of GDP | | | | | | | | | |
| Revenues | 41.3 | 40.9 | 40.5 | 41.8 | 43.6 | 42.6 | 42.0 | 41.0 | 41.0 |
| Expenditures | 39.9 | 39.4 | 37.6 | 37.7 | 37.6 | 38.5 | 39.0 | 39.0 | 39.0 |
| Deficit (-) / surplus (+) | 1.4 | 1.5 | 3.0 | 4.0 | 6.1 | 4.1 | 3.0 | 2.0 | 2.0 |
| General gov.gross debt, nat. def., % of GDP 3) | 53.0 | 53.5 | 53.4 | 44.0 | . | . | 42.0 | 41.0 | 41.0 |
| Stock of loans of non-fin.private sector, % p.a. | 19.4 | -6.2 | 7.2 | 12.7 | 10.3 | 12.2 | . | . | . |
| Non-performing loans (NPL), in %, eop 4) | 6.8 | 12.8 | 12.9 | 5.0 | 3.7 | 5.8 | . | . | . |
| Central bank policy rate, % p.a., eop 5) | 25.0 | 18.0 | 11.0 | 10.0 | 10.0 | 10.0 | 9.5 | 9.0 | 9.0 |
| Current account, EUR mn 6) | -1,669 | -1,464 | -843 | -29 | -604 | -683 | -200 | -700 | -800 |
| Current account, % of GDP | -3.3 | -3.4 | -1.7 | -0.1 | -2.6 | -2.7 | -0.4 | -1.2 | -1.4 |
| Exports of goods, BOP, EUR mn 6) | 23,854 | 20,988 | 25,405 | 28,409 | 13,556 | 13,834 | 29,000 | 29,000 | 29,300 |
| annual change in % | -13.2 | -12.0 | 21.0 | 11.8 | 8.5 | 2.1 | 2.1 | 0.0 | 1.0 |
| Imports of goods, BOP, EUR mn 6) | 25,807 | 23,270 | 28,043 | 30,536 | 14,599 | 15,166 | 31,700 | 32,100 | 32,600 |
| annual change in % | -12.6 | -9.8 | 20.5 | 8.9 | 9.6 | 3.9 | 3.8 | 1.3 | 1.6 |
| Exports of services, BOP, EUR mn 6) | 6,099 | 6,255 | 7,000 | 7,493 | 3,486 | 3,852 | 8,000 | 8,200 | 8,400 |
| annual change in % | -1.2 | 2.6 | 11.9 | 7.0 | 4.6 | 10.5 | 6.8 | 2.5 | 2.4 |
| Imports of services, BOP, EUR mn 6) | 4,025 | 3,981 | 4,274 | 4,584 | 2,086 | 2,234 | 4,800 | 4,900 | 5,000 |
| annual change in % | -10.0 | -1.1 | 7.4 | 7.3 | 7.7 | 7.1 | 4.7 | 2.1 | 2.0 |
| FDI liabilities, EUR mn 6) | 1,506 | 1,133 | 1,130 | 1,212 | 923 | 943 | 1,300 | . | . |
| FDI assets, EUR mn 6) | 97 | 112 | 60 | 47 | 12 | -55 | 100 | . | . |
| Gross reserves of NB excl. gold, EUR mn 6) | 2,510 | 3,071 | 4,502 | 4,561 | 4,259 | 5,352 | . | . | . |
| Gross external debt, EUR mn 6) | 34,996 | 35,930 | 33,363 | 34,307 | 33,584 | 35,215 | 34,600 | 34,100 | 33,400 |
| Gross external debt, % of GDP | 69.4 | 83.3 | 68.9 | 67.8 | 66.3 | 62.1 | 61.0 | 58.5 | 57.0 |
| Average exchange rate BYN/EUR | 1.7828 | 2.2010 | 2.1833 | 2.4008 | 2.3969 | 2.3917 | 2.3 | 2.4 | 2.6 |

1) Preliminary. - 2) Domestic output prices. - 3) Including publicly guaranteed debt. - 4) From 2018 NPL definition comprises doubtful, bad and small part of supervised assets (before that doubtful and large part of supervised assets were considered). - 5) Refinancing rate of NB. - 6) Converted from USD.

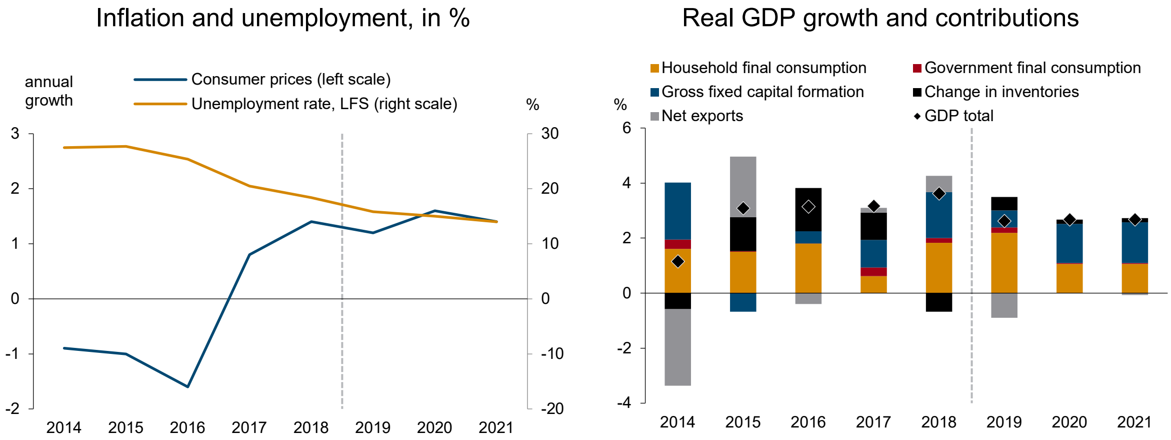
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# BOSNIA AND HERZEGOVINA: Suffering in the face of external headwinds

VLADIMIR GLIGOROV

Prospects for growth are more or less where they almost always are; below 3% this year and around that level in the medium run. The political crisis is not all that consequential for the economy, but does represent a barrier to improving international relations. The key sticking point is NATO integration. It is seen as an instrument of stability (as in Montenegro and North Macedonia), but it is opposed by the majority among the Bosnian Serbs. The EU for its part has run out of ideas when it comes to this country.

**Figure 5.3 / Bosnia and Herzegovina: Main macroeconomic indicators**




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

**Economic growth has slowed somewhat so far in 2019 and the headline growth rate is likely to be below 3% for the year as a whole.** The slowdown in the Euro Area, a key source of export demand and remittances, appears to have had an impact on economic activity in Bosnia and Herzegovina. Real GDP expanded by 2.8% year on year in Q1 and slowed to 2.6% in Q2 according to a flash estimate released by the statistics office on October 11th. In seasonally adjusted terms, real GDP rose by 1% in Q2 relative to the previous three months.

**The policy framework is the one which is geared towards export-led growth.** There is a currency board and fiscal policy is constrained by the exchange rate and financial stability. Given the available resources, the comparative advantages need to be found in industry. In the last years, exports of services have increased, but there are clear limits to their growth. The country also needs significant investments in energy, as it is dependent on coal in an unsustainable manner. It is also in need of infrastructure investments which are, however, hard to agree on as those can be seen as instruments of state-building which is strongly opposed by the main Serbian party. Within the Berlin process, however, a highway between Belgrade and Sarajevo was agreed on and its building has just started. Given the geography, infrastructure investments, going inwards as well as outwards, would certainly be supportive of economic development.

**Given the importance of exports for growth, the slump in industrial production this year is certainly not a good sign for future growth prospects too.** In year-on-year terms, industrial output has contracted in every month of 2019 so far, most recently declining by 5.9% on this basis in August. Export of services continues to grow but that is no adequate substitute for the export of goods which is stagnating this year, reflecting tougher external conditions.

**Bosnia and Herzegovina is strongly dependent on remittances, which will continue to flow in given the persistent outward migration.** The remittances support large merchandise trade imbalances as well as the consumption-based economy. As a result, the current account deficit (4.5% of GDP projected for this year) is rather moderate by Western Balkan standards and much of it is financed by transfers and non-debt creating investments.

**The country's public finances are not threatened by sustainability but the levels of public spending and taxation as shares of GDP are very high given the level of development.** Given the low employment rate and the high unemployment, together with the aging population, it is to be expected that public expenditures will be relied on rather heavily in the future. In terms of the government's final consumption, however, it might be higher by only a couple of percentage points in the GDP in comparison with other Balkan economies and perhaps on the level of developed European economies.

**Consumption (public and private) is around 100% of GDP which is probably the best indicator of the character of the economy.** The country lives one day at a time not just in economic and political terms, but also socially. The key determinant of the state of affairs is the political and policy set-up which makes it rather impossible for people to vote in the needed changes, so they basically rely on the opportunities to vote with their feet and to send cash transfers to the relatives left behind. As things stand, there is not much of a chance that this situation will change.

**In the short run, growth will struggle to reach 3%, while in the medium term that might be the best the economy can do.** Industrial production appears to be losing steam and thus exports are too. Given quite negative trends in the global economy, including in the Euro Area, this may well continue into next year. However, investments should continue to grow. Foreign capital inflows and remittances will continue to cover the trade deficit and support the growth of consumption.

## Table 5.3 / Bosnia and Herzegovina: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 | 2019 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 3,518 | 3,511 | 3,504 | 3,496 | . | . | 3,495 | 3,490 | 3,485 |
| Gross domestic product, BAM mn, nom. 2) | 28,589 | 29,904 | 31,376 | 33,408 | 16,002 | 16,914 | 34,700 | 36,200 | 37,700 |
| annual change in % (real) | 3.1 | 3.1 | 3.2 | 3.6 | 3.7 | 2.7 | 2.6 | 2.7 | 2.7 |
| GDP/capita (EUR at PPP) 2) | 8,800 | 9,000 | 9,300 | 9,800 | . | . | . | . | . |
| Consumption of households, BAM mn, nom. 2) | 23,157 | 23,653 | 24,231 | 25,203 | 12,390 | 12,952 | . | . | . |
| annual change in % (real) | 1.8 | 2.2 | 0.8 | 2.4 | 1.6 | 3.0 | 2.9 | 1.4 | 1.4 |
| Gross fixed capital form., BAM mn, nom. 2) | 5,097 | 5,189 | 5,653 | 6,310 | . | . | . | . | . |
| annual change in % (real) | -3.5 | 2.5 | 5.8 | 9.2 | . | . | 3.3 | 7.5 | 7.8 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 3.1 | 4.4 | 3.2 | 1.6 | 3.1 | -4.3 | -3.0 | 2.3 | 2.0 |
| Gross agricultural production 3) | | | | | | | | | |
| annual change in % (real) | 12.6 | 12.0 | 4.1 | 2.3 | . | . | . | . | . |
| Construction output total | | | | | | | | | |
| annual change in % (real) | 1.7 | -1.9 | -1.1 | 0.4 | 1.2 | -1.6 | . | . | . |
| Employed persons, LFS, th, April | 822.0 | 801.0 | 815.7 | 822.4 | . | . | 840 | 850 | 860 |
| annual change in % | 1.2 | -2.6 | 1.8 | 0.8 | . | . | 1.8 | 1.0 | 0.7 |
| Unemployed persons, LFS, th, April | 315.0 | 273.0 | 210.7 | 185.5 | . | . | 158 | 150 | 140 |
| Unemployment rate, LFS, in %, April | 27.7 | 25.4 | 20.5 | 18.4 | 18.4 | 15.7 | 15.8 | 15.0 | 14.0 |
| Reg. unemployment rate, in %, eop | 42.9 | 40.9 | 38.7 | 34.7 | 35.7 | 33.1 | . | . | . |
| Average monthly gross wages, BAM | 1,289 | 1,301 | 1,321 | 1,363 | 1,348 | 1,405 | 1,420 | 1,470 | 1,510 |
| annual change in % (real, gross) | 1.0 | 2.5 | 0.8 | 1.7 | 1.3 | 3.3 | 3.0 | 2.0 | 1.3 |
| Average monthly net wages, BAM | 830 | 838 | 851 | 879 | 867 | 911 | 920 | 960 | 990 |
| annual change in % (real, net) | 1.0 | 2.6 | 0.7 | 1.9 | 1.2 | 4.2 | 4.0 | 2.5 | 1.3 |
| Consumer prices, % p.a. | -1.0 | -1.6 | 0.8 | 1.4 | 1.1 | 0.9 | 1.2 | 1.6 | 1.4 |
| Producer prices in industry, % p.a. | 0.6 | -2.1 | 3.0 | 3.5 | 3.6 | 0.9 | 2.1 | 2.0 | 1.6 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 43.0 | 42.7 | 43.1 | 43.1 | . | . | 43.0 | 42.5 | 42.0 |
| Expenditures | 42.3 | 41.5 | 40.5 | 40.8 | . | . | 42.5 | 42.0 | 42.0 |
| Deficit (-) / surplus (+) | 0.7 | 1.2 | 2.6 | 2.3 | . | . | 0.5 | 0.5 | 0.0 |
| General gov.gross debt, nat.def., % of GDP | 41.9 | 40.4 | 36.1 | 34.2 | . | . | 30.0 | 28.0 | 27.0 |
| Stock of loans of non-fin.private sector, % p.a. | 2.0 | 3.5 | 7.3 | 5.5 | 7.0 | 6.0 | . | . | . |
| Non-performing loans (NPL), in %, eop | 13.7 | 11.8 | 10.0 | 8.8 | 9.3 | 8.0 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | . | . | . | . | . | . | . | . | . |
| Current account, EUR mn 5) | -741 | -720 | -697 | -633 | -354 | -497.2 | -800 | -795 | -780 |
| Current account, % of GDP | -5.1 | -4.7 | -4.3 | -3.7 | -4.3 | -5.7 | -4.5 | -4.3 | -4.0 |
| Exports of goods, BOP, EUR mn 5) | 3,679 | 3,937 | 4,776 | 5,327 | 2,588 | 2,596 | 5,570 | 5,930 | 6,300 |
| annual change in % | 5.1 | 7.0 | 21.3 | 11.5 | 16.5 | 0.3 | 4.5 | 6.5 | 6.2 |
| Imports of goods, BOP, EUR mn 5) | 7,348 | 7,561 | 8,568 | 9,158 | 4,421 | 4,651 | 9,710 | 10,260 | 10,820 |
| annual change in % | -2.4 | 2.9 | 13.3 | 6.9 | 8.9 | 5.2 | 6.0 | 5.7 | 5.5 |
| Exports of services, BOP, EUR mn 5) | 1,515 | 1,621 | 1,774 | 1,876 | 821 | 881 | 2,050 | 2,220 | 2,400 |
| annual change in % | 21.0 | 7.0 | 9.5 | 5.7 | 4.2 | 7.3 | 9.1 | 8.3 | 8.0 |
| Imports of services, BOP, EUR mn 5) | 514 | 530 | 583 | 606 | 266 | 290 | 640 | 670 | 700 |
| annual change in % | 29.9 | 3.2 | 10.0 | 3.9 | 11.0 | 8.8 | 5.0 | 4.8 | 4.8 |
| FDI liabilities, EUR mn 5) | 345 | 284 | 415 | 412 | 218 | 331 | 400 | . | . |
| FDI assets, EUR mn 5) | 85 | 3 | 85 | -17 | -7 | 8 | 40 | . | . |
| Gross reserves of NB excl. gold, EUR mn 5) | 4,307 | 4,768 | 5,293 | 5,835 | 5,572 | 6,028 | . | . | . |
| Gross external debt, EUR mn 6) | 7,937 | 8,379 | 8,695 | 9,241 | . | . | 9,670 | 10,300 | 11,000 |
| Gross external debt, % of GDP 6) | 54.3 | 54.8 | 54.2 | 54.1 | . | . | 54.5 | 55.6 | 57.1 |
| Average exchange rate BAM/EUR | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 |

1) Preliminary. - 2) According to ESA'10 (FISIM not yet reallocated to industries). - 3) Based on UN-FAO data, wiiw estimate from 2017. - 4) Bosnia and Herzegovina has a currency board. There is no policy rate and even no money market rate available. - 5) Converted from national currency. - 6) Based on IMF estimates.

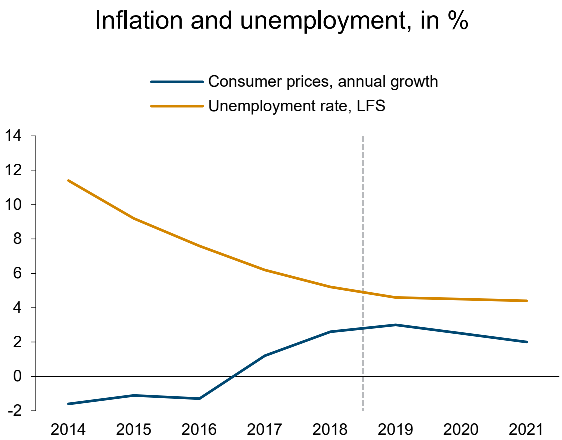
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

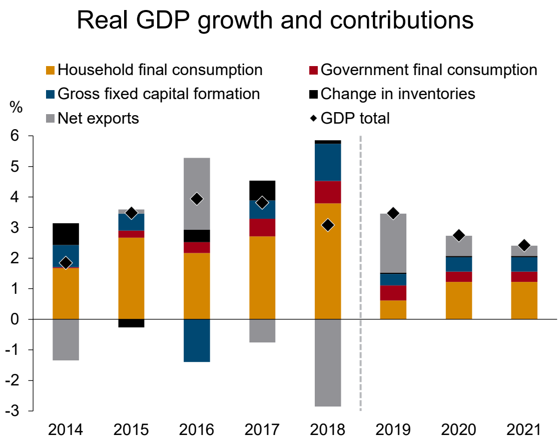

# BULGARIA: Uneven growth signalling a slowdown

RUMEN DOBRINSKY

After a strong first quarter, GDP growth slowed down reflecting a worsening domestic and external environment. Cost-push inflationary pressures were partly offset by the weaker domestic demand and inflation stopped rising. Domestic and external demand are expected to weaken further and this will be coupled with continued labour shortages The rate of GDP growth for 2019 as a whole will still be decent, at some 3.5%, but it is expected to slow down in the following years.

**Figure 5.4 / Bulgaria: Main macroeconomic indicators**




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

**The unexpectedly strong economic upturn in the first quarter when GDP grew by 4.8% was not sustained in the course of the year.** GDP growth moderated to 3.7% year on year in the second quarter and recent business statistics suggest an even more pronounced slowdown in the summer months.

**Uneven export performance was one of the main factors behind both the upturn in the first quarter and the moderation that followed**. In current euro terms, the exports of goods in the summer months almost came to a standstill while the exports of services went into the red partly due to weaker tourism revenues. After the first quarter, exports to all major destinations, both EU and non-EU countries, were slowing down in parallel with the global economic slowdown. Mirroring these dynamics, manufacturing activity weakened considerably in the summer months. Recent business sentiment surveys suggest a trend of further worsening of expectations in industry. If this slowdown continues, manufacturing performance for the year as a whole may turn out to be the worst since 2013.

**Domestic demand was also losing steam in the course of the year**. After decent year on year growth in the first trimester, both private consumption and gross fixed capital formation stalled in the second quarter. In fact, domestic absorption made a negative contribution to GDP growth in the second trimester. Paradoxically, in statistical terms, despite the worsening export performance, net exports made the biggest contribution to GDP growth in the first half of the year but this was due to the negative year on year growth of real imports of goods and services in this period.

**Such dynamics of trade flows led to a sharp contraction in the merchandise trade deficit and a parallel surge in the current account surplus**. This surplus has been growing rapidly since 2016 and current expectations are that the year 2019 will end with the highest surplus on record. This development, which indicates that the country has become a net lender to the rest of the world, cannot be considered as favourable for an emerging economy such as Bulgaria.

**As noted, investment activity was losing steam in the course of the year**. One of the factors behind this was the uneven pace of implementation of EU-supported public investment projects. As evident in the dynamics of engineering construction in 2019, real business investment also subsided, reflecting worsening expectations by the business sector. Only housing construction recorded positive growth backed by still strong mortgage lending.

**Bank lending was also moderating on a par with business activity**. The year on year growth of the stock of outstanding credit to non-financial corporations fell from 5.8% in January to 3.3% in August. The corresponding growth numbers for the stock of household credit were 10.8% and 8.8% respectively.

**There was further improvement in the quality of assets in the banking system**. During the past several years Bulgarian commercial banks were actively engaged in the cleaning up of their balance sheets from substandard and non-performing loans, in the first place, to households. They did that by selling such assets (at largely discounted prices) to debt collection companies. This became possible after several large foreign debt collection companies entered the Bulgarian market. Thus during the year 2018 alone, Bulgarian banks sold some BGN 1.5 billion of substandard and non-performing loans to such debt collection companies. Accordingly, by June 2019 the share of non-performing loans in the total loan portfolio of Bulgarian commercial banks fell to 7.2%, compared to 14.5% in 2015.

**The labour market remained very tight with persistent labour shortages both for high skilled and low skilled labour**. Hiring rose in the first half of the year mostly thanks to the economic upturn in the first quarter. The number of employed in the second quarter of 2019 was up by 2.5% (106000 persons) from a year earlier. The rate of unemployment (both LFS and registered) fell to historically low levels and so did the employment rate which reached 75.7% for the age group from 20 to 64 years. Mirroring the tight labour market, wage pressures intensified and average real wages rose by 8.5% in the first half of the year. However, these processes are likely to subside in the short run in line with the expected further economic slowdown.

**Cost-push inflationary pressures were partly offset by the weaker domestic demand in 2019**. After a period of deflation between 2014 and 2016, CPI had been accelerating since the beginning of 2017. However, this process likely came to an end around March 2019 and since that time inflation had been gradually subsiding in average annual terms. For the year as a whole, the rise in the HICP should not surpass the 3% level.

**Bulgaria's fiscal position remains strong but the final outcome in 2019 will be affected by a big one-off fiscal outlay**. In June, the government concluded a long negotiated BGN 2.1 billion deal for the delivery of eight F-16 fighter jets. The prolonged public tender for this deal was marred by recurrent corruption allegations due to changes in the tender conditions during the process which, it was claimed, pre-determined the winner. Apart from the fact that the final delivery price was considerably higher than the preannounced ceiling, the final deal implied full advance payment of the delivery, something that was also precluded in the initial tender conditions. To implement the deal, the government passed a budget amendment increasing the cash deficit for the year by BNG 1.83 billion. Therefore we now expect a deterioration of the fiscal balance for the year by some 2 percentage points from what was envisaged earlier.

**Despite an earlier announced firm intention by the government to apply for participation in ERM II in July of this year, this did not happen in reality**. No explanation was given for abandoning this plan and actually in recent months the authorities kept silent on the topic. One could just speculate that the main reason is grounded in the current conditions specified in the EU legal framework, namely the requirement that Bulgaria simultaneously joins ERM II and the Banking Union. In relation to the latter, the ECB recently conducted an asset quality review complemented by a stress test exercise in six large Bulgarian banks. The results of this review are probably key for ECB's judgment on whether Bulgaria can join the EU Banking Union under the Close Co-operation Mechanism. So far the ECB has not announced its overall conclusions regarding Bulgaria's membership in the Banking Union but according to a press release published in July, the asset quality review found capital shortages in two of the surveyed banks.

**The political situation in the country was marked by rising tensions in the ruling centre-right coalition**. A series of social protests by different interest groups added to these tensions. The most serious test for the government in 2019 will be the local elections scheduled for 27 October which may bring about some reshuffling in the country's political balance.

**In the current circumstances it can be expected that the slowdown of the Bulgarian economy will continue**. There are no signs of reversal in the dynamics of the waning domestic demand which is coupled with an ongoing weakening in the Euro Area. However, thanks to the relatively high rate of GDP growth in the first half of the year, the rate of GDP growth for 2019 as a whole will still be decent, at some 3.5%. However, under the assumptions of a further weakening of domestic and external demand and continued labour shortages, the slowdown is likely to continue in the following years. Thus GDP growth in 2020 and 2021 is likely to slow down to below 3.0%. Unless there is a policy shift towards the support of domestic demand, such economic dynamics will continue to generate large current account surpluses. There are no imminent threats to macroeconomic stability.

## Table 5.4 / Bulgaria: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 January-June | 2019 January-June | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 7,178 | 7,128 | 7,076 | 7,025 | . | . | 6,950 | 6,900 | 6,850 |
| Gross domestic product, BGN mn, nom. | 88,575 | 94,130 | 101,043 | 107,925 | 48,291 | 53,763 | 115,000 | 121,100 | 126,500 |
| annual change in % (real) | 3.5 | 3.9 | 3.8 | 3.1 | 3.4 | 4.2 | 3.5 | 2.7 | 2.4 |
| GDP/capita (EUR at PPP) | 13,700 | 14,200 | 14,800 | 15,500 | . | . | . | . | . |
| Consumption of households, BGN mn, nom. | 54,831 | 56,715 | 60,694 | 66,179 | 31,146 | 32,066 | . | . | . |
| annual change in % (real) | 4.3 | 3.5 | 4.5 | 6.3 | 7.9 | 1.4 | 1.0 | 2.0 | 2.0 |
| Gross fixed capital form., BGN mn, nom. | 18,612 | 17,484 | 18,717 | 20,549 | 9,382 | 9,619 | . | . | . |
| annual change in % (real) | 2.7 | -6.6 | 3.2 | 6.5 | 8.5 | 1.0 | 2.0 | 2.5 | 2.5 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | 2.9 | 2.7 | 3.4 | 1.1 | 1.6 | 1.7 | 0.5 | 1.0 | 1.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -8.2 | 1.7 | 6.3 | -3.1 | . | . | . | . | . |
| Construction industry 3) | | | | | | | | | |
| annual change in % (real) | 11.1 | -16.7 | 4.6 | 1.6 | 3.1 | 4.0 | . | . | . |
| Employed persons, LFS, th, average | 3,032 | 3,017 | 3,150 | 3,153 | 3,128 | 3,205 | 3,190 | 3,200 | 3,210 |
| annual change in % | 1.7 | -0.5 | 4.4 | 0.1 | 0.8 | 2.5 | 1.2 | 0.2 | 0.2 |
| Unemployed persons, LFS, th, average | 305 | 247 | 207 | 173 | 185 | 154 | 150 | 150 | 150 |
| Unemployment rate, LFS, in %, average | 9.2 | 7.6 | 6.2 | 5.2 | 5.6 | 4.6 | 4.6 | 4.5 | 4.4 |
| Reg. unemployment rate, in %, eop | 10.0 | 8.0 | 7.1 | 6.1 | 5.7 | 5.2 | . | . | . |
| Average monthly gross wages, BGN | 878 | 948 | 1,037 | 1,135 | 1,101 | 1,234 | 1,260 | 1,360 | 1,450 |
| annual change in % (real, gross) | 7.0 | 8.9 | 7.2 | 6.4 | 5.2 | 8.5 | 8.0 | 5.0 | 4.5 |
| Consumer prices (HICP), % p.a. | -1.1 | -1.3 | 1.2 | 2.6 | 2.0 | 2.6 | 3.0 | 2.5 | 2.0 |
| Producer prices in industry, % p.a. | -2.2 | -3.1 | 5.0 | 3.9 | 4.1 | 3.0 | 3.0 | 2.5 | 2.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 38.8 | 35.2 | 36.2 | 36.8 | . | . | 37.5 | 37.0 | 37.0 |
| Expenditures | 40.5 | 35.1 | 35.0 | 34.8 | . | . | 39.0 | 37.0 | 37.0 |
| Net lending (+) / net borrowing (-) | -1.7 | 0.1 | 1.2 | 2.0 | . | . | -1.5 | 0.0 | 0.0 |
| General gov.gross debt, EU def., % of GDP | 26.2 | 29.6 | 25.6 | 22.6 | . | . | 23.5 | 22.5 | 21.5 |
| Stock of loans of non-fin.private sector, % p.a. | -1.6 | 0.8 | 3.3 | 7.7 | 3.8 | 4.6 | . | . | . |
| Non-performing loans (NPL), in %, eop | 14.5 | 13.2 | 10.4 | 7.8 | 9.3 | 7.2 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 0.01 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.0 | 0.0 | 0.0 |
| Current account, EUR mn | 55 | 1,551 | 1,825 | 3,002 | 389 | 2,020 | 3,500 | 2,700 | 2,100 |
| Current account in % of GDP | 0.1 | 3.2 | 3.5 | 5.4 | 1.6 | 7.3 | 6.0 | 4.4 | 3.2 |
| Exports of goods, BOP, EUR mn | 21,920 | 23,104 | 26,951 | 27,745 | 13,171 | 13,849 | 28,500 | 29,200 | 30,000 |
| annual change in % | 4.2 | 5.4 | 16.6 | 2.9 | 2.1 | 5.1 | 2.7 | 2.5 | 2.7 |
| Imports of goods, BOP, EUR mn | 24,542 | 24,088 | 27,716 | 29,603 | 14,264 | 14,361 | 30,000 | 31,200 | 32,500 |
| annual change in % | 3.1 | -1.8 | 15.1 | 6.8 | 7.0 | 0.7 | 1.3 | 4.0 | 4.2 |
| Exports of services, BOP, EUR mn | 7,316 | 8,050 | 8,256 | 9,133 | 3,673 | 3,869 | 8,600 | 8,800 | 9,000 |
| annual change in % | 7.8 | 10.0 | 2.6 | 10.6 | 3.0 | 5.3 | -5.8 | 2.3 | 2.3 |
| Imports of services, BOP, EUR mn | 4,236 | 4,640 | 5,203 | 5,573 | 2,698 | 2,514 | 5,100 | 5,200 | 5,400 |
| annual change in % | -0.2 | 9.5 | 12.1 | 7.1 | 9.7 | -6.8 | -8.5 | 2.0 | 3.8 |
| FDI liabilities, EUR mn | 1,956 | 1,313 | 1,760 | 1,057 | 321 | 468 | 1100 | . | . |
| FDI assets, EUR mn | 105 | 754 | 446 | 744 | 371 | 128 | 500 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 19,022 | 22,475 | 22,257 | 23,620 | 22,114 | 23,578 | . | . | . |
| Gross external debt, EUR mn 5) | 33,855 | 34,655 | 34,211 | 33,156 | 34,288 | 33,989 | 34000 | 34500 | 35000 |
| Gross external debt, % of GDP 5) | 74.8 | 72.0 | 66.2 | 60.1 | 62.1 | 57.8 | 58.0 | 56.0 | 54.0 |
| Average exchange rate BGN/EUR | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 |

1) Preliminary. - 2) Enterprises with 10 and more employees. - 3) Enterprises with 5 and more employees. - 4) Base interest rate. This is a reference rate based on the average interbank LEONIA rate of previous month (Bulgaria has a currency board). - 5) BOP 5th edition.

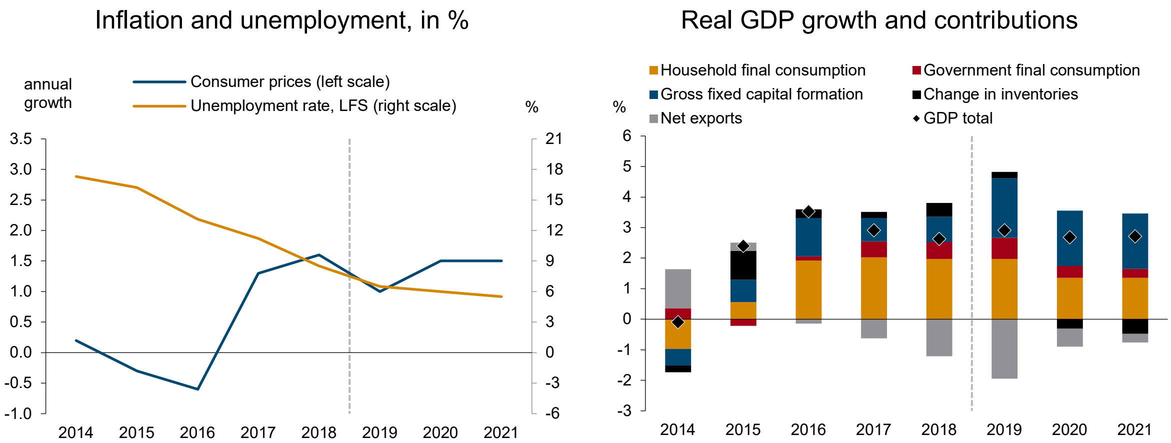
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# CROATIA: Aiming at euro accession

HERMINE VIDOVIC

**The economy will grow by 2.9% in 2019, an improvement the last year, mainly due to the strengthening of domestic demand (both consumption and investment). Assuming a deterioration of the external environment, domestic demand should remain the main driver of growth in 2020-21. The goal of adopting the euro will be an incentive to continue fiscal consolidation.**

**Figure 5.5 / Croatia: Main macroeconomic indicators**




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

**Croatia's real GDP grew by 3.2% year on year in the first half of 2019.** Growth was backed by domestic demand: both private consumption and investments expanded. Private consumption growth, boosted by real wage increases and rising remittances from abroad, remained high at 3.5%. Gross fixed capital formation growth was at its highest level since the onset of the global financial crisis, gaining momentum most notably through EU-funding. High investment growth was reflected in a noticeable increase in construction output, e.g. in infrastructure (roads, railways and airports) as well as in buildings. The contribution of net exports was negative due to imports rising faster than exports.

**After the decline in 2018, industrial production remained very volatile in 2019 too**. Having grown only moderately at the beginning of the year and dropping again in June and August, industrial output grew by a mere 0.7% in the first eight months of 2019 along with declining employment. Within manufacturing, the most outstanding declines are reported for shipbuilding (-42%) and manufacture of coke and refined petroleum products (-35%) while the strongest increase was recorded in the production of computers, electronic and optical products (15%). The steady decline in shipbuilding is mainly due to the continuing difficulties of the two shipyards, 3. Maj and Uljanik. In May, the bankruptcy procedure was initiated against Uljanik in Pula. As for the 3. Maj shipyard in Rijeka, a member of the Uljanik group, the

Ministry of Finance issued a government guarantee for a loan to be taken from the Croatian Bank for Reconstruction and Development (HBOR) and/or other commercial banks in the amount of EUR 26 million in order to complete the construction of a ship at the dock. Overall, industrial output is likely to end up with a slightly positive annual growth in 2019.

**Employment continued to increase during the first seven months of 2019**. According to Pension Insurance data, employment rose by 2.3%. The LFS unemployment rate stood at 7.1% in July and remained fairly unchanged as compared to the beginning of the year. In order to address labour and skill shortages in certain sectors, such as construction, tourism and IT, the Croatian government has raised the quotas for foreign workers up to 68,100 in 2019, from 38,000 in 2018. Labour shortages, apart from rising minimum wages and rises in public sector wages, are among the major causes of wage increases: real gross wages increased by 2.8% in the first half of 2019, net wages by 2.5%.

**The trade deficit widened in the first half of 2019** as a **result of the higher growth of goods imports (8.8%) ahead of exports (5.6%)**. Export growth to the EU was below average, while imports from this area expanded above average; Croatia reports trade deficits with almost all EU countries. Trade dynamics with the Central European Free Trade Agreement, (CEFTA) countries were contrary to this, with goods exports rising by 17% along with stagnating imports in the first half of 2019. In services trade, exports grew moderately (4.5%), whereas imports expanded by 10.3%.

**At the end of September the Croatian National Bank published revised external trade statistics starting from 2000.** Accordingly the most important methodological changes in the balance of payments relate to (i) a new calculation of earnings from tourism, (ii) the estimate of workers' informal remittances and (iii) the inclusion of imports of used vehicles by natural persons from the EU as well the inclusion of trade credits with an original maturity of up to six months in the external debt, both on liabilities and assets. The revision has partly resulted in significant changes in the respective time series. So, for example, the current account surplus was lower than originally reported, e.g. in 2018 it stood at EUR 987 million instead of EUR 1.3 billion prior to the revision. Foreign debt on the other hand was constantly higher than originally reported, amounting to EUR 48.2 billion in 2018 compared to EUR 45.4 billion before the revision. Informal workers' remittances, which were not included in the current account up to now, increased the net inflow of remittances by between EUR 178 million and EUR 326 million per year. The inclusion of imports of used vehicles from the EU has contributed to a reduction of the current account surplus. As for the first half of 2019, earnings from tourism, based on the new methodology, remained unchanged compared to a year ago, but might be somewhat lower in the rest of the year due to the return of competition from Northern Africa and particularly Turkey which was considered safe again. Thus, assuming that the services trade surplus will slightly narrow as compared to 2018 and the merchandise trade deficit will continue to widen the current account will close with a lower surplus in 2019 than a year earlier.

**In July Croatia sent a letter of intent expressing interest for entering the ERM II –** a necessary step in the process of accession to the Euro Area. In the Action Plan attached to the letter, Croatia committed itself to implement reforms in six policy areas prior to joining the ERM II as follows i) to further strengthen the supervision of the banking system by establishing close cooperation between the Croatian National Bank (CNB) and the ECB, ii) strengthen the macro-prudential policy framework by introducing an explicit mandate for borrower-based measures; iii) strengthen the anti-money laundering framework; iv) upgrade the system of statistical data collection, processing and publication; v) improve public-sector management and vi) reduce the administrative and financial burden on the economy. All measures are envisaged to be implemented by mid-2020. However, it seems questionable whether the latter two reform steps can be implemented by 2020 in view of the rather unsuccessful attempts in the past. So far, Croatia has satisfied the criteria of price stability, public finance sustainability and interest rate convergence.

**Fiscal consolidation is continued in view of Croatia's aspiration to join the ERM II.** In the first half of the year, public revenues increased by 8.5% and expenditures went up by 8.3% as compared with the same period of the previous year, with the fiscal balance slightly negative. Assuming similar developments for the rest of the year including guarantee payments for the ailing shipyard Uljanik, the general government balance might end up with a small deficit of 0.4% of the GDP in 2019. The Ministry of Finance expects the public debt to GDP ratio to decline to 71.3% from 74.6% in 2018. The Economic and Fiscal Policy Guidelines 2020-2022 envisage a continuation of fiscal consolidation with the public debt to GDP ratio falling to 62% by 2022.

**The government bowed to trade union pressure and announced a lowering of the retirement age again.** Recently, the Prime Minister announced that the government would accept the demands of the trade unions initiative '67 is too much' – earlier this year signed by more than 700,000 people to force a national referendum to withdraw some provisions of the pension reform adopted by the end of 2018. Thus, the government forwarded a bill of amendments to the parliament to return the pension eligibility age to 65 and reduce the penalties for early retirement as well as amendments to the Labour Act that will enable people to continue working if they wish after they turn 65.

**Following the positive developments in the first half of the year, wiiw has slightly revised upwards its GDP growth forecast to 2.9% for 2019.** Considering a slowdown of foreign demand, for the period 2020 to 2021 we expect GDP to grow by some 2.7% annually, driven primarily by domestic demand. Revenues from tourism are expected to remain robust although probably below the levels reached in the past couple of years due to the return of competition from Turkey and Northern Africa. The current account should remain in positive territory, but declining gradually due to widening trade deficits. The government will make every effort to continue fiscal consolidation in order to join the ERM II in 2020 as a precondition for the euro adoption.

## Table 5.5 / Croatia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 | 2019 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 4,208 | 4,172 | 4,130 | 4,091 | . | . | 4,050 | 4,000 | 4,000 |
| Gross domestic product, HRK bn, nom. | 339.6 | 351.3 | 365.6 | 381.8 | 180.2 | 188.6 | 397 | 414 | 431 |
| annual change in % (real) | 2.4 | 3.5 | 2.9 | 2.6 | 2.7 | 3.1 | 2.9 | 2.7 | 2.7 |
| GDP/capita (EUR at PPP) | 17,200 | 17,800 | 18,400 | 19,400 | . | . | . | . | . |
| Consumption of households, HRK bn, nom. | 192.3 | 196.4 | 205.5 | 215.3 | 105.8 | 110.2 | . | . | . |
| annual change in % (real) | 1.0 | 3.4 | 3.6 | 3.5 | 3.7 | 3.5 | 3.5 | 2.4 | 2.4 |
| Gross fixed capital form., HRK bn, nom. | 66.4 | 70.4 | 73.3 | 76.7 | 37.7 | 41.4 | . | . | . |
| annual change in % (real) | 3.8 | 6.5 | 3.8 | 4.1 | 3.3 | 9.7 | 9.7 | 9.0 | 9.0 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | 2.7 | 5.3 | 1.4 | -1.0 | 0.5 | 0.7 | 1.0 | 2.0 | 2.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 2.9 | 6.9 | -4.9 | 2.6 | . | . | . | . | . |
| Construction output 2) | | | | | | | | | |
| annual change in % (real) | -0.5 | 3.3 | 1.7 | 4.9 | 3.1 | 9.6 | . | . | . |
| Employed persons, LFS, th, average | 1,585 | 1,590 | 1,625 | 1,655 | 1,644 | 1,669 | 1,680 | 1,700 | 1,720 |
| annual change in % | 1.3 | 0.3 | 2.2 | 1.8 | 3.4 | 1.6 | 1.5 | 1.0 | 1.0 |
| Unemployed persons, LFS, th, average | 306 | 240 | 205 | 152 | 161 | 122 | 120 | 110 | 100 |
| Unemployment rate, LFS, in %, average | 16.2 | 13.1 | 11.2 | 8.5 | 9.0 | 6.9 | 6.5 | 6.0 | 5.5 |
| Reg. unemployment rate, in %, eop 3) | 17.6 | 14.1 | 11.2 | 8.9 | 8.2 | 6.7 | 8.0 | . | . |
| Average monthly gross wages, HRK 4) | 8,055 | 7,752 | 8,055 | 8,448 | 8,441 | 8,736 | 8,770 | 9,200 | 9,600 |
| annual change in % (real, gross) | 1.8 | 3.0 | 2.8 | 3.3 | 3.8 | 2.8 | 2.8 | 2.8 | 2.5 |
| Average monthly net wages, HRK 4) | 5,711 | 5,685 | 5,985 | 6,242 | 6,236 | 6,436 | 6,460 | 6,700 | 7,000 |
| annual change in % (real, net) | 3.7 | 2.7 | 4.1 | 2.8 | 3.2 | 2.5 | 2.4 | 2.3 | 2.3 |
| Consumer prices (HICP), % p.a. | -0.3 | -0.6 | 1.3 | 1.6 | 1.5 | 0.8 | 1.0 | 1.5 | 1.5 |
| Producer prices in industry, % p.a. | -3.8 | -4.3 | 2.0 | 2.2 | 1.8 | 1.5 | 2.0 | 2.0 | 2.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 45.2 | 46.3 | 46.1 | 46.6 | . | . | 44.4 | 43.9 | 43.9 |
| Expenditures | 48.3 | 47.3 | 45.3 | 46.4 | . | . | 44.8 | 43.8 | 43.9 |
| Net lending (+) / net borrowing (-) | -3.2 | -1.0 | 0.8 | 0.2 | . | . | -0.4 | 0.1 | 0.0 |
| General gov.gross debt, EU def., % of GDP | 83.7 | 80.5 | 77.8 | 74.6 | . | . | 71.3 | 68.0 | 66.5 |
| Stock of loans of non-fin.private sector, % p.a. | -3.1 | -4.3 | -0.1 | 2.3 | 2.2 | 2.6 | . | . | . |
| Non-performing loans (NPL), in %, eop | 16.7 | 13.8 | 11.4 | 9.8 | 11.2 | 9.2 | . | . | . |
| Central bank policy rate, % p.a., eop 5) | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Current account, EUR mn | 1,436 | 983 | 1,660 | 970 | -1,953 | -2,617 | 300 | 100 | 50 |
| Current account, % of GDP | 3.2 | 2.1 | 3.4 | 1.9 | -8.0 | -10.3 | 0.6 | 0.2 | 0.1 |
| Exports of goods, BOP, EUR mn | 10,197 | 10,512 | 11,707 | 12,240 | 5,864 | 6,174 | 13,200 | 14,100 | 14,800 |
| annual change in % | 8.1 | 3.1 | 11.4 | 4.6 | 3.5 | 5.3 | 8.0 | 6.5 | 5.0 |
| Imports of goods, BOP, EUR mn | 17,319 | 18,119 | 20,152 | 21,882 | 10,787 | 11,704 | 23,800 | 25,500 | 27,000 |
| annual change in % | 7.9 | 4.6 | 11.2 | 8.6 | 6.6 | 8.5 | 8.9 | 7.0 | 6.0 |
| Exports of services, BOP, EUR mn | 10,523 | 11,725 | 12,885 | 13,848 | 4,531 | 4,737 | 14,700 | 15,600 | 16,500 |
| annual change in % | 12.3 | 11.4 | 9.9 | 7.5 | 6.6 | 4.5 | 6.0 | 6.0 | 6.0 |
| Imports of services, BOP, EUR mn | 3,282 | 3,562 | 4,109 | 4,634 | 2,172 | 2,395 | 5,000 | 5,400 | 5,800 |
| annual change in % | 13.1 | 8.5 | 15.4 | 12.8 | 18.3 | 10.3 | 7.5 | 7.0 | 7.0 |
| FDI liabilities, EUR mn | 33 | 356 | 462 | 995 | 1,060 | 314 | 600 | . | . |
| FDI assets, EUR mn | -189 | -1,631 | -679 | 264 | 207 | 86 | 120 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 13,707 | 13,514 | 15,706 | 17,438 | 16,694 | 19,880 | . | . | . |
| Gross external debt, EUR mn 6) | 48,230 | 44,714 | 43,683 | 42,710 | 44,107 | 44,564 | 44,500 | 44,700 | 43,700 |
| Gross external debt, % of GDP 6) | 108.1 | 95.9 | 89.2 | 83.0 | 85.7 | 83.1 | 83.0 | 80.0 | 75.0 |
| Average exchange rate HRK/EUR | 7.6137 | 7.5333 | 7.4637 | 7.4182 | 7.4181 | 7.4199 | 7.4 | 7.4 | 7.4 |

1) Preliminary. - 2) Enterprises with 20 and more employees. - 3) From 2016 new source for labour force. - 4) From 2016 data are based on tax records (survey JOPPD); prior to that data are based on a monthly survey. - 5) Discount rate of NB. - 6) Including trade credits less than 6 months.

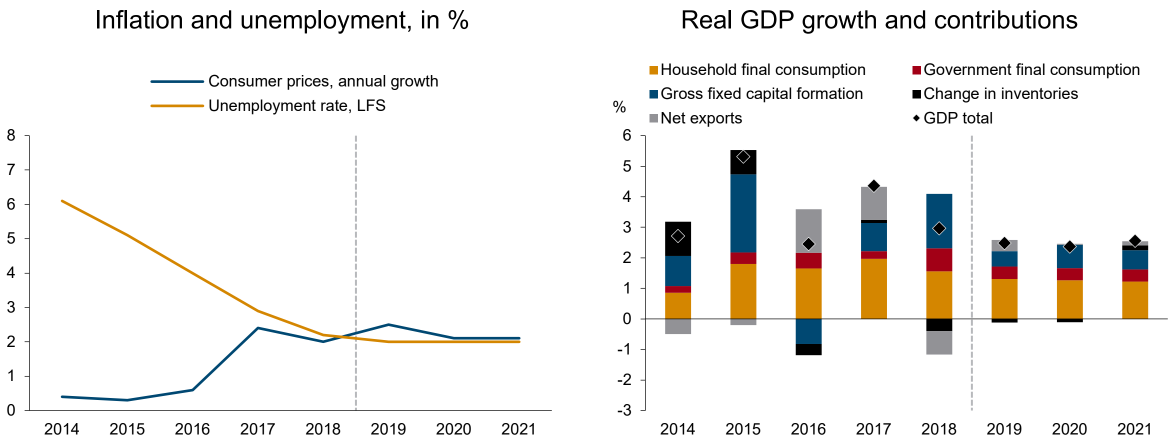
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# CZECH REPUBLIC: Weak growth at full employment

LEON PODKAMINER

**GDP growth has been losing momentum gradually as productive investment starts to decline. Labour resources are nearing depletion, but labour shortages have failed to prompt intensified capital formation. A high dependence on the car industry may become a problem. Signs of recession in Germany are spilling over into Czech manufacturing. Consumption remains the backbone of a subdued output growth. We forecast average growth of around 2.5% in the medium run.**

**Figure 5.6 / Czech Republic: Main macroeconomic indicators**




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

**GDP growth has been losing momentum gradually.** Faltering investment spending is the main demand-side factor responsible for the weakening output growth. In the second quarter of 2019 the volume of gross fixed capital formation stagnated (after increasing at over 7% a year ago and 3% in the first quarter of 2019).

**Productive investment starts to decline**. The volumes of investment in the form of machinery, equipment and means of transportation declined in the first half of 2019 while only investment in dwellings and other buildings and structures (the latter are, primarily, related to the realisation of infrastructural projects) still keeps rising (though at very low rate).

**Labour shortages fail to prompt intensified capital formation**. This is a rather unexpected development. The conventional wisdom would rather suggest an opposite tendency – rising investment into labour saving technologies. However, under the rising unit labour costs – and thus declining profitability of the business sector – the attractiveness of investing in the Czech Republic may have diminished generally, even with the labour-saving technologies. Labour shortages are likely to persist in the future, also on account of adverse demographic trends – and this too may discourage capital formation. Locating new production facilities in less costly countries where labour shortages are less acute (e.g. in Romania) may have become a viable alternative. Of course, that alternative may not be available to many smaller-scale domestic-owned firms. Also larger foreign firms (e.g. in the automotive industry), with factories already operating in the Czech Republic, may not be able to move out quickly. But they may have become more cautious when it comes to extending their existing production facilities.

**Labour resources are nearing depletion**. At the beginning of the year the number of vacancies reached an all-time high (with about 2 vacancies per unemployed person). Since then the number of vacancies has diminished slightly – still exceeding the number of unemployed by a large margin. Labour shortages are now particularly acute in the service sectors (especially in retail trade). Record-high economic activity rates permit only marginally higher employment (in manufacturing by 0.6% in the second quarter of 2019). Pretty high net inflows of migrants (primarily from Ukraine, but also from Russia, Slovakia and Romania) have continued, easing the labour shortages a bit. In the first half of 2019 the net migration inflow was close to 21000 people (4% more than a year ago).

**Interest rates on loans are no longer as low as they used to be**. Despite its 'dovish' reputation, The Czech National Bank has been responding to higher inflation with the policy interest rate increasing gradually. Although in real terms the policy rate has been negative, the money market interest rates are positive. It is very likely that this reflects the expectations of further hikes in the policy rate and/or higher inflation. The interest rates on loans to the non-financial private sector are also moderately positive. Correspondingly the growth in loans has been slowing down generally. But loans supporting the real estate activities have expanded quite dynamically, especially in Prague (which is not yet something to worry about).

**Exchange rate has been remarkably stable**. Despite the growing interest rates' differentials vs. the Euro Area, the CZK has not been appreciating in nominal terms vs. the euro. This development runs counter to the widely held anticipations whereby the CZK must tend to appreciate. Absence of pronounced nominal appreciation moderates the scale of real appreciation and is beneficial for the foreign trade.  On the other hand this development is not helping to control inflation. The interest rates' disparities, under the stability of the nominal interest rates, are normally activating some amounts of the short-term carry trade and may also lead to larger net debts denominated in the euro.

**Exceptional dependence on the automotive industry starts exacting a price**. Manufacture of motor vehicles (and the related activities covered in the NACE 29 category) is the leading branch of the Czech economy. In 2018 the branch accounted for over 5% of total value added, over 23% of exports of goods and services and close to 9% of the total investment outlays. Together with its supplying industries, the automotive industry generates over 9% of total gross value added and accounts for over 8% of the total employment.

**The recessionary tendencies coming to the fore in Germany have started spilling over into Czech manufacturing** which is tightly integrated with the German industry. During the first eight months of 2019 manufacturing output rose 0.5% in real terms. Brexit and the tensions disrupting global trade will also affect the Czech economy (similarly as in most other industrial countries). The suppressed export sales (by 1.5% in the second quarter of 2019) are already having negative repercussions for current production and employment. More ominously, the foreign recessionary tendencies are likely to discourage investment, especially in the automotive branch.

**Sound fiscal policy is continued** but the size of public sector surpluses is set to gradually diminish in the medium-term perspective. Thereby, the fiscal policy will be generating a modest pro-growth impulse which is likely to compensate, at least partly, for the effects of diminished private investment spending.

**Consumption remains the backbone of a subdued output growth**. Driven by strong rise in wages and pensions, the household consumption remains the main demand-side source of output growth. But consumption growth is not exorbitant as inflation follows, with some delay, the rising unit labour costs. In September 2019 the consumer price inflation reached 2.7% (y-o-y). Inflation (also due to the hikes in administered prices, already announced) will be thus eroding the real disposable incomes in 2020.

**The longer-term perspective remains uncertain**. The strong – but structurally skewed – manufacturing base will permit balanced (externally as well as internally) growth over a few more years. However, dwindling labour resources and stagnant levels of fixed capital formation do not bode particularly well in the longer run. The Czech economy may need a structural change with an aggressive technological reorientation. Whether such reorientations could be compatible with the strong reliance on foreign direct investment, characterising the Czech economy, remains an open question.

## Table 5.6 / Czech Republic: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 January-June | 2019 January-June | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 10,546 | 10,566 | 10,594 | 10,630 | . | . | 10,645 | 10,650 | 10,655 |
| Gross domestic product, CZK bn, nom. | 4,596 | 4,768 | 5,047 | 5,329 | 2,565 | 2,723 | 5,620 | 5,870 | 6,150 |
| annual change in % (real) | 5.3 | 2.5 | 4.4 | 3.0 | 3.1 | 2.6 | 2.5 | 2.4 | 2.6 |
| GDP/capita (EUR at PPP) | 25,300 | 25,600 | 26,900 | 28,100 | . | . | . | . | . |
| Consumption of households, CZK bn, nom. | 2,125 | 2,213 | 2,361 | 2,495 | 1,208 | 1,277 | . | . | . |
| annual change in % (real) | 3.8 | 3.6 | 4.2 | 3.3 | 3.9 | 2.7 | 2.8 | 2.7 | 2.6 |
| Gross fixed capital form., CZK bn, nom. | 1,216 | 1,189 | 1,250 | 1,358 | 616 | 643 | . | . | . |
| annual change in % (real) | 10.2 | -3.1 | 3.7 | 7.2 | 6.8 | 1.5 | 2.0 | 3.0 | 2.5 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 4.3 | 3.4 | 6.5 | 3.1 | 2.7 | 0.2 | 0.5 | 1.5 | 2.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -4.8 | 7.0 | -6.5 | -0.3 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 6.8 | -5.6 | 3.3 | 9.2 | 10.1 | 3.1 | . | . | . |
| Employed persons, LFS, th, average | 5,042 | 5,139 | 5,222 | 5,294 | 5,274 | 5,301 | 5,320 | 5,340 | 5,350 |
| annual change in % | 1.4 | 1.9 | 1.6 | 1.4 | 1.7 | 0.5 | 0.5 | 0.3 | 0.2 |
| Unemployed persons, LFS, th, average | 268 | 211 | 155 | 122 | 124 | 106 | 110 | 110 | 110 |
| Unemployment rate, LFS, in %, average | 5.1 | 4.0 | 2.9 | 2.2 | 2.3 | 2.0 | 2.0 | 2.0 | 2.0 |
| Reg. unemployment rate, in %, eop | 6.2 | 5.2 | 3.8 | 3.1 | 2.9 | 2.6 | . | . | . |
| Average monthly gross wages, CZK | 26,591 | 27,764 | 29,638 | 31,868 | 31,023 | 33,295 | 34,100 | 36,200 | 38,400 |
| annual change in % (real, gross) | 2.9 | 3.7 | 4.1 | 5.3 | 5.8 | 4.4 | 4.5 | 4.0 | 4.0 |
| Consumer prices (HICP), % p.a. | 0.3 | 0.6 | 2.4 | 2.0 | 1.9 | 2.4 | 2.5 | 2.1 | 2.1 |
| Producer prices in industry, % p.a. | -2.4 | -3.2 | 0.7 | 0.7 | -1.3 | 2.8 | 3.0 | 1.5 | 1.5 |
| General governm. budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 41.1 | 40.2 | 40.5 | 41.5 | . | . | 40.0 | 40.5 | 40.5 |
| Expenditures | 41.7 | 39.5 | 38.9 | 40.6 | . | . | 39.2 | 40.0 | 40.5 |
| Net lending (+) / net borrowing (-) | -0.6 | 0.7 | 1.6 | 0.9 | . | . | 0.8 | 0.5 | 0.0 |
| General gov.gross debt, EU def., % of GDP | 40.0 | 36.8 | 34.7 | 32.6 | . | . | 32.0 | 31.0 | 30.0 |
| Stock of loans of non-fin.private sector, % p.a. | 6.6 | 6.7 | 6.5 | 6.8 | 6.1 | 5.4 | . | . | . |
| Non-performing loans (NPL), in %, eop | 5.8 | 4.8 | 4.0 | 3.3 | 3.4 | 2.8 | . | . | . |
| Central bank policy rate, % p.a., eop 2) | 0.05 | 0.05 | 0.50 | 1.75 | 1.00 | 2.00 | 2.00 | 2.25 | 2.00 |
| Current account, EUR mn | 368 | 2,744 | 3,058 | 628 | 2,236 | 3,016 | 800 | 700 | 500 |
| Current account, % of GDP | 0.2 | 1.6 | 1.6 | 0.3 | 2.2 | 2.8 | 0.4 | 0.3 | 0.2 |
| Exports of goods, BOP, EUR mn | 115,573 | 118,033 | 129,242 | 137,024 | 69,097 | 70,694 | 141,100 | 149,400 | 156,900 |
| annual change in % | 4.7 | 2.1 | 9.5 | 6.0 | 5.4 | 2.3 | 3.0 | 5.9 | 5.0 |
| Imports of goods, BOP, EUR mn | 108,701 | 108,946 | 119,458 | 128,533 | 63,207 | 64,802 | 132,400 | 140,300 | 147,000 |
| annual change in % | 6.1 | 0.2 | 9.6 | 7.6 | 6.9 | 2.5 | 3.0 | 6.0 | 4.8 |
| Exports of services, BOP, EUR mn | 20,603 | 21,923 | 24,161 | 25,776 | 12,407 | 13,097 | 26,700 | 28,000 | 29,700 |
| annual change in % | 8.9 | 6.4 | 10.2 | 6.7 | 7.9 | 5.6 | 3.5 | 5.0 | 6.0 |
| Imports of services, BOP, EUR mn | 17,742 | 17,942 | 19,308 | 21,069 | 9,747 | 10,178 | 22,100 | 23,400 | 24,800 |
| annual change in % | 5.0 | 1.1 | 7.6 | 9.1 | 7.1 | 4.4 | 5.0 | 6.0 | 6.0 |
| FDI liabilities, EUR mn | 1,521 | 9,809 | 9,997 | 7,272 | 2,339 | 4,398 | 4,300 | . | . |
| FDI assets, EUR mn | 3,357 | 2,909 | 8,288 | 3,730 | 1,612 | 3,817 | 2,000 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 58,903 | 80,999 | 123,273 | 124,142 | 123,348 | 128,577 | . | . | . |
| Gross external debt, EUR mn | 115,396 | 129,448 | 171,115 | 169,308 | 166,453 | 170,630 | 176,300 | 180,300 | 184,000 |
| Gross external debt, % of GDP | 68.5 | 73.4 | 89.3 | 81.5 | 80.1 | 77.4 | 80.0 | 78.0 | 76.0 |
| Average exchange rate CZK/EUR | 27.28 | 27.03 | 26.33 | 25.65 | 25.50 | 25.68 | 25.5 | 25.4 | 25.4 |

1) Preliminary. - 2) Two-week repo rate.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

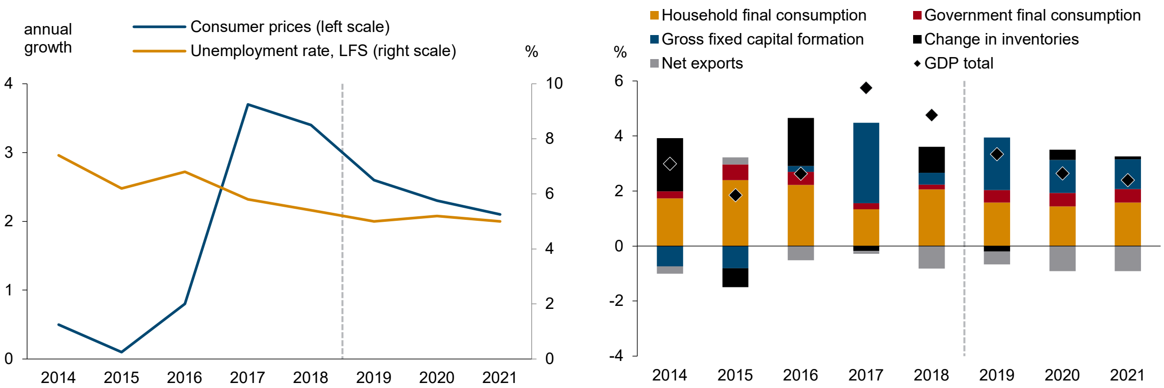

# ESTONIA: Revival of investment keeps growth buoyant

SEBASTIAN LEITNER

**Investment activity revived in 2019, following last year's slowdown. Furthermore, external demand continued growing at a higher pace than expected. Household consumption, backed by a considerable rise in employment and real wages, continues to be a strong driver of economic activity. We project GDP to grow at a rate of 3.4% in 2019, followed by a slowdown to 2.7% in 2020 and further to 2.4% in 2021.**

**Figure 5.7 / Estonia: Main macroeconomic indicators**

Inflation and unemployment, in % | Real GDP growth and contributions




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

**Contrary to expectations, GDP growth remained high in the first half of 2019, at 4.2% in real terms year on year.** One of the reasons is that exports continued to grow strongly in 2019. Estonia's trade partners in the Scandinavian region have relatively stronger links with the USA, which keeps exports afloat in spite of the slowdown in the Euro Area. External demand from Sweden however is sluggish due to the cooling of the housing market there. This results in negative effects on the manufacturing and service exports of the Estonian building sector. The slowdown of growth in Russia also caused a further decline of Estonian exports to the neighbouring country in 2019.

**Fluctuations in the oil price have a rather strong influence on Estonia's export dynamics.** After a rise in 2017-2018, the stabilisation of the price of crude oil at the lower level of about USD 65 in 2019 resulted in a reduction in foreign demand for Estonian shale oil, being used as a substitute for crude oil, by about 10% in nominal terms this year compared to 2018. Overall, we expect real growth in goods exports to level off in 2020-2021. Given swiftly rising household incomes, imports will increase more strongly than exports. In general, extensive wage increases and thus unit labour costs are putting pressure on the competitiveness of the industrial sector in Estonia. Accordingly, a gradual decline of the manufacturing share in the economy is taking place.

**After a slowdown in 2018, growth in investment activity revived this year.** Following the design phase and site investigations, the construction of the main infrastructure of Rail Baltica, the high-speed train project connecting the Baltics with the Central European network, started. Furthermore, public road infrastructure investment will enable growth to continue. Given the favourable demand situation, private enterprises are increasing their investments in equipment, particularly strongly in the manufacturing branches, wholesale and retail, transport and the ICT sectors. Strong growth in wages and very low interest rates are driving an ongoing increase in new mortgages (+7% January to August year on year) to households. Real estate prices are still growing rapidly and are above pre-crisis levels in Tallinn. Following a decline in granted building permits for dwellings in 2018, we see a revival thereof this year. Thus an upswing in housing construction is also likely to take place in 2020.

**Throughout the year, the unemployment rate continued to decline and is expected to average 5% (according to LFS) for 2019 as a whole.** A further fall however will not take place in the near future. Job vacancy rates did not increase further compared to the previous year and fell strongly in the financial sector, accommodation and construction. Public administration and the ICT sectors, however, are intensively searching for employees. Given the expected growth slowdown, the labour market situation is likely to remain unchanged in the coming two years. However, a gradual increase in jobs is expected to take place, particularly in the private service sectors, but also in public sectors like health and education. Since the native work force is going to decline in the coming years, short-term labour immigration from Ukraine and Belarus is likely to increase in the medium term.

**Given the still rather tight labour market situation, wages continued to rise strongly this year.** Real gross wages picked up by another 4.9% year on year in the first half of 2019, and as a result, growth in retail trade turnover even accelerated compared to the previous year. Household incomes will be bolstered by a further increase of approximately 8-9% in the minimum wage from January 2020 onwards. Following an increase to 3.4% last year, consumer price inflation has declined again in 2019 (mostly caused by a falling oil price and smaller excise taxes hikes) which has further strengthened real income growth. Household consumption will remain a stable driver of growth in the coming two years; however forward-looking consumer confidence indicators show a slight downturn.

**The draft budget of the coalition government for 2020 foresees a continuation of the path close to balance.** No changes in taxes are announced for 2020 except an increase in the non-taxable minimum income and a smaller than expected rise in excise taxes. Above average expenditure growth is planned for defence and the health and welfare sectors. The concluded pension hike of EUR 45 per month will increase the average pension by about 10% in nominal terms in 2020. The foreseen wage increase for teachers, kindergarten teachers and social workers will result in only a small catching up in comparison to the average salary level. The increase of the R&D budget to only 0.74% of GDP in comparison to the promised 1% resulted in protests by the university personnel and opposition from the wider public. The public debt level is expected to decrease further, to as low as 8% of GDP in 2020.

**Compared to our Summer Forecast we have become more optimistic, increasing the forecast GDP growth rate for 2019 from 3.2% to 3.4%** on account of reviving public and private investment and higher than expected external demand. The relatively tight situation in the labour market will keep wage growth high and will thus also bolster private consumption over the coming two years. While investment growth lost steam in 2018, public infrastructure projects will result in a revival in 2019-2020. In the medium term, however, we expect export growth to lose momentum while import demand will remain strong due to rising household incomes. As a result, we forecast a decline of GDP growth rates to 2.7% and 2.4% for 2020 and 2021 respectively.

## Table 5.7 / Estonia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 | 2019 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 1,315 | 1,316 | 1,317 | 1,322 | 1,319 | 1,325 | 1,325 | 1,328 | 1,330 |
| Gross domestic product, EUR mn, nom. | 20,782 | 21,694 | 23,776 | 26,036 | 12,516 | 13,594 | 27,600 | 29,000 | 30,300 |
| annual change in % (real) | 1.8 | 2.6 | 5.7 | 4.8 | 4.6 | 4.2 | 3.3 | 2.6 | 2.4 |
| GDP/capita (EUR at PPP) | 22,100 | 22,500 | 23,800 | 25,500 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. | 10,329 | 10,869 | 11,566 | 12,502 | 6,024 | 6,392 | . | . | . |
| annual change in % (real) | 4.9 | 4.5 | 2.7 | 4.2 | 3.4 | 3.2 | 3.3 | 3.0 | 3.3 |
| Gross fixed capital form., EUR mn, nom. | 5,054 | 5,054 | 5,899 | 6,211 | 2,729 | 3,462 | . | . | . |
| annual change in % (real) | -3.2 | 0.9 | 12.5 | 1.7 | -8.2 | 21.4 | 8.0 | 5.0 | 4.5 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 0.3 | 3.4 | 4.1 | 4.0 | 4.1 | 0.5 | 3.5 | 3.0 | 2.5 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 8.7 | -17.2 | 6.5 | -5.6 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | -3.5 | 4.6 | 21.5 | 17.4 | 20.5 | 2.6 | . | . | . |
| Employed persons, LFS, th, average | 640.9 | 644.6 | 658.6 | 664.7 | 658.6 | 667.7 | 672 | 676 | 678 |
| annual change in % | 2.6 | 0.6 | 2.2 | 0.9 | 1.3 | 1.4 | 1.1 | 0.6 | 0.3 |
| Unemployed persons, LFS, th, average | 42.3 | 46.7 | 40.3 | 37.7 | 41.6 | 34.1 | 35 | 37 | 36 |
| Unemployment rate, LFS, in %, average | 6.2 | 6.8 | 5.8 | 5.4 | 6.0 | 4.9 | 5.0 | 5.2 | 5.0 |
| Reg. unemployment rate, in %, eop 2) | 4.7 | 4.4 | 4.8 | 4.8 | 4.5 | 4.6 | . | . | . |
| Average monthly gross wages, EUR | 1,065 | 1,146 | 1,226 | 1,310 | 1,282 | 1,380 | 1,400 | 1,480 | 1,560 |
| annual change in % (real, gross) | 6.5 | 7.4 | 3.5 | 3.5 | 3.7 | 4.9 | 4.0 | 3.2 | 3.0 |
| Average monthly net wages, EUR | 859 | 924 | 985 | 1,050 | . | . | 1,120 | 1,180 | 1,240 |
| annual change in % (real, net) | 8.0 | 7.4 | 3.0 | 3.2 | . | . | 4.0 | 3.0 | 2.7 |
| Consumer prices (HICP), % p.a. | 0.1 | 0.8 | 3.7 | 3.4 | 3.3 | 2.6 | 2.6 | 2.3 | 2.1 |
| Producer prices in industry, % p.a. | -2.5 | -0.9 | 3.3 | 3.9 | 3.6 | 0.8 | 0.5 | -0.5 | 1.0 |
| General governm. budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 39.5 | 39.1 | 38.6 | 38.4 | . | . | 39.5 | 39.2 | 39.5 |
| Expenditures | 39.4 | 39.4 | 39.0 | 39.0 | . | . | 39.8 | 39.4 | 39.7 |
| Net lending (+) / net borrowing (-) | 0.1 | -0.3 | -0.4 | -0.5 | . | . | -0.3 | -0.2 | -0.2 |
| General gov.gross debt, EU def., % of GDP | 9.8 | 9.2 | 9.2 | 8.3 | . | . | 8.3 | 8.3 | 8.0 |
| Stock of loans of non-fin.private sector, % p.a. | 4.8 | 6.6 | 0.7 | 5.1 | 1.1 | 5.7 | . | . | . |
| Non-performing loans (NPL), in %, eop | 1.1 | 1.0 | 0.8 | 0.5 | 0.7 | 0.5 | . | . | . |
| Central bank policy rate, % p.a., eop 3) | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | 366 | 360 | 635 | 516 | 349 | 175 | 784 | 635 | 636 |
| Current account, % of GDP | 1.8 | 1.7 | 2.7 | 2.0 | 2.8 | 1.3 | 2.8 | 2.2 | 2.1 |
| Exports of goods, BOP, EUR mn | 10,692 | 11,293 | 12,029 | 12,720 | 6,309 | 6,722 | 13,700 | 14,150 | 14,600 |
| annual change in % | -3.0 | 5.6 | 6.5 | 5.7 | 6.4 | 6.5 | 7.7 | 3.3 | 3.2 |
| Imports of goods, BOP, EUR mn | 11,571 | 12,043 | 12,866 | 13,720 | 6,705 | 7,094 | 14,500 | 15,200 | 15,700 |
| annual change in % | -3.7 | 4.1 | 6.8 | 6.6 | 5.7 | 5.8 | 5.7 | 4.8 | 3.3 |
| Exports of services, BOP, EUR mn | 5,284 | 5,509 | 6,074 | 6,613 | 3,136 | 3,206 | 6,800 | 7,100 | 7,400 |
| annual change in % | -1.9 | 4.3 | 10.2 | 8.9 | 9.2 | 2.2 | 2.8 | 4.4 | 4.2 |
| Imports of services, BOP, EUR mn | 3,593 | 3,911 | 4,219 | 4,699 | 2,206 | 2,307 | 4,850 | 5,050 | 5,300 |
| annual change in % | -2.7 | 8.9 | 7.9 | 11.4 | 9.6 | 4.6 | 3.2 | 4.1 | 5.0 |
| FDI liabilities, EUR mn | -654 | 832 | 1,532 | 996 | 805 | 1,700 | 1250 | . | . |
| FDI assets, EUR mn | -522 | 315 | 606 | -221 | 164 | 1,573 | 300 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 373 | 325 | 279 | 651 | 325 | 942 | . | . | . |
| Gross external debt, EUR mn | 19,161 | 19,194 | 19,766 | 19,886 | 20,064 | 22,045 | 21,000 | 21,500 | 21,800 |
| Gross external debt, % of GDP | 92.2 | 88.5 | 83.1 | 76.4 | 77.1 | 79.9 | 76.0 | 74.0 | 72.0 |

1) Preliminary. - 2) In % of labour force (LFS). - 3) Official refinancing operation rate for euro area (ECB).

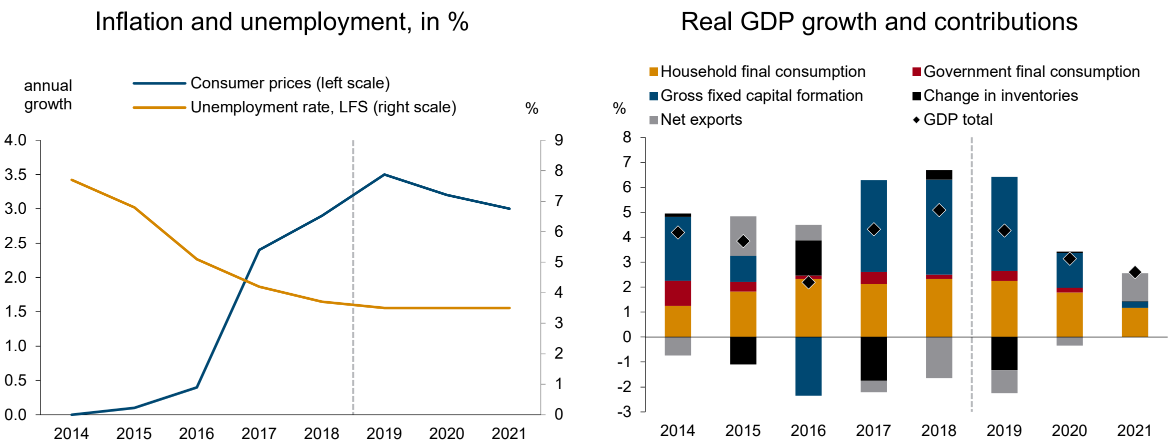
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# HUNGARY: Clear signs of decelerating growth

SÁNDOR RICHTER

**Hungarian economic growth was strong in the first half of 2019, but the signs of a deceleration are already discernible. In Q2 compared to Q1, investment growth slowed notably, while the external environment deteriorated. From next year, EU transfers will drop by a substantial degree, further weighing on investment. Labour shortages will remain problematic, and put further upward pressure on wages. We expect a significant slowdown of economic growth over the forecast horizon, from 4.3% this year to 3.1% in 2020 and to 2.6% in 2021.**

**Figure 5.8 / Hungary: Main macroeconomic indicators**




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

**Hungarian economic growth increased dynamically in the first half of 2019, becoming one of the EU28 top performers, but the signs of a deceleration are already clearly discernible.** The second quarter GDP growth (4.9%) was only 0.4 percentage points lower than that of the first quarter, but some key indicators of the current growth path show radical changes. Construction, a sector tightly related to EU co-financed projects, has decelerated from a 46.7% rate of Q1 growth to 27.9% in Q2. The growth rate of manufacturing nearly halved in the same period, from 5.8% to 3.1%. It was the services sector which saved the day with a steady growth performance over the two quarters. Within the services sector, each segment increased except ‘public administration, education and health and social work activities’ where the value added has been stagnating for at least four years.

**On the demand side the important change can be seen in gross fixed capital formation: here the Q2 growth rate was a formidable 16.4%, but much smaller than in Q1, 23.4%.** The increase of both household and government consumption has become slightly less dynamic. There are unfavourable developments in foreign trade. According to national accounts statistics, the 7.7% increase of exports in Q1 fell to 2.8% in Q2. Import growth has also been slower in Q2 compared to Q1 but the fall was more moderate and that led to a 1.6 percentage points higher imports than exports growth rate in Q2. After continuously decreasing over the past months of the year, in September the GKI Business Confidence index dropped to its lowest level since early 2017.

**Labour shortage is a serious challenge further on, but labour migration comes to the rescue.** While the government propaganda is dominated by bombastic anti-immigration rhetoric, the government tacitly opened the door to labour migration. According to Eurostat, the permission for labour migrants from non-EU countries has more than doubled. Migrants are arriving primarily from the Ukraine and also from Vietnam, Mongolia and India, i.e. non-Middle East countries. The stock of these migrants is assumed to range between 150 000 and 200 000 persons. The limit set for permissions for new foreign workers is 57 000 this year, up from 55 000 in 2018.

**Since the end of August 2019, the Hungarian currency gradually devalued reaching its historically weakest level of 336 HUF/€ on September 27.** The central bank communicates every other day that it is not concerned because of the weakening HUF and sees no reason to modify its extremely loose monetary policy. Indeed, the inflationary pressure increasing in the first half of 2019 subdued from the middle of summer, with a year-on-year CPI of 3.9 in May (core inflation 4%) and only 3.1 % (core inflation 3.7%) in August. Most probably the HUF/€ exchange rate will not return to its 310-320 HUF/€ level which it sustained in the last few years. The main Hungarian exporters are a part of production chains and are main players as importers as well, gaining only marginally due to a weak HUF. The SME sector will, however, suffer from a weakening forint. While the SMEs provide 44% of the gross value added of the business sector, their share of the exports is only 20%. That means that SME's gains are modest on the export side, while higher costs of imports due to a weak HUF may painfully increase production costs and curb investment.

**A weak forint is less risky for the budget than it was a few years ago.** The foreign currency denominated share in public debt of Hungary has fallen from the immediate post-crisis level of close to 50% to below 20% to date. The government further encourages the purchase of HUF denominated government bonds by households with the help of the Hungarian Government Security Plus. The yield on this security of 5 year maturity is 4.95%, while the central bank's policy rate is 0.9%. No wonder people are queuing up to buy this security. Nevertheless, the high yield on this very popular financial investment makes the financing of the government debt more expensive compared to alternative solutions.

**The most important question in the autumn of 2019 is how strong and how lasting the slowdown of the economic growth will be in the coming years.** From next year on the EU transfers will drop by a substantial degree, largely reducing public investment and, to some extent, business investments as well. Labour shortages will prevail which implies some pressure for further substantial wage increases. While lending activity of the financial institutions has been dynamically increasing, the negative cost side-effects (rocketing wages, more expensive imports) will curb expansion in the business sector. The time has come for a major take off in productivity, however, government policy has created legal uncertainty, favouritism, centralisation, corruption, furthered the hostility of the government toward autonomous entities and repugnance towards educational and scientific institutions which makes this turn around currently unachievable. The wiiw expects a significant slowdown of economic growth over the forecast horizon: from 4.3% to 3.1% next year and to 2.6% in 2021. Main downward risks are, first, a radical cut or even disruption of EU transfers due to political quarrels with the EU and, second, a crisis in the automotive sector due to global trade disputes. An upward risk is the positive impact of lending activities enjoying a rebirth after a long period of stagnation.

## Table 5.8 / Hungary: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 January-June | 2019 January-June | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 9,843 | 9,814 | 9,788 | 9,776 | . | . | 9,720 | 9,700 | 9,670 |
| Gross domestic product, HUF bn, nom. | 34,785 | 35,896 | 38,835 | 42,662 | 19,750 | 21,675 | 45,900 | 48,900 | 51,800 |
| annual change in % (real) | 3.8 | 2.2 | 4.3 | 5.1 | 4.9 | 5.1 | 4.3 | 3.1 | 2.6 |
| GDP/capita (EUR at PPP) | 20,000 | 19,800 | 20,600 | 22,000 | . | . | . | . | . |
| Consumption of households, HUF bn, nom. | 16,418 | 17,253 | 18,497 | 19,970 | 9,681 | 10,499 | . | . | . |
| annual change in % (real) | 3.7 | 4.9 | 4.4 | 4.9 | 5.0 | 4.8 | 4.8 | 3.8 | 2.5 |
| Gross fixed capital form., HUF bn, nom. | 7,750 | 7,058 | 8,632 | 10,739 | 4,344 | 5,669 | . | . | . |
| annual change in % (real) | 4.8 | -10.6 | 18.7 | 17.1 | 14.3 | 20.6 | 15.0 | 5.5 | 1.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 7.4 | 0.9 | 4.7 | 3.5 | 3.5 | 5.4 | 4.5 | 5.0 | 4.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -2.4 | 9.3 | -4.1 | 3.6 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 3.0 | -18.9 | 29.7 | 21.2 | 16.9 | 35.2 | . | . | . |
| Employed persons, LFS, th, average | 4,211 | 4,352 | 4,421 | 4,470 | 4,455 | 4,504 | 4,510 | 4,520 | 4,520 |
| annual change in % | 2.7 | 3.4 | 1.6 | 1.1 | 1.4 | 1.1 | 0.8 | 0.3 | 0.1 |
| Unemployed persons, LFS, th, average | 308 | 235 | 192 | 172 | 172 | 161 | 160 | 160 | 160 |
| Unemployment rate, LFS, in %, average | 6.8 | 5.1 | 4.2 | 3.7 | 3.8 | 3.5 | 3.5 | 3.5 | 3.5 |
| Reg. unemployment rate, in %, eop | 7.6 | 6.1 | 5.6 | 5.2 | 5.2 | 5.4 | . | . | . |
| Average monthly gross wages, HUF 2) | 247,924 | 263,171 | 297,017 | 329,943 | 324,408 | 359,462 | 365,400 | 395,900 | 413,900 |
| annual change in % (real, gross) | 4.4 | 5.7 | 10.3 | 8.3 | 9.2 | 6.9 | 7.0 | 5.0 | 1.5 |
| Average monthly net wages, HUF 2) | 162,391 | 175,009 | 197,516 | 219,412 | 215,731 | 239,042 | 243,000 | 263,300 | 275,300 |
| annual change in % (real, net) | 4.4 | 7.4 | 10.3 | 8.3 | 9.2 | 6.9 | 7.0 | 5.0 | 1.5 |
| Consumer prices (HICP), % p.a. | 0.1 | 0.4 | 2.4 | 2.9 | 2.4 | 3.5 | 3.5 | 3.2 | 3.0 |
| Producer prices in industry, % p.a. | -1.1 | -1.7 | 3.3 | 5.6 | 4.4 | 2.7 | 4.0 | 3.2 | 3.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 47.6 | 44.6 | 44.2 | 43.6 | . | . | 44.5 | 44.0 | 45.0 |
| Expenditures | 49.5 | 46.2 | 46.3 | 45.8 | . | . | 46.2 | 45.6 | 47.9 |
| Net lending (+) / net borrowing (-) | -1.9 | -1.6 | -2.2 | -2.2 | . | . | -1.7 | -1.6 | -2.9 |
| General gov.gross debt, EU def., % of GDP | 75.8 | 75.1 | 72.5 | 69.9 | . | . | 69.1 | 68.2 | 67.5 |
| Stock of loans of non-fin.private sector, % p.a. | -12.3 | -1.3 | 5.5 | 10.6 | 8.7 | 11.4 | . | . | . |
| Non-performing loans (NPL), in %, eop 3) | 13.6 | 10.8 | 7.5 | 5.4 | 6.6 | 4.9 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 1.35 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 1.20 | 1.50 |
| Current account, EUR mn 5) | 2,648 | 5,209 | 2,830 | -717 | 728 | -66 | -200 | -200 | -100 |
| Current account, % of GDP 4) | 2.4 | 4.5 | 2.3 | -0.5 | 1.2 | -0.1 | -0.1 | -0.1 | -0.1 |
| Exports of goods, BOP, EUR mn 5) | 78,477 | 78,588 | 85,555 | 88,626 | 44,710 | 47,199 | 92,900 | 97,500 | 103,400 |
| annual change in % | 6.3 | 0.1 | 8.9 | 3.6 | 3.7 | 5.6 | 4.8 | 5.0 | 6.0 |
| Imports of goods, BOP, EUR mn 5) | 74,425 | 74,630 | 83,646 | 90,280 | 44,458 | 47,505 | 96,200 | 101,700 | 107,800 |
| annual change in % | 3.8 | 0.3 | 12.1 | 7.9 | 6.8 | 6.9 | 6.6 | 5.7 | 6.0 |
| Exports of services, BOP, EUR mn 5) | 20,286 | 21,878 | 23,862 | 24,991 | 12,026 | 12,235 | 25,500 | 26,800 | 28,400 |
| annual change in % | 8.1 | 7.9 | 9.1 | 4.7 | 6.7 | 1.7 | 2.0 | 5.0 | 6.0 |
| Imports of services, BOP, EUR mn 5) | 15,378 | 15,753 | 16,618 | 17,466 | 8,401 | 8,496 | 17,800 | 18,700 | 19,800 |
| annual change in % | 8.4 | 2.4 | 5.5 | 5.1 | 7.0 | 1.1 | 2.0 | 5.0 | 6.0 |
| FDI liabilities, EUR mn 5) | 7,192 | -5,851 | 7,208 | 8,469 | 3,124 | 2,831 | 5,000 | . | . |
| FDI assets, EUR mn 5) | 5,753 | -8,414 | 5,044 | 5,657 | 2,582 | 1,679 | 5,000 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 30,226 | 24,384 | 23,261 | 26,273 | 23,955 | 25,807 | . | . | . |
| Gross external debt, EUR mn 5) | 119,339 | 110,940 | 105,583 | 107,218 | 106,395 | 110,907 | 111,000 | 111,000 | 111,000 |
| Gross external debt, % of GDP 5) | 106.4 | 96.3 | 84.1 | 80.1 | 79.5 | 78.8 | 78.8 | 75.1 | 72.0 |
| Average exchange rate HUF/EUR | 310.00 | 311.44 | 309.19 | 318.89 | 314.09 | 320.39 | 326 | 331 | 336 |

1) Preliminary. - 2) Enterprises with 5 and more employees. From 2019 data according to tax administration. - 3) From 2016 broader definition of NPL (90 days criteria plus loans unlikely to be paid). - 4) Base rate (two-week NB bill). - 5) Excluding SPE.

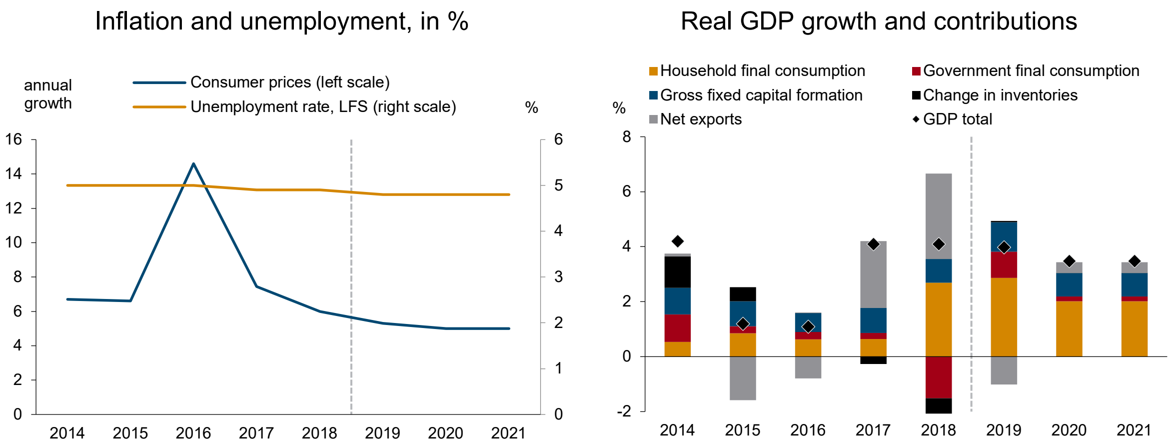
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# KAZAKHSTAN: Relying on state support to sustain economic growth

ALEXANDRA BYKOVA

**GDP growth will remain robust at 4% in 2019, driven mainly by private consumption, but will slow to around 3.5% in 2020 and 2021, as the stimulating effect of fiscal packages dies out. The current account balance will deteriorate as imports rise on the back of stronger demand for consumer and capital goods. Export growth could decelerate amid an expected economic slowdown in Kazakhstan's main trading partners.**

**Figure 5.9 / Kazakhstan: Main macroeconomic indicators**




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

**We have revised up our 2019 GDP growth forecast by 0.4 p.p. to 4.0%, owing to better than expected second quarter results.** The decrease in oil production, mainly due to maintenance works in the three major oil fields, was offset by the strong growth of non-ferrous metals production, construction, and trade and transport services.

**Household consumption will be the main driver of economic growth in 2019 and in the medium term.** Data for the first half of 2019 demonstrate a significant increase in real wages by 7.1% compared to the same period of the previous year. Consumer lending is also expanding rapidly despite interest rates above 20% p.a., with new loans for general consumption growing by 24.5% annually in August 2019. Consumption will continue to play a leading role in the next two years, but it might diminish as the state support package that has triggered income growth this year is expected to be less comprehensive.

**Large public and private investments will support economic growth in 2019-2021.** Real annual growth of fixed investments reached 5.7% in the first half of 2019. In 2020-2021, the expansion of production capacities of the Tengiz, Kashagan and Karachaganak oil fields will move forward, with foreign investors playing a key role. According to official estimates, total investment in these projects will amount to USD 44.5 billion. Completion of the Saryarka gas pipeline in 2019 will be complemented by the construction of a gas distribution network and appropriate facilities in 2020. Joint public and private funding of gas infrastructure projects will reportedly reach KZT 92 billion (USD 230 million) in the medium-term perspective. The construction of roads was already booming in 2019 with an annual growth of 15% over the first half of the year and is set to continue as the 'Nurly-Zhol' infrastructure investment program will be extended until 2025. A heavily subsidised lending in the framework of the '7-20-25' program will aim at further stimulating new housing investment in the coming years.

**Rising external imbalances are putting pressure on the tenge and might hamper economic growth in the future.** Rapidly growing demand for imported goods for consumption and investment combined with a poor export performance in 2019, and a moderate one for the next two years, will lead to the deterioration of the current account. Merchandise imports grew by 13.2% in US dollar terms over January-August 2019 compared to 2018. Simultaneously, merchandise exports declined by 4.5% mainly on the back of cuts in the oil revenues due to lower oil prices and a one-month-long production stop at several oil fields in April of this year. A sharp increase in oil production that could mitigate price effects is only expected in the long-term perspective after 2023, upon completion of the oil fields expansion projects. Authorities estimate that annual oil production may expand from 90 to 105 million tons by 2025. The slowdown in global demand and volatility in oil prices bring further uncertainty to oil export revenue forecasts for the coming years.

**Reliance on oil revenues is expected to persist in the next few years.** However, although progress has been slow, there are some signs of success in attempts to diversify the economy. Three large oil refineries in Atyrau, Shymkent and Pavlodar have been modernised this year. Their production capacity is enough to satisfy domestic demand for petroleum products. Car production is booming with 57.9% growth in January-September 2019 year-on-year and will further expand driven by strong domestic demand. Construction of the large polypropylene plant in Atyrau will be finished in 2021, with production destined for external markets.

**Economic policy will remain expansionary, giving impetus to consumption and investment growth.** In 2019, stimulus measures included: a minimum wage hike by 50% at the beginning of the year, an additional 30% wage increase for low-paid public officials in July and a package of social benefits. The budget for the next three years envisages further expansion of social spending: expenditures related to the introduction of the compulsory health insurance system in 2020, an increase in teachers' salaries to attract them to rural areas and the indexation of pensions and social benefits. Public investments will be directed to the gas and water infrastructure and road construction. Recently, President Tokayev has announced new policy measures to support SMEs development through income tax reliefs and inspection exemptions for three years.

**Despite the announced increase in budget spending for social purposes, fiscal consolidation aimed at the reduction of the non-oil deficit will remain on the government agenda.** It is intended to achieve this by improving tax administration and increasing the efficiency of budget expenditures, for example, by developing a competitive tender system for public procurements. In his first State of the

Nation Address on September 2, President Tokayev presented several new initiatives on public sector reform and fiscal decentralisation. However, it is doubtful that these ambitious administrative reforms will be fully implemented.

**Monetary policy will target inflation of 4-6% in the next few years.** The National Bank of Kazakhstan (NBK) hiked the base rate by 0.25 p.p. to 9.25% on 9 September 2019 to contain inflationary pressure caused by higher than expected growth dynamics. Based on nine-month data, we forecast that annual inflation will reach 5.3% in 2019 and decelerate to 5% over the next two years amid weakening fiscal stimulus. We estimate that the NBK will gradually cut the interest rate to 8.75% by 2021 if inflationary conditions permit.

**Booming unsecured consumer lending poses additional risks to the banking system that still needs to cope with the high level of bad loans** (the NPL ratio was 9.5% in August 2019). The likely slowdown in income growth in the next few years may hamper timely loan repayment. Albeit the share of loans to households in GDP is less than 10%, and the systemic risk is not high, one can expect difficulties for more exposed banks and social consequences for certain groups of the population. Already this year, a rescue package with partial write-off of the debt was needed to alleviate the credit burden of the most heavily indebted low-income households. By the end of the year the NBK will respond with a set of prudent measures. Starting from 2020, financial regulation will be carried out by the specially created Agency for Regulation and Development of Financial Markets which reports directly to the President.

**The establishment of the National Council of Public Trust is a small, cautious step by the new President to allow civil society to participate in the reform process.** However, the lack of genuine political freedom is pushing the opposition toward street protests, which are still mostly cracked down on by the government. Apparently, by emphasising stronger social orientation of its economic policy, the government hopes to prevent the spread of public discontent.

**We project GDP growth to remain stable at 3.5 % for the 2020-2021 period as a baseline scenario.** Downside risks stem from the uncertainties regarding global demand and oil prices, as well as the exchange rate and inflationary pressures.

## Table 5.9 / Kazakhstan: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 | 2019 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 17,543 | 17,794 | 18,038 | 18,276 | 18,215 | 18,452 | 18,500 | 18,700 | 18,900 |
| Gross domestic product, KZT bn, nom. 2) | 40,884 | 46,971 | 54,379 | 61,820 | 24,857 | 27,909 | 68,800 | 74,400 | 80,500 |
| annual change in % (real) | 1.2 | 1.1 | 4.1 | 4.1 | 4.2 | 4.1 | 4.0 | 3.5 | 3.5 |
| GDP/capita (EUR at PPP) | 18,900 | 18,400 | 19,600 | 20,400 | . | . | . | . | . |
| Consumption of households, KZT bn, nom. | 21,492 | 25,087 | 26,991 | 30,003 | 12,205 | 13,607 | . | . | . |
| annual change in % (real) | 1.8 | 1.2 | 1.2 | 5.3 | 4.5 | 5.9 | 5.7 | 4.0 | 4.0 |
| Gross fixed capital form., KZT bn, nom. | 9,355 | 10,671 | 11,622 | 12,755 | 4,293 | 5,682 | . | . | . |
| annual change in % (real) | 4.2 | 3.0 | 4.0 | 3.9 | 5.3 | 5.7 | 5.0 | 4.0 | 4.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | -1.6 | -1.1 | 7.3 | 4.1 | 5.2 | 2.6 | 3.2 | 2.5 | 2.5 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 3.4 | 5.4 | 3.0 | 3.5 | 4.1 | 3.8 | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 5.8 | 7.4 | 2.8 | 4.1 | 3.8 | 11.1 | . | . | . |
| Employed persons, LFS, th, average | 8,624 | 8,553 | 8,585 | 8,695 | 8,602 | 8,748 | 8,830 | 8,920 | 9,010 |
| annual change in % | 1.3 | -0.8 | 0.4 | 1.3 | 1.2 | 1.7 | 1.5 | 1.0 | 1.0 |
| Unemployed persons, LFS, th, average | 451 | 446 | 442 | 444 | 441 | 442 | 450 | 450 | 450 |
| Unemployment rate, LFS, in %, average | 5.0 | 5.0 | 4.9 | 4.9 | 4.9 | 4.8 | 4.8 | 4.8 | 4.8 |
| Reg. unemployment rate, in %, eop | 0.4 | 0.4 | 0.8 | 1.0 | 1.7 | 1.9 | . | . | . |
| Average monthly gross wages, KZT 3) | 126,021 | 142,898 | 150,827 | 162,673 | 157,597 | 177,513 | 185,000 | 202,000 | 218,500 |
| annual change in % (real, gross) | -2.3 | -1.1 | -1.7 | 1.7 | 1.9 | 7.1 | 8.0 | 4.0 | 3.0 |
| Consumer prices (HICP), % p.a. | 6.6 | 14.6 | 7.4 | 6.0 | 6.5 | 5.2 | 5.3 | 5.0 | 5.0 |
| Producer prices in industry, % p.a. | -20.5 | 16.8 | 15.3 | 19.0 | 15.9 | 10.0 | 8.0 | 1.0 | 1.0 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 18.7 | 19.8 | 21.3 | 17.5 | 21.1 | 22.2 | 19.0 | 20.0 | 19.0 |
| Expenditures | 20.9 | 21.4 | 23.9 | 18.8 | 21.4 | 22.6 | 21.0 | 22.0 | 20.8 |
| Deficit (-) / surplus (+) | -2.2 | -1.6 | -2.7 | -1.3 | -0.3 | -0.4 | -2.0 | -2.0 | -1.8 |
| General gov.gross debt, nat.def., % of GDP | 22.7 | 25.0 | 25.7 | 26.0 | 23.9 | 23.5 | 25.0 | 25.0 | 24.5 |
| Stock of loans of non-fin.private sector, % p.a. | 4.7 | 0.3 | 0.0 | 3.0 | 1.0 | 0.6 | . | . | . |
| Non-performing loans (NPL), in %, eop | 8.0 | 6.7 | 9.3 | 7.4 | 8.8 | 9.4 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 16.00 | 12.00 | 10.25 | 9.25 | 9.00 | 9.00 | 9.25 | 9.00 | 8.75 |
| Current account, EUR mn 5) | -5,423 | -7,349 | -4,516 | -245 | -1,214 | -1,700 | -3,800 | -3,400 | -3,500 |
| Current account in % of GDP | -3.3 | -5.9 | -3.1 | -0.2 | -1.9 | -2.6 | -2.4 | -2.0 | -1.9 |
| Exports of goods, BOP, EUR mn 5) | 40,437 | 32,068 | 41,866 | 50,672 | 23,402 | 25,288 | 50,200 | 50,600 | 52,200 |
| annual change in % | -32.0 | -20.7 | 30.6 | 21.0 | 12.6 | 8.1 | -0.9 | 0.8 | 3.2 |
| Imports of goods, BOP, EUR mn 5) | 29,948 | 23,706 | 27,060 | 29,030 | 13,258 | 15,231 | 34,300 | 36,300 | 38,500 |
| annual change in % | -6.3 | -20.8 | 14.2 | 7.3 | 1.3 | 14.9 | 18.2 | 5.8 | 6.1 |
| Exports of services, BOP, EUR mn 5) | 5,573 | 5,498 | 5,757 | 6,192 | 2,879 | 3,124 | 6,700 | 7,100 | 7,500 |
| annual change in % | 5.7 | -1.3 | 4.7 | 7.5 | 0.6 | 8.5 | 8.2 | 6.0 | 5.6 |
| Imports of services, BOP, EUR mn 5) | 9,831 | 8,898 | 8,924 | 10,154 | 4,516 | 4,762 | 10,700 | 11,200 | 11,800 |
| annual change in % | -5.7 | -9.5 | 0.3 | 13.8 | 4.5 | 5.4 | 5.4 | 4.7 | 5.4 |
| FDI liabilities, EUR mn 5) | 5,934 | 15,562 | 4,171 | 181 | 750 | 811 | 900 | . | . |
| FDI assets, EUR mn 5) | 2,992 | 3,140 | 847 | -3,936 | -2,780 | -2,479 | -3,600 | . | . |
| Gross reserves of NB excl. gold, EUR mn 5) | 18,555 | 19,191 | 15,505 | 14,460 | 14,734 | 9,813 | . | . | . |
| Gross external debt, EUR mn 5) | 139,886 | 155,979 | 140,153 | 138,839 | 141,200 | 139,100 | 138,900 | 143,000 | 143,800 |
| Gross external debt, % of GDP | 84.1 | 125.7 | 94.9 | 91.3 | 92.9 | 87.1 | 87.0 | 84.0 | 80.0 |
| Average exchange rate KZT/EUR | 245.80 | 378.63 | 368.32 | 406.66 | 395.35 | 428.31 | 431 | 437 | 448 |

1) Preliminary. - 2) From 2017 new methodology for assessing the non-observed economy. - 3) Excluding small enterprises, engaged in entrepreneurial activity. - 4) One-day (overnight) repo rate. - 5) Converted from USD.

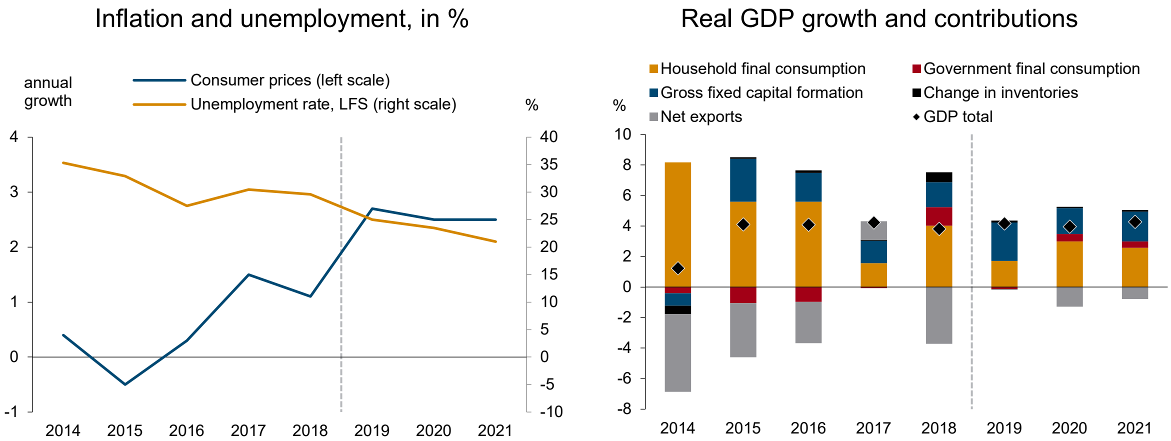
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# KOSOVO: Opposition parties triumph

ISILDA MARA

**Kosovo has been one of the fastest growing economies in the region and is likely to remain so. Growth will be supported by consumption and gross fixed capital formation. The 100% tariff imposed on imports from Serbia and Bosnia and Herzegovina in 2019 is likely to remain in place, and will continue to push up prices. The new government could deliver important domestic reforms, and is also likely to shake up international relations in the Western Balkans region.**

**Figure 5.10 / Kosovo: Main macroeconomic indicators**




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

**Opposition parties came out victorious from October 2019 early parliamentary elections.** In July 2019 the former Prime Minister Ramush Haradinaj announced his resignation and consequently triggered early parliamentary elections after being called for questioning by Kosovo Special Court of Justice[21] in The Hague. The self-determination party 'Levizja Vete Vetevendosje – LVV' and the Democratic League of Kosovo (LDK) have been the main winners. The new government will be led by these two parties which gained close to 50% of votes and 61 out of 120 places in the new parliament. The LVV is a new movement, founded in 2005 and led by Albin Kurti – whose opposition towards previous governments - for alleged corruption, nepotism and lack of reforms - has been very tough and radical.

21 Kosovo Specialist Chambers and Specialist Prosecutor´s Office is part of Kosovo judicial system, but sits in The Hague. The court is composed of international judges and prosecutors who are supposed to investigate alleged crimes during the Kosovo war - 1998 to 2000 period.

**Vetevendosje, on the whole, owes its victory to the youth vote.** Kurti managed to give voice to their frustrations at not being heard, not being represented, not being offered the chance to build a decent life at home as well being denied the possibility to build it elsewhere. The LDK - founded 30 years ago by Ibrahim Rugova – was represented by Vjosa Osmani. She is one of the lawyers who defended the legitimacy of Kosovo's independence declaration in front of International Court of Justice. Another winner from these parliamentary elections has also been Srpska Lista (SL) of Kosovo - a minority political party in Kosovo backed by government of Serbia - who got 6.7% of votes – their best result achieved ever.

**The geopolitics in the Western Balkans is likely to take a new route as Albin Kurti takes office as Prime Minister. The** already difficult Kosovo – Serbia dialogue will have another epicentre. According to Albin Kurti pronouncements, the discourse of the Kosovo – Serbia dialogue might shift from ‘Kosovo recognition’ to ‘what Serbia is indebted to Kosovo’. Also, he is prone to further integration between Kosovo and Albania and supports the idea ‘one nation, one state’ of ethnic Albanians. Last April 2019, LVV officially extended and established its activity in Albania too. Therefore, new and unexplored paths might emerge in the Western Balkan region as the new Prime Minister takes office in Kosovo. The role that international partners will play – given the new political constellation in Kosovo as well as recently nominated representatives of the EU and the USA in this matter - still remains to be seen.

**Strong impetus to growth thanks to consumption and infrastructure investment projects.** GDP growth for the first half of the year 2019, y-o-y, was close to 4.2%, driven by both domestic and external demand. Gross fixed capital formation expanded at 9%. Household consumption went up by 3.6% whereas government consumption shrank by 2.6% over the same period. In production terms, growth characterised all sectors of the economy by and large, except for agriculture and public administration. Sectors which expanded the most have been financial and insurance activities, manufacturing and wholesale and retail trade.

**Despite strong economic growth, improvements in the labour market remain meagre.** More than 15,000 new jobs were created between Q2/2018 and Q2/2019. The employment rate rose by 2 pp but at 29.8% in the second quarter is still extremely low. The inactivity rate stands at 60.1 %. Youth unemployment is one of the highest in the region - at 49.1%. The employment rate among women is one of lowest in the region - at only 13%. This is a continuous source of frustration and social tensions especially between youths and women.

**Public debt slightly declined to 16.5% of GDP for the first half of 2019.** General budget revenues by far exceeded expenditures generating a surplus in the general government budget and lowering public debt over the first half of 2019, y-o-y. Despite, the wage hike in the public sector – at 15% - compensation to employees still only soared by 4% for the first half of 2019, y-o-y. With the establishment of the new government the outlook might change in the sense that rising expenditures on health and education will be prioritised against infrastructure projects. It is likely that EUR 1 billion infrastructure projects are under threat, e.g. the Dukagjini highway announced by the previous government will not make its way through parliament since both the LVV and LDK have been against it.

**The 100% tariff imposed on imports from Serbia and Bosnia and Herzegovina last year will most probably stay.** In their electoral campaign, all political parties - including the LVV and LDK – have been in favour of preserving the tariff. Because of the tariff, imports from Serbia and Bosnia and Herzegovina dropped to close to nil and imports from CEFTA as a whole fell by 43%. North Macedonia and Montenegro have benefited by gaining parts of the Kosovo trade markets that Serbia lost: North Macedonia expanded exports to Kosovo by almost 50% and Montenegro almost doubled its exports (starting from a low base), while Albanian imports to Kosovo rose by only 21% for January – August 2019, y-o-y. Imports from Greece, as well as from Turkey, China, Brazil and Egypt have also replaced imports from Serbia to some extent. The prohibitive tariff also fuelled inflation: import prices and consumer prices in general soared – especially for food, meat and other consumption goods – respectively by 3.9 and 2.7% for the second quarter of 2019, y-o-y. Thus, consumers have been affected and this is becoming visible. Overall, imports of goods grew by 4.4% January – August 2019, y-o-y.

**Goods exports went up and the merchandise trade deficit slightly improved.** In nominal terms goods exports soared by 10% while imports by 4.4%, January – August 2019, y-o-y. Still, the goods trade deficit remains high, with the cover ratio of exports to imports at only 13% over the same period. Exports of services achieved a growth of 11% for the first half of the year, y-o-y, against services imports expansion at 7% over the same period. Nevertheless, the current account deficit will persist being high and close to 8% of GDP despite positive developments.

**The foreign direct investment position ameliorated over the first half of 2019.** Over this period, FDI inflows recovered by 23%. Albeit, the largest share of FDI inflows continued being absorbed by the Real Estate sector. Countries which intensified their FDI inflows to Kosovo over this period were Germany, Slovenia, USA, Albania and the Netherlands – countries where large communities of migrants from Kosovo are settled hinting that ethnic networks might have been important for mobilising FDI inflows to Kosovo. Otherwise, expectancies about the lignite power plant ‘Kosova e Re’ are dying out. The World Bank withdrew from the project and currently it does not have the support of either the former or the new government.

**Remittances continue to be an important source of secondary income**. Kosovo diaspora abroad is estimated to be at 42% of its current population. Remittances inflow increased by 7% for January – August 2019, y-o-y and in 2018 it amounted to 12% of GDP. However, close to 75% of remittances go for smoothing consumption. Recently, business associations representing the diaspora of Kosovo launched the idea of a Diaspora Bank underpinned with capital from the diaspora – an initiative that if it gets through would certainly contribute to leverage financial support for entrepreneurs and boost job creation in Kosovo.

**For the forecasting period we expect economic growth to accelerate above 4%** backed by improved domestic demand. The new government ruled by the new coalition – the LVV and LDK – is likely to undertake structural reforms which might give a new impetus to the Kosovo economy.

## Table 5.10 / Kosovo: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 January-June | 2019 January-June | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 1,788 | 1,778 | 1,791 | 1,797 | . | . | 1,820 | 1,845 | 1,860 |
| Gross domestic product, EUR mn, nom. | 5,807 | 6,070 | 6,414 | 6,726 | 3,067 | 3,245 | 7,200 | 7,700 | 8,200 |
| annual change in % (real) | 4.1 | 4.1 | 4.2 | 3.8 | 7.0 | 4.2 | 4.2 | 4.0 | 4.3 |
| GDP/capita (EUR at PPP) | 7400 | 7600 | 7800 | 8300 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. | 4,943 | 5,194 | 5,370 | 5,738 | 2,776 | 2,891 | . | . | . |
| annual change in % (real) | 6.5 | 6.6 | 1.8 | 4.8 | 6.3 | 1.5 | 2.0 | 3.5 | 3.0 |
| Gross fixed capital form., EUR mn, nom. | 1,499 | 1,550 | 1,729 | 1,888 | . | . | . | . | . |
| annual change in % (real) | 12.1 | 7.3 | 5.7 | 6.1 | . | . | 9.0 | 6.0 | 7.0 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | 3.7 | -6.7 | 4.9 | -1.3 | . | . | 3.5 | 3.0 | 5.0 |
| Gross agricultural production 3) | | | | | | | | | |
| annual change in % (real) | 13.8 | 14.5 | -4.1 | -20.4 | . | . | . | . | . |
| Construction output 4) | | | | | | | | | |
| annual change in % (real) | 15.8 | 4.5 | 8.6 | 9.3 | . | . | . | . | . |
| Employed persons, LFS, th, average 5) | 296.9 | 331.8 | 357.1 | 345.1 | 342.0 | 349.2 | 360 | 365 | 370 |
| annual change in % | -8.2 | 11.7 | 7.6 | -3.4 | -3.1 | 2.1 | 3.6 | 2.0 | 1.5 |
| Unemployed persons, LFS, th, average 5) | 145.8 | 126.1 | 156.6 | 145.0 | 133.0 | 123.5 | 120 | 110 | 100 |
| Unemployment rate, LFS, in %, average 5) | 32.9 | 27.5 | 30.5 | 29.6 | 28.0 | 26.1 | 25.0 | 23.5 | 21.0 |
| Reg. unemployment rate, in %, eop | . | . | . | . | . | . | . | . | . |
| Average monthly gross wages, EUR | 510 | 519 | 528 | 558 | . | . | 590 | 630 | 670 |
| annual change in % (real, gross) | 0.0 | 1.5 | 1.7 | 4.7 | . | . | 5.0 | 4.0 | 4.0 |
| Average monthly net wages, EUR | 451 | 457 | 471 | 498 | . | . | 550 | 590 | 630 |
| annual change in % (real, net) | 5.4 | 1.0 | 1.5 | 4.6 | . | . | 7.0 | 5.0 | 4.0 |
| Consumer prices (HICP), % p.a. | -0.5 | 0.3 | 1.5 | 1.1 | 0.3 | 3.2 | 2.7 | 2.5 | 2.5 |
| Producer prices, % p.a. | 2.7 | -0.1 | 0.6 | 1.4 | 0.9 | 1.6 | 1.0 | 0.5 | 1.2 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 29.4 | 29.3 | 30.0 | 29.8 | 28.4 | 33.1 | 31.0 | 31.0 | 31.5 |
| Expenditures | 27.8 | 29.1 | 28.6 | 29.4 | 27.9 | 27.6 | 33.0 | 33.0 | 32.0 |
| Deficit (-) / surplus (+) | 1.6 | 0.2 | 1.3 | 0.4 | 0.5 | 5.6 | -2.0 | -2.0 | -0.5 |
| General gov.gross debt, nat.def., % of GDP | 12.9 | 14.0 | 15.5 | 16.3 | 16.3 | 16.3 | 17.0 | 17.5 | 18.0 |
| Stock of loans of non-fin.private sector, % p.a. | 7.2 | 10.5 | 11.6 | 10.8 | 11.4 | 10.5 | . | . | . |
| Non-performing loans (NPL), in %, eop | 6.2 | 4.9 | 3.1 | 2.7 | 2.8 | 2.5 | . | . | . |
| Central bank policy rate, % p.a., eop 6) | 7.69 | 7.22 | 6.83 | 5.99 | 6.5 | 6.3 | 6.00 | 6.00 | 5.50 |
| Current account, EUR mn | -497 | -481 | -349 | -509 | -348 | -288 | -520 | -580 | -650 |
| Current account, % of GDP | -8.6 | -7.9 | -5.4 | -7.6 | -11.3 | -8.9 | -7.2 | -7.5 | -7.9 |
| Exports of goods, BOP, EUR mn | 322 | 308 | 378 | 377 | 173 | 183 | 400 | 420 | 450 |
| annual change in % | -0.6 | -4.5 | 22.9 | -0.4 | -3.1 | 5.3 | 5.0 | 6.0 | 6.0 |
| Imports of goods, BOP, EUR mn | 2,432 | 2,599 | 2,843 | 3,114 | 1,443 | 1,484 | 3,250 | 3,460 | 3,650 |
| annual change in % | 2.1 | 6.9 | 9.4 | 9.6 | 10.7 | 2.9 | 4.5 | 6.5 | 5.5 |
| Exports of services, BOP, EUR mn | 952 | 1,131 | 1,359 | 1,562 | 523 | 587 | 1,700 | 1,810 | 1,930 |
| annual change in % | 2.5 | 18.8 | 20.2 | 14.9 | 27.7 | 12.2 | 9.0 | 6.5 | 6.8 |
| Imports of services, BOP, EUR mn | 494 | 492 | 531 | 706 | 272 | 293 | 790 | 850 | 910 |
| annual change in % | 5.5 | -0.5 | 8.1 | 32.8 | 26.6 | 7.6 | 12.0 | 8.0 | 7.5 |
| FDI liabilities, EUR mn | 309 | 220 | 255 | 272 | 93 | 111 | 290 | . | . |
| FDI assets, EUR mn | 37 | 43 | 43 | 46 | 19.5 | 20.2 | 20 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 708 | 605 | 683 | 769 | 699 | 1,006 | . | . | . |
| Gross external debt, EUR mn | 1,932 | 2,015 | 2,089 | 2,036 | 2,072 | 2,142 | 2,300 | 2,500 | 2,500 |
| Gross external debt, % of GDP | 33.3 | 33.2 | 32.6 | 30.3 | 30.8 | 29.7 | 32.5 | 32.0 | 31.0 |

1) Preliminary. - 2) Turnover in manufacturing industry (NACE C). - 3) wiiw estimate in 2018. - 4) Value added. -
5) Population 15-64. - 6) Average weighted effective lending interest rate of commercial banks (Kosovo uses the euro as national currency).

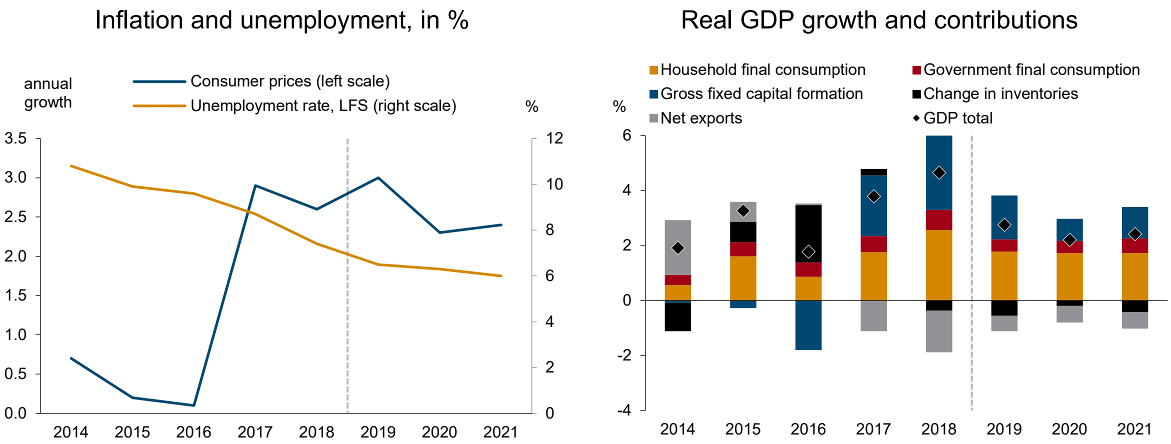
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# LATVIA: In the midst of a soft landing

SEBASTIAN LEITNER

**Economic growth has almost halved in comparison to the last two boom years. Investment growth has slowed, although household consumption remains robust. Although abating slightly, exports have grown more strongly than expected so far in 2019. Despite the economic slowdown, the labour market is tightening further with the unemployment rate falling towards 6.5% in 2019. This year, we expect GDP growth to decline to 2.7%, followed by a further slowdown to 2.2% in 2020 and amelioration to 2.4% in 2021.**

**Figure 5.11 / Latvia: Main macroeconomic indicators**




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

**Overall, GDP growth declined to 2.4% in the first half of 2019 in real terms year on year. The slowdown in global economic activity resulted in Latvia's exports stagnating nominally in the same period compared to last year.** Export growth however only abated with Western Europe whereas an absolute decline was reported with the main trading partner Russia. Swiftly rising wages are putting the competitive position and thus the world export share of the Latvian manufacturing sector under pressure. Generally, stagnation in industrial production despite increasing household consumption shows the mounting problem in the manufacturing sector. However, the most important export items, wood and articles thereof and electrical machinery, are still reporting good growth figures. Besides, the export of services is rising at a higher pace. In particular, trade in transport and business services is flourishing. Since the growth of imports is also declining, the negative contribution of net exports to overall GDP growth is expected to decrease for this year. We may even see the current account deficit decreasing further and remaining below -1% of GDP in the period 2020-2021.

**Gross fixed capital investment growth has slowed compared with 2018, but was still robust at 5.9% year on year in H1 2019.** Fresh EU funds were used on a larger scale last year, while public investment for this year and 2020-2021 is expected to remain at the same level in relation to GDP. The government continues to invest in the Rail Baltica high speed train project. This year contracts were signed for the design of all main tracks and related infrastructure such as bridges and stations. The construction of the tracks will start in 2021 and the project is scheduled to be finished in 2026. In total, Latvia had spent 38% of the planned EU funds from the 2014-2020 budget by July 2019. Along with Estonia and Lithuania, Latvia is a frontrunner in the group of new EU Member States in this respect. Only a few EU countries (e.g. Finland, Ireland and Sweden) have already spent 50% or more. Last year's construction boom levels off this year, however, the number of building permits granted shows that the growth of building activity will continue next year too and not only in the field of dwellings, but also in industrial and other commercial buildings. Investment in machinery and equipment has also grown quickly so far in 2019.

**In August 2019 the ECB assessed that PNB banka, Latvia's sixth largest institute, was failing or likely to fail in accordance with the Single Resolution Mechanism Regulation and had to be shut down.** The ECB concluded after inspection, that PNB banka, formerly known as Norvik, failed to provide evidence that it would be able to replenish its capital in order to meet its liabilities. This is another blow to the country's financial sector, following the shutdown of the operations of Latvia's third largest bank, ABLV, due to institutionalised money laundering in 2018. The turmoil resulted in a stronger decline of foreign deposits in the first quarter of 2018, levelling off in the following months. However, in the second quarter of 2019, a decline of more than 10% was experienced again.

**Job growth cooled off in the first half of 2019 to 1% year on year.** However, given the continuous decrease in the working age population, another strong decline of the unemployment rate to 6.5% is expected on average this year. Also rising vacancy rates highlight the tight situation in the labour market. Employers are increasingly in need of technicians and trade workers and plant and machine operators. Given the likely economic slowdown in the coming two years, we however expect the unemployment rate to remain at the current level in the forecasting period till 2021.

**The further tightening of the labour market also resulted in net wages rising at a fast pace, by 7.5% in the first half of 2019 year on year in real terms.** Following the last increase in the minimum wage of 13% in January 2018 to EUR 430, the government announced that the next hike would not take place before 2021. However, it plans to lift it to not less than EUR 500 then. The budget proposal foresees increasing the non-taxable minimum to EUR 300 on 1 January 2020, while the coalition also agreed to lift it to EUR 400 in 2021 and EUR 500 in 2022. Thus, household incomes will increase slower but still substantially in the coming years. This will further fuel household consumption which is projected to increase by about 3.2% in real terms this year. In the period 2020-2021, we expect some slowdown but consumption still to grow by 3.0% per annum.

**Despite strong wage growth, consumer price inflation is likely to remain below 3% in 2019.** Low growth of import prices and a slight decline of oil prices are expected to result in the growth of consumer prices to fall below 2.5% in 2020 and 2021.

**All in all, compared to our Summer Forecast we have become less optimistic, lowering the forecast GDP growth rate for this year from 3.3% to 2.8%.** Private investment activity has slowed down more strongly than expected, while external demand still grew stronger than recently forecasted. Rising household incomes will help private consumption to keep on growing steadily. The continuing investment in public transport infrastructure, not only in this year but also in 2020 and 2021, is facilitated by ongoing inflows of EU funds. For 2020, we see more cooling off particularly in external demand, thus we have revised our growth forecast slightly to 2.2%, while in 2021 a stabilisation will result in GDP increasing to 2.4%.

## Table 5.11 / Latvia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 | 2019 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 1,978 | 1,960 | 1,942 | 1,927 | 1,934 | 1,919 | 1,920 | 1,910 | 1,900 |
| Gross domestic product, EUR mn, nom. 2) | 24,426 | 25,073 | 26,798 | 29,155 | 13,776 | 14,567 | 30,900 | 32,300 | 33,900 |
| annual change in % (real) | 3.3 | 1.8 | 3.8 | 4.6 | 4.7 | 2.4 | 2.8 | 2.2 | 2.4 |
| GDP/capita (EUR at PPP) 2) | 18,700 | 18,800 | 19,900 | 21,500 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. 2) | 14,424 | 14,791 | 15,698 | 16,840 | 8,163 | 8,691 | . | . | . |
| annual change in % (real) | 2.7 | 1.5 | 3.0 | 4.4 | 4.9 | 3.2 | 3.1 | 3.0 | 3.0 |
| Gross fixed capital form., EUR mn, nom. 2) | 5,368 | 4,899 | 5,554 | 6,554 | 2,760 | 2,979 | . | . | . |
| annual change in % (real) | -1.2 | -8.2 | 11.3 | 15.8 | 17.1 | 5.9 | 7.0 | 3.5 | 5.0 |
| Gross industrial production 3) | | | | | | | | | |
| annual change in % (real) | 3.6 | 5.4 | 8.3 | 1.5 | 2.1 | -0.4 | 1.0 | 2.0 | 2.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 14.0 | -7.3 | 0.1 | -11.5 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | -0.6 | -16.6 | 18.7 | 21.8 | 33.3 | 3.4 | . | . | . |
| Employed persons, LFS, th, average | 896.1 | 893.3 | 894.8 | 909.4 | 903.8 | 904.6 | 915 | 920 | 925 |
| annual change in % | 1.3 | -0.3 | 0.2 | 1.6 | 1.9 | 0.1 | 0.6 | 0.5 | 0.5 |
| Unemployed persons, LFS, th, average | 98.2 | 95.3 | 85.4 | 72.8 | 77.7 | 64.2 | 64 | 62 | 59 |
| Unemployment rate, LFS, in %, average | 9.9 | 9.6 | 8.7 | 7.4 | 8.0 | 6.7 | 6.5 | 6.3 | 6.0 |
| Reg. unemployment rate, in %, eop 4) | 8.7 | 8.4 | 6.8 | 6.4 | 6.4 | 6.0 | . | . | . |
| Average monthly gross wages, EUR | 818.0 | 859.0 | 926.0 | 1,010.0 | 983.2 | 1,059.5 | 1,090 | 1,160 | 1,230 |
| annual change in % (real, gross) | 6.7 | 4.9 | 4.5 | 6.0 | 6.3 | 4.5 | 4.5 | 4.0 | 3.8 |
| Average monthly net wages, EUR | 603.0 | 631.0 | 676.0 | 740.0 | 729.5 | 784.2 | 790 | 840 | 890 |
| annual change in % (real, net) | 7.4 | 4.3 | 3.8 | 7.0 | 7.7 | 4.3 | 4.3 | 3.8 | 3.6 |
| Consumer prices (HICP), % p.a. | 0.2 | 0.1 | 2.9 | 2.6 | 2.2 | 3.1 | 3.0 | 2.3 | 2.4 |
| Producer prices in industry, % p.a. | -1.0 | -2.5 | 2.5 | 4.3 | 3.5 | 3.6 | 2.7 | 1.3 | 1.5 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 36.7 | 37.0 | 37.6 | 38.0 | . | . | 36.4 | 36.3 | 36.5 |
| Expenditures | 38.1 | 36.9 | 38.1 | 39.0 | . | . | 37.4 | 37.6 | 38.0 |
| Net lending (+) / net borrowing (-) | -1.4 | 0.1 | -0.6 | -1.0 | . | . | -1.0 | -1.3 | -1.5 |
| General gov.gross debt, EU def., % of GDP | 36.7 | 40.2 | 40.3 | 36.4 | . | . | 36.0 | 35.5 | 35.0 |
| Stock of loans of non-fin.private sector, % p.a. | -2.8 | 0.1 | -4.7 | -5.2 | -5.3 | -3.5 | . | . | . |
| Non-performing loans (NPL), in %, eop 5) | 6.0 | 4.4 | 4.1 | 5.3 | 5.9 | 5.4 | . | . | . |
| Central bank policy rate, % p.a., eop 6) | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | -216 | 360 | 273 | -198 | 330 | 161 | -60 | -160 | -210 |
| Current account, % of GDP | -0.9 | 1.4 | 1.0 | -0.7 | 2.4 | 1.1 | -0.2 | -0.5 | -0.6 |
| Exports of goods, BOP, EUR mn | 10,480 | 10,543 | 11,683 | 12,603 | 6,176 | 6,174 | 12,800 | 13,200 | 13,800 |
| annual change in % | 1.0 | 0.6 | 10.8 | 7.9 | 11.5 | 0.0 | 1.6 | 3.1 | 4.5 |
| Imports of goods, BOP, EUR mn | 12,721 | 12,430 | 13,905 | 14,953 | 7,048 | 7,343 | 15,400 | 16,000 | 16,800 |
| annual change in % | -1.0 | -2.3 | 11.9 | 7.5 | 6.1 | 4.2 | 3.0 | 3.9 | 5.0 |
| Exports of services, BOP, EUR mn | 4,351 | 4,601 | 4,964 | 5,268 | 2,498 | 2,675 | 5,600 | 5,800 | 6,200 |
| annual change in % | 6.1 | 5.7 | 7.9 | 6.1 | 5.4 | 7.1 | 6.3 | 3.6 | 6.9 |
| Imports of services, BOP, EUR mn | 2,334 | 2,468 | 2,702 | 2,972 | 1,373 | 1,485 | 3,150 | 3,250 | 3,500 |
| annual change in % | 10.4 | 5.7 | 9.5 | 10.0 | 8.8 | 8.2 | 6.0 | 3.2 | 7.7 |
| FDI liabilities, EUR mn | 729 | 302 | 991 | 390 | -94 | 189 | 500 | . | . |
| FDI assets, EUR mn | 128 | 202 | 516 | -290 | -145 | 39 | 100 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 2,957 | 3,100 | 3,620 | 3,578 | 3,629 | 3,665 | . | . | . |
| Gross external debt, EUR mn | 34,861 | 37,217 | 37,922 | 35,697 | 35,657 | 35,152 | 34,000 | 32,300 | 32,200 |
| Gross external debt, % of GDP | 142.7 | 148.4 | 141.5 | 122.4 | 122.3 | 113.8 | 110.0 | 100.0 | 95.0 |

1) Preliminary. - 2) Half-year data unrevised. - 3) Enterprises with 20 and more employees. - 4) In % of labour force (LFS). - 5) From 2018 loans more than 90 days overdue plus those unlikely to pay, loans more than 90 days overdue before. -
6) Official refinancing operation rates for euro area (ECB).

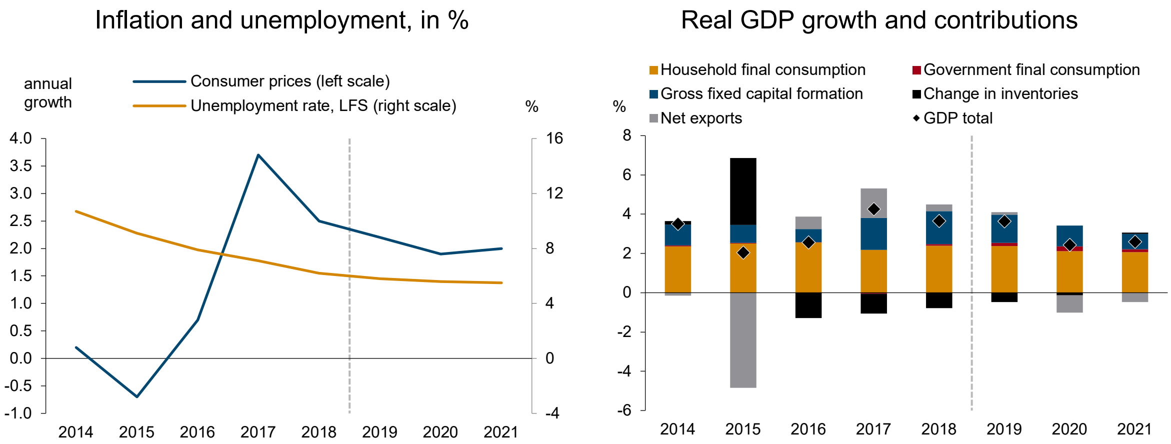
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# LITHUANIA: Still growing swiftly, but slowdown ahead

SEBASTIAN LEITNER

Growth accelerated again in 2019, underpinned in particular by public and private investment. A further decline in unemployment, a minimum wage hike and a reduction of the effective income tax rate have resulted in rapid increases in the purchasing power of households. External demand has been stronger than expected in 2019 but is likely to abate in the coming two years. For 2019, we estimate real GDP growth of 3.6%, followed by a projected slowdown to 2.4% in 2020 and 2.6% in 2021.

**Figure 5.12 / Lithuania: Main macroeconomic indicators**




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

**Overall GDP growth remained unchanged in the first half of 2019, increasing by 4.2% in real terms year on year. Despite a slowdown of economic activity in the Euro Area, exports increased even faster in the first half of the year from 6.2% in 2018 in nominal terms to 9.5% in 2019.** While exports to the main trade partners Latvia and Russia are growing slowly, those to Germany and the whole Euro Area increased by more than 8% year on year in nominal terms. Despite a decline in the oil price nominal growth of exports of the most important Lithuanian merchandise group, refined petroleum and oil products like chemicals, plastics and fertilizers, remained lively. However, the demand for foodstuff and wood-based goods has abated.

**Trade in services has also continued to flourish in 2019, particularly due to transit which amounts to more than half of the service exports of Lithuania.** However, the transport sector, which accounts for 12% of total Lithuanian jobs, is expected to shrink somewhat in terms of employment over the coming years. The EU Mobility package, concluded in the EU parliament in April 2019, increases the compulsory wages of workers posted abroad and improves working conditions like mandatory rest times. Thus ‘social dumping’ in the sector should be reduced, biting into Lithuania’s competitive position in this market. Furthermore, exports in the field of business services are growing swiftly. Due to strong investment and consumption growth, imports are increasing as fast as exports. As a result, the contribution of net exports to GDP growth is expected to be balanced in 2019. However, in 2020 we expect the slowdown in the Euro Area to also affect the Lithuanian export sector more negatively, dragging down the GDP growth rate.

**Figures for the second quarter of 2019 provide a further indication that gross fixed capital investment is likely to grow even faster compared to last year, by 7.5% per annum.** The inflow of EU funds also allows the government to increase capital spending this year. The Rail Baltica high speed train project is still in the design phase in Lithuania. However, construction work will start in 2020. In addition, private investment continued to increase in real terms in 2019; the increases of investment in machinery and vehicles show that enterprises are upgrading their production infrastructure. The construction of new dwellings rose strongly in the first half of 2019 while housing prices increased considerably in the cities. In the coming two years we expect construction growth to remain strong, as indicated by the latest figures for building permits granted. In general, business and consumer sentiment indicators are still rather positive concerning the current situation and the near future.

**We expect employment to increase by another 1% in 2019 as a whole.** Jobs in business services, accommodation and domestic trade have been strongly on the rise in the first half of this year. However, the construction sector has further created new employment as well. The unemployment rate is likely to drop to 5.8% in 2019. In order to counteract the shortage of skilled labour caused by the shrinkage of the working age population, the Lithuanian government allows higher immigration of workers, particularly from Ukraine and Belarus. The number of issued labour permits almost doubled in the first nine months of 2019 year on year. Further, monthly figures show that net international migration will be positive in 2019 for the first time in many years. An increase in the minimum wage to EUR 555 from January 2019 onwards supported the pushing up of the overall growth rate of net salaries to about 10% in real terms this year. The government announced an even stronger rise in the minimum wage of 9.4% from 2020 to EUR 607. Moreover, a reduction of labour taxation will take place, since the non-taxable income will be increased to EUR 400 in 2020 and to EUR 500 in 2021. Thus, household consumption is likely to remain a driver of growth not only in 2019, but also in the forecast period 2020-2021.

**Although wages are rising more rapidly, consumer price inflation is declining to 2.2% in 2019.** The main reason is the most recently falling price of energy raw materials. Also, in the coming two years, the subdued international economic environment will hold down the import prices. While prices for services will increase more swiftly, overall consumer price inflation is expected to hover around 2% both in 2020 and 2021.

**Compared to our Summer Forecast we have become slightly more optimistic, increasing our forecast for real GDP growth from 3.2% to 3.6% in 2019.** Investment in residential buildings and machinery has even picked up, while exports have also performed better than expected. Sentiment indicators still show strong confidence levels among both businesses and consumers. A sustained upswing in public investment, not only this year, but also in 2020 and 2021, will be facilitated by an ongoing inflow of EU funds. Strongly rising household incomes, pushed upwards by a tightening labour market and tax cuts, will help private consumption to keep on growing steadily. In the coming two years, however, external demand is likely to lose momentum, which may also result in weaker investment activity by the private sector. Thus for 2020 and 2021, we forecast real GDP to grow at lower paces, by 2.4% and 2.6% respectively.

## Table 5.12 / Lithuania: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 January-June | 2019 January-June | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 2,905 | 2,868 | 2,828 | 2,801 | 2,801 | 2,792 | 2,780 | 2,760 | 2,740 |
| Gross domestic product, EUR mn, nom. | 37,322 | 38,893 | 42,269 | 45,264 | 21,197 | 22,772 | 47,900 | 50,000 | 52,300 |
| annual change in % (real) | 2.0 | 2.6 | 4.2 | 3.6 | 3.8 | 4.0 | 3.6 | 2.4 | 2.6 |
| GDP/capita (EUR at PPP) | 21,700 | 22,100 | 23,500 | 25,000 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. | 23,250 | 24,430 | 26,174 | 27,891 | 13,417 | 14,128 | . | . | . |
| annual change in % (real) | 4.1 | 4.1 | 3.5 | 3.9 | 3.6 | 3.3 | 3.8 | 3.4 | 3.3 |
| Gross fixed capital form., EUR mn, nom. | 7,324 | 7,723 | 8,449 | 9,300 | 4,208 | 4,649 | . | . | . |
| annual change in % (real) | 4.9 | 3.4 | 8.2 | 8.4 | 9.5 | 8.1 | 7.5 | 5.5 | 4.5 |
| Gross industrial production (sales) | | | | | | | | | |
| annual change in % (real) | 4.4 | 2.8 | 7.0 | 4.8 | 5.6 | 4.8 | 4.0 | 3.5 | 4.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 8.6 | -1.7 | 2.6 | -11.1 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | -3.5 | -9.3 | 8.9 | 13.8 | 17.0 | 12.2 | . | . | . |
| Employed persons, LFS, th, average | 1,335 | 1,361 | 1,355 | 1,375 | 1,359 | 1,378 | 1,390 | 1,400 | 1,405 |
| annual change in % | 1.2 | 2.0 | -0.5 | 1.5 | 0.4 | 1.4 | 1.1 | 0.7 | 0.4 |
| Unemployed persons, LFS, th, average | 134 | 116 | 103 | 90 | 95 | 92.7 | 86 | 83 | 82 |
| Unemployment rate, LFS, in %, average | 9.1 | 7.9 | 7.1 | 6.2 | 6.6 | 6.4 | 5.8 | 5.6 | 5.5 |
| Reg. unemployment rate, in %, eop 2) | 9.0 | 8.5 | 8.7 | 8.9 | 8.3 | 8.0 | 8.0 | . | . |
| Average monthly gross wages, EUR 3) | 714.1 | 774.0 | 840.4 | 920.0 | 903.3 | 1,265.0 | 1,310 | 1,390 | 1,470 |
| annual change in % (real, gross) | 6.4 | 7.4 | 4.7 | 6.5 | 7.0 | 6.1 | 8.2 | 4.5 | 4.0 |
| Average monthly net wages, EUR 3) | 553.9 | 602.3 | 660.2 | 720.0 | 705.8 | 804.0 | 820 | 880 | 930 |
| annual change in % (real, net) | 6.1 | 7.7 | 5.7 | 6.0 | 6.1 | 11.2 | 12.0 | 4.8 | 4.0 |
| Consumer prices (HICP), % p.a. | -0.7 | 0.7 | 3.7 | 2.5 | 2.8 | 2.3 | 2.2 | 1.9 | 2.0 |
| Producer prices in industry, % p.a. | -9.7 | -4.4 | 5.1 | 5.6 | 4.1 | 2.2 | 1.0 | 0.0 | 1.0 |
| General goverm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 34.7 | 34.3 | 33.5 | 34.6 | . | . | 35.0 | 34.7 | 34.8 |
| Expenditures | 35.0 | 34.1 | 33.0 | 33.9 | . | . | 34.9 | 34.7 | 34.5 |
| Net lending (+) / net borrowing (-) | -0.3 | 0.2 | 0.5 | 0.7 | . | . | 0.1 | 0.0 | -0.2 |
| General gov.gross debt, EU def., % of GDP | 42.7 | 39.9 | 39.3 | 34.1 | . | . | 37.5 | 36.5 | 35.0 |
| Stock of loans of non-fin.private sector, % p.a. | 4.1 | 7.1 | 4.5 | 6.0 | 7.4 | 2.5 | . | . | . |
| Non-performing loans (NPL), in %, eop | 5.5 | 3.8 | 3.1 | 2.4 | 2.9 | 2.1 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | -910 | -434 | 213 | 131 | -387 | 349 | 400 | 100 | 0 |
| Current account, % of GDP | -2.4 | -1.1 | 0.5 | 0.3 | -1.8 | 1.5 | 0.8 | 0.2 | 0.0 |
| Exports of goods, BOP, EUR mn | 19,655 | 19,470 | 22,763 | 24,552 | 11,627 | 12,726 | 26,400 | 27,600 | 28,800 |
| annual change in % | -4.4 | -0.9 | 16.9 | 7.9 | 6.2 | 9.5 | 7.5 | 4.5 | 4.3 |
| Imports of goods, BOP, EUR mn | 21,785 | 21,362 | 24,815 | 27,333 | 13,136 | 13,981 | 28,700 | 30,000 | 31,300 |
| annual change in % | 0.9 | -1.9 | 16.2 | 10.1 | 8.6 | 6.4 | 5.0 | 4.5 | 4.3 |
| Exports of services, BOP, EUR mn | 6,030 | 6,814 | 8,349 | 9,678 | 4,498 | 5,537 | 10,000 | 10,600 | 11,300 |
| annual change in % | 2.5 | 13.0 | 22.5 | 15.9 | 15.0 | 23.1 | 3.3 | 6.0 | 6.6 |
| Imports of services, BOP, EUR mn | 4,273 | 4,619 | 5,290 | 6,018 | 2,833 | 3,292 | 6,500 | 7,000 | 7,400 |
| annual change in % | 2.3 | 8.1 | 14.5 | 13.8 | 12.6 | 16.2 | 8.0 | 7.7 | 5.7 |
| FDI liabilities, EUR mn | 942 | 1,190 | 1,204 | 1,201 | 561 | 616 | 1,000 | 1,000 | 1,000 |
| FDI assets, EUR mn | 325 | 842 | 353 | 844 | 815 | 522 | 600 | 600 | 600 |
| Gross reserves of NB excl. gold, EUR mn | 1,376 | 2,263 | 3,509 | 4,831 | 4,361 | 4,634 | . | . | . |
| Gross external debt, EUR mn | 28,331 | 33,087 | 35,271 | 35,400 | 35,404 | 34,109 | 35,900 | 35,000 | 35,600 |
| Gross external debt, % of GDP | 75.9 | 85.1 | 83.4 | 78.2 | 78.2 | 71.2 | 75.0 | 70.0 | 68.0 |

1) Preliminary. - 2) In % of working age population. - 3) Including earnings of sole proprietors. From 2019 the employer's social security contribution (28.9%) was transferred to the employees; real growth in 2019 estimated by wiiw. - 4) Official refinancing operation rate for euro area (ECB).

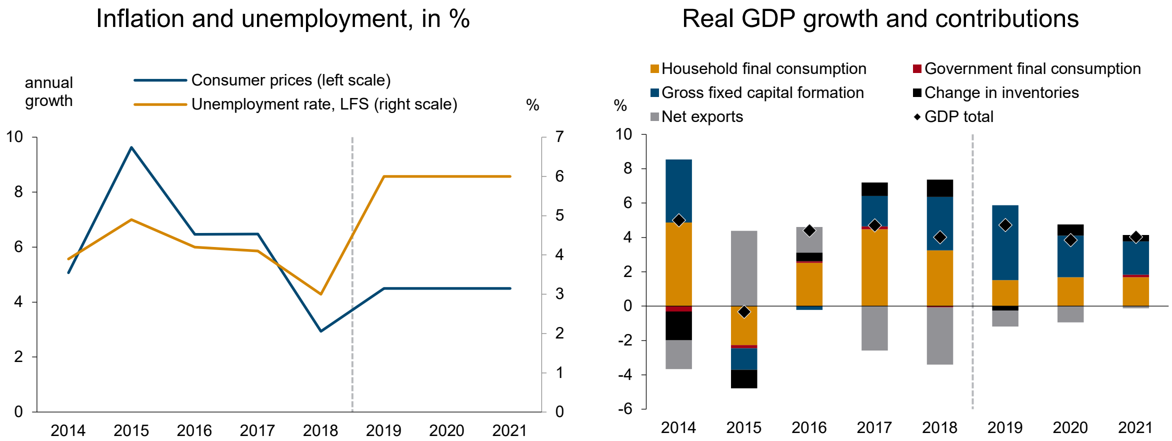
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# MOLDOVA: Solid growth amidst fragile political consolidation

GÁBOR HUNYA

**Economic growth should accelerate to about 5% in 2019 on account of booming investments. After correcting for the current overheating, growth is expected to hover at around 4% in the coming years. A resumption of transfers from the IMF and EU will stabilise external financing. The current government coalition of pro-EU and pro-Russian parties has strong external support but may clash on domestic reforms.**

**Figure 5.13 / Moldova: Main macroeconomic indicators**




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

**Real GDP soared by 5.2% in the first half of 2019, making Moldova the fastest growing economy in the CESEE region covered by wiiw.** Investments have become the most important factor of growth contributing 4.4 percentage points. Gross fixed capital formation expanded by 20% and investment outlays increased by 26.8% in real terms compared to the corresponding period of the previous year. Public investments soared by 50% but they only contributed less than 7% to total investment outlays. One third of the private sector investments went into machinery and equipment which supports the restructuring of production and export expansion.

**Manufacturing production has put on the brakes expanding by only 1.3% in the first half of 2019.** Agriculture and food industry were in decline due to adverse weather conditions. The production of light industry goods and general machinery also declined while the production of car components continued its rapid expansion. Foreign car suppliers which had invested in Romania have moved part of their production to Moldova due to it having lower labour costs.

**The negative contribution of net exports to growth is shrinking.** Exports of goods expanded somewhat more than imports, still the export revenues covered only 37% of imports in the first seven months of 2019. A slow upgrading of the commodity structure of exports gives hope that the current account deficit may shrink in the future. The exports of machinery and transport equipment products have grown more strongly than other commodity groups and accounted for almost 25% of the total. Agricultural and food products, as well as diverse manufactured goods, comprise similar but declining shares. A reorientation of exports from the CIS to the EU, which has taken place since the Deep and Comprehensive Free Trade Areas (DCFTA) with the EU came into force in 2016, has slowed down. Two thirds of exports went to the EU and 15% to the CIS in the first seven months of 2019. Both are lower shares than in the previous year while the share of other countries expanded mainly on account of Turkey. Romania is the most important export destination with 28% of the total, supported by geographic and cultural proximity. This country is approaching the end of an overheated growth period which may have a negative impact on Moldovan exporters.

**The dependence on Russia is higher on the import side.** Romania supplies only about 14% of the imports to Moldova, a share that has not changed much over recent years. Russia has maintained a share of 12% and Ukraine 10% – countries that are the main suppliers of energy and raw materials. The share of the EU is around 50% while China has reached a share of 10% and Turkey 7% in goods imports. Raw materials, energy carriers and chemical products comprise one third of the imports, almost one quarter are transport equipment and another third is comprised of various manufactured goods. It is important to note that although Moldovan statistics do not comprise data for the breakaway territory of Transnistria, companies from the latter have established subsidiaries in Moldova and enjoy the benefits of free trade with the EU.

**The current account deficit of about 10% of GDP has imposed a challenge to external financing.** The balances on the primary and the secondary incomes are positive but cover less than two thirds of trade deficits. This includes the remittances of about 18% of GDP transferred home by one quarter of the 3.55 million total population who live abroad. Capital inflows were severely inadequate thus the depletion of reserves financed most of the deficit in the first quarter of the year.

**EU and IMF funding resumed thus a more solid financing is expected for the second half of the current year and beyond.** The government signed an agreement with the EU promising assistance worth USD 45 million of which USD 16 million has already been disbursed. This is an important break-through as the EU had suspended financial support a year before amid concerns about a backsliding in the rule of law and democracy situation. While the government has succeeded to initiate several reform steps, the Association Implementation Report published on September 12 calls for further efforts in fighting corruption and in making improvements in the rule of law. Moldova has also benefitted from USD 46 million from the IMF this year under the current programme which would have expired in October but will be extended till March 2020.

**Government and IMF reached an understanding on fiscal measures needed to correct the fiscal loosening from 2018 which led to rising budgetary pressures in 2019.** The first semester of 2019 general government deficit expanded to 2.3% after a surplus achieved in the first six months of 2018. However the budget has been amended under the IMF agreement in July. The pressure on the pension fund has been reduced as the retirement age was increased by 6 months from 1 July 2019, to 63 years for men and to 58½ years for women. The 2020 budget reckons with a 2% of GDP deficit and provides advantages to spending on investments and supporting poorer people.

**The annual inflation rate has been on the rise all through the year reaching 5.5% in August year-on-year.** Unfavourable weather conditions and buoyant private demand boosted the prices of fruits and vegetables. The national bank expects the annual rate of inflation to increase to 8% by the end of this year and then diminish in 2020. Therefore it increased the base rate to 7.5% leaving the deposit and lending facility in a symmetrical corridor of ± 3 p.p. to the base rate.

**Population and employment are lower than supposed earlier – this is the result of recent corrections and changes in definition.** Population data now cover only those who have lived in the country for at least 9 months in the past 12 months. By this, the country's population has been reduced from 3.54 million to 2.70 million in 2018. The difference increased the number of those living abroad. The number of employed persons also fell as the auxiliary agricultural workers producing for self-consumption only has been taken out of the statistics (see new LFS data in the country table). As a result, the participation rate of people above 15 years fell from 48.6% to 43.4% in the second quarter of 2019. The impact on the unemployment rate is also remarkable, as it increased from 3% to 6%.

**The parties that came out second and third in the February 2019 elections, the pro-EU bloc ACUM and the pro-Russian Party of Socialists, formed a coalition in June.** The Russian and US governments and the EU have given strong support to this unlikely couple as a sign of lowering tension in the region. Balancing between the EU and Russia is a viable option to safeguard the external stability of Moldova, but may not be enough to solve inherent conflicts between the coalition partners. As of now, there is a fruitful cooperation between the President, socialist party Igor Dodon, negotiating price discounts with Gazprom and the Prime Minister from ACUM, Maria Sandu, making reformist statements in the West. However, the two parties disagree on a number of issues including the status of Transnistria.

**The current overheated dynamics of investments and economic growth cannot be maintained for the coming years, but a fairly robust growth rate of around 4% seems realistic.** Fiscal austerity, privatisation and reforms of the business environment may suppress demand initially but do support longer-term growth.

## Table 5.13 / Moldova: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 January-June | 2019 January-June | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th pers., average 2) | 2,835 | 2,802 | 2,755 | 2,706 | . | . | 2,640 | 2,600 | 2,560 |
| Gross domestic product, MDL bn, nom. | 145.8 | 160.8 | 178.9 | 192.3 | 82.5 | 90.9 | 210 | 228 | 248 |
| annual change in % (real) | -0.3 | 4.4 | 4.7 | 4.0 | 4.6 | 5.2 | 4.7 | 3.8 | 4.0 |
| GDP/capita (EUR at PPP) | 5,700 | 5,900 | 6,200 | 6,900 | . | . | . | . | . |
| Consumption of households, MDL bn, nom. | 125.4 | 136.4 | 150.8 | 161.6 | 71.7 | 75.4 | . | . | . |
| annual change in % (real) | -2.5 | 2.9 | 5.3 | 3.8 | 2.8 | 1.8 | 1.8 | 2.0 | 2.0 |
| Gross fixed capital form., MDL bn, nom. | 35.4 | 35.7 | 39.9 | 46.6 | 19.2 | 23.6 | | | |
| annual change in % (real) | -4.8 | -0.9 | 8.0 | 14.0 | 9.8 | 20.3 | 18.0 | 10.0 | 8.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 0.6 | 0.9 | 3.4 | 3.7 | 8.5 | 1.3 | 1.5 | 2.0 | 2.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -13.4 | 18.6 | 9.1 | 2.5 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | -12.7 | -8.1 | 3.6 | 10.3 | . | . | . | . | . |
| Employed persons, LFS, th, average 3) | 1,204 | 1,220 | 1,208 | 1,252 | . | 865 | 860 | 880 | 900 |
| annual change in % 3) | 1.6 | 1.3 | -1.0 | 3.7 | . | . | . | 2.0 | 2.0 |
| Unemployed persons, LFS, th, average 3) | 62.1 | 53.3 | 51.6 | 38.4 | . | 56 | 50.0 | 60.0 | 60.0 |
| Unemployment rate, LFS, in %, average | 4.9 | 4.2 | 4.1 | 3.0 | . | 6.1 | 6.0 | 6.0 | 6.0 |
| Reg. unemployment rate, in %, eop | 2.1 | 2.3 | 2.1 | 1.7 | 1.6 | 1.2 | . | . | . |
| Average monthly gross wages, MDL 4) | 4,538 | 4,998 | 5,587 | 6,322 | 6,138 | 7,113 | 7,300 | 8,000 | 8,700 |
| annual change in % (real, gross) | 1.2 | 3.7 | 5.0 | 9.9 | 9.6 | 10.3 | 10.0 | 5.0 | 4.0 |
| Average monthly net wages, MDL | 3,752 | 4,103 | 4,564 | 5,220 | . | . | 6,000 | 6,600 | 7,200 |
| annual change in % (real, net) | 0.7 | 2.7 | 4.5 | 11.0 | . | . | 10.0 | 5.0 | 4.0 |
| Consumer prices, % p.a. | 9.6 | 6.5 | 6.5 | 2.9 | 4.1 | 3.1 | 4.5 | 4.5 | 4.5 |
| Producer prices in industry, % p.a. | 6.3 | 4.5 | 3.3 | 0.4 | 1.1 | 1.0 | 1.0 | 2.0 | 2.0 |
| General governm. budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 30.0 | 28.6 | 29.8 | 30.2 | 33.7 | 32.4 | 31.0 | 31.0 | 31.5 |
| Expenditures | 31.8 | 30.1 | 30.5 | 31.0 | 32.6 | 34.7 | 33.0 | 32.5 | 33.0 |
| Deficit (-) / surplus (+) | -1.9 | -1.6 | -0.6 | -0.8 | 1.1 | -2.3 | -2.0 | -1.5 | -1.5 |
| General gov.gross debt, nat.def., % of GDP 5) | 23.3 | 31.8 | 29.1 | 27.2 | . | . | 26.9 | 26.3 | 25.7 |
| Stock of loans of non-fin.private sector, % p.a. | . | . | -3.3 | 6.0 | -2.3 | 16.2 | . | . | . |
| Non-performing loans (NPL), in %, eop 6) | 10.0 | 16.4 | 18.4 | 12.5 | 14.7 | 10.6 | . | . | . |
| Central bank policy rate, %, p.a., eop 7) | 19.50 | 9.00 | 6.50 | 6.50 | 6.50 | 7.00 | 7.75 | 7.50 | 7.50 |
| Current account, EUR mn 8) | -417 | -255 | -493 | -1026 | -410 | -488 | -1,030 | -1,000 | -970 |
| Current account, % of GDP | -6.0 | -3.5 | -5.7 | -10.6 | -10.0 | -10.6 | -9.8 | -9.2 | -8.2 |
| Exports of goods, BOP, EUR mn 8) | 1,357 | 1,407 | 1,657 | 1,672 | 797 | 874 | 1,780 | 1,850 | 1,950 |
| annual change in % | -0.9 | 3.7 | 17.7 | 1.0 | 10.8 | 9.6 | 6.4 | 3.9 | 5.4 |
| Imports of goods, BOP, EUR mn 8) | 3,269 | 3,285 | 3,928 | 4,462 | 2042 | 2274 | 4,730 | 4,870 | 5,070 |
| annual change in % | -10.7 | 0.5 | 19.6 | 13.6 | 11.9 | 11.4 | 6.0 | 3.0 | 4.1 |
| Exports of services, BOP, EUR mn 8) | 884 | 964 | 1,113 | 1,250 | 567 | 661 | 1,400 | 1,520 | 1,640 |
| annual change in % | 2.7 | 9.0 | 15.5 | 12.3 | 8.6 | 16.6 | 12.0 | 8.6 | 7.9 |
| Imports of services, BOP, EUR mn 8) | 765 | 759 | 837 | 944 | 440 | 487 | 1,070 | 1,160 | 1,220 |
| annual change in % | 0.0 | -0.8 | 10.3 | 12.8 | 9.8 | 10.6 | 13.3 | 8.4 | 5.2 |
| FDI liabilities, EUR mn 8) | 203 | 80 | 137 | 264 | 97 | 372 | 230 | 260 | 350 |
| FDI assets, EUR mn 8) | 7 | 12 | 10 | 36 | 1 | 19 | 0 | . | . |
| Gross reserves of NB excl. gold, EUR mn 8) | 1,608 | 2,110 | 2,349 | 2,630 | 2,499 | 2,558 | . | . | . |
| Gross external debt, EUR mn 8) | 5,561 | 5,930 | 5,844 | 6,555 | 6,164 | 6,460 | 6,600 | 6,800 | 7,600 |
| Gross external debt, % of GDP | 79.7 | 81.3 | 68.0 | 67.7 | 63.6 | 61.5 | 63.0 | 63.0 | 64.0 |
| Average exchange rate MDL/EUR | 20.90 | 22.05 | 20.83 | 19.84 | 20.2 | 19.8 | 20.0 | 21.0 | 21.0 |

Note: All series excluding data on districts from the left side of the river Nistru and municipality Bender.

1) Preliminary. - 2) According to census May 2014, usual residence. - 3) From 2019 according to census May 2014 and further adjustments to international standards. Data not comparable with previous years. - 4) Quarterly data refer to all public enterprises and private enterprises with 4 and more employees. - 5) Excluding government guaranteed debt. -
6) Substandard, doubtful and compromised credit portfolio. - 7) Overnight (refinancing) operations rate of National Bank. - 8) Converted from USD.

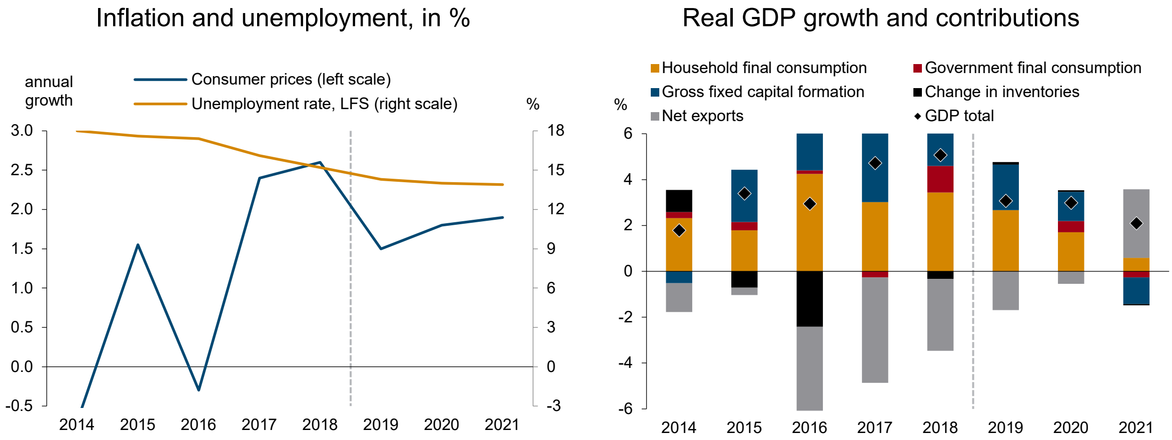
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# MONTENEGRO: Fiscal consolidation puts a brake on growth

VLADIMIR GLIGOROV

**Growth will slow to around 3% in the short run but may accelerate somewhat beyond that, depending primarily on the resumptions of ambitious government investments. Politically, the opposition is yet to find a way to challenge the governing coalition, though the democratic deficit is taking its toll on internal and external credibility. Montenegro is a front-runner in EU integration, though the prospects of accession are not rosy as the EU does not appear to be interested in enlargement any time soon.**

**Figure 5.14 / Montenegro: Main macroeconomic indicators**




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

**The economy grew by 4.9% last year but momentum has slowed significantly this year on the back of fiscal consolidation and weaker investment activity.** Real GDP growth was 3% year on year in Q1 but firmed slightly to 3.2% in the second quarter of the year. A growth rate of around 3% looks likely for 2019 as a whole.

**Montenegro is a services based economy with significant dependence on tourism and related activities.** However, the country has large regional disparities which are an economic as well as a political problem. The government has embarked on an ambitious series of investments. These investments are intended both to connect the south and the north of the country, to improve the overall tourism offering, and to increase the number of arrivals outside of the peak summer season. In recent years, these investments have contributed to the speeding up of economic growth.

**In the last couple of years, the government has been under pressure to start worrying about its public, and especially foreign, debt.** Montenegro uses the euro as it official currency, so all its debts, public as well as private, are in some sense foreign. Public debt has indeed grown but it is not clear if it faces a sustainability problem as long as the economy grows at 3-4% per year. The level of foreign debt is not precisely known, but according to some estimates it is more than twice the GDP, and probably around two-thirds privately owned. To assess its sustainability, it has to be seen as basically a mortgage as it is mostly tied up in real estate. Clearly, if tourism were to go into crisis, these debts would be problematic as real estate prices might collapse. That might suggest that it would be prudent for the country to diversify outside of tourism, but there are not all that many opportunities. Improved infrastructure would be useful in that case too.

**Given Montenegro's weak industrial base, and with the heavy reliance on foreign finance, we do not expect external imbalances to be corrected any time soon.** They are also not as risky as in other countries which have to export goods rather than services to finance foreign debts. This is because there is still a lot of scope for investments to increase as real estate prices could still rise much further. Demand for the kind of services which tourism in the Adriatic provides can continue to be upgraded for quite some time.

**Democratisation, meaning a change in the party in power, would certainly contribute to both economic growth and political stability.** However, the opposition has a hard time coming up with a viable programme and with a sustainable coalition. That is in part due to the opposition being in two minds about Montenegro's independence from Serbia and about Russian support. As long as the opposition is pushing for reintegration with Serbia, it is bound to be persistently in the minority. The country joined NATO for the most part to strengthen internal stability, which makes the opposition to NATO a disadvantage given that stability is rather high on the voters' agenda, given not just recent history.

**Overall, growth should return to somewhere between 3% and 4% in the medium run.** It would be strongly supported by positive signals from Brussels which, however, are not forthcoming.

## Table 5.14 / Montenegro: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 January-June | 2019 January-June | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 622 | 622 | 622 | 622 | . | . | 625 | 625 | 630 |
| Gross domestic product, EUR mn, nom. | 3,655 | 3,954 | 4,299 | 4,663 | 1,934.6 | 2,014.5 | 4,900 | 5,100 | 5,300 |
| annual change in % (real) | 3.4 | 2.9 | 4.7 | 5.1 | 4.8 | 3.1 | 3.1 | 3.0 | 2.1 |
| GDP/capita (EUR at PPP) | 12,300 | 13,000 | 13,700 | 14,700 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. 2) | 2,893 | 3,035 | 3,216 | 3,425 | 1,619 | 1,681 | . | . | . |
| annual change in % (real) | 2.2 | 5.4 | 3.9 | 4.6 | 4.8 | 4.1 | 3.6 | 2.3 | 0.8 |
| Gross fixed capital form., EUR mn, nom. | 736 | 978 | 1,157 | 1,364 | 667 | 660.8 | . | . | . |
| annual change in % (real) | 11.9 | 38.4 | 18.7 | 14.7 | 24.6 | -1.8 | 6.7 | 4.3 | -3.9 |
| Gross industrial production 3) | | | | | | | | | |
| annual change in % (real) | 7.9 | -2.9 | -4.2 | 22.4 | 31.6 | -12.1 | -10.0 | 4.0 | 4.0 |
| Net agricultural production 4) | | | | | | | | | |
| annual change in % (real) | 9.4 | -8.5 | -3.2 | 2.0 | . | . | . | . | . |
| Construction output 3) | | | | | | | | | |
| annual change in % (real) | 5.8 | 31.5 | 51.5 | 24.9 | 40.4 | 12.3 | . | . | . |
| Employed persons, LFS, th, average | 222 | 224 | 229 | 237 | 233 | 242 | 246 | 248 | 249 |
| annual change in % | 2.5 | 1.1 | 2.3 | 3.5 | 2.2 | 3.8 | 3.6 | 1.0 | 0.4 |
| Unemployed persons, LFS, th, average | 47.2 | 48.3 | 43.9 | 42.5 | 41.9 | 42 | 40.0 | 40.0 | 40.0 |
| Unemployment rate, LFS, in %, average | 17.6 | 17.4 | 16.1 | 15.2 | 15.3 | 14.7 | 14.3 | 14.0 | 13.9 |
| Reg. unemployment rate, %, average | 16.5 | 19.4 | 21.7 | 18.7 | 19.4 | 16.0 | . | . | . |
| Average monthly gross wages, EUR | 725 | 751 | 765 | 766 | 766 | 770 | 780 | 800 | 820 |
| annual change in % (real, gross) | -1.1 | 3.5 | -1.1 | -2.6 | -2.9 | 0.1 | 0.2 | 1.0 | 0.2 |
| Average monthly net wages, EUR | 480 | 499 | 510 | 511 | 511 | 513 | 520 | 530 | 540 |
| annual change in % (real, net) | -0.9 | 4.2 | -0.2 | -2.3 | -2.9 | -0.1 | 0.2 | 1.0 | 0.2 |
| Consumer prices, % p.a. | 1.6 | -0.3 | 2.4 | 2.6 | 3.0 | 0.5 | 1.5 | 1.8 | 1.9 |
| Producer prices in industry, % p.a. 5) | 0.3 | -0.1 | 0.4 | 1.7 | 1.2 | 2.1 | 1.5 | 1.5 | 1.5 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 41.8 | 42.6 | 41.5 | 42.3 | . | . | 43.1 | 42.8 | 42.0 |
| Expenditures | 50.0 | 46.2 | 46.8 | 45.2 | . | . | 45.3 | 42.3 | 40.6 |
| Deficit (-) / surplus (+) | -8.3 | -3.6 | -5.3 | -2.9 | . | . | -2.2 | 0.5 | 1.4 |
| General gov.gross debt, nat.def., % of GDP | 66.2 | 64.4 | 64.2 | 70.1 | . | . | 69.0 | 66.0 | 62.0 |
| Stock of loans of non-fin.private sector, % p.a. | 2.5 | 5.4 | 7.7 | 9.1 | 8.5 | 5.6 | . | . | . |
| Non-performing loans (NPL), in %, eop | 12.6 | 10.3 | 7.3 | 6.7 | 7.0 | 4.8 | . | . | . |
| Central bank policy rate, % p.a., eop 6) | 7.70 | 6.74 | 6.16 | 5.75 | 5.86 | 5.61 | 5.50 | 5.50 | 5.50 |
| Current account, EUR mn | -402 | -642 | -691 | -793 | -619 | -644 | -870 | -920 | -760 |
| Current account, % of GDP | -11.0 | -16.2 | -16.1 | -17.0 | -32.0 | -32.0 | -17.8 | -18.0 | -14.3 |
| Exports of goods, BOP, EUR mn | 330 | 351 | 382 | 436 | 211 | 216 | 440 | 460 | 480 |
| annual change in % | -7.6 | 6.2 | 9.0 | 14.0 | 26.6 | 2.2 | 1.0 | 4.0 | 4.0 |
| Imports of goods, BOP, EUR mn | 1,794 | 2,008 | 2,243 | 2,485 | 1173 | 1207 | 2,640 | 2,760 | 2,730 |
| annual change in % | 3.5 | 12.0 | 11.7 | 10.8 | 13.0 | 2.9 | 6.1 | 4.7 | -1.0 |
| Exports of services, BOP, EUR mn | 1,214 | 1,255 | 1,382 | 1,563 | 475 | 534 | 1,700 | 1,830 | 1,950 |
| annual change in % | 17.8 | 3.3 | 10.2 | 13.1 | 19.4 | 12.5 | 8.8 | 7.5 | 6.5 |
| Imports of services, BOP, EUR mn | 425 | 486 | 531 | 627 | 277 | 323 | 680 | 730 | 740 |
| annual change in % | 25.0 | 14.1 | 9.3 | 18.1 | 17.0 | 16.7 | 9.0 | 7.8 | 2.0 |
| FDI liabilities, EUR mn | 630 | 205 | 494 | 415 | 177 | 280 | 510 | . | . |
| FDI assets, EUR mn | 11 | -167 | 10 | 92 | 23 | 52 | 20 | . | . |
| Gross reserves of NB excl. gold, EUR mn 7) | 624 | 753 | 847 | 1,050 | 970 | 837 | . | . | . |
| Gross external public debt, EUR mn | 1,956 | 2,003 | 2,214 | 2,760 | 2,644 | 2,622 | 2,890 | 2,910 | 2,860 |
| Gross external public debt, % of GDP | 53.5 | 50.6 | 51.5 | 59.2 | 56.7 | 53.5 | 59.0 | 57.0 | 54.0 |
| Average exchange rate EUR/EUR | 1.00 | 1.00 | 1.00 | 1.00 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 |

1) Preliminary. - 2) Including expenditures of NPISHs. - 3) Enterprises with 5 and more employees. - 4) Based on UN-FAO data, wiiw estimate from 2017. - 5) Domestic output prices. - 6) Average weighted lending interest rate of commercial banks (Montenegro uses the euro as national currency). - 7) Data refer to reserve requirements of the Central Bank.

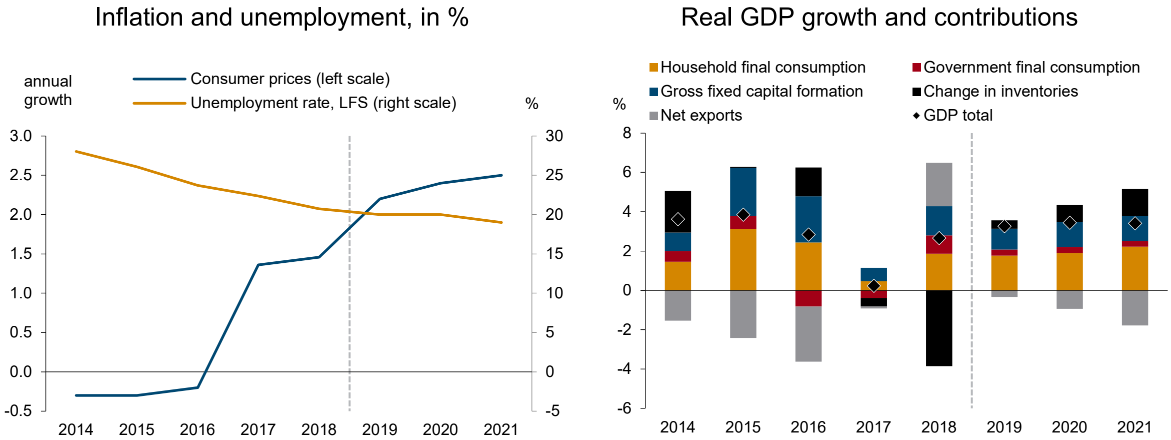
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# NORTH MACEDONIA: Recovery underway

VLADIMIR GLIGOROV

**The economy is recovering after its growth came to a halt during the political crisis two years ago. The potential growth rate is around 4%, at least as long as there is large slack in the labour market. Growth should be above 3% this year, and increase further in the medium run. The delayed start to EU accession negotiations could yet have negative repercussions for domestic politics.**

**Figure 5.15 / North Macedonia: Main macroeconomic indicators**




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

**The economy remains broadly in recovery mode, having expanded by at least 3% year on year in every quarter since Q2 2018.** However, after reaching 4.1% in Q1 2019, the rate of growth slowed to 3.1% in April-June, suggesting negative spill-overs from the weakness in the Euro Area. The initial breakdown released by the statistics office for Q2 indicated that the key reason for the weaker momentum was net exports. Household consumption rose by 3.1%, up from 2.6% in the previous quarter. Gross capital formation, meanwhile, expanded by a robust 11.1% year on year in Q2, up from 9.9% in the previous three months.

**Unlike most neighbouring economies, the North Macedonian one is pretty much adapted to the policy environment which aims for export led growth.** Monetary policy targets the hard fix of the exchange rate and fiscal policy is supportive of that aim. Over time, that has increased the openness of the economy and supported the growth of the production of tradable goods. External imbalances have proved manageable and foreign debt is at a comparatively low level.

**Also, unlike many other economies in the region, public spending is relatively low, as is taxation.** In addition, inflation has been slow and the expectations well anchored at the rate which does not erode the economy's competitiveness.

**All this has made it possible to cautiously change the public investment and the income policies to more expansionary ones.** This turnaround started after the global crisis of 2008-2009 and has continued cautiously ever since. The new government has continued to support wage growth as well as public investments. The expectation is that the more active policy measures supporting growth and employment will continue in the medium term.

**North Macedonia is a landlocked economy which depends on its neighbours, although over time the sources of export demand have been diversified.** Dependence on neighbours has not been all that beneficial in the past because of uncertain growth prospects for most of them, most importantly Greece. Somewhat improved prospects regionally are proving helpful to exports and investment, but industry has also been able to reorient itself significantly towards non-regional sources of demand, particularly Germany. The recovery of the Greek economy will be supportive of North Macedonian economic growth during the forecast period.

**The main target of North Macedonia politics has been stability, both internally and externally.** With the change in government and the agreement with Greece, the latter making it possible for North Macedonia to join NATO in the near future, external threats to stability have been minimised. In addition, renewed efforts to improve inter-ethnic relations have contributed to internal stability. These efforts to keep the country stable will continue.

**Prospects for EU integration hang in the balance.** The hope was that with the newly concluded agreement with Greece on a new country name, the path to the start of the negotiations for membership would be opened. The agreement has caught the EU less than ready for this step and the European Council decided against that for the time being. This is in part dependent on the overall EU strategy towards the Western Balkans which is unclear at the moment. It is to be expected though that the EU will eventually come around to starting the accession negotiations with North Macedonia which will certainly be stabilising for the country and for the region.

**Quite recently, Albania, North Macedonia and Serbia have agreed to work for Schengen-like liberalisation measures.** It is unclear exactly what is contemplated, but it is likely to be a net positive from the perspective of stability and security. Relations with Serbia are close and those with Albania are developing rapidly in a positive direction. For North Macedonia, Serbia is an important economic partner and any improved economic prospects there will spill over to the North Macedonian prospects almost immediately.

**Overall, growth should top 3% this year and should tend towards 4% in the medium run.** The start of negotiations with the EU would help as will the improved relations in the region. With the recent agreement with Greece, North Macedonia has taken itself out of the regional crisis area at least to the extent that it itself can help it.

## Table 5.15 / North Macedonia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 January-June | 2019 January-June | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 2,070 | 2,072 | 2,075 | 2,076 | . | . | 2,100 | 2,100 | 2,100 |
| Gross domestic product, MKD bn, nom. | 559.0 | 594.8 | 616.6 | 660.3 | 308.6 | 322.3 | 691 | 732 | 776 |
| annual change in % (real) | 3.9 | 2.8 | 0.2 | 2.7 | 2.0 | 3.6 | 3.3 | 3.4 | 3.4 |
| GDP/capita (EUR at PPP) | 10,400 | 10,800 | 10,800 | 11,600 | . | . | . | . | . |
| Consumption of households, MKD bn, nom. | 380.2 | 392.2 | 400.3 | 418.5 | 205.1 | 213.8 | . | . | . |
| annual change in % (real) | 4.5 | 3.6 | 0.7 | 2.9 | 1.9 | 2.9 | 2.8 | 3.0 | 3.5 |
| Gross fixed capital form., MKD bn, nom. | 133.3 | 145.0 | 135.3 | 140.0 | . | . | | | |
| annual change in % (real) | 10.5 | 9.9 | 2.9 | 6.8 | . | . | 5.0 | 6.0 | 6.0 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | 4.9 | 3.4 | 0.2 | 5.4 | 5.1 | 4.7 | 5.0 | 4.5 | 6.0 |
| Gross agricultural production 3) | | | | | | | | | |
| annual change in % (real) | 5.2 | 5.2 | -9.9 | 5.0 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 40.7 | 7.2 | -27.2 | -6.8 | -18.2 | 3.1 | . | . | . |
| Employed persons, LFS, th, average | 706.0 | 723.6 | 740.6 | 759.1 | 752.5 | 791.9 | 795 | 810 | 820 |
| annual change in % | 2.3 | 2.5 | 2.4 | 2.5 | 2.1 | 5.2 | 4.5 | 1.5 | 1.5 |
| Unemployed persons, LFS, th, average | 248.9 | 225.0 | 213.6 | 198.6 | 204.6 | 169.8 | 180 | 170 | 170 |
| Unemployment rate, LFS, in %, average | 26.1 | 23.7 | 22.4 | 20.7 | 21.4 | 17.7 | 18.5 | 17.5 | 17.5 |
| Reg. unemployment rate, in %, eop | 22.1 | 21.2 | 20.1 | 19.3 | 19.4 | 19.8 | . | . | . |
| Average monthly gross wages, MKD | 32,171 | 32,821 | 33,688 | 35,626 | 35,102 | 36,753 | 37,200 | 38,900 | 40,700 |
| annual change in % (real, gross) | 3.0 | 2.2 | 1.2 | 4.2 | 3.8 | 3.5 | 3.0 | 2.0 | 2.0 |
| Average monthly net wages, MKD | 21,904 | 22,342 | 22,928 | 24,276 | 23,922 | 24,760 | 25,400 | 26,500 | 27,700 |
| annual change in % (real, net) | 2.7 | 2.2 | 1.2 | 4.4 | 4.0 | 2.3 | 3.0 | 2.0 | 2.0 |
| Consumer prices, % p.a. | -0.3 | -0.2 | 1.4 | 1.5 | 1.6 | 1.2 | 1.4 | 2.4 | 2.5 |
| Producer prices in industry, % p.a. | -3.9 | -3.1 | 4.8 | 0.9 | 1.9 | 0.6 | 2.5 | 3.0 | 3.0 |
| General governm. budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 31.0 | 30.6 | 31.0 | 30.4 | 29.4 | 29.8 | 31.0 | 32.0 | 32.0 |
| Expenditures | 34.4 | 33.2 | 33.9 | 31.5 | 30.8 | 32.0 | 33.0 | 33.0 | 33.0 |
| Deficit (-) / surplus (+) | -3.4 | -2.7 | -2.8 | -1.1 | -1.5 | -2.2 | -2.0 | -1.0 | -1.0 |
| General gov.gross debt, nat.def., % of GDP | 46.6 | 48.7 | 47.7 | 48.4 | 47.9 | 46.8 | 47.0 | 46.0 | 46.0 |
| Stock of loans of non-fin.private sector, % p.a. | 9.6 | -0.1 | 5.4 | 7.2 | 6.1 | 8.1 | . | . | . |
| Non-performing loans (NPL), in %, eop 4) | 10.4 | 6.4 | 6.2 | 5.1 | 5.0 | 5.4 | . | . | . |
| Central bank policy rate, %, p.a., eop 5) | 3.25 | 3.75 | 3.25 | 2.50 | 3.00 | 2.25 | 2.25 | 2.25 | 2.25 |
| Current account, EUR mn | -177 | -275 | -105 | -15 | -110 | -196 | -160 | -300 | -390 |
| Current account, % of GDP | -2.0 | -2.9 | -1.1 | -0.1 | -2.2 | -3.7 | -1.4 | -2.5 | -3.1 |
| Exports of goods, BOP, EUR mn | 3,047 | 3,529 | 4,075 | 4,881 | 2,264 | 2,596 | 5,370 | 5,800 | 6,380 |
| annual change in % | 9.4 | 15.8 | 15.4 | 19.8 | 15.6 | 14.7 | 10.0 | 8.0 | 10.0 |
| Imports of goods, BOP, EUR mn | 4,870 | 5,342 | 5,862 | 6,616 | 3,130 | 3,503 | 7,150 | 7,720 | 8,490 |
| annual change in % | 5.0 | 9.7 | 9.7 | 12.9 | 10.4 | 11.9 | 8.0 | 8.0 | 10.0 |
| Exports of services, BOP, EUR mn | 1,378 | 1,390 | 1,434 | 1,571 | 710 | 736 | 1,650 | 1,720 | 1,810 |
| annual change in % | 5.7 | 0.9 | 3.2 | 9.5 | 10.5 | 3.8 | 5.0 | 4.0 | 5.0 |
| Imports of services, BOP, EUR mn | 1,029 | 1,049 | 1,060 | 1,209 | 488 | 536 | 1,230 | 1,250 | 1,290 |
| annual change in % | 11.8 | 2.0 | 1.0 | 14.1 | -2.8 | 9.7 | 2.0 | 2.0 | 3.0 |
| FDI liabilities, EUR mn | 262 | 495 | 351 | 539 | 421 | 339 | 500 | . | . |
| FDI assets, EUR mn | 59 | 179 | 171 | -65 | 117 | 290 | 100 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 2,049 | 2,370 | 2,097 | 2,619 | 2,405 | 2,653 | . | . | . |
| Gross external debt, EUR mn | 6,291 | 7,217 | 7,372 | 7,844 | 8,386 | 8,324 | 8,600 | 8,900 | 9,500 |
| Gross external debt, % of GDP | 69.3 | 74.7 | 73.6 | 73.1 | 78.1 | 73.8 | 76.0 | 75.0 | 75.0 |
| Average exchange rate MKD/EUR | 61.61 | 61.60 | 61.57 | 61.51 | 61.5 | 61.5 | 61.3 | 61.4 | 61.4 |

1) Preliminary. - 2) Enterprises with 10 and more employees. - 3) wiiw estimate in 2018. - 4) The decline in the loans in 2016 was due to the write-off of doubtful and contested claims on loans. - 5) Central Bank bills (28-days).

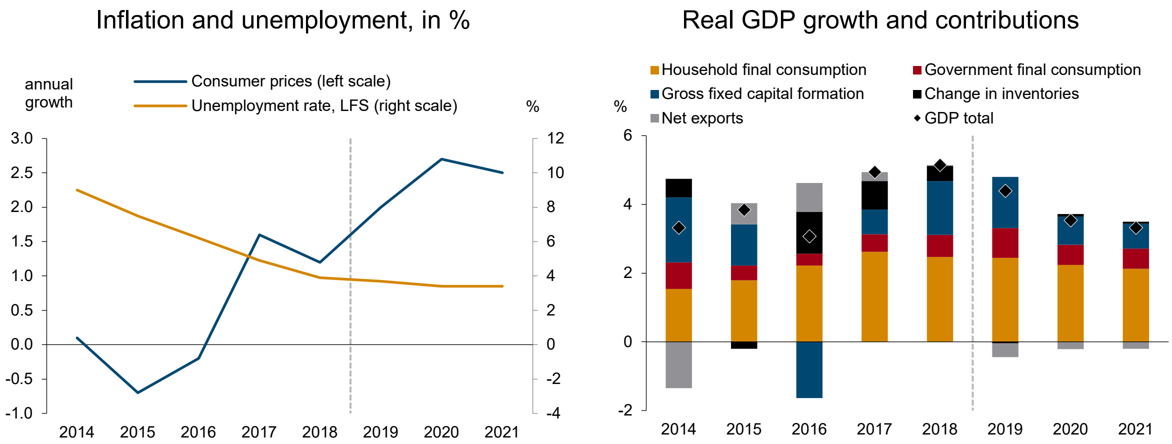
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# POLAND: Soft landing ahead is a possibility

LEON PODKAMINER

**Broad-based economic growth has continued. German economic stagnation is not yet affecting foreign trade, but industrial output has started to underperform. A strong rise in gross fixed capital formation primarily reflects larger infrastructural and public sector investments. Household consumption is driven by strongly rising wages and social transfers. Labour shortages have become less acute while moderate inflation is back. The next government may feel obliged to continue the lavish social policies.**

**Figure 5.16 / Poland: Main macroeconomic indicators**




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

**In the first half of 2019 the broadly-based and fairly strong economic growth has continued:** GDP increased by 4.6%. All components of the domestic demand have grown respectably while the foreign trade in goods and non-factor services performed unexpectedly well – especially in the first quarter of the year (rising by 5.9% in real terms).

**German economic stagnation is not yet affecting the foreign trade aggregates** (though the shares of Germany in Poland’s exports and imports have gone down - gently so far - primarily on account of contracting trade in vehicles and parts thereof). Trade with the UK brings quite large surpluses. These surpluses may well diminish, or even vanish, after Brexit.

**Industrial output has been underperforming recently**. Quite strong growth in industrial sales recorded in the first half of the year has performed rather weekly since. In August the industrial output declined. The manufacture of vehicles suffered the most with over 24% decline in sales. Although quite a few manufacturing branches still keep expanding sales (though at the rates lower than earlier this year, and much lower than a year ago) the general business climate in industry and the construction sector has turned rather pessimistic, reflecting weakening foreign and domestic demand.

**Statistics suggest a strong rise in Gross Fixed Capital Formation.** Investment growth is particularly strong as far as construction of 'buildings and structures' is concerned – with much weaker growth in the volumes of 'machinery' installed. 'Transportation' and 'electricity' sectors record the highest rates of growth in investment outlays (over 30% in nominal terms) while investment outlays in manufacturing have risen by less than 15%. But the sectors receiving high investments are infrastructural in character and are predominantly publicly-owned. In addition, it turns out that very large firms (with 1000 or more employees, quite typical of the public ownership) account for over 50% of the total investment outlays of the whole enterprise sector.

**The volume of capital formation by the market-oriented private sector (and of its small and medium sized segments in particular) has been stagnant**[22]. This does not bode particularly well for the future productive capacities. Moreover, investment propelled disproportionately by public spending may get restricted by the budgetary considerations. In this case the fixed investment may stop supporting the aggregate demand and the overall GDP growth.

**Household consumption is driven by strongly rising wages and social transfers**. Nominally the average wage in the enterprise sector rose by 6.8% in the first eight months of the year and the average retirement pay by 4.7% (in real terms 4% and 1.8% respectively). With still increasing employment and the ranks of retirees, the total disposable income of the household sector must have increased by at least over 4% in real terms. All in all, this configuration of factors has been conducive to expanding consumption and the overall growth. Growth in the household incomes and consumption is likely to go on in the near future, though not necessarily indefinitely. An unexpected return of higher inflation and/or unemployment could erode the real value of the household sector's disposable income while the re-emerging budgetary bottlenecks might make the continuation of the generous social spending more difficult.

**Labour shortages seem less acute**. The number of vacancies reported has gone down quite strongly and firms report grossly insufficient employment less often. This may suggest that the natural process of matching individual jobs with individual employees has advanced. At the same time the number of new jobs created is falling while the number of jobs liquidated is rising strongly. This may augur a short-term stabilisation of registered unemployment rate at a level which is not excessively low (over 5%).

**Moderate inflation is back**. Wages, rising faster than labour productivity, have been eroding the volumes of profits earned by the business sector. So far this has been inconsequential as far the prices charged by producers are concerned. The producer price index for manufacturing is low and falling. But this situation is unlikely to persist. Upon some delay the suppliers may start requesting higher prices compensating for higher unit labour costs. This will feed into higher consumer prices. In addition,

22 The share of foreign-owned firms in the total investment outlays (of the non-financial business sector) fell to about 40% in the first half of the year (from 44% a year previous).

inflation may accelerate in 2020 if the government administers (as already signalled) steep hikes in the energy tariffs.

**Monetary policy remains dovish**: the NBP does not see the point in pre-empting inflation (and thus in possibly affecting, negatively, the investment/consumption growth) with more restrictive policy. Quite fortunately, the exchange rate has been remarkably stable recently and the indebtedness levels remain low and so are non-performing loans.

**The government has continued to shower the population with monetary transfers of various sorts**. These are highly appreciated especially by the lower-income and lower-skill social strata. The parliamentary elections held on 13 Oct. 2019 brought a clear victory to the incumbent government.

**The next government may feel obliged to continue the lavish social and economic policies**, including e.g. substantial hikes in minimum wages.[23] However, the financing of extraordinary social spending has been quite unproblematic under rather fast growth (since 2017), high EU transfers and much improved collection of indirect taxes. In 2020-21 these factors may be less supportive and the rising public sector deficits could enforce hikes in taxes or/and cuts in spending (e.g. on public investment or for the already underfunded health and education services). Under less expansionary fiscal policy, less pronounced improvements in household disposable incomes and possibly less favourable external conditions (such as the German business climate), Poland's output growth is forecast to slow down. Soft landing is a real possibility in 2020.

[23] See L.Podkaminer, 'Higher minimum wages? Not necessarily the end of the world', wiiw Monthly Report No 10, October 2019.

## Table 5.16 / Poland: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 | 2019 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 38,458 | 38,435 | 38,434 | 38,423 | 38,434 | 38,411 | 38,400 | 38,410 | 38,420 |
| Gross domestic product, PLN bn, nom. 2) | 1,800 | 1,861 | 1,989 | 2,115 | 995 | 1,066 | 2,250 | 2,380 | 2,510 |
| annual change in % (real) | 3.8 | 3.1 | 4.9 | 5.1 | 5.3 | 4.4 | 4.4 | 3.5 | 3.3 |
| GDP/capita (EUR at PPP) | 19,900 | 19,900 | 20,900 | 21,900 | . | . | . | . | . |
| Consumption of households, PLN bn, nom. 2) | 1,038 | 1,074 | 1,145 | 1,213 | 607 | 641 | . | . | . |
| annual change in % (real) | 3.0 | 3.9 | 4.5 | 4.3 | 4.2 | 3.9 | 4.3 | 3.9 | 3.7 |
| Gross fixed capital form., PLN bn, nom. 2) | 361 | 335 | 349 | 386 | 142 | 161 | . | . | . |
| annual change in % (real) | 6.1 | -8.2 | 4.0 | 8.9 | 7.9 | 10.6 | 8.2 | 4.5 | 4.0 |
| Gross industrial production (sales) 3) | | | | | | | | | |
| annual change in % (real) | 4.8 | 2.8 | 6.6 | 5.9 | 6.4 | 5.3 | 5.3 | 4.2 | 4.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -2.7 | 8.5 | 2.9 | -0.6 | . | . | . | . | . |
| Construction industry 3) | | | | | | | | | |
| annual change in % (real) | 0.3 | -14.5 | 13.7 | 19.7 | 23.4 | 8.7 | . | . | . |
| Employed persons, LFS, th, average | 16,084 | 16,197 | 16,423 | 16,484 | 16,455 | 16,379 | 16,580 | 16,630 | 16,660 |
| annual change in % | 1.4 | 0.7 | 1.4 | 0.4 | 0.4 | -0.5 | 0.6 | 0.3 | 0.2 |
| Unemployed persons, LFS, th, average | 1,304 | 1,063 | 844 | 659 | 663 | 607 | 640 | 590 | 590 |
| Unemployment rate, LFS, in %, average | 7.5 | 6.2 | 4.9 | 3.9 | 3.9 | 3.6 | 3.7 | 3.4 | 3.4 |
| Reg. unemployment rate, in %, eop | 9.7 | 8.3 | 6.6 | 5.8 | 5.8 | 5.3 | . | . | . |
| Average monthly gross wages, PLN 4) | 3,908 | 4,052 | 4,272 | 4,560 | 4,434 | 4,572 | 4,880 | 5,210 | 5,530 |
| annual change in % (real, gross) 4) | 4.5 | 4.2 | 3.5 | 5.5 | 3.0 | 5.7 | 5.0 | 4.0 | 3.5 |
| Consumer prices (HICP), % p.a. | -0.7 | -0.2 | 1.6 | 1.2 | 1.1 | 1.7 | 2.0 | 2.7 | 2.5 |
| Producer prices in industry, % p.a. | -2.2 | -0.3 | 2.7 | 2.1 | 1.2 | 2.1 | 1.8 | 2.0 | 1.8 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 39.0 | 38.9 | 39.7 | 41.2 | . | . | 41.0 | 40.5 | 40.5 |
| Expenditures | 41.7 | 41.1 | 41.2 | 41.6 | . | . | 42.2 | 42.5 | 42.5 |
| Net lending (+) / net borrowing (-) | -2.7 | -2.2 | -1.5 | -0.4 | . | . | -1.2 | -2.0 | -2.0 |
| General gov.gross debt, EU def., % of GDP | 51.3 | 54.2 | 50.6 | 48.9 | . | . | 50.0 | 50.5 | 51.0 |
| Stock of loans of non-fin.private sector, % p.a. | 7.1 | 5.3 | 3.1 | 7.1 | 5.5 | 5.3 | . | . | . |
| Non-performing loans (NPL), in %, eop | 7.5 | 7.1 | 6.8 | 6.8 | . | . | . | . | . |
| Central bank policy rate, % p.a., eop 5) | 1.5 | 1.5 | 1.5 | 1.5 | 1.50 | 1.50 | 1.50 | 1.75 | 1.75 |
| Current account, EUR mn 6) | -2,379 | -2,234 | 285 | -5,048 | -288 | 2,538 | -5,400 | -6,400 | -5,000 |
| Current account, % of GDP 6) | -0.6 | -0.5 | 0.1 | -1.0 | -0.1 | 1.0 | -1.0 | -1.2 | -0.9 |
| Exports of goods, BOP, EUR mn 6) | 172,150 | 177,412 | 201,963 | 216,924 | 106,742 | 114,156 | 229,900 | 243,100 | 257,100 |
| annual change in % | 8.5 | 3.1 | 13.8 | 7.4 | 6.9 | 6.9 | 6.0 | 5.8 | 5.8 |
| Imports of goods, BOP, EUR mn 6) | 169,937 | 174,479 | 200,536 | 221,707 | 108,768 | 113,403 | 232,800 | 247,700 | 262,600 |
| annual change in % | 5.0 | 2.7 | 14.9 | 10.6 | 10.5 | 4.3 | 5.0 | 6.4 | 6.0 |
| Exports of services, BOP, EUR mn 6) | 40,663 | 44,929 | 51,884 | 58,772 | 27,886 | 29,997 | 62,900 | 67,900 | 73,300 |
| annual change in % | 10.7 | 10.5 | 15.5 | 13.3 | 15.0 | 7.6 | 7.0 | 8.0 | 8.0 |
| Imports of services, BOP, EUR mn 6) | 29,749 | 30,963 | 33,927 | 37,116 | 16,827 | 18,247 | 39,700 | 41,700 | 43,800 |
| annual change in % | 7.5 | 4.1 | 9.6 | 9.4 | 8.1 | 8.4 | 7.0 | 5.0 | 5.0 |
| FDI liabilities, EUR mn 6) | 13,534 | 16,628 | 10,182 | 14,022 | 7,276 | 5,019 | 12,000 | . | . |
| FDI assets, EUR mn 6) | 4,385 | 12,807 | 3,430 | 1,593 | 648 | 186 | 3,000 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 83,676 | 104,440 | 90,967 | 97,633 | 89,986 | 94,335 | . | . | . |
| Gross external debt, EUR mn 6) | 303,120 | 321,305 | 318,850 | 314,538 | 312,614 | 309,379 | 314,000 | 332,100 | 346,200 |
| Gross external debt, % of GDP 6) | 70.5 | 75.3 | 68.2 | 63.4 | 63.0 | 59.1 | 60.0 | 60.0 | 60.0 |
| Average exchange rate PLN/EUR | 4.1841 | 4.3632 | 4.2570 | 4.2615 | 4.2200 | 4.2920 | 4.30 | 4.30 | 4.35 |

1) Preliminary. - 2) Half-year data unrevised. - 3) Enterprises with 10 and more employees. - 4) Half-year data refer to enterprises with 10 and more employees. - 5) Reference rate (7-day open market operation rate). - 6) Including SPE.

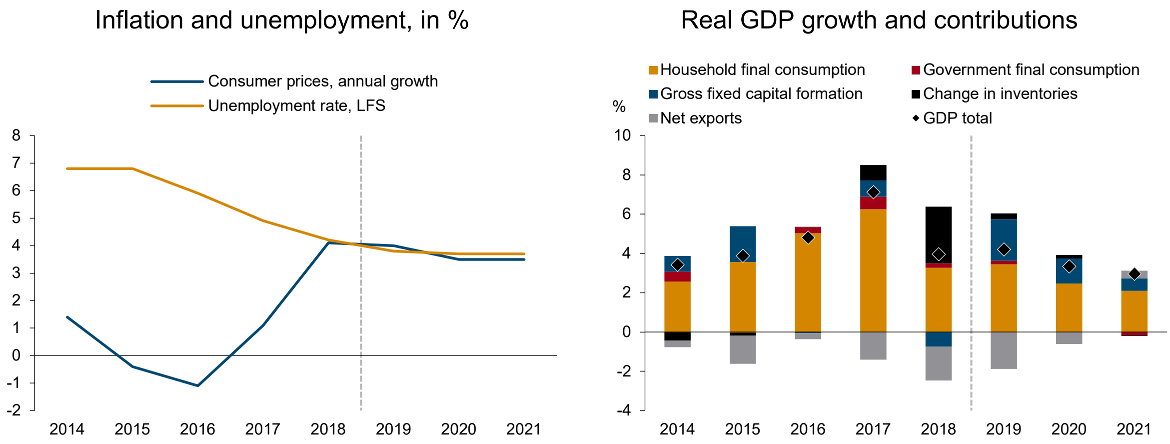
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# ROMANIA: New government to initiate fiscal consolidation

GÁBOR HUNYA

**Economic growth is even stronger than last year, and could reach 4.2% in 2019, driven by household consumption and investment. Monetary and fiscal policy remains loose. Expanding deficits can be easily financed due to abundant international liquidity, albeit at a relatively high cost, constituting a burden for the future. Weaker external demand is already feeding through to industrial production, and will act as a barrier to growth in the future. We expect the interim government to take steps to curtail the fiscal deficit in 2020.**

**Figure 5.17 / Romania: Main macroeconomic indicators**




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

**Real GDP growth reached a surprisingly strong 4.7% in the first half of 2019, prompting an upward revision of our full-year growth forecast to above 4%.** Rapidly rising wages fuelled household consumption, which increased by 6.2% in the first semester. Gross fixed capital formation recovered from a depressed level (+11.6%). Many of the unfinished projects, which fed into inventories in the previous year, were finished. The construction sector emerged from its three years of decline with very strong growth (+23.1%). Residential building was especially strong.

**However, industrial production and foreign trade data point towards a marked slowdown of the economy in the rest of the year.** Manufacturing production fell by 1.2% in the first eight months of the year and so did labour productivity. The production of textiles, leather and furniture declined as these labour intensive industries were strongly hit by soaring wages and labour shortages. Some foreign investors in these sectors left the country to cheaper destinations, such as Vietnam. The production of cars and other transport equipment remained buoyant, supported by rapidly rising investments and labour productivity. The value of new orders in manufacturing was higher in August 2019 than a year earlier in nominal terms, but lower if corrected by the producer price index. The manager index expects stagnation of output in the manufacturing industry for the rest of the year.

**Manufacturing output reflects demand constraints appearing on foreign markets as seen in sluggish export growth**, (+1.7% in the first eight months y-o-y). Almost half of the exports were constituted by machinery and transport equipment. They are destined mainly to various European markets with no special concentration on recession-threatened Germany. Imports of goods expanded by 4.8% in the same period thus the trade deficit constituted the main component of the current account deficit. The services balance and the secondary income balance were on the positive side. The current account deficit is expected to widen to about 5.2% of GDP this year and be financed from bond issues as well as increasing capital transfers of the EU, as well as FDI.

**Fiscal and monetary policies have supported overheating, leading to higher deficits in the budget and the current account than last year.** The majority of the fiscal deficit remains externally financed at a high yield on 10-year sovereign bonds of about 4.2% which points at the rather high risk of unsustainability. (EU-CEE peers such as Hungary or Poland are being charged less than 2% as of August 2019.) But general government debt is still below 40% of GDP and may expand with no immediate punishment by the financial markets. The budget deficit is expected to widen to more than 3% of GDP in 2019. This may trigger a consolidation course in 2020 to avoid an excessive deficit procedure by the EU.

**Inflation accelerated to 4% on annual terms, which is well above the BNR target of 2.5%**. However, the policy rate is kept firm also at 2.5% with a +/- 1pp band and is not expected to move up as core inflation is moderate and the exchange rate stable. Lending rates of commercial banks are positive in real terms keeping credit expansion under control.

**Real wages have grown stronger than last year despite a higher inflation rate.** Increase in the minimum wages by 15% is one explanation. The other is that the labour shortages have increased the bargaining power of workers. But the labour market tightness started to ease as indicated by the reduced job vacancy rates in recent months. Meanwhile the unemployment rate declined to 3.8% in the second quarter of 2019, 0.4 pp lower than a year before. The quota for non-EU foreign workers for 2019 was increased from twenty to thirty thousand in July. Most of the new temporary immigrants will come from Vietnam based on a recent agreement between the two governments. With the expected economic slowdown, the strain on the labour market may ease in the future and we do not expect a further increase in temporary immigration or a decline in the unemployment rate. Meanwhile emigration keeps increasing, albeit moderately, despite higher incomes and better job opportunities in Romania. The wage gap in comparison with the advanced EU countries is still wide enough.

**The government was ousted in a non-confidence vote on October 30.** The Social Democratic Party (PSD) lost its coalition partner ALDE and thus the governing majority. PSD was shaken by bad results in the European Parliament elections on 26 May but it was able to get rid of its controversial leader, Liviu Dragnea, who was put in jail for corruption just a day later. Within a week, the party and the government had been reshuffled and they gave up controversial initiatives to reform the legal system. Thus it could improve cooperation with EU institutions. But party leader and Prime Minister, Viorica Dancila, could not resist running for the presidency by which she broke the agreement with ALDE which ended the coalition.

**The leading party of the opposition, the National Liberal Party (PNL), will form a minority interim government.** Early parliamentary elections are not possible before the presidential elections due in November. They are anyway unusual in Romania as MPs prefer sticking to their seats in Parliament although not necessarily to their party affiliation. Regular elections are scheduled for November 2020 until which time the PNL will have to govern with an unstable majority. But incumbent president, Klaus Iohannis from the same party, is expected to get a mandate for another five years and may press for early elections to consolidate his party’s power. The need for fiscal consolidation is another argument to press for new elections as early as possible, because financing popular policies for another year may face financial limits. Social peace is unlikely to set in even after elections, as the PSD is expected to mobilise the people against austerity and take them on to the street against the PNL government.

**The new government is expected to pass an austerity budget for 2020.** This will mean consolidation with a soft landing and putting the brakes on economic growth. The government will likely curtail wage growth in the public sector and abstain from hiking minimum wages. The second step of the pension reform, which started in September 2019 and would add 2% of GDP to the budgetary expenditures in 2020, may be postponed. But public investments may not be cut and the drawing of EU funds will be stepped up. BNR may increase the policy rate by 25 basis points to tighten monetary policy in view of the above target inflation. External demand is also likely to curtail economic growth in 2020 which is expected to slow down to 3.3%.

## Table 5.17 / Romania: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 | 2019 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 19,816 | 19,702 | 19,587 | 19,466 | . | . | 19,400 | 19,300 | 19,200 |
| Gross domestic product, RON bn, nom. | 712.6 | 765.1 | 857.9 | 944.2 | 395.9 | 441.0 | 1,040 | 1,130 | 1,210 |
| annual change in % (real) | 3.9 | 4.8 | 7.1 | 4.0 | 4.0 | 4.7 | 4.2 | 3.3 | 3.0 |
| GDP/capita (EUR at PPP) | 16,300 | 17,400 | 18,800 | 20,000 | . | . | . | . | . |
| Consumption of households, RON bn, nom. | 432.6 | 471.9 | 533.7 | 582.5 | 254.1 | 284.2 | . | . | . |
| annual change in % (real) | 5.9 | 8.3 | 10.1 | 5.2 | 5.5 | 6.2 | 5.6 | 4.0 | 3.4 |
| Gross fixed capital form., RON bn, nom. | 176.5 | 175.0 | 192.2 | 200.4 | 74.0 | 88.3 | . | . | . |
| annual change in % (real) | 7.5 | -0.2 | 3.6 | -3.3 | -2.2 | 11.6 | 10.0 | 6.0 | 3.0 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | 2.8 | 3.1 | 7.9 | 3.5 | 4.2 | -0.5 | 0.0 | 2.0 | 3.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -6.8 | 2.5 | 12.5 | 11.9 | . | . | . | . | . |
| Construction industry 2) | | | | | | | | | |
| annual change in % (real) | 10.5 | -4.4 | -5.5 | -4.1 | -0.7 | 23.1 | . | . | . |
| Employed persons, LFS, th, average | 8,535 | 8,449 | 8,671 | 8,689 | 8,655 | 8,651 | 8,690 | 8,690 | 8,690 |
| annual change in % | -0.9 | -1.0 | 2.6 | 0.2 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Unemployed persons, LFS, th, average | 624 | 530 | 449 | 380 | 397 | 354 | 340 | 330 | 330 |
| Unemployment rate, LFS, in %, average | 6.8 | 5.9 | 4.9 | 4.2 | 4.4 | 4.0 | 3.8 | 3.7 | 3.7 |
| Reg. unemployment rate, in %, eop | 5.0 | 4.8 | 4.0 | 3.3 | 3.5 | 3.0 | . | . | . |
| Average monthly gross wages, RON 3)4) | 2,555 | 2,809 | 3,223 | 4,357 | 4,382 | 5,003 | 4,900 | 5,300 | 5,700 |
| annual change in % (real, gross) | 10.4 | 11.7 | 13.2 | 8.0 | 7.7 | 9.9 | 9.0 | 5.0 | 3.0 |
| Average monthly net wages, RON 4) | 1,859 | 2,046 | 2,338 | 2,642 | 2,636 | 3,050 | 3,000 | 3,300 | 3,500 |
| annual change in % (real, net) | 10.1 | 11.8 | 12.8 | 8.0 | 7.7 | 11.4 | 9.0 | 5.0 | 3.0 |
| Consumer prices (HICP), % p.a. | -0.4 | -1.1 | 1.1 | 4.1 | 4.1 | 4.0 | 4.0 | 3.5 | 3.5 |
| Producer prices in industry, % p.a. | -2.3 | -1.8 | 3.5 | 5.1 | 4.6 | 4.5 | 4.5 | 3.0 | 4.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 35.4 | 31.8 | 30.9 | 32.0 | . | . | 33.0 | 33.0 | 33.0 |
| Expenditures | 36.1 | 34.5 | 33.6 | 35.0 | . | . | 36.5 | 36.0 | 36.0 |
| Net lending (+) / net borrowing (-) | -0.7 | -2.7 | -2.7 | -3.0 | . | . | -3.5 | -3.0 | -3.0 |
| General gov.gross debt, EU def., % of GDP | 37.8 | 37.3 | 35.1 | 35.0 | . | . | 35.0 | 35.5 | 36.0 |
| Stock of loans of non-fin.private sector, % p.a. | 2.5 | 0.9 | 5.3 | 7.9 | 7.0 | 6.7 | . | . | . |
| Non-performing loans (NPL), in %, eop | 13.5 | 9.6 | 6.4 | 5.0 | 5.7 | 4.7 | . | . | . |
| Central bank policy rate, % p.a., eop 5) | 1.75 | 1.75 | 1.75 | 2.50 | 2.50 | 2.50 | 2.50 | 2.75 | 2.75 |
| Current account, EUR mn | -1,977 | -3,548 | -5,991 | -9,335 | -3,632 | -4,565 | -11,400 | -11,800 | -12,000 |
| Current account, % of GDP | -1.2 | -2.1 | -3.2 | -4.6 | -4.3 | -4.9 | -5.2 | -5.0 | -4.9 |
| Exports of goods, BOP, EUR mn | 49,111 | 52,167 | 57,160 | 61,836 | 31,050 | 31,882 | 63,100 | 65,000 | 67,600 |
| annual change in % | 4.8 | 6.2 | 9.6 | 8.2 | 10.2 | 2.7 | 2.0 | 3.0 | 4.0 |
| Imports of goods, BOP, EUR mn | 56,896 | 61,467 | 69,339 | 76,677 | 37,133 | 39,553 | 81,300 | 85,400 | 89,100 |
| annual change in % | 6.6 | 8.0 | 12.8 | 10.6 | 11.0 | 6.5 | 6.0 | 5.0 | 4.3 |
| Exports of services, BOP, EUR mn | 16,640 | 18,006 | 20,692 | 23,265 | 10,930 | 12,453 | 26,300 | 28,900 | 31,200 |
| annual change in % | 10.2 | 8.2 | 14.9 | 12.4 | 10.7 | 13.9 | 13.0 | 10.0 | 8.0 |
| Imports of services, BOP, EUR mn | 9,849 | 10,284 | 12,482 | 14,564 | 6,827 | 8,097 | 17,200 | 18,700 | 20,000 |
| annual change in % | 6.6 | 4.4 | 21.4 | 16.7 | 17.4 | 18.6 | 18.0 | 9.0 | 7.0 |
| FDI liabilities, EUR mn | 3,885 | 5,656 | 5,225 | 6,205 | 2,432 | 2,977 | 6,800 | . | . |
| FDI assets, EUR mn | 930 | 1,143 | 348 | 1,259 | 839 | 282 | 500 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 32,238 | 34,242 | 33,494 | 33,065 | 31,766 | 32,569 | . | . | . |
| Gross external debt, EUR mn | 92,069 | 92,910 | 97,361 | 99,841 | 97,125 | 105,363 | 110,000 | 115,000 | 120,000 |
| Gross external debt, % of GDP | 57.4 | 54.5 | 51.9 | 49.2 | 47.9 | 48.1 | 50.2 | 49.1 | 48.6 |
| Average exchange rate RON/EUR | 4.4454 | 4.4904 | 4.5688 | 4.6540 | 4.6545 | 4.7420 | 4.75 | 4.82 | 4.90 |

1) Preliminary. - 2) Enterprises with 4 and more employees. - 3) In 2018 the social security contribution paid by employers was added to gross wages; real growth 2018 refers to net wages. - 4) Half-year data refer to enterprises with 4 and more employees. - 5) One-week repo rate.

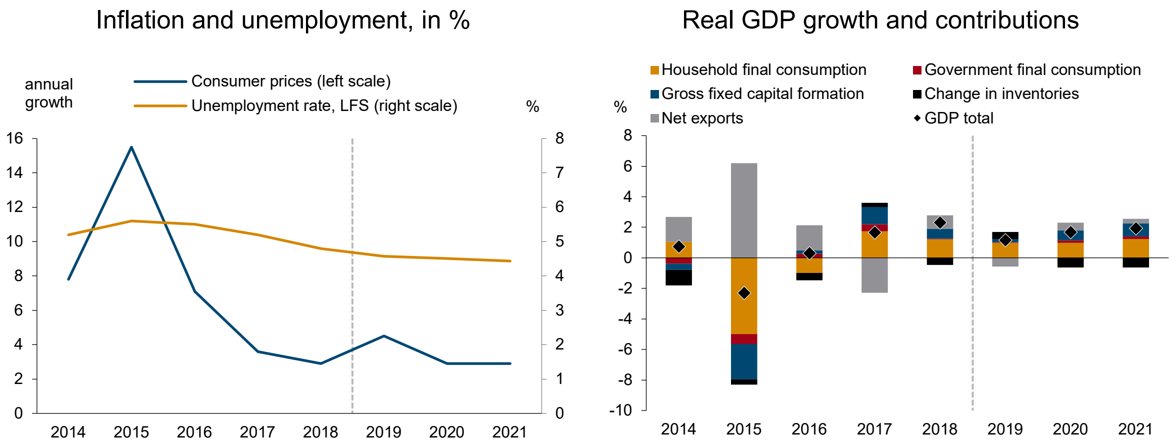
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# RUSSIA: Self-inflicted stagnation

VASILY ASTROV

**Growth in the first half of the year decelerated sharply, largely on account of weaker investment activity and declining net exports. Private consumption remains weak, constrained not least by the tight fiscal policy, although monetary policy has been softened in response to recent disinflation. Even with the planned start of infrastructure projects and increased social spending, it is difficult to see the Russian economy growing above 2% p.a. in the medium term.**

**Figure 5.18 / Russia: Main macroeconomic indicators**




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

**In the second quarter of 2019, economic growth picked up to 0.9% year-on-year** from 0.5% in the first quarter. This was to a large extent due to the basis effect: the second quarter of 2018 saw a moderation of government spending after the presidential elections held in April. Still, GDP growth in the first half of 2019 was only 0.7% - a marked slowdown compared to the first half of last year (+2.1%), largely on account of weaker investment activity and declining net exports. Viewed from the supply side, growth was driven primarily by extraction industry (+3.8%), while manufacturing rose by only 0.6%, construction was flat, and agriculture and trade declined by 0.4% and 1.8% respectively (all in value-added terms). Overall, the growth performance of the Russian economy remains lacklustre and on an annual basis it is the second worst in the CESEE region (after Turkey).

**The main reason for the lacklustre growth performance has been flat domestic demand.** In January-August, the retail trade turnover picked up by only 1.5%, while the volume of market services to households declined by 1%. The weakness of private consumption is hardly surprising given the ongoing downward trend in incomes. Real disposable incomes of households have been declining almost invariably since 2014 (by around 9% in total between 2014 and 2018) and dropped by another 1.3% (yoy) in the first half of this year. Investment dynamics remains disappointing as well. In the first half of 2019, gross fixed capital formation dropped by 0.5% (after a relatively strong 2.9% growth last year). The reluctance to invest may come across as surprising, given the strong rise in corporate profits (by 37% in nominal terms in the first five months of the year), and is partly due to the low levels of capacity utilisation.[24]

**The weakness of consumer demand has contributed to fast disinflation…** CPI jumped markedly at the start of the year (by 1 pp in January alone) because of the hike in the VAT rate from 18 to 20%. However, given the weak domestic demand, businesses found it ultimately difficult to shift the entire burden of higher VAT taxation on consumers, and price growth has been progressively losing momentum. By September, CPI inflation declined to 4% on an annual basis, matching the 4% inflation target of the Central Bank.

**… prompting the Central Bank to cut the policy rate.** Over the past few months, the latter was cut in three steps by a combined 75 basis points, to 7%. This should lower the interest rates on loans and thus ease the financial burden on borrowers, but may also fuel credit demand which is already running high, especially for consumer credit. Although the peak of credit expansion to households appears now to have been passed, it still hovers at around 23% on an annual basis. 57% of the stock of household loans is accounted for by consumer credit, typically at high interest rates of around 10%. Coupled with (at best) stagnant real incomes, fast credit expansion at high interest rates results in a growing share of incomes being spent on servicing debt, with potential sustainability risks in the medium term. This danger is well acknowledged by the authorities, which have recently tightened regulations on consumer lending.[25]

**High credit growth is driven above all by the necessity to make up for the falling incomes, which are constrained not least by the tight fiscal policy.** In the first half of 2019, general government budget surplus reached 5.2% of GDP – 2 pp more than in the first half of 2018, reflecting a strong fiscal consolidation effort. On top of that, the sovereign National Welfare Fund (NWF), which accumulates ‘windfall’ profits from energy exports, reached 7.6% of GDP by 1 August – the highest level in the past three years.[26] The tight fiscal policy is meant to reduce further the public debt to GDP ratio (from the already very low level of 12%) and make the Russian economy even more resilient to western sanctions. However, the current fiscal stance appears to be overly restrictive, weighing heavily on growth. It is conceivable that the government would have room for some fiscal relaxation without jeopardising stability or resilience – for instance, by borrowing domestically.

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24 According to the assessment by the Institute of Economic Forecasting of the Russian Academy of Sciences, capacity utilisation stands at around 80% in extractive industries, less than 65% in the production of consumer goods, and around 50% in the production of investment goods.

25 As of 1 July 2019, the authorities introduced caps on the interest rates charged on short-term consumer loans by micro-financial organisations (at maximum 1% per day) and on the volume of the overall debt repayment (the latter cannot exceed twice the size of the original loan). Besides, as of 1 October banks need to take into account the ‘coefficient of credit burden’ when taking a lending decision.

26 Under the new ‘fiscal rule’, any revenue from oil prices higher than USD 41.6 per barrel is being accumulated in the NWF. This year, oil prices have been generally hovering at USD 60-70 per barrel, translating into ample liquidity inflows into the NWF.

**The contribution of net exports to GDP growth has declined, but external surplus remains solid.** In the first nine months of 2019, imports of goods stagnated, while goods exports declined by 5% (in US dollar terms) on account of lower oil prices and Russia's oil supply cuts commitments within the framework of the OPEC+ deal. These trends were largely mirrored in the dynamics of real exports and imports, resulting in declining contribution of net exports (of goods and services) to GDP growth. However, the trade and current account surpluses remain comfortably high. The latter reached USD 57 billion in January-September 2019, contributing to the growth of foreign exchange reserves by USD 51 billion over the same time period. By the end of September, the stock of Russia's foreign exchange reserves reached USD 532 billion, corresponding to 19 months of imports (of goods and services) and making the country the fourth largest holder of foreign exchange globally. Similarly to tight fiscal policy, the accumulation of forex reserves is part of the government strategy to withstand western sanctions and reduce external vulnerability.

**In August, the US announced a new package of sanctions against Russia,** formally linked to the attempted poisoning of former Russian-British double agent Sergei Skripal and his daughter in the UK last year. The direct impact of the newly imposed sanctions will be at best limited. They prohibit assistance by international financial organisations (which Russia hardly needs anyway), ban the purchase of Russian sovereign debt by US banks in the primary (but not in the secondary) market, and restrict exports of selected technological products from the US to Russia. Similarly to earlier sanctions packages, the main damage to the Russian economy is likely to be indirect, contributing to higher perceived risks (not only in the US) of doing business with Russia and limiting the inflows of foreign investment. Meanwhile, the EU has been refraining from imposing additional sanctions on Russia, although those imposed back in 2014 have been regularly prolonged so far.

**The local elections held in September 2019 exposed cracks in the popular support of the ruling United Russia party.** This was most visible in the Moscow city council, where the party lost nearly half of its seats and retained only a thin majority. This, and especially a recent wave of popular protests across the country, is a manifestation of the declining popularity of the incumbent authorities, fuelled in part by the economic stagnation and the falling living standards. The authorities' response to the growing popular discontent has been mixed, ranging from brutal crackdowns on protests to selected concessions, including a release of several high-profile detainees, whose arrests had been widely perceived to be politically-driven. In the medium run, keeping popular dissatisfaction in check will almost certainly require noticeable economic improvements – something which is currently not in sight.

**After a dip in 2019, economic growth will likely pick up somewhat over the next few years**. In the second half of 2019, economic dynamics is likely to improve somewhat. However, given the weak first half, our growth forecast for the year as a whole has been cut once again: by 0.2 pp compared to the summer forecast, to 1.1%. Over the next two years, growth is projected to speed up a bit thanks to the planned implementation of large-scale infrastructure and other 'national' projects (such as in health care, education, etc.) in line with the development targets, which aim at making Russia one of the five biggest world economies by 2024 – the year of next presidential elections. However, even with a modest additional fiscal stimulus, economic growth will likely stay below 2% p.a., owing to structural bottlenecks (especially institutional weaknesses) and the difficult geopolitical climate. The overall economic policy mix will remain by and large restrictive, prioritising stability and resilience against western sanctions over growth. At the projected growth pace, Russia will continue falling behind in the global economic context.

**Russia's economic prospects are dependent on how the geopolitical conflict with the West evolves.** The recent signs of détente with Ukraine following the change in the Ukrainian leadership earlier this year have been encouraging. However, the implementation of the Minsk agreement on the status of Donbas – a crucial pre-condition for easing EU sanctions on Russia – will not be an easy process, given the strong opposition to it in large parts of the Ukrainian society. Besides, US sanctions will likely stay in place regardless, constraining the inflows of investments into Russia and the badly needed modernisation and restructuring of its economy.

## Table 5.18 / Russia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 | 2019 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 146,406 | 146,675 | 146,842 | 146,831 | 146,836 | 146,748 | 146,750 | 146,700 | 146,700 |
| Gross domestic product, RUB bn, nom. | 83,094 | 86,014 | 92,101 | 103,876 | 47,262 | 50,675 | 111,400 | 117,800 | 124,900 |
| annual change in % (real) | -2.3 | 0.3 | 1.6 | 2.3 | 2.1 | 0.7 | 1.1 | 1.7 | 1.9 |
| GDP/capita (EUR at PPP) | 18,100 | 17,500 | 18,200 | 19,500 | . | . | . | . | . |
| Consumption of households, RUB bn, nom. | 43,242 | 45,317 | 48,136 | 50,851 | 23,991 | 25,740 | . | . | . |
| annual change in % (real) | -9.4 | -1.9 | 3.3 | 2.3 | 2.3 | 2.2 | 2.0 | 2.0 | 2.5 |
| Gross fixed capital form., RUB bn, nom. | 17,326 | 18,911 | 20,571 | 22,237 | 8,371 | 9,113 | . | . | . |
| annual change in % (real) | -10.7 | 1.0 | 5.2 | 2.9 | 3.9 | -0.5 | 1.0 | 3.0 | 4.0 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | -0.8 | 2.2 | 2.1 | 2.9 | 3.0 | 2.5 | 2.7 | 3.0 | 4.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 2.6 | 4.8 | 2.4 | -0.6 | 2.0 | 1.2 | . | . | . |
| Construction output 3) | | | | | | | | | |
| annual change in % (real) | -4.8 | -2.1 | -1.2 | 5.3 | 6.2 | 0.1 | . | . | . |
| Employed persons, LFS, th, average 4) | 72,324 | 72,393 | 72,142 | 72,532 | 72,250 | 71,519 | 71,800 | 72,000 | 72,200 |
| annual change in % | -0.4 | 0.1 | -0.3 | 0.3 | 0.5 | -1.0 | -1.0 | 0.3 | 0.3 |
| Unemployed persons, LFS, th, average 4) | 4,264 | 4,243 | 3,967 | 3,658 | 3,733 | 3,522 | 3,440 | 3,400 | 3,350 |
| Unemployment rate, LFS, in %, average 4) | 5.6 | 5.5 | 5.2 | 4.8 | 4.9 | 4.7 | 4.6 | 4.5 | 4.4 |
| Reg. unemployment rate, in %, eop 4)5) | 1.3 | 1.2 | 1.0 | 0.9 | 0.9 | 1.0 | . | . | . |
| Average monthly gross wages, RUB 6) | 34,030 | 36,709 | 39,167 | 43,445 | 42,522 | 46,159 | 46,500 | 49,300 | 52,800 |
| annual change in % (real, gross) | -9.0 | 0.7 | 2.9 | 6.8 | 9.2 | 3.2 | 2.5 | 3.0 | 4.0 |
| Consumer prices, % p.a. | 15.5 | 7.1 | 3.6 | 2.9 | 2.4 | 5.2 | 4.5 | 2.9 | 2.9 |
| Producer prices in industry, % p.a. 7) | 13.5 | 4.2 | 7.7 | 11.9 | 8.5 | 7.8 | 5.0 | 4.0 | 4.0 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 32.4 | 32.8 | 33.7 | 35.9 | 35.5 | 36.7 | 37.0 | 37.0 | 37.0 |
| Expenditures | 35.8 | 36.4 | 35.2 | 33.0 | 32.3 | 31.5 | 33.0 | 35.0 | 37.0 |
| Deficit (-) / surplus (+) | -3.4 | -3.7 | -1.5 | 2.9 | 3.2 | 5.2 | 4.0 | 2.0 | 1.5 |
| General gov.gross debt, nat.def., % of GDP | 13.2 | 12.9 | 12.6 | 12.1 | 11.6 | 12.2 | 12.0 | 11.0 | 10.0 |
| Stock of loans of non-fin.private sector, % p.a. | 7.6 | -6.9 | 3.5 | 13.9 | 8.5 | 11.4 | . | . | . |
| Non-performing loans (NPL), in %, eop 8) | 5.3 | 5.2 | 5.2 | 4.7 | 5.4 | 5.7 | . | . | . |
| Central bank policy rate, % p.a., eop 9) | 11.00 | 10.00 | 7.75 | 7.75 | 7.25 | 7.50 | 6.75 | 6.25 | 6.00 |
| Current account, EUR mn 10) | 60,952 | 22,094 | 28,726 | 96,254 | 39,419 | 39,182 | 76,200 | 92,500 | 96,400 |
| Current account, % of GDP | 5.0 | 1.9 | 2.1 | 6.8 | 6.0 | 5.7 | 5.1 | 5.9 | 6.0 |
| Exports of goods, BOP, EUR mn 10) | 307,040 | 254,371 | 312,779 | 375,946 | 173,758 | 180,648 | 375,900 | 394,700 | 414,400 |
| annual change in % | -18.2 | -17.2 | 23.0 | 20.2 | 13.0 | 4.0 | 0.0 | 5.0 | 5.0 |
| Imports of goods, BOP, EUR mn 10) | 173,585 | 172,911 | 211,161 | 210,995 | 99,852 | 104,203 | 222,100 | 228,700 | 240,200 |
| annual change in % | -25.4 | -0.4 | 22.1 | -0.1 | 1.1 | 4.4 | 5.3 | 3.0 | 5.0 |
| Exports of services, BOP, EUR mn 10) | 46,418 | 45,729 | 51,050 | 54,828 | 25,287 | 27,088 | 57,700 | 60,600 | 63,600 |
| annual change in % | -6.6 | -1.5 | 11.6 | 7.4 | 1.3 | 7.1 | 5.2 | 5.0 | 5.0 |
| Imports of services, BOP, EUR mn 10) | 79,829 | 67,363 | 78,716 | 80,227 | 37,071 | 39,639 | 86,100 | 90,400 | 96,800 |
| annual change in % | -12.7 | -15.6 | 16.9 | 1.9 | 0.4 | 6.9 | 7.3 | 5.0 | 7.1 |
| FDI liabilities, EUR mn 10) | 6,163 | 29,381 | 25,296 | 7,453 | 8,385 | 14,622 | 27,000 | . | . |
| FDI assets, EUR mn 10) | 19,861 | 20,149 | 32,559 | 26,620 | 15,084 | 12,703 | 26,000 | . | . |
| Gross reserves of NB excl. gold, EUR mn 10)11) | 292,467 | 301,871 | 297,823 | 333,617 | 325,521 | 367,192 | . | . | . |
| Gross external debt, EUR mn 10) | 474,121 | 486,489 | 433,412 | 397,516 | 422,012 | 421,436 | 391,400 | 377,000 | 352,300 |
| Gross external debt, % of GDP | 38.7 | 42.0 | 31.0 | 28.3 | 30.0 | 28.0 | 26.0 | 24.0 | 22.0 |
| Average exchange rate RUB/EUR | 67.76 | 74.26 | 65.87 | 73.87 | 71.81 | 73.83 | 74.0 | 75.0 | 78.0 |

Note: Including Crimean Federal District (growth rates for LFS employment and real wages from 2016).

1) Preliminary. - 2) Excluding small enterprises. - 3) In 2015 according to NACE Rev.1. - 4) From 2018 population 15+, population 15-72 before. - 5) In % of labour force (LFS). - 6) From 2017 improved coverage of small enterprises. - 7) Domestic output prices. - 8) According to Russian Accounting Standards overdue debt is defined as debt service overdue, therefore the data are not fully comparable with other countries. - 9) One-week repo rate. - 10) Converted from USD. - 11) Including part of resources of the Reserve Fund (until 2017) and the National Wealth Fund of the Russian Federation.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

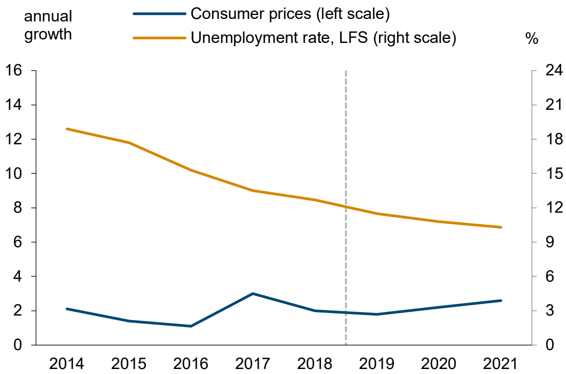

# SERBIA: Back to reality

RICHARD GRIEVESON

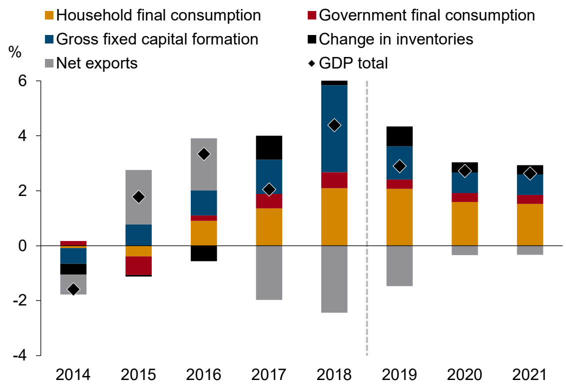
**After posting comfortably its strongest real GDP increase for a decade in 2018, the Serbian economy has adjusted back to a more muted growth path, and should expand by just under 3% this year. Growth of 2.5-3% is likely during the rest of the forecast period, with the government set to remain focussed on FDI-driven investment. Political tensions in the region are rising, but would have to get much worse to constitute a significant downside risk to the economy.**

**Figure 5.19 / Serbia: Main macroeconomic indicators**

Inflation and unemployment, in %




Real GDP growth and contributions




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

**Economic momentum has tailed off so far in 2019, in line with our expectations, and we continue to expect full-year expansion of a bit below 3%.** This is down from 4.3% in 2018, and reflects a combination of domestic and external headwinds. 100% tariffs on exports imposed by Kosovo, production shutdowns at the key Fiat-Chrysler plant and the broader downturn in the global manufacturing sector all present challenges for near-term economic growth. The growth contribution from agriculture in 2019 has also been held down by the high statistical base.

**Investment continues to hold up very well, and this looks set to remain the case during the forecast period.** Big infrastructure projects are ongoing and FDI inflows remain robust. Strong investment activity has contributed to rapid import growth (up 11% year on year in Q2), leading to a clear negative contribution from net exports to headline growth so far this year.

**Nevertheless, in the context of the Kosovo tariffs, production shutdowns and external weakness, exports have held up quite well so far.** However, it is unlikely that this will remain the case indefinitely. The recent election result in Kosovo suggests that tariffs will not be removed anytime soon (this would require unimaginable political concessions from Serbia), while the downturn in the global manufacturing sector appears unlikely to abate. At the global level, the situation could get worse before it gets better. In a prolonged period of low growth or recession in countries like Germany and Italy, it is hard to see how Serbia will not suffer.

**Private consumption trends look solid, continuing at a similar level to 2018.** Real wages surged by 7.5% year on year in Q2, while employment and credit growth have also been strong. The trends in employment and real wages largely mirror those seen in much of the rest of CESEE, and especially the EU Member States of the region, with labour shortages starting to bite and increasing employees' bargaining power. Declining inflation is also helping to push up real income growth; inflation fell from 3.1% (on an annual basis) in April to 1.3% in August.

**Monetary policy looks set to remain at historically loose levels throughout the forecast period.** With inflationary pressures cooling rapidly, and the big central banks (the ECB and the US Federal Reserve) back in easing mode, the National Bank of Serbia (NBS) has felt comfortable cutting rates twice recently. The real policy rate is now at around 1%, compared with almost 8% as recently as 2015. We expect the NBS to retain this loose monetary stance, and to get away with it, owing to high levels of global liquidity. This should provide some moderate support for growth. Inflation should bottom out and gradually pick up towards the end of the year, although a lot of that will depend on the direction of oil prices. The dinar is likely to remain roughly stable against the euro during the forecast period.

**Fiscal policy is being slightly loosened ahead of the upcoming parliamentary election, but this is unlikely to make a significant difference to the headline budget balance.** The government has increased social transfers, and has promised to increase public sector wages and make a one-off payment to pensioners by the end of 2019. However, it also remains committed to quite a tight fiscal stance and to bringing down the public debt burden and the announced measures do not change this materially. We expect general government debt as a share of GDP to fall below 50% by 2021, compared with 70% as recently as 2015.

**Regional political tensions have increased in the last couple of years and could rise further following the Kosovo election result.** There, the left-wing Vetevendosje took the largest share of the vote. The party's leader, Albin Kurti, has said he will only remove the 100% tariffs on Serbia in return for Serbian recognition of Kosovan licence plates and IDs (very difficult to imagine). He has also in the past spoken in favour of the unification of Kosovo and Albania, and is strongly opposed to the territorial swap plan hatched by Kosovan president Hashim Thaçi and his Serbian equivalent Aleksandar Vučić. Taken together, it appears that progress on negotiations between Serbia and Kosovo has become less likely, and that the chances of higher tensions have increased. A territorial swap between Serbia and Kosovo was never very likely, mostly because of the practical difficulties of implementation rather than opposition from outside actors (although that also exists, not least from Germany).

**Parliamentary elections are due in Serbia in 2020, and tensions could rise further in the run up to polling as hardliners try to fire up their base.** The main opposition coalition, the Alliance for Serbia, continues to boycott parliament. In addition, popular protests against the government have been quite significant and widespread. These protests started in December 2018, after opposition leader Borko Stefanovic was attacked before a television debate, and have continued every week since. However, it would take quite a severe ratcheting up of tensions (either internally or between Serbia and Kosovo) to put off foreign investors, and there is no evidence of that so far in the data. We expect the ruling Serbian Progressive Party (SNS) to win the election and stay in power, potentially again in coalition with the Socialist Party of Serbia.

**Separately, Serbia has agreed to sign a free trade agreement (FTA) with the Eurasian Economic Union (EAEU) on October 20th.** Economically, the agreement is of little significance; Serbia already has an FTA with Russia, Kazakhstan and Belarus, and the remaining EAEU countries are barely visible in external trade data. The political symbolism is potentially more significant as it brings Serbia closer to Russia and has angered the EU. On joining the EU, Serbia will be required to exit all other trade arrangements and adopt those of the EU. However, given the obstacles remaining on Serbia's EU accession path (not least the normalisation of relations with Kosovo), accession is likely to be some way off. As a result, Serbia will likely be able to continue to play a double game between Russia and the EU for some time yet.

## Table 5.19 / Serbia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 January-June | 2019 January-June | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th. pers., mid-year | 7,095 | 7,058 | 7,021 | 6,983 | . | . | 6,950 | 6,920 | 6,880 |
| Gross domestic product, RSD bn, nom. 2) | 4,312 | 4,521 | 4,754 | 5,069 | 2,410 | 2,537 | 5,300 | 5,600 | 5,900 |
| annual change in % (real) | 1.8 | 3.3 | 2.0 | 4.4 | 4.9 | 2.8 | 2.9 | 2.7 | 2.6 |
| GDP/capita (EUR at PPP) | 11,200 | 11,400 | 11,600 | 12,300 | . | . | . | . | . |
| Consumption of households, RSD bn, nom. 2) | 3,052 | 3,152 | 3,311 | 3,453 | 1,659 | 1,750 | . | . | . |
| annual change in % (real) | -0.5 | 1.3 | 2.0 | 3.0 | 3.3 | 3.3 | 3.0 | 2.3 | 2.2 |
| Gross fixed capital form., RSD bn, nom. 2) | 723 | 766 | 844 | 1,017 | 432 | 482 | . | . | . |
| annual change in % (real) | 4.9 | 5.4 | 7.3 | 17.8 | 13.7 | 8.3 | 6.5 | 4.0 | 4.0 |
| Gross industrial production 3) | | | | | | | | | |
| annual change in % (real) | 7.3 | 5.2 | 3.9 | 1.3 | 3.9 | -2.3 | 0.7 | 2.5 | 3.3 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -8.4 | 9.0 | -11.9 | 11.3 | . | . | . | . | . |
| Construction output | | | | | | | | | |
| annual change in % (real) | 20.7 | 7.2 | 8.5 | 14.1 | 24.6 | 15.3 | . | . | . |
| Employed persons, LFS, th, average | 2,574 | 2,719 | 2,795 | 2,833 | 2,793 | 2,864 | 2,950 | 2,980 | 3,010 |
| annual change in % | 0.6 | 5.6 | 2.8 | 1.4 | 0.9 | 2.5 | 4.0 | 1.0 | 1.0 |
| Unemployed persons, LFS, th, average | 552 | 489 | 435 | 412 | 430 | 361 | 380 | 360 | 350 |
| Unemployment rate, LFS, in %, average | 17.7 | 15.3 | 13.5 | 12.7 | 13.4 | 11.2 | 11.5 | 10.8 | 10.3 |
| Reg. unemployment rate, in %, eop | 26.8 | 25.7 | 23.0 | 20.3 | 21.3 | 19.5 | . | . | . |
| Average monthly gross wages, RSD 4) | 61,145 | 63,474 | 65,976 | 68,629 | 68,198 | 74,727 | 74,400 | 78,500 | 83,000 |
| annual change in % (real, gross) | -2.4 | 2.6 | 0.9 | 3.9 | 3.7 | 7.1 | 6.5 | 3.2 | 3.1 |
| Average monthly net wages, RSD 4) | 44,432 | 46,097 | 47,893 | 49,650 | 49,331 | 54,146 | 53,900 | 56,200 | 58,800 |
| annual change in % (real, net) | -2.1 | 2.5 | 0.9 | 4.4 | 4.2 | 7.3 | 6.7 | 2.0 | 2.0 |
| Consumer prices, % p.a. | 1.4 | 1.1 | 3.0 | 2.0 | 1.7 | 2.3 | 1.8 | 2.2 | 2.6 |
| Producer prices in industry, % p.a. | 1.0 | 0.0 | 2.3 | 0.9 | -0.2 | 1.1 | 1.5 | 2.8 | 3.3 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 39.3 | 40.8 | 41.5 | 41.5 | 41.5 | 42.4 | 44.5 | 44.5 | 44.5 |
| Expenditures | 42.8 | 41.9 | 40.4 | 40.9 | 40.1 | 41.7 | 44.5 | 45.0 | 45.0 |
| Deficit (-) / surplus (+) | -3.5 | -1.2 | 1.1 | 0.6 | 1.4 | 0.7 | 0.0 | -0.5 | -0.5 |
| General gov.gross debt, nat.def., % of GDP | 70.0 | 67.8 | 57.9 | 53.7 | 56.0 | 51.4 | 52.0 | 51.5 | 48.5 |
| Stock of loans of non-fin.private sector, % p.a. | 3.0 | 2.3 | 2.1 | 9.9 | 4.4 | 8.9 | . | . | . |
| Non-performing loans (NPL), in %, eop | 21.6 | 17.0 | 9.8 | 5.7 | 7.8 | 5.2 | . | . | . |
| Central bank policy rate, % p.a., eop 5) | 4.5 | 4.0 | 3.5 | 3.0 | 3.0 | 3.0 | 2.5 | 2.5 | 3.0 |
| Current account, EUR mn | -1,234 | -1,075 | -2,051 | -2,223 | -1,078 | -1,636 | -2,700 | -2,600 | -2,700 |
| Current account, % of GDP | -3.5 | -2.9 | -5.2 | -5.2 | -5.3 | -7.6 | -6.0 | -5.5 | -5.4 |
| Exports of goods, BOP, EUR mn | 11,454 | 12,814 | 14,066 | 15,238 | 7,503 | 8,143 | 16,500 | 17,800 | 19,200 |
| annual change in % | 7.6 | 11.9 | 9.8 | 8.3 | 7.6 | 8.5 | 8.0 | 8.0 | 8.0 |
| Imports of goods, BOP, EUR mn | 15,099 | 15,933 | 18,064 | 20,483 | 9,798 | 10,803 | 22,400 | 24,000 | 25,700 |
| annual change in % | 2.4 | 5.5 | 13.4 | 13.4 | 11.6 | 10.3 | 9.5 | 7.0 | 7.0 |
| Exports of services, BOP, EUR mn | 4,273 | 4,571 | 5,246 | 6,000 | 2,683 | 3,132 | 7,000 | 7,600 | 8,200 |
| annual change in % | 12.2 | 7.0 | 14.8 | 14.4 | 14.1 | 16.7 | 16.0 | 8.0 | 8.0 |
| Imports of services, BOP, EUR mn | 3,544 | 3,664 | 4,280 | 4,909 | 2,210 | 2,672 | 5,800 | 6,200 | 6,600 |
| annual change in % | 6.0 | 3.4 | 16.8 | 14.7 | 13.3 | 20.9 | 18.0 | 7.0 | 7.0 |
| FDI liabilities, EUR mn | 2,114 | 2,127 | 2,548 | 3,496 | 1,476 | 1,905 | 5,000 | . | . |
| FDI assets, EUR mn | 310 | 228 | 130 | 308 | 70.2 | 131.9 | 500 | . | . |
| Gross reserves of NB, excl. gold, EUR mn | 9,812 | 9,543 | 9,287 | 10,526 | 10,421 | 11,307 | . | . | . |
| Gross external debt, EUR mn 6) | 26,234 | 26,494 | 25,574 | 26,829 | 26,084 | 27,817 | 27,000 | 27,100 | 27,200 |
| Gross external debt, % of GDP 6) | 73.5 | 72.1 | 65.3 | 62.6 | 60.9 | 61.9 | 60.0 | 57.0 | 54.0 |
| Average exchange rate RSD/EUR | 120.73 | 123.12 | 121.34 | 118.27 | 118.30 | 118.10 | 118 | 118 | 118 |

1) Preliminary. - 2) Half-year data unrevised. - 3) Excluding arms industry. - 4) From 2018 based on tax administration data, before on wage survey data supplemented by tax administration data. - 5) Two-week repo rate. - 6) BOP 5th Edition.

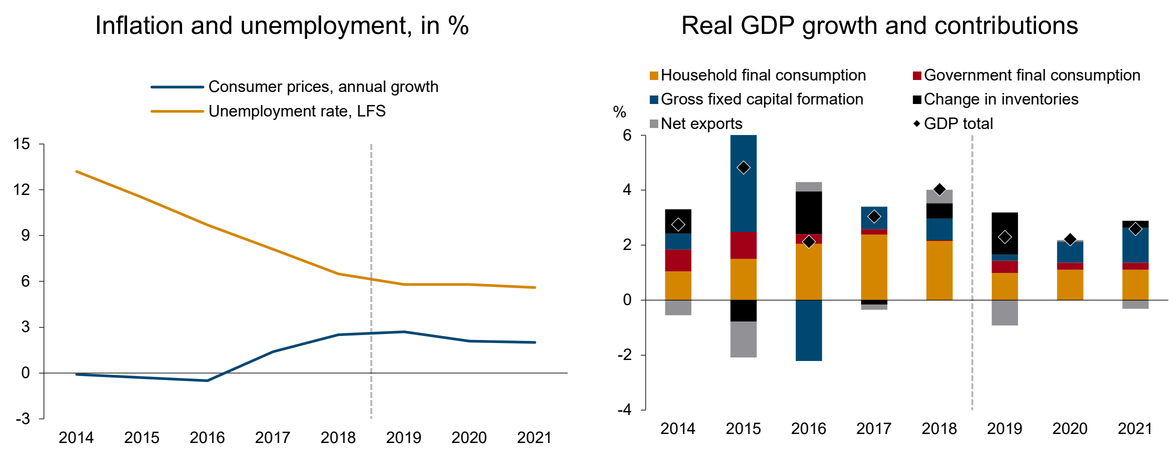
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# SLOVAKIA: Cooling due to external slowdown

DORIS HANZL-WEISS

**Slovakia's growth decelerated sharply in the second quarter of 2019 due to declining exports and investments. Growth in the key automotive industry turned negative in June. Growth will slow down in the coming years, with forecasts for this and next year amounting to 2.3% and 2.2%.**

**Figure 5.20 / Slovakia: Main macroeconomic indicators**




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

**Growth sharply decelerated in the second quarter**. In the first half of 2019, Slovak GDP grew by 2.8%, compared to 4% for the whole year 2018. Overall, a strong decelerating trend became visible during the first half year: While in the first quarter of 2019, growth was robust and exhibited a y-o-y increase of 3.7%, the second quarter results came as a negative surprise when GDP grew by only 2%. While gross fixed capital formation and exports declined on the one hand, household consumption, government consumption and building up of stocks contributed to growth on the other.

**Household consumption slightly recovered.** In the first half of 2019, household consumption grew by 1.5%, markedly accelerating from the first to the second quarter from 1.1% to 1.9%. Still, this is very low taking into account the good situation on the labour market and the household saving rate rose further. Although employment growth slowed down in the second quarter, employment grew by 1.2% for the first half year. The employment rate now stands at 73%. The unemployment rate further declined and is now at a historical low level of 5.8%. Shortages of skilled labour persist but the tightness of the labour market started to ease as employers' expectations for employment growth (especially in manufacturing) went down recently.

**Growing labour costs erode international competitiveness**. In the second quarter of 2019, nominal wages edged up and rose by 9.7% - the strongest increase since the first quarter of 2008. For the first half year, nominal wages increased by 8.3%. As inflation reached 2.5% in that period, real wages were up by 5.8% and reached an average of EUR 1062 per month. As productivity increases were lagging behind wage increases, unit labour costs rose and steadily erode international cost competitiveness. High wage growth is driven by both shortages of skilled labour as well as government measures. State salaries went up markedly in both quarters; the minimum wage was raised by EUR 40 to EUR 520 in January 2019 (+8.33%) and will probably rise further to EUR 580 next year (+11.5%). In May, surcharges for night, weekend and holiday work rose for the second time; thirteenth salaries were paid out in the second quarter.

**Investments declined significantly but stocks were built up.** Investments declined by 1.2% in the first half of 2019 due to a strong fall in the second quarter. While gross fixed capital formation was still up by 2.1% in the first quarter, it fell by almost 4% in the second, also due to a strong base effect (the construction of Jaguar Land Rover plant was finished in the second quarter of last year). Construction output fell by 2.3% over the first seven months, also connected to problems in public motorway construction. Due to a strong built up of inventories, gross capital formation still rose by about 10% in the first half of 2019.

**Industrial production is growing but the performance of the main automotive sector was disappointing.** Regarding the sectoral structure of growth, industrial production increased by 4.6% in the first seven months of 2019. However, a major change in the growth pattern has become visible since June: The automotive industry – the key industrial sector in Slovakia – lost its main role as a growth driver and production has declined since then also due to a strong base effect. This came as a surprise as the new Jaguar Land Rover plant started production last October and should have provided a main growth impetus this year. Jaguar Land Rover plans to launch the second shift by the end of 2019 to order to produce 150,000 cars by then. Positive news also appeared when looking at the other main car manufacturers in Slovakia: PSA Peugeot Citroen showcased the electric Peugeot 208 model at the beginning of September, which it will only manufacture in Trnava. Overall, the company plans to produce 380,000 vehicles in 2019 (up from 350,000 in 2018). Kia Motors started the production of its new model, the Kia XCeed, at the beginning of August. Only VW Bratislava, which faces a loss of its small car segment (Škoda Citigo and Volkswagen UP!) at the end of 2021, has no assignment of a new car model thereafter yet.

**Among other manufacturing sectors, positive contributions to growth for the first seven months came from the machinery & equipment sector, electrical equipment, the repair and the food sector.** Otherwise, the basic metals & fabricated metal products sector saw a strong decline over the first seven months (due to troubles in the European steel industry which have also affected the U.S. Steel Košice company who announced plans to lay off 2,500 persons by 2021 – out of its 10,000 employees) as well as the refinery sector (due to a temporary shutdown of parts of the Slovnaft oil refinery).

**Export declined unexpectedly**. Export growth of goods and services turned negative in the second quarter of 2019 and declined by 2%, down from a very positive expansion of 7% in the first quarter. Imports of goods and services also slowed down from 6.4% to about 1% (at constant prices). Thus net real exports had a negative effect on growth. The National Bank of Slovakia cites declining exports to the UK, Sweden, the Czech Republic and partly Poland as the main reason (Brexit; decline of auto part exports through value chains).

**Upcoming parliamentary elections in February 2020 and lower growth jeopardize fiscal targets.** Government deficits and hence debt to GDP ratios have gone down in the last years, reaching -0.7% and 48.9% respectively in 2018. This year, however, the planned target of a balanced budget will not be reached. On the one hand this is due to lower than expected growth and thus lower tax revenues, and on the other, generous social actions before the upcoming parliamentary elections in February 2020. The deficit in 2019 thus is expected to reach -1.2% of GDP. Tax revenues might also decline over the coming years due to changes in taxes, i.e. lowering value added tax on certain food items, suggesting that the budget deficit may widen further.

**30th anniversary of the Velvet Revolution in 1989 will be celebrated in mid-November,** accompanied by protests ‘For a Decent Slovakia’. The protests symbolise the fight against corruption and a call for the rule of law and were brought to a head with the murder of the investigative journalist Ján Kuciak and his fiancée Martina Kušnírová in February 2018. The protests present a major challenge for Slovakia today.

**Cooling down of the economy is already taking place this year.** The wiiw-forecast for this year has been revised downwards due to surprising low growth figures in the second quarter of 2019. Household consumption will remain stable and thus be the main growth driver this year. Government consumption (parliamentary elections ahead) will also contribute to growth. The output of the key sector of Slovakia – the automotive industry - turned negative in June. For the coming years, household consumption will form the basis for growth, together with a revival of investments heading up with the end of the EU financing period. However, external risks are growing (trade wars, Brexit), which particularly affect the main automotive industry. Its major trading partner, Germany, is also facing troubles in its automotive sector.

## Table 5.20 / Slovakia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 | 2019 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 5,424 | 5,431 | 5,439 | 5,447 | . | . | 5,450 | 5,455 | 5,460 |
| Gross domestic product, EUR mn, nom. 2) | 79,758 | 81,038 | 84,517 | 89,721 | 43,078 | 45,513 | 94,300 | 98,400 | 103,000 |
| annual change in % (real) | 4.8 | 2.1 | 3.0 | 4.0 | 4.1 | 2.8 | 2.3 | 2.2 | 2.6 |
| GDP/capita (EUR at PPP) | 22,500 | 22,400 | 22,800 | 23,900 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. 2) | 42,416 | 43,904 | 46,473 | 49,395 | 23,624 | 24,575 | . | . | . |
| annual change in % (real) | 2.8 | 3.9 | 4.4 | 3.9 | 2.8 | 1.5 | 1.8 | 2.0 | 2.0 |
| Gross fixed capital form., EUR mn, nom. 2) | 18,919 | 17,019 | 17,965 | 19,050 | 9,101 | 9,177 | . | . | . |
| annual change in % (real) | 21.6 | -9.3 | 3.9 | 3.7 | 13.7 | -1.2 | 1.0 | 3.5 | 6.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 6.7 | 4.7 | 3.2 | 4.4 | 3.5 | 4.8 | 1.0 | 2.0 | 2.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -3.2 | 13.9 | -6.1 | -1.1 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 18.1 | -10.7 | 3.0 | 8.5 | 7.0 | -1.3 | . | . | . |
| Employed persons, LFS, th, average | 2,424 | 2,492 | 2,531 | 2,567 | 2,549 | 2,579 | 2590 | 2600 | 2600 |
| annual change in % | 2.6 | 2.8 | 1.5 | 1.4 | 1.2 | 1.2 | 0.9 | 0.3 | 0.0 |
| Unemployed persons, LFS, th, average | 314 | 267 | 224 | 180 | 188 | 157 | 160 | 160 | 150 |
| Unemployment rate, LFS, in %, average | 11.5 | 9.7 | 8.1 | 6.5 | 6.9 | 5.8 | 5.8 | 5.8 | 5.6 |
| Reg. unemployment rate, in %, eop | 10.6 | 8.8 | 5.9 | 5.0 | 5.4 | 5.0 | . | . | . |
| Average monthly gross wages, EUR | 883 | 912 | 954 | 1,013 | 980 | 1,062 | 1100 | 1170 | 1230 |
| annual change in % (real, gross) | 3.2 | 3.8 | 3.3 | 3.6 | 3.8 | 5.8 | 5.5 | 3.8 | 3.2 |
| Consumer prices (HICP), % p.a. | -0.3 | -0.5 | 1.4 | 2.5 | 2.6 | 2.5 | 2.7 | 2.1 | 2.0 |
| Producer prices in industry, % p.a. | -2.9 | -3.9 | 2.5 | 2.3 | 1.3 | 2.8 | 3.0 | 2.5 | 3.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 42.2 | 39.3 | 39.6 | 40.1 | . | . | 39.0 | 38.6 | 38.4 |
| Expenditures | 44.7 | 41.5 | 40.4 | 40.8 | . | . | 40.2 | 40.1 | 40.0 |
| Net lending (+) / net borrowing (-) | -2.5 | -2.2 | -0.8 | -0.7 | . | . | -1.2 | -1.5 | -1.6 |
| General gov.gross debt, EU def., % of GDP | 51.8 | 51.9 | 51.2 | 49.2 | . | . | 48.2 | 47.8 | 47.5 |
| Stock of loans of non-fin.private sector, % p.a. | 9.7 | 9.3 | 9.9 | 9.8 | 10.2 | 7.2 | . | . | . |
| Non-performing loans (NPL), in %, eop | 4.8 | 4.4 | 3.6 | 3.1 | 3.5 | 2.9 | . | . | . |
| Central bank policy rate, % p.a., eop 3) | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | -1,669 | -2,221 | -1,618 | -2,371 | -610 | -495 | -2,800 | -2,800 | -2,600 |
| Current account, % of GDP | -2.1 | -2.7 | -1.9 | -2.6 | -1.4 | -1.1 | -3.0 | -2.8 | -2.5 |
| Exports of goods, BOP, EUR mn | 64,577 | 66,686 | 70,510 | 75,698 | 37,490 | 39,442 | 77,500 | 80,200 | 83,000 |
| annual change in % | 3.2 | 3.3 | 5.7 | 7.4 | 7.4 | 5.2 | 2.4 | 3.5 | 3.5 |
| Imports of goods, BOP, EUR mn | 63,779 | 65,432 | 69,913 | 75,919 | 37,016 | 38,975 | 78,300 | 81,000 | 84,000 |
| annual change in % | 6.6 | 2.6 | 6.8 | 8.6 | 8.0 | 5.3 | 3.2 | 3.5 | 3.7 |
| Exports of services, BOP, EUR mn | 7,324 | 8,350 | 9,339 | 10,209 | 4,802 | 5,053 | 10,700 | 11,200 | 12,000 |
| annual change in % | 6.3 | 14.0 | 11.8 | 9.3 | 8.2 | 5.2 | 5.0 | 5.0 | 7.0 |
| Imports of services, BOP, EUR mn | 7,196 | 7,967 | 8,457 | 9,284 | 4,313 | 4,494 | 9,700 | 10,200 | 10,600 |
| annual change in % | 7.2 | 10.7 | 6.1 | 9.8 | 6.6 | 4.2 | 4.0 | 5.0 | 4.0 |
| FDI liabilities, EUR mn | 1,357 | 4,326 | 3,749 | 2,158 | 824 | 729 | 1,500 | . | . |
| FDI assets, EUR mn | 1,266 | 3,684 | 1,367 | 1,354 | 1,107 | 850 | 1,000 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 1,648 | 1,624 | 1,609 | 3,426 | 2,777 | 4,437 | . | . | . |
| Gross external debt, EUR mn | 67,398 | 74,917 | 94,188 | 101,914 | 95,866 | 103,455 | 105,000 | 110,000 | 110,000 |
| Gross external debt, % of GDP | 84.5 | 92.4 | 111.4 | 113.6 | 106.8 | 109.7 | 111.3 | 111.8 | 106.8 |

1) Preliminary. - 2) Half-year data unrevised. - 3) Official refinancing operation rates for euro area (ECB).

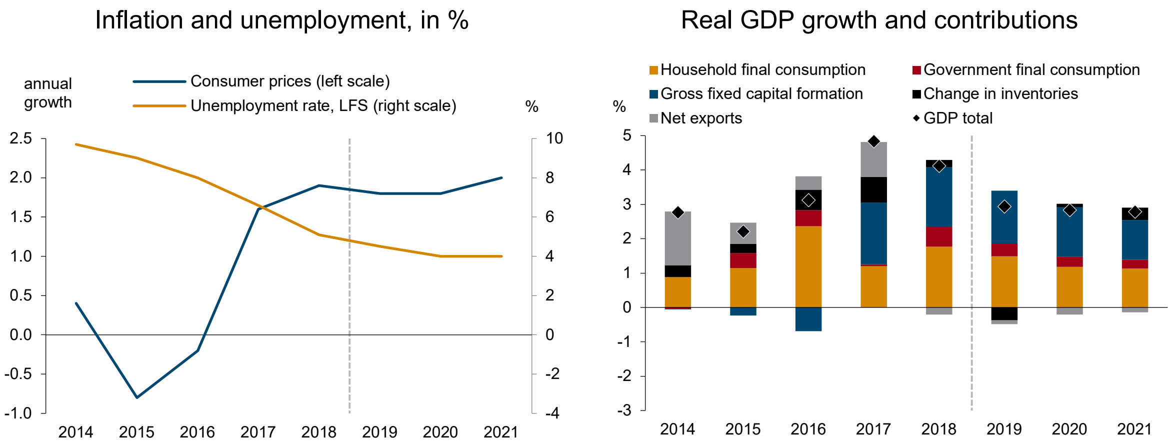
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# SLOVENIA: Domestic resilience amid external weakness

HERMINE VIDOVIC

**After a strong increase in 2018, economic activity slowed in the course of 2019 due to weakening foreign demand. However, thanks to a continued rise in consumption and investments, GDP growth will end up at a fairly robust 2.9% for the year as a whole, with unemployment reaching record lows. In the coming years we expect GDP growth to remain subdued, driven mostly by domestic demand. Banking privatisation has been finally completed after a long lasting process.**

**Figure 5.21 / Slovenia: Main macroeconomic indicators**




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

**Slovenia's GDP growth slowed from 3.3% in the first quarter of 2019 to 2.5% in the second quarter of the year.** Growth in the first half of the year (2.9%) was mainly driven by rising domestic demand: private consumption growth supported by rising employment, wages and increasing household loans remained strong and gross fixed capital formation, still benefiting from the inflow of EU funding, expanded by 8.3%. Investment growth was particularly felt in rising construction activities in both civil engineering (15%) and buildings (12%), but was almost negligible with respect to machinery and equipment. However, changes in inventories contributed negatively to GDP growth, as did the contribution of net exports.

**Construction, which was one of the hardest hit sectors by the economic crisis, has not yet returned to the levels prior to the crisis, despite two digit growth rates in the past three years.** Both the turnover and the number of employees are below pre-crisis levels, while the number of construction companies reached the pre-crisis figures, with small enterprises of up to 10 workers dominating. In contrast, there were around half as many medium-sized and large companies as in 2008. Industrial output grew by 4.5% in the first half of the year, with high growth rates recorded for the manufacture of leather and wood products, while car production – after steady increases in the past couple of years – was shrinking.

In September, the economic sentiment indicator decreased at an annual level, which was mainly due to declining confidence indicators in services, manufacturing, construction and among consumers. The confidence indicator in retail trade had contributed positively to the overall indicator.

**The labour market situation remained favourable, with the unemployment rate narrowing to the pre-crisis level (4.5%) and employment growth moderating to 1.1%.** Average real gross wages increased by 2.7% compared with the first half of 2018. Wage rises resulted from new wage agreements in the public sector in late 2018 and an increase in minimum wages, and as a consequence of rising labour shortages in sectors such as tourism, administrative and support services, manufacturing and trade and often those with a high share of minimum wage recipients. So far labour shortages have partly been offset by the recruitment of foreign workers, especially from Bosnia and Herzegovina, Croatia and Serbia. Among other measures, employers try to fill the gaps by overtime work, recruiting through temping agencies or encouraging pensioners to return to work.

**Rising imports ahead of exports are reflected in a lowering of the external trade surplus.** Goods exports – pharmaceuticals in particular - grew by 10% in the first seven months of 2019 and imports expanded by 12% resulting in a narrowing of the foreign trade surplus compared with the same period of 2018. The surplus in services trade was higher than a year earlier due to exports – of construction services in particular – rising faster than imports. The deficit in the primary income narrowed, but increased in the secondary income balance due to higher payments into the EU budget as compared to the first half of 2018. Hence, the current account closed with a slightly lower surplus in the first six months of 2019 than a year ago and is expected to end up with a surplus of close to 5% of the GDP in 2019. The net FDI inflow was almost double the amount than in the first half 2018, mainly due to major acquisitions in the insurance and non-financial activity sectors. Recent data provided by the Statistical Office of Slovenia show that foreign affiliates represented 5.6% of all enterprises in Slovenia in 2017 and these generated 27% of value added, employed 26% of all workers and generated 39% of R&D expenditures. In July 2019, gross external debt amounted to EUR 44.3 billion, which is EUR 1.9 billion more than a year ago. The largest increase was recorded by the central bank (EUR 1.3 billion) and the general government sector (EUR 0.7 billion) while other sectors reduced their indebtedness by EUR 0.5 billion.

**Fiscal consolidation continued in 2019.** During the first half of 2019 the consolidated general government balance closed with a 0.3% surplus of the GDP, which was slightly lower than a year ago and the public debt amounted to 67.7% of the GDP. Also, for the whole year we expect a (small) budget surplus. Following the downward revision of the GDP forecast for 2019-2021 by the country's main economic institute IMAD, the government adopted the draft budgets by cutting expenditures for the next two years. The budget has yet to be approved by the parliament.

**Growth of the household sector lending remained higher than corporate lending, at 6.6% versus 3.9% in July year on year;** growth in housing loans was at 5.3%. Non-performing loans continued to decline accounting for 4.1% by the end of July, with most of the decline coming from the corporate sector. But the ratio of the non-performing exposure (NPE) was still above average in the corporate sector (6%), with sectors such as real estate, construction and wholesale and retail trade reporting NPE ratios of up to 13.5%. In June the privatisation process of Nova Ljubljanska Banka – starting in November 2018 - was finally completed, with the sale of the remaining 10% minus 1 Share of the Republic of Slovenia's stake in Nova Ljubljanska banka.. Thus, the government's stake in the bank decreased to 25% plus one share, the level agreed in exchange for the European Commission's approval of state aid to the banks in 2013 and 2014. Also in June, the country's third largest bank, state-owned Abanka, was sold to the second largest bank Nova KBM (NKBM). The new conglomerate holds a market share of 22.5%, only slightly smaller than the NLB's share of 23%. Overall, the banking sector profitability improved in the first seven months of 2019, up about one fifth as compared to the same period in 2018. This was mainly due to a strong increase in non-interest income, growth in net-interest income and a net release in of impairments and provisions.

**Given the available data for the year, wiiw has revised the GDP growth forecast for 2019 downwards to 2.9% from 3.2% earlier due to a weakening of foreign demand.** Beyond 2019 we expect GDP growth to remain subdued, driven primarily by private consumption and continued investments supported by EU funding. The contribution of net exports will remain negative due to the expected economic slowdown in Slovenia's main trading partners. Given the tight labour market situation, wages will continue to rise strongly in the next few years.

## Table 5.21 / Slovenia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 | 2019 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 2,064 | 2,065 | 2,066 | 2,074 | 2,065 | 2,067 | 2,070 | 2,070 | 2,070 |
| Gross domestic product, EUR mn, nom. | 38,853 | 40,367 | 42,987 | 45,755 | 22,072 | 23,293 | 47,900 | 50,100 | 52,500 |
| annual change in % (real) | 2.2 | 3.1 | 4.8 | 4.1 | 4.0 | 2.9 | 2.9 | 2.8 | 2.8 |
| GDP/capita (EUR at PPP) | 23,800 | 24,200 | 25,500 | 26,900 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. | 20,640 | 21,416 | 22,278 | 23,542 | 11,178 | 11,719 | . | . | . |
| annual change in % (real) | 2.1 | 4.5 | 2.3 | 3.4 | 3.6 | 2.9 | 2.9 | 2.3 | 2.2 |
| Gross fixed capital form., EUR mn, nom. | 7,248 | 7,019 | 7,875 | 8,799 | 4,132 | 4,597 | . | . | . |
| annual change in % (real) | -1.2 | -3.7 | 10.4 | 9.4 | 9.5 | 8.3 | 8.0 | 7.5 | 6.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 5.6 | 7.1 | 7.7 | 4.9 | 6.7 | 3.7 | 4.0 | 3.0 | 3.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 6.4 | -3.2 | -9.7 | 18.0 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | -8.2 | -17.7 | 17.7 | 19.7 | 17.7 | 14.3 | . | . | . |
| Employed persons, LFS, th, average | 917.4 | 915.0 | 959.1 | 980.6 | 974.0 | 984.5 | 990 | 1,000 | 1,010 |
| annual change in % | 0.1 | -0.3 | 4.8 | 2.2 | 3.0 | 1.1 | 1.0 | 1.0 | 1.0 |
| Unemployed persons, LFS, th, average | 90.3 | 79.6 | 67.4 | 52.8 | 57.4 | 46.5 | 47 | 42 | 42 |
| Unemployment rate, LFS, in %, average | 9.0 | 8.0 | 6.6 | 5.1 | 5.6 | 4.5 | 4.5 | 4.0 | 4.0 |
| Reg. unemployment rate, in %, eop | 12.3 | 10.8 | 9.0 | 8.1 | 7.9 | 7.3 | . | . | . |
| Average monthly gross wages, EUR | 1,556 | 1,584 | 1,626 | 1,682 | 1,658 | 1,729 | 1,750 | 1,820 | 1,870 |
| annual change in % (real, gross) | 1.2 | 1.9 | 1.3 | 1.7 | 2.0 | 2.7 | 2.5 | 2.0 | 1.0 |
| Average monthly net wages, EUR | 1,013 | 1,030 | 1,062 | 1,093 | 1,076 | 1,115 | 1,130 | 1,170 | 1,220 |
| annual change in % (real, net) | 0.9 | 1.8 | 1.7 | 1.2 | 1.5 | 2.1 | 2.0 | 2.0 | 2.0 |
| Consumer prices (HICP), % p.a. | -0.8 | -0.2 | 1.6 | 1.9 | 1.8 | 1.5 | 1.8 | 1.8 | 2.0 |
| Producer prices in industry, % p.a. | -0.2 | -1.4 | 2.2 | 2.1 | 2.2 | 1.0 | 2.0 | 2.0 | 2.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 44.9 | 43.4 | 43.2 | 43.3 | . | . | 42.2 | 42.0 | 41.5 |
| Expenditures | 47.7 | 45.3 | 43.2 | 42.5 | . | . | 42.2 | 41.8 | 41.5 |
| Net lending (+) / net borrowing (-) | -2.8 | -1.9 | 0.0 | 0.7 | . | . | 0.0 | 0.2 | 0.0 |
| General gov.gross debt, EU def., % of GDP | 82.6 | 78.7 | 74.1 | 70.4 | . | . | 66.0 | 63.0 | 61.0 |
| Stock of loans of non-fin.private sector, % p.a. | -6.4 | -3.9 | 1.9 | 3.0 | 1.8 | 4.2 | . | . | . |
| Non-performing loans (NPL), in %, eop 2) | 9.9 | 5.5 | 8.4 | 5.6 | 6.9 | 4.3 | . | . | . |
| Central bank policy rate, % p.a., eop 3) | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | 1,482 | 1,942 | 2,635 | 2,593 | 1,392 | 1,298 | 2,310 | 2,320 | 2,330 |
| Current account, % of GDP | 3.8 | 4.8 | 6.1 | 5.7 | 6.3 | 5.6 | 4.8 | 4.6 | 4.4 |
| Exports of goods, BOP, EUR mn | 24,039 | 24,991 | 28,478 | 31,134 | 15,470 | 16,976 | 33,940 | 36,490 | 38,680 |
| annual change in % | 4.7 | 4.0 | 14.0 | 9.3 | 10.5 | 9.7 | 9.0 | 7.5 | 6.0 |
| Imports of goods, BOP, EUR mn | 22,563 | 23,454 | 26,899 | 30,005 | 14,715 | 16,410 | 33,310 | 35,970 | 38,310 |
| annual change in % | 3.6 | 3.9 | 14.7 | 11.5 | 11.3 | 11.5 | 11.0 | 8.0 | 6.5 |
| Exports of services, BOP, EUR mn | 5,940 | 6,501 | 7,288 | 7,963 | 3,568 | 3,883 | 8,600 | 9,200 | 9,800 |
| annual change in % | 4.2 | 9.4 | 12.1 | 9.3 | 8.4 | 8.8 | 8.0 | 7.0 | 6.5 |
| Imports of services, BOP, EUR mn | 4,306 | 4,575 | 5,048 | 5,285 | 2,395 | 2,512 | 5,570 | 5,850 | 6,140 |
| annual change in % | 1.4 | 6.3 | 10.3 | 4.7 | 6.7 | 4.9 | 5.4 | 5.0 | 5.0 |
| FDI liabilities, EUR mn | 1,560 | 1,298 | 1,065 | 1,295 | 500 | 890 | 1,600 | . | . |
| FDI assets, EUR mn | 292 | 434 | 570 | 362 | 250 | 331 | 400 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 687 | 593 | 632 | 702 | 605 | 780 | . | . | . |
| Gross external debt, EUR mn | 46,148 | 44,293 | 43,191 | 42,100 | 42,857 | 43,693 | 43,600 | 44,100 | 44,100 |
| Gross external debt, % of GDP | 118.8 | 109.7 | 100.5 | 92.0 | 93.7 | 91.2 | 91.0 | 88.0 | 84.0 |

1) Preliminary. - 2) From 2017 loans more than 90 days overdue plus those unlikely to pay, loans more than 90 days overdue before. - 3) Official refinancing operation rates for euro area (ECB).

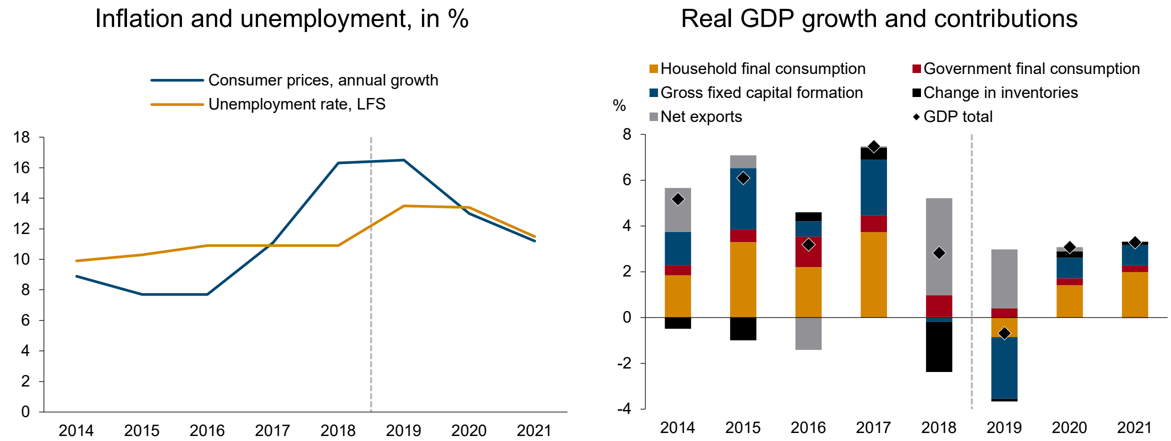
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# TURKEY: Recovery arrives but risks rising again

RICHARD GRIEVESON

**The economy is expanding in quarterly terms, but overall growth is still likely to be negative in 2019. From next year the recovery will firm; we expect the economy to expand by a bit more than 3% in 2020-21. However, while external vulnerabilities are much reduced, the possibility of serious sanctions and volatility in the exchange rate related to the military operation in Northern Syria pose material downside risks to our forecasts.**

**Figure 5.22 / Turkey: Main macroeconomic indicators**




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

**After a sharp downturn in the second half of 2018, the economic recovery has taken hold this year, and should continue to firm in 2020-21.** As expected, the Turkish economy has staged a typically rapid bounce-back from a period of weakness, with positive quarterly growth posted in both Q1 and Q2 2019. As a result, we have revised our 2019 real GDP growth estimate up to -0.7%, compared with -1.2% previously. This forecast is on the conservative side, and would be higher were it not for the huge uncertainty surrounding the recent military operations in Syria and potential for international sanctions.

**The economic impact of Turkey's military operations in Northern Syria launched in October is highly uncertain, although the net impact is likely to be negative.** The US has already introduced, and then quickly removed, limited sanctions. At present, it appears that US President Donald Trump is unwilling to take sterner action, although much of the rest of Washington (including key players in both parties) is keen to impose tougher sanctions. There remains the possibility that the conflict will escalate, with a series of armies present in the region, including the US, Russia and Syria, as well as the Kurdish forces that Turkey is attacking (although at the end of October Russia and Turkey reached an agreement on a ‘buffer zone’ in Northern Syria). Missiles have already been fired into Turkey in retaliation, and if the security situation inside the country deteriorates, it will likely have an impact on tourism inflows.

**At present, the drivers of growth are fairly diverse, indicating a broad-based recovery**. Economic growth is being underpinned by state bank credit provision, exports (including both goods and tourism), and better international market sentiment (bolstered by a more dovish Fed and ECB stance). Importantly, higher-spending Western tourists have returned amid a reduction in perceived security risks. Total tourist arrivals rose by 16% year on year in January-July. It is highly doubtful that these positive trends can continue at the same level considering the operations in Northern Syria.

**Despite the increasingly positive headline numbers, and aside from events in Syria, there are reasons to remain cautious on near-term momentum.** Investment in particular remains very weak, reflecting low levels of confidence among firms and historically high real interest rates. Meanwhile the labour market is struggling, with the unemployment rate set to rise from 10.9% on average last year to 13.9% in 2019. Linked to this, consumer confidence continues to struggle as well (albeit improving recently relative to recent quarters). The manufacturing sector remains stuck in a rut, reflecting the broader global weakness of this sector. However, here the worst appears to have passed, with the most recent manufacturing purchasing managers’ index (PMI) for Turkey, compiled by the Istanbul Chamber of Industry, standing at 50 in September (exactly on the mark separating contraction from expansion). This was up from 48 in August, and the first non-contraction (i.e. sub-50) reading for 17 months.

**High inflation is less of a barrier to the economic recovery than was the case at the start of the year.** The consumer price index rose by 9.3% year on year in September, the first sub-10% outturn since mid-2017. Base effects clearly had a large influence on the reading, although a sharp (albeit delayed) hike to the policy rate in the second half of 2018 also had an impact. Inflation has fallen from over 25% at the end of last year, and the central bank has been quick to take advantage, cutting interest rates aggressively from 24% to 14% as of late October. Real interest rates are still in strongly positive territory, which will almost certainly prompt further loosening from the central bank. However, with the lira weakening following the incursion into Syria, imported inflation is likely to be higher in the remainder of the year than would otherwise have been the case.

**Doubts over the capacity and independence of the central bank have increased in recent months which will increase the lira’s vulnerability if investor sentiment turns again.** During the summer, the president, Recep Tayyip Erdoğan, removed Murat Cetinkaya, the bank’s head, a year ahead of the end of his term, as well as dismissing nine other high ranking officials from their posts. Mr Erdoğan said the sacking was because Mr Cetinkaya ‘wouldn’t follow orders’ (reinforcing concerns in the market about political influence on central bank decisions). The removal of the chief economist, Hakan Kara, appears to have particularly unsettled some investors.

**The new head of the central bank is Murat Uysal who appears to have the relevant qualifications to do the job.** However, after his appointment he almost immediately faced allegations about plagiarising his masters’ thesis on inflation targeting, a less-than-ideal start to his tenure. Mr Uysal is likely to face political pressure to further lower interest rates, and real interest rates may well return to negative territory. The lira has recovered strongly since 2018, but is likely to gradually weaken versus the euro over the forecast period.

**External conditions have generally improved from the perspective of Turkey.** Although the slowdown in global growth is a net negative, the impact on Turkey's relatively closed economy (in terms of goods exports/GDP) will be limited, and less than in most of its regional peers. More important for Turkey is that global growth weakness has prompted major central banks, including the US Federal Reserve and the European Central Bank (ECB), to move in the direction of further monetary loosening. Given Turkey's large external debt rollover needs, this increase in global liquidity will act as a factor of stability. Turkey's short-term external debt is equivalent to around 17% of last year's GDP, and of this 80% is in either US dollars or euros.

**The external adjustment that Turkey has undergone since mid-2018 has been quite severe, but is now over.** The current account deficit has basically disappeared; we expect a deficit equivalent to 0.3% of GDP this year, from 3.4% in 2018 and 5.5% in 2017. Lira weakness, the tourism recovery, and the traditional strength of Turkish goods exporters in adjusting to external shocks have prompted a robust increase in exports. Meanwhile imports have fallen, reflecting weaker consumption and investment. Along with positive real interest rates, this is a big part of why Turkey had been relatively immune from market volatility so far this year (in stark contrast to 2018), at least up until the military operations in Syria.

**Following the move into Syria, the lira weakened, although so far the sell-off has been nowhere near as dramatic as last year.** The lira had appreciated from around TRY 7/EUR at the start of the year to TRY 6.3/EUR in September-October, but has since fallen back to around TRY 6.4/EUR at the time of writing. In general, we still expect the current account deficit to start widening again from here, financed by a new wave of hot money inflows. Portfolio investors are searching desperately for yield in an environment of mostly scant returns on any remotely 'safe' asset (German sovereign debt yields are not negative out to a 30-year maturity, for example). This makes Turkey, with its positive real interest rates, quite attractive to many investors. However, on the other hand, the conflict in Syria introduces a significant degree of uncertainty, and is likely to put off some investors.

**President Erdoğan and his AKP party are on the back foot, amid the greatest challenge to their power for many years (and potentially since they came to power in the early 2000s).** This opposition comes from two main sources. First, the National Alliance, a broad coalition of parties opposed to the AKP, and whose candidate Ekrem İmamoğlu won the election for Istanbul mayor (twice) earlier this year. Second, several prominent former close Erdoğan allies have split off from the AKP to form or join opposition factions, including former Prime Minister Ahmet Davutoğlu, former Deputy Prime Minister Ali Babacan and former President Abdullah Gül. Although Mr Erdoğan still has a large and loyal voting base, these splinter groups may well eat into his vote share at the next election. At least in the short term, however, his support will be swelled by the military operations in Syria.

**The government's announced economic policy programme up to 2022 is on the optimistic side.** They assume real GDP growth of 5% in 2020 and 2021. Although not impossible, we view this as a very much optimistic scenario (our baseline forecasts are for growth of slightly above 3% for both years). To achieve growth of 5% next year, the economy will probably need to attract pre-2018 levels of 'hot money'. Although as stated above, global liquidity conditions are highly favourable, the collapse of the lira and the very delayed central bank response in 2018, as well as events in Syria, are likely to keep at least some portfolio investors wary this time.

**The old economic model is unlikely to deliver growth at the same rate in the future as during most of the AKP's time in office.** In 2002-2017, the economy grew by an average of 5.9% per year. However, this growth model relied quite heavily on working-age population growth, urbanisation, construction investment and hot money inflows. As already stated, hot money inflows are likely to be reduced, while the working-age population is set to grow significantly more slowly in the coming years according to UN projections. Although there remains the possibility to lift the activity rate, this is not guaranteed and may require significant reforms.

**The main risk to the forecast is to the downside, both in the near and medium term, and is centred chiefly on the relationship with the US.** Turkey has faced the threat of US sanctions for some time but the likelihood has increased sharply following the operations in Syria. The risk of sanctions related to the purchase of a Russian missile defence system or allegations that a Turkish bank helped Iran to evade US sanctions, is also non-negligible during the forecast period. Should sanctions be enacted, they would likely have a significant and negative impact on growth, not least because of the Turkish economy's heavy reliance on short-term dollar funding.

## Table 5.22 / Turkey: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 January-June | 2019 January-June | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 78,218 | 79,278 | 80,313 | 81,407 | . | . | 81,900 | 82,700 | 83,600 |
| Gross domestic product, TRY bn, nom. | 2,339 | 2,609 | 3,111 | 3,724 | 1,681 | 1,945 | 4,300 | 4,900 | 5,600 |
| annual change in % (real) | 6.1 | 3.2 | 7.5 | 2.8 | 6.5 | -1.9 | -0.7 | 3.1 | 3.3 |
| GDP/capita (EUR at PPP) | 19,300 | 19,200 | 19,900 | 20,100 | . | . | . | . | . |
| Consumption of households, TRY bn, nom. | 1,412 | 1,561 | 1,836 | 2,111 | 970 | 1,114 | . | . | . |
| annual change in % (real) | 5.4 | 3.7 | 6.2 | 0.0 | 4.3 | -2.9 | -1.5 | 2.5 | 3.5 |
| Gross fixed capital form., TRY bn, nom. | 695 | 765 | 936 | 1,114 | 533 | 522 | . | . | . |
| annual change in % (real) | 9.3 | 2.2 | 8.2 | -0.6 | 8.1 | -18.0 | -9.0 | 3.0 | 3.0 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | 6.2 | 3.4 | 9.1 | 1.1 | 6.8 | -4.5 | -1.0 | 2.8 | 3.0 |
| Gross agricultural production 3) | | | | | | | | | |
| annual change in % (real) | 5.2 | 0.5 | 2.0 | 0.5 | . | . | . | . | . |
| Construction industry 2) | | | | | | | | | |
| annual change in % (real) | 1.7 | 2.9 | 3.8 | -5.0 | . | . | . | . | . |
| Employed persons, LFS, th, average | 26,619 | 27,216 | 28,197 | 28,734 | 28,652 | 27,812 | 28,000 | 28,700 | 29,400 |
| annual change in % | 2.7 | 2.2 | 3.6 | 1.9 | 3.4 | -2.9 | -2.5 | 2.5 | 2.5 |
| Unemployed persons, LFS, th, average | 3,050 | 3,332 | 3,451 | 3,535 | 3,245 | 4,444 | 4,370 | 4,440 | 3,820 |
| Unemployment rate, LFS, in %, average | 10.3 | 10.9 | 10.9 | 10.9 | 10.2 | 13.8 | 13.5 | 13.4 | 11.5 |
| Reg. unemployment rate, in %, eop | . | . | . | . | . | . | . | . | . |
| Average monthly gross wages, TRY 4) | 2,014 | 2,280 | 2,470 | 2,690 | . | . | 3130 | 3640 | 4190 |
| annual change in % (real, gross) | 2.8 | 5.2 | -2.5 | -2.0 | . | . | 0.0 | 2.8 | 3.5 |
| Consumer prices (HICP), % p.a. | 7.7 | 7.7 | 11.1 | 16.3 | 11.6 | 18.9 | 16.5 | 13.0 | 11.2 |
| Producer prices in industry, % p.a. 5) | 5.3 | 4.3 | 15.8 | 27.0 | 16.7 | 29.2 | 22.2 | 15.0 | 13.0 |
| General governm. budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 31.9 | 33.0 | 30.1 | 30.0 | . | . | 31.0 | 32.2 | 33.5 |
| Expenditures | 32.9 | 34.7 | 32.1 | 32.8 | . | . | 34.0 | 35.0 | 36.2 |
| Deficit (-) / surplus (+) | -1.0 | -1.7 | -2.0 | -2.8 | . | . | -3.0 | -2.8 | -2.7 |
| General gov.gross debt, nat.def., % of GDP | 27.6 | 28.3 | 28.2 | 30.2 | . | . | 32.0 | 32.0 | 31.2 |
| Stock of loans of non-fin.private sector, % p.a. | 19.4 | 15.2 | 19.9 | 9.6 | 19.4 | 4.4 | . | . | . |
| Non-performing loans (NPL), in %, eop | 3.1 | 3.2 | 2.9 | 3.9 | 3.0 | 4.4 | . | . | . |
| Central bank policy rate, % p.a., eop 6) | 7.50 | 8.00 | 8.00 | 24.00 | 17.75 | 24.00 | 15.00 | 13.00 | 12.00 |
| Current account, EUR mn | -28,986 | -29,981 | -41,679 | -22,119 | -25,583 | -2,509 | -1,100 | -11,176 | -16,253 |
| Current account, % of GDP | -3.7 | -3.8 | -5.5 | -3.4 | -7.5 | -0.8 | -0.2 | -1.6 | -2.3 |
| Exports of goods, BOP, EUR mn | 136,978 | 135,795 | 147,218 | 148,024 | 70,889 | 78,847 | 155,000 | 159,000 | 167,000 |
| annual change in % | 7.7 | -0.9 | 8.4 | 0.5 | -6.0 | 11.2 | 5.0 | 2.5 | 5.0 |
| Imports of goods, BOP, EUR mn | 180,353 | 172,701 | 198,906 | 182,938 | 98,773 | 86,040 | 174,000 | 188,000 | 201,000 |
| annual change in % | 2.9 | -4.2 | 15.2 | -8.0 | 2.7 | -12.9 | -5.0 | 8.0 | 7.0 |
| Exports of services, BOP, EUR mn | 42,419 | 34,125 | 38,691 | 41,614 | 16,923 | 19,640 | 43,000 | 44,000 | 46,000 |
| annual change in % | 8.3 | -19.6 | 13.4 | 7.6 | 9.4 | 16.1 | 4.0 | 2.0 | 5.0 |
| Imports of services, BOP, EUR mn | 20,563 | 20,366 | 21,250 | 19,497 | 9,687 | 9,930 | 19,000 | 20,000 | 22,000 |
| annual change in % | 7.9 | -1.0 | 4.3 | -8.3 | -5.5 | 2.5 | -1.0 | 7.5 | 8.0 |
| FDI liabilities, EUR mn | 17,376 | 12,627 | 10,201 | 11,078 | 4,327 | 4,041 | 9,000 | . | . |
| FDI assets, EUR mn | 4,595 | 2,837 | 2,419 | 3,069 | 1,667 | 1,318 | 1,750 | . | . |
| Gross reserves of NB excl. gold, EUR mn 7) | 85,356 | 87,334 | 70,202 | 63,666 | 64,804 | 64,564 | . | . | . |
| Gross external debt, EUR mn 7) | 367,873 | 388,730 | 379,459 | 388,261 | 392,464 | 392,671 | 409,800 | 408,300 | 411,100 |
| Gross external debt, % of GDP | 47.6 | 49.8 | 50.3 | 59.5 | 60.1 | 58.4 | 61.0 | 60.0 | 58.0 |
| Average exchange rate TRY/EUR | 3.0255 | 3.3433 | 4.1206 | 5.7077 | 4.9551 | 6.3543 | 6.40 | 7.20 | 7.90 |

1) Preliminary. - 2) Enterprises with 20 and more employees; for construction wiiw estimate from 2017. - 3) Based on UN-FAO data, wiiw estimate from 2017. - 4) Data based on Annual Industry and Service Statistics excluding NACE activities agriculture and fishing, finance and insurance, public administration, defence and social security. wiiw estimate from 2016. - 5) Domestic output prices. - 6) One-week repo rate. - 7) Converted from USD.

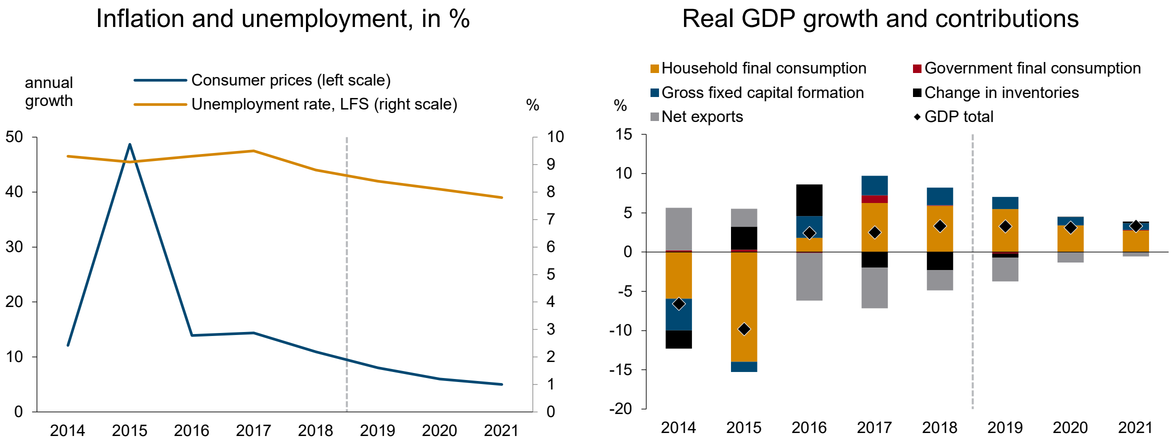
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# UKRAINE: New reforms provide reason for optimism

OLGA PINDYUK

**Progress in the peace negotiations with Russia and the reform agenda of the new government sent strong positive signals to investors. If the reforms are implemented the economy will receive a significant boost, though it will likely only be felt in the medium run. During 2019-2021, GDP growth will remain rather moderate at around 3% per annum. The major negative risk to the forecast is inability of the government to shake off the influence of oligarchs.**

**Figure 5.23 / Ukraine: Main macroeconomic indicators**




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

**Investors' confidence got a boost as President Volodymyr Zelensky achieved progress in the peace talks with Russia.** Ukraine and Russia exchanged 70 prisoners on 7 September, which was seen as a starting point for fresh negotiations over a five-year military conflict between the two countries. On 1 October, Kyiv and Moscow reached a deal aimed at reviving the Minsk peace process. As part of the agreement, Ukraine has provisionally agreed to hold local elections in the occupied territories of Donbas (according to the so-called 'Steinmeier formula'[27]) once all armed formations leave the area and control is regained over about 400 km of border with Russia. The precise date of these elections is yet to be decided. Russia and Ukraine also agreed to renew pulling troops and equipment from Donbas starting on 7 October 2019.

[27] Steinmeier formula is a simplified version of Minsk agreements proposed in 2016 by Frank-Walter Steinmeier, who was then the German foreign minister. According to the formula, the parties involved should hold free and fair local elections in the Russian-occupied Donbas under Ukrainian law; in exchange, the region will receive special self-governance status.

**Domestically, agreement to hold local elections in Donbas caused mixed reactions.** Opposition politicians and their supporters showed their disdain for the deal. However, Zelensky's approval ranking still remains high (at about 70%). The President scored points with his party by voting for stripping deputies of immunity to prosecution, which was seen as an important step in fighting corruption.

**Investors also cheered the formation of a new government on 29 August.** It is comprised mostly of young reform-oriented technocrats (average age of ministers is 39 years old, which makes it the youngest government in Europe). Prime Minister Oleksiy Honcharuk announced an ambitious five-year action plan according to which the economy is to grow by 40% during this period, which implies GDP growth by 5% in 2020, and by at least 7% in 2021-24. The goal is hardly realistic and might be achieved only in a very optimistic scenario, when successful reforms implementation will boost investors' confidence and stimulate fast FDI growth already in the short run. According to the government's estimates, Ukraine needs to attract USD 50 billion in investment over the next five years for the plan to work out (for comparison, in 2018 net FDI inflow was at USD 2.5 billion). Still, implementation of reforms is expected to give a significant boost to the economic growth, though it will be mostly felt in the medium run only.

**Major reforms on the government's agenda include**:

› Lifting the ban on farmland sales and launch of farmland market from mid-2020. The moratorium on land sales that has existed till now, while meant to protect small farmers, has actually hurt them as farmers were unable to use their lands as collateral to secure bank loans for farm operations. In this situation large agribusiness could get very long lease agreements (up to 49 years) on very favourable terms,

› Resuming large-scale privatisation of state assets, with very few companies remaining on the list of exceptions,

› Downsizing and overhaul of the Prosecutor General's Office and restarting of the judicial reform.

**Economic growth in Q2 2019 outperformed expectations having achieved 4.6% year-on-year.** This came on the back of very strong private consumption (+11.8% year-on-year) bolstered by improving consumer confidence, robust accumulation of gross fixed capital formation (7.9%) and a good harvest that supported exports growth. However industry's performance was rather disappointing; in January-August 2019 its output remained flat as compared with the same period last year.

**However, we do not expect growth acceleration to last as it was caused to a large extent by temporary factors** such as pension indexation and extra pre-election payments, the effects of which will be phased out in the second half of the year. Contribution of agriculture will also decline in Q3 2019 due to a lower harvest of oilseeds. Thus in the second half of 2019, GDP growth is likely to slow down and annual growth is expected to be 3.3% year-on-year.

**In 2020-2021 the economy will continue growing by about 3% a year** – too slowly for Ukraine to catch up with its EU neighbours in terms of household income. The primary reason for such a mediocre growth forecast is the lack of investment (in particular FDI) needed to improve labour productivity, which is currently less than 10% of average productivity in the EU. Without a significant increase in productivity, real wage growth (and expanding private consumption) cannot be sustainable in the long run. The newly formed government intends to implement reforms to curb corruption and increase the quality of legal institutions to improve the business environment. However, the effects of the reforms will most likely be felt only in the medium run.

**Monetary policy continues being very tight in order to restrain underlying inflation pressures.** The National Bank cut the policy rate by 50 bp to 16.5% in September 2019, but the real interest rate is still very high at about 7.5%. High interest rates have been attracting inflows of portfolio investment by non-residents into UAH-denominated government bonds, which brought about noticeable appreciation of hryvnia (in September, the average rate USD/UAH was 24.77, 11% lower than in January 2019). A high policy rate has a low transmission to the real sector of the economy as can be seen from the robust performance of gross fixed capital formation. Companies rely to a large extent on their own resources to finance investment (73% of capital investment in H1 2019 was financed from own funds) as access to loans remains constrained – outstanding loans stock to non-financial corporations in August 2019 was 10% lower in annual terms.

**More significant loosening of the monetary policy is planned in 2020 as NBU expects consumer inflation to decline** to 6.3% by the end of this year and reach the target range of 5% ± 1 pp in early 2020. Next year, the policy rate is expected to be cut by up to 500 bp. The real interest rate will remain relatively high, however further significant appreciation of hryvnia during the forecast period is not likely as increasing imports will push the exchange rate in the opposite direction.

**The major negative risk to the forecast is inability of the government to shake off the influence of oligarchs and deliver on the promised judicial and anti-corruption reforms.** Backsliding on Privatbank's nationalisation, as demanded by its former owner oligarch Ihor Kolomojsky, would jeopardize cooperation with the IMF and discourage investors. Recent developments (such as launched criminal proceedings against the current management of Privatbank, a police raid of the bank's headquarters and the home of Valeria Gontareva, the ex-central bank governor responsible for Privatbank nationalisation, and an arson attack on a countryside residence of Ms Gontareva) are seen as particularly worrying. The IMF mission to Kyiv in September 2019 made it clear that a new three-year arrangement under the Extended Fund Facility would be possible only if central bank independence is preserved and any settlement over Privatbank involves maximum recovery of assets from its ex-owners. External negative risks which could be detrimental to the economic growth are a full launch of the Nord Stream 2 pipeline during the forecast period (which will ship Russian gas to Europe avoiding the Ukrainian territory) and damaging repercussions of the US scandal surrounding the possible impeachment of President Trump, where Ukraine unwittingly got caught in the crossfire.

## Table 5.23 / Ukraine: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 1) | 2018 | 2019 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 42,845 | 42,673 | 42,485 | 42,270 | 42,325 | 42,082 | 42,150 | 42,050 | 41,950 |
| Gross domestic product, UAH bn, nom. | 1,989 | 2,385 | 2,984 | 3,559 | 1,516 | 1,736 | 4,000 | 4,400 | 4,800 |
| annual change in % (real) | -9.8 | 2.4 | 2.5 | 3.3 | 3.6 | 3.6 | 3.3 | 3.1 | 3.3 |
| GDP/capita (EUR at PPP) | 6,000 | 6,000 | 6,100 | 6,500 | . | . | . | . | . |
| Consumption of households, UAH bn, nom. | 1,332 | 1,570 | 1,978 | 2,431 | 1,097 | 1,355 | . | . | . |
| annual change in % (real) | -19.8 | 2.7 | 9.5 | 8.9 | 7.5 | 11.3 | 8.0 | 5.0 | 4.0 |
| Gross fixed capital form., UAH bn, nom. | 269 | 369 | 470 | 611 | 243 | 281 | . | . | . |
| annual change in % (real) | -9.2 | 20.4 | 16.1 | 14.3 | 18.7 | 11.9 | 9.0 | 6.0 | 5.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | -13.0 | 2.8 | 0.4 | 1.6 | 3.1 | 0.5 | 1.0 | 2.0 | 3.5 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -4.8 | 6.3 | -2.2 | 7.8 | 11.4 | 5.8 | . | . | . |
| Construction output | | | | | | | | | |
| annual change in % (real) | -12.3 | 17.4 | 26.3 | 8.5 | 7.0 | 21.2 | . | . | . |
| Employed persons, LFS, th, average | 16,443 | 16,277 | 16,156 | 16,361 | 16,283 | 16,486 | 16,500 | 16,600 | 16,700 |
| annual change in % | -0.4 | -1.0 | -0.7 | 1.3 | 1.0 | 1.2 | 0.9 | 0.6 | 0.6 |
| Unemployed persons, LFS, th, average | 1,655 | 1,678 | 1,698 | 1,579 | 1,600 | 1,528 | 1,510 | 1,460 | 1,410 |
| Unemployment rate, LFS, in %, average | 9.1 | 9.3 | 9.5 | 8.8 | 9.0 | 8.5 | 8.4 | 8.1 | 7.8 |
| Reg. unemployment rate, in %, eop 2) | 1.6 | 1.5 | 1.4 | 1.3 | . | . | . | . | . |
| Average monthly gross wages, UAH 3) | 4,195 | 5,183 | 7,104 | 8,865 | 8,378 | 10,030 | 10,500 | 11,700 | 12,900 |
| annual change in % (real, gross) | -18.9 | 8.5 | 19.8 | 12.5 | 12.0 | 9.8 | 10.0 | 5.0 | 5.0 |
| annual change in % (real, net) | -20.2 | 9.0 | 19.0 | 12.5 | 19.7 | 12.0 | 12.0 | 5.0 | 5.0 |
| Consumer prices, % p.a. | 48.7 | 13.9 | 14.4 | 10.9 | 12.6 | 9.0 | 8.0 | 6.0 | 5.0 |
| Producer prices in industry, % p.a. 4) | 36.0 | 20.5 | 26.4 | 17.4 | 17.8 | 8.3 | 8.0 | 6.0 | 6.0 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 32.8 | 32.8 | 34.1 | 33.3 | 37.4 | 37.0 | 33.7 | 33.7 | 33.7 |
| Expenditures | 34.3 | 35.1 | 35.5 | 35.2 | 36.7 | 35.8 | 36.0 | 35.7 | 35.7 |
| Deficit (-) / surplus (+) 5) | -1.6 | -2.3 | -1.4 | -1.9 | 0.7 | 1.2 | -2.3 | -2.0 | -2.0 |
| General gov.gross debt, nat.def., % of GDP | 79.1 | 80.9 | 71.8 | 60.9 | 56.1 | 52.6 | 55.0 | 57.0 | 59.0 |
| Stock of loans of non-fin.private sector, % p.a. | -2.8 | 2.4 | 1.9 | 5.6 | 7.4 | 0.0 | . | . | . |
| Non-performing loans (NPL), in %, eop 6) | 28.0 | 30.5 | 54.5 | 52.9 | 55.7 | 50.8 | . | . | . |
| Central bank policy rate, % p.a., eop 7) | 22.00 | 14.00 | 14.50 | 18.00 | 17.00 | 17.50 | 15.0 | 12.0 | 10.0 |
| Current account, EUR mn 8) | 1,457 | -1,210 | -2,165 | -3,696 | -543 | -590 | -3,500 | -4,200 | -5,100 |
| Current account, % of GDP | 1.8 | -1.4 | -2.2 | -3.3 | -1.2 | -1.0 | -2.6 | -3.0 | -3.5 |
| Exports of goods, BOP, EUR mn 8) | 31,935 | 30,309 | 35,192 | 36,677 | 17,499 | 19,887 | 41,400 | 43,400 | 45,300 |
| annual change in % | -16.5 | -5.1 | 16.1 | 4.2 | -0.4 | 13.6 | 12.9 | 4.8 | 4.4 |
| Imports of goods, BOP, EUR mn 8) | 35,050 | 36,579 | 43,758 | 47,436 | 21,087 | 24,762 | 54,500 | 56,700 | 58,500 |
| annual change in % | -19.7 | 4.4 | 19.6 | 8.4 | 1.4 | 17.4 | 14.9 | 4.0 | 3.2 |
| Exports of services, BOP, EUR mn 8) | 11,218 | 11,242 | 12,558 | 13,365 | 6,031 | 7,190 | 15,500 | 15,800 | 15,000 |
| annual change in % | -0.4 | 0.2 | 11.7 | 6.4 | -0.9 | 19.2 | 16.0 | 1.9 | -5.1 |
| Imports of services, BOP, EUR mn 8) | 10,232 | 10,801 | 11,655 | 12,226 | 5,636 | 6,418 | 13,500 | 14,200 | 14,700 |
| annual change in % | 9.4 | 5.6 | 7.9 | 4.9 | -1.2 | 13.9 | 10.4 | 5.2 | 3.5 |
| FDI liabilities, EUR mn 8) | 2,750 | 3,108 | 2,506 | 2,095 | 1,007 | 1,009 | 1,800 | . | . |
| FDI assets, EUR mn 8) | 34 | 156 | 207 | 98 | 101 | 58 | 100 | . | . |
| Gross reserves of NB excl. gold, EUR mn 8) | 11,320 | 13,965 | 14,872 | 15,955 | 14,559 | 17,191 | . | . | . |
| Gross external debt, EUR mn 8) | 107,695 | 107,648 | 96,741 | 92,352 | 97,454 | 101,665 | 104,000 | 107,000 | 109,000 |
| Gross external debt, % of GDP | 131.2 | 127.7 | 97.3 | 83.4 | 88.0 | 75.5 | 77.2 | 76.4 | 74.9 |
| Average exchange rate UAH/EUR | 24.23 | 28.29 | 30.00 | 32.14 | 32.42 | 30.43 | 29.7 | 31.4 | 33.0 |

Note: Excluding the occupied territories of Crimea and Sevastopol and except for population temporarily occupied territories in the Donetsk and Luhansk regions.

1) Preliminary. - 2) In % of working age population. - 3) Enterprises with 10 and more employees. - 4) Domestic output prices. - 5) Without transfers to Naftohaz and other bail-out costs. - 6) From 2017 including NPLs of the nationalised Privatbank and changes in rules of credit risk assessment. - 7) Discount rate of NB. - 8) Converted from USD.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

# 6. Appendix

**Table 6.1 / European Union-Central and Eastern Europe (EU-CEE11): an overview of economic fundamentals, 2018**

| | BG | CZ | EE | HR | HU | LT | LV | PL | RO | SI | SK | EU-CEE11 [1)] | EU28 [2)] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross domestic product | | | | | | | | | | | | | |
| EUR bn, at ER | 55.2 | 207.8 | 26.0 | 51.5 | 133.8 | 45.3 | 29.2 | 496.4 | 202.9 | 45.8 | 89.7 | *1,383* | *15,862* |
| EUR bn, at PPP | 109.3 | 299.1 | 33.7 | 79.7 | 215.2 | 70.1 | 41.4 | 842.9 | 389.0 | 55.7 | 130.2 | *2,266* | *15,865* |
| EU28=100, at PPP | 0.7 | 1.9 | 0.2 | 0.5 | 1.4 | 0.4 | 0.3 | 5.3 | 2.5 | 0.4 | 0.8 | *14.3* | *100.0* |
| Per capita, EUR, at PPP | 15,500 | 28,100 | 25,500 | 19,400 | 22,000 | 25,000 | 21,500 | 21,900 | 20,000 | 26,900 | 23,900 | *22,000* | *30,900* |
| Per capita, EU28=100, at PPP | 50 | 91 | 83 | 63 | 71 | 81 | 70 | 71 | 65 | 87 | 77 | *71* | *100* |
| 1990=100 [3)] | 144.7 | 170.1 | 177.0 | 118.9 | 155.8 | 148.4 | 132.7 | 247.2 | 181.4 | 178.4 | 207.1 | *202.0* | *164.1* |
| 2007=100 | 124.4 | 119.6 | 111.7 | 101.0 | 117.7 | 118.4 | 104.3 | 146.6 | 134.1 | 111.4 | 131.3 | *131.0* | *112.1* |
| Price level | | | | | | | | | | | | | |
| EU-28=100 (PPP/ER) | 51 | 69 | 77 | 65 | 62 | 65 | 70 | 59 | 52 | 82 | 69 | *61* | *100* |
| Industrial production | | | | | | | | | | | | | |
| 2007=100 [4)] | 99.4 | 120.1 | 131.0 | 91.2 | 120.6 | 129.9 | 124.0 | 152.3 | 152.7 | 117.4 | 154.9 | *137.8* | *102.3* |
| Population | | | | | | | | | | | | | |
| in thousand, average | 7,025 | 10,630 | 1,322 | 4,091 | 9,776 | 2,802 | 1,927 | 38,423 | 19,466 | 2,074 | 5,447 | *102,981* | *513,572* |
| Employed persons, LFS | | | | | | | | | | | | | |
| in thousand, average | 3,153 | 5,294 | 665 | 1,655 | 4,470 | 1,375 | 909 | 16,484 | 8,689 | 981 | 2,567 | *46,240* | *230,437* |
| Unemployment rate, LFS | | | | | | | | | | | | | |
| in % | 5.2 | 2.2 | 5.4 | 8.5 | 3.7 | 6.2 | 7.4 | 3.9 | 4.2 | 5.1 | 6.5 | *4.3* | *6.8* |
| Average gross monthly wages | | | | | | | | | | | | | |
| EUR [5)] | 580 | 1,243 | 1,310 | 1,139 | 1,035 | 920 | 1,010 | 1,070 | 936 | 1,682 | 1,013 | *1,038* | *2,474* |
| EU28=100 | 23.5 | 50.2 | 52.9 | 46.0 | 41.8 | 37.2 | 40.8 | 43.2 | 37.8 | 68.0 | 40.9 | *41.9* | *100.0* |
| General government budget, EU-def., % of GDP | | | | | | | | | | | | | |
| Revenues | 36.8 | 41.5 | 38.4 | 46.6 | 43.6 | 34.6 | 38.0 | 41.2 | 32.0 | 43.3 | 40.1 | *39.8* | *45.0* |
| Expenditures | 34.8 | 40.6 | 39.0 | 46.4 | 45.8 | 33.9 | 39.0 | 41.6 | 35.0 | 42.5 | 40.8 | *40.4* | *45.6* |
| Balance | 2.0 | 0.9 | -0.5 | 0.2 | -2.2 | 0.7 | -1.0 | -0.4 | -3.0 | 0.7 | -0.7 | *-0.6* | *-0.6* |
| Public debt, EU def., % of GDP | 22.6 | 32.6 | 8.3 | 74.6 | 69.9 | 34.1 | 36.4 | 48.9 | 35.0 | 70.4 | 49.2 | *45.3* | *80.0* |
| BOP items, % of GDP | | | | | | | | | | | | | |
| Current account | 5.4 | 0.3 | 2.0 | 2.6 | -0.5 | 0.3 | -0.7 | -1.0 | -4.6 | 5.7 | -2.6 | *-0.7* [6)] | *2.1* [6)] |
| Exports of goods | 50.3 | 65.9 | 48.9 | 23.7 | 66.2 | 54.2 | 43.2 | 43.7 | 30.5 | 68.0 | 84.4 | *50.7* [6)] | *31.5* [6)] |
| Imports of goods | 53.6 | 61.9 | 52.7 | 41.8 | 67.5 | 60.4 | 51.3 | 44.7 | 37.8 | 65.6 | 84.6 | *52.8* [6)] | *31.8* [6)] |
| Exports of services | 16.6 | 12.4 | 25.4 | 27.9 | 18.7 | 21.4 | 18.1 | 11.8 | 11.5 | 17.4 | 11.4 | *14.2* [6)] | *13.7* [6)] |
| Imports of services | 10.1 | 10.1 | 18.0 | 8.8 | 13.1 | 13.3 | 10.2 | 7.5 | 7.2 | 11.6 | 10.3 | *9.3* [6)] | *11.6* [6)] |
| FDI stock per capita, EUR [7)] | 6,027 | 12,256 | 15,104 | 6,797 | 7,736 | 5,275 | 7,550 | 5,179 | 3,884 | 6,753 | 9,116 | *6,741* | *14,871* |

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) For Poland 1989=100 is the appropriate reference year. - 4) EU-28 working-day adjusted. - 5) RO: Gross wages include employer's social security contribution (28.9%). EU28: Gross wages according to national accounts concept. - 6) Data for EU-CEE and EU-28 include transactions within the region (sum over individual countries). - 7) Excluding SPE. Year 2017.

Source: wiiw Annual Database, Eurostat.

**Table 6.2 / Western Balkans and Turkey, selected CIS countries and Ukraine: an overview of economic fundamentals, 2018**

| | AL | BA | ME | MK | RS | XK | TR | BY | KZ | MD | RU | UA | *EU-CEE11 1)* | *EU28 2)* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross domestic product | | | | | | | | | | | | | | |
| EUR bn, at ER | 12.8 | 17.1 | 4.7 | 10.7 | 42.9 | 6.7 | 652.5 | 50.6 | 152.0 | 9.7 | 1,406.2 | 110.7 | *1,383* | *15,862* |
| EUR bn, at PPP | 27.1 | 34.4 | 9.1 | 24.1 | 86.2 | 14.9 | 1,636.5 | 134.1 | 373.0 | 18.6 | 2,869.0 | 276.4 | *2,266* | *15,865* |
| EU28=100, at PPP | 0.2 | 0.2 | 0.1 | 0.2 | 0.5 | 0.1 | 10.3 | 0.8 | 2.4 | 0.1 | 18.1 | 1.7 | *14.3* | *100.0* |
| Per capita, EUR, at PPP | 9,500 | 9,800 | 14,700 | 11,600 | 12,300 | 8,300 | 20,100 | 14,100 | 20,400 | 6,900 | 19,500 | 6,500 | *22,000* | *30,900* |
| Per capita, EU28=100, at PPP | 31 | 32 | 48 | 38 | 40 | 27 | 65 | 46 | 66 | 22 | 63 | 21 | *71* | *100* |
| 1990=100 | 240.9 | . | . | 146.0 | . | . | 340.8 | 197.1 | 209.5 | 78.2 | 121.6 | 63.4 | *202.0* | *164.1* |
| 2007=100 | 140.7 | 121.5 | 128.6 | 129.7 | 119.0 | 151.1 | 167.5 | 129.8 | 154.6 | 148.2 | 114.5 | 87.1 | *131.0* | *112.1* |
| Price level | | | | | | | | | | | | | | |
| EU28=100 (PPP/ER) | 47 | 50 | 51 | 44 | 50 | 45 | 40 | 38 | 41 | 52 | 49 | 40 | *61* | *100* |
| Industrial production | | | | | | | | | | | | | | |
| 2007=100 3) | 289.0 | 125.9 | 78.4 | 117.7 | 104.5 | 187.7 | 166.3 | 140.7 | 134.9 | 122.9 | 116.5 | 69.9 | *137.8* | *102.3* |
| Population | | | | | | | | | | | | | | |
| in thousand, average | 2,866 | 3,496 | 622 | 2,076 | 6,983 | 1,797 | 81,407 | 9,484 | 18,276 | 2,706 | 146,831 | 42,270 | *102,981* | *513,572* |
| Employed persons, LFS in thousand, average | 1,231 | 822 | 237 | 759 | 2,833 | 345 | 28,734 | 4,336 | 8,695 | 1,252 | 72,532 | 16,361 | *46,240* | *230,437* |
| Unemployment rate, LFS in % | 12.3 | 18.4 | 15.2 | 20.7 | 12.7 | 29.6 | 10.9 | 4.8 | 4.9 | 3.0 | 4.8 | 8.8 | *4.3* | *6.8* |
| Average gross monthly wages | | | | | | | | | | | | | | |
| EUR at ER | 397 | 697 | 766 | 579 | 580 | 558 | 471 | 405 | 400 | 319 | 588 | 276 | *1,038* | *2,474 4)* |
| EU28=100 | 16.0 | 28.2 | 31.0 | 23.4 | 23.5 | 22.6 | 19.0 | 16.4 | 16.2 | 12.9 | 23.8 | 11.1 | *41.9* | *100.0* |
| General government budget, nat. def., % of GDP | | | | | | | | | | | | | | |
| Revenues | 27.6 | 43.1 | 42.3 | 30.4 | 41.5 | 29.8 | 30.0 | 41.8 | 17.5 | 30.2 | 35.9 | 33.3 | *39.8 5)* | *45.0 5)* |
| Expenditures | 29.2 | 40.8 | 45.2 | 31.5 | 40.9 | 29.4 | 32.8 | 37.7 | 18.8 | 31.0 | 33.0 | 35.2 | *40.4 5)* | *45.6 5)* |
| Balance | -1.6 | 2.3 | -2.9 | -1.1 | 0.6 | 0.4 | -2.8 | 4.0 | -1.3 | -0.8 | 2.9 | -1.9 | *-0.6 5)* | *-0.6 5)* |
| Public debt, nat. def., % of GDP | 67.9 | 34.2 | 70.1 | 48.4 | 53.7 | 16.3 | 30.2 | 44.0 | 26.0 | 27.2 | 12.1 | 60.9 | *45.3 5)* | *80.0 5)* |
| BOP items, % of GDP | | | | | | | | | | | | | | |
| Current account | -6.7 | -3.7 | -17.0 | -0.1 | -5.2 | -7.6 | -3.4 | -0.1 | -0.2 | -10.6 | 6.8 | -3.3 | *-0.7 6)* | *2.1 6)* |
| Exports of goods | 7.7 | 31.2 | 9.4 | 45.5 | 35.6 | 5.6 | 22.7 | 56.1 | 33.3 | 17.3 | 26.7 | 33.1 | *50.7 6)* | *31.5 6)* |
| Imports of goods | 30.2 | 53.6 | 53.3 | 61.6 | 47.8 | 46.3 | 28.0 | 60.3 | 19.1 | 46.0 | 15.0 | 42.8 | *52.8 6)* | *31.8 6)* |
| Exports of services | 24.0 | 11.0 | 33.5 | 14.6 | 14.0 | 23.2 | 6.4 | 14.8 | 4.1 | 12.9 | 3.9 | 12.1 | *14.2 6)* | *13.7 6)* |
| Imports of services | 15.3 | 3.5 | 13.4 | 11.3 | 11.5 | 10.5 | 3.0 | 9.1 | 6.7 | 9.7 | 5.7 | 11.0 | *9.3 6)* | *11.6 6)* |
| FDI stock per capita, EUR 7) | 1,958 | 1,964 | 7,219 | 2,264 | 4,475 | 1,957 | 2,052 | 1,132 | 6,762 | 1,130 | 2,512 | 855 | *6,741* | *14,871* |

Note: Country specific methodological remarks see in the respective country table in this report.

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) EU-28 working-day adjusted. - 4) Gross wages according to national account concept. - 5) EU definition: expenditures and revenues according to ESA 2010, excessive deficit procedure. - 6) Data for EU-CEE and EU-28 include transactions within the region. - 7) Excluding SPE. Year 2017.

Source: wiiw Annual Database, Eurostat.

## Table 6.3 / GDP per capita at current PPPs (EUR), from 2019 at constant PPPs and population

| | | 1990 | 1995 | 2000 | 2005 | 2010 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020<br>Forecast | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| BG | Bulgaria | 4,600 | 6,500 | 5,600 | 8,600 | 11,200 | 13,700 | 14,200 | 14,800 | 15,500 | 16,000 | 16,400 | 16,800 |
| CZ | Czech Republic | 9,400 | 11,600 | 14,200 | 18,600 | 21,100 | 25,300 | 25,600 | 26,900 | 28,100 | 28,800 | 29,500 | 30,300 |
| EE | Estonia | 6,000 | 5,400 | 8,200 | 14,100 | 16,700 | 22,100 | 22,500 | 23,800 | 25,500 | 26,400 | 27,100 | 27,700 |
| HR | Croatia | 7,800 | 6,600 | 9,300 | 13,000 | 15,100 | 17,200 | 17,800 | 18,400 | 19,400 | 20,000 | 20,500 | 21,100 |
| HU | Hungary | 6,800 | 7,700 | 10,400 | 14,500 | 16,500 | 20,000 | 19,800 | 20,600 | 22,000 | 22,900 | 23,600 | 24,200 |
| LT | Lithuania | 7,000 | 5,000 | 7,400 | 12,300 | 15,300 | 21,700 | 22,100 | 23,500 | 25,000 | 25,900 | 26,500 | 27,200 |
| LV | Latvia | 6,500 | 4,600 | 7,000 | 11,800 | 13,500 | 18,700 | 18,800 | 19,900 | 21,500 | 22,100 | 22,600 | 23,100 |
| PL | Poland | 4,700 | 6,500 | 9,300 | 11,800 | 15,900 | 19,900 | 19,900 | 20,900 | 21,900 | 22,900 | 23,700 | 24,500 |
| RO | Romania | 4,200 | 4,600 | 5,100 | 8,200 | 13,000 | 16,300 | 17,400 | 18,800 | 20,000 | 20,800 | 21,500 | 22,100 |
| SI | Slovenia | 9,200 | 11,500 | 15,800 | 20,300 | 21,300 | 23,800 | 24,200 | 25,500 | 26,900 | 27,700 | 28,500 | 29,300 |
| SK | Slovakia | 6,600 | 7,300 | 10,000 | 14,100 | 19,200 | 22,500 | 22,400 | 22,800 | 23,900 | 24,400 | 24,900 | 25,500 |
| | EU-CEE11 | 5,700 | 6,700 | 8,700 | 12,100 | 15,900 | 19,500 | 19,800 | 20,800 | 22,000 | 22,800 | 23,500 | 24,200 |
| AL | Albania | 1,900 | 2,000 | 3,400 | 5,000 | 7,400 | 8,800 | 8,600 | 9,100 | 9,500 | 9,800 | 10,200 | 10,500 |
| BA | Bosnia & Herzeg. | . | . | 4,000 | 5,400 | 6,900 | 8,800 | 9,000 | 9,300 | 9,800 | 10,100 | 10,400 | 10,700 |
| ME | Montenegro | . | . | 5,300 | 7,100 | 10,400 | 12,300 | 13,000 | 13,700 | 14,700 | 15,200 | 15,700 | 16,000 |
| MK | North Macedonia | 4,400 | 4,000 | 5,400 | 6,700 | 8,700 | 10,400 | 10,800 | 10,800 | 11,600 | 12,000 | 12,400 | 12,800 |
| RS | Serbia | . | 3,200 | 5,300 | 7,800 | 9,800 | 11,200 | 11,400 | 11,600 | 12,300 | 12,700 | 13,000 | 13,300 |
| XK | Kosovo | . | . | 4,200 | 5,400 | 5,900 | 7,400 | 7,600 | 7,800 | 8,300 | 8,600 | 8,900 | 9,300 |
| TR | Turkey | 5,000 | 6,000 | 8,300 | 10,000 | 13,200 | 19,300 | 19,200 | 19,900 | 20,100 | 20,000 | 20,600 | 21,300 |
| BY | Belarus | 4,200 | 3,400 | 5,300 | 8,500 | 11,900 | 13,800 | 13,200 | 13,400 | 14,100 | 14,300 | 14,500 | 14,800 |
| KZ | Kazakhstan | 7,300 | 5,100 | 6,900 | 12,100 | 15,100 | 18,900 | 18,400 | 19,600 | 20,400 | 21,200 | 21,900 | 22,700 |
| MD | Moldova | 3,100 | 2,000 | 2,000 | 3,000 | 3,500 | 5,700 | 5,900 | 6,200 | 6,900 | 7,200 | 7,500 | 7,800 |
| RU | Russia | 6,700 | 4,700 | 6,000 | 10,000 | 15,700 | 18,100 | 17,500 | 18,200 | 19,500 | 19,700 | 20,000 | 20,400 |
| UA | Ukraine | 5,700 | 3,100 | 3,300 | 5,700 | 6,100 | 6,000 | 6,000 | 6,100 | 6,500 | 6,700 | 6,900 | 7,100 |
| AT | Austria | 17,700 | 19,900 | 25,700 | 29,800 | 32,200 | 37,500 | 37,700 | 38,100 | 39,300 | 39,900 | 40,500 | 41,300 |
| DE | Germany | 22,200 | 19,900 | 24,100 | 27,400 | 30,400 | 35,800 | 36,000 | 36,800 | 37,600 | 37,800 | 38,400 | 39,200 |
| EL | Greece | 12,100 | 13,000 | 17,100 | 21,700 | 21,500 | 20,200 | 19,800 | 20,200 | 21,000 | 21,500 | 22,000 | 22,400 |
| IE | Ireland | 12,500 | 16,000 | 26,500 | 34,400 | 33,100 | 52,000 | 51,400 | 54,800 | 58,800 | 61,000 | 63,100 | 64,400 |
| IT | Italy | 16,900 | 18,800 | 23,700 | 25,500 | 26,700 | 27,700 | 28,500 | 29,100 | 29,600 | 29,600 | 29,800 | 30,400 |
| PT | Portugal | 10,600 | 12,100 | 16,500 | 19,300 | 20,900 | 22,300 | 22,600 | 23,100 | 23,700 | 24,100 | 24,500 | 25,000 |
| ES | Spain | 12,400 | 13,700 | 18,900 | 23,500 | 24,300 | 26,300 | 26,600 | 27,500 | 28,100 | 28,700 | 29,200 | 29,800 |
| US | United States | 20,000 | 24,100 | 31,800 | 37,400 | 37,000 | 42,700 | 42,100 | 42,400 | 44,500 | 45,600 | 46,500 | 47,400 |
| | EU28 average | 13,700 | 15,200 | 19,800 | 23,400 | 25,500 | 29,100 | 29,200 | 30,000 | 30,900 | 31,300 | 31,700 | 32,200 |

### European Union (28) average = 100

| | | 1990 | 1995 | 2000 | 2005 | 2010 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| BG | Bulgaria | 34 | 43 | 28 | 37 | 44 | 47 | 49 | 49 | 50 | 51 | 52 | 52 |
| CZ | Czech Republic | 69 | 76 | 72 | 79 | 83 | 87 | 88 | 90 | 91 | 92 | 93 | 94 |
| EE | Estonia | 44 | 36 | 41 | 60 | 65 | 76 | 77 | 79 | 83 | 84 | 85 | 86 |
| HR | Croatia | 57 | 43 | 47 | 56 | 59 | 59 | 61 | 61 | 63 | 64 | 65 | 66 |
| HU | Hungary | 50 | 51 | 53 | 62 | 65 | 69 | 68 | 69 | 71 | 73 | 74 | 75 |
| LT | Lithuania | 51 | 33 | 37 | 53 | 60 | 75 | 76 | 78 | 81 | 83 | 84 | 84 |
| LV | Latvia | 47 | 30 | 35 | 50 | 53 | 64 | 64 | 66 | 70 | 71 | 71 | 72 |
| PL | Poland | 34 | 43 | 47 | 50 | 62 | 68 | 68 | 70 | 71 | 73 | 75 | 76 |
| RO | Romania | 31 | 30 | 26 | 35 | 51 | 56 | 60 | 63 | 65 | 66 | 68 | 69 |
| SI | Slovenia | 67 | 76 | 80 | 87 | 84 | 82 | 83 | 85 | 87 | 88 | 90 | 91 |
| SK | Slovakia | 48 | 48 | 51 | 60 | 75 | 77 | 77 | 76 | 77 | 78 | 79 | 79 |
| | EU-CEE | 42 | 44 | 44 | 52 | 62 | 67 | 68 | 69 | 71 | 73 | 74 | 75 |
| AL | Albania | 14 | 13 | 17 | 21 | 29 | 30 | 29 | 30 | 31 | 31 | 32 | 33 |
| BA | Bosnia & Herzeg. | . | . | 20 | 23 | 27 | 30 | 31 | 31 | 32 | 32 | 33 | 33 |
| ME | Montenegro | . | . | 27 | 30 | 41 | 42 | 45 | 46 | 48 | 49 | 50 | 50 |
| MK | North Macedonia | 32 | 26 | 27 | 29 | 34 | 36 | 37 | 36 | 38 | 38 | 39 | 40 |
| RS | Serbia | . | 21 | 27 | 33 | 38 | 38 | 39 | 39 | 40 | 41 | 41 | 41 |
| XK | Kosovo | . | . | 21 | 23 | 23 | 25 | 26 | 26 | 27 | 27 | 28 | 29 |
| TR | Turkey | 36 | 39 | 42 | 43 | 52 | 66 | 66 | 66 | 65 | 64 | 65 | 66 |
| BY | Belarus | 31 | 22 | 27 | 36 | 47 | 47 | 45 | 45 | 46 | 46 | 46 | 46 |
| KZ | Kazakhstan | 53 | 34 | 35 | 52 | 59 | 65 | 63 | 65 | 66 | 68 | 69 | 70 |
| MD | Moldova | 23 | 13 | 10 | 13 | 14 | 20 | 20 | 21 | 22 | 23 | 24 | 24 |
| RU | Russia | 49 | 31 | 30 | 43 | 62 | 62 | 60 | 61 | 63 | 63 | 63 | 63 |
| UA | Ukraine | 42 | 20 | 17 | 24 | 24 | 21 | 21 | 20 | 21 | 21 | 22 | 22 |
| AT | Austria | 129 | 131 | 130 | 127 | 126 | 129 | 129 | 127 | 127 | 127 | 128 | 128 |
| DE | Germany | 162 | 131 | 122 | 117 | 119 | 123 | 123 | 123 | 122 | 121 | 121 | 122 |
| EL | Greece | 88 | 86 | 86 | 93 | 84 | 69 | 68 | 67 | 68 | 69 | 69 | 70 |
| IE | Ireland | 91 | 105 | 134 | 147 | 130 | 179 | 176 | 183 | 190 | 195 | 199 | 200 |
| IT | Italy | 123 | 124 | 120 | 109 | 105 | 95 | 98 | 97 | 96 | 95 | 94 | 94 |
| PT | Portugal | 77 | 80 | 83 | 82 | 82 | 77 | 77 | 77 | 77 | 77 | 77 | 78 |
| ES | Spain | 91 | 90 | 95 | 100 | 95 | 90 | 91 | 92 | 91 | 92 | 92 | 93 |
| US | United States | 146 | 159 | 161 | 160 | 145 | 147 | 144 | 141 | 144 | 146 | 147 | 147 |
| | EU28 average | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

Sources: wiiw Annual Database incorporating national and Eurostat statistics; forecasts by wiiw and EC - Spring Report 2019.

## Table 6.4 / Indicators of macro-competitiveness, 2014-2021, annual changes in %

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 Forecast | 2021 | 2014-18 average |
|---|---|---|---|---|---|---|---|---|---|
| **Bulgaria** | | | | | | | | | |
| GDP deflator | 0.5 | 2.2 | 2.2 | 3.4 | 3.6 | 3.0 | 2.5 | 2.0 | 2.4 |
| Real ER (CPI-based) | -2.1 | -1.1 | -1.6 | -0.5 | 0.7 | 1.6 | 1.1 | 0.4 | -0.9 |
| Real ER (PPI-based) | 0.6 | 0.0 | -1.7 | 1.9 | 1.0 | 1.0 | 0.7 | 0.4 | 0.4 |
| Average gross wages, real (PPI based) | 7.3 | 9.2 | 11.5 | 4.2 | 5.3 | 7.8 | 5.3 | 4.5 | 7.5 |
| Average gross wages, real (CPI based) | 7.7 | 8.0 | 9.4 | 8.1 | 6.7 | 7.8 | 5.3 | 4.5 | 8.0 |
| Average gross wages, EUR (ER) | 6.0 | 6.8 | 8.0 | 9.4 | 9.4 | 10.3 | 9.4 | 5.7 | 7.9 |
| Employed persons (LFS) | 1.6 | 1.7 | -0.5 | 4.4 | 0.1 | 1.2 | 0.3 | 0.3 | 1.4 |
| GDP real per employed person, NCU | 0.2 | 1.7 | 4.5 | -0.6 | 3.0 | 2.5 | 2.1 | 2.0 | 1.8 |
| Unit labour costs, ER (EUR) adjusted | 5.7 | 5.0 | 3.4 | 10.0 | 6.2 | 8.3 | 5.8 | 4.5 | 6.1 |
| **Czech Republic** | | | | | | | | | |
| GDP deflator | 2.5 | 1.2 | 1.3 | 1.4 | 2.5 | 2.9 | 2.0 | 2.1 | 1.8 |
| Exchange rate (ER), EUR/NC | -5.7 | 0.9 | 0.9 | 2.7 | 2.6 | 0.6 | 0.4 | 0.0 | 0.3 |
| Real ER (CPI-based) | -5.7 | 1.2 | 1.2 | 3.4 | 2.7 | 1.7 | 1.1 | 0.5 | 0.5 |
| Real ER (PPI-based) | -2.6 | 0.7 | -0.9 | 0.4 | 0.5 | 1.5 | 0.1 | -0.1 | -0.4 |
| Average gross wages, real (PPI based) | 1.5 | 5.7 | 7.9 | 6.0 | 6.8 | 3.9 | 4.6 | 4.5 | 5.6 |
| Average gross wages, real (CPI based) | 2.5 | 2.9 | 3.8 | 4.2 | 5.4 | 4.4 | 4.0 | 3.9 | 3.8 |
| Average gross wages, EUR (ER) | -2.9 | 4.2 | 5.4 | 9.6 | 10.4 | 7.8 | 6.7 | 5.6 | 5.2 |
| Employed persons (LFS) | 0.8 | 1.4 | 1.9 | 1.6 | 1.4 | 0.5 | 0.4 | 0.2 | 1.4 |
| GDP real per employed person, NCU | 1.9 | 3.9 | 0.5 | 2.7 | 1.6 | 2.0 | 2.0 | 2.4 | 2.1 |
| Unit labour costs, ER (EUR) adjusted | -4.7 | 0.3 | 4.8 | 6.7 | 8.7 | 5.5 | 4.5 | 3.6 | 3.0 |
| **Estonia** | | | | | | | | | |
| GDP deflator | 2.9 | 1.1 | 1.7 | 3.6 | 4.5 | 2.6 | 2.4 | 2.0 | 2.8 |
| Real ER (CPI-based) | 0.0 | 0.1 | 0.5 | 2.0 | 1.5 | 1.2 | 0.9 | 0.5 | 0.8 |
| Real ER (PPI-based) | -0.3 | -0.3 | 0.5 | 0.3 | 1.0 | -1.5 | -2.3 | -0.6 | 0.2 |
| Average gross wages, real (PPI based) | 8.2 | 8.7 | 8.6 | 3.6 | 2.8 | 6.3 | 6.2 | 4.4 | 6.3 |
| Average gross wages, real (CPI based) | 5.4 | 5.9 | 6.8 | 3.2 | 3.3 | 4.2 | 3.3 | 3.2 | 4.9 |
| Average gross wages, EUR (ER) | 5.9 | 6.0 | 7.6 | 7.0 | 6.9 | 6.9 | 5.7 | 5.4 | 6.7 |
| Employed persons (LFS) | 0.6 | 2.6 | 0.6 | 2.2 | 0.9 | 1.1 | 0.6 | 0.3 | 1.4 |
| GDP real per employed person, NCU | 2.4 | -0.7 | 2.0 | 3.5 | 3.8 | 2.2 | 2.0 | 2.2 | 2.2 |
| Unit labour costs, ER (EUR) adjusted | 3.4 | 6.7 | 5.5 | 3.4 | 2.9 | 4.6 | 3.7 | 3.1 | 4.4 |
| **Croatia** | | | | | | | | | |
| GDP deflator | 0.0 | 0.0 | -0.1 | 1.1 | 1.7 | 1.1 | 1.5 | 1.4 | 0.6 |
| Exchange rate (ER), EUR/NC | -0.7 | 0.3 | 1.1 | 0.9 | 0.6 | 0.2 | 0.0 | 0.0 | 0.4 |
| Real ER (CPI-based) | -1.0 | 0.0 | 0.2 | 0.5 | 0.3 | -4.7 | 0.1 | -0.1 | 0.0 |
| Real ER (PPI-based) | -1.6 | -1.4 | -1.9 | 0.0 | -0.1 | 0.2 | 0.2 | 0.4 | -1.0 |
| Average gross wages, real (PPI based) | 3.0 | 5.3 | 6.5 | 1.9 | 2.6 | 1.8 | 2.8 | 2.3 | 3.8 |
| Average gross wages, real (CPI based) | -0.4 | 1.3 | 3.7 | 1.9 | 3.9 | 2.8 | 3.4 | 2.8 | 2.1 |
| Average gross wages, EUR (ER) | -0.6 | 1.6 | 3.0 | 4.9 | 5.5 | 4.5 | 4.2 | 4.8 | 2.9 |
| Employed persons (LFS) | 2.7 | 1.3 | 0.3 | 2.2 | 1.8 | 1.5 | 1.2 | 1.2 | 1.7 |
| GDP real per employed person, NCU | -2.7 | 1.1 | 3.2 | 0.7 | 0.8 | 1.3 | 1.5 | 1.5 | 0.6 |
| Unit labour costs, ER (EUR) adjusted | 2.3 | 0.4 | -0.2 | 4.2 | 4.7 | 2.7 | 3.3 | 2.8 | 2.2 |
| **Hungary** | | | | | | | | | |
| GDP deflator | 3.6 | 2.5 | 1.0 | 3.7 | 4.5 | 3.2 | 3.3 | 3.2 | 3.0 |
| Exchange rate (ER), EUR/NC | -3.8 | -0.4 | -0.5 | 0.7 | -3.0 | -2.2 | -1.5 | -1.5 | -1.4 |
| Real ER (CPI-based) | -4.3 | -0.3 | -0.4 | 1.4 | -2.1 | -11.0 | 0.2 | -0.1 | -1.2 |
| Real ER (PPI-based) | -2.4 | 0.7 | -0.8 | 1.0 | -0.5 | -0.3 | -0.2 | -0.1 | -0.4 |
| Average gross wages, real (PPI based) | 3.3 | 5.5 | 8.0 | 9.3 | 5.4 | 6.5 | 5.0 | 1.5 | 6.3 |
| Average gross wages, real (CPI based) | 2.4 | 4.3 | 8.0 | 10.7 | 10.2 | 7.0 | 5.0 | 1.5 | 7.1 |
| Average gross wages, EUR (ER) | -0.9 | 3.9 | 5.7 | 13.7 | 7.9 | 8.2 | 7.1 | 2.5 | 5.9 |
| Employed persons (LFS) | 5.3 | 2.7 | 3.4 | 1.6 | 1.1 | 0.9 | 0.2 | 0.0 | 2.8 |
| GDP real per employed person, NCU | -1.1 | 1.1 | -1.1 | 2.7 | 4.0 | 3.4 | 2.9 | 2.6 | 1.1 |
| Unit labour costs, ER (EUR) adjusted | 0.2 | 2.7 | 6.8 | 10.7 | 3.8 | 4.8 | 3.7 | 0.4 | 4.8 |
| **Lithuania** | | | | | | | | | |
| GDP deflator | 0.9 | 0.1 | 1.6 | 4.3 | 3.3 | 6.0 | -1.8 | 1.9 | 2.0 |
| Real ER (CPI-based) | -0.3 | -0.7 | 0.4 | 2.0 | 0.6 | -8.2 | 0.5 | 0.4 | 0.4 |
| Real ER (PPI-based) | -3.3 | -7.7 | -3.0 | 2.0 | 2.6 | -1.0 | -1.8 | -0.6 | -1.9 |
| Average gross wages, real (PPI based) | 10.3 | 16.7 | 13.4 | 3.3 | 3.7 | 9.5 | 6.1 | 4.7 | 9.4 |
| Average gross wages, real (CPI based) | 4.2 | 5.4 | 10.3 | 6.5 | 8.4 | 8.2 | 4.1 | 3.7 | 6.9 |
| Average gross wages, EUR (ER) | 4.8 | 5.4 | 8.4 | 8.6 | 9.5 | 10.6 | 6.1 | 5.8 | 7.3 |
| Employed persons (LFS) | 2.0 | 1.2 | 2.0 | -0.5 | 1.5 | 1.1 | 0.7 | 0.4 | 1.2 |
| GDP real per employed person, NCU | 1.5 | 0.8 | 0.6 | 4.8 | 2.1 | 2.5 | 1.8 | 2.1 | 1.9 |
| Unit labour costs, ER (EUR) adjusted | 3.3 | 4.6 | 7.8 | 3.6 | 7.2 | 7.9 | 4.2 | 3.6 | 5.3 |

(Table 6.4 ctd.)

**Table 6.4 / ctd.**

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2014-18 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | | average |
| **Latvia** | | | | | | | | | |
| GDP deflator | 1.8 | 0.0 | 0.9 | 3.0 | 4.0 | 3.1 | 2.3 | 2.5 | 1.9 |
| Real ER (CPI-based) | 0.0 | 0.2 | -0.2 | 1.2 | 0.7 | 1.6 | 0.9 | 0.8 | 0.4 |
| Real ER (PPI-based) | 2.1 | 1.2 | -1.1 | -0.5 | 1.4 | 0.7 | -0.5 | -0.1 | 0.6 |
| Average gross wages, real (PPI based) | 6.5 | 8.0 | 7.7 | 5.2 | 4.6 | 5.1 | 5.1 | 4.5 | 6.4 |
| Average gross wages, real (CPI based) | 6.1 | 6.7 | 4.9 | 4.8 | 6.3 | 4.8 | 4.0 | 3.5 | 5.8 |
| Average gross wages, EUR (ER) | 6.7 | 6.9 | 5.0 | 7.8 | 9.1 | 7.9 | 6.4 | 6.0 | 7.1 |
| Employed persons (LFS) | -1.0 | 1.3 | -0.3 | 0.2 | 1.6 | 0.6 | 0.5 | 0.5 | 0.3 |
| GDP real per employed person, NCU | 3.0 | 1.9 | 2.1 | 3.6 | 3.0 | 2.2 | 1.5 | 1.9 | 2.7 |
| Unit labour costs, ER (EUR) adjusted | 3.6 | 4.9 | 2.9 | 4.0 | 5.9 | 5.6 | 4.8 | 4.1 | 4.3 |
| **Poland** | | | | | | | | | |
| GDP deflator | 0.5 | 0.8 | 0.3 | 1.9 | 1.1 | 1.9 | 2.2 | 2.1 | 0.9 |
| Exchange rate (ER), EUR/NC | 0.3 | 0.0 | -4.1 | 2.5 | -0.1 | -0.9 | 0.0 | -1.1 | -0.3 |
| Real ER (CPI-based) | -0.1 | -0.7 | -4.6 | 2.4 | -0.8 | -0.3 | 1.3 | -0.3 | -0.8 |
| Real ER (PPI-based) | 0.7 | 0.0 | -3.0 | 2.2 | -0.9 | -1.1 | 0.2 | -1.0 | -0.2 |
| Average gross wages, real (PPI based) | 4.7 | 5.8 | 4.0 | 2.6 | 4.6 | 5.1 | 4.7 | 4.3 | 4.3 |
| Average gross wages, real (CPI based) | 3.1 | 4.2 | 3.9 | 3.8 | 5.5 | 4.9 | 4.0 | 3.6 | 4.1 |
| Average gross wages, EUR (ER) | 3.5 | 3.5 | -0.6 | 8.0 | 6.6 | 5.6 | 7.1 | 5.0 | 4.2 |
| Employed persons (LFS) | 1.9 | 1.4 | 0.7 | 1.4 | 0.4 | 0.6 | 0.3 | 0.2 | 1.2 |
| GDP real per employed person, NCU | 1.4 | 2.4 | 2.3 | 3.5 | 4.8 | 3.8 | 3.2 | 3.2 | 2.9 |
| Unit labour costs, ER (EUR) adjusted | 2.1 | 1.0 | -2.8 | 4.4 | 1.8 | 2.2 | 3.5 | 1.6 | 1.3 |
| **Romania** | | | | | | | | | |
| GDP deflator | 1.7 | 2.6 | 2.5 | 4.7 | 5.9 | 5.7 | 5.2 | 4.0 | 3.5 |
| Exchange rate (ER), EUR/NC | -0.6 | 0.0 | -1.0 | -1.7 | -1.8 | -2.0 | -1.5 | -1.6 | -1.0 |
| Real ER (CPI-based) | 0.3 | -0.4 | -2.4 | -2.3 | 0.3 | 0.5 | 0.6 | 0.2 | -0.9 |
| Real ER (PPI-based) | 1.1 | -0.1 | -1.4 | -1.2 | 0.3 | 0.4 | -0.3 | 0.7 | -0.3 |
| Average gross wages, real (PPI based) | 7.8 | 12.3 | 12.0 | 10.9 | 7.5 | 7.6 | 5.0 | 3.4 | 10.1 |
| Average gross wages, real (CPI based) | 6.1 | 10.2 | 11.2 | 13.5 | 8.5 | 8.1 | 4.5 | 3.9 | 9.9 |
| Average gross wages, EUR (ER) | 7.0 | 9.7 | 8.8 | 12.8 | 10.9 | 10.0 | 6.8 | 5.5 | 9.8 |
| Employed persons (LFS) | 0.8 | -0.9 | -1.0 | 2.6 | 0.2 | 0.2 | 0.0 | 0.0 | 0.3 |
| GDP real per employed person, NCU | 2.6 | 4.8 | 5.9 | 4.4 | 3.7 | 4.0 | 3.3 | 2.9 | 4.3 |
| Unit labour costs, ER (EUR) adjusted | 4.3 | 4.7 | 2.8 | 8.0 | 6.9 | 6.0 | 3.2 | 2.8 | 5.3 |
| **Slovenia** | | | | | | | | | |
| GDP deflator | 0.5 | 1.0 | 0.8 | 1.6 | 2.2 | 5.6 | -1.9 | 1.9 | 1.2 |
| Real ER (CPI-based) | -0.1 | -0.8 | -0.5 | -0.1 | 0.0 | 0.4 | 0.4 | 0.4 | -0.3 |
| Real ER (PPI-based) | 1.1 | 2.0 | 0.0 | -0.8 | -0.8 | 0.0 | 0.2 | 0.4 | 0.3 |
| Average gross wages, real (PPI based) | 1.8 | 0.9 | 3.3 | 0.4 | 1.3 | 2.0 | 2.0 | 0.7 | 1.5 |
| Average gross wages, real (CPI based) | 0.7 | 1.5 | 2.0 | 1.0 | 1.5 | 2.2 | 2.2 | 0.7 | 1.4 |
| Average gross wages, EUR (ER) | 1.1 | 0.7 | 1.8 | 2.7 | 3.4 | 4.1 | 4.0 | 2.7 | 1.9 |
| Employed persons (LFS) | 1.2 | 0.1 | -0.3 | 4.8 | 2.2 | 1.0 | 1.0 | 1.0 | 1.6 |
| GDP real per employed person, NCU | 1.6 | 2.1 | 3.4 | 0.0 | 1.8 | 1.9 | 1.8 | 1.8 | 1.8 |
| Unit labour costs, ER (EUR) adjusted | -0.4 | -1.4 | -1.5 | 2.6 | 1.5 | 2.2 | 2.1 | 0.9 | 0.2 |
| **Slovakia** | | | | | | | | | |
| GDP deflator | -0.2 | -0.2 | -0.5 | 1.2 | 2.0 | 2.7 | 2.1 | 2.0 | 0.5 |
| Real ER (CPI-based) | -0.6 | -0.3 | -0.8 | -0.3 | 0.6 | 1.3 | 0.7 | 0.4 | -0.3 |
| Real ER (PPI-based) | -1.5 | -0.7 | -2.5 | -0.5 | -0.6 | 1.0 | 0.7 | 1.4 | -1.2 |
| Average gross wages, real (PPI based) | 7.7 | 6.0 | 7.5 | 2.1 | 3.8 | 5.4 | 3.8 | 2.1 | 5.4 |
| Average gross wages, real (CPI based) | 4.2 | 3.2 | 3.8 | 3.2 | 3.6 | 5.7 | 4.2 | 3.1 | 3.6 |
| Average gross wages, EUR (ER) | 4.1 | 2.9 | 3.3 | 4.6 | 6.2 | 8.6 | 6.4 | 5.1 | 4.2 |
| Employed persons (LFS) | 1.5 | 2.6 | 2.8 | 1.5 | 1.4 | 0.9 | 0.4 | 0.0 | 2.0 |
| GDP real per employed person, NCU | 1.3 | 2.2 | -0.7 | 1.5 | 2.6 | 1.5 | 1.5 | 2.6 | 1.4 |
| Unit labour costs, ER (EUR) adjusted | 2.8 | 0.7 | 4.0 | 3.1 | 3.5 | 7.0 | 4.8 | 2.4 | 2.8 |
| **Albania** | | | | | | | | | |
| GDP deflator | 1.5 | 0.6 | -0.6 | 1.5 | 0.9 | 1.4 | 2.0 | 2.1 | 0.8 |
| Exchange rate (ER), EUR/NC | 0.2 | 0.2 | 1.7 | 2.4 | 5.1 | 3.3 | 0.8 | 0.0 | 1.9 |
| Real ER (CPI-based) | 1.3 | 2.1 | 2.7 | 2.7 | 5.3 | 3.6 | 1.5 | 0.8 | 2.8 |
| Real ER (PPI-based) | 1.6 | 0.3 | 1.7 | 2.0 | 3.9 | 1.1 | -0.5 | -1.8 | 1.9 |
| Average gross wages, real (PPI based) | 1.4 | 7.4 | 0.7 | 0.4 | 1.6 | 6.6 | 4.7 | 4.6 | 2.3 |
| Average gross wages, real (CPI based) | -0.7 | 3.2 | -2.0 | 1.0 | 1.3 | 4.6 | 3.0 | 2.0 | 0.5 |
| Average gross wages, EUR (ER) | 1.1 | 5.4 | 0.9 | 5.5 | 8.6 | 11.0 | 4.5 | 4.3 | 4.3 |
| Employed persons (LFS) | 1.3 | 4.8 | 6.5 | 3.3 | 3.0 | 3.6 | 0.4 | 0.8 | 3.8 |
| GDP real per employed person, NCU | 0.5 | -2.4 | -3.0 | 0.5 | 1.1 | -0.8 | 3.4 | 2.6 | -0.7 |
| Unit labour costs, ER (EUR) adjusted | 0.6 | 8.0 | 4.0 | 4.9 | 7.4 | 10.7 | 2.6 | 1.8 | 5.0 |

(Table 6.4 ctd.)

## Table 6.4 / ctd.

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 Forecast | 2021 | 2014-18 average |
|---|---|---|---|---|---|---|---|---|---|
| **Bosnia and Herzegovina** | | | | | | | | | |
| GDP deflator | 1.0 | 1.4 | 1.4 | 1.7 | 2.8 | 1.2 | 1.6 | 1.4 | 1.6 |
| Real ER (CPI-based) | -1.4 | -1.0 | -1.9 | -0.9 | -0.5 | -0.2 | 0.2 | -0.2 | -1.1 |
| Real ER (PPI-based) | 1.3 | 2.9 | -0.7 | 0.0 | 0.6 | 0.1 | 0.2 | 0.0 | 0.8 |
| Average gross wages, real (PPI based) | 0.4 | -0.6 | 3.1 | -1.4 | -0.4 | 2.1 | 1.5 | 1.1 | 0.2 |
| Average gross wages, real (CPI based) | 0.8 | 1.0 | 2.5 | 0.8 | 1.7 | 3.0 | 1.9 | 1.3 | 1.4 |
| Average gross wages, EUR (ER) | -0.1 | 0.0 | 0.9 | 1.6 | 3.1 | 4.8 | 2.7 | 2.7 | 1.1 |
| Employed persons (LFS) | -1.2 | 1.2 | -2.6 | 1.8 | 0.8 | 2.1 | 1.2 | 1.2 | 0.0 |
| GDP real per employed person, NCU | 2.3 | 1.8 | 5.8 | 1.3 | 2.8 | 0.4 | 1.6 | 1.3 | 2.8 |
| Unit labour costs, ER (EUR) adjusted | -2.4 | -1.8 | -4.7 | 0.3 | 0.3 | 3.8 | 1.8 | 1.4 | -1.7 |
| **Montenegro** | | | | | | | | | |
| GDP deflator | 1.0 | 2.2 | 5.1 | 3.8 | 3.2 | 1.9 | 1.1 | 1.8 | 3.1 |
| Real ER (CPI-based) | -1.2 | 1.6 | -0.6 | 0.7 | 0.7 | 0.1 | 0.4 | 0.3 | 0.2 |
| Real ER (PPI-based) | 1.9 | 2.6 | 1.3 | -2.5 | -1.2 | -0.5 | -0.3 | -0.1 | 0.4 |
| Average gross wages, real (PPI based) | -0.5 | 0.0 | 3.7 | 1.5 | -1.5 | 0.3 | 1.0 | 1.0 | 0.6 |
| Average gross wages, real (CPI based) | 0.3 | -1.3 | 3.9 | -0.5 | -2.4 | 0.3 | 0.8 | 0.6 | 0.0 |
| Average gross wages, EUR (ER) | -0.4 | 0.3 | 3.6 | 1.9 | 0.1 | 1.8 | 2.6 | 2.5 | 1.1 |
| Employed persons (LFS) | 7.1 | 2.5 | 1.1 | 2.3 | 3.5 | 3.6 | 0.8 | 0.4 | 3.3 |
| GDP real per employed person, NCU | -5.0 | 0.9 | 1.8 | 2.4 | 1.5 | -0.5 | 2.1 | 1.7 | 0.3 |
| Unit labour costs, ER (EUR) adjusted | 4.8 | -0.6 | 1.8 | -0.5 | -1.3 | 2.3 | 0.5 | 0.7 | 0.8 |
| **North Macedonia** | | | | | | | | | |
| GDP deflator | 1.4 | 2.0 | 3.5 | 3.4 | 4.3 | 1.3 | 2.5 | 2.5 | 2.9 |
| Exchange rate (ER), EUR/NC | -0.1 | 0.0 | 0.0 | 0.0 | 0.1 | 0.3 | -0.2 | 0.0 | 0.0 |
| Real ER (CPI-based) | -0.9 | -0.3 | -0.5 | -0.3 | -0.3 | 0.3 | 0.8 | 0.9 | -0.4 |
| Real ER (PPI-based) | -0.2 | -1.7 | -1.7 | 1.8 | -1.8 | 0.8 | 1.0 | 1.4 | -0.7 |
| Average gross wages, real (PPI based) | 2.9 | 6.9 | 5.3 | -2.1 | 4.8 | 1.9 | 1.5 | 1.6 | 3.5 |
| Average gross wages, real (CPI based) | 1.3 | 3.0 | 2.2 | 1.3 | 4.2 | 3.0 | 2.1 | 2.1 | 2.4 |
| Average gross wages, EUR (ER) | 0.9 | 2.7 | 2.0 | 2.7 | 5.9 | 5.3 | 3.3 | 4.8 | 2.8 |
| Employed persons (LFS) | 1.7 | 2.3 | 2.5 | 2.4 | 2.5 | 4.7 | 1.9 | 1.2 | 2.3 |
| GDP real per employed person, NCU | 1.9 | 1.5 | 0.4 | -2.1 | 0.2 | -1.4 | 1.5 | 2.1 | 0.4 |
| Unit labour costs, ER (EUR) adjusted | -1.0 | 1.2 | 1.7 | 4.9 | 5.7 | 6.2 | 2.9 | 2.4 | 2.4 |
| **Serbia** | | | | | | | | | |
| GDP deflator | 2.6 | 1.8 | 1.5 | 3.0 | 2.1 | 1.6 | 2.9 | 2.7 | 2.2 |
| Exchange rate (ER), EUR/NC | -3.6 | -2.8 | -1.9 | 1.5 | 2.6 | 0.2 | 0.0 | 0.0 | -0.9 |
| Real ER (CPI-based) | -2.0 | -1.5 | -1.2 | 2.8 | 2.7 | 0.6 | 0.8 | 1.0 | 0.1 |
| Real ER (PPI-based) | -0.5 | 0.3 | -0.5 | 0.8 | 0.6 | -0.3 | 1.0 | 1.7 | 0.1 |
| Average gross wages, real (PPI based) | -0.1 | -1.4 | 3.8 | 1.6 | 5.1 | 6.8 | 2.6 | 2.4 | 1.8 |
| Average gross wages, real (CPI based) | -0.9 | -1.8 | 2.7 | 0.9 | 3.9 | 6.5 | 3.2 | 3.1 | 0.9 |
| Average gross wages, EUR (ER) | -2.4 | -3.3 | 1.8 | 5.5 | 8.7 | 8.6 | 6.3 | 4.5 | 2.0 |
| Employed persons (LFS) | 4.8 | 0.6 | 5.6 | 2.8 | 1.4 | 4.1 | 1.0 | 1.0 | 3.0 |
| GDP real per employed person, NCU | -6.1 | 1.2 | -2.2 | -0.7 | 3.0 | -1.2 | 1.7 | 1.6 | -1.0 |
| Unit labour costs, ER (EUR) adjusted | 3.9 | -4.4 | 4.1 | 6.2 | 5.6 | 10.0 | 3.8 | 4.1 | 3.0 |
| **Kosovo** | | | | | | | | | |
| GDP deflator | 3.3 | 0.2 | 0.4 | 1.4 | 1.0 | 2.7 | 2.8 | 2.1 | 1.3 |
| Real ER (CPI-based) | -0.1 | -0.5 | 0.0 | -0.2 | -0.8 | 1.3 | 1.1 | 0.9 | -0.3 |
| Real ER (PPI-based) | 3.6 | 5.0 | 1.3 | -2.3 | -1.5 | -1.0 | -1.3 | -0.4 | 1.2 |
| Average gross wages, real (PPI based) | 6.7 | 3.0 | 1.9 | 1.1 | 4.2 | 4.7 | 6.2 | 5.1 | 3.4 |
| Average gross wages, real (CPI based) | 8.1 | 6.3 | 1.5 | 0.2 | 4.5 | 3.0 | 4.2 | 3.8 | 4.1 |
| Average gross wages, EUR (ER) | 8.6 | 5.8 | 1.8 | 1.7 | 5.7 | 5.7 | 6.8 | 6.3 | 4.7 |
| Employed persons (LFS) | -4.4 | -8.2 | 11.7 | 7.6 | -3.4 | 4.3 | 1.4 | 1.4 | 0.4 |
| GDP real per employed person, NCU | 5.9 | 13.4 | -6.9 | -3.2 | 7.4 | 0.0 | 2.4 | 2.9 | 3.1 |
| Unit labour costs, ER (EUR) adjusted | 2.5 | -6.7 | 9.3 | 5.1 | -1.6 | 5.7 | 4.3 | 3.3 | 1.6 |
| **Turkey** | | | | | | | | | |
| GDP deflator | 7.4 | 7.8 | 8.1 | 11.0 | 16.4 | 16.3 | 10.5 | 10.6 | 10.1 |
| Real ER (CPI-based) | -5.5 | 3.5 | -2.8 | -11.4 | -17.6 | 2.5 | -0.9 | -0.2 | -7.1 |
| Real ER (PPI-based) | -2.3 | 3.4 | -4.3 | -8.8 | -10.9 | 6.8 | 0.4 | 1.4 | -4.7 |
| Average gross wages, real (PPI based) | 0.2 | 5.1 | 8.5 | -6.4 | -14.2 | -4.8 | 1.1 | 1.9 | -1.7 |
| Average gross wages, real (CPI based) | 1.3 | 2.8 | 5.1 | -2.5 | -6.4 | -0.1 | 2.9 | 3.5 | 0.0 |
| Average gross wages, EUR (ER) | -3.9 | 6.3 | 2.4 | -12.1 | -21.4 | 4.0 | 4.1 | 3.9 | -6.3 |
| Employed persons (LFS) 5) | 5.4 | 2.7 | 2.2 | 3.6 | 1.9 | -2.6 | 2.5 | 2.4 | 3.2 |
| GDP real per employed person, NCU | -0.2 | 3.3 | 0.9 | 3.7 | 0.9 | 1.9 | 0.6 | 0.9 | 1.7 |
| Unit labour costs, ER (EUR) adjusted | -3.6 | 2.9 | 1.5 | -15.3 | -22.1 | 1.9 | 2.8 | 4.0 | -7.9 |

(Table 6.4 ctd.)

## Table 6.4 / ctd.

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 Forecast | 2021 | 2014-18 average |
|---|---|---|---|---|---|---|---|---|---|
| **Belarus** | | | | | | | | | |
| GDP deflator | 18.1 | 16.0 | 8.3 | 8.7 | 11.6 | 6.0 | 5.5 | 5.0 | 12.5 |
| Exchange rate (ER), EUR/NC | -10.5 | -25.8 | -19.0 | 0.8 | -9.1 | 4.4 | -4.2 | -7.7 | -13.2 |
| Real ER (CPI-based) | 5.2 | -15.8 | -9.7 | 5.1 | -6.4 | 9.1 | -0.3 | -4.6 | -4.7 |
| Real ER (PPI-based) | 2.5 | -11.1 | -8.0 | 7.5 | -5.6 | 9.5 | 0.2 | -3.7 | -3.2 |
| Average gross wages, real (PPI based) | 6.4 | -5.3 | -3.9 | 3.7 | 10.5 | 6.8 | 4.9 | 5.0 | 2.1 |
| Average gross wages, real (CPI based) | 1.3 | -2.2 | -3.7 | 7.4 | 12.5 | 7.8 | 5.9 | 6.0 | 2.9 |
| Average gross wages, EUR (ER) | 7.0 | -17.7 | -12.8 | 14.8 | 7.4 | 18.6 | 8.3 | 1.9 | -1.1 |
| Employed persons (LFS) | -0.6 | -1.2 | -2.0 | 0.8 | -0.1 | 0.5 | -0.4 | -0.4 | -0.6 |
| GDP real per employed person, NCU | 2.3 | -2.6 | -0.5 | 1.7 | 3.1 | 0.0 | 2.6 | 2.6 | 0.8 |
| Unit labour costs, ER (EUR) adjusted | 4.6 | -15.5 | -12.4 | 12.9 | 4.1 | 19.2 | 4.3 | 0.2 | -1.9 |
| **Kazakhstan** | | | | | | | | | |
| GDP deflator | 5.8 | 1.8 | 13.6 | 8.4 | 9.2 | 7.0 | 4.5 | 4.5 | 7.7 |
| Exchange rate (ER), EUR/NC | -15.1 | -3.1 | -35.1 | 2.8 | -9.4 | -5.6 | -1.4 | -2.5 | -13.1 |
| Real ER (CPI-based) | -9.9 | 3.3 | -25.8 | 8.6 | -5.8 | -2.0 | 2.1 | 0.8 | -6.7 |
| Real ER (PPI-based) | -5.4 | -21.3 | -23.1 | 15.1 | 4.7 | -0.1 | -2.2 | -3.0 | -7.1 |
| Average gross wages, real (PPI based) | 1.3 | 31.0 | -2.9 | -8.5 | -9.4 | 5.3 | 8.1 | 7.1 | 1.3 |
| Average gross wages, real (CPI based) | 3.9 | -2.3 | -1.1 | -1.8 | 1.7 | 8.0 | 4.0 | 3.0 | 0.1 |
| Average gross wages, EUR (ER) | -5.9 | 0.9 | -26.4 | 8.5 | -2.3 | 7.5 | 7.0 | 6.5 | -5.8 |
| Employed persons (LFS) | -0.7 | 1.3 | -0.8 | 0.4 | 1.3 | 1.6 | 1.0 | 1.0 | 0.3 |
| GDP real per employed person, NCU | 4.9 | -0.1 | 1.9 | 6.4 | 2.8 | 2.4 | 2.5 | 2.5 | 3.2 |
| Unit labour costs, ER (EUR) adjusted | -10.3 | 1.0 | -27.8 | 1.9 | -5.0 | 4.8 | 5.1 | 3.0 | -8.7 |
| **Moldova** | | | | | | | | | |
| GDP deflator | 6.4 | 9.6 | 5.7 | 6.3 | 3.4 | 4.3 | 4.6 | 4.6 | 6.2 |
| Exchange rate (ER), EUR/NC | -10.2 | -10.8 | -5.2 | 5.9 | 5.0 | -0.8 | -4.8 | 0.0 | -3.4 |
| Real ER (CPI-based) | -6.2 | -2.3 | 0.6 | 10.9 | 6.0 | 2.3 | -1.9 | 2.9 | 1.6 |
| Real ER (PPI-based) | -3.6 | -3.1 | 0.4 | 6.2 | 2.4 | -1.8 | -4.6 | 0.4 | 0.4 |
| Average gross wages, real (PPI based) | 5.5 | 4.4 | 5.4 | 8.2 | 12.7 | 14.3 | 7.4 | 6.6 | 7.2 |
| Average gross wages, real (CPI based) | 5.9 | 1.2 | 3.4 | 5.0 | 9.9 | 10.5 | 4.9 | 4.1 | 5.1 |
| Average gross wages, EUR (ER) | -0.1 | -1.1 | 4.3 | 18.4 | 18.8 | 16.1 | 2.7 | 7.9 | 7.7 |
| Employed persons (LFS) | 1.0 | 1.6 | 1.3 | -1.0 | 3.7 | . | 2.3 | 2.3 | 1.3 |
| GDP real per employed person, NCU | 3.9 | -1.9 | 3.0 | 5.7 | 0.3 | . | 1.5 | 1.7 | 2.2 |
| Unit labour costs, ER (EUR) adjusted | -3.9 | 0.8 | 1.3 | 12.0 | 18.4 | . | 2.9 | 6.9 | 5.4 |
| **Russia** | | | | | | | | | |
| GDP deflator | 7.3 | 7.6 | 3.2 | 5.3 | 10.2 | 6.1 | 4.0 | 4.1 | 6.7 |
| Exchange rate (ER), EUR/NC | -16.7 | -25.1 | -8.8 | 12.7 | -10.8 | -0.2 | -1.3 | -3.8 | -10.6 |
| Real ER (CPI-based) | -10.7 | -13.5 | -2.6 | 14.9 | -10.0 | 2.9 | 0.1 | -2.6 | -4.9 |
| Real ER (PPI-based) | -9.8 | -13.1 | -3.6 | 17.9 | -3.0 | 2.7 | 0.8 | -1.6 | -2.9 |
| Average gross wages, real (PPI based) | 2.5 | -7.4 | 3.5 | -0.9 | -1.8 | 1.9 | 1.9 | 3.0 | -0.9 |
| Average gross wages, real (CPI based) | 1.2 | -9.0 | 0.7 | 3.0 | 6.8 | 2.4 | 3.0 | 4.1 | 0.4 |
| Average gross wages, EUR (ER) | -9.2 | -21.3 | -1.6 | 20.3 | -2.0 | 7.1 | 4.8 | 3.0 | -3.7 |
| Employed persons (LFS) | 0.2 | -0.4 | 0.1 | -0.3 | 0.3 | -1.0 | 0.3 | 0.3 | 0.0 |
| GDP real per employed person, NCU | 0.5 | -1.9 | 0.2 | 2.0 | 2.0 | 2.1 | 1.4 | 1.6 | 0.6 |
| Unit labour costs, ER (EUR) adjusted | -9.7 | -19.7 | -1.8 | 17.9 | -3.9 | 4.6 | 3.2 | 1.3 | -4.2 |
| **Ukraine** | | | | | | | | | |
| GDP deflator | 16.0 | 38.9 | 17.1 | 22.0 | 15.5 | 8.8 | 6.7 | 5.6 | 21.6 |
| Exchange rate (ER), EUR/NC | -32.5 | -35.1 | -14.4 | -5.7 | -6.7 | 8.2 | -5.4 | -4.8 | -19.9 |
| Real ER (CPI-based) | -24.7 | -3.5 | -2.7 | 6.1 | 1.6 | 15.3 | -1.1 | -1.7 | -5.3 |
| Real ER (PPI-based) | -19.5 | -9.8 | 4.7 | 15.7 | 6.5 | 14.6 | -1.5 | -0.7 | -1.3 |
| Average gross wages, real (PPI based) | -9.5 | -11.4 | 2.5 | 8.4 | 6.3 | 9.7 | 5.1 | 4.0 | -1.1 |
| Average gross wages, real (CPI based) | -5.4 | -18.9 | 8.5 | 19.8 | 12.5 | 9.7 | 5.1 | 5.0 | 2.3 |
| Average gross wages, EUR (ER) | -28.4 | -21.8 | 5.8 | 29.2 | 18.3 | 25.0 | 5.7 | 5.4 | -2.0 |
| Employed persons (LFS) | -6.4 | -0.4 | -1.0 | -0.7 | 1.3 | 0.9 | 0.6 | 0.6 | -1.5 |
| GDP real per employed person, NCU | -0.2 | -9.4 | 3.4 | 3.3 | 2.0 | 2.4 | 2.6 | 2.5 | -0.3 |
| Unit labour costs, ER (EUR) adjusted | -28.3 | -13.7 | 2.3 | 25.2 | 14.2 | 25.2 | 2.7 | 2.3 | -2.0 |
| **Austria** | | | | | | | | | |
| GDP deflator | 2.2 | 2.3 | 1.7 | 1.1 | 1.7 | 1.9 | 1.8 | 1.8 | 1.8 |
| Real ER (CPI-based) | 1.2 | 0.9 | 0.6 | 0.4 | 0.1 | 0.2 | 0.3 | 0.2 | 0.6 |
| Real ER (PPI-based) | 0.7 | 0.7 | -0.4 | -1.1 | -0.5 | -0.1 | -0.1 | 0.2 | -0.1 |
| Average gross wages, real (PPI based) | 2.9 | 3.6 | 4.3 | -0.4 | 0.1 | 1.3 | 0.0 | 0.3 | 2.1 |
| Average gross wages, real (CPI based) | 0.1 | 1.1 | 1.5 | -0.6 | 0.5 | 1.6 | 0.1 | 0.3 | 0.5 |
| Average gross wages, EUR (ER) | 1.8 | 2.1 | 2.4 | 1.5 | 2.5 | 3.2 | 1.8 | 2.1 | 2.0 |
| Employed persons (LFS) | 0.2 | 0.9 | 1.7 | 1.0 | 1.4 | 1.4 | 0.9 | 0.9 | 1.0 |
| GDP real per employed person, NCU | 0.5 | 0.1 | 0.3 | 1.5 | 1.0 | 0.3 | 0.5 | 0.4 | 0.7 |
| Unit labour costs, ER (EUR) adjusted | 1.3 | 1.9 | 2.0 | 0.0 | 1.5 | 2.9 | 1.3 | 1.7 | 1.3 |

For country-specific notes please see the respective country table.
NC = national currency (including euro-fixed series for euro area countries - AT, EE, LT, LV, SI, SK). ER = Exchange Rate, PPI = Producer price index, CPI = Consumer price index. Positive growth of real exchange rates means real appreciation.

Sources: wiiw Annual Database incorporating national and Eurostat statistics, WIFO, wiiw estimates. Forecasts by wiiw, WIFO (for Austria).

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Wien 6, Rahlgasse 3

ZVR-Zahl: 329995655

Postanschrift: A 1060 Wien, Rahlgasse 3, Tel: [+431] 533 66 10, Telefax: [+431] 533 66 10 50
Internet Homepage: www.wiiw.ac.at



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