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Forecast Report

Labour Shortages Driving Economic Growth?

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

Labour Shortages Driving Economic Growth?

VASILY ASTROV
MARIO HOLZNER
MICHAEL LANDESMANN
ISILDA MARA
OLIVER REITER
SÁNDOR RICHTER
ROBERT STEHRER

et al. (Serkan Çiçek, Rumen Dobrinsky, Vladimir Gligorov,
Doris Hanzl-Weiss, Peter Havlik, Gábor Hunya, Sebastian Leitner, Olga Pindyuk,
Leon Podkaminer and Hermine Vidovic)

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Executive summary

The global economic environment continues to be challenging. The 'wounds' inflicted by the global financial crisis of 2008 have not yet fully healed, and world economic growth remains rather subdued. This applies particularly to the advanced countries and especially to the euro area, which is the most important trading partner of the CESEE countries. Economic growth in the euro area is projected to stay below the 2% mark in both 2016 and 2017. In addition, considerable uncertainties over the economic prospects engendered by the forthcoming Brexit persist, following the outcome of the UK referendum held on 23 June 2016.

Despite the sluggish external environment, economic growth remains fairly strong in the majority of CESEE countries; the economic dynamics in almost half of them have intensified over the current year compared to 2015. In the Western Balkans, growth goes from strength to strength and is historically speaking relatively high by the region's standards. Growth in the new EU member states from Central and Eastern Europe (EU-CEE) has declined only modestly this year, mostly on account of temporary investment weakness. It remains 1.5 pp higher on average than in the euro area, implying ongoing convergence of those countries to the EU average. In Turkey, economic dynamics were very solid up until mid-2016 – albeit accompanied by signs of 'overheating'. The CIS countries are experiencing a 'bottoming out' after being hit by multiple adverse shocks over the past two years.

The main growth driver throughout the CESEE region continues to be private consumption. It is primarily underpinned by sharply rising wages and incomes, which go hand in hand with a decrease in unemployment. The tightening of labour markets is confirmed by the increase in the number of job vacancies, which surged strongly in the first half of 2016. This is partly a consequence of sizeable outward migration over the past years, which may have had a cumulative negative effect on the labour supply in many CESEE countries, thus leading to the recent increase in the shortage of labour. Another reason for the strong wage growth in a number of countries has been the introduction of higher minimum wages, sometimes as part of a more general fiscal relaxation package.

Despite solid wage growth, inflationary pressures in most CESEE countries – with the exceptions of the CIS countries and Turkey – are almost non-existent. A number of countries have recorded consumer price deflation for quite a number of years. One reason for the low inflationary pressures has been marked gains in labour productivity, which have resulted in unit labour costs increasing far less than wages. On top of that, the growing unit labour costs have to a large extent been offset by a profit squeeze, leading to a general containment of inflationary pressures. The recent rise in the share of labour income in GDP is to be seen as a natural consequence of increasingly tight labour markets and represents a marked turnaround in comparison to the first ten years of this century.

The expansion of fixed investments, which were an important pillar of GDP growth in 2015, has largely run out of steam this year. In the EU-CEE region, the main reason for this lies in a temporary drop in EU transfers that, in previous years, used to be an important source of investments. EU funds disbursed under the previous 2007-2013 Multiannual Financial Framework (MFF) were absorbed in

2015 at the latest, whereas attracting new funds under the recently adopted 2014-2020 MFF will take time. At the same time, disregarding the 'EU transfers effect', the underlying dynamics of investments remain strong and go hand in hand with solid growth in wages and private consumption. In other countries in the CESEE region, investment performance has been mixed.

The export dynamics in many CESEE countries has been better than that of imports, resulting in a positive contribution of net exports to GDP growth. In most EU-CEE countries and Serbia, this is largely a reflection of their ever-strengthening export base and further gains in competitiveness. However, in the CIS countries it is entirely due to the weakness of domestic demand which is still depressed following strong currency depreciations over the past two years.

Credit expansion in the CESEE region remains rather modest: no country, with the possible exception of Slovakia, is currently experiencing a credit boom. Other factors tend to be more important determinants of the demand for loans rather than interest rates, which in many CESEE countries are rather low. By and large, private agents tend to finance their consumption and investments from other sources rather than by taking out loans. Going forward, this reduces the risk of 'boom-and-bust' developments that have characterised the trajectories of a number of CESEE countries in the run-up to and during the global financial crisis.

Domestic demand in many CESEE economies is supported by fiscal policy relaxation, particularly in Romania and Ukraine. One reason for this may have been a decline in government borrowing costs, which in nearly all EU-CEE countries are now below the growth rates of their nominal GDP. Besides, the general disenchantment with the practical results of 'expansionary austerity' pursued in the past has played a role as well. At the same time, in most Western Balkan countries and in the CIS, the fiscal stance tends to be either neutral or restrictive – and in the case of the CIS countries it is essentially pro-cyclical.

In the EU-CEE region, the virtuous circle of rising consumption and incomes is set to continue at least in the near term, accompanied by solid GDP growth to the tune of some 3% p.a. Inflationary pressures will strengthen somewhat, but will stay reasonably low, while balance-of-payments constraints are unlikely to become binding any time soon – with the possible exception of Romania. Ongoing labour market improvements and rising wages will continue to be the main growth driver throughout the region; they will be complemented by a surge in fixed investments as new EU funds become available. It is somewhat ironic that economic growth in the EU-CEE countries is driven primarily by 'labour shortages' which appear to be the main factor behind the growth of wages and private consumption throughout the region.

In the Western Balkan countries, growth is projected to pick up further, to around 3%, largely thanks to fixed investments gaining momentum. However, their weak external position may become a drag on longer-term growth prospects. The strengthening of their export capacities hinges on increased inflows of FDI and the prospects of joining the EU, which have hardly improved in recent times. **The economies of Russia and other CIS countries (except Belarus) are expected to bottom out**, as the negative shocks of the past two years have already been largely absorbed. None the less, the long-term prospects for Russia look rather bleak: reduced cooperation with the West will impose limits on the urgently needed modernisation and diversification of its economy. In Ukraine, even short-term economic stability hinges on continued cooperation with the IMF and the 'semi-frozen' status of the conflict in the

Donbass region. Finally, **Turkey is heading for a 'soft landing',** with growth projected to slow down to less than 3% on account of increased political uncertainties, which are progressively weighing on domestic demand. In addition, the country is facing realistic prospects of a fully-fledged balance-of-payments crisis.

The impact of the forthcoming Brexit on CESEE economies should be contained by those countries' relatively low trade exposure to the UK economy. In the EU-CEE region, only some 1.6% of GDP is accounted for by final demand from the UK, and this share is even lower in other CESEE countries. A slowdown of growth in the UK by 1 pp would dampen growth in the CESEE region by a mere 0.05 pp on average; however, the impact may be stronger if the free trade arrangement between the UK and the EU is revoked in the wake of Brexit.

At the same time, **the EU-CEE region potentially faces the prospects of much lower EU transfers** once the UK – the second largest net contributor country to the EU budget after Germany – leaves the bloc. However, any ensuing losses for the EU-CEE countries are not expected before 2019 at the earliest and will depend on the extent of the reduction in UK contributions following Brexit. In the 'worst case scenario', they may amount up to 20% annually.

Finally, **the forthcoming Brexit should reduce migration flows from the EU-CEE region to the UK**, possibly by nearly half compared to the past two years. Even without any changes to the migration regime, the UK will become less of a magnet for migrants as its economic growth slows down, other migrant destinations become more attractive and the one-off effect of expiry of transitional restrictions on access to the UK labour market for Bulgarians and Romanians in 2014 gradually dies out. In response to migration restrictions, migration from the EU-CEE to the UK might in part take on more of a 'circular' form, with migrants staying for short spells conditional on the duration of their visas.

COUNTRY SUMMARIES

ALBANIA

Buoyant household consumption and private investment have had a positive impact on the acceleration of GDP growth, whereas sluggish external demand for Albanian products partly attributable to shrinkage in oil and mineral exports has had the opposite effect. Fiscal consolidation has for the most part been backed by containment of expenditures and a rise in revenues. Based on expectations of vigorous domestic demand, we have revised our forecast upwards slightly to 3.0%, 3.3% and 3.6% for 2016, 2017 and 2018, respectively.

BELARUS

The recession in Belarus has continued for the second year running. GDP dropped by 2.5% in the first half of 2016. Balance of payments constraints have compelled Belarus to pursue macroeconomic austerity policies, which dampened economic activity. The country's problems have been compounded by a dispute with Russia over gas prices. GDP growth in 2016 as a whole will be negative and the recession will most likely continue into 2017.

BOSNIA AND HERZEGOVINA

With politics as usual, economic developments cannot take all that radical a turnaround for better or for worse. Growth should thus be around 3% over the medium term, in tandem with a gradual structural shift towards greater industrial production and exports activities.

BULGARIA

GDP grew by 3.5% in the first half of 2016, at the same rate as in the previous year. Growth remained relatively balanced, with both private consumption and exports lending impetus. The continuing upturn contributed to a cyclical improvement in the fiscal position and a large headline surplus. Moderate GDP growth is likely to continue in the short term; it is projected to be around 3% per annum over the period 2016-2018.

CROATIA

Croatia's economy continues on its path of recovery, with GDP up by an estimated 2.5% in 2016. Growth is backed by a rise in domestic demand, both household consumption and investments. Investments fuelled by EU-funding and continued private consumption recovery should help to stimulate more robust GDP growth over the biennium 2017-2018. Fiscal consolidation coupled with high public debt will remain the main challenges to sustainable growth.

CZECH REPUBLIC

Solid external balances and low levels of indebtedness in both the private and public sectors will support moderate growth of above 2% over the period 2016-2018. Some uncertainties persist, however, as to the future course of fiscal policy and the impact of the expected strengthening of the domestic currency.

ESTONIA

Household consumption, backed by a rapid rise in minimum and overall real wages, continues to be the strongest driver of economic activity in Estonia. For the two years ahead we expect a recovery in terms of trade with Western markets, while the decline in exports to Russia has already steadied. Moreover, an upswing in public investments should also speed up economic activity next year. GDP growth is projected to increase from 1.6% in 2016 to 2.2% in 2017.

HUNGARY

Economic growth is expected to slow down to 2% in 2016 on account of a major decline in investments. Household consumption and net exports will contribute positively to growth. Economic growth is expected to accelerate in 2017 thanks to a turnaround in investment, with many more EU transfers being disbursed than in the current year. Parliamentary elections are scheduled for spring 2018. A substantial fiscal stimulus to growth is a likely scenario for the election year.

KAZAKHSTAN

The Kazakh economy has been anaemic throughout 2016 primarily on account of poor performance in the oil sector. Oil production and exports are expected to increase following the launch of the Kashagan oil field at the end of 2016. GDP growth will accelerate from 0.4% in 2016 to 2% in 2017, rising further to 3% in 2018. Household consumption will fall by 1% in real terms in the course of the current year, yet recover in the two years thereafter. That notwithstanding, household consumption will still lag behind investment: the main growth factor in the short term.

KOSOVO

The main reason for revising Kosovo's GDP growth prospects downwards for the years ahead lies in the failure of a major foreign investment project in the winter tourism industry that accounted for some 7% of the country's GDP. Growth of less than 3% is expected for 2016, largely driven by household consumption.

LATVIA

We have slightly reduced our GDP growth forecast for Latvia for 2016: down to 2.4%. Private investment activity has become increasingly sluggish, whereas the current year's major cuts in public capital expenditure by a third were not unexpected. It proved possible to offset by and large the slump in Russian demand by securing growth via exports to the EU and Asian markets. Household consumption has developed at a smart pace, while the rapidly rising real wages will continue to buoy the spendthrift mood among consumers. In both 2017 and 2018 we expect an upswing in GDP growth to 2.6% and 2.9%, respectively, the main driver being stronger external demand and greater investment activity in both the public and private sectors.

LITHUANIA

Throughout 2016 economic growth in Lithuania has continued to be dampened by the slump in external demand both from the CIS economies and for oil products. Moreover, public investment has reached its nadir before fresh funds from the EU bring about an upswing in 2017. That notwithstanding, stable growth in terms of employment and rapid wage increases has resulted in consumer demand developing at a swift pace. For 2016, we forecast a moderate GDP growth rate of 2.3%, followed by an upswing to 2.6% and 3% in 2017 and 2018, respectively.

MACEDONIA

At present, the economy is not suffering from a misaligned exchange rate or financial problems. Thus, once the political crisis has been resolved, the country should return to growth rates of around or above 3% in the medium term.

MONTENEGRO

With political risks influencing investment decisions in both the private and public sectors, GDP growth may well prove disappointing in the current year. Assuming, however, that the political uncertainty finally gets resolved, medium-term growth should rise to somewhere around 3% and possibly slightly above.

POLAND

The current moderate and broad-based growth will continue throughout the biennium 2017-2018, with the GDP growth rate averaging 3.4%. The current evolution of the political system may well prove harmful – in purely economic terms as well. 2017 will prove a critical year for fiscal policy as the increase in social expenditures may call for higher taxation.

ROMANIA

Economic growth is projected to accelerate exceptionally to 4.7% in 2016. Private consumption has received a pro-cyclical boost in the form of tax cuts and wage increases, while fixed investments have also continued to grow. With every expectation of inflation climbing to positive levels and wage increases losing momentum, the consumption boom will settle down in 2017. An economic growth of 3.5% is expected for 2017 and 3.7% for 2018, thus helping the country to retain its relative robustness by international standards.

RUSSIA

The renewed plunge in oil prices at the beginning of 2016 has resulted in lower export and budget revenues, prompting a delay in stabilising the economy. Only since mid-2016 has the Russian economy seemingly begun to emerge slowly from recession. With oil prices more or less flat, financial and trade sanctions remaining in place and structural and institutional reforms absent, economic growth will stay sluggish – at less than 2% – even in the medium term.

SERBIA

Macroeconomic balances are improving in terms of both the current account and fiscal deficits, while the rate of unemployment is dropping. The growth rate will pick up speed, attaining a level of 3% in the medium term. Prospects of the current government remaining in office for a full term are good.

SLOVAKIA

An unexpectedly high GDP growth of 3.6% in the first half of 2016 has resulted in Slovakia being one of the most rapidly growing countries in the region. While investments will drop in the course of the current year, growth has been backed by household consumption and net exports. For the years ahead, new capacities in the automotive industry will lend a fresh impetus to growth.

SLOVENIA

In 2016 external demand has been the key driver of Slovenia's GDP growth; it is expected to reach 2.4%. GDP growth will gain momentum throughout the forecast period given the openings offered by the new cycle of EU-funded investments. Exports and the gradual recovery of household consumption on account of better labour market conditions will remain the main drivers of growth.

TURKEY

Although economic growth was firm in the first half of 2016, driven by an increase in private consumption and government spending, expectations have somewhat waned recently owing to rising vulnerabilities. Despite the government's measures to boost private consumption, we expect a GDP growth rate of 3.3% for the current year, before it slows down to 3% and 2.7% for 2017 and 2018, respectively.

UKRAINE

Ukraine's economy continues to recover, driven by marked growth in both investments and, to a lesser extent, private consumption. Two other factors, rapid disinflation on the back of exchange rate stabilisation and an easing of fiscal policy, have also proven growth-supportive. Nonetheless, ongoing cooperation with the IMF is still crucially important for maintaining short-term stability. Barring adverse shocks, GDP is expected to pick up by 0.8% in the course of the current year, followed by gradual acceleration to around 2% per annum in 2017-2018.

Keywords: CESEE, economic forecast, Europe, Central and East Europe, Southeast Europe, Western Balkans, new EU Member States, CIS, Russia, Ukraine, Kazakhstan, Turkey, growth divergence, external risks, macroeconomic imbalances, consumption-led growth, unemployment, inflation, competitiveness, public debt, private debt, current account

JEL classification: C33, C50, E20, E29, F34, G01, G18, O52, O57, P24, P27, P33, P52

Table 1 / OVERVIEW 2014-2015 AND OUTLOOK 2016-2018

	GDP real change in % against prev. year					Consumer prices change in % against prev. year					Unemployment (LFS) rate in %, annual average					Current account in % of GDP				
			Forecast					Forecast					Forecast					Forecast		
	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018
EU-CEE																				
Bulgaria	1.3	3.6	3.0	3.0	3.1	-1.6	-1.1	0.0	0.5	1.0	11.4	9.2	8.5	8.0	7.5	0.1	0.4	2.1	2.1	2.0
Croatia	-0.4	1.6	2.5	2.7	2.8	0.2	-0.3	-0.5	1.0	1.0	17.3	16.3	14.5	14.0	13.0	2.1	5.1	3.8	1.9	1.5
Czech Republic	2.7	4.5	2.2	2.4	2.6	0.4	0.3	0.7	1.3	1.8	6.1	5.1	4.1	3.9	3.8	0.2	0.9	1.2	0.9	0.6
Estonia	2.8	1.4	1.6	2.2	2.3	0.5	0.1	0.4	1.5	2.5	7.4	6.2	6.5	6.7	7.0	0.9	2.2	-0.2	-1.9	-3.6
Hungary	4.0	3.1	2.0	2.6	2.9	0.0	0.1	0.4	2.0	2.5	7.7	6.8	5.5	5.5	5.5	2.1	3.4	4.4	4.1	4.0
Latvia	2.1	2.7	2.4	2.6	2.9	0.7	0.2	0.0	1.8	2.1	10.8	9.9	9.8	9.2	8.8	-2.0	-0.8	-0.4	-1.9	-2.2
Lithuania	3.5	1.8	2.3	2.6	3.0	0.2	-0.7	0.6	2.1	2.3	10.7	9.1	8.0	7.5	7.0	3.6	-2.3	-2.2	-2.8	-2.9
Poland	3.3	3.6	3.2	3.5	3.3	0.1	-0.7	-0.6	1.3	1.8	9.0	7.5	6.3	6.0	6.0	-2.1	-0.6	-0.3	-0.6	-1.0
Romania	3.0	3.8	4.7	3.5	3.8	1.4	-0.4	-0.7	2.0	2.5	6.8	6.8	6.2	6.0	6.0	-0.7	-1.2	-4.0	-5.0	-5.0
Slovakia	2.5	3.6	3.2	3.1	3.4	-0.1	-0.3	-0.5	1.2	1.8	13.2	11.5	9.8	9.5	9.0	0.1	-1.3	-1.0	-1.6	-1.1
Slovenia	3.1	2.3	2.4	2.6	2.9	0.4	-0.8	-0.5	1.0	1.0	9.7	9.0	8.5	8.0	7.5	6.2	5.2	7.0	6.0	5.0
EU-CEE [1)2)]	*2.9*	*3.5*	*3.1*	*3.1*	*3.2*	*0.3*	*-0.4*	*-0.2*	*1.5*	*1.9*	*9.0*	*7.8*	*6.8*	*6.5*	*6.4*	*-0.2*	*0.3*	*0.2*	*-0.3*	*-0.6*
EA-19	*1.1*	*2.0*	*1.6*	*1.8*	.	*0.4*	*0.0*	*0.2*	*1.4*	.	*11.6*	*10.9*	*10.3*	*9.9*	.	*3.0*	*3.6*	*3.7*	*3.6*	.
EU-28	*1.5*	*2.2*	*1.8*	*1.9*	.	*0.5*	*0.0*	*0.3*	*1.5*	.	*10.2*	*9.4*	*8.9*	*8.5*	.	*1.6*	*2.0*	*2.2*	*2.1*	.
Western Balkans																				
Albania	1.8	2.8	3.0	3.3	3.6	1.6	1.9	2.0	2.3	2.8	17.5	17.1	15.5	15.3	15.0	-12.9	-10.8	-11.8	-10.3	-9.3
Bosnia and Herzegovina	1.1	3.1	3.1	3.3	3.5	-0.9	-1.0	0.0	1.0	1.5	27.5	27.7	25.4	25.0	25.0	-7.4	-5.7	-6.0	-7.0	-7.0
Kosovo	1.2	4.0	2.6	3.0	3.2	0.4	-0.5	0.1	1.0	2.0	35.3	32.9	33.0	33.0	32.0	-7.8	-9.1	-12.9	-12.8	-12.7
Macedonia	3.6	3.8	2.5	3.1	3.3	-0.3	-0.3	0.5	1.0	1.5	28.0	26.1	24.0	24.0	23.0	-0.8	-1.4	-4.0	-4.0	-4.0
Montenegro	1.8	3.4	2.7	3.1	2.9	-0.5	1.4	0.5	1.5	2.0	18.0	17.6	17.5	17.0	16.5	-15.2	-13.3	-15.0	-15.0	-14.4
Serbia	-1.8	0.8	2.2	2.5	2.5	2.9	1.9	1.5	2.0	2.0	18.9	17.7	15.0	15.0	14.0	-6.0	-4.7	-4.0	-5.0	-5.0
WB [1)2)]	*0.3*	*2.2*	*2.6*	*2.9*	*3.0*	*1.3*	*0.9*	*1.0*	*1.6*	*2.0*	*22.4*	*21.2*	*19.1*	*19.0*	*18.3*	*-7.1*	*-6.1*	*-6.8*	*-6.8*	*-6.7*
Turkey	3.0	4.0	3.3	3.0	2.7	8.9	7.7	7.8	7.6	7.1	9.9	10.3	10.4	10.3	10.2	-5.5	-4.5	-5.5	-5.0	-5.0
Belarus [3)]	1.7	-3.9	-2.8	-0.9	1.6	18.1	13.5	12.0	11.0	10.0	0.5	1.0	1.1	1.1	1.1	-6.9	-3.8	-2.3	-1.8	-1.2
Kazakhstan	4.2	1.2	0.4	2.0	3.0	6.7	6.6	14.0	7.0	6.0	5.0	5.0	5.2	5.0	5.0	2.7	-3.0	-3.5	-2.7	-2.4
Russia [4)]	0.7	-3.7	-0.8	0.8	1.8	7.8	15.5	7.5	6.0	6.0	5.2	5.6	5.5	5.3	5.2	2.8	5.2	1.6	1.2	1.3
Ukraine [5)]	-6.6	-9.9	0.8	1.9	2.4	12.1	48.7	14.5	8.9	6.0	9.3	9.1	9.4	9.2	9.0	-3.4	-0.2	-1.8	-1.7	-2.2

Note: LFS: Labour Force Survey. EU-CEE: European Union - Central and Eastern Europe. EA: Euro area. WB: Western Balkans.
1) wiiw estimates. - 2) Current account data include transactions within the region (sum over individual countries). - 3) Unemployment rate by registration. - 4) Including Crimea. - 5) Excluding Crimea and parts of Donbas.

Source: wiiw, Eurostat. Forecasts by wiiw (Nov. 2016) and European Commission for EU and Euro area (Spring Report, May 2016).

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TABLES AND FIGURES

The statistical data until 2015 presented in this Report are as of 14 October 2016, forecasts as of November 2016. Most data are taken from the wiiw Databases. Direct access is available at: http://data.wiiw.ac.at/.

ABBREVIATIONS

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

EU-CEE	European Union – Central and Eastern Europe: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia
CIS-3	Belarus, Kazakhstan, Russia
WB	Western Balkans: Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, Serbia

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

bbl	barrel
BPM5	Balance of Payments Manual Fifth Edition
BPM6	Balance of Payments and International Investment Position Manual Sixth Edition
BOP	balance of payments
CESEE	Central, East and Southeast Europe
CIS	Commonwealth of Independent States
CIS-STAT	Interstate Statistical Committee of the Commonwealth of Independent States
CPI	consumer price index
EA-19	euro area 19 countries
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
EFSI	European Fund for Strategic Investments
EIB	European Investment Bank
ER	exchange rate
ESA'95	European system of national and regional accounts, ESA 1995
ESA 2010	European system of accounts, ESA 2010
EU-28	European Union 28 countries
EU-15	15 original members of the European Union
ESIF	European Structural and Investment Funds
FDI	Foreign Direct Investment
FISIM	Financial Intermediation Services, Indirectly Measured
GFCF	gross fixed capital formation
GDP	Gross Domestic Product
GNI	Gross National Income
ICP	International Comparison Program
IMF	International Monetary Fund
LFS	Labour Force Survey
MFF	Multiannual Financial Framework
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
OECD	Organisation for Economic Co-operation and Development
OPEC	Organisation of the Petroleum Exporting Countries
pp	percentage points
PPI	producer price index
PPP	Purchasing Power Parity
SME	small and medium-sized enterprise
SNA	System of National Accounts
SPE	Special Purpose Entity
VAT	value added tax
WB	Western Balkans
WIFO	Austrian Institute of Economic Research
wiiw	The Vienna Institute for International Economic Studies

.	not available (in tables)
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

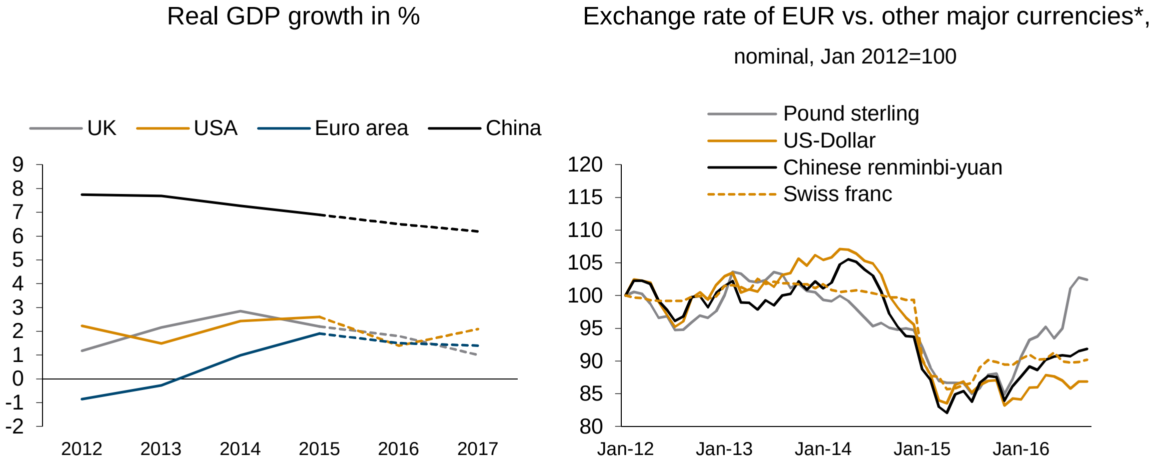
Labour shortages driving economic growth?

BY VASILY ASTROV*

WEAK GLOBAL DEMAND AND UNCERTAINTIES OVER BREXIT

The global economic environment continues to be challenging. The 'wounds' inflicted by the global crisis of 2008 have not yet fully healed. In some cases – most notably in the euro area – they have been aggravated by sub-optimal policy responses. As a result, world economic growth remains rather subdued. For 2016, global GDP is expected to pick up by 2.9%, with only minor acceleration to 3.2% expected for next year.[1] Investments in the United States (US) have surprised on the downside, and US economic growth is projected to fall slightly below the growth expected in the euro area for the current year – for the first time since 2008; however, it should pick up in 2017 (see left-hand panel in Figure 1). In China, the high level of economic dynamics observed in the past has also continued to lose momentum as the country's economy continues its rebalancing from exports to domestic demand and from industry to services. Given the country's surplus capacities, fixed investments in China have declined.

Figure 1 / International GDP growth and exchange rates



Note: *) Declining line indicates EUR depreciation.
Source: OECD (2016), Interim Economic Outlook, September. Eurostat, wiiw calculations.

In the advanced countries, the main policy response to the economic crisis was a marked relaxation of monetary policy. Although the large-scale quantitative easing programme implemented in the US has meanwhile been phased out, to date the US Fed has refrained from increasing its policy

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1 OECD, 'Global growth warning: weak trade, financial distortions', Interim Economic Assessment, 21 September 2016.

rate; it remains at an historically low range – 0.25-0.5%. In the euro area, monetary policy has since become more accommodative than in the US. The European Central Bank (ECB) has set the refinancing rate at 0% and the deposit rate at -0.4%, while a quantitative easing programme (whereby the ECB purchases government bonds worth EUR 80 billion each month) will remain in place at least until the end of March 2017. However, the success of this extremely lax monetary policy in the euro area is generally seen as modest. Even though it has helped to lower the euro exchange rate and heighten the competitiveness of European goods (see right-hand panel in Figure 1), bank lending has expanded only sluggishly – especially on the 'periphery' of the euro area where the volume of non-performing loans is still high. Economic growth in the euro area is projected to stay below the 2% mark in both 2016 and 2017.

There has been growing consensus among economists that **easy monetary policy alone will not suffice to bring about higher growth for the economies in the advanced countries**: a view that both the OECD and the IMF share in the meantime**.** Higher growth would require a more accommodative fiscal policy, particularly in the euro area and, more particularly, in those euro area member states which enjoy budget and current account surpluses and very low (often negative) interest on government debt – with Germany heading the list.[2]

Concerns over global growth prospects are also fuelled by uncertainties engendered by the forthcoming Brexit, following the outcome of the referendum held on 23 June 2016. Although the United Kingdom (UK) will not leave the European Union (EU) before 2019, certain consequences of the Brexit vote are already making themselves felt. Pound sterling has fallen against other major currencies (including the euro – see right-hand panel in Figure 1), while misgivings over increased uncertainties have prompted the Bank of England to cut the policy rate to 0.25%. Perhaps thanks to those two factors, the much feared adverse impact of the Brexit vote on the economic dynamics in the UK has so far failed to materialize, although in the year to come the country's GDP growth is projected to slow down markedly – to a mere 1%.[3]

The longer-term prospects for a new institutional relationship between the UK and the EU are clouded. Unless a free-trade agreement between the two sides is reached, the mutual trade arrangement will shift to a default option: a 'most-favoured-nation' WTO regime; this implies the erection of massive trade barriers, including the levying of customs duties. This would have an impact on UK trade not only with the rest of the EU, including new EU member states in Central and Eastern Europe (EU-CEE), but also other countries in Central, Eastern and Southeast Europe (CESEE) that have free-trade arrangements with the EU: the Western Balkans, Turkey and Ukraine. Further, the probable changes in the EU budget due to Brexit (the UK is one of its principal net contributors) might bear repercussions for the EU-CEE countries, which are major recipients of EU transfers. Finally, the UK is hosting – and still attracting – a large number of migrants from the EU-CEE countries, who so far have enjoyed unrestricted access to the UK labour market and whose status may well be jeopardised following Brexit. Even though it is rather unlikely that EU-CEE citizens already resident in the UK will be required to leave, there is little doubt that newcomers seeking entry into the UK will find things more difficult. In all likelihood, they will lose automatic access to the UK labour market and will have to compete on an equal footing with nationals from third countries. The most important factors of the

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2 According to OECD (op. cit.), 35% of the sovereign debt of its member states is now trading at negative yields.

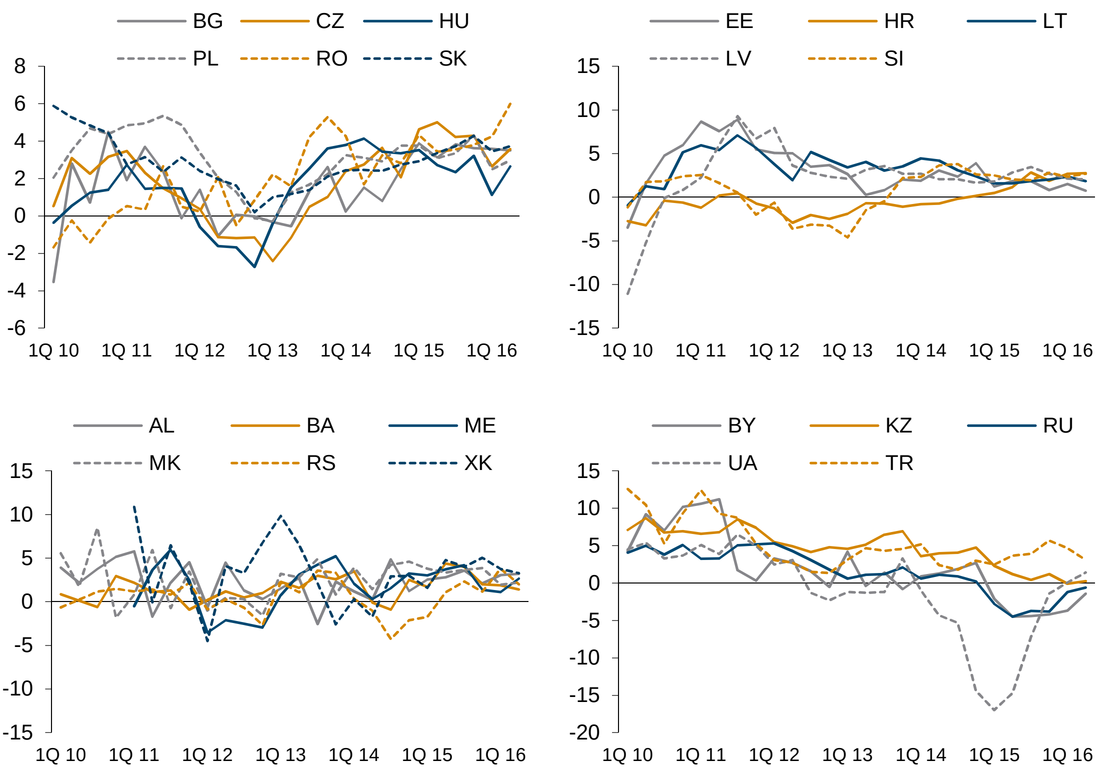
3 Ibid.

forthcoming Brexit and their impact on the economies of the CESEE countries are covered in Special Sections in this report.

SOLID GROWTH THROUGHOUT THE CESEE REGION – EXCEPT IN THE CIS

Despite the sluggish external environment, economic growth remains fairly strong in the majority of CESEE countries (Figure 2). Almost half of the countries in the region – Albania, Belarus, Croatia, Estonia, Lithuania, Romania, Russia, Serbia, Slovenia and Ukraine – are showing better economic dynamics in the current year compared to 2015. In most of the remaining CESEE countries, GDP growth is expected to stay at roughly the same level as in the previous year or decline only insignificantly.

Figure 2 / Quarterly real GDP growth of the CESEE countries, change in % against preceding year



Source: National and Eurostat statistics.

Growth in the EU-CEE region has declined only modestly this year, dropping to an estimated 3.1% on average from 3.5% in 2015 and 2.9% in 2014. This decline is mostly due to: (i) the marked deceleration in growth in the Czech Republic (by more than 2 pp year on year); and (ii) the more moderate slowdowns in Hungary and Poland. However, in the Czech Republic the deceleration has emerged against a backdrop of exceptionally high growth recorded the previous year: 4.5%. In a manner of speaking, it represents a ‘return to normality’, given the high level of development that the country had already achieved. At the same time, the pace of GDP expansion has picked up markedly in Croatia, Lithuania and Romania. With an estimated GDP growth rate of 4.7% in the current year, Romania is currently the ‘star performer’ in the EU-CEE region – primarily on account of the fiscal stimulus that the country has put into effect.

Economic dynamics in the EU-CEE region look all the more impressive given the sharp drop in EU transfers, which weighs heavily on investment activities in the recipient countries. In general, the region continues to perform better than the euro area, with an estimated growth differential of 1.5 pp this year. This differential is substantial, although it may not come as a surprise given the EU-CEE countries’ still sizeable convergence potential. The main reason for this higher growth is the strong consumer demand in the EU-CEE region, which is generally more vibrant than in most euro area countries. In general, unemployment is receding, wages are rising and in many instances fiscal policy has become less restrictive. Public finances and the financial sector of the EU-CEE countries are generally in better shape than in the euro area (especially, in those countries on the southern ‘periphery’ of the euro area). The tourist industry, an important sector in the countries on the southern fringes of the EU-CEE region, such as Bulgaria and Croatia, has benefited from the current instability in Turkey and the Middle East, while a good harvest has boosted agricultural output in Hungary and Romania.

In the Western Balkans, growth goes from strength to strength; in the current year, it has risen to an estimated 2.6% on average (from 2.2% in 2015 and a mere 0.3% in 2014). Historically speaking, and given the well-known long-standing ‘structural’ constraints, this pace is relatively high by the region’s standards. Labour markets in the Western Balkan countries have improved recently and unemployment rates have declined somewhat – albeit starting from extraordinarily high levels. Besides, in both Albania and Montenegro the tourist season has also been very good throughout the current year. The improved growth dynamics across the region as a whole owe much to the ongoing recovery in Serbia, whose economy has benefited from improved price and exchange rate stability, as well as the strengthening of export capacities, especially in the automotive industry. Only in Macedonia and Kosovo, is a marked slowdown in growth expected for the current year (by more than 1 pp), in both countries driven by investment weaknesses (in Kosovo on account of a failed investment project).

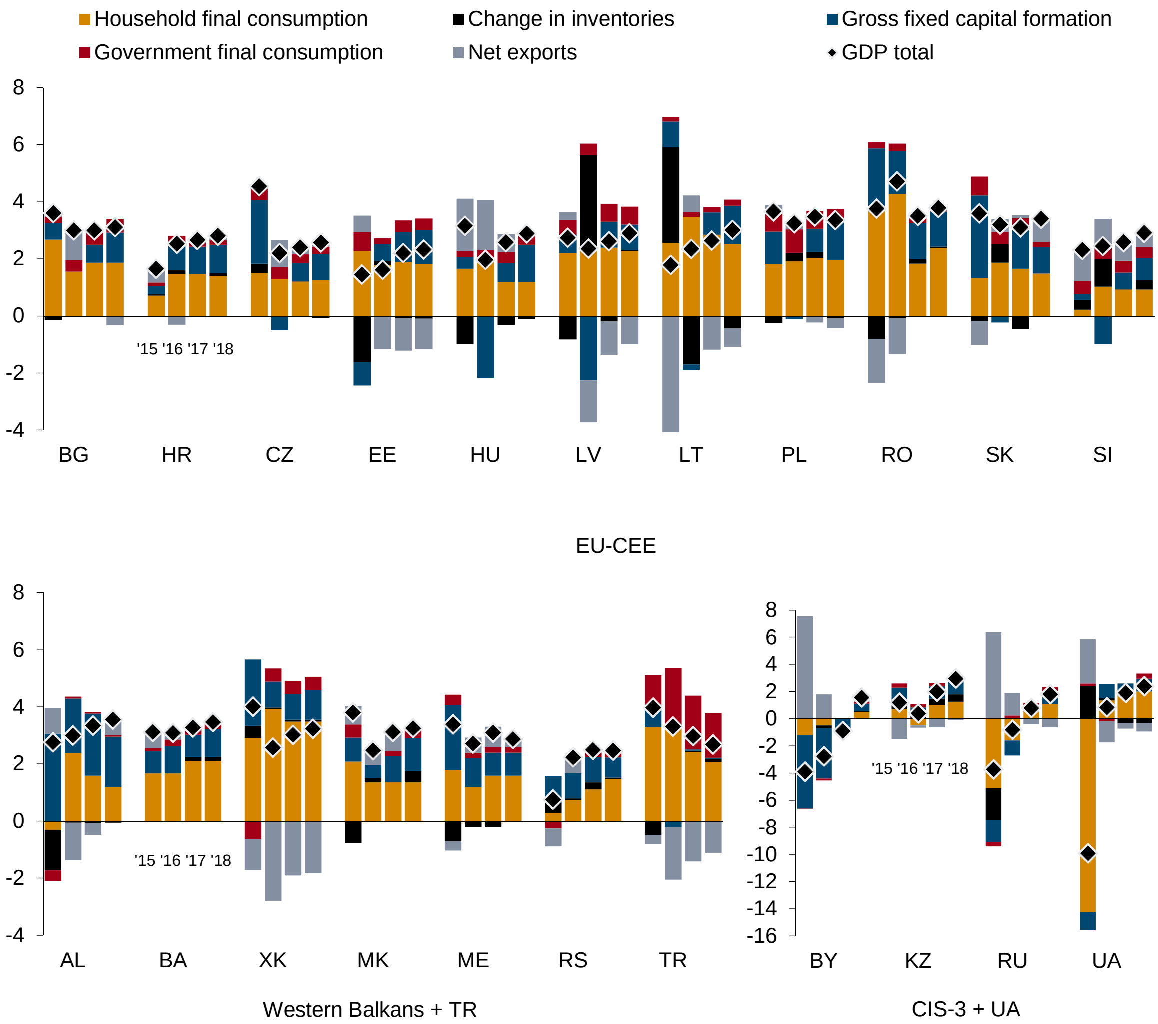
In Turkey, the country’s economic dynamics were very solid up until mid-2016: close to 4% – albeit accompanied by signs of ‘overheating’ such as relatively high inflation and sizeable external deficits. The economic boom in Turkey appears all the more remarkable as the country’s exports have been affected by the instability in the Middle East and the dip in relations with Russia. However, since mid-2016, the uncertainties that arose in the wake of the recent failed coup are imposing an increasingly heavy burden on the Turkish economy.

The CIS countries are displaying growing signs of a ‘bottoming out’ after having been hit by multiple shocks, such as low commodity prices, currency devaluations, war, sanctions and the related disruptions in mutual trade and investments over the past two years. The shocks listed above have since been largely absorbed, whereas the exchange rate stabilisation (achieved partly via the imposition of capital controls, viz. Ukraine) has bolstered disinflation and the stabilisation of domestic demand. In Russia, the estimated recession in the current year (-0.8%) will be far less deep than in 2015, while the economy in Ukraine will grow for the first time since 2012. Growth in Kazakhstan, on the other hand, is projected to decline to near-zero levels – although it will still stay in positive territory thanks to the fiscal stimulus that the country has put into effect. In Belarus, recession continues almost unabated – owing to the combined impact of weaker exports to neighbouring Russia and the restrictive fiscal and monetary policies that the country is pursuing.

PRIVATE CONSUMPTION: THE MAIN ENGINE OF GROWTH

Private consumption has continued to be the main driver of growth in most of the CESEE countries throughout the current year (Figure 3). In many instances, the contribution of private consumption has increased and is highly positive in almost all CESEE countries – with the exception of the CIS (in Ukraine, it is marginally positive).

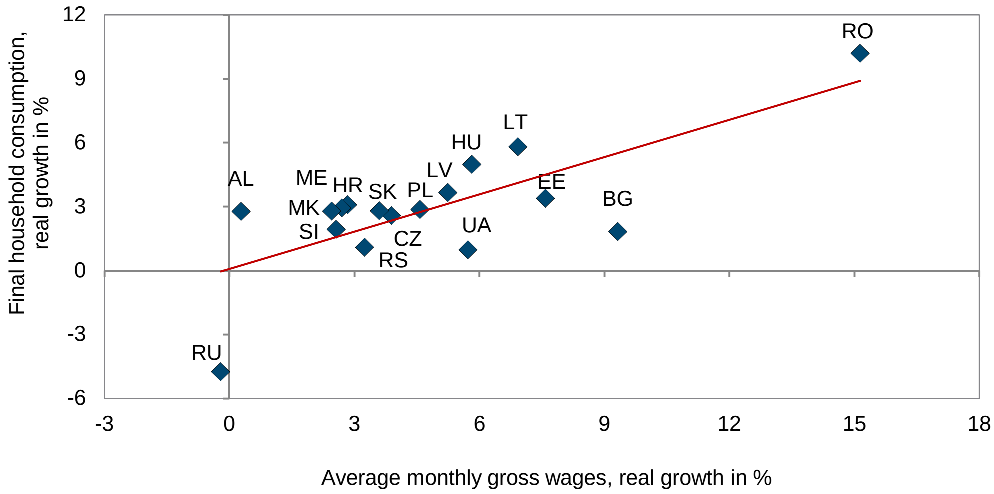
Figure 3 / GDP growth in 2015-2018 and contribution of individual demand components in percentage points



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

The growth of private consumption is primarily underpinned by sharply rising nominal wages and household incomes in general (Figure 4). Consumer loans only play a role in certain countries, while remittances – a traditionally important pillar of consumer demand, especially in the Western Balkans – have either stagnated or even declined. The extremely low inflation (even deflation in some cases) observed in most CESEE economies is certainly strengthening the purchasing power of households. However, low inflation cannot explain the high growth to be observed in nominal wages: generally to the tune of 4-6%. Sudden disinflation usually comes as a welcome surprise for households whose nominal wages may have been negotiated at a time when inflation was still high. However, low or negative inflation in the CESEE region has been around for a few years; present inflationary expectations must be accordingly low.

Figure 4 / Household final consumption and average monthly gross wages, real change in % against preceding year, first half of 2016

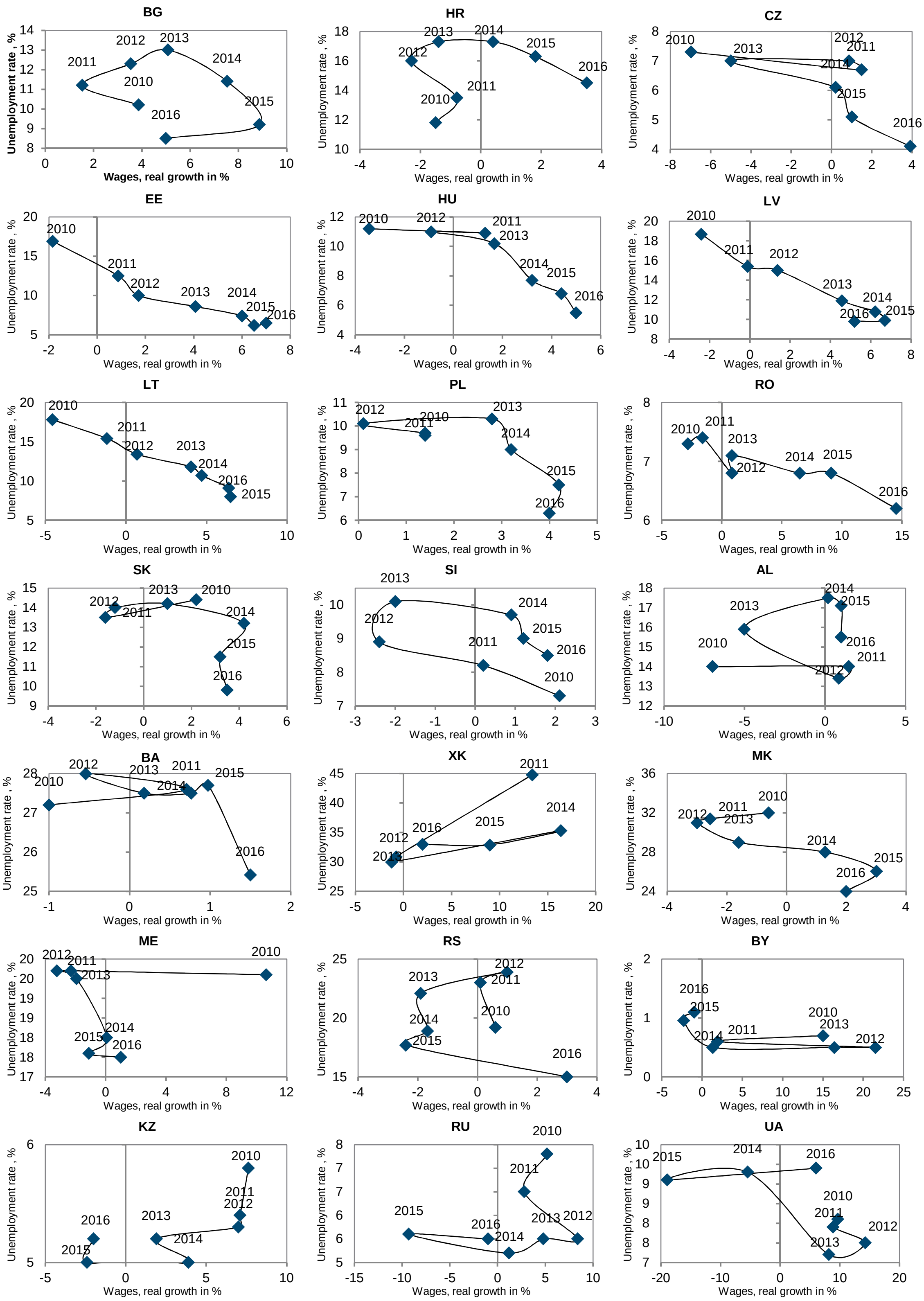


Source: wiiw Database incorporating national and Eurostat statistics, wiiw.

The growth in nominal wages in most of the CESEE countries goes hand in hand with a decrease in unemployment – although causality between the two phenomena is not necessarily obvious and may well go in either direction. On the one hand, as unemployment rates recede (in some countries drastically), one would expect the bargaining power to shift in favour of wage earners, resulting in generally better deals for them. On the other hand, higher wages fuel private consumption and overall growth and thus contribute to a decline in the unemployment rate. As shown in Figure 5, the negative relationship to be observed between the unemployment rate and wage growth holds reasonably well for nearly all EU-CEE countries; it can be interpreted as one variant of the famous downward-sloping 'Phillips curve'.

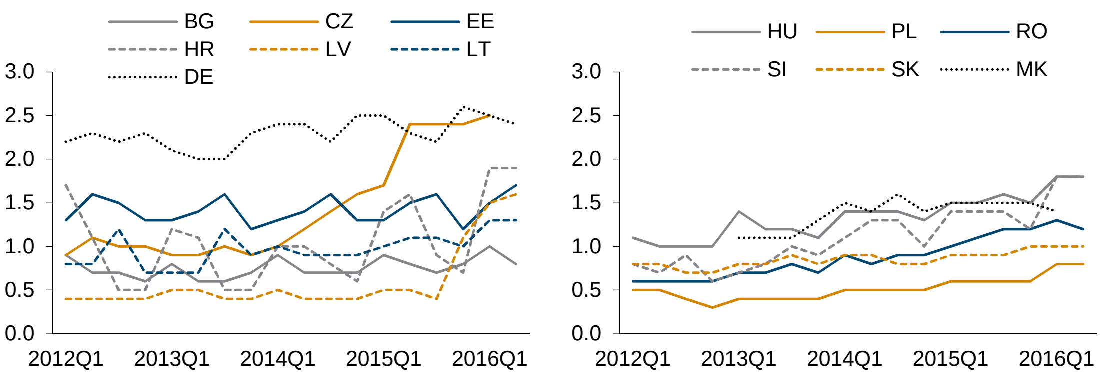
The tightening of labour markets in the majority of CESEE countries is confirmed by the increase in the number of job vacancies. Whereas job vacancy rates had already been steadily on the rise for a number of years in most countries, they surged strongly in the first half of 2016 (Figure 6), thus suggesting that labour shortages may have become even more acute. In the Czech Republic, labour shortages appear to be the most pronounced. Displaying a job vacancy rate of 2.5% and an unemployment rate of 4%, the Czech labour market shows every indication of being one of the tightest in Europe – on a par with Germany, for example. At the same time, not everywhere are rising job vacancy rates accompanied by receding unemployment. In Estonia and Latvia for instance, the vacancy rates went up *despite* unemployment rates remaining almost unchanged (in Estonia, the unemployment rate actually went up, while in Latvia it is stuck fast at a fairly high level). This may suggest that in both countries, labour market improvements may be constrained by 'structural' factors, such as a mismatch in skills and/or occupations between the unemployed and the vacancy announcements.

Figure 5 / Unemployment rate (LFS) and growth of average monthly gross wages



Remark: BY registered unemployment rate, XK net wages.
Source: wiiw Annual Database incorporating national and Eurostat statistics, wiiw forecasts.

Figure 6 / Job vacancy rate, in %



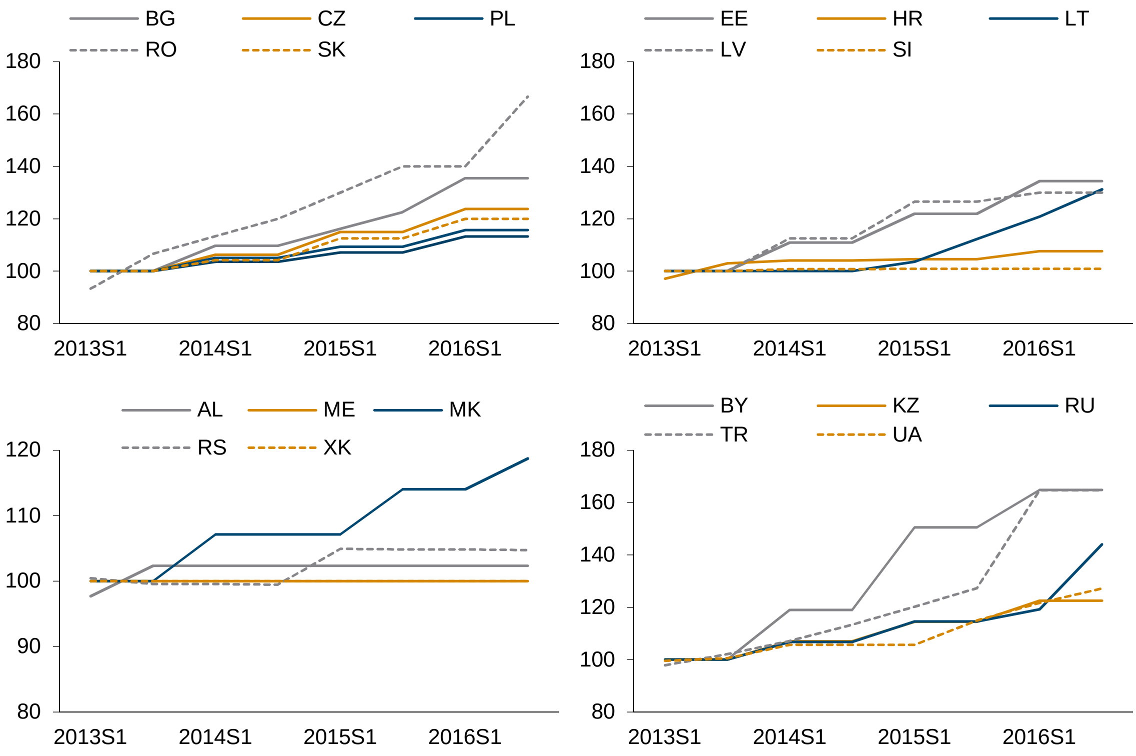
Note: Job vacancy rate is defined as the ratio of job vacancies to the sum of occupied posts and job vacancies.
Source: Eurostat.

There is little doubt that **tight labour markets and growing labour shortages in the CESEE region are partly a consequence of sizeable outward migration.** Outward migration from EU-CEE countries, mostly to Western Europe, gained momentum after those countries joined the EU. According to UN estimates, the number of Central and Eastern Europeans of working age residing in other EU countries has since risen to 6 million. Despite being outside the EU and thus facing much higher (visa and other) barriers to entering EU countries, the Western Balkans and Ukraine have been a major source of migration, as well. However, with the possible exception of Croatia (which entered the EU and whose citizens gained better access to the EU job market only in 2013), it would be difficult to attribute recent labour market improvements to emigration flows as the sole most significant explanatory factor. While no statistics on outward migration are available for the first half of 2016, anecdotal evidence suggests that those flows have hardly picked up. On the other hand, the recent labour market tightening may represent a *cumulative* effect of past outward migration flows; they probably did not drain the pool of labour resources instantaneously, but they may ultimately have become a binding constraint on labour supply, thus leading to more recent growing labour shortages.[4]

Tight labour markets apart, strong wage growth has been also fuelled by the introduction of higher minimum wages (Figure 7 and Box 1), which in some countries entered into effect as part of a more general fiscal relaxation package (see below for more on that). Unlike some countries in Western Europe, including Austria, all CESEE countries have a statutory minimum wage; in some cases, it constitutes the formal basis for wage and salary levels in the public sector. Under such a system, any increase in the minimum wage automatically leads to a proportionate increase in wages and salaries in the public sector. A case in point is Romania, where the very high growth in nominal wages (14% in the first half of 2016) was to a large extent driven by the introduction of a higher minimum wage. In mid-2016, the minimum wage in Romania was 28% higher in nominal terms than at the beginning of 2015, followed by Lithuania (26%), Bulgaria (16%), and Estonia (11%). In Turkey, the increase in the minimum wage that came into effect was even more impressive (+37%), but that has to be seen against a backdrop of much higher inflation.

[4] An analysis of the relationship between outward migration from the CESEE region and labour market shortages is presented in: Mara I. (2016), 'Outmigration and labour shortage in the EU-CEE', Special section in the wiiw Forecast Report, Spring 2016.

Figure 7 / Monthly gross minimum wages, half-year data, in national currency, 2013=100



Source: National Statistics and Eurostat.

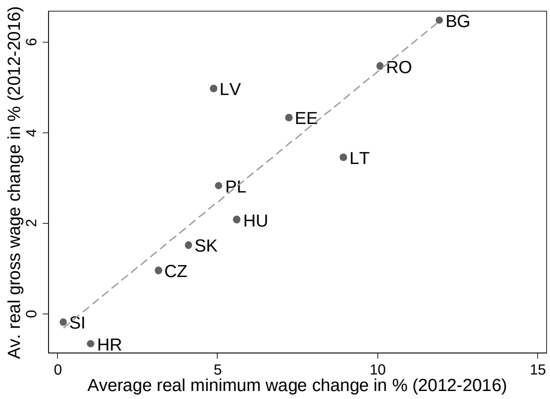
BOX 1 / DECLINING UNEMPLOYMENT AND RISING MINIMUM WAGES DRIVING REAL WAGE GROWTH IN THE EU-CEE COUNTRIES

by Mario Holzner

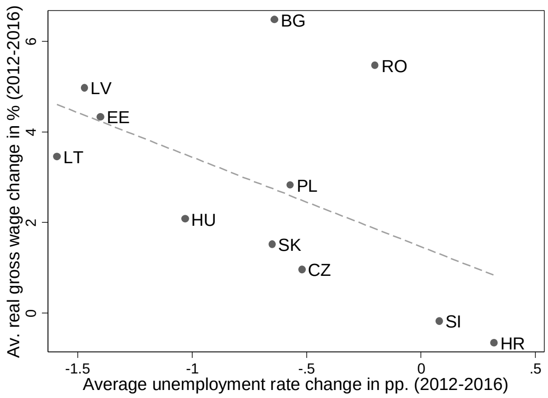
In recent years, many EU-CEE economies have experienced greater waves of out-migration, especially among the young members of their working-age population (over the period 2010-2015 the stock of migrants from the region increased by about 6%). That exodus was most probably a major reason for the drop in unemployment rates. After years of fiscal austerity, the political backlash has recently struck the region; many governments have started to increase minimum wages, pensions and social spending. Our hypothesis is that all those factors have (inter alia) caused real wages to increase. Lower unemployment rates ought to push wages upwards on account of the intensified competition among employers seeking to recruit workers, while the latter should enjoy a better bargaining position in an environment marked by labour shortages. Higher minimum wages had, by definition, a direct impact on average wages throughout the economy. This is confirmed by the correlations of both the change in real minimum wages and unemployment rates with the change in average real gross wages for the 11 EU-CEE countries from early-2012 to mid-2016 as shown in the two panels of Box Figure 1 below.

Box Figure 1 / Real wage dynamics, the minimum wage and the unemployment rate change in EU-CEE

Real wage and the minimum wage change



Real wage and the unemployment rate change



Note: The gross wage and gross minimum wage data in national currency units (NCU) were deflated using the respective CPI index (2015 = 100). The unemployment figures are LFS based. The periodicity of data is January and July of each year or the preceding quarter in those cases where monthly data were not available.
Source: Eurostat, wiiw Monthly Database, own calculations.

The conclusions drawn from the scatter plots are also supported by a simple single equation error correction panel model that tries to explain the change in the log real gross wages in 2015 prices. The explanatory variables are: the one-year lag of the wage levels; the year-on-year changes in the log of the real gross minimum wage in 2015 prices; the year-on-year change in the unemployment rate in percentage points; and their one-year lagged levels. The latter two variables capture the long-term effects and the former two the short-term effects on the change in real gross wages. The model also includes country- and time-fixed effects. Data for the 11 EU-CEE countries correspond either to values for January and July (the periodicity for which minimum wage information is available) or, if monthly data are not available, to values for the preceding quarter. The period since the outbreak of the global financial crisis from late-2008 up until mid-2016 was investigated (longer time periods since 1999 also yield very similar results). The regression equation including the estimated coefficients is the following:

$$\Delta lnwage_{it} = 0.737 - 0.270\, lnwage_{it-1} + 0.205\, \Delta\, lnminwage_{it} + 0.196\, lnminwage_{it-1} \\ - 0.007\, \Delta\, unemployment_{it} - 0.004\, unemployment_{it-1} + country_i + time_t + \varepsilon_{it}$$

All the coefficients are statistically significant, at least at the five percent level, and display the signs expected. Both the short- and long-term effects of higher real minimum wages on average real wage changes are positive. Furthermore, both the short- and long-term effects of a lower (higher) unemployment rate are positive (negative) with regard to the change in the average real gross wage. A one percent increase in minimum wages is related to a long-term increase of 0.2 per cent in overall wages and a reduction of one percentage point in the unemployment rate corresponds to a long-term increase of 0.4 per cent in wages. This suggests that intensified competition among employers to recruit and a better bargaining position for workers owing to a drop in unemployment rates and an increase in minimum wages have a statistically significant and positive impact on real wage changes in the EU-CEE countries.

NO INFLATIONARY PRESSURES DESPITE STRONG WAGE GROWTH

Remarkably, inflationary pressures in most CESEE countries are almost non-existent – despite solid wage growth. A number of countries – particularly in the EU-CEE region, but also in the Western Balkans – have recorded consumer price deflation for quite a number of years. Clearly, deflationary tendencies throughout the region over the past few years have been reinforced by the drop in energy prices (with the exception of Albania, Kazakhstan and Russia, the region is a net energy importer). However, energy prices in the meantime have stabilised, while inflationary pressures still remain very low. The important exceptions are the CIS countries where, despite having subsided recently to one-digit levels, inflation is still relatively high, while in Turkey inflation has been an accompanying feature of the economic boom.

Strong wage growth has been partly offset by gains in labour productivity (Figure 8). As a result, nominal unit labour costs have generally increased far less than wages. That partly explains the reasons for inflationary pressures in the majority of CESEE countries having been so low. Slow growth in unit labour costs went hand in hand with low inflation.[5] *Per se*, strong labour productivity gains are by no means new to the region. They were an essential feature that accompanied its transition to a market economy, arguably the most important manifestation of that transition. In many cases, they have been the key driver of economic growth over decades (the so-called ‘jobless growth’ phenomenon). Resources were reallocated to more productive use, and new (especially foreign) investment brought in new capital and technologies that raised labour productivity, sometimes to quite a dramatic degree.

However, **this time round labour productivity gains are unlikely to be driven by the supply side.** The EU-CEE economies are now functioning market economies, further to which there have been comparatively few major investment projects or technological advances over the past few years that could provide justification for substantial labour productivity gains. More likely, they were driven by ‘economies of scale’ (‘increasing returns’); as output increases, the labour available can be utilised more efficiently, thus leading to gains in labour productivity.[6]

In addition, **the rise in nominal unit labour costs has to a large extent been offset by a profit squeeze**, leading to a general containment of inflationary pressures (Figure 8). This suggests that following a dramatic decline during the first ten years of this century, the labour share in most CESEE countries has been on the rise over the past few years. This should come as no surprise, given the backdrop of increasingly tight labour markets; it may also reflect in part the increased bargaining power of trade unions. A particularly pertinent example is Bulgaria where prices have been close to stable (and competitiveness largely intact) despite a growth in nominal unit labour costs of the order of 30%, while the labour share in national income rose by 8.5 pp over the period 2011-2015. The developments to be observed in Slovenia were quite the opposite, it being the only country in the EU-CEE region where nominal unit labour costs *declined* as a result of the wage repression policy pursued over the period 2010-2015 (the current year, however, has witnessed a correction of the previous trend as fiscal and wage policies have been relaxed considerably in Slovenia).

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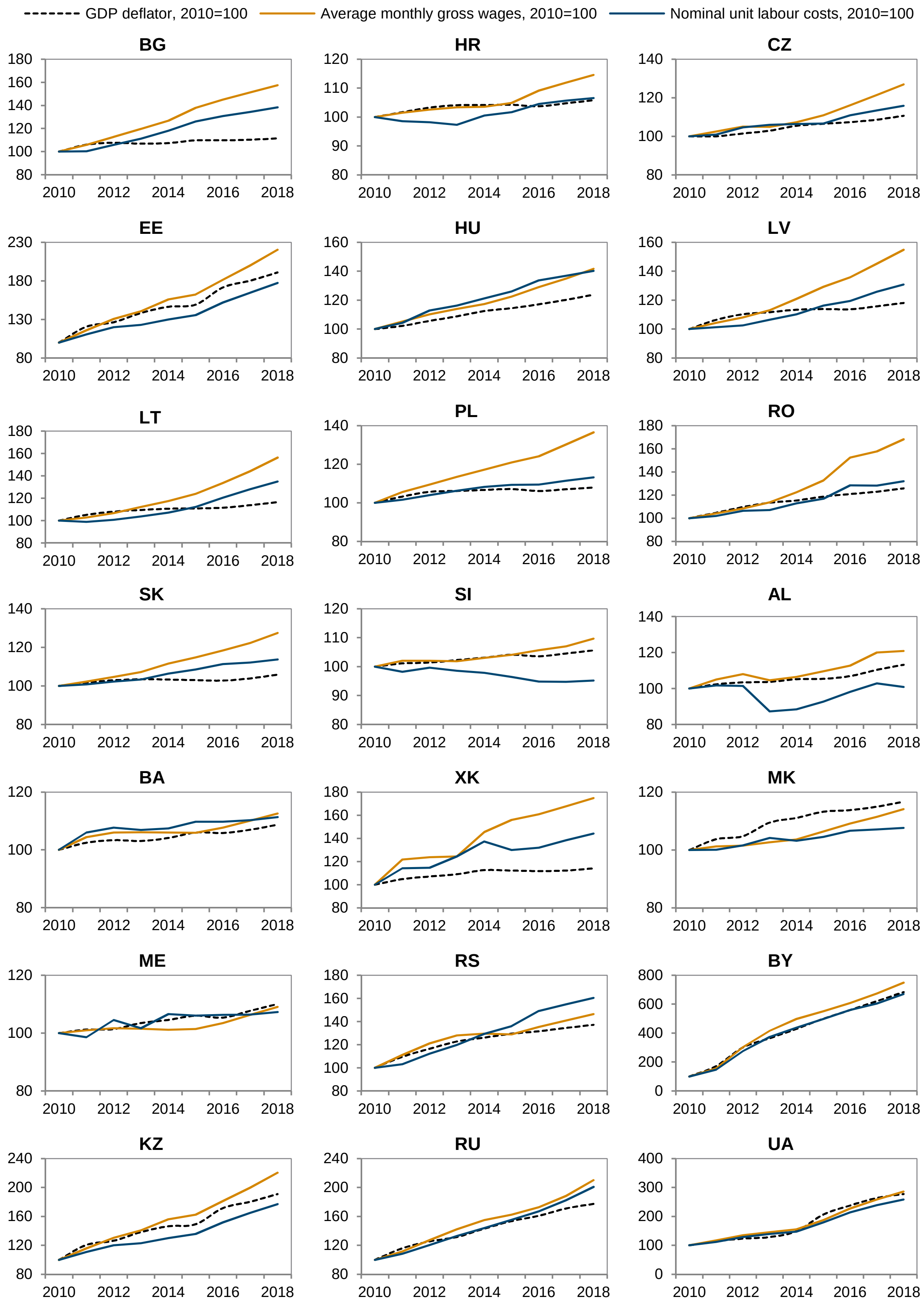
[5] To make sure, the GDP deflator has been rising in most of CESEE somewhat faster than consumer prices.

[6] Such an explanation would be consistent with the so-called ‘Kaldor-Verdoorn law’, according to which labour productivity gains are the *consequence* – rather than the source – of economic growth and are thus demand-side driven.

Figure 8 / Wages, unit labour costs and inflation, 2010-2018



Source: wiiw Annual Database incorporating national and Eurostat statistics, wiiw own calculations, wiiw forecasts.

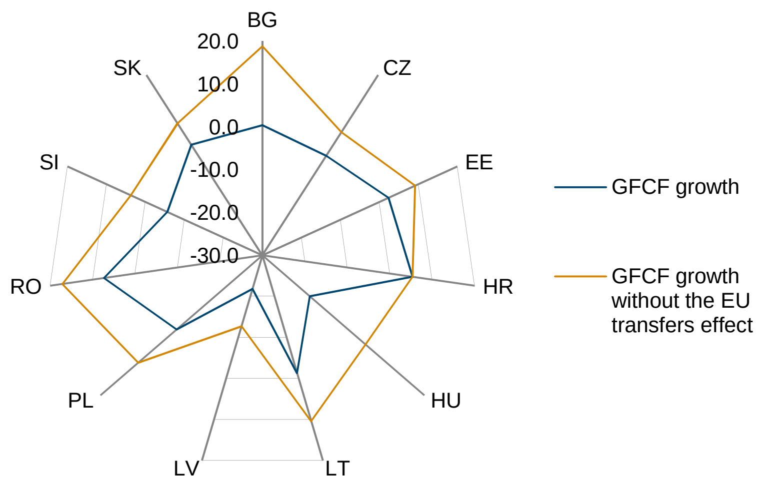
DROP IN EU TRANSFERS PUTS A BRAKE ON INVESTMENTS

The expansion of fixed investments, which were an important pillar of GDP growth in 2015,[7] has run out of steam this year. In some cases, the decline in gross fixed capital formation (GFCF) observed in the first half of 2016 was in the double-digits, as evidenced by Hungary and Latvia. In the EU-CEE region, the main reason for this weakness in investment and construction lay in a drop in EU transfers that, in previous years, used to account for up to 20% of GFCF in the recipient countries. EU funds disbursed under the previous 2007-2013 Multiannual Financial Framework (MFF) were absorbed in 2015 at the latest, whereas attracting new funds under the recently adopted 2014-2020 MFF will take time. The resultant dip in EU transfers has had an impact not only on public investment in the EU-CEE countries (especially in infrastructure), but to some extent on private investment as well.

At the same time, our estimates suggest that, **disregarding the 'EU transfers effect', the underlying dynamics of investments in the EU-CEE region remain strong** (Figure 9). Among the EU-CEE countries, only in Latvia did domestic investment drop substantially in the first half of the current year. The probable strong performance of domestic investments goes hand in hand with solid growth in wages and private consumption; it may thus reflect improved perceptions of future growth prospects. By and large, investments are being financed from profits retained rather than by taking out loans. That in itself is interesting, since interest rates are now at historic lows and credit is generally readily available. It would appear that for the purposes of investment, enterprises are now drawing increasingly on their cash reserves that had lain idle for a number of years following the outbreak of the global financial crisis.

Figure 9 / Gross fixed capital formation with and without EU transfers

real change in % against preceding year, first half of 2016



Note: Estimated growth rate of gross fixed capital formation (GFCF) including/excluding investments related to EU transfers. For the first half of 2015, the share of EU transfers in total GFCF is assumed to be the same as in the late disbursement period (2012-2014) of the latest MFF; for the first half of 2016 that share is assumed to be the same as in the early disbursement period (2007-2009). In the case of Croatia, a late entrant into the EU, the share assumed for both 2015 and 2016 is the average of the late disbursement period.
Source: wiiw Monthly Database incorporating national statistics, EU Commission, wiiw estimations.

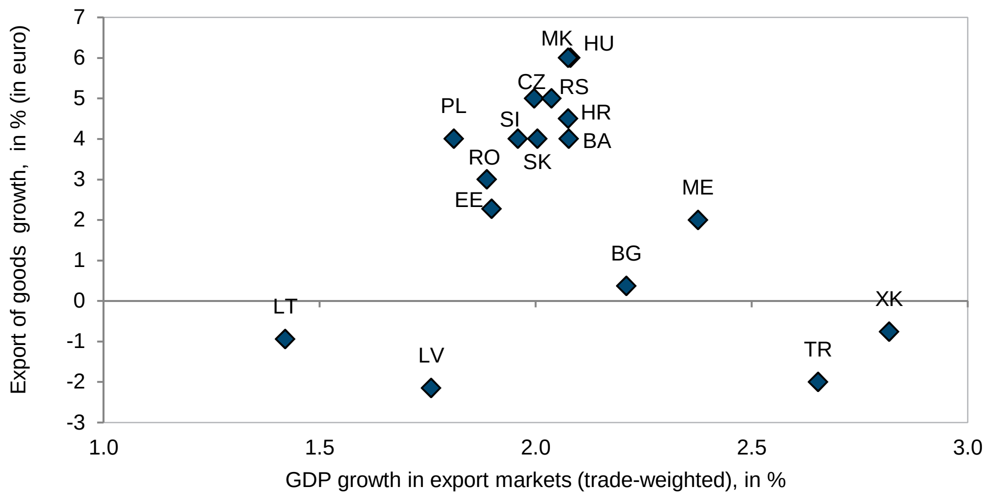
[7] The previous wiiw Forecast Report issued in spring 2016 was appropriately entitled 'Growth stabilizes: investment a major driver, except in countries plagued by recession'.

In all the other countries in the CESEE region, investment performance has been mixed. In Turkey and Macedonia, investment growth has been constrained by increased political risks. In most other Western Balkan countries, however, investments have performed reasonably well – although they could have done even better had it not been for the delay in infrastructure investments in Montenegro, the failure to attract foreign investment in ski resorts in Kosovo, and the persistence of long-standing 'institutional bottlenecks' in Bosnia and Herzegovina. In Russia and especially Belarus, the excessive slump in investments should come as no surprise, given the economic recession in both countries. However, in Ukraine investments bounced back solidly (albeit starting from a very low basis) in response to relative economic stabilisation.

THE MIXED ROLE OF NET EXPORTS

By and large, the export performance of the CESEE countries cannot be explained by the growth dynamics in the region's export markets (Figure 10). Notable exceptions to this may well be Latvia and Lithuania, for example, as they are relatively more dependent on trade with Russia and their exports have declined in the course of the current year. The structure of both countries' exports has also played a role: food products, a key item in their exports to Russia, are subject to the Russian embargo.[8] Turkish exports of food, and construction and tourism-related services to Russia have likewise declined ever since diplomatic relations between the two countries soured in the first half of 2016. CIS countries' exports to Russia have suffered still more. For instance, Belarus has recorded a decline in exports of close to 30% over the past two years (Russia accounts for around one half of Belarusian exports).

Figure 10 / Growth in export markets and export performance, 2016



Source: wiiw Database incorporating national and Eurostat statistics, wiiw calculations, wiiw forecasts.

Other country-specific factors appear to take on greater importance as an explanation for shifts in export performance. For instance, in Bulgaria the stagnation of exports is the outcome of the high basis owing to one-off sale of military equipment to non-EU countries in 2015. In Kosovo exports have

8 Indeed, Russia's choice of food as a sanctioned product can probably be explained in part by the fact that the Baltic countries have taken a particularly critical stance towards Russia over the Ukraine crisis.

suffered on account of the decline in metal prices, while in Albania, Kazakhstan and Russia the drop in oil prices has been the determining factor. In Ukraine, the 'sanctions war' with Russia weighs heavily on exports not only to the latter country, but also to Central Asian countries on account of transit restrictions, further to which the recently signed Deep and Comprehensive Free Trade Agreement with the EU has yielded few benefits.[9] On the other hand, many EU-CEE and West Balkan countries tend to display steady export dynamics – better than the growth dynamics in their main export markets would suggest. This implies an improvement in those countries' export competitiveness (in terms of costs or otherwise) and their growing market shares. This applies in particular to the EU-CEE countries, which are firmly integrated in the production chains in Western Europe (especially Germany): for example, in the automotive and electronics industries.

Despite vibrant growth in private consumption, the export dynamics in many CESEE countries is better than that of imports. Interestingly, the strong pick-up in private consumption in a number of CESEE economies has not brought about a marked rise in import demand, possibly suggesting a drop in import propensity and a shift in consumer preferences towards non-tradable services. Another important reason may have been the weak investment performance that tends to be import-intensive. As a result, the contribution of net exports of goods and services to real GDP growth has been mixed throughout 2016. In some countries, especially in Bulgaria, Czech Republic, Hungary and Slovenia, it has been positive, whereas in others, notably in Albania, Estonia, Kosovo, Latvia, Romania and Turkey, net exports have been a drag on growth (see Figure 3 above).

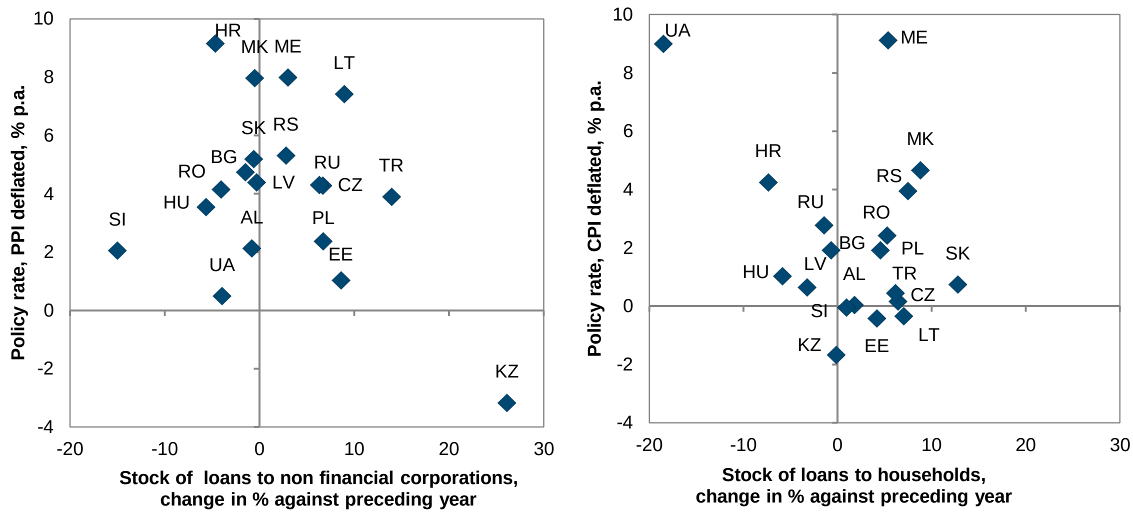
MONETARY POLICY LARGELY IRRELEVANT

Large parts of the CESEE region are essentially deprived of monetary policy tools. In the Baltic countries, Slovakia and Slovenia, this is a natural consequence of their membership in the euro area. However, it also largely applies to the other CESEE countries with euro-based currency boards (Bosnia and Herzegovina, and Bulgaria), to those using euro as a *de facto* legal tender (Kosovo and Montenegro) and to those maintaining fixed exchange rate regimes against the euro (Croatia and Macedonia). All of them have very little manoeuvring space when it comes to monetary policy instruments. In the remaining EU-CEE countries, the monetary stance tends to be rather accommodative: most notably in the Czech Republic where the policy interest rate has long been set at zero.

In addition, even low interest rates fail to generate strong credit demand. As can be inferred from Figure 11, the level of the real policy rate has been largely irrelevant where the dynamics of credit to the private sector in the CESEE countries are concerned. In seven of them – Albania, Bulgaria, Croatia, Hungary, Latvia, Slovenia and Ukraine – credit stock has declined: an indication of private sector deleveraging in those countries. In addition, exchange rate developments have played a role. Wherever the share of loans denominated in foreign currency was substantial and exchange rate depreciated (for example, in the CIS countries and Turkey), the credit stock expressed in national currency terms has risen – without any positive effect on domestic demand. This has been the case in Kazakhstan, for instance, where the stock of loans to non-financial corporations increased by almost 30% between mid-2015 and mid-2016.

[9] With estimated double-digit export declines in 2016 (in euro terms), the CIS countries, Ukraine and Albania are not presented in Figure 10.

Figure 11 / Policy rate and loans to non financial private sector, June 2016



Source: wiiw Monthly Database incorporating National Bank statistics, wiiw own calculations.

All in all, credit expansion in the CESEE region has been rather modest and generally within the one-digit range: no country, with the possible exception of Slovakia, is currently experiencing a credit boom. This suggests that **rather than borrowing costs, other factors tend to be more important determinants of the demand for loans**: a trend similar to that observed in the euro area and advanced economies in general. For instance, a major factor may well be the level of indebtedness. Wherever that level is already high, the readiness to take out new loans is understandably low. Under such circumstances, low interest rates tend to have quite the opposite effect on credit dynamics. They make it easier for borrowers to pay off old debts, thus leading to overall stagnation or a decline in credit stock.

By and large, **private agents tend to finance their consumption and investments from other sources rather than by taking out loans.** From the viewpoint of macroeconomic stability, this is a welcome development. All other things being equal, it reduces the risk of 'boom-and-bust' developments that have characterised the trajectories of a number of CESEE countries, above all the Baltic States, Bulgaria and Ukraine, in the run-up to and in the wake of the global economic crisis. This does not apply, however, to the CIS countries, which under the current circumstances could have benefited from more vibrant credit activity. Recent disinflation in those countries has not been strong enough to permit a marked relaxation of monetary policy, which remains relatively tight – and essentially pro-cyclical.[10]

FISCAL POLICY GENERALLY GROWTH-SUPPORTIVE

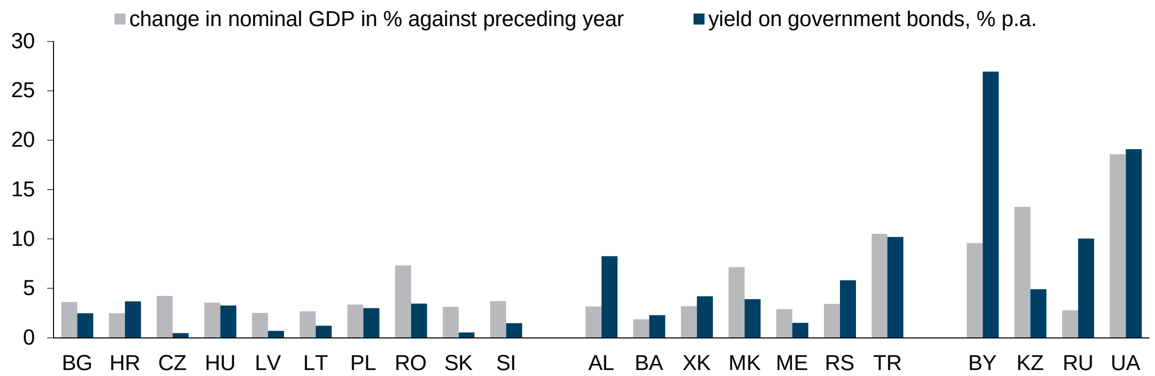
Domestic demand in many CESEE economies is supported by fiscal policy relaxation. In nearly half of the countries (the south-east quadrant in Box Figure 2), the current fiscal stance is clearly expansionary: the budget balance in those countries is worsening despite cyclically higher tax revenues and other 'automatic stabilizers'. Interestingly enough, in some EU-CEE countries budget deficits are on the rise, notwithstanding the lower co-financing needs from national budgets in connection with EU-

10 For instance, central banks in Russia and Ukraine are formally targeting inflation (and in Belarus the monetary aggregates). Therefore, at least formally they are not concerned with the state of the real economy, which is still very fragile at best.

funded investment projects in the current year. In Romania and Ukraine, fiscal relaxation has been particularly pronounced throughout the year – primarily to the benefit of private consumption. In Romania, the minimum wage has been palpably increased and the VAT rate lowered, while the government in Ukraine has drastically cut social security contributions in order to 'de-shadow' the economy. (As next in line, the increase of the budget deficit in Bosnia and Herzegovina is due to the one-off effect of the previous year's good budget performance.) Even Serbia, which officially pursues a policy of fiscal consolidation, is projected to record a budget deficit exceeding that of the previous year. In three other countries (Latvia, Slovakia and Slovenia), fiscal policy has most probably become more accommodative as well: they are expected to record only a minor reduction in their budget deficits despite solid GDP growth.

One reason for a laxer fiscal policy may have been a decline in borrowing costs. Although low interest rates may have done little to trigger substantially more demand for credits in the private sector, they made it easier for governments to borrow.[11] As a result, the gap between the yield on government bonds and the growth rate of nominal GDP which, for instance, was extremely positive at the peak of the euro area 'sovereign debt crisis' has narrowed. In almost all EU-CEE countries (except Croatia) it has turned negative (Figure 12). If sustained over a prolonged period of time, the negative gap between the nominal GDP growth rate and the yield on government bonds suggests a dramatic improvement in the sustainability of public debts in the EU-CEE countries. It implies that additional government revenues accompanying a growing economy are more than sufficient to pay the interest on public debt, thus making for its progressive reduction as a share of GDP. In Bulgaria, the government has taken advantage of low interest rates to build up fiscal reserves, rather than spend borrowed funds. In Turkey, fiscal sustainability has been helped by the proceeds from privatisation and the high profits accruing to the National Bank that have markedly augmented government revenues over the current year.

Figure 12 / GDP growth and yield on long-term government bonds, first half year of 2016



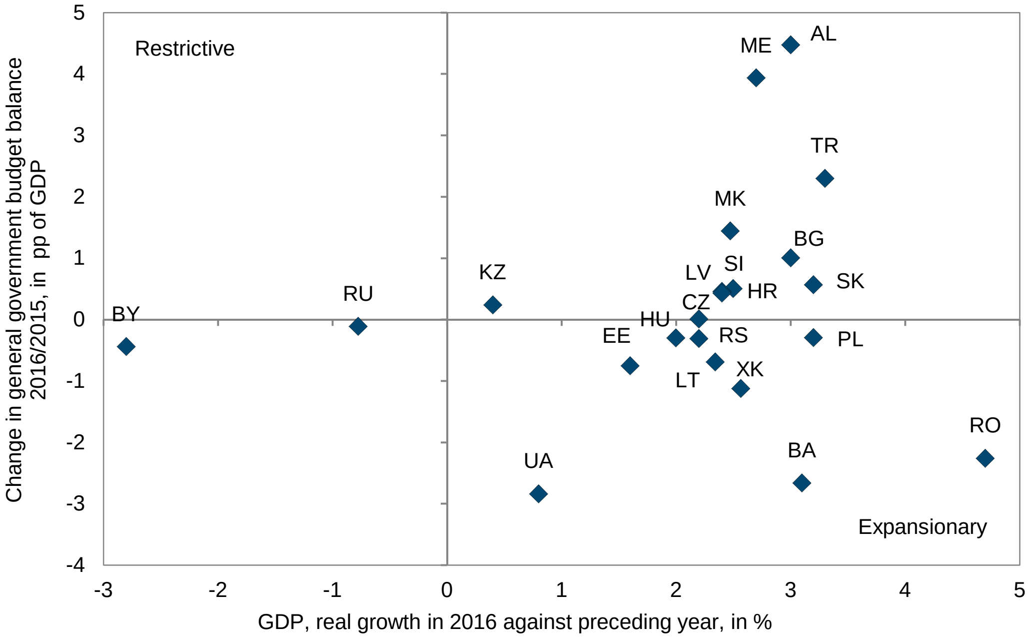
Definitions: EU-CEE: EMU convergence criterion bond yields as defined by Eurostat, TR: 10-year government bond yields, HR: 7-year government bond yields, AL: results of government 10-year bonds auctions (coupon rate), BA and XK: results of government 10-year bonds auctions (weighted average yield rate), MK: results of government 3-year bonds auctions (coupon rate), ME: results of 182 days T-bills auctions (average discount rate), RS: 3-year government bond yields, BY: GDO (Government Long–term Bonds) market portfolio rates, KZ: average effective yield for MEUKAM Long-term Government Treasury obligation with over 5 years maturity, RU: GKO-OFZ long-term bonds auctions weighted-average rate, UA: average weighted yield for domestic T-Bills placements with maturity of up to 3 years.
Source: wiiw Monthly Database incorporating national statistics; Eurostat; National Banks and National Ministries of Finance.

[11] Needless to say, borrowing in US dollar and euro (which is still widespread, especially in less advanced CESEE countries) is even cheaper.

BOX 2 / ASSESSING FISCAL STANCE IN CESEE COUNTRIES

A proper assessment of the fiscal stance requires that the headline budget balance 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 stabilizers (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 spread of the budget deficit during a recession need not necessarily be indicative of fiscal policy easing. 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 Box Figure 2. 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 clear 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.

Box Figure 2 / Fiscal stance in CESEE countries in 2016



Source: wiiw forecasts.

A general change in attitudes may play a role as well, following growing disenchantment – even at the EU level – with the practical results of 'expansionary austerity' pursued over the past few years. In any event, in the EU-CEE countries budget deficits do not exceed the 3% 'Maastricht benchmark' and thus formally comply with the EU rules. In the Czech Republic and the Baltic states, the budgets are essentially balanced. As long as budget deficits and public debts are not excessively high, fiscal loosening is to be seen as a welcome turnaround: it fuels economic growth in the EU-CEE countries and thus advances their convergence towards West European levels.

In most Western Balkan countries and the CIS, the fiscal stance tends to be either neutral or restrictive (although no country is to be found in the north-west quadrant in Box Figure 2). The cautious fiscal policy in the Western Balkan countries (and in Croatia as well) is plausible. Many of those countries have high levels of public debt and, unlike most EU-CEE economies, they face relatively high borrowing costs: higher than the growth rates of their nominal GDP. However, in Russia and Kazakhstan it is less easy to fathom. Both countries could well benefit from fiscal stimulus under the current circumstances and have enough fiscal policy space to allow that. On top of low public debt levels, they have accumulated sizeable fiscal buffers in the form of sovereign funds (some of which are currently being drawn down).

NEAR-TERM OUTLOOK

Virtuous circle of rising consumption and incomes in EU-CEE set to continue

The short-term prospects for the EU-CEE countries are generally bright: their **growth is expected to stay reasonably strong at around 3% per year in 2017-2018** (Table 2). In nearly all EU-CEE countries (except Romania), growth is projected to gain momentum over the coming two years. In Romania, the current boom will not be sustained, as the effects of the fiscal stimulus launched in the course of 2016 will gradually fade away, resulting in a growth slowdown estimated to be of an order of 1 pp in the year to come. On the back of labour shortages, unemployment is generally expected to recede further – with the exception of the Czech Republic and Hungary, whose labour markets are already very tight. However, the reduction in the unemployment rate will proceed not as rapidly as was the case over the past two years: dropping by about 0.2 pp on average in both 2017 and 2018 and attaining 6.4% by the end of the forecast period. Ongoing labour market improvements and rising wages will continue to be the main growth driver throughout the region. In some countries, such as Hungary, they will complement the fiscal stimulus that will likely precede the parliamentary elections in early 2018. On top of that, public investments will pick up as new EU funds become available after the short-lived dip in the current year. Private-sector investments are also expected to gain momentum in some countries: for example, funding new capacities in the automotive industry in Slovakia. Thus, overall fixed investments will gain momentum and contribute more markedly to GDP growth than has been the case in the current year (see Figure 3 above).

Inflationary pressures will strengthen somewhat, but will stay reasonably low. After two consecutive years of deflation, consumer price inflation in the EU-CEE region is expected to pick up and reach 1.5% on average next year and 1.9% in 2018, as the effects of the drop in energy prices gradually fade away and demand-side pressures build up progressively. Thus, inflation is projected to shift closer to the 2% target set by the ECB, while greater inflationary expectations may exert a mildly positive impact on consumer demand in the EU-CEE countries.

Table 2 / Real GDP growth forecast and revisions

		Forecast, %			Revisions, pp		
		2016	2017	2018	2016	2017	2018
EU-CEE	BG	3.0	3.0	3.1	0.1	0.0	0.0
	HR	2.5	2.7	2.8	0.5	0.5	0.5
	CZ	2.2	2.4	2.6	-0.2	-0.2	0.0
	EE	1.6	2.2	2.3	-0.4	-0.1	-0.1
	HU	2.0	2.6	2.9	0.0	0.1	0.0
	LV	2.4	2.6	2.9	-0.1	-0.4	-0.4
	LT	2.3	2.6	3.0	-0.5	-0.5	-0.4
	PL	3.2	3.5	3.3	-0.1	0.2	-0.1
	RO	4.7	3.5	3.8	0.7	0.3	0.3
	SK	3.2	3.1	3.4	0.2	-0.1	0.1
	SI	2.4	2.6	2.9	0.4	0.3	0.1
Western Balkans	AL	3.0	3.3	3.6	0.1	0.0	0.3
	BA	3.1	3.3	3.5	0.2	0.4	0.5
	XK	2.6	3.0	3.2	-0.7	-1.2	-0.8
	MK	2.5	3.1	3.3	-0.9	0.0	0.2
	ME	2.7	3.1	2.9	-0.4	-0.2	-0.6
	RS	2.2	2.5	2.5	0.3	0.2	0.0
Turkey	TR	3.3	3.0	2.7	-0.8	-0.7	-0.8
CIS-3 +UA	BY	-2.8	-0.9	1.6	-0.8	-1.4	0.2
	KZ	0.4	2.0	3.0	0.0	0.0	0.0
	RU	-0.8	0.8	1.8	0.0	0.0	0.0
	UA	0.8	1.9	2.4	0.3	0.0	0.0

Note: Current forecast and revisions relative to the wiiw July forecast 2016. Colour scale reflects variation from the minimum (red) to the maximum (green) values.
Source: National and Eurostat statistics.

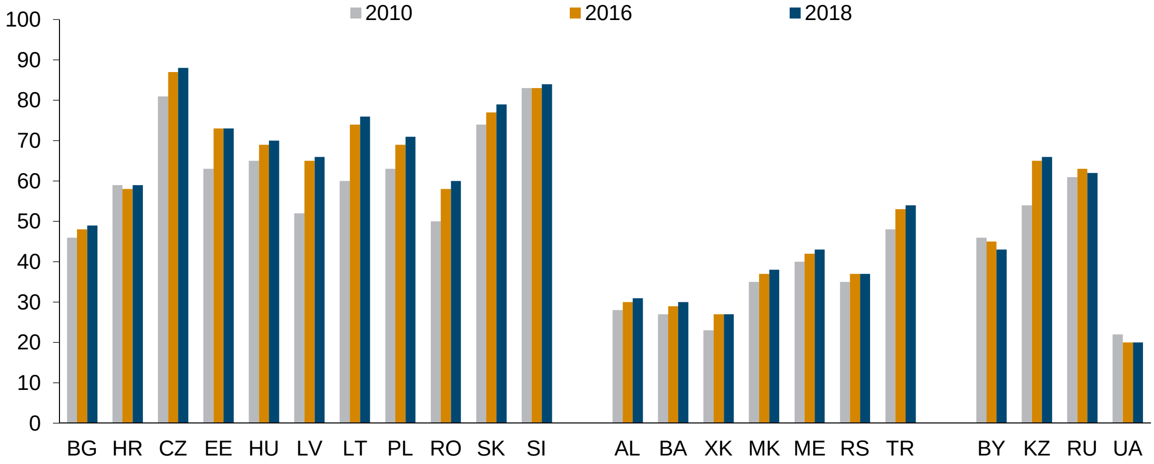
Balance-of-payments constraints are unlikely to become binding any time soon – with the possible exception of Romania. In most EU-CEE economies, net exports are expected to contribute positively to GDP growth in the next two years. Even in those cases where they will act as a drag on growth (Poland and the Baltic countries), the external positions of those countries appear secure enough to accommodate any deterioration that might occur in the years to come. Half of the EU-CEE countries are recording current account surpluses, while deficits in the remaining countries are generally moderate. The strong external position of the region is indicative of its robust export base and reduces its vulnerability to changes in mood on international markets. In addition, in some countries (notably Croatia, Hungary, Latvia and Lithuania) the increased inflow of remittances from their nationals working abroad will also support their external position in the years ahead.

As long as inflationary pressures remain low and external constraints do not surface, **the virtuous circle of growing consumption and labour income observed throughout the EU-CEE region is set to continue** and may be sustainable over extended periods of time.[12] Besides, it is essential to stable GDP growth in the face of a temporary investment weakness. It is somewhat ironic that strong wage growth, which is the main driver of private consumption and GDP growth, appears to be driven primarily by 'labour shortages' – not least owing to outward migration. In addition, all other things being equal, outward migration also contributes to slower population growth and/or a decline in the number of

[12] Such a virtuous circle of growing consumption and labour income characterised e.g. advanced countries in the 1950s and 1960s, a period often referred to as the 'golden age of capitalism'.

inhabitants in a country, and results in GDP growth *per capita* being even more striking. The persistence of reasonably high growth rates despite 'labour shortages' seems to suggest that the latter are a relative concept and depend essentially on wage levels that ultimately equilibrate supply and demand in the labour markets.[13] To some extent, these conclusions seem to contradict, at least for the time being, the findings of the IMF which argues that labour shortages are set to become a major constraint on the growth prospects in the EU-CEE countries.[14]

Figure 13 / GDP per capita, at PPP, EU-28 average = 100



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

This does not mean, however, that the longer-term prospects of the EU-CEE region are unclouded. **Its ultimate convergence to West European levels will require a change in specialisation patterns**: a shift from medium-quality to higher-quality goods. Such a transition is in no way certain, and the risks of getting mired in an infamous 'middle-income trap' are real. Those risks are amplified by the recent shift towards right-wing populist policies in a number of countries: notably (but not only) Hungary and Poland. While short-term economic prospects of the countries in question may not be overly affected by these developments (for instance, Hungary under prime-minister Orbán has fared much better than many had anticipated), in the longer term they may become binding, as crony capitalism, widespread corruption and freedom restrictions may ultimately undermine the countries' productive potential.

Growth picks up in the Western Balkans

Growth in the Western Balkans is projected to pick up slightly: rising to 3% by 2018. Similar to the EU-CEE region, rising wages will remain the most important pillar of growth in the Western Balkan countries, even if remittances from outward migrants continue to stagnate or decline slightly, as has been the case to date. Unemployment should recede further, although it will still remain very high. Furthermore, investments should gain momentum as well. In Montenegro the long delayed infrastructure projects should be finally launched, while Albania should benefit from more FDI flowing into the

[13] Throughout the 1960s, the average unemployment rate in Western Europe (EU-15) stood at around 2%, while per capita GDP was growing by more than 4% per year (Source: AMECO database).

[14] IMF, Emigration and its economic impact on Eastern Europe, IMF Staff Discussion Note, July 2016.

construction of the Trans-Adriatic gas pipeline and a new hydropower station. Similar to the EU-CEE region, inflation is expected to pick up slightly, except in Serbia and Albania where it will remain at a 'comfortable' level of 2-3%.

That being said**, the weak external position of the Western Balkan countries may become a drag on longer-term growth prospects.** Their current account deficits tend to be persistently high or even extremely high; in some cases they are rising (Bosnia and Herzegovina, Kosovo). In general, their export capacities are much weaker than those of the EU-CEE countries, and their exports tend to be characterised by low-skill products such as metals, footwear and textiles. Progress in terms of economic modernisation and restructuring in the Western Balkan countries would basically require increased inflows of FDI. The past experience of the EU-CEE countries strongly suggests, however, that such FDI inflows hinge to a large extent on the countries' prospects of joining the EU. In the case of the Western Balkans those prospects have hardly improved in recent times. Two countries in the region, Bosnia and Herzegovina and Kosovo, have yet to acquire official candidate status, even though a Stabilisation and Association Agreement between Kosovo and the EU entered into force at the beginning of the current year. Various factors still impede the integration of the Western Balkan countries into the EU: internal divisions in Bosnia and Herzegovina; the 'Russian factor' in both the Serbian entity within Bosnia and Herzegovina and Serbia itself (and possibly in Macedonia and Montenegro as well); the unresolved issue of the country's name in Macedonia; internal political conflicts and border issues in Kosovo; and corruption in Albania.

'Bottoming out' in the CIS

The Russian economy is expected to rebound slightly in the second half of the current year, followed by a somewhat stronger recovery of 1-2% in the period 2017-2018. By now Russia has largely adapted to the 'new normal': low oil prices, a much weaker rouble and Western sanctions, which will probably remain in effect throughout the forecast period. In the short run, the pace of recovery in Russia will be constrained by restrictive monetary and fiscal policies, although the latter may effectively slacken in the wake of increased military spending. At the same time, a stable rouble and low demand pressures are likely to bring about further disinflation, most likely to be followed by a relaxation of monetary policy. However, the long-term prospects look rather bleak: reduced cooperation with the West will impose limits on the urgently needed modernization of the country's economy and its diversification away from the energy sector.

In other CIS countries (except Belarus), recovery will gain momentum as well, particularly thanks to more buoyant investment activity. In addition, Kazakhstan is planning to go on stream with a large new oil field that will boost its exports. In Ukraine, however, economic recovery will largely depend on the country's continued cooperation with the IMF and the 'semi-frozen' status of the conflict in the Donbass region. The downside risks in our forecast are thus high. In Belarus, there is still no light at the end of the tunnel. Although recession in 2017 will be not as deep as in the past two years, a return to positive growth before 2018 is hardly realistic. It is highly uncertain that the Belarusian and Kazakhstani economies will derive any positive impulse from increased cooperation within the Eurasian Economic Union (EAEU), given the current weakness of Russia, the 'core' economy of the EAEU, and the reluctance of the member countries to participate in some of Russia's policies (such as those related to sanctions).

Clouded outlook for Turkey

Turkey is the only CESEE country for which a progressive worsening of the economic dynamics is forecast. The projected slowdown will be mostly due to the increased political uncertainties following the recent failed coup and the repressive policies that the Turkish authorities have pursued in response. Those uncertainties will weigh all the more heavily on domestic consumer and investor confidence, while exports on the other hand are expected to pick up. Given a less vibrant domestic demand, GDP growth is expected to fall in stages to below 3% by 2018. Of itself, a ‘soft landing’ of that kind may, however, not necessarily prove problematic for the Turkish economy; it may well constitute a welcome correction to the recent economic boom that was revealing signs of ‘overheating’.

Moreover, **Turkey may also have to face the realistic prospects of a full-fledged balance-of-payments crisis**. Under this scenario, the projected ‘soft landing’ of the Turkish economy may well turn out to be ‘hard’. With an appreciable external deficit and high dependence on ‘hot’ capital inflows, Turkey is by far the most vulnerable of the CESEE countries to changes in global market sentiments, which, for instance, might surface after the forthcoming hike in the US interest rates which some observers see coming by the end of the current year. It could well prompt a re-orientation of global capital flows away from ‘emerging markets’. Clearly, domestic developments in Turkey may play a role as well. Apart from increased political uncertainties, the monetary policy has softened markedly over recent months, making the country less attractive to foreign investors and contributing potentially to a dangerous vicious circle of currency depreciation and further loss of confidence.

Special Section I: The impact of Brexit on GDP in the CESEE countries via trade links

OLIVER REITER AND ROBERT STEHRER

INTRODUCTION

Before the referendum on 23 June 2016, numerous studies had been undertaken in an endeavour to assess the likely impact on the UK economy of a decision in favour of leaving the EU. Neither in the period prior to the referendum nor even today is it clear what form the future relationship between the UK and the remaining EU-27 will take. Various scenarios have been assumed concerning the future access of the UK to the EU Single Market in terms of trade in goods and services, financial market regulations (viz. 'passporting rights'), eventual future fiscal contributions to the EU budget and the like. Some of the assumptions mimic alternatives that are currently in effect, such as the relationship between the EU and Norway or Switzerland.

Depending on those underlying assumptions and the related methodologies for assessing the probable impact of Brexit on the UK economy, a comparatively heterogeneous set of results has emerged. They range from minor negative effects of a cumulative GDP loss in the order of -1% to -3% in the short term to a greater impact incurring a cumulative GDP loss in the order of -3% to -10% over the longer term. In most of the studies models were developed for a variety of channels, all of which are interlinked, relating to the possible impact that Brexit would have on the UK. Those channels are: (i) emerging (short-term) uncertainties; (ii) a reduction in both trade (for instance, owing to rising tariffs) and FDI flows; (iii) productivity losses resulting from the same; (iv) changes in migration patterns, (v) productivity effects of deregulation; and (vi) the lower or even zero contributions to the EU budget. Whereas all those channels have some bearing in terms of impact, the most important factors identified are the short-term effects deriving from the many uncertainties (cushioned perhaps by policy measures such as changes in interest rates and exchange-rate policy), as well as the impact via trade channels (see e.g. Armstrong and Portes, 2016; Campos, 2016; IMF, 2016). Furthermore, following the vote to leave, some studies pointed to the possibility of a short-term negative GDP shock (e.g. IMF, 2016), although that has not materialised to date since the shock in question has been mitigated by other short-term policies. None the less, concerns over Brexit having a negative impact on the UK economy persist, given the short-term uncertainties that remain and the potential negative effects of a drop in both trade and FDI flows between the UK and the EU-27. Other concerns relate more specifically to the risks of a negative impact on the City and the banking sector in London, housing markets and exchange rate movements, with a concomitant impact on real-estate values.

In the paragraphs below, an analysis is given of the potential effects on the countries in Central, East and Southeast European (CESEE) countries, were we assume the GDP in the UK to decline. The exercise draws on a recently compiled inter-country input-output database that permitted the authors to model the impact of changes in the UK income on other countries' performance.[15]

THE CESEE COUNTRIES' VALUE-ADDED EXPORTS TO THE UK

In methodological terms, the results presented here rely on the concept of 'value-added exports' which indicates how much income is generated in one country to satisfy final demand in other countries. It should be noted that in this analysis 'value-added exports' are made up of all goods and services produced in a country and finally absorbed in the UK – either via direct exports or indirect exports via third countries. Of specific interest here is the income (GDP) generated in each country through final demand in the UK (including household consumption, investment and government consumption) expressed as a percentage of each country's GDP. A country's value-added exports to the UK include the domestic value-added embodied in that country's gross exports to the UK (those gross exports, it should be noted, also include foreign value-added which is duly subtracted) together with the value-added absorbed in the UK via third-country exports to the UK. For example, the value-added generated by Croatia producing and exporting an intermediate product to another country (for example, Austria) where that intermediate is used to produce a final product that is subsequently shipped to the UK where it is absorbed as a final consumer or investment good (viz. a piece of machinery or equipment) constitutes part of Croatia's value-added exports to the UK (see Box 3 for a technical outline).

BOX 3 / CALCULATING VALUE-ADDED EXPORTS

Formally, value-added exports of a country r are calculated as $\mathrm{VAX}^{\mathrm{r}} = \mathbf{v}^{\mathrm{r}}\mathbf{L}\mathbf{f}$ where $\mathbf{v}^{\mathrm{r}}$ denotes the value-added coefficient vector with non-zero entries for country r (and value-added coefficients for all other countries set to 0), $\mathbf{L}$ is the global Leontief inverse and $\mathbf{f}$ is a global final demand vector. Bilateral value-added exports of country r to s are calculated accordingly as $\mathrm{VAX}^{\mathrm{rs}} = \mathbf{v}^{\mathrm{r}}\mathbf{L}\mathbf{f}^{\mathbf{s}}$, i.e. the global final demand vector is replaced by the final demand vector of country s.

Some relevant indicators of the countries' value-added exports in total and to the UK in particular are presented in Table 3. The first column shows the extent to which a country's GDP is dependent on overall exports in value-added terms[16]. There is a clear variance across country groups. Whereas for the EU-CEE countries, the average is about 35% (ranging from 40% of the GDP in Slovakia, Slovenia and the Czech Republic to less than 27% in Croatia), the average of value-added exports as a percentage of GDP in the Western Balkan countries is of the order of 25% (with a particularly low share of less than 20% in Bosnia and Herzegovina). Similar shares are shown for Turkey, Russia and Ukraine.[17]

However, only a minor portion of the value-added generated for export is attributable to absorption in the United Kingdom. This is reported in the second column and graphically represented in Figure 14. On

15 The data used are based on the recently revised and updated world input-output database WIOD (see Stehrer and Timmer, 2016) and its extension to include CESEE countries heretofore not included, e.g. the Western Balkan countries and Ukraine (see Reiter and Stehrer, 2016, for details).

16 Note that these numbers are generally much lower than other (common) measures such as the exports-to-GDP ratio as gross exports are produced using a considerable amount of imported intermediate imports.

17 The remaining CESEE countries Belarus, Kazakhstan, Kosovo, and Moldova have not yet been included.

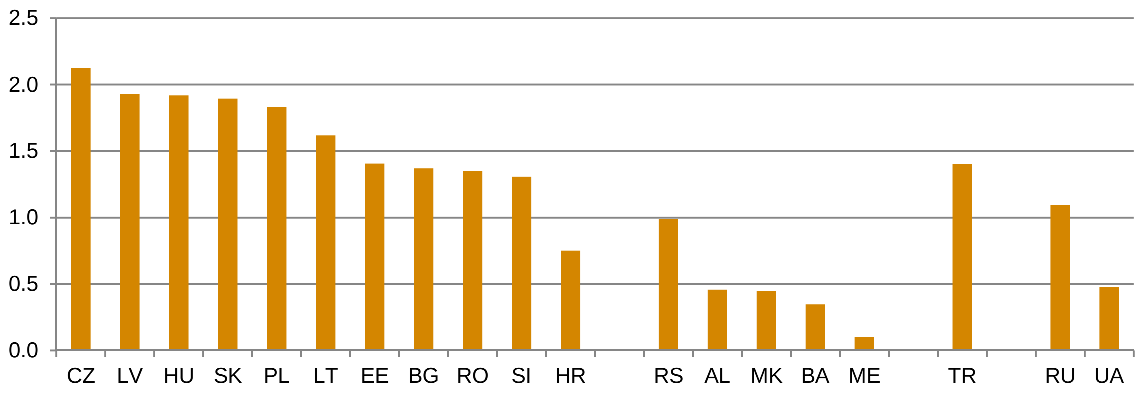
average, about 1.6% of the GDP in the EU-CEE countries is dependent on final absorption in the United Kingdom, ranging between more than 2% in the case of the Czech Republic and some 0.8% in Croatia. Those shares are much lower in the Western Balkan countries where they are generally less than 0.5% of GDP; only in the case of Serbia is the share about 1%. A somewhat higher share is also to be observed for Turkey: slightly below 1.5%. The share for Russia is about 1% and that of the Ukraine 0.5%, thus comparable with the four smaller Western Balkan countries.

Table 3 / Value-added exports in 2014, in % of GDP

	Value added exports in % of GDP	of which: Value added exports to UK in % of GDP	Share of value added exports to UK in % of total value added exports
EU-CEE			
Slovakia	40.0	1.9	4.7
Slovenia	39.7	1.3	3.3
Czech Republic	39.5	2.1	5.4
Estonia	38.2	1.4	3.7
Hungary	38.1	1.9	5.0
Latvia	37.9	1.9	5.1
Lithuania	36.6	1.6	4.4
Bulgaria	35.1	1.4	3.9
Romania	30.2	1.3	4.5
Poland	28.9	1.8	6.3
Croatia	26.6	0.8	2.8
Mean	*35.5*	*1.6*	*4.5*
Western Balkans			
Albania	25.3	0.5	1.8
Bosnia and Herzegovina	18.8	0.3	1.8
Macedonia	24.8	0.4	1.8
Montenegro	21.9	0.1	0.5
Serbia	28.7	1.0	3.5
Mean	*23.9*	*0.5*	*1.9*
Turkey	23.9	1.4	5.9
Russia	26.4	1.1	4.2
Ukraine	26.2	0.5	1.8

Note: Mean is the unweighted mean across country groups
Source: Wider Europe WIOD (preliminary version, October 2016); wiiw calculations

Figure 14 / Value-added exports to the United Kingdom in 2014, in % of GDP



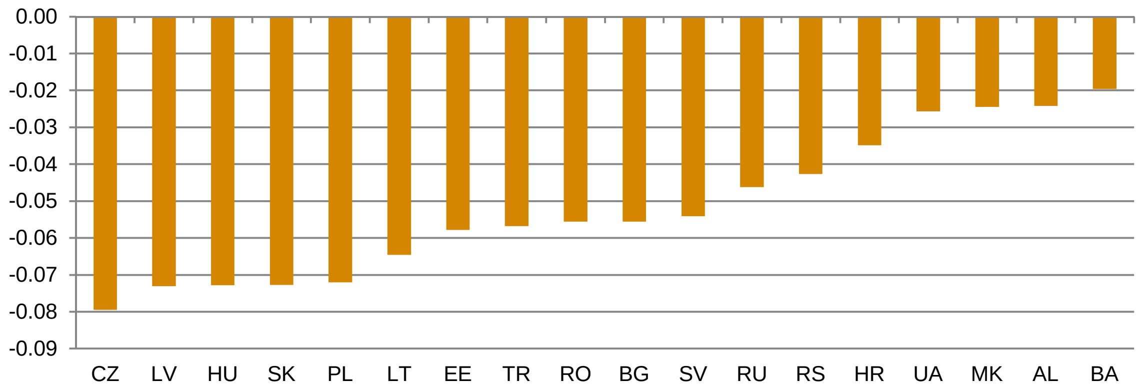
Source: Wider Europe WIOD (preliminary version, October 2016); wiiw calculations

The third column in Table 3 reports the share of value-added exports to the UK as a percentage of total value-added exports. Once again, where the EU-CEE countries are concerned, the UK accounts for a sizeable share in total value-added exports ranging from 6.3% in Poland to less than 3% in Croatia. The corresponding shares in the Western Balkan countries are much lower, standing at slightly less than 2% in Albania, Bosnia and Herzegovina and Macedonia and even lower at 0.5% in Montenegro. Only in Serbia does the UK account for a larger share in total value-added exports: 3.5%. That share is even higher in the case of Turkey with almost 6%, while Russia's share is slightly more than 4%. The share for the Ukraine stands at 1.8%.

THE IMPACT OF LOWER INCOME IN THE UK ON THE CESEE COUNTRIES' GDP

Given these trade relations, the question arises about the magnitude of the impact that a change in income in the UK would have on the CESEE countries' GDP. First, a decrease in UK final demand (household consumption, investment and government consumption) for both its domestic and imported products would reduce production in the UK and other countries via direct and indirect (i.e. third-country) trade linkages. Secondly, a reduction in income in all countries owing to the final demand shock in the UK would imply a further drop in demand for both domestic and foreign products in all other countries, thus leading to further induced effects on incomes. Using the definition of value added-exports given in Box 3 allows one to calculate the changes in GDP attributable to a 1% decline in final demand in the UK, together with the extent of the negative income and demand effects that it would trigger in all other countries.[18]

Figure 15 / Impact of a -1% final demand shock in the UK, in % of GDP



Note: The scenario assumes a drop in UK final demand by 1% and includes direct, indirect and induced effects (assuming a ratio of final demand to GDP change of 0.5).
Source: Wider Europe WIOD (preliminary version, October 2016); wiiw calculations

[18] This is taken into account by an iterative procedure assuming that final demand in all countries is changing by half of the decline in GDP. Formally, this corresponds to the so-called Type II multipliers which endogenise changes in household consumption because of exogenous shocks. For want of data (e.g. share of labour income in value-added) the procedure described above has to be applied. The ratio of a change in final demand relative to change in GDP of 0.5 has been assumed because a change in GDP is not immediately reflected in a change in final demand (for instance, on account of other exogenous components such as investment or government expenditures and other sluggish responses such as labour hoarding or changes in household savings rates).

The results of those model simulations are presented in Figure 15. As expected, those CESEE countries that are more exposed to the UK in terms of value-added exports are affected the most. That particular group includes the more advanced EU-CEE countries such as the Czech Republic, Hungary, Slovakia and Poland. However, even for those countries the actual impact on their GDP is comparatively minor. Were final demand in the UK to decline by 1 per cent, the GDP in those countries would drop on average by 0.06%, including the induced effects. The Western Balkan countries are far less affected; the findings of the modelling exercise point towards a decrease of some 0.02% of GDP.

SUMMARY

In summary, the trade exposure of the CESEE countries to the UK in terms of value-added trade is highest for the EU-CEE countries and ranges from 1% to 2% of GDP. Given the weaker trade links with the Western Balkan countries and Ukraine, the exposure in terms of GDP is lower: less than 0.5%. Turkey and Russia are positioned between the two groups. Any reduction in income in the UK in the wake of Brexit would have an impact on the CESEE countries via direct trade relations as well as international spillover effects. Our modelling results indicate that a 1% decline in UK GDP would on average result in a GDP loss of a mere 0.05% in the more advanced EU-CEE countries, while the impact on other CESEE economies would even be lower. Even the 'worst case' scenario, whereby on account of Brexit the UK GDP might cumulatively dip by as much as 10% over the long term, would only imply an aggregate long-term GDP loss of about 0.6% in the advanced EU-CEE countries and even less in the other CESEE economies. It should be emphasised that the figures cited do not take into account other channels such a negative impact arising out of a general mood of uncertainty in the EU or a broader impact on EU exports owing to changes in tariffs and the like. The figures should thus be interpreted as lower bounds.

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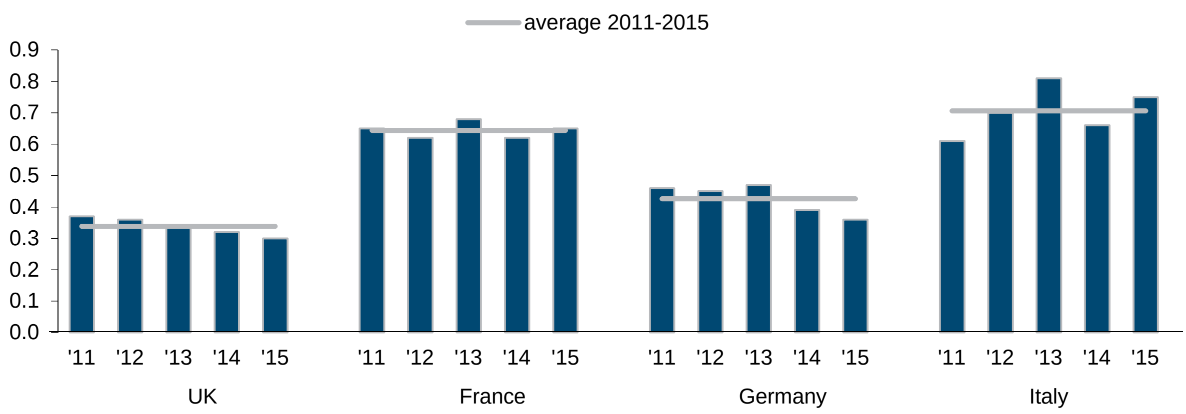
Special Section II: Brexit, the EU budget and the EU-CEE countries

SÁNDOR RICHTER

THE UK AND THE EU BUDGET

The relationship between the United Kingdom and the European Union's budget has always been difficult, the best-known feature of the relationship being the UK rebate. The UK's participation in EU-funded projects has invariably been significantly less fervent than that of the other three major economies in the Union: Germany, France and Italy. Figure 16 shows that over the past five years, EU-allocations to the UK, measured as a percentage of the country's GNI, were less than half of the corresponding allocations to France and Italy, and about a quarter less than the funds allocated to Germany. This is an old problem; it led to an excessive negative financial position of the UK and ultimately culminated in an agreement reached in 1984 on granting the UK a rebate so as to reduce the country's negative balance.[19]

Figure 16 / Expenditures from the EU budget allocated to major EU economies, in % of their GNI, 2011-2015



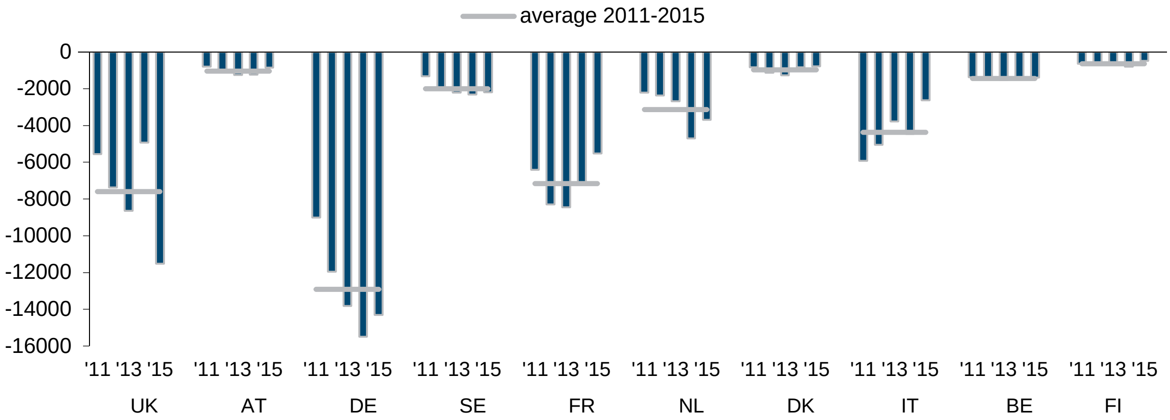
Source: European Commission.

A major issue during the public debate prior to the Brexit referendum was the magnitude of the UK contribution to the EU budget: in brief, the net financial position of the UK. Opponents of the UK

19 The UK 'abatement', 'rebate' or 'correction' is the ad hoc mechanism that is applied to reduce the UK's contribution to the EU budget by reimbursing 66% of the country's budgetary imbalance (the difference between payments and receipts). After granting the UK that rebate, other Member States argued that their EU budgetary burden was also excessive and asked that their contributions likewise be reduced, including those funds that they had paid to finance the UK rebate. This has led to a complex system of ad hoc permanent and temporary corrections. For the period 2014-2020, the Member States other than the UK benefiting from explicit corrections on the revenue side of the EU budget are: Austria, Denmark, Germany, the Netherlands and Sweden. Source: European Parliament (2016).

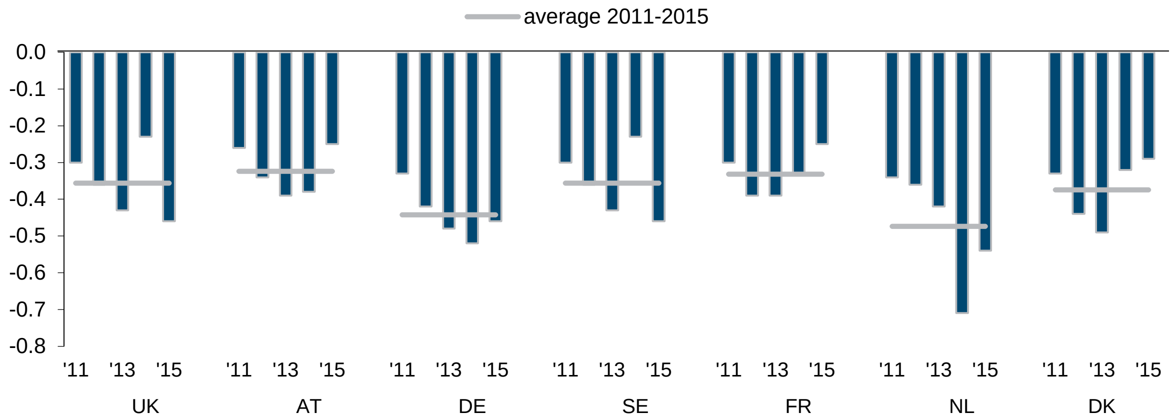
membership in the EU often discussed alternatives and possible ways of utilising those resources. Figure 17 shows the net financial positions of the net contributor Member States over the past five years, Figure 18 shows the net financial position of the major contributor Member States as a percentage of their GNI.

Figure 17 / Net financial position of net contributor Member States, in EUR million, 2011-2015



Source: European Commission.

Figure 18 / Net financial position of major net contributor Member States, in % of GNI, 2011-2015

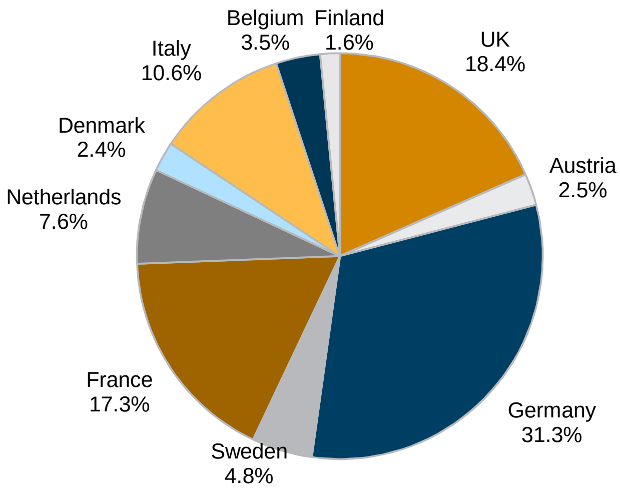


Source: European Commission.

Over the past five years the net contributor Member States have spent a total of some EUR 41.3 billion (annual average) on financing EU expenditures in net beneficiary Member States.[20] That sum can be considered the net cross-Member State redistribution via the EU budget. With its 18.4% share of the total, the UK ranked second (after Germany) among the most important contributors to that redistribution of resources across Member States (see Figure 19).

[20] http://ec.europa.eu/budget/figures/2007-2013/index_en.cfm; http://ec.europa.eu/budget/figures/interactive/index_en.cfm and own calculations.

Figure 19 / The share of net contributor Member States in the net cross-Member State redistribution in the EU, 2011-2015, in %



Source: Calculations based on European Commission data.

The real burden that cross-Member State redistribution imposes on individual net contributor countries is reflected in the weight of their net contributions as a percentage of their GNI (see Figure 18). Of the seven major net contributor countries in the EU, the UK with 0.36% of its GNI (the average for the period 2011-2015) lies mid-field; the onus on Germany and the Netherlands is much heavier, somewhat less on France and Austria and practically the same on Denmark and Sweden. Nevertheless it is important to bear in mind that in this particular case, the calculation of the UK net contribution shows the position *after* the rebate. In a 'normal case', i.e. not allowing for the rebate, the negative net financial position would have leapt to some 1% of the country's GNI.

THE EU BUDGET AFTER BREXIT

The easiest, but not necessarily the most expedient way of assessing the impact of Brexit on the EU budget is to reduce the annual total net redistribution of resources from EUR 41.3 billion to EUR 33.7 billion: a reduction of 18.4%, the UK share in the net cross-Member State redistribution via the EU budget.[21] Such a move would imply reducing to the same extent the transfers from the EU budget for the net beneficiary Member States, yielding some EUR 7.6 billion. It would deal a serious blow to cohesion policy among the net beneficiary countries. An alternative solution would be to have net contributor countries increase their EU budget contributions so as to offset the loss triggered by the UK's departure. The likelihood of that option being taken up is practically zero.

The situation, however, is far more complicated than that. First of all, the EU budget funds a variety of policies. Of those policies, the common agricultural policy is quite a different animal compared to the other programmes. Reducing support to the farmers (direct payments) would be well-nigh impossible, at least in the current 2014-2020 Multiannual Financial Framework (MFF). That may also hold true for the

[21] For an alternative approach estimating this impact see Ferrer and Rinaldi (2016).

funding of other expenditure items as well. It would imply introducing over-proportional cuts among the remaining items of expenditure, a prime target being those relating to the cohesion policy.[22]

The above considerations were based on the assumption that the UK will leave the EU *without* simultaneously entering into some kind of an agreement with the EU that preserves major features of its earlier EU membership mode. Another possible option is that after Brexiting, the UK adopts the Norwegian or Swiss model.[23]

Norway is a member of the European Economic Area (EEA). The Norwegians (just like the other two EEA members, Iceland and Liechtenstein) contribute to the EU budget in return for the right to participate in number of EU programmes (such as Horizon 2020, Erasmus and Galileo) and thus enjoy the benefits of European integration. More importantly, Norway contributes to European cohesion efforts by funding the availability of the *EEA and Norway Grants* scheme to the net beneficiary Member States.[24]

Table 4 shows Norway's relation to the EU budget in toto, Norway's contribution amounts to EUR 869 million a year in the current MFF; that corresponds to approximately 0.2% of Norway's GNI. About half of that contribution finances programmes in which Norway itself participates, the residual amount can be compared to the EU members' net contribution to the EU budget. Should the UK adopt the Norwegian model in the post-Brexit period, its 'net contribution' might drop GNI proportionally from 0.36% (2010-2015 average) to 0.09% (Norway's estimated share for the period 2015-2020): equivalent to 0.27 percentage points of its GNI. Translated into concrete financial terms, the resulting loss for the net beneficiary countries would amount to approximately EUR 5.5 -6 billion a year: a deterioration of about 13-14% compared to the pre-Brexit situation.

Table 4 / Annual EU-related payments by Norway in 2014-2020

Chapters	EUR mn
Payments for 15 net beneficiary MS	391
Justice and home affairs	6
Interreg	25
Participation in European programmes	447
Total	869
Total in % of GNI*	0,20
> Unilateral transfers for net beneficiary MS*	0,09
> For programmes with participation of Norway*	0,11

Notes: * Estimation.
Source: Norway Mission to the EU: http://www.eu-norway.org/eu/Financial-contribution/#.V7VpK6L09jw

Alternatively, the UK may choose to adopt the Swiss model in the post-Brexit period. Switzerland's relationship with the EU is looser than that of Norway; the country is not member of the EEA.

22 European Regional Development Fund, European Social Fund, Cohesion Fund, European Agricultural Fund for Rural Development and the European Maritime & Fisheries Fund.

23 A UK specific solution may include the UK paying a large fee to maintain certain privileges (such as passporting rights in finance) – see *Financial Times*, 'UK looks at paying billions into EU budget after Brexit', 17 Oct. 2016 (https://www.ft.com/content/a8ec5e90-938c-11e6-a1dc-bdf38d484582).

24 Norway Mission to the EU (2016).

Nevertheless, Switzerland contributes to the costs of EU programmes in which it participates as well as to programmes designed to reduce economic and social disparities within the EU. In the period 2011-2014 the latter programme known as “External Public Sector Funding Support for Economic and Social Cohesion in the ‘new’ EU Member States” amounted to about EUR 85 million a year.[25] That corresponds to less than 0.02% of the Swiss GNI, far less than Norway’s contribution.[26] If the UK were to opt for the Swiss model, its GNI proportional net contribution would drop from 0.36% to 0.02%. This means that each year the net beneficiary Member States would lose some 94% of the pre-Brexit UK net contribution (EUR 7.1 billion), equivalent to a 17% drop compared to the situation prior to Brexit.

TIMING MATTERS

The UK government intends to trigger article 50 by March 2017, formally notifying the EU of its intention to withdraw. If that happens, Brexit will enter on stream two years thereafter, before the current MFF comes to a formal conclusion in 2020 and the final payments are made under that particular framework in 2022. This is a matter of major concern, as the MFF programme operates on the basis of seven-year budgetary cycles that are carefully designed to ensure acceptance of the programme by stakeholders with quite divergent interests. Once this very delicate balancing act is signed and sealed, it is difficult to introduce any major changes to the allocation scheme.

Three major issues will have to be addressed.

First, it is all too likely that the Brexit negotiations and the notoriously difficult bargaining process over the upcoming MFF will coincide. This will make agreeing on the EU budget especially difficult where the cohesion policy-related expenditures are concerned, given the extreme divergence in the views and interests of the Member States that follow the fault line between the net contributors and net beneficiaries.

Second, given the tensions arising between Germany and the EU-CEE over the allocation of refugees, the latter group’s limited readiness to be part of the solution sets ‘solidarity’, the key word of European integration, in a new context. The highly developed segment of the EU is asking itself why it is sacrificing part of its GNI, if the would-be beneficiaries persist in showing no solidarity with its endeavours to solve the refugee crisis.

Third, more and more research–based information has revealed growing evidence of a persistent risk of corruption that it is often related to co-financed EU cohesion policy projects in the net beneficiary countries.[27]

The political consequences of the conflict over the refugee crisis, the ominous risks of corruption and the problems associated with Brexit, primarily the (partial or full) loss of the second most important net contributor country’s financial contribution to the EU budget, may well become a game-changer in the forthcoming negotiations on the upcoming MFF. The possibility of programmes being redesigned or cut

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25 Own calculation based on data of the Swiss Agency for Development and Cooperation SDC, Federal Department of Foreign Affairs. Evaluation and Corporate Controlling Division SDC Quality and Resources Unit SECO, 3/2016, p. 51.

26 Own estimation based on the wiiw Database.

27 Bold et al. (2013); Beblavý and Sičáková-Beblavá (2014); Corruption Research Centre Budapest (2016).

cannot be excluded, first and foremost those programmes where a considerable portion of the net contributors' funds is re-allocated to the net beneficiary Member States within the context of the EU budget. The primary targets may well be the European Regional Development Fund, the European Social Fund and the Cohesion Fund.

Notwithstanding the above, the net beneficiary Member States have no reason to start worrying in 2017 and 2018. It is highly improbable that any changes will be made in terms of the allocation of cohesion policy funds over the next two years. The risks of reduced cohesion policy transfers will, however, loom larger as time passes. They will become ineluctable in 2019-2020 and even more so thereafter.

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Special Section III: Ending the free movement of persons to the UK and its implications for the mobility of the EU-CEE countries

ISILDA MARA AND MICHAEL LANDESMANN*

EU enlargement eastwards marked a turning point for the economies and societies of the countries which joined the club. The EU enlargement has led to significant intra-EU mobility. Over the past fifteen years, movement from the EU countries in Central and Eastern Europe (EU-CEE)[28] to the EU-15 has ensued in three distinct phases following: (i) the first round of EU enlargement in 2004; (ii) the second round in 2007; and (iii) the onset of the international financial crisis in 2007-2008. The next event which is expected to affect the mobility patterns across the EU is the exit of the UK from the EU.

In the context of the forthcoming negotiations, the British government's declared position is to introduce a new migration regime in the UK that supposedly will reduce significantly net migration flows (from both the EU and the rest of the world): from a current level of 330.000 in 2015 to below 100.000 or thereabouts. Half of current net migration flows to the UK are from the EU. To date, details of the envisaged migration regime are still unknown and the same presumably applies to the outcome of the negotiations as well. Given this state of affairs, the question arises whether at the present juncture, conjectures are permissible as to the possible impact of Brexit on the mobility patterns of EU-CEE citizens headed to the UK and the implications that it might bear for future cross-border mobility in the EU.

In order to answer that question, it is useful to consider: (i) the magnitude of flows from EU-CEE countries to the UK starting with the eastern enlargement of the EU in 2004; (ii) the interaction between the push and pull factors and their impact on mobility of the EU-CEE countries; and (iii) the current position in which UK has been placed.

EU-CEE MIGRATION TO THE EU-15 AND THE UK

Looking back to the early 2000s, the stock of migrants from the EU-CEE countries to the EU-15 was 2.4 million.[29] By the end of 2015 the estimated stock was 8.5 million. Thus, within fifteen years, net migration from the EU-CEE countries to the EU reached almost 6.1 million[30] (see Table 5). Those figures suggest

* We are grateful to Vasily Astrov, Mario Holzner, Richard Grieveson and Robert Stehrer for useful comments and remarks.

28 The EU-CEE countries used throughout the text are: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia.

29 Source: UN Statistics (2016), recording of migrants by country of birth or citizenship.

30 ibid

that about 72% of the persons from EU-CEE residing in the EU-15 arrived after the EU underwent enlargement. The EU-CEE countries that have witnessed the largest net outward migration over that period relative to their populations[31] are: Romania (12%), Lithuania (7%), Bulgaria (7%), Poland (6%), Latvia (5%), Czech Republic and Estonia (4%). The main destinations for EU-CEE migrants have been: Germany (36%), the UK (18%), Italy (17%) and Spain (14%). In comparison to other EU-15 countries, the UK in particular has been the preferred destination: for Latvians (53%), Lithuanians (52%), Slovaks (51%), Poles (28%) and Hungarians (23%).[32] Net migration from the EU-CEE countries to the UK over the past fifteen years reached 1.1 million, less than half of whom (460,000) arrived during the first phase of EU enlargement. Notably, 42% of all Polish migrants to the UK arrived at that time. The largest influx of migrants from the EU-CEE countries invariably occurred immediately after their respective countries' accession to the EU.

Table 5 / Net migration from EU-CEE to EU-15, 2000-2015

Destination	Origin									
	Bulgaria	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	total
Denmark	4945	938	1041	2329	3775	7967	21472	12006	1227	274	55974
Finland	1850	-38	44710	1933	1705	1075	3944	2383	200	49	57811
Ireland	893	2681	1215	6062	13105	22588	86857	14399	6554	123	154477
Sweden	5005	1417	246	2431	4369	9941	43419	13447	1276	531	82082
United Kingdom	**46697**	**29786**	**7418**	**43445**	**61914**	**112647**	**644354**	**82023**	**62684**	**1106**	**1092074**
Greece	34359	738	69	156	296	378	334	19882	456	23	56691
Italy	47291	4728	990	7837	2564	5066	75481	902877	7723	-129	1054428
Portugal	4390	111	-99	171	130	222	588	19251	61	24	24849
Spain	126438	6903	1751	8012	3797	16620	55253	649643	6891	1095	876403
Austria	4845	16939	114	26371	247	280	23461	38899	8368	1922	121446
Belgium	25401	3142	950	5090	1746	2327	61806	54801	5873	882	162018
France	7614	-3181	28	-3717	1396	970	-32145	55800	1503	-978	27290
Germany	72117	442672	2571	83854	17722	33320	1259480	267267	18409	13578	2210990
Luxembourg	784	826	512	966	483	588	2585	1439	647	435	9265
Netherlands	17064	-3980	772	7650	2947	4091	82246	10721	478	126	122115
EU-15	**399693**	**503682**	**62288**	**192590**	**116196**	**218080**	**2329135**	**2144838**	**122350**	**19061**	**6107913**

Source: Own calculations using UN Statistics. United Nations, Department of Economic and Social Affairs (2015). Trends in International Migrant Stock: Migrants by Destination and Origin (United Nations database, POP/DB/MIG/Stock/Rev.2015).

PUSH AND PULL FACTORS OF MOBILITY

In institutional terms, the EU enlargement process was characterised by transitional periods: the 2+3+2-year formula that permitted the regulation of mobility and the free movement of workers. During the first phase of EU enlargement that started in 2004, eight CEE-countries (EU-8) were granted EU membership[33]. Except for the UK, Sweden and Ireland, the remaining EU member states (EU-15) exercised their right to impose transitional restrictions on the free movement of workers from the EU-8[34].

31 Population of the country of origin in 2015

32 Source: UN Statistics(2016)

33 The new members were Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia.

34 EU-8 comprises Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia.

Exceptionally, Germany and Austria imposed the longest transitional period tending over all seven years. These variances in the application of the transitional arrangements contributed significantly to determining the pattern of the EU-CEE countries' mobility within the EU.

In terms of economic push and pull factors, the EU-CEE economies prior to enlargement, were characterised by high unemployment rates[35]. By way of contrast, the UK and some other EU-15 countries had far lower unemployment rates – in the order of some 5%. The significant difference in unemployment rates worked as a strong push factor, but as an even stronger pull factor, favouring the UK and, to a lesser extent, the other EU-15 countries as well (where, however, transitional arrangements had entered into effect).

The other factor was the earnings differential between the EU-CEE and EU-15 countries, including the UK, where monthly earnings in purchasing power standard terms (PPS) were three times higher than those in the EU-CEE countries. At the time the UK was an economy with a substantial growth differential compared to the rest of the EU-15 countries; it thus attracted EU-CEE migrants like a magnet. In 2003, GDP in the UK was growing at a rate of 3.5%[36] as against a growth rate of 1.2% in the EU-15 (see Overview Table 1). Accordingly, both institutional and economic factors particularly favoured the mobility of EU-CEE migrants to the UK.[37]

In the second round of EU enlargement in 2007 when Romania and Bulgaria (EU-2) joined the EU, all the other EU-15 member states, with the exception of Finland and Sweden, opted for transitional restrictions, thus limiting the mobility of workers from the EU-2. Given its experience of how net migration from the EU-CEE peaked immediately after the first wave of EU enlargement, the UK endeavoured to stem the flow of migrants from the EU-2 by imposing transitional arrangements on workers from both countries.

The international financial crisis that struck at the end of 2007 marked the onset of economic recession in the UK and the other EU economies. The consequences are self-evident, the main traits being: (i) the economic slowdown in both the EU-CEE and EU-15 countries (see Overview Table 1); (ii) a rise in unemployment rates throughout the EU-27; and (iii) a significant drop in net migration from the EU-8 to the UK that fell to below 20,000 in 2010 [38] (see Figure 20).

This phase was nonetheless characterized by a new shift in migration flows towards the UK. Especially, there has been a considerable outward migration of Romanian and Bulgarian nationals from Spain and Italy – two of the main destination countries of EU-2 migrants that were in deep economic crisis from 2008 onwards. As a result, 29% of the EU-CEE migrants moved to the UK in the period 2010-2015 as against 17% in the period 2005-2010. By way of contrast, Spain registered a net outflow of 9% of EU-

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35 In 2003 Poland recorded an unemployment rate of 19.6 %, Slovakia 18% unemployment rate and the Baltic states more than 10%.

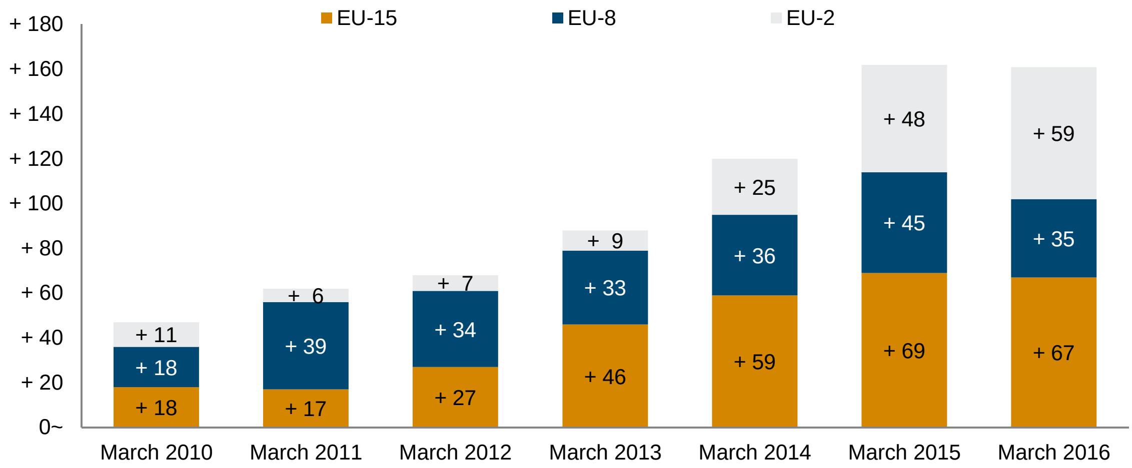
36 The sources of statistics are Eurostat and wiiw Annual database.

37 Certainly, other pull factors such as networks, language, distance or geographical proximity matter and determine the migration choice, but in this context they have not been addressed.

38 Year ending in March. The data provided for 2015-2016 are still provisional, Source: Migration Statistics Quarterly Report: August 2016, http://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/internationalmigration/bulletins/migrationstatisticsquarterlyreport/august2016

CEE migrants (mainly EU-2 nationals), whereas Italy attracted a meagre share of 0.05% in the period 2010-2015.

Figure 20 / Net migration[39] from EU-2, EU-8, and EU-15 to the UK, 2010-2016, in thousands



Source: UK Office of National Statistics.[40]

Once the transitional restrictions on Romanians and Bulgarians were lifted at the beginning of 2014, net migration to the UK accelerated, reaching almost 60,000 by the end of March 2016, on a year-on-year basis, Figure 20. This suggests that the UK still remains an attractive destination for migrants from Bulgaria and Romania despite the recent economic recovery in their home countries.

EU-CEE MIGRANTS AND THE UK JOB MARKET

Migration from the EU-CEE countries to the UK has been primarily driven by the search for jobs and earnings.[41] Employment statistics relating to migrants from the EU-CEE countries show that EU-2 and EU-8 migrants are well placed in the UK job market. The figures for the period 2004-2015 show that migrants from the EU-CEE countries enjoy high employment rates that are stable over time, exceed the employment rates of British citizens and outstrip by far those of non-EU migrants (see Figure 21). However, in terms of earnings, migrants from the EU-CEE countries find themselves being paid wages far below those paid to native workers[42] and all other migrant groups; on average, the migrants from the EU-CEE countries earn around GBP 8.3 an hour compared to GBP 11.1 an hour earned by native workers (see Figure 22). In terms of occupations, EU-CEE migrants are mainly concentrated in those sectors of the economy, such as manufacturing, domestic personnel, transport, services and construction, in which both native workers and other EU or non-EU migrants are less frequently found.

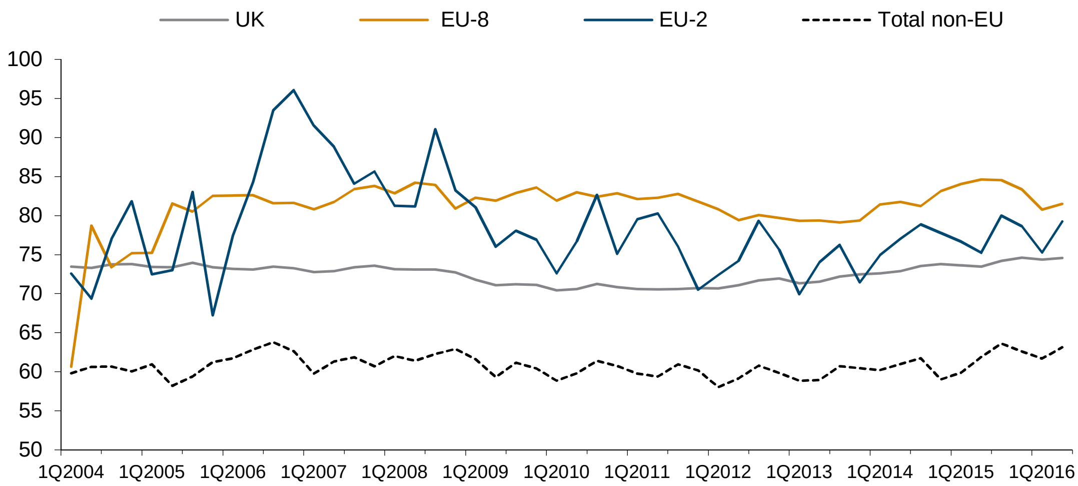
[39] Annual net migration = inflow – outflow of international migrants within a given year (March is considered the end of the year).

[40] https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/internationalmigration/

[41] According to the Office of National Statistics in the UK (2016), migration from the EU to the UK for study purposes amounted to 47,000 by end of June 2015. 6,000 and 3,000 originated from EU-8 and EU-2, respectively. Work motives are prevalent among the EU-CEE migrants, whereas students might be more of an issue for migrants from the EU-15.

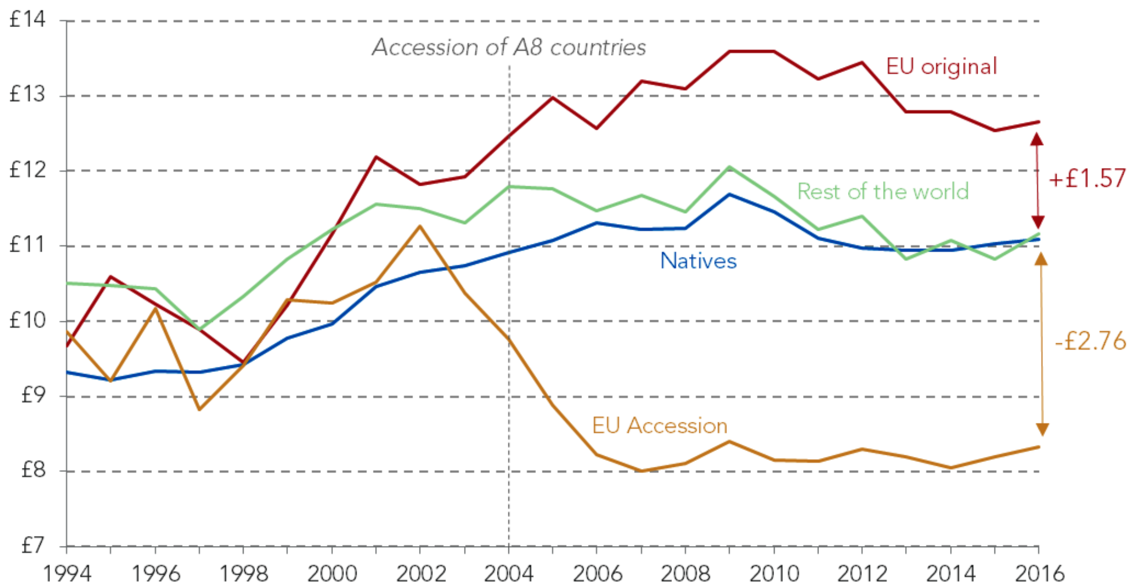
[42] S. Clarke (2016), 'A Brave New World: how reduced migration could affect earnings, employment and the labour market', Resolution Foundation Briefing, p 10.

Figure 21 / Employment rate in the UK, by country of origin, age 16-64



Source: UK Office of National Statistics.[43]

Figure 22 / Median hourly earnings in the UK, natives and migrants, 1994-2016



Source: RF Analysis of LFS.[44]

FUTURE MOBILITY OF EU-CEE MIGRANTS TO THE UK

More recently, the pattern of push and pull factors inducing EU-CEE migration has changed. The difference in unemployment rates in the country of origin compared to EU-15 is no longer that dominant a factor (on average the unemployment rate in the EU-CEE region is lower than in EU-15, see Overview

43 https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/internationalmigration/

44 Source: Clarke (2016), op. cit, p. 10.

Table 1). However, despite wage differentials having narrowed from EUR 1,500 to 1,130 per month in PPS terms, the income gap between the EU-CEE and EU-15 countries still remains a strong pull factor triggering further migration (see Table 30).

As for EU-CEE citizens currently working in the UK, they are unlikely to be affected by the change in migration regulations (which will enter into effect in 2019 at the earliest when Brexit goes on stream). As EU-CEE migrants mostly work in sectors that native workers/other migrants are less inclined to choose and the wages they are paid are far lower than those earned by native workers, it will be hard to find native workers or other migrants to replace them.

From the current perspective, the measures that the UK is planning to impose on immigration from the EU following Brexit are shrouded in uncertainty, as are the means by which the intensity of mobility from the EU-CEE countries will be curbed. Brexit negotiations between the EU and the UK have yet to start and in the UK itself, many and diverse are the views regarding the possible type of migration regime to be applied. Among the options that could be negotiated might be a new points system or the migration criteria already applied to non-EU migrants being extended to EU migrants as well.

Any restrictions imposed (as well as the UK's loss of attractiveness) would lead to a diversion of mobility patterns away from the UK to other EU countries. A likely outcome could well be a redirection of the flow of migrants to neighbouring and wealthier countries, such as Germany or Austria, whose labour markets are fully open to EU-CEE migrants. To a certain extent, independent of the EU referendum in the UK, some redirection has already taken place. In 2015, net migration from the EU-CEE countries to Germany reached 224,000 (100,000 from the EU-8 and 124,000 from the EU-2: a substantial increase compared to the period 2013-2014). From the perspective of the sending countries and in terms of net migration to the UK (defined as a share of the population of the country of origin as well as the share of migrants sent), the EU-CEE countries most likely to be affected by Brexit are: Poland, Lithuania, Latvia and Romania.

CONCLUSION

We assess the likely impact of Brexit on migration flows within the EU as follows:

Even without any changes to the migration regime in the wake of Brexit, we would expect a decline in EU-CEE migration to the UK. As Figure 1 has shown, net migration flows from the EU-8 had already started to level off from 2012 onwards. Thereafter net flows from the EU-15 increased strongly, a trend largely attributable to both the crisis in Southern Europe and the inflows from the EU-2. The increase in flows from Romania and Bulgaria is due to: (i) the fact that the transitional restrictions on full labour market access were only lifted at the beginning of 2014; and (ii) the traditional target countries for EU-2 migrants in the southern areas of the EU countries were beset by a deep crisis. The impact of those developments accounted for the redirection of flows to the UK.

Irrespective of changes to the migration regime, the UK can expect a slowdown in EU-CEE migration to its shores on a number of counts. First, certain countries in the southern region of Europe, notably Spain, are currently experiencing a recovery. Secondly, the UK will no longer enjoy the same positive growth differential vis-à-vis other advanced European economies that it had enjoyed over the past three years (most forecasters have significantly revised their growth prognoses downwards – partly on account of Brexit). Thirdly, the end of the initial bulge of migrant flows following the expiry of the transitional restrictions means that EU-2 net outflows would have declined in any event, further to which Romania has also recently embarked on relatively rapid growth.

In the light of the foregoing, it is quite conceivable that the flow of migrants from the EU-CEE countries to the UK will drop from the level of 95,000 registered in the biennium 2015-2016 to some 50-60,000 from 2019-1920 onwards, even without any new migration restrictions. Given that Brexit will also diminish the UK's attractiveness as a location for international businesses and professionals, the net flows from the EU-15 will also decline to 45-50,000 as against the high levels registered in the biennium 2015-16. Thus, without imposing any restrictions on migration, one can reckon with net flows of some 100,000 migrants from the EU in the longer term – down from some 160-180,000 in 2015/16. In the eyes of the electorate, that figure would already amount to a substantial drop, thus greatly facilitating the task of reaching an agreement on additional migration controls in the forthcoming Brexit negotiations.

In response to migration restrictions, migration from the EU-CEE to the UK might in part take on more of a 'circular' form, with migrants staying for short spells in the country conditional on the duration of their visas. As visas become more difficult to obtain, people may start overstaying their visas more frequently than at present. Migration for study purposes may well become a more recurrent channel for migration to the UK, especially since British universities will lobby hard to keep access open to students from the EU. The frequency with which EU-CEE citizens migrate onwards from the UK to other EU destinations might also increase.

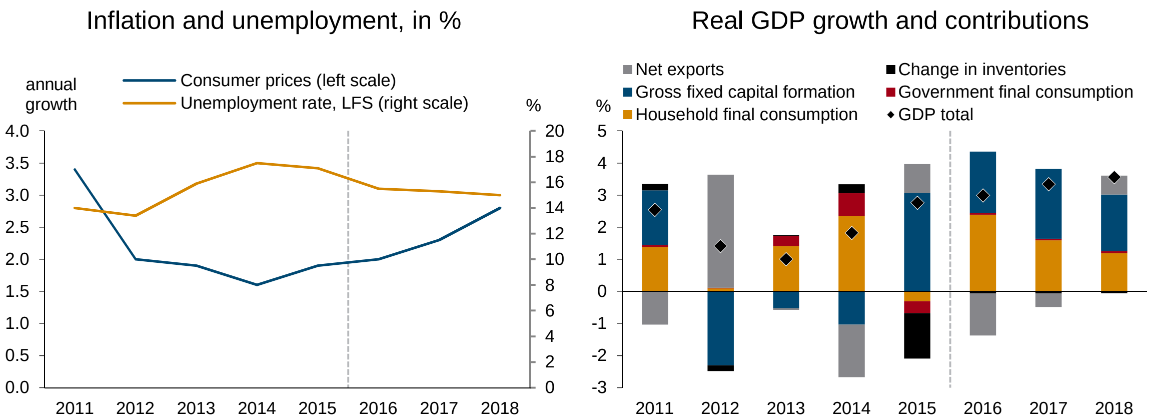
Country reports

ALBANIA: China, the new old strategic partner?

ISILDA MARA

Buoyant household consumption and private investment have had a positive impact on the acceleration of GDP growth, whereas sluggish external demand for Albanian products partly attributable to shrinkage in oil and mineral exports has had the opposite effect. Fiscal consolidation has for the most part been backed by containment of expenditures and a rise in revenues. Based on expectations of vigorous domestic demand, we have revised our forecast upwards slightly to 3.0%, 3.3% and 3.6% for 2016, 2017 and 2018, respectively.

Figure 23 / Albania: Main macroeconomic indicators



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

The political turmoil during summer 2016 ended up with the judicial reform finally seeing green light from the parliament. The reform was unanimously voted by the governing and the opposition parties under the constant pressure put forth by the international partners. The reform aims to combat the high corruption in the judiciary system. Besides it is one of the key conditions for the opening of EU membership negotiations. In the medium and long run, the reform is expected to improve law enforcement and the business climate as well as to assure fairer competition. Currently, the political debate is centred on a law on ‘integrated management of waste’, the latter to be imported from the European Union. The law had been repealed in October 2013, but was relaunched in September this year by the current government; it has encountered a lot of resistance on the part of the civil society, environmentalists but also ordinary citizens. They are sceptical about the hazardousness of the waste that will enter the country and the ability to properly control it, and are trying to get through a referendum on the issue.

In economic terms, for the first half of 2016, compared with the same period in 2015, a rise in overall domestic demand of 3% stimulated the economy to grow at a similar rate. With reference to the same period, exports continued to be oriented mainly towards services and less towards goods – in nominal terms the former increased by 13% while the latter dropped by 26%; low international oil prices continued to affect negatively the mining industry; gross fixed capital formation grew by 5% in real terms while foreign direct investments, despite a fall by 12% in euro terms, still poured in at a level which corresponds to 72% of the current account deficit.

Household consumption rose by 2.8% during the first half of 2016, year on year, partly due to low inflation, but also owing to the upsurge in employment by 0.9 pp, to 48.4%, and the fall in unemployment by 1.8 pp, to 15.5%, partly attributable also to the government campaign against informality. Even though emigrants transferred less remittances, -5% in the first half of 2016, year on year, still these stood at a remarkable 5% of GDP.

In fiscal terms, consolidation has characterised public finances until August 2016. For the first time since 2008 a budget surplus of 2.2% of GDP has been achieved for the first half of 2016, triggering a reduction in the public debt to GDP ratio from 72% to 70.8%. Until August, on a year-on-year basis, revenues increased by 7%: the collection improved especially in VAT, profit, and personal income and excise taxes. For the same time span, on a year-on-year basis, expenditures were cut by 4.8%. The shrinking occurred mainly on account of arrears and to a lower extent due to interest payments, wages and social benefits, whereas capital expenditures almost stagnated. According to the national accounts, final government consumption has been on the positive side but rather flat for the first half of 2016. The budget revision in July 2016 was characterised mainly by a reallocation of expenditures towards covering recently generated arrears (between January and April 2016 amounting to LEK 1,383 million). Moreover, the general elections to be held in mid-2017 hint at the possibility of government spending to slightly accelerate for the rest of the year.

In monetary terms, the monetary easing of central bank has been preserved also in 2016 with a policy rate maintained at a low level of 1.25%. Until August, the level of overall loans stagnated, year on year. Still, total new loans to businesses slowed down by 2.1%. Such a tendency among businesses can be partly explained by tighter credit standards applied to businesses. It is also reflected in the deterioration of confidence indicators for the industry and trade sectors. In contrast, new loans to households moved up by 11.5% in the first eight months of 2016 as compared to the same period a year earlier. The consumer confidence indicator also improved. In terms of currency, new loans in domestic currency grew, both for businesses and households. In contrast, new loans in foreign currency fell, lowering the exposure to exchange rate risks. Non-performing loans have started to move up again, to a level of 21% of total loans in the first half of 2016. The further increase in NPLs is also attributable to the bankruptcy of Kurum Albania early this year: one of the biggest steel producing companies in Albania belonging to the Kurum Holding Group, based in Turkey. Already in 2015 a new strategy and a new bankruptcy law, aiming to better deal with NPLs, were drafted under the technical assistance of the IMF. However, a further deterioration of NPLs is not excluded if the law and the strategy do not become effective.

As concerns external demand, exports continue to be driven mainly by the textile and garments industry, with a share of 45% and an increase of 21% year on year in January to August 2016. In contrast, in the same period exports of minerals, fuels and electricity declined by 13% in real terms and by 39% in nominal terms. Despite the sharp decline in nominal terms, the increase in real terms by 2% experienced during July-August 2016 indicates some recovery of the sector. The recent changes reflect the moderate rise in international oil prices which started in the second quarter of 2016. In contrast, imports increased by 8%. In particular, the 18% rise in import of machinery and equipment points to a further recovery in private investments.

A further stabilisation of international oil prices might reverse the decline in exports of minerals, fuels and electricity. Bankers Petroleum, the main oil producer, has entered into an agreement with the Albanian government to sell up to 65% of its crude oil in the domestic market. At the same time the Chinese government has approved an arrangement between the Canadian Bankers Petroleum and the Chinese Geo-Jade Petroleum Corporation about the acquisition of the former by the latter. The acquisition by the Chinese company ‘China Everbright International Limited’ of the Tirana International Airport in early October 2016 points to an increasing influence of China in strategic sectors of the Albanian economy. (These developments are reminiscent of the close alliance Albania and China had between the late 1950s and the late 1970s.) Foreign direct investments, despite the setback in the first half of the year, are expected to regain importance for the Albanian economy especially through two key infrastructure projects: the TAP (Trans Adriatic Pipeline) and the Devoll Hydropower station project which are moving forward.

All in all, the recent GDP growth acceleration has been fuelled by buoyant household consumption and private investments, but dragged down by sluggish external demand partly attributable to oil and mineral exports shrinking in nominal and real terms. The magnitude of external imbalances will continue to depend largely on the oil price; some optimistic signals in this respect have started to become evident with the recent dynamics. Fiscal consolidation is ongoing and is backed by a rise in revenues but also a slight restraint on expenditures. Based on expectations of stronger domestic demand (household consumption and private investment), our forecasts are that the economy will grow by 3.0%, 3.3% and 3.6% in 2016, 2017 and 2018, respectively.

Table 6 / Albania: Selected economic indicators

	2012	2013	2014	2015 1)	2015	2016	2016	2017	2018
					January-June			Forecast	
Population, th pers., average	2,900	2,897	2,894	2,889	.	.	2,886	2,880	2,870
Gross domestic product, ALL bn, nom.	1,333	1,350	1,394	1,436	699	721	1,500	1,600	1,700
annual change in % (real)	1.4	1.0	1.8	2.8	2.7	3.1	3.0	3.3	3.6
GDP/capita (EUR at exchange rate)	3,300	3,300	3,400	3,600	.	.	3800	4000	4300
GDP/capita (EUR at PPP)	7,800	7,700	8,300	8,600	.	.	.	.	.
Consumption of households, ALL bn, nom.	1,032	1,074	1,130	1,141	576.6	596.0	.	.	.
annual change in % (real)	0.1	1.8	3.0	-0.4	-2.0	2.8	3.0	2.0	1.5
Gross fixed capital form., ALL bn, nom.	353	352	343	391	166.3	176.6	.	.	.
annual change in % (real)	-7.9	-2.0	-4.0	12.5	15.4	5.2	7.0	8.0	6.5
Gross industrial production									
annual change in % (real)	15.7	28.3	1.6	-5.0	-2.2	-12.7	-7.0	1.0	2.0
Gross agricultural production 2)									
annual change in % (real)	5.7	-3.4	2.0	2.9	.	.	.	.	.
Construction output total									
annual change in % (real)	-11.4	-13.0	5.0	19.3	20.1	1.7	.	.	.
Employed persons, LFS, th	1,140	1,024	1,037	1,087	1,075	1,139	1,150	1,170	1,180
annual change in %	-1.8	-10.2	1.3	4.8	7.0	6.0	5.8	1.7	0.9
Unemployed persons, LFS, th	176	194	220	224	219	217	210	210	210
Unemployment rate, LFS, in %	13.4	15.9	17.5	17.1	17.0	16.0	15.5	15.3	15.0
Reg. unemployment rate, in %, end of period	12.8	13.5	13.0	12.9	13.8	10.7	.	.	.
Average monthly gross wages, ALL	37,534	36,332	36,997	38,077	.	.	39,200	41,700	42,000
annual change in % (real, gross)	0.9	-5.0	0.2	1.0	.	.	1.0	4.0	2.0
Consumer prices, % p.a.	2.0	1.9	1.6	1.9	1.9	0.7	2.0	2.3	2.8
Producer prices in industry, % p.a.	1.1	-0.4	-0.5	-2.1	-1.5	-3.0	-3.0	-1.0	1.0
General governm.budget, nat.def., % of GDP									
Revenues	24.8	24.2	26.3	26.5	26.1	27.5	28.0	28.5	28.5
Expenditures	28.2	29.2	31.5	30.5	28.0	25.3	27.5	28.5	29.0
Deficit (-) / surplus (+)	-3.4	-5.0	-5.2	-4.0	-1.9	2.2	0.5	0.0	-0.5
Public debt, nat.def., % of GDP	62.1	65.6	70.1	72.7	70.8	71.3	69.0	65.0	62.0
Central bank policy rate, % p.a., end of period 3)	4.00	3.00	2.25	1.75	2.00	1.25	1.25	1.50	1.75
Current account, EUR mn 4)	-978	-1,049	-1,287	-1,105	-394	-578	-1,300	-1,200	-1,150
Current account, % of GDP 4)	-10.2	-10.9	-12.9	-10.8	-7.9	-10.7	-11.9	-10.3	-9.3
Exports of goods, BOP, EUR mn 4)	1,526	1,051	932	771	423	320	620	610	630
annual change in %	8.5	-31.1	-11.3	-17.2	-12.1	-24.3	-20.0	-2.0	3.0
Imports of goods, BOP, EUR mn 4)	3,525	3,030	3,147	3,070	1,400	1,576	3,350	3,550	3,690
annual change in %	-3.4	-14.0	3.9	-2.5	-3.8	12.6	9.0	6.0	4.0
Exports of services, BOP, EUR mn 4)	1,673	1,715	1,881	2,028	877	1,006	2,270	2,430	2,620
annual change in %	-4.2	2.5	9.7	7.8	8.4	14.7	12.0	7.0	8.0
Imports of services, BOP, EUR mn 4)	1,460	1,489	1,558	1,503	633	708	1,640	1,720	1,820
annual change in %	-9.5	2.0	4.6	-3.5	-11.5	11.8	9.0	5.0	6.0
FDI liabilities (inflow), EUR mn 4)	666	945	869	890	473	418	790	.	.
FDI assets (outflow), EUR mn 4)	18	22	58	72	23	35	45	.	.
Gross reserves of NB excl. gold, EUR mn	1,909	1,971	2,142	2,831	2,335	2,767	.	.	.
Gross external debt, EUR mn 4)	5,513	6,368	6,927	7,686	7,230	7,881	7,900	8,300	8,600
Gross external debt, % of GDP 4)	57.5	66.2	69.5	74.8	70.4	72.0	72.0	71.0	70.0
Average exchange rate ALL/EUR	139.04	140.26	139.97	139.74	140.43	138.28	137	137	138
Purchasing power parity ALL/EUR	58.64	60.67	58.25	57.97	.	.	.	.	.

1) Preliminary. - 2) Based on UN-FAO data, from 2014 wiiw estimate. - 3) One-week repo rate. - 4) From 2013 based on BOP 6th edition, 5th edition before.

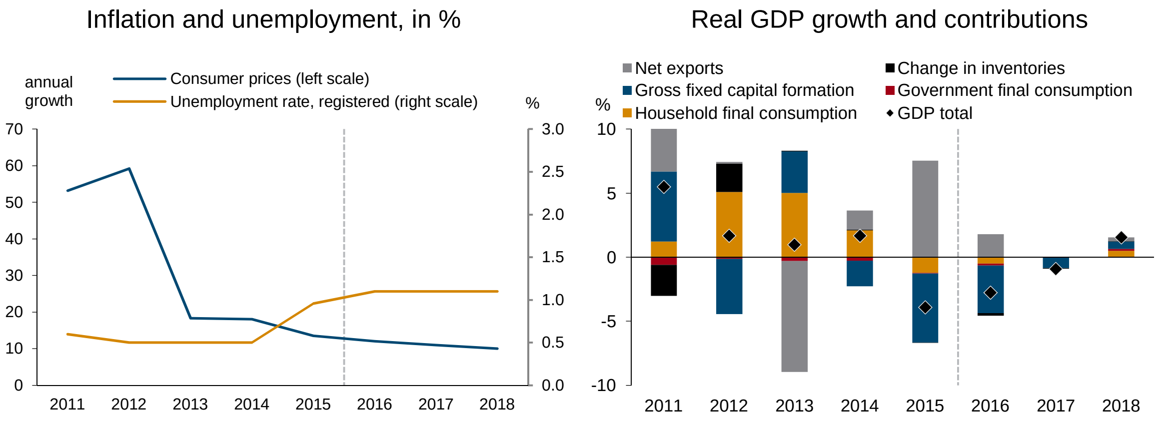
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

BELARUS: No end to the recession in sight

RUMEN DOBRINSKY

The recession in Belarus has continued for the second year running. GDP dropped by 2.5% in the first half of 2016. Balance of payments constraints have compelled Belarus to pursue macroeconomic austerity policies, which dampened economic activity. The country's problems have been compounded by a dispute with Russia over gas prices. GDP growth in 2016 as a whole will be negative and the recession will most likely continue into 2017.

Figure 24 / Belarus: Main macroeconomic indicators



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

The recession in Belarus is still in full swing for a second consecutive year. GDP fell by 2.5% in the first half of 2016 and while the aggregate output decline was decelerating in the first six months, it started accelerating again in July-August. Industrial output (industry being the backbone of the Belarusian economy) followed a similar dynamic: while in year-on-year terms monthly industrial output turned the corner in April-May, it switched back into the red in the months that followed.

The causes for the continuing recession in Belarus are numerous and involve both external and domestic factors; structural as well as cyclical elements. Regarding the external environment, the main negative factor is the continuing slump in the Russian economy – Belarus' main market – which translates into further reduction in the demand for exports from Belarus. In 2016, this was aggravated by an ongoing dispute between the two countries on the price of gas. The actual price for gas delivered from Russia is still unsettled, each side sticking to its understanding of how the agreed price mechanism translates into a price level (the latter is higher according to Russia and lower according to Belarus). Meanwhile Russia treats the implied price difference vis-à-vis the price it has set but which was not paid by the other side as unpaid Belarusian debt and insists on the settlement of this debt.

In 2016, Russia started applying oil deliveries as a lever in an attempt to press Belarus to pay these accumulating liabilities and reduced oil supplies. Russia is virtually the only external supplier of oil for Belarus and the Belarusian economy (especially the manufacturing industry) is extremely dependent on this supply. According to Belarusian estimates, the delivery shortage for 2016 as a whole may amount to 5 million tonnes (18 million instead of the 23 million initially planned). The undersupply of resources hurts the Belarusian oil processing and chemical industries and impacts negatively on Belarusian exports. In the first half of 2016 total Belarusian exports of goods dropped by some 12% year-on-year in current euro terms after the 11% year-on-year drop experienced in the first half of 2015.

On top of that, Belarus is facing balance of payments constraints due to the large service of the external debt and the inability to raise sufficient new external finance. Hence, it has been pursuing policies of macroeconomic austerity, mainly by tightening the fiscal stance and incomes policies. This has contributed to the curbing of domestic demand (in the first place public investment but also private consumption), with negative implications for output. Thus the Belarusian economy at present is facing both an external and a domestic squeeze.

Confronted with uncertain future prospects, firms have also been downsizing their investment programmes. Access to credit is difficult as banks are burdened with a growing pile of substandard and non-performing loans while the government has scaled down directed credit. As a result, gross fixed capital formation is shrinking at double-digit rates for a second year in a row.

On the other hand, macroeconomic austerity and the ensuing suppression of private consumption contributed to the stabilisation of the exchange rate and the lowering of inflationary pressure. Belarus now adheres to a floating exchange rate regime (with the US dollar as the reference currency) under monetary targeting and despite the lack of direct controls, the nominal exchange rate vis-à-vis the dollar has basically been flat during the past several months.

Belarus' central bank has been sticking to its tight monetary targets which also contributes to the harsh macroeconomic environment. Many commercial banks experience liquidity problems due to a maturity mismatch in their balance sheets: large outstanding long-term credits (including those extended under directed lending) on the asset side and prevailing short-term deposits on the liability side. Additionally, many banks are burdened with non-performing loans which further aggravates their liquidity problems. In an attempt to address some of the problems in the banking sector, the government established in July 2016 an Agency for Asset Management which is due to take over non-performing loans from commercial banks, in the first place those extended to agricultural firms.

On 1 July Belarus implemented a currency redenomination crossing out four zeros of the Belarusian rouble. The operation was technically well prepared and went ahead smoothly. So far there have been no visible effects of this operation on daily life or the price dynamics. Inflation notably slowed down its pace and now seems to be approaching the desirable single-digit level.

In the absence of LFS-based statistics, it is difficult to assess the full effect of the recession on the Belarusian labour market. Initially, there was a moderate surge in the number of registered unemployed but starting in May this trend was reversed. However, the statistics on employment in the current year indicate a drop of some 2% in the number of employed compared to 2015.

The foreign debt remains a heavy burden on the Belarusian economy. In the first half of 2016, Belarus allocated USD 2.97 billion to foreign debt service, of which USD 2.25 billion were apportioned to the repayment of maturing debt and USD 716 million were disbursed for interest payments. Given the recessionary environment and the fall in foreign exchange revenue due to shrinking exports, debt service is impossible without new external borrowing. The main such source in 2016 was the Eurasian Fund for Stabilisation and Development (EFSD – an instrument of the Eurasian Development Bank). In March 2016, Belarus struck a deal with EFSD on a USD 2 billion loan which is due to be disbursed in 7 tranches over the period 2016-2018. Belarus already received two tranches totalling USD 800 million, and a third tranche worth USD 300 million is expected until the end of 2016.

Since 2015, Belarus has been conducting negotiations with the IMF for a new IMF-funded programme. However, the two sides have not been able to agree on the terms of this programme so negotiations are still ongoing and their outcome is uncertain. Belarus has also announced its intention for a Eurobond emission worth USD 800 million but the issue date has been postponed several times. The next target date is in 2017.

While there have been major shifts in macroeconomic policy after the currency crisis of 2014-2015 equivalent to a significant tightening of the policy stance, Belarus is still far from a point of a stable macroeconomic equilibrium. One chronic source of instability is the lack of hard budget constraints on the operations of state-owned firms and banks. In these circumstances the state-owned sector continues to generate a quasi-fiscal deficit which keeps accumulating, thus undermining the foundations of public finances and, ultimately, the declared objectives and efforts of macroeconomic policy. However, addressing the issue of soft budget constraints would entail restructuring of the state-owned sector of the economy, including the shedding of redundant labour. It remains to be seen whether the Belarusian authorities would be prepared to take radical steps in these directions.

In these circumstances no end to the recession is in sight in the short term. The authorities are likely to go on pursuing tight monetary, fiscal and incomes policies in the foreseeable future and these will continue to curb domestic demand. The external environment remains uncertain due to both the weakness of the Russian economy and the unsettled gas dispute with Russia. The foreign debt service and the ensuing balance of payments constraints further reduce the room for manoeuvre of policy-makers. Therefore, the rate of GDP growth is bound to be negative for 2016 as a whole and most likely will stay in negative territory in 2017. On the other hand, macroeconomic austerity supports the process of disinflation and the curbing of inflation expectations; this process can be expected to continue in the years ahead. So far the Belarusian authorities have managed to escape a full-blown foreign debt crisis and there are no signs that such a crisis is imminent. However, the macroeconomic situation is still fragile and will need further policy stabilisation efforts, especially through the restructuring of the state-owned part of the economy.

Table 7 / Belarus: Selected economic indicators

	2012	2013	2014	2015 1)	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., average	9,465	9,466	9,475	9,490	.	.	9,510	9,530	9,550
Gross domestic product, BYN mn, nom. 2)	53,036	64,911	77,809	86,970	39,911	43,737	94,700	104,200	116,500
annual change in % (real) 2)	1.7	1.0	1.7	-3.9	-3.4	-2.5	-2.8	-0.9	1.6
GDP/capita (EUR at exchange rate)	5,200	5,800	6,200	5,100	.	.	4,500	4,800	5,100
GDP/capita (EUR at PPP)	13,100	13,300	13,700	13,500	.	.	.	.	.
Consumption of households, BYN mn, nom. 2)	24,486	31,833	39,212	43,714	20,225	24,385	.	.	.
annual change in % (real) 2)	10.8	10.9	4.3	-2.4	-2.1	-1.6	-1.0	0.0	1.0
Gross fixed capital form., BYN mn, nom. 2)	17,845	24,430	26,369	24,835	10,598	9,908	.	.	.
annual change in % (real) 2)	-11.3	9.6	-5.3	-15.9	-14.2	-18.3	-13.0	-3.0	2.0
Gross industrial production									
annual change in % (real)	5.8	-4.9	2.0	-6.6	-7.4	-1.6	-3.0	-1.0	2.0
Gross agricultural production									
annual change in % (real)	6.6	-4.2	2.9	-2.9	2.7	3.3	.	.	.
Construction industry									
annual change in % (real)	-8.6	4.6	-5.7	-11.3	.	.	.	.	.
Reg. employment, th, average	4,612	4,578	4,551	4,494	4,505	4,423	4,400	4,350	4,350
annual change in %	-1.7	-0.7	-0.6	-1.2	-1.2	-1.8	-2.1	-1.1	0.0
Reg. unemployed persons, th, end of period	24.9	21.0	24.2	43.3	46.8	47.2	50	50	50
Reg. unemployment rate, in %, end of period	0.5	0.5	0.5	1.0	1.0	1.1	1.1	1.1	1.1
Average monthly gross wages, BYN	368	506	605	671	646	699	740	820	910
annual change in % (real, gross)	21.5	16.4	1.3	-2.3	-2.9	-3.6	-1.0	0.0	1.0
Consumer prices, % p.a.	59.2	18.3	18.1	13.5	15.3	12.3	12.0	11.0	10.0
Producer prices in industry, % p.a. 3)	76.0	13.6	12.8	16.8	17.7	14.0	15.0	13.0	11.0
General governm.budget, nat. def., % of GDP									
Revenues	38.5	40.3	38.7	42.7	43.2	42.6	40.0	39.0	39.0
Expenditures	37.7	40.1	37.3	41.2	39.3	40.9	39.0	38.0	38.0
Deficit (-) / surplus (+)	0.8	0.2	1.3	1.4	3.9	1.6	1.0	1.0	1.0
Public debt, EU-def., % of GDP	38.5	37.6	39.8	40.0	.	.	40.0	40.0	40.0
Central bank policy rate, % p.a., end of period 4)	30.0	23.5	20.0	25.0	25.0	20.0	18.0	16.0	15.0
Current account, EUR mn 5)	-1,446	-5,737	-4,057	-1,857	-813	-1,402	-1,000	-800	-600
Current account, % of GDP 5)	-2.9	-10.5	-6.9	-3.8	-3.4	-7.1	-2.3	-1.8	-1.2
Exports of goods, BOP, EUR mn 5)	35,391	27,701	27,492	23,854	12,056	9,904	20,000	20,500	21,000
annual change in %	24.2	-21.7	-0.8	-13.2	-11.6	-17.8	-16.2	2.5	2.4
Imports of goods, BOP, EUR mn 5)	34,952	31,183	29,537	25,807	12,411	10,936	22,000	22,500	23,000
annual change in %	13.1	-10.8	-5.3	-12.6	-10.5	-11.9	-14.8	2.3	2.2
Exports of services, BOP, EUR mn 5)	4,901	5,690	6,115	6,058	2,874	2,776	5,900	6,000	6,200
annual change in %	25.5	16.1	7.5	-0.9	2.8	-3.4	-2.6	1.7	3.3
Imports of services, BOP, EUR mn 5)	3,140	3,983	4,449	3,985	1,819	1,877	3,900	3,800	3,900
annual change in %	34.5	26.8	11.7	-10.4	-14.7	3.2	-2.1	-2.6	2.6
FDI liabilities (inflow), EUR mn 5)	1,137	1,703	1,445	1,506	1,266	805	1,000	.	.
FDI assets (outflow), EUR mn 5)	121	199	57	97	70	24	100	.	.
Gross reserves of NB, excl. gold, EUR mn 5)	4,390	3,589	2,820	2,510	3,254	2,874	.	.	.
Gross external debt, EUR mn 5)	25,518	28,807	32,982	34,996	34,297	34,504	34,400	34,000	34,000
Gross external debt, % of GDP 5)	51.9	52.5	56.0	71.7	70.3	80.2	80.0	75.0	70.0
Average exchange rate BYN/EUR	1.078	1.183	1.322	1.783	1.647	2.221	2.200	2.300	2.400
Purchasing power parity BYN/EUR	0.428	0.514	0.599	0.677	.	.	.	.	.

Note: 1 July 2016 denomiation of the Belarusian roubel by 10,000. All time series in nominal and real terms as well as the exchange rates and PPP rates have been divided for statistical purposes by 10,000 to achieve the new currency BYN.

1) Preliminary. - 2) According to SNA'93 (FISIM not yet reallocated to industries). - 3) Domestic output prices. - 4) Refinancing rate of NB. - 5) Converted from USD.

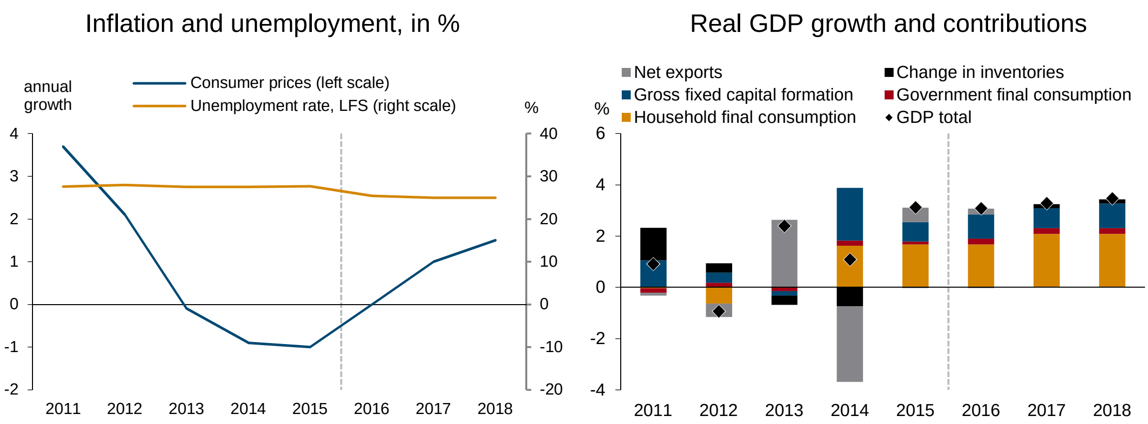
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

BOSNIA AND HERZEGOVINA: Economic and political prospects diverge

VLADIMIR GLIGOROV

With politics as usual, economic developments cannot take all that radical a turnaround for better or for worse. Growth should thus be around 3% over the medium term, in tandem with a gradual structural shift towards greater industrial production and exports activities.

Figure 25 / Bosnia and Herzegovina: Main macroeconomic indicators



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

This year's growth should be around 3%. That should also be the medium-term growth rate, or perhaps a bit better than that. The growth drivers should continue to be growth of industry and exports. However, consumption is practically equal to GDP, so its slow growth dampens overall growth to a very large extent. In that, private consumption has more room to grow compared to other components of the GDP. The government cannot run significant deficits, given the currency board monetary and exchange rate regime, while additional tax revenues are hard to extract because those are already high not only by regional but by European standards too. Unlike in most other countries in the region, foreign direct investments have continued to flow into the economy, though more so in services than in industry. Finally, the unemployment rate has declined somewhat and that decline is expected to continue, though that is probably more the consequence of outward migration rather than due to growing employment. Overall the employment level remains low and the unemployment rate at about 25% among the highest anywhere.

As in most other Balkan economies, low prices of oil and gas have proved beneficial for the external balances. The current account deficit has declined, which is important because of the high foreign debt. The statistics on foreign debt are not altogether reliable (and the same can be said about those on public debt). Though the levels of both debts are not as high as in most neighbouring countries, it is to be expected that the country's international financial position is rather more worrisome, as is the case in most neighbouring countries. Public debts, by contrast, are much more in the international focus, but are not necessarily growing all that much if at all given that the general government deficit tends to be rather small (between 1% and 2%). However, given the fiscal regime, with various levels of responsibilities and almost none on the central level, increases in public investments are hard to engineer. In addition, crossing internal borders of jurisdiction is all but impossible, so some investments are possible within the two entities and within cantons, but not throughout the state.

In general, the country will continue to depend on foreign investments, sustained consumption, and growth of industry destined for exports. The latter development faces the problem of relatively high wages, which are due to the predominance of public employment. Indeed, fiscal sustainability depends on taxes collected from those working for the government in one way or another. This is also true for social contributions, which are quite stable and reliable as sources of revenues. Indeed, wages in the public sector tend to grow with no detectable increase in services or their efficiency, which is to say that they increase faster than productivity, which is one of the reasons why the trade deficit is so high. Remittances and now low oil prices help the sustainability of the current account, though that remains clearly the main vulnerability of the economy.

Consumer prices have recorded negative growth, as in most of the economies in the region. Producer price inflation, however, has been slow but positive. Neither mean much if anything for monetary policy because of the strict currency board regime which has been in place for about two decades now. Together with the indirect taxation authority, which means mainly the collection of VAT, which is state-wide, those are two pillars of integration of the economy and the state. Though the central state has a very small budget, its tax collection responsibility is what supports its fundamental legitimacy. Similarly, the stable currency, in terms of the euro, supports the internal market, as otherwise currency substitution, which would be inevitable, would additionally disintegrate the country.

Politically, however, the country continues not to function all that smoothly. On the back of the strategic decision by Serbia to seek membership in the EU, representatives of the Republika Srpska in the Parliament of Bosnia and Herzegovina were ready to support a programme with the same intention. However, with the EU becoming less of an anchor and Russia supporting gradual disintegration of the Bosnian state, politics has become even more complex. In recent regional elections, ethnically more committed parties and leaders staged a comeback, after a couple of years of some rise in more moderate and more democratic policies and people gaining ground.

This setback is particularly important in the Republika Srpska, where the ruling party not only survived but extended its grip on power. It succeeded in beefing up the patriotic vote with a referendum on the Day of the Republic and with a highly publicised visit by its leader, Milorad Dodik, with Russian President Vladimir Putin just ahead of the elections. So, the country is back to its divided ethnic self once again.

With politics as usual, economic developments cannot take all that radical a turnaround for better or for worse, so growth should be around 3% in the medium term with slow structural change towards more industrial production and more exports.

Table 8 / Bosnia and Herzegovina: Selected economic indicators

	2012	2013	2014	2015 1)	2015	2016	2016	2017	2018
					January-June			Forecast	
Population, th pers., mid-year 2)	3,836	3,832	3,827	3,819	.	.	3,820	3,820	3,820
Gross domestic product, BAM mn, nom. 3)	26,193	26,743	27,304	28,659	13,693	13,948	29,500	30,800	32,400
annual change in % (real)	-0.9	2.4	1.1	3.1	3.1	1.7	3.1	3.3	3.5
GDP/capita (EUR at exchange rate) 3)	3,500	3,600	3,600	3,800	.	.	3,900	4,100	4,300
GDP/capita (EUR at PPP) 3)	7,300	7,400	7,700	8,100	.	.	.	.	.
Consumption of households, BAM mn, nom. 3)	22,334	22,521	22,830	23,143	.	.	.	.	.
annual change in % (real)	-0.7	0.0	1.9	1.7	.	.	2.0	2.5	2.5
Gross fixed capital form., BAM mn, nom. 3)	4,783	4,714	5,234	5,024	.	.	.	.	.
annual change in % (real)	2.2	-1.0	11.7	-3.5	.	.	5.0	4.0	5.0
Gross industrial production									
annual change in % (real)	-3.9	5.2	0.2	3.1	2.7	4.7	5.0	5.0	5.0
Gross agricultural production 4)									
annual change in % (real)	-10.0	15.3	0.0	5.0	.	.	.	.	.
Construction output total									
annual change in % (real)	-3.1	-2.4	6.8	-3.2	-0.1	-1.7	.	.	.
Employed persons, LFS, th, April	813.7	821.6	812.0	822.0	822.0	801.0	800	820	840
annual change in %	-0.3	1.0	-1.2	1.2	1.2	-2.6	-2.6	2.0	2.0
Unemployed persons, LFS, th, April	316.6	311.5	308.0	315.0	315.0	273.0	273	274	280
Unemployment rate, LFS, in %, April	28.0	27.5	27.5	27.7	27.7	25.4	25.4	25.0	25.0
Reg. unemployment rate, in %, end of period	44.6	44.5	43.6	42.9	42.9	41.6	.	.	.
Average monthly gross wages, BAM	1,290	1,291	1,290	1,289	1,288	1,295	1,310	1,340	1,370
annual change in % (real, gross)	-0.5	0.2	0.8	1.0	0.5	2.0	1.5	1.0	1.0
Average monthly net wages, BAM	826	827	831	830	830	834	840	860	880
annual change in % (real, net)	-0.8	0.2	1.3	1.0	0.5	2.0	1.0	1.0	1.0
Consumer prices, % p.a.	2.1	-0.1	-0.9	-1.0	-0.5	-1.4	0.0	1.0	1.5
Producer prices in industry, % p.a.	0.3	-1.8	-0.5	0.6	1.4	-3.1	1.0	2.0	2.0
General governm.budget, nat.def., % of GDP									
Revenues	43.8	42.7	43.8	43.2	.	.	44.0	44.0	44.0
Expenditures	45.8	44.8	45.8	42.6	.	.	46.0	46.0	46.0
Deficit (-) / surplus (+)	-2.0	-2.2	-2.0	0.7	.	.	-2.0	-2.0	-2.0
Public debt, nat.def., % of GDP 5)	44.3	43.5	44.0	45.0	.	.	46.0	46.0	46.0
Central bank policy rate, % p.a., end of period 6)	.	.	.	.	.	.	.	.	.
Current account, EUR mn 7)	-1,160	-723	-1,029	-833	-401	-444	-900	-1,100	-1,100
Current account, % of GDP 7)	-8.7	-5.3	-7.4	-5.7	-6.0	-6.0	-6.0	-7.0	-7.0
Exports of goods, BOP, EUR mn 7)	2,988	3,286	3,385	3,562	1,714	1,750	3,700	3,900	4,100
annual change in %	1.2	10.0	3.0	5.3	7.2	2.1	4.0	5.0	6.0
Imports of goods, BOP, EUR mn 7)	7,079	7,027	7,527	7,355	3,534	3,579	7,600	7,900	8,300
annual change in %	-0.1	-0.7	7.1	-2.3	0.6	1.3	3.0	4.0	5.0
Exports of services, BOP, EUR mn 7)	1,349	1,334	1,365	1,484	680	679	1,600	1,700	1,800
annual change in %	0.4	-1.1	2.3	8.8	8.2	-0.1	5.0	5.0	5.0
Imports of services, BOP, EUR mn 7)	404	385	385	423	175	179	440	460	480
annual change in %	1.2	-4.7	0.1	9.9	10.3	2.1	5.0	5.0	5.0
FDI liabilities (inflow), EUR mn 7)	305	239	392	264	186	99	250	.	.
FDI assets (outflow), EUR mn 7)	46	64	6	43	34	-2	50	.	.
Gross reserves of NB excl. gold, EUR mn	3,246	3,530	3,908	4,307	3,944	4,371	.	.	.
Gross external debt, EUR mn 5)	6,991	7,138	7,245	7,825	.	.	7,650	7,800	8,250
Gross external debt, % of GDP 5)	52.2	52.2	51.9	53.4	.	.	50.7	49.5	49.8
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.96	1.96	1.96
Purchasing power parity BAM/EUR	0.9321	0.9369	0.9218	0.9243	.	.	.	.	.

1) Preliminary. - 2) According to census 1991. - 3) According to ESA'95 (FISIM not yet reallocated to industries). - 4) Based on UN-FAO data, from 2014 wiiw estimate. - 5) Based on IMF estimates. - 6) Bosnia and Herzegovina has a currency board. There is no policy rate and even no money market rate available. - 7) Converted from national currency.

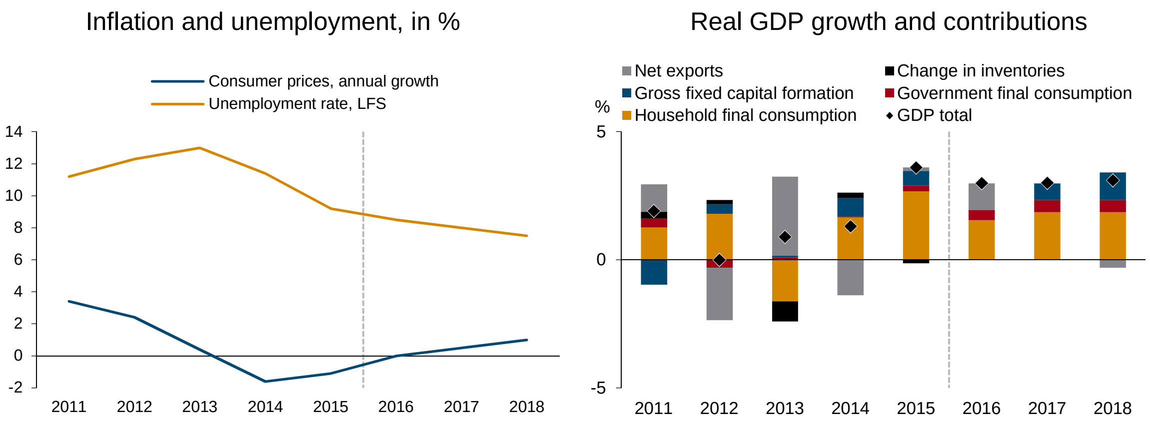
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

BULGARIA: Upturn in private consumption supports moderate growth

RUMEN DOBRINSKY

GDP grew by 3.5% in the first half of 2016, at the same rate as in the previous year. Growth remained relatively balanced, with both private consumption and exports lending impetus. The continuing upturn contributed to a cyclical improvement in the fiscal position and a large headline surplus. Moderate GDP growth is likely to continue in the short term; it is projected to be around 3% per annum over the period 2016-2018.

Figure 26 / Bulgaria: Main macroeconomic indicators



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

GDP grew by 3.5% in the first half of 2016, replicating the growth performance in the previous year. The Bulgarian economy seems finally to have departed from the trap of subdued performance that characterised the period 2009-2014. While modest, the current rates of output growth likely reflect the own potential of the economy in the present circumstances of a weak external environment. GDP growth remained relatively balanced, reflecting an impetus from both domestic demand (primarily private consumption) and exports.

Aggregate output growth could have been higher had it not been for the slump in fixed investment: while the continuing recovery in private consumption provided a strong support to GDP growth, the contribution of gross fixed capital formation was negative. The main reason for the weakening in fixed investment was the drop in public capital expenditure due to delays in the launch of public investment projects under the new EU financial framework 2014-2020. In the period January-July total public capital expenditure in nominal terms was just 44% of the expenditure in the same period of 2015; its share in total public expenditure dropped from 13.8% in January-July 2015 to 6.4% a year later. In the main, this reflects a plunge in the absorption of EU funds supporting public investment projects: in the first 7 months of 2016 Bulgaria reported a mere 14% of the funds absorbed in the same period of 2015.

Export activity also continued to provide support to GDP growth. According to national accounts data, real exports of goods and services grew by more than 4% year-on-year in the first half and net exports made a positive contribution to GDP growth. At the same time, both exports and imports of goods in current euros dropped year-on-year in the first half of 2016. Apart from the effect of the price dynamics (with some exporters experiencing falling prices in 2016), the contraction of the nominal trade flows is to some extent a statistical phenomenon due to an abnormally high base in the same period of 2015. In turn, the latter was due to some large but one-off sales of military weapons and equipment to non-EU countries effectuated in 2015. Due to the confidential nature of the deals, no details are publicly available but most likely producing the armaments also involved imports of intermediate goods. The inflated but atypical base prevents an accurate assessment of the underlying dynamics of the trade in goods in 2016.

The economic rebound has contributed to a cyclical improvement in the fiscal position: in the period January-July 2016, the total revenue of the consolidated general government was 8.0% higher in nominal terms than a year earlier. At the same time, the total expenditure of the consolidated general government actually dropped by 5.3% in nominal terms year-on-year, reflecting the fact that public capital expenditure was much below targets. As a result, the public sector has been reporting a large headline surplus. It is not likely that the government will manage to catch up on its delayed public investment projects in the remaining months of 2016 so the headline surplus will probably stay for the year as a whole. It can be expected that there will be a cyclical improvement in Bulgaria’s fiscal position also in ESA95 terms, although it will not be so pronounced.

The situation in the labour market also continued its trend improvement: total employment has been growing by some 1.5% per annum since 2014 while the unemployment rate (both registered and LFS-measured) fell to some 8% in the summer of 2016. Bulgaria had not seen such low rates of unemployment since 2009. Labour shortages, especially for skilled workers, are being reported in more and more sectors. The tightening labour market has been putting upward pressure on wages and they continued their rise in real terms. Sooner or later rising wages and income and the ensuing strong consumer demand should give rise to inflationary pressures. There were signs of this happening in the first half of the year but later they were offset by the seasonal weakening of CPI in the summer when abundant produce contributed to a seasonal fall of food prices and added negatively into the average index.

Manufacturing, tourism and some business services added the most to GDP growth in the first half. By contrast, construction activity fell year-on-year and agricultural output was basically flat. The employment dynamics by sectors matched the dynamics of output: labour shortages are most acute in the ICT sector, in manufacturing as well as in the tourism industry.

There was also some revival in credit activity after several years of squeeze. A new development has been the recent switch in the preferences of corporate borrowers to BGN-denominated credit, which grew much faster than forex-denominated credit. The drop in lending rates in local currency (by some 2-3 percentage points year-on-year at mid-2016) must have contributed to this change in borrowing preferences.

Despite the recovery in domestic demand, the current account balance remained in the positive territory and a relatively large surplus can be expected for the year as a whole. The main reason for this was the substantial positive balance in services trade thanks to tourism and business services. The tourist industry benefited from the turmoil in neighbouring Turkey, diverting some flows of West European and Russian tourists in 2016, while the exports of business services (mostly ICT) have grown steadily in recent years as Bulgaria was recognised as an attractive destination for outsourcing. The continuing upturn in the exports of services has been a persisting trend and this may underpin a lasting switch of the Bulgarian economy towards a positive current account balance, at least as regards the near future.

As for policy, the cash fiscal surplus is becoming somewhat of a headache for the government. On the one hand, the public investment programme is far behind schedule, which is the source of the surplus. Most of the delay can be attributed to the slow preparation of new EU-funded projects which generates both domestic discontent and some tensions in the relations with the EC. On the other hand, the presence of a large and idle cash fiscal surplus is a source of bewilderment both for the cash-strapped public sectors and for the public at large and provokes new claims for unplanned public spending. Moreover, the government undertook in 2016 large precautionary borrowing targeted at future servicing of maturing public debt. These funds are also now ‘frozen’ in the fiscal reserve; some of them will probably not be used for the initial purpose in view of the availability of a cash surplus. So it remains to be seen how the government will tackle this issue in the remaining months of the current year. While some of the current cash fiscal surplus is of a cyclical nature, its persistence will likely prompt higher future public spending and hence some relaxation of the structural fiscal stance. This is noticeable already in the preliminary deliberations on the 2017 budget although no target figures have been announced yet.

One unanticipated spending item for the government will be the payment of EUR 550 million to Russian ‘Atomstroyexport’ (ACE) as per a judgment of the International Court of Arbitration for commissioned, but unpaid until now, equipment for the nuclear power project in Belene which was put on hold. The problem is aggravated additionally by the fact that the title holder of the liability is the National Electricity Company (NEC), which is a commercial company but is unable to raise the necessary cash. So the Bulgarian parliament recently adopted a special law for extending a special loan to NEC from public funds. However, it is not clear whether the European Commission will endorse such a loan as it may consider it as an implicit illegal subsidy.

Other unforeseen public spending may come from the growing influx of refugees and migrants. While these flows used to bypass the country, with the gradual closure of easier routes, migrants opt more and more often for Bulgaria as a transit path on their way to Europe, and some of them choose to stay in the country.

In the present circumstances, moderate growth may be expected to continue supported by both private consumption and exports. However, a possible further weakening of EU manufacturing may have a negative effect on Bulgarian exports in the second half of the year so the external impetus to growth may weaken in the short run. At the same time, public investment should start to pick up and will contribute to aggregate output growth. Hence current expectations are for GDP growing by close to 3% for 2016 as a whole. While domestic demand will likely continue to recover in 2017 and 2018, the prospects for GDP growth in this period will also depend on the external environment. If EU growth and import demand remain weak, it would be difficult for Bulgaria’s economy to achieve rates of growth above the moderate range.

Table 9 / Bulgaria: Selected economic indicators

	2012	2013	2014	2015 1)	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., average	7,306	7,265	7,224	7,178	.	.	7,150	7,100	7,050
Gross domestic product, BGN mn, nom.	82,040	82,166	83,634	88,571	40,043	41,499	91,200	94,400	98,300
annual change in % (real)	0.0	0.9	1.3	3.6	3.5	3.5	3.0	3.0	3.1
GDP/capita (EUR at exchange rate)	5,700	5,800	5,900	6,300	.	.	6,500	6,800	7,100
GDP/capita (EUR at PPP)	12,200	12,300	12,800	13,600	.	.	.	.	.
Consumption of households, BGN mn, nom.	53,346	50,660	51,963	54,831	25,629	25,634	.	.	.
annual change in % (real)	2.9	-2.5	2.7	4.3	1.6	1.8	2.5	3.0	3.0
Gross fixed capital form., BGN mn, nom.	17,443	17,365	17,653	18,612	7,911	7,879	.	.	.
annual change in % (real)	1.8	0.3	3.4	2.7	-0.9	0.4	0.0	3.0	5.0
Gross industrial production 2)									
annual change in % (real)	-0.3	-0.2	1.8	2.9	3.3	2.0	2.5	3.0	3.5
Gross agricultural production									
annual change in % (real)	-10.0	14.2	-0.6	-10.2	.	.	.	.	.
Construction industry 3)									
annual change in % (real)	-0.8	-3.7	7.0	2.4	3.7	-9.6	.	.	.
Employed persons, LFS, th, average	2,934	2,935	2,981	3,032	2,981	3,004	3,080	3,130	3,180
annual change in %	-1.1	0.0	1.6	1.7	1.5	0.8	1.5	1.5	1.5
Unemployed persons, LFS, th, average	410	436	385	305	340	273	290	270	260
Unemployment rate, LFS, in %, average	12.3	13.0	11.4	9.2	10.3	8.3	8.5	8.0	7.5
Reg. unemployment rate, in %, end of period	11.4	11.8	10.7	10.0	9.6	8.4	.	.	.
Average monthly gross wages, BGN	731.1	775.1	821.7	893.7	869.2	934.0	940	980	1,020
annual change in % (real, gross)	3.5	5.1	7.5	8.9	7.7	8.8	5.0	4.0	3.0
Consumer prices (HICP), % p.a.	2.4	0.4	-1.6	-1.1	-1.2	-1.7	0.0	0.5	1.0
Producer prices in industry, % p.a.	4.4	-1.5	-1.2	-1.9	-0.6	-4.9	-4.0	0.0	1.0
General governm.budget, EU-def., % of GDP									
Revenues	34.2	37.2	36.6	37.2	.	.	37.5	37.0	37.0
Expenditures	34.5	37.6	42.1	39.2	.	.	38.5	38.0	37.5
Net lending (+) / net borrowing (-)	-0.3	-0.4	-5.4	-2.0	.	.	-1.0	-1.0	-0.5
Public debt, EU-def., % of GDP	16.7	17.0	27.0	26.0	.	.	27.7	27.7	27.1
Central bank policy rate, % p.a., end of period 4)	0.03	0.02	0.02	0.01	0.02	0.00	.	.	.
Current account, EUR mn	-358	536	35	172	-90	780	1,000	1,000	1,000
Current account in % of GDP	-0.9	1.3	0.1	0.4	-0.4	3.7	2.1	2.1	2.0
Exports of goods, BOP, EUR mn	19,675	21,218	21,027	21,920	10,960	10,582	22,000	22,500	23,000
annual change in %	3.2	7.8	-0.9	4.2	12.1	-3.4	0.4	2.3	2.2
Imports of goods, BOP, EUR mn	23,667	24,151	23,803	24,542	12,098	11,398	23,700	24,200	24,800
annual change in %	8.8	2.0	-1.4	3.1	7.1	-5.8	-3.4	2.1	2.5
Exports of services, BOP, EUR mn	5,817	5,889	6,738	7,080	1,898	3,165	7,200	7,350	7,500
annual change in %	9.3	1.2	14.4	5.1	9.8	66.7	1.7	2.1	2.0
Imports of services, BOP, EUR mn	3,229	3,235	4,224	3,998	1,898	2,075	4,000	4,100	4,200
annual change in %	26.0	0.2	30.6	-5.4	-1.0	9.3	0.1	2.5	2.4
FDI liabilities (inflow), EUR mn	1,383	1,509	1,539	1,661	1,058	1,063	1,500	.	.
FDI assets (outflow), EUR mn	315	266	657	65	104	220	200	.	.
Gross reserves of NB excl. gold, EUR mn	13,935	13,303	15,276	19,022	17,866	20,910	.	.	.
Gross external debt, EUR mn 5)	37,714	36,936	39,356	34,091	35,591	34,891	34,200	33,500	33,000
Gross external debt, % of GDP 5)	89.9	87.9	92.0	75.3	78.6	74.8	73.0	69.0	66.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
Purchasing power parity BGN/EUR	0.9167	0.9224	0.9039	0.9017	.	.	.	.	.

1) Preliminary. - 2) Enterprises with 10 and more employees. - 3) All enterprises in public sector, private 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.

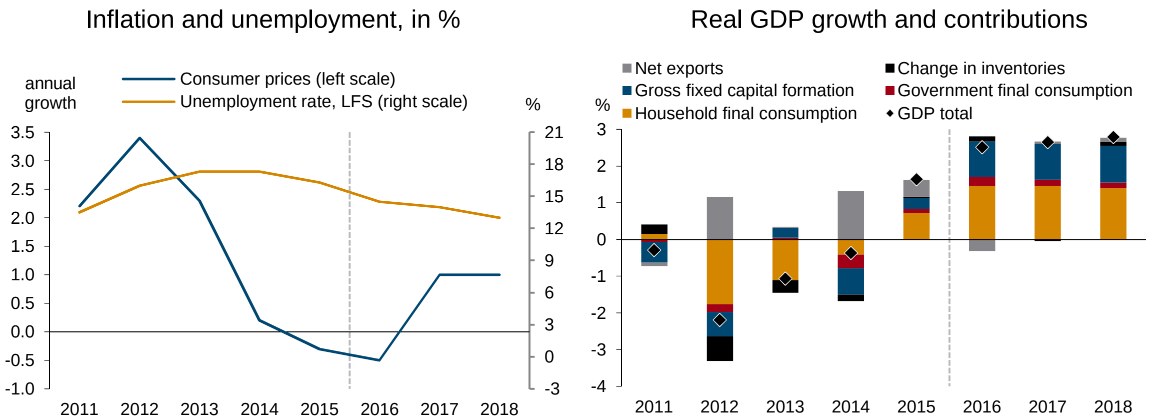
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

CROATIA: Economy back on a more stable growth path

HERMINE VIDOVIC

Croatia's economy continues on its path of recovery, with GDP up by an estimated 2.5% in 2016. Growth is backed by a rise in domestic demand, both household consumption and investments. Investments fuelled by EU-funding and continued private consumption recovery should help to stimulate more robust GDP growth over the biennium 2017-2018. Fiscal consolidation coupled with high public debt will remain the main challenges to sustainable growth.

Figure 27 / Croatia: Main macroeconomic indicators



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

Having shown first signs of recovery last year, after six years of contraction, GDP continued to grow in the first half of 2016. Domestic demand, both household consumption and rising investments, were the driving forces behind the 2.7% rise in GDP; foreign demand contributed negatively to this expansion. Private consumption growth gained momentum owing to a recovery in the labour market combined with real wage increases and increased earnings from tourism. Gross fixed capital formation continued its growth path starting from the second quarter of 2015 and translated, among other things, into an increase in construction activities – which had declined for the past seven years. Industrial production continued to grow, but at a slower pace than at the beginning of the year. During the first eight months industrial output was up by 5%, with the highest growth reported for the manufacture of chemicals and of electrical equipment, while the output of shipbuilding contracted again.

The situation in the labour market continued to improve: according to Pension Insurance data, employment rose by almost 2% in the first half of the year; Labour Force Survey data report an increase by 1%, with the unemployment rate falling strongly to 14.1%, from 16.9% in the first six months of 2015. Apart from rising employment, especially outward migration has contributed to the positive labour market outcome: since the country’s accession to the EU in July 2013, the number of Croatian workers in Germany has increased by 57,500 and in Austria by about 6,000. Both real gross and net wages rose, by 3.6% and 3.1% respectively, in the first half of 2016.

Over the same period, external trade in goods performed less dynamically than a year earlier, with exports and imports both growing at about 4.7% in euro terms. The trade deficit was about EUR 160 million higher, while the surplus in the services trade went up, thanks to increased earnings from tourism. Revenues from tourism are expected to reach a record level in 2016, likely benefiting inter alia from political turbulence in Turkey. Assuming that the surplus in services trade will go on increasing, the current account is expected to report a surplus again in 2016 as a whole.

The consolidated general government deficit continued to narrow in 2016, mostly on account of higher than expected (tax) revenues coupled with lower expenditures, particularly on subsidies, intermediary consumption as well as spending on employees. The expenditure cut is partly due to provisional budget financing in the first quarter of the year, limiting state expenditures. According to a recent statement by the Minister of Finance, reducing the deficit as planned to 2.6% of GDP seems to be feasible this year.

In mid-June 2016, the Croatian parliament dismissed Prime Minister Tihomir Orešković in a notion of no confidence. As this action marked also the end of the coalition government between the Croatian Democratic Union (HDZ) and its junior partner Most, the Croatian deputies decided on the dissolution of the parliament (which had been elected only in late January 2016). Contrary to opinion polls predicting a victory of the Social Democratic Party, HDZ won the snap elections held on 11 September, although it fell short of the absolute majority. As expected, HDZ formed again a coalition with its former partner Most and representatives of smaller parties including the representatives of minorities. The new government is led by Andrej Plenković, the newly elected head of HDZ and former Member of the European Parliament.

With respect to the country’s economy the new government has very ambitious goals: accordingly, GDP growth should accelerate to 5% in 2020 and the employment rate increase to 68%, i.e. creating 180,000 new jobs. The economic policy will have five main pillars: (1) simplification of the tax system; (2) investment in growth drivers such as agriculture, tourism and industry; (3) efficiency of institutions; (4) sustainability of public finances; and (5) reform of the educational system. Fiscal stability – apart from economic growth – is considered key to achieve a better credit ranking and a more favourable position in the international financial market. In 2017 Croatia will have to repay almost EUR 4 billion of maturing bonds and interest. Even if the new government manages to absorb EU funds more efficiently than was the case in the past, there will be the need for adequate national co-financing which might lead to a trade-off between meeting fiscal consolidation targets and stimulating economic growth by an expansion of government spending.

wiiw expects the Croatian GDP to grow by 2.5% in 2016, which is one percentage point higher than the forecast made in spring. The upward revision is mainly due to rising domestic demand and the earlier than expected revival of investment. Economic growth will become more robust over the forecasting period 2017-2018 backed by (public) investments supported by EU funds and a further recovery of private sector investments. Also the sustained recovery of household consumption should contribute to GDP growth, which is expected to translate into a steady improvement in the labour market. The current account is expected to remain in surplus over the period 2016-2018, but that surplus will be declining (the high surplus in 2015 was mainly due to one-off effects related to the conversion of Swiss franc loans). The downside risks to the outlook are: long-lasting fiscal consolidation coupled with high public debt. In addition, the new Croatian government will need to prove its commitment to fiscal consolidation and related reforms. Demographic challenges (ageing of the population coupled with increased migration) are becoming increasingly apparent as well.

Table 10 / Croatia: Selected economic indicators

	2012	2013	2014	2015 1)	2015	2016	2016	2017	2018
					January-June			Forecast	
Population, th pers., average	4,269	4,254	4,236	4,208	.	.	4,190	4,190	4,190
Gross domestic product, HRK mn, nom.	330,456	329,571	328,431	334,219	158,580	162,521	340,900	353,600	367,100
annual change in % (real)	-2.2	-1.1	-0.4	1.6	0.8	2.7	2.5	2.7	2.8
GDP/capita (EUR at exchange rate)	10,300	10,200	10,200	10,400	.	.	10,700	11,100	11,500
GDP/capita (EUR at PPP)	15,900	15,800	16,100	16,700	.	.	.	.	.
Consumption of households, HRK mn, nom.	195,623	195,623	193,524	194,878	96,321	97,675	.	.	.
annual change in % (real)	-3.0	-1.9	-0.7	1.2	0.5	3.1	2.5	2.5	2.4
Gross fixed capital form., HRK mn, nom.	64,820	65,257	62,639	63,888	31,231	32,731	.	.	.
annual change in % (real)	-3.3	1.4	-3.6	1.6	0.2	5.4	5.0	5.1	5.2
Gross industrial production 2)									
annual change in % (real)	-5.6	-1.8	1.2	2.7	1.2	6.4	4.9	4.0	4.0
Gross agricultural production									
annual change in % (real)	-9.4	4.2	-7.0	-0.2	.	.	.	.	.
Construction output 2)									
annual change in % (real)	-12.6	-4.6	-7.3	-0.6	-0.7	4.0	.	.	.
Employed persons, LFS, th, average	1,566	1,524	1,566	1,589	1,572	1,587	1,610	1,630	1,650
annual change in %	-3.6	-2.7	2.7	1.5	2.2	0.9	1.0	1.5	1.5
Unemployed persons, LFS, th, average	297	318	327	309	317	260	270	270	250
Unemployment rate, LFS, in %, average	16.0	17.3	17.3	16.3	16.9	14.1	14.5	14.0	13.0
Reg. unemployment rate, in %, end of period	21.1	21.6	19.6	17.9	16.1	13.6	.	.	.
Average monthly gross wages, HRK 3)	7,875	7,939	7,953	8,055	7,597	7,751	7,800	8,000	8,200
annual change in % (real, gross)	-2.3	-1.4	0.4	1.8	.	3.6	3.5	2.0	2.0
Average monthly net wages, HRK 3)	5,478	5,515	5,533	5,711	5,582	5,674	5,700	5,900	6,100
annual change in % (real, net)	-2.6	-1.5	0.5	3.7	.	3.1	3.0	2.5	2.5
Consumer prices (HICP), % p.a.	3.4	2.3	0.2	-0.3	-0.2	-0.8	-0.5	1.0	1.0
Producer prices in industry, % p.a.	5.0	-0.4	-2.7	-3.9	-3.6	-5.4	-2.0	1.0	1.0
General governm.budget, EU-def., % of GDP									
Revenues	41.7	42.5	42.6	43.7	.	.	44.1	44.3	44.0
Expenditures	47.0	47.8	48.1	46.9	.	.	46.8	46.6	46.0
Net lending (+) / net borrowing (-)	-5.3	-5.3	-5.5	-3.2	.	.	-2.7	-2.3	-2.0
Public debt, EU-def., % of GDP	70.7	82.2	86.5	86.7	.	.	87.6	87.3	87.0
Central bank policy rate, % p.a., end of period 4)	7.0	7.0	7.0	3.0	7.0	3.0	3.0	3.0	3.0
Current account, EUR mn	-23	441	901	2,237	-1,227	-1,428	1,700	900	740
Current account, % of GDP	-0.1	1.0	2.1	5.1	-5.9	-6.6	3.8	1.9	1.5
Exports of goods, BOP, EUR mn	8,673	8,924	9,761	10,698	5,067	5,305	11,200	11,800	12,400
annual change in %	-0.8	2.9	9.4	9.6	10.3	4.7	4.5	5.0	5.5
Imports of goods, BOP, EUR mn	14,969	15,511	16,116	17,357	8,515	8,909	18,100	19,000	20,100
annual change in %	-1.0	3.6	3.9	7.7	6.3	4.6	4.4	5.0	6.0
Exports of services, BOP, EUR mn	9,642	9,840	10,221	11,255	3,810	3,939	11,600	12,100	12,600
annual change in %	2.9	2.1	3.9	10.1	13.1	3.4	3.0	4.0	4.0
Imports of services, BOP, EUR mn	3,127	3,062	2,989	3,348	1,564	1,613	3,400	3,600	3,800
annual change in %	-1.4	-2.1	-2.4	12.0	11.5	3.1	3.0	4.5	5.5
FDI liabilities (inflow), EUR mn	1,145	710	2,393	170	508	606	300	.	.
FDI assets (outflow), EUR mn	-87	-111	1,596	-27	227	-108	-100	.	.
Gross reserves of NB excl. gold, EUR mn	11,236	12,908	12,688	13,707	13,734	12,937	.	.	.
Gross external debt, EUR mn	45,297	45,958	46,664	45,534	48,793	43,432	49,100	50,500	51,900
Gross external debt, % of GDP	103.1	105.7	108.5	103.7	111.2	96.4	109.0	108.5	107.5
Average exchange rate HRK/EUR	7.5217	7.5786	7.6344	7.6137	7.6278	7.5610	7.57	7.60	7.60
Purchasing power parity HRK/EUR	4.8716	4.8938	4.8134	4.7447	.	.	.	.	.

1) Preliminary. - 2) Enterprises with 20 and more employees. - 3) Half-year data for 2016 according to new data sources. - 4) Discount rate of NB.

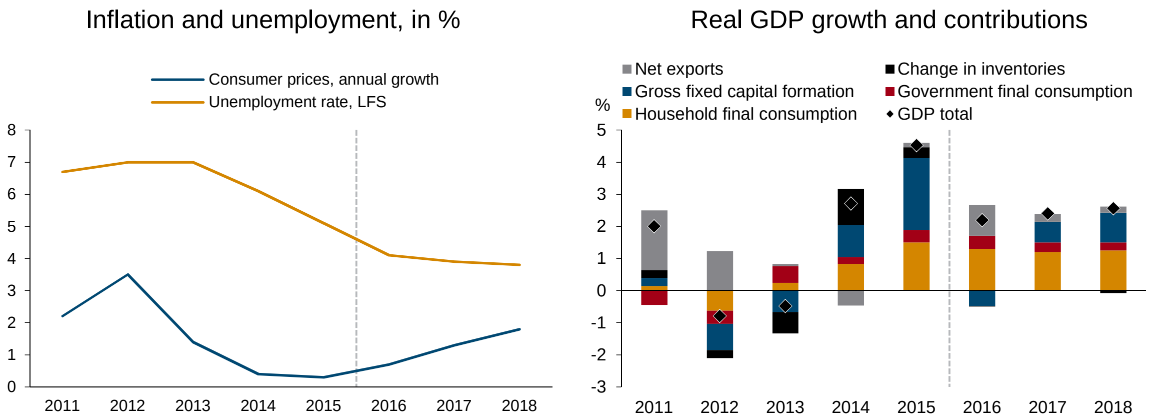
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

CZECH REPUBLIC: Economic growth driven by external surplus

LEON PODKAMINER

Solid external balances and low levels of indebtedness in both the private and public sectors will support moderate growth of above 2% over the period 2016-2018. Some uncertainties persist, however, as to the future course of fiscal policy and the impact of the expected strengthening of the domestic currency.

Figure 28 / Czech Republic: Main macroeconomic indicators



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

After an extraordinarily strong performance in 2015, growth slowed down in the first quarter of 2016 – though not as much as could have been expected. The real GDP growth rate (adjusted for seasonal and working-time effects) reached 3% vs. the same period of 2015. GDP growth slowed down further, to 2.6%, in the second quarter. Growth in all GDP components (except government consumption) decelerated. The growth rate of household consumption fell from 2.7% in the first quarter to 2.2% in the second. The rates of growth of exports (of goods and services) declined from 5.9% to 5.7% respectively, and those of imports (of goods and services) from 5.6% to 3.1%. Gross fixed capital formation, which still rose 2.6% in the first quarter of 2016, contracted by 4.4% in the second. Rising private consumption contributed 1.3 percentage points (pp) to overall GDP growth in the first quarter, and 1 pp in the second. The contribution of gross fixed capital formation, still positive in the first quarter (+0.7 pp), turned negative (-1.2 pp) in the second. However, the contribution of the trade balance rose from 0.1 pp in the first quarter to 1.6 pp in the second.

As elsewhere in the region, the weakening performance of gross fixed capital formation (GFCF) is essentially due to the finalisation of infrastructural investment projects co-financed under the EU financial perspective for 2007-2013. While investment in dwellings, transport equipment, machinery and installations is edging up generally, investment classified as taking the form of 'other buildings and structures' declined by about 19% in the second quarter of 2016. It is generally expected that infrastructural investment co-financed from the EU structural funds will be gradually recovering. However, it is unrealistic to expect much of its acceleration in the current year.

The foreign trade surplus reached about 9% of GDP in the first half of the year. This is a record level which is due not only to the recent slowdown in growth of consumption and investment and the exceptionally low world market prices of raw materials but also to the improvements in the external competitiveness of the Czech economy. No small role is played also by its tight integration into the European (mostly German-dominated) manufacturing production networks. The export-oriented and technologically fairly advanced manufacturing sector represents an obvious strength of the Czech economy. But at the same time it is also a potential risk factor because it renders the whole national economy unduly vulnerable to unforeseeable external developments. High dependence on exports is also not necessarily a good thing, given the turbulences shaking the global economy.

Given the large current account surpluses (further augmented by the trade surpluses) it is quite natural that the Czech currency has been subject to a nominal appreciation tendency. For several years now (since November 2013) the Czech National Bank has been keeping the appreciation pressures in check by resolutely intervening, when the need arose, in the foreign exchange market. For quite a long time the threat of such intervention sufficed to prevent appreciation. The policy of keeping the CZK/EUR exchange rate above the level of 27 through unsterilised interventions was easy to conduct as long as inflation was not a threat and it was possible to keep the policy interest rates low (technically at zero).

At present inflation is still very low but the likelihood of inflation exceeding the official 2% target in the second half of 2017 is now considered quite substantial. The return to 'normal' inflation targeting with the policy interest rates used for controlling inflation may be incompatible, in the longer run, with the attempts to control the level of the exchange rate (as it is claimed by the proponents of the 'impossible trinity' thesis). Once the policy interest rate (since November 2012 set at a 'technical zero') assumes magnitudes consistent with positive and rising inflation, the nominal appreciation may become hard to contain. Under such conditions positive interest rates would be attracting additional inflows of short-term capital ('carry trade') likely to strengthen the domestic currency, at least temporarily. But if the CZK is allowed to appreciate – possibly strongly – a part of the cost competitiveness of the economy may be gradually eroded.

Of course it is still much too early to be definitive about the risks facing the economy. These risks need not materialise anytime soon. The return of meaningful inflation is not quite certain and the eventual phasing out of the policy of controlling the exchange rate could take time. As the Czech labour market has proved to be rather exceptional (with very low unemployment rates, and emerging shortages of skilled labour coexisting with fairly stable wages) the eventual competitiveness losses due to a strong nominal appreciation might perhaps be partly neutralised through wage moderation, at least temporarily. Besides, it remains to be seen whether the strong external performance of the economy has been a matter of mere cost competitiveness.

The financial positions of households and non-financial corporations have been improving consistently, with the shares of their non-performing loans contracting consistently from the peaks reached in 2010-2011. Low and falling interest rates have supported the ‘cleaning’ of the balance sheets – as has also the revealed aversion to draw new credits and the preference for accumulation of bank deposits. The period of exaggerated financial caution may now be approaching an end as the private sector’s demand for credit seems to be showing signs of recovery and banks seem to be more inclined to lower their lending standards. Changing moods may be essential as far as the private sector’s investment and consumption spending is concerned. They are expected to strengthen growth in aggregate demand in tandem with rising employment and wages in 2016 and beyond. The cumulative ‘virtuous’ cycle is thus a real possibility to be sustained over the next two to three years.

The fiscal policy was unduly restrictive from 2011 through 2013, provoking stagnation in 2012-2013. The policy was also quite restrictive in 2015 – arguably unnecessarily so. The fiscal policy envisioned for 2016-2018 targets balanced public finances and further decline in the (already low) GDP share of public debt. As long as GDP growth continues and the economy nears its ‘potential’ represented by the stock of available labour force, such a fiscal policy is of course understandable. The trouble might arise should the fiscal policy try to respond to unwelcome developments (in domestic consumption, investment or foreign trade) with a more restrictive stance (as was the case in 2011-2013). Such an instinctive response may then only worsen the situation.

Summing up, private consumption will be the main driver of moderate GDP growth in 2016-2018. A cumulative ‘virtuous’ cycle of rising domestic demand and rising wages, consumption and investment is expected. Solid external balances will also be playing a positive role, even if rendering the country vulnerable to uncontrollable external shocks. Gradually growth is likely to accelerate from 2.4% in 2016 to 2.6% in 2017-2018 as infrastructural investment co-financed by the EU under the new financial perspective will be gaining momentum. Private investment is also likely to accelerate somewhat as the levels of utilisation of productive capacities are comparatively high and the financial standing of firms, households and banks is solid. All in all, the country’s prospects are looking good, though this may change if the authorities decide to undertake another round of unnecessary – and harmful – fiscal consolidation.

Table 11 / Czech Republic: Selected economic indicators

	2012	2013	2014	2015 1)	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., average	10,511	10,514	10,525	10,546	.	.	10,525	10,525	10,525
Gross domestic product, CZK bn, nom.	4,060	4,098	4,314	4,555	2,196	2,289	4,690	4,860	5,080
annual change in % (real)	-0.8	-0.5	2.7	4.5	4.8	3.1	2.2	2.4	2.6
GDP/capita (EUR at exchange rate)	15,400	15,000	14,900	15,800	.	.	16,500	17,300	18,200
GDP/capita (EUR at PPP)	21,800	22,300	23,500	25,000	.	.	.	.	.
Consumption of households, CZK bn, nom.	1,970	1,997	2,044	2,110	1,028	1,055	.	.	.
annual change in % (real)	-1.3	0.5	1.7	3.2	3.5	2.6	2.8	2.6	2.7
Gross fixed capital form., CZK bn, nom.	1,052	1,027	1,084	1,198	551	538	.	.	.
annual change in % (real)	-3.1	-2.6	4.0	8.9	8.0	-2.4	-1.8	2.4	3.5
Gross industrial production									
annual change in % (real)	-0.8	-0.1	5.0	4.6	5.4	4.2	4.0	4.0	4.0
Gross agricultural production									
annual change in % (real)	-5.8	6.0	9.9	-6.1	.	.	.	.	.
Construction industry									
annual change in % (real)	-7.6	-6.7	4.3	7.0	11.2	-9.7	.	.	.
Employed persons, LFS, th, average	4,890	4,937	4,974	5,042	5,016	5,108	5,120	5,130	5,140
annual change in %	0.4	1.0	0.8	1.4	1.5	1.8	1.5	0.2	0.1
Unemployed persons, LFS, th, average	367	369	324	268	289	221	220	210	200
Unemployment rate, LFS, in %, average	7.0	7.0	6.1	5.1	5.5	4.1	4.1	3.9	3.8
Reg. unemployment rate, in %, end of period 2)	9.4	8.2	7.5	6.2	6.2	5.2	.	.	.
Average monthly gross wages, CZK	25,067	25,035	25,607	26,467	25,815	26,895	27,700	29,000	30,300
annual change in % (real, gross)	-0.8	-1.5	1.9	3.1	2.9	4.2	3.9	3.3	2.7
Consumer prices (HICP), % p.a.	3.5	1.4	0.4	0.3	0.4	0.3	0.7	1.3	1.8
Producer prices in industry, % p.a.	2.4	0.7	0.9	-2.4	-1.8	-4.2	-3.0	1.0	1.6
General governm. budget, EU-def., % of GDP									
Revenues	40.5	41.4	40.3	41.4	.	.	41.5	41.6	41.6
Expenditures	44.5	42.6	42.2	41.8	.	.	41.9	42.3	42.3
Net lending (+) / net borrowing (-)	-3.9	-1.2	-1.9	-0.4	.	.	-0.4	-0.7	-0.7
Public debt, EU-def., % of GDP	44.5	44.9	42.2	40.3	.	.	40.0	39.5	39.0
Central bank policy rate, % p.a., end of period 3)	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.5	1.5
Current account, EUR mn	-2,518	-829	281	1,473	2,247	4,059	2,080	1,640	1,150
Current account, % of GDP	-1.6	-0.5	0.2	0.9	2.8	4.8	1.2	0.9	0.6
Exports of goods, BOP, EUR mn	104,336	103,184	110,397	118,167	58,972	60,507	124,000	130,000	135,000
annual change in %	5.3	-1.1	7.0	7.0	6.6	2.6	5.0	4.5	4.0
Imports of goods, BOP, EUR mn	99,413	96,735	102,417	110,463	54,142	54,143	114,000	120,000	126,000
annual change in %	3.5	-2.7	5.9	7.9	7.5	0.0	3.0	5.5	5.0
Exports of services, BOP, EUR mn	18,863	18,059	18,915	20,491	9,810	10,282	21,000	22,000	23,000
annual change in %	5.2	-4.3	4.7	8.3	9.8	4.8	1.0	3.5	4.0
Imports of services, BOP, EUR mn	15,776	15,346	16,892	17,741	8,427	8,595	18,000	19,000	20,000
annual change in %	8.0	-2.7	10.1	5.0	9.5	2.0	1.0	3.5	4.5
FDI liabilities (inflow), EUR mn	7,348	5,544	6,101	2,223	980	2,171	4,000	.	.
FDI assets (outflow), EUR mn	2,531	5,831	3,175	3,211	628	3	1,000	.	.
Gross reserves of NB excl. gold, EUR mn	33,560	40,460	44,528	58,903	50,651	67,055	.	.	.
Gross external debt, EUR mn	96,826	99,652	106,251	115,877	109,064	123,596	121,600	129,000	136,100
Gross external debt, % of GDP	60.0	63.2	67.8	69.4	65.3	71.2	70.0	71.0	71.0
Average exchange rate CZK/EUR	25.15	25.98	27.54	27.28	27.50	27.04	27.00	26.75	26.50
Purchasing power parity CZK/EUR	17.70	17.49	17.44	17.29	.	.	.	.	.

1) Preliminary. - 2) From 2013 available job applicants 15-64 in % of working age population 15-64, all available job applicants in % of labour force before. - 3) Two-week repo rate.

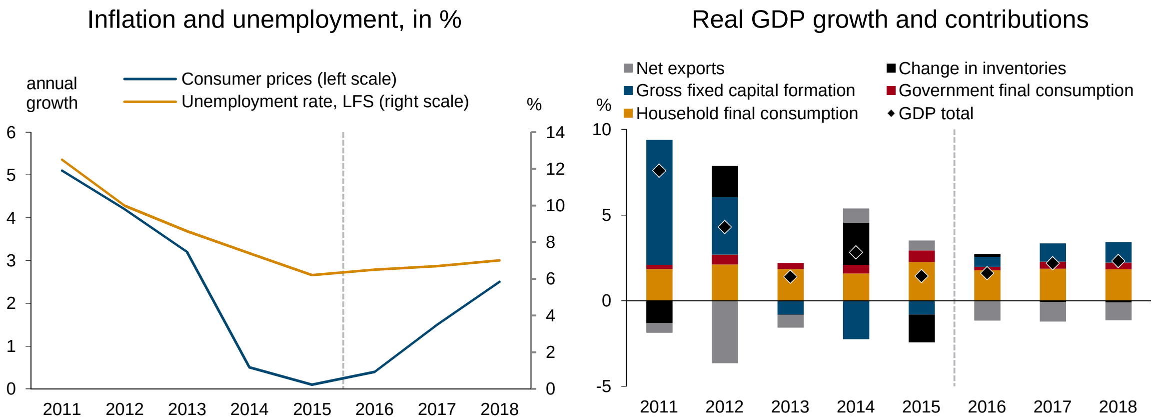
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ESTONIA: Investment and exports to gain momentum

SEBASTIAN LEITNER

Household consumption, backed by a rapid rise in minimum and overall real wages, continues to be the strongest driver of economic activity in Estonia. For the two years ahead we expect a recovery in terms of trade with Western markets, while the decline in exports to Russia has already steadied. Moreover, an upswing in public investments should also speed up economic activity next year. GDP growth is projected to increase from 1.6% in 2016 to 2.2% in 2017.

Figure 29 / Estonia: Main macroeconomic indicators



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

Estonian exporters have experienced a slight tailwind in the past months, goods volumes have increased year on year, while prices are still on the decline. Particularly goods and services exports to Russia are stabilising gradually after having dropped by more than a third in 2015. The economy of neighbouring Sweden is continuously flourishing at an average growth rate of 3% per annum, while Finland came out of a three-year recession period last year and is expected to grow by about 1% this year and in 2017, respectively. Exports to the third-most important trade partner, Latvia, are ailing on account of a slump in investment in the neighbouring country. Low oil prices render the production of shale oil – Estonia's second-most important export product – inefficient. As a result, mostly shale oil-based electricity production is gradually declining due to higher electricity imports from Finland. Overall, we expect exports to continue to recover towards the end of this year and further on in 2017. However, imports will grow even more strongly, dragging down overall GDP growth.

Investment activity of the enterprise sector slightly increased in the first half of 2016 and will continue to do so. On the one hand, external demand and industrial production are still developing rather sluggishly; on the other hand, activity in the construction sector has gained momentum. Data on building permits and mortgage loan growth suggest that dwelling construction will continue to rise this year and in 2017. Public investments will strongly increase in 2017. At the end of September 2016, the Estonian government approved the draft state budget of 2017, expecting additional EU funds for public and private investments of 2% to 3% of GDP. Moreover, the government plans to introduce various measures to lower the income tax burden, such as a reduction of the employer social security contributions by 1 percentage point to 32% over the coming two years and establishing an income tax refund for low-income groups. Overall, the budget is foreseen to remain slightly in surplus in 2017 and a further reduction of the public debt burden is envisaged, which will be below 10% of GDP already this year.

The recovery in the years after the bust in 2008/2009 brought about a continuous decline in the unemployment rate, to 6.2% in 2015. This improvement of the labour market situation started to stumble in the first half of 2016. While employment in the services sectors went on rising, it fell particularly in the shale oil and energy industry. The work ability reform, launched in July 2016, will increase the number of people registered as unemployed. In order to continue receiving benefits, persons that have been qualifying for work incapacity pensions up to now have to look more actively for jobs and take part in public activation measures. This is expected to increase both activity rates but also unemployment rates since only part of those having to look for a job will finally find employment. Demographic statistics show that net emigration, which was substantial in the years after the economic crisis, has finally come to a halt in Estonia.

Strongly increasing real net wages (up 8.5% in the first half of 2016) are further pushing consumption activity of Estonian households upwards; we expect an increase of 3.5% in real terms in 2016 and a slight upswing in the coming years. Forward-looking consumer confidence indicators show an improvement throughout the year 2016 and most recent retail trade and credit statistics indicate an increasing propensity to spend. Monthly wages will keep on growing strongly, not least due to another planned increase in the minimum wage by 10% at the beginning of 2017, following a hike of the same magnitude at the beginning of 2016. Nevertheless, the ratio of the minimum wage to the national average wage is still one of the lowest in the European Union.

Consumer prices have started to increase slightly in recent months. However, the upward price movement is mostly caused by an increase in excise taxes. The downward pressure of falling energy prices is fading, while the core inflation rate is still rather low despite the fast growth of wages. In 2017 consumer prices will rise again more swiftly.

Due to an unexpectedly poor performance in the second quarter of this year we had to revise our forecast for GDP growth in Estonia in 2016 to 1.6% in real terms. An upswing in external demand is in sight but delayed and private investment activity is still ailing. For 2017 and 2018 we forecast an upswing to 2.2% and 2.3%, respectively. We expect a recovery of external demand mostly from Western trade partners, while the decline in exports to Russia should come to a halt. A strong upswing in investments will be facilitated from 2017 onwards by increasing inflows of EU funds.

Table 12 / Estonia: Selected economic indicators

	2012	2013	2014	2015 1)	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., average	1,323	1,318	1,315	1,315	.	.	1,310	1,305	1,300
Gross domestic product, EUR mn, nom.	17,935	18,890	19,758	20,252	9,824	10,099	20,700	21,500	22,500
annual change in % (real)	4.3	1.4	2.8	1.4	1.6	1.1	1.6	2.2	2.3
GDP/capita (EUR at exchange rate)	13,500	14,300	15,000	15,400	.	.	15,800	16,500	17,300
GDP/capita (EUR at PPP)	19,500	19,900	20,700	21,200	.	.	.	.	.
Consumption of households, EUR mn, nom.	8,885	9,465	9,818	10,267	5,120	5,309	.	.	.
annual change in % (real)	4.3	3.7	3.2	4.6	5.6	3.4	3.5	3.7	3.6
Gross fixed capital form., EUR mn, nom.	5,128	5,206	4,814	4,790	2,153	2,170	.	.	.
annual change in % (real)	12.7	-2.8	-8.1	-3.3	-5.8	2.4	2.5	4.5	5.0
Gross industrial production									
annual change in % (real)	1.1	4.1	3.9	-2.2	0.1	-1.5	-1.2	2.5	3.0
Gross agricultural production									
annual change in % (real)	5.6	4.7	4.6	4.0	.	.	.	.	.
Construction industry									
annual change in % (real)	16.7	-0.1	-2.1	-5.3	-4.8	3.9	.	.	.
Employed persons, LFS, th, average	614.9	621.3	624.8	640.9	631.6	643.5	650	655	660
annual change in %	1.9	1.0	0.6	2.6	2.3	1.9	1.4	0.8	0.8
Unemployed persons, LFS, th, average	68.5	58.7	49.6	42.3	44.3	44.5	45	47	50
Unemployment rate, LFS, in %, average	10.0	8.6	7.4	6.2	6.6	6.5	6.5	6.7	7.0
Reg. unemployment rate, in %, end of period 2)	6.2	5.3	4.4	4.7	4.1	4.3	.	.	.
Average monthly gross wages, EUR	887	949	1,005	1,065	1,046	1,127	1,140	1,230	1,320
annual change in % (real, gross)	1.7	4.1	6.0	6.5	5.6	8.4	7.0	6.0	5.0
Average monthly net wages, EUR	706	757	799	859	843	910	920	980	1,030
annual change in % (real, net)	1.1	4.3	5.7	8.0	7.2	8.5	6.5	4.5	2.5
Consumer prices (HICP), % p.a.	4.2	3.2	0.5	0.1	0.1	0.2	0.4	1.5	2.5
Producer prices in industry, % p.a.	2.7	7.2	-2.7	-3.0	-2.2	-2.2	-2.0	1.0	2.0
General governm. budget, EU-def., % of GDP									
Revenues	39.0	38.4	39.1	40.4	.	.	38.7	38.5	38.6
Expenditures	39.2	38.5	38.4	39.9	.	.	39.0	39.0	39.0
Net lending (+) / net borrowing (-)	-0.3	-0.2	0.8	0.5	.	.	-0.3	-0.5	-0.4
Public debt, EU-def., % of GDP	9.6	10.0	10.5	9.8	.	.	10.0	9.0	8.0
Central bank policy rate, % p.a., end of period 3)	0.75	0.25	0.05	0.05	0.05	0.00	.	.	.
Current account, EUR mn	-350	-66	182	447	196	19	-50	-400	-800
Current account, % of GDP	-1.9	-0.4	0.9	2.2	2.0	0.2	-0.2	-1.9	-3.6
Exports of goods, BOP, EUR mn	10,750	11,080	11,089	10,853	5,405	5,467	11,100	11,500	12,000
annual change in %	3.5	3.1	0.1	-2.1	0.2	1.1	2.3	3.6	4.3
Imports of goods, BOP, EUR mn	12,030	12,057	12,092	11,714	5,762	5,970	12,230	12,800	13,400
annual change in %	12.1	0.2	0.3	-3.1	-2.5	3.6	4.4	4.7	4.7
Exports of services, BOP, EUR mn	4,672	4,876	5,322	5,204	2,476	2,553	5,480	5,770	6,000
annual change in %	15.7	4.4	9.1	-2.2	-1.2	3.1	5.3	5.3	4.0
Imports of services, BOP, EUR mn	3,115	3,534	3,623	3,502	1,700	1,781	3,690	3,840	4,000
annual change in %	13.9	13.5	2.5	-3.3	-2.1	4.8	5.4	4.1	4.2
FDI liabilities (inflow), EUR mn	1,394	820	1,252	-597	-774	350	400	.	.
FDI assets (outflow), EUR mn	996	635	677	-423	-585	218	300	.	.
Gross reserves of NB excl. gold, EUR mn	218	222	352	373	336	418	.	.	.
Gross external debt, EUR mn	17,957	17,593	19,101	19,208	19,831	19,566	19,500	19,800	20,700
Gross external debt, % of GDP	100.1	93.1	96.7	94.8	97.9	94.5	94.0	92.0	92.0
Purchasing power parity EUR/EUR	0.6944	0.7195	0.7252	0.7284	.	.	.	.	.

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

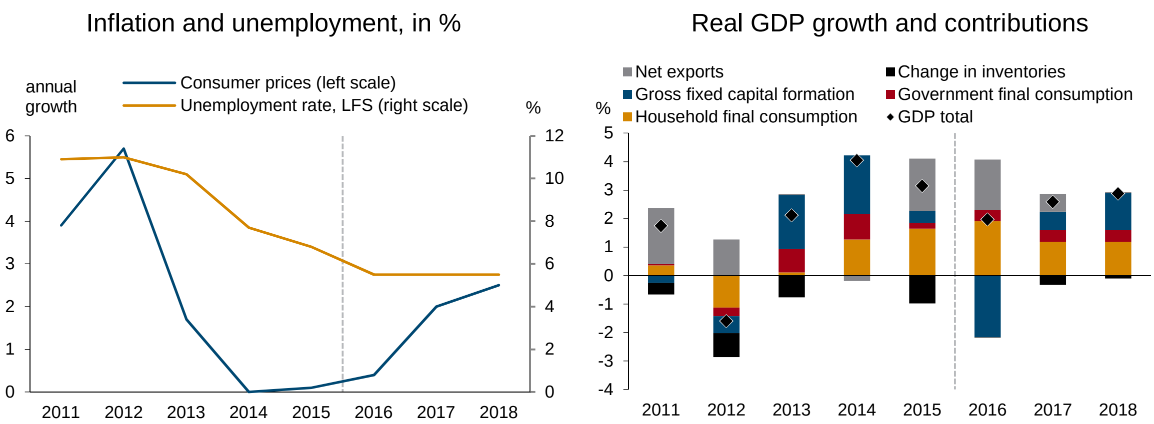
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

HUNGARY: Investments implode – consumption and net exports come to the rescue

SÁNDOR RICHTER

Economic growth is expected to slow down to 2% in 2016 on account of a major decline in investments. Household consumption and net exports will contribute positively to growth. Economic growth is expected to accelerate in 2017 thanks to a turnaround in investment, with many more EU transfers being disbursed than in the current year. Parliamentary elections are scheduled for spring 2018. A substantial fiscal stimulus to growth is a likely scenario for the election year.

Figure 30 / Hungary: Main macroeconomic indicators



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

After relatively strong growth in 2014 (4.0%) and 2015 (3.1%) the expansion of the economy is slowing down this year. GDP increased by only 1.9% in the first six months (year on year). Even if the government initiates fiscal stimulation in the last quarter of the year, economic growth will most probably not surpass 2% in 2016.

The most important development in the first half of 2016 was the implosion of investments (-15.4% year on year) due to the phasing out of EU projects under the 2007-2013 Multiannual Financial Framework (MFF) and the protracted kick-off of the disbursement of the transfers from the 2014-2020 MFF. The decline is especially strong in the public sector where EU transfers have been utilised intensively, but business sector investments contracted as well in the first two quarters. The only positive news is that in manufacturing (accounting for over one third of all investments) an 11% growth was registered. Two major FDI projects, a greenfield tyre factory and another one in toy production, delivered a major contribution to manufacturing outlays.

Household consumption expanded strongly, by 5% in the first half of 2016. This figure reflects the impact of a rapid increase (7.6%) of net real wages. The unexpected rise in wages is a consequence of labour shortage becoming a more and more serious problem due to ongoing outward migration. Migration helps household consumption growth from another aspect as well: migrants' remittances from abroad have been increasing in the past few years, accounting for an inflow corresponding to over 2% of GDP. According to a recent survey of the Central Statistical Office, outward migrants are better educated and younger than the average population; skilled workers and persons with tertiary education are overrepresented. There are more male than female outward migrants. About three quarters of outward migrants choose Germany, the UK and Austria as destination countries.

Foreign trade has been, apart from consumption, the other driver of economic growth this year. In the first six months the export growth rate was 3.6 percentage points higher than the import growth rate. The slow expansion of imports is explained by the steep fall in investment. The import-inducing effect of the ongoing household consumption boom has not appeared as yet in the statistics. Though this large difference in favour of the export growth rate will not be sustainable, net exports will become a considerable component of economic growth in 2016.

Agriculture achieved high growth rates in the first two quarters of the year and the odds are good that the positive performance of this sector will substantially support this year's GDP growth. All other sectors showed a much less formidable performance. Growth rate in industry shrank to one third of the respective figure a year earlier. The relatively highest expansion of value added was reported for the manufacture of computer, electronic and optical products, while the performance of the manufacture of machinery and equipment figured the worst. Construction, the main loser of the 'evaporation' of EU transfers, declined by over 25% in the first half of the year. With the exception of financial services, the sub-sectors of the services sector expanded, with above-average dynamism in wholesale and retail trade, accommodation and food service activities, information and communication, as well as transportation and storage.

The fiscal deficit in the first six months of the year was well below 3% of GDP. If the current trend continues, an annual fiscal deficit below 2% of GDP could be achieved. Nevertheless, the good record may tempt the government to reconsider the expenditure side of the budget in the last months of the year. A fiscal stimulus would push the deficit above 2%, but it could safely remain below the 3% threshold while replacing part of the lost aggregate demand due to the implosion of investments. Acceleration of disbursement of EU transfers via elevated advance payments from the budget from the 2014-2020 MFF would be the cheapest version of growth stimulation but the implementation of this measure has been lagging far behind the originally very ambitious plans in this field.

In September Standard & Poor's raised its credit rating for Hungary to BB+/B, i.e. to investment grade. Thus, out of the three leading credit rating agencies, Moody's remains the only one to leave Hungary in junk grade. Standard & Poor's mentioned the following key issues explaining their decision: improving economic performance; stronger external financial profile (lasting current account surplus, reduction in the share of foreign currency debt); diminishing public debt to GDP ratio; completed conversion of foreign-currency-denominated loans into forint loans; and rising employment and real disposable income of households. In contrast to the upgrading by Standard & Poor's, Hungary's position in the international competitiveness ranking of the World Economic Forum deteriorated by six notches this year, to rank 69, the worse ever result achieved by the country. Looking at the detailed ranking, Hungary's assessment was devastating concerning the institutional system (place 114); in this field, policy instability, corruption, tax regulations, inadequately educated work force, inefficient government bureaucracy and insufficient capacity to innovate were mentioned as the main problems.

For the full year 2016, economic growth is projected to slow down to 2%. The fall in investment may decelerate in the second half of the year, and the annual change will be around -10%, with strong downward risks. Household consumption will expand dynamically and net export will be significantly positive. These latter two components of GDP will 'save the day' for the Hungarian economy this year.

In 2017 economic growth is expected to accelerate due to a turnaround in investment with much more EU transfers disbursed than this year. The government pushes hard for early disbursement of the EU funds but the already mentioned stepped-up advance payments for beneficiaries may prove to be unacceptable for the EU. Household consumption and net export will continue to play a positive role, but less so than in 2016.

Parliamentary elections are scheduled for spring 2018. A substantial fiscal stimulus to growth is a likely scenario in the election year as the current and the medium-run fiscal stance provide sufficient room for that. Consequently, both investment and consumption will increase in 2018, however, at the expense of stronger import than export growth. The fiscal deficit may deteriorate to nearly 3% of GDP. As before, low priority will be given to education and health care, with devastating consequences to be expected in the long run. A major concern for the medium- and longer-term outlook of the Hungarian economy is the planned construction of the Paks II nuclear power station envisaged to be financed by Russian credits. The profitability of this huge project is considered to be highly questionable by independent experts. Another giant project over the longer time horizon is the 2024 Olympic Games for which Budapest applied as host. If Budapest should happen to win, this would probably lead to a serious misallocation of the country's resources.

Table 13 / Hungary: Selected economic indicators

	2012	2013	2014	2015 [1]	2015	2016	2016	2017	2018
					January-June			Forecast	
Population, th pers., average	9,920	9,893	9,866	9,843	.	.	9,810	9,800	9,780
Gross domestic product, HUF bn, nom. [2]	28,661	30,127	32,400	33,999	15,749	16,309	35,500	37,400	39,600
annual change in % (real)	-1.6	2.1	4.0	3.1	3.1	1.9	2.0	2.6	2.9
GDP/capita (EUR at exchange rate)	10,000	10,300	10,600	11,100	.	.	11,700	12,100	12,700
GDP/capita (EUR at PPP)	17,200	17,800	18,800	19,700	.	.	.	.	.
Consumption of households, HUF bn, nom. [2]	14,922	15,207	15,730	16,205	7,898	8,278	.	.	.
annual change in % (real)	-2.2	0.2	2.5	3.4	3.1	5.0	4.0	2.5	2.5
Gross fixed capital form., HUF bn, nom. [2]	5,548	6,308	7,064	7,367	2,958	2,518	.	.	.
annual change in % (real)	-3.0	9.8	9.9	1.9	0.8	-15.4	-10.0	3.0	6.0
Gross industrial production									
annual change in % (real)	-1.8	1.1	7.7	7.4	7.1	2.3	2.5	6.0	7.0
Gross agricultural production									
annual change in % (real)	-10.0	12.4	11.1	-3.1	.	.	.	.	.
Construction industry									
annual change in % (real)	-6.5	8.4	13.5	3.0	7.7	-25.3	.	.	.
Employed persons, LFS, th, average	3,827	3,893	4,101	4,211	4,159	4,302	4,320	4,340	4,360
annual change in %	1.8	1.7	5.3	2.7	2.5	3.5	2.5	0.5	0.5
Unemployed persons, LFS, th, average	473	441	343	308	329	253	250	250	250
Unemployment rate, LFS, in %, average	11.0	10.2	7.7	6.8	7.4	5.6	5.5	5.5	5.5
Reg. unemployment rate, in %, end of period	12.7	9.3	8.9	7.6	8.3	6.5	.	.	.
Average monthly gross wages, HUF [3]	223,060	230,714	237,695	247,924	243,370	258,003	261,400	273,300	287,100
annual change in % (real, gross)	-0.9	1.7	3.2	4.4	4.0	5.9	5.0	2.5	2.5
Average monthly net wages, HUF [3]	144,085	151,118	155,690	162,391	159,408	171,573	171,200	179,000	188,100
annual change in % (real, net)	-3.4	3.1	3.2	4.4	4.0	7.5	5.0	2.5	2.5
Consumer prices (HICP), % p.a.	5.7	1.7	0.0	0.1	-0.3	0.2	0.4	2.0	2.5
Producer prices in industry, % p.a.	4.1	0.6	-0.4	-0.9	-1.0	-1.8	-1.5	1.0	2.0
General governm.budget, EU-def., % of GDP									
Revenues	46.2	46.9	47.2	48.3	.	.	47.5	47.5	47.5
Expenditures	48.6	49.5	49.5	50.3	.	.	49.8	50.4	50.4
Net lending (+) / net borrowing (-)	-2.3	-2.6	-2.3	-2.0	.	.	-2.3	-2.9	-2.9
Public debt, EU-def., % of GDP	78.2	76.6	75.7	74.7	.	.	74.4	74.0	73.7
Central bank policy rate, % p.a., end of period [4]	5.75	3.00	2.10	1.35	1.50	0.90	0.90	1.00	1.30
Current account, EUR mn [5]	1,752	3,892	2,181	3,714	2,052	3,302	5,000	4,900	5,000
Current account, % of GDP [5]	1.8	3.8	2.1	3.4	4.0	6.3	4.4	4.1	4.0
Exports of goods, BOP, EUR mn [5]	69,961	70,243	74,423	79,604	39,257	41,250	84,400	90,300	96,600
annual change in %	-2.6	0.4	6.0	7.0	6.8	5.1	6.0	7.0	7.0
Imports of goods, BOP, EUR mn [5]	67,028	66,912	72,051	75,237	37,073	38317	78,600	84,100	90,600
annual change in %	-2.7	-0.2	7.7	4.4	4.2	3.4	4.5	7.0	7.7
Exports of services, BOP, EUR mn [5]	16,060	16,993	18,640	19,957	9,468	9929	21,000	21,600	22,500
annual change in %	0.1	5.8	9.7	7.1	7.1	4.9	5.0	3.0	4.0
Imports of services, BOP, EUR mn [5]	12,263	13,232	13,732	14,562	6,823	7024	15,100	15,600	16,200
annual change in %	-3.8	7.9	3.8	6.0	4.1	2.9	4.0	3.0	4.0
FDI liabilities (inflow), EUR mn [5]	4,405	4,986	6,868	5,964	1,306	-8,984	1,000	.	.
FDI assets (outflow), EUR mn [5]	2,310	3,848	4,035	5,565	2,316	-8,753	1,000	.	.
Gross reserves of NB, excl. gold, EUR mn	33,757	33,696	34,481	30,226	34,657	24,668	.	.	.
Gross external debt, EUR mn [5]	127,667	119,963	120,077	116,937	123,900	114,419	113,900	110,900	107,800
Gross external debt, % of GDP [5]	128.8	118.2	114.4	106.6	113.0	99.9	99.5	93.4	87.1
Average exchange rate HUF/EUR	289.25	296.87	308.71	310.00	307.43	312.70	310	315	320
Purchasing power parity HUF/EUR	168.07	171.31	174.90	175.65	.	.	.	.	.

1) Preliminary. - 2) Half-year GDP data unrevised. - 3) Enterprises with 5 and more employees. - 4) Base rate (two-week NB bill). - 5) Excluding SPE.

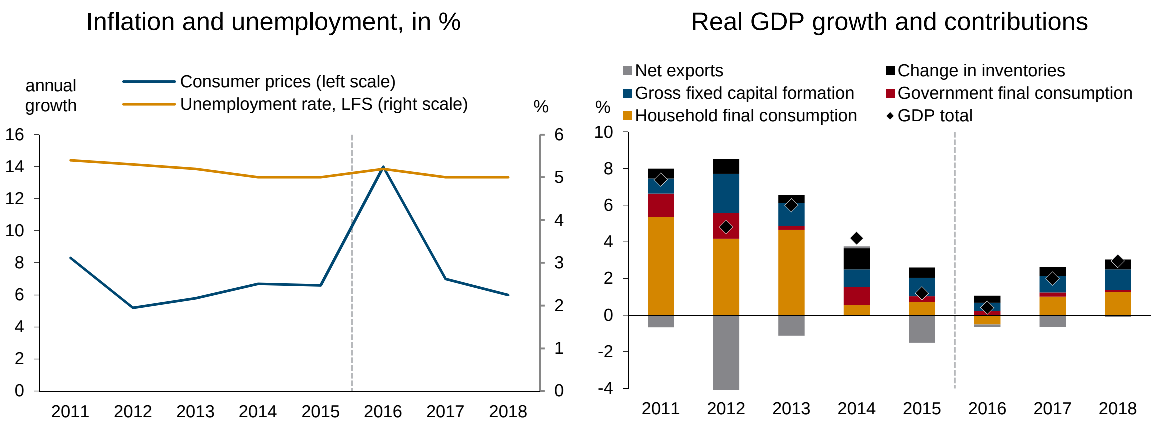
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

KAZAKHSTAN: Nearly avoiding recession

OLGA PINDYUK

The Kazakh economy has been anaemic throughout 2016 primarily on account of poor performance in the oil sector. Oil production and exports are expected to increase following the launch of the Kashagan oil field at the end of 2016. GDP growth will accelerate from 0.4% in 2016 to 2% in 2017, rising further to 3% in 2018. Household consumption will fall by 1% in real terms in the course of the current year, yet recover in the two years thereafter. That notwithstanding, household consumption will still lag behind investment: the main growth factor in the short run.

Figure 31 / Kazakhstan: Main macroeconomic indicators



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

Kazakhstan is nearly avoiding recession in 2016: in the first half of 2016, GDP growth was only at 0.1% year on year primarily due to the poor performance of the mining sector (reflecting both weak external demand and supply-side constraints) and sluggish performance of the country's main trading partners. In contrast, positive dynamics has been recorded in construction and real estate, the transport sector, and agriculture. By the year end, GDP growth is expected to slightly speed up to 0.4% as oil production will pick up somewhat and the oil price is expected to be higher compared to the same period in 2015.

Lower oil prices and a drop in the oil output were the primary factors behind the drastic decline in Kazakhstan's exports in the first half of 2016. In January-July 2016, goods exports fell by 30% year on year, mostly in value terms. At the same time the depreciation of the national currency earlier this year caused a drop in goods imports of a similar magnitude: during January-July 2016, they fell by 29% year on year (practically uniformly across all product groups). The import decrease has mitigated the effects of plummeting exports on the current account balance, but the latter still reached a record deficit of 6.4% of GDP in the first half of 2016. As the export decline is expected to slow down by the end of the year, the current account deficit will shrink to about 3.5% of GDP for 2016 as a whole.

Oil production is expected to increase with the launch of the Kashagan oil field this autumn. The development of one of the world's largest conventional oil fields was marked by a series of technical issues that raised the costs of development from an initially estimated USD 10 billion to more than USD 50 billion and caused a delay of the start of operation by several years. According to conservative estimates by Kazakhstan's government, the new field will allow pumping at least 100 thousand barrels of oil per day by mid-2017, adding around 6% to the current volume of oil production in the country. More optimistic estimates envisage an increase of oil production by up to 360 thousand barrels per day in the near future (up by about 20% from the current level).

The construction sector has been growing primarily on the back of the support coming from the counter-cyclical fiscal stimulus package 'Nurly Zhol' (Path to the Future), which targets mainly residential construction and transport infrastructure projects. In 2016, it is envisaged to spend about KZT 770 billion (around 1.6% of GDP) as part of the package. However, the sector continues to suffer from constrained access to credit that is crucial for its long-run sustainable growth. During the first 8 months of 2016, newly issued loans to the sector were 25% lower than during the same period of 2015.

The government continues to put a lot of effort into attracting investment through public-private partnerships, in particular with China. In September 2016, President Nazarbayev announced about the reached agreements to create 51 joint ventures that are expected to bring about USD 23 billion in investment. The main focus of the investment projects will be on the development of transport infrastructure and oil processing. Recently Kazakhstan has finished the construction of its section of the Turkmenistan-Uzbekistan-Kazakhstan-China gas pipeline, which is expected to start operating in the fourth quarter of 2016.

The boost in the oil output as well as increased investment into the mining sector and transport infrastructure projects will be the main driving forces behind the expected acceleration of economic growth in Kazakhstan in 2017-2018: wiiw forecasts that during this period GDP will grow by 2% and 3%, respectively.

Household demand has been weak due to declining real wages and consumer loans. Real household incomes fell by 6.3% year on year in January-July 2016. Although the banking sector has been showing signs of recovery as issuance of new loans picked up, positive dynamics have been recorded only in the segment of short-term loans to corporate clients, while loans to individuals are still in decline – during January-August 2016, the value of newly issued loans to households decreased by 3% year on year. We forecast that private consumption will fall by 1% in real terms in 2016; it will switch to growth in 2017-2018, but will be still lagging behind investment.

After a marked depreciation in 2015, the exchange rate of the tenge has continued to be relatively stable at a level of around 335 KZT/USD. As oil prices are assumed to remain at about 50 USD per barrel during the forecast period, there should be no further depreciation in the near future. During the next two years the current account balance is likely to remain negative but the deficit will gradually decrease as exports are expected to recover and grow somewhat faster than imports. After accommodating the effects of last year's depreciation in 2016 (when CPI is forecasted to average 14% p.a.), inflation is expected to remain in the target range of 6-8% in 2017-2018.

Overall economic growth will stay below the pre-crisis rates as recovery in the mining sector alone will not be sufficient to accelerate growth significantly under the current oil prices, and the returns on infrastructure investment are likely to materialise only over a longer time span.

Table 14 / Kazakhstan: Selected economic indicators

	2012	2013	2014	2015 1)	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., average	16,791	17,035	17,289	17,544	17,479	17,712	17,800	18,100	18,350
Gross domestic product, KZT bn, nom.	31,015	35,999	39,676	40,884	17,092	19,357	47,200	50,600	55,200
annual change in % (real)	4.8	6.0	4.2	1.2	1.7	0.1	0.4	2.0	3.0
GDP/capita (EUR at exchange rate)	9,600	10,500	9,600	9,500	.	.	7,000	7,500	8,000
GDP/capita (EUR at PPP)	16,900	17,500	18,400	19,000	.	.	.	.	.
Consumption of households, KZT bn, nom.	13,659	17,617	18,806	20,494	.	.	.	.	.
annual change in % (real)	10.1	10.6	1.1	1.5	.	.	-1.0	2.0	2.5
Gross fixed capital form., KZT bn, nom.	7,072	7,877	8,552	9,276	.	.	.	.	.
annual change in % (real)	9.9	5.5	4.4	4.7	.	.	2.0	4.0	5.0
Gross industrial production									
annual change in % (real)	0.7	2.5	0.3	-1.6	0.6	-1.6	-2.0	2.0	3.0
Gross agricultural production									
annual change in % (real)	-17.8	11.7	1.0	3.4	2.3	2.7	.	.	.
Construction industry									
annual change in % (real)	3.1	3.5	4.6	4.4	5.1	6.6	.	.	.
Employed persons, LFS, th, average	8,507	8,571	8,510	8,624	8,512	8,474	8,670	8,710	8,750
annual change in % 2)	1.0	0.7	-0.7	1.3	-1.2	-0.4	0.5	0.5	0.5
Unemployed persons, LFS, th, average	475	471	452	451	448	446	480	460	460
Unemployment rate, LFS, in %, average	5.3	5.2	5.0	5.0	5.0	5.0	5.2	5.0	5.0
Reg. unemployment rate, in %, end of period	0.4	0.3	0.4	0.4	0.7	0.8	.	.	.
Average monthly gross wages, KZT 3)	101,263	109,141	121,021	126,021	121,433	138,185	140,800	155,200	171,100
annual change in % (real, gross)	7.0	1.9	3.9	-2.4	0.5	-1.7	-2.0	3.0	4.0
Consumer prices (HICP), % p.a.	5.2	5.8	6.7	6.6	5.3	15.8	14.0	7.0	6.0
Producer prices in industry, % p.a.	3.5	-0.3	9.5	-20.5	-22.6	11.9	16.0	1.0	5.0
General governm.budget, nat.def., % of GDP									
Revenues	18.7	17.7	18.5	18.7	23.5	21.4	18.5	19.0	19.0
Expenditures	21.6	19.7	21.2	20.9	23.5	23.7	20.5	20.7	20.6
Deficit (-) / surplus (+)	-2.9	-1.9	-2.7	-2.2	0.1	-2.4	-2.0	-1.7	-1.6
Public debt, nat.def., % of GDP	12.7	12.6	14.6	22.7	14.3	23.1	25.0	27.0	28.0
Central bank policy rate, % p.a., end of period 4)	5.5	5.5	5.5	16.0	5.5	15.0	12.0	10.0	9.0
Current account, EUR mn 5)	823	894	4,483	-4,929	-2,021	-3,217	-4,400	-3,700	-3,500
Current account in % of GDP 5)	0.5	0.5	2.7	-3.0	-2.4	-6.4	-3.5	-2.7	-2.4
Exports of goods, BOP, EUR mn 5)	67,629	64,435	60,440	41,961	22,269	15,353	35,300	37,800	41,200
annual change in %	10.5	-4.7	-6.2	-30.6	-28.9	-31.1	-15.9	7.1	9.0
Imports of goods, BOP, EUR mn 5)	37,954	38,244	33,162	30,523	15,504	11,249	26,000	27,000	28,900
annual change in %	30.9	0.8	-13.3	-8.0	4.0	-27.4	-14.8	3.8	7.0
Exports of services, BOP, EUR mn 5)	3,756	3,988	4,981	5,782	2,720	2,789	5,900	6,200	6,500
annual change in %	20.5	6.2	24.9	16.1	21.6	2.5	2.0	5.1	4.8
Imports of services, BOP, EUR mn 5)	9,925	9,379	9,721	10,403	4,594	4,497	10,200	10,600	11,100
annual change in %	25.9	-5.5	3.6	7.0	5.4	-2.1	-2.0	3.9	4.7
FDI liabilities (inflow), EUR mn 5)	10,618	7,536	5,336	5,940	2,868	7,048	8,200	.	.
FDI assets (outflow), EUR mn 5)	1,394	1,488	1,749	2,881	1,700	1,905	2,000	.	.
Gross reserves of NB excl. gold, EUR mn	16,665	13,940	17,920	18,559	19,001	18,297	.	.	.
Gross external debt, EUR mn 5)	103,150	109,137	129,328	140,517	139,996	144,688	147,600	155,000	162,700
Gross external debt, % of GDP 5)	63.7	61.3	77.6	84.5	84.2	115.7	118.0	114.9	110.6
Average exchange rate KZT/EUR	191.67	202.09	238.10	245.80	206.79	385.76	377	375	375
Purchasing power parity KZT/EUR 6)	109.17	120.71	124.80	122.94	.	.	.	.	.

1) Preliminary. - 2) wiiw estimate in 2012 due to census March 2009. - 3) Excluding small enterprises, engaged in entrepreneurial activity. - 4) From 2015 one day (overnight) repo rate, refinancing rate of NB before. - 5) Converted from USD. - 6) wiiw estimates based on the 2011 International Comparison Project benchmark.

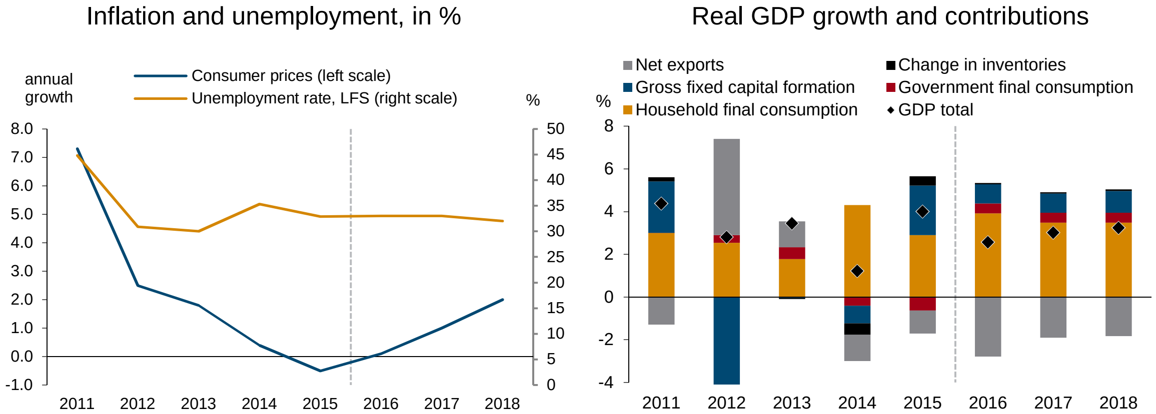
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

KOSOVO: Investment failure dragging down growth

MARIO HOLZNER

The main reason for revising Kosovo's GDP growth prospects downwards for the years ahead lies in the failure of a major foreign investment project in the winter tourism industry that accounted for some 7% of the country's GDP. Growth of less than 3% is expected for 2016, largely driven by household consumption.

Figure 32 / Kosovo: Main macroeconomic indicators



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

This summer it became clear that the envisaged sale of Kosovo's only ski resort to a French consortium had failed as the potential investor of the planned EUR 400 million (approximately 7% of 2016 GDP) project was unable to secure the contractually pledged funding. This is a severe setback for a small and poor country desperately in need of productive investments in the tiny export sector. In this respect it is only a small crumb of comfort that other potential investment projects are being discussed. Apparently several foreign investors have shown interest in taking part in the EUR 60 million worth construction of a second ski resort in Kosovo. And in other news, the Belgian bus manufacturer Van Hool is negotiating possible investments in the country with Kosovo's government.

Nevertheless, gross capital formation in the first half of 2016 increased by almost 15% in real terms as compared to the same period of 2015. This is also reflected in a fairly strong increase in construction activities of more than 5% in the first half. However, new investment loans decreased in the first seven months of 2016 by almost 19% as compared to the corresponding period a year earlier – despite new loans’ (effective) interest rates further declining year on year by 1.1 percentage points to a level of about 7% in July 2016. Another concern is the massive drop in FDI inflows: by more than 40% in the first half of 2016 compared to the first half of the previous year. Hence the surprisingly high growth of capital formation in the first half is unlikely to continue throughout the whole year.

Also government activity is supporting growth only marginally, if at all. In the first six months of 2016, public expenditures increased by 10% while revenues rose by 17% year on year. Still, on 8 July 2016, Kosovo's parliament approved a budget revision, raising the projected deficit slightly to EUR 122 million (from the previously expected 107 million, around 2% of GDP). In particular, planned capital expenditures were increased by almost 8%.

As it appears, household consumption will provide the biggest contribution to GDP growth in this and the following years. In the first half of 2016, real growth of household consumption of almost 6% was recorded year on year. This is also reflected in new consumer loans up by almost 19% over the period from January to July 2016 as compared to the same period of 2015. Moreover, customs data for the first half of the year indicate strong growth of imports by more than 8% year on year, which is another indicator of dynamic household consumption activity. (Nominal exports in the same period were declining by almost 6%, partly related to declining prices for metals.)

It is interesting to note that both household consumption and construction activities are doing well against the backdrop of a slight fall in remittances (-2.7%) in the first half of this year against the same period a year earlier. This is despite a stable outlook for the German economy in 2016 and the Swiss economy being able to regain momentum in recent quarters – the two countries being the main host countries for Kosovo migrant workers. (The Swiss growth outlook for 2017 is stable and that of Germany was revised slightly downwards due to assumed negative Brexit effects, but both are expected to grow at a relatively robust rate of around 1.7%.)

Overall, we have to substantially reduce our GDP growth forecast for Kosovo, mostly due to the failed ski resort investment. The new forecast is now 2.6% for 2016, 3.0% for 2017 and 3.2% for 2018 (down from 3.3%, 4.2% and 4.0%, respectively, in our summer 2016 forecast update). If, however, household consumption keeps on growing and investment does not plummet in the second half of the current year, GDP growth in 2016 could be above 3%. Nevertheless, without major foreign investment and an increase in export capacities, in the years to come the country will grow slightly below its trend growth rate of 3.3% observed since the outbreak of the global financial crisis.

Table 15 / Kosovo: Selected economic indicators

	2012	2013	2014	2015 1)	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., average	1,807	1,818	1,813	1,788	.	.	1,780	1,780	1,790
Gross domestic product, EUR mn, nom.	5,059	5,327	5,567	5,772	2,645	2,729	5,900	6,100	6,400
annual change in % (real)	2.8	3.4	1.2	4.0	3.3	3.5	2.6	3.0	3.2
GDP/capita (EUR at exchange rate)	2800	2900	3100	3200	.	.	3,300	3,400	3,600
GDP/capita (EUR at PPP)	6500	6700	7000	7600	.	.	.	.	.
Consumption of households, EUR mn, nom.	4,458	4,652	4,926	5,024	.	.	.	.	.
annual change in % (real)	2.9	2.0	4.9	3.3	.	.	4.5	4.0	4.0
Gross fixed capital form., EUR mn, nom.	1,317	1,323	1,294	1,480	.	.	.	.	.
annual change in % (real)	-13.6	-0.2	-3.3	10.0	.	.	3.5	3.5	4.0
Gross industrial production 2)									
annual change in % (real)	14.9	6.5	-1.3	5.0	.	.	3.5	4.0	5.0
Gross agricultural production 2)									
annual change in % (real)	-8.5	1.4	0.8	-3.0	.	.	.	.	.
Construction output 2)									
annual change in % (real)	-8.5	2.6	-6.1	4.0	.	.	.	.	.
Employed persons, LFS, th, average 3)	303	338	324	297	.	.	300	310	320
annual change in %	.	11.7	-4.4	-8.2	.	.	1.0	2.0	2.0
Unemployed persons, LFS, th, average 3)	136	145	177	146	.	.	150	150	150
Unemployment rate, LFS, in %, average 3)	30.9	30.0	35.3	32.9	.	.	33.0	33.0	32.0
Unemployment rate, reg., in %, end of period	.	.	.	.	.	.	.	.	.
Average monthly net wages, EUR 4)	354	356	416	446	.	.	460	480	500
annual change in % (real, net)	-0.8	-1.2	16.4	9.0	.	.	2.0	3.0	3.0
Consumer prices, % p.a.	2.5	1.8	0.4	-0.5	-0.4	0.0	0.1	1.0	2.0
Producer prices, % p.a.	1.9	2.5	1.7	2.7	3.9	-3.0	-2.0	2.0	4.0
General governm.budget, nat.def., % of GDP									
Revenues	27.3	25.5	24.2	29.6	.	.	31.0	30.0	31.0
Expenditures	28.6	28.0	27.2	27.9	.	.	30.5	31.0	32.0
Deficit (-) / surplus (+)	-1.2	-2.5	-2.9	1.6	.	.	0.5	-1.0	-1.0
Public debt, nat.def., % of GDP	8.1	8.9	10.5	13.0	11.2	13.8	12.2	12.8	13.2
Central bank policy rate, % p.a., end of period 5)	12.24	10.90	9.29	7.69	7.63	7.21	6.00	5.50	5.00
Current account, EUR mn	-380	-339	-437	-528	-208	-321	-760	-780	-810
Current account, % of GDP	-7.5	-6.4	-7.8	-9.1	-7.9	-11.8	-12.9	-12.8	-12.7
Exports of goods, BOP, EUR mn	282	291	324	322	158	150	320	340	370
annual change in %	-10.9	3.4	11.3	-0.6	11.9	-5.5	-0.8	6.3	8.8
Imports of goods, BOP, EUR mn	2,332	2,287	2,383	2,432	1,099	1,210	2,550	2,700	2,900
annual change in %	-1.3	-1.9	4.2	2.1	2.5	10.1	4.9	5.9	7.4
Exports of services, BOP, EUR mn	641	633	767	796	322	330	820	880	950
annual change in %	2.6	-1.4	21.3	3.8	10.9	2.6	3.0	7.3	8.0
Imports of services, BOP, EUR mn	318	320	431	442	189	157	350	370	400
annual change in %	-13.9	0.9	34.6	2.5	24.8	-16.9	-20.8	5.7	8.1
FDI liabilities (inflow), EUR mn	229	280	151	324	162	85	180	.	.
FDI assets (outflow), EUR mn	16	30	27	37	13	1	10	.	.
Gross reserves of NB excl. gold, EUR mn	840	800	747	862	750	919	.	.	.
Gross external debt, EUR mn	1,517	1,608	1,737	1,932	1,831	2,003	2,100	2,300	2,400
Gross external debt, % of GDP	30.0	30.2	31.2	33.5	31.7	34.0	36.0	37.0	38.0
Purchasing power parity EUR/EUR	0.431	0.436	0.437	0.424	.	.	.	.	.

1) Preliminary - 2) According to gross value added (manufacturing industry for industrial production). - 3) Population 15-64. - 4) Net wages in state administration. - 5) Average weighted effective lending interest rate (Kosovo uses the euro as national currency).

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

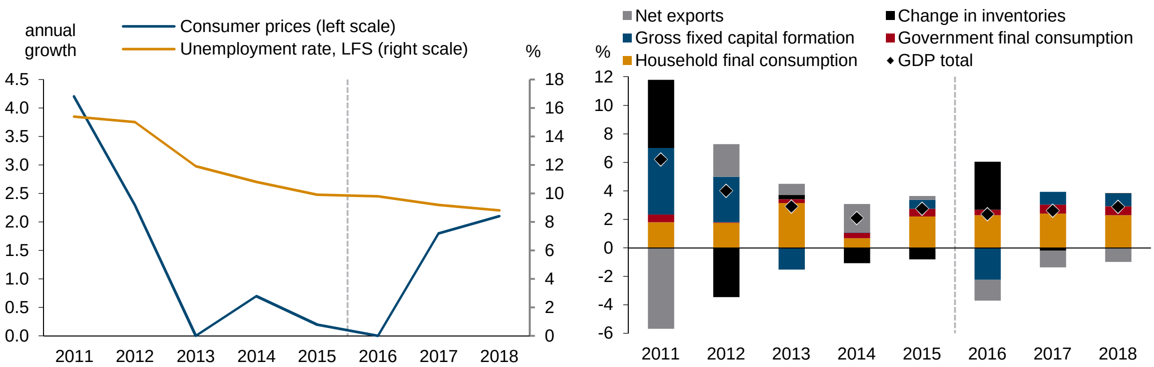
LATVIA: EU funds to rekindle investment ahead

SEBASTIAN LEITNER

We have slightly reduced our GDP growth forecast for Latvia for 2016: down to 2.4%. Private investment activity has become increasingly sluggish, whereas the current year's major cuts in public capital expenditure by a third were not unexpected. It proved possible to offset by and large the slump in Russian demand by securing growth via exports to the EU and Asian markets. Household consumption has developed at a smart pace, while the rapidly rising real wages will continue to buoy the spendthrift mood among consumers. In both 2017 and 2018 we expect an upswing in GDP growth to 2.6% and 2.9%, respectively, the main driver being stronger external demand and greater investment activity in both the public and private sectors.

Figure 33 / Latvia: 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.

In the second quarter of this year Latvian goods exports stabilised in nominal terms and increased already in value added terms year on year. While demand from Russia is still declining, trade with Western Europe, the Scandinavian countries and the rest of the world has expanded again more rapidly. Exports of fish and products thereof are still ailing due to the Russian embargo and those of mineral products due to the low level of the oil price. Good news comes from the wood sector reporting strong export growth figures. In general, we have to revise our forecast for export growth in 2016 downwards, while a stronger revival will take place only in 2017.

As expected, in mid-September 2016 Liepajas Metalurgs, the only steel mill in the Baltic states, was declared insolvent by a local court. The government had lately refrained from subsidising the heavily indebted company. After running into insolvency already two years ago, the plant was sold to Ukrainian investors, the KVV Group. Shortly thereafter, the worldwide decline in steel prices, resulting inter alia from Chinese producers flooding the market, rendered production at the Latvian site cost inefficient. The KVV Group announced to sue Latvia in the EC's Anti-Monopoly and Corruption Prevention Committee, claiming to have been treated detrimentally by the government.

Gross fixed capital investment dropped by more than 20% in real terms in the first half of 2016. This resulted particularly from a reduction of capital expenditure by about a third both by the central state and local governments. Nevertheless, given the modest expansion of industrial production, also private fixed capital investments are going to decline this year. Private residential construction output fell as well, particularly in the second quarter of 2016, and declining numbers of building permits both for non-residential and residential buildings are reinforcing the negative prospects in the sector. For 2017, however, public investment in infrastructure will revive with fresh EU funds becoming available. Overall, we expect total gross fixed investment to decline by at least 10% in 2016 and to grow at a rate of 4% in real terms in 2017.

As expected, the significantly lower level of prices for imported goods in the first three quarters of 2016 compared to the previous year kept consumer inflation stagnant. Strong wage growth has raised core inflation slightly. However, only in 2017 and thereafter will rising prices in the services sector and an upswing in import prices result in consumer inflation increasing to about 1.8%.

The declining activity in construction leads to lower employment there, while job growth is recorded in the industrial sectors. Overall employment is almost stagnating in Latvia in 2016. Demographic developments – including continuing net emigration – result in a further decline in the working-age population; thus growth in employment is likely to remain below 1% in the coming years. Towards the end of 2015, the unemployment rate had receded to single digits for the first time since the outbreak of the global financial crisis in 2008. However, for this year we expect it to remain almost unchanged and in the years to come to decline more gradually. Gross real wages will keep on growing by about 5% not only in 2016 but also in the years ahead. The government plans to increase the minimum wage in 2017, most likely by more than 5%. Thus, growth of household consumption will continue to increase next year after having accelerated already in 2016. Higher than expected government revenues will result in a lower than envisaged budget deficit amounting to about 0.8% of GDP this year.

Due to the delayed expansion of external demand and the stronger than anticipated investment decline, we have slightly reduced our GDP growth forecast for 2016, down to 2.4%. However, because of the expected speed-up in demand in the EU and a rise in domestic investment activity driven by the inflow of EU funds, we expect GDP growth to accelerate somewhat in 2017 and 2018, to 2.6% and 2.9%, respectively.

Table 16 / Latvia: Selected economic indicators

	2012	2013	2014	2015 [1)]	2015	2016	2016	2017	2018
					January-June			Forecast	
Population, th pers., average	2,034	2,013	1,994	1,978	1,982	1,965	1,965	1,950	1,945
Gross domestic product, EUR mn, nom.	21,849	22,774	23,608	24,349	11,487	11,778	24,900	26,000	27,300
annual change in % (real)	4.0	2.9	2.1	2.7	2.4	2.1	2.4	2.6	2.9
GDP/capita (EUR at exchange rate)	10,800	11,300	11,800	12,300	.	.	12,700	13,300	14,000
GDP/capita (EUR at PPP)	16,000	16,700	17,500	18,500	.	.	.	.	.
Consumption of households, EUR mn, nom.	13,065	13,780	14,166	14,584	7,088	7,357	.	.	.
annual change in % (real)	2.9	5.2	1.1	3.7	3.7	3.7	3.8	4.0	3.8
Gross fixed capital form., EUR mn, nom.	5,551	5,291	5,337	5,497	2,222	1,712	.	.	.
annual change in % (real)	14.4	-6.0	0.1	2.8	2.3	-21.8	-10.0	4.0	4.0
Gross industrial production [2)]									
annual change in % (real)	6.2	-0.9	-1.0	3.6	3.5	4.7	5.0	4.0	5.0
Gross agricultural production									
annual change in % (real)	17.3	3.4	3.1	8.7	.	.	.	.	.
Construction industry									
annual change in % (real)	13.7	8.1	7.9	-1.2	-2.2	-19.0	.	.	.
Employed persons, LFS, th, average	875.6	893.9	884.6	896.1	891.2	893.9	900	905	910
annual change in %	1.6	2.1	-1.0	1.3	0.6	0.3	0.4	0.6	0.6
Unemployed persons, LFS, th, average	155.1	120.4	107.6	98.2	98.9	98.1	100	90	90
Unemployment rate, LFS, in %, average	15.0	11.9	10.8	9.9	10.0	9.9	9.8	9.2	8.8
Reg. unemployment rate, in %, end of period [3)]	10.5	9.5	8.5	8.7	8.6	8.3	.	.	.
Average monthly gross wages, EUR	684.4	715.7	765.0	818.0	798.5	835.2	860	920	980
annual change in % (real, gross)	1.4	4.6	6.2	6.7	5.9	5.2	5.2	5.0	4.5
Average monthly net wages, EUR	488.0	515.4	560.0	603.0	589.8	615.2	630	660	690
annual change in % (real, net)	1.6	5.6	8.0	7.4	6.6	5.0	5.0	3.5	2.5
Consumer prices (HICP), % p.a.	2.3	0.0	0.7	0.2	0.4	-0.6	0.0	1.8	2.1
Producer prices in industry, % p.a.	4.2	1.6	0.4	-1.0	-0.4	-3.5	-3.0	1.0	1.5
General governm.budget, EU-def., % of GDP									
Revenues	36.3	36.1	35.9	36.0	.	.	36.3	36.2	36.0
Expenditures	37.1	37.0	37.4	37.2	.	.	37.1	37.0	36.5
Net lending (+) / net borrowing (-)	-0.8	-0.9	-1.6	-1.3	.	.	-0.8	-0.8	-0.5
Public debt, EU-def., % of GDP	41.3	39.0	40.7	36.4	.	.	36.0	35.0	34.0
Central bank policy rate, % p.a., end of period [4)]	2.50	0.25	0.05	0.05	0.05	0.00	.	.	.
Current account, EUR mn	-794	-621	-463	-189	-135	115	-100	-500	-600
Current account, % of GDP	-3.6	-2.7	-2.0	-0.8	-1.2	1.0	-0.4	-1.9	-2.2
Exports of goods, BOP, EUR mn	9,645	9,810	10,214	10,322	4,962	4,808	10,100	10,500	11,000
annual change in %	16.2	1.7	4.1	1.1	2.5	-3.1	-2.2	4.0	4.8
Imports of goods, BOP, EUR mn	12,282	12,431	12,414	12,364	6,033	5,726	12,200	13,000	14,000
annual change in %	13.6	1.2	-0.1	-0.4	1.3	-5.1	-1.3	6.6	7.7
Exports of services, BOP, EUR mn	3,768	3,900	3,853	4,038	1,915	1,993	4,120	4,470	4,800
annual change in %	8.6	3.5	-1.2	4.8	4.5	4.1	2.0	8.5	7.4
Imports of services, BOP, EUR mn	2,145	2,127	2,101	2,273	1,053	1,117	2,350	2,450	2,600
annual change in %	7.7	-0.8	-1.2	8.2	7.7	6.1	3.4	4.3	6.1
FDI liabilities (inflow), EUR mn	840	743	813	684	389	-178	200	.	.
FDI assets (outflow), EUR mn	127	373	441	112	64	166	100	.	.
Gross reserves of NB excl. gold, EUR mn [5)]	5,373	5,565	2,448	2,957	2,783	2,912	.	.	.
Gross external debt, EUR mn	30,254	30,501	33,794	34,505	34,963	37,810	37,400	40,300	43,700
Gross external debt, % of GDP	137.4	133.7	143.1	141.7	143.6	151.8	150.0	155.0	160.0
Average exchange rate EUR-LVL/EUR	0.9922	0.9981	1.0000	1.0000	1.0000	1.0000	1	1	1
Purchasing power parity EUR-LVL/EUR	0.6711	0.6793	0.6750	0.6657	.	.	.	.	.

1) Preliminary. - 2) Enterprises with 20 and more employees. - 3) In % of labour force (LFS). - 4) From 2014 official refinancing operation rate for euro area (ECB), refinancing rate of National Bank before. - 5) From January 2014 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.

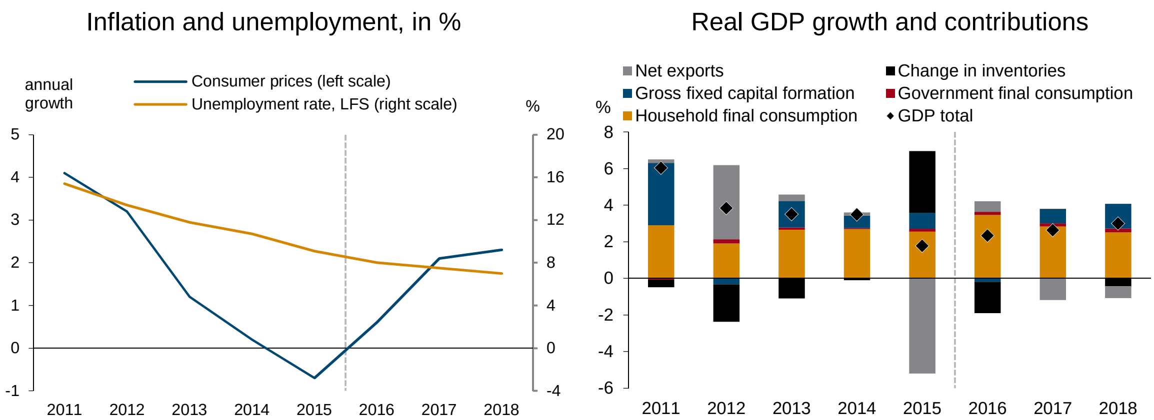
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

LITHUANIA: Wage increases push consumption

SEBASTIAN LEITNER

Throughout 2016 economic growth in Lithuania has continued to be dampened by the slump in external demand both from the CIS economies and for oil products. Moreover, public investment has reached its nadir before fresh funds from the EU bring about an upswing in 2017. That notwithstanding, stable growth in terms of employment and rapid wage increases has resulted in consumer demand developing at a swift pace. For 2016, we forecast a moderate GDP growth rate of 2.3%, followed by an upswing to 2.6% and 3% in 2017 and 2018, respectively.

Figure 34 / Lithuania: Main macroeconomic indicators



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

Following a revival in the first months of 2016, trade became stagnant again in the 2nd and 3rd quarters of this year. Rising exports to Nordic countries and the United States can only compensate for the still declining volumes destined for Russia. After a slump in exports to the Eastern neighbour of about 40% in nominal terms in 2015, we expect a stabilisation towards the end of the current year. A strong recovery of the Russian economy and thus a swift upswing of Lithuanian exports from 2017 onwards are, however, not likely. Another reason for stagnating exports was the slump in external demand for refined oil products and the fall in prices, squeezing the profits of the Lithuanian refinery Mazeiku Nafta, which accounts for about a third of the country's total exports. The transport sector, being strongly exposed to Russian transit trade, is currently hit less than expected. Moreover, also tourism exports developed at a fast pace in the first half of 2016. Although household demand evolves well, imports increase – in value added terms – below the rate of exports due to low investment activity this year. While the current account deficit is likely to decline in 2016, over the medium term it will attain 3% of GDP.

Gross fixed capital investment dropped by more than 3% in real terms in the first half of 2016. This is mainly a result of the decline in public capital expenditures – a reduction of about 10% from the 2015 level was envisaged in the 2016 budget. Similar to other new EU Member States, Lithuania is experiencing a depression phase of the investment cycle driven by EU structural funds. However, for 2017 the budget envisages a boost in investment in road and railway infrastructure – an ongoing major EU-funded project is Rail Baltica, connecting the Baltics with the European railway network. The construction of dwellings started to increase gradually in the second quarter of 2016 and the rising number of building permits indicates that the upswing will continue next year as well. Also, the mortgage loan portfolio of households started to grow again more swiftly in the first half of this year after having stagnated since 2008.

The fall in prices for imports, particularly of oil and gas, still drags on overall price developments in Lithuania. Producer prices fell by more than 8% in the first half of 2016, while consumer inflation is stagnant. This is particularly remarkable as average gross wages continued to increase substantially; in the first half of 2016 by almost 7% year on year in real terms. Stronger economic stimulus in the rest of the EU and higher investment activity are going to lead to rising consumer inflation in 2017 and 2018. Employment is expected to increase this year by close to 2%. Apart from construction, agriculture and transport (the latter two being hit by the Russian crisis and embargo), job growth is eminent in all sectors of the economy, particularly in recreational and business services. Simultaneously, however, net outward migration is continuing and likely to attain about 1% of the Lithuanian labour force also in 2016. The employment rate of those aged 15-64 reached 76%, almost the level of Germany, and the unemployment rate is likely to drop to about 8% of the labour force.

In September 2016 the parliament finally enacted the laws of the ‘New social model’, a comprehensive reform package of the labour law and complementary laws concerning the social protection and pension system which was intensively contested this and past year. The core of the new laws is the liberalisation of labour contracts: notice periods for dismissals and severance payments have been reduced and the possibility of atypical work and overtime expanded. Labour unions have opposed the new laws, arguing that these result in a reduction of guarantees for employees in general and for working parents in particular. Apart from a reduction of employers’ social contributions, the reforms also foresee an indexation of public pensions to the average wage development.

The resistance of the public against the labour market liberalisation package proved to be disastrous for the incumbent Social Democrats and its coalition partners in the parliamentary elections which took place in October 2016. The centre-conservative ‘Peasant and Greens Union’ party won a landslide victory and will most probably form a government with the conservative ‘Homeland Union’. The political and economic guidelines of the incoming coalition do not differ substantially from those of the leaving government. The budget proposal of the outgoing government for 2017 foresees increased expenditures due to the enactment of the ‘New social model’, a further increase of the minimum wage and the non-taxable income bracket and another hike in the defence budget with the aim to attain a level of 2% of GDP by 2018.

Given the improving situation in the labour market and strongly rising incomes, household consumption remains the most important driver of growth for the Lithuanian economy in 2016 and the years thereafter. Slightly reducing our July forecast, we expect GDP to expand by 2.3% in 2016, followed by an upswing to 2.6% in 2017 and 3% in 2018. The assumed drivers of that growth are an economic stabilisation in the eastern neighbourhood and growth in the euro area gaining momentum. Moreover, public investment activity should be facilitated by inflows of EU funds from the 2014-2020 planning period. The budget deficit will fall below 1% of GDP already in 2016 due to tax revenues being above expectations. In the years to follow it will drop even further, resulting in a continuously falling public debt to GDP ratio.

Table 17 / Lithuania: Selected economic indicators

	2012	2013	2014	2015 1)	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., average	2,988	2,958	2,932	2,905	.	.	2,880	2,860	2,840
Gross domestic product, EUR-LTL mn, nom.	33,348	35,002	36,590	37,331	17,680	18,154	38,400	40,200	42,400
annual change in % (real)	3.8	3.5	3.5	1.8	1.6	2.1	2.3	2.6	3.0
GDP/capita (EUR at exchange rate)	11,200	11,800	12,500	12,900	.	.	13,300	14,100	14,900
GDP/capita (EUR at PPP)	18,500	19,600	20,700	21,300	.	.	.	.	.
Consumption of households, EUR-LTL mn, nom.	20,690	21,792	22,762	23,486	11,224	11,978	.	.	.
annual change in % (real)	3.1	4.3	4.3	4.1	3.5	5.8	5.5	4.5	4.0
Gross fixed capital form., EUR-LTL mn, nom.	5,788	6,458	6,770	7,195	3,238	3,208	.	.	.
annual change in % (real)	-1.8	8.3	3.7	4.7	6.0	-1.2	-1.0	4.0	7.0
Gross industrial production (sales)									
annual change in % (real)	3.7	3.4	0.0	4.8	5.1	2.7	3.5	5.0	4.0
Gross agricultural production									
annual change in % (real)	14.2	-1.8	8.4	5.3	.	.	.	.	.
Construction industry									
annual change in % (real)	-7.2	11.3	17.0	-3.5	8.2	-14.8	.	.	.
Employed persons, LFS, th, average	1,276	1,293	1,319	1,335	1,327	1,359	1,360	1,370	1,375
annual change in %	1.8	1.3	2.0	1.2	1.9	2.4	1.9	0.7	0.4
Unemployed persons, LFS, th, average	197	173	158	134	142	121	118	111	103
Unemployment rate, LFS, in %, average	13.4	11.8	10.7	9.1	9.7	8.2	8.0	7.5	7.0
Reg. unemployment rate, in %, end of period 2)	11.4	11.1	9.3	9.0	8.5	7.4	.	.	.
Average monthly gross wages, EUR-LTL 3)	615	646	677	714	706	760	770	830	900
annual change in % (real, gross)	0.7	4.0	4.7	6.4	5.7	6.7	6.5	6.0	5.7
Average monthly net wages, EUR-LTL 3)	478	501	527	554	549	592	590	640	690
annual change in % (real, net)	0.5	3.8	5.1	6.1	5.4	7.0	6.3	5.8	5.3
Consumer prices (HICP), % p.a.	3.2	1.2	0.2	-0.7	-0.8	0.5	0.6	2.1	2.3
Producer prices in industry, % p.a.	5.0	-2.4	-4.9	-9.7	-9.0	-8.1	-7.0	2.5	3.5
General goverm.budget, EU-def., % of GDP									
Revenues	33.0	32.9	34.0	34.8	.	.	34.0	33.4	33.0
Expenditures	36.1	35.5	34.7	35.0	.	.	34.9	34.0	33.5
Net lending (+) / net borrowing (-)	-3.1	-2.6	-0.7	-0.2	.	.	-0.9	-0.6	-0.5
Public debt, EU-def., % of GDP	39.8	38.7	40.5	42.5	.	.	41.0	40.0	39.0
Central bank policy rate, % p.a., end of period 4)	0.52	0.27	0.12	0.05	0.05	0.00	.	.	.
Current account, EUR mn	-393	539	1,317	-872	-987	-417	-850	-1,130	-1,250
Current account, % of GDP	-1.2	1.5	3.6	-2.3	-5.6	-2.3	-2.2	-2.8	-2.9
Exports of goods, BOP, EUR mn	22,426	23,998	23,750	22,310	10,681	10,391	22,100	23,400	25,000
annual change in %	15.5	7.0	-1.0	-6.1	-4.4	-2.7	-0.9	5.9	6.8
Imports of goods, BOP, EUR mn	23,529	24,917	24,686	24,296	11,977	11,360	23,800	25,500	27,300
annual change in %	9.5	5.9	-0.9	-1.6	1.9	-5.2	-2.0	7.1	7.1
Exports of services, BOP, EUR mn	4,793	5,390	5,850	6,011	2,837	3,169	6,700	7,400	8,300
annual change in %	18.8	12.5	8.5	2.7	1.7	11.7	11.5	10.4	12.2
Imports of services, BOP, EUR mn	3,404	4,033	4,212	4,266	2,051	2,137	4,400	4,800	5,400
annual change in %	23.1	18.5	4.4	1.3	1.5	4.2	3.1	9.1	12.5
FDI liabilities (inflow), EUR mn	454	531	387	873	295	-254	0	.	.
FDI assets (outflow), EUR mn	215	322	382	164	-128	364	450	.	.
Gross reserves of NB excl. gold, EUR mn 5)	6,203	5,705	6,991	1,376	1,910	2,043	.	.	.
Gross external debt, EUR mn	26,031	24,596	25,551	28,332	28,564	31,394	30,700	34,200	36,000
Gross external debt, % of GDP	78.1	70.3	69.8	75.9	76.5	81.8	80.0	85.0	85.0
Average exchange rate EUR-LTL/EUR	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1	1	1
Purchasing power parity EUR-LTL/EUR	0.6027	0.6042	0.6033	0.6047	.		.	.	.

Note: Lithuania has introduced the Euro from 1 January 2015. Up to and including 2014 all time series in LTL as well as the exchange rates and PPP rates have been divided for statistical purporses by the conversion factor 3.4528 (LTL per EUR) to achieve euro-fixed series (EUR-LTL).

1) Preliminary. - 2) In % of working age population. - 3) Annual data include earnings of sole proprietors. - 4) From 2015 official refinancing operation rate for euro area (ECB), VILIBOR one-month interbank offered rate before (Lithuania had a currency board until Euro introduction). - 5) From January 2015 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.

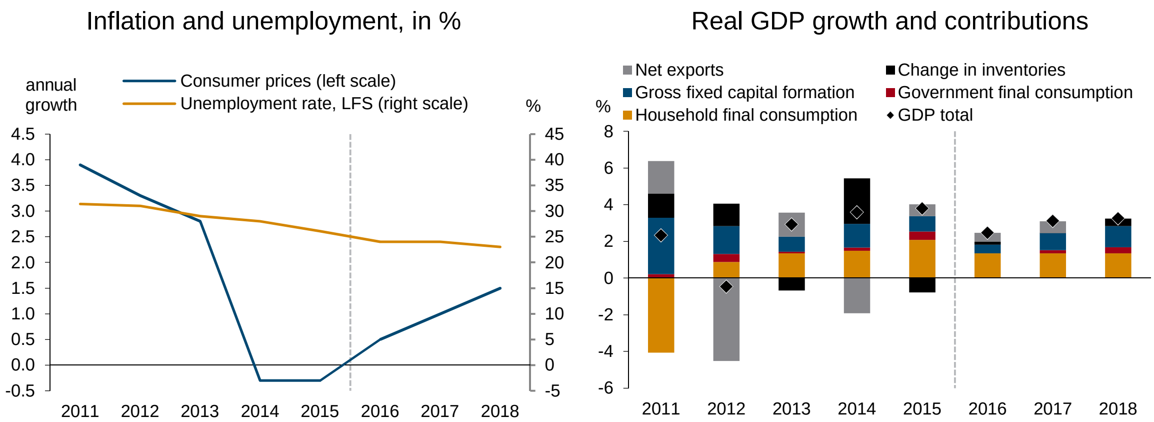
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

MACEDONIA: Instability slows down investments

VLADIMIR GLIGOROV

At present, the economy is not suffering from a misaligned exchange rate or financial problems. Thus, once the political crisis has been resolved, the country should return to growth rates of around or above 3% in the medium term.

Figure 35 / Macedonia: Main macroeconomic indicators



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

The persistent crisis of legitimacy has started to bite into economic activity. In the last few years, i.e. after the 2008-2009 crisis, investments, not the least public ones, and exports have been driving growth and employment. In addition, wages have been growing because the country did not enter into the 2008/2009 crisis with a misaligned real exchange rate. With stable prices and an improved current account, monetary policy could be relaxed while fiscal policy could be expansionary because public debt development looked sustainable given declining interest rates and the speed-up of recovery. Finally, the financial sector looked sound even despite the strong presence of Greek banks (especially the National Bank of Greece). With that, employment increased, the unemployment rate declined, and the growth performance was among the best in the Balkans.

The government, however, was seen as biased towards the governing parties in terms of employment and income distribution, which is why there were three early elections held since 2008. The last one, in 2014, was considered as being rigged and then that was substantiated with leaked phone conversations and other compromising material. That led to a legitimacy crisis with the opposition, primarily the ethnic

Macedonian one, calling for criminal investigations in addition to the resignation of the government and early elections. That initiated a yearlong crisis which finally ended with an agreement to hold early elections at the beginning of December 2016. The agreement was not easy to forge, and the United States and the EU had their inputs for better or worse.

The upcoming elections have been agreed under specific conditions, which however do not seem to be adhered to by the government as intended. There are criminal charges on the one hand and the issue of free and fair elections on the other. The December date is the third attempt; two previous elections – supposed to take place last March and then in June – failed because the opposition felt that it had been denied access to the media, it complained about the voters register, and was outraged by the attempt of the President to pardon government officials, starting with the Prime Minister, of criminal charges even before they were brought in front of a court. It is not clear whether any of these deficiencies are going to be corrected before the voters go to the polling booths in December.

This prolonged political instability started to influence economic activity already late last year, but more visibly in the first half of 2016. Growth has slowed down to slightly more than 2%, though it might recover somewhat in the second half of the year. Whether it does, may depend on three factors.

One is the decreasing private investments. When it still looked as if the crisis could be resolved relatively quickly, investments continued unabated. The prolonged crisis, however, not only supports a delay in investment decisions, it also is not reassuring about the eventual resolution. While initially the private sector and foreign investors, who play an important part in the country, expected that the government would weather the legitimacy crisis quickly and successfully, that is not the mainstream forecast now. The government is seen as business-friendly, but it is not expected to regain the needed legitimacy even if it survives the challenge in the elections. So, declining private investments may not be just due to delayed decisions, but may lead to disinvestments. Therefore, a resolution of the crisis and the legitimacy of the electoral results are crucial.

The second problem is declining public investments. At the beginning of the year, an interim government was installed. And though it is behaving as the continuation of the government it was supposed to take over from, it faces difficulties in financing the public investment projects that have been started or new ones. In addition, the IMF and other international financial institutions, and also the EU, worry about the growing public debt and warn against the continuation of public spending.

The third problem is the worry of the central bank that growing uncertainty may initiate an outflow of foreign currency, which would be a problem for the fixed exchange rate regime to which it is committed for more than 20 years now. So, it decided to hike, ever so slightly, the policy rate just when the economic activity slowed down. In addition, it is worried about the increase in household loans, though private debt, both corporate and that of households, is not high by any measure in Macedonia. As a result, there is some fiscal and monetary tightening, though those are perhaps not all that strong. Still, given deflationary pressures and expectations, it is not something that is in any way called for.

Fundamentally, the economy is not suffering from either a misaligned exchange rate or financial problems and it should return to growth rates of above 3% once the political crisis is resolved. So, assuming that the elections prove stabilising, medium-term growth rates in excess of 3% should be expected.

Table 18 / Macedonia: Selected economic indicators

	2012	2013	2014	2015 [1]	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., mid-year	2,061	2,064	2,067	2,070	2070	2070	2,085	2,090	2,095
Gross domestic product, MKD mn, nom.	466,703	501,891	527,631	558,240	269,587	288,844	575,000	599,000	628,000
annual change in % (real)	-0.5	2.9	3.6	3.8	3.6	2.1	2.5	3.1	3.3
GDP/capita (EUR at exchange rate)	3,700	3,900	4,100	4,400	.	.	4,500	4,700	4,900
GDP/capita (EUR at PPP)	9,000	9,500	10,100	10,600	.	.	.	.	.
Consumption of households, MKD mn, nom. [2]	340,875	355,959	364,039	377,683	189,219	193,414	.	.	.
annual change in % (real)	1.2	1.9	2.1	3.0	2.4	2.8	2.0	2.0	2.0
Gross fixed capital form., MKD mn, nom.	109,071	119,003	123,549	129,095	.	.	.	.	.
annual change in % (real)	6.5	3.5	5.5	3.6	.	.	2.0	4.0	5.0
Gross industrial production [3]									
annual change in % (real)	-2.7	3.2	4.8	4.9	0.8	5.6	5.0	5.0	5.0
Gross agricultural production [4]									
annual change in % (real)	-5.6	6.4	1.7	3.0	.	.	.	.	.
Construction industry									
annual change in % (real)	8.1	43.1	-3.4	40.8	16.4	41.8	.	.	.
Employed persons, LFS, th, average	650.6	678.8	690.2	706.0	698.4	717.6	720	730	740
annual change in %	0.8	4.3	1.7	2.3	1.7	2.7	2.0	1.0	1.0
Unemployed persons, LFS, th, average	292.5	277.2	268.8	248.9	248.9	229.6	230	220	200
Unemployment rate, LFS, in %, average	31.0	29.0	28.0	26.1	26.1	24.3	24.0	24.0	23.0
Reg. unemployment rate, in %, end of period	25.8	22.8	23.4	22.1	22.1	21.2	.	.	.
Average monthly gross wages, MKD	30,670	31,025	31,325	32,171	31,879	32,553	33,000	33,700	34,500
annual change in % (real, gross)	-3.0	-1.6	1.3	3.0	3.1	2.5	2.0	1.0	1.0
Average monthly net wages, MKD	20,902	21,145	21,394	21,904	21,696	22,165	22,500	23,000	23,600
annual change in % (real, net)	-2.9	-1.6	1.5	2.7	2.7	2.5	2.0	1.0	1.0
Consumer prices, % p.a.	3.3	2.8	-0.3	-0.3	-0.3	-0.3	0.5	1.0	1.5
Producer prices in industry, % p.a.	1.4	-1.4	-1.9	-3.9	-3.2	-4.1	-3.0	0.0	2.0
General governm. budget, nat.def., % of GDP									
Revenues	32.1	30.1	29.7	31.0	.	.	31.0	31.0	31.0
Expenditures	36.0	34.1	33.9	34.4	.	.	33.0	33.0	33.0
Deficit (-) / surplus (+)	-3.9	-4.0	-4.2	-3.4	.	.	-2.0	-2.0	-2.0
Public debt, nat.def., % of GDP	38.3	40.2	45.7	46.6	43.3	45.8	47.0	47.0	47.0
Central bank policy rate, %, p.a., end of period [5]	3.73	3.25	3.25	3.25	3.25	4.00	4.00	4.00	4.00
Current account, EUR mn	-240	-134	-69	-127	-129	-181	-370	-390	-410
Current account, % of GDP	-3.2	-1.6	-0.8	-1.4	-2.9	-3.9	-4.0	-4.0	-4.0
Exports of goods, BOP, EUR mn	2,307	2,375	2,780	3,042	1,450	1,588	3,220	3,380	3,550
annual change in %	-3.7	2.9	17.0	9.4	12.6	9.5	6.0	5.0	5.0
Imports of goods, BOP, EUR mn	4,315	4,238	4,635	4,867	2,317	2,502	5,110	5,370	5,640
annual change in %	0.3	-1.8	9.4	5.0	5.0	8.0	5.0	5.0	5.0
Exports of services, BOP, EUR mn	1,067	1,155	1,277	1,369	633	664	1,450	1,520	1,600
annual change in %	2.1	8.2	10.6	7.2	8.8	4.9	6.0	5.0	5.0
Imports of services, BOP, EUR mn	757	780	919	1,027	472	475	1,080	1,130	1,190
annual change in %	10.5	2.9	17.9	11.6	0.4	0.7	5.0	5.0	5.0
FDI liabilities (inflow), EUR mn	265	302	37	172	113	170	200	.	.
FDI assets (outflow), EUR mn	134	73	-160	1	-1	55	55	.	.
Gross reserves of NB, excl. gold, EUR mn	1,918	1,803	2,221	2,049	2,024	1,899	.	.	.
Gross external debt, EUR mn	5,172	5,220	5,992	6,291	6,416	6,915	6,750	6,800	6,900
Gross external debt, % of GDP	68.2	64.0	70.0	69.4	70.8	74.0	72.0	70.0	68.0
Average exchange rate MKD/EUR	61.53	61.58	61.62	61.61	61.59	61.68	61.5	61.5	61.5
Purchasing power parity MKD/EUR	25.08	25.61	25.18	25.43	.	.	.	.	.

1) Preliminary. - 2) Half-year data including NPISH. - 3) Enterprises with 10 and more employees. - 4) In 2015 wiiw estimate. - 5) Central Bank bills (28-days).

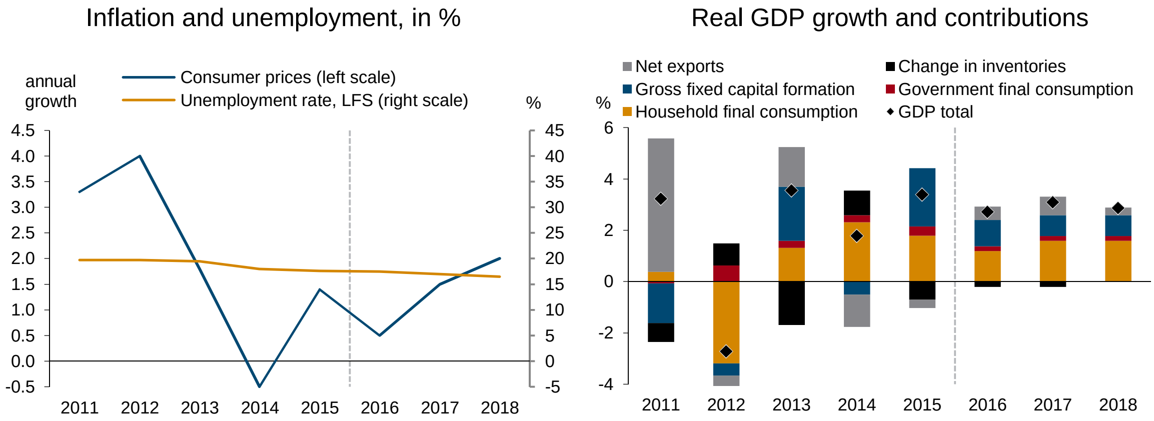
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

MONTENEGRO: Public investment intentions

VLADIMIR GLIGOROV

With political risks influencing investment decisions in both the private and public sectors, GDP growth may well prove disappointing in the current year. Assuming, however, that the political uncertainty finally gets resolved, medium-term growth should rise to somewhere around 3% and possibly slightly above.

Figure 36 / Montenegro: Main macroeconomic indicators



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

The beginning of the year was not encouraging, with growth of GDP decelerating to just over 1% in the first quarter. The first half saw an improvement apparently due to a surge, somewhat spurious, in investments in infrastructure. There should be some additional acceleration thanks to a good tourist season and the resumption of infrastructure projects along with political stabilisation.

These plans have been criticised by the international financial institutions on concerns for the sustainability of public finances. Indeed, public debt is increasing anyway and would jump significantly as a share of GDP if the planned highways and railways are going to be built. It is not as if the country has much of a choice. Montenegro is a services economy and it will continue to rely on tourism and related services, which require improvements in communal and city services. Also, the real estate market is crucial for the sustainability of consumption and investment, because in a way the economy is premised on the continuous mortgaging of the country. And given the mountainous geography, improved infrastructure is clearly the way to support growing touristic and other services.

Tourism is supposed to have been quite successful this year too. Traditional visitors from the region and from abroad (e.g. from Russia) have not changed their holiday plans and some seem to have redirected theirs from other Mediterranean countries to the Adriatic Sea. Industrial production, however, has continued its decline. It does not play much of a role anyway, but its decline does fuel up the negative social sentiments among those who have lost their jobs and demand for their professions.

Even if there were efforts put into the revival of industry, which is one of the strategic goals of the government, those will be hard to implement given the relatively high wages, which continue to go up even with inflation turning negative. Still, with that, employment is slowly increasing and unemployment decreasing, though the latter's rate has been stuck to closer to 20% for many years. It is to be remembered also that Montenegro uses the euro, so a significant real exchange rate adjustment would be needed for manufacturing to be comparatively advantageous. Alternatively, the internationalisation of small and medium-sized enterprises in the sense of getting connected with regional and European production chains seems not to be the preferred business strategy. Eventually that may work if regional investments increase, but there is no evidence that this is happening in manufacturing.

The financial sector has stabilised and does not seem to present the economy with high risks as was the case immediately after the start of the crisis in 2008-2009. However, stock prices, which may proxy for real estate prices, have not performed well and improvement is not in sight. Also, yields on government bonds have gone up by around 200 basis points, which may be one of the reasons why the planned infrastructure investments have not been put to effect so far this year.

These developments in the financial and capital markets are in part influenced by the continuing political crisis in the country. The opposition was exerting huge pressure on the government ahead of the 16 October general elections. Two issues have dominated the prolonged legitimacy crisis. One is corruption, given that the government has been run by the same parties and the same people for a decade or two. The charges are directed towards Milo Đukanović, who has been running the country as its President and now Prime Minister at least since independence in 2006 (prior to that he was also in charge, but had to share power with the Serbian leader as Montenegro was in a federation and confederation with Serbia). Indeed, Montenegro faces a typical succession problem, as the ruling party does not seem to be able to have a change in its leadership. The outcome of the elections suggests that there will be no significant change in the ruling coalition, though Mr. Đukanović is stepping down as a Prime Minister.

The other issue is membership in NATO. NATO has voted to accept Montenegro as a member. This has been criticised by the opposition, which has also received strong support in that from Russia. The opposition demands that the government's decision to join NATO be tested in a referendum. It is banking on a strong traditionally pro-Russian popular sentiment both among the Montenegrins and among the Serbs. It is, however, unclear whether the win by the opposition, which is by no means certain, would also mean that the new government, with a composition hard to tell at the moment, will indeed want to give up on the membership in NATO.

These political risks are influencing investment decisions, both private and public ones, which is why GDP growth may disappoint this year. Assuming that the political uncertainty is resolved, medium-term growth should be somewhere around and possibly slightly above 3%.

Table 19 / Montenegro: Selected economic indicators

	2012	2013	2014	2015 [1]	2015	2016	2016	2017	2018
					January-June		Forecast		
Population, th pers., mid-year	621	621	622	622	.	.	625	625	625
Gross domestic product, EUR mn, nom.	3,181	3,362	3,458	3,625	1,524	1,568	3,700	3,900	4,100
annual change in % (real)	-2.7	3.5	1.8	3.4	3.4	2.0	2.7	3.1	2.9
GDP/capita (EUR at exchange rate)	5,100	5,400	5,600	5,800	.	.	5,900	6,200	6,600
GDP/capita (EUR at PPP)	10,400	10,800	11,200	11,900	.	.	.	.	.
Consumption of households, EUR mn, nom. [2]	2,632	2,724	2,775	2,872	1,335	1,368.9	.	.	.
annual change in % (real)	-3.9	1.6	2.9	2.2	1.5	2.9	1.5	2.0	2.0
Gross fixed capital form., EUR mn, nom.	628	678	657	736	356	459.1	.	.	.
annual change in % (real)	-2.4	10.7	-2.5	11.9	6.7	28.6	5.0	4.0	4.0
Gross industrial production [3]									
annual change in % (real)	-7.0	10.6	-11.4	7.9	9.7	-5.3	-4.0	3.0	5.0
Net agricultural production									
annual change in % (real)	-12.7	5.0	3.0	3.0	.	.	.	.	.
Construction output [3]									
annual change in % (real)	7.7	41.6	34.1	20.3	21.9	40.1	.	.	.
Employed persons, LFS, th, average	200	202	216	222	219	221	224	226	228
annual change in %	2.4	1.0	7.1	2.5	2.5	1.1	1.0	1.0	1.0
Unemployed persons, LFS, th, average	49	49	48	47	48	47	50	50	50
Unemployment rate, LFS, in %, average	19.7	19.5	18.0	17.6	18.0	18.3	17.5	17.0	16.5
Reg. unemployment rate, %, average	15.3	15.8	16.1	16.5	14.7	17.9	.	.	.
Average monthly gross wages, EUR	727	726	723	725	727	745	740	760	780
annual change in % (real, gross)	-3.2	-1.9	0.1	-1.1	-0.6	2.7	1.0	1.0	1.0
Average monthly net wages, EUR	487	479	477	480	480	495	495	510	530
annual change in % (real, net)	-3.3	-3.4	0.1	-0.8	-0.3	3.3	1.0	1.0	1.0
Consumer prices, % p.a.	4.0	1.8	-0.5	1.4	0.9	-0.2	0.5	1.5	2.0
Producer prices in industry, % p.a. [4]	1.9	1.6	0.1	0.3	0.6	-0.5	0.0	1.0	2.0
General governm.budget, nat.def., % of GDP									
Revenues	35.4	37.0	39.1	36.6	38.6	40.4	39.0	39.0	40.0
Expenditures	41.9	40.7	42.1	44.5	55.4	46.3	43.0	42.0	42.0
Deficit (-) / surplus (+)	-4.3	-3.7	-3.0	-7.9	-16.8	-5.9	-4.0	-3.0	-2.0
Public debt, nat.def., % of GDP	53.4	55.7	56.2	62.8	60.2	60.6	61.0	60.0	60.0
Central bank policy rate, % p.a., end of period [5]	8.83	8.68	8.41	8.53	8.14	7.98	8.00	8.00	8.00
Current account, EUR mn	.	-487	-526	-483	-488	-662	-555	-585	-590
Current account, % of GDP	.	-14.5	-15.2	-13.3	-32.0	-42.2	-15.0	-15.0	-14.4
Exports of goods, BOP, EUR mn	.	396	357	325	149	148	330	340	360
annual change in %	.	.	-9.7	-9.0	-5.7	-0.5	2.0	4.0	5.0
Imports of goods, BOP, EUR mn	.	1,724	1,734	1,789	837	947	1,860	1,930	2,010
annual change in %	.	.	0.6	3.2	3.5	13.2	4.0	4.0	4.0
Exports of services, BOP, EUR mn	.	994	1,031	1,214	296	313	1,310	1,380	1,450
annual change in %	.	.	3.6	17.8	8.9	5.6	8.0	5.0	5.0
Imports of services, BOP, EUR mn	.	341	340	425	174	221	450	470	490
annual change in %	.	.	-0.3	24.8	15.1	26.8	5.0	5.0	5.0
FDI liabilities (inflow), EUR mn	.	337	375	630	191	-23	150	.	.
FDI assets (outflow), EUR mn	.	13	21	11	8	-119	120	.	.
Gross reserves of NB, excl. gold, EUR mn [6]	348	424	545	674	819	671	.	.	.
Gross external public debt, EUR mn	1,295	1,433	1,562	1,956	2,160	2,034	2,050	2,150	2,300
Gross external public debt, % of GDP	40.7	42.6	45.2	54.0	59.6	55.0	53.0	55.0	57.0
Purchasing power parity EUR/EUR	0.4907	0.5015	0.4964	0.4901	.	.	.	.	.

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

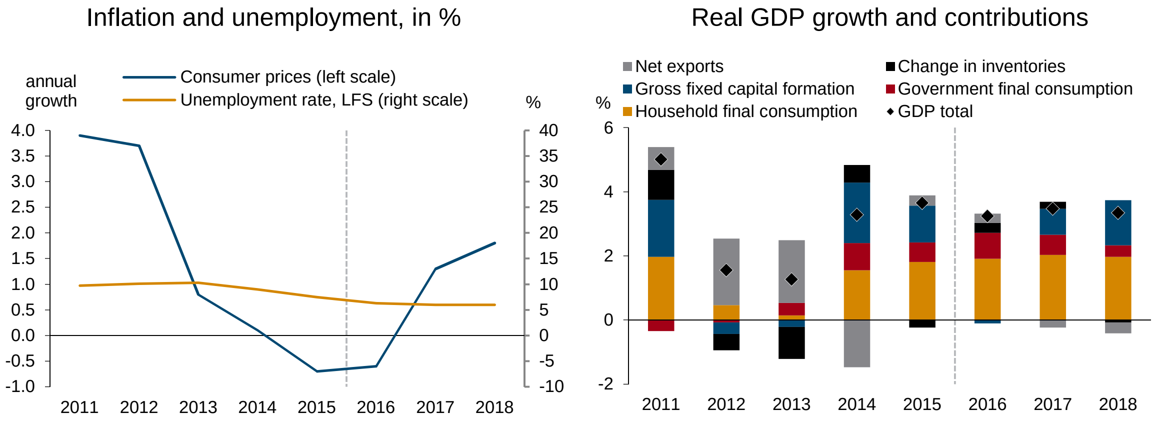
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

POLAND: So far so good?

LEON PODKAMINER

The current moderate and broad-based growth will continue throughout the biennium 2017-2018, with the GDP growth rate averaging 3.4%. The current evolution of the political system may well prove harmful – in purely economic terms as well. 2017 will prove a critical year for fiscal policy as the increase in social expenditures may call for higher taxation.

Figure 37 / Poland: Main macroeconomic indicators



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

At 3% the GDP growth in the first quarter of 2016 was perceptibly weaker than generally expected or throughout 2014-2015. In the second quarter growth did not accelerate visibly. While unfavourable foreign trade (in goods and services) developments were the main factor slowing down GDP growth in the first quarter, the strong decline in capital formation suppressed growth in the second. Overall, the contribution of foreign trade to the 3.1% GDP growth reported for the first half of the year appears to have been about zero. Gross fixed capital formation contributed negatively, by 0.6 percentage points (pp) and rising inventories contributed positively (again by 0.6 pp). Contrary to earlier expectations, growth in household and public consumption did not accelerate. The contributions of household and public consumption to GDP growth in the first half of the year were 2.0 pp and 0.8 pp respectively. Growth in household consumption remains, unexpectedly, rather subdued – and that despite some significant additional public transfers to households (promised or already implemented) and despite rising employment and real wages. Apparently, the household sector’s propensity to consume must have been depressed, most possibly temporarily (perhaps also on account of self-reinforcing deflationary expectations).

As elsewhere in the region, the decline in gross fixed capital formation has been primarily due to the completion of infrastructural projects co-financed by EU transfers under the 2007-2013 financial perspective. This fact is confirmed by information on investment outlays at the sectoral level. While the investment outlays in manufacturing sill expanded by 7.6% in the first half of 2016, such outlays declined in the construction sector by over 10% and in the transport and storage sector (the main beneficiary of EU structural grants) by about 38%. The estimated value of investment projects actually started in the first half of 2016 fell by close to 2% in manufacturing, by over 20% in the construction sector and by close to 80% in land transport. The slack in investment activities will be continuing until the means available under the new perspective feed the new investment projects (whose preparation will also take some time-consuming paperwork).

The financial standing of the non-financial corporate sector is good. The sector's net profit rose by 11.4% in the first half of the year, reaching PLN 74.8 billion (equivalent to some EUR 17 billion). The commercial banks swallowed the 'banking tax' in force since February 2016 (amounting to 0.44% of banks' assets). In the first half of the year banks' net profits managed to rise by 1.2%, reaching over EUR 1.8 billion.

Despite continuing deflation (in both consumer and producer prices) the interest rates administered by the National Bank have stayed at comparatively high levels. The change at the helm of the National Bank has not (yet) changed the NBP's approach to the real economy. The prevalence of high nominal (and even higher real) interest rates on credit is, at least partly, the consequence of the official policy. It is therefore not surprising that the private non-financial sector's bank deposits rise much faster than the bank loans drawn. In the first half of 2016, private (non-financial sector) deposits rose by 11% while loans by 5.5%. In the same period, loans to households (financing mainly the satisfaction of housing needs) rose 4.5% and loans to the non-financial corporate sector by 7.4%. Banks' 'financing gap' (filled by liabilities to foreign parties) has been narrowing. Thereby banks' resilience to eventual negative shocks has been further strengthened.

Only a fraction of the new loans to firms has been declared as serving the financing of new fixed investment. The bulk of loans extended serve other purposes such as the financing of working capital or investment in real estate. A very slow decline in the shares of bad loans in total loans (currently 6.3% in the case of households and 9.6% in the case of non-financial firms) has been another consequence of the difficult deleveraging under unduly high interest rates.

The foreign trade performance has been satisfactory though a part of the credit for this must go to weak world market prices of raw materials, including oil and natural gas. Also, the contraction in gross fixed capital formation must have reduced the demand for imports. If 'normalcy' returns (with the recovery of prices of energy carriers and the takeoff of investment activities) trade may become a real worry. Real currency depreciation and falling unit labour costs may then be needed – although the latter development may be difficult to square with the faster growth of domestic consumption.

Whether the country has reached a stage where the improvements in cost competitiveness have exhausted their potential as a reliable source of balanced longer-term growth remains to be seen. But there are good grounds to believe that Poland is entering a 'middle-income trap': the levels of spending on research and development is miserably low, the country has been specialising in medium- rather than high-tech activities. Getting out of that trap may require the institution of radically new economic and social policies, with priorities given, among other items, to the accumulation of human rather than physical capital. Under the present government led by the Law and Justice Party (in office for about a year now), no such radically new policy is to be expected. If anything, the policies imposed (or officially contemplated) are quite likely to lead the country astray. For example, the government seems determined to protect the oversized and inherently loss-making hard coal mining industry indefinitely.

At mid-year the central government budget deficit was lower than expected. To some extent this is due to one-off income accruing to the public accounts (large profit made by the National Bank and income from the LTE licences auctioned). Lower public spending on the required domestic co-financing of infrastructural projects financed from EU grants has also been a factor. All the same, the general government deficit is likely to approach 3% of GDP in 2016. In 2017 the public sector deficit will have to be much higher not only because one-off income need not be forthcoming. The transfers to households introduced in 2016 will cost much more in the future while some additional taxation proposed (e.g. on retail trade) may prove incompatible with the EU competition law. To muddle through 2017 fiscally, the government may decide to nationalise the remaining portion of the second (capital-based) pillar of the pension system – and appropriate its assets as well as the current income. Because of the expected worries about the public finances the government may shelve a number of social 'reforms' promised before the elections (e.g. on the lowering of the retirement age). Also, the announced re-Polonisation of foreign-owned banks and insurance companies will remain empty rhetoric, at least for the time being.

Domestic political developments have been highly disquieting. The ruling party, enjoying parliamentary (though not constitutional) majority, does not pay much attention to the Constitution itself. It is bent on subjugating all public institutions, including the ones in charge of controlling and balancing the powers of the government. That this undermines the rule of law is evident – also to the European Commission. No doubt the political system developing in Poland is unlikely to do any good to the country in the long run. In the short run it is also likely to do more harm than good. The wholesale purge of the managing personnel in the public sector (including state-owned corporations and official agencies in charge of negotiations over EU transfers) leaves a vacuum that is filled by loyal party apparatchiks often lacking any requisite skills or knowledge.

Summing up, Poland's corporate non-financial sector and the banking system are in good shape. Despite persistent deflation and inadequate monetary policy, the country will continue to grow at a moderate speed in 2016 and 2017-2018 (by 3.3% to 3.4%). Currently gross fixed capital formation is a drag on growth. But this will be changing due to the return of higher financing of infrastructural projects expected in the future. The ongoing evolution of the political system is likely to prove harmful, also economically.

Table 20 / Poland: Selected economic indicators

	2012	2013	2014	2015 1)	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., average	38,536	38,514	38,487	38,458	38,459	38,427	38,500	38,550	38,560
Gross domestic product, PLN bn, nom.	1,629.0	1,656.3	1,719.1	1,789.7	844.1	872.5	1,830	1,910	1,990
annual change in % (real)	1.6	1.3	3.3	3.6	3.4	2.7	3.2	3.5	3.3
GDP/capita (EUR at exchange rate)	10,100	10,200	10,700	11,100	.	.	11,100	11,500	12,100
GDP/capita (EUR at PPP)	17,600	17,900	18,600	19,700	.	.	.	.	.
Consumption of households, PLN bn, nom.	988.2	994.1	1,018.6	1,036.7	524.4	537.2	.	.	.
annual change in % (real)	0.8	0.2	2.6	3.1	3.6	2.9	3.3	3.5	3.4
Gross fixed capital form., PLN bn, nom.	322.5	311.7	339.4	360.4	136.0	131.6	.	.	.
annual change in % (real)	-1.8	-1.1	10.0	5.8	7.7	-3.6	-0.5	4.0	7.0
Gross industrial production (sales) 2)									
annual change in % (real)	1.3	2.3	3.4	4.8	4.7	4.0	4.0	4.5	5.0
Gross agricultural production									
annual change in % (real)	1.2	0.7	6.6	-2.8	.	.	.	.	.
Construction industry 2)									
annual change in % (real)	-5.2	-10.2	4.3	0.3	1.7	-13.2	.	.	.
Employed persons, LFS, th, average	15,591	15,568	15,862	16,084	15,911	16,097	16,230	16,260	16,280
annual change in %	0.2	-0.1	1.9	1.4	1.5	1.2	0.9	0.2	0.1
Unemployed persons, LFS, th, average	1,749	1,793	1,567	1,304	1,388	1,134	1,090	1,040	1,040
Unemployment rate, LFS, in %, average	10.1	10.3	9.0	7.5	8.0	6.6	6.3	6.0	6.0
Reg. unemployment rate, in %, end of period	13.4	13.4	11.4	9.8	10.2	8.8	.	.	.
Average monthly gross wages, PLN 3)	3,530	3,659	3,777	3,900	4,051	4,220	4,000	4,200	4,400
annual change in % (real, gross) 3)	0.1	2.8	3.2	4.2	4.8	5.1	4.0	4.0	3.5
Consumer prices (HICP), % p.a.	3.7	0.8	0.1	-0.7	-0.9	-0.4	-0.6	1.3	1.8
Producer prices in industry, % p.a.	3.3	-1.3	-1.3	-2.0	-2.2	-1.3	-1.0	-0.5	1.0
General governm.budget, EU-def., % of GDP									
Revenues	38.9	38.4	38.9	38.9	.	.	39.5	39.0	39.0
Expenditures	42.6	42.4	42.2	41.5	.	.	42.4	42.5	42.5
Net lending (+) / net borrowing (-)	-3.7	-4.0	-3.3	-2.6	.	.	-2.9	-3.5	-3.5
Public debt, EU-def., % of GDP	54.0	56.0	50.5	51.3	.	.	52.2	53.0	53.5
Central bank policy rate, % p.a., end of period 4)	4.3	2.5	2.0	1.5	1.5	1.5	1.5	1.8	2.0
Current account, EUR mn 5)	-14,458	-5,028	-8,529	-2,654	832	807	-1,300	-2,700	-4,700
Current account, % of GDP 5)	-3.7	-1.3	-2.1	-0.6	0.4	0.4	-0.3	-0.6	-1.0
Exports of goods, BOP, EUR mn 5)	141,026	149,113	158,657	172,150	85,484	87,405	179,000	188,000	197,400
annual change in %	6.5	5.7	6.4	8.5	9.7	2.2	4.0	5.0	5.0
Imports of goods, BOP, EUR mn 5)	149,156	149,448	161,911	169,937	83,596	84,995	176,700	187,300	198,500
annual change in %	2.4	0.2	8.3	5.0	5.1	1.7	4.0	6.0	6.0
Exports of services, BOP, EUR mn 5)	31,949	33,592	36,743	40,663	19,364	20,271	42,300	44,000	45,800
annual change in %	8.8	5.1	9.4	10.7	11.5	4.7	4.0	4.0	4.0
Imports of services, BOP, EUR mn 5)	25,947	25,948	27,679	29,745	13,757	13,805	30,500	31,700	33,000
annual change in %	7.2	0.0	6.7	7.5	8.7	0.3	2.5	4.0	4.0
FDI liabilities (inflow), EUR mn 5)	5,771	658	14,824	12,631	6,067	6,445	9000	.	.
FDI assets (outflow), EUR mn 5)	1,055	-2,524	5,096	3,790	3,277	2,190	3000	.	.
Gross reserves of NB excl. gold, EUR mn	78,403	74,257	79,379	83,676	89,906	95,254	.	.	.
Gross external debt, EUR mn 5)	279,739	278,948	293,509	302,063	308,289	309,221	314,900	328,700	346,500
Gross external debt, % of GDP 5)	71.9	70.7	71.4	70.6	72.1	72.7	74.0	74.0	74.0
Average exchange rate PLN/EUR	4.1847	4.1975	4.1843	4.1841	4.1397	4.3686	4.30	4.30	4.25
Purchasing power parity PLN/EUR	2.3978	2.4087	2.4060	2.3647	.	.	.	.	.

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

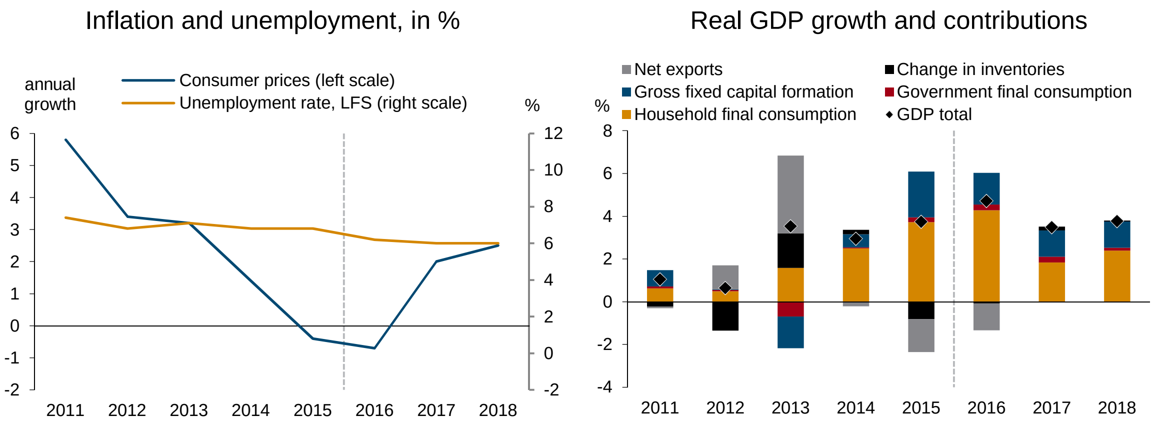
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ROMANIA: Sobering to follow upbeat

GÁBOR HUNYA

Economic growth is projected to accelerate exceptionally to 4.7% in 2016. Private consumption has received a pro-cyclical boost in the form of tax cuts and wage increases, while fixed investments have also continued to grow. With every expectation of inflation climbing to positive levels and wage increases losing momentum, the consumption boom will settle down in 2017. An economic growth of 3.5% is expected for 2017 and 3.7% for 2018, thus helping the country to retain its relative robustness by international standards.

Figure 38 / Romania: Main macroeconomic indicators



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

Economic growth is ahead of expectation in 2016, reaching 5.2% in the first half of the year. Household demand has been the main driver of growth (up 10.4%). A general VAT-rate cut from 24% to 20% has been in place since the beginning of the year and the minimum wage was hiked in May (to about EUR 270; it is still the second lowest among the EU members), leading to an automatic proportional increase in the salaries of civil servants. An unexpectedly good harvest has generated additional income and consumption in rural areas.

Another source of high economic growth has been the vibrant investment activity. Gross fixed capital formation expanded by 6.4% in the first half of 2016 and investment outlays increased by 8.7%. Investments in equipment, including means of transport, grew faster (13.3%) than investments in new buildings (6.1%). The branches having achieved a higher increase in investments than a year before comprised industry, trade and construction. Most of the corporate investments were financed from growing retained profits while new credit to the economy shrank. The construction industry expanded by 5.3% mainly on account of building roads, flats and shop-spaces. During the first half of 2016, 20% more dwellings were completed than a year earlier. This boom does not seem lasting as the number of newly issued construction permits declined.

Industrial production stagnated in the first eight months of 2016 manly due to declining mining activity but also to sluggish manufacturing output growth, at less than 2%. Relatively strong growth was observed in the manufacturing of cars, electrical equipment and construction materials, while production declined in the pharmaceutics, metallurgy and electronics industries. The low rate of industrial growth was coupled with declining labour productivity and rising unit labour costs. It is too early to predict a loss of longer-term cost competitiveness of the Romanian industry, but recent developments might suggest a need for correction.

Despite higher turnover, the tax cuts had a negative impact on fiscal revenues. The budget deficit amounted to 0.4% of GDP in the first eight months of the year in contrast to the surplus of 0.9% in the same period of last year. It is unusual in Romania to have budget deficits in the middle of a year as most of the expenditures are booked in December. Therefore, the deficit for the whole year of 2016 may reach 3% of GDP. The consolidated budget revenues went down by 1.9% in the first eight months of 2016 compared to the same period of last year. The drop was mainly due to lower VAT revenues and lower EU fund inflows, which cancelled out the increase recorded by other revenue categories. On the expenditure side, a 4.7% increase was recorded in the first eight months of this year, most of it owing to current expenditures driven up by higher personnel costs in the public sector, and higher welfare expenses.

Export activity increased only modestly in the first half of 2016 mainly on account of sales to the EU. The share of machinery and transport equipment expanded, comprising almost half of the exports, while the share of crude materials declined (measured in current euros, thus reflecting price effects). Imports expanded in all product groups except fuels. Low international commodity prices helped curtail expenditures on imports, but external vulnerability has increased in the wake of the consumption boom.

The current account deficit widened almost threefold in the first seven months of the year against the same period of the previous year mainly on account of higher goods imports. The surplus on the services balance, which is predominantly earned by the transport sector, increased also in telecommunications, computer, and information services, signalling that Romania is a favoured location for shared service outsourcing and call centres. The primary account deficit contracted due to somewhat lower profits earned by foreign investors. The secondary income surplus declined on account of lower remittances transferred by Romanians working abroad. Higher incomes earned in Romania seem to curtail the need for remittances. The financing of the current account deficit has a favourable structure. Transfers through the capital account increased due to delayed EU financing for the 2007-2013 period. Also the inflow of FDI increased (calculated according to the directional principle) mainly in the form of equity and reinvested earnings.

Accelerated economic growth has generated employment; still, the number of employed persons declined for demographic reasons. In the second quarter of 2016, the employment rate for the working-age population was 61.8%, 2 percentage points higher than last year. The unemployment rate declined rapidly: from 6.8% in August 2015 to a mere 6% in August of the current year. The vacancy rate increased only marginally, to 1.2% in the second quarter of 2016 year on year. As emigration is a permanent process, the government wants to stimulate immigration. To this end, it intends to shorten the work permit and visa procedures and simplify the visa regime for neighbouring non-EU country citizens. The inflow of refugees through the Balkan route is curtailed by the Romanian authorities and very few intend to stay in the country. Similar to other EU-wide discussions, Romania keeps a low profile in the refugee question and has no intention to join the Visegrad group. The country takes a more active stance in NATO by allowing the stationing of additional troops and a US missiles base on its territory.

Monetary policy has not reacted to the temporary deflation caused by lower VAT and oil prices. The policy rate has been kept at 1.75% – close to the underlying inflation rate. The National Bank managed to modify but could not block some new legislative acts which benefit the population by softening their financial constraints. Parliament has passed a ‘giving in payment law’, which allows debtors to transfer mortgaged assets to banks and get out of (mostly non-serviced) loans. In the future, banks will be obliged to look for solutions to help mortgage clients who have difficulties in repaying their loans and reduce their financial burden before foreclosure. Another law, on personal insolvency, comes in force as of November this year. Insolvent persons will be able to reschedule their debts over five years. A further initiative under discussion in Parliament intends allowing the conversion of foreign currency loans into local currency at a yet undecided historic rate. While such measures provide relief to victims of the financial crisis, they also discourage prudent behaviour in the future.

Installing a caretaker government in December 2015 was the solution to a political crisis. Despite some intellectual efforts to initiate changes in public governance, this government lacks political support in Parliament to implement thorough reforms before the elections scheduled for 11 December. Economic policy will most probably not be in the focus of the upcoming election campaign except generous wage promises from all parties. Currently the odds are in favour of the previously governing socialists-led coalition, but if they do not win with a convincing majority, the President will do all he can to help the national-liberals to form a government.

The new government will not be installed before January, thus the 2017 budget will not be passed by Parliament before late February. Nevertheless, the EU Commission expects the current government to take steps in order to keep the fiscal deficit within 3% of GDP. There is ample room for improving tax collection by making online payment general and putting stricter limits on using cash between economic agents. As this can only be achieved in the longer run, we expect that the scheduled VAT cut by 1 percentage point together with another minimum-wage hike will not come into force as of 1.1.2017.

As the one-time effects of previous tax cuts and wage corrections expire, a slowdown in economic growth will set in in 2017. Household demand will cool down; first signs of this can already be observed in construction and retail trade. Investments may keep growing, with the disbursement of EU funds playing a crucial role. Romania has been allocated EUR 30.8 billion from ESI funds over the period 2014-2020 and only a tiny fraction has been used in the first three years. Disbursement may accelerate in 2018 and GDP growth may speed up to close to 4%.

Table 21 / Romania: Selected economic indicators

	2012	2013	2014	2015 1)	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., average	20,058	19,984	19,909	19,815	.	.	19,830	19,780	19,700
Gross domestic product, RON bn, nom.	595.4	637.5	667.6	712.8	303.4	325.6	760	800	850
annual change in % (real)	0.6	3.5	3.0	3.8	3.9	5.2	4.7	3.5	3.8
GDP/capita (EUR at exchange rate)	6,700	7,200	7,500	8,100	.	.	8,600	9,000	9,600
GDP/capita (EUR at PPP)	14,300	14,400	15,200	16,300	.	.	.	.	.
Consumption of households, RON bn, nom.	366.2	385.5	406.2	435.8	195.9	211.9	.	.	.
annual change in % (real)	0.8	2.6	4.1	6.1	5.1	10.2	7.0	3.0	3.9
Gross fixed capital form., RON bn, nom.	162.8	157.5	161.4	176.2	64.8	70.4	.	.	.
annual change in % (real)	0.1	-5.4	2.5	8.9	7.9	7.3	6.0	5.0	5.0
Gross industrial production 2)									
annual change in % (real)	2.4	7.8	6.1	2.8	2.4	1.3	1.0	2.0	3.0
Gross agricultural production									
annual change in % (real)	-21.9	24.5	2.9	-10.5	.	.	.	.	.
Construction industry 2)									
annual change in % (real)	1.4	-0.6	-6.7	10.3	10.4	4.6	.	.	.
Employed persons, LFS, th, average	8,605	8,549	8,614	8,535	8,450	8,388	8,550	8,550	8,550
annual change in %	0.9	-0.7	0.8	-0.9	-1.0	-0.7	0.2	0.0	0.0
Unemployed persons, LFS, th, average	627	653	629	624	640	558	570	550	550
Unemployment rate, LFS, in %, average	6.8	7.1	6.8	6.8	7.1	6.3	6.2	6.0	6.0
Reg. unemployment rate, in %, end of period	5.5	5.7	5.4	5.0	5.0	4.7	.	.	.
Average monthly gross wages, RON 3)	2,063	2,163	2,328	2,525	2,485	2,803	2,900	3,000	3,200
annual change in % (real, gross)	0.8	0.8	6.5	9.1	6.9	15.7	14.5	3.0	3.0
Average monthly net wages, RON 3)	1,507	1,579	1,697	1,838	1,797	2,029	2,100	2,200	2,300
annual change in % (real, net)	1.0	0.8	6.4	9.0	6.8	15.8	14.5	3.0	3.0
Consumer prices (HICP), % p.a.	3.4	3.2	1.4	-0.4	0.4	-2.1	-0.7	2.0	2.5
Producer prices in industry, % p.a.	5.2	2.0	-0.2	-2.4	-2.0	-2.8	1.0	2.0	2.5
General governm.budget, EU-def., % of GDP									
Revenues	33.4	33.1	33.5	34.8	.	.	33.0	33.0	33.0
Expenditures	37.1	35.2	34.3	35.5	.	.	36.0	35.5	35.5
Net lending (+) / net borrowing (-)	-3.7	-2.1	-0.9	-0.7	.	.	-3.0	-2.5	-2.5
Public debt, EU-def., % of GDP	37.4	38.0	39.8	38.4	.	.	38.0	38.0	38.5
Central bank policy rate, % p.a., end of period 4)	5.25	4.00	2.75	1.75	1.75	1.75	1.75	2.25	3.00
Current account, EUR mn	-6,394	-1,542	-1,004	-1,928	273	-2,027	-6,800	-8,900	-9,500
Current account, % of GDP	-4.8	-1.1	-0.7	-1.2	0.4	-2.8	-4.0	-5.0	-5.0
Exports of goods, BOP, EUR mn	39,855	43,893	46,839	49,119	24,369	25,509	50,600	53,100	55,800
annual change in %	-0.6	10.1	6.7	4.9	7.4	4.7	3.0	5.0	5.0
Imports of goods, BOP, EUR mn	49,114	49,709	53,375	56,892	27,282	29,631	60,900	63,900	67,700
annual change in %	-0.7	1.2	7.4	6.6	7.4	8.6	7.0	5.0	6.0
Exports of services, BOP, EUR mn	9,868	13,434	15,104	16,640	7,960	8,584	16,600	17,400	18,300
annual change in %	13.6	36.1	12.4	10.2	11.9	7.8	0.0	5.0	5.0
Imports of services, BOP, EUR mn	7,392	8,733	9,236	9,849	4,748	4,825	9,600	10,100	10,600
annual change in %	5.1	18.1	5.8	6.6	12.4	1.6	-3.0	5.0	5.0
FDI liabilities (inflow), EUR mn	2,380	2,894	2,931	3,885	2,268	2,067	3,000	.	.
FDI assets (outflow), EUR mn	-175	-24	227	930	655	68	0	.	.
Gross reserves of NB excl. gold, EUR mn	31,206	32,525	32,216	32,238	30,111	31,729	.	.	.
Gross external debt, EUR mn	100,857	98,069	94,744	90,034	90,858	88,256	90,000	92,000	95,000
Gross external debt, % of GDP	75.5	68.0	63.1	56.1	56.7	52.0	53.1	51.8	50.3
Average exchange rate RON/EUR	4.4593	4.4190	4.4437	4.4454	4.4475	4.4956	4.48	4.50	4.50
Purchasing power parity RON/EUR	2.0753	2.2083	2.2120	2.2036	.	.	.	.	.

1) Preliminary. - 2) Enterprises with 4 and more employees. - 3) Half-year data refer to enterprises with 4 and more employees. - 4) One-week repo rate.

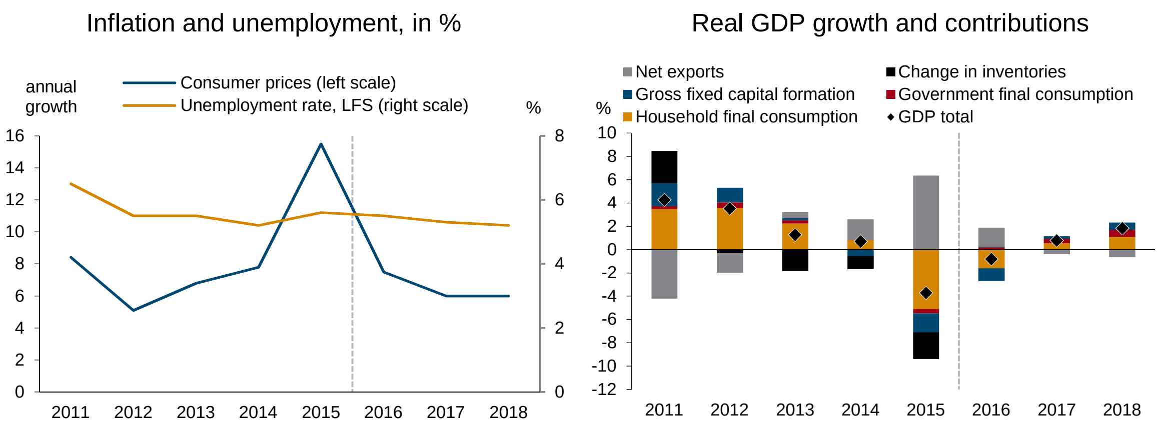
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

RUSSIAN FEDERATION: Stagnation becomes the 'new normal'

PETER HAVLIK

The renewed plunge in oil prices at the beginning of 2016 has resulted in lower export and budget revenues, prompting a delay in stabilising the economy. Only since mid-2016 has the Russian economy seemingly begun to emerge slowly from recession. With oil prices more or less flat, financial and trade sanctions remaining in place and structural and institutional reforms absent, economic growth will stay sluggish – at less than 2% – even in the medium term.

Figure 39 / Russian Federation: Main macroeconomic indicators



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

The Russian economic recession is slowly coming to an end. By mid-2016, the adjustment to the collapse in oil prices and the subsequent devaluation of the rouble, as well as the imposition of Western sanctions and Russian counter-sanctions in the course of 2014-2015, have been by and large swallowed. The multiple shocks that hit domestic demand and foreign trade have thus been largely over and the economy has now seemingly stabilised at a new 'stagnation normal'. The exchange rate stabilised (and even appreciated somewhat in the course of the year), inflation is receding to single-digit levels. Yet signals of an emerging recovery are still feeble and contradictory: agricultural production, the extraction industry and transport are modestly growing (the former thanks to better harvests and the food import ban), while the remaining sectors – in particular, manufacturing industry, trade and especially construction industry – shrank anew in the first half of 2016. In nominal terms, the Russian

GDP contracted by more than EUR 500 billion (by more than one third, to the level of 2010, largely due to rouble devaluation) between 2013 and 2016; previous levels of nominal GDP will not be reached for years.

External shocks and related overall adjustments have been most spectacular in trade with the EU: Overall Russian goods exports dropped by nearly 30% in the first half of 2016 (in nominal EUR terms, after a drop by almost 20% in 2015) and the share of the EU in the total dropped below 50%, largely owing to lower energy prices. At the same time, imports from the EU fell even more: by nearly 40%, mostly due to the devaluation of the rouble. Due to the conflict, Russian trade with Ukraine shrank by more than 60% and the share of Ukraine in Russian exports dropped below 3%. By contrast, export shares of the Eurasian Economic Union (EAEU), the United States, China, Japan and Turkey increased by 0.4, 0.7, 1.5, 0.5 and 0.8 pp, respectively, between 2013 and 2015 – reflecting the relative shift away from the EU against the background of the overall trade decline (which continues in 2016). In 2016, both exports and imports are expected to decline by another 20% and 10%, respectively. Trade and current account surpluses will narrow accordingly, the latter will drop below 3% of GDP.

Amendments to the 2016 federal budget announced in October reckon with somewhat lower revenues (2.8%) while simultaneously increasing expenditure by about the same amount. While state-supported investment outlays and the financing of regional programmes (including subsidies to Crimea and Kaliningrad) will be curtailed, defence expenditures will apparently be increased (details have not been revealed yet).

In addition to domestic investment cuts, FDI inflows nearly dried out in the course of 2015 (and turned even negative in the first quarter of 2016). FDI stocks had been drastically reduced during the last two years – by more than EUR 200 billion between end-2013 and end-2015 (to USD 343 billion). The reduction in FDI flows results from recession, Western financial sanctions and the associated worsening of the investment climate; part of the disinvestment can also be attributed to the official 'de-offshorisation' campaign (launched in 2014, aiming at returning Russian flight capital home and implemented since the beginning of 2015). A part of the capital outflow can be attributed to debt service payments. A massive reduction of investments – domestic as well as foreign – is definitely no good sign for modernisation and diversification prospects.

The results of the parliamentary elections in September 2016 reflect resignation – a fragile domestic stability of sorts – which may be easily shaken by the growing number of external political and economic risks. The latter relate mostly to the oil price while the former are connected with deteriorating relations with the West (especially the United States) which have reached their lowest point at least since before the launch of Gorbachev's perestroika 30 years ago. After the recent collapse of the Syrian truce, the Dutch-led commission's suggestion that Russia was directly involved in downing the MH17 flight in eastern Ukraine, and Putin's withdrawal from the 2010 plutonium deal with the USA because of 'unfriendly US actions towards Russia', a new round of dangerous escalation of the conflict cannot be ruled out.

Increasingly assertive Russian external policies (Ukraine, Turkey, Syria), as well as the sanctions' tug-of-war with the West, have been associated with the inward-looking, import-substitution and more 'eastern-focused' (China and Japan) economic policies. Domestically, the rather cautious monetary policy stance pursued by the Central Bank and the fiscal restraint of the Ministry of Finance remain in place, despite the recent lowering of the CBR policy rate. The modestly rising budget deficit reflects the shortfall of tax revenues, rather than a more accommodative fiscal policy stance. As usual, these policies face harsh domestic criticism from both conservative (presidential adviser S. Glazyev) and liberal (former Finance Minister A. Kudrin) corners. The outcome of these disputes will likely remain inconclusive while any radical change in economic policy would be rather risky, at least before the forthcoming presidential elections in 2018. A muddling through of sorts is thus to be expected.

We share the assessment of both the Government and Central Bank medium-term forecasts from September 2016 which reckon with sanctions staying in place. In their baseline scenario (with the oil price hovering at around USD 40/bbl) GDP will grow less than 1% in 2017 and below 2% p.a. in 2018-2019. Inflation is expected to drop to low single digits (4% at the end of 2017). Investment growth should gradually recover, but is expected to stay below 2% in 2017 and between 3-4% per year during 2018-2019 – a rather conservative growth scenario. Even the ‘Strategic long-term forecast until 2035’ elaborated by the Economics Ministry and recently leaked to the press does not envisage significant growth acceleration: GDP growth of 2.6% per year during 2016-2020 and less than 4% per year thereafter.

With sanctions remaining in place and partly even widening (e.g. Russia banned the state procurement of foreign food products in August 2016, the EU and USA expanded the list of sanctioned Russian entities), prospects for modernisation cum restructuring are bleak due to the shortage of available investment resources and other institutional bottlenecks – even in the medium term. There seems to be a consensus that Russia is facing a prolonged period of stagnation in both economic and societal developments. Turning inwards and continuing with more assertive policies is not helpful – though obviously popular at home as evidenced by the results of the recent Duma elections. The attempted change of the pivot to the East (China, Japan, South Korea and Vietnam) cannot compensate for the trade and investment setbacks with the EU. So far, there have been little visible signs of import substitution – even in the sanctions-protected food processing industry. The damaged links with most of the near neighbourhood in both west and south, Ukraine in particular, will be hard to restore and the conflict with the West may even escalate. Also the recently established Eurasian Economic Union flagship integration project has been adversely affected by a number of ill-considered unilateral steps on the part of Russia (food sanctions, restrictions on Ukrainian transit trade, etc.).

Overall, our current assessment remains unchanged: the expected mild recession in 2016 is confirmed and a gradual, yet rather modest, GDP growth acceleration is forecast in both 2017 and 2018. Economic growth will stay below 2% and investment weak even in the medium run. Inflation will return to single digits and unemployment will fall.

Table 22 / Russia: Selected economic indicators

	2012	2013	2014	2015 1)	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., average	143,202	143,507	146,091	146,406	146,291	146,600	146,500	146,500	146,500
Gross domestic product, RUB bn, nom.	66,927	71,017	77,945	80,804	37,494	38,541	84,000	90,000	95,000
annual change in % (real)	3.5	1.3	0.7	-3.7	-3.7	-0.9	-0.8	0.8	1.8
GDP/capita (EUR at exchange rate)	11,700	11,700	10,500	8,100	.	.	7,600	8,000	8,100
GDP/capita (EUR at PPP)	19,100	17,800	18,700	18,600	.	.	.	.	.
Consumption of households, RUB bn, nom.	34,334	38,068	41,611	43,331	20,699	21,092	.	.	.
annual change in % (real)	7.4	4.4	1.5	-9.6	-7.5	-4.8	-3.0	1.0	2.0
Gross fixed capital form., RUB bn, nom.	13,522	14,357	16,651	17,668	6,534	6,774	.	.	.
annual change in % (real)	6.0	0.9	-2.6	-7.6	-6.9	-6.7	-5.0	1.0	3.0
Gross industrial production 2)									
annual change in % (real)	3.4	0.4	1.7	-3.4	-2.6	0.2	0.5	2.0	3.0
Gross agricultural production									
annual change in % (real)	-4.8	5.8	3.5	3.0	2.9	2.6	.	.	.
Construction output									
annual change in % (real)	2.5	0.1	-2.3	-7.0	-6.9	-5.7	.	.	.
Employed persons, LFS, th, average	71,545	71,392	71,539	72,324	71,919	71,850	72,500	73,000	73,500
annual change in %	1.0	-0.2	0.2	-0.4	-0.4	-0.1	0.2	0.7	0.7
Unemployed persons, LFS, th, average	4,131	4,137	3,889	4,264	4,314	4,404	4,200	4,100	4,000
Unemployment rate, LFS, in %, average	5.5	5.5	5.2	5.6	5.7	5.8	5.5	5.3	5.2
Reg. unemployment rate, in %, end of period 3)	1.4	1.2	1.2	1.3	1.3	1.3	.	.	.
Average monthly gross wages, RUB	26,629	29,792	32,495	34,030	33,175	35,708	36,200	39,500	44,000
annual change in % (real, gross)	8.4	4.8	1.2	-9.3	-8.7	-0.2	-1.0	3.0	5.0
Consumer prices, % p.a.	5.1	6.8	7.8	15.5	16.0	7.9	7.5	6.0	6.0
Producer prices in industry, % p.a. 4)	6.8	3.3	6.1	12.4	11.8	4.1	6.0	5.0	5.0
General governm.budget, nat.def., % of GDP									
Revenues	34.5	34.4	34.3	33.3	34.0	32.5	31.4	32.0	33.0
Expenditures	34.1	35.6	35.4	36.8	36.4	35.2	35.0	35.5	36.0
Deficit (-) / surplus (+)	0.4	-1.2	-1.1	-3.5	-2.4	-2.8	-3.6	-3.5	-3.0
Public debt, nat.def., % of GDP 5)	9.3	9.8	10.8	10.6	9.9	10.4	14.0	15.0	15.0
Central bank policy rate, % p.a., end of period 6)	8.25	5.50	17.00	11.00	11.50	10.50	10.00	8.00	6.00
Current account, EUR mn 7)	55,452	25,164	43,477	62,052	41,531	12,287	18,000	13,600	15,000
Current account, % of GDP 7)	3.3	1.5	2.8	5.2	7.1	2.5	1.6	1.2	1.3
Exports of goods, BOP, EUR mn 7)	410,300	392,827	375,561	307,083	162,036	114,864	228,800	241,000	262,500
annual change in %	10.9	-4.3	-4.4	-18.2	-12.8	-29.1	-25.5	5.3	8.9
Imports of goods, BOP, EUR mn 7)	261,202	256,901	232,739	173,525	82,381	75,152	158,600	168,600	180,400
annual change in %	14.2	-1.6	-9.4	-25.4	-26.2	-8.8	-8.6	6.3	7.0
Exports of services, BOP, EUR mn 7)	48,495	52,787	49,700	46,532	22,128	20,682	44,800	47,200	49,100
annual change in %	16.4	8.8	-5.8	-6.4	-6.4	-6.5	-3.7	5.4	4.0
Imports of services, BOP, EUR mn 7)	84,736	96,643	91,487	79,694	38,045	30,501	64,900	68,400	69,700
annual change in %	29.0	14.1	-5.3	-12.9	-9.8	-19.8	-18.6	5.4	1.9
FDI liabilities (inflow), EUR mn 7)	39,353	52,107	16,655	5,826	1,405	6,033	8,000	.	.
FDI assets (outflow), EUR mn 7)	37,980	65,120	43,151	19,954	7,251	13,409	15,000	.	.
Gross reserves of CB, excl. gold, EUR mn 8)	367,323	341,787	279,383	292,467	282,782	297,124	.	.	.
Gross external debt, EUR mn 7)	480,440	530,481	493,861	474,139	501,442	472,350	448,000	385,700	356,300
Gross external debt, % of GDP 7)	28.7	31.6	32.2	39.8	42.1	42.2	40.0	33.0	30.0
Exchange rate RUB/EUR, average	39.9	42.3	50.8	67.8	64.4	78.4	75.0	77.0	80.0
Purchasing power parity RUB/EUR 9)	24.4	27.8	28.6	29.6	.	.	.	.	.

Note: From 2014 including Crimean Federal District (for LFS and wages from 2015, growth rates for employment and real wages from 2016).

1) Preliminary. - 2) Excluding small enterprises. - 3) In % of labour force (LFS). - 4) Domestic output prices. - 5) wiiw estimate. - 6) From 2013 one-week repo rate, refinancing rate before. - 7) Converted from USD. - 8) Including part of resources of the Reserve Fund and the National Wealth Fund of the Russian Federation. - 9) wiiw estimates based on the 2011 International Comparison Project benchmark.

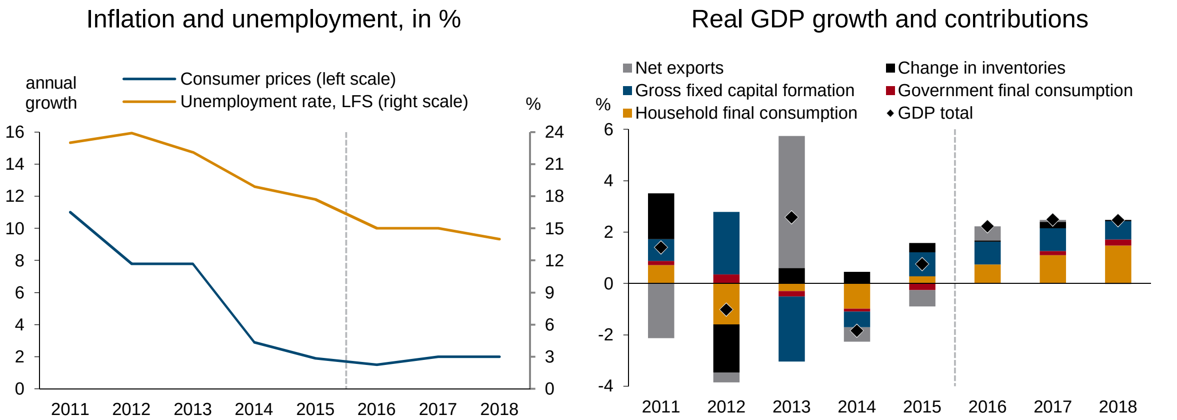
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SERBIA: Fiscal adjustment with recovery

VLADIMIR GLIGOROV

Macroeconomic balances are improving in terms of both the current account and fiscal deficits, while the rate of unemployment is dropping. The growth rate will pick up speed, attaining a level of 3% in the medium term. Prospects of the current government remaining in office for a full term are good.

Figure 40 / Serbia: Main macroeconomic indicators



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

The second year into fiscal consolidation has seen surpluses on a cash basis and the government expects the year to end with a fiscal deficit as low as 2% of GDP. The final outcome will depend on the amount of debt and losses of the private sector that will have to be taken over by the budget. A realistic forecast of the final fiscal deficit may be about 4% of GDP, or somewhere in between the officially expected and the forecasted figure. The government counts with a growth rate of 2.5%, and is hoping for an even better outcome, and indeed the first half of 2016 has seen growth of 2.9%. In the second quarter, more importantly, all components of GDP showed positive contributions to growth. If indeed consumption continues to grow, while there is no significant deterioration in net exports, growth may surpass the forecast of 2.2%, which is on the pessimistic side of most forecasts.

Fiscal consolidation is key to the government's economic policy as public debt was growing rapidly before 2015. A significant part of public debt is in foreign currency (mostly dollars and euros), so it is somewhat sensitive to the changes in the exchange rates. The government believes that this year public debt will stabilise somewhere in the mid-70s in per cent of GDP and will start declining in the following years. This is achievable assuming that the dinar's exchange rate remains stable.

This is in fact the most important aspect of the macroeconomic developments. Due to a slowly growing economy and declining prices of imports (especially of oil and gas), inflation has decelerated to around 1% and may accelerate only slightly in the medium term. This, together with growing exports and declining current account deficits, has supported the stability of the currency in the last couple of years. A stable currency, in turn, supports subdued inflationary pressures. In addition, there is every indication that slow inflation has become a firmly established expectation at least in the medium term.

Most commentators and also the IMF argue that it is the fiscal consolidation that has made it possible for the monetary policy to support a stable, or rather de facto fixed, exchange rate, which has then stabilised prices with the help of declining oil prices supporting the stability of the exchange rate. The alternative explanation in fact makes more sense. Historically, the Serbian economy worked with inflationary expectations of above but close to 10%. That supported consumption and an expansion of services in periods of a stable exchange rate. Periodically, there were devaluations, with a new fixed exchange rate and some initial speed-up of inflation, which then slowed down before the start of the new cycle. That supported relatively low fiscal deficits and slow growth of public debt because the government benefited from the inflation tax while the tax payers delayed paying taxes as much as they could and looked for ways to evade them altogether. So, once the crisis hit in 2008-2009, revenues declined and expenditures increased and the fiscal deficit increased, pushing public debt up quite dramatically. Once the public debt development took an unsustainable path, devaluation became unavailable due to high foreign debt, the fixed exchange rate along with declining inflation deprived the government of the inflationary tax, and of measures of financial repression in general, but paying taxes early became advantageous for the tax payers. In addition, the policy rate was cut repeatedly and the interest rate declined generally. So, it has been price and exchange rate stability that has supported a better fiscal performance. In that context, it is questionable whether the cut in expenditures, which took place as a nominal cut in public wages and pensions, was useful or rather counterproductive given that it was a drag on recovery and still stands in the way of its speed-up.

The recovery, the way it has been unfolding, has been mostly based on investments and exports. This is continuing this year and is expected to be where growth should be coming from in the medium term. With a slow recovery of household consumption and also public investments, a medium-term growth rate of about 3% looks as the potential one. Even with slow growth, the unemployment rate has declined strongly, which is due to outward migration and also the recovery of low-paying jobs in services. Manufacturing is posting positive growth rates, but it is not clear how long that may last because of uncertainties e.g. in the viability of the automotive industry.

External imbalances are narrowing, which is partly due to a delayed recovery of imports. Low prices of oil have been quite helpful in that. Also, a strong growth of exports indicates that a small open economy can increase its exports even to markets that do not show strong growth, e.g. the EU market. This is true of other Balkan economies which either do not have a misaligned real exchange rate or were able to devalue nominally.

Political stability has been a problem in Serbia for decades and things are only somewhat different now. Early elections gave the government a strong mandate, so it does not need to waiver in its strategic economic and other policies. It is in its interest that it stays the course as it were. However, its legitimacy is not all that deep, though electoral support is, and it is in two minds on regional and European issues, so politics may prove challenging. However, with relative political stability, slow recovery, with a growth rate of around 3%, is in the cards in the medium run.

Table 23 / Serbia: Selected economic indicators

	2012	2013	2014	2015 1)	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th. pers., mid-year	7,201	7,167	7,132	7,095	.	.	7,010	7,000	7,000
Gross domestic product, RSD bn, nom.	3,584	3,876	3,908	4,043	1,872	1,937	4,200	4,400	4,600
annual change in % (real)	-1.0	2.6	-1.8	0.8	-0.3	2.9	2.2	2.5	2.5
GDP/capita (EUR at exchange rate)	4,400	4,800	4,700	4,700	.	.	4,900	5,100	5,300
GDP/capita (EUR at PPP)	9,800	10,100	10,200	10,500	.	.	.	.	.
Consumption of households, RSD bn, nom.	2,728	2,886	2,922	2,982	1,437	1,456	.	.	.
annual change in % (real)	-2.1	-0.4	-1.3	0.4	-0.7	1.1	1.0	1.5	2.0
Gross fixed capital form., RSD bn, nom.	759	668	652	715	333	353	.	.	.
annual change in % (real)	13.2	-12.0	-3.6	5.6	6.6	6.5	5.0	5.0	4.0
Gross industrial production 2)									
annual change in % (real)	-2.2	5.4	-6.4	8.2	5.2	4.5	6.0	5.0	4.0
Gross agricultural production									
annual change in % (real)	-19.5	21.7	2.1	-8.0	.	.	.	.	.
Construction output									
annual change in % (real)	-0.3	-20.0	2.4	20.9	15.1	10.3	.	.	.
Employed persons, LFS, th, average 3)	2,228	2,311	2,421	2,574	2587.8	2761.5	2,750	2,810	2,870
annual change in %	-1.1	3.7	4.8	0.6	1.6	6.7	1.0	2.0	2.0
Unemployed persons, LFS, th, average 3)	701	656	563	552	542	496	500	480	450
Unemployment rate, LFS, in %, average 3)	23.9	22.1	18.9	17.7	17	15	15.0	15.0	14.0
Reg. unemployment rate, in %, end of period 4)	28.6	29.1	28.4	26.8	27	26	.	.	.
Average monthly gross wages, RSD	57,430	60,708	61,426	61,145	59,444	62,012	64,200	66,800	69,500
annual change in % (real, gross)	1.0	-1.9	-1.7	-2.4	-2.1	3.2	3.0	2.0	2.0
Average monthly net wages, RSD	41,377	43,932	44,530	44,432	43,218	45,069	46,500	48,400	50,400
annual change in % (real, net)	1.1	-1.5	-1.5	-2.1	-1.7	3.3	3.0	2.0	2.0
Consumer prices, % p.a.	7.8	7.8	2.9	1.9	1.3	1.0	1.5	2.0	2.0
Producer prices in industry, % p.a.	6.8	2.7	1.3	1.0	1.7	-0.8	0.0	1.0	1.2
General governm.budget, nat.def., % of GDP									
Revenues	41.1	39.7	41.5	41.9	43.0	45.2	43.0	43.0	43.0
Expenditures	47.9	45.1	48.1	45.6	44.9	46.2	47.0	46.0	44.0
Deficit (-) / surplus (+)	-6.8	-5.5	-6.6	-3.7	-1.9	-0.9	-4.0	-3.0	-1.0
Public debt, nat.def., % of GDP	56.2	59.6	70.4	74.6	.	.	77.0	77.0	76.0
Central bank policy rate, % p.a., end of period 5)	11.25	9.50	8.00	4.50	6.00	4.25	4.00	4.00	4.00
Current account, EUR mn	-3,671	-2,098	-1,985	-1,577	-790	-635	-1,500	-1,600	-1,700
Current account, % of GDP	-11.6	-6.1	-6.0	-4.7	-5.1	-4.0	-4.0	-5.0	-5.0
Exports of goods, BOP, EUR mn	8,376	10,515	10,641	11,357	5,598	6,258	11,900	12,500	13,100
annual change in %	3.2	25.5	1.2	6.7	6.0	11.8	5.0	5.0	5.0
Imports of goods, BOP, EUR mn	14,011	14,674	14,752	15,350	7,518	7,925	16,000	16,600	17,400
annual change in %	2.9	4.7	0.5	4.1	4.8	5.4	4.0	4.0	5.0
Exports of services, BOP, EUR mn	3,093	3,422	3,810	4,273	1,932	2,061	4,500	4,700	4,900
annual change in %	2.2	10.6	11.3	12.2	15.0	6.7	5.0	5.0	5.0
Imports of services, BOP, EUR mn	2,981	3,109	3,344	3,548	1,681	1,691	3,700	3,900	4,100
annual change in %	3.8	4.3	7.6	6.1	9.3	0.6	5.0	5.0	5.0
FDI liabilities (inflow), EUR mn	1,009	1,548	1,500	2,114	932	970	1,200	.	.
FDI assets (outflow), EUR mn	256	250	264	310	151	130	150	.	.
Gross reserves of NB, excl. gold, EUR mn	10,295	10,734	9,351	9,812	9,694	8,585	.	.	.
Gross external debt, EUR mn 6)	25,645	25,644	25,679	26,374	26,408	25,926	29,000	30,000	31,000
Gross external debt, % of GDP 6)	80.9	74.8	77.1	78.8	79.0	76.0	85.0	85.0	84.0
Average exchange rate RSD/EUR	113.13	113.14	117.31	120.76	121.00	122.90	124	124	125
Purchasing power parity RSD/EUR	50.64	53.64	53.77	54.48	108.40	110.20	.	.	.

1) Preliminary. - 2) Excluding arms industry. - 3) Until 2013 survey of April and October, quarterly thereafter. From 2013 census 2011, from 2015 further adjustments according to ILO, Eurostat and EU-LFS. - 4) From 2015 new labour force potential. - 5) Two week repo rate. - 6) BOP 5th Edition.

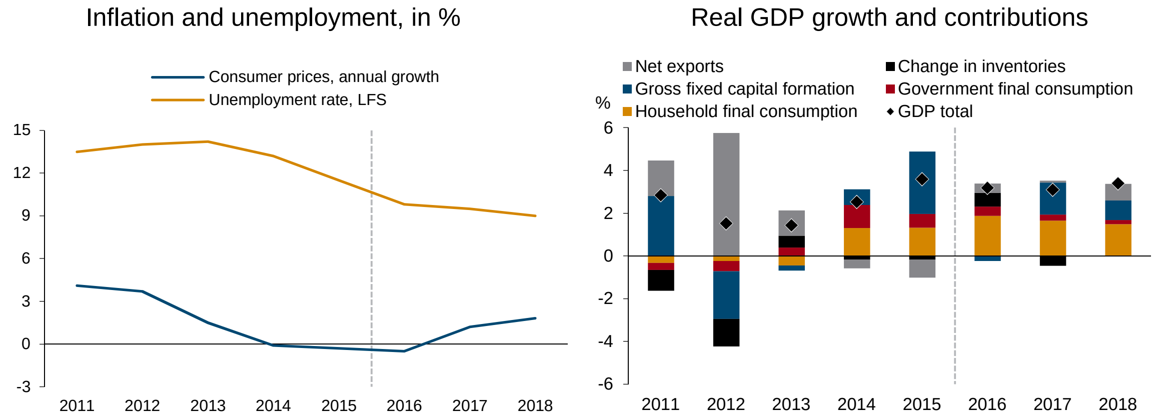
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SLOVAKIA: Solid growth

DORIS HANZL-WEISS

An unexpectedly high GDP growth of 3.6% in the first half of 2016 has resulted in Slovakia being one of the most rapidly growing countries in the region. While investments will drop in the course of the current year, growth has been backed by household consumption and net exports. For the years ahead, new capacities in the automotive industry will lend a fresh impetus to growth.

Figure 41 / Slovakia: Main macroeconomic indicators



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

Slovak GDP grew by 3.6% in the first half of 2016, at about the same pace as in the previous year. It was backed by accelerating household consumption, rising by almost 3% in the first half of the year. This was due to ongoing positive developments in the labour market and real wage growth of 3.6%. Consumer prices still declined by -0.5%. Strong growth of credits to households continued: after an increase of 13% in 2015 they rose by 13.4% in the second quarter of 2016; household indebtedness rose strongly while still remaining at a low level. Government consumption also contributed to growth, increasing by 2.6%. Gross fixed capital formation – which had benefited from the speeding-up of EU structural spending last year due to the end of the last disbursement year of the EU's Multiannual Financial Framework 2007-2013 – saw a continuous slowdown in the first six months of 2016. However, overall it still registered a small increase by 0.7%, while gross capital formation rose by 3%. Credit growth to non-financial corporations slowed down in 2016 (7% in 2015, 3% in the first quarter of 2016 and only 0.7% in the second).The construction sector, which had suffered a six-year decline after the economic crisis and recovered finally in 2015, was strongly affected by the end of the last EU perspective's disbursement period and again saw a drop, by 1%, in the first half of 2016. Construction of civil engineering works decreased in both quarters, that of buildings decreased in the second quarter. Trade performance improved markedly in the second quarter of 2016 and net exports had a positive effect on growth in the first half of the year. Overall, goods exports rose by 3.9%, goods imports by 3.7%. Exports to Germany, Slovakia's largest export partner (accounting for 23% of total goods exports), increased by 4% (imports by 9%). Exports to the Czech Republic, the second most important export partner of Slovakia, accounting for 12% of total exports, remained constant. Exports improved markedly to France (+16%), the United Kingdom (+14%), Italy (+6%), Spain (+23%), the Netherlands (+21%) and Romania (+5%). Exports to the UK take the 5th place with 6% of total exports.

Regarding the sectoral structure of growth, manufacturing remained the main growth driver of the Slovak economy. Industrial production increased by almost 4% in the first half of 2016. The automotive industry, the largest manufacturing sector in Slovakia, remains the major engine of growth. After the Brexit vote in June, fears emerged that the new investment by Jaguar Land Rover would not be realised; however, construction actually started in September. The three main established car manufacturers, Volkswagen, KIA Motors and PSA Peugeot-Citroën, had a successful half-year, reporting production increases of one, five and eight per cent, respectively. Volkswagen, the largest producer in the country, kept production levels constant for 2015 (plus 3,000 cars) and the first half of 2016 despite the emission scandal erupting in September 2015.

Continued positive developments prevailed in the labour market. Employment increased by 3% in the first half of 2016 and the unemployment rate was steadily declining. In the second quarter of 2016 it reached 9.6%, approaching the all-time low of 9.5% registered in 2008. However, the structure of unemployed is unfavourable (with large shares of long-term and youth unemployment, and of the Roma population). Also, shortages of skilled labour are emerging, often cited by automotive companies. Efforts to relaunch and promote a dual education system have begun. Meanwhile, teachers have restarted their strike activity in September as they perceive the current government measures (increasing salaries by 6%) as unsatisfactory.

The budget deficit reached 3% of GDP in 2015, with the debt to GDP ratio declining to slightly below 53%. The new government,[45] elected in March 2016, carries on the consolidation process, but in a less ambitious way. The official budget balance targets announced in the Slovak Stability Programme 2016-2019 are: -1.9% for the year 2016, -1.3% in 2017, -0.4% in 2018 and +0.2% in 2019. However, it is questionable whether these targets can realistically be met. On the revenue side, measures of the new government include a reduction of the corporate income tax rate from 22% to 21% as of 2017, the introduction of a tax on dividends of 7%, the extension and increase of a special levy on regulated businesses and taxation changes for insurance companies. On the expenditure side, the implemented measures comprise the increase in salaries for teachers by 6% as of 1 September 2016, additional expenditures related to the Slovak Presidency of the Council of the European Union (including e.g. road construction in Bratislava), the building of the Bratislava ring road (financed by the Juncker Fund), the preparation of an industrial park for Jaguar Land Rover's investment near Nitra, as well as the construction of the national football stadium. A new law for the promotion of small and medium-sized enterprises is under discussion.

[45] Consisting of Mr Fico's Smer, the Slovak National Party, Most-Híd and Siet'. However, in the meantime Siet' fell apart and the government now comprises only three parties.

For the year 2016, we have slightly revised our growth forecast upwards by 0.2 pp compared to the Spring Forecast, due to the unexpectedly good performance in the first half of 2016. Growth is estimated to reach 3.2%, which is however still lower than the 3.6% observed in the first half of the year. For the second half of 2016 we expect a decline in gross fixed capital formation, as the strong growth of last year cannot be repeated. Household consumption together with slightly positive net exports will constitute the basis for this year's growth. The economic sentiment indicator is characterised by strong up- and downward movements. It reached a peak in March, followed by a trough in June, and is now again moving upwards. All components of this indicator (including that for industry, construction, services, and consumer confidence) have strongly fluctuated, only the retail-trade confidence indicator has shown an improving trend throughout the year. For the first time since joining the EU in 2004, Slovakia took over the presidency of the Council of the European Union on 1 July 2016 for half a year. Organising various events, including the informal summit in Bratislava on 16 September, have put Slovakia in the spotlight of international attention and media.

In 2017, along with household consumption, gross fixed capital formation will again become a growth driver, not least due to the low base effect. Public investment projects such as the construction of highways and the Bratislava bypass together with private investment, such as the building of the Jaguar Land Rover plant and related investments by car parts suppliers, will take off. However, the latter will also trigger increased imports, which together with sluggish exports will have a neutral effect on net exports. Only with the start of operation at the new Jaguar Land Rover plant at the end of 2018/2019 new export capacities will provide fresh impetus to growth. For the next two years, solid growth is expected (3.1% in 2017 and 3.4% in 2018), while uncertainties surrounding Brexit might pose some risks for the time thereafter.

Table 24 / Slovakia: Selected economic indicators

	2012	2013	2014	2015 [1)]	2015	2016	2016	2017	2018
					January-June			Forecast	
Population, th pers., average	5,408	5,413	5,419	5,424	.	.	5,429	5,434	5,439
Gross domestic product, EUR mn, nom.	72,420	73,835	75,561	78,071	37,283	38,456	80,200	83,700	88,100
annual change in % (real)	1.5	1.4	2.5	3.6	3.2	3.6	3.2	3.1	3.4
GDP/capita (EUR at exchange rate)	13,400	13,600	13,900	14,400	.	.	14,800	15,400	16,200
GDP/capita (EUR at PPP)	19,700	20,200	21,100	22,000	.	.	.	.	.
Consumption of households, EUR mn, nom.	40,868	41,083	42,010	42,945	21,135	21,594	.	.	.
annual change in % (real)	-0.4	-0.8	2.4	2.4	1.9	2.8	3.4	3.0	2.7
Gross fixed capital form., EUR mn, nom.	15,405	15,292	15,766	17,969	7,459	7,472	.	.	.
annual change in % (real)	-9.2	-1.1	3.5	13.9	8.3	0.7	-1.0	6.5	4.0
Gross industrial production									
annual change in % (real)	8.0	3.8	8.6	7.0	8.4	3.8	3.0	3.0	5.0
Gross agricultural production									
annual change in % (real)	-5.7	6.7	7.4	-4.8	.	.	.	.	.
Construction industry									
annual change in % (real)	-12.4	-5.3	-4.1	17.9	12.9	-0.9	.	.	.
Employed persons, LFS, th, average	2,329	2,329	2,363	2,424	2,404	2,476	2480	2500	2520
annual change in %	0.6	0.0	1.5	2.6	2.6	3.0	2.5	1.0	0.7
Unemployed persons, LFS, th, average	378	386	359	314	322	275	270	260	250
Unemployment rate, LFS, in %, average	14.0	14.2	13.2	11.5	11.8	10.0	9.8	9.5	9.0
Reg. unemployment rate, in %, end of period	14.4	13.5	12.3	10.6	11.6	9.5	.	.	.
Average monthly gross wages, EUR	805	824	858	883	858	884	910	940	980
annual change in % (real, gross)	-1.2	1.0	4.2	3.2	2.6	3.6	3.5	2.5	2.0
Consumer prices (HICP), % p.a.	3.7	1.5	-0.1	-0.3	-0.3	-0.5	-0.5	1.2	1.8
Producer prices in industry, % p.a.	1.9	-1.0	-3.5	-2.9	-3.1	-4.7	-4.5	1.5	2.0
General governm.budget, EU-def., % of GDP									
Revenues	36.2	38.6	39.2	42.7	.	.	40.8	40.4	40.2
Expenditures	40.5	41.3	41.9	45.6	.	.	43.2	42.6	42.0
Net lending (+) / net borrowing (-)	-4.3	-2.7	-2.7	-3.0	.	.	-2.4	-2.2	-1.8
Public debt, EU-def., % of GDP	52.4	55.0	53.9	52.9	.	.	53.2	53.6	52.3
Central bank policy rate, % p.a., end of period [2)]	0.75	0.25	0.05	0.05	0.05	0.00	.	.	.
Current account, EUR mn	684	1,446	100	-1,016	-4	-197	-800	-1,300	-1,000
Current account, % of GDP	0.9	2.0	0.1	-1.3	0.0	-0.5	-1.0	-1.6	-1.1
Exports of goods, BOP, EUR mn	60,159	62,145	62,581	65,900	32,468	33,760	68,500	71,200	75,100
annual change in %	10.0	3.3	0.7	5.3	3.4	4.0	4.0	4.0	5.5
Imports of goods, BOP, EUR mn	57,653	59,097	59,722	64,064	30,944	32,194	66,500	69,700	73,200
annual change in %	5.4	2.5	1.1	7.3	4.3	4.0	3.8	4.8	5.0
Exports of services, BOP, EUR mn	6,049	6,892	6,833	7,253	3,408	3,563	7,500	7,700	8,100
annual change in %	15.7	13.9	-0.8	6.1	2.8	4.6	4.0	3.0	5.0
Imports of services, BOP, EUR mn	5,628	6,481	6,749	7,163	3,296	3,374	7,300	7,700	8,100
annual change in %	2.4	15.2	4.1	6.1	1.8	2.4	2.0	5.0	5.0
FDI liabilities (inflow), EUR mn	1,356	757	27	1,917	1,583	1,616	2,400	.	.
FDI assets (outflow), EUR mn	-958	976	184	1,028	1,373	2,248	2,700	.	.
Gross reserves of NB excl. gold, EUR mn	620	670	1,165	1,648	1,345	1,606	.	.	.
Gross external debt, EUR mn	54,882	60,444	67,776	67,225	67,252	69,677	70,000	72,000	74,600
Gross external debt, % of GDP	75.8	81.9	89.7	86.1	86.1	86.9	87.3	86.0	84.7
Purchasing power parity EUR/EUR	0.6787	0.6741	0.6616	0.6540	.	.	.	.	.

1) Preliminary. - 2) Official refinancing operation rates for euro area (ECB).

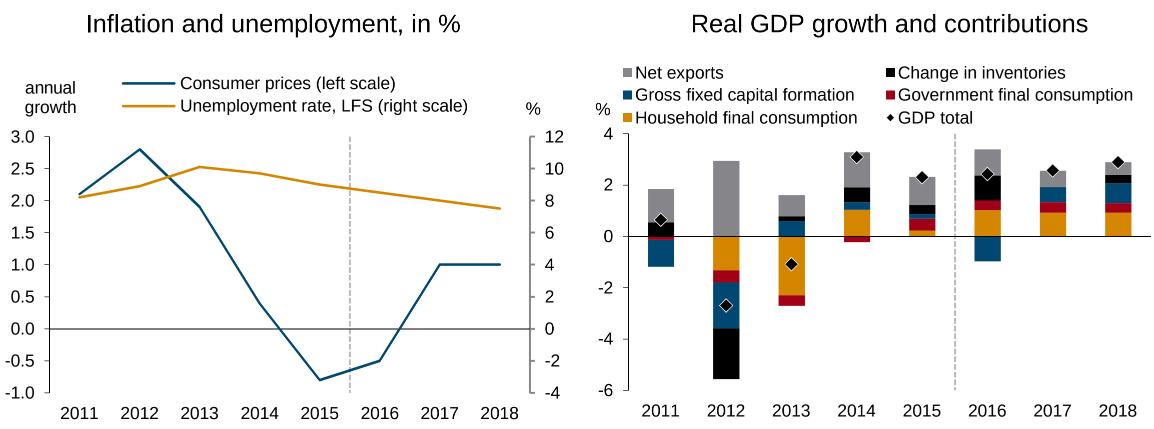
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

SLOVENIA: Waiting for new EU investment cycle

HERMINE VIDOVIC

In 2016 external demand has been the key driver of Slovenia's GDP growth; it is expected to reach 2.4%. GDP growth will gain momentum throughout the forecast period given the openings offered by the new cycle of EU-funded investments. Exports and the gradual recovery of household consumption on account of better labour market conditions will remain the main drivers of growth.

Figure 42 / Slovenia: Main macroeconomic indicators



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

Slovenia's GDP was up 2.5% in the first half of 2016, backed by net exports and rising inventories. Growth of household consumption accelerated in the wake of rising disposable income due to faster growing wages and rising social benefits and transfers, while gross fixed capital formation contracted again after three years of moderate growth. The latter was mainly due to a drop in public investment following the ending of the EU funding period 2007-2013. The decrease in investments was particularly felt in construction, which reported a continued decline (25%) in the first half of 2016; conversely, investments in machinery and equipment continued to grow. Industrial production grew by 6% in the first half of the year, with the highest output increases reported for manufacturing of computer and optical products, fabricated metal products and other transport equipment. By contrast, car production – one of Slovenia's major industrial branches – contracted slightly.

Data on the labour market performance are contradictory: while Labour Force Survey data report a slight decrease both in employment and unemployment along with rising inactivity, national account data indicate an employment increase by 1.8% in the first half of 2016. Jobs were mainly generated in manufacturing. Overall, employment expectation indicators are positive with construction being the only exception. Growth in average real net wages was the strongest since 2009 – but still modest – both in the private and in the public sector. Following a very restrictive wage policy since 2009, public sector wage rises were made possible through payments of promotions agreed in 2014 and the elimination of some austerity measures (partial release of holiday allowances, somewhat higher basic wages starting from September 2016).

In external trade, goods exports went up 3.3% during the first seven months of 2016, ahead of import growth, resulting in a trade surplus that was EUR 230 million higher than in the same period of 2015. Also the surplus in services trade was higher than a year earlier, due to rising exports – of transport, travel and construction services in particular – ahead of import growth. The deficit in the primary income balance has been narrowing on account of the smaller net outflow of direct investment income and a larger inflow of agricultural subsidies from the EU budget. Thus, the current account closed with a surplus of EUR 1.8 billion, a large improvement (by EUR 640 million) year on year. The FDI inflow in the first seven months of 2016 was at the same level as in the same period a year earlier. Gross foreign debt stood at EUR 44.7 billion or 114% of the GDP in June 2016, which is EUR 700 million or 4 percentage points less than in June 2015. More than half of foreign debt was accounted for by the state sector.

Fiscal consolidation has continued in 2016: during the first half of the year the general government deficit decreased further owing to higher than expected revenues (particularly from taxes) along with spending cuts, e.g. in the fields of capital expenditures (acquisition of capital assets) and capital transfers (transfers to institutions outside the government) as well as lower payments into the EU budget. By contrast, transfers to individuals and households increased remarkably due to a partial removal of austerity measures. In mid-2016, public debt as a share of the GDP amounted to 83%. Fiscal consolidation, the completion of the state support package to the banking sector as well as the approval of expenditure ceilings and deficit targets by parliament for the 2017-2019 period as part of the new fiscal rules have also been reflected by recent ratings: Fitch has upgraded Slovenia's Long-Term Foreign and Local Currency Issuer Default Ratings (IDR) from 'BBB+' to 'A-' with a stable outlook. Already in June Standard & Poor’s upgraded Slovenia's rating to A (outlook stable).

The performance of Slovenia’s banking system has further improved in the first half of 2016, with profits more than double as compared to the first half of 2015. However, lending activities are still suppressed: loans to the corporate sector continued to shrink in the first half of the year, while loans to the household sector grew only moderately. Interest rates of domestic banks remained above the euro-area average, despite having dropped considerably. Non-performing loans have been steadily on the decline, accounting for 7.3% of total loans by the end of July 2016 (minus 4 pp as against July 2015), owing partly to a transfer of overdue loans to the bad bank (Bank Asset Management Company). The privatisation of state-owned enterprises approved by the Slovenian parliament in 2013 is proceeding slowly. As of October 2016, only 8 companies out of 15 have been sold. Preparations for an initial public offering (IPO) of Nova Ljubljanska Banka (NLB) are in line with the predetermined strategy, aiming to complete the sale by the end of 2017.

Based on available economic data, wiiw has slightly raised its summer 2016 GDP growth forecast to 2.4%. In 2017 and 2018, GDP growth is likely to accelerate to 2.6% and 2.9%, respectively. Foreign demand will remain the major driver of growth, but also domestic demand is expected to gradually increase in the wake of the expansion of investments fuelled by EU transfers under the new (2014-2020) financial perspective as well as rising household consumption. The latter should be spurred by a continued improvement in the labour market along with rising employment and wages. Unemployment is expected to fall during the forecasting period, not least because of the shrinking working-age population. Current account surpluses are expected to persist but will narrow once domestic demand strengthens. Public debt is expected to decline over the forecasting period to below 80% of GDP.

Table 25 / Slovenia: Selected Economic Indicators

	2012	2013	2014	2015 1)	2015	2016	2016	2017	2018
					January-June			Forecast	
Population, th pers., average	2,057	2,060	2,062	2,064	2,062	2,064	2,063	2,063	2,063
Gross domestic product, EUR mn, nom.	36,003	35,917	37,332	38,570	18,809	19,510	39,300	40,700	42,300
annual change in % (real)	-2.7	-1.1	3.1	2.3	2.3	2.5	2.4	2.6	2.9
GDP/capita (EUR at exchange rate)	17,500	17,400	18,100	18,700	.	.	19,000	19,700	20,500
GDP/capita (EUR at PPP)	21,600	21,500	22,600	23,700	.	.	.	.	.
Consumption of households, EUR mn, nom.	20,129	19,460	19,827	19,773	9,538	9,629	.	.	.
annual change in % (real)	-2.4	-4.1	1.9	0.4	-0.1	1.9	2.0	1.8	1.8
Gross fixed capital form., EUR mn, nom.	6,934	7,175	7,316	7,525	3,726	3,534	.	.	.
annual change in % (real)	-8.8	3.1	1.5	1.0	-0.5	-5.6	-5.0	3.0	4.0
Gross industrial production									
annual change in % (real)	-1.1	-1.0	2.2	5.6	5.9	6.3	5.5	4.5	4.5
Gross agricultural production									
annual change in % (real)	-11.0	-2.0	12.8	4.4	.	.	.	.	.
Construction industry 2)									
annual change in % (real)	-16.8	-2.6	19.5	-8.1	-5.2	-25.1	.	.	.
Employed persons, LFS, th, average	924	906	917	917	911	907	910	920	930
annual change in %	-1.3	-1.9	1.2	0.1	-0.3	-0.4	-0.4	1.0	1.0
Unemployed persons, LFS, th, average	90	102	98	90	95	82	85	80	75
Unemployment rate, LFS, in %, average	8.9	10.1	9.7	9.0	9.5	8.4	8.5	8.0	7.5
Reg. unemployment rate, in %, end of period	13.0	13.5	13.0	12.3	12.0	10.8	.	.	.
Average monthly gross wages, EUR 3)	1,525	1,523	1,540	1,556	1,541	1,571	1,580	1,600	1,640
annual change in % (real, gross)	-2.4	-2.0	0.9	1.2	1.0	0.7	1.8	1.5	1.5
Average monthly net wages, EUR 3)	991	997	1,005	1,013	1,005	1,021	1,030	1,060	1,090
annual change in % (real, net)	-2.1	-1.2	0.6	0.9	0.7	2.2	2.0	1.5	1.5
Consumer prices (HICP), % p.a.	2.8	1.9	0.4	-0.8	-0.7	-0.6	-0.5	1.0	1.0
Producer prices in industry, % p.a.	0.9	0.0	-0.7	-0.3	0.4	-2.1	-2.0	0.5	1.0
General governm.budget, EU-def., % of GDP									
Revenues	44.4	45.2	44.9	45.1	.	.	43.2	43.2	43.0
Expenditures	48.5	60.3	49.9	48.0	.	.	45.7	45.2	44.9
Net lending (+) / net borrowing (-)	-4.1	-15.0	-5.0	-2.9	.	.	-2.5	-2.0	-1.9
Public debt, EU-def., % of GDP	53.9	71.0	80.9	83.1	.	.	80.2	78.0	77.0
Central bank policy rate, % p.a., end of period 4)	0.75	0.25	0.05	0.05	0.05	0.00	.	.	.
Current account, EUR mn	930	1,732	2,325	1,998	897	1,555	2,750	2,450	2,130
Current account, % of GDP	2.6	4.8	6.2	5.2	4.8	8.0	7.0	6.0	5.0
Exports of goods, BOP, EUR mn	21,256	21,692	22,961	24,039	11,944	12,474	25,000	26,000	27,000
annual change in %	1.0	2.1	5.9	4.7	6.1	4.4	4.0	4.0	4.0
Imports of goods, BOP, EUR mn	21,337	20,984	21,780	22,541	11,214	11,482	23,000	24,000	25,200
annual change in %	-3.1	-1.7	3.8	3.5	4.8	2.4	2.0	4.5	5.0
Exports of services, BOP, EUR mn	5,107	5,318	5,558	6,025	2,771	2,931	6,300	6,700	7,100
annual change in %	4.1	4.1	4.5	8.4	8.2	5.8	5.0	6.0	6.0
Imports of services, BOP, EUR mn	3,596	3,586	3,862	4,006	1,853	1,875	4,100	4,200	4,400
annual change in %	2.7	-0.3	7.7	3.7	2.0	1.1	1.5	3.0	4.0
FDI liabilities (inflow), EUR mn	28	71	739	1,516	787	746	1,500	.	.
FDI assets (outflow), EUR mn	-439	24	155	278	394	161	200	.	.
Gross reserves of NB excl. gold, EUR mn	593	580	736	687	786	649	.	.	.
Gross external debt, EUR mn	42,872	41,866	46,514	44,954	45,466	44,738	44,000	43,500	42,700
Gross external debt, % of GDP	119.1	116.6	124.6	116.6	117.9	113.8	112.0	107.0	101.0
Purchasing power parity EUR/EUR	0.8121	0.8117	0.7997	0.7874	.	.	.	.	.

1) Preliminary. - 2) Enterprises with 20 and more employees and output of some non-construction enterprises. - 3) From 2015 new data sources in public sector. - 4) Official refinancing operation rates for euro area (ECB).

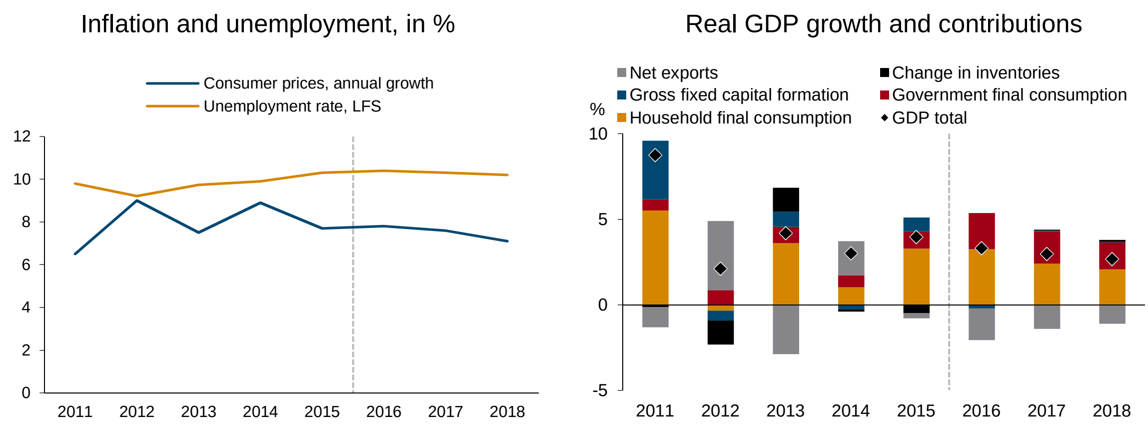
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

TURKEY: Inevitable economic slowdown in sight

SERKAN ÇIÇEK

Although economic growth was firm in the first half of 2016, driven by an increase in private consumption and government spending, expectations have somewhat waned recently owing to rising vulnerabilities. Despite the government's measures to boost private consumption, we expect a GDP growth rate of 3.3% for the current year, before it slows down to 3% and 2.7% for 2017 and 2018, respectively.

Figure 43 / Turkey: Main macroeconomic indicators



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

The Turkish economy has lost momentum this year in the face of a string of extreme political and economic shocks. On the night of 15 July 2016, a group of Turkish military officers allegedly connected to the exiled preacher Fethullah Gulen tried to stage a coup against the Turkish government and President Recep Tayyip Erdogan. Following the failure of the coup attempt, the government declared a state of emergency for three months, allowing it to bypass parliament while drafting new laws and to restrict or suspend the rights and freedoms of citizens. So far, tens of thousands of people who are allegedly connected with the Gulen movement have been dismissed or suspended from government jobs, including education, police, military and judiciary. The ownership of more than 200 leading companies allegedly financing the Gulen movement has been transferred to the Saving Deposit Insurance Fund (TMSF) as part of the investigation into the so-called Gulenist Terror Group (FETÖ). The main opposition Republican People's Party (CHP) leader has accused the government of opportunistically using the state of emergency to go after its opponents. Many opposition-minded people have been removed from their positions, including academics and teachers who signed a pro-peace declaration earlier this year or are members of left-wing unions. In addition, the licences of some opposition television channels and radio stations have been revoked by statutory decree.

There have also been significant developments in Turkish foreign policy. The Turkish government has been trying to mend its relations with Russia, which had worsened after the downing of a Russian war plane by the Turkish military in November 2015. Additionally, since the Ataturk airport attack at the end of June 2016, Turkey has hardened its position towards the Islamic State of Iraq and the Levant (ISIS). In late August 2016, Turkish forces entered Syria in order both to enable Syrian rebels to take control of important strongholds in the region, and to prevent Kurds from establishing control of the border area on the Syrian side.

The conflict between the Turkish army and the Kurdistan Workers' Party (PKK) has intensified since the ceasefire collapsed after the June 2015 parliamentary elections. Since then, tension in the region has remained high. It appears that the Turkish government is reluctant to re-start peace talks with PKK. The parliamentary immunity of some pro-Kurdish People's Democratic Party (HDP) deputies was removed in June 2016 and some were accused of helping terrorist organisations and detained. Since then a crisis of confidence has emerged between the two sides. It is not clear how the major problems will be solved and whether the Turkish government will be able to restore stability in its internal and external relations.

These crucial developments have increased economic as well as political uncertainties. Moody's downgraded Turkey's sovereign rating to junk status at the end of September 2016, citing worries about the rule of law after the 15 July failed coup attempt and the risks from a slowing economy. Standard and Poor's, which has long rated Turkey below investment grade, cut its rating further immediately following the attempted coup in July to 'BB'. Fitch, the third major ratings agency, maintained Turkey at 'BBB-', the lowest investment grade rating, after its most recent review in August. The broadly negative trend in the agencies' assessments of Turkey's creditworthiness is particularly important given the country's large external financing needs.

Despite these unfavourable developments, the Turkish economy grew by 3.9% year on year in the first half of 2016, although the rate of growth decelerated from 4.9% year on year in the first quarter to 3.1% in the second quarter. The relatively strong economic growth was mainly due to a rise in private consumption and government spending. Household final consumption rose by 6.1% year on year in the first half of 2016, thanks to a strong rise in hourly wages in real terms following a 30% hike in the minimum wage at the beginning of the year. The favourable employment trends helped household consumption growth to remain strong because of substantial wage hikes. Since the last quarter of 2014, the real growth rate of government spending has been increasing. It reached 16% year on year in the second quarter of this year, the fastest pace recorded in 26 quarters. Because of increasing private and public consumption, net exports again made a negative contribution to GDP growth year on year in the first half of 2016: export growth slowed to 1.3% year on year due to decelerating global demand, while import growth accelerated to 7.5% year on year.

For 2016 as a whole, we expect GDP growth of 3.3%, implying a slowdown in the second half because of increased political and economic uncertainties. Although the government has attempted to ease monetary policy by relaxing the consumer loan maturity, increasing the mortgage loan/property's value ratio and increasing instalments for credit card purchases among others in order to boost private consumption, we still expect a slowdown in household consumption expenditure growth due to weaker consumer confidence. On the government spending side, we expect a continuation of the current growth level for the rest of this year because of the higher military expenditures. Following the agreement between OPEC countries in September to limit oil production, we also expect a moderate rise in oil prices during the rest of the year which may hinder a contribution of net exports to growth in the remainder of 2016. Additionally, the potential for a slump in investment in the United States and global uncertainties over Brexit could also limit foreign demand in the remainder of the year. Thereafter, we forecast a deceleration of GDP growth to 3.0% and 2.7% in 2017 and 2018, respectively, mostly due to an expected slowdown in domestic demand.

One of the vulnerabilities of the Turkish economy can be observed via the development of gross fixed capital formation. For the first two quarters of 2016, it provided a negative contribution to GDP growth by -0.3pp year on year. Investment in machinery and equipment fell especially strongly (particularly in the private sector). Investment has fallen in seven of the past ten quarters, which may constrain future production potential. In construction, we project a 5.9% and 6.9% growth rate for the current year for the public and private sector, respectively. Since the economic and political outlook remains uncertain and is likely to remain so in the near future, we expect gross fixed capital formation to continue contributing negatively to GDP growth until the end of the current year. In 2017-2018, we expect strong government spending on construction and the private sector’s response to monetary loosening to offset the decline in machinery and equipment investment. Therefore we forecast a roughly zero contribution of gross fixed capital formation to growth in the next two years.

In the first two quarters of 2016, the central government budget balance and primary budget balance posted a surplus of TRY 1.1 billion (0.1% of GDP) and TRY 27.5 billion, respectively. The main drivers of the budget surplus were the fall in interest expenditures due to lower interest rates, continued strong tax revenue collection and increases in non-tax revenues for the first half of the year. Central government expenditure rose by 15.7% year on year in nominal terms in the first half of 2016, driven by transfers and government consumption. This was partly offset by an 8% decline in public investment expenditure over the same period. On the revenue side, central government budget revenue increased by 15.8% in nominal terms. This was largely driven by the inclusion of privatisation revenues (TRY 9.9 billion) into the budget in the first half of 2016, coupled with a substantial Central Bank profit transfer (TRY 9.3 billion). Therefore, we forecast a budget surplus of 0.7% of GDP in 2016. We expect it to return to deficits of -1.2% in 2017 and -1.5% in 2018, close to the average level of the budget deficit in the last five years.

Despite a relatively stable exchange rate of the Turkish lira against both the US dollar and the euro, and limited increases in the price of unprocessed food, the inflation rate only fell to 8% year on year in August 2016. This was due to a rise in import prices, especially oil. Regarding some negative expectations including a rise in oil prices, volatile prices of unprocessed foods, strong domestic demand and a rise in the policy rate of the Fed, we forecast average inflation rates of 7.8% in 2016, 7.6% in 2017 and 7.1% in 2018.

Following the appointment of a new governor in mid-April 2016, the Central Bank of the Republic of Turkey (CBRT) cut its upper bound interest rate by a cumulative 225 basis points between April and September 2016 (it had previously left interest rates unchanged since the beginning of 2015). This behaviour implies that the CBRT has been loosening its policy stance. Since the band between the upper bound and the policy rate already narrowed and, more importantly, the monetary policy-makers in the United States are leaning towards a rate hike after the US presidential elections, we do not forecast any further cuts in policy rates in 2016 and 2017 unless inflation rises. We expect the policy rate to be cut to 7% in 2018 as the inflation rate falls.

In 2014 and 2015, the Turkish lira weakened considerably, especially against the US dollar. In early 2016 the exchange rate stabilised, thanks in part to the narrowing of the current account deficit. However, for the remainder of 2016 and into 2017-2018, we forecast a gradual depreciation of the lira, owing to expected monetary tightening in the US, the possibility of further negative action by credit rating agencies, and the expected rise in the price of oil. The materialisation of one or more of these factors could prompt foreign capital to flow out of the country.

Although Russia used to be one of Turkey's largest trading partners, its share in total exports decreased to 1% in the first three quarters of 2016 (from 3.8% and 2.5% in 2014 and 2015, respectively). However, the relationship between Russia and Turkey appears to have been improving since the summer of 2016, and we expect Turkey's exports of goods (food) and services (tourism, construction) to Russia to rise during the rest of 2016. The recovery in Europe and steady depreciation of the value of the domestic currency might also help Turkey's exports to remain stable or to rise moderately. On the import side, the expected slight but steady rise in oil prices may lead to higher import payments in 2017-2018. On the other hand, import growth for the rest of the year and in the following years will be restricted by the expected steady depreciation in the value of the Turkish lira.

In summary, risks to Turkish growth are increasing, owing to deterioration in economic sentiment and the weakening of the institutional environment in the aftermath of the failed coup attempt. Therefore, we expect a slowdown in the growth rate of GDP for the rest of the year, taking full-year growth to 3.3%. We expect GDP growth to decelerate to 3% and 2.7% in 2017 and 2018, respectively, due to the expected slowdown in domestic demand as well as ongoing weak foreign demand.

Table 26 / Turkey: Selected economic indicators

	2012	2013	2014	2015 [1]	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., average	75,176	76,148	77,182	78,218	.	.	79,000	79,800	80,500
Gross domestic product, TRY bn, nom. [2]	1,417	1,567	1,748	1,953	926	1,024	2,200	2,400	2,600
annual change in % (real)	2.1	4.2	3.0	4.0	3.1	3.9	3.3	3.0	2.7
GDP/capita (EUR at exchange rate) [2]	8,100	8,100	7,800	8,300	.	.	8,400	8,700	9,000
GDP/capita (EUR at PPP) [2]	13,900	14,100	14,500	15,000	.	.	.	.	.
Consumption of households, TRY bn, nom. [2]	994	1,110	1,204	1,349	645	719	.	.	.
annual change in % (real)	-0.5	5.1	1.4	4.8	4.9	6.1	4.7	3.5	3.0
Gross fixed capital form., TRY bn, nom. [2]	287	319	352	399	202	223	.	.	.
annual change in % (real)	-2.7	4.4	-1.3	4.0	5.5	-0.3	-1.0	0.2	0.2
Gross industrial production									
annual change in % (real)	2.5	3.0	3.6	3.2	2.4	4.2	2.1	2.2	2.5
Gross agricultural production [3]									
annual change in % (real)	5.5	2.8	2.0	2.0	.	.	.	.	.
Construction industry									
annual change in % (real)	0.8	7.7	3.0	1.7	-0.1	6.4	.	.	.
Employed persons, LFS, th, average	24,820	25,520	25,931	26,619	26,324	27,162	27,300	27,800	28,400
annual change in %	3.0	2.8	1.6	2.7	2.2	3.2	2.4	2.0	2.0
Unemployed persons, LFS, th, average	2,517	2,750	2,854	3,050	2,999	3,048	3,170	3,190	3,230
Unemployment rate, LFS, in %, average	9.2	9.7	9.9	10.3	10.3	10.2	10.4	10.3	10.2
Reg. unemployment rate, in %, end of period	.	.	.	.	.	.	.	.	.
Average monthly gross wages, TRY	.	.	.	.	.	.	.	.	.
annual change in % (real, gross)	.	.	.	.	.	.	.	.	.
Consumer prices (HICP), % p.a.	9.0	7.5	8.9	7.7	7.7	7.6	7.8	7.6	7.1
Producer prices in industry, % p.a. [4]	6.1	5.7	10.1	5.3	4.6	4.0	3.7	4.0	4.0
General governm. budget, nat.def., % of GDP									
Revenues	35.7	37.8	37.3	36.9	.	.	39.8	37.8	37.5
Expenditures	37.7	39.2	38.2	38.5	.	.	39.1	39.0	39.0
Deficit (-) / surplus (+)	-2.0	-1.5	-0.9	-1.6	.	.	0.7	-1.2	-1.5
Public debt, nat.def., % of GDP [5]	36.2	36.1	33.5	32.9	.	.	36.0	35.0	35.0
Central bank policy rate, % p.a., end of period [6]	5.50	4.50	8.25	7.50	7.50	7.50	7.50	7.50	7.00
Current account, EUR mn	-37,208	-47,966	-32,951	-29,044	-19,630	-17,065	-37,000	-35,000	-36,000
Current account, % of GDP	-6.1	-7.8	-5.5	-4.5	-6.1	-5.4	-5.5	-5.0	-5.0
Exports of goods, BOP, EUR mn	126,137	121,819	127,237	136,978	69,331	67,558	134,000	141,000	148,000
annual change in %	23.2	-3.4	4.4	7.7	11.1	-2.6	-2.0	5.0	5.0
Imports of goods, BOP, EUR mn	177,043	182,057	175,312	180,381	92,144	85,742	171,000	176,000	183,000
annual change in %	6.5	2.8	-3.7	2.9	9.9	-6.9	-5.0	3.0	4.0
Exports of services, BOP, EUR mn	34,078	36,306	39,105	42,089	17,889	14,560	36,000	40,000	42,000
annual change in %	15.3	6.5	7.7	7.6	10.8	-18.6	-15.0	12.0	5.0
Imports of services, BOP, EUR mn	16,347	18,457	18,915	20,341	10,171	10,218	20,000	22,000	23,000
annual change in %	7.6	12.9	2.5	7.5	13.6	0.5	-0.5	10.0	4.0
FDI liabilities (inflow), EUR mn	10,305	9,297	9,447	15,238	6,368	3,683	4,500	.	.
FDI assets (outflow), EUR mn	3,167	2,716	5,377	4,593	1,721	1,409	2,000	.	.
Gross reserves of NB excl. gold, EUR mn	75,749	80,435	88,058	85,355	90,050	91,591	.	.	.
Gross external debt, EUR mn [7]	257,444	282,856	331,346	365,289	362,188	379,602	383,300	403,500	426,100
Gross external debt, % of GDP [7]	42.0	45.7	55.1	56.6	56.1	56.9	57.5	58.0	59.0
Average exchange rate TRY/EUR	2.31	2.53	2.91	3.03	2.86	3.26	3.30	3.45	3.60
Purchasing power parity TRY/EUR	1.36	1.46	1.56	1.66	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (FISIM not yet reallocated to industries). - 3) Based on UN-FAO data, from 2014 wiiw estimate. - 4) Domestic output prices. - 5) Defined according to EU standards. - 6) One-week repo rate. - 7) BOP 5th Edition.

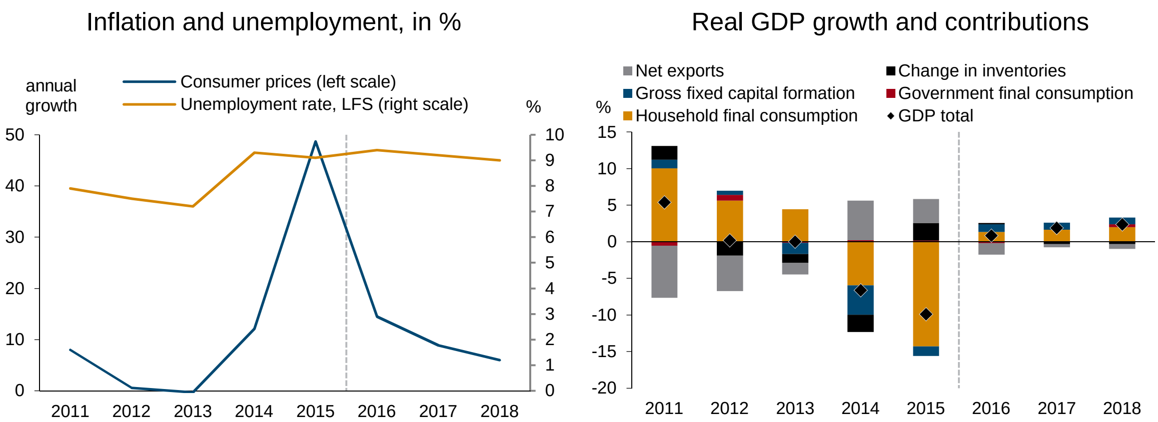
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

UKRAINE: Still addicted to IMF injections

VASILY ASTROV

Ukraine's economy continues to recover, driven by marked growth in both investments and, to a lesser extent, private consumption. Two other factors, rapid disinflation on the back of exchange rate stabilisation and an easing of fiscal policy, have also proven growth-supportive. Nonetheless, ongoing cooperation with the IMF is still crucially important for maintaining short-term stability. Barring adverse shocks, GDP is expected to pick up by 0.8% in the course of the current year, followed by gradual acceleration to around 2% per annum in 2017-2018.

Figure 44 / Ukraine: Main macroeconomic indicators



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

Recent data present evidence of Ukraine's economy continuing to recover from the multiple shocks of territorial break-up, ongoing war in Donbas, disruptions in trade with Russia, plummeting exchange rate and extreme fiscal austerity – all experienced over the past two years. After the rather disappointing first quarter, in the second quarter 2016 real GDP picked up by 1.4% on an annual basis and by 0.6% on a quarterly (seasonally-adjusted) basis, bringing GDP growth to 0.7% in the first half of the year.

The growth acceleration in the second quarter of 2016 was entirely driven by domestic demand; the contribution of net exports switched to negative. Particularly gross fixed capital formation was booming (+17.6% year on year), mirrored in construction value-added soaring by 14.9%. The observed revival of investments may not come as a big surprise, with businesses making up for years of under-investment in response to relative economic stabilisation. It has been generally broad-based, but with investments in agriculture recording particularly high growth rates (+72%), potentially suggesting a further reorientation of the economy from metals and chemicals towards agriculture. Investments are predominantly financed from enterprises' own funds, while the role of bank credits, investments from the budget and foreign direct investors is rather marginal. The bulk of statistically recorded – rather meagre – FDI inflows into Ukraine in reality represent recapitalisation of foreign-owned banks by parent structures.

The dynamics of household consumption, which was still negative in the first quarter 2016, turned positive in the second quarter (+4.3% year on year), helped by rapid disinflation and rising real wages. However, the pick-up in private consumption in the first half of 2016 by 1% appears to be surprisingly anaemic, given the solid growth in real net wages: by 6.1% over the same time period. This implies that the household saving rate must have been rather high – partly reflecting the need to service debts. Indeed, household deposits went up by 4% in the first eight months of 2016 (in nominal hryvnia terms), while the volume of outstanding credits to households contracted by 10%, to levels last observed in 2008.

One factor which has been supportive of the turnaround in private consumption has been a marked relaxation of fiscal policy. Following pronounced fiscal adjustments of 2.5 pp and 4.3 pp of GDP in 2014 and 2015 respectively, a fiscal expansion of 3.5 pp is projected for this year.[46] Unlike over the past two years, salaries in the public sector and pensions are now being indexed largely in line with inflation. Besides, the drastic cut in the single social contribution paid by employers (from an average rate of 41% to a flat rate of 22%) implemented at the start of 2016 effectively proved fiscally expansionary as well. As predicted by most experts (including wiiw), the readiness to declare 'shadow' wages in response to the lower rate proved to be rather inelastic, resulting in a shortfall of revenues and a soaring deficit of the Pension Fund. The latter is expected to reach 6.4% of GDP this year and will be covered from the budget. Other factors behind the widespread tax evasion – above all the reluctance to be exposed to the corrupt and arbitrary state apparatus – continue to prove more serious obstacles to the 'de-shadowing' of the economy than the (high) statutory tax rate *per se*. Instead, there is anecdotal evidence that funds saved by businesses thanks to the lower social contribution rate have been partly channelled to pay higher *official* wages, which may help explain the overall vigorous wage dynamics since the start of the year.

Foreign trade developments continue to disappoint. In the first eight months of 2016, goods exports declined by 10% in US dollar terms – more than imports (-4%), primarily on account of the 32% export decline to Russia, although exports to other markets except the EU suffered as well. The main reason for the drop was the erection of new barriers in trade with Russia: in response to Ukraine implementing the Deep and Comprehensive Free Trade Area (DCFTA) with the EU starting from January 2016, Russia unilaterally revoked the existing free trade agreement with Ukraine,[47] imposed an import embargo on Ukrainian food, and hampered the transit of Ukrainian goods to the Central Asian countries. These transit restrictions were further tightened as of July 2016. All in all, since 2014 the bulk of Ukraine's trade with Russia – which used to be its principal single export destination – has already been lost, with little prospects for recovery given the ongoing geopolitical conflict over Crimea and Donbas. At

[46] The fiscal adjustment is defined as a change in the cyclically-adjusted primary budget balance calculated by Bohdan et al., 'Assessment of fiscal policy of Ukraine', wiiw study (forthcoming).

[47] This move was not supported by other countries of the Eurasian Economic Union (Belarus, Kazakhstan, Armenia and Kyrgyzstan).

the same time, exports to the EU picked up by only 3.5% in the first eight months of 2016 (in US dollar terms). Ukrainian producers still cannot take full advantage of the free access to EU markets because of the existing gap in standards, EU tariff quotas for a number of agricultural products, and the generally low competitiveness of Ukrainian products, especially in quality terms.

Despite the ongoing economic recovery, the recent months have also demonstrated the fragility of macroeconomic stability in Ukraine and the crucial role of continued IMF support. Between September 2015 and September 2016, the latter was effectively frozen – first because of the protracted political instability and later because of the government's allegedly insufficient reform effort. As public belief in a resumption of the IMF programme (and related support from other multilateral and bilateral sources) started to wane at the end of August and was compounded by the escalation of fighting in Donbas, the hryvnia came under pressure – despite interventions by the National Bank and the fact that many of the capital controls introduced in spring 2015 were still in place. It only recovered part of the losses once the IMF disbursed USD 1 billion on 14 September 2016 and hinted that another tranche of potentially USD 1.3 billion may be coming before the end of the year.

Continuing cooperation with the IMF represents an obvious dilemma for the Ukrainian authorities. On the one hand, it provides an important anchor for short-term macroeconomic stability – particularly when it comes to the stability of the exchange rate and prices. On the other hand, there is a growing recognition that yielding to some of the IMF demands may undermine the welfare state (or whatever is left of it in present-day Ukraine), social stability, and ultimately long-term growth prospects. The IMF conditionalities attached to the upcoming tranche reportedly include a comprehensive pension reform (including an increase in the retirement age and the introduction of a funded pension system along with the current pay-as-you-go system) and a possibility of further hikes in retail gas tariffs for households by linking them to price movements in Europe (despite the fact that the bulk of natural gas consumed by Ukrainian households is now produced domestically).

Going forward, the current economic recovery is likely to gain momentum. In the baseline scenario, the economy should pick up by at least 0.8% this year, followed by a projected 1.9% and 2.4% in 2017 and 2018, respectively, driven primarily by an ongoing recovery of domestic demand. This recovery will be accompanied by receding unemployment, further disinflation, and external deficits remaining rather moderate.

However, sizeable downside risks remain, such as a possible resumption of a large-scale war in Donbas and an abortion of the IMF programme which would undermine short-term macroeconomic stability. The latter risk is all the more real since fiscal policy is likely to remain reasonably lax, which may become a problem for the IMF. The current relative political stability may not last very long either given the plummeting rating of President Poroshenko. Although Mr. Poroshenko has been generally successful in securing enough support from the parliament, he has been unable to ensure the adoption of the controversial bill on decentralisation and a special status to the separatist-held areas of Donbas – a key milestone envisaged in the Minsk-II ceasefire agreement. It still remains unclear how the conflict in Donbas can be effectively resolved, given that the Minsk-II agreement is very vague on political issues and open to contrasting interpretations by the two sides.

Table 27 / Ukraine: Selected economic indicators

	2012	2013	2014	2015 1)	2015 January-June	2016 January-June	2016 Forecast	2017 Forecast	2018 Forecast
Population, th pers., average	45,593	45,490	43,001	42,845	42,876	42,709	42,680	42,550	42,450
Gross domestic product, UAH bn, nom.	1,459	1,523	1,587	1,979	831	985	2,300	2,600	2,800
annual change in % (real)	0.2	0.0	-6.6	-9.9	-15.8	0.7	0.8	1.9	2.4
GDP/capita (EUR at exchange rate)	3,100	3,200	2,300	1,900	.	.	2,000	2,000	2,100
GDP/capita (EUR at PPP)	6,600	6,600	6,400	6,000	.	.	.	.	.
Consumption of households, UAH bn, nom.	1,002	1,099	1,121	1,326	582	699	.	.	.
annual change in % (real)	8.4	6.5	-8.3	-20.2	-24.5	1.0	2.0	2.5	3.0
Gross fixed capital form., UAH bn, nom.	283	264	224	263	101	130	.	.	.
annual change in % (real)	3.3	-8.0	-24.0	-9.3	-18.1	11.5	8.0	7.0	7.0
Gross industrial production									
annual change in % (real)	-0.5	-4.3	-10.1	-13.0	-20.0	2.0	2.0	4.0	4.0
Gross agricultural production									
annual change in % (real)	-4.5	13.3	2.2	-4.8	-9.7	-0.3	.	.	.
Construction output									
annual change in % (real)	-8.3	-14.5	-20.4	-12.3	-26.2	9.1	.	.	.
Employed persons, LFS, th, average	20,354	20,404	18,073	16,443	16,408	16,239	16,250	16,250	16,350
annual change in %	0.1	0.2	-6.4	-0.4	-3.0	-1.0	-1.2	0.0	0.6
Unemployed persons, LFS, th, average	1,657	1,577	1,848	1,655	1,667	1,692	1,700	1,600	1,600
Unemployment rate, LFS, in %, average	7.5	7.2	9.3	9.1	9.2	9.5	9.4	9.2	9.0
Reg. unemployment rate, in %, end of period 2)	1.8	1.8	1.7	1.6	1.7	1.5	.	.	.
Average monthly gross wages, UAH 3)	3,026	3,265	3,480	4,195	3,882	4,847	5,100	5,800	6,400
annual change in % (real, gross)	14.3	8.2	-5.4	-18.9	-22.1	5.7	6.0	5.0	4.0
annual change in % (real, net)	14.4	8.2	-6.5	-20.2	-23.9	6.1	6.0	5.0	4.0
Consumer prices, % p.a.	0.6	-0.3	12.1	48.7	48.1	18.1	14.5	8.9	6.0
Producer prices in industry, % p.a. 4)	3.7	-0.1	17.1	36.0	42.5	15.2	15.5	7.0	6.0
General governm.budget, nat.def., % of GDP						.			
Revenues	30.5	29.1	28.7	32.9	36.0	34.5	32.5	33.9	33.0
Expenditures	34.0	33.3	33.3	34.5	34.5	35.6	36.9	36.9	35.5
Deficit (-) / surplus (+) 5)	-3.5	-4.2	-4.5	-1.6	1.5	-1.1	-4.4	-3.0	-2.5
Public debt, nat.def., % of GDP	35.3	38.4	69.4	79.4	72.7	72.5	79.0	88.0	91.0
Central bank policy rate, % p.a., end of period 6)	7.50	6.50	14.00	22.00	30.00	16.50	14.5	10.0	8.0
Current account, EUR mn 7)	-11,153	-12,441	-3,476	-170	-87	-544	-1,400	-1,400	-1,900
Current account, % of GDP 7)	-7.9	-8.7	-3.4	-0.2	-0.2	-1.6	-1.8	-1.7	-2.2
Exports of goods, BOP, EUR mn 7)	50,127	44,518	38,235	31,935	15,503	13,648	28,300	28,900	30,100
annual change in %	11.9	-11.2	-14.1	-16.5	-20.3	-12.0	-11.5	2.0	4.0
Imports of goods, BOP, EUR mn 7)	67,124	61,185	43,626	35,050	16,975	15,682	32,900	33,600	35,300
annual change in %	16.2	-8.8	-28.7	-19.7	-22.5	-7.6	-6.0	2.0	5.0
Exports of services, BOP, EUR mn 7)	17,186	17,032	11,257	11,218	5,457	5,174	10,800	11,300	11,900
annual change in %	12.5	-0.9	-33.9	-0.4	-3.4	-5.2	-4.0	5.0	5.0
Imports of services, BOP, EUR mn 7)	11,351	12,141	9,350	9,639	4,541	4,675	9,700	10,200	10,700
annual change in %	18.1	7.0	-23.0	3.1	-2.2	3.0	1.0	5.0	5.0
FDI liabilities (inflow), EUR mn 7)	6,360	3,396	641	2,750	1,247	1,915	3,500	.	.
FDI assets (outflow), EUR mn 7)	762	324	414	34	79	11	100	.	.
Gross reserves of NB excl. gold, EUR mn	17,186	13,592	5,429	11,320	8,353	11,645	.	.	.
Gross external debt, EUR mn 7)	102,120	102,852	103,557	108,666	111,643	103,666	107,000	110,000	114,000
Gross external debt, % of GDP 7)	71.9	71.7	102.6	133.0	136.7	130.7	134.9	135.4	134.4
Average exchange rate UAH/EUR	10.271	10.612	15.716	24.229	23.881	28.427	29.0	32.0	33.0
Purchasing power parity UAH/EUR 8)	4.814	5.069	5.741	7.681	.	.	.	.	.

Note: From 2014 excluding the occupied territories of Crimea and Sevastopol. From 2015 excluding parts of the anti-terrorist operation zone for some indicators.

1) Preliminary. - 2) In % of working age population. - 3) Enterprises with 10 and more employees. - 4) Domestic output prices. From 2013 according to NACE Rev. 2. - 5) Without transfers to Naftohaz and other bail-out costs, in 2014 including VAT refund via issued government bonds. - 6) Discount rate of NB. - 7) Converted from USD. - 8) wiiw estimates based on the 2011 International Comparison Project benchmark.

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

Appendix

Table 28 / European Union-Central and Eastern Europe (EU-CEE): an overview of economic fundamentals, 2015

	Bulgaria	Croatia	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	EU-CEE [1]	EU-28 [2]
GDP in EUR at exchange rates, EUR bn	45.3	43.9	167.0	20.3	109.7	24.3	37.3	427.7	160.4	78.1	38.6	1,152	14,699
GDP in EUR at PPP, EUR bn	98.2	70.4	263.4	27.8	193.6	36.6	61.7	756.9	323.5	119.4	49.0	2,000	14,699
GDP in EUR at PPP, EU-28=100	0.7	0.5	1.8	0.2	1.3	0.2	0.4	5.1	2.2	0.8	0.3	13.6	100.0
GDP in EUR at PPP, per capita	13,600	16,700	25,000	21,200	19,700	18,500	21,300	19,700	16,300	22,000	23,700	19,300	28,800
GDP in EUR at PPP per capita, EU-28=100	47	58	87	74	68	64	74	68	57	76	82	67	100
GDP at constant prices, 1990=100	146.1	106.8	153.8	153.0	137.6	120.0	133.8	216.5 [3]	152.3	186.0	159.0	177.8	152.8
GDP at constant prices, 2007=100	111.7	90.8	108.1	97.9	104.1	94.7	106.7	128.4	112.5	118.0	98.5	115.0	103.9
Industrial production real, 2007=100 [4]	92.6	86.2	106.1	114.2	110.3	107.0	114.9	131.5	132.4	143.5	97.2	121.1	95.8
Population, thousands, average	7,178	4,208	10,546	1,315	9,843	1,978	2,905	38,458	19,815	5,424	2,064	103,733	509,608
Employed persons, LFS, thousands, average	3,032	1,589	5,042	641	4,211	896	1,335	16,084	8,535	2,424	917	44,706	220,845
Unemployment rate, LFS, in %	9.2	16.3	5.1	6.2	6.8	9.9	9.1	7.5	6.8	11.5	9.0	7.8	9.4
General gov. revenues, EU-def., in % of GDP	37.2	43.7	41.4	40.4	48.3	36.0	34.8	38.9	34.8	42.7	45.1	40.0	45.1
General gov. expenditures, EU-def., in % of GDP	39.2	46.9	41.8	39.9	50.3	37.2	35.0	41.5	35.5	45.6	48.0	41.8	47.4
General gov. balance, EU-def., in % of GDP	-2.0	-3.2	-0.4	0.5	-2.0	-1.3	-0.2	-2.6	-0.7	-3.0	-2.9	-1.8	-2.4
Public debt, EU def., in % of GDP	26.0	86.7	40.3	9.8	74.7	36.4	42.5	51.3	38.4	52.9	83.1	50.3	85.2
Price level, EU-27=100 (PPP/exch. rate)	46	62	63	73	57	67	60	57	50	65	79	58	100
Compensation per employee, monthly, in EUR [5]	616	1,291	1,255	1,433	959	1,163	1,108	1,039	696	1,296	2,085	1,024	2,985
Compensation per employee, monthly, EU-28=100	20.6	43.3	42.0	48.0	32.1	39.0	37.1	34.8	23.3	43.4	69.9	34.3	100.0
Exports of goods in % of GDP	48.4	24.4	70.8	53.6	72.6	42.4	59.8	40.2	30.6	84.4	62.3	50.8 [6]	31.5 [6]
Imports of goods in % of GDP	54.2	39.5	66.2	57.8	68.6	50.8	65.1	39.7	35.5	82.1	58.4	51.1 [6]	29.6 [6]
Exports of services in % of GDP	15.6	25.6	12.3	25.7	18.2	16.6	16.1	9.5	10.4	9.3	15.6	12.5 [6]	12.3 [6]
Imports of services in % of GDP	8.8	7.6	10.6	17.3	13.3	9.3	11.4	7.0	6.1	9.2	10.4	8.7 [6]	10.7 [6]
Current account in % of GDP	0.4	5.1	0.9	2.2	3.4	-0.8	-2.3	-0.6	-1.2	-1.3	5.2	0.3 [6]	2.0 [6]
FDI stock per capita in EUR, 2015 [7]	5,259	5,781	9,840	13,270	7,799	6,880	4,673	4,350	3,213	8,153	5,602	5,535	11,441

Note: EU-CEE: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia. PPP: Purchasing power parity.

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) 1989=100, which in the Polish case is the appropriate reference year. - 4) EU-28 working-day adjusted. - 5) Gross wages plus indirect labour costs, according to national account concept. - 6) Data for EU-CEE and EU-28 include transactions within the region (sum over individual countries). - 7) Excluding SPE, data for EU-28 refer to 2014.

Source: wiiw Annual Database, Eurostat, AMECO.

Table 29 / Western Balkans, Turkey, selected CIS countries and Ukraine: an overview of economic fundamentals, 2015

	Albania	Bosnia - Herze-govina	Kosovo	Mace-donia	Monte-negro	Serbia	Turkey	Belarus	Kazakh-stan	Russia 1)	Ukraine 2)	*EU-CEE 3)*	*EU-28 4)*
GDP in EUR at exchange rates, EUR bn	10.3	14.7	5.8	9.1	3.6	33.5	645.4	48.8	166.3	1,192.5	81.7	*1,152*	*14,699*
GDP in EUR at PPP, EUR bn	24.8	31.0	13.6	22.0	7.4	74.2	1,175.6	128.4	332.6	2,728.0	257.7	*2,000*	*14,699*
GDP in EUR at PPP, EU-28=100	0.2	0.2	0.1	0.1	0.05	0.5	8.0	0.9	2.3	18.6	1.8	*13.6*	*100.0*
GDP in EUR at PPP, per capita	8,600	8,100	7,600	10,600	11,900	10,500	15,000	13,500	19,000	18,600	6,000	*19,300*	*28,800*
GDP in EUR at PPP per capita, EU-28=100	30	28	26	37	41	36	52	47	66	65	21	*67*	*100*
GDP at constant prices, 1990=100	216.9	.	.	137.8	.	.	259.8	191.3	193.3	114.1	58.4	*177.8*	*152.8*
GDP at constant prices, 2007=100	126.7	110.1	134.1	122.5	113.1	104.6	129.6	126.0	141.1	107.4	80.3	*115.0*	*103.9*
Industrial production real, 2007=100 5)	290.7	115.0	196.5	107.7	68.9	95.9	125.7	126.0	122.1	104.8	66.2	*121.1*	*95.8*
Population, thousands, average	2,889	3,819	1,788	2,070	622	7,095	78,218	9,490	17,544	146,406	42,845	*103,733*	*509,608*
Employed persons, LFS, thousands, average	1,087	822	297	706	222	2,574	26,619	4,494	8,624	72,324	16,443	*44,706*	*220,845*
Unemployment rate, LFS, in %	17.1	27.7	32.9	26.1	17.6	17.7	10.3	1.0 6)	5.0	5.6	9.1	*7.8*	*9.4*
General gov. revenues, nat. def., in % of GDP	26.5	43.2	29.6	31.0	36.6	41.9	36.9	42.7	18.7	33.3	32.9	*40.0 7)*	*45.1 7)*
General gov. expenditures, nat. def., in % of GDP	30.5	42.6	27.9	34.4	44.5	45.6	38.5	41.2	20.9	36.8	34.5	*41.8 7)*	*47.4 7)*
General gov. balance, nat. def., in % of GDP	-4.0	0.7	1.6	-3.4	-7.9	-3.7	-1.6	1.4	-2.2	-3.5	-1.6	*-1.8 7)*	*-2.4 7)*
Public debt, nat. def., in % of GDP	72.7	45.0	13.0	46.6	62.8	74.6	32.9	40.0	22.7	10.6	79.4	*50.3 7)*	*85.2 7)*
Price level, EU-28=100 (PPP/exch. rate)	41	47	42	41	49	45	55	38	50	44	32	*58*	*100*
Average gross monthly wages, EUR at exchange rate	272	659	446 8)	522	725	506	675 9)	377	513	502	173	*1,024 9)*	*2,985 9)*
Average gross monthly wages, EU-28=100	9.1	22.1	14.9	17.5	24.3	17.0	22.6 9)	12.6	17.2	16.8	5.8	*34.3 9)*	*100.0 9)*
Exports of goods in % of GDP	7.5	24.3	5.6	33.6	9.0	33.9	21.2	48.9	25.2	25.8	39.1	*50.8 10)*	*31.5 10)*
Imports of goods in % of GDP	29.9	50.2	42.1	53.7	49.3	45.8	27.9	52.9	18.4	14.6	42.9	*51.1 10)*	*29.6 10)*
Exports of services in % of GDP	19.7	10.1	13.8	15.1	33.5	12.8	6.5	12.4	3.5	3.9	13.7	*12.5 10)*	*12.3 10)*
Imports of services in % of GDP	14.6	2.9	7.7	11.3	11.7	10.6	3.2	8.2	6.3	6.7	11.8	*8.7 10)*	*10.7 10)*
Current account in % of GDP	-10.8	-5.7	-9.1	-1.4	-13.3	-4.7	-4.5	-3.8	-3.0	5.2	-0.2	*0.3 10)*	*2.0 10)*
FDI stock per capita in EUR, 2015 11)	1,663	1,634	1,837	2,027	6,750	3,742	1,728	1,731	6,218	1,605	1,323	*5,535*	*11,441*

Note: EU-CEE: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia. PPP: Purchasing power parity, wiiw estimates for Belarus, Kazakhstan, Russia and Ukraine; IMF for Kosovo.

1) Including Crimean Federal District. - 2) Exluding the occupied territories of Crimea and Sevastopol and parts of Donbas. - 3) wiiw estimates. - 4) wiiw estimates and Eurostat. - 5) EU-28 working-day adjusted. - 6) Unemployment rate by registration. - 7) EU definition: expenditures and revenues according to ESA 2010, excessive deficit procedure. - 8) Average net monthly wages in state administration. - 9) Gross wages plus indirect labour costs, according to national account concept. - 10) Data for EU-CEE and EU-28 include transactions within the region. - 11) Excluding SPE, data for EU-28 refer to year 2014.

Source: wiiw Annual Database, Eurostat, AMECO.

Table 30 / GDP per capita at current PPPs (EUR), from 2016 at constant PPPs and population

	1991	1995	2000	2005	2010	2012	2013	2014	2015	2016	2017	2018
											Forecast	
Bulgaria	4,400	5,100	5,500	8,500	11,700	12,200	12,300	12,800	13,700	14,100	14,500	14,900
Croatia	6,700	6,900	9,500	13,400	14,900	15,900	15,800	16,100	16,700	17,100	17,600	18,100
Czech Republic	8,800	11,500	14,100	18,600	20,600	21,800	22,300	23,500	25,000	25,600	26,200	26,900
Estonia	5,500	5,300	8,600	13,900	16,100	19,500	19,900	20,700	21,100	21,400	21,900	22,400
Hungary	6,800	7,600	10,500	14,500	16,500	17,200	17,800	18,800	19,700	20,100	20,600	21,200
Latvia	6,400	5,000	7,100	11,800	13,300	16,000	16,700	17,500	18,500	18,900	19,400	20,000
Lithuania	7,100	5,200	7,600	12,300	15,300	18,500	19,600	20,700	21,300	21,800	22,400	23,100
Poland	4,500	6,300	9,200	11,600	15,900	17,600	17,900	18,600	19,700	20,300	21,000	21,700
Romania	4,000	4,800	5,000	8,000	12,600	14,300	14,400	15,200	16,300	17,100	17,700	18,400
Slovakia	5,800	7,100	9,700	13,800	18,700	19,700	20,200	21,100	22,000	22,700	23,400	24,200
Slovenia	8,500	11,100	15,500	20,000	21,100	21,500	21,500	22,600	23,700	24,300	24,900	25,600
EU-CEE	5,400	6,600	8,700	12,000	15,600	17,100	17,400	18,200	19,300	19,900	20,500	21,200
Albania	1,400	2,000	3,400	5,100	7,100	7,800	7,700	8,300	8,600	8,900	9,200	9,500
Bosnia & Herzeg.	.	.	3,900	5,400	6,800	7,300	7,400	7,700	8,100	8,400	8,700	9,000
Kosovo	.	.	.	5,200	5,900	6,500	6,700	7,000	7,600	7,800	8,000	8,300
Macedonia	4,300	4,000	5,400	6,900	8,900	9,000	9,500	10,100	10,600	10,900	11,200	11,600
Montenegro	.	.	5,700	7,000	10,200	10,400	10,800	11,200	11,900	12,200	12,600	13,000
Serbia	.	3,100	5,000	7,400	9,000	9,800	10,100	10,200	10,500	10,700	11,000	11,300
Turkey	3,700	4,300	7,800	9,600	12,200	13,900	14,100	14,500	15,000	15,500	16,000	16,400
Belarus	3,800	3,200	5,000	8,100	11,700	13,100	13,300	13,700	13,500	13,100	13,000	13,200
Kazakhstan	4,900	3,800	3,700	7,300	13,600	16,900	17,500	18,400	19,000	19,100	19,500	20,100
Russia	6,700	4,700	5,900	9,900	15,600	19,100	17,800	18,700	18,600	18,500	18,600	18,900
Ukraine	3,500	2,400	3,100	4,800	5,600	6,600	6,600	6,400	6,000	6,000	6,100	6,200
Austria	18,900	19,900	25,700	29,000	32,000	34,700	35,000	35,600	36,600	37,100	37,700	38,500
Germany	18,800	19,400	23,400	27,300	30,800	33,000	33,300	34,600	36,000	36,600	37,200	37,900
Greece	12,800	12,900	16,800	21,300	22,100	19,600	19,700	19,900	20,300	20,200	20,700	21,100
Ireland	12,800	15,500	25,700	33,900	33,200	35,000	35,300	37,600	49,600	52,000	53,900	55,000
Italy	17,500	18,400	23,100	24,700	26,200	26,800	26,200	26,500	27,500	27,800	28,200	28,800
Portugal	10,800	11,400	15,500	18,500	20,500	20,500	20,600	21,400	22,300	22,600	23,000	23,500
Spain	13,200	13,600	18,900	23,300	24,700	24,300	24,100	24,900	26,200	26,900	27,600	28,200
United States	20,800	24,100	31,600	37,000	36,800	38,900	39,100	40,700	41,700	42,700	43,600	44,500
EU-28 average	14,100	15,200	19,800	23,400	25,400	26,600	26,700	27,500	28,800	29,300	29,900	30,500

European Union (28) average = 100

	1991	1995	2000	2005	2010	2012	2013	2014	2015	2016	2017	2018
Bulgaria	31	34	28	36	46	46	46	47	48	48	48	49
Croatia	48	45	48	57	59	60	59	59	58	58	59	59
Czech Republic	62	76	71	79	81	82	84	85	87	87	88	88
Estonia	39	35	43	59	63	73	75	75	73	73	73	73
Hungary	48	50	53	62	65	65	67	68	68	69	69	70
Latvia	45	33	36	50	52	60	63	64	64	65	65	66
Lithuania	50	34	38	53	60	70	73	75	74	74	75	76
Poland	32	41	46	50	63	66	67	68	68	69	70	71
Romania	28	32	25	34	50	54	54	55	57	58	59	60
Slovakia	41	47	49	59	74	74	76	77	76	77	78	79
Slovenia	60	73	78	85	83	81	81	82	82	83	83	84
EU-CEE	38	43	44	51	61	64	65	66	67	68	69	70
Albania	10	13	17	22	28	29	29	30	30	30	31	31
Bosnia & Herzeg.	.	.	20	23	27	27	28	28	28	29	29	30
Kosovo	.	.	.	22	23	24	25	25	26	27	27	27
Macedonia	30	26	27	29	35	34	36	37	37	37	37	38
Montenegro	.	.	29	30	40	39	40	41	41	42	42	43
Serbia	.	.	25	32	35	37	38	37	36	37	37	37
Turkey	26	28	39	41	48	52	53	53	52	53	54	54
Belarus	.	21	25	35	46	49	50	50	47	45	43	43
Kazakhstan	.	25	19	31	54	64	66	67	66	65	65	66
Russia	48	31	30	42	61	72	67	68	65	63	62	62
Ukraine	25	16	16	21	22	25	25	23	21	20	20	20
Austria	134	131	130	124	126	130	131	129	127	127	126	126
Germany	133	128	118	117	121	124	125	126	125	125	124	124
Greece	91	85	85	91	87	74	74	72	70	69	69	69
Ireland	91	102	130	145	131	132	132	137	172	177	180	180
Italy	124	121	117	106	103	101	98	96	95	95	94	94
Portugal	77	75	78	79	81	77	77	78	77	77	77	77
Spain	94	89	95	100	97	91	90	91	91	92	92	92
USA	148	159	160	158	145	146	146	148	145	146	146	146
EU-28 average	100	100	100	100	100	100	100	100	100	100	100	100

Sources: wiiw Annual Database incorporating national and Eurostat statistics, wiiw estimates, Eurostat, EC - Spring Report 2016.

Table 31 / Indicators of macro-competitiveness, 2011-2018, EUR based, annual averages

	2011	2012	2013	2014	2015	2016	2017	2018
							Forecast	
Bulgaria								
Producer price index, 2010=100	109.2	114.0	112.3	110.9	108.8	104.4	104.4	105.5
Consumer price index, 2010=100	103.4	105.9	106.3	104.6	103.5	103.5	104.0	105.0
GDP deflator, 2010=100	106.0	107.7	106.9	107.4	109.8	109.7	110.3	111.4
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.3	100.1	99.0	96.9	95.9	95.6	94.6	93.9
Real ER (PPI-based), 2010=100	103.7	105.3	103.8	104.4	104.9	99.6	98.0	97.2
PPP, NC/EUR	0.9261	0.9167	0.9224	0.9039	0.9017	0.89	0.88	0.87
Price level, EU28 = 100	47	47	47	46	46	46	45	45
Average monthly gross wages, EUR (ER)	351	374	396	420	457	480	500	520
Average monthly gross wages, EUR (PPP)	741	798	840	909	991	1,050	1,110	1,170
GDP per employed person, 2010=100	105.5	106.0	106.9	106.6	108.6	110.2	111.9	113.1
Unit labour costs, ER adj., 2010=100	100.3	106.4	111.8	118.9	126.9	131.6	135.2	139.2
Unit labour costs, PPP adj., Austria=100	25.1	25.8	26.5	27.6	28.9	29.5	30.0	30.3
Croatia								
Producer price index, 2010=100	107.0	112.4	111.9	108.9	104.7	102.6	103.6	104.7
Consumer price index, 2010=100	102.2	105.7	108.1	108.3	108.0	107.5	108.5	109.6
GDP deflator, 2010=100	101.7	103.3	104.1	104.1	104.3	103.7	104.8	105.8
Exchange rate (ER), NC/EUR	7.439	7.522	7.579	7.634	7.614	7.57	7.60	7.60
ER, nominal, 2010=100	102.1	103.2	104.0	104.7	104.5	103.9	104.3	104.3
Real ER (CPI-based), 2010=100	97.1	96.8	96.8	95.8	95.8	95.6	94.8	94.0
Real ER (PPI-based), 2010=100	99.6	100.6	99.5	97.9	96.6	94.2	93.3	92.5
PPP, NC/EUR	5.007	4.872	4.894	4.813	4.745	4.67	4.64	4.61
Price level, EU28 = 100	67	65	65	63	62	62	61	61
Average monthly gross wages, EUR (ER) 1)	1,048	1,047	1,048	1,042	1,058	1,030	1,050	1,080
Average monthly gross wages, EUR (PPP) 1)	1,557	1,617	1,622	1,652	1,698	1,670	1,720	1,780
GDP per employed person, 2010=100	103.0	96.0	97.6	94.6	94.8	95.9	97.3	98.8
Unit labour costs, ER adj., 2010=100	96.6	103.5	101.9	104.5	106.0	102.0	102.7	103.7
Unit labour costs, PPP adj., Austria=100	52.3	54.3	52.2	52.5	52.2	49.5	49.3	49.0
Czech Republic								
Producer price index, 2010=100	103.7	106.2	106.9	107.9	105.3	102.1	103.2	104.8
Consumer price index, 2010=100	102.2	105.8	107.3	107.7	108.0	108.8	110.2	112.2
GDP deflator, 2010=100	100.0	101.5	102.9	105.5	106.6	107.4	108.6	110.7
Exchange rate (ER), NC/EUR	24.59	25.15	25.98	27.54	27.28	27.00	26.75	26.50
ER nominal, 2010=100	97.3	99.5	102.8	108.9	107.9	106.8	105.8	104.8
Real ER (CPI-based), 2010=100	101.9	100.5	97.2	91.6	92.8	94.1	94.8	95.7
Real ER (PPI-based), 2010=100	101.3	98.6	96.2	93.3	94.1	91.2	91.5	92.2
PPP, NC/EUR	17.76	17.70	17.49	17.44	17.29	17.2	17.2	17.2
Price level, EU28 = 100	72	70	67	63	63	64	64	65
Average monthly gross wages, EUR (ER)	995	997	964	930	970	1,030	1,080	1,140
Average monthly gross wages, EUR (PPP)	1,377	1,416	1,432	1,468	1,531	1,610	1,690	1,760
GDP per employed person, 2010=100	101.6	101.1	99.6	101.6	104.8	105.4	107.8	110.3
Unit labour costs, ER adj., 2010=100	103.7	104.5	102.5	97.0	98.1	103.1	106.6	109.8
Unit labour costs, PPP adj., Austria=100	47.2	46.0	44.1	40.9	40.6	42.2	42.9	43.4
Estonia								
Producer price index, 2010=100	104.2	107.0	114.7	111.6	108.3	106.1	107.2	109.3
Consumer price index, 2010=100	105.1	109.5	113.0	113.6	113.7	114.2	115.9	118.8
GDP deflator, 2010=100	105.3	108.6	112.8	114.7	115.9	116.6	118.5	121.2
Real ER (CPI-based), 2010=100	101.9	103.5	105.3	105.3	105.4	105.5	105.5	106.2
Real ER (PPI-based), 2010=100	99.0	98.8	106.1	105.1	104.4	101.2	100.6	100.8
PPP, NC/EUR	0.6948	0.6944	0.7195	0.7252	0.7284	0.72	0.73	0.73
Price level, EU28 = 100	69	69	72	73	73	72	73	73
Average monthly gross wages, EUR (ER)	839	887	949	1,005	1,065	1,140	1,230	1,320
Average monthly gross wages, EUR (PPP)	1,208	1,277	1,319	1,386	1,462	1,570	1,700	1,810
GDP per employed person, 2010=100	100.8	104.2	104.6	106.9	105.8	105.9	107.5	109.0
Unit labour costs, ER adj., 2010=100	105.0	107.4	114.5	118.6	127.1	135.9	144.5	152.8
Unit labour costs, PPP adj., Austria=100	47.3	46.9	48.7	49.5	52.0	54.8	57.7	60.0

1) From 2016 lower wages due to new data sources.

(Table 31 / ctd.)

Table 31 / (ctd.)

	2011	2012	2013	2014	2015	2016	2017 Forecast	2018
Hungary								
Producer price index, 2010=100	104.2	108.5	109.1	108.7	107.7	106.1	107.1	109.3
Consumer price index, 2010=100	103.9	109.8	111.7	111.7	111.8	112.2	114.5	117.4
GDP deflator, 2010=100	102.2	105.7	108.8	112.5	114.4	117.1	120.3	123.7
Exchange rate (ER), NC/EUR	279.4	289.3	296.9	308.7	310.0	310	315	320
ER, nominal 2010=100	101.4	105.0	107.8	112.1	112.5	112.5	114.3	116.2
Real ER (CPI-based), 2010=100	99.4	98.9	96.5	92.4	92.1	92.2	91.1	90.3
Real ER (PPI-based), 2010=100	97.6	95.5	93.6	91.3	92.2	89.9	87.9	86.7
PPP, NC/EUR	165.5	168.1	171.3	174.9	175.7	177.9	179.7	181.7
Price level, EU28 = 100	59	58	58	57	57	57	57	57
Average monthly gross wages, EUR (ER)	763	771	777	770	800	840	870	900
Average monthly gross wages, EUR (PPP)	1,288	1,327	1,347	1,359	1,411	1,470	1,520	1,580
GDP per employed person, 2010=100	100.9	98.9	99.3	98.1	98.5	98.0	100.0	102.5
Unit labour costs, ER adj., 2010=100	102.8	106.1	106.5	106.8	110.4	117.1	118.0	119.1
Unit labour costs, PPP adj., Austria=100	37.0	37.0	36.2	35.6	36.1	37.6	37.8	37.5
Latvia								
Producer price index, 2010=100	107.7	112.2	114.0	114.5	113.3	109.9	111.0	112.7
Consumer price index, 2010=100	104.2	106.6	106.6	107.3	107.6	107.6	109.5	111.8
GDP deflator, 2010=100	106.4	110.3	111.7	113.4	113.9	113.7	115.7	118.1
Real ER (CPI-based), 2010=100	101.4	102.4	100.3	100.3	100.5	100.2	100.5	100.8
Real ER (PPI-based), 2010=100	102.6	105.3	106.5	108.7	110.1	105.7	105.0	104.7
PPP, NC/EUR	0.6698	0.6711	0.6793	0.6750	0.6657	0.66	0.66	0.66
Price level, EU28 = 100	67	68	68	67	67	66	66	66
Average monthly gross wages, EUR (ER)	657	690	717	765	818	860	920	980
Average monthly gross wages, EUR (PPP)	986	1,020	1,054	1,133	1,229	1,310	1,400	1,480
GDP per employed person, 2010=100	103.0	118.7	119.6	123.4	125.2	128.0	130.1	133.2
Unit labour costs, ER adj., 2010=100	101.6	92.6	95.5	98.7	104.1	107.0	112.6	117.1
Unit labour costs, PPP adj., Austria=100	45.9	40.5	40.8	41.4	42.8	43.3	45.2	46.2
Lithuania								
Producer price index, 2010=100	113.9	119.6	116.7	111.0	100.2	93.2	95.5	98.9
Consumer price index, 2010=100	104.1	107.4	108.7	108.9	108.2	108.8	111.1	113.7
GDP deflator, 2010=100	105.2	108.1	109.6	110.7	110.9	111.6	113.8	116.6
Real ER (CPI-based), 2010=100	101.0	101.6	101.3	101.0	100.3	100.6	101.1	101.6
Real ER (PPI-based), 2010=100	108.2	110.5	107.9	104.5	96.6	88.8	89.6	91.1
PPP, NC/EUR	0.6071	0.6027	0.6042	0.6033	0.6047	0.60	0.60	0.61
Price level, EU28 = 100	61	60	60	60	60	60	60	61
Average monthly gross wages, EUR (ER)	593	615	646	677	714	770	830	900
Average monthly gross wages, EUR (PPP)	976	1,021	1,070	1,123	1,181	1,280	1,370	1,480
GDP per employed person, 2010=100	103.9	116.0	118.5	120.2	120.9	121.3	123.2	126.6
Unit labour costs, ER adj., 2010=100	99.0	92.1	94.8	97.9	102.6	110.3	117.0	123.5
Unit labour costs, PPP adj., Austria=100	34.4	31.0	31.2	31.6	32.5	34.4	36.1	37.5
Poland								
Producer price index, 2010=100	107.3	110.8	109.4	108.0	105.8	104.7	104.2	105.3
Consumer price index, 2010=100	103.9	107.7	108.6	108.7	108.0	107.3	108.7	110.7
GDP deflator, 2010=100	103.2	105.7	106.1	106.7	107.1	106.1	107.0	108.0
Exchange rate (ER), NC/EUR	4.121	4.185	4.198	4.184	4.184	4.30	4.30	4.25
ER, nominal, 2010=100	103.2	104.8	105.1	104.7	104.7	107.6	107.6	106.4
Real ER (CPI-based), 2010=100	97.7	97.2	96.3	96.2	95.5	92.1	91.9	93.0
Real ER (PPI-based), 2010=100	98.8	97.7	96.3	97.1	97.4	92.8	90.8	91.2
PPP, PLN/EUR	2.423	2.398	2.409	2.406	2.365	2.32	2.30	2.28
Price level, EU28 = 100	59	57	57	57	57	54	53	54
Average monthly gross wages, EUR (ER)	826	844	872	903	932	930	980	1,040
Average monthly gross wages, EUR (PPP)	1,405	1,472	1,519	1,570	1,649	1,730	1,830	1,930
GDP per employed person, 2010=100	103.9	109.2	110.7	112.2	114.7	117.4	121.3	125.0
Unit labour costs, ER adj., 2010=100	98.5	95.7	97.6	99.6	100.7	98.2	99.8	102.6
Unit labour costs, PPP adj., Austria=100	44.7	42.1	41.8	41.9	41.5	39.9	40.3	40.8

(Table 31 / ctd.)

Table 31 / (ctd.)

	2011	2012	2013	2014	2015	2016	2017	2018
							Forecast	
Romania								
Producer price index, 2010=100	107.1	112.7	115.0	114.8	112.1	113.2	115.5	118.4
Consumer price index, 2010=100	105.8	109.4	112.9	114.5	114.0	113.2	115.5	118.4
GDP deflator, 2010=100	104.7	109.6	113.4	115.3	118.7	120.9	122.9	125.8
Exchange rate (ER), NC/EUR	4.239	4.459	4.419	4.444	4.445	4.48	4.50	4.50
ER, nominal, 2010=100	100.6	105.9	104.9	105.5	105.5	106.4	106.8	106.8
Real ER (CPI-based), 2010=100	102.0	97.7	100.2	100.6	100.1	98.4	98.4	99.1
Real ER (PPI-based), 2010=100	101.1	98.3	101.4	102.5	102.4	101.5	101.4	102.1
PPP, NC/EUR	2.110	2.075	2.208	2.212	2.204	2.22	2.22	2.23
Price level, EU28 = 100	50	47	50	50	50	50	49	50
Average monthly gross wages, EUR (ER)	467	463	489	524	568	650	670	710
Average monthly gross wages, EUR (PPP)	939	994	979	1,052	1,146	1,310	1,350	1,430
GDP per employed person, 2010=100	102.2	109.2	113.8	116.3	121.8	127.2	131.7	136.7
Unit labour costs, ER adj., 2010=100	101.2	93.8	95.3	99.8	103.3	112.7	112.1	115.2
Unit labour costs, PPP adj., Austria=100	35.2	31.6	31.3	32.2	32.7	35.2	34.8	34.9
Slovakia								
Producer price index, 2010=100	104.5	106.5	105.4	101.7	98.7	94.3	95.7	97.6
Consumer price index, 2010=100	104.1	108.0	109.6	109.5	109.1	108.6	109.9	111.9
GDP deflator, 2010=100	101.6	102.9	103.5	103.3	103.0	102.7	103.9	105.9
Real ER (CPI-based), 2010=100	101.0	102.1	102.1	101.4	101.1	100.3	100.0	100.0
Real ER (PPI-based), 2010=100	99.2	98.4	97.5	95.8	95.1	89.9	89.8	89.9
PPP NC/ EUR	0.6873	0.6787	0.6741	0.6616	0.6540	0.65	0.64	0.64
Price level, EU28 = 100	69	68	67	66	65	65	64	64
Average monthly gross wages, EUR (ER)	786	805	824	858	883	910	940	980
Average monthly gross wages, EUR (PPP)	1,144	1,186	1,222	1,297	1,350	1,410	1,460	1,520
GDP per employed person, 2010=100	101.4	103.9	105.4	106.5	107.5	108.0	110.7	113.8
Unit labour costs, ER adj., 2010=100	100.8	100.8	101.7	104.8	106.8	109.6	110.4	112.0
Unit labour costs, PPP adj., Austria=100	38.0	36.8	36.3	36.6	36.6	37.0	37.0	36.8
Slovenia								
Producer price index, 2010=100	104.6	105.5	105.5	104.8	104.5	102.4	102.9	104.0
Consumer price index, 2010=100	102.1	105.0	107.0	107.4	106.5	106.0	107.0	108.1
GDP deflator, 2010=100	101.1	101.4	102.3	103.1	104.1	103.6	104.6	105.6
Real ER (CPI-based), 2010=100	99.0	99.2	99.6	99.5	98.7	97.9	97.4	96.7
Real ER (PPI-based), 2010=100	99.3	97.5	97.6	98.7	100.7	97.6	96.6	95.8
PPP, NC/EUR	0.8356	0.8121	0.8117	0.7997	0.7874	0.77	0.77	0.76
Price level, EU28 = 100	84	81	81	80	79	77	77	76
Average monthly gross wages, EUR (ER)	1,525	1,525	1,523	1,540	1,556	1,580	1,600	1,640
Average monthly gross wages, EUR (PPP)	1,825	1,878	1,876	1,926	1,976	2,040	2,080	2,150
GDP per employed person, 2010=100	103.9	102.4	103.3	105.3	107.6	111.1	112.7	114.8
Unit labour costs, ER adj., 2010=100	98.2	99.6	98.6	97.9	96.7	95.1	95.0	95.5
Unit labour costs, PPP adj., Austria=100	70.1	69.0	66.6	64.8	62.8	60.8	60.2	59.5
Albania								
Producer price index, 2010=100	102.6	103.8	103.3	102.9	100.7	97.7	96.7	97.7
Consumer price index, 2010=100	103.4	105.5	107.5	109.2	111.3	113.5	116.1	119.4
GDP deflator, 2010=100	102.3	103.4	103.7	105.2	105.4	106.9	110.4	113.2
Exchange rate (ER), NC/EUR	140.3	139.0	140.3	140.0	139.7	137.0	137.0	138.0
ER, nominal, 2010=100	101.8	100.9	101.8	101.6	101.4	99.4	99.4	100.2
Real ER (CPI-based), 2010=100	98.5	98.8	98.3	99.6	101.7	105.5	106.3	106.6
Real ER (PPI-based), 2010=100	95.7	95.0	93.9	95.3	95.7	93.7	91.3	89.9
PPP, NC/EUR	61.57	58.64	60.67	58.25	57.97	58.2	59.1	59.5
Price level, EU28 = 100	44	42	43	42	41	42	43	43
Average monthly gross wages, EUR (ER)	260	270	259	264	272	290	300	300
Average monthly gross wages, EUR (PPP)	593	640	599	635	657	670	710	710
GDP per employed person, 2010=100	103.2	106.5	119.8	120.4	118.1	114.9	116.7	119.9
Unit labour costs, ER adj., 2010=100	99.9	100.5	85.7	87.0	91.4	98.7	103.4	100.6
Unit labour costs, PPP adj., Austria=100	30.4	29.6	24.6	24.5	25.3	27.2	27.5	26.3

(Table 31 / ctd.)

Table 31 / (ctd.)

	2011	2012	2013	2014	2015	2016	2017	2018
							Forecast	
Bosnia and Herzegovina								
Producer price index, 2010=100	105.5	105.8	104.0	103.4	104.0	105.1	107.2	109.3
Consumer price index, 2010=100	103.7	105.9	105.8	104.8	103.8	103.8	105.8	108.0
GDP deflator, 2010=100	102.5	103.4	103.1	104.1	106.0	105.8	107.0	108.7
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.6	100.1	98.5	97.1	96.2	95.9	96.4	96.5
Real ER (PPI-based), 2010=100	100.2	97.8	96.1	97.4	100.3	100.2	100.6	100.8
PPP, NC/EUR	0.9622	0.9321	0.9369	0.9218	0.9243	0.91	0.91	0.91
Price level, EU28 = 100	49	48	48	47	47	47	46	46
Average monthly gross wages, EUR (ER)	650	660	660	659	659	670	690	700
Average monthly gross wages, EUR (PPP)	1,321	1,384	1,378	1,399	1,395	1,440	1,480	1,510
GDP per employed person, 2010=100	104.2	103.5	105.0	107.4	109.4	116.1	116.7	118.0
Unit labour costs, ER adj., 2010=100	100.2	102.4	101.1	98.7	96.9	92.8	94.4	95.4
Unit labour costs, PPP adj., Austria=100	42.8	42.4	40.9	39.1	37.7	35.5	36.1	35.6
Kosovo								
Producer price index, 2010=100	104.5	106.5	109.2	111.0	114.0	111.7	114.0	118.5
Consumer price index, 2010=100	107.3	110.0	112.0	112.4	111.8	112.0	113.1	115.3
GDP deflator, 2010=100	104.8	107.1	109.0	112.6	112.2	111.8	112.2	114.1
Real ER (CPI-based), 2010=100	104.1	104.0	104.3	104.2	103.7	103.4	102.9	103.1
Real ER (PPI-based), 2010=100	99.2	98.4	100.9	104.5	109.9	106.5	106.9	109.2
PPP, NC/EUR	0.4330	0.4310	0.4360	0.4370	0.4240	0.42	0.41	0.41
Price level, EU28 = 100	43	43	44	44	42	42	41	41
Average monthly gross wages, EUR (ER) 2)	348	354	356	416	446	460	480	500
Average monthly gross wages, EUR (PPP) 2)	804	821	817	952	1,052	1,100	1,160	1,210
GDP per employed person, 2010=100	106.5	101.4	93.9	99.4	112.6	114.4	113.8	113.8
Unit labour costs, ER adj., 2010=100	114.2	122.0	132.6	146.3	138.4	140.5	147.5	153.6
Unit labour costs, PPP adj., Austria=100	18.9	19.6	20.7	22.4	20.8	20.8	21.7	22.2
Macedonia								
Producer price index, 2010=100	111.9	113.4	111.8	109.7	105.4	102.2	102.2	104.3
Consumer price index, 2010=100	103.9	107.3	110.3	110.0	109.7	110.2	111.3	113.0
GDP deflator, 2010=100	103.7	104.8	109.5	111.1	113.2	113.8	115.0	116.7
Exchange rate (ER), NC/EUR	61.53	61.53	61.58	61.62	61.61	61.5	61.5	61.5
ER, nominal, 2010=100	100.0	100.0	100.1	100.2	100.2	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.8	101.4	102.6	101.8	101.5	101.9	101.4	101.1
Real ER (PPI-based), 2010=100	106.2	104.8	103.3	103.1	101.4	97.5	96.0	96.1
PPP, NC/EUR	25.59	25.08	25.61	25.18	25.43	25.3	25.1	25.1
Price level, EU28 = 100	42	41	42	41	41	41	41	41
Average monthly gross wages, EUR (ER)	497	498	504	508	522	540	550	560
Average monthly gross wages, EUR (PPP)	1,196	1,223	1,211	1,244	1,265	1,310	1,340	1,380
GDP per employed person, 2010=100	101.2	99.9	98.5	100.4	101.9	102.4	104.1	106.1
Unit labour costs, ER adj., 2010=100	100.0	101.6	104.1	103.1	104.3	106.7	107.1	107.6
Unit labour costs, PPP adj., Austria=100	36.4	35.8	35.8	34.8	34.5	35.0	34.8	34.1
Montenegro								
Producer price index, 2010=100	103.2	105.1	106.8	106.9	107.3	107.3	108.3	110.5
Consumer price index, 2010=100	103.3	107.4	109.4	108.8	110.3	110.9	112.6	114.8
GDP deflator, 2010=100	101.2	101.4	103.5	104.6	106.0	105.4	107.7	110.1
Real ER (CPI-based), 2010=100	100.2	101.6	101.9	100.8	102.3	102.5	102.5	102.7
Real ER (PPI-based), 2010=100	98.0	97.1	98.8	100.7	103.4	98.0	98.6	98.8
PPP, NC/EUR	0.4910	0.4907	0.5015	0.4964	0.4901	0.48	0.48	0.49
Price level, EU28 = 100	49	49	50	50	49	48	48	49
Average monthly gross wages, EUR (ER)	722	727	726	723	725	740	760	780
Average monthly gross wages, EUR (PPP)	1,471	1,482	1,448	1,456	1,479	1,540	1,570	1,600
GDP per employed person, 2010=100	110.0	104.5	107.2	101.8	102.7	104.6	107.2	109.2
Unit labour costs, ER adj., 2010=100	91.8	97.3	94.7	99.3	98.7	99.0	99.1	99.9
Unit labour costs, PPP adj., Austria=100	45.9	47.1	44.8	46.0	44.9	44.3	44.0	43.6

2) Net wages in state administration.

(Table 31 / ctd.)

Table 31 / (ctd.)

	2011	2012	2013	2014	2015	2016	2017	2018
							Forecast	
Serbia								
Producer price index, 2010=100	112.7	120.4	123.6	125.2	126.5	126.5	127.8	129.3
Consumer price index, 2010=100	111.0	119.7	129.0	132.7	135.3	137.3	140.0	142.8
GDP deflator, 2010=100	109.6	116.4	122.7	126.1	129.5	131.6	134.5	137.2
Exchange rate (ER), NC/EUR	101.95	113.13	113.14	117.31	120.76	124	124	125
ER, nominal, 2010=100	98.9	109.8	109.8	113.8	117.2	120.3	120.3	121.3
Real ER (CPI-based), 2010=100	108.8	103.0	109.4	108.1	107.0	105.4	105.9	105.3
Real ER (PPI-based), 2010=100	108.2	101.3	104.1	103.6	104.0	100.2	99.6	98.2
PPP, NC/EUR	49.67	50.64	53.64	53.77	54.48	54.8	55.1	55.2
Price level, EU28 = 100	49	45	47	46	45	44	44	44
Average monthly gross wages, EUR (ER)	517	508	537	524	506	520	540	560
Average monthly gross wages, EUR (PPP)	1,062	1,134	1,132	1,142	1,122	1,170	1,210	1,260
GDP per employed person, 2010=100	107.8	107.9	106.8	100.0	94.8	90.7	91.0	91.3
Unit labour costs, ER adj., 2010=100	104.2	102.1	109.1	113.7	116.0	124.0	128.6	132.3
Unit labour costs, PPP adj., Austria=100	37.3	35.5	37.0	37.8	37.8	40.0	41.0	41.6
Belarus								
Producer price index, 2010=100	171.4	301.7	342.7	386.6	451.5	519.2	586.7	651.3
Consumer price index, 2010=100	153.2	243.9	288.5	340.8	386.8	433.2	480.8	528.9
GDP deflator, 2010=100	171.3	300.5	364.2	429.3	499.2	559.2	620.9	683.3
Exchange rate (ER), NC/EUR	0.805	1.078	1.183	1.322	1.783	2.2	2.3	2.4
ER, nominal, 2010=100	200.9	269.0	295.4	330.0	445.0	549.1	574.0	599.0
Real ER (CPI-based), 2010=100	74.0	85.7	91.0	95.7	80.6	72.9	76.2	79.0
Real ER (PPI-based), 2010=100	81.0	103.6	107.3	110.3	97.8	90.1	95.9	100.2
PPP, NC/EUR	0.250	0.428	0.514	0.599	0.677	0.8	0.8	0.9
Price level, EU28 = 100	31	40	43	45	38	34	36	37
Average monthly gross wages, EUR (ER)	236	341	428	458	377	340	360	380
Average monthly gross wages, EUR (PPP)	759	858	984	1,011	992	990	1,000	1,030
GDP per employed person, 2010=100	105.8	109.4	111.3	113.9	110.9	108.7	111.5	111.5
Unit labour costs, ER adj., 2010=100	73.4	102.6	126.5	132.3	111.8	101.9	105.2	111.9
Unit labour costs, PPP adj., Austria=100	20.1	27.2	32.7	33.5	27.8	25.2	25.8	26.8
Kazakhstan								
Producer price index, 2010=100	127.2	131.7	131.3	143.7	114.3	132.6	133.9	140.6
Consumer price index, 2010=100	108.3	113.9	120.5	128.6	137.1	156.3	167.2	177.3
GDP deflator, 2010=100	120.6	126.4	138.4	146.4	149.2	171.6	180.3	191.0
Exchange rate (ER), NC/EUR	204.1	191.7	202.1	238.1	245.8	377	375	375
ER, nominal, 2010=100	104.3	98.0	103.3	121.7	125.6	192.7	191.6	191.6
Real ER (CPI-based), 2010=100	100.7	110.0	108.7	98.0	101.1	75.0	79.4	82.7
Real ER (PPI-based), 2010=100	115.8	124.2	117.5	111.2	87.7	65.6	65.5	67.6
PPP, NC/EUR	106.3	109.2	120.7	124.8	122.9	139.8	144.6	150.5
Price level, EU28 = 100	52	57	60	52	50	37	39	40
Average monthly gross wages, EUR (ER)	441	528	540	508	513	370	410	460
Average monthly gross wages, EUR (PPP)	847	928	904	970	1,025	1,010	1,070	1,140
GDP per employed person, 2010=100	104.9	107.3	112.9	118.4	118.2	118.0	119.8	122.9
Unit labour costs, ER adj., 2010=100	106.0	124.1	120.6	108.2	109.4	79.8	87.1	93.6
Unit labour costs, PPP adj., Austria=100	32.8	37.2	35.3	31.0	30.8	21.9	23.7	25.5
Russia 3)								
Producer price index, 2010=100	117.7	125.7	129.9	137.8	154.9	164.1	172.4	181.0
Consumer price index, 2010=100	108.4	113.9	121.7	131.2	151.5	265.1	281.0	297.9
GDP deflator, 2010=100	115.9	125.5	131.6	143.1	153.6	161.0	171.1	177.4
Exchange rate (ER), NC/EUR	40.87	39.94	42.27	50.77	67.76	75	77	80
ER, nominal, 2010=100	101.5	99.2	105.0	126.1	168.3	186.2	191.2	198.7
Real ER (CPI-based), 2010=100	103.6	108.6	108.0	96.4	83.4	131.5	133.8	134.1
Real ER (PPI-based), 2010=100	110.1	117.1	114.4	102.9	88.7	84.0	84.6	84.0
PPP, NC/EUR	22.99	24.41	27.75	28.57	29.62	30.7	32.1	32.7
Price level, EU28 = 100	56	61	66	56	44	41	42	41
Average monthly gross wages, EUR (ER)	572	667	705	640	502	480	510	550
Average monthly gross wages, EUR (PPP)	1,016	1,091	1,074	1,137	1,149	1,180	1,230	1,340
GDP per employed person, 2010=100	102.9	112.5	114.2	115.0	109.9	108.7	108.8	110.0
Unit labour costs, ER adj., 2010=100	106.8	113.9	118.6	107.0	87.9	85.3	90.6	96.1
Unit labour costs, PPP adj., Austria=100	37.1	38.4	39.0	34.5	27.8	26.4	27.8	29.1

3) From 2014 including Crimean Federal District (for LFS employment and wages from 2015).

(Table 31 / ctd.)

Table 31 / (ctd.)

	2011	2012	2013	2014	2015	2016	2017 Forecast	2018
Ukraine 4)								
Producer price index, 2010=100	119.0	123.4	123.3	144.4	196.3	226.8	242.6	257.2
Consumer price index, 2010=100	108.0	108.6	108.3	121.4	180.6	206.7	225.1	238.7
GDP deflator, 2010=100	114.2	123.3	128.6	149.1	206.3	237.9	263.9	277.5
Exchange rate (ER), NC/EUR	11.09	10.27	10.61	15.72	24.23	29.0	32.0	33.0
ER, nominal, 2010=100	105.3	97.5	100.8	149.2	230.0	275.3	303.8	313.3
Real ER (CPI-based), 2010=100	99.5	105.3	100.1	75.4	72.7	69.4	67.5	68.1
Real ER (PPI-based), 2010=100	107.3	116.9	113.1	91.1	82.3	78.5	74.9	75.7
PPP, NC/EUR	4.547	4.814	5.069	5.741	7.681	8.76	9.56	9.88
Price level, EU28 = 100	41	47	48	37	32	30	30	30
Average monthly gross wages, EUR (ER)	237	295	308	221	173	180	180	190
Average monthly gross wages, EUR (PPP)	579	629	644	606	546	580	610	650
GDP per employed person, 2010=100	105.1	105.1	104.9	106.5	105.5	107.6	109.6	111.6
Unit labour costs, ER adj., 2010=100	106.2	131.9	137.9	97.8	77.2	76.9	77.8	81.8
Unit labour costs, PPP adj., Austria=100	37.7	45.3	46.3	32.2	24.9	25.0	24.3	24.8
Austria								
Producer price index, 2010=100	104.0	104.9	104.0	102.9	101.4	103.3	104.9	106.7
Consumer price index, 2010=100	103.3	105.8	107.9	109.7	110.7	111.8	113.7	115.7
GDP deflator, 2010=100	101.9	103.9	105.6	107.5	109.5	111.5	113.3	115.2
Real ER (CPI-based), 2010=100	100.2	100.0	100.5	101.7	102.6	103.3	103.5	103.4
Real ER (PPI-based), 2010=100	98.8	96.9	96.2	96.9	97.7	98.5	98.5	98.3
PPP, NC/EUR	1.107	1.084	1.088	1.086	1.075	1.083	1.083	1.081
Price level, EU28 = 100	111	108	109	109	107	108	108	108
Average monthly gross wages, EUR	3,178	3,278	3,346	3,429	3,500	3,560	3,610	3,680
Average monthly gross wages, EUR (PPP)	2,870	3,023	3,075	3,158	3,257	3,290	3,330	3,400
GDP per employed person, 2010=100	101.9	101.9	101.5	101.9	102.0	102.3	102.8	102.9
Unit labour costs, ER adj., 2010=100	100.4	103.6	106.1	108.3	110.4	112.1	113.0	115.1
Unit labour costs, PPP 2010 adjusted	0.56	0.581	0.595	0.607	0.619	0.628	0.634	0.645

4) From 2014 excluding the occupied territories of Crimea and Sevastopol and from 2015 parts of the anti-terrorist operation zone.

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

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

Table 32 / Indicators of macro-competitiveness, 2011-2018, annual changes in %

	2011	2012	2013	2014	2015	2016	2017 Forecast	2018	2011-15 average
Bulgaria									
GDP deflator	6.0	1.6	-0.7	0.5	2.2	0.0	0.5	1.0	1.9
Real ER (CPI-based)	0.3	-0.2	-1.1	-2.1	-1.1	-0.3	-1.0	-0.8	-0.8
Real ER (PPI-based)	3.7	1.6	-1.4	0.6	0.4	-5.0	-1.6	-0.8	1.0
Average gross wages, real (PPI based)	-3.1	2.1	7.6	7.4	10.9	9.6	4.3	3.1	4.9
Average gross wages, real (CPI based)	2.3	4.1	5.6	7.7	10.0	5.2	3.7	3.1	5.9
Average gross wages, EUR (ER)	5.8	6.6	6.0	6.0	8.8	5.0	4.2	4.0	6.6
Employed persons (LFS)	-3.4	-1.1	0.0	1.6	1.7	1.6	1.6	1.6	-0.3
GDP per empl. person, NC at 2010 ref. pr.	5.5	1.1	0.9	-0.3	1.9	1.5	1.5	1.1	1.8
Unit labour costs, ER (EUR) adjusted	0.3	5.4	5.1	6.3	6.8	3.7	2.7	3.0	4.8
Croatia									
GDP deflator	1.7	1.6	0.8	0.0	0.1	-0.5	1.0	1.0	0.8
Exchange rate (ER), EUR/NC	-2.0	-1.1	-0.8	-0.7	0.3	0.6	-0.4	0.0	-0.9
Real ER (CPI-based)	-2.9	-0.3	0.0	-1.0	0.0	-0.2	-0.9	-0.8	-0.9
Real ER (PPI-based)	-0.4	1.1	-1.1	-1.6	-1.3	-2.5	-1.0	-0.8	-0.7
Average gross wages, real (PPI based) [1)]	-5.1	-3.8	1.3	2.9	5.3	6.1	1.5	1.5	0.0
Average gross wages, real (CPI based) [1)]	-0.7	-2.3	-1.5	0.0	1.6	4.5	1.5	1.5	-0.6
Average gross wages, EUR (ER) [1)]	-0.5	-0.1	0.1	-0.6	1.6	4.6	1.9	2.9	0.1
Employed persons (LFS)	-3.2	-3.6	-2.7	2.7	1.5	1.3	1.2	1.2	-1.1
GDP per empl. person, NC at 2010 ref. pr.	3.0	1.5	1.7	-3.0	0.1	1.2	1.4	1.6	0.6
Unit labour costs, ER (EUR) adjusted	-3.4	-1.5	-1.6	2.5	1.4	3.4	0.7	0.9	-0.5
Czech Republic									
GDP deflator	0.0	1.4	1.4	2.5	1.0	0.8	1.2	1.9	1.3
Exchange rate (ER), EUR/NC	2.8	-2.2	-3.2	-5.7	0.9	1.0	0.9	0.9	-1.5
Real ER (CPI-based)	1.9	-1.4	-3.3	-5.7	1.2	1.4	0.7	0.9	-1.5
Real ER (PPI-based)	1.3	-2.6	-2.5	-3.0	0.8	-3.1	0.3	0.7	-1.2
Average gross wages, real (PPI based)	-1.2	0.1	-0.8	1.3	5.9	7.9	3.7	2.8	1.0
Average gross wages, real (CPI based)	0.3	-1.0	-1.5	1.9	3.0	3.9	3.3	2.6	0.5
Average gross wages, EUR (ER)	5.4	0.2	-3.3	-3.5	4.3	6.2	4.9	5.6	0.6
Employed persons (LFS)	0.4	0.4	1.0	0.8	1.4	1.5	0.2	0.2	0.8
GDP per empl. person, NC at 2010 ref. pr.	1.6	-1.2	-1.4	1.9	3.1	0.6	2.2	2.4	0.8
Unit labour costs, ER (EUR) adjusted	3.7	1.4	-1.9	-5.3	1.2	5.1	3.4	3.0	-0.2
Estonia									
GDP deflator	5.3	3.2	3.9	1.7	1.0	0.6	1.6	2.3	3.0
Real ER (CPI-based)	1.9	1.6	1.7	0.0	0.1	0.1	0.0	0.7	1.1
Real ER (PPI-based)	-1.0	-0.1	7.3	-0.9	-0.7	-3.1	-0.6	0.2	0.9
Average gross wages, real (PPI based)	1.6	3.0	-0.2	8.8	9.2	9.2	6.8	5.2	4.4
Average gross wages, real (CPI based)	0.8	1.5	3.7	5.4	5.9	6.6	6.3	4.7	3.4
Average gross wages, EUR (ER)	5.9	5.7	7.0	5.9	6.0	7.0	7.9	7.3	6.1
Employed persons (LFS)	6.7	1.9	1.0	0.6	2.6	1.4	0.8	0.8	2.5
GDP per empl. person, NC at 2010 ref. pr.	0.8	2.4	0.4	2.2	-1.1	0.1	1.5	1.4	0.9
Unit labour costs, ER (EUR) adjusted	5.0	3.3	6.6	3.6	7.2	6.9	6.3	5.8	5.1
Hungary									
GDP deflator	2.2	3.4	2.9	3.4	1.7	2.4	2.7	2.9	2.7
Exchange rate (ER), EUR/NC	-1.4	-3.4	-2.6	-3.8	-0.4	0.0	-1.6	-1.6	-2.3
Real ER (CPI-based)	-0.6	-0.5	-2.4	-4.3	-0.3	0.1	-1.1	-0.9	-1.6
Real ER (PPI-based)	-2.4	-2.2	-1.9	-2.4	1.0	-2.6	-2.2	-1.4	-1.6
Average gross wages, real (PPI based)	1.0	0.5	2.9	3.4	5.3	7.0	3.5	3.0	2.6
Average gross wages, real (CPI based)	1.3	-1.0	1.7	3.0	4.2	5.0	2.5	2.5	1.8
Average gross wages, EUR (ER)	3.8	1.1	0.8	-0.9	3.9	5.0	3.6	3.4	1.7
Employed persons (LFS)	0.8	1.8	1.7	5.3	2.7	2.6	0.5	0.5	2.5
GDP per empl. person, NC at 2010 ref. pr.	0.9	-3.3	0.4	-1.2	0.5	-0.6	2.1	2.4	-0.6
Unit labour costs, ER (EUR) adjusted	2.8	4.6	0.4	0.3	3.4	6.1	0.8	1.0	2.3
Latvia									
GDP deflator	6.4	3.6	1.3	1.5	0.4	-0.1	1.8	2.0	2.6
Real ER (CPI-based)	1.4	1.0	-2.1	0.0	0.2	-0.3	0.3	0.3	0.1
Real ER (PPI-based)	2.6	2.6	1.1	2.1	1.3	-4.1	-0.6	-0.3	1.9
Average gross wages, real (PPI based)	-3.2	-0.5	2.9	6.4	8.1	8.4	5.9	4.9	2.7
Average gross wages, real (CPI based)	0.1	1.3	4.6	6.1	6.7	5.1	5.1	4.3	3.7
Average gross wages, EUR (ER)	4.6	5.0	3.9	6.7	6.9	5.1	7.0	6.5	5.4
Employed persons (LFS)	3.1	1.6	2.1	-1.0	1.3	0.4	0.6	0.6	1.4
GDP per empl. person, NC at 2010 ref. pr.	3.0	2.4	0.8	3.2	1.4	2.2	1.6	2.4	2.1
Unit labour costs, ER (EUR) adjusted	1.6	2.6	3.1	3.4	5.4	2.8	5.3	4.0	3.2

1) From 2016 new data sources, growth rates comparable.

(Table 32 / ctd.)

Table 32 / (ctd.)

	2011	2012	2013	2014	2015	2016	2017 Forecast	2018	2010-14 average
Lithuania									
GDP deflator	5.2	2.7	1.4	1.0	0.2	0.6	2.0	2.4	2.1
Real ER (CPI-based)	1.0	0.6	-0.3	-0.3	-0.7	0.3	0.6	0.5	0.1
Real ER (PPI-based)	8.2	2.1	-2.3	-3.1	-7.6	-8.0	0.9	1.7	-0.7
Average gross wages, real (PPI based)	-9.7	-1.1	7.7	10.2	16.8	15.9	5.2	4.8	4.4
Average gross wages, real (CPI based)	-1.1	0.6	3.8	4.6	6.2	7.2	5.6	6.0	2.8
Average gross wages, EUR (ER)	2.9	3.8	5.1	4.8	5.4	7.8	7.8	8.4	4.4
Employed persons (LFS)	2.0	1.8	1.3	2.0	1.2	1.9	0.7	0.4	1.7
GDP per empl. person, NC at 2010 ref. pr.	3.9	2.0	2.1	1.4	0.6	0.4	1.6	2.7	2.0
Unit labour costs, ER (EUR) adjusted	-1.0	1.8	2.9	3.3	4.8	7.4	6.1	5.6	2.3
Poland									
GDP deflator	3.2	2.4	0.4	0.5	0.4	-0.9	0.8	0.9	1.4
Exchange rate (ER), EUR/NC	-3.1	-1.5	-0.3	0.3	0.0	-2.7	0.0	1.2	-0.9
Real ER (CPI-based)	-2.3	-0.5	-1.0	-0.1	-0.7	-3.6	-0.2	1.2	-0.9
Real ER (PPI-based)	-1.2	-1.1	-1.5	0.8	0.3	-4.7	-2.1	0.4	-0.5
Average gross wages, real (PPI based)	-1.6	0.5	5.0	4.6	5.4	3.6	5.5	3.7	2.7
Average gross wages, real (CPI based)	1.6	0.0	2.8	3.1	4.0	3.2	3.7	2.9	2.3
Average gross wages, EUR (ER)	2.3	2.1	3.3	3.5	3.3	-0.2	5.4	6.1	2.9
Employed persons (LFS)	1.1	0.2	-0.1	1.9	1.4	0.9	0.2	0.1	0.9
GDP per empl. person, NC at 2010 ref. pr.	3.9	1.4	1.4	1.4	2.2	2.3	3.3	3.1	2.0
Unit labour costs, ER (EUR) adjusted	-1.5	0.8	1.9	2.1	1.0	-2.5	1.7	2.8	0.9
Romania									
GDP deflator	4.7	4.7	3.4	1.7	2.9	1.8	1.7	2.4	3.5
Exchange rate (ER), EUR/NC	-0.6	-4.9	0.9	-0.6	0.0	-0.8	-0.4	0.0	-1.1
Real ER (CPI-based)	2.0	-4.2	2.6	0.3	-0.4	-1.8	0.0	0.7	0.0
Real ER (PPI-based)	1.1	-2.7	3.1	1.1	-0.1	-0.9	-0.1	0.7	0.5
Average gross wages, real (PPI based)	-2.8	-1.0	2.8	7.8	11.1	13.7	1.4	4.1	3.4
Average gross wages, real (CPI based)	-1.6	0.8	1.6	6.1	8.9	15.7	1.4	4.1	3.1
Average gross wages, EUR (ER)	3.4	-1.0	5.8	7.0	8.4	14.4	3.1	6.0	4.7
Employed persons (LFS)	-1.1	0.9	-0.7	0.8	-0.9	0.2	0.0	0.0	-0.2
GDP per empl. person, NC at 2010 ref. pr.	2.2	-0.3	4.2	2.2	4.7	4.5	3.5	3.8	2.6
Unit labour costs, ER (EUR) adjusted	1.2	-0.7	1.5	4.7	3.5	9.1	-0.5	2.8	2.1
Slovakia									
GDP deflator	1.6	1.3	0.5	-0.2	-0.3	-0.3	1.1	1.9	0.6
Real ER (CPI-based)	1.0	1.1	0.0	-0.6	-0.3	-0.8	-0.3	0.0	0.2
Real ER (PPI-based)	-0.8	-0.9	-0.9	-1.7	-0.7	-5.5	-0.1	0.2	-1.0
Average gross wages, real (PPI based)	-2.2	0.5	3.4	7.9	6.0	7.9	1.8	2.2	3.1
Average gross wages, real (CPI based)	-1.8	-1.2	0.8	4.2	3.2	3.6	2.1	2.4	1.0
Average gross wages, EUR (ER)	2.2	2.4	2.4	4.1	2.9	3.1	3.3	4.3	2.8
Employed persons (LFS)	1.5	0.6	0.0	1.5	2.6	2.3	0.8	0.8	1.2
GDP per empl. person, NC at 2010 ref. pr.	1.4	0.9	1.4	1.1	1.0	0.4	2.5	2.8	1.1
Unit labour costs, ER (EUR) adjusted	0.8	1.5	0.9	3.0	1.9	2.6	0.7	1.4	1.6
Slovenia									
GDP deflator	1.1	0.3	0.9	0.8	1.0	-0.5	0.9	1.0	0.8
Real ER (CPI-based)	-1.0	0.2	0.4	-0.1	-0.8	-0.8	-0.5	-0.8	-0.3
Real ER (PPI-based)	-0.7	-1.9	0.1	1.2	2.1	-3.1	-1.1	-0.8	0.1
Average gross wages, real (PPI based)	-2.5	-0.8	-0.2	1.8	1.0	3.6	0.8	1.5	-0.1
Average gross wages, real (CPI based)	-0.1	-2.7	-2.0	0.7	1.5	2.1	0.3	1.5	-0.5
Average gross wages, EUR (ER)	2.0	0.1	-0.2	1.1	0.7	1.5	1.3	2.5	0.7
Employed persons (LFS)	-3.1	-1.3	-1.9	1.2	0.1	-0.8	1.1	1.1	-1.0
GDP per empl. person, NC at 2010 ref. pr.	3.9	-1.4	0.9	1.9	2.2	3.3	1.4	1.9	1.5
Unit labour costs, ER (EUR) adjusted	-1.8	1.5	-1.0	-0.8	-1.5	-1.7	-0.2	0.6	-0.7
Albania									
GDP deflator	2.3	1.0	0.3	1.4	0.2	1.4	3.3	2.6	1.1
Exchange rate (ER), EUR/NC	-1.8	0.9	-0.9	0.2	0.2	2.0	0.0	-0.7	-0.3
Real ER (CPI-based)	-1.5	0.3	-0.5	1.3	2.1	3.7	0.8	0.3	0.3
Real ER (PPI-based)	-4.3	-0.7	-1.2	1.6	0.4	-2.1	-2.6	-1.5	-0.9
Average gross wages, real (PPI based)	2.3	1.8	-2.8	2.3	5.1	6.1	7.5	-0.3	1.7
Average gross wages, real (CPI based)	1.5	0.9	-5.0	0.2	1.0	0.9	4.0	-2.0	-0.3
Average gross wages, EUR (ER)	3.0	3.8	-4.0	2.0	3.1	6.4	3.4	0.0	1.5
Employed persons (LFS)	-0.6	-1.8	-10.2	1.3	4.8	5.8	1.7	0.9	-1.4
GDP per empl. person, NC at 2010 ref. pr.	3.2	3.2	12.5	0.5	-1.9	-2.7	1.5	2.7	3.4
Unit labour costs, ER (EUR) adjusted	-0.1	0.6	-14.7	1.5	5.1	7.9	4.8	-2.7	-1.8

(Table 32 / ctd.)

Table 32 / (ctd.)

	2011	2012	2013	2014	2015	2016	2017 Forecast	2018	2010-14 average
Bosnia and Herzegovina									
GDP deflator	2.5	0.9	-0.3	1.0	1.8	-0.2	1.1	1.6	1.2
Real ER (CPI-based)	0.6	-0.5	-1.6	-1.4	-1.0	-0.3	0.5	0.2	-0.8
Real ER (PPI-based)	0.2	-2.4	-1.7	1.3	3.0	-0.1	0.4	0.2	0.1
Average gross wages, real (PPI based)	-1.0	1.2	1.9	0.4	-0.6	0.6	0.3	0.2	0.4
Average gross wages, real (CPI based)	0.7	-0.5	0.2	0.8	1.0	1.6	0.3	0.2	0.4
Average gross wages, EUR (ER)	4.4	1.5	0.1	-0.1	0.0	1.7	3.0	1.4	1.2
Employed persons (LFS)	-3.2	-0.3	1.0	-1.2	1.2	-2.7	2.5	2.4	-0.5
GDP per empl. person, NC at 2010 ref. pr.	4.2	-0.6	1.4	2.3	1.8	6.1	0.6	1.1	1.8
Unit labour costs, ER (EUR) adjusted	0.2	2.2	-1.3	-2.4	-1.8	-4.2	1.7	1.1	-0.6
Kosovo									
GDP deflator	4.8	2.2	1.8	3.3	-0.3	-0.4	0.4	1.7	2.3
Real ER (CPI-based)	4.1	-0.1	0.3	-0.1	-0.5	-0.2	-0.5	0.2	0.7
Real ER (PPI-based)	-0.8	-0.9	2.6	3.6	5.1	-3.1	0.4	2.2	1.9
Average net wages, real (PPI based) 2)	16.4	-0.2	-1.9	14.9	4.4	5.2	2.3	0.2	6.5
Average net wages, real (CPI based) 2)	13.4	-0.8	-1.2	16.4	7.8	3.0	3.3	2.1	6.9
Average net wages, EUR (ER) 2)	21.7	1.7	0.6	16.9	7.2	3.1	4.3	4.2	9.3
Employed persons (LFS) 3)	-2.0	1.4	11.7	-4.4	-8.2	1.0	3.3	3.2	-0.5
GDP per empl. person, NC at 2010 ref. pr.	6.5	1.4	-7.4	5.8	13.3	1.6	-0.6	0.0	3.7
Unit labour costs, ER (EUR) adjusted	14.2	0.3	8.6	10.4	-5.4	1.5	4.9	4.2	5.4
Macedonia									
GDP deflator	3.7	1.0	4.5	1.5	1.9	0.5	1.0	1.5	2.5
Exchange rate (ER), EUR/NC	0.0	0.0	-0.1	-0.1	0.0	0.2	0.0	0.0	0.0
Real ER (CPI-based)	0.8	0.7	1.2	-0.9	-0.3	0.4	-0.5	-0.3	0.3
Real ER (PPI-based)	6.2	-1.4	-1.4	-0.2	-1.6	-3.9	-1.6	0.2	0.3
Average gross wages, real (PPI based)	-9.5	-1.1	2.6	3.0	6.9	5.7	2.1	0.4	0.2
Average gross wages, real (CPI based)	-2.6	-3.0	-1.6	1.3	3.0	2.1	1.1	0.9	-0.6
Average gross wages, EUR (ER)	1.2	0.2	1.1	0.9	2.7	3.4	1.9	1.8	1.2
Employed persons (LFS)	1.1	0.8	4.3	1.7	2.3	2.0	1.4	1.4	2.1
GDP per empl. person, NC at 2010 ref. pr.	1.2	-1.3	-1.4	1.9	1.5	0.5	1.7	1.9	0.4
Unit labour costs, ER (EUR) adjusted	0.0	1.5	2.5	-1.0	1.2	2.2	0.4	0.5	0.9
Montenegro									
GDP deflator	1.2	0.2	2.1	1.0	1.4	-0.6	2.2	2.2	1.2
Real ER (CPI-based)	0.2	1.4	0.3	-1.0	1.4	0.2	0.0	0.2	0.4
Real ER (PPI-based)	-2.0	-0.9	1.7	1.9	2.7	-5.2	0.6	0.2	0.7
Average gross wages, real (PPI based)	-2.1	-1.2	-1.7	-0.5	0.0	2.1	1.7	0.6	-1.1
Average gross wages, real (CPI based)	-2.2	-3.2	-1.9	0.1	-1.1	1.6	1.2	0.6	-1.7
Average gross wages, EUR (ER)	1.0	0.7	-0.1	-0.4	0.3	2.1	2.7	2.6	0.3
Employed persons (LFS)	0.8	2.4	1.0	7.1	2.5	1.0	0.9	0.9	2.7
GDP per empl. person, NC at 2010 ref. pr.	2.4	-5.0	2.6	-5.0	0.9	1.8	2.5	1.9	-0.9
Unit labour costs, ER (EUR) adjusted	-1.4	6.0	-2.6	4.8	-0.6	0.3	0.2	0.8	1.2
Serbia									
GDP deflator	9.6	6.3	5.4	2.7	2.7	1.6	2.2	2.0	5.3
Exchange rate (ER), EUR/NC	1.1	-9.9	0.0	-3.6	-2.9	-2.6	0.0	-0.8	-3.1
Real ER (CPI-based)	8.8	-5.3	6.2	-1.3	-1.0	-1.5	0.5	-0.6	1.4
Real ER (PPI-based)	8.2	-6.4	2.8	-0.5	0.5	-3.7	-0.6	-1.4	0.8
Average gross wages, real (PPI based)	-1.4	2.0	2.9	-0.1	-1.5	5.0	3.0	2.8	0.4
Average gross wages, real (CPI based)	0.1	1.0	-1.9	-1.7	-2.3	3.4	2.0	2.0	-1.0
Average gross wages, EUR (ER)	12.3	-1.9	5.7	-2.4	-3.3	2.7	3.8	3.7	1.9
Employed persons (LFS)	-6.0	-1.1	3.7	4.8	6.3	6.8	2.2	2.1	1.4
GDP per empl. person, NC at 2010 ref. pr.	7.8	0.1	-1.1	-6.3	-5.2	-4.3	0.3	0.4	-1.1
Unit labour costs, ER (EUR) adjusted	4.2	-1.9	6.8	4.2	2.0	6.9	3.7	2.8	3.0
Belarus									
GDP deflator	71.3	75.5	21.2	17.9	16.3	12.0	11.0	10.0	37.9
Exchange rate (ER), EUR/NC	-50.2	-25.3	-8.9	-10.5	-25.8	-19.0	-4.3	-4.2	-25.8
Real ER (CPI-based)	-26.0	15.9	6.2	5.2	-15.8	-9.5	4.6	3.6	-4.2
Real ER (PPI-based)	-19.0	27.9	3.6	2.8	-11.3	-7.8	6.4	4.5	-0.4
Average gross wages, real (PPI based)	-8.9	9.9	21.2	6.0	-5.0	-4.2	-1.9	0.0	4.1
Average gross wages, real (CPI based)	1.9	21.5	16.4	1.3	-2.2	-1.6	-0.2	0.9	7.4
Average gross wages, EUR (ER)	-22.3	44.5	25.4	7.0	-17.7	-9.7	5.9	5.6	4.4
Employment registered	-0.3	-1.7	-0.7	-0.6	-1.2	-2.1	-1.1	0.0	-0.9
GDP per empl. person, NC at 2010 ref. pr.	5.8	3.4	1.7	2.3	-2.7	-2.0	2.6	0.0	2.1
Unit labour costs, ER (EUR) adjusted	-26.6	39.7	23.3	4.6	-15.5	-8.9	3.3	6.4	2.3

2) Net wages in state administration. - 3) wiiw estimate in 2011-2012 due to missing data in 2010 and break in time series 2012.

(Table 32 / ctd.)

Table 32 / (ctd.)

	2011	2012	2013	2014	2015	2016	2017 Forecast	2018	2010-14 average
Kazakhstan									
GDP deflator	20.6	4.8	9.5	5.8	1.9	15.0	5.1	5.9	8.3
Exchange rate (ER), EUR/NC	-4.1	6.5	-5.2	-15.1	-3.1	-34.8	0.5	0.0	-4.5
Real ER (CPI-based)	4.3	9.2	-1.1	-9.9	3.3	-25.9	6.0	4.1	0.9
Real ER (PPI-based)	0.7	7.2	-5.3	-5.4	-21.2	-25.2	-0.1	3.1	-5.3
Average gross wages, real (PPI based)	-8.8	8.7	8.1	1.3	31.0	-3.7	9.1	5.0	7.3
Average gross wages, real (CPI based)	7.1	6.9	1.9	3.9	-2.3	-2.0	3.0	4.0	3.4
Average gross wages, EUR (ER)	11.2	19.8	2.2	-5.9	0.9	-27.8	10.8	12.2	5.3
Employed persons (LFS)	1.1	1.0	0.7	-0.7	1.3	0.5	0.5	0.5	0.7
GDP per empl. person, NC at 2010 ref. pr.	4.8	3.7	5.2	4.9	-0.2	-0.1	1.5	2.5	3.7
Unit labour costs, ER (EUR) adjusted	6.2	15.5	-2.8	-10.3	1.1	-27.1	9.1	7.5	1.5
Russia 4)									
GDP deflator	15.9	8.3	4.8	8.8	7.3	4.8	6.3	3.7	9.0
Exchange rate (ER), EUR/NC	-1.5	2.3	-5.5	-16.7	-25.1	-9.7	-2.6	-3.7	-9.9
Real ER (CPI-based)	3.6	4.8	-0.6	-10.7	-13.5	57.6	1.7	0.2	-3.6
Real ER (PPI-based)	10.1	6.3	-2.3	-10.0	-13.8	-5.3	0.7	-0.7	-2.4
Average gross wages, real (PPI based)	-5.2	6.7	8.3	2.8	-6.8	0.4	3.9	6.1	1.0
Average gross wages, real (CPI based)	2.9	8.4	4.8	1.2	-9.3	-39.2	2.9	5.1	1.4
Average gross wages, EUR (ER)	9.9	16.6	5.7	-9.2	-21.5	-4.4	6.3	7.8	-0.7
Employed persons (LFS)	1.3	1.0	-0.2	0.2	-0.4	0.2	0.7	0.7	0.4
GDP per empl. person, NC at 2010 ref. pr.	2.9	2.4	1.5	0.7	-3.0	-1.0	0.1	1.1	0.9
Unit labour costs, ER (EUR) adjusted	6.8	13.9	4.2	-9.8	-19.1	-2.9	6.1	6.1	-1.6
Ukraine 5)									
GDP deflator	14.2	8.0	4.3	15.9	38.4	15.3	10.9	5.2	15.6
Exchange rate (ER), EUR/NC	-5.0	8.0	-3.2	-32.5	-35.1	-16.5	-9.4	-3.0	-15.3
Real ER (CPI-based)	-0.5	5.9	-4.9	-24.7	-3.5	-4.6	-2.8	1.0	-6.2
Real ER (PPI-based)	7.3	8.9	-3.2	-19.5	-9.7	-4.6	-4.6	1.0	-3.8
Average gross wages, real (PPI based)	-1.2	10.8	8.0	-9.5	-11.4	5.3	6.3	4.1	-1.0
Average gross wages, real (CPI based)	8.9	14.2	8.2	-5.4	-18.9	6.2	4.4	4.1	0.6
Average gross wages, EUR (ER)	11.7	24.1	4.4	-28.4	-21.8	4.0	0.0	5.6	-4.1
Employed persons (LFS)	0.3	0.1	0.2	-6.4	-0.4	-1.2	0.0	0.6	-1.3
GDP per empl. person, NC at 2010 ref. pr.	5.1	0.0	-0.2	-0.2	-9.5	2.0	1.8	1.8	-1.1
Unit labour costs, ER (EUR) adjusted	6.2	24.1	4.6	-28.3	-13.6	-0.4	1.2	5.1	-3.1
Austria									
GDP deflator	1.9	2.0	1.6	1.8	1.9	1.9	1.6	1.7	1.8
Real ER (CPI-based)	0.2	-0.2	0.5	1.2	0.9	0.7	0.2	-0.1	0.5
Real ER (PPI-based)	-1.2	-1.9	-0.8	0.8	0.9	0.8	0.0	-0.1	-0.5
Average gross wages, real (PPI based)	-1.6	2.2	3.0	3.6	3.6	-0.1	-0.2	0.3	2.1
Average gross wages, real (CPI based)	-1.0	0.7	0.1	0.8	1.2	0.7	-0.3	0.2	0.3
Average gross wages, EUR (ER)	2.3	3.1	2.1	2.5	2.1	1.7	1.4	1.9	2.4
Employed persons (LFS)	0.9	0.8	0.5	0.2	0.9	1.5	1.0	1.2	0.6
GDP per empl. person, NC at 2010 ref. pr.	1.9	0.0	-0.4	0.4	0.1	0.2	0.5	0.1	0.4
Unit labour costs, ER (EUR) adjusted	0.4	3.2	2.5	2.0	2.0	1.5	0.9	1.8	2.0

4) From 2014 including Crimean Federal District (for LFS employment and wages from 2015), growth rates comparable. -
5) From 2014 excluding the occupied territories of Crimea and Sevastopol and from 2015 parts of the anti-terrorist operation zone, growth rates comparable.

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

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

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