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SPRING 2019

Forecast Report

Moving Into the Slow Lane

Economic Analysis and Outlook for Central, East and Southeast Europe

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

Moving Into the Slow Lane

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The authors of this report wish to thank Nadya Heger, Beate Muck, Renate Prasch, Monika Schwarzhappel, Galina Vasaros and David Zenz for statistical assistance, as well as Clive Liddiard and Eva Strobl for language editing and proof reading and Michaela Bönisch for text processing.

Press date: 27 March 2019

Executive summary

Economic activity in large swathes of the CESEE region remains very robust, despite increasing external risks and a marked slowdown in the eurozone. Aggregate growth in both EU-CEE11 and WB6 is at or close to a post-crisis high. Activity in the CIS and Ukraine is bumping along at a low level, but has picked up from 2015-2016; and if Russia is taken out of the equation the situation does not look too bad. Last year was, for most countries in the region, another good one in the post-crisis context. For the second year in a row, no country recorded negative growth (a first since 2007).

The fastest-growing economies in the region – perhaps surprising for readers of political news – were Hungary and Poland. Hungary's growth rate was its best since 2004, while Poland also achieved a post-crisis high. The biggest improvements relative to 2017 were largely concentrated in the Western Balkans, and especially in Serbia and North Macedonia. Ukraine and Slovakia also had a good year, compared to the previous 12 months. Aside from Russia, the clear negative story was Turkey, where activity dropped off precipitously in the second half of 2018, following a series of external shocks. Romania also recorded significantly lower growth last year. In both Turkey and Romania, this reflected a slowdown after a period of overheating.

Strong external headwinds to growth emerged in the second half of last year, and these had important implications for the export contribution to economic activity. Export growth was especially weak in EU-CEE11, reflecting greater integration with European and global value chains, and the slowdown in key sources of final demand, such as Germany and China.

Growth for CESEE as a whole peaked in 2017-2018, and will be slower in the next three years than over the previous three. The sharpest slowdowns are expected in Romania and Turkey. We also forecast notably weaker growth in Montenegro, Estonia, Hungary, Slovenia and Bulgaria. Despite the projected slowdown, however, every country will grow more quickly than the eurozone aggregate during the forecast period, implying convergence with Western Europe.

Overheating is not a concern at the aggregate level, and growth in the two countries where potential overheating was previously most visible – Turkey and Romania – has slowed. In CESEE as a whole, we see the greatest potential signs of overheating in labour markets and property prices, especially in EU-CEE countries. By contrast, signs of under-heating are visible in current account and fiscal balances. On the credit front, loans to households are growing rapidly in Russia, Ukraine and Belarus; this trend could become a concern if it continues. We also note very negative real interest rates in the Baltic states, Hungary, Slovakia and Slovenia. However, asset quality continues to improve in most places, providing an important source of stability.

The drivers of growth during the forecast period vary across the region, but it is clear that support from external factors is likely to be weaker almost everywhere than was the case in the past few years. With the global economic cycle slowing (if not ending), and weaker growth projected in all major economies, CESEE will be affected.

The three smaller Visegrád countries, plus Slovenia, are those most exposed to trade tensions at the global level. This reflects not only their high degree of openness (measured in terms of exports/GDP), but also their high degree of integration into regional and global value chains. Commodity exporters, especially those in the CIS, will also have to adjust to weaker oil price growth, after a big windfall in 2018. Some support will be provided by tourism, which has become an increasingly important driver of growth in many countries.

Despite recently very strong wage growth, we see little threat to external competitiveness for most countries. The exceptions are Bulgaria, Romania and Croatia, where merchandise trade balances have deteriorated quite significantly. Generally, across the region, firms not at the frontier in terms of productivity (especially SMEs) will face particular problems from the pressure to pay higher wages in the face of ever-worsening labour shortages.

Despite expected strong wage growth, in most CESEE countries we expect private consumption to make a smaller contribution to growth in the forecast period than in the last three years. One issue is confidence: people read the news and understand that a trade war between the world's two biggest economies is an issue that could have repercussions for them. This could in turn lead to higher savings. A second issue is demographics: populations are declining in most countries in the region. The scale of population decline projected across most of CESEE is unprecedented in peacetime, and there are only limited options to offset this. Employment rates have already risen considerably in many countries, and so the scope for further impetus from this source is limited. The model of importing workers from Ukraine to address labour shortages is not really a long-term solution. Financially incentivising people to have children will only, at best, bring results in 1–2 decades from now.

The general backdrop for investment remains quite supportive in most of the region. Business sentiment in many countries has been affected by external developments, but is still generally at historically high levels. EU funds are playing an important role, and this should continue in most EU-CEE11 countries. Meanwhile real interest rates remain very low by historical standards almost everywhere (admittedly, with the important exceptions of Russia and Turkey). FDI inflows into EU-CEE11 and the Western Balkans rose last year, but Russia and Turkey experienced declines. Labour shortages and strong wage growth could present barriers to FDI growth during the forecast period.

One possible response to increasingly acute labour shortages in the region would be an increase in productivity-enhancing investment. We see an increase in imports of industrial robots in many parts of EU-CEE11, possibly in response to labour shortages. However, these trends are by no means guaranteed to continue, and the gap between CESEE and the frontrunners in Western Europe, North America and ASia (measured in terms of robots per worker) is still generally quite high.

A factor that may discourage firms from investing more to offset labour shortages and higher wages is the negative political development in many countries. The impact of politically driven legal uncertainty on private investment in countries such as Poland and Russia has been clear for some time, and there is reason to think that this could become an issue in other countries as well. Increased authoritarianism, state capture and interference in the independence of institutions appear to be on the rise across much of CESEE, including in the EU-CEE11 countries. Institutional de-convergence over the past ten years is particularly apparent in Hungary and Turkey.

Inflation in most countries of the region is surprisingly weak, particularly in the context of last year's sharp increase in oil prices and the very strong wage rises in some countries. The disparity between wage growth and inflation is particularly apparent in Romania, Ukraine, Belarus, Hungary, Russia, Albania, Lithuania, Bulgaria, the Czech Republic, Latvia and Poland. In all likelihood, a confluence of factors is keeping price growth low relative to wages in most of CESEE. These factors include weak inflation in the eurozone, slack in parts of the economy, a de-anchoring of inflation expectations, increased competition from online retailers, lower international food prices, higher savings rates, a relatively low labour income share, and remittance outflows. With the exception of some CIS countries (where inflation fell quite sharply last year, and will bounce back), we do not expect current inflation dynamics in CESEE to change significantly during the forecast period.

Russia and Turkey are easily the biggest economies in CESEE – and currently also the worst performing. However, while this looks like being a long-term issue for the former, we do see a somewhat brighter (albeit volatile) future for the latter. Russia is bumping along at a bit below 2%; and without major institutional and other reforms (the latter impossible to imagine any time soon), this will not change. By contrast, Turkey is in recession and has a tough near-term outlook; but by 2021, it could again be one of the fastest-growing economies in the region.

The dovish tone of our recent reports (often going against consensus expectations) has turned out to be correct. Except for in Hungary (where core inflation has risen above 3%), central banks in EU-CEE appear reluctant to tighten monetary policy, reflecting the continued weakness of inflation. The other three major EU-CEE central banks (Czech Republic, Romania and Poland) appear relaxed about inflation, with real interest rates either around zero or negative. This stance is reinforced by an increasingly dovish ECB (it would be difficult to overstate the impact of years of ultra-low policy rates by the major global central banks, and particularly the ECB, on interest rates in CESEE). The exceptions among the major CESEE central banks are Russia, Ukraine and Turkey, where policy is much tighter.

The risks to the growth outlook in our region are fairly significant, and overwhelmingly tilted to the downside. Our main concerns are unchanged from the autumn: a global trade war and sharp slowdown in the Chinese economy, a smaller EU budget from 2021, and a renewed outbreak of the eurozone crisis.

COUNTRY SUMMARIES

ALBANIA

Economic growth, supported both by domestic and external demand, will continue, but at a slower pace. Remittances – close to 6% of GDP – will boost consumption, and will also contribute to a lower current account deficit. Fiscal consolidation is expected to continue, via a cut in expenditures. Intensification of investments in renewable energy is expected to boost alternate sources of energy production. Uncertainty about FDI inflows is expected. Political unrest and massive protests threaten macroeconomic stability and the process of EU integration.

BELARUS

Economic activity slowed down abruptly in the second half of 2018 due to a combination of domestic and external factors. These include changes in Russia's energy taxation system which affect Belarus. Private consumption remained the main growth driver thanks to rising income and a boom in consumer credit. There are no imminent threats to macroeconomic stability but the short-term prospects have deteriorated and the Belarusian economy is expected to slow down in the coming years.

BOSNIA AND HERZEGOVINA

Following the general elections in October 2018, the process of government formation at the country level and in the Federation of Bosnia and Herzegovina is lengthy. Along with slightly deteriorating external conditions over the whole forecasting period, the political factors will negatively affect growth in 2019, with an estimated growth rate of 2.5%. Under the assumption that the political stalemate is resolved soon, we expect growth in 2020 and 2021 to mildly increase.

BULGARIA

The 3% increase in GDP in 2018 was below the rates of growth in the preceding years. The slowdown mirrors a weakening of exports which became a drag on economic activity. The tight labour market was adding supply constraints to growth. By contrast, private consumption surged, providing an impetus to economic activity in 2018. We expect further moderation of GDP growth in the period 2019-2011. In the absence of external shocks, the macroeconomic situation will remain stable and under control.

CROATIA

Croatia's GDP growth will continue to moderate to 2.5% in the 2019-2021 period. The main support to growth will come from private consumption and tourism. A more effective use of EU funds would be key to stimulating investments and growth. Continued emigration of young people together with the ageing of the population is becoming a growth limiting factor. Joining the euro area is high on the political agenda.

CZECH REPUBLIC

The strong rise in public investment in 2018 is to moderate in 2019 thus reducing overall growth accordingly. Tight labour markets and the ongoing wage push support private consumption. Despite this, higher inflation is not on the horizon while rising unit labour costs are responsible for falling corporate profitability and may weaken foreign trade performance. Monetary policy may become too restrictive. Fiscal policy targeting surpluses does little to support growth.

ESTONIA

Investment activity will revive in 2019-2020, induced by inflows of EU funds and increased capital spending for machinery by enterprises. Household consumption, backed by a considerable rise in employment and incomes, continues to be a strong driver of growth. However, given the weakened outlook for external demand, exports will develop at a declining pace in the coming years. We project GDP to grow at lower rates of 2.9% in 2019 and 2.5% in 2020, while even diminishing to 2.2% in 2021.

HUNGARY

Economic growth has been driven by domestic demand. Beside strong investment growth also household consumption expanded more rapidly than the GDP. In trade of goods the expansion of imports exceeded to a large extent that of the exports. The strong dependence on EU transfers, a characteristic feature of the current growth path, makes it likely that the expected huge drop in EU supported investments in 2019-2022 will significantly deteriorate Hungary's growth prospects.

KAZAKHSTAN

GDP growth reached 4% year on year in 2018, mainly owing to high oil prices and expansion of production in the oil sector. In 2019, the negative effect of the drop in oil prices on the economy will be somewhat offset by government stimulus measures directed primarily at stimulating private consumption. Nevertheless, economic growth will slow down to about 3% p.a. during the forecast period.

KOSOVO

The pace of growth will pick up to above 4% in the medium term. Consumption as well as public and private investment will provide a new impetus to growth. The external sector will be characterised by a further widening of the trade deficit. The 100% tariff on imports from Serbia is unlikely to have a strong impact on the economy. 2019 is expected to be a decisive year for the Kosovo-Serbia dialogue and their future place in the EU.

LATVIA

Both public and private investment keep the economy growing at a high pace in 2019, whereas export activity is further abating this year. Household consumption will continue to rise rapidly in 2019. While employment increases, skill shortage results in strong wage growth. The incoming coalition government may pursue a more lax fiscal policy. In 2019 we expect GDP to grow still considerably, by 3.5% in real terms, followed by a further slowdown to 3% in 2020 and 2.5% in 2021.

LITHUANIA

External demand dynamic cooled off last year and is expected to continue abating in 2019 and the coming two years. Public and private investment will drive growth for another year. Thereafter we expect private investment activity to subside gradually. A further decline in unemployment is driving rapid wage increases. In addition, the implemented income tax reform will foster growth in household consumption. For 2019, we expect real GDP to grow by 3%, followed by 2.6% in 2020 and 2.3% in 2021.

MOLDOVA

Economic growth of 4% or more for the third consecutive year in 2018 has corrected for the setbacks suffered during the bank-fraud related crisis in 2015. Inflation has come down and the local currency stabilised. Economic prospects are positive but cumbersome coalition building following inconclusive recent elections can delay necessary reforms.

MONTENEGRO

In 2018, GDP is estimated to have grown by 4% and was mostly driven by surging investment and growing exports. Employment increased considerably, but unemployment still remains high. The high government debt burden represents the largest challenge for policy-makers, which pursue an ambitious fiscal consolidation plan. During 2019-2021, economic growth will gradually slow down with an average rate of around 2.2%. In 2019, the government started the Montenegro Citizenship by Investment Programme.

NORTH MACEDONIA

The North Macedonian economy grew by 2.3% year on year in 2018 on the back of strong export growth and a pick-up in private consumption. The approval by the Greek Parliament of the new official name of North Macedonia was a major positive political development. Improved political stability will boost investor confidence and promote robust investment growth. Overall GDP will grow by about 3% p.a. during 2019-2021.

POLAND

Despite lower profits the corporate sector's financial standing and financing conditions are good. But private domestic firms are still reluctant to expand investment. Ongoing political changes are destabilising the country's legal framework, undermining trust in the rule of law. The conflict between the European Commission and the Polish government may lead to substantial cuts in the funds available to Poland which would also undermine public investment and reduce medium-term growth prospects.

ROMANIA

Economic growth turned out at 4.2% in 2018, above wiiw expectation, and the decline to or below 3% p.a. in 2019-2021 will be below earlier forecasts. Beyond deteriorating external conditions and weak investments, new unorthodox fiscal policy measures will drag on the economy. Raising fiscal revenues by taxing turnover in the banking, telecom and energy sectors will suppress economic activity.

RUSSIA

GDP growth for 2018 surprised everybody. Net exports and investments were the main drivers, the record current account surplus and a low inflation among the cheerful passengers. But neither the pace of growth nor the size of the current account surplus is sustainable and will be maintained. Still, the accumulated reserves and cautious economic policies will serve as a buffer mitigating external risks. Stability and weak growth will thus characterise Russian developments in the coming years.

SERBIA

After a desperately weak post-crisis performance even by CESEE standards, the Serbian economy finally had a good year in 2018. Growth will weaken a bit in 2019, but remain fairly robust in the context of the last decade. A bigger slowdown is likely in 2020-2021. Domestic and international political risks have risen, which is an issue for an economy that relies so much on FDI. The EU reform process will continue to provide an important policy anchor, but accession is still many years away.

SLOVAKIA

Slovakia saw high growth in 2018, thanks to increasing household consumption and gross capital formation. However, our forecasts for this and next year have been revised downwards and amount to 3.6% in 2019 and about 3% thereafter. Domestic and external risks are on the rise.

SLOVENIA

After another successful year, GDP growth is expected to moderate to 3% or even less between 2019 and 2021. Investments spurred by EU funding and consumption backed by rising wages will continue to be important drivers of economic activity. The contribution of net exports is likely to turn negative in the forecast period given a weakening of external demand. In the medium term the shrinking of the working-age population and increasing labour shortages may become growth-limiting factors.

TURKEY

The worst of the crisis may have passed, assuming that the government does not attempt any radical measures and that relations with the US do not deteriorate. However, the economy will have a difficult year in 2019. Things should improve by 2020, with the economy bouncing back to reasonable growth. External risks remain, but the current account deficit has shrunk considerably, reducing vulnerabilities, and a more dovish US Federal Reserve provides important support.

UKRAINE

In 2018, Ukraine’s economy recorded its highest growth since 2011 thanks to robustly rising wages and remittances, currency stability, and a record grain harvest. However, growth is projected to lose steam this year on the back of monetary tightening and a lower harvest, and owing to reduced gas transit revenues next year. The forthcoming presidential elections may result in more populist economic policies, but will not change the country’s current EU and NATO integration efforts.

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

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

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The statistical data until 2018 presented in this Report are as of 27 February 2019, forecasts as of March 2019. Most data are taken from the wiiw Databases. Direct access is available at: http://data.wiiw.ac.at/.

wiiw COUNTRY GROUPS

CESEE23 Central, East and Southeast Europe

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

EU-CEE11 Central and East European EU members

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

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

SEE9 Southeast Europe

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

non-EU12 non-European Union CESEE countries

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

WB6 Western Balkans

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

CIS3+UA	**Commonwealth of Independent States-3 and Ukraine**		
BY	Belarus	MD	Moldova
KZ	Kazakhstan	UA	Ukraine

CIS4+UA	**Commonwealth of Independent States-4 and Ukraine**		
BY	Belarus	RU	Russia
KZ	Kazakhstan	UA	Ukraine
MD	Moldova		

EU28	**European Union**		
AT	Austria	IE	Ireland
BE	Belgium	IT	Italy
BG	Bulgaria	LT	Lithuania
CY	Cyprus	LU	Luxembourg
CZ	Czech Republic	LV	Latvia
DE	Germany	MT	Malta
DK	Denmark	NL	Netherlands
EE	Estonia	PL	Poland
EL	Greece	PT	Portugal
ES	Spain	RO	Romania
FI	Finland	SE	Sweden
FR	France	SI	Slovenia
HR	Croatia	SK	Slovakia
HU	Hungary	UK	United Kingdom

EA19	**Euro area**		
AT	Austria	LT	Lithuania
BE	Belgium	LU	Luxembourg
CY	Cyprus	LV	Latvia
DE	Germany	MT	Malta
EE	Estonia	NL	Netherlands
EL	Greece	PT	Portugal
ES	Spain	SI	Slovenia
FR	France	SK	Slovakia
IE	Ireland	UK	United Kingdom
IT	Italy		

ABBREVIATIONS

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

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

EU	European Union
EU15	European Union – 15 countries
FDI	Foreign Direct Investment
FISIM	Financial Intermediation Services, Indirectly Measured
FW	Free Voters of Bavaria
GDP	Gross Domestic Product
GNP	Gross National Product
GVA	Gross Value Added
ICP	International Comparison Project
IFR	International Federation of Robotics
IMF	International Monetary Fund
LFS	Labour Force Survey
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne (Statistical classification of economic activities in the European Community)
NACE Rev. 1	first revision of the original NACE (1970)
NACE Rev. 2	revised classification, introduced in 2008
NB	National Bank
NC	national currency
NMS	new EU Member States
NPL	non-performing loan
OECD	Organisation for Economic Co-operation and Development
OICA	Organisation Internationale des Constructeurs d’Automobiles
OMS	old EU Member States
OPEC	Organization of the Petroleum Exporting Countries
PMI	purchasing managers’ index
pp	percentage points
PPI	producer price index
PPP	Purchasing Power Parity
PPS	purchasing power standard
RER	Real exchange rate
RIR	Real interest rate
SME	small and medium-sized enterprise
SNA	System of National Accounts
SPE	Special Purpose Entity
SPS	sanitary and phytosanitary
TEN-T	Trans-European Transport Network
VAT	value added tax
WBIF	Western Balkan Investment Framework
WIFO	Austrian Institute of Economic Research
wiiw	The Vienna Institute for International Economic Studies

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

1. Global economic outlook

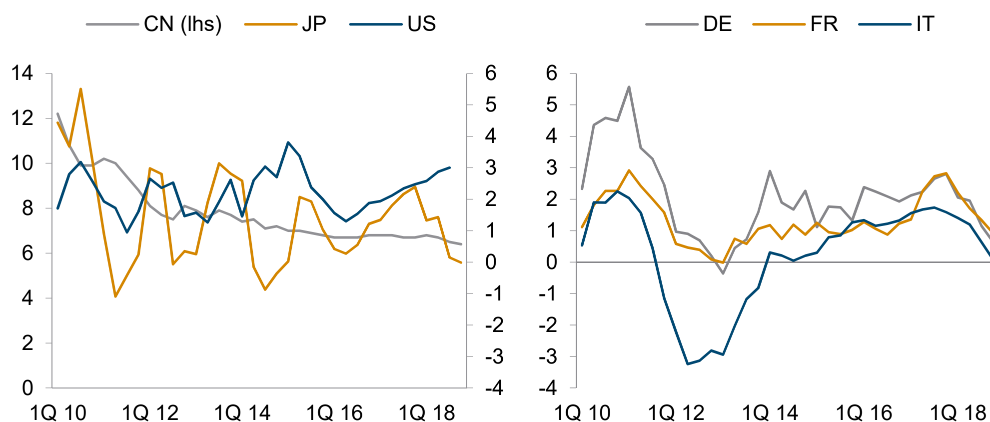
1.1. INTERNATIONAL ECONOMIC ENVIRONMENT

by Mario Holzner

Economic growth in the G20 and the eurozone peaked in the 3rd quarter of 2017 and has been decelerating ever since. In the last quarter of 2018, real GDP growth rates stood at around 3.5% in the G20 and slightly above 1% in the eurozone, up from 4% and 3% at the peak, respectively. The trends are quite similar in the largest economies that go to make up those two economic groups (Figure 1.1). Growth peaked toward the end of 2017 and has been decelerating since then. In the 4th quarter of 2018, real GDP growth rates in both France and Germany were below 1%. Italy's economy had started to stagnate. And Japan even went negative. The dynamics of the Chinese economy have been on a downward path for quite some time, albeit at a high level – the most recent growth figures are well above 6%. The major exception to all of this is the USA. There, growth accelerated from mid-2016 and likely peaked in the 3rd quarter of 2018, with a robust growth rate of 3%. But there, too, a deceleration of the economic dynamics is expected to set in. Clearly, the broad-ranged boom of the past couple of years has come to an end. The question is whether it will be followed by a bust, or whether a soft landing can be expected.

Figure 1.1 / Quarterly real GDP growth, 1Q 2010 – 4Q 2018

change in % against preceding year

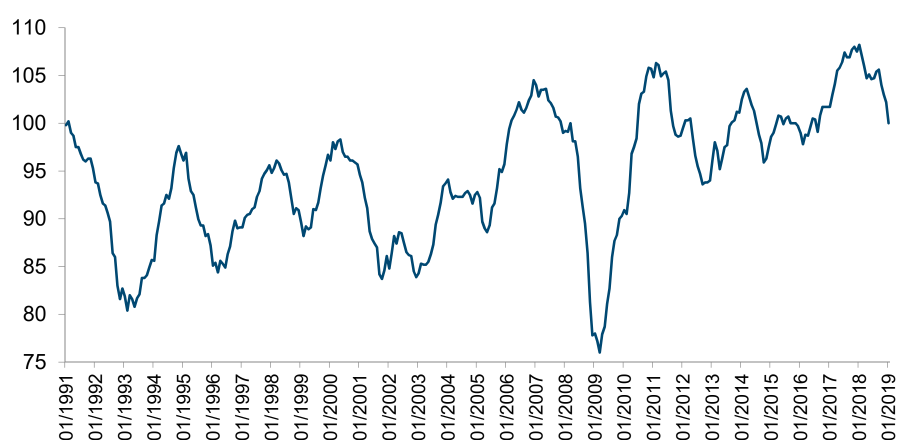


Source: OECD.

Despite a negative trend, the business climate in the eurozone's main economy – Germany – is still at a very high level. Since German reunification, there have been only very few times when economic agents in manufacturing, trade and construction had a better opinion of the business situation and business expectations than today (Figure 1.2). Particularly in the construction sector, the business climate is good; and it even improved in recent months, compared to the same months the year

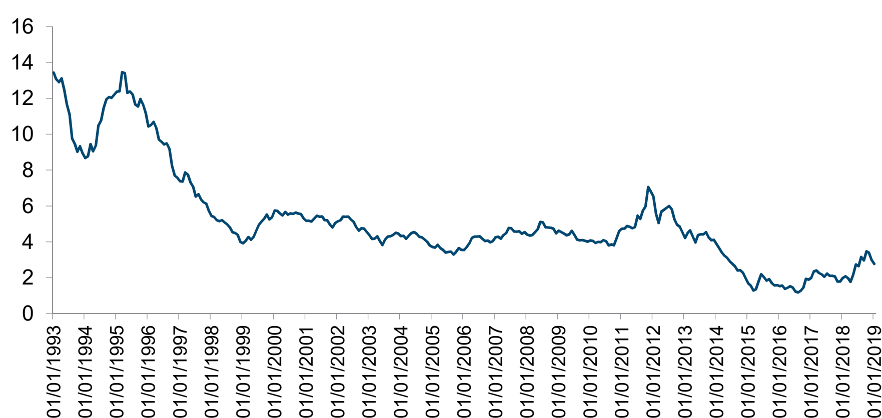
previously. That raises hopes of more public and private investment in Germany's ailing infrastructure, which would stimulate demand in the rest of Europe – including Central, Eastern and Southeast Europe (CESEE). In this respect, it is reassuring that in its Annual Growth Survey 2019[1] 'For a stronger Europe in the face of global uncertainty', the European Commission identified 'a frontloading of investment in the modernisation and decarbonisation of Europe's industry, transport and energy systems' as one of the key priority areas. Also, the latest Franco-German manifesto for a European industrial policy is reassuring.

Figure 1.2 / German manufacturing, trade and construction business climate index, 2015=100



Source: ifo.

Figure 1.3 / Italian long-term interest rate, in %, 10 years maturity, 28/02/1993 - 31/01/2019



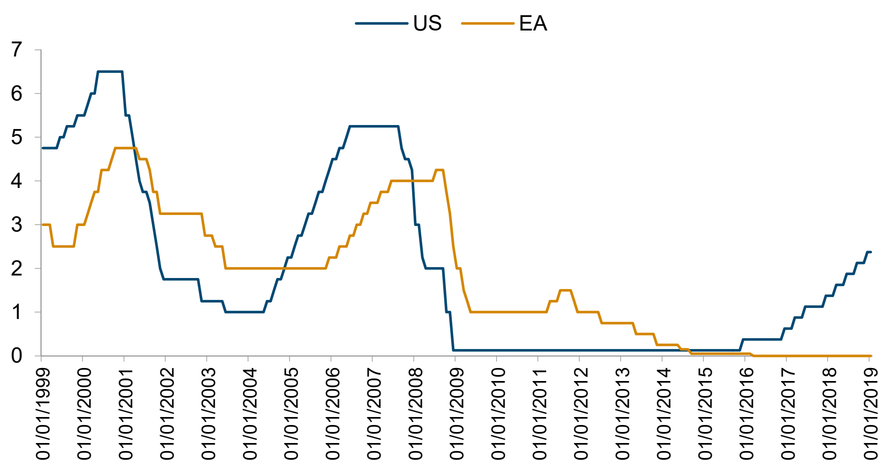
Source: ECB.

1 http://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-770-F1-EN-MAIN-PART-1.PDF

Even the economic situation in Italy – the sick man of Europe[2] – although worrying, is not hopeless. Despite some recent increases in the Italian long-term interest rates (Figure 1.3) related to the new populist government's confrontational stance vis-à-vis the European Commission, 10-year interest rates in Italy are at a historically low level. At the end of January 2019, the nominal rate was 2.77%. According to the Italian National Institute of Statistics (ISTAT), inflation stood at 0.9% that month, which leaves the real interest rate at 1.87%. This certainly represents a fiscal burden for Italy at a time of economic stagnation, but it should be manageable in the medium run, and it should be possible to finance key public investment programmes[3] and to produce counter-cyclical effects on the economy.

While global monetary policy was tightening with the US Federal Reserve's policy rate hikes, this trend might have come to an end, with a marked increase in economic policy risks and the fading of the economic boom. By the end of November 2015, US and eurozone central bank policy rates were close to zero (Figure 1.4). Since then, the Fed has gradually hiked the rate up – to a level of 2.375% at the end of January 2019. By contrast, and following different paths of growth dynamics, the ECB reduced its policy rate to zero. However, more recently, the ECB has also phased out its quantitative easing programmes. Nevertheless, with the strong rise in economic policy uncertainty (Figure 1.5) – including US trade disputes and Brexit, as well as weakening Chinese growth prospects – policy rate rises do appear, for the time being, to be off the agenda.[4]

Figure 1.4 / Central bank policy rates, in % p.a., 31/01/1999 – 31/01/2019



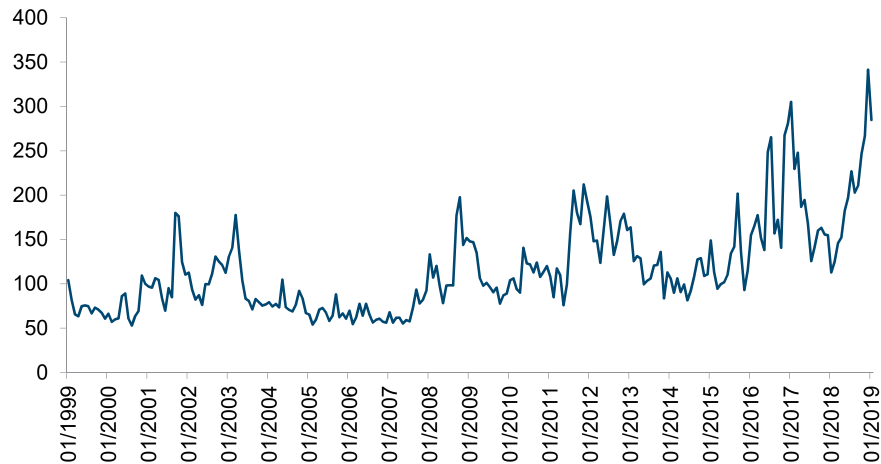
Source: BIS.

2 https://www.bloomberg.com/opinion/articles/2019-01-23/the-case-for-a-european-bounce-depends-on-the-ecb

3 https://www.ft.com/content/6bd24218-248f-11e9-8ce6-5db4543da632

4 https://www.ft.com/content/24508f0e-2b91-11e9-88a4-c32129756dd8

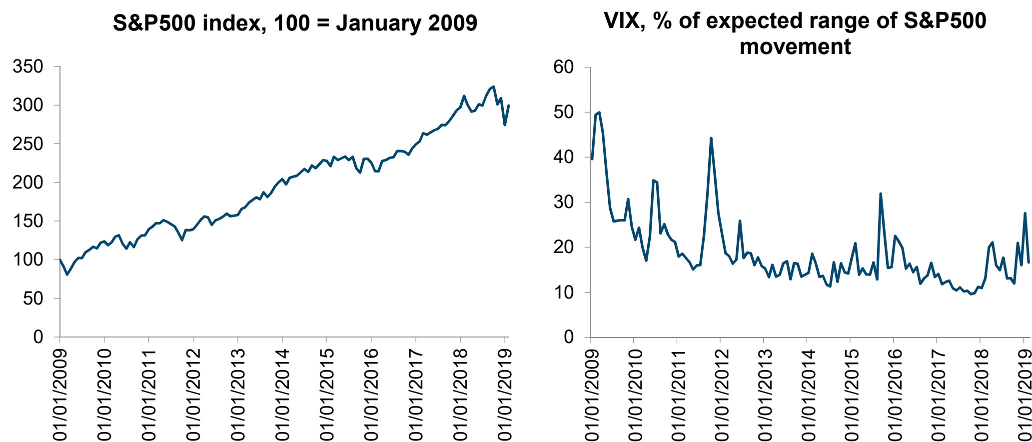
Figure 1.5 / Global Economic Policy Uncertainty, 100 = mean value 1997-2016, 01/1999-01/2019



Source: Economic Policy Uncertainty.

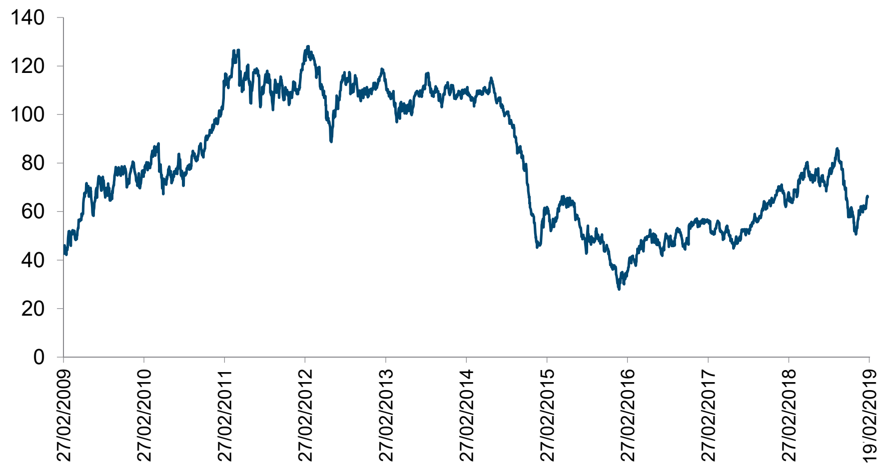
Increased uncertainty about global economic prospects and monetary policy responses are also driving asset markets, causing a downward correction in the oil price and many stock markets at the end of 2018, as well as raising volatility in the markets. This is reflected in the recent ups and downs in, for example, the S&P500 index and the related CBOE VIX volatility index (Figure 1.6). Oil prices, too, have slid to historically low levels (Figure 1.7). However, most recently the asset markets have started to stabilise again, which is related to the expected end of global monetary tightening.

Figure 1.6 / S&P500 and CBOE VIX index, 01/2009 – 02/2019



Source: yahoo finance.

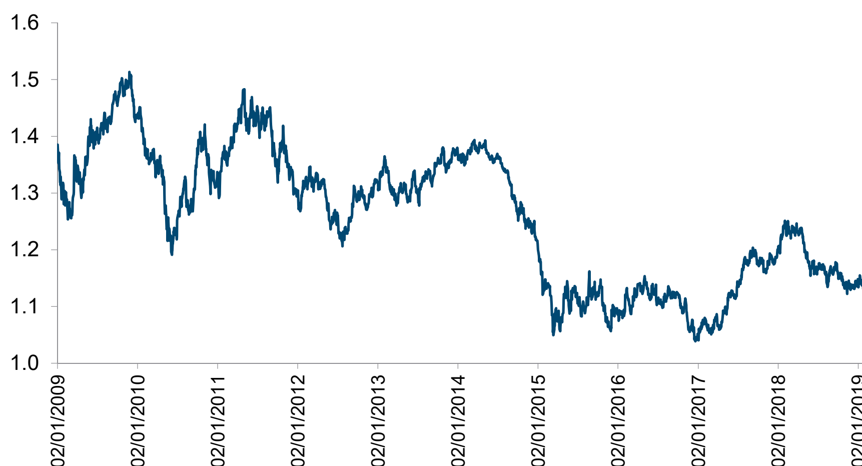
Figure 1.7 / Daily Brent Crude oil price, in USD, 27/02/2009 – 19/02/2019



Source: macrotrends.net.

A potential end of monetary tightening might also put an end to the strengthening of the US dollar against the euro that has been observed over the past year. The USD/EUR exchange rate dropped from levels of 1.25 USD per 1 euro in February 2018 to 1.14 in February 2019 (Figure 1.8). This reflects a nominal euro depreciation against the dollar of almost 9% within a year. Most recently, signs of the Fed becoming dovish have led to a stagnation of the USD/EUR exchange rate over the past few months (which has to be seen in combination with the ECB being dovish too). Thus, our expectation is that over our forecast period (2019-2021), both the oil price and the USD/EUR exchange rate will remain relatively stable, at close to current levels of above 60 USD/barrel and at 1.14 USD/EUR, respectively (Table 1.1).

Figure 1.8 / US dollar euro exchange rate, in USD per 1 EUR, 02/01/2009 – 26/02/2019



Source: macrotrends.net.

Table 1.1 / Technical assumptions for 2018 and the wiiw forecast period 2019-2021

	2018	2019	2020	2021
Eurozone real GDP growth	1.9	1.6	1.5	1.4
USD/EUR exchange rate	1.18	1.14	1.14	1.16
USD per barrel Brent oil	71.5	62	61	60

Source: Own assumptions.

Despite increased global uncertainties – including Brexit, reduced global trade volumes and fears of a renewed euro crisis, this time around Italy – our expectation is that eurozone growth will only decelerate slowly over the forecast period. While the European Commission in its latest Winter Forecast predicts a fairly strong growth correction in 2019 – 1.3%, down from 1.9% in 2018 – our own forecast of 1.6% provides a somewhat smoother picture (Table 1.1). This is based on our stronger valuation of the potential positive risks to the forecast, including a more extensive use of EU funds for investment at the end of the current EU Multiannual Financial Framework and the still favourable labour market conditions that should result in stronger domestic demand. Particularly the latter factor has so far been underestimated in the Commission's GDP growth forecasts. Moreover, recent high frequency indicators related to domestic demand in Germany are pretty strong and might even be a bit stronger at the beginning of this year. Also, a weaker euro exchange rate and lower oil prices should additionally soften the eurozone's business cycle downswing. On the other hand (and unlike the Commission), we do not expect a rebound in 2020, but rather a further gradual deceleration of economic dynamics in the eurozone, which will have associated smoothing effects for the CESEE economies as well.

2. CESEE economic outlook

2.1. CESEE OVERVIEW: SLOWER GROWTH IS HERE

by Richard Grieveson

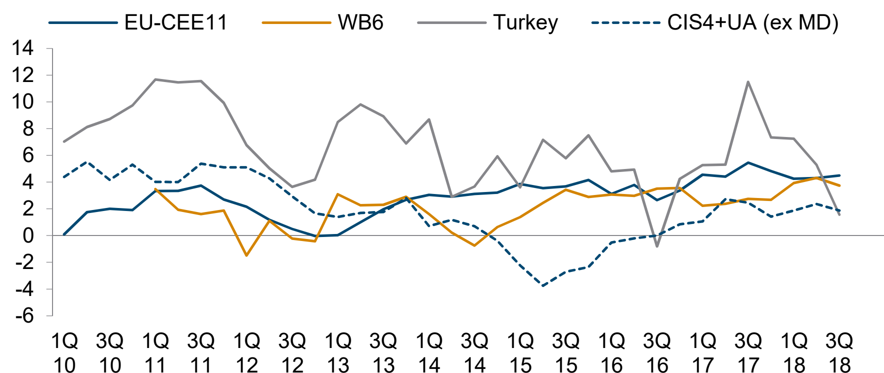
Growth in much of CESEE is still at or close to its best level since the global financial crisis, and the outlook for 2019-21 is reasonably positive for most. This reflects a combination of strong wage rises, low interest rates, and a generally good outlook for investment. However, growth has now peaked for CESEE, and most of the region's economies will expand more slowly in 2019-21 than in 2016-18. The slowdown in key sources of final demand such as Germany and China will weigh on exports. Regionally, the main challenges are increasingly severe labour shortages, the impact of global developments on confidence, and the potential for lower EU funds inflows. Authoritarianism, state capture and interference in the independence of institutions are all on the rise, creating significant risks for growth in the medium- and long-term.

2.1.1. Review of 2018: Another good year for most in CESEE

Economic activity in large swathes of the CESEE region remains very robust, despite increasing external risks and a marked slowdown in the eurozone. Aggregate growth in both EU-CEE11 and WB6 remains at or close to a post-crisis high (Figure 2.1). Activity in the CIS and Ukraine is bumping along at a low level, but has picked up from 2015-2016; and if Russia is taken out of the equation the situation does not look too bad. Last year was therefore, for most countries in the region, another good one in the post-crisis context. For the second year in a row, no country recorded negative growth (a first since 2007). Aside from Russia, the clear negative story is Turkey, where activity dropped off precipitously in the second half of 2018, following a series of external shocks.

Figure 2.1 / Quarterly real GDP growth

change in % against preceding year



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

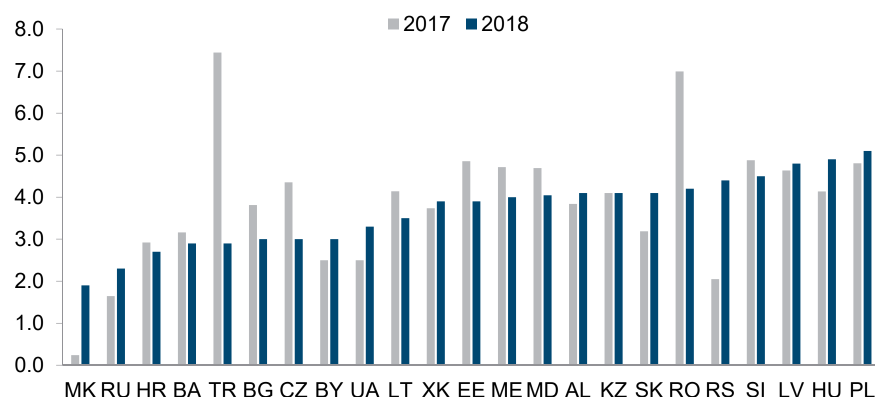
Turkey's large size and sharp slowdown had a big impact on aggregate growth in CESEE last year. Aggregate real GDP growth in the CESEE23 was 3.2% in 2018 – rather a significant drop from 4% the previous year. Far and away the largest part of the aggregate CESEE23 slowdown was due to Turkey, with additional minor contributions from Romania and the Czech Republic. We estimate that Turkish real GDP growth was 4.5 percentage points (p.p.) lower in 2018 than in 2017, and that in Romania it declined by 2.8 p.p., both reflecting a slowdown from overheating. Other notable fallers were Estonia (-1 p.p.), the Czech Republic (-1.4 p.p.) and Bulgaria (-0.8 p.p.). In 14 of the 23 countries, growth was slower in 2018 than in 2017 (in the other nine it was more rapid). However, for most countries where a slowdown occurred, the difference was small.

Aside from Turkey, Romania and the Czech Republic, all the other big countries in the region posted either similar or better growth rates in 2018 than in 2017. The upswing in Russian growth came as a surprise (although this was not enough to prevent it being the second slowest-growing economy in the CESEE23). Growth in Ukraine also picked up relative to the previous year. The fastest-growing economies in the region – perhaps surprising for readers of political news – were Hungary and Poland.

The big improvements in 2018 relative to the previous year were largely concentrated in the Western Balkans. North Macedonian real GDP growth improved by 1.7 p.p., as the country emerged from a political crisis; and in Serbia, output was 2.4 p.p. higher, as the economy bounced back from a drought. Otherwise notable improvements were recorded in Slovakia (+0.9 p.p.), helped by particularly strong investment (notably construction) activity, and Ukraine, where high real wage growth and remittance inflows played an important role in stimulating growth. Incredibly, Hungary recorded its best growth rate since 2004. Growth in both Serbia and Poland also reached a post-crisis high.

Figure 2.2 / Real GDP growth

change in % against preceding year



Source: wiiw Annual Database incorporating national and Eurostat statistics.

Taking a simple average of the CESEE23 countries, private consumption added 2.4 percentage points to growth last year, 0.1 percentage points higher than in 2017. However, this masked some big differences between countries. In the Baltics and the Balkans, as well as in Belarus, consumers moved up a gear. The main exceptions were the 'overheaters', Turkey and Romania. Although in both

countries private consumption still made a positive contribution to growth in 2018, that contribution was 2.7 and 3.1 percentage points, respectively, less than in 2017. In Turkey, we estimate that real private consumption added only 0.9 percentage points to headline growth, by far the weakest contribution since 2009.

The strength of private consumption in CESEE reflects a combination of low inflation, improved labour market performance, and higher wages and social transfers. Inflation is at historically low levels pretty much everywhere, except Turkey, and in many cases nominal wage growth is strong, meaning high real wage increases. Several countries have recently raised the minimum wage, in some cases for the first time since before the crisis.

Real gross fixed capital formation added 1.5 percentage points to growth on average across CESEE countries last year, down marginally from 2017 (1.6 percentage points). The strongest contributions were recorded in EU-CEE11 and the Western Balkans, and in particular in Hungary, Latvia, Slovenia, Montenegro, Kosovo and Serbia. In EU-CEE11, we attribute at least some of the strong investment growth to labour shortages, while the EU funds cycle also no doubt played a role (especially in Hungary). However, these explanations apply less to the Western Balkan countries, where foreign direct investment and pent-up demand from the bad post-crisis years (for example, in Serbia) were likely more influential. Across the region, very low real interest rates were also supportive of growth. The countries where investment played much less of a role in 2018 than in 2017 were Turkey, Romania, Estonia and Russia. In the first two countries, a response to overheating was probably the reason. In Russia, we attribute the disappointing results to weak investor confidence.

A key development for regional growth, especially in the second half of last year, was the emergence of external headwinds, which had implications for the export contribution to economic activity. Overall external trade growth slowed quite markedly for the region as a whole in 2018, after a very strong 2017. In nominal euro terms, we estimate that CESEE23 exports rose by 6.8% in 2018, compared with 14.2% in 2017. Growth was especially weak in EU-CEE11 (0.7%, from 10.9% in 2017), reflecting greater integration with European and global value chains, and the slowdown in key sources of final demand, such as Germany and China. Industrial output trends generally reflected this, with slowdowns in 2018 recorded in much of EU-CEE11 (and Turkey) compared to the previous year. By contrast, industrial output growth increased in 2018 in most of the Western Balkans and (to a lesser extent) in the CIS and Ukraine.

On average, exports of goods and services added 2.8 percentage points to GDP growth last year in the CESEE countries – down from 4 percentage points in 2017. Combined with relatively strong import growth on the back of robust private consumption and investment trends, this meant that net trade subtracted on average 0.6 percentage points from headline growth, similar to 2017. The most significant change in 2018 was in Turkey, where we estimate that net exports added 3 p.p. to headline growth (from 0.1 p.p. in 2017), reflecting the collapse of the lira and consequently higher exports and lower imports in the second half of the year. Russia’s net export contribution also shifted from a large negative in 2017 to a small positive last year.

2.1.2. Forecasts for 2019-21: Slower growth is here

Table 2.1 / Overview 2017-2018 and outlook 2019-2021

		GDP real change in % against prev. year					Consumer prices change in % against prev. year				
				Forecast					Forecast		
		2017	2018	2019	2020	2021	2017	2018	2019	2020	2021
BG	Bulgaria	3.8	3.0	2.8	2.5	2.5	1.2	2.6	2.5	2.5	2.5
CZ	Czech Republic	4.4	3.0	2.6	2.7	2.8	2.4	2.0	2.1	2.1	2.0
EE	Estonia	4.9	3.9	2.9	2.5	2.2	3.7	3.4	2.8	2.7	2.5
HR	Croatia	2.9	2.7	2.6	2.5	2.5	1.3	1.6	1.8	1.8	1.5
HU	Hungary	4.1	4.9	3.3	2.3	1.9	2.4	2.9	3.0	3.0	3.0
LT	Lithuania	4.1	3.5	3.0	2.6	2.3	3.7	2.5	2.4	2.4	2.3
LV	Latvia	4.6	4.8	3.5	3.0	2.5	2.9	2.6	2.4	2.4	2.3
PL	Poland	4.8	5.1	3.7	3.3	3.3	1.6	1.2	2.2	2.1	2.0
RO	Romania	7.0	4.2	2.8	3.0	3.2	1.1	4.1	2.5	3.0	3.0
SI	Slovenia	4.9	4.5	3.2	3.0	2.9	1.6	1.9	1.8	1.8	2.0
SK	Slovakia	3.2	4.1	3.6	3.0	2.5	1.4	2.5	2.6	2.3	2.3
	EU-CEE11 [1)2)]	*4.8*	*4.3*	*3.2*	*3.0*	*2.9*	*1.8*	*2.2*	*2.3*	*2.4*	*2.3*
	EA19 [3)]	*2.4*	*1.9*	*1.6*	*1.5*	*1.4*	*1.5*	*1.8*	*1.6*	*1.6*	*1.6*
	EU28 [3)]	*2.4*	*1.9*	*1.8*	*1.8*	*1.6*	*1.7*	*1.9*	*1.8*	*1.9*	*1.9*
AL	Albania	3.8	4.1	3.8	3.8	3.4	2.0	2.0	2.4	2.6	2.8
BA	Bosnia and Herzegovina	3.2	2.9	2.5	2.6	2.7	0.8	1.4	1.5	1.6	1.4
ME	Montenegro	4.7	4.0	2.5	2.2	2.0	2.4	2.6	1.9	1.8	1.9
MK	North Macedonia	0.2	1.9	3.0	3.0	3.0	1.4	1.5	2.0	2.0	2.0
RS	Serbia	2.0	4.4	3.4	2.9	2.9	3.0	2.0	2.7	2.8	2.8
XK	Kosovo	3.7	3.9	4.1	4.0	3.9	1.5	1.1	1.6	1.6	1.6
	WB6 [1)2)]	*2.5*	*3.8*	*3.3*	*3.0*	*3.0*	*2.1*	*1.8*	*2.2*	*2.3*	*2.3*
TR	Turkey	7.4	2.9	-0.7	3.2	3.7	11.1	16.3	15.8	9.3	7.9
BY	Belarus	2.5	3.0	2.4	2.2	2.0	6.0	4.9	7.0	8.0	8.0
KZ	Kazakhstan	4.1	4.1	3.0	3.0	3.0	7.4	6.0	6.0	5.5	5.5
MD	Moldova	4.7	4.0	3.8	3.6	3.5	6.5	2.9	4.0	4.0	5.0
RU	Russia	1.6	2.3	1.8	1.7	1.9	3.6	2.9	5.5	4.0	4.0
UA	Ukraine	2.5	3.3	2.5	2.0	2.9	14.4	10.9	9.1	5.2	5.0
	CIS4+UA [1)2)]	*2.0*	*2.6*	*2.0*	*1.9*	*2.1*	*4.9*	*3.9*	*5.9*	*4.4*	*4.4*
	V4 [1)2)]	*4.5*	*4.6*	*3.4*	*3.0*	*2.9*	*1.9*	*1.7*	*2.3*	*2.2*	*2.2*
	BALT3 [1)2)]	*4.4*	*4.0*	*3.1*	*2.7*	*2.3*	*3.5*	*2.7*	*2.5*	*2.5*	*2.3*
	SEE9 [1)2)]	*5.0*	*3.8*	*2.9*	*2.9*	*3.0*	*1.4*	*3.0*	*2.4*	*2.6*	*2.6*
	CIS3+UA [1)2)]	*3.3*	*3.6*	*2.7*	*2.5*	*2.8*	*9.6*	*7.5*	*7.2*	*5.8*	*5.7*
	non-EU12 [1)2)]	*3.7*	*2.7*	*1.2*	*2.3*	*2.6*	*6.7*	*7.6*	*8.8*	*5.8*	*5.4*
	CESEE23 [1)2)]	*4.0*	*3.2*	*1.8*	*2.5*	*2.7*	*5.3*	*6.0*	*6.9*	*4.8*	*4.5*

ctd.

Table 2.1 / (ctd.)

		Unemployment (LFS) rate in %, annual average					Current account in % of GDP				
				Forecast					Forecast		
		2017	2018	2019	2020	2021	2017	2018	2019	2020	2021
BG	Bulgaria	6.2	5.2	5.0	4.8	4.6	6.5	4.6	3.0	2.0	1.1
CZ	Czech Republic	2.9	2.2	2.2	2.2	2.2	1.0	0.7	0.3	0.3	0.2
EE	Estonia	5.8	5.5	5.7	6.0	5.8	3.2	1.2	1.3	1.3	1.2
HR	Croatia	11.2	8.8	9.0	8.5	8.0	4.0	2.7	2.4	2.1	1.0
HU	Hungary	4.2	3.7	3.5	3.5	3.5	3.2	1.3	1.2	0.9	1.1
LT	Lithuania	7.1	6.4	5.8	5.5	5.5	0.9	0.9	-0.2	-0.3	-0.6
LV	Latvia	8.7	7.4	7.0	6.5	6.0	0.7	-0.5	-0.7	-1.0	-1.1
PL	Poland	4.9	3.8	3.7	3.4	3.4	0.2	-0.7	-1.0	-1.0	-1.1
RO	Romania	4.9	4.2	4.0	4.2	4.3	-3.4	-4.6	-4.3	-4.2	-4.0
SI	Slovenia	6.6	5.4	4.5	4.0	4.0	7.2	7.4	6.8	6.2	5.9
SK	Slovakia	8.1	6.5	6.2	5.8	5.6	-2.0	-2.5	-1.6	-1.3	-1.0
	EU-CEE11 1)2)	*5.3*	*4.4*	*4.2*	*4.0*	*4.0*	*0.6*	*-0.3*	*-0.5*	*-0.6*	*-0.6*
	EA19 3)	*9.1*	*8.3*	*7.8*	*7.6*	*7.6*	*3.8*	*3.3*	*3.1*	*2.9*	*2.8*
	EU28 3)	*7.6*	*6.8*	*6.3*	*6.1*	*6.1*	*2.6*	*2.0*	*1.8*	*1.6*	*1.5*
AL	Albania	13.7	12.1	11.5	11.0	10.0	-7.5	-6.4	-6.4	-5.9	-5.8
BA	Bosnia and Herzegovina	20.5	18.4	17.0	15.6	14.1	-4.7	-4.5	-4.6	-4.3	-4.0
ME	Montenegro	16.1	14.8	14.3	13.8	13.6	-16.1	-17.2	-16.9	-16.8	-14.0
MK	North Macedonia	22.4	21.0	20.0	20.0	19.0	-1.0	-0.8	-1.1	-2.4	-3.0
RS	Serbia	13.6	12.6	12.1	11.4	10.9	-5.2	-5.2	-5.1	-4.8	-4.6
XK	Kosovo	30.5	29.0	29.5	29.0	28.0	-6.1	-6.5	-7.3	-7.8	-7.7
	WB6 1)2)	*16.9*	*15.6*	*14.8*	*14.4*	*13.6*	*-5.5*	*-5.4*	*-5.5*	*-5.4*	*-5.2*
TR	Turkey	10.9	10.9	11.8	11.2	10.5	-5.5	-3.5	-0.4	-1.4	-1.9
BY	Belarus	5.6	4.8	4.6	4.5	4.5	-1.6	-2.0	-2.5	-2.6	-2.7
KZ	Kazakhstan	4.9	4.8	5.0	5.0	5.0	-3.3	0.5	-3.1	-3.2	-2.5
MD	Moldova	4.1	3.0	3.0	3.0	3.0	-5.8	-7.2	-8.3	-6.8	-7.4
RU	Russia	5.2	4.8	4.9	4.9	4.7	2.1	6.9	2.7	2.8	2.7
UA	Ukraine	9.5	8.8	8.4	8.1	7.8	-2.2	-3.6	-3.8	-5.3	-6.0
	CIS4+UA 1)2)	*5.9*	*5.4*	*5.4*	*5.4*	*5.2*	*1.3*	*5.4*	*1.6*	*1.6*	*1.5*
	V4 1)2)	*4.7*	*3.7*	*3.6*	*3.4*	*3.4*	*0.6*	*-0.3*	*-0.5*	*-0.5*	*-0.5*
	BALT3 1)2)	*7.3*	*6.4*	*6.1*	*5.9*	*5.7*	*1.4*	*0.6*	*0.0*	*-0.1*	*-0.3*
	SEE9 1)2)	*9.7*	*8.6*	*8.3*	*8.2*	*7.9*	*-1.5*	*-2.6*	*-2.8*	*-2.8*	*-3.0*
	CIS3+UA 1)2)	*7.5*	*6.9*	*6.7*	*6.5*	*6.3*	*-2.7*	*-1.5*	*-3.4*	*-3.9*	*-3.9*
	non-EU12 1)2)	*7.5*	*7.1*	*7.3*	*7.1*	*6.8*	*-1.0*	*2.6*	*0.8*	*0.6*	*0.3*
	CESEE23 1)2)	*7.0*	*6.4*	*6.5*	*6.3*	*6.1*	*-0.4*	*1.6*	*0.4*	*0.2*	*0.0*

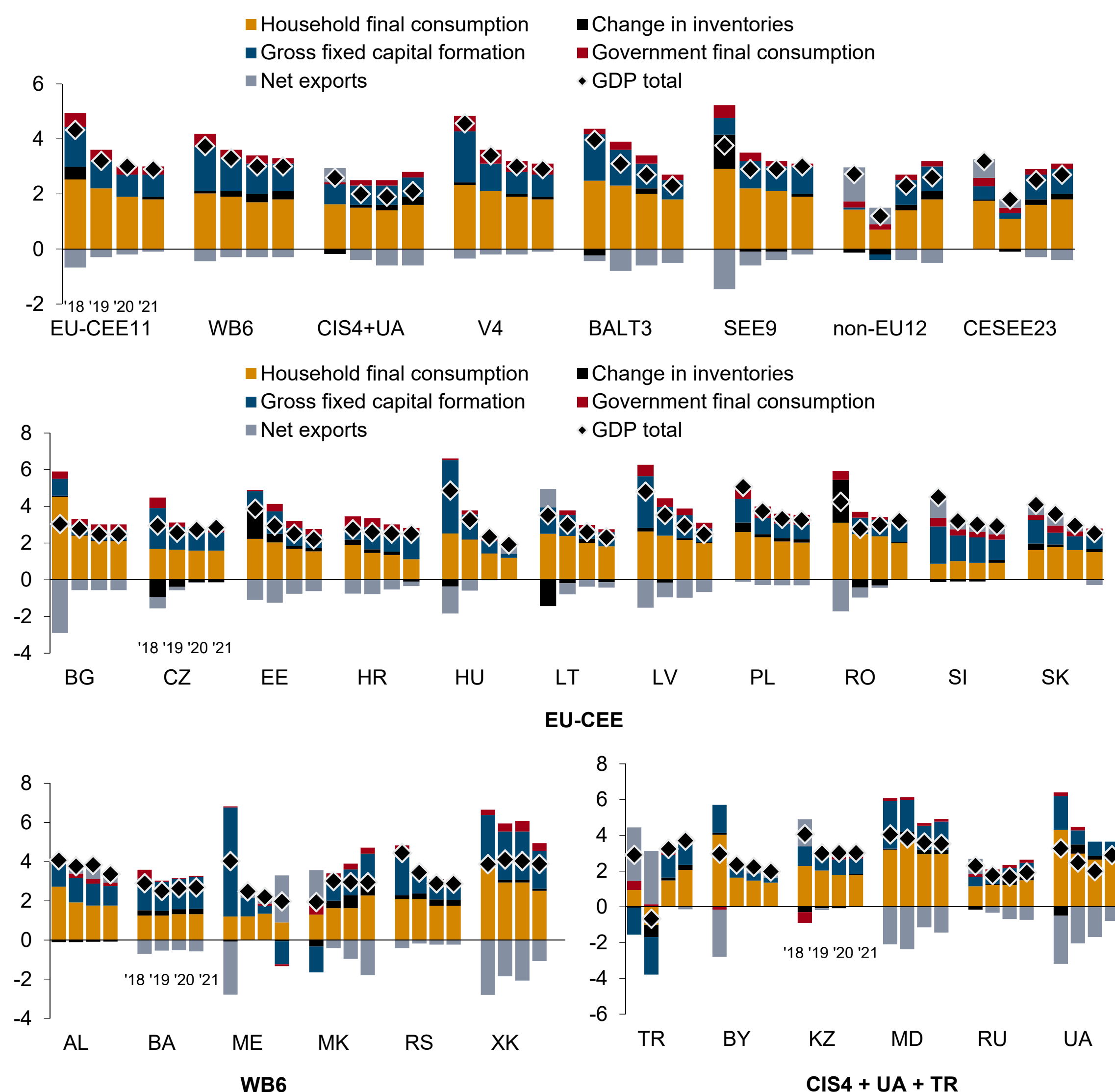
1) wiiw estimates. - 2) Current account data include transactions within the region (sum over individual countries). - 3) Forecasts estimated by wiiw.

Source: wiiw, Eurostat. Forecasts by wiiw (March 2019).

Growth for the region as a whole peaked in 2017-2018, and will be slower in the next three years than over the previous three. In 17 of the 23 countries in CESEE, we expect real GDP growth in 2019-2021 to be lower than in 2016-2018. The sharpest slowdowns are, unsurprisingly, in Romania and Turkey (2.4 and 2.3 percentage points, respectively), reflecting previous overheating and the need for tighter policy (or market pressure) to prevent imbalances creating systemic problems for the economy. We also forecast notable slowdowns (1 p.p. or more) in Montenegro, Estonia, Hungary, Slovenia and Bulgaria. Only four countries will have higher growth rates in the forecast period: two in the Balkans (Kosovo and North Macedonia) and two in the CIS (Russia and Belarus). The expected improvement in Belarus and Russia is largely because of a particularly weak 2016, which has dragged down the historical period average. North Macedonia is recovering from a political crisis, which meant basically no growth in 2017. In Kosovo, the improvement will be only by 0.1 p.p.

Figure 2.3 / GDP growth in 2018-2021

and contribution of individual demand components in percentage points



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

Despite the projected slowdown in growth, every country will grow more quickly than the eurozone aggregate during the forecast period, implying convergence with Western Europe. The fastest growth over the three years will be in Kosovo and Albania. In Kosovo, this will be helped by positive demographic trends (one of only three countries – the others being Turkey and Kazakhstan – where we expect population growth of any significance over the forecast period). Other countries where we expect average growth to be significantly above 3% are Moldova, Poland and Slovakia. No other economy will average growth of above 3.1% per year during the forecast period. The weakest performer will be Russia, with average growth of below 2% over the three years, reflecting deep-seated structural issues, Western sanctions and fairly low oil prices.

2.1.2.1. A weaker outlook for external demand

The drivers of growth during the forecast period vary across the region, but it is clear that support from external factors is likely to be weaker almost everywhere than was the case in the past few years. With the global economic cycle slowing (if not ending), and weaker growth projected in all major economies, CESEE will be affected. However, the extent to which this matters will differ quite considerably from country to country.

As the external environment deteriorates, so the region's big exporters will struggle. There will be less support for growth from net external trade for the region's most open economies, including the Baltic states, the Czech Republic and Slovenia (in general the region's economies are very open in terms of exports/GDP, Figure 2.4). In January, the Czech manufacturing purchasing managers' index (PMI) – an important leading indicator of economic activity – fell to a six-year low, emphasising the impact of recent developments in Germany and other key markets on export-dependent economies. By contrast, a big positive change will take place in Turkey, reflecting the large external adjustment there. Net exports will add 3 p.p. to Turkish GDP growth in 2019, according to our forecasts.

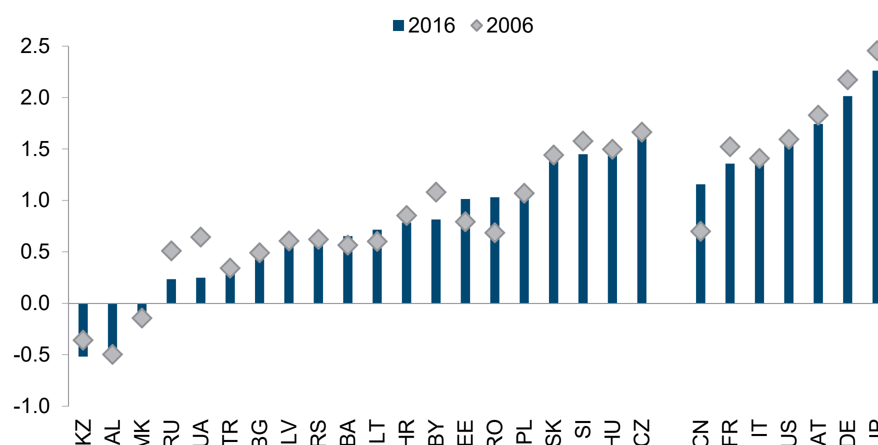
Figure 2.4 / Exports of goods and services, in % of GDP, 2017

Source: World Bank.

The three smaller Visegrád countries, plus Slovenia, are those most exposed to trade tensions at the global level. The extent to which countries in the CESEE region are affected by trade issues in the global economy depends not only on the degree of their openness, but also on their level of integration into global value chains. As a proxy for global value chain integration, we use the Economic Complexity Index (ECI).[5] As Figure 2.5 shows, the Czech Republic clearly stands out on its own, with a score that is higher than the US's and similar to Austria's (the Czech Republic is ranked seventh in the world). However, three other CESEE countries – Slovenia, Slovakia and Hungary – also score very high (ahead of France, Italy and China, for example). The combination of a higher degree of integration into regional and global value chains and a generally high level of openness (in terms of goods exports/GDP) means that a drop in global trade would affect these countries more.

Commodity exporters, especially those in the CIS, will also have to adjust to weaker oil price growth, after a big windfall in 2018. In US dollar terms, the price of front-month Brent crude increased by 31.5% on average in 2018, but this will not be repeated during the forecast period (we expect a drop in 2019, and basically flat oil prices in the next two years). Diversification of the Russian and the Kazakh economies away from oil on a scale that would actually make a difference is not really feasible (even with the fairly strong measures announced recently in Kazakhstan), and certainly not in the next 2–3 years; thus both will have to soldier on one way or another with this model. Belarus is also facing the implications of this (see country report).

Figure 2.5 / Economic Complexity Index, 2016, CESEE and selected developed countries



Source: ECI; Observatory of Economic Complexity.

A final and increasingly important factor for externally driven growth in CESEE is tourism. Some countries in the region (such as Montenegro and Croatia) are established tourist destinations, and have continued to perform well. However, other countries with less pedigree in this area have in recent years also recorded rapid growth, especially in the Western Balkans, but also in the Baltic states. We attribute the strength of tourism in the region to various factors, including higher security risks in competitor markets, such as Turkey and North Africa.

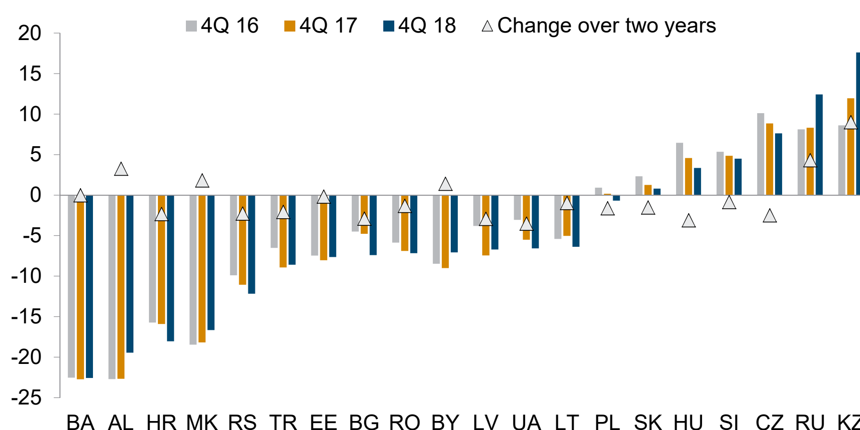
5 The ECI is compiled by the Observatory of Economic Complexity, and measures the knowledge intensity of an economy.

2.1.2.2. The challenge of higher wage growth

Aside from the weakness in external demand, there is also the question of the impact of recently strong wage growth on external competitiveness. If the region loses external competitiveness at a time of weaker overall external demand, then – considering the heavy export orientation of many economies – it could be particularly problematic. Much of the CESEE region has seen big wage increases recently, reflecting growing labour shortages. There is the further potential problem that this could force firms out of the region (to countries where labour is more plentiful and/or wages are lower), and thereby deliver a more crushing blow to exports (although in general unit labour costs are still low).

One way to assess this is via the development of trade balances. Outside the CIS, trade balances have deteriorated in many CESEE countries over the past two years, including in the Visegrád countries, which could suggest some deterioration in external competitiveness (Figure 2.6). However, the Visegrád countries and Slovenia all still run trade surpluses (or only a minor deficit in the case of Poland), indicating little reason to worry. In others parts of EU-CEE11 and the Western Balkans, widening merchandise goods deficits indicate a further deterioration in external competitiveness from an already weak position. In 2018, Romania – which, of the EU-CEE11 countries, has a particular issue with overheating – posted its biggest trade deficit as a share of GDP for almost a decade. Bulgaria and Croatia also recorded a notable widening of their goods trade deficits last year. Generally, across the region, firms not at the frontier in terms of productivity (especially SMEs) will face particular problems from the pressure to pay higher wages in the face of ever-worsening labour shortages.

Figure 2.6 / Trade balance of goods, in % of GDP, four-quarter average



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

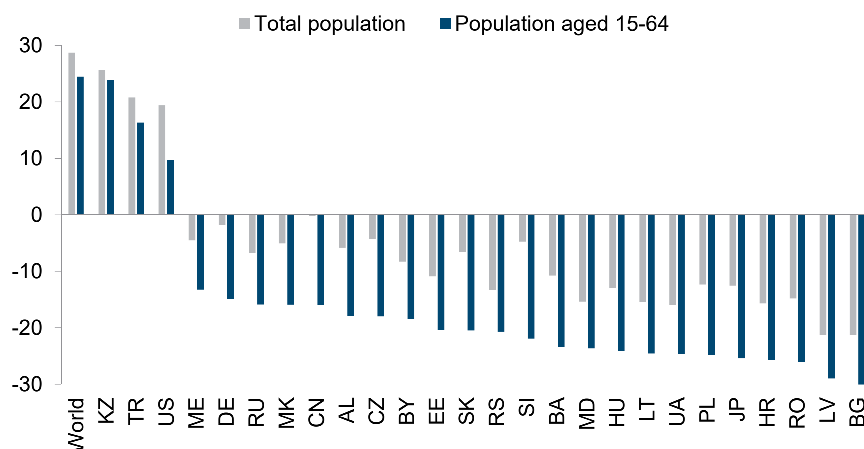
2.1.2.3. Can domestic consumption pick up the slack?

As support from external factors fades, it is possible to make a fairly positive case for private consumption growth in the region during the forecast period. Oil prices have fallen from 2018 levels, and are set to remain largely flat during the forecast period. Wages in many places are growing very strongly, and this will continue, given that labour shortages will not go away. Labour market trends are generally highly positive, and unemployment is falling quite rapidly, even in the Western Balkans.

Despite expected strong wage growth, however, in most CESEE countries we expect private consumption to make a smaller contribution to growth in the forecast period than in the last three years (2016-2018). In 18 out of the 23 countries, this will be the case, according to our forecasts, with only five registering an improvement (Latvia, Russia, North Macedonia, Serbia and Kazakhstan). We expect particularly sharp declines (of at least 1 percentage point) in the contribution of private consumption to growth relative to the last three years in Romania, Montenegro, Ukraine and Turkey. In Romania and Turkey, this will reflect the slowdown after overheating. In Turkey, for example, it will be a result of much higher real interest rates, weaker confidence and higher inflation – all of which will weigh on consumer spending. In Romania, it will also reflect tighter credit conditions.

The relative weakness of private consumption growth in 2019-2021 will come as a result of many common factors. One issue is confidence: people read the news and understand that a trade war between the world's two biggest economies is an issue that could have repercussions for them. Many may also be concerned about domestic or international political developments. This could lead, for example, to higher savings (especially in economies like the Czech Republic and Slovakia, where a greater share of employment is tied directly and indirectly to exports). We also see indications of this in Poland.

Figure 2.7 / UN population projections, % change between 2015 and 2045



Source: UN. Medium fertility variant.

A second issue is demographics: populations are declining in most countries in the region. The scale of population decline projected across most of CESEE is unprecedented in peacetime (Figure 2.7), and there are only limited options to offset this. Employment rates have already risen considerably in many countries, and so the scope for further impetus from this source is limited (the rates in the Czech Republic and the Baltic states are already among the highest in the EU). In some of the countries where there could be scope for higher employment rates, such as Poland, Romania, Croatia and Hungary, there are political obstacles to this happening. Anyway, in some of those countries – notably Hungary and Romania – significant increases have already been achieved over the past decade, according to Eurostat.[6] The model of importing workers from Ukraine to address labour shortages is not really a long-

6 Hungary's so-called 'slave law' can be understood as a particularly extreme attempt to fully exploit potential labour reserves. However, the government appears less interested in attempting to lift skills levels or access to work among the less-educated, poorer, rural population. https://wiiw.ac.at/protest-against-slave-law-in-hungary-n-356.html

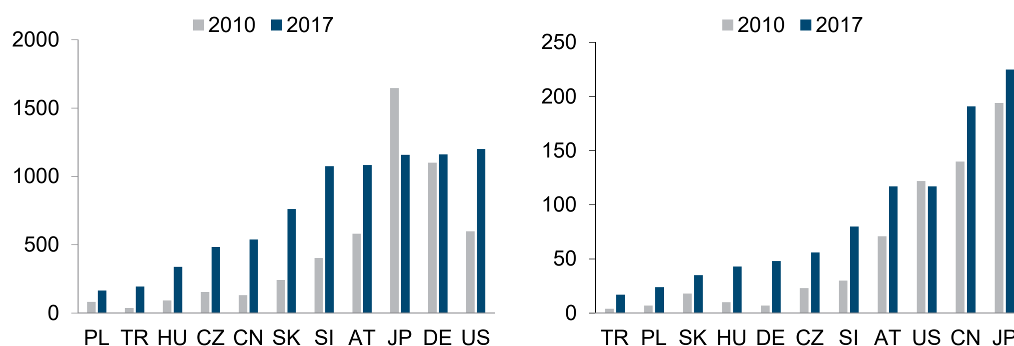
term solution, especially as Ukrainians now find it easier to move to Western Europe (see Ukraine country report). Financially incentivising people to have children will only, at best, bring results in 1–2 decades from now. For the EU-CEE11 countries, there also remains the simple fact that they have free movement with countries in Western Europe, where substantially higher wages are on offer and where labour shortages are also often acute.

2.1.2.4. A mixed outlook for investment

Taking a simple average across the 23 countries, we expect gross fixed capital formation to add 1 p.p. to growth in 2019-2021 (from 1.1 p.p. in the last three years, so not a big change). Within this, though, there are some interesting country stories. In Montenegro, investment growth will weaken considerably, after several strong years related largely to a Chinese-financed motorway. We also expect a sharp weakening of real investment growth in Hungary, owing to a drop-off in the inflow of EU funds after previous front-loading of disbursements. Meanwhile investment growth will be stronger in the forecast period in Slovakia, Belarus, Poland, Romania and North Macedonia.

The general backdrop for investment remains quite supportive in most of the region. Business sentiment in many countries has been affected by external developments, but is still generally at historically high levels. EU funds are playing an important role, and this should continue in most EU-CEE11 countries. The long-hoped-for improvement in absorption capacity in Croatia and Romania has yet to materialise, however. Meanwhile real interest rates remain very low by historical standards almost everywhere (admittedly, with the important exceptions of Russia and Turkey).

Figure 2.8 / Estimated number of multipurpose industrial robots per 10,000 persons employed in automotive industry (left) and in all other industries (right)



Source: International Federation of Robotics (2018), World Robotics 2018, Tables 2.6 and 2.7.

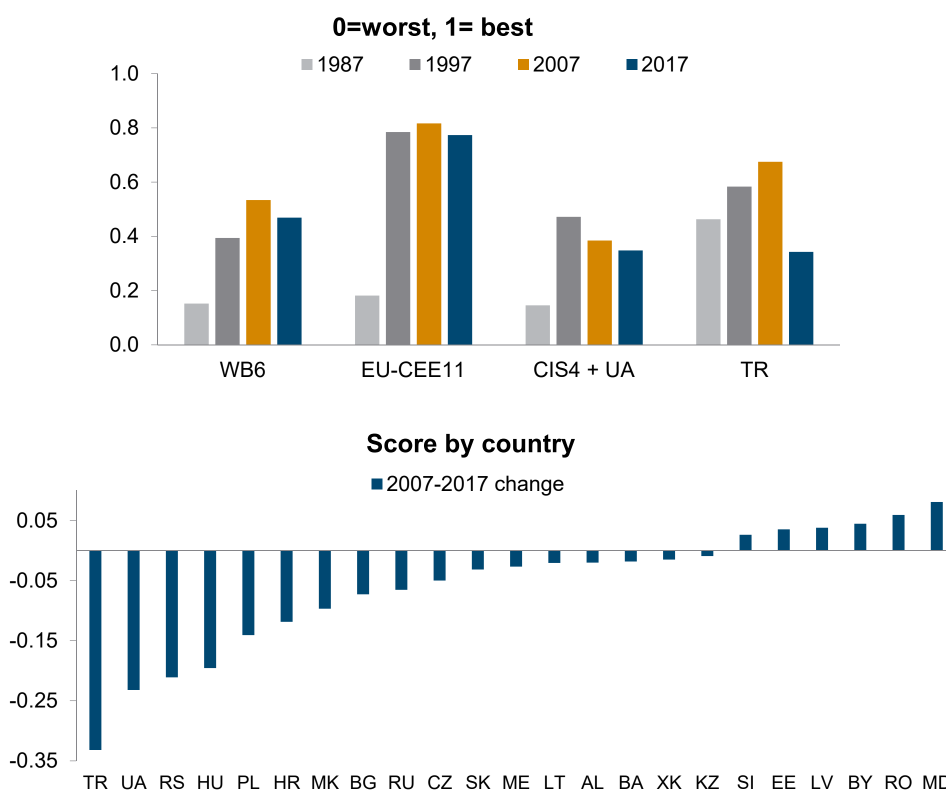
Finally, one possible response to increasingly acute labour shortages in the region would be an increase in productivity-enhancing investment. We have already noted an increase in imports of industrial robots in many parts of EU-CEE11, possibly in response to labour shortages. The country that appears to have gone most strongly in this direction so far is the Czech Republic; that makes sense, considering this is the country with the most extreme labour shortage problem. However, these trends are far from guaranteed to last, and the gap to the frontrunners (measured in terms of robots per worker) is generally quite high (Figure 2.8). It is also clear that for many firms this is not even an option: those

with lower productivity will not be able to pay the higher wages and stay in business. Some labour-intensive firms in Romania, for example, have already shut down and moved production to Asia in the face of labour shortages and higher wages (see Romania country report). More generally, the biggest potential for productivity improvements lies in the services sector, including the government. However, such firms (or the government) do not necessarily have the resources to commit to such new investments, unlike, say, a large German carmaker.

One factor that may discourage firms (including foreign ones) from investing more to offset labour shortages and higher wages is the negative political development in many countries. The impact of politically driven legal uncertainty on private investment in countries such as Poland and Russia has been clear for some time, and there is reason to think that this could become an issue in other countries as well.

Increased authoritarianism, state capture and interference in the independence of institutions appear to be on the rise across much of CESEE, including in the EU-CEE11 countries. According to the Varieties of Democracy Index (V-Dem), democracy is on the back foot almost everywhere in CESEE, and this has been especially the case over the past ten years (Figure 2.9). Negative political trends in many parts of CESEE are already having important implications for institutional quality, capacity and independence, and this in turn could be a problem for economic growth in the future.

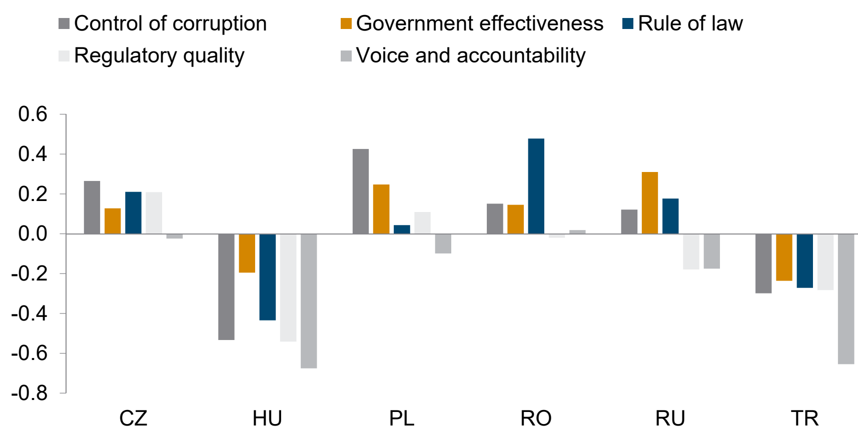
Figure 2.9 / V-Dem electoral democracy index



Source: V-Dem.

Institutional de-convergence over the past ten years is particularly apparent in Hungary and Turkey, according to the World Bank Governance Indicators (Figure 2.10 shows comparisons with the other big CESEE countries). In Turkey, there has been a clear deterioration across all the selected indicators during the past decade (and particularly strongly for 'voice and accountability'). Political developments have undermined both the capacity and the independent functioning of many institutions. Hungary also tells a very negative story: on all five of the indicators used here, Hungary recorded the largest (or the joint-largest) deterioration among CESEE countries in its score between 2007 and 2017. The comparison with Hungary's Visegrád peers is stark. For example, in 2007 Hungary was equal with, or better than, the Czech Republic on four out of the five indicators. As of 2017, by contrast, it scored clearly worse on all five. It is notable that the same trends are not visible in Poland. However, the Law and Justice (PiS) party has only been in power since the end of 2015. Interestingly, the biggest improvements over the period 2007-2017 were recorded in the CIS, and specifically in Belarus and Kazakhstan, albeit from a low base.

Figure 2.10 / World Bank Governance Indicators for major CESSE economies, change 2007-17



Source: World Bank.

2.1.2.5. Fiscal policy unlikely to save the day

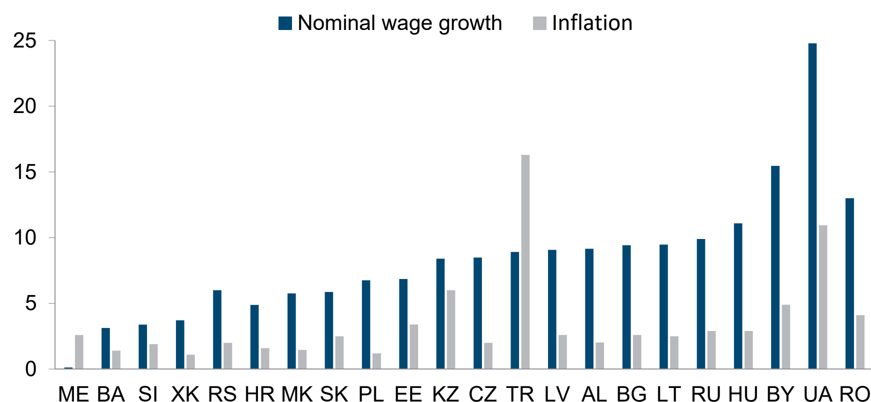
It is not likely that fiscal policy will make a significant contribution to growth on aggregate in the region during the forecast period. It may well be the case that, as external conditions deteriorate (with implications in some cases for private consumption and investment), so fiscal policy could pick up some of the slack in certain countries. Strong fiscal positions and still very attractive financing conditions certainly create room for this in many CESEE countries. However, we are not convinced that most will use this opportunity, and certainly not in a decisive way from the perspective of headline real GDP growth. On average, we expect government spending to add around 0.3 percentage points to headline growth in CESEE countries in 2019-2021, similar to the historical period. In only two countries – North Macedonia and Kosovo – do we expect a significantly bigger contribution in the forecast period than over the past three years. Meanwhile, in many countries the contribution will be smaller – most significantly in Turkey (0.6 percentage points less per year on average), reflecting the much tighter policy stance.

2.1.2.6. Where is the inflation and will it rise again?

Inflation in most countries of the region is surprisingly weak, particularly in the context of last year's sharp increase in oil prices and the very strong wage rises in some countries. Much of the region at least flirted with deflation in 2014-2016, but this episode now seems to be decisively over, with price growth back in positive territory everywhere. However, particularly in EU-CEE11 and parts of the CIS and Ukraine, real wage growth is running well ahead of inflation (Figure 2.11). In 2018, only a few countries saw significantly higher (i.e. more than a couple of tenths of a percentage point) inflation than in the previous year, and in almost all of them it was due to overheating/idiosyncratic factors (Bulgaria, Romania, Slovakia, Hungary and Turkey). The rest recorded either negligible increases or declines.

Figure 2.11 / Nominal gross monthly wages and inflation in 2018

change in % against preceding year



Note: Data based on wage or earning surveys. Romanian wages include employers' social security contributions.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

Several countries stand out in the region for having recently had particularly high nominal wage growth in relation to inflation: Romania, Ukraine, Belarus, Hungary, Russia, Albania, Lithuania, Bulgaria, Czech Republic, Latvia and Poland. For these countries, nominal wage growth was at least 5 percentage points higher than headline inflation in 2018. In all cases, this was well above the post-crisis average. Only two countries – Turkey and Montenegro – posted wage growth below inflation last year.

At first glance, the general lack (so far) of pass-through from very strong and sustained wage growth to headline inflation presents something of a mystery. In all likelihood, a confluence of factors is keeping price growth low by historical standards in most of CESEE, and it is probable that the balance of these factors differs between countries:

› First, inflation is **going nowhere in most of the eurozone**. Given the very high degree of trade integration between most of CESEE and the single currency area, this is likely playing a role (and possibly the decisive one).

- Second, there remains substantial **slack** in some parts of the economy, partly as a legacy of the crisis, and this is now being eaten up by productivity gains (as opposed to strong growth at a time of high capacity utilisation, which should then translate into higher inflation).
- Third, it may be that, after years of subdued price growth, **inflation expectations have de-anchored**, leading to a more permanent state of ultra-low inflation/deflation.[7]
- Fourth, looking at inflation breakdowns, there appears to be a fairly standard consistency in **consumer-focused products** (such as furniture or household equipment) falling in price. In addition to this, retail trade value and retail trade volume are growing at similar rates in most countries. All of this suggests that firms selling consumer goods are struggling to increase prices, indicating either that competition is playing a much greater role (see below), or that consumer demand is not as strong as it appears.
- Fifth, and linked to the previous point, it may be that **consumer goods are predominantly being produced abroad**, and that therefore exchange rates could be playing a role. It is true that after fairly sustained and significant post-crisis appreciation, since the start of 2015 the Chinese yuan has steadily depreciated against the euro.
- Sixth, it may just be that the **collapse in the cost of Brent crude in 2014** has had broad knock-on effects for producer (and therefore consumer) prices over a multi-year time horizon.
- Seventh, **low international food prices** are likely to be playing a role. Food prices tend to be the biggest component of the consumer price index (CPI). According to the Food and Agriculture Organization of the United Nations (FAO), global food prices have fallen for six of the last seven years. Between 2011 and 2018, the FAO's global food price index fell by almost 27%.[8]
- Eighth, higher household **savings rates** may be playing a role. We find evidence for this in some countries for which full comparable data are available, but by no means in all (Figure 2.12).
- Ninth, there appears to be evidence that the **rise of online retailers** has had a disinflationary impact on the overall price level.[9]
- Tenth, it is possible that the fact that the **labour income share is at a historically low level** in many countries means that wage developments do not matter as much for inflation as in, say, the 1970s.
- Finally, several of the wealthier parts of CESEE (such as Poland and the Czech Republic) now host a lot more immigrants (often from other parts of the region), meaning that a greater share of the money earned in those countries is not spent there, but rather flows out in the form of **remittances**.[10]

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[7] Recent data show that this may have happened in Germany, for example.

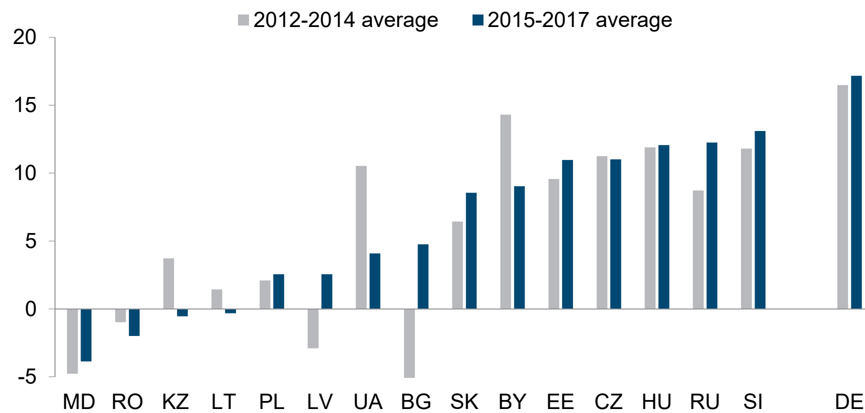
[8] http://www.fao.org/worldfoodsituation/foodpricesindex/en/

[9] https://www.reuters.com/article/us-usa-fed-inflation/amazon-effect-could-have-impact-on-inflation-dynamics-paper-idUSKCN1LA0IO

[10] https://wiiw.ac.at/ukrainian-workers-in-poland-demand-by-far-exceeds-supply-n-308.html

Figure 2.12 / Household savings rates

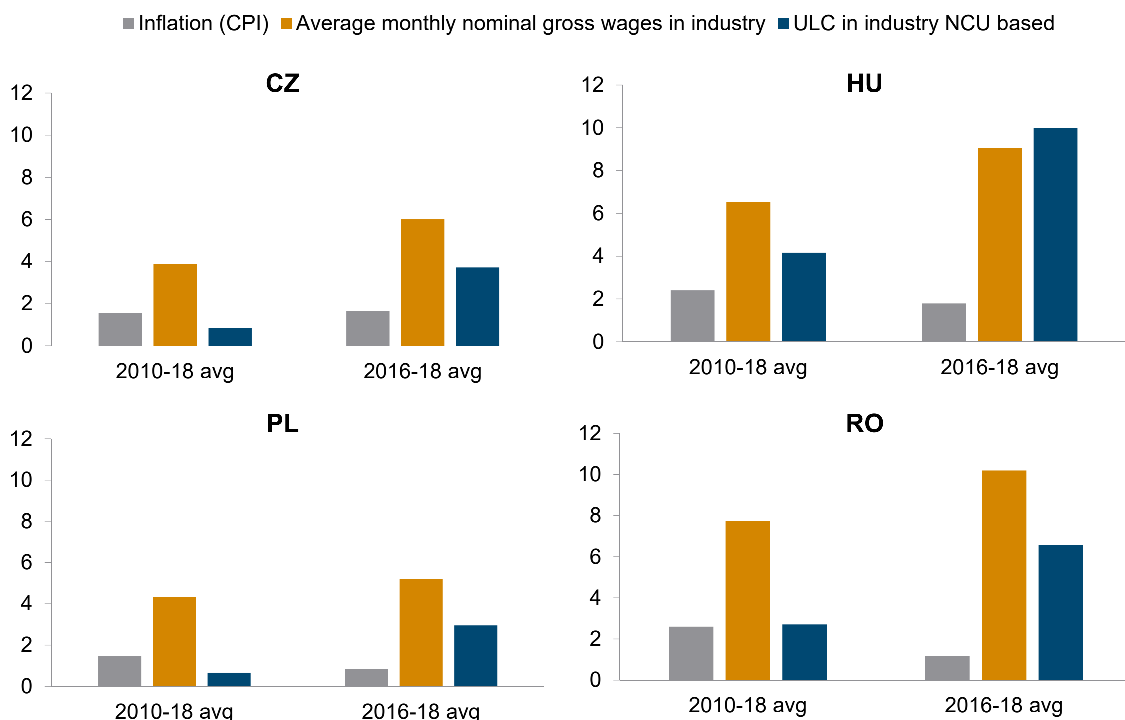
gross saving in % of gross disposable income



Source: AMECO.

Figure 2.13 / Inflation, wages and unit labour costs

change in % against preceding year



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

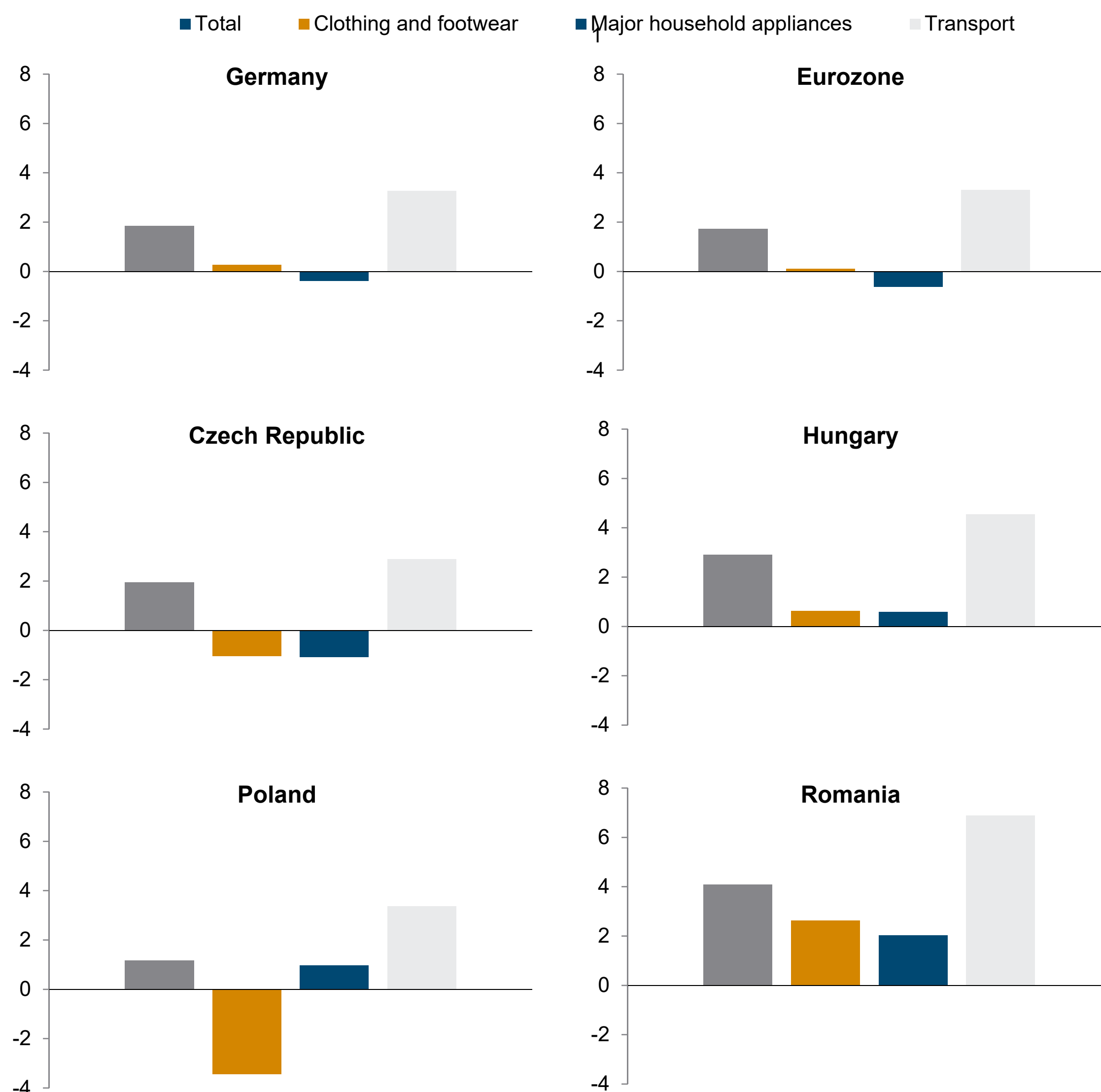
The argument about improved productivity offsetting nominal wage rises also remains quite persuasive for CESEE, and finds some support in the data. In most countries for which data are available, we find that unit labour costs are rising much more slowly than nominal wages (implying productivity gains), and this is mirrored in low inflation (we use data for industry as the sector generally most exposed to international competition). This is certainly the case in the Czech Republic, the country

with the most acute labour shortages, for example; but it also applies to most other countries in the region. Our conclusions overall are unchanged from a similar analysis conducted in 2016 (Astrov et al. 2016). Wage increases are being offset by improved labour productivity or improved non-price competitiveness of products (e.g. quality).

However, rather different developments can be observed in Hungary (and to an extent in Slovakia). At least over the past couple of years, unit labour costs have risen more quickly than wages in industry in these two countries, implying that productivity is declining marginally (Figure 2.13). This could indicate that problems may emerge for Hungary, in particular. Hungarian core inflation is now running at around 3%, which is high by EU-CEE standards. More generally, it is clear that in most countries unit labour costs have risen much more quickly in the last couple of years.

Figure 2.14 / HICP growth in 2018

% change against preceding year, selected components



Source: Eurostat.

Delving deeper into the inflation dynamics of those countries that generally operate with inflation-targeting monetary regimes,[11] two things become noteworthy. First, the role of energy prices (demonstrated by the 'transport' component of the EU-harmonised index of consumer prices) has recently had a big impact on overall price growth, reflecting the sharp rise in Brent crude prices last year. And second, there appears to be a clear weakness of price growth in sectors that are reliant on domestic demand. Of these countries, only in Romania is there any sign of price growth edging toward 2% in consumer demand-focused segments, such as clothing/footwear or major household appliances (Figure 2.14). This suggests still rather 'soft' consumer demand conditions, implying that consumers are not allocating all of their higher wages to increased spending (or that higher competition or online retail are depressing price growth in these sectors). Moreover, high frequency data indicate that retail trade growth is trending down in these countries, albeit from high levels in at least some of them.

With the exception of some CIS countries (where inflation fell quite sharply last year, and will bounce back), we do not expect current inflation dynamics in CESEE to change significantly during the forecast period. Looking at the scale of labour shortages and the wage response, one might conclude that a spike in inflation is imminent. However, as demonstrated, these conditions have been around for several years, without any apparent inflationary response. In the absence of a sharp increase in international commodities prices, it appears likely that a combination of the factors listed above will keep inflation at historically low levels in most of CESEE during the forecast period. We expect oil prices to be generally flat during the forecast period, meaning that the large positive contribution to headline inflation from transport costs last year will not be repeated.

2.1.2.7. The curious cases of Russia and Turkey

Russia and Turkey are easily the biggest economies in CESEE – and currently also the worst performing. However, while this looks like being a long-term issue for the former, we do see a somewhat brighter (albeit volatile) future for the latter. In the end, Russia reported a better-than-expected 2018, but we are not 100% convinced by the numbers; and even if one accepts them, Russia was still CESEE's weakest economy last year. High frequency indicators suggest a bad start to 2019 for Russia. Meanwhile, although the Turkish economy grew by around 3% overall in 2018, this hides a deep downturn in the final quarter of the year, which looks set to continue during at least the first half of this year.

For Russia and Turkey, our average growth forecasts for 2019-2021 are 1.9% and 2.2%, respectively, making them two of the three slowest growers in CESEE in the period (the other being Belarus, which is, of course, highly integrated with Russia). However, the two are facing very different challenges, and as such the medium-term outlook is quite different. Russia is bumping along at a bit below 2%; and without major institutional and other reforms (the latter impossible to imagine any time soon), this will not change. By contrast, Turkey is in recession and has a tough near-term outlook; but by 2021, it will again be one of the fastest-growing economies in the region.

Under pressure from much weaker oil prices, high rouble volatility, and never-ending rounds of US and EU sanctions, the Russian authorities have made a clear decision to sacrifice growth for

[11] Here we mean the Czech Republic, Poland, Hungary and Romania. We exclude Turkey and Russia, as the conditions there are quite different.

macroeconomic stability. This has worked, and has certainly reduced the vulnerability to (especially) US influence. Fiscal and monetary policies have been very tight, and the current account surplus last year reached over 7% of GDP. External debt (public and private) is being repaid early, and the central bank is reducing the share of FX reserves held in US dollars. Import substitution has been actively pursued (with mixed results), and trade is being reoriented east (especially to China). In short, Russia has settled into a 'new normal' of Western sanctions. Nobody expects these sanctions to go away, and indeed they may get worse (elections in Ukraine and for the European Parliament could have implications here).

Combined with the likelihood that the oil price will not rise, and the low chances of any reforms to address Russia's inherent structural weaknesses, this makes Russia's growth outlook the worst in CESEE. Back in 2008, then-presidential candidate Dmitry Medvedev argued that Russia needed to make progress on the 'four I's' – infrastructure, institutions, investment and innovation – to diversify away from its reliance on oil and gas, increase its growth potential and reduce energy dependence vulnerabilities. More than a decade on, nothing has changed, and these issues continue to hamstring the economy. Moreover, even with the big macroeconomic defences that have been put up over the past few years, external factors – such as politics in Ukraine, the escalating global trade war, potential new sanctions and a further collapse in the oil price – remain a threat. There is also a small chance of more serious political instability; but President Vladimir Putin's promises in February to focus on social spending and protection suggest that the government is worried enough to decisively address this. Still, Russia is doomed to fall behind and will be overstretched by its external ambitions.

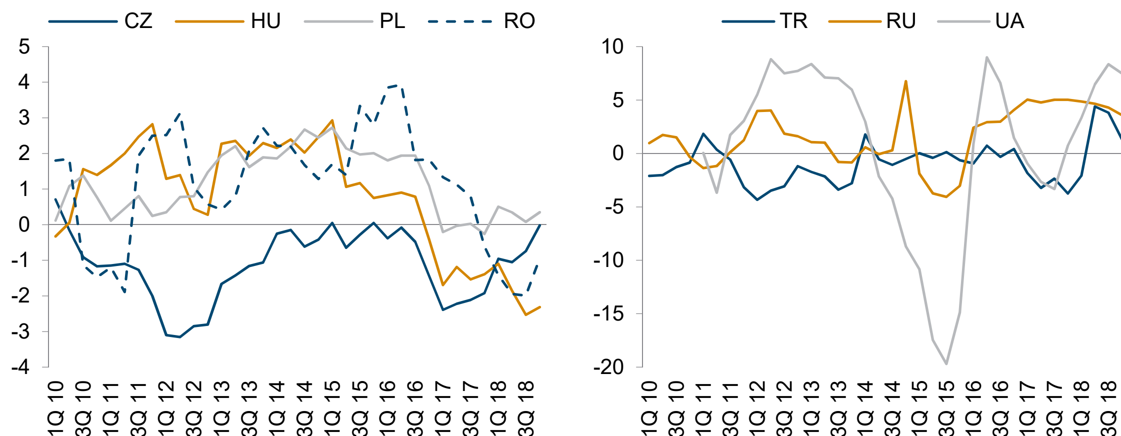
Turkey is hardly in great shape either, but it is very likely to grow significantly more quickly than Russia over the forecast period and beyond. The economic model of Turkey leaves it highly exposed to changes in global dollar liquidity and investor sentiment, and volatility in the future is almost assured. However, Turkey compares well with Russia on most, if not all, of the 'four I's', and has a young, growing population. As a result, Turkey's fortunes are likely to depend heavily on global investor sentiment and dollar liquidity. If the US Federal Reserve retains its currently dovish stance, Turkey could well return to its current account deficit-driven growth model of the recent past.

2.1.2.8. Monetary policy will stay supportive of growth in most places

As the above discussion on inflation shows, the dovish tone of our recent reports (often going against consensus expectations) has turned out to be correct. Except for in Hungary (where core inflation looks set to rise above the 3% target), central banks in EU-CEE do not appear keen to quickly tighten monetary policy, reflecting the continued weakness of inflation. The other three major EU-CEE central banks (Czech Republic, Romania and Poland) appear relaxed about inflation, with real interest rates either around zero or negative (Figure 2.15). Czech rate hike expectations have been pushed back, and the Polish central bank looks set to keep interest rates at their current low levels for an extended period. This stance is reinforced by an increasingly dovish ECB (it would be difficult to overstate the impact of years of ultra-low policy rates by the major global central banks, and particularly the ECB, on interest rates in CESEE). In Hungary, political factors will mean that the central bank will likely tighten policy as slowly as possible.

The exceptions among the major CESEE central banks are Russia, Ukraine and Turkey, where policy is much tighter. All three countries have strongly positive real interest rates, indicating restrictive monetary policy. In Russia, this reflects primarily a desire to shield the economy and support the currency against US sanctions, as well as a prioritisation of macroeconomic stability over growth. Similarly, in Ukraine, high real interest rates represent an attempt to tame persistently high inflation, even at the expense of growth. In Turkey, high real policy rates were introduced in 2018 in response to the collapse of the lira, but only reluctantly and with a significant delay.

Figure 2.15 / Real interest rates, CPI-adjusted, in %



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

2.1.2.9. Political risk still fairly high

Election wise, 2019 is a busy year for CESEE; and some of the elections will have important implications for the region's economies. Parliamentary elections were held in Moldova in February (inconclusive), and will take place in Estonia in March, Ukraine in October and Poland in November. Meanwhile, presidential elections were be held in Slovakia and Ukraine in March, North Macedonia in April, Lithuania in May and Croatia in December-January 2020.

The votes in Ukraine and Poland could be of most consequence. In Poland, another victory for Law and Justice (PiS) would keep the country on its confrontational course with the EU, and would herald further reforms that are probably not conducive to long-term growth (we put the chances of a PiS victory at 50%). Meanwhile in Ukraine, the outcome of the presidential election is highly uncertain (see country report for full details). All of the main contenders suffer from high disapproval ratings, suggesting a general lack of faith in the country's political class (admittedly, this is hardly unique to Ukraine in the region). Whoever wins, the country's decisive pro-Western political alignment will not change; but policy could move to the left and could bring more conflict with outside sponsors, such as the IMF. Backsliding in some reform areas has already been observed (such as anti-corruption laws). A further 'heating up' of the conflict with Russia, meanwhile, certainly cannot be ruled out and would have devastating consequences.

2.1.2.10. Sovereign risk contained by wall of global liquidity

The sovereign ratings backdrop is positive, and generally mirrors trends in the macro economy across most of the region. Robust growth and a lot of fiscal austerity have combined to significantly improve many of the ratios used by ratings agencies to assess sovereign creditworthiness. Countries where public and/or external debt ratios appeared only a few years ago to be in danger of spiralling out of control – such as Croatia, Serbia and Hungary – now find themselves on consistent, positive upward ratings trajectories.

This may change as growth slows; but the likelihood is that, rather than witnessing the onset of downgrades, we will see upgrades peter out. The unwinding of macro imbalances – both fiscal and external – has been significant and fairly broad-based across CESEE in the past few years. In addition, a major source of stability for CESEE sovereigns is the persistent weakness of inflation in most of the developed world, especially now that the Fed has paused in its interest rate hikes. With so much global liquidity chasing such little yield, and with many of the big money managers struggling to meet liabilities, demand for CESEE sovereign debt is likely to remain very healthy over the medium term. If, however, inflation in the eurozone and the US suddenly shoots higher (not inconceivable, at least in the latter), then the situation could change quite quickly, and in a nasty way for CESEE.

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2.2. WHAT ARE THE CHANCES OF NEW CONDITIONALITY IN THE NEXT EU BUDGET?

by Sándor Richter

The negotiations on the next seven-year EU budget will reach a decisive stage this year and next. The main issues will be how to mitigate the impact of Brexit (whatever happens); a new conditionality related to respect for the rule of law and the fundamental values of democracy in beneficiary Member States; and, finally, the search for innovative solutions to reduce the risk of corruption related to EU transfers.

Never at the preparatory stage of a Multiannual Financial Framework (MFF, generally referred to as 'the EU budget') has there been more uncertainty as now, as preparations are being made for the 2021-2027 MFF. The potential for a so-called 'hard' Brexit, 'soft' Brexit or no Brexit creates three diverging scenarios for the next MFF. A 'hard' Brexit could even affect the current 2014-2020 MFF, with transfers to be paid for two additional years after the nominal closure in 2020. Spending cuts will be necessary as a consequence of Brexit (the UK is one of the main net contributors), but the remaining Member States are by no means in agreement on how these cuts will be allocated across the main policy areas, and finding a good (or at least acceptable) compromise is likely to be fairly difficult.

2.2.1. The rule of law

Beyond the question of the available resources for the next EU budget, one of the top issues in the coming months will be how to link cohesion policy to the rule of law and respect for basic European values. In January of this year, the European Parliament endorsed a draft law to reduce pre-financing or suspend EU budget payments to Member States that interfere with the courts or that do not tackle fraud and corruption: 397 MEPs voted in favour, 158 were against and there were 69 abstentions.[12]

Based on the work of a panel of independent experts, the EU Commission would be invited to establish 'generalised deficiencies as regards the rule of law' and to decide on sanctions, which could include suspending EU budget payments or reducing pre-financing. The European Parliament and Council would have to approve the decision. The Member States involved would not lose the resources for good: if and when the Member State remedies the deficits identified by the EU Commission, the European Parliament and EU ministers can unlock the funds.[13]

The European Commission may establish that the rule of law is under threat if one or more of the following are undermined:[14]

› proper functioning of the authorities of the Member State implementing the EU budget;

› proper functioning of the authorities carrying out financial control;

› proper investigation of fraud (including tax fraud), corruption or other breaches affecting implementation of the EU budget;

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[12] https://multimedia.europarl.europa.eu/en/protection-of-the-unions-budget-vote-debate_I166383-V_v

[13] http://www.europarl.europa.eu/news/en/press-room/20190109IPR23011/member-states-jeopardising-the-rule-of-law-will-risk-losing-eu-funds

[14] ibid.

› effective judicial review by independent courts;

› recovery of funds unduly paid;

› preventing and penalising tax evasion and tax competition;

› cooperation with the European Anti-Fraud Office and, if applicable, the European Public Prosecutor's Office.

It is planned that the above-mentioned panel of independent experts should include one expert appointed by the national parliament of each Member State, while five would be delegated by the European Parliament. Sanctions could include reducing pre-financing and suspending payments, depending on the scope of the problems identified. For governments under threat of sanctions, a particularly unpleasant feature of the draft is that they would have to implement – from their own resources – the necessary programmes, and also provide payments to final beneficiaries (firms, NGOs, local and other government bodies).[15]

It is no coincidence that the topic 'rule of law and the fight against corruption' has become one of the central issues in discussion of the 2021-2027 MFF. Conflicts between the EU institutions and certain Member States have never before been so sharp as now, in the course of the current MFF, with the main protagonists being Hungary and Poland. Traditional 'soft power' attempts to compel those countries to change their behaviour (which is, in many respects, at odds with the fundamental democratic values on which the European Union is based) have proved rather toothless. However, a requirement for the stability of institutions that safeguard democracy, the rule of law and human rights is nothing new: it has always been an integral part of the 'Copenhagen Criteria' membership requirements for any candidate country wishing to join the EU. Unfortunately, the original expectation – that if a candidate country fulfils the criteria, then no further proof will be necessary – has proved flawed.

2.2.2. Corruption

Another key issue that will play a role in discussions about the next MFF is corruption. Recently published research confirms the existence of a strong relationship between corruption and the use of EU cohesion policy funds in the EU Member States.[16] Identifying and proving individual cases of corruption is a difficult and lengthy process that often ends inconclusively. In their ground-breaking publication, the researchers used mathematical methods to analyse over 100,000 individual cases of public procurement contracts issued by public and semi-public organisations in two EU Member States (Hungary and the Czech Republic) in the period 2009-2012.[17] Of the 100,000-plus public procurement contracts, about a third were co-financed from EU funding. The combined value of the EU co-financed contracts investigated amounted to over 17 billion euros.

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[15] ibid.

[16] Beblavý and Sičáková-Beblavá (2014); Bouda et al. (2013); Corruption Research Centre Budapest (2016); Fazekas and Tóth (2015); Fazekas and King (2018).

[17] Fazekas and King (2018).

The core of the analysis involved the identification of so-called 'red flags', i.e. circumstances which suggested a high probability of corruption. Then the EU co-financed contracts were compared to similar contracts financed from national funds.[18]

Red flags:

› Instances of single-bidder contracts: lack of competition allows above-market-price contracts and makes the extraction of corrupt rents possible.

› A particular company winning a large share of all the contracts awarded by the issuer in a given period.

› Short time between the advertisement of the tender and the submission deadline: it is harder for competitors to prepare a bid.

› Changing the bidding conditions (technical conditions, eligibility criteria) after the official publication.

› Tailoring the conditions to a single company through over-specification.

› Eligibility criteria that are subjective and hard to quantify.

Take the case of the red flag of 'single bidding'. Single-bidder contracts are 6-15% more expensive than multiple-bidder contracts. The authors of the study estimate that increased corruption risks in EU co-financed projects may have pushed up procurement prices by between 218 million and 219 million euros in the two countries in the four years analysed. In an earlier published study, the EU28-wide loss due to corruption in EU-funded contract awards (contracted price versus estimated price) was put at 9.9 billion euros annually.[19] It should be added that the misuse of EU transfers is not confined to the CEE Member States: it is a problem elsewhere, too (e.g. Greece and Italy).

Fazekas and King come to the final conclusion that 'resources associated with EU Structural and Cohesion Funds increase institutionalised grand corruption in two characteristic countries of the CEE, the Czech Republic and Hungary'.[20] Their recommendation is not to introduce greater administrative control, but rather to decrease the ratio of EU funds to beneficiaries' own funds in the financing of individual projects. This is important in order to maintain or restore the link between local taxes, local policy performance and local civil society oversight.

2.2.3. Grants versus financial instruments

The recommendation just outlined can be interpreted as a desperate call for more 'ownership' of EU co-financed projects. Greater ownership also provides motivation for stronger competition in the bidding process, which in turn situates EU co-financed projects in the real world, subordinated to the rules of careful management of limited resources. Here we have to confront the fact that a large part of EU financing comes in the form of grants. If a local kindergarten is financed predominantly from grants (from EU funds), then the local 'ownership' (and with that, resistance to corruption) will be much weaker than if the project were implemented from a preferential credit (supported by the EU), to be paid back by the

[18] Ibid.

[19] Fazekas and Tóth (2015).

[20] Fazekas and King (2018).

local government from its revenues. In that case, a higher price through corruption would hurt the local community in a much more perceivable way.

Compared to market-compatible assistance, grants increase the temptation of corruption. An escalation of the fight against corruption can be facilitated by phasing out grants from the cohesion policy funds and replacing them with financial instruments (FIs). The idea and practice of employing FIs in cohesion policy is not new: they were used (albeit to a modest extent) as early as in the 1994-1999 MFF. Their importance increased in subsequent MFFs, and is expected to rise even higher in the current one. However, the result is fairly modest: in 2014-2020, FIs amount to about 6% of funding for cohesion policy. It would be expedient (for reasons that go far beyond curbing corruption) to attach much more significance to this tool in the 2021-2027 MFF. FIs could fully replace grants in cohesion policy expenditure in the business sector, while in the non-profit sector and parts of public investment, grants could continue to be given, but in line with carefully selected criteria.

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3. CESEE risk outlook

3.1. CESEE RISK MATRIX

Table 3.1 / Summary of risks

Changes since last report:

› We have introduced two new risks. First, 'European Parliament election leads to big gains for anti-EU forces'. We rank this risk as high in terms of likelihood, but think that the impact will be quite low.

› Second, we introduce a new positive scenario: 'German consumption growth roars into life'. We rank this low for likelihood, but high for impact on CESEE.

		Impact on CESEE countries*		
		High	Medium	Low
Likelihood	High	Global trade war/major Chinese slowdown Smaller EU budget (only EU countries) Renewed outbreak of EZ crisis	Rule of law and quality/independence of institutions deteriorate further	European Parliament election leads to big gains for anti-EU forces
	Medium	Labour shortages stimulate higher investment		
	Low	Formalised core/periphery in EU (only EU countries) German consumption growth roars into life	EM crisis affects more countries in CESEE Faster-than-expected tightening by ECB Hard/no deal Brexit	Improvement in EU-Russia relations

Note: Red = negative risk, green = positive risk. *Impact on all 22 CESEE countries covered by wiiw unless otherwise stated. Risks related to the forecast period, 2019-21. When measuring likelihood, high = 30-49% chance, medium = 10-30% chance, low = 1-10% chance.

Table 3.2 / Positive risks detail

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

Table 3.3 / Negative risks detail

Risk	Likelihood		Impact on CESEE	
Renewed outbreak of the eurozone crisis.	High	Progress on reforms of the eurozone to better insulate it from the next downturn in growth remains painfully slow. In Germany, such reforms tend to be seen as the German taxpayer subsidising profligate Southern Europeans. The government in Italy makes this an ever harder sell in Germany. Some insurance is provided by the expanded role of the ECB in recent years, but over the medium term this may not be enough on its own to prevent a new crisis.	High	The eurozone is not in great shape for the next downturn (which may already be here). In the long run it needs a banking union and some kind of fiscal sharing to be able to ward off speculative market attacks during downturns. Any break-up of the eurozone (which is highly unlikely, although no longer unthinkable with the current Italian government in particular) would badly affect the economies of CESEE, due to high levels of trade, investment and financial integration.
Global trade war involving exchange of sanctions between US and China and visible impact on global trade volumes.	High	This is already to an extent underway. Trade restrictions on imports into both the US and China have increased significantly over the past decade, and global trade relative to GDP has been flat since the crisis. However, several exchanges of sanctions between the US and China would have a significant additional impact on global growth and trade.	High	This is a key risk for growth in our region during the forecast period. Most economies in our region are very open in terms of exports/GDP, and many deliver inputs into the German supply chain that go directly to China or the US. If the US introduces higher tariffs on EU car exports, the impact would be even higher.
Rule of law and institutional quality deteriorates further in CESEE countries.	High	This is already happening to an extent. Indicators of institutional and governance quality have declined for some CESEE countries in recent years, such as Turkey, Poland and Hungary. Governments in these countries look quite well entrenched, and are popular in most cases, meaning that current trends may well continue. For the EU countries, Brussels has so far shown itself largely unable to take any action.	Medium	Governments can get away with it for a while, but as the example of Turkey shows, an undermining of institutional independence can contribute to a crisis. In the case of Poland and Hungary, there are already signs that it is affected domestic private investment. Lower quality institutions also threaten long-term growth.
EU budget is cut and EU-CEE countries receive significantly less money in the new financing period	High	A smaller post-Brexit EU budget is highly likely. Funding priorities may also change, including a linking of future EU funding to certain benchmarks. There is a growing feeling in some Western European capitals that funding should be tied more closely to indicators such as compliance with EU law.	High	EU-CEE countries receive 2-5 percentage points of GDP per year from the EU, so cuts to the budget would be important for them.
European Parliament election leads to big gains for anti-EU forces	High	Opinion polls suggest anti-EU forces will do well, and in general voters may be more inclined to vote for 'anti-system' parties in the European Parliament rather than national elections (as they perceive the consequences to be less important). In addition, in many countries the turnout is substantially lower, so smaller groups with highly motivated voters can have a big impact on the result.	Low	There are two main reasons that this is unlikely to have a big impact. First, while the share of seats taken up by anti-EU parties is likely to be quite high, their ability to function as a single, coherent bloc will be quite low. Second, the power of the European Parliament remains quite limited. Maybe the most important implication will be greater fragmentation (and therefore difficulties in passing legislation) of the parliament, following trends already well-established at the national level.

ctd.

Table 3.3 / ctd.

Risk	Likelihood		Impact on CESEE	
Rings of EU integration are formalised and most of EU-CEE left out.	Low	Irritation in some Western European capital with parts of EU-CEE has been growing for some time. This is for three main reasons: a lack of 'solidarity' on the sharing of refugees, threats to institutional independence and the rule of law, and corruption in the use of EU funds. Recent French proposals suggested 'rings' of integration, which could lead to a more formalised 'core' and 'periphery' in the EU.	High	Any formalisation of 'core' and 'periphery' could have important political and economic consequences, particularly if it affects things like Schengen. Many EU-CEE countries could end up in the outer ring.
Hard/no-deal Brexit	Low	The likelihood of some kind of deal between the EU27 and the UK remains quite high. There are major incentives on both sides to avoid a 'hard' Brexit. Moreover, the UK parliament has put in place various measures that make a 'no deal' Brexit almost impossible.	Medium	The UK and EU27 economies are heavily intertwined, and London has huge importance for eurozone finance. A breakdown of talks and 'hard' Brexit would likely have quite serious economic and political consequences. The most direct effects would be felt in Western Europe, but the strong linkages between the German economy and CESEE would provide a channel of contagion to our region as well.
Emerging markets crisis moves beyond Turkey to affect more countries in the CESEE region.	Low	So far, most countries in our region have been relatively unaffected. Countries in our region tend to be much more exposed to the euro interest rate than the dollar, and the ECB is (and will remain) at a very different point in the tightening cycle to the Fed. In addition, most countries have reduced private debt/GDP since the crisis, including in foreign currency, and generally external vulnerabilities are lower (current account deficits have mostly been cut or disappeared over the past decade). Turkey seems like a big outlier in our region.	Medium	The impact in 2018 on Turkey's currency and bond markets, and then as a follow-through on inflation and the economy, are a big warning sign to the rest of the region. However, the much lower external vulnerabilities of almost all other CESEE countries provides a lot of insulation. The most exposed are probably those which also tend to borrow in US dollars, specifically Ukraine and Kazakhstan.
Faster-than-expected monetary tightening by the ECB causes financing difficulties for countries in CESEE.	Low	The ECB has become more dovish, in line with our long-held expectations. Core inflation trends in much of the eurozone remain very weak, reflecting major slack in many labour markets. Meanwhile economic growth slowed quite in 2018, and is unlikely to pick up again soon. A significant change in inflation dynamics looks unlikely.	Medium	Most countries in CESEE are more exposed to euro interest rates rather than dollars, and as such have been relatively insulated from the recent market turmoil. If the ECB did start a fairly quick tightening cycle, this would change, and other countries in CESEE could run into trouble. However, few would find themselves in the position of Turkey under this scenario. Turkey has much bigger external imbalances and financing needs than other countries in CESEE.

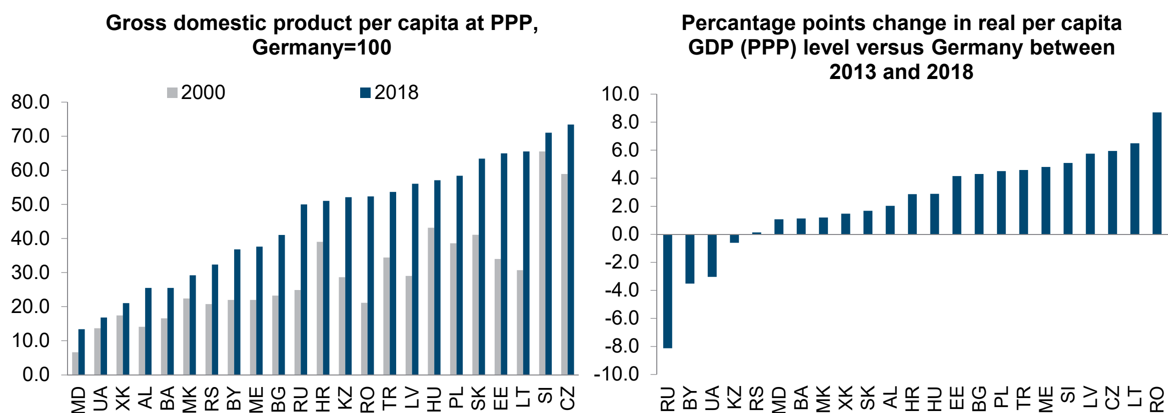
4. CESEE monitors

4.1. CONVERGENCE MONITOR: A LONG WAY TO GO

by Mario Holzner

Income convergence is a slow process: among the CESEE economies only the two most western countries – the Czech Republic and Slovenia – had surpassed a GDP per capita at PPP level above 70% of the German[21] level by 2018. Over a period of almost two decades they have improved their relative position by 15 and 6 percentage points, respectively. The next in the ranking (Figure 4.1, left panel) with values above 60% of the German level are Lithuania, Estonia and Slovakia. They improved vis-à-vis the situation in the year 2000 by about 30 percentage points. At the other end of the ranking are Moldova and Ukraine, with less than 20% of the German per capita income level in 2018. Against the situation of some two decades ago they only improved by a few percentage points.

Figure 4.1 / GDP per capita at PPP convergence against Germany



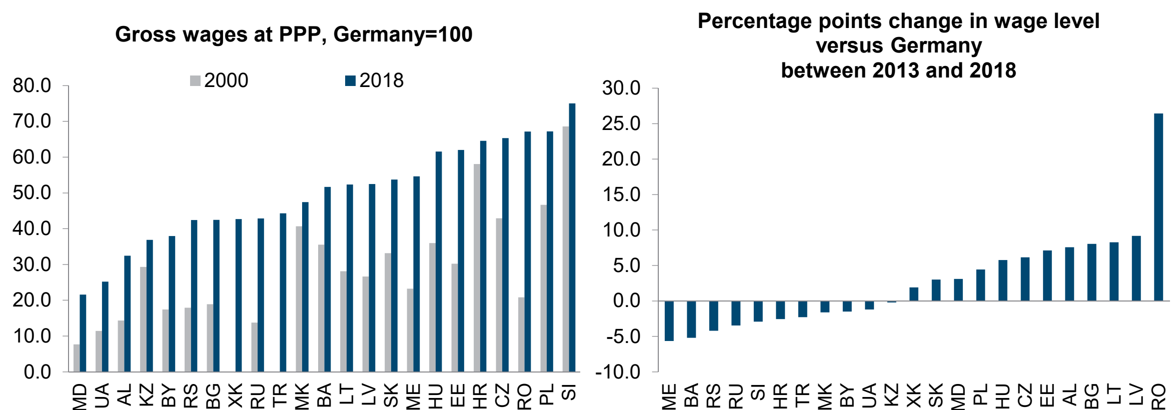
Source: wiiw Annual Database incorporating national statistics and Eurostat.

The most recent (2013-2018) income convergence dynamics were by far the strongest in Romania with an increase of almost 9 percentage points in GDP per capita at PPP relative to the German level. The Romanian result was only achievable through massive fiscal stimuli, the sustainability of which might be questionable over the longer run. About half of the CESEE economies converged in the same period by about 3 to 6 percentage points (Figure 4.1, right panel). At the same time Serbia, Ukraine and the CIS countries Kazakhstan, Belarus and Russia experienced a divergence or at best stagnation vis-à-vis Germany. The latter country dropped in per capita income by more than 8 percentage points between 2013 and 2018 – a consequence of the sanctions and oil price decline. The remaining (mostly Western Balkan) countries improved by a mere 1½ percentage points.

[21] We chose Germany as a benchmark country due to its position as the technological leader in Europe.

In terms of gross wages at PPP relative to the German level in 2018, only Slovenia surpassed the 70% threshold, indicating that GDP does not always correlate perfectly with income from labour. The Czech Republic is only in the group of countries that have surpassed the 60% threshold, together with Poland, Romania, Croatia, Estonia and Hungary (Figure 4.2, left panel). In these countries the average relative wage improved over the last two decades or so by about 25 percentage points against German wages. It has to be mentioned that the definition of average gross wages in the region is not homogenous and hence only the broad ranges and not single percentage point differences should be analysed. Most economies register wages that are around 40% to 50% of the German level. The downward outliers in this ranking are Albania, Ukraine and Moldova with shares of 30% to 20% of the German wage level in 2018. Still, these represent improvements of about 15 percentage points as compared to the year 2000.

Figure 4.2 / Gross wages at PPP convergence against Germany



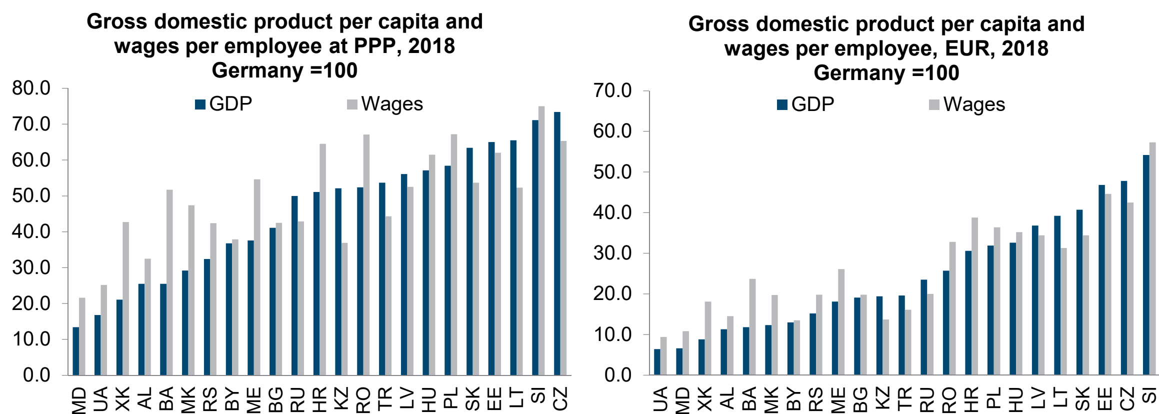
Note: Data based on wage or earning surveys. Germany refers to National Accounts data. Romanian wages include employers' social security contributions.
Source: wiiw Annual Database incorporating national statistics and Eurostat.

Again, between 2013 and 2018, Romanian gross wages at PPP grew the fastest relative to German ones, followed by relatively strong wage growth in the Baltic Republics, Bulgaria and Albania. The relative Romanian gross wage growth of 26 percentage points, however, is not only due to the economic boom but also due to the shift of social security contributions paid by employers to employees in 2018. It is, however, interesting to note that in half the countries of CESEE relative wages over the last couple of years grew by less than those of Germany (Figure 4.2, right panel). These countries are to a large extent from the Western Balkans and the CIS. This is certainly going to be an additional factor supporting further emigration from the European periphery towards the centre.

Comparing GDP and wage levels with those of Germany explains why it is still very profitable and productivity-enhancing to outsource labour-intensive production from Western Europe to the CESEE region. By and large productivity and wage levels are between 10% and 20% of the German level for the more peripheral regions and between 30% and 50% of the German level for the more Western countries that are already part of the EU and the German automotive cluster (Figure 4.3). It is also interesting to observe the differences between the relative wage and GDP per capita levels. Countries with higher relative wage than GDP per capita levels are more often than not from Southeast

Europe and have a recent track record of current account imbalances. In countries like the Baltic States, Slovakia and the Czech Republic it is the other way around.

Figure 4.3 / GDP and gross wages at PPP and in EUR at exchange rate relative to German levels



Note: Data based on wage or earning surveys. Germany refers to National Accounts data. Romanian wages include employers' social security contributions.
Source: wiiw Annual Database incorporating national statistics and Eurostat.

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

	BG	CZ	EE	HR	HU	LT	LV	PL	RO	SI	SK		EU-CEE11
GDP per capita	15,600	27,900	24,700	19,400	21,700	24,900	21,300	22,200	19,900	27,000	24,100	.	22,000
Gross wages	13,928	21,420	20,330	21,163	20,178	17,158	17,208	22,027	22,011	24,602	17,613	.	20,742
	AL	**BA**	**BY**	**KZ**	**MD**	**ME**	**MK**	**RS**	**RU**	**TR**	**UA**	**XK**	**non-EU12**
GDP per capita	9,700	9,700	14,000	19,800	5,100	14,300	11,100	12,300	19,000	20,400	6,400	8,000	17,000
Gross wages	10,645	16,947	12,442	12,097	7,073	17,906	15,557	13,913	14,060	14,519	8,272	14,002	13,227

Note: Data based on wage or earning surveys. Romanian wages include employers' social security contributions.
Source: wiiw Annual Database incorporating national statistics and Eurostat.

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

	BG	CZ	EE	HR	HU	LT	LV	PL	RO	SI	SK		EU-CEE11
GDP per capita	7,800	19,500	19,100	12,500	13,300	16,000	15,000	13,000	10,500	22,100	16,600	.	13,400
Gross wages	6,965	14,973	15,720	13,666	12,416	11,040	12,120	12,841	11,572	20,179	12,120	.	12,524
	AL	**BA**	**BY**	**KZ**	**MD**	**ME**	**MK**	**RS**	**RU**	**TR**	**UA**	**XK**	**non-EU12**
GDP per capita	4,600	4,800	5,300	7,900	2,700	7,400	5,000	6,200	9,600	8,000	2,600	3,600	7,700
Gross wages	5,117	8,360	4,748	4,825	3,822	9,192	6,950	6,963	7,058	5,656	3,309	6,360	6,064

Note: Data based on wage or earning surveys. Romanian wages include employers' social security contributions.
Source: wiiw Annual Database incorporating national statistics and Eurostat.

Looking at the very long run since the beginning of transition, in roughly a quarter of a century, CESEE convergence outcomes are mixed, depending on the indicator observed: average compound annual GDP growth was almost identical to OECD growth. However, using the latest version of the Penn World Table (version 9.0) for the period 1990-2014 shows that GDP per capita growth was double and GDP per employed growth was three times higher than the OECD performance

(Table 4.3). The main reason for the difference was an increase of population and employment in the OECD countries of almost 1% per annum, and a stagnation of population growth and 1% annual drop of the number of employed in CESEE. This indicates the importance of outward migration as one of the channels for productivity increase in developing nations. This, however, is also related to a massive shrinkage of the working age population and connected social and political distortions.

The countries that have outperformed all the other CESEE (and thus OECD) economies in terms of long run GDP growth since 1990, with compound annual growth rates above 3%, were Poland, Turkey, Albania, Romania and Kazakhstan. However, if additional indicators of success of transition[22] such as stable income distribution and a consolidated democracy are applied to the above list, we end up with very few (if any) success stories, at least in terms of overall GDP growth. The number of successful transition economies in terms of annual GDP per capita growth above 3%, converging swiftly with Western productivity levels, is somewhat higher and includes: Poland, Albania, Romania, Kazakhstan, Estonia and Lithuania. It becomes even higher if annual growth of GDP per employed above 3% is looked at: Poland, Albania, Romania, Kazakhstan, North Macedonia, Estonia, Hungary, Serbia and Lithuania. However, for some of these countries this came at a massive loss of employment. Romania, Serbia and Lithuania lost more than 2% of the employed persons annually over the period 1990-2014, which includes particularly young families that have emigrated to Western Europe for good.

Table 4.3 / Long term catching up, compound annual growth rates, 1990-2014

	GDP	GDP per capita	GDP per employed	Population	Employment
UA	-0.8	-0.2	0.6	-0.5	-1.3
BA	0.0	0.7	1.1	-0.7	-1.0
MD	0.1	0.4	1.9	-0.3	-1.8
LV	0.3	1.5	2.6	-1.2	-2.3
BG	0.7	1.5	1.5	-0.8	-0.8
RU	0.7	0.8	0.5	-0.1	0.2
HR	1.1	1.6	2.5	-0.5	-1.4
CZ	1.5	1.4	1.8	0.1	-0.3
BY	1.5	1.8	2.1	-0.3	-0.6
ME	1.6	1.6	1.6	0.1	0.1
SK	1.8	1.7	2.4	0.1	-0.5
LT	1.9	3.0	4.2	-1.0	-2.2
RS	2.1	2.5	4.2	-0.4	-2.0
SI	2.2	2.1	2.8	0.1	-0.6
HU	2.3	2.5	3.2	-0.2	-0.9
EE	2.6	3.4	3.9	-0.7	-1.2
MK	2.8	2.7	3.8	0.2	-0.9
KZ	3.4	3.2	3.1	0.2	0.3
RO	3.7	4.5	6.2	-0.7	-2.3
AL	3.8	4.4	5.3	-0.5	-1.4
TR	4.4	2.8	2.5	1.5	1.8
PL	4.9	4.9	4.9	0.0	0.1
CESEE av.	2.2	2.4	3.1	-0.2	-0.8
OECD	2.0	1.3	1.1	0.7	0.9

Source: Penn World Table 9.0, wiiw Annual Database, World Development Indicators, own calculations.

[22] http://glineq.blogspot.com/2014/11/for-whom-wall-fell-balance-sheet-of.html

4.2. BUSINESS CYCLE MONITOR: STILL WATCHING LABOUR MARKETS AND PROPERTY PRICES

by Alexandra Bykova

- Our headline business cycle index is broadly unchanged for all countries from the Autumn. It suggests no major signals for overheating or underheating in the region in the Q4 2018, especially when compared with the immediate pre-crisis period (see Figure 4.4).

- At the country level, small positive and negative deviations from Q2 2018 values were roughly balanced. Due to the bad economic performance in Q4 2018 the headline score for Turkey fell by 0.3 points (also taking it 0.3 points below it historic average). This was the largest decrease in headline score among CESEE countries. The Czech Republic headline score fell by 0.2 points, the second biggest drop in the region. As a result, the Czech Republic's headline index score is now the fifth highest in CESEE, having been top in Q2 2018. The country with the highest overall index ranking is now Slovakia. The largest increase (0.2 points) was in Serbia. However, this is still below its historical mean.

- Two new countries have been included into the business cycle monitor: Kosovo and Belarus. Kosovo's headline index score is slightly above its historical average. Meanwhile, Belarus is 0.6 points below its historical average, and has the lowest overall score in the region, dragged down by domestic finance under-heating on the back of a large fiscal surplus.

- Signs of potential overheating persist for the same set of indicators as in the previous report. Labour market overheating has increased, and now all countries except Turkey and Ukraine experience it. The property prices indicator is also sending signals of overheating, especially for Croatia and Slovenia, where the growth rates are more than two times the standard deviation from historical averages (see Table 4.4 and Figure 4.5).

- Some under-heating is visible in fiscal balances and current accounts as was the case in the Autumn. These indicators, together with moderate inflation, low private credit and broad money growth below historical averages, reinforce our expectation that regional economic growth is slowing.

- Cross-country comparisons for current levels (Table 4.5) suggest several sources of potential risk. These include double-digit property price growth in Slovenia and Turkey. Negative real interest rates in the Baltics, Bulgaria and Slovakia persist. In Albania and the Czech Republic the RER index (2015=100) shows the highest appreciation in the region. The Visegrád countries show the highest GDP growth and fastest decline in the unemployment rate. However, this is combined with low inflation, mitigating overheating risks.

Table 4.4 / Number of standard deviations from historical mean, 4Q 2018

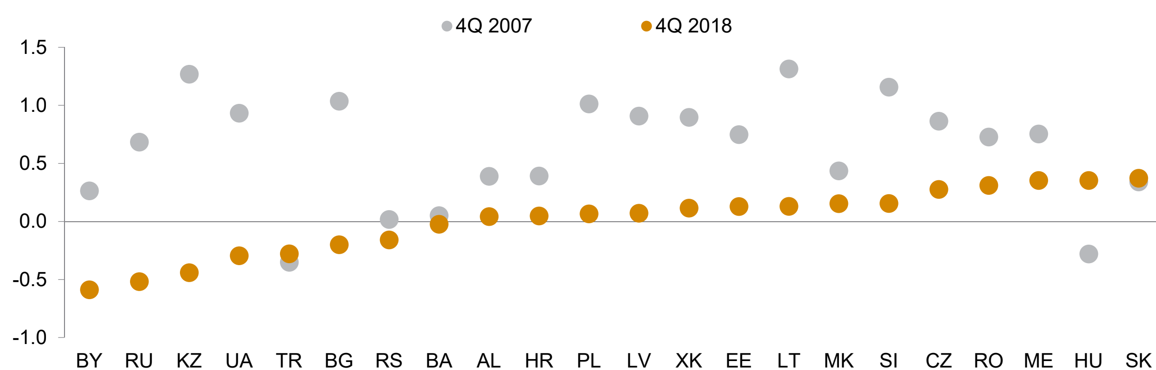
	Domestic economy			External finance			Domestic finance				
	Real GDP	Unemployment	CPI	CA	RER	External debt	RIR	Private credit	Broad money	Fiscal balance	Property prices
BG	-0.24	1.41	-0.35	-1.20	0.45	-1.15	0.26	-0.42	-0.65	-0.48	0.19
CZ	0.06	2.42	-0.07	-1.20	0.96	1.80	0.26	-0.49	-0.17	-1.72	1.21
EE	-0.01	1.08	-0.06	-0.87	1.43	-0.41	1.11	-0.49	-0.44	0.22	-0.13
HR	0.24	1.60	-0.46	-1.50	0.25	-0.24	1.02	-0.38	-0.22	-1.90	2.13
HU	0.96	1.71	-0.51	-0.72	-0.46	-0.57	2.21	0.34	0.91	-1.01	1.05
LT	-0.13	1.13	0.01	-1.05	1.19	0.84	0.89	-0.37	-0.38	-0.95	0.26
LV	0.14	1.12	-0.30	-0.68	0.87	0.26	0.65	-0.63	-0.43	-0.48	0.28
PL	0.86	1.54	-0.59	-1.28	-0.71	0.66	0.90	-0.61	-0.45	-1.46	1.87
RO	0.05	2.95	-0.47	-0.24	-0.01	-0.10	1.38	-0.48	-0.70	-0.07	1.11
SI	0.67	1.04	-0.45	-1.77	-0.08	0.13	1.66	-0.22	0.06	-1.36	2.04
SK	0.03	2.06	-0.25	-0.50	0.75	2.24	1.29	-0.27	-0.21	-1.25	0.24
AL	-0.12	1.55	-0.56	-1.09	2.22	1.07	1.66	-0.91	-1.75	-1.63	
BA	-0.05	2.55	-0.18	-1.16	-1.70	1.36	0.92	-0.32	-0.37	-1.29	
ME	0.37	1.44	-0.43	-0.34	0.88	1.32	1.13	-0.35	-0.38	-0.10	
MK	-0.31	2.19	-0.29	-0.94	-0.41	1.76	0.80	-0.63	-0.40	-0.09	0.04
RS	0.14	1.32	-0.60	-0.43	0.86	-0.15	-0.18	-0.72	-0.76	-1.10	-0.12
XK	-0.01	1.37	-0.24	-0.76	0.31	0.59	1.18	-0.48	-0.48	-0.33	
TR	-0.54	-0.42	0.02	-0.36	-2.42	2.41	0.39	-0.84	-0.32	0.04	-1.02
BY	-0.41	1.43	-0.71	-0.90	-1.35	0.94	-0.59	-1.26	-0.95	-2.05	
KZ	-0.68	1.00	-0.77	-0.39	-1.10	1.27	-1.35	-0.77	-1.51	-0.09	
RU	-0.33	1.42	-1.61	-0.12	-0.20	-0.81	-1.16	-0.67	-1.10	-0.42	-0.68
UA	0.11	-0.25	-0.19	0.56	-1.26	0.69	-1.13	-0.56	-1.00	0.08	

overheating > 1 SD above historical average

underheating > 1 SD below historical average

Note: Data for unemployment, current account, real interest rate, fiscal balance are inverted (as for these indicators lower values would indicate overheating). Historical mean calculated for 4Q 2000 - 4Q 2018. Calculations are based on four-quarter trailing averages.
Source: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

Figure 4.4 / Business Cycle Index



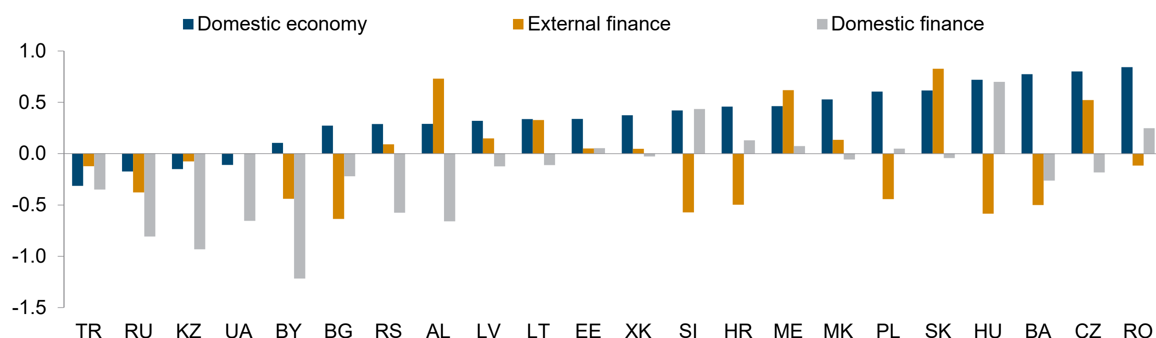
Note: Number of standard deviations from historical mean, average of 11 indicators. Indicators are those in Table 4.4.
Source: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

Table 4.5 / Over-/under-heating in relation to regional peers, 4Q 2018 (4-q trailing average)

	Domestic economy			External finance			Domestic finance				
	Real GDP	Unemployment	CPI	CA	RER	External debt	RIR	Private credit	Broad money	Fiscal balance	Property prices
	%	%	% yoy	% of GDP	2015 = 100	% of GDP	%	% yoy	% yoy	% of GDP	% yoy
BG	3.0	5.2	2.6	4.6	98.6	61.6	-2.6	5.8	9.1	1.0	7.0
CZ	3.0	2.2	2.0	0.7	107.7	81.7	-0.7	6.3	6.0	1.4	8.1
EE	3.9	5.5	3.4	1.2	104.0	78.3	-3.3	3.1	9.0	0.0	6.0
HR	2.7	8.8	1.6	2.7	101.0	76.9	1.4	1.7	7.8	0.3	6.6
HU	4.9	3.7	2.9	1.3	99.0	80.9	-1.9	8.5	13.6	-2.0	9.7
LT	3.5	6.4	2.5	0.9	103.1	79.4	-2.5	5.8	9.2	0.3	7.3
LV	4.8	7.4	2.6	-0.5	101.7	124.0	-2.5	-5.3	9.0	-0.8	9.6
PL	5.1	3.8	1.2	-0.7	97.0	64.7	0.3	5.7	7.5	-1.5	6.2
RO	4.2	4.2	4.1	-4.6	95.7	47.6	-1.6	6.8	10.9	-2.9	5.7
SI	4.5	5.4	1.9	7.4	99.5	94.1	-1.9	2.2	7.4	0.8	14.0
SK	4.1	6.5	2.5	-2.5	99.6	110.6	-2.5	9.8	6.5	-0.9	7.7
AL	4.1	12.1	2.0	-6.4	111.1	63.8	-0.9	-2.3	-0.3	-1.7	
BA	2.9	18.4	1.4	-4.5	96.9	32.8	-1.4	6.5	9.7	2.8	
ME	4.0	14.8	2.6	-17.2	100.8	56.0	3.2	8.8	9.5	-2.9	
MK	1.9	21.0	1.5	-0.8	98.9	79.5	1.3	6.7	10.3	-2.0	1.9
RS	4.2	12.6	2.0	-5.2	104.5	60.6	1.1	5.7	8.5	0.2	9.5
XK	3.9	29.0	1.1	-6.5	99.0	31.3	5.5	11.1	6.0	0.5	
TR	3.0	10.9	16.2	-3.5	71.8	59.9	1.9	17.7	21.0	-3.3	10.3
BY	3.0	4.8	4.9	-2.0	87.3	63.4	5.0	11.1	10.8	4.1	
KZ	4.1	4.9	6.2	0.3	73.4	96.7	2.8	0.1	0.8	-1.1	
RU	2.3	4.8	3.0	6.9	99.9	29.3	4.3	10.8	10.3	3.2	1.7
UA	3.3	8.8	11.0	-3.6	104.6	88.8	5.9	8.3	8.9	-1.9	

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

Figure 4.5 / Sub-components of the Business Cycle Index, 4Q 2018



Note: Number of standard deviations from historical mean, average of indicators in each sub-component. Indicators are those in Table 4.4.
Source: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

4.3. CREDIT MONITOR: RAPID HOUSEHOLD LOAN GROWTH IN CIS + UKRAINE

by Olga Pindyuk

› In the second half of 2018 loans to households continued to grow faster than loans to non-financial corporations throughout the CESEE region with exception of Hungary, Poland, and Turkey (see Table 4.6). Latvia is the only country where households continued deleveraging, which accelerated in the second half of 2018 – in November 2018 the country's loans stock shrank by 5.8% year over year. In the EU-CEE region as an aggregate household loans' growth rate remained robust and practically stable at around 6% year over year (see Figure 4.6). A growth rate has stabilised in the Western Balkans as well – at around 9% year over year.

› CIS and Ukraine remain the leaders in terms of household loans accumulation – and at an increasing speed on top of that. In November 2018, household credit growth in the region reached 24.1% year over year – almost 4 p.p. higher as compared with June 2018. Particularly fast growth took place in Belarus and Ukraine, indicating a high risk of overheating in their banking sectors.

› The situation in the non-financial corporations' segment has remained less favourable, with ongoing deleveraging in five countries. However, the tide seems to have turned as loans accumulation in most of the countries accelerated in the second half of 2018. Loans revival has been helped by the persisting low real interest rates in the EU-CEE, as well as in Albania, Bosnia and Herzegovina, North Macedonia, and Serbia. Very low real interest rates in Estonia, Latvia, and Bulgaria point to mounting risks of potential instability due to ultra-loose monetary policy.

› The share of non-performing loans remained quite low in the EU-CEE with an exception of Bulgaria, Croatia, and Poland. Moreover, in the second half of 2018 the assets quality has been improving across the whole region apart from Bosnia and Herzegovina, Belarus, and Turkey.

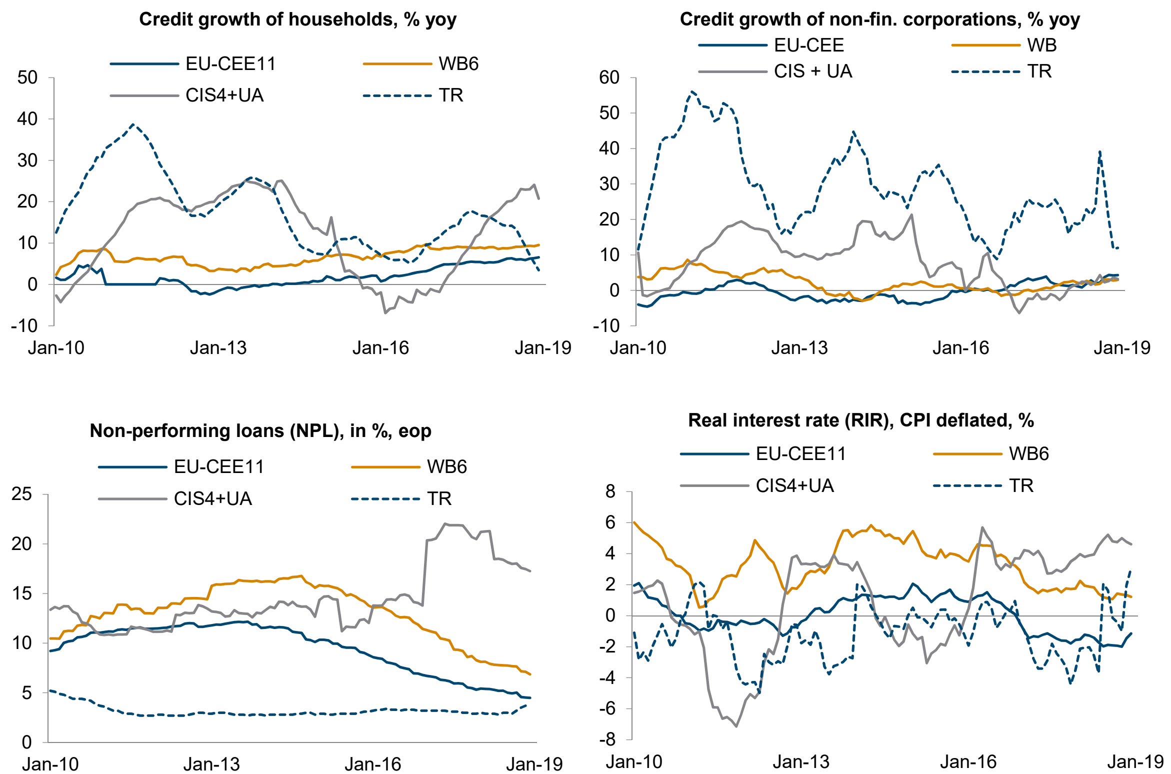
Table 4.6 / Indicators of financial sector developments, December 2018

	AL	BA	BG	BY	CZ	EE	HR	HU	KZ	LT	LV	ME	MK	PL	RO	RS	RU	SI	SK	TR	UA	XK
Loans to non-fin.corporations, % yoy	-7.2	3.7	5.2	7.7	5.7	3.6	-1.1	14.8	-4.6	3.9	-5.0	5.9	4.5	7.6	6.3	7.8	10.5	-0.4	7.0	12.0	3.6	10.6
Loans to households, % yoy	3.8	7.3	11.2	28.4	7.6	6.3	4.6	5.8	16.8	8.0	-5.4	12.0	10.3	7.0	9.2	12.5	22.4	6.5	11.4	3.4	15.5	11.2
Real interest rate, CPI deflated, %	-0.8	-1.6	-2.3	4.1	0.1	-3.2	2.0	-1.8	3.6	-1.7	-2.5	4.1	1.6	0.6	-0.5	1.0	3.2	-1.4	-1.8	3.1	7.5	3.0
Non-performing loans (NPL), in %, eop	11.1	9.4	7.6	4.1	3.2	0.5	10.3	3.5	7.4	2.5	4.2	6.5	5.1	6.8	5.0	6.4	4.7	2.5	3.3	3.9	54.0	2.7

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

Note: The deeper the orange shading, the greater the potential instability/overheating relative to regional peers; the deeper the grey shading, the greater the stability/under-heating. BA, BY, HR, HU, LT, LV, ME, RS, SI, UA data for non-performing loans 2018 wiiw estimate.
Source: wiiw Monthly Database incorporating national statistics.

Figure 4.6 / Indicators of financial sector developments over time



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

4.4. FDI MONITOR: INFLOWS UP IN THE EU-CEE11 AND THE WESTERN BALKANS; DOWN IN RUSSIA

by Gábor Hunya

- Global FDI inflows fell by an estimated 19% in 2018 against the previous year,[23] mainly due to repatriation of accumulated US overseas earnings (negative inflows). FDI inflows into CESEE fell by around 12% in 2017 (revised data[24]), and by another 9% (estimated)[25] in 2018. The decline was mainly on account of Russia, where inflows fell by 35% in 2018 (Table 4.7).
- The EU-CEE11 area received about 4% more FDI in 2018 than in the precious year, but less than one year earlier. Investments throughout the region were stimulated by a robust growth of demand for goods and services both internally and externally, and also by labour shortages necessitating labour saving investments. But the main difference compared with 2017 was that inflows in Poland were less depressed by disinvestments.
- Foreign subsidiaries in EU-CEE11 have increasingly struggled to find qualified staff, paid higher wages to those that they have found, and hired labour from other countries. Investments in technology have been made to make production less labour intensive. Production sites were closed down only in exceptional cases, mainly in labour-intensive clothing, shoemaking and automotive component production.
- The Western Balkans received 6% more FDI in 2018, continuing the upward trend for the third consecutive year. Turkey suffered a decline of a similar magnitude. In the CIS3 and Ukraine it was the latter which suffered some decline, while the other three countries in the group received stable amounts.
- Small open economies in the EU-CEE11 and the Western Balkans have been the top receivers of FDI in per capita terms, with Estonia receiving comfortably the most (Figure 4.7). Some CIS countries and other large economies such as Turkey and Ukraine have generally attracted the least investment relative to their size.
- As of 2010, the stock of inward FDI in relation to GDP was highest in Montenegro, Bulgaria and Estonia, in the range of 80-100%. Kazakhstan and Serbia joined the leading group in 2017 (Figure 4.8). Other catching up countries were Albania and Poland, which received relatively high amounts of FDI while also posting relatively fast GDP growth. Along with Turkey and Russia, the least open countries to FDI are Slovenia and Belarus, outliers to the general FDI-based development path.
- The future may bring less investment into EU-CEE11 as a consequence of the German slowdown and possible US duties on car imports. The Western Balkans may get some more projects in mining and energy, while FDI in the CIS is less dependent on global developments.

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[23] UNCTAD Investment Trends Monitor, January 2019.

[24] 2016 and 2017 data have been only marginally revised compared with the Forecast Report / Autumn 2018

[25] 2018 FDI inflow data, according to directional principle, were estimated based on date for the first three quarters of the year, or if not available, calculated using the change in FDI liabilities in the first three quarters of 2018 against the same period in 2017. These are rough estimations as the relationship is volatile both between FDI inflows and FDI liabilities and between sub-annual data of different years.

Table 4.7 / FDI inflows in CESEE overtime

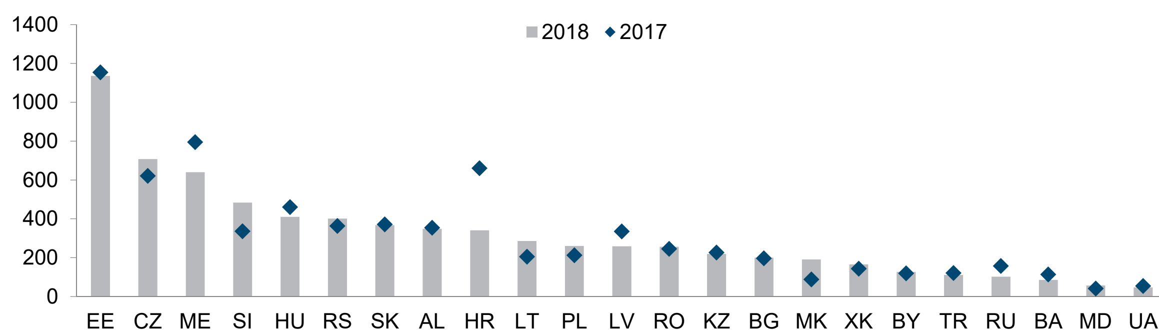
EUR mn

	2010	2011	2012	2013	2014	2015	2016	2017	2018
EU-CEE11	23,278	25,179	30,022	13,272	26,341	25,387	37,048	33,604	35,200
WB6	3,473	5,675	2,806	3,577	3,487	4,450	4,171	4,894	5,200
TR	6,861	11,576	10,341	10,212	9,875	16,225	12,054	9,668	9,000
CIS3+UA	14,790	18,250	18,210	13,024	8,309	7,877	11,575	7,664	7,400
RU	23,875	26,476	23,483	40,196	22,037	10,664	33,568	22,990	15,000
CESEE23	72,276	87,157	84,863	80,281	70,049	64,603	98,415	78,820	71,800

Note: Data are based on Direct Investment Statistics directional principle, excluding Special Purpose Entities (SPEs). wiiw estimates in 2018.
Source: wiiw FDI Database incorporating national bank statistics.

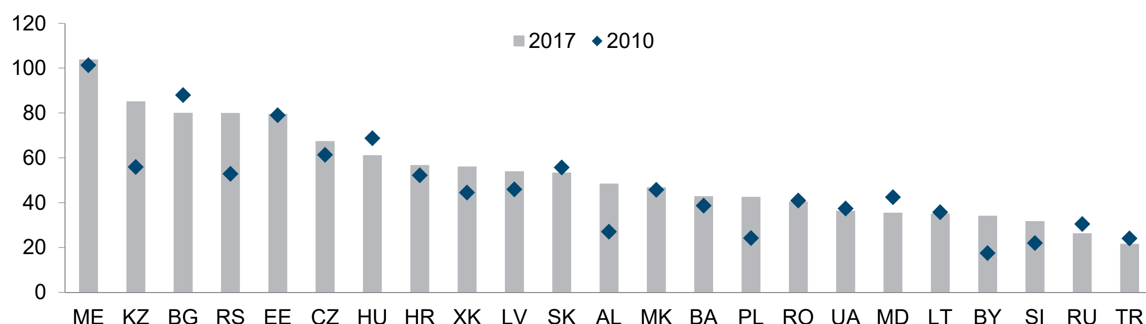
Figure 4.7 / FDI inflow per capita, 2017 and 2018

EUR



Note: Data are based on Direct Investment Statistics directional principle, excluding Special Purpose Entities (SPEs). wiiw estimates in 2018.
Source: wiiw FDI Database incorporating national bank statistics.

Figure 4.8 / FDI inward stock in % of GDP, 2010 and 2017



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

5. Special section

5.1. TEN YEARS AFTER THE GLOBAL FINANCIAL CRISIS: THE STATE OF THE FINANCIAL SECTOR OF THE CESEE REGION

by Olga Pindyuk

Quantitative easing undertaken by the ECB was supposed to provide liquidity to the banking sector, in order to make it easier and cheaper for banks to extend loans to companies and households. It has had limited effect on the CESEE countries, as foreign banks have not restored their pre-crisis positions in the region. Non-financial corporations have increasingly come to prefer direct lending and private equity to bank loans as sources of funding. Both companies and financial corporations tend to pile up cash on their balance sheets. As a result, the efficiency of resource allocation has decreased in the economies of the region, while the risk of asset price bubbles has grown.

5.1.1. Introduction

In this section we will analyse developments in the lending activities of European banks and deleveraging across companies and households in the CESEE region, to see whether there has been a reversal of the early post-crisis trends. The ECB's programme of quantitative easing (QE) was supposed, among other things, to restore the role of banks as financial intermediaries. Getting access to cheap liquidity was supposed to make it easier for the banking sector to extend loans to companies and households. The programme focused on the countries in the eurozone; however, it was expected to have a positive effect on non-euro EU members, as well as other CESEE countries that had benefited from cross-border credit from the EU prior to the global financial crisis. In our analysis, we use data from the Bank for International Settlements (BIS), and specifically its consolidated banking statistics on an ultimate risk basis,[26] its global liquidity dataset and its real property prices time series. Sectoral balance-sheet analysis is done using the national sector accounts statistics published by Eurostat.

Overall, the CESEE region is still experiencing difficulties in gaining access to international financing. Figure 5.1 shows that while the international liquidity situation remains worse than prior to the crisis for both the US and the eurozone, it is the countries of Central Europe[27] that have suffered the biggest decrease in access to cross-border credit in relative terms. The share of banks' international claims in Central Europe's GDP dropped from about 18% in Q1 2009 to a little less than 8% in Q3 2018. The eurozone has also experienced a decline in international banks' claims post-2009, with the steepest downward trend in 2015-2017. The US appears to have stabilised the inflow of cross-border bank credit at the Q1 2005 level.

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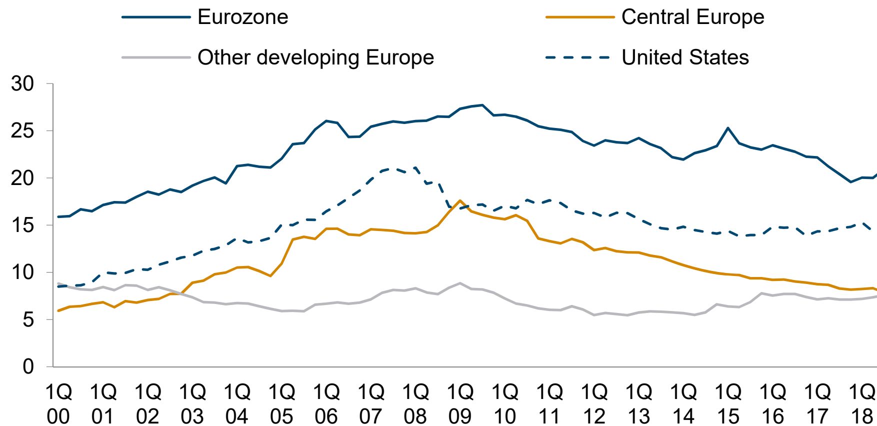
[26] The country of ultimate risk is defined as the country in which the guarantor of a financial claim resides or the country in which the head office of a legally dependent branch is located.

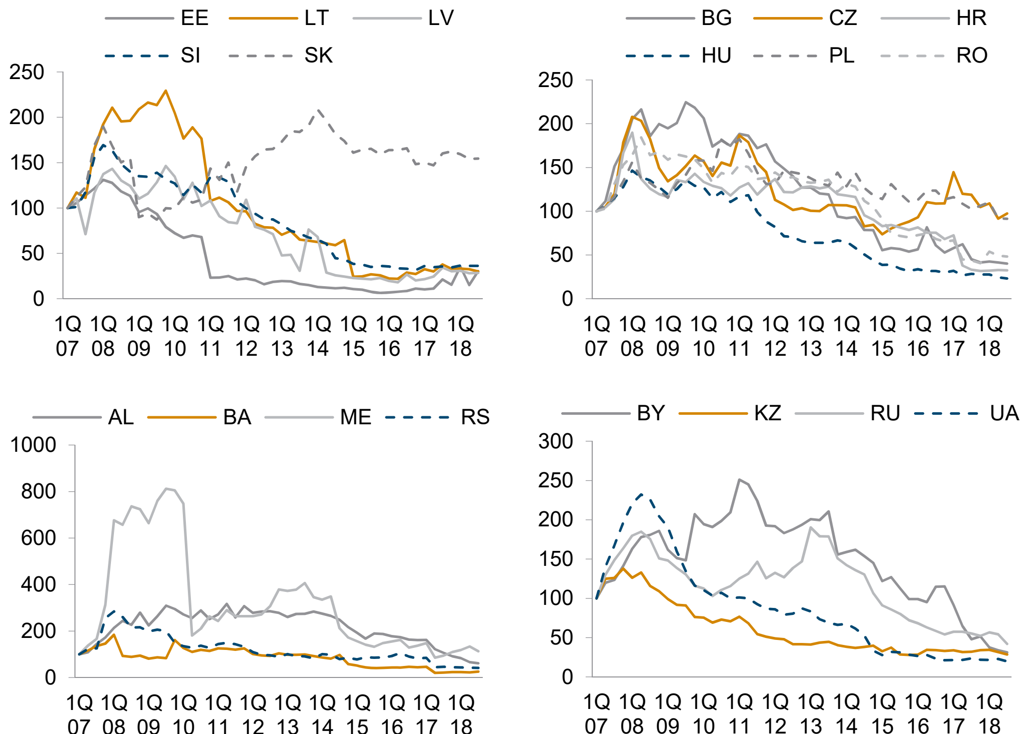
[27] Central Europe here comprises the Czech Republic, Hungary, Poland, Slovakia and Slovenia.

Figure 5.1 / Banks' international claims by residence of borrower, in % of GDP



Source: BIS global liquidity indicators.

Figure 5.2 / Cross border consolidated bank claims on an ultimate risk basis by counterparty, nominal EUR terms, 1Q 2007=100



Source: BIS.

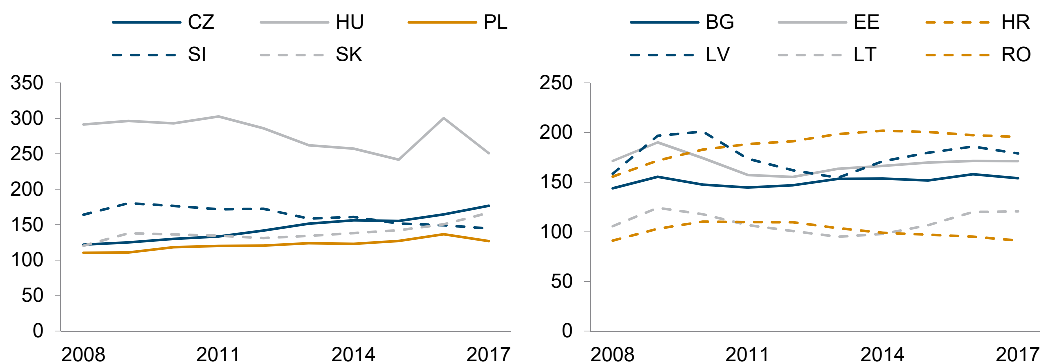
Foreign banks have not yet restored their positions in the majority of the CESEE countries. Figure 5.2 shows the indices of cross-border bank claims in different countries of the region. Generally, those countries that had been very active in accumulating European banks' foreign claims prior to the crisis have had the most difficulty in reversing the trend of decline in foreign banks' claims since the crisis. Among members of the eurozone, only Slovakia has reached the pre-crisis level of foreign banks'

claims. Another four eurozone countries witnessed a sharp decrease in cross-border bank inflows and have not yet bounced back. Poland and the Czech Republic, which experienced the slowest growth in cross-border banks' claims prior to 2008, have performed better than most of their peers in CESEE – during 2008-2017 they lost only 33% and 55% of the foreign banks' claims, respectively. In the Western Balkans and CIS + Ukraine, the situation with cross-border bank claims remains rather gloomy. In Belarus and Russia, a rise in foreign banks' activity around 2010-2012 turned out to be a temporary phenomenon, and cross-border banks' claims plunged thereafter.

5.1.2. Financial corporations

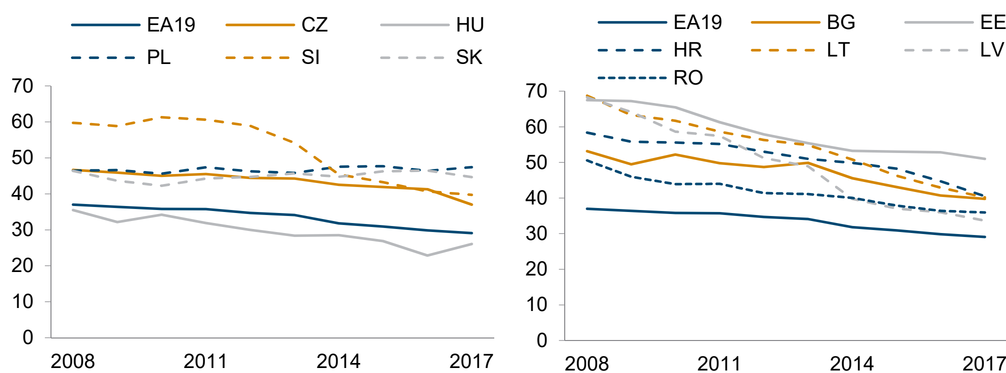
Financial corporations were directly hit by the declining exposure of European banks to the region. As Figure 5.3 shows, in only a few countries of EU-CEE[28] did financial corporations increase their assets relative to GDP during 2009-2017: namely, the Czech Republic, Croatia, Poland and Slovakia. In other countries, assets accumulation was negative.

Figure 5.3 / Assets of financial corporations, in % of GDP



Source: Eurostat.

Figure 5.4 / Loans, in % of total assets of financial corporations

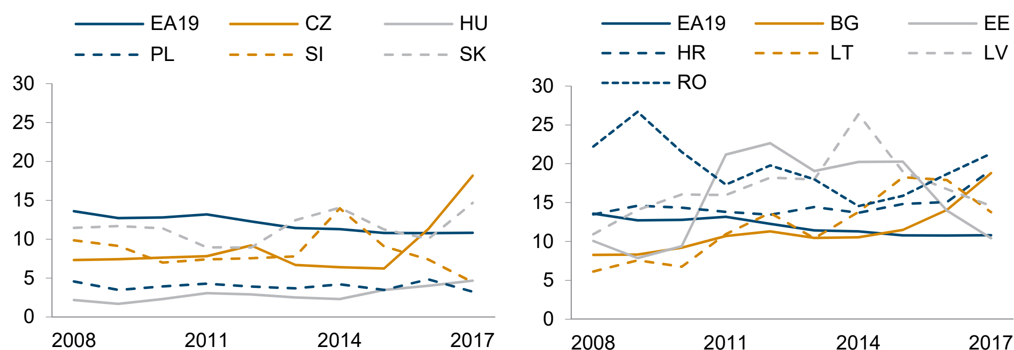


Source: Eurostat.

[28] Eurostat covers only 11 countries of the CESEE region in the national sector accounts statistics; we refer to these 11 countries as EU-CEE.

Though the situation concerning access to finance has recently improved somewhat, bank lending has not been restored. Banks are increasingly reluctant to provide loans, regardless of the improvement in the quality of existing portfolios with reduction of the shares of non-performing loans (NPLs) in most of the countries (see 4.3 Credit monitor). As can be seen from Figure 5.4, in all the countries (apart from Poland) the share of loans in financial corporations' total assets decreased during 2008-2017, with the biggest reductions in Latvia (34.6 p.p.), Lithuania (28.6 p.p.) and Slovenia (20.0 p.p.). According to the CESEE Bank Lending Survey, demand for loans and credit lines continued to increase robustly in net balances in recent years; therefore the causes of such behaviour by the banks most likely lie on the supply side, and have to do with insufficient profitability of loans in a low-interest-rate environment.

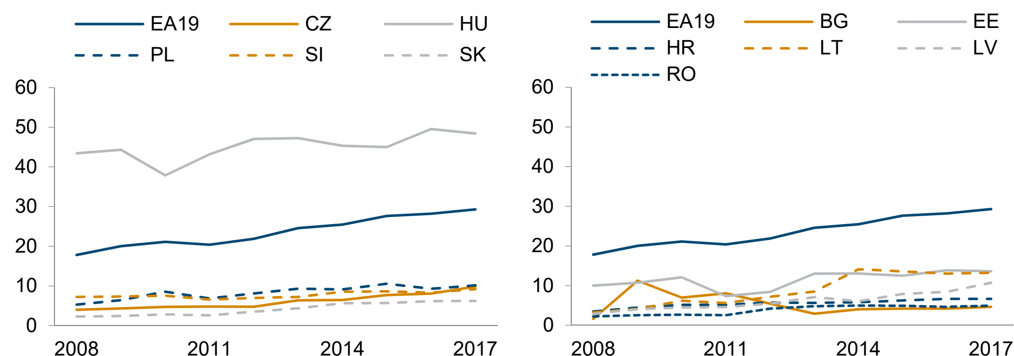
Figure 5.5 / Currency and deposits, in % of total assets of financial corporations



Source: Eurostat.

Currency and deposits and equity and bonds have been replacing loans in banks' portfolios. By 2017, financial corporations in all EU-CEE countries, apart from Poland and Slovenia, were still keeping a higher share of currency and deposits than in 2008 (see Figure 5.5). Moreover, in the majority of the countries, the shares of currency and deposits were higher in 2017 than in 2013 as well, indicating a possible continuation of the liquidity hoarding tendency. The proportions of equity and investment fund shares have also been on the rise in all the countries of the region analysed (see Figure 5.6). Hungarian banks have an especially high share of this type of assets in their portfolios – almost twice as high as the average EU level.

Figure 5.6 / Equity and investment fund shares, in % of total assets of financial corporations

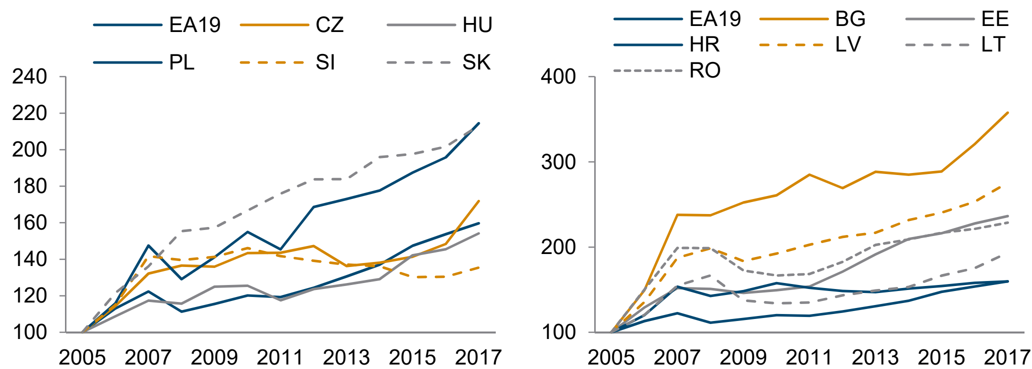


Source: Eurostat.

5.1.3. Non-financial corporations

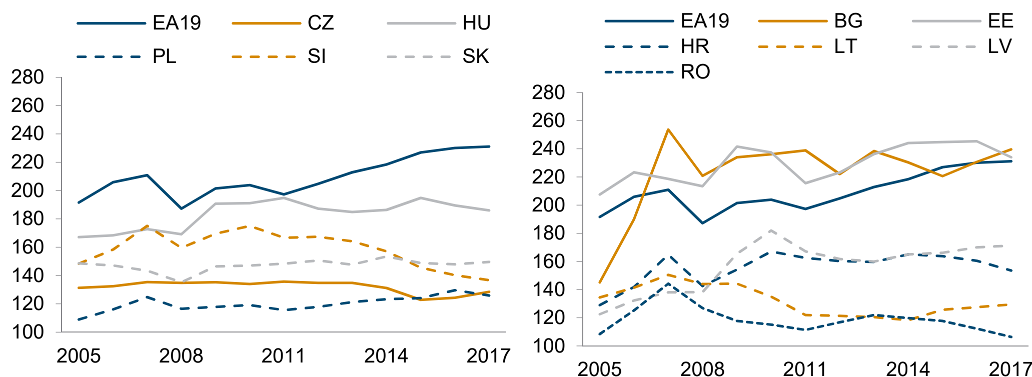
Prior to the crisis, all the EU-CEE countries experienced a much faster accumulation of corporate debt than the eurozone; but the situation changed post-crisis, when the eurozone outpaced most countries of the region in terms of growth rates of corporate debt. Still, overall during 2005-2017, firms' financial liabilities in most countries of the region expanded much faster than in the eurozone; Hungary, Slovenia and Croatia are the only exceptions (see Figure 5.7). Slovenia is the only country that has not recovered its pre-crisis level of corporate debt – due to the prolonged effects of the bursting of the property bubble. Poland stands out as a country with the most dynamic corporate debt expansion (measured as an average growth rate) in the post-crisis period, followed by Estonia and Bulgaria. During 2015-2017, financial liabilities growth accelerated in most countries (apart from Estonia and Slovakia) – probably reflecting injections of extra liquidity by the ECB.

Figure 5.7 / Total financial liabilities of non-financial corporations, 2005=100



Source: Eurostat.

Figure 5.8 / Total financial liabilities of non-financial corporations, in % of GDP



Source: Eurostat.

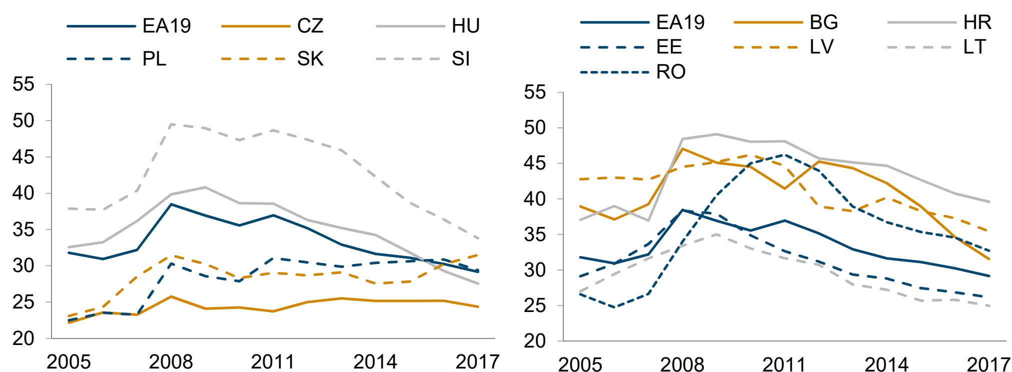
In contrast to the eurozone, where the share of the financial liabilities of non-financial corporations in GDP increased during 2011-2017 by almost 34 p.p., to 231%, in the EU-CEE countries there has been no significant upswing in the value of this indicator (see Figure 5.8). At the same time, the depth of the corporate debt market has not decreased either, even in those countries where there were signs of corporate debt overhang prior to the crisis. By 2018, non-financial

corporations in Bulgaria and Estonia (which had been the most heavily indebted) were keeping their financial liabilities at above 230% of GDP. Slovenia and Lithuania are the only countries of those analysed that have continued in recent years to reduce corporate debt relative to GDP.

The importance of loans as a source of funding has been declining in most of the countries (see Figure 5.9). Poland and Slovakia are the only countries in the region where loans to non-financial corporations as a share of GDP expanded slightly during 2008-2017. In all the other countries, they were lower in 2017 than in 2008. The most dramatic decline took place in Slovenia and Bulgaria, which initially had among the highest levels of NPLs among the peer countries, as well as among the highest shares of loans to non-financial corporations in their GDP; they had to go through significant deleveraging to cleanse banks' balance sheets. Though the situation with NPLs has improved recently, companies in all EU-CEE countries, apart from Poland and Slovakia, continued deleveraging during 2013-2017.

Instead, companies have been opting for direct lending and private equity as sources of financing, as these forms tend to have less stringent requirements for borrowers. The past few years have seen a significant rise in direct lenders and alternative funding structures, which are much less strictly regulated than banks. In particular, a rapidly growing market of leveraged loans (which are extended to already indebted or poorly rated companies) gives cause for concern. The lion's share of the leveraged loans issued are 'covenant-lite', which means fewer restrictions on the borrower and less protection for the lender. Though Europe has lagged behind the US in terms of the size of the leveraged loans market, it has started to catch up: according to S&P European Leveraged Loan Index (ELLI), the market grew by almost 80% during 2016-2018, to 181 billion euros.

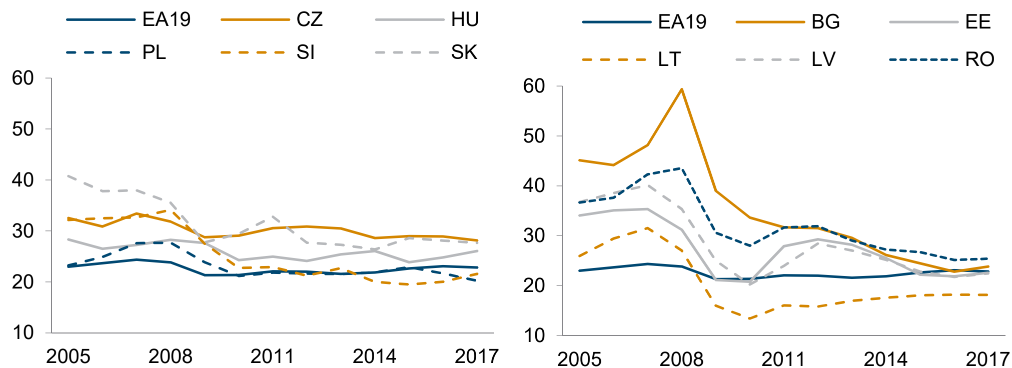
Figure 5.9 / Loans to non-financial corporations in % of the sector's total financial liabilities



Source: Eurostat.

There is some debate about whether the increase in corporate debt in the past decade has funded much investment. Figure 5.10 shows that firms in all the EU-CEE countries have massively reduced their share of gross fixed capital formation (GFCF) in gross value added (GVA) – by an average of as much as 11.8 p.p. during 2009-2017. This is much higher than the average of 1.2 p.p. in the eurozone. The most striking decreases during this period were recorded in Bulgaria (35.5 p.p.) and Romania (18.2 p.p.). These countries had unsustainably high volumes of investments prior to the crisis: in 2008, the share of GFCF in GVA reached 59% in Bulgaria and 44% in Romania.

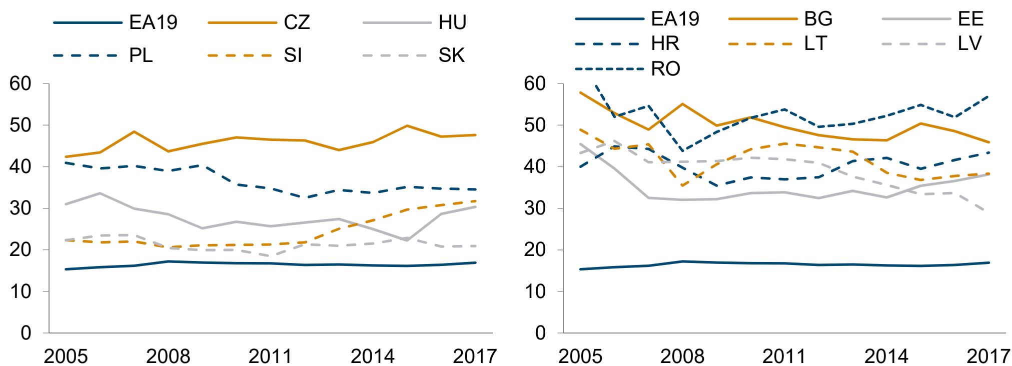
Figure 5.10 / Gross fixed capital formation of non-financial corporations, in % of GVA



Source: Eurostat.

Companies in many EU-CEE countries still had a lot of cash piled up on their balance sheets in 2017. In all the EU-CEE countries, the share of currency and deposits in the total assets of non-financial corporations has been significantly higher than on average in the eurozone (see Figure 5.11). Only in Bulgaria, Latvia and Poland was the share of currency and deposits in the total assets of non-financial corporations lower in 2017 than in 2008.

Figure 5.11 / Currency and deposits, in % of total assets of non-financial corporations

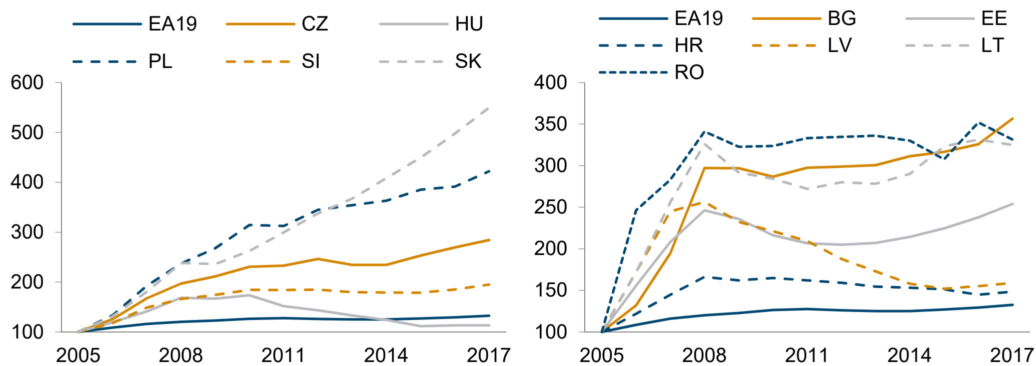


Source: Eurostat.

5.1.4. Households

As was the case with firms, prior to 2009 households in all the EU-CEE countries accumulated debt much faster than in the eurozone; but the situation changed post-crisis, when households in many countries either went through deleveraging or expanded household debt more slowly than in the eurozone. Latvia experienced the most dramatic decline in household debt value in relative terms – in 2017 it was still 38% lower than in 2008. Slovakia stands out as a country with the most dynamic debt expansion in the post-crisis period, with an average annual growth rate of about 10%. During 2015-2017, many countries recorded a speeding up in the growth of households' financial liabilities.

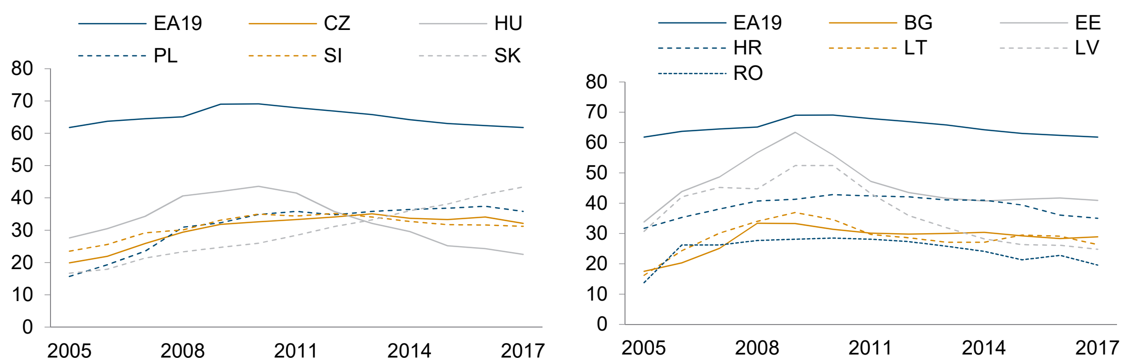
Figure 5.12 / Total financial liabilities of households, 2005=100



Source: Eurostat.

The EU-CEE countries have experienced various developments in household debt as a share of GDP. Notwithstanding the decline in NPLs and low interest rates on loans, households in the Baltic states, Bulgaria, Croatia, Romania and Hungary have reduced their leverage relative to GDP – as is the case in the eurozone (see Figure 5.13). In the Czech Republic, Poland, Slovakia and Slovenia, by contrast, the opposite trend has occurred. In 2017, Slovakia had the highest share of household debt to GDP in the region – 43.4%, which is 20.1 p.p. higher than the value in 2008. However, it is still significantly lower than the average in the eurozone.

Figure 5.13 / Total financial liabilities of households, in % of GDP



Source: Eurostat.

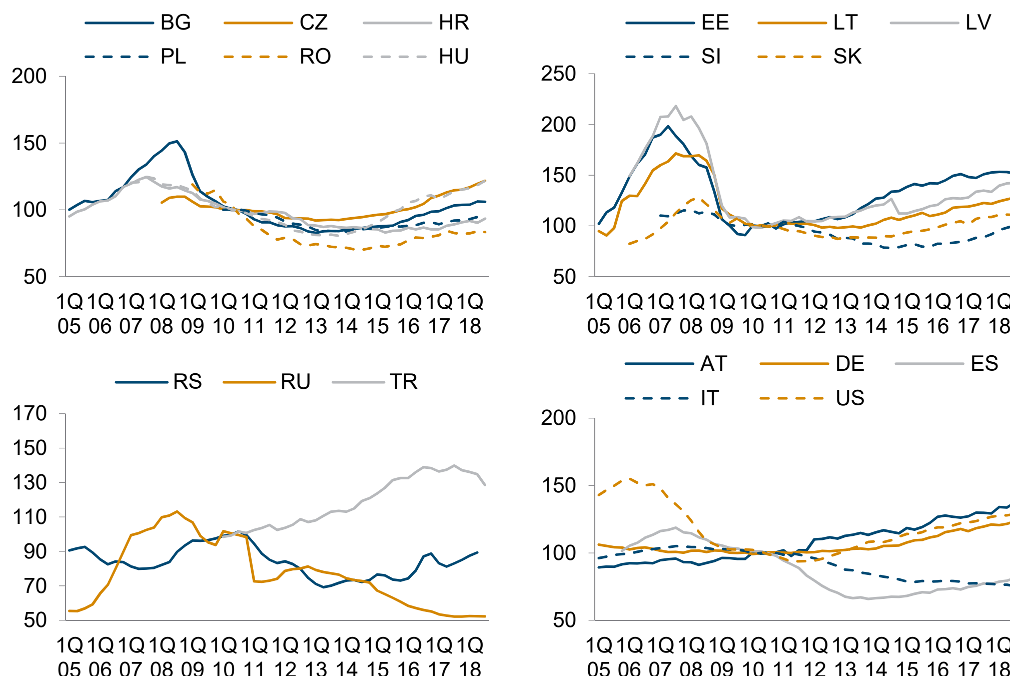
The relatively slow accumulation of households' indebtedness in many EU-CEE countries might have to do with rapid wage growth in the context of a shortage of labour. Consumers are likely to finance their expenditure more out of wage income. Additionally, gross household savings rates have been growing recently in many countries (see Overview). This behaviour on the part of households could well be explained by dwindling confidence in the economy, which makes them less willing to increase spending – as well as less willing to finance that spending through loans.

5.1.5. Where has all the liquidity gone?

All in all, it may be concluded that the legacy of the financial crisis of 2008-2009 is still largely being felt in the financial sector of many CESEE countries. It appears that the ample liquidity provided to the banking sector in the eurozone as part of quantitative easing (as well as loose monetary policy in many non-euro countries) has not had any significant positive effect on the economies of the EU-CEE countries. Foreign banks have not restored their exposure to the region, and financial corporations in the region have continued to take a cautious approach to loans expansion, still favouring liquidity hoarding. Non-financial corporations in many countries appear to have benefited from access to low-cost liquidity – though to a lesser extent than in the eurozone. This has allowed even countries with significant corporate debt overhang to keep its share in GDP unchanged. However, instead of increasing investment in fixed capital, many companies are tending to pile up cash on their balance sheets.

Another worrisome development in the aftermath of the global financial crisis is the increasing reliance of firms on direct lending and private equity as sources of financing. Lenders in these markets have less strict requirements of borrowers and are much less regulated, which could enable reckless lending by firms. This reduces the efficiency of resource allocation in the economy, as companies that might otherwise have gone bankrupt continue to function due to low borrowing costs.

Figure 5.14 / Real residential property prices, 2010=100



Source: BIS.

Moreover, there is increasing evidence that the bulk of the extra liquidity went into asset bubbles that might pose the risk of another financial crisis. Real residential property prices have been on the rise throughout the EU, with the fastest growth taking place in the Western European countries such as Austria and Germany (see Figure 5.14). CESEE countries appear to have followed suit over recent years. In pushing up the price of assets, QE exacerbates social divides, since those who do not own financial assets are unable to earn interest on their savings. This particularly affects future pensioners' income.

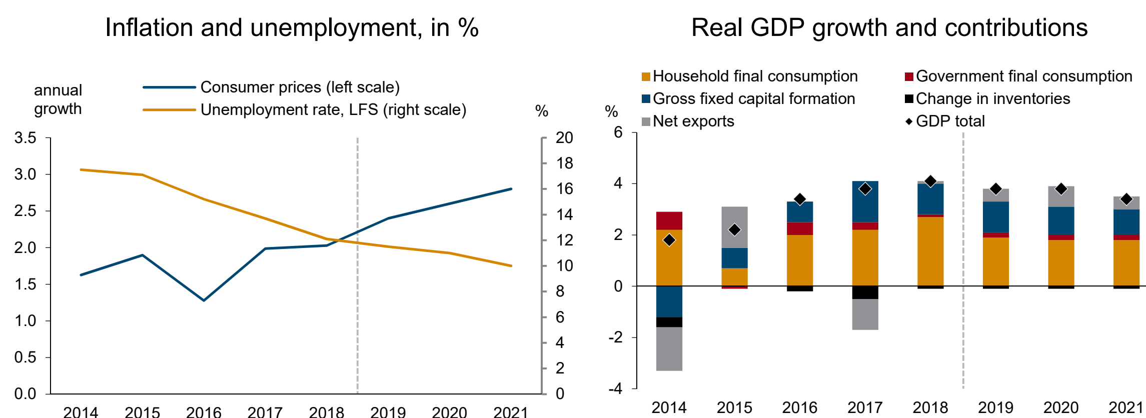
6. Country reports

ALBANIA: Growth will lose vigour

ISILDA MARA

Economic growth, supported both by domestic and external demand, will continue, but at a slower pace. Remittances – close to 6% of GDP – will boost consumption, and will also contribute to a lower current account deficit. Fiscal consolidation is expected to continue, via a cut in expenditures. Intensification of investments in renewable energy is expected to boost alternate sources of energy production. Uncertainty about FDI inflows is expected. Political unrest and massive protests threaten macroeconomic stability and the process of EU integration.

Figure 6.1 / Albania: Main macroeconomic indicators



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

Political unrest and massive protests threaten the stability of the country, the progress of the reforms and the opening of EU membership talks by June 2019. 2018 closed with massive protests all over the country, among others students' protests against the deterioration of the accessibility and quality of the education system. 2019 is continuing on a similar course. Protests have intensified because a number of corruption affairs in infrastructure projects and facts about manipulations of the electorate vote (during the 2017 central government elections) have emerged. Two thirds of the government were recomposed by January 2019 – 7 out of 13 ministers were replaced. Local elections are due in June 2019, but the opposition is pressing for the government to resign and have full parliamentary elections instead. The protests reached a peak on 16 February 2019.

Participation in this protest was massive – the largest in the three decades of democracy – and indicated the population's huge discontent with the current government. The protest was led by the opposition and its old political cast. Hence, it is doubtful whether the latter can be part of the solution

as long as they are part of the problem. Instead, a bottom-up approach led by a third pole in the Albanian politics is necessary for getting the country out of this baffled transition, but the chances for this to happen are scarce.

The reform of the judicial system, key to EU integration and the opening of EU membership talks, due in June 2019, is progressing slowly. Part of that reform is the establishment of a number of institutions – such as the Special Anti-Corruption and Organised Crime Structure (SPAK) – which has not been finalised yet. The progress of reforms, the economy and the EU integration perspective are expected to suffer the most from the political unrest.

Growth hovered above 4% in 2018, but will lose vigour in the medium term. During the first three quarters of 2018 the economy grew by 4.4% compared with the same period of the previous year. The main drivers were domestic demand – consumption rose by 3.4% and investments accelerated by 4% – and an upsurge in goods exports, which expanded by 16%. In production terms growth was driven by an 18% rise in industrial production, electricity in particular. The industrial sector – mainly electricity – contributed more than 2 percentage points to GDP growth in the first three quarters of 2018.

Growth of above 4% is not generating many jobs. Labour market indicators for the third quarter of 2018 suggest a drop in unemployment to 12.2% compared to 13.6% reported in Q3 2017. However, while more than 57,000 jobs were absorbed by the age group 15-29, employment of the age group 30-65 shrank by 35,000. These dynamics therefore rather hint at an exchange of jobs between young and older age cohorts. For the latter group not only employment, but also labour force, unemployment and inactivity dropped – dynamics which partly might be explained by the intensification of emigration. Informal employment dropped from 50% in 2014 to 35% in 2018. Still its level persists being one of the highest in the Western Balkan region – as long as 1 out of 3 of those employed is working informally. Taking into account real wage growth of 2.4% in 2018, against an inflation rate of 2% in 2018, working and remaining poor is persisting and driving further emigration. According to the World Bank Macro Poverty Outlook, the poverty headcount for 2018 is estimated at 28.3% – measured as USD 5.5 per person per day, at 2011 PPP.

Emigration has intensified further and its effect on human capital and demography might turn problematic in the medium and long run. The Albanian Institute of Statistics has projected that the active workforce is expected to decline by 2021 (Instat Albania, 2019). The rise in remittances – by 8% in the first three quarters of 2018, year on year, accounting for 6% of GDP – is certainly an indicator that emigration is in the growth stage of its cycle. In 2019 a new baby bonus has been introduced, aimed at curbing the rapid demographic decline, but its desired effects – likely to be visible in the long run – are still questionable as long as emigration, especially of the youth, is not ceasing. According to Eurostat, starting with visa liberalisation in 2011, more than 187,000 Albanians have knocked on EU doors seeking asylum. Between 2011 and 2016 more than 254,000 thousand Albanians acquired the citizenship of any of the EU28 and EFTA countries where they reside (Eurostat data). UNESCO[29] (2019) reports almost 130,000 *internationally mobile tertiary students* from Albania between 2011 and 2017 – a number close to the level of students enrolled in Albanian universities in 2017-2018. Around 90% of *internationally mobile tertiary students* have moved to the USA or EU and the likelihood of

[29] Source: Data extracted on 29 Jan 2019, 16:32 UTC (GMT) from UIS.Stat, http://data.uis.unesco.org/

returning home is low. Emigration at these levels, especially of those highly skilled, will generate losses in human capital and consequently affect the sustainability of growth in the medium to long run.

Fiscal consolidation is expected to continue by keeping expenditures low, rather than by rising revenues. General government budget performance has been below expectations. Revenues grew by 4% in 2018, hovering at 26.4% of GDP compared to 27.7% in 2017. Government spending rose by roughly 3%. Capital expenditures absorbed only 17% of total expenditures, despite an increase of 14.5%. The announced budget for 2019-2021 foresees that its level, both in terms of revenues and expenditures, will remain low hinting at parsimonious public spending on investment.

Demand for credit has not recovered as expected and its stock will continue to stay flat. Non-performing loans dropped by 2 percentage points to 11% of the total in 2018, but the stock of credit remains stuck at the 2011 level. Besides, the stock of loans to the non-financial private sector dropped by 5% until November 2018, year on year. The Albanian lek appreciated remarkably against the euro in 2018, by 7% year on year, and was floating at around 124.5 in January-February 2019. The Central Bank's monetary policy will remain loose: interest rates will be kept at 1% and no further rise is expected until the second half of 2019. Also, the Central Bank has announced that it will not intervene by buying euro in the market– as it did during 2018 – to prevent a further over-appreciation of the lek. This is in line with the economy's de-euroisation, which is strongly recommended by the IMF.

I**nvestments in solar power plants are expected to boost alternate sources of renewable energy production.** Early this year the Norwegian state-owned company Statkraft will complete the second hydropower plant (HPP) on the Devoll river. The start of energy production is expected by the second half of 2019. The two HPPs Banja and Moglica, completed in 2016 and 2019, respectively, will raise energy production by 17%. Taking into account the abundance of sunny days and the risks of droughts, Statkraft submitted to the Albanian government a request for building a floating solar power plant (SPP) in the lake of the Banja HPP. More than 95% of electricity production depends on HPPs – therefore, further investments in SPPs are supported by the government. Another priority of the government is the gasification of the country. Apart from being a transit country for the Trans Adriatic Pipeline (TAP) the government is aiming at getting access to the gas that TAP will deliver. Starting from 2020, TAP will deliver gas from Azerbaijan to the EU – transiting through Albania.

Exports of goods and services have performed well, but are unlikely to continue at a similar pace. The external sector has been characterised by a strong push, in export of both goods and services. The upsurge in goods exports was helped by electricity exports. Thanks to heavy rains during the first three quarters of 2018 energy production doubled while electricity exports were six times higher than for the same period in 2017. The main external trading partners continue to be the EU countries. More than two thirds of exported goods go to Italy, Spain, Germany, Greece and Kosovo. Italy – with a 50% market share – is the main trading partner and two thirds of goods exported to Italy are accounted for by the garment industry. However, in 2018 exports to Italy rose only by 2%. Taking into account the strong appreciation of the lek, which is expected to continue, and the fact that the Italian economy is going through a recession period, we expect that goods export – in particular the sector of the garment industry – might be negatively hit. Besides, as long as the export goods basket continues to be undiversified and concentrated on few partners, the external sector demand will continue to bear certain risks.

There is a high uncertainty about the pace of FDI inflows in the medium term. Foreign direct investment inflows rose by 11% in the first three quarters of 2018. Nevertheless, in terms of structure and rise in FDI inflows, the main driver continued to be TAP and the Devoll HPPs – both to be completed this year. Good news in the manufacturing sector is the entry of Yura Corporation, a South Korean company which produces electric and electronic components for the automobile industry. Yura Corporation plans to invest EUR 6.5 million already in 2019 and will provide 600 new jobs. Less good news is the announcement of Shell about the suspension of its seismic survey for oil reserves in Zagorie (in the South-East of the country) because a number of designated sites fall into protected areas under Albanian legislation. In spring 2018, Ivicom Holding GmbH, based in Austria, proposed to build a 500 MW power plant worth EUR 350 million for producing electricity via the gas that will be supplied by TAP. Even though the project has gained the status of strategic investment, the negotiations are moving slowly. Also last spring, the government announced the construction of a new airport near the city of Vlora in the south of Albania, worth EUR 100 million, to be launched in the course of 2019. Nevertheless, there seem to be delays also in this case. Bankers Petroleum, run by the Chinese company Geo-Jade, announced an invest plan of USD 158 million in 2019. However, the drop in international oil prices raises concerns that this investments might be postponed as well. Overall, taking into account the lag in time between the announcement and commencement of a project, we expect the trend in FDI inflows to move downwards.

Overall, growth is expected to stay close to or below 4% in the medium term. Both domestic and external demand will continue to provide a positive impetus to growth – nevertheless, at a lower intensity. The political tensions in the country might not only threaten macroeconomic stability and the business climate, but also the process of EU integration and the opening of EU membership talks due in June 2019. We have therefore slightly revised downwards the medium-term projections, to below 4%.

Table 6.1 / Albania: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020 Forecast	2021
Population, th pers., average	2,889	2,881	2,876	2,873	2,866	2,870	2,865	2,865
Gross domestic product, ALL bn, nom.	1,395	1,434	1,475	1,553	1,600	1,700	1,800	1,900
annual change in % (real)	1.8	2.2	3.4	3.8	4.1	3.8	3.8	3.4
GDP/capita (EUR at PPP)	8,300	8,800	8,700	9,100	9,700	.	.	.
Consumption of households, ALL bn, nom.	1,120	1,147	1,187	1,242	1,310	.	.	.
annual change in % (real)	2.8	0.9	2.6	2.7	3.4	2.4	2.2	2.2
Gross fixed capital form., ALL bn, nom.	337	350	362	386	410	.	.	.
annual change in % (real)	-4.5	3.5	3.3	6.5	5.0	5.0	4.5	4.0
Gross industrial production								
annual change in % (real)	1.5	-2.1	-18.0	-0.6	12.0	4.0	3.0	6.0
Gross agricultural production [2]								
annual change in % (real)	1.4	2.6	3.3	4.0	5.0	.	.	.
Construction output total								
annual change in % (real)	5.0	19.4	5.1	19.6	6.0	.	.	.
Employed persons, LFS, th	1,037	1,087	1,157	1,195	1,234	1,260	1,300	1,320
annual change in %	1.3	4.8	6.5	3.3	3.3	2.1	3.2	1.5
Unemployed persons, LFS, th	220	224	208	190	170	160	160	150
Unemployment rate, LFS, in %	17.5	17.1	15.2	13.7	12.1	11.5	11.0	10.0
Reg. unemployment rate, in %, eop	13.0	12.9	8.8	7.2	6.0	.	.	.
Average monthly gross wages, ALL	45,539	46,829	45,845	49,840	54,400	57,700	61,000	64,000
annual change in % (real, gross)	-0.7	0.9	-3.3	6.6	7.0	3.5	3.0	2.0
Consumer prices, % p.a.	1.6	1.9	1.3	2.0	2.0	2.4	2.6	2.8
Producer prices in industry, % p.a.	-0.5	-2.1	-1.4	2.6	1.8	1.6	2.0	1.8
General governm.budget, nat.def., % of GDP								
Revenues	26.3	26.4	27.6	27.7	28.1	26.5	27.0	27.0
Expenditures	31.4	30.5	29.4	29.7	29.7	28.0	28.5	28.0
Deficit (-) / surplus (+)	-5.2	-4.1	-1.8	-2.0	-1.7	-1.5	-1.5	-1.0
General gov.gross debt, nat.def., % of GDP	70.1	72.7	72.3	70.1	72.8	67.5	67.0	66.0
Stock of loans of non-fin.private sector, % p.a.	2.4	-2.6	0.2	0.7	-3.6	.	.	.
Non-performing loans (NPL), in %, eop	22.8	18.2	18.3	13.2	11.1	.	.	.
Central bank policy rate, % p.a., eop [3]	2.25	1.75	1.25	1.25	1.00	1.0	1.3	1.3
Current account, EUR mn	-1,076	-884	-812	-866	-800	-880	-850	-890
Current account, % of GDP	-10.8	-8.6	-7.6	-7.5	-6.4	-6.4	-5.9	-5.8
Exports of goods, BOP, EUR mn	932	771	714	797	930	1,040	1,140	1,200
annual change in %	-12.7	-17.2	-7.4	11.7	16.7	12.0	9.5	5.7
Imports of goods, BOP, EUR mn	3,147	3,070	3,317	3,621	3,950	4,250	4,480	4,700
annual change in %	3.9	-2.5	8.0	9.2	9.1	7.5	5.5	5.0
Exports of services, BOP, EUR mn	1,881	2,028	2,396	2,856	3,230	3,550	3,890	4,240
annual change in %	9.7	7.8	18.1	19.2	13.1	10.0	9.5	9.0
Imports of services, BOP, EUR mn	1,558	1,503	1,599	1,774	1,930	2,060	2,170	2,300
annual change in %	4.6	-3.5	6.4	11.0	8.8	6.5	5.5	6.0
FDI liabilities, EUR mn	869	890	943	900	900	.	.	.
FDI assets, EUR mn	58	72	6	-94	-50	.	.	.
Gross reserves of NB excl. gold, EUR mn	2,142	2,831	2,889	2,941	3,342	.	.	.
Gross external debt, EUR mn	6,927	7,634	7,882	7,949	8,400	8,500	8,900	9,200
Gross external debt, % of GDP	69.5	74.4	73.4	68.7	63.0	62.0	61.0	60.0
Average exchange rate ALL/EUR	139.97	139.74	137.36	134.15	127.59	124.5	124.0	123.5

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

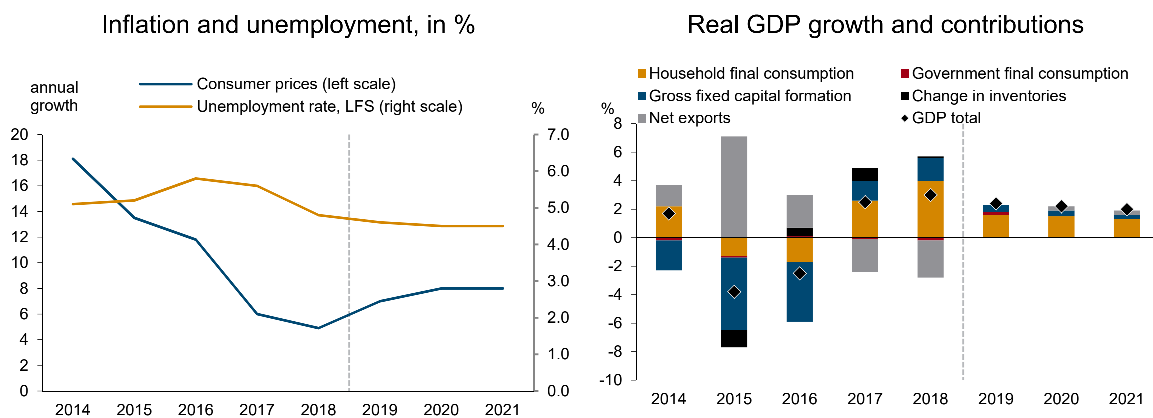
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

BELARUS: Growth set to slow down

RUMEN DOBRINSKY

Economic activity slowed down abruptly in the second half of 2018 due to a combination of domestic and external factors. These include changes in Russia's energy taxation system which affect Belarus. Private consumption remained the main growth driver thanks to rising income and a boom in consumer credit. There are no imminent threats to macroeconomic stability but the short-term prospects have deteriorated and the Belarusian economy is expected to slow down in the coming years.

Figure 6.2 / Belarus: Main macroeconomic indicators



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

While the first half of 2018 was marked by a robust economic recovery, economic activity slowed down abruptly in the second half. After the unexpectedly high 5.3% year-on-year rise recorded in the first quarter, GDP growth continuously slowed down in the course of the year to 3.9% in the second, 2.2% in the third quarter and came to a near standstill in the fourth quarter. According to the first official estimates average GDP growth for 2018 as a whole came to 3%.

Such dynamics reflects the combined effect of several factors. The high rates reported in the first half can partly be attributed to a low base but this base effect was diminishing in the course of the year (the recovery in Belarus started in the second half of 2017). Another factor contributing to the general economic slowdown was the drop in agricultural output in 2018 related to bad weather conditions. In addition to that, Belarus' external environment also changed with some unfavourable factors emerging in the second half of the year.

Among them was the so-called Russian ‘tax manoeuvre’ initiated in 2018. It amounts to a change in the redistribution of import and export duties within the Eurasian Economic Union requested by Russia which results in lower revenue for Belarus. The redistribution of duties which has been in force within the Eurasian Union makes it possible for countries like Belarus to generate windfall revenue from the re-export of Russian petroleum products. Under the new arrangement Belarus will be receiving a diminishing share of such duties. If fully introduced in the course of several years, the Russian ‘tax manoeuvre’ would eliminate the implicit subsidy to the Belarusian budget and support to the balance of payments that it receives from Russia. According to some estimates, the cumulative negative effect to Belarus over the period 2019-2024 (when the ‘tax manoeuvre’ will be fully phased in) may amount to the equivalent of USD 8bn.

The start of partial implementation of these measures made the imports of Russian petroleum products less attractive for re-export. Consequently, the imports of such products fell sharply in the second half of 2018: in November these exports amounted to just 24.3 ths tonnes whereas the average monthly imports in the first half of the year had exceeded 300 ths tonnes. This had a dampening effect on overall economic activity.

In the months before the launch of the ‘tax manoeuvre’, Belarus also benefited from the surge in export prices related to higher petroleum prices in 2018. Higher revenue from export tariffs boosted overall public revenue and generated a sizeable fiscal surplus. Such an outcome supported a surge in public investment, the policy of raising wages in the public sector as well as overall economic growth in the country. However, this source of windfall revenue started to dry up in the final months of the year.

One of the important growth drivers throughout the year was final domestic demand, which continued its robust recovery. In particular, private consumption grew by more than 7% in 2018 boosted by the significant increase in real wages in both 2017 and 2018 as the effects of the policy of raising wages in the public sector proliferated in the whole economy. Consequently, average real disposable income of the population increased by 8% in 2018. At the same time the overall macroeconomic stance (both monetary and fiscal) remained tight which, at least until now, prevented the emergence of an inflationary spiral.

Private consumption was boosted further by a significant rise in consumer credit. The stock of outstanding consumer credit grew by 46% in 2018. In January the central bank issued a statement expressing concern with this rise and its possible consequences for financial and macroeconomic stability.

Despite this rapid credit expansion, the overall financial state of the banking sector stabilised in 2018. The share of nonperforming loans (the overwhelming share of these loans is held by the corporate sector) fell from 12.9% at the end of 2017 to just 4.1% in December 2018. This outcome was due to two main factors. In the first place, the Belarusian central bank has been sticking to its tight policies which limits the capacity of banks to engage in new large-scale corporate lending. And second, in the last several years Belarus has been following a policy of gradual reduction of the so-called ‘directed lending’ (lending to state-owned firms included in different government programmes). The authorities have stated that such lending should be discontinued altogether but it is still too early to ascertain that this will happen in reality.

Given the relatively positive economic situation, the servicing of Belarus' external debt did not pose serious problems. In 2018 Belarus raised new external financing amounting to USD 2.35bn, of which, among others, USD 879m from Russia, USD 590m from Chinese banks and USD 600m from a Eurobond issue. In October, Belarus also received funding amounting to USD 200m from the Eurasian Development Bank which was the delayed sixth tranche from the USD 2bn funding agreement concluded in 2016. The servicing of the public external debt in 2018 amounted to USD 2bn.

On average the main economic performance figures for 2018 were favourable. Manufacturing output reported a strong upturn for the second consecutive year. Trade in goods and services also continued its recovery, with imports outpacing exports due to the strong domestic demand. Despite the surge in imports, the current account deficit remained manageable thanks to improving terms of trade. There were also some improvements in the labour market: the rate of unemployment declined in 2018 whereas the slashing of employment in large state-owned enterprises (which reflects an ongoing process of restructuring) was virtually put on hold.

However, as noted, the average numbers for the year mostly reflect the positive trends in the first six months. The second half was marked by a notable slowdown and deterioration in performance both as regards the real economy and as regards the macroeconomic stance. The dynamics of real gross industrial output is quite indicative to this effect: the growth of quarterly output decelerated from 9.3% year on year in the first quarter to 6.2% in the second, to 4.8% in the third and just 2.4% in the fourth quarter. Inflation, which was steadily subsiding until September, started to reverse its course in the last quarter, likely triggered by pressure coming from the surging wages.

The short-term prospects for Belarus have deteriorated since the wiiw Autumn 2018 Forecast. The start of the year 2019 was not very favourable either. Belarus and Russia have continued the negotiations on the implications of the Russian 'tax manoeuvre'. Belarus has been insisting on an eventual compensation of the negative effects on its economy. However, several meetings at the highest political level on this issue that already took place have so far not brought any solution agreeable to Belarus and this is a source of considerable uncertainty for the short-term economic prospects. As regards the real economy, the slowdown continued at the beginning of 2019 and the prospects for a reversal are dim. The government projections incorporated in the 2019 budget obviously did not take into account these negative developments and at the time of writing they look excessively optimistic: annual GDP growth of 4% and annual CPI inflation lower than 5%.

As regards the servicing of the foreign debt, Belarus has been managing it rather skilfully and it already announced the tentative servicing schedule for 2019. The servicing of the public external debt is estimated at USD 2.1bn; USD 600m of this is expected to be covered by new borrowing from Russia; another USD 700m from new bond issues and the rest from other sources. Belarus expects one more USD 200m disbursement from the Eurasian Development Bank – the final tranche under the 2016 agreement.

We envisage a lowering of the GDP rate of growth to 2.4% in 2019 and further to around 2% in 2020 and 2021. The demand-driven pattern of growth that prevailed in 2018 seems to have run its course and will probably be not so visible in the coming years. There are also considerable uncertainties related to the negative implications of Russia's new energy taxation system. In case Belarus does not manage to negotiate some concessions from Russia that would partly offset the negative effects of the

‘tax manoeuvre’, the GDP growth rates may be even lower. We do not see imminent threats to macroeconomic stability, provided the authorities maintain the relatively tight macroeconomic stance. As regards the latter, there are more risks on the fiscal side as one can expect a shortfall of public revenue. Inflation can also be expected to rise due to carry-over effects of the generous wage policy of the government. In case such policies are prolonged, this may lead to a reversal of the process of disinflation in the country.

Table 6.2 / Belarus: Selected economic indicators

	2014	2015	2016	2017	2018 1)	2019	2020	2021
							Forecast	
Population, th pers., average	9,475	9,490	9,502	9,498	9,484	9,470	9,450	9,430
Gross domestic product, BYN mn, nom.	80,579	89,910	94,949	105,748	121,600	133,200	147,100	162,000
annual change in % (real)	1.7	-3.8	-2.5	2.5	3.0	2.4	2.2	2.0
GDP/capita (EUR at PPP)	13,900	13,800	13,200	13,400	14,000	.	.	.
Consumption of households, BYN mn, nom.	42,082	47,006	51,122	56,843	64,500	.	.	.
annual change in % (real)	4.3	-2.4	-3.2	4.8	7.5	3.0	2.7	2.5
Gross fixed capital form., BYN mn, nom.	26,772	25,763	24,155	27,662	31,500	.	.	.
annual change in % (real)	-5.7	-15.5	-14.5	5.5	6.0	2.0	1.5	1.0
Gross industrial production								
annual change in % (real)	1.9	-6.6	-0.4	6.1	5.7	3.0	2.0	2.0
Gross agricultural production								
annual change in % (real)	3.1	-2.5	3.3	4.2	-3.4	.	.	.
Construction industry								
annual change in % (real)	-5.7	-11.3	-14.8	-3.7	2.2	.	.	.
Employed persons, LFS, th	.	.	4,862	4,902	4,920	4,900	4,880	4,860
annual change in %	.	.	.	0.8	0.4	-0.4	-0.4	-0.4
Unemployed persons, LFS, th	267	273	302	293	248	236	230	229
Unemployment rate, LFS, in %	5.1	5.2	5.8	5.6	4.8	4.6	4.5	4.5
Reg. unemployment rate, in %, eop	0.5	1.0	0.8	0.5	0.3	0.4	0.4	0.4
Average monthly gross wages, BYN	605.2	671.5	722.7	822.8	950.0	1,060	1,180	1,300
annual change in % (real, gross)	1.3	-2.3	-3.8	7.5	10.0	4.0	3.0	2.0
Consumer prices, % p.a.	18.1	13.5	11.8	6.0	4.9	7.0	8.0	8.0
Producer prices in industry, % p.a. 2)	12.4	17.2	12.0	9.8	6.8	9.0	10.0	10.0
General governm.budget, nat. def., % of GDP								
Revenues	38.9	41.3	40.9	40.5	41.8	40.0	39.0	39.0
Expenditures	37.8	39.9	39.4	37.6	37.7	38.0	38.0	38.0
Deficit (-) / surplus (+)	1.0	1.4	1.5	3.0	4.1	2.0	1.0	1.0
General gov.gross debt, nat. def., % of GDP 3)	38.8	53.0	53.5	53.4	44.0	43.0	42.0	41.0
Stock of loans of non-fin.private sector, % p.a.	21.1	19.4	-6.2	7.2	12.7	.	.	.
Non-performing loans (NPL), in %, eop 4)	4.4	6.8	12.8	12.9	4.1	.	.	.
Central bank policy rate, % p.a., eop 5)	20.0	25.0	18.0	11.0	10.0	11.0	11.0	11.0
Current account, EUR mn 6)	-4,057	-1,669	-1,465	-789	-1,000	-1,300	-1,400	-1,500
Current account, % of GDP	-6.7	-3.3	-3.4	-1.6	-2.0	-2.5	-2.6	-2.7
Exports of goods, BOP, EUR mn 6)	27,492	23,854	20,988	25,397	28,000	29,300	30,000	30,200
annual change in %	-0.8	-13.2	-12.0	21.0	10.3	4.6	2.4	0.7
Imports of goods, BOP, EUR mn 6)	29,537	25,807	23,270	27,960	30,600	32,100	32,700	32,900
annual change in %	-5.3	-12.6	-9.8	20.2	9.4	4.9	1.9	0.6
Exports of services, BOP, EUR mn 6)	6,115	6,048	6,203	6,944	7,200	7,700	8,000	8,100
annual change in %	7.5	-1.1	2.6	11.9	3.7	6.9	3.9	1.3
Imports of services, BOP, EUR mn 6)	4,449	4,003	3,950	4,248	4,500	4,800	5,000	5,200
annual change in %	11.7	-10.0	-1.3	7.5	5.9	6.7	4.2	4.0
FDI liabilities, EUR mn 6)	1,445	1,506	1,133	1,130	1,000	.	.	.
FDI assets, EUR mn 6)	57	97	112	60	100	.	.	.
Gross reserves of NB excl. gold, EUR mn 6)	2,820	2,510	3,071	4,502	4,561	.	.	.
Gross external debt, EUR mn 6)	32,982	34,996	35,930	33,443	35,600	36,000	37,000	37,400
Gross external debt, % of GDP	54.1	69.4	83.3	69.0	70.3	69.0	68.0	67.0
Average exchange rate BYN/EUR	1.3220	1.7828	2.2010	2.1833	2.4008	2.6	2.7	2.9

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

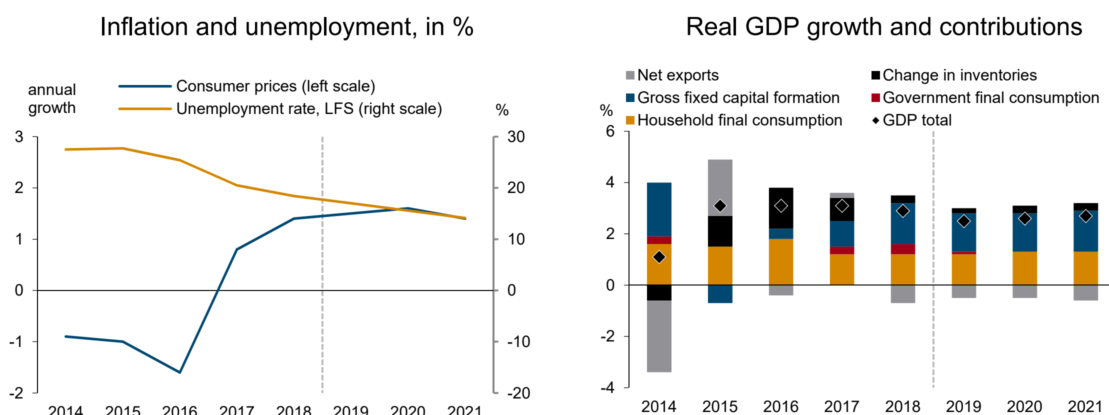
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

BOSNIA AND HERZEGOVINA: Once again politics impede stronger growth

GORAN VUKŠIĆ

Following the general elections in October 2018, the process of government formation at the country level and in the Federation of Bosnia and Herzegovina is lengthy. Along with slightly deteriorating external conditions over the whole forecasting period, the political factors will negatively affect growth in 2019, with an estimated growth rate of 2.5%. Under the assumption that the political stalemate is resolved soon, we expect growth in 2020 and 2021 to mildly increase.

Figure 6.3 / Bosnia and Herzegovina: Main macroeconomic indicators



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

The real GDP growth rate in 2018 is estimated at 2.9% – slightly lower than previously expected, due to a likely slowdown in the last quarter, as signalled by decelerating growth of exports and imports of goods, as well as industrial production. The largest contributors to growth were investment and household consumption – based on the available national accounts data for the first three quarters of 2018, which also contain a revision of 2017 quarterly data that was particularly significant for investment statistics.

According to the first data for the whole year, real industrial output expanded by only 1.6% during 2018, with the highest increase of 6.6% recorded in the energy sector. While the overall construction output rose by only 0.8%, there are signs of construction companies becoming more oriented towards foreign markets. Though this market segment is still comparatively small, exports of construction services rose at an estimated rate of 13%.

The overall contribution of net exports of goods and services to growth turned out negative despite solid, although decelerating, real exports growth estimated at 6% for the year 2018. Exports of services were largely driven by the strengthening tourism sector with the number of foreign tourist arrivals and overnight stays in 2018 rising by 14% and 13% compared to 2017, respectively. At the same time, however, imports rose by 5.5% leading to an overall negative contribution from net exports (owing to a much bigger absolute size of imports versus exports). The current account deficit amounted to 4.5% of GDP, which is only a slight improvement from the previous two years. Strong remittances inflows continued financing a large part of the persistent deficit in trade in goods and services.

Labour market developments were moderately positive, with employment rising by 0.8% and real gross wages by 1.7% for the full year 2018. Despite a significant decline of 2.1 percentage points, the unemployment rate still remains exceptionally high and amounts to 18.1% according to Labour Force Survey data 2018. In such an environment, the consumer price inflation remained low and amounted to 1.4%. The largest price increases were 8.9% for transport, following the international oil price increase, and 8.8% for tobacco products, which is related to tobacco excise hikes introduced at the beginning of 2018.

The sizeable government balance surplus from 2017 is estimated to have further slightly expanded in 2018, largely due to solid increases in revenues, which outpaced the estimated expenditure growth. The likely under-execution of public investment over the first eight months of 2018 may have contributed to such developments. At the current stage, however, there is no definitive information on the government-spending dynamics in the last quarter. The share of public debt in GDP declined to below 32%, which opens up some fiscal space for increasing the much needed public investment over the years to come.

For the forecasting period, we expect a deceleration of growth in 2019 to 2.5%, and mild improvements in the following two years. These developments will mostly reflect the increased political uncertainty in 2019, and the slight deterioration of external economic conditions. As in 2018, the largest contributions to growth in the following three years are expected to come from investment and household consumption. Real government consumption will grow at rates just above zero, while the contribution from net exports is to remain slightly negative as exports are expected to further decelerate after recording exceptionally high growth rates during the 2015-2017 period.

The largest (internal) downward risk to our forecasts is related to the political situation, after the general elections held on 7 October last year. Currently, it appears that the government formation process, particularly in the Federation of Bosnia and Herzegovina, may be prolonged. Obstacles for government formation appear mostly related to diverging views of potential coalition partners with respect to the country's path towards NATO accession, at the country level, and with respect to the Electoral Law at the level of the Federation. Bosnia and Herzegovina has been rather slow in the implementation of reforms, not only in the fiscal area, even with a government in place. This is likely due to the complex organisational structure of the state and, correspondingly, fragmented and inefficient decision-making. Therefore, at least in the short term with more pronounced political challenges than usual, an even less-active policy-making can be expected. The recent example of the belated 2019 budget of the Federation, which was finally adopted on 20 February, shows that policy-making has been considerably slowed, but that even in the current political constellation at least the most crucial decisions for the functioning of the state are still met. Thus, we base our forecasts on the assumption that the

political stalemate will be largely resolved during the first half of 2019, i.e. that the political factors, although still a burden, will be less of a drag on the economy in the second half of 2019 and the rest of the forecasting period.

The investment in Bosnia and Herzegovina, as a share in GDP, has been the lowest when compared to other Western Balkan countries, and by far the lowest when expressed in per cent of final expenditures. Despite a rather unsupportive regulatory and business environment, which is not likely to change quickly, the country has experienced a significant (private) investment surge over the last three years. We expect this recent investment momentum to be maintained to some extent. In addition, the share of government investment in aggregate gross fixed capital formation in recent years amounted to below 15%, with a gradual increase projected in last year's government medium-term plans. Our growth projections are based on the assumption that public investment will increase, but with a likely delay at least in 2019, caused by political factors. Although we do not expect the government to fully absorb the investment potential, we do find it likely that public investment will pick up towards the end of the forecasting period, lending support to the overall investment dynamics and possibly creating some spillovers to the private sector. Correspondingly, the government balance is projected to stay in positive territory in the following years as well, but diminishing to zero by 2021.

Consumer price inflation is likely to remain low, at levels around 1.5%, in line with eurozone trends. Stable, although modest growth will bring about small employment gains, moderate real wage increases, and further reductions in the unemployment rate, which, however, will still remain high. Such developments will lend support to real increases in household consumption.

The current account deficit shall remain at levels comparable to the previous two years, i.e. around 4.5% of GDP, with small gradual improvements towards the end of forecast period. Remittances flows will remain a significant and slightly increasing source of finance.

In summary, our growth estimates of 2.5% in 2019, 2.6% in 2020, and 2.7% in 2021, are mildly revised downwards from our previous forecast. The reasons are the deteriorating external conditions affecting the export performance, as well as the increased political uncertainty (especially in 2019), which endangers government fiscal and reform plans. The negative political factors, unless they escalate, represent more of an obstacle in accelerating longer-term growth by implementing planned reforms and executing growth-enhancing public investment, rather than an immediate risk to current, positive but modest, economic performance.

Table 6.3 / Bosnia and Herzegovina: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020	2021
							Forecast	
Population, th pers., average	3,526	3,518	3,511	3,505	3,500	3,495	3,490	3,485
Gross domestic product, BAM mn, nom. [2]	27,359	28,589	29,904	31,376	32,700	34,000	35,500	37,000
annual change in % (real)	1.1	3.1	3.1	3.2	2.9	2.5	2.6	2.7
GDP/capita (EUR at PPP) [2]	8,300	8,800	9,000	9,300	9,700	.	.	.
Consumption of households, BAM mn, nom. [2]	22,830	23,157	23,653	24,416	25,150	.	.	.
annual change in % (real)	1.9	1.8	2.2	1.5	1.6	1.6	1.7	1.7
Gross fixed capital form., BAM mn, nom. [2]	5,330	5,097	5,189	5,653	6,250	.	.	.
annual change in % (real)	11.5	-3.5	2.5	5.8	9.0	8.2	8.5	9.0
Gross industrial production								
annual change in % (real)	0.2	3.1	4.4	3.2	1.6	2.5	2.3	2.0
Gross agricultural production [3]								
annual change in % (real)	-16.8	12.6	12.0	4.1	2.3	.	.	.
Construction output total								
annual change in % (real)	6.3	1.7	-2.2	-1.3	0.5	.	.	.
Employed persons, LFS, th, April	812.0	822.0	801.0	815.7	822.4	830	840	850
annual change in %	-1.2	1.2	-2.6	1.8	0.8	0.8	0.7	0.7
Unemployed persons, LFS, th, April	308.0	315.0	273.0	210.7	185.5	170	155	140
Unemployment rate, LFS, in %, April	27.5	27.7	25.4	20.5	18.4	17.0	15.6	14.1
Reg. unemployment rate, in %, eop	43.6	42.9	40.9	38.7	34.7	.	.	.
Average monthly gross wages, BAM	1,290	1,289	1,301	1,321	1,363	1,410	1,450	1,490
annual change in % (real, gross)	0.8	1.0	2.5	0.8	1.7	1.7	1.3	1.3
Average monthly net wages, BAM	831	830	838	851	879	910	940	970
annual change in % (real, net)	1.3	1.0	2.6	0.7	1.9	1.7	1.3	1.3
Consumer prices, % p.a.	-0.9	-1.0	-1.6	0.8	1.4	1.5	1.6	1.4
Producer prices in industry, % p.a.	-0.5	0.6	-2.1	3.0	3.5	2.1	2.1	2.1
General governm.budget, nat.def., % of GDP								
Revenues	43.7	43.2	42.7	43.0	43.9	43.0	42.5	42.0
Expenditures	45.8	42.5	41.5	40.4	41.1	42.5	42.0	42.0
Deficit (-) / surplus (+)	-2.0	0.7	1.2	2.6	2.8	0.5	0.5	0.0
General gov.gross debt, nat.def., % of GDP	41.6	41.9	40.4	36.1	31.7	30.0	28.0	27.0
Stock of loans of non-fin.private sector, % p.a.	1.7	2.0	3.5	7.3	5.5	.	.	.
Non-performing loans (NPL), in %, eop	14.2	13.7	11.8	10.0	9.4	.	.	.
Central bank policy rate, % p.a., eop [4]	.	.	.	.	.	.	.	.
Current account, EUR mn [5]	-1,025	-774	-711	-754	-757	-794	-786	-757
Current account, % of GDP	-7.3	-5.3	-4.7	-4.7	-4.5	-4.6	-4.3	-4.0
Exports of goods, BOP, EUR mn [5]	3,501	3,678	3,936	4,775	5,140	5,490	5,850	6,220
annual change in %	3.0	5.1	7.0	21.3	7.6	6.8	6.5	6.4
Imports of goods, BOP, EUR mn [5]	7,527	7,355	7,546	8,551	9,060	9,520	9,990	10,460
annual change in %	7.1	-2.3	2.6	13.3	6.0	5.1	4.9	4.7
Exports of services, BOP, EUR mn [5]	1,252	1,419	1,514	1,654	1,770	1,870	1,960	2,050
annual change in %	2.4	13.3	6.7	9.2	7.0	5.5	5.0	4.6
Imports of services, BOP, EUR mn [5]	395	440	450	500	530	560	590	610
annual change in %	0.8	11.2	2.3	11.0	6.1	5.0	4.6	4.0
FDI liabilities, EUR mn [5]	408	345	256	413	450	.	.	.
FDI assets, EUR mn [5]	7	85	-1	83	26	.	.	.
Gross reserves of NB excl. gold, EUR mn [5]	3,908	4,307	4,768	5,293	5,835	.	.	.
Gross external debt, EUR mn [6]	7,470	7,936	8,378	8,683	9,030	9,670	10,300	11,000
Gross external debt, % of GDP [6]	53.4	54.3	54.8	54.1	54.0	55.6	56.7	58.1
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

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

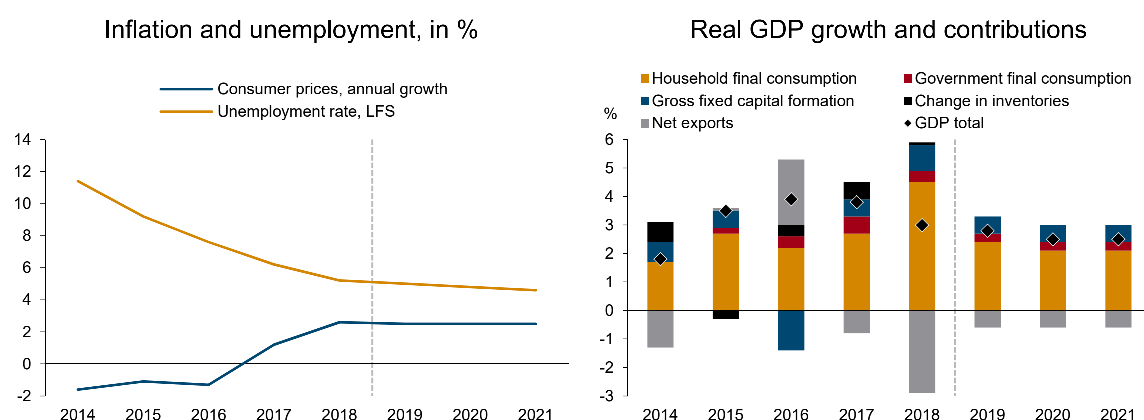
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

BULGARIA: Economy loses pace

RUMEN DOBRINSKY

The 3% increase in GDP in 2018 was below the rates of growth in the preceding years. The slowdown mirrors a weakening of exports which became a drag on economic activity. The tight labour market was adding supply constraints to growth. By contrast, private consumption surged, providing an impetus to economic activity in 2018. We expect further moderation of GDP growth in the period 2019-2011. In the absence of external shocks, the macroeconomic situation will remain stable and under control.

Figure 6.4 / Bulgaria: Main macroeconomic indicators



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

Growth continued to moderate in Bulgaria throughout 2018. GDP grew by a modest 2.7% year on year in the third quarter after rising by 3.2% in the second and by 3.5% in the first quarter. Preliminary estimates indicate that the average annual rate of GDP growth for the year as a whole can be expected to be around 3%. The economic slowdown mirrors a notable weakening of exports in 2018. Given the concomitant upturn in imports, net exports made a large negative contribution to GDP growth.

By contrast, private consumption surged, providing the main impetus to growth. In fact, the 7.5% rate of growth of private consumption in 2018 was the strongest since 2007. Several factors contributed to this outcome. Real wages (and, parallel to that, real income) have been steadily rising in recent years which has helped to improve consumer confidence. Thus, while GDP per capita grew by 26% between 2011 and 2018, real wages increased by a cumulative 66% during the same period. Adding to that, 2018 witnessed a surge in household borrowing boosted by both consumer confidence and low interest rates. In December 2018, the stock of outstanding consumer credit was up by 17.7% from a year earlier and

the stock of outstanding mortgage credit was up by 11.4%. For comparison, the corresponding numbers in December 2017 were 5.8% and 7.4% while those at end-2016 were 0.8% and 1.8%, respectively.

Gross fixed capital formation also made a positive contribution to GDP growth in 2018. However, after a solid start, investment activity slowed down in the second half. Fixed investment by the private sector remained modest, including that supported by inward FDI. While spending on public investment on average was relatively strong thanks to increased EU funding, actual construction remained behind schedule which added to the overall weakening of fixed investment activity in the second half of the year.

Exports of goods weakened considerably in 2018 mostly due to the contraction of exports to non-EU countries. The latter partly owes to at a high base period (2016) but it also reflects reduced orders from some traditional non-EU partners such as Russia and Turkey. By contrast, merchandise exports to the EU increased by 9.5% in value terms. These exports are increasingly dominated by the participation of Bulgarian manufacturers in global value chains dominated by large EU companies. Moreover, there has been a steady rise in the value-added content of these exports due to an increasing number of local producers moving up the value chain.

Exports of high value added services also expanded in 2018. Bulgaria's outsourcing sector, which is dominated by IT services, is estimated to contribute to some 5% of GDP and the exports of such services have been growing at double-digit rates in recent years. Tourism also reported record revenues in 2018.

In fact, the large surplus in the balance of trade in services in recent years largely offsets the deficit in the trade in goods. In 2018, the current account surplus contracted slightly but still remained sizeable.

However, the relatively favourable average economic performance numbers for the year as a whole are not indicative of the full picture. In fact the second half of the year witnessed a gradual weakening of economic activity. Exports to the EU started to decelerate, reflecting the weakening of economic growth in the major West European economies. Mirroring the slowdown in exports, manufacturing output was also decelerating in the course of the year: the rate of growth of gross manufacturing output for 2018 as a whole came to a meagre 2.1%, down from 5.4% in 2017.

Apart from the worsening external environment, the tight labour market was also adding supply constraints to growth. In recent business sentiment surveys, most Bulgarian firms indicate labour shortages as the major impediment to their future expansion. There are indications that at present the Bulgarian economy is probably close to full employment. The LFS unemployment rate in 2018 fell to 5.2% and is well below the EU average. During the four years of moderate growth (from 2015 to 2018) when GDP grew by a total of 15%, net job creation amounted to just 180,000 jobs, or a cumulative increase of employment by some 6%. 2018 was marked by another paradox: while the rate of unemployment fell by 1 percentage point from the previous year, the total number of employed remained virtually unchanged, suggesting a shrinking of the economically active population, a consequence of its unfavourable age structure. There is growing pressure from the business community for liberalising the access to the local labour market to non-EU applicants but so far only some partial measures have been agreed.

The tight labour market has also been pushing wages up and this was one of the main factors for their continued surge in 2018. Given this cost-push pressure, inflation was also on the rise but so far it has remained within a reasonable range. Still, at its present levels, inflation may prompt some concern as regards the declared intention of the Bulgarian authorities (which was recently reconfirmed) to apply for joining ERM II by July 2019.

Judging from the cash budget balance the fiscal stance remained relatively tight in 2018. A closer look at the numbers suggests that this was mostly due to two factors. On the one hand, this is the excessively conservative projection of public revenue. This has been a chronic feature of the Bulgarian budgetary process which results in a persistent revenue surplus compared to the numbers fixed in the budget. On the other hand, 2018 saw considerable delays in the implementation of some public investment programmes which produced an unintended cash surplus.

Faced with a large surplus at the end of the year, the government made several large-scale fiscal allocations in December. According to preliminary reports, the government allocated some BGN 7.3bn in December which is almost triple the regular monthly budgetary allocations. This practice of ad hoc allocation of public funds has been subject to wide and persistent criticism by both political opponents and by experts due to the fact that such spending bypasses parliamentary scrutiny and control. However, it has been continued year after year for exactly the same reason: the fiscal windfall provides the government in office with supplementary degrees of freedom that it can use to its own advantage.

Indications are that the conservative approach to budgetary planning prevails in the 2019 budget as well. At the same time, the new budget features some openly populist elements which are clearly targeted to the two ballots envisaged in 2019: the European Parliament elections in May and the municipal elections in autumn. Among these are the envisaged increase of wages in the public sector by 10% in 2019; the minimum wage in Bulgaria was also raised by 10% in January.

Despite these moves, recently the standing of the Bulgarian government has been shaken by a series of internal conflicts within the ruling broad and heterogeneous centrist coalition. So far Prime Minister Boyko Borisov has managed to keep the political situation under control but it is not certain whether he will be able to continue mastering the balance until 2021 when the next regular parliamentary elections are due to take place.

The short-term prospects for the Bulgarian economy have deteriorated somewhat since wiiw's Autumn 2018 Forecast. The weakening of EU demand will weigh on the further expansion of Bulgaria's exports. The supply constraints on future growth have also become all too visible.

In addition, the current pattern of demand-driven growth cannot be sustained for a long period of time. The observed level of economic activity in 2018 was mostly supported by borrowing and increased indebtedness of households and this obviously has its limits. In recent times, there have not been notable inflows of foreign capital (neither FDI nor portfolio investment) and under the currency board arrangement the domestic financial system has limited capacity to support a sustained rise in lending. On the other hand, while private borrowing did provide an impetus to economic activity in the short run, its excessive rise may pose risks to financial stability and there was a recent statement by the central bank governor to this effect.

In these circumstances we envisage further moderation of economic growth in the short run. GDP can be expected to grow by some 2.8% in 2019, decelerating to 2.5% in the two following years. This reflects the assumptions of relatively meagre export demand in the short run coupled with a moderation in the expansion of domestic demand, resulting in a reduced impetus to economic activity. In the absence of unexpected external shocks, the macroeconomic situation will remain stable and under control.

Table 6.4 / Bulgaria: Selected economic indicators

	2014	2015	2016	2017	2018 1)	2019	2020	2021
							Forecast	
Population, th pers., average	7,224	7,178	7,128	7,076	7,000	6,950	6,900	6,850
Gross domestic product, BGN mn, nom.	83,756	88,575	94,130	101,043	106,800	112,500	118,200	124,200
annual change in % (real)	1.8	3.5	3.9	3.8	3.0	2.8	2.5	2.5
GDP/capita (EUR at PPP)	12,900	13,700	14,200	14,800	15,600	.	.	.
Consumption of households, BGN mn, nom.	51,963	54,831	56,715	60,694	67,500	.	.	.
annual change in % (real)	2.7	4.3	3.5	4.5	7.5	4.0	3.5	3.5
Gross fixed capital form., BGN mn, nom.	17,653	18,612	17,484	18,717	21,000	.	.	.
annual change in % (real)	3.4	2.7	-6.6	3.2	5.0	3.0	3.0	3.0
Gross industrial production 2)								
annual change in % (real)	1.8	2.9	2.7	3.4	0.8	1.5	1.5	1.5
Gross agricultural production								
annual change in % (real)	-0.6	-8.2	1.7	6.3	-3.1	.	.	.
Construction industry 3)								
annual change in % (real)	7.0	11.1	-16.7	4.6	1.3	.	.	.
Employed persons, LFS, th, average	2,981	3,032	3,017	3,150	3,153	3,160	3,170	3,180
annual change in %	1.6	1.7	-0.5	4.4	0.1	0.2	0.2	0.2
Unemployed persons, LFS, th, average	385	305	247	207	173	170	160	150
Unemployment rate, LFS, in %, average	11.4	9.2	7.6	6.2	5.2	5.0	4.8	4.6
Reg. unemployment rate, in %, eop	10.7	10.0	8.0	7.1	6.1	.	.	.
Average monthly gross wages, BGN	821.7	877.9	948.3	1,037.3	1,135.1	1,230	1,320	1,410
annual change in % (real, gross)	7.5	7.0	8.9	7.2	6.4	5.5	5.0	4.5
Consumer prices (HICP), % p.a.	-1.6	-1.1	-1.3	1.2	2.6	2.5	2.5	2.5
Producer prices in industry, % p.a.	-1.2	-2.2	-3.1	5.0	3.9	3.5	3.0	3.0
General governm.budget, EU-def., % of GDP								
Revenues	37.7	38.8	35.3	36.2	39.0	38.0	38.0	38.0
Expenditures	43.1	40.5	35.1	35.1	38.0	37.5	38.0	38.0
Net lending (+) / net borrowing (-)	-5.4	-1.7	0.2	1.1	1.0	0.5	0.0	0.0
General gov.gross debt, EU def., % of GDP	27.1	26.2	29.6	25.6	22.6	21.5	20.5	19.5
Stock of loans of non-fin.private sector, % p.a.	-8.2	-1.6	1.0	3.3	7.5	.	.	.
Non-performing loans (NPL), in %, eop	16.7	14.5	12.9	10.2	7.6	.	.	.
Central bank policy rate, % p.a., eop 4)	0.02	0.01	0.00	0.00	0.00	0.0	0.0	0.0
Current account, EUR mn	531	-15	1,244	3,368	2,539	1,700	1,200	700
Current account in % of GDP	1.2	0.0	2.6	6.5	4.6	3.0	2.0	1.1
Exports of goods, BOP, EUR mn	21,027	21,920	23,104	26,950	27,427	28,000	28,500	29,000
annual change in %	-0.9	4.2	5.4	16.6	1.8	2.1	1.8	1.8
Imports of goods, BOP, EUR mn	23,803	24,542	24,088	27,716	29,676	31,000	32,000	33,000
annual change in %	-1.4	3.1	-1.8	15.1	7.1	4.5	3.2	3.1
Exports of services, BOP, EUR mn	6,787	6,967	7,688	7,813	8,450	8,800	9,200	9,500
annual change in %	15.3	2.7	10.3	1.6	8.1	4.1	4.5	3.3
Imports of services, BOP, EUR mn	4,244	3,964	4,628	5,048	5,137	5,400	5,600	5,800
annual change in %	31.2	-6.6	16.8	9.1	1.8	5.1	3.7	3.6
FDI liabilities, EUR mn	803	2,342	1,390	1,896	1,936	.	.	.
FDI assets, EUR mn	657	101	774	817	713	.	.	.
Gross reserves of NB excl. gold, EUR mn	15,276	19,022	22,475	22,257	23,620	.	.	.
Gross external debt, EUR mn 5)	39,338	33,493	34,221	33,397	32,716	32500	32000	31500
Gross external debt, % of GDP 5)	91.9	74.0	71.1	64.6	60.0	57.0	53.0	50.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

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

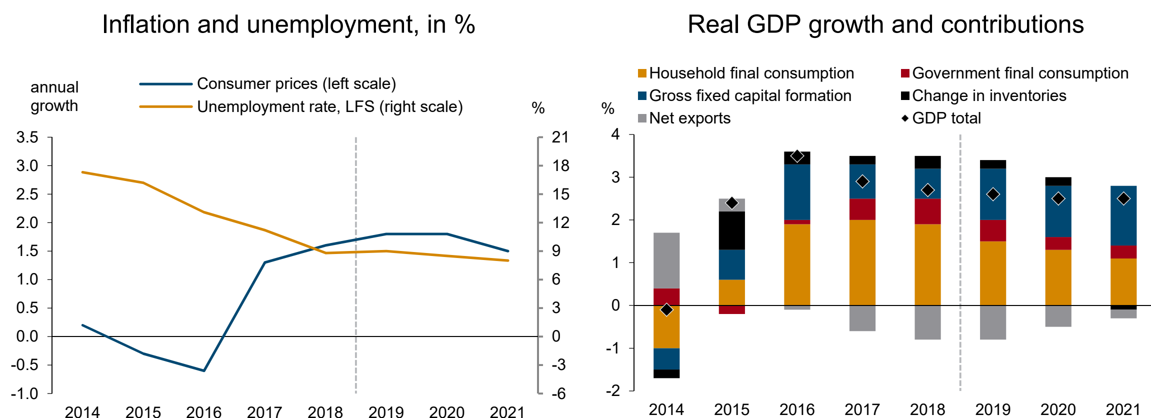
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

CROATIA: Weaker growth momentum

HERMINE VIDOVIC

Croatia's GDP growth will continue to moderate to 2.5% in the 2019-2021 period. The main support to growth will come from private consumption and tourism. A more effective use of EU funds would be key to stimulating investments and growth. Continued emigration of young people together with the ageing of the population is becoming a growth limiting factor. Joining the euro area is high on the political agenda.

Figure 6.5 / Croatia: Main macroeconomic indicators



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

Croatia's real GDP is estimated to have reached 2.7% in 2018 driven by private consumption and tourism. Consumption was pushed up by rising disposable income - growing real wages as well as increasing remittances from abroad. The increase in gross fixed capital formation remained below expectations, indicating still low absorption of EU funds. Hence, the output growth in construction was only modest, at 4.5%. Net exports made a negative contribution to GDP growth. Industrial production dropped by 1% in 2018, with the most pronounced output declines in the production of fabricated metal products, chemicals and chemical products and shipbuilding in particular. As for the latter, still no solution could be found for the ailing Uljanik shipyard, and wages have not been paid for months. The weaknesses in the chemical industry are partly related to the difficulties of Petrokemija, a company producing agricultural fertilisers and animal feed supplements, which has been in troubles for years. Only in November the oil and gas company INA, together with the natural gas provider PPD (Prvo Plinarsko Društvo), became the largest shareholders of the state-owned company, while the share of the state was reduced to 20%.

Labour market conditions continued to improve in 2018. Employment based on Pension Insurance data increased by 2.3%, while Labour Force Survey data indicate a 1.5% increase. The unemployment rate fell to 8.8% and youth unemployment to about 23%, which is still 10 p.p. higher than the EU average. While part of this improvement is due to rising domestic employment, continued outward migration played an important role for the reduction in unemployment. Despite still high unemployment, labour shortages have already become a concern for companies in some sectors (e.g. construction, tourism, IT), which are considered as a limiting factor for production. Real net wages continued to increase and were up by 3% in 2018, owing to minimum and public sector wage increases and to tax changes. The minimum wage for 2019 was raised by 9% to HRK 3000 (EUR 405) or 45% of the average wage – which was the highest one-off increase since 2008. About 37,000 workers are earning a minimum wage, mostly in the textile, timber, leather and metal industries. Consumer price inflation averaged 1.6% in 2018, mostly driven by higher energy prices in the first half of the year.

After a strong upturn in external trade in 2017, export and import growth subsided in 2018. Goods exports and imports increased by 5% and 6% respectively. Trade with EU countries developed favourably, whereas exports to CEFTA countries remained stagnant, but declined significantly to Russia and Turkey. The overall trade deficit was about EUR 600 million higher than in 2017, while the surplus in services trade – tourism in particular – increased by an estimated EUR 300 million. Hence, the current account remained in surplus in 2018, at an estimated 2.7% of GDP. The inflow of FDI was lower than in 2017, at about EUR 1.1 billion.

The upswing in tourism is likely to weaken. Having achieved record earnings from tourism in the past couple of years not least because of political uncertainties in Turkey and Northern Africa, Croatia's tourism is increasingly facing competition particularly from Turkey, which is considered safe again. Also the economic weakening in tourists' main countries of origin, e.g. Germany and Italy, could have a dampening effect on Croatia's tourism. In addition, labour shortages – so far mainly offset by workers from abroad – may have an impact on wages and prices, so that Croatia might become too expensive and tourists may opt for Turkey or Greece instead.

Croatia reported a surplus in the general government budget for the second year in a row. The general government budget closed likely with a small surplus in 2018, mostly on account of an increase in revenues which was partly due to rising tax revenues (VAT in particular). Expenditures went up as well, e.g. for employee compensations due to an increase in the number of civil servants and government employees, as well as expenditures on social benefits. By contrast, expenditures, e.g. on subsidies and interest payments decreased. The budget surplus would have been even higher if the Ministry of Finance had not had to pay HRK 2.5 billion (EUR 330 million) in guarantees for the Uljanik shipyard; additional payments are expected in 2019. Public debt is estimated to have declined to 73.3% of GDP in 2018, from almost 78% in 2017. For 2019 the Ministry of Finance expects the general government to run a deficit of 0.5% of the GDP.

The absorption of EU funds remains low. Being a driver of investment and growth in a number of new EU Member States, EU funding still does not play an import role in Croatia. Though the causes of low absorption, such as limited administrative capacity, lack of strategic planning, lack of human resources particularly at the local level, or insufficient information of potential recipients, have been identified and calls for improvement repeated for years, there are no visible solutions on the horizon. Up to now commitments worth 58% within the current financial perspective worth EUR 12.7 billion (of which

EUR 10.7 billion ESIF funding) were made, but actual payments amount to only 15%, for the European Social Fund (ESF) only 6%.

The adoption of the euro is in the mutual interest of the government and the National Bank. In May 2018 the government adopted a 'Strategy for the Introduction of the Euro in the Republic of Croatia', analysing the costs and benefits of euro adoption and presenting policies to be undertaken in order to introduce the euro as well as policy options after the adoption of the new currency. Croatia's economy is highly euroised – about 75% of domestic savings and two thirds of total debt liabilities are linked to the euro. According to the governor of the Croatian National Bank, a letter of intent for the entry into the ERM II will be submitted probably in the second quarter of this year, which would allow joining the ERM II in 2020. So far, there are no objections by euro countries against the euro introduction in Croatia, as was reported in the case of Bulgaria. Only recently, Prime Minister Andrej Plenković stated that Croatia aims to become a member of the eurozone by the end of the next Croatian government mandate, in 2024. Results of a recent survey conducted by the National Bank show that more than half of the Croatian population is in favour of the introduction of the euro, 37% are against and 12% are undecided.

GDP growth will slow down in the forecast period mainly due to weaker foreign conditions. In 2019 GDP should grow by 2.5% but will slightly decelerate in the following years. Household consumption should benefit from a further improvement in the labour market and rising wages, while an intensification of investments remains questionable considering the low absorption of EU funds. Assuming a further strengthening of domestic demand, imports will rise and consequently result in higher trade deficits. The services trade surplus, by contrast, may remain at high levels due to earnings from tourism, but competition from Northern Africa and Turkey will be growing in the coming years. Thus, the current account will remain in positive territory, but is expected to dwindle in line with higher trade deficits. Downside risks stem from weaker demand from Croatia's main trading partners, Italy in particular. Public debt is expected to continue its downward path as a share of GDP in the coming two to three years, but downside risks are related to further guarantees provided to the Uljanik shipyard or payments of health care arrears. The shrinkage of the working-age population and continued emigration of young people might become more of a growth limiting factor in the future.

Table 6.5 / Croatia: Selected economic indicators

	2014	2015	2016	2017	2018 [1)]	2019	2020	2021
							Forecast	
Population, th pers., average	4,236	4,208	4,172	4,130	4,100	4,050	4,000	4,000
Gross domestic product, HRK bn, nom.	331.6	339.6	351.3	365.6	381.7	399	416	433
annual change in % (real)	-0.1	2.4	3.5	2.9	2.7	2.6	2.5	2.5
GDP/capita (EUR at PPP)	16,300	17,300	17,900	18,500	19,400	.	.	.
Consumption of households, HRK bn, nom.	191.4	192.3	196.4	205.5	220.0	.	.	.
annual change in % (real)	-1.6	1.0	3.4	3.6	3.4	2.6	2.4	2.0
Gross fixed capital form., HRK bn, nom.	63.8	66.4	70.4	73.3	80.0	.	.	.
annual change in % (real)	-2.8	3.8	6.5	3.8	3.4	6.0	6.0	7.0
Gross industrial production [2)]								
annual change in % (real)	1.2	2.7	5.3	1.4	-1.0	2.5	2.0	2.0
Gross agricultural production								
annual change in % (real)	-6.9	2.9	6.9	-4.9	-0.8	.	.	.
Construction output [2)]								
annual change in % (real)	-6.9	-0.5	3.3	1.7	4.5	.	.	.
Employed persons, LFS, th, average	1,566	1,585	1,590	1,625	1,650	1,670	1,690	1,710
annual change in %	2.7	1.3	0.3	2.2	1.5	1.0	1.0	1.0
Unemployed persons, LFS, th, average	327	306	240	205	160	170	160	150
Unemployment rate, LFS, in %, average	17.3	16.2	13.1	11.2	8.8	9.0	8.5	8.0
Reg. unemployment rate, in %, eop	19.4	17.6	14.7	12.2	9.6	.	.	.
Average monthly gross wages, HRK [3)]	7,953	8,055	7,752	8,055	8,448	8,860	9,300	9,700
annual change in % (real, gross)	0.4	1.8	3.0	2.8	3.3	3.0	3.0	2.5
Average monthly net wages, HRK [3)]	5,533	5,711	5,685	5,985	6,242	6,540	6,800	7,100
annual change in % (real, net)	0.5	3.7	2.7	4.1	2.8	3.0	2.5	2.5
Consumer prices (HICP), % p.a.	0.2	-0.3	-0.6	1.3	1.6	1.8	1.8	1.5
Producer prices in industry, % p.a.	-2.7	-3.8	-4.3	2.0	2.2	2.0	2.0	2.0
General governm.budget, EU-def., % of GDP								
Revenues	42.9	44.8	46.0	45.8	45.7	44.4	43.9	43.9
Expenditures	48.1	48.3	46.9	45.0	45.4	44.0	43.8	43.9
Net lending (+) / net borrowing (-)	-5.1	-3.4	-0.9	0.9	0.3	0.4	0.1	0.0
General gov.gross debt, EU def., % of GDP	84.0	83.7	80.2	77.5	73.3	70.1	68.0	66.5
Stock of loans of non-fin.private sector, % p.a.	-2.0	-3.1	-4.3	-0.1	2.3	.	.	.
Non-performing loans (NPL), in %, eop	17.1	16.7	13.8	11.4	10.3	.	.	.
Central bank policy rate, % p.a., eop [4)]	7.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Current account, EUR mn	858	2,019	1,207	1,984	1,400	1,300	1,200	600
Current account, % of GDP	2.0	4.5	2.6	4.0	2.7	2.4	2.1	1.0
Exports of goods, BOP, EUR mn	9,440	10,193	10,511	11,712	12,310	12,900	13,600	14,300
annual change in %	5.8	8.0	3.1	11.4	5.1	4.5	5.5	5.0
Imports of goods, BOP, EUR mn	15,952	17,168	17,896	19,966	21,200	22,800	24,300	25,900
annual change in %	2.8	7.6	4.2	11.6	6.2	7.5	6.5	6.5
Exports of services, BOP, EUR mn	10,237	11,280	12,274	13,417	14,200	15,100	16,000	17,000
annual change in %	4.0	10.2	8.8	9.3	5.8	6.0	6.0	6.0
Imports of services, BOP, EUR mn	2,903	3,280	3,566	4,100	4,630	5,100	5,600	6,200
annual change in %	-6.0	13.0	8.7	15.0	12.9	11.0	10.0	10.0
FDI liabilities, EUR mn	2,299	191	1,764	1,787	1,100	.	.	.
FDI assets, EUR mn	1,608	-42	-176	584	400	.	.	.
Gross reserves of NB excl. gold, EUR mn	12,688	13,707	13,514	15,706	17,438	.	.	.
Gross external debt, EUR mn	46,416	45,384	41,668	40,069	39,100	39,300	39,900	39,800
Gross external debt, % of GDP	106.9	101.7	89.3	81.8	76.0	73.0	71.0	68.0
Average exchange rate HRK/EUR	7.6344	7.6137	7.5333	7.4637	7.4182	7.4	7.4	7.4

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) From 2016 data are based on tax records (survey JOPPD); prior to that data are based on a monthly survey covering 70% of persons in employment. - 4) Discount rate of NB.

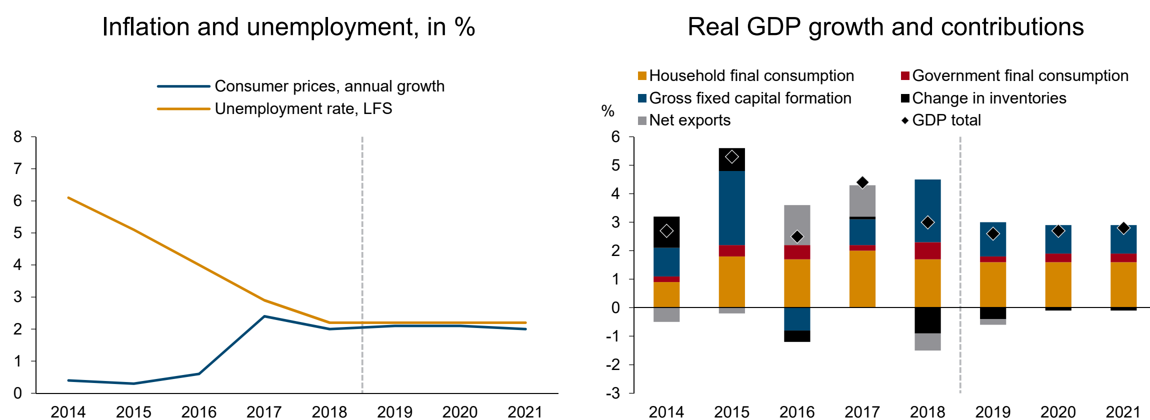
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

CZECH REPUBLIC: Stability and (undue) caution

LEON PODKAMINER

The strong rise in public investment in 2018 is to moderate in 2019 thus reducing overall growth accordingly. Tight labour markets and the ongoing wage push support private consumption. Despite this, higher inflation is not on the horizon while rising unit labour costs are responsible for falling corporate profitability and may weaken foreign trade performance. Monetary policy may become too restrictive. Fiscal policy targeting surpluses does little to support growth.

Figure 6.6 / Czech Republic: Main macroeconomic indicators



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

After an exceptionally strong performance in 2017, moderate GDP growth of about 3% is provisionally posted for 2018. The household consumption growth rate has returned to a moderate level close to the ones recorded earlier (in 2015-2016). But foreign trade growth has weakened quite radically. Moreover, in contrast to 2016-2017, growth in exports of goods and services lagged behind the growth of imports. In effect the foreign trade balance reduced the 2018 GDP growth rate by about 0.6 percentage points. Contracting inventories also shaved off a large portion of the GDP growth rate. The negative impacts of trade and inventory developments were not fully compensated by the effects of very fast growth in gross fixed capital formation.

Gross fixed capital formation (GFCF) rose strongly in 2018, primarily due to the surge in public investment in the second half of the year. The drawdown of the EU funds may be lower in 2019-2020. In effect the rising public investment will not have much of an impact on the overall rate of growth of GFCF. Growth in private investment will continue to be quite moderate – also on account of much

higher interest rates, some deterioration of corporate profitability indicators and enhanced external risks – all likely to further dampen optimistic expectations crucial for boosting private investment.

Close to full employment has been adding to the wage pressures. With the unemployment rate hovering below 2.5%, the reserves of employable domestic labour are rather limited. Although one observes a (slow) increase in participation rates and longer working hours as well as a rise in various forms of informal and part-time employment (also by migrant foreign workers), labour shortages may also persist due to pronounced population ageing. The tight labour market has natural consequences for wages. In 2018 the average wage in the corporate sector increased by close to 8% in nominal terms (about 6% in real terms). Wage hikes were even stronger in the non-market sectors (i.e. in public service sectors). Nominally, total employees' compensation rose by an estimated 9% while the gross operating surplus and mixed income (representing primarily corporate profits) by a 'mere' 4.7%. Strong wage pressures, higher economy-wide unit labour costs (up by an estimated 6.4%) and thus depressed corporate profits which have shaped economic conditions so far will remain in place also in the coming two years. Importantly, it may be worth remembering that at about 43% the wage share (employees' compensation as a percentage of GDP) still remains quite low by international standards.

A pickup in inflation is still a possibility. Rising unit labour costs and the relatively weak currency have not yet affected core inflation, which is running at about 1% annually. Inflation slightly in excess of 2% is currently due to fast rising prices of foodstuffs as well as to the hikes in administered prices. Neither the tight labour market, nor the huge increases in unit labour costs seem to matter. Such an outcome tends to be attributed, in contemporary mainstream economics, to the absence of 'inflationary expectations' emerging in stable economic environments (such as prevailing in the Czech Republic). Nonetheless, in the future rising production costs (especially unit labour costs) could affect overall inflation – or else depress the profit margins further. Higher inflation might also erode the purchasing power of household incomes and suppress the growth of household consumption. The prospect of higher inflation has alerted the National Bank, which responded by tightening its policy. Further substantial hikes in the policy interest rates cannot be ruled out – especially if the Czech currency refuses to appreciate (which seems to be expected and desired by the National Bank).

Private consumption lagging behind household disposable income indicates rising saving propensity. A rising proportion of household savings out of rising income is one reason why there is little evidence of an inflationary demand pull. Household incomes are financing domestic investment (e.g. into real estate) to a much greater extent than in the past. Price differentials could suggest that a real-estate expansion may be developing. In 2018 the transaction price index for housing rose by over 10% (year on year). The index of asking prices for new flats in Prague rose by over 12%. The excess of domestic bank deposits over domestic loans, currently coexisting with increased residents' investment abroad, may also represent – even if partially and indirectly – a temporary leakage of household savings.

Foreign trade growth has slowed down and the trade balance has deteriorated. In 2018 the growth rates of exports of goods and non-factor services slowed down as compared with 2017. The rate of growth of imports also fell, although less so. The trade surplus/GDP ratio fell from over 7.2% a year earlier to an estimated 6.4%. The foreign trade contribution to GDP growth was negative for the first time since the third quarter of 2015. A weaker net trade performance in the near future is a real possibility because of the speedup of capital formation by the corporate sector which may be seeking to modernise

its productive capital (and substitute for labour) and higher imports of capital goods may thus result. Weaker growth in Germany (and in Germany's export destinations) is certain to additionally depress exports and output rather strongly. Brexit is yet another negative factor. Rising unit labour costs would also negatively affect trade performance. A stronger currency appreciation is also a risk for foreign trade (and real activity in general) – though possibly an advantage as far as inflation is concerned.

The exchange rate has not appreciated as much as expected. Initially, the central bank's discontinuation (in mid-April 2017) of its policy targeting a CZK/EUR exchange rate of 27 was followed by rapid appreciation. Within one year the koruna strengthened by 7%. That seemed to justify the expectation of further appreciation. As late as January 2018 the Czech National Bank (CNB) forecast an average rate of 25.4 for the first quarter of 2018, followed by 24.9 for the second quarter (and for the full year 2018). However, the koruna weakened thereafter. The actual average rate for the first half of 2018 was 25.5 (against the 25.15 implied by the CNB forecasts). The most recent CNB forecast (January 2019) envisages a less steep appreciation in the coming quarters. Nonetheless it maintains its earlier forecast for the fourth quarter of 2019 (at 24.5 CZK/EUR) and puts the forecast for the fourth quarter of 2020 at 24.2. Whether the expectation of appreciation of that size is realistic remains debatable. For some time now the CZK/EUR rate has fluctuated around 25.8. Much higher interest rates (e.g. 3M PRIBOR) do not seem to have strengthened the koruna. Such a development may be put down to the financial investors' widespread fears over prospects for emerging markets generally – or simply the expectation of the koruna possibly depreciating further. As such the failure of Czech currency to appreciate may have been a temporary 'aberration'. On the other hand, that could also suggest that the koruna's appreciation potential has been fundamentally overrated. If the trade and current account balances deteriorate further, the appreciation pressures may turn out to be much less pronounced than expected.

Fiscal policy eyes further cuts in public debt and monetary policy needs to avoid overreacting. Given the growth slowdown, the fiscal policy stubbornly targeting budgetary surpluses cannot be helpful. In the past the monetary policy conducted by the Czech National Bank served the economy well – by keeping its policy rates very low (practically at 0%) from November 2012 through August 2017. Since then the CNB has raised its rates several times – and seems to consider further hikes. But inflation is still quite low and does not seem to require much more interest rate activism. Keeping interest rates as low as possible may be essential in helping to prevent undue currency appreciation[30] and in encouraging expansion of private fixed capital formation.

Overall the Czech economy faces a period of slowing growth. Tight labour markets and the ensuing wage push, which have supported growth recently, produce second-round effects such as rising unit labour costs, falling corporate profitability and possibly disadvantageous foreign trade performance. These effects may actually depress growth especially if monetary policy becomes too restrictive, the foreign demand for Czech goods proves insufficient and/or productivity advances are less impressive than generally assumed.

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[30] Apparently, there is a belief at CNB that higher interest rates may be essential for avoiding currency depreciation. And currency depreciation is seen as an engine of inflation. Targeting exchange rates – instead of inflation itself – may be a rather inefficient strategy if only because, as the recent Czech experience has shown, higher interest rates (and higher interest rate differentials vs. the euro area) may fail to strengthen the Czech koruna. (Interestingly, the koruna was strong vs. the euro precisely when interest rates in the euro area were high and the Czech rates about zero.)

Table 6.6 / Czech Republic: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020	2021
							Forecast	
Population, th pers., average	10,525	10,546	10,566	10,594	10,640	10,645	10,650	10,655
Gross domestic product, CZK bn, nom.	4,314	4,596	4,768	5,047	5,320	5,580	5,850	6,140
annual change in % (real)	2.7	5.3	2.5	4.4	3.0	2.6	2.7	2.8
GDP/capita (EUR at PPP)	23,800	25,300	25,600	26,900	27,900	.	.	.
Consumption of households, CZK bn, nom.	2,044	2,125	2,213	2,361	2,510	.	.	.
annual change in % (real)	1.8	3.8	3.6	4.2	3.6	3.5	3.4	3.4
Gross fixed capital form., CZK bn, nom.	1,084	1,216	1,189	1,250	1,400	.	.	.
annual change in % (real)	3.9	10.2	-3.1	3.7	9.0	5.0	4.0	4.0
Gross industrial production								
annual change in % (real)	5.0	4.3	3.4	6.5	3.0	3.0	3.0	3.0
Gross agricultural production								
annual change in % (real)	10.1	-4.8	7.0	-6.5	-0.1	.	.	.
Construction industry								
annual change in % (real)	4.2	6.8	-5.6	3.3	8.4	.	.	.
Employed persons, LFS, th, average	4,974	5,042	5,139	5,222	5,294	5,320	5,340	5,350
annual change in %	0.8	1.4	1.9	1.6	1.4	0.5	0.3	0.2
Unemployed persons, LFS, th, average	324	268	211	155	122	120	120	120
Unemployment rate, LFS, in %, average	6.1	5.1	4.0	2.9	2.2	2.2	2.2	2.2
Reg. unemployment rate, in %, eop	7.5	6.2	5.2	3.8	3.1	.	.	.
Average monthly gross wages, CZK	25,768	26,591	27,764	29,496	32,000	34,100	36,200	38,400
annual change in % (real, gross)	2.5	2.9	3.7	3.6	6.4	4.5	4.0	4.0
Consumer prices (HICP), % p.a.	0.4	0.3	0.6	2.4	2.0	2.1	2.1	2.0
Producer prices in industry, % p.a.	1.4	-2.4	-3.2	0.7	0.7	1.5	1.5	1.2
General governm. budget, EU-def., % of GDP								
Revenues	40.3	41.1	40.2	40.5	39.8	40.0	40.5	40.5
Expenditures	42.4	41.7	39.5	39.0	38.4	39.2	40.0	40.5
Net lending (+) / net borrowing (-)	-2.1	-0.6	0.7	1.5	1.4	0.8	0.5	0.0
General gov.gross debt, EU def., % of GDP	42.2	40.0	36.8	34.7	33.3	32.0	31.0	30.0
Stock of loans of non-fin.private sector, % p.a.	2.7	6.6	6.7	6.5	6.8	.	.	.
Non-performing loans (NPL), in %, eop	6.1	5.8	4.8	4.0	3.2	.	.	.
Central bank policy rate, % p.a., eop [2]	0.05	0.05	0.05	0.50	1.75	1.75	1.75	1.75
Current account, EUR mn	296	368	2,744	1,952	1,490	700	600	600
Current account, % of GDP	0.2	0.2	1.6	1.0	0.7	0.3	0.3	0.2
Exports of goods, BOP, EUR mn	110,401	115,573	118,033	128,344	137,067	145,000	153,700	161,400
annual change in %	7.0	4.7	2.1	8.7	6.8	5.8	6.0	5.0
Imports of goods, BOP, EUR mn	102,406	108,701	108,946	119,247	127,683	135,600	143,700	150,900
annual change in %	5.9	6.1	0.2	9.5	7.1	6.2	6.0	5.0
Exports of services, BOP, EUR mn	18,915	20,603	21,923	23,921	25,309	26,800	28,400	30,100
annual change in %	4.7	8.9	6.4	9.1	5.8	5.8	6.0	6.0
Imports of services, BOP, EUR mn	16,892	17,742	17,942	19,285	20,704	22,000	23,300	24,700
annual change in %	10.1	5.0	1.1	7.5	7.4	6.2	6.0	6.0
FDI liabilities, EUR mn	6,101	1,521	9,809	8,206	7,181	.	.	.
FDI assets, EUR mn	3,175	3,357	2,909	3,096	4,340	.	.	.
Gross reserves of NB excl. gold, EUR mn	44,528	58,903	80,999	123,028	124,142	.	.	.
Gross external debt, EUR mn	106,303	115,396	129,448	171,197	170,100	181,600	193,500	203,100
Gross external debt, % of GDP	67.9	68.5	73.4	89.3	82.0	83.0	84.0	84.0
Average exchange rate CZK/EUR	27.54	27.28	27.03	26.33	25.65	25.50	25.40	25.40

1) Preliminary and wiiw estimates. - 2) Two-week repo rate.

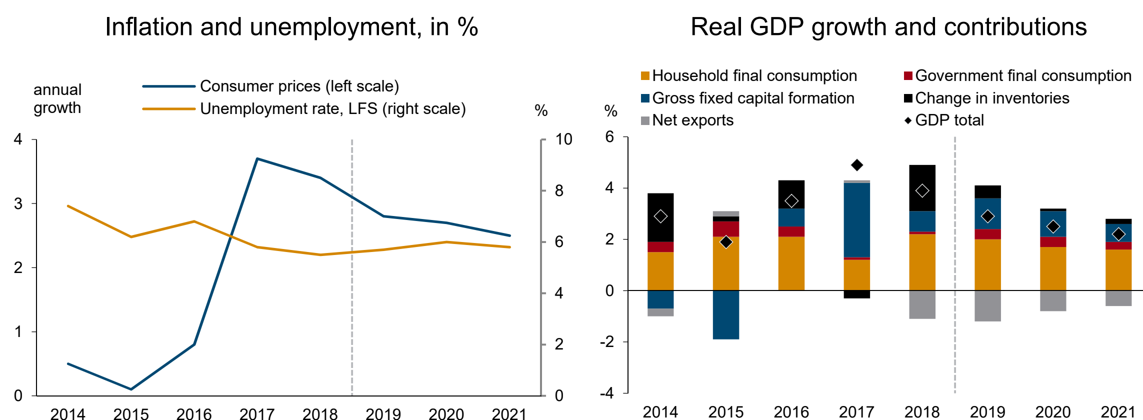
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ESTONIA: At full capacity – heading for a soft landing

SEBASTIAN LEITNER

Investment activity will revive in 2019-2020, induced by inflows of EU funds and increased capital spending for machinery by enterprises. Household consumption, backed by a considerable rise in employment and incomes, continues to be a strong driver of growth. However, given the weakened outlook for external demand, exports will develop at a declining pace in the coming years. We project GDP to grow at lower rates of 2.9% in 2019 and 2.5% in 2020, while even diminishing to 2.2% in 2021.

Figure 6.7 / Estonia: Main macroeconomic indicators



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

In 2018 export growth was still rather lively, however mostly driven by increases in a few particular goods categories. The high oil price supported demand for Estonian shale oil – exports almost doubled in nominal terms in 2018 compared to 2017. For certain, in 2019 we will see declining exports of this basic materials sector. The Estonian wood manufacturers still benefited last year from stable growth of housing construction in Finland and Sweden. In 2019, however, the price decline of real estate in Sweden will be followed by a fall in investments there and thus deteriorating prospects for the Estonian wood industry. Exports of the electronics producers are developing at a good pace. Their hopes rely on a swift spread of the 5G mobile networks in Europe, which should increase demand for network equipment from Nokia and Ericsson and their suppliers in Estonia in the coming years. In general, we expect a slowdown in economic activity in the export destinations of Estonia. A slight increase of import demand in Russia should help to keep Estonian goods exports afloat. However, only about a quarter of the exports to Russia are of Estonian origin, the rest is transit trade. Fast rising wages in Estonia are putting pressure on exporting firms particularly in the low-productive sectors of manufacturing. The worldwide market shares of Estonian exporters have been stagnating in the past

2-3 years and are likely to decline given the ongoing rise in unit labour costs. Thus a contraction of the Estonian manufacturing sector in general is probable in the coming years. Overall, we expect real growth in goods exports to level off in 2019-2021. Given swiftly rising household incomes, imports will keep on expanding more strongly than exports.

After a slowdown in 2018, growth in investment activity will revive in 2019 and 2020. Public infrastructure investment, supported by inflows from EU funds, will develop swiftly in 2019 and 2020. This includes the construction of the main terminals of Rail Baltica, the high-speed train project connecting the Baltics with the Central European network, and the extension of the Tallinn-Tartu highway. After 2020 public investments will rise at a slower pace when the end of the EU funds 2014-2020 programming period is approaching. Investments of private enterprises in machinery will increase more swiftly this year after stagnating in 2018. Strong growth in wages and very low interest rates are still driving an increase in mortgages to households and thus investment in housing. Real estate prices already increased less rapidly towards the end of 2018 and declining building permits granted show that a levelling off in dwelling construction is going to take place from 2019 onwards.

In 2018, the unemployment rate continued to fall gradually towards 5.4% (according to LFS data) on average, but will rise slightly during the forecast period. The favourable economic developments resulted also in an increase in employment by 1% last year. Due to the work ability reform, introduced in 2016, people having received work incapacity pensions in the past now have to look for jobs and take part in public work activation measures in order to be eligible for benefits. The scheme is expected to increase the labour force by about 1.6% towards 2020 compared to 2017. However, the reform will also trigger a slight increase in the unemployment rate in the coming two years. Moreover, in 2020 at the latest we expect a reduction in jobs in the construction sector. Thereafter a continuous decline in the workforce is going to take place, even though immigration is likely to increase slightly. The employment rate will thus rise even further, which at 76% (among 15-64 year-olds as of Q4/2018) is already at the level of the Scandinavian countries (which is the highest in the EU). In the 65-74 age group, 27% of the population is still working, which is much more than anywhere else in the EU28 (average 10% in Q4/2018).

Given the tight labour market situation, wages will continue to rise strongly in the next few years. Real gross wages picked up by another 3.8% year on year in 2018, resulting in private consumption to increase by more than 4% last year. Household incomes are bolstered by a further 8% increase in the minimum wage, effective from January 2019, to EUR 540 per month. Forward-looking consumer confidence indicators are still very positive and retail trade and credit statistics indicate favourable sentiment among consumers. Entrepreneurs however expect some cooling not only of external but also domestic demand already this year. Consumer price inflation will continue to decline towards 2.8% in 2019. Although rising wages keep core inflation above 2%, energy prices will fall and the rise in excise taxes will contribute only little to inflation in the coming two years.

On 19 February 2019 the Estonian financial supervisor instructed Danske Bank Estonia to close down its business within 8 months. The Estonian branch of the Danish institute, being an important player in the Nordic banking sector, failed to prevent suspected money laundering of about USD 230 billion in the years 2007 to 2015 mostly from non-residents. In December 2018, 10 former employees of Danske Estonia were arrested. Following pressure from the Estonian financial supervisory authority, Danske had already withdrawn step-by-step from the Estonian market from 2015 onwards,

when it stopped providing services to private individuals and non-residents. Danske recently announced also to close its operations in Russia, Latvia and Lithuania.

On 3 March 2019 parliamentary elections were held in Estonia. The coalition government of Prime Minister Jüri Ratas lost its majority in the parliament, since the support for the junior partners of the leading Centre Party, the Social Democrats and the conservative Pro Patria, fell strongly. The next Prime Minister will most probably be Kaja Kallas, the daughter of the former European Commissioner and Estonian Prime Minister Siim Kallas. Her liberal Reform Party attained a third of the seats in the parliament. The biggest change in the political landscape was the strong gain in votes of the Conservative People's Party, a nationalist right-wing movement strongly opposing immigration that came in third with 18% of the votes. However, neither 'Centre' nor 'Reform' are willing to go into coalition with them. For 2019 the Estonian government budget foresees a continuation of the fiscal surplus path without further tax changes planned. Above-average expenditure growth will occur for defence and the health and welfare sectors, including an increase in child benefits. Subsidies will be raised for public transport in order to expand the scheme of free public transport, which was first introduced in the capital city of Tallinn in 2013 and is run in 11 of 15 counties now. The medium-term fiscal strategy of the Estonian government foresees a general budget surplus of 0.3% on average and thus to bring the level of public debt down to 5% of GDP over the coming four years.

Following the gradual deterioration in the external environment we slightly reduced our prospects for the Estonian economy compared to our previous forecast; real GDP is expected to grow by 2.9% in 2019. The relatively tight situation in the labour market will keep wage growth high, and will thus also bolster private consumption over the coming two years. While investment growth lost steam in 2018, public infrastructure projects will result in a revival in 2019-2020. In the medium term, however, we expect export growth to fall while import demand will remain strong due to rising household incomes. As a result, we forecast a decline in GDP growth rates to 2.5% and 2.2% for 2020-2021 respectively.

Table 6.7 / Estonia: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020	2021
							Forecast	
Population, th pers., average	1,315	1,315	1,316	1,317	1,320	1,325	1,328	1,330
Gross domestic product, EUR mn, nom.	20,061	20,652	21,683	23,615	25,200	26,900	28,300	29,600
annual change in % (real)	2.9	1.9	3.5	4.9	3.9	2.9	2.5	2.2
GDP/capita (EUR at PPP)	21,400	21,900	22,500	23,600	24,800	.	.	.
Consumption of households, EUR mn, nom.	9,835	10,243	10,777	11,448	12,300	.	.	.
annual change in % (real)	3.0	4.3	4.3	2.5	4.6	4.2	3.5	3.2
Gross fixed capital form., EUR mn, nom.	5,139	4,872	4,978	5,770	6,100	.	.	.
annual change in % (real)	-2.6	-7.6	2.9	12.5	3.3	5.0	4.0	3.0
Gross industrial production								
annual change in % (real)	3.9	0.3	3.4	7.7	4.2	3.5	3.0	2.5
Gross agricultural production								
annual change in % (real)	4.6	8.7	-17.2	6.5	-6.1	.	.	.
Construction industry								
annual change in % (real)	-2.1	-3.5	4.6	17.7	18.0	.	.	.
Employed persons, LFS, th, average	624.8	640.9	644.6	658.6	665.0	668	672	670
annual change in %	0.6	2.6	0.6	2.2	1.0	0.5	0.6	-0.3
Unemployed persons, LFS, th, average	49.6	42.3	46.7	40.3	38.7	40	43	41
Unemployment rate, LFS, in %, average	7.4	6.2	6.8	5.8	5.5	5.7	6.0	5.8
Reg. unemployment rate, in %, eop [2]	4.4	4.7	4.4	4.8	4.8	.	.	.
Average monthly gross wages, EUR	1,005	1,065	1,146	1,226	1,310	1,390	1,470	1,550
annual change in % (real, gross)	6.0	6.5	7.4	3.5	3.5	3.3	3.2	3.0
Average monthly net wages, EUR	799	859	924	985	1,050	1,110	1,170	1,230
annual change in % (real, net)	5.7	8.0	7.4	3.0	3.2	3.0	3.0	2.7
Consumer prices (HICP), % p.a.	0.5	0.1	0.8	3.7	3.4	2.8	2.7	2.5
Producer prices in industry, % p.a.	-2.1	-2.5	-0.9	3.3	3.9	2.6	2.5	2.2
General governm. budget, EU-def., % of GDP								
Revenues	38.5	39.7	39.1	38.9	39.5	39.5	39.2	39.5
Expenditures	37.8	39.6	39.5	39.3	39.5	39.3	39.1	39.4
Net lending (+) / net borrowing (-)	0.7	0.1	-0.3	-0.4	0.0	0.2	0.1	0.1
General gov.gross debt, EU def., % of GDP	10.5	9.9	9.2	8.7	8.5	7.8	7.5	7.0
Stock of loans of non-fin.private sector, % p.a.	2.6	4.8	6.6	0.7	5.1	.	.	.
Non-performing loans (NPL), in %, eop	1.5	1.1	1.0	0.8	0.5	.	.	.
Central bank policy rate, % p.a., eop [3]	0.05	0.05	0.00	0.00	0.00	.	.	.
Current account, EUR mn	162	381	425	751	310	360	361	362
Current account, % of GDP	0.8	1.8	2.0	3.2	1.2	1.3	1.3	1.2
Exports of goods, BOP, EUR mn	11,026	10,689	11,294	12,022	12,600	13,100	13,550	14,000
annual change in %	0.5	-3.1	5.7	6.4	4.8	4.0	3.4	3.3
Imports of goods, BOP, EUR mn	12,019	11,571	12,055	12,839	13,800	14,400	15,050	15,600
annual change in %	1.1	-3.7	4.2	6.5	7.5	4.3	4.5	3.7
Exports of services, BOP, EUR mn	5,385	5,284	5,532	6,054	6,500	6,950	7,400	7,800
annual change in %	7.9	-1.9	4.7	9.4	7.4	6.9	6.5	5.4
Imports of services, BOP, EUR mn	3,678	3,575	3,888	4,162	4,600	4,900	5,150	5,450
annual change in %	4.1	-2.8	8.8	7.0	10.5	6.5	5.1	5.8
FDI liabilities, EUR mn	1,331	-654	845	1,403	1,700	.	.	.
FDI assets, EUR mn	847	-521	341	543	300	.	.	.
Gross reserves of NB excl. gold, EUR mn	352	373	325	279	651	.	.	.
Gross external debt, EUR mn	19,040	19,163	19,162	19,512	19,900	20,400	20,900	21,300
Gross external debt, % of GDP	94.9	92.8	88.4	82.6	79.0	76.0	74.0	72.0

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

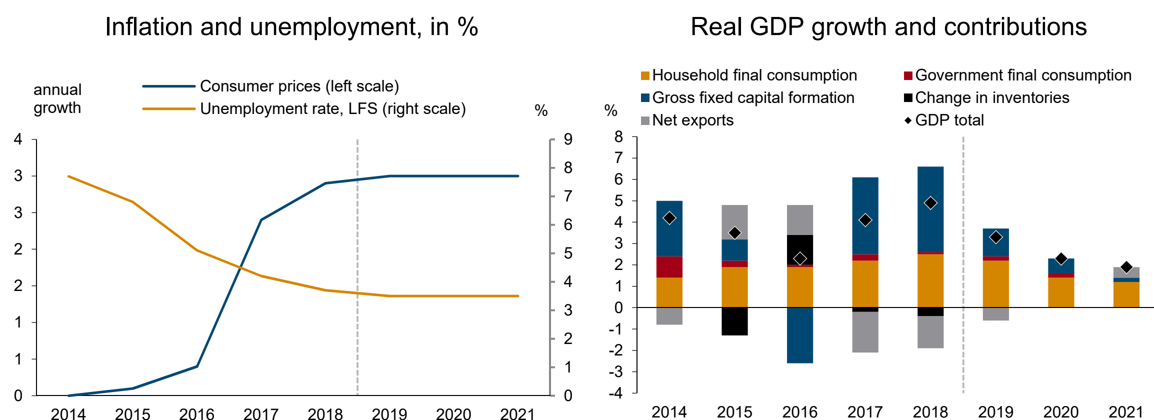
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

HUNGARY: Strong domestic demand driven growth on the back of EU transfers

SÁNDOR RICHTER

Economic growth has been driven by domestic demand. Beside strong investment growth also household consumption expanded more rapidly than the GDP. In trade of goods the expansion of imports exceeded to a large extent that of the exports. The strong dependence on EU transfers, a characteristic feature of the current growth path, makes it likely that the expected huge drop in EU supported investments in 2019-2022 will significantly deteriorate Hungary's growth prospects.

Figure 6.8 / Hungary: Main macroeconomic indicators



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

Thanks mainly to EU cohesion policy transfers, 2018 was a year of dynamic expansion of economic activities in Hungary. According to preliminary data GDP growth amounted to 4.9%, the highest rate since 1996. Important indicators however reveal the one-sidedness of this growth, which is strongly determined by the accelerated allocation of transfers from the EU's cohesion policy. On the output side, the pace of expansion in industry and agriculture remained below the average growth rate of the economy. Construction output may have increased by 22%, related to a large extent to EU transfers (and also helped by a long due upturn in the construction of dwellings). On the final use side of the GDP, the growth rate of investments was impressive, around 18%, but detailed data reveal the strong dependence on EU transfers. In the first three quarters of 2018 investments increased by a mere 1.2% in manufacturing and 2.6% in agriculture. In contrast, investment in the category public administration and defence; compulsory social security grew by 72%. A relatively dynamic investment expansion was reported for transportation and storage and retail activities.

Economic growth was driven primarily by domestic demand in 2018. Beside strong investment growth, household consumption expanded more rapidly than overall GDP, while public consumption practically stagnated. Foreign trade figures reflect this process: imports of goods may have outperformed exports by over 3 percentage points. The rapidly shrinking trade balance of goods was to some extent compensated by the improving balance of trade in services. With regard to the threat of a global trade war and the exposure of the automotive industry, an upturn in exports is questionable. After a long period of shrinking, a take-off in lending to both corporations and households by the reinvigorated financial sector fostered the expansion of economic activities.

The current account surplus had been shrinking over the last year, likely to below 2% of the GDP. The EU's important role is clearly visible here as well: net transfers may have amounted to +3% of GDP, and transfers of Hungarian workers from abroad, predominantly from Western European EU countries, may have accounted for 2% of GDP. In January 2019 tax-filtered core inflation reached 3% (year on year). This is seen as a signal for the central bank to start with a cautious phasing out of its loose monetary policy.

Last year the strong increase in real wages continued. Altogether, in the period 2016-2018 real wages may have increased by about 28%, much faster than GDP (about 11.5%). Recent analysis raises doubts about the validity of the wage growth data for methodological reasons, referring to a possible bias in the sample employed by the Central Statistical Office. The sample does not include (among others) wage increase data at firms employing less than 5 persons, although about half of all firms belong to this category. In these micro-enterprises, wages are typically lower than at the larger firms, and for micro-enterprises it is also more difficult to raise wages. Altogether net wages may have increased substantially more slowly than officially reported.

Labour shortages are a big problem for firms. The problem of skills mismatch is reflected in the statistics, according to which despite labour shortages some 240,000 persons were looking for a job at the end of 2018, a figure corresponding to 5.2% of the active population. Agitating fervently against immigration as a potential solution to ease the labour shortage, the government announced a programme to increase the birth rate. A central element of it is an interest-free credit (equivalent to about EUR 50,000 in purchasing power terms) for all married women younger than 40 years. The credit can be turned into a grant if the prescribed three children are 'delivered'. (If not, the credit must be paid back with interest.) The implied costs of the whole programme are estimated to amount to 0.3% of the GDP this year and 0.5% in the next year. Nevertheless, even if the programme reaches its goal, it would take at least two decades to ease the shortages in the labour market.

There have been continuous protests in Budapest and in several other cities in Hungary against controversial labour law changes. These changes enable employers to raise the threshold of overtime hours from 250 to 400 per year. The time frame for paying out overtime compensation was extended to 36 months. As an alternative to paid compensation, employers may opt for providing leave days. The so-called 'Slave Law' is extremely unpopular: according to polls 83% of the employees do not agree with the new regulation. For one, the extension is extreme – it potentially allows the re-introduction of the six-day working week. Although overtime can be ordered only with the consent of the employees, there is a widespread fear that employees are at the mercy of employers in practice. While no general strike seems to be in the making, isolated strikes have been reported, the most prominent one at Audi Hungaria, although this was focused on wages. In the next three years wages may continue to grow,

even if to a smaller extent than so far, in the foreign-owned enterprises with high productivity and profitability, but a further strong wage growth will become more and more unfeasible in the predominantly Hungarian-owned SME sector. That, apart from shrinking EU transfers, will put a major constraint on growth.

wiiw expects a slowdown of economic growth in Hungary during the forecast period. The government is optimistic: in a medium-term forecast published by the Ministry of Finance at the end of 2018, it reckoned with a mild deceleration of economic growth from this year on, but even so GDP is expected to expand by around 4% on average in the coming years. This rate of growth is expected to ensure a steep decline of the public debt to GDP ratio, to below 60% by 2022. We think that this scenario is not feasible. EU co-financed investments will sharply decrease from the next year. With the mounting uncertainties due to Brexit and the likely conditionality related to the proper functioning of democratic institutions and the rule of law in each beneficiary Member State, a full-scale revival of EU transfers, especially for the EU's 'black sheep' Hungary, is highly questionable. Even if that were to occur, then probably not before 2023 and to a substantially smaller extent than in the current seven-year financing period.

Table 6.8 / Hungary: Selected economic indicators

	2014	2015	2016	2017	2018 1)	2019	2020	2021
							Forecast	
Population, th pers., average	9,866	9,843	9,814	9,788	9,750	9,720	9,700	9,670
Gross domestic product, HUF bn, nom.	32,583	34,379	35,474	38,355	41,500	44,200	46,700	49,100
annual change in % (real)	4.2	3.5	2.3	4.1	4.9	3.3	2.3	1.9
GDP/capita (EUR at PPP)	18,800	19,800	19,500	20,300	21,700	.	.	.
Consumption of households, HUF bn, nom.	15,875	16,428	17,033	18,281	19,880	.	.	.
annual change in % (real)	2.8	3.9	4.0	4.7	5.3	4.6	3.0	2.5
Gross fixed capital form., HUF bn, nom.	7,223	7,744	6,961	8,528	10,400	.	.	.
annual change in % (real)	12.3	4.7	-11.7	18.2	18.0	6.0	3.0	1.0
Gross industrial production								
annual change in % (real)	7.6	7.4	0.9	4.7	3.6	4.5	5.0	4.0
Gross agricultural production								
annual change in % (real)	11.4	-2.4	9.3	-4.1	3.1	.	.	.
Construction industry								
annual change in % (real)	13.6	3.0	-18.9	29.7	22.2	.	.	.
Employed persons, LFS, th, average	4,101	4,211	4,352	4,421	4,470	4,490	4,490	4,490
annual change in %	5.3	2.7	3.4	1.6	1.1	0.5	0.1	0.1
Unemployed persons, LFS, th, average	343	308	235	192	172	160	160	160
Unemployment rate, LFS, in %, average	7.7	6.8	5.1	4.2	3.7	3.5	3.5	3.5
Reg. unemployment rate, in %, eop	8.9	7.6	6.1	5.6	5.2	.	.	.
Average monthly gross wages, HUF 2)	237,695	247,924	263,171	297,017	329,943	356,800	378,500	395,700
annual change in % (real, gross)	3.2	4.4	5.7	10.3	8.3	5.0	3.0	1.5
Average monthly net wages, HUF 2)	155,690	162,391	175,009	197,516	219,412	237,300	251,800	263,200
annual change in % (real, net)	3.2	4.4	7.4	10.3	8.3	5.0	3.0	1.5
Consumer prices (HICP), % p.a.	0.0	0.1	0.4	2.4	2.9	3.0	3.0	3.0
Producer prices in industry, % p.a.	-0.3	-1.1	-1.7	3.3	5.6	3.0	3.0	3.0
General governm.budget, EU-def., % of GDP								
Revenues	46.9	48.2	45.1	44.7	47.5	47.4	47.2	47.0
Expenditures	49.5	50.1	46.8	46.9	49.5	49.7	50.4	50.4
Net lending (+) / net borrowing (-)	-2.6	-1.9	-1.6	-2.2	-2.0	-2.3	-2.7	-2.9
General gov.gross debt, EU def., % of GDP	76.6	76.6	75.9	73.3	70.9	70.4	70.1	69.9
Stock of loans of non-fin.private sector, % p.a.	-0.3	-12.3	-1.3	5.5	10.5	.	.	.
Non-performing loans (NPL), in %, eop	16.7	11.1	7.2	4.2	3.5	.	.	.
Central bank policy rate, % p.a., eop 3)	2.10	1.35	0.90	0.90	0.90	1.15	1.30	1.50
Current account, EUR mn 4)	1,587	3,127	7,071	3,947	1,645	1,600	1,300	1,700
Current account, % of GDP 4)	1.5	2.8	6.2	3.2	1.3	1.2	0.9	1.1
Exports of goods, BOP, EUR mn 4)	73,826	78,477	80,106	85,566	90,172	94,700	99,400	105,400
annual change in %	5.1	6.3	2.1	6.8	5.4	5.0	5.0	6.0
Imports of goods, BOP, EUR mn 4)	71,701	74,425	75,482	83,662	90,972	97,000	102,400	108,500
annual change in %	7.2	3.8	1.4	10.8	8.7	6.6	5.6	6.0
Exports of services, BOP, EUR mn 4)	18,727	20,229	22,114	23,746	24,490	25,700	27,000	28,600
annual change in %	10.2	8.0	9.3	7.4	3.1	5.0	5.0	6.0
Imports of services, BOP, EUR mn 4)	14,120	15,302	15,338	16,394	16,459	17,100	18,000	19,100
annual change in %	6.7	8.4	0.2	6.9	0.4	4.0	5.0	6.0
FDI liabilities, EUR mn 4)	7,134	6,966	-6,158	6,546	5,850	.	.	.
FDI assets, EUR mn 4)	4,186	5,753	-8,467	4,911	2,469	.	.	.
Gross reserves of NB excl. gold, EUR mn	34,481	30,226	24,384	23,261	26,273	.	.	.
Gross external debt, EUR mn 4)	121,129	119,339	110,637	104,941	106,000	105,000	101,000	99,000
Gross external debt, % of GDP 4)	114.8	107.6	97.1	84.6	81.5	77.0	71.2	66.9
Average exchange rate HUF/EUR	308.71	310.00	311.44	309.19	318.89	324	329	332

1) Preliminary and wiiw estimates. - 2) Enterprises with 5 and more employees. - 3) Base rate (two-week NB bill). - 4) Excluding SPE.

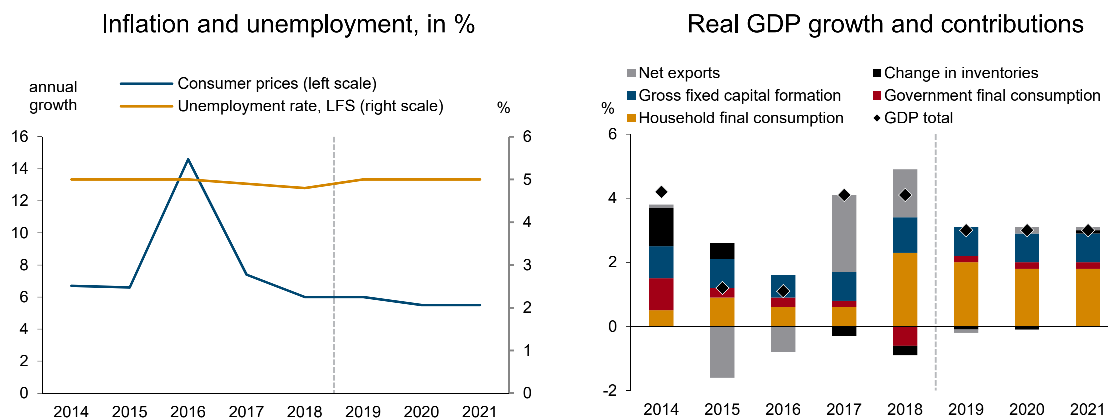
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

KAZAKHSTAN: Falling oil prices bring economic diversification to the fore

OLGA PINDYUK

GDP growth reached 4% year on year in 2018, mainly owing to high oil prices and expansion of production in the oil sector. In 2019, the negative effect of the drop in oil prices on the economy will be somewhat offset by government stimulus measures directed primarily at stimulating private consumption. Nevertheless, economic growth will slow down to about 3% p.a. during the forecast period.

Figure 6.9 / Kazakhstan: Main macroeconomic indicators



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

2018 was a relatively successful year for the Kazakh economy, which grew by about 4% year on year primarily on the back of higher global oil prices. The average price of Brent crude oil in 2018 was 31.5% higher than in 2017, which allowed exports, the main driving force behind economic growth, to increase in 2018 by about 25% year on year in USD terms. Additionally, the oil sector received a boost from the supply side as total oil output in 2018 reached the record level of 90.3 million tonnes – 4 million tonnes more than in the previous year. Output expansion was driven in particular by the operation of the recently launched Kashagan oil field.

The expected drop in oil prices in 2019 creates a challenge for the economy, which has not diversified sufficiently to soften the blow. The shutdown of the three main oil fields Karachaganak, Kashagan, and Tengiz in 2019 for major repairs, which is estimated to last for about a month, will be an additional factor adversely affecting performance of the extractive sector. As a result, we forecast that merchandise exports will fall in 2019 by 15% and then rebound in 2020-2021 – but only modestly as oil prices are assumed not to grow significantly during this period.

Government policies to promote economic diversification have not been very successful so far. The extractive sector still plays the central role in the economy – it accounted for about 75% of total goods exports and for 69% of fixed capital investment in industry in 2018. Moreover, it continues to attract the bulk of FDI, two other important sectors being metallurgy and retail and wholesale trade.

On 21 February 2019, President Nursultan Nazarbayev dismissed the government, **citing its failure to diversify the economy away from the energy sector, as well as to raise living standards**. He announced a number of measures to strengthen social welfare at a conference of his Nur Otan party on 27 February and promised to allocate considerable funds to pay for the measures. This will mark a sharp change in the economic policy course, which recently was focused on promoting investment, in particular into infrastructure development.

Structural reforms will remain high on the governmental agenda during the forecast period, but are not likely to advance significantly. In November 2018, the government adopted the 'Kazakhstan 2025' strategic development plan, which contains a roadmap for a new model of private sector growth, as well as measures to increase productivity, and develop human capital, competition and investment. In line with President Nazarbayev's request, KZT 500 billion (equivalent to 0.85% of 2018 GDP) will be allocated during 2019-2021 to support the manufacturing industry and non-commodity exports. Additionally, the National Bank is required to allocate long-term tenge liquidity of at least KZT 600 billion (1% of 2018 GDP) to provide affordable loans for priority sectors.

Government stimulus measures will somewhat offset the dampening effect of falling oil prices on the economy. On the downside, state support has been costly and is associated with risks of rising imbalances in the economy as the state's role in the economy increases. Credit subsidies introduce distortions to economic activity and might have inflationary effects. Besides, funding of subsidies by the National Bank runs contrary to the requirement of its independence and interferes with its focus on inflation targeting. Risks to the efficiency of the new policies are as usual related to corruption and funds misappropriation.

The clean-up of the banking sector has continued, with a USD 3.4 billion bailout of the second largest lender Tsesnabank. First Heartland Securities, part of a group controlled by the state-owned Nazarbayev University, bought the bank after Kazakh authorities agreed to take a further KZT 604 billion (USD 1.6 billion) of non-performing loans off its balance sheet. It was the second purchase of bad debts from Tsesnabank by Kazakhstan's problem asset fund in less than six months, following a KZT 450 billion transfer in September 2018. The state also provided a liquidity injection to the bank making the total bill for the bailout exceed KZT 1.1 trillion.

Banks have continued to expand their loans portfolios mainly with loans to households. In December 2018, the stock of loans to households was 16.8% higher as compared with December 2017, while for corporate loans growth was negative at -4.6%. The dynamics of the latter was caused to a large extent by perceived lack of good borrowers among corporate clients and higher cautiousness of banks in the face of tightening banking supervision. In addition, writing-off of non-performing loans, the bulk of which is concentrated in the corporate segment, also played its role.

Double-digit growth in loans to households, whose incomes have been rising rather modestly, can hardly be sustained in the long run. A bubble could develop if banks do not restrain their loan activity in this market. However, decent credit growth is still quite likely over the forecast period for the following reasons: the end of the sector's consolidation, finalising writing off distressed assets, and government programmes of forex mortgage loans refinancing and loans to 'priority economic sectors'.

The trade surplus widened in 2018 by more than USD 10 billion (about 6% of 2018 GDP) as merchandise import growth was less impressive in 2018 as compared to exports – 7.5% year on year in USD terms. Machinery and equipment, metals and chemicals, which together account for about two thirds of merchandise imports, contributed the most to growth. The current account balance managed to stay in positive territory in 2018 – for the first time since 2014.

During 2019-2021, sluggish oil price dynamics will cause the trade surplus to gradually shrink, consequently the current account balance will go back into the red. Rising depreciation pressures on the tenge will make the National Bank of Kazakhstan more cautious in its monetary policy this year. On 15 January 2019, it left the base interest rate unchanged at 9.25% and signalled the possibility of a rate increase during the year if the external conditions are unfavourable. However, in the absence of big oil price shocks, significant depreciation and a spike in inflation are not likely. Inflation is expected to remain in the target corridor of 4-6% and gradually decline over the forecast period.

The government is determined to continue fiscal consolidation, though the budget for 2019 envisages wage increases, higher social spending and support for SMEs and manufacturing sectors. Expansionary policies will be introduced in order to stimulate private consumption over the next few years. The increase in expenditures is expected to be financed from higher VAT and corporate income tax revenues, so that transfers of the National Oil Fund can phase out as planned.

On March 19, 2019, President Nazarbayev announced his resignation after 29 years in power. His duties will be performed by Senate Speaker Kassym-Jomart Tokayev until the early presidential elections take place. Even though he is stepping down as head of state, Nazarbayev will retain a wide-ranging degree of authority under his title of Leader of the Nation and as a lifelong head of the national Security Council. This should facilitate a smooth transition of power in the country, but it is not clear yet who will be Nazarbayev's successor and what changes in policies to expect.

Given lower oil prices, GDP growth will slow down to about 3% p.a. during the forecast period. Private consumption, supported by the state stimulus programmes, will make the biggest contribution to growth. Sizeable progress in diversification of the economy is not likely to happen during the forecast period as the effects of the related government policies are more long-term in nature.

Table 6.9 / Kazakhstan: Selected economic indicators

	2014	2015	2016	2017	2018 [1)]	2019	2020	2021
							Forecast	
Population, th pers., average	17,288	17,543	17,794	18,038	18,276	18,450	18,630	18,820
Gross domestic product, KZT bn, nom.	39,676	40,884	46,971	53,101	58,786	63,900	69,100	74,700
annual change in % (real)	4.2	1.2	1.1	4.1	4.1	3.0	3.0	3.0
GDP/capita (EUR at PPP)	18,300	18,800	18,400	19,100	19,800	.	.	.
Consumption of households, KZT bn, nom.	18,806	21,492	25,087	26,991	29,900	.	.	.
annual change in % (real)	1.1	1.8	1.2	1.2	4.5	4.0	3.5	3.5
Gross fixed capital form., KZT bn, nom.	8,552	9,355	10,671	11,622	14,500	.	.	.
annual change in % (real)	4.4	4.2	3.0	4.0	5.0	4.0	4.0	4.0
Gross industrial production								
annual change in % (real)	0.3	-1.6	-1.1	7.3	4.1	2.0	2.0	2.0
Gross agricultural production								
annual change in % (real)	1.0	3.4	5.4	3.0	3.4	.	.	.
Construction industry								
annual change in % (real)	4.6	5.8	7.4	2.8	4.1	.	.	.
Employed persons, LFS, th, average	8,510	8,624	8,553	8,585	8,720	8,810	8,900	8,990
annual change in %	-0.7	1.3	-0.8	0.4	1.6	1.0	1.0	1.0
Unemployed persons, LFS, th, average	452	451	446	442	440	460	470	470
Unemployment rate, LFS, in %, average	5.0	5.0	5.0	4.9	4.8	5.0	5.0	5.0
Reg. unemployment rate, in %, eop	0.4	0.4	0.4	0.8	1.0	.	.	.
Average monthly gross wages, KZT [2)]	121,021	126,021	142,898	150,827	163,500	180,200	195,800	212,800
annual change in % (real, gross)	3.9	-2.3	-1.1	-1.7	2.3	4.0	3.0	3.0
Consumer prices (HICP), % p.a.	6.7	6.6	14.6	7.4	6.0	6.0	5.5	5.5
Producer prices in industry, % p.a.	9.5	-20.5	16.8	15.3	19.0	-10.0	1.0	1.0
General governm.budget, nat.def., % of GDP								
Revenues	18.5	18.7	19.8	21.8	18.4	19.0	20.0	20.0
Expenditures	21.2	20.9	21.4	24.5	19.8	21.5	22.0	22.0
Deficit (-) / surplus (+)	-2.7	-2.2	-1.6	-2.7	-1.4	-2.5	-2.0	-2.0
General gov.gross debt, nat.def., % of GDP	14.6	22.7	25.0	26.3	27.3	24.0	23.0	22.0
Stock of loans of non-fin.private sector, % p.a.	7.2	4.7	0.3	0.0	3.0	.	.	.
Non-performing loans (NPL), in %, eop	23.5	8.0	6.7	9.3	7.4	.	.	.
Central bank policy rate, % p.a., eop [3)]	5.50	16.00	12.00	10.25	9.25	9.00	8.25	7.50
Current account, EUR mn [4)]	4,621	-4,632	-8,029	-4,770	784	-4,800	-5,100	-4,200
Current account in % of GDP	2.8	-2.8	-6.5	-3.3	0.5	-3.1	-3.2	-2.5
Exports of goods, BOP, EUR mn [4)]	60,440	41,961	33,673	43,772	52,470	46,200	46,600	47,100
annual change in %	-6.2	-30.6	-19.8	30.0	19.9	-11.9	0.9	1.1
Imports of goods, BOP, EUR mn [4)]	33,162	30,530	25,366	28,418	29,252	31,800	33,300	34,100
annual change in %	-13.3	-7.9	-16.9	12.0	2.9	8.7	4.7	2.4
Exports of services, BOP, EUR mn [4)]	4,981	5,842	5,699	5,699	5,892	6,400	6,700	7,000
annual change in %	22.9	17.3	-2.4	0.0	3.4	8.6	4.7	4.5
Imports of services, BOP, EUR mn [4)]	9,721	10,448	9,997	9,610	9,387	10,000	10,300	10,400
annual change in %	3.6	7.5	-4.3	-3.9	-2.3	6.5	3.0	1.0
FDI liabilities, EUR mn [4)]	5,437	5,755	15,273	4,119	362	.	.	.
FDI assets, EUR mn [4)]	1,982	2,992	3,140	847	-3,080	.	.	.
Gross reserves of NB excl. gold, EUR mn [4)]	17,920	18,555	19,191	15,505	14,460	.	.	.
Gross external debt, EUR mn [4)]	129,438	140,266	155,980	140,158	143,200	149,700	151,000	149,900
Gross external debt, % of GDP	77.7	84.3	125.7	97.2	99.1	97.4	93.5	89.7
Average exchange rate KZT/EUR	238.10	245.80	378.63	368.32	406.66	416	428	447

1) Preliminary and wiiw estimates. - 2) Excluding small enterprises, engaged in entrepreneurial activity. - 3) From 2015 one-day (overnight) repo rate, refinancing rate of NB before. - 4) Converted from USD.

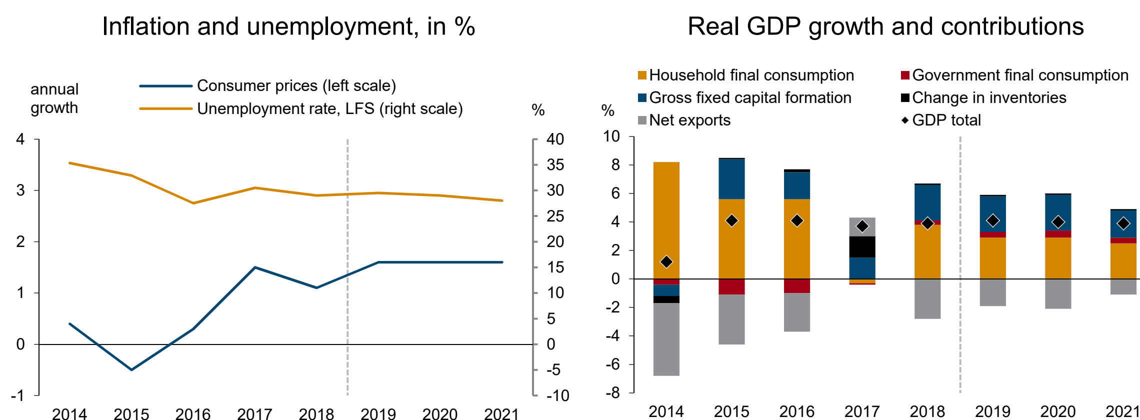
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

KOSOVO: 2019 a decisive year for relations with Serbia

ISILDA MARA

The pace of growth will pick up to above 4% in the medium term. Consumption as well as public and private investment will provide a new impetus to growth. The external sector will be characterised by a further widening of the trade deficit. The 100% tariff on imports from Serbia is unlikely to have a strong impact on the economy. 2019 is expected to be a decisive year for the Kosovo-Serbia dialogue and their future place in the EU.

Figure 6.10 / Kosovo: Main macroeconomic indicators



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

Economic growth is estimated to have accelerated to around 4% in 2018 as gross fixed capital formation picked up at a double-digit rate. In addition, supportive to growth has been the rise in consumption, at 4.3% in the first three quarters of 2018, year on year, which was backed mainly by a strong recovery in household consumption, up 4.7% in the same period. The boost in consumption is explained by the rise in remittances of 7% during Q1-Q3 2018, year on year, and that in real wages of 3%. Medium-term prospects are rather in favour of consumption continuing to support growth due to further hikes in real wages, social transfers and remittances. In addition, we expect a strong increase in public and private investment in the medium term – dynamics which can contribute to rebalancing the GDP's structural composition, which is largely dominated by consumption with a share of 85%.

The new general government budget is expected to put some strain on public debt. The fiscal position until November 2018 was characterised by rising budget revenues, up 4.4%, and expanding expenditures, up 13%. Indirect taxes and especially VAT continue to be the main sources of revenues. The strong rise in expenditures was due to public capital investment and expenditures on wages/salaries – which picked up by 19% and 8%, respectively. Still, such dynamics left the structural composition of

expenditures almost unchanged, with close to one third allocated to wages/salaries and one quarter to public capital investment. The general government deficit widened, but the public debt to GDP ratio remained low, at around 17%. The general government budget in 2019 foresees a much stronger push on public wages and pensions, which might contribute to a further shift in expenditures towards wages and social transfers – the latter risking to jump to a 50% share in total budget expenditures. Leaving aside the change in composition, the foreseen budget might contribute to a rapid rise in the public deficit.

The banking sector continues to be stable. Demand for new loans has been on the rise and until November 2018 the stock of loans of the non-financial private sector picked up by 11%, year on year, while non-performing loans stood at a negligible level of 2.7% in the same period. Inflation, mainly imported from the economies of the EU, reached a relatively low level of 1.1% and in the near future will continue to stay subdued following the EU trend.

Signals from the labour market indicators are pessimistic. Despite a real GDP growth rate of close to 4%, labour market indicators did not improve: labour force participation shrank by 1.5 p.p. to 42% in the third quarter of 2018, year on year. In the same period the unemployment rate rose by 0.5 p.p. to 30.7%. More severe is the unemployment rate among the age group 15-24, which deteriorated further to 55%. It is especially this generation which suffers the most from the isolation and restricted mobility outside the country. The postponement of the EU Council's decision to grant free visa travel to citizens of Kosovo and the lengthy processing of visa applications are generating further frustration and social tensions especially for this age cohort. This decade the number of asylum seekers from Kosovo to the EU reached 179,000, even though their applications have been declining recently.

Foreign direct investment inflows are likely to recover in the medium term. FDI inflows have been shrinking in 2018, dropping by 15% until October 2018, year on year. Nevertheless, starting from 2019 the outlook is promising. SOWI Kosovo LCC, a German-Kosovo joint venture, will invest EUR 169 million to build a wind farm with 30 turbines and a total capacity of 105 megawatt in Mitrovica in the north of Kosovo. Also two other companies, Solar Kosova 2020 and KelKos-Energy Peja, both plan to invest EUR 225 million in renewable energy. Despite the withdrawal of the World Bank from supporting the construction of the Kosova e Re coal power plant, the government of Kosovo is keen to go ahead with the project. It has been confirmed that the US company Global Contour, in charge of building the new coal power plant, has found new financial partners supporting the project. EUR 1.3 billion are expected to be invested in its construction. It will have a capacity of 500 megawatt and will use lignite coal; the estimated $C0_2$ emission is 2.01 Mt/year. The new plant will replace the existing 'Kosovo B' coal power plant, which is at the end of its life cycle. The new project has been criticised by the Vienna-based Energy Community concerning the unfavourable terms of the deal towards the Kosovo government. For a small economy such as Kosovo's, this investment project will give a strong impetus to growth. Nevertheless, for a number of reasons – delays and uncertainties about its financing, the timing of construction, environmental impact and terms of agreement – the project is not included among the contributing components to our mid-term forecast.

Damaging rhetoric has surrounded the fragile Kosovo-Serbia dialogue. Recent statements about the idea of territorial swapping, border corrections, the potential of Kosovo being another arena for NATO-Russia tensions, the idea of 'ethnic Albania' and many more challenging issues do not make the dialogue between Kosovo and Serbia, which has been stalling, any easier.

A tariff of 100% was imposed on imports from Serbia and Bosnia and Herzegovina. Last November Kosovo introduced a tariff of 100% on imports from Serbia and Bosnia and Herzegovina, with the argument that Serbia had been sabotaging Kosovo's membership in international organisations such as Interpol, UNESCO etc. and its recognition by further countries. Since then Serbia refuses to continue the dialogue with Kosovo as long as the 100% tariff on its exports remains in place. The international partners have stepped in to calm the tensions. The United States and the EU have invited Kosovo to suspend the 100% tariff and at the same time President Trump urged Serbia to take concrete steps towards Kosovo's recognition. The Achilles' heel of the Kosovo-Serbia relationship is certainly the north of Kosovo. Prime Minister Ramush Haradinaj is firm in that the integrity of Kosovo territory is indisputable. For the most, territorial swapping or border correction was never part of the Kosovo-Serbia dialogue convened by the EU and its High Representative for Foreign Affairs, Federica Mogherini. As concerns Serbia, its progress on EU integration is conditioned on the recognition of Kosovo. As for Kosovo, despite the EU Parliament's recommendation for visa liberalisation in September 2018, the EU Council has still not decided to support it. After so many years of dialogue – starting already in 2011 as two entities – Kosovo and Serbia need to take courageous steps and come up with an agreement (for example one similar to the Prespa agreement between Greece and Macedonia) which would bring to an end the centennial disputes and pave the way for EU integration of both countries. Given the current state of affairs, it is difficult to say whether such an agreement will be reached and what will be the outcome.

Obviously, the 100% tariff has been a political rather than an economic instrument. In November-December 2018 imports from Serbia to Kosovo dropped by 90%, year on year, and their share in total imports shrank from 18% to less than 2%. Certainly, Kosovo quickly diversified its trading partners and stepped up imports from its neighbours. A large part of imports from Serbia has been replaced with imports from Albania, Macedonia, Slovenia, Greece and Bulgaria – countries whose exports to Kosovo rose by 45% combined during the same period. Nevertheless, Kosovo is quite dependent on imports of electricity from Serbia. Statistics for 2017 indicate that 90% of electricity imported to Kosovo came from Serbia. Serbia does not report trade statistics with Kosovo. However, mirror statistics suggest that Serbian exports to Kosovo represented not more than 3% of total Serbian exports – at least in 2017. In fact, trade statistics indicate that overall Serbian goods exports rose by 8% in 2018; in November-December 2018 the rise was at 7% compared with the same period in 2017 – a rate of growth higher than the 5% observed for the same period between 2016 and 2017. Accordingly, Serbia is likely to quickly counterbalance the effect of the 100% tariff imposed by Kosovo.

Growth will accelerate to above 4% in the medium term, backed by domestic demand and investment in infrastructure projects. A number of new projects in renewable energy will contribute to the diversification of energy sources, raising the energy supply and reducing Kosovo's dependence on imported energy. 2019 might be a pivotal year for the Kosovo-Serbia dialogue and for the EU perspective of both countries.

Table 6.10 / Kosovo: Selected economic indicators

	2014	2015	2016	2017	2018 1)	2019	2020 Forecast	2021
Population, th pers., average	1,813	1,788	1,778	1,791	1,813	1,830	1,845	1,860
Gross domestic product, EUR mn, nom.	5,567	5,807	6,070	6,282	6,600	7,000	7,400	7,800
annual change in % (real)	1.2	4.1	4.1	3.7	3.9	4.1	4.0	3.9
GDP/capita (EUR at PPP)	6800	7400	7600	7700	8000	.	.	.
Consumption of households, EUR mn, nom.	4,802	4,943	5,194	5,271	5,600	.	.	.
annual change in % (real)	9.8	6.5	6.6	-0.4	4.5	3.5	3.5	3.0
Gross fixed capital form., EUR mn, nom.	1,294	1,499	1,550	1,729	1,900	.	.	.
annual change in % (real)	-3.3	12.1	7.3	5.7	9.0	9.0	9.0	7.0
Gross industrial production 2)								
annual change in % (real)	7.3	3.7	-6.7	4.9	3.0	3.5	3.0	5.0
Gross agricultural production								
annual change in % (real)	-21.4	13.8	15.2	-8.6	2.0	.	.	.
Construction output 3)								
annual change in % (real)	-6.1	15.8	4.5	12.4	10.0	.	.	.
Employed persons, LFS, th, average 4)	323.5	296.9	331.8	357.1	357.8	365	370	375
annual change in %	-4.4	-8.2	11.7	7.6	0.2	2.0	1.5	1.5
Unemployed persons, LFS, th, average 4)	176.7	145.8	126.1	156.6	150.0	150	150	150
Unemployment rate, LFS, in %, average 4)	35.3	32.9	27.5	30.5	29.0	29.5	29.0	28.0
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.	.
Average monthly gross wages, EUR	482	510	519	511	530	570	600	630
annual change in % (real, gross)	-6.0	0.0	1.5	-0.1	3.0	5.0	4.0	4.0
Average monthly net wages, EUR	430	451	457	450	490	520	540	570
annual change in % (real, net)	9.0	5.4	1.0	-3.0	7.0	4.0	3.0	3.0
Consumer prices (HICP), % p.a.	0.4	-0.5	0.3	1.5	1.1	1.6	1.6	1.6
Producer prices, % p.a.	1.7	2.7	-0.1	3.4	3.0	2.0	1.5	1.2
General governm.budget, nat.def., % of GDP								
Revenues	24.2	29.4	29.3	30.6	31.5	31.0	31.0	31.5
Expenditures	27.2	27.8	29.1	29.2	31.0	33.0	33.0	33.0
Deficit (-) / surplus (+)	-2.9	1.6	0.2	1.4	0.5	-2.0	-2.0	-1.5
General gov.gross debt, nat.def., % of GDP	10.5	12.9	14.0	15.9	17.0	18.0	19.0	20.0
Stock of loans of non-fin.private sector, % p.a.	6.2	7.2	10.5	11.6	10.8	.	.	.
Non-performing loans (NPL), in %, eop	8.3	6.2	4.9	3.1	2.7	.	.	.
Central bank policy rate, % p.a., eop 5)	9.29	7.69	7.22	6.83	5.99	6.00	6.00	5.50
Current account, EUR mn	-385	-497	-481	-383	-430	-510	-580	-600
Current account, % of GDP	-6.9	-8.6	-7.9	-6.1	-6.5	-7.3	-7.8	-7.7
Exports of goods, BOP, EUR mn	324	323	308	379	364	380	390	400
annual change in %	11.3	-0.5	-4.5	23.1	-4.0	5.0	3.5	3.5
Imports of goods, BOP, EUR mn	2,383	2,432	2,599	2,843	3,077	3,300	3,550	3,730
annual change in %	4.2	2.1	6.9	9.4	8.2	7.2	7.5	5.0
Exports of services, BOP, EUR mn	929	952	1,131	1,330	1,420	1,510	1,590	1,690
annual change in %	6.1	2.5	18.8	17.6	6.8	6.0	5.0	6.0
Imports of services, BOP, EUR mn	469	494	492	536	570	630	660	710
annual change in %	32.0	5.5	-0.5	9.0	6.3	10.0	5.0	7.0
FDI liabilities, EUR mn	151	309	220	255	230	.	.	.
FDI assets, EUR mn	27	37	43	43	60	.	.	.
Gross reserves of NB excl. gold, EUR mn	645	708	605	683	769	.	.	.
Gross external debt, EUR mn	1,737	1,932	2,015	2,089	2,110	2,300	2,400	2,400
Gross external debt, % of GDP	31.2	33.3	33.2	33.2	32.0	32.5	32.0	31.0

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

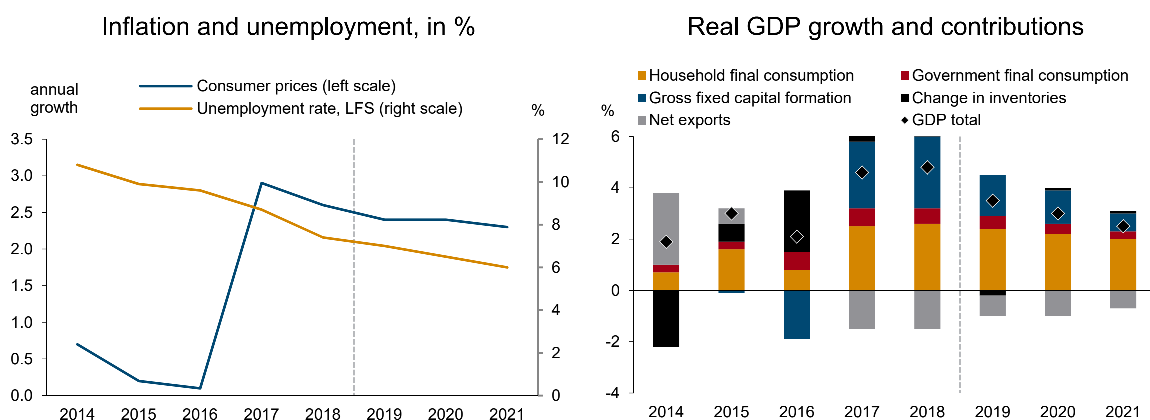
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

LATVIA: Beyond peak, but growth further bolstered by investment

SEBASTIAN LEITNER

Both public and private investment keep the economy growing at a high pace in 2019, whereas export activity is further abating this year. Household consumption will continue to rise rapidly in 2019. While employment increases, skill shortage results in strong wage growth. The incoming coalition government may pursue a more lax fiscal policy. In 2019 we expect GDP to grow still considerably, by 3.5% in real terms, followed by a further slowdown to 3% in 2020 and 2.5% in 2021.

Figure 6.11 / Latvia: Main macroeconomic indicators



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

Surprisingly strong investment activity in the second half of last year helped Latvian GDP to grow remarkably, by 4.8% in real terms, in 2018. Capital spending will continue to bolster economic activity in 2019 but to a minor degree. One of the major ongoing public investment projects co-financed by EU funds is Rail Baltica, the high-speed train connecting the Baltics with central Europe. At the moment the project is in the phase of detailed technical design, while the construction will be realised in 2020-2025. EU-financed road upgrading has already been accomplished to a great extent. The current investment boom is fostered by construction activity; however, investment in machinery revived in the second half of 2018 in manufacturing and service sectors. Historically high rates of capacity utilisation show the need for investment in production equipment. The latest figures for building permits granted indicate that the rise in construction activity related to dwellings, but also office, industrial and other commercial buildings is going to continue in 2019. Given strongly rising prices and wages in the construction sector from 2020 onwards an amelioration of demand is to be expected.

Export growth fell more than expected in 2018, given the weaker developments in major trading partners. Growth in exports to Western Europe, Estonia and Latvia abated, but remained high to Sweden and Finland. Positive contributions came from the important export sectors wood, articles of base metals, transport vehicles and prepared foodstuffs, while electrical and mechanical appliances fared rather badly. So far, Latvian producers have been able to maintain their shares in the world market. However, their external competitive position is under pressure, given sustained wage growth. Declining employment in manufacturing, despite increasing household consumption, shows the mounting problem of the industrial sectors. Although capital investment and household consumption are rising strongly, real growth in imports declines, given the high share of re-exported goods and transit trade in the Latvian economy. As a result, the current account deficit will widen only slightly this year. However, in 2020-2021 we expect net exports to become more negative, in line with a cooling of external demand.

Following the parliamentary elections in October 2018, it took until the end of January 2019 to form a new government, and the stability of the government is questionable. The rather heterogeneous coalition comprises the liberal 'Unity' and the populist right-wing 'National Alliance', both already partners in the former government. In addition, three newly founded parties that together attained almost half of the seats in the parliament were incorporated: the populist anti-establishment party 'Who owns the state?' – KPV (16 seats), the 'New Conservative Party' – JKP (16 seats) and the liberal 'Development/For!' (13 seats). The centre-left 'Harmony Centre', which came first in the elections (as in 2011 and 2014) with 20% of the votes and has a stronghold in the Russian-speaking minority, was again excluded from coalition talks. Up to now all Latvian parties from the liberal-nationalistic block reject collaboration with 'Harmony Centre', stressing the at least former strong ties with the party 'United Russia' of President Putin. Given the multitude of claims announced before the elections by the five coalition partners and the anti-EU stance of the populist KPV party, the stability of the government is in question. Over the medium term we might observe more strongly rising minimum wages and swifter rising government consumption, i.e. somewhat laxer fiscal policy, in order to meet the demands of all coalition parties. In the absence of a government, 2019 started with a temporary budget. The incoming Finance Minister announced that no tax changes will be introduced this year or next. The medium-term budget strategy foresees substantial increases in family benefits and public health expenditure for the coming years. At the same time, however, the fiscal strategy foresees a reduction of the overall share of the government in GDP via gradual tax reductions.

Employment grew swiftly in 2018 (+1.7% year on year), driven particularly by the upswing in construction. Strongly rising wages in the sector attracted employees from other industries and foreign workers. However, jobs also increased considerably in trade, the ICT sector and hotels and restaurants. Tourism in general is flourishing, the number of foreigners visiting the country increased by 9% last year compared to 2017. Employment rates are increasing strongly and are approaching the levels of Scandinavian countries, which are the frontrunners in the EU in this respect. The unemployment rate fell to 7.5% in 2018 on average and is expected to decline to about 6% by the end of the forecast period in 2021. In the longer term, Latvia is going to experience a substantial decline of the working-age population. In the past 15 years the age group 15-64 already shrank by 20% – without policy changes a reduction of the same extent is likely up to 2030 given ongoing negative net migration and the natural population decline. Even the strong wage rises experienced at the moment are not likely to increase return migration sufficiently to reverse the trend.

The rather tight situation in the labour market resulted in strong growth of gross wages, by 6% in 2018 year on year in real terms. This was also an outcome of the strong increase in the minimum wage (+13%) in January last year. Given the political standstill following the parliamentary elections, no further increase was arranged for 2019. Thus, this year we expect a slower but still substantial increase in household incomes, which will continue also in 2020-2021. This will further fuel household consumption which is projected to increase by about 4.1% in real terms in 2019. In the period 2020-2021 we expect some slowdown but consumption to still grow by 3.5% on average. The above-mentioned strong rise in household incomes is, however, unequally distributed; a considerable part of the Latvian population is left behind. Overall, 23% of the Latvian population was at risk of poverty (according to EU definition) in 2017, substantially more than in most other EU countries. 49% of pensioners and 60% of the unemployed fall below the poverty line, showing that support provided by social transfers is rather low in Latvia.

Strong wage growth has not fed through into rising inflation in 2018. On the contrary, although high oil prices contributed substantially to consumer inflation, the CPI declined to 2.6% last year. This can be explained by slowly rising prices for imported goods and rather high productivity growth in the economy. With falling prices for imported energy and low increases of excises, we expect the level of consumer inflation to decrease further to about 2.4% in 2019 and 2020.

Surprised by strong investment activity in the second half of last year, we have also become slightly more optimistic for this year. Thus, we have increased the forecast for the GDP growth rate to 3.5% in 2019. Private investment activity and also public investment will remain buoyant, not only this year but also in 2020, the latter facilitated by ongoing inflows of EU funds. An increase in employment and rising wages help private consumption to keep on growing steadily. Although export activity is losing momentum, the net contribution of trade is expected to improve this year. Thereafter, we see some cooling off, given the deterioration of the external economic environment and a downward trend in the investment cycle towards the end of the forecast period. However, we forecast the Latvian GDP to grow still by 3% in 2020 and 2.5% in 2021.

Table 6.11 / Latvia: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020	2021
							Forecast	
Population, th pers., average	1,994	1,978	1,960	1,942	1,930	1,920	1,910	1,900
Gross domestic product, EUR mn, nom.	23,618	24,320	25,038	27,033	29,000	31,300	33,000	34,600
annual change in % (real)	1.9	3.0	2.1	4.6	4.8	3.5	3.0	2.5
GDP/capita (EUR at PPP)	17,500	18,600	18,800	20,000	21,300	.	.	.
Consumption of households, EUR mn, nom.	14,178	14,393	14,751	15,842	17,000	.	.	.
annual change in % (real)	1.2	2.7	1.4	4.2	4.5	4.1	3.7	3.4
Gross fixed capital form., EUR mn, nom.	5,337	5,385	4,915	5,651	6,600	.	.	.
annual change in % (real)	0.1	-0.5	-8.4	13.1	13.5	7.5	6.0	3.5
Gross industrial production [2]								
annual change in % (real)	-1.1	3.6	5.4	8.3	1.5	3.2	2.5	2.0
Gross agricultural production								
annual change in % (real)	4.5	14.0	-7.3	0.1	-8.1	.	.	.
Construction industry								
annual change in % (real)	10.5	-0.6	-16.6	18.7	21.8	.	.	.
Employed persons, LFS, th, average	884.6	896.1	893.3	894.8	910.0	920	925	930
annual change in %	-1.0	1.3	-0.3	0.2	1.7	1.1	0.5	0.5
Unemployed persons, LFS, th, average	107.6	98.2	95.3	85.4	72.8	69	64	59
Unemployment rate, LFS, in %, average	10.8	9.9	9.6	8.7	7.4	7.0	6.5	6.0
Reg. unemployment rate, in %, eop [3]	8.5	8.7	8.4	6.8	6.4	.	.	.
Average monthly gross wages, EUR	765.0	818.0	859.0	926.0	1,010.0	1,080	1,150	1,220
annual change in % (real, gross)	6.2	6.7	4.9	4.5	6.0	4.5	4.0	3.8
Average monthly net wages, EUR	560.0	603.0	631.0	676.0	740.0	790	840	890
annual change in % (real, net)	8.0	7.4	4.3	3.8	7.0	4.3	3.8	3.6
Consumer prices (HICP), % p.a.	0.7	0.2	0.1	2.9	2.6	2.4	2.4	2.3
Producer prices in industry, % p.a.	0.4	-1.0	-2.5	2.5	4.3	2.0	2.5	2.5
General governm.budget, EU-def., % of GDP								
Revenues	36.6	36.9	37.0	37.2	36.5	36.4	36.3	36.5
Expenditures	38.1	38.2	37.0	37.8	37.3	37.4	37.6	38.0
Net lending (+) / net borrowing (-)	-1.5	-1.4	0.1	-0.6	-0.8	-1.0	-1.3	-1.5
General gov.gross debt, EU def., % of GDP	40.9	36.8	40.3	40.0	37.0	36.0	35.5	35.0
Stock of loans of non-fin.private sector, % p.a.	-3.3	-2.8	0.1	-4.7	-5.2	.	.	.
Non-performing loans (NPL), in %, eop	6.9	6.0	4.4	4.1	4.2	.	.	.
Central bank policy rate, % p.a., eop [4]	0.05	0.05	0.00	0.00	0.00	.	.	.
Current account, EUR mn	-411	-113	403	191	-141	-214	-314	-364
Current account, % of GDP	-1.7	-0.5	1.6	0.7	-0.5	-0.7	-1.0	-1.1
Exports of goods, BOP, EUR mn	10,242	10,340	10,411	11,543	12,103	12,700	13,200	13,750
annual change in %	4.4	1.0	0.7	10.9	4.9	4.9	3.9	4.2
Imports of goods, BOP, EUR mn	12,621	12,538	12,296	13,851	14,665	15,400	16,100	16,850
annual change in %	1.5	-0.7	-1.9	12.6	5.9	5.0	4.5	4.7
Exports of services, BOP, EUR mn	4,105	4,356	4,606	4,973	5,212	5,400	5,700	6,000
annual change in %	5.3	6.1	5.7	8.0	4.8	3.6	5.6	5.3
Imports of services, BOP, EUR mn	2,066	2,279	2,432	2,641	2,831	3,000	3,200	3,350
annual change in %	-2.9	10.3	6.7	8.6	7.2	6.0	6.7	4.7
FDI liabilities, EUR mn	704	712	222	1,024	305	.	.	.
FDI assets, EUR mn	409	134	199	499	-248	.	.	.
Gross reserves of NB excl. gold, EUR mn	2,448	2,957	3,100	3,620	3,578	.	.	.
Gross external debt, EUR mn	34,035	34,947	37,289	37,984	36,300	37,600	38,000	39,800
Gross external debt, % of GDP	144.1	143.7	148.9	140.5	125.2	120.0	115.0	115.0

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) In % of labour force (LFS). - 4) Official refinancing operation rates for euro area (ECB).

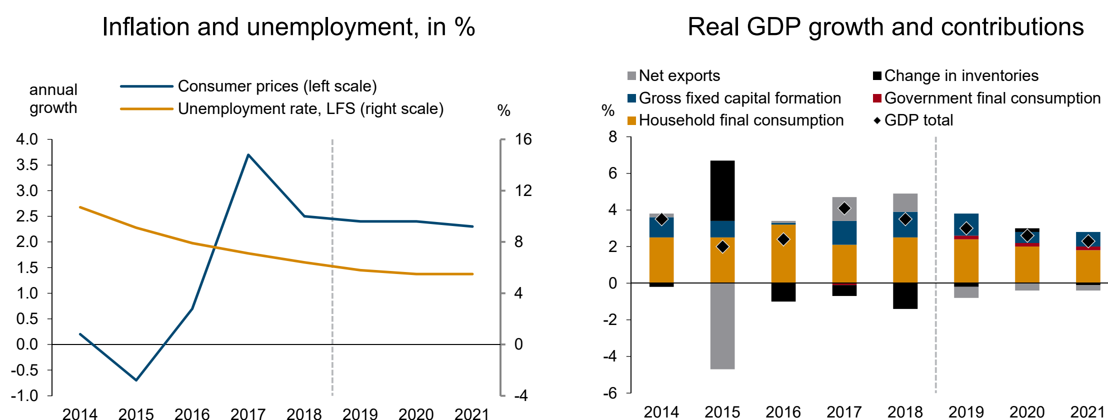
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

LITHUANIA: Domestic demand keeps growth buoyant

SEBASTIAN LEITNER

External demand dynamic cooled off last year and is expected to continue abating in 2019 and the coming two years. Public and private investment will drive growth for another year. Thereafter we expect private investment activity to subside gradually. A further decline in unemployment is driving rapid wage increases. In addition, the implemented income tax reform will foster growth in household consumption. For 2019, we expect real GDP to grow by 3%, followed by 2.6% in 2020 and 2.3% in 2021.

Figure 6.12 / Lithuania: Main macroeconomic indicators



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

Growth in exports declined in 2018; however, the balance of goods and services still contributed remarkably to overall GDP growth. External demand for goods increased by 7% in net terms, year on year. Exports increased significantly to Poland, Sweden and the UK, while remaining almost stagnant to Russia. The external demand for the important goods categories petroleum products, chemicals and tobacco increased swiftly, while growth in machinery exports remained weak. Trade in services has also continued to flourish in 2018, particularly due to the export of transport services to euro area countries. In addition, tourism evolved at a good pace last year; the number of inbound visitors increased by about 10% compared to 2017. In 2019 and the following two years the deterioration of the external economic environment will result in further declining growth figures for Lithuanian exports. In addition, due to ongoing lively investment and consumption growth, imports will increase faster than exports. As a result, the contribution of net exports to GDP growth is expected to turn negative again from this year onwards.

Last year saw an upswing in gross fixed investment by 7.5% in real terms, whereas for 2019 we expect some slowdown of growth in capital spending. The co-financing from EU funds allows the

government to keep up public investment at 4% of GDP this year and 2020, respectively. By February 2019 Lithuania has already received a third of the payments from the EU structural and investment funds from the 2014-2020 programming period. Thus, it is a frontrunner in the group of new EU Member States together with Estonia. However, private investment has increased at an even swifter pace in 2018; the strong rise in capital spending in machinery and vehicles shows that enterprises are in need of upgrading their production infrastructure. The construction of new dwellings rose strongly in 2018 and housing prices increased considerably in the cities. While figures for building permits granted pointed towards a decline in dwellings construction in the last quarter of 2018, sentiment indicators of construction entrepreneurs showed a further upswing in prospects concerning business developments in the first two months of 2019. In addition, mortgage loans to households are still increasing at the beginning of this year. In the coming two years, however, we expect construction growth figures to subside. In general, business and consumer sentiment indicators are very positive at the moment and increasing.

Employment increased unexpectedly strong by 0.8% in 2018. Jobs in trade, hotels and restaurants and the ICT sector, but also manufacturing increased above average. The unemployment rate dropped to 6.2% in 2018 and is likely to decline gradually to 5.5% in 2020. Eurostat projections suggest a strong decline in the working-age population (15-64) over the coming two decades if no policy changes are implemented. In the past 15 years the country already experienced a decline in that age group by almost 20%. In order to counteract the population shrinkage and the current skills shortage, the Lithuanian government adopted a more liberal attitude towards work migration. In the past two years, national visas on employment grounds were granted to a substantially greater number of foreigners, but the latter still accounted for only about 2% of the Lithuanian workforce in 2018. About 60% of those immigrants were Ukrainians; more than 20% were citizens from Belarus. Another measure to counteract the population shrinkage was the introduction of a general child benefit last year, which was almost doubled to EUR 50-70 in January 2019. However, net international migration is only gradually moving towards a balance (having previously been negative).

This year the reforms of the pension and personal income tax system are being implemented. The latter comprises inter alia a reduction of the applied tax rates and social security contributions, but also the introduction of progressivity in the income tax scheme. Moreover, the government is introducing a package of measures to reduce the high share of shadow economy in Lithuania to below 20% of GDP in 2019. This includes not only the increase of penalties for future tax-related offences and easier banning of enterprises from public procurement competitions, but also a number of incentives to pay taxes voluntarily. These are e.g. amnesty periods to legalise former shadow activities or the possibility for citizens to deduct payments for officially paid household services from their tax burden. The additional tax income would be needed to increase the low level of social transfers in Lithuania. Concerning the pension reform, the IMF has recently highlighted that the enacted changes to the funded pillar of the pension system are inadequate to reduce old-age poverty.

The monthly minimum wage was increased by 7.5% in nominal terms, to EUR 430, from January 2019 onwards. However, since part of the social security contributions were transferred to the personal income tax scheme, the effective increase of the lowest incomes is more than 35%. This measure will contribute to pushing up the overall salaries in the economy by about 5.5% in real terms this year. The ongoing tightening in the labour market will keep growth rates high in the forecast period. As a result, household consumption will continue to be an important driver of growth for the Lithuanian economy and

is expected to increase by another 3.8% this year and 3% on average in the period 2020-2021. Despite swiftly rising wages, core inflation remains subdued. In 2019 and thereafter we even expect a slight decline in consumer prices to 2.4% p.a. This is due to the decline in import prices for crude oil and low growth of food prices.

The budget plan of the Lithuanian government foresees a surplus of 0.4% of GDP for 2019. We however expect public consumption and investment to grow more swiftly towards the next parliamentary elections scheduled for 2020. In general, the fiscal policy is projected to be broadly neutral in 2019-2021. Additional social spending will be partly offset by rising revenues from stricter tax administration and increases in excise taxes.

Despite rising external risks, we have kept our forecast for real GDP growth at 3% in 2019 unchanged compared to our Autumn 2018 Forecast. In the coming two years, however, external demand is going to lose momentum, which will result in the current account balance to turn negative again. Public investment activity will remain lively over the forecast period, facilitated by an ongoing inflow of EU funds. Private investment in residential buildings and machinery is still growing swiftly but is expected to subdue from 2019 onwards. At the beginning of 2019 sentiment indicators still show strong and rising confidence levels among both businesses and consumers, but a deteriorating international economic environment may result in sudden changes also in the domestic sphere. Rising household incomes, pushed up by a tightening labour market, will help private consumption to keep on rising steadily. However, the declining Lithuanian working-age population is a bottleneck for the economy, resulting in declining growth rates. Thus for 2020 and 2021, we forecast real GDP to grow at a somewhat lower pace, by 2.6% and 2.3% respectively.

Table 6.12 / Lithuania: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020	2021
							Forecast	
Population, th pers., average	2,932	2,905	2,868	2,828	2,800	2,780	2,760	2,740
Gross domestic product, EUR mn, nom.	36,568	37,434	38,849	42,191	44,800	47,200	49,600	51,900
annual change in % (real)	3.5	2.0	2.4	4.1	3.5	3.0	2.6	2.3
GDP/capita (EUR at PPP)	20,800	21,700	22,000	23,500	24,900	.	.	.
Consumption of households, EUR mn, nom.	22,686	23,372	24,783	26,468	28,200	.	.	.
annual change in % (real)	4.0	4.0	5.1	3.4	4.0	3.8	3.2	2.9
Gross fixed capital form., EUR mn, nom.	6,906	7,330	7,506	8,098	8,900	.	.	.
annual change in % (real)	5.8	4.9	0.3	6.8	7.5	6.0	3.0	4.0
Gross industrial production (sales)								
annual change in % (real)	0.1	4.5	2.9	6.9	4.7	4.0	3.5	4.0
Gross agricultural production								
annual change in % (real)	8.4	8.6	-1.7	2.6	-10.9	.	.	.
Construction industry								
annual change in % (real)	17.1	-3.5	-9.3	8.9	13.8	.	.	.
Employed persons, LFS, th, average	1,319	1,335	1,361	1,355	1,366	1,373	1,378	1,380
annual change in %	2.0	1.2	2.0	-0.5	0.8	0.5	0.4	0.1
Unemployed persons, LFS, th, average	158	134	116	103	91	85	80	80
Unemployment rate, LFS, in %, average	10.7	9.1	7.9	7.1	6.4	5.8	5.5	5.5
Reg. unemployment rate, in %, eop [2]	9.3	9.0	8.5	8.7	8.9	.	.	.
Average monthly gross wages, EUR [3]	677.4	714.1	774.0	840.4	920.0	990	1,060	1,130
annual change in % (real, gross)	4.7	6.4	7.4	4.7	6.5	5.5	4.5	4.0
Average monthly net wages, EUR [3]	527.2	553.9	602.3	660.2	720.0	780	840	890
annual change in % (real, net)	5.1	6.1	7.7	5.7	6.0	5.5	4.8	4.0
Consumer prices (HICP), % p.a.	0.2	-0.7	0.7	3.7	2.5	2.4	2.4	2.3
Producer prices in industry, % p.a.	-5.0	-9.7	-4.3	4.9	5.5	1.0	0.5	2.0
General goverm.budget, EU-def., % of GDP								
Revenues	34.0	34.6	34.4	33.6	34.5	35.0	34.7	34.8
Expenditures	34.6	34.9	34.1	33.1	34.2	34.9	34.7	34.5
Net lending (+) / net borrowing (-)	-0.6	-0.3	0.3	0.5	0.3	0.1	0.0	-0.2
General gov.gross debt, EU def., % of GDP	40.5	42.6	39.9	39.4	36.5	37.5	36.5	35.0
Stock of loans of non-fin.private sector, % p.a.	-0.9	4.1	7.1	4.5	6.0	.	.	.
Non-performing loans (NPL), in %, eop	6.5	5.5	3.8	3.1	2.5	.	.	.
Central bank policy rate, % p.a., eop [4]	0.12	0.05	0.00	0.00	0.00	.	.	.
Current account, EUR mn	1,158	-847	-300	371	410	-100	-150	-300
Current account, % of GDP	3.2	-2.3	-0.8	0.9	0.9	-0.2	-0.3	-0.6
Exports of goods, BOP, EUR mn	23,750	22,309	21,922	25,724	27,450	28,200	28,700	29,400
annual change in %	-1.0	-6.1	-1.7	17.3	6.7	2.7	1.8	2.4
Imports of goods, BOP, EUR mn	24,686	24,296	23,690	27,673	30,100	31,100	31,800	32,700
annual change in %	-0.9	-1.6	-2.5	16.8	8.8	3.3	2.3	2.8
Exports of services, BOP, EUR mn	5,850	6,011	6,845	8,405	9,600	10,200	10,850	11,600
annual change in %	8.5	2.8	13.9	22.8	14.2	6.3	6.4	6.9
Imports of services, BOP, EUR mn	4,212	4,267	4,602	5,283	5,700	6,100	6,500	7,000
annual change in %	4.4	1.3	7.9	14.8	7.9	7.0	6.6	7.7
FDI liabilities, EUR mn	387	873	870	1,024	950	.	.	.
FDI assets, EUR mn	382	164	732	474	600	.	.	.
Gross reserves of NB excl. gold, EUR mn [5]	6,991	1,376	2,263	3,509	4,831	.	.	.
Gross external debt, EUR mn	25,551	28,331	33,087	35,271	35,800	36,800	37,700	38,900
Gross external debt, % of GDP	69.9	75.7	85.2	83.6	79.9	78.0	76.0	75.0

1) Preliminary and wiiw estimates. - 2) In % of working age population. - 3) Including 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.

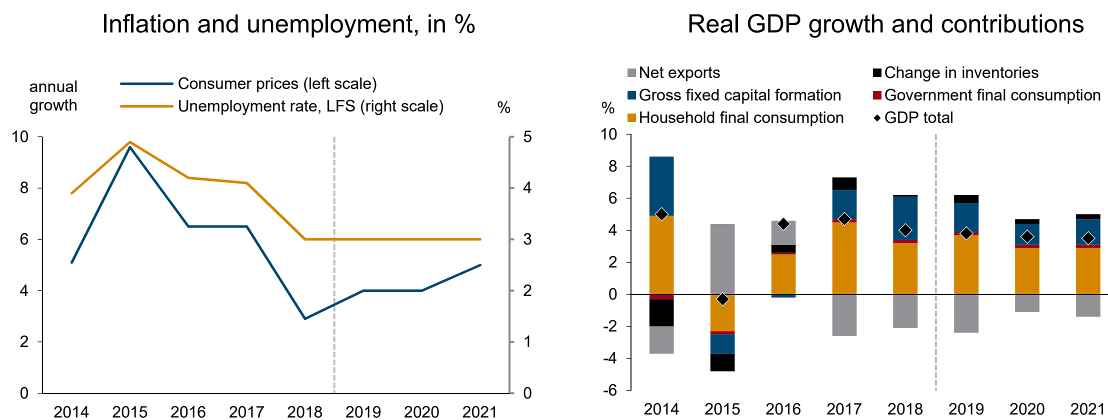
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

MOLDOVA: Solid growth with prospects with elevated risks

GÁBOR HUNYA

Economic growth of 4% or more for the third consecutive year in 2018 has corrected for the setbacks suffered during the bank-fraud related crisis in 2015. Inflation has come down and the local currency stabilised. Economic prospects are positive but cumbersome coalition building following inconclusive recent elections can delay necessary reforms.

Figure 6.13 / Moldova: Main macroeconomic indicators



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

Moldova is the least developed in terms of per capita GDP among the countries covered by wiiw (GDP per capita at PPP: EUR 5100). Agriculture has a relatively high contribution to GDP, 12%, and even more to employment, 40%. Manufacturing contributes to GDP with only 21%, with the rest accounted for by services mostly in non-tradeable sectors. Moldova’s transition to a market economy has suffered several setbacks since the disintegration of the former Soviet Union. The latest such event was a bank fraud in 2015 when about USD 1 billion (13% of GDP) was stolen from the banking system. However, the economy has stabilised in recent years and the banking sector underwent restructuring under an IMF-led programme. The country is involved in a frozen conflict with the secessionist territory Transnistria[31] (or Pridnestrovian Moldavian Republic, PMR, recognised only by Russia). Here, relations have stabilised, the borders are easy to cross and allow for a lot of legal and illegal trade. The area enjoys the benefits of Moldova’s DCFTA with the EU while having free trade with and financial support from Russia.

[31] The website of the National Bureau of Statistics of the Republic of Moldova notes that ‘Information for Moldova is presented without data on the districts on the left side of the river Nistru and municipality Bender’, meaning without Transnistria.

Private consumption was a key component of Moldovan economic growth in 2018. Consumption received a boost in October from the implementation of the flat tax on personal income, 12% instead of 7-18% before. The rate of social security contributions paid by private-sector employers has been reduced from 23% to 18%. In addition, the payroll reform in the public sector has brought substantial salary increases allowing for further consumption growth in 2019.

Gross fixed capital formation also contributed positively to economic growth last year. During January-September 2018, a 13.5% increase in investment was recorded; the construction of roads and residential buildings in particular boomed. The construction industry was the fastest growing segment of the economy (up by 15%) while industrial production grew by a more modest 3.7%, and agriculture by 2.5%.

The foreign trade deficit widened by 27% and only 47% of the imports could be covered by exports in 2018. Both exports and imports of goods expanded rapidly, by 11.6% and 19.3%, respectively. Higher oil and gas prices as well as increasing imports of production goods were the main reasons for the expansion of imports and of the trade deficit. An appreciation of the local currency also played a role.

The weak and narrow export base is a long-standing problem for Moldova. Agricultural products constitute the main category of exports, although their share fell below one quarter of the total in 2018. Diverse manufactured goods comprise a similar share. The third main category is transport equipment products, which have grown more strongly than other commodity groups in recent years, and accounted for almost 22% of the total.

The Deep and Comprehensive Free Trade Areas (DCFTA) entered into force in July 2016 as part of the Association Agreement with the EU. A restructuring of export destinations from the CIS to the EU has taken place subsequently. The recurring Russian embargoes (lifted for the time being) on food products and wine have accelerated the process. Almost 69% of exports went to the EU in 2018 (up from 66% a year earlier). The main export destination is Romania; its share rose from 25% to 29%; Italy is second with 12%. The previous main partner, Russia, ranks only third with 8% in 2018, down from 11% in the previous year. Imports have a different structure: Romania supplies only about 15%, a share that has not changed much over recent years. Russia has maintained a share of 12% and Ukraine 10% – countries that are the main suppliers of energy and raw materials. The share of the EU has stagnated at 50%; Germany (8%) and Italy (7%) are the main source countries beyond Romania. China has reached a share of more than 10% in recent years, while Turkey's has declined to 7%. The commodity structure of imports is more stable than of exports. Raw materials, energy carriers and chemical products comprise one third of the imports, almost one quarter are transport equipment and another third is comprised of various manufactured goods.

The current account deficit has widened on account of the larger goods shortfall to more than 7% of GDP. Remittances are important to moderate the deficit. They amount to 20% of GDP, the seventh highest rate in the world according to the World Bank. Seeking temporary work abroad was widespread also in the 1990s when the CIS was the main destination. Citizens have enjoyed visa-free entry into the EU since 2015 and the EU replaced Russia as the main destination of jobseekers abroad. Despite the current account deficit, inflows of foreign currency allowed some appreciation of the Moldovan leu and moderated inflation below 3% in 2018. This is below the lower band of the central

bank rate of 3.5%. The National Bank kept the policy rate at 6.5% for the second consecutive year in 2018, and expects inflation to approach the policy rate by the end on 2019.

The lending activity of banks increased in 2018 and the level of non-performing loans declined for the first time since the banking crisis. A major step in the banking sector restructuring took place on 18 February 2019 when Moldindconbank, one of the largest banks in the country that had belonged to oligarch Veaceslav Platon (one of the persons involved in the 2015 bank fraud and sentenced to 25 years in jail), was bought by the Public Property Agency before being sold to the Bulgaria-based Doverie United Holding.

The domestic labour market is distorted due to widespread employment abroad. It is characterised by both low employment and unemployment rates. Currently employment is rising and unemployment declining (reaching 3% in 2018 on average) on account of the economic recovery, giving a boost to wages (12%) and consumption.

The 24 February parliamentary elections produced no clear winner. According to preliminary results, the pro-Russian Socialists of President Dodon won 35 seats in the next parliament, Vladimir Plahotniuc's ruling Democratic Party (pro-EU in words) 30 seats, ACUM ('Now') – a coalition of two pro-European parties – 26 seats, and the conservative Shor Party seven seats. Three independent candidates will receive the remaining seats. While any two of the three leading parties can form a majority, coalition-building will be cumbersome and snap elections cannot be excluded. This was the first elections organised under new rules which allocate only half of the parliamentary seats based on national party lists, the other half being distributed to the winners of single constituencies. Electoral reform and delays in the democratisation process prompted the EU to freeze development aid to Moldova (EUR 100 million) saying that disbursement can take place only if elections are declared fair by observers. The European Parliament called Moldova 'a state captured by oligarchic interests'. International observers have recognised the results of the elections, but investigations are going on concerning voting fraud and misuse of public resources.

Balancing between the EU and Russia may not be desirable, but is a practically viable option to serve the national interest amid conflicting foreign pressures. More important than business orientation would be improvements in business conditions and the rule of law. FDI has started to discover the country in the areas of the manufacturing of automotive parts and IT services. The government has initiated some important improvements such as the setting up of industrial parks, enlarging the Danube port and of border crossings which can attract investors even if the general standard of infrastructure is poor.

Some slowdown of growth and acceleration of inflation are expected during the forecast period. The fiscal measures introduced in late 2018 will generate more household consumption in 2019 and keep the level of GDP growth just below 4%. A slowdown to 3.5% is expected in the following years due to sluggish external demand and cooling of the construction boom. Current low inflation and the stable currency are the results of financial stabilisation in the wake of the 2015 crisis, and it can be expected that the country returns to somewhat higher inflation and moderate depreciation.

Table 6.13 / Moldova: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020	2021
							Forecast	
Population, th pers., average	3,556	3,554	3,552	3,549	3,540	3,520	3,500	3,500
Gross domestic product, MDL bn, nom.	133.5	145.8	160.8	178.9	192.0	207	223	242
annual change in % (real)	5.0	-0.3	4.4	4.7	4.0	3.8	3.6	3.5
GDP/capita (EUR at PPP)	4,400	4,500	4,600	4,800	5,100	.	.	.
Consumption of households, MDL bn, nom.	118.5	125.4	136.4	150.8	161.1	.	.	.
annual change in % (real)	5.4	-2.5	2.9	5.3	3.8	4.4	3.5	3.5
Gross fixed capital form., MDL bn, nom.	34.6	35.4	35.7	39.9	44.8			
annual change in % (real)	15.9	-4.8	-0.9	8.0	12.0	8.0	6.0	7.0
Gross industrial production								
annual change in % (real)	7.3	0.6	0.9	3.4	3.7	3.0	3.0	2.0
Gross agricultural production								
annual change in % (real)	8.6	-13.4	18.6	8.6	0.0	.	.	.
Construction industry								
annual change in % (real)	-1.3	-12.7	-8.1	3.6	14.5	.	.	.
Employed persons, LFS, th, average	1,185	1,204	1,220	1,208	1,270	1,310	1,340	1,370
annual change in %	1.0	1.6	1.3	-1.0	5.2	3.0	2.0	2.0
Unemployed persons, LFS, th, average	47.5	62.1	53.3	51.6	40.0	40.0	40.0	40.0
Unemployment rate, LFS, in %, average	3.9	4.9	4.2	4.1	3.0	3.0	3.0	3.0
Reg. unemployment rate, in %, eop	1.7	2.1	2.3	1.9	1.4	.	.	.
Average monthly gross wages, MDL	4,090	4,538	4,998	5,587	6,320	7,200	7,900	8,600
annual change in % (real, gross)	5.9	1.2	3.7	5.2	9.9	10.0	5.0	4.0
Average monthly net wages, MDL	3,399	3,752	4,103	4,564	5,200	5,900	6,400	7,000
annual change in % (real, net)	5.3	0.7	2.7	4.5	11.0	10.0	5.0	4.0
Consumer prices, % p.a.	5.1	9.6	6.5	6.5	2.9	4.0	4.0	5.0
Producer prices in industry, % p.a.	5.5	6.3	4.5	3.3	0.4	2.0	3.0	3.0
General governm. budget, nat.def., % of GDP								
Revenues	31.8	30.0	28.6	29.8	30.2	31.0	31.0	31.0
Expenditures	33.3	31.8	30.1	30.5	31.0	32.0	32.0	33.0
Deficit (-) / surplus (+)	-1.5	-1.9	-1.6	-0.6	-0.8	-1.0	-1.0	-2.0
General gov.gross debt, nat.def., % of GDP [2]	20.8	23.3	31.8	29.1	27.9	1.0	2.0	3.8
Stock of loans of non-fin.private sector, % p.a.	.	.	.	-3.3	6.0	.	.	.
Non-performing loans (NPL), in %, eop [3]	11.7	10.0	16.4	18.4	12.5	.	.	.
Central bank policy rate, %, p.a., eop [4]	6.50	19.50	9.00	6.50	6.50	6.00	6.00	6.00
Current account, EUR mn [5]	-428	-417	-257	-499	-700	-900	-800	-900
Current account, % of GDP	-6.0	-6.0	-3.5	-5.8	-7.2	-8.3	-6.8	-7.4
Exports of goods, BOP, EUR mn [5]	1,369	1,357	1,398	1,649	1,800	2,000	2,200	2,400
annual change in %	-4.2	-0.9	3.0	18.0	9.1	11.1	10.0	9.1
Imports of goods, BOP, EUR mn [5]	3,660	3,269	3,284	3,930	4,500	5,200	5,600	6,100
annual change in %	-3.5	-10.7	0.5	19.7	14.5	15.6	7.7	8.9
Exports of services, BOP, EUR mn [5]	861	884	958	1,104	1,300	1,500	1,600	1,800
annual change in %	0.1	2.7	8.4	15.3	17.7	15.4	6.7	12.5
Imports of services, BOP, EUR mn [5]	765	765	751	823	900	1,000	1,100	1,200
annual change in %	2.6	0.0	-1.8	9.6	9.4	11.1	10.0	9.1
FDI liabilities, EUR mn [5]	258	195	86	143	200	.	.	.
FDI assets, EUR mn [5]	31	7	12	10	0	.	.	.
Gross reserves of NB excl. gold, EUR mn [5]	1,770	1,606	2,107	2,346	2,628	.	.	.
Gross external debt, EUR mn [5]	5,306	5,550	5,924	5,835	6,323	7,200	7,900	8,200
Gross external debt, % of GDP	75.5	81.8	77.0	66.6	65.0	66.0	67.0	68.0
Average exchange rate MDL/EUR	18.63	20.90	22.05	20.83	19.84	19.0	19.0	20.0

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

1) Preliminary and wiiw estimates. - 2) Excluding government garantied debt. - 3) Substandard, doubtful and compromised credit portfolio. - 4) Overnight (refinancing) operations rate of National Bank. - 5) Converted from USD.

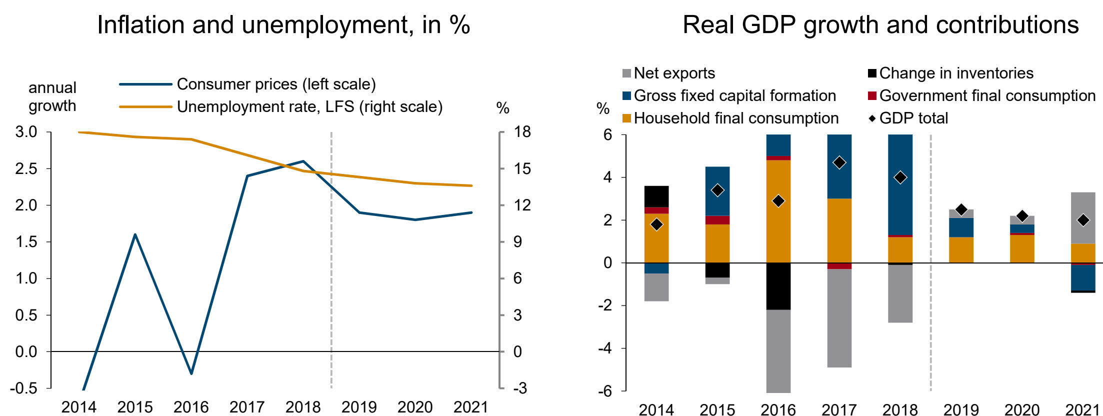
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

MONTENEGRO: Gradual growth deceleration expected

GORAN VUKŠIĆ

In 2018, GDP is estimated to have grown by 4% and was mostly driven by surging investment and growing exports. Employment increased considerably, but unemployment still remains high. The high government debt burden represents the largest challenge for policy-makers, which pursue an ambitious fiscal consolidation plan. During 2019-2021, economic growth will gradually slow down with an average rate of around 2.2%. In 2019, the government started the Montenegro Citizenship by Investment Programme.

Figure 6.14 / Montenegro: Main macroeconomic indicators



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

In 2018, real GDP is estimated to have grown by 4%, down from 4.7% in 2017. The largest contribution to growth came from gross fixed capital formation, which expanded by more than 20%. This investment surge has largely been driven by the Bar-Boljare highway construction project, but also by investment in tourism and energy production capacities. Government consumption grew only slightly, while household consumption is estimated to have risen by 1.6%.

The contribution of the external sector to GDP growth was negative despite the accelerating growth of exports of goods and services. Considerable increases were recorded in exports of electricity, of medical and pharmaceutical products, as well as in transport and tourism services. However, the strong domestic (mostly investment) demand led to an import surge – imports of machinery and transport equipment grew by 15% year on year, and represented around a quarter of merchandise imports in 2018. As a consequence, the persistent trade and current account deficits deteriorated further during 2018.

Boosted by the strong investment performance, construction output recorded a 24.9% increase in 2018. Industrial production did not lag far behind as it expanded by 22.4%, with the strongest increases in the sectors of electricity, gas, steam and air conditioning supply, in the manufacture of other non-metallic mineral products, and manufacture of furniture. Such developments contributed to employment increases estimated at 2.5%, and the unemployment rate declining to 14.8%. With unemployment still being high, strong economic performance was not reflected in wage developments and the real wage decline from 2017 continued into 2018 and intensified. This has been supported by the stagnating nominal wages in the government-dominated sectors of economic activities.

Despite negative real wage growth, domestic prices increased by 2.9% in 2018 measured by the harmonised index of consumer prices. The price push is likely to have been fuelled by the consumption tax hikes in 2018, as the general VAT rate and some excises were increased. The largest price increases were recorded for alcoholic beverages and tobacco, and in transport services.

Favourable economic developments and the aforementioned tax increases during 2018 contributed to narrowing down the government deficit to an estimated 2.7% of GDP, down from 5.3% in 2017. The government is dedicated to bring the soaring public debt on a downward trajectory, by increasing revenues and implementing fiscal consolidation in the segment of current expenditures, while leaving some fiscal space for capital investment. Given the projected real decline in government expenditure over the 2019-2021 period, further planned increases in some excises, and reforms aiming at more efficient tax collection, the government expects Montenegro to reach a substantial budget surplus in 2020, which should further expand in 2021.

The fiscal medium-term plans are very ambitious, and their fulfilment will require very strict fiscal discipline over a prolonged period of time including the likely election year 2020 (the last parliamentary elections were held on 16 October 2016). At the same time, public investment dynamics, as well as the fiscal consolidation efforts in the current transfers segment will considerably influence the overall economic performance.

A gradual deceleration of economic growth for the forecasting period is expected, with an average rate of around 2.2% – a forecast based on the assumptions of considerable fiscal discipline in current expenditures, though not as strong as in the government's plans, of the announced public investment dynamics, and of slightly deteriorating external conditions.

The final consumption of households will be a comparatively more important source of growth, although the contribution to GDP growth from domestic investment will remain positive for the next two years. Given that investment demand will first stabilise and then decline, import growth is expected to weaken, especially towards the end of the forecasting period. With projected further increases in exports of goods and services, driven, inter alia, by current investment in tourism capacities or electricity production, the contribution of net exports is expected to turn out positive over the forecasting period. Correspondingly, the current account deficit is expected to narrow gradually.

Employment growth and the decline in unemployment are expected to continue, although at a slower pace. Real wage growth should pick up, even if only modestly. Such trends will lend support to an expected inflation rate of slightly below 2% over the forecasting period.

The public debt share in GDP is expected to decline from (the government's estimate of) 70% at the end of 2018, to around 62% in 2021 – under the above assumption of strong fiscal discipline motivated by the high debt burden. The government balance is expected to show a small surplus already in 2020, which should then widen in 2021.

The government announced hedging arrangements to mitigate the increased exchange rate risk. Although the largest part of public debt is denominated in euros (around 83% in 2018), the share of debt denominated in US dollars is bound to increase due to remaining tranches of the Chinese Exim bank loan, used to finance the Bar-Boljare highway construction project.

On 1 January 2019, the government started the Montenegro Citizenship by Investment Programme which could contribute to increased government revenues and foreign financing of investment projects. The programme will last for three years and offers full citizenship to (up to 2,000) investors (and their families) against a contribution of a government fee (called a grant) amounting to EUR 100,000, and an investment of at least EUR 250,000 in government-approved investment projects in underdeveloped areas of the country. For investment in more developed regions of Montenegro, the minimum amount is EUR 450,000. Other fees will also be charged to applicants.

In summary, our real GDP growth forecasts of 2.5%, 2.2% and 2% for 2019, 2020 and 2021, respectively, represent a considerable deceleration from the growth rates recorded in the last two years. It will mostly be driven by a significant slowdown in public investment, coupled with fiscal consolidation efforts in the segment of current transfers. Some support for growth will come from net exports, especially towards the end of the forecasting period, as the domestic investment-related imports should decline more strongly.

Table 6.14 / Montenegro: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020	2021
							Forecast	
Population, th pers., average	622	622	622	622	625	625	625	630
Gross domestic product, EUR mn, nom.	3,458	3,655	3,954	4,299	4,600	4,800	5,000	5,200
annual change in % (real)	1.8	3.4	2.9	4.7	4.0	2.5	2.2	2.0
GDP/capita (EUR at PPP)	11,300	12,300	13,000	13,700	14,300	.	.	.
Consumption of households, EUR mn, nom. [2]	2,775	2,872	3,035	3,216	3,400	.	.	.
annual change in % (real)	2.9	2.2	6.1	3.9	1.6	1.6	1.8	1.2
Gross fixed capital form., EUR mn, nom.	657	736	978	1,157	1,400	.	.	.
annual change in % (real)	-2.5	11.9	38.4	18.7	20.7	3.4	1.5	-4.4
Gross industrial production [3]								
annual change in % (real)	-11.4	7.9	-2.9	-4.2	22.4	5.0	4.0	4.0
Net agricultural production [4]								
annual change in % (real)	-6.1	9.4	-8.5	-3.2	2.0	.	.	.
Construction output [3]								
annual change in % (real)	1.9	5.8	31.5	51.5	24.9	.	.	.
Employed persons, LFS, th, average	216.3	221.7	224.2	229.3	234.0	236	238	239
annual change in %	7.1	2.5	1.1	2.3	2.0	1.0	1.0	0.4
Unemployed persons, LFS, th, average	47.5	47.2	48.3	43.9	40.0	40	40	40
Unemployment rate, LFS, in %, average	18.0	17.6	17.4	16.1	14.8	14.3	13.8	13.6
Reg. unemployment rate, %, average	16.1	16.5	21.9	21.7	18.7	.	.	.
Average monthly gross wages, EUR	723	725	751	765	766	790	810	830
annual change in % (real, gross)	0.1	-1.1	3.5	-1.1	-2.6	1.0	1.0	0.2
Average monthly net wages, EUR	477	480	499	510	511	530	540	550
annual change in % (real, net)	0.3	-0.9	4.2	-0.2	-2.3	1.0	1.0	0.2
Consumer prices, % p.a.	-0.7	1.6	-0.3	2.4	2.6	1.9	1.8	1.9
Producer prices in industry, % p.a. [5]	0.1	0.3	-0.1	0.4	1.7	1.5	1.5	1.5
General governm.budget, nat.def., % of GDP								
Revenues	44.8	41.8	42.6	41.5	42.9	43.1	42.8	42.0
Expenditures	47.7	50.0	46.2	46.8	45.8	45.3	42.3	40.6
Deficit (-) / surplus (+)	-2.9	-8.3	-3.6	-5.3	-2.9	-2.2	0.5	1.4
General gov.gross debt, nat.def., % of GDP	56.2	62.3	60.8	61.1	70.0	69.0	66.0	62.0
Stock of loans of non-fin.private sector, % p.a.	-1.1	2.5	5.4	7.7	9.1	.	.	.
Non-performing loans (NPL), in %, eop	15.9	12.6	10.3	7.3	6.5	.	.	.
Central bank policy rate, % p.a., eop [6]	8.41	7.70	6.74	6.16	5.75	5.50	5.50	5.50
Current account, EUR mn	-429	-402	-642	-691	-793	-810	-840	-730
Current account, % of GDP	-12.4	-11.0	-16.2	-16.1	-17.2	-16.9	-16.8	-14.0
Exports of goods, BOP, EUR mn	357	330	351	382	436	460	480	500
annual change in %	-9.7	-7.6	6.2	9.0	14.0	5.0	4.5	4.0
Imports of goods, BOP, EUR mn	1,734	1,794	2,008	2,243	2,486	2,600	2,700	2,730
annual change in %	0.6	3.5	12.0	11.7	10.8	4.5	4.0	1.0
Exports of services, BOP, EUR mn	1,031	1,214	1,255	1,383	1,563	1,690	1,810	1,940
annual change in %	3.6	17.8	3.3	10.2	13.1	8.0	7.0	7.0
Imports of services, BOP, EUR mn	340	425	486	530	627	670	710	720
annual change in %	-0.3	25.0	14.1	9.2	18.2	6.5	6.0	2.0
FDI liabilities, EUR mn	375	630	205	494	415	.	.	.
FDI assets, EUR mn	21	11	-167	10	87	.	.	.
Gross reserves of NB excl. gold, EUR mn [7]	545	674	803	898	1,101	.	.	.
Gross external public debt, EUR mn	1,562	1,956	2,003	2,214	2,760	2,830	2,850	2,810
Gross external public debt, % of GDP	45.2	53.5	50.6	51.5	60.0	59.0	57.0	54.0

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

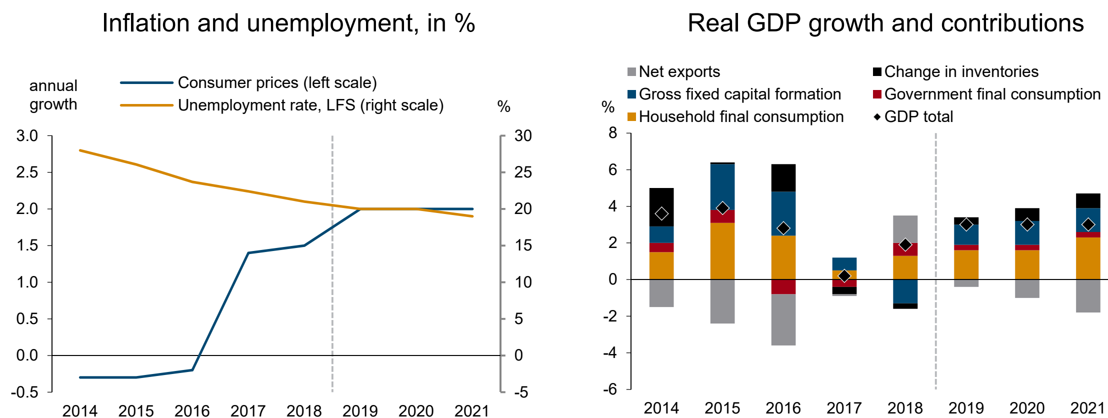
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

NORTH MACEDONIA: Solving name dispute to boost investor confidence

OLGA PINDYUK

The North Macedonian economy grew by 2.3% year on year in 2018 on the back of strong export growth and a pick-up in private consumption. The approval by the Greek Parliament of the new official name of North Macedonia was a major positive political development. Improved political stability will boost investor confidence and promote robust investment growth. Overall GDP will grow by about 3% p.a. during 2019-2021.

Figure 6.15 / North Macedonia: Main macroeconomic indicators



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

The North Macedonian economy grew by an estimated 2.3% year on year in 2018 on the back of solid export performance and a reasonable pick-up in private consumption. The result was much better compared with 2017 when growth had practically stalled. On the negative side, gross capital formation experienced a contraction in 2018 due to the postponement of infrastructure projects and the continuing fall in construction.

Merchandise exports grew strongly in 2018 (by about 14% year on year) in all the key export sectors apart from clothing. Particularly strong growth was recorded in electrical machinery, road vehicles, and furniture. Services exports demonstrated a robust performance as well – both in traditional transport and travel sectors, but also in computer services (35% increase year on year in the first three quarters of 2018) and other business services (11%). Strong growth was registered in exports to almost all destinations. Germany, which accounted for 47% of goods exports in 2017, saw an increase in imports from North Macedonia of 13.5% year on year in the first three quarters of 2018.

The slowdown in growth in the eurozone, primarily in Germany, will drag on export dynamics during 2019-2021. Nonetheless, we forecast rather robust export growth of 8-10%. The major risk to the forecast stems from an escalation of the trade war between the EU and the US, which could strongly hurt the German economy.

Private consumption has been on the rise owing to growth in employment, wages, workers' remittances and household credit. Real wages grew by 4.2% year on year in 2018 – the highest rate achieved since 2009, and remittances increased at a similar rate. The unemployment rate declined by 2.4 p.p., however, it still remains very high – at 21%. Household credit in December 2018 was 10.3% higher compared to the same month of the previous year. We expect that robust private consumption growth will continue over the forecast period on the back of positive labour market developments, and it will provide the biggest contribution to overall economic growth.

Bank credit has been growing rather dynamically both in the household and non-financial corporations' segments, supported by monetary policy easing, strong deposit growth and improving quality of loans portfolios. Moderate inflation and a stable foreign exchange rate allowed the National Bank to cut the policy interest rate in 2018 by 75 bps to 2.5%. The banking sector's liquidity improved, with the loan-to-deposit ratio reaching 0.86 by the end of the year.

However, the issue of loans' euroisation has not been resolved. Though denar-denominated loans have been growing faster than foreign exchange ones, the share of the latter still remains significant – 44.5% at the end of 2018. Deposits in foreign currency do not provide sufficient funding for banks that have to rely on external sources of financing. This situation might pose risks for the banking system in case of significant external shocks and necessitates implementing measures to decrease foreign currency lending.

A major positive political development was the approval by the Greek Parliament of the new official name of North Macedonia. This clears the path for the country to join NATO and potentially the EU, strengthening the West's position in the Balkans over Moscow's protests. The Greek Parliament has also ratified North Macedonia's accession to the NATO alliance, lifting a veto imposed more than a decade ago; this makes Greece the first of 29 NATO members to ratify the accession protocol signed by North Macedonia's foreign minister in February 2019. The country is expected to join the alliance in 2020.

Improved political stability will boost investor confidence. Prime Minister Zoran Zaev has announced that four large companies had decided on projects that would employ several thousand people, and a big European car company is considering a EUR 1 billion investment. We forecast strong investment growth during 2019-2021 at a rate of 5-6% per year.

Overall, we forecast GDP to grow by about 3% p.a. during 2019-2021. Robust private consumption and strong investment growth will be the main drivers of growth. Monetary policy is likely to remain accommodative against the backdrop of moderate economic growth and moderate inflation. Labour market issues – skills shortages and mismatches combined with high unemployment – will linger during the forecast period and will remain a main obstacle to growth.

Table 6.15 / North Macedonia: Selected economic indicators

	2014	2015	2016	2017	2018 [1)]	2019	2020	2021
							Forecast	
Population, th pers., average	2,067	2,070	2,072	2,075	2,095	2,100	2,100	2,100
Gross domestic product, MKD bn, nom.	527.6	559.0	594.8	616.6	638.0	670.0	704.0	739.0
annual change in % (real)	3.6	3.9	2.8	0.2	1.9	3.0	3.0	3.0
GDP/capita (EUR at PPP)	9,900	10,400	10,800	10,800	11,100	.	.	.
Consumption of households, MKD bn, nom.	363.6	380.2	392.2	400.3	414.0	.	.	.
annual change in % (real)	2.1	4.5	3.6	0.7	2.0	2.5	2.5	3.5
Gross fixed capital form., MKD bn, nom.	123.5	133.3	145.0	135.3	140.0			
annual change in % (real)	4.0	10.5	9.9	2.9	-6.0	5.0	6.0	6.0
Gross industrial production [2)]								
annual change in % (real)	4.8	4.9	3.4	0.2	5.4	5.0	4.5	6.0
Gross agricultural production [3)]								
annual change in % (real)	1.7	5.2	5.2	4.0	5.0	.	.	.
Construction industry								
annual change in % (real)	-3.3	40.7	7.2	-27.2	-6.8	.	.	.
Employed persons, LFS, th, average	690.2	706.0	723.6	740.6	750.0	765	780	790
annual change in %	1.7	2.3	2.5	2.4	1.5	2.0	1.5	1.5
Unemployed persons, LFS, th, average	268.8	248.9	225.0	213.6	200.0	190	200	190
Unemployment rate, LFS, in %, average	28.0	26.1	23.7	22.4	21.0	20	20	19
Reg. unemployment rate, in %, eop	23.4	22.1	21.2	20.1	19.4	.	.	.
Average monthly gross wages, MKD	31,325	32,171	32,821	33,687	35,626	37,400	38,900	40,500
annual change in % (real, gross)	1.3	3.0	2.2	1.2	4.2	3.0	2.0	2.0
Average monthly net wages, MKD	21,394	21,904	22,342	22,928	24,276	25,500	26,500	27,600
annual change in % (real, net)	1.5	2.7	2.2	1.2	4.4	3.0	2.0	2.0
Consumer prices, % p.a.	-0.3	-0.3	-0.2	1.4	1.5	2.0	2.0	2.0
Producer prices in industry, % p.a.	-1.9	-3.9	-3.1	4.8	0.9	3.0	3.0	3.0
General governm. budget, nat.def., % of GDP								
Revenues	29.7	31.0	30.6	31.0	31.3	31.0	32.0	32.0
Expenditures	33.9	34.4	33.2	33.9	33.3	33.0	33.0	33.0
Deficit (-) / surplus (+)	-4.2	-3.4	-2.7	-2.8	-2.0	-2.0	-1.0	-1.0
General gov.gross debt, nat.def., % of GDP	45.7	46.6	48.7	47.7	48.5	47.0	46.0	46.0
Stock of loans of non-fin.private sector, % p.a.	10.0	9.6	-0.1	5.4	7.2	.	.	.
Non-performing loans (NPL), in %, eop [4)]	10.9	10.4	6.4	6.2	5.1	.	.	.
Central bank policy rate, %, p.a., eop [5)]	3.25	3.25	3.75	3.25	2.50	3.50	3.50	3.50
Current account, EUR mn	-43	-177	-275	-103	-80	-120	-270	-360
Current account, % of GDP	-0.5	-2.0	-2.9	-1.0	-0.8	-1.1	-2.4	-3.0
Exports of goods, BOP, EUR mn	2,784	3,047	3,529	4,074	4,640	5,100	5,510	6,060
annual change in %	17.2	9.4	15.8	15.4	13.9	10.0	8.0	10.0
Imports of goods, BOP, EUR mn	4,640	4,870	5,342	5,861	6,360	6,870	7,420	8,160
annual change in %	9.5	5.0	9.7	9.7	8.5	8.0	8.0	10.0
Exports of services, BOP, EUR mn	1,304	1,378	1,390	1,439	1,510	1,590	1,650	1,730
annual change in %	12.9	5.7	0.9	3.6	4.9	5.0	4.0	5.0
Imports of services, BOP, EUR mn	920	1,029	1,049	1,062	1,120	1,140	1,160	1,190
annual change in %	18.0	11.8	2.0	1.3	5.4	2.0	2.0	3.0
FDI liabilities, EUR mn	37	262	495	351	450	.	.	.
FDI assets, EUR mn	-160	59	179	171	180	.	.	.
Gross reserves of NB excl. gold, EUR mn	2,221	2,049	2,370	2,097	2,619	.	.	.
Gross external debt, EUR mn	5,992	6,291	7,217	7,372	8,000	8,300	8,600	9,000
Gross external debt, % of GDP	70.0	69.3	74.7	73.6	76.0	76.0	75.0	75.0
Average exchange rate MKD/EUR	61.62	61.61	61.60	61.57	61.51	61.3	61.4	61.4

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) wiiw estimate from 2017. - 4) The decline in the loans in 2016 was due to the write-off of doubtful and contested claims on loans. - 5) Central Bank bills (28-days).

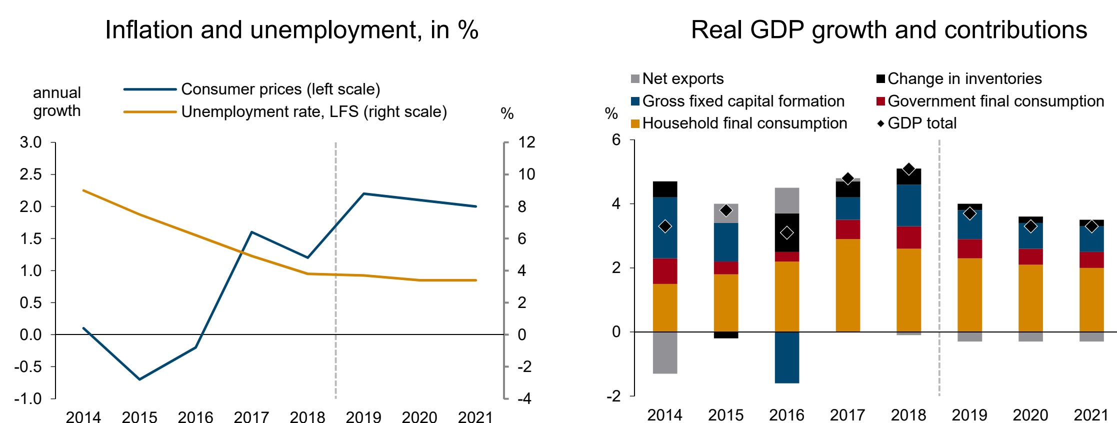
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

POLAND: Slower growth a real possibility

LEON PODKAMINER

Despite lower profits the corporate sector's financial standing and financing conditions are good. But private domestic firms are still reluctant to expand investment. Ongoing political changes are destabilising the country's legal framework, undermining trust in the rule of law. The conflict between the European Commission and the Polish government may lead to substantial cuts in the funds available to Poland which would also undermine public investment and reduce medium-term growth prospects.

Figure 6.16 / Poland: Main macroeconomic indicators



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

Strong GDP growth driven by domestic demand continues. Starting from the beginning of 2017, quarterly GDP growth rates have been close to 5% (year on year). The provisional estimate for the GDP growth rate for the full year 2018 is 5.1%. Consumption, rising by 4.3%, was an essential driver of growth (with private consumption rising 4.5% and public consumption by 4%). Gross capital formation increased by over 9%, with gross fixed capital formation increasing by 7.3%. Inventories rose strongly again (as they already did in 2016 and 2017), contributing 0.5 percentage points to overall growth. The contribution of foreign trade (in goods and services) to overall growth was negative, but quantitatively negligible.

Growth in private consumption will slow during the forecast period. Although under tight labour market conditions wage rates are on the rise, the total wage bill will not grow as fast as in the past. Given the contracted labour reserves, employment growth will be rather moderate. Moreover, the additional (and sizeable) social transfers addressing families with children (in place since April 2016) no longer positively affect households' disposable income. Last, but not least, household saving as a share

of disposable income is likely to increase further. The gap between rising income and rising consumption spending is likely to continue to widen. This fact is reflected in differential developments in households' bank deposits and loans. The former are growing clearly faster than the latter. (The latter primarily finance households' residential investment, not consumption.) Besides, consumer demand will not keep up with the growing wage bill because a large and growing portion of that bill, representing the earnings of foreign guest workers, tends to be sent back home (mostly to Ukraine).

Gross fixed investment is not (yet) driven by domestic private firms. Instead it primarily still depends on growing public investment spending. An estimated two thirds of the increase in investment in 2018 can be attributed to spending by local authorities (who prepared, that way, for the local elections held in October 2018). The entire corporate sector's investment growth continues to be dominated by the larger foreign-owned and publicly-owned firms. The most recent business climate survey available does not augur any significant change in the structure of corporates' investment. Some 40% of the public-owned corporations plan an acceleration of investment spending – against less than 10% for the private domestic-owned firms.

Investment appears to be correlated with the increased utilisation of EU funds. The rather skewed structure of investment reflects the sectoral differences in the current investment propensities. Thus, over the first three quarters of 2018 the investment outlays in manufacturing increased by 7.3%. At the same time such outlays increased in the 'infrastructure' sectors such as 'water collection and treatment' by over 54% and 'transportation' by over 40%.[32] Much the same message follows the available data on the composition of the sales of production of the construction-and-assembly sector. The total value of sales of that sector rose 23.7% in 2018 – of which the sales of output in the form of 'complex construction on industrial sites' by only 4.2% while e.g. the sales of output classified as 'waste water treatment plants' by 94%. The EU funds still available under the current (2014-2020) perspective are still quite sizeable (possibly as much as about PLN 65bn or one third of the original total). Very likely these funds will support high investment in 2019 (primarily by the public sector). But private sector investment proper is likely to remain rather weak. Institutional (legal) and economic uncertainties (including on the growth prospects in the euro area) as well as concerns about a profit squeeze (through rising unit labour costs, rising administered energy prices) are not conducive to waging an investment offensive. It is also possible that the skilled labour which would be needed for the realisation and operation of new private-sector production facilities is siphoned off into the investment tasks financed or run by the public sector enjoying 'free access' to the EU funds.

Foreign trade in goods and non-factor services is performing relatively weakly. In 2018 trade in goods and non-factor services registered a surplus worth EUR 17.1bn – against 19.4bn in 2017.Trade in services fares quite well – much better than trade in goods. In current euro terms, exports (of goods and services) rose 7.2% and imports by 9%. Unfavourable terms-of-trade developments may be a part of the problem. However, the expected (on account of faltering performance of the euro area) deteriorations in the trade (and also current account) balances – although affecting the overall GDP growth rates – are unlikely to signal any immediate and serious troubles for the country's exchange rate (which has been remarkably stable recently) or for Poland's external payments position.

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[32] One also notices a 66% rise in the investment outlays into the coal mining sector (which is run by state-owned conglomerates fully subordinated to the government).

Corporate profitability is deteriorating. Net (post-tax) profits of the corporate non-financial sector declined by 1.4% (year on year) over the first three quarters of 2018. In industry the decline was steep (-8.5%) – largely on account of a rather dreadful performance of the coal mining branch. Also the 'electricity, gas, steam etc.' sector performed dismally, with profits declining by 35%. Profitability developments are surely influenced by gaps opening, despite rising labour productivity, between the producer prices received and production costs. Producer prices are rising quite weakly (in manufacturing by about 2% on average so far). However, production costs are rising quite visibly (under the impact of a close to 7% hike in the average nominal wage rate). The ongoing gains in labour productivity (close to 4% currently) in many sectors or branches are insufficient to close the growing gaps between costs and revenues. Subdued inflation in producer prices may reflect fairly strong competitive pressures keeping domestic prices (both producers' and consumers') in check to some extent at least. Despite reduced corporate profits the financial standing of firms in most sectors or branches is still quite satisfactory and the profitability indicators are good, by historical standards. But the situation of coal mining and electricity sectors is rather critical.

Consumer prices are suppressed – perhaps temporarily. At 1.6% the consumer price index for 2018 seems unbelievably low. However, the reported CPI may in fact be correct. As already mentioned, the rising household disposable income appears to be associated with rising saving rates. Thus the usual 'demand pull' may be weaker than perhaps commonly believed. Also, in many branches of manufacturing (and market services) the rise in costs (and wage costs in particular) has not depressed profit margins. In these branches the cost-push may not have emerged so far. Finally, the low CPI may have been a consequence of the policy of 'freezing' energy prices (electricity, coal etc.) pursued by the present government. The energy sectors are run by state-owned conglomerates and the suppression of energy prices by governmental decrees is not a problem at all (especially in view of the parliamentary elections due this coming autumn). In the meantime the 'missing' earnings of the energy suppliers are replenished by temporary subsidies from the state budget (or temporarily foregone taxes normally levied on the energy suppliers). Whether this practice (quite typical of 'planned economies') will go unnoticed by the European Commission remains to be seen. In any case this practice may be discontinued after the elections (no matter who wins). The large hikes in energy prices that would then follow could put an end to the current inflation tranquillity.

Lending is expanding rather moderately amid banks' strongly improved profits. The policy interest rate remains fairly low (1.5%) and is unlikely to go up because the National Bank is unlikely to do anything unpalatable to the government. The interest rates charged by commercial banks on new loans are also not exorbitant (on average 4.4% for household mortgage loans and 3.5% for loans to non-financial corporates). Despite this, loan growth is rather slow. Over one year ending 30 September 2018 the stock of loans to non-financial corporates increased by over 4% (by less than 0.1% for small and medium-sized firms) and by less than 4% to the household sector (mostly in the form of mortgages). The demand for bank loans remains subdued on account of low investment by corporates and high 'idle' cash resources of the private non-financial sector (primarily accumulating as bank deposits). Banks' net profits rose all the same: from PLN 10.5bn in the first three quarters of 2017 to PLN 11.6bn in the same period of 2018 (in current euro terms from 2.4bn to 2.6bn, respectively). Unlike in the non-financial corporate sector, the costs of banking operations have risen less than their revenues. The latter increased quite strongly not only on account of higher net interest income, but also because of much higher dividends earned.

Summing up: slower growth in 2019 is a real possibility. The economic strategy in fact boiling down to increased investment spending by the public sector (and by the state-owned corporations 'guided' by the politicians) does not seem to promise much success in the long – or even medium – run. Moreover, continuing conflicts between the European Commission and the Polish government (over the latter's 'reforms' undermining the independence of the judiciary) could lead to substantial cuts in the EU funds available to the country. That would undermine public investment spending and thus reduce growth in the medium run. Another downside risk pertains to a likely return of higher inflation which would then erode the purchasing power of household incomes – hence negatively affecting consumer demand as well. The situation could improve with the private sector resuming investment on a broader scale. But, for many reasons, this need not happen anytime soon.

Table 6.16 / Poland: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020	2021
							Forecast	
Population, th pers., average	38,487	38,458	38,435	38,434	38,400	38,400	38,410	38,420
Gross domestic product, PLN bn, nom.	1,720	1,800	1,861	1,989	2,120	2,250	2,350	2,480
annual change in % (real)	3.3	3.8	3.1	4.8	5.1	3.7	3.3	3.3
GDP/capita (EUR at PPP)	18,600	19,900	19,900	20,900	22,200	.	.	.
Consumption of households, PLN bn, nom.	1,019	1,038	1,074	1,151	1,220	.	.	.
annual change in % (real)	2.6	3.0	3.9	4.9	4.5	4.0	3.6	3.5
Gross fixed capital form., PLN bn, nom.	339	361	335	352	380	.	.	.
annual change in % (real)	10.0	6.1	-8.2	3.9	7.3	5.0	4.5	4.5
Gross industrial production (sales) [2]								
annual change in % (real)	3.5	4.8	2.8	6.6	5.9	5.0	4.5	4.0
Gross agricultural production								
annual change in % (real)	6.9	-2.7	8.5	2.9	0.5	.	.	.
Construction industry [2]								
annual change in % (real)	4.3	0.3	-14.5	13.7	19.7	.	.	.
Employed persons, LFS, th, average	15,862	16,084	16,197	16,423	16,550	16,650	16,700	16,730
annual change in %	1.9	1.4	0.7	1.4	0.8	0.6	0.3	0.2
Unemployed persons, LFS, th, average	1,567	1,304	1,063	844	650	640	590	590
Unemployment rate, LFS, in %, average	9.0	7.5	6.2	4.9	3.8	3.7	3.4	3.4
Reg. unemployment rate, in %, eop	11.4	9.7	8.3	6.6	5.8	.	.	.
Average monthly gross wages, PLN [3]	3,777	3,908	4,052	4,272	4,560	4,890	5,190	5,480
annual change in % (real, gross) [3]	3.2	4.5	4.2	3.5	5.5	5.0	4.0	3.5
Consumer prices (HICP), % p.a.	0.1	-0.7	-0.2	1.6	1.2	2.2	2.1	2.0
Producer prices in industry, % p.a.	-1.4	-2.2	-0.3	2.7	2.1	1.8	1.8	1.8
General governm.budget, EU-def., % of GDP								
Revenues	38.7	39.0	38.9	39.7	40.5	40.5	40.5	40.5
Expenditures	42.4	41.7	41.1	41.1	42.0	42.5	42.5	42.5
Net lending (+) / net borrowing (-)	-3.7	-2.7	-2.2	-1.4	-1.5	-2.0	-2.0	-2.0
General gov.gross debt, EU def., % of GDP	50.4	51.3	54.2	50.6	50.9	51.1	51.4	51.8
Stock of loans of non-fin.private sector, % p.a.	5.8	7.1	5.3	3.1	7.2	.	.	.
Non-performing loans (NPL), in %, eop	8.1	7.5	7.1	6.8	6.8	.	.	.
Central bank policy rate, % p.a., eop [4]	2.0	1.5	1.5	1.5	1.5	1.50	1.75	1.50
Current account, EUR mn [5]	-8,529	-2,409	-2,240	706	-3,389	-5,200	-5,400	-6,000
Current account, % of GDP [5]	-2.1	-0.6	-0.5	0.2	-0.7	-1.0	-1.0	-1.1
Exports of goods, BOP, EUR mn [5]	158,656	172,150	177,412	201,963	213,912	224,800	237,700	251,400
annual change in %	6.4	8.5	3.1	13.8	5.9	5.1	5.8	5.8
Imports of goods, BOP, EUR mn [5]	161,911	169,937	174,479	200,536	218,744	236,200	253,000	270,700
annual change in %	8.3	5.0	2.7	14.9	9.1	8.0	7.1	7.0
Exports of services, BOP, EUR mn [5]	36,743	40,663	44,929	51,883	58,236	62,900	67,900	73,300
annual change in %	9.4	10.7	10.5	15.5	12.2	8.0	8.0	8.0
Imports of services, BOP, EUR mn [5]	27,679	29,749	30,963	33,926	36,270	38,800	40,700	42,700
annual change in %	6.7	7.5	4.1	9.6	6.9	7.0	5.0	5.0
FDI liabilities, EUR mn [5]	14,824	13,534	16,628	9,292	7,843	.	.	.
FDI assets, EUR mn [5]	5,096	4,385	12,807	3,688	139	.	.	.
Gross reserves of NB excl. gold, EUR mn	79,379	83,676	104,440	90,967	97,633	.	.	.
Gross external debt, EUR mn [5]	293,510	303,120	321,305	318,851	338,300	345,300	366,200	387,700
Gross external debt, % of GDP [5]	71.4	70.5	75.3	68.3	68.0	66.0	67.0	68.0
Average exchange rate PLN/EUR	4.1843	4.1841	4.3632	4.2570	4.2615	4.30	4.30	4.35

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) Excluding employees in national defence and public safety. - 4) Reference rate (7-day open market operation rate). - 5) Including SPE.

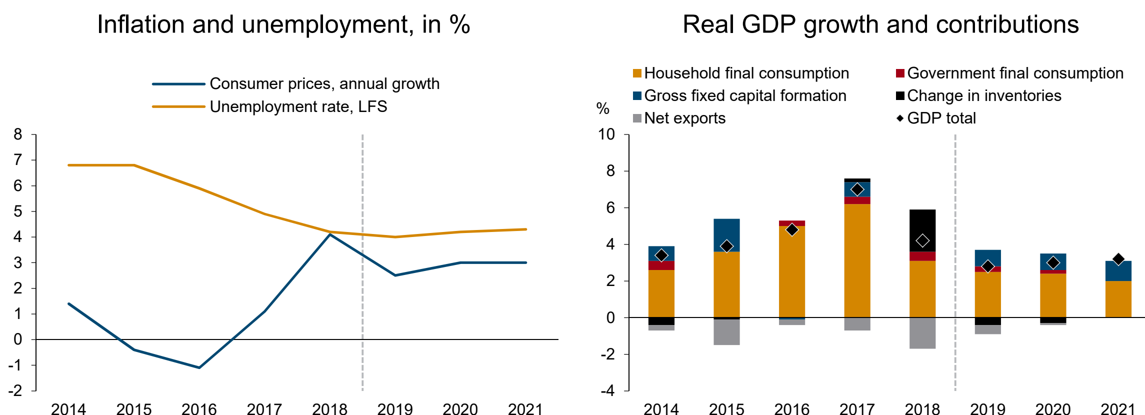
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ROMANIA: Who pays the bill for fiscal loosening?

GÁBOR HUNYA

Economic growth turned out at 4.2% in 2018, above wiiw expectation, and the decline to or below 3% p.a. in 2019-2021 will be below earlier forecasts. Beyond deteriorating external conditions and weak investments, new unorthodox fiscal policy measures will drag on the economy. Raising fiscal revenues by taxing turnover in the banking, telecom and energy sectors will suppress economic activity.

Figure 6.17 / Romania: Main macroeconomic indicators



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

Economic growth of 4.2% in 2018 was based on growing household consumption and the expansion of inventories. Fixed investments stagnated and the balance of goods and services trade deteriorated steeply. Industrial production increased by a moderate 3.5%. Mainly the automotive industry expanded its production, by 20% despite labour shortages, largely on account of a new model launched by the Ford plant in Craiova. Agriculture had another excellent year boosting the production and exports of foodstuff and also on-the-farm consumption. The construction industry reported declining production for the third year in a row.

Investments are the sore point of the Romania economy. In 2017 public investments were subdued as budgetary revenues faltered in the wake of tax cuts and expenditures were shifted to public sector wages. The resulting soaring household income gave a 70% boost to private house construction. Thus, not surprisingly, in 2018 residential building fell by 24% and non-residential construction by 5.5%. On the other hand, 8% growth was attained in civil engineering works in 2018 after a 22% decline in the previous year. The latter signalises that public investments in infrastructure started to recover in the second half of 2018 which was also visible on the expenditure side of the state budget. But investment

projects remained unfinished by the end of the year, increasing inventories instead of gross fixed capital formation. All in all, investment outlays were about the level of the previous year in 2018; construction investments fell in real terms (note the 15% increase in construction costs) but investments in machinery and transport equipment increased due to companies' efforts to replace workers by technology.

Labour shortages have shown up in increasing employment and vacancy rates while the unemployment rate came below 4% by the end of 2018. This has a two-way impact on investments: (i) it hinders labour-intensive construction works and pushes up wages and prices in this sector, and (ii) it triggers labour-substituting investments in companies that can afford it. Some companies in the labour-intensive clothing and shoe-making sectors have not been able to keep up with surging wage demands and closed down factories. (One of them moved production to Vietnam.)

The government has tried to make employment in the construction sector more attractive by raising the minimum wage in this sector to RON 3000 as of January 2019 (EUR 638, the same also in net terms, as the payment of income tax and social contributions has been suspended in this sector). The general minimum wage in other sectors rose only to RON 2080 (RON 1263, or EUR 265 in net terms). Public sector wage hikes are moderating in 2019, but pension hikes will come in September 2019 just ahead of the presidential elections. Public pensions are planned to be hiked by 70% during 2019-2021, but pillar II private pension funds will be squeezed.

In view of expanding fiscal deficits, the government decided to introduce extra taxes in various segments of the economy without touching on the basic tax rates. The budget for 2019 was passed with much delay on 15 February due to the new revenue-side measures published in a decree just before the end of 2018. The targets of turnover-based extra taxes are banking, energy and telecom companies. In the explanation, Finance Minister Teodorovici blamed multinational companies for reporting abnormally low profits (hence profit taxes paid) in energy and telecom, abnormally high profits in the banking sector and for the high energy prices paid by both residential and industrial users. The government has therefore capped energy prices for households. The banks will have to pay a tax on their financial assets when the average interbank offer rate (ROBOR) for the maturities of three and six months exceeds the 2% benchmark; it has recently been in the range of 3-3.5%. Further revenues will be generated by channelling a major part of the mandatory private pension fund contributions back to the public pension system. All these measures have a touch of unorthodox economic policy similar to Hungary applied during the post-crisis years. Preliminary calculations of the government suggest that the fiscal package could hinder about 1% of GDP fiscal shortfall. Thus, Romania could avoid a fiscal deficit slippage below 3% of GDP provided the assumptions of the budget, 5.5% economic growth in 2019, prove realistic – but they certainly won't and not just because of deteriorating external conditions.

The new fiscal measures will have negative effects on economic growth. The economic activity of the sectors hit by extra taxation will decline. The tax on financial assets will account for a major part of the banks' profits. This will not threaten the viability of the largest banks, but it may make the rest unprofitable. Banks have just come out of a prolonged loss-making period cleaning up non-performing loans and increasing credits to the economy. They made a net profit of EUR 1.5 billion, up by 30% in 2018, which in the government's opinion should be shared with the budget. Negative effects can be expected, however, as banks will reduce assets. In general, investor trust has been shaken.

As a first reaction, the local currency devalued, sovereign bond yields soared, and commercial banks got worse ratings. The impact on corporate investments may not be a disaster, as banks have a minor role compared with companies' own funds. But everyday life may become more difficult if revolving credit lines used to finance companies' daily activities become more expensive and available under stricter conditions. The impact on FDI could be negative as investors' confidence more generally may deteriorate due to the government's unpredictable economic policy. If foreign investors leave the affected sectors, a redistribution of assets to less transparent investors may follow – the state or oligarchs may buy cheap as has been the case in Hungary. Seeing the outrage of affected banks, the National Bank and also of the ECB, negotiations have started in Romania to scale down and better target the banking tax, yet with no results at the time of writing.

Financial inflows are highly necessary, as expanding domestic demand triggered a deterioration of the trade balance, which made 1.7 percentage point negative contribution to GDP growth in 2018. Exports of goods did not constitute a problem as more than 8% increase (in nominal euro terms) was recorded and the shift to higher value added products continued. The sore point was the 11% surge in goods imports. Part of the increase was triggered by international prices for fuels and chemicals but also by import volumes of these products. The impact of consumer demand was most visible in the imports of cars and various consumer goods. Lower international oil prices will help Romania to narrow the import bill gap in 2019. At the same time, we expect lower demand on the main foreign markets, especially in Italy and Germany, thus also exports will grow at a slower pace. As a result, the current account deficit will stay near 4.5% of GDP.

The government and other public institutions passed the 'National Plan for the Adoption of the Euro' on 15 February 2019, setting the target accession date for 2026. The plan lists some intended structural measures such as increasing fiscal revenues, increasing the fiscal space and sustainably strengthening public finances, developing infrastructure, and increasing the competitiveness of the economy through a better structure of production. One may be sceptical about these plans as they go against the fiscal policy of recent years.

Worsening external and internal conditions will squeeze economic growth below 3% this year and close to it in the rest of the forecasting period. Fixed capital formation is expected to pick up moderately on account of EU transfers, but household consumption will be less robust than before. Wages are expected to rise more moderately while pensions will grow but private consumption all-in-all will give a smaller boost to GDP. Whatever the EU funds allocation principle will look like during the next financing period, Romania will still be eligible for substantial transfers of structural and investment funds on account of its low level of economic development. If the compliance with democratic values plays a role in funds allocation, this would – based on the current situation in the country – reduce the access to funds. The disintegration of the political system will continue towards the presidential and parliamentary elections (late 2019 and late 2020, respectively) and represents a downside risk to the current forecast.

Table 6.17 / Romania: Selected economic indicators

	2014	2015	2016	2017	2018 [1)]	2019	2020 Forecast	2021
Population, th pers., average	19,909	19,815	19,702	19,584	19,500	19,400	19,300	19,200
Gross domestic product, RON bn, nom.	668.6	712.6	765.1	856.7	950.0	1,030	1,100	1,180
annual change in % (real)	3.4	3.9	4.8	7.0	4.2	2.8	3.0	3.2
GDP/capita (EUR at PPP)	15,200	16,300	17,400	18,800	19,900	.	.	.
Consumption of households, RON bn, nom.	405.7	432.6	471.9	533.5	590.0	.	.	.
annual change in % (real)	4.2	5.9	8.3	10.1	5.0	4.0	3.8	3.2
Gross fixed capital form., RON bn, nom.	162.4	176.5	175.0	192.0	210.0	.	.	.
annual change in % (real)	3.3	7.5	-0.2	3.5	0.0	4.0	4.0	5.0
Gross industrial production [2)]								
annual change in % (real)	6.0	2.8	3.1	7.9	3.5	3.0	2.0	3.0
Gross agricultural production								
annual change in % (real)	2.9	-6.8	2.5	12.5	8.4	.	.	.
Construction industry [2)]								
annual change in % (real)	-6.7	10.5	-4.4	-5.5	-4.1	.	.	.
Employed persons, LFS, th, average	8,614	8,535	8,449	8,671	8,690	8,710	8,710	8,710
annual change in %	0.8	-0.9	-1.0	2.6	0.2	0.2	0.0	0.0
Unemployed persons, LFS, th, average	629	624	530	449	380	360	380	390
Unemployment rate, LFS, in %, average	6.8	6.8	5.9	4.9	4.2	4.0	4.2	4.3
Reg. unemployment rate, in %, eop	5.4	5.0	4.8	4.0	3.3	.	.	.
Average monthly gross wages, RON [3)]	2,328	2,555	2,809	3,223	4,488	4,800	5,100	5,400
annual change in % (real, gross)	6.5	10.4	11.7	13.2	8.0	5.0	4.0	3.0
Average monthly net wages, RON	1,697	1,859	2,046	2,338	2,644	2,800	3,000	3,200
annual change in % (real, net)	6.4	10.1	11.8	12.8	8.1	5.0	4.0	3.0
Consumer prices (HICP), % p.a.	1.4	-0.4	-1.1	1.1	4.1	2.5	3.0	3.0
Producer prices in industry, % p.a.	-0.2	-2.3	-1.8	3.5	5.1	3.0	3.0	3.0
General governm.budget, EU-def., % of GDP								
Revenues	34.2	35.5	31.9	30.8	30.0	31.0	31.0	31.0
Expenditures	35.4	36.2	34.9	33.7	32.9	34.5	34.0	34.0
Net lending (+) / net borrowing (-)	-1.3	-0.7	-2.9	-2.9	-2.9	-3.5	-3.0	-3.0
General gov.gross debt, EU def., % of GDP	39.2	37.8	37.3	35.2	35.0	35.0	36.0	36.0
Stock of loans of non-fin.private sector, % p.a.	-3.7	2.5	0.9	5.3	7.8	.	.	.
Non-performing loans (NPL), in %, eop [4)]	13.9	13.5	9.6	6.4	5.0	.	.	.
Central bank policy rate, % p.a., eop [5)]	2.75	1.75	1.75	1.75	2.50	2.75	3.00	2.75
Current account, EUR mn	-1,004	-1,977	-3,496	-6,298	-9,416	-9,400	-9,500	-9,600
Current account, % of GDP	-0.7	-1.2	-2.1	-3.4	-4.6	-4.3	-4.2	-4.0
Exports of goods, BOP, EUR mn	46,839	49,111	52,164	57,159	61,880	65,000	68,300	72,400
annual change in %	6.7	4.8	6.2	9.6	8.3	5.0	5.0	6.0
Imports of goods, BOP, EUR mn	53,375	56,896	61,412	69,067	76,691	81,300	85,400	90,500
annual change in %	7.4	6.6	7.9	12.5	11.0	6.0	5.0	6.0
Exports of services, BOP, EUR mn	15,104	16,640	18,006	20,683	22,016	23,600	25,300	27,100
annual change in %	12.4	10.2	8.2	14.9	6.4	7.0	7.0	7.0
Imports of services, BOP, EUR mn	9,236	9,849	10,284	12,752	13,908	14,900	15,800	16,700
annual change in %	5.8	6.6	4.4	24.0	9.1	7.0	6.0	6.0
FDI liabilities, EUR mn	2,931	3,885	5,656	4,378	5,762	.	.	.
FDI assets, EUR mn	227	930	1,143	-196	824	.	.	.
Gross reserves of NB excl. gold, EUR mn	32,216	32,238	34,242	33,494	33,065	.	.	.
Gross external debt, EUR mn	94,744	92,069	92,910	97,361	98,476	102,000	105,000	110,000
Gross external debt, % of GDP	63.0	57.4	54.5	51.9	48.2	47.0	46.0	45.7
Average exchange rate RON/EUR	4.4437	4.4454	4.4904	4.5688	4.6540	4.75	4.82	4.90

1) Preliminary and wiiw estimates. - 2) Enterprises with 4 and more employees. - 3) In 2018 the social security contribution paid by employers was added to gross wages; real growth 2018 estimated. - 4) From 2015 broader definition of NPL (90 days criteria + loans where the creditor presumes that, without realising the collateral, the debtor will not be able to repay all of its debt). - 5) One-week repo rate.

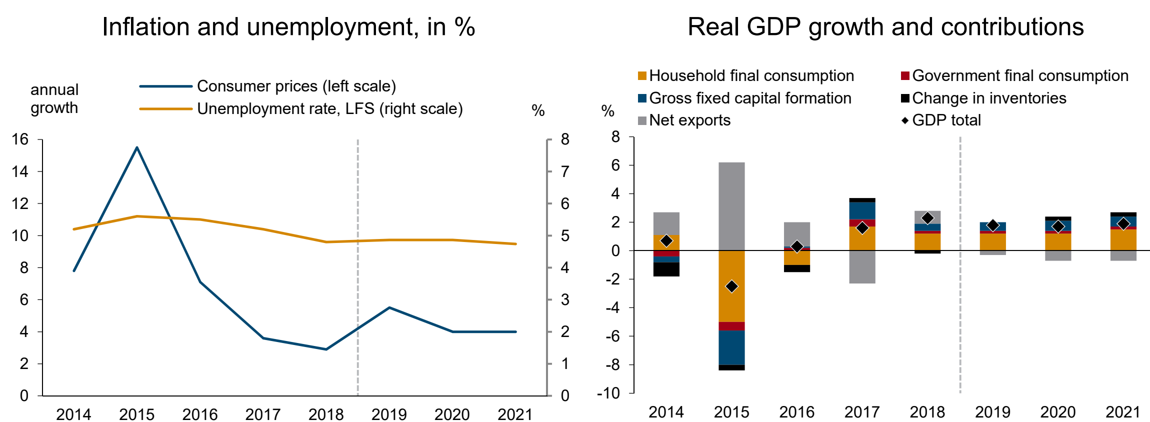
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

RUSSIA: GDP growth will fall back after an unexpected uptick in 2018

PETER HAVLIK

GDP growth for 2018 surprised everybody. Net exports and investments were the main drivers, the record current account surplus and a low inflation among the cheerful passengers. But neither the pace of growth nor the size of the current account surplus is sustainable and will be maintained. Still, the accumulated reserves and cautious economic policies will serve as a buffer mitigating external risks. Stability and weak growth will thus characterise Russian developments in the coming years.

Figure 6.18 / Russia: Main macroeconomic indicators



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

Russia's GDP growth reached a six-year high in 2018, according to a first estimate released by Rosstat on 4 February. Defying all earlier forecasts and expectations (including those of the Ministry of Economy and the Central Bank of Russia), the revealed 2018 GDP growth was 2.3%. The growth was driven by net exports and gross capital formation on the demand side, and by construction, mining, hotels, restaurants and financial intermediation on the production side. These and other official data are puzzling and partly inconsistent (implying inter alia a huge reduction in stocks and a huge jump in construction in December), and will be surely revised (there was another revision of national accounts data three years back recently).

Industry grew by 2.9% (manufacturing by 2.6%) in 2018. Drought-affected agricultural output fell by 0.6% (grain and sugar beet harvests were down by nearly 20%), interrupting the period of robust agricultural performance during the past five years. Construction output recovered strongly (+5%, reportedly due to the completion of the LNG plant on the Yamal Peninsula), after a period of protracted crisis, but gross investment fell by 0.5%. Retail and wholesale trade, as well as goods transport,

increased by some 2.5%. Consumer price inflation reached a record low in 2018 (just 2.8% on annual average), but the PPI and the GDP deflator jumped to double digits (12% and 10%, respectively, fuelled by rouble depreciation and higher commodity prices). Real wages picked up strongly in 2018 (+6.8%) owing to lower inflation and wage increases in the public sector. Nevertheless, real disposable incomes of the population stagnated in 2018 and a part of rising household consumption was financed by credits (consumer credits grew by more than 20% during the year). Employment (but also labour shortages) has been rising, unemployment declining.

The external surplus rose substantially in 2018. Export revenues grew by 20% in nominal EUR terms, largely thanks to higher oil prices, while imports were nearly flat. Apart from energy revenues, the last year witnessed also a huge increase in grain exports. Owing to the record trade surplus, the current account surplus reached 7% of GDP (about EUR 100 billion) in 2018. Also fiscal revenues increased, and the government budget was in surplus. External debts (both public and private) are being repaid – partly even ahead of schedule – owing to both sanctions-related refinancing problems and efforts to reduce vulnerability. While overall foreign exchange reserves grew by EUR 30 billion in 2018 (to EUR 410 billion as of the beginning of 2019), the Central Bank has been reducing its USD-denominated holdings in foreign exchange reserves – a likely response to current and expected future US sanctions. Foreign direct investment is one of the main victims of the sanctions: FDI inflows diminished further in 2018 and there has been again a net outflow of capital from Russia, not least owing to the high debt service payments (more than USD 60 billion scheduled for 2019), but also due to the poor investment climate owing to the sanctions.

Russia has been confronted with volatile US sanctions policies that elevate risks, though the sanctions and the related conflict with the West, lasting already for at least five years, have become a 'new normal'. New rounds of US sanctions announced in April and August 2018 increased uncertainty as they target 'Russian oligarchs and entities in response to worldwide malign activity'. However, US sanctions on Rusal and other companies linked to the 'Kremlin-close oligarch' Oleg Deripaska were lifted in January 2019, after the requested shares' swap that reduced Mr Deripaska's controlling package in Rusal below 50% was completed. EU sanctions related to Crimea and Eastern Ukraine were once again formally prolonged by another year in September 2018; in December 2018, 9 more persons were added to the sanctions list because of their involvement in the so-called 'elections' in the so-called 'Donetsk People's Republic' and 'Luhansk People's Republic' – despite increasing difficulties to reach the necessary consensus among the EU Member States on the sanctions issue. New US sanctions may affect private Russian oil companies (Novatek).

Sanctions-related uncertainties impact adversely not only the investment climate and related capital flows, but also the rouble exchange rate and inflationary expectations. The Russian Central Bank raised the key rate to 7.75% in mid-December 2018 and left the rate unchanged in February 2019. VAT was raised by 2 p.p. on 1 January 2019 (to 20%), excise taxes on motor fuel were lifted as well. Owing to high fiscal revenues, the government budget was in surplus last year and will stay in the black in 2019 as well. Under a new 'fiscal rule', any revenue from oil prices higher than USD 40 per barrel is being accumulated in the National Wealth Fund, which is part of Russia's foreign exchange reserves and serves as an insurance buffer for a crisis (the average Brent oil price was USD 71/bbl in 2018, and is expected to fall to some USD 60/bbl in 2019).

President Vladimir Putin's approval ratings have been falling – especially after the unpopular pension reforms were announced in August 2018. The sluggish economic performance and dismal growth prospects erode Putin's ratings as well (the latest polls from January 2019 suggest a drop in Putin's approval ratings to around 60%). The pension reform aims at lifting the retirement age for women to 60 years and for men to 65 years. In addition, in his annual address in February 2019, President Putin announced more support for families. There were some sporadic protests against the pension reform, yet the reform was both expected and necessary owing to demographic developments and sustainability of the pension system. There is no other substantial economic reform in sight; the confrontation with the West will continue and the investment climate will continue to suffer. Russia is pursuing rather conservative economic policies: accumulating reserves, paying back foreign debts and being cautious in spending. As for import substitution, protectionism and trade reorientation to the East (China), these are strategies that Russia will follow with even more vigour in future. But current account surpluses will diminish in the coming years, to some 4-5% of GDP by 2021, as oil prices are expected to fall.

After a surprisingly robust performance, GDP growth is expected to fall back in 2019 – definitely below 2% – as the export surplus will diminish and the recovery of investment stall. Inflation will temporarily pick up slightly, but return to low single digits soon. With stagnating employment and without sufficient modernisation and restructuring investment that would increase total factor productivity, a stronger economic recovery is unlikely. With forecast GDP growth rates below 2% even in the medium term, Russia will not meet Putin's ambitious target to become the world's 5th largest economy by the end of his current presidency. Russia's estimated GDP in 2020 – USD 1,525 billion – will be nominally about the same as it was in 2010. A number of external risks (EU parliamentary elections, presidential election in Ukraine, an escalating global trade war, the imposition of new financial sanctions by the US, and oil price fluctuations being the most obvious ones) may affect Russian economic development already in the coming months. Still, the population longs for stability and the government assembled sufficient buffers to mitigate and handle potential future crises.

Table 6.18 / Russia: Selected economic indicators

	2014	2015	2016	2017	2018 1)	2019	2020	2021
							Forecast	
Population, th pers., average	146,091	146,406	146,675	146,842	146,837	147,000	147,000	147,000
Gross domestic product, RUB bn, nom.	79,200	83,387	86,010	92,089	103,627	111,800	118,200	125,300
annual change in % (real)	0.7	-2.5	0.3	1.6	2.3	1.8	1.7	1.9
GDP/capita (EUR at PPP)	19,000	18,600	18,000	18,400	19,000	.	.	.
Consumption of households, RUB bn, nom.	42,016	43,337	45,413	48,165	50,755	.	.	.
annual change in % (real)	2.0	-9.4	-1.9	3.2	2.2	2.5	2.5	3.0
Gross fixed capital form., RUB bn, nom.	16,828	16,942	18,861	20,571	22,120	.	.	.
annual change in % (real)	-1.8	-11.2	0.7	5.5	2.3	3.0	3.0	3.0
Gross industrial production 2)								
annual change in % (real)	2.5	-0.8	2.2	2.1	2.9	3.0	3.0	4.0
Gross agricultural production								
annual change in % (real)	3.5	2.6	4.8	2.4	-0.6	.	.	.
Construction output 3)								
annual change in % (real)	-2.3	-4.8	-2.2	-1.4	5.3	.	.	.
Employed persons, LFS, th, average 4)	71,539	72,324	72,393	72,142	72,532	72,400	72,400	72,400
annual change in %	0.2	-0.4	0.1	-0.3	0.3	-0.2	0.0	0.0
Unemployed persons, LFS, th, average 4)	3,889	4,264	4,243	3,967	3,658	3,700	3,700	3,600
Unemployment rate, LFS, in %, average 4)	5.2	5.6	5.5	5.2	4.8	4.9	4.9	4.7
Reg. unemployment rate, in %, eop 4)5)	1.2	1.3	1.2	1.0	0.9	.	.	.
Average monthly gross wages, RUB 6)	32,495	34,030	36,709	39,167	43,445	47,200	51,100	55,300
annual change in % (real, gross)	1.2	-9.0	0.7	2.9	6.8	3.0	4.0	4.0
Consumer prices, % p.a.	7.8	15.5	7.1	3.6	2.9	5.5	4.0	4.0
Producer prices in industry, % p.a. 7)	6.4	13.5	4.2	7.7	11.9	8.0	5.0	5.0
General governm.budget, nat.def., % of GDP								
Revenues	33.8	32.3	32.8	33.7	35.6	37.0	36.0	37.0
Expenditures	34.9	35.7	36.4	35.2	32.5	37.0	37.0	37.0
Deficit (-) / surplus (+)	-1.1	-3.4	-3.7	-1.5	3.1	0.0	-1.0	0.0
General gov.gross debt, nat.def., % of GDP	13.0	13.1	12.9	12.6	12.1	11.0	10.0	10.0
Stock of loans of non-fin.private sector, % p.a.	25.9	7.6	-6.9	3.5	13.9	.	.	.
Non-performing loans (NPL), in %, eop 8)	3.8	5.3	5.2	5.2	4.7	.	.	.
Central bank policy rate, % p.a., eop 9)	17.00	11.00	10.00	7.75	7.75	7.50	7.00	6.00
Current account, EUR mn 10)	43,477	60,952	22,138	29,472	97,480	41,300	44,300	43,900
Current account, % of GDP	2.8	5.0	1.9	2.1	6.9	2.7	2.8	2.7
Exports of goods, BOP, EUR mn 10)	375,561	307,040	254,371	313,173	376,175	350,100	374,600	390,200
annual change in %	-4.4	-18.2	-17.2	23.1	20.1	-6.9	7.0	4.2
Imports of goods, BOP, EUR mn 10)	232,739	173,585	172,911	210,932	211,249	233,700	252,400	265,400
annual change in %	-9.4	-25.4	-0.4	22.0	0.2	10.6	8.0	5.2
Exports of services, BOP, EUR mn 10)	49,700	46,418	45,759	51,137	55,400	55,600	58,300	60,200
annual change in %	-5.8	-6.6	-1.4	11.8	8.3	0.4	4.9	3.3
Imports of services, BOP, EUR mn 10)	91,487	79,829	67,331	78,681	81,021	89,600	95,000	98,000
annual change in %	-5.3	-12.7	-15.7	16.9	3.0	10.6	6.0	3.2
FDI liabilities, EUR mn 10)	16,655	6,163	29,381	25,296	12,700	.	.	.
FDI assets, EUR mn 10)	43,151	19,861	20,149	32,559	33,900	.	.	.
Gross reserves of NB excl. gold, EUR mn 10)11)	279,383	292,467	301,871	297,823	333,617	.	.	.
Gross external debt, EUR mn 10)	493,861	474,121	486,489	433,320	396,659	407,900	425,500	433,700
Gross external debt, % of GDP	31.7	38.5	42.0	31.0	28.3	27.0	27.0	27.0
Average exchange rate RUB/EUR	50.77	67.76	74.26	65.87	73.87	74.0	75.0	78.0

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

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

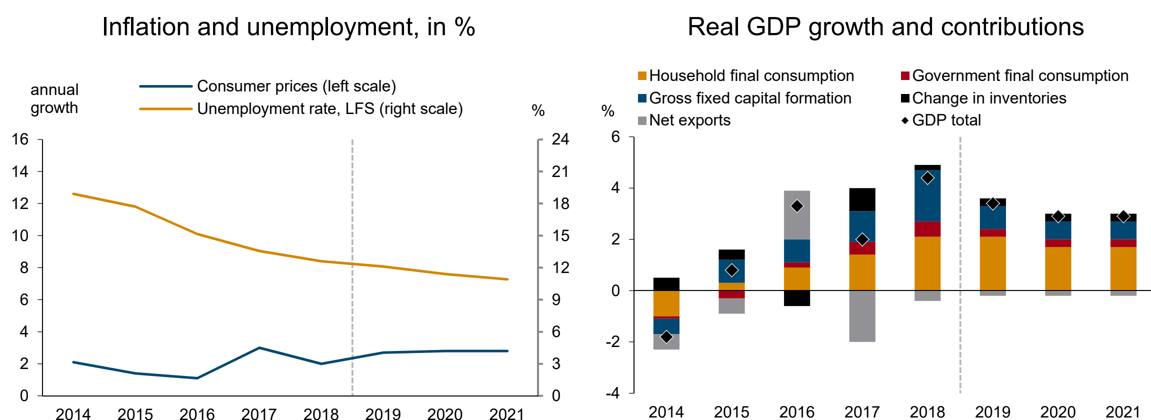
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SERBIA: Slowdown ahead after a strong 2018

RICHARD GRIEVESON

After a desperately weak post-crisis performance even by CESEE standards, the Serbian economy finally had a good year in 2018. Growth will weaken a bit in 2019, but remain fairly robust in the context of the last decade. A bigger slowdown is likely in 2020-2021. Domestic and international political risks have risen, which is an issue for an economy that relies so much on FDI. The EU reform process will continue to provide an important policy anchor, but accession is still many years away.

Figure 6.19 / Serbia: Main macroeconomic indicators



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

2018 was by some distance the best year for the Serbian economy since 2008, but the peak has already passed and growth in the forecast period will be more subdued. Base effects from agriculture, after the 2017 drought, had a major positive impact on overall growth last year. The partial unwinding of (now heavily criticised) austerity policies of recent years also helped (although overall the fiscal stance is still not especially loose: Serbia recorded a second consecutive budget surplus in 2018). External support was also important, particularly in the early part of the year, with still-robust activity in most key trading partners, and the increasingly large share of exports in Serbia's overall GDP, supporting activity. Meanwhile private consumption – which accounts for around 70% of GDP, one of the highest levels in the region – was pushed up by solid wage and employment trends. Real GDP growth was 4.4% for the year as a whole, a very decent outturn considering that average growth in 2010-2017 had averaged just 1.3%.

In 2019 growth will be slower than 2018 as temporary effects fade (a bit of a slowdown was already observed in the second half of last year). However, at around 3.5%, growth in 2019 will still be very healthy by post-crisis standards. Private consumption should make a significant contribution, reflecting higher employment and wages, and its overall large share of GDP. Strong recent growth and a consequent increase in labour demand appears to be sucking more people into the formal labour market, with recent data indicating an increase in participation rates. Real investment growth will also be positive, reflecting contributions from both private and public sources, helped by decent confidence levels and historically loose monetary conditions. The real CPI-adjusted central bank policy rate is currently at around 1%, down sharply from roughly 8% in 2013-2015.

While the outlook remains generally positive, Serbia will certainly not be immune from the deterioration in external conditions. Serbia's economy is much more open than it was ten years ago, reflecting both a ramping up of export capacity on the back of robust FDI inflows, and the persistent weakness of domestic demand in the post-crisis period. Weaker trends in the eurozone economy, led by Germany, are a particular concern, as Serbia has become increasingly integrated into regional value chains. Around 40% of Serbia's exports go to the EU15.

Strong recent growth is gradually eating up spare capacity, but we expect inflation to remain subdued by historical standards. Serbia has tended to have a high inflation rate in the CESEE context since the crisis, but in recent years price growth has increasingly converged with (low) regional levels and those of the eurozone. Moreover, unlike in 2018, energy prices will make little or no contribution to inflation in 2019. The weakness of inflation, even at a time when the labour market is performing well, suggests that there is still plenty of unused capacity in the economy. This will allow the central bank to maintain a relaxed policy stance, meaning that real interest rates will stay low, supporting domestic economic activity and helping to offset external weakness. Inflation will rise gradually, but only to around 3% by the end of the forecast period.

We expect FDI inflows to remain an important driver of growth. A mixture of reforms and incentives have had a positive impact on Serbia's ability to attract investment from abroad, and this should continue. However, the spike in tensions with Kosovo, and higher domestic political instability, could affect foreign investor sentiment somewhat. A large part of Serbia's FDI appeal is linked to perceptions of greater domestic and international stability in recent years. The EU reform anchor is also a key driver of foreign investors' willingness to commit to Serbia. Here, we expect further progress and the opening of new chapters in the EU accession negotiations. In economic terms, Serbia is also close to the convergence level (relative to Germany) that Romania and Bulgaria reached before their accession in 2007.

Political risk is probably higher than it has been for a while in Serbia, and from both a domestic and international perspective. In terms of foreign policy, the discussion of a land swap with Kosovo is unlikely to go anywhere, but has stirred up feelings on both sides. A 'normalisation' of relations will be necessary for EU accession, but that is unlikely to be achieved anytime soon. Tensions were heightened further at the end of 2018 by Kosovo's decision to impose 100% tariffs on imports from Serbia (this came after Kosovo's attempt to join Interpol was rejected, which Kosovo blames Serbia for). Broadly, Serbia has been quite successful in cultivating good relationships with various important international partners. The relationship with Russia is well known (and reinforced by a recent visit by Russian President Vladimir Putin to Belgrade), but Serbia has also been successful in cultivating ties with Turkey

and China among others. Chinese support for Serbia in the dispute with Kosovo may turn out to be quite important.

Domestically, the government has come under increased pressure from a wave of protests across the country, which could threaten political stability. Protesters are unhappy with what they see as increased authoritarianism and state capture. The President, Aleksandar Vučić, is accused by his opponents of many of the same things seen in some EU Member States in CESEE: winning power by democratic means, but then using authoritarian measures to stay there. The Varieties of Democracy index for Serbia shows a marked deterioration in 2007-2017, one of the worst in the CESEE region. In addition, Transparency International has singled out Serbia as one of the CESEE countries where corruption has got worse in recent years.

These protests appear unlikely to go away anytime soon, although it is extremely questionable whether or not they will succeed. A key problem for the protesters is that the opposition is very broad, and only really united by its anti-government position. It also appears to lack effective leaders. For now, a key stability factor for Mr Vučić is that he still has legitimacy in the eyes of many key Western leaders. Western countries have generally refrained from commenting on the protests (incredibly in the eyes of many inside and outside of Serbia, Mr Vučić was even invited to speak on a panel about media freedom at Davos in January). Mr Vučić's stated desire to keep Serbia firmly on course for EU accession is a key part of this. As long as Mr Vučić is seen at home to have this 'external legitimacy', he will be very difficult to dislodge.

In 2020-2021, we expect growth to slow further, reflecting weaker external conditions, and various structural bottlenecks. The economy remains plagued by a legacy of structural weaknesses from the pre-crisis years, including loss-making state-owned companies that continue to pose contingent liability risks for the state finances (although public debt/GDP has fallen markedly in recent years, so the emergence of additional costs for the state would not be as problematic now as would have been the case a few years ago). Although positive reform momentum should continue under the umbrella of EU accession, the pace of progress will likely be underwhelming. We think a growth rate of around 3% is realistic for 2020-2021. This will mean further convergence with Western Europe, but at a disappointingly slow pace. Growth will continue to be primarily driven by private consumption and FDI-financed investment. We are still relatively positive above EU accession, but think that the target date of 2025 is very unrealistic.

Table 6.19 / Serbia: Selected economic indicators

	2014	2015	2016	2017	2018 1)	2019	2020 Forecast	2021
Population, th. pers., mid-year	7,132	7,095	7,058	7,021	6,986	6,950	6,920	6,880
Gross domestic product, RSD bn, nom.	4,161	4,312	4,521	4,754	5,100	5,400	5,700	6,000
annual change in % (real)	-1.6	1.8	3.3	2.0	4.4	3.4	2.9	2.9
GDP/capita (EUR at PPP)	10,800	11,200	11,400	11,600	12,300	.	.	.
Consumption of households, RSD bn, nom.	3,012	3,052	3,152	3,311	3,500	.	.	.
annual change in % (real)	-0.1	-0.5	1.3	2.0	3.0	3.0	2.5	2.5
Gross fixed capital form., RSD bn, nom.	664	723	766	844	1,000	.	.	.
annual change in % (real)	-3.4	4.9	5.4	7.3	11.0	5.0	4.0	4.0
Gross industrial production 2)								
annual change in % (real)	-7.3	7.3	5.2	3.9	1.3	3.5	3.3	3.3
Gross agricultural production								
annual change in % (real)	2.4	-8.4	8.3	-11.8	11.3	.	.	.
Construction output								
annual change in % (real)	2.5	20.7	7.2	8.5	13.3	.	.	.
Employed persons, LFS, th, average 3)	2,421	2,574	2,719	2,795	2,850	2,910	2,940	2,970
annual change in %	4.8	0.6	5.6	2.8	2.0	2.0	1.0	1.0
Unemployed persons, LFS, th, average 3)	563	552	489	435	410	400	380	360
Unemployment rate, LFS, in %, average 3)	18.9	17.7	15.2	13.6	12.6	12.1	11.4	10.9
Reg. unemployment rate, in %, eop 4)	28.4	26.8	25.7	23.0	20.3	.	.	.
Average monthly gross wages, RSD 5)	61,426	61,145	63,474	65,976	68,629	72,600	77,000	81,600
annual change in % (real, gross)	-1.7	-2.4	2.6	0.9	3.9	3.0	3.2	3.1
Average monthly net wages, RSD 5)	44,530	44,432	46,097	47,893	49,650	52,500	55,000	57,700
annual change in % (real, net)	-1.5	-2.1	2.5	0.9	4.4	3.0	2.0	2.0
Consumer prices, % p.a.	2.1	1.4	1.1	3.0	2.0	2.7	2.8	2.8
Producer prices in industry, % p.a.	1.3	1.0	0.0	2.3	0.9	2.9	3.3	3.3
General governm.budget, nat.def., % of GDP								
Revenues	39.0	39.3	40.8	41.5	42.0	44.0	43.0	43.0
Expenditures	45.2	42.8	41.9	40.4	41.8	45.0	45.0	45.0
Deficit (-) / surplus (+)	-6.2	-3.5	-1.2	1.1	0.2	-1.0	-2.0	-2.0
General gov.gross debt, nat.def., % of GDP	66.2	70.0	67.8	57.9	58.0	56.0	53.0	51.0
Stock of loans of non-fin.private sector, % p.a.	4.5	3.0	2.3	2.1	9.9	.	.	.
Non-performing loans (NPL), in %, eop	21.5	21.5	17.0	9.8	6.4	.	.	.
Central bank policy rate, % p.a., eop 6)	8.00	4.50	4.00	3.50	3.00	3.25	4.00	4.50
Current account, EUR mn	-1,985	-1,234	-1,075	-2,051	-2,223	-2,300	-2,300	-2,300
Current account, % of GDP	-5.6	-3.5	-2.9	-5.2	-5.2	-5.1	-4.8	-4.6
Exports of goods, BOP, EUR mn	10,641	11,454	12,814	14,066	15,238	16,300	17,600	19,000
annual change in %	1.2	7.6	11.9	9.8	8.3	7.0	8.0	8.0
Imports of goods, BOP, EUR mn	14,752	15,099	15,933	18,064	20,483	21,800	23,300	24,900
annual change in %	0.5	2.4	5.5	13.4	13.4	6.5	7.0	7.0
Exports of services, BOP, EUR mn	3,810	4,273	4,571	5,246	6,000	6,400	6,900	7,500
annual change in %	11.3	12.2	7.0	14.8	14.4	7.0	8.0	8.0
Imports of services, BOP, EUR mn	3,344	3,544	3,664	4,280	4,909	5,300	5,700	6,100
annual change in %	7.6	6.0	3.4	16.8	14.7	7.0	7.0	7.0
FDI liabilities, EUR mn	1,500	2,114	2,127	2,548	3,496	.	.	.
FDI assets, EUR mn	264	310	228	130	308	.	.	.
Gross reserves of NB, excl. gold, EUR mn	9,351	9,812	9,543	9,287	10,526	.	.	.
Gross external debt, EUR mn 7)	25,679	26,234	26,494	25,588	26,500	26,600	26,700	26,800
Gross external debt, % of GDP 7)	72.4	73.5	72.1	65.3	61.5	59.0	56.0	54.0
Average exchange rate RSD/EUR	117.31	120.73	123.12	121.34	118.27	119	120	120

1) Preliminary and wiiw estimates. - 2) Excluding arms industry. - 3) From 2015 adjustments according to ILO, Eurostat and EU-LFS. - 4) From 2015 new source for labour force potential. - 5) From 2018 based on tax administration data, before on wage survey data supplemented by tax administration data. - 6) Two-week repo rate. - 7) BOP 5th Edition.

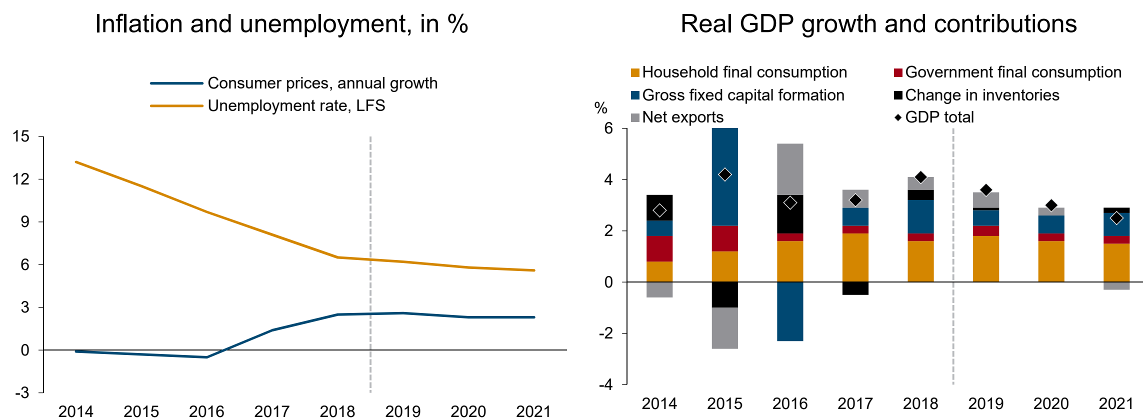
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SLOVAKIA: Strong growth at stake?

DORIS HANZL-WEISS

Slovakia saw high growth in 2018, thanks to increasing household consumption and gross capital formation. However, our forecasts for this and next year have been revised downwards and amount to 3.6% in 2019 and about 3% thereafter. Domestic and external risks are on the rise.

Figure 6.20 / Slovakia: Main macroeconomic indicators



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

Growth was strong in 2018, but slowed towards the end of the year. Slovak GDP saw a substantial rise in 2018, increasing by 4.1%, compared to about 3% in the previous two years. However, GDP growth in the fourth quarter (3.6%, year on year) was somewhat lower than in the second (4.5%) and third quarters (4.6%) (non-adjusted data). Overall, growth was driven mainly by household consumption, which increased by 3% during the first three quarters. Also consumption of government rose slightly (+1%). Gross capital formation surged by 7%, mostly thanks to growth in gross fixed capital formation (+6%) as well as building up of inventories. Construction experienced a favourable development in 2018, expanding by 8.4% during the whole year. Exports of goods and services rose by 4.8% during the first three quarters, imports by 4.4, thus showing a slightly positive effect.

The labour market is tight, which will ensure that high wage growth continues, but part of this will find its way into higher savings rather than consumption. Household consumption rose less than the good conditions on the labour market would suggest, due to an increase in the savings rate. Employment is growing and the unemployment rate is going down. The number of persons employed increased by 1.3% during the first three quarters of 2018 while the unemployment rate fell to 6.7% (LFS). This represents a huge improvement, with the unemployment rate coming down from 14% after the economic and financial crisis. Still it has to be noted that large regional disparities exist, with low unemployment rates in the West and higher ones in the Eastern part of the country where less jobs and

FDI is located. On the other hand, shortages of skilled labour are increasing. In order to counteract this trend, measures to simplify work permit processing have been in effect since January 2019. The number of foreign workers (in particular from Serbia, Ukraine or Romania) goes slightly up.

Rising wages and surcharges are putting off weekend shifts in the automotive industry already and might deter future investment plans. During the first three quarter of 2018, real wages grew by 3.6%, still lower than expected. Part of the nominal wage increase was made up by inflation, which reached 2.5% in 2018. Administrative measures, such as an increase in state salaries of 10% (in January 2019 and also January 2020), the continuous increase of the minimum wage (which rose by EUR 40 to EUR 520 as of January 2019), or surcharges for night and weekend work (in two steps, May 2018 and May 2019) push up wages further.

Industrial production rose thanks to the automotive industry in 2018 but there are clouds on the horizon. Looking at the sectoral structure of growth, industrial production increased by 4.5% in 2018 (based on data from the Slovak Statistical Office). This was also partly due to a revision of transport equipment measurement at the end of the year. The automotive industry – the main industrial sector in Slovakia in terms of production and exports – thus contributed most to the expansion of industry last year. The now four car plants in the country – VW Bratislava, KIA Motors, PSA Peugeot-Citroën and Jaguar Land Rover – produced 1,080,000 cars in 2018, up from 1,025,000 in 2017. The new Jaguar Land Rover plant officially started production on 25 October. Located in Nitra, in the Western part of Slovakia, it is going to produce 150,000 cars annually with about 1,500 employees in one shift. An expansion of shifts is planned for the end of 2019. However, first clouds appeared on the automotive horizon at the beginning of 2019. KIA was the first to announce a reduction in the number of employees due to lower demand for cars with diesel engines. Although the stated number was small (27) it was the first negative signal from the automotive sector. In the meantime also Volkswagen announced larger layoffs/shifts of employees citing lower growth in China and the drop in Germany's industrial production as main reasons (first announcements rose from 500 to 3,000). Apart from transport equipment, other sectors contributing to industry growth in 2018 were machinery & equipment, rubber & plastic & other non-metallic mineral products, and the food industry. In contrast, production declined in five industries, including computer, electronic & optical products and the other manufacturing & repair sector.

The external sector had a balanced impact on growth. During 2018, goods exports from Slovakia increased by 6.9% while goods imports to Slovakia rose much faster, by 8%. Exports to Slovakia's main trading partners Germany and the Czech Republic grew by 17% and 10% respectively (the respective imports rose by 14% and 5% respectively). Already before the Brexit, trade with the United Kingdom declined on both sides. Exports to the UK fell by about 5% in 2018, and the UK now accounts for about 5.2% of Slovak exports (being the eighth largest export destination). The overall trade balance will most probably be zero in the balance-of-payments statistics for 2018, while the services trade balance is slightly positive. Together with a negative primary and secondary income balance (about EUR 3 billion), the current account for 2018 will turn out slightly negative.

In 2019 a balanced budget is planned for the first time but parliamentary elections are ahead in 2020. For the first time ever, revised plans for the general government budget foresee a balanced budget in 2019; the debt-to-GDP-ratio should decline to 47.3%. However, as parliamentary elections are ahead at the beginning of 2020, this figure might not hold. In fact, a number of social measures are planned targeting families and older persons (e.g. free school lunches; a Christmas bonus for

pensioners; holiday/recreation vouchers). On the other hand, taxes have been newly introduced or reformed. A new levy on retailers has been in effect as of January 2019, and an insurance tax has replaced the insurance levy. In addition, there is the Fiscal Responsibility Act with its incorporated changes (thresholds for the debt-to-GDP level started to decline from the fiscal year 2018 onwards, i.e. the 50-60% debt-to-GDP thresholds continuously go down by 1 percentage point to 40% by 2027).

Growth will slow during the forecast period. wiiw has revised its growth forecasts for Slovakia for the coming years slightly downwards. For 2019, GDP growth will be lower than in 2018 and will probably reach about 3.6%; nevertheless, growth is pronounced compared to regional peers and the economy is in a good condition. The new Jaguar Land Rover car manufacturing plant, which started operation in October 2018, will shift up car production and exports, which should provide a major growth impetus. However, declining external demand and negative news from the other car manufacturers might represent counteracting factors. Still, increasing household consumption will provide a stable basis for growth in the next years based on favourable labour market developments. After strong investment expansion in 2018, the pace of growth will moderate and revive only when the EU-funding cycle draws to a close (2021/22). The push from Jaguar Land Rover will vanish after 2019 and growth will go down to normal levels around 3% in the years thereafter. Internal risks such as growing labour shortages as well as external risks such as the approaching Brexit are becoming more pronounced and acute. A hard Brexit and/or an increase in tariffs on automotive imports by the US would have a strong negative impact on the Slovak economy.

Table 6.20 / Slovakia: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020	2021
							Forecast	
Population, th pers., average	5,419	5,424	5,431	5,439	5,445	5,450	5,455	5,460
Gross domestic product, EUR mn, nom.	76,088	79,138	81,226	84,851	90,215	95,900	101,000	105,900
annual change in % (real)	2.8	4.2	3.1	3.2	4.1	3.6	3.0	2.5
GDP/capita (EUR at PPP)	21,300	22,300	22,500	22,900	24,100	.	.	.
Consumption of households, EUR mn, nom.	41,605	42,496	43,579	45,730	47,760	.	.	.
annual change in % (real)	1.4	2.3	2.9	3.5	3.0	3.3	3.0	2.8
Gross fixed capital form., EUR mn, nom.	15,772	19,213	17,280	18,155	19,510	.	.	.
annual change in % (real)	3.0	21.9	-9.4	3.4	6.0	3.0	3.5	4.0
Gross industrial production								
annual change in % (real)	2.9	6.0	3.8	2.9	2.2	2.0	1.0	1.0
Gross agricultural production								
annual change in % (real)	7.4	-3.2	13.9	-6.1	-1.4	.	.	.
Construction industry								
annual change in % (real)	-4.2	18.1	-10.7	3.0	8.4	.	.	.
Employed persons, LFS, th, average	2,363	2,424	2,492	2,531	2,560	2580	2590	2590
annual change in %	1.5	2.6	2.8	1.5	1.2	0.7	0.5	0.1
Unemployed persons, LFS, th, average	359	314	267	224	180	170	160	150
Unemployment rate, LFS, in %, average	13.2	11.5	9.7	8.1	6.5	6.2	5.8	5.6
Reg. unemployment rate, in %, eop	12.3	10.6	8.8	5.9	5.0	.	.	.
Average monthly gross wages, EUR	858	883	912	954	1,010	1080	1150	1210
annual change in % (real, gross)	4.2	3.2	3.8	3.3	3.7	4.0	3.8	3.2
Consumer prices (HICP), % p.a.	-0.1	-0.3	-0.5	1.4	2.5	2.6	2.3	2.3
Producer prices in industry, % p.a.	-3.3	-2.9	-3.9	2.5	2.3	2.5	2.5	3.0
General governm.budget, EU-def., % of GDP								
Revenues	39.3	42.5	39.2	39.4	39.8	39.1	38.9	38.6
Expenditures	42.0	45.1	41.5	40.2	40.7	39.8	39.5	38.9
Net lending (+) / net borrowing (-)	-2.7	-2.6	-2.2	-0.8	-0.9	-0.7	-0.6	-0.3
General gov.gross debt, EU def., % of GDP	53.5	52.2	51.8	50.9	48.7	48.1	47.2	46.3
Stock of loans of non-fin.private sector, % p.a.	6.7	9.7	9.3	9.9	9.8	.	.	.
Non-performing loans (NPL), in %, eop	6.0	5.2	4.7	3.9	3.3	.	.	.
Central bank policy rate, % p.a., eop [2]	0.05	0.05	0.00	0.00	0.00	.	.	.
Current account, EUR mn	871	-1,391	-1,756	-1,690	-2,255	-1,500	-1,300	-1,100
Current account, % of GDP	1.1	-1.8	-2.2	-2.0	-2.5	-1.6	-1.3	-1.0
Exports of goods, BOP, EUR mn	62,581	64,650	67,164	71,479	76,539	80,700	83,700	86,600
annual change in %	0.3	3.3	3.9	6.4	7.1	5.5	3.7	3.5
Imports of goods, BOP, EUR mn	59,823	63,601	65,527	70,789	76,491	80,000	82,800	85,900
annual change in %	0.5	6.3	3.0	8.0	8.1	4.6	3.5	3.7
Exports of services, BOP, EUR mn	6,889	7,301	8,350	9,214	9,810	10,300	10,800	11,600
annual change in %	-1.1	6.0	14.4	10.3	6.5	5.0	5.0	7.0
Imports of services, BOP, EUR mn	6,713	7,144	7,881	8,334	9,037	9,500	10,000	10,400
annual change in %	3.6	6.4	10.3	5.7	8.4	5.0	5.0	4.0
FDI liabilities, EUR mn	-324	1,357	4,326	5,313	5,726	.	.	.
FDI assets, EUR mn	94	1,266	3,684	3,603	5,497	.	.	.
Gross reserves of NB excl. gold, EUR mn	1,165	1,648	1,624	1,609	3,426	.	.	.
Gross external debt, EUR mn	67,776	67,225	73,750	94,149	100,000	105,000	110,000	110,000
Gross external debt, % of GDP	89.1	84.9	90.8	111.0	110.8	109.5	108.9	103.9

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

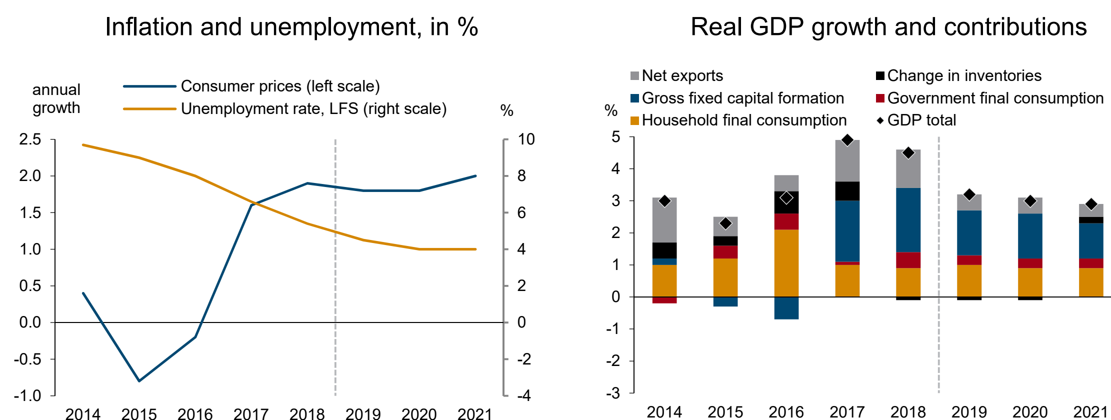
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

SLOVENIA: Solid growth

HERMINE VIDOVIC

After another successful year, GDP growth is expected to moderate to 3% or even less between 2019 and 2021. Investments spurred by EU funding and consumption backed by rising wages will continue to be important drivers of economic activity. The contribution of net exports is likely to turn negative in the forecast period given a weakening of external demand. In the medium term the shrinking of the working-age population and increasing labour shortages may become growth-limiting factors.

Figure 6.21 / Slovenia: Main macroeconomic indicators



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

Slovenia's GDP increased by an estimated 4.5% in 2018 driven by domestic demand and net exports. Private consumption grew at a surprisingly low rate (1.7%), whereas government consumption was up by almost 3% against a year earlier. Thanks to EU co-financing also gross fixed capital formation gained momentum, translating into a further increase in construction activities, non-residential building in particular. Noticeable investment growth was also reported in machinery and equipment, especially in transport equipment. Both changes in inventories and net exports contributed positively to the GDP expansion. After a solid start, industrial output growth slowed down in the second half of the year, increasing by 4.5%, with the highest growth rates reported for the manufacturing of textiles, computers and optical equipment and car production.

Labour market conditions continued to strengthen in 2018. Labour Force Survey data indicate an employment increase of 2.5% and a fall in the unemployment rate to 5.4%, narrowing to the pre-crisis level. Slovenian companies are increasingly facing labour shortages in sectors with below-average wages, becoming a limiting factor for production. So far, Slovenian firms have relied at least partially on

the admission of foreign workers to address the problem of labour shortage. In 2018, foreign workers accounted for about 10% of total employment, the majority coming from Bosnia and Herzegovina, Serbia, Croatia, Kosovo and Macedonia, and were primarily employed in construction, manufacturing and transport and storage. Average real gross wages rose only moderately in 2018, by 1.6%, which is partly due to the fact that the employment of low-wage earners has risen the most, thus having a low impact on average wage growth. Wage growth in 2019 will be impacted by wage increases for public sector employees agreed between the government and public sector trade unions in late 2018.

Consumer price inflation averaged 1.9% in 2018 and was mainly driven by external factors. Inflation was mainly impacted by energy prices, which however eased off towards the end of the year. It is expected that over the forecast horizon, higher wage increases will lead to rising services prices. Real estate prices have been rising since the end of 2014 and recorded their highest growth after the crisis in 2018. In the third quarter of 2018 Slovenia recorded the highest annual increase in housing prices (15.1%) among EU countries. Available data do currently not indicate an overheating of the housing market: prices have reached only their pre-crisis level and the ratio of real estate prices to income stood at its long-term average. In Slovenia only about 10% of households have a mortgage compared to 19% in the euro area, and about a third of the recent real estate transactions was carried out without bank financing.[33]

External trade growth was weaker than a year earlier, but still at high levels. Goods exports and imports rose by 9% and 11% respectively in 2018 with the trade surplus by EUR 330 million lower than a year earlier. By contrast, in services trade the surplus widened owing to exports – transport, travel in particular – rising ahead of lower import growth. The primary income deficit narrowed compared to a year earlier, while the secondary income shortfall increased modestly. The current account surplus reached an all-time high of EUR 3.4 billion or 7.4% of GDP. Foreign direct investment inflows were higher than a year earlier, amounting to EUR 1.3 billion in 2018.

The general government budget closed again with a surplus in 2018 (0.8% of GDP) compared to an almost balanced budget in 2017. This was made possible through an increase in total tax revenues and social contributions, higher inflows from the EU budget as well as dividends from Nova Ljubljanska Banka including retained profits from previous years. On the expenditures side, spending grew at a much lower rate than revenues. Also the continuing decline of interest payments contributed significantly to the improvement of the fiscal stance.

The Slovenian government eventually sold 65% of Nova Ljubljanska Banka (NLB) in a public offering in November 2018. Currently the state holds a 35% share, the EBRD 6.3% and Brandes Investment Partners 7.6%. Details about other buyers were not reported by the NLB. The privatisation of the country's biggest bank was part of the restructuring plan agreed with the European Commission in 2013 when the state aid contribution was approved. Another 10% will be sold in 2019 and by the end of the year the Slovenian government will reduce its share in the bank to 25% plus one share. Also Abanka, the country's third largest bank, is expected to be privatised in 2019.

[33] IMF Country Report No. 19/58, February 2019, p. 12.

Lending activities of banks strengthened in 2018, mainly due to increasing household loans. Within household loans (+6%), consumer loans grew by 11% and housing loans by around 5%, while loans to enterprises and non-financial institutions decreased by 1.4%. After reaching a peak of 14.5% in 2012, the share of non-performing loans (NPLs) in total loans fell substantially, to 2.5% in 2018. But, NPLs of small and medium-sized enterprises remained at two-digit levels. In the last months of 2018 bank deleveraging abroad came to a halt. Between 2008 and November 2018 banks reduced their exposure from EUR 18 billion to EUR 1.6 billion.

The outlook remains favourable. wiiw expects GDP to grow at around 3% annually in the 2019-2021 period backed by domestic demand, while the contribution of net exports will turn negative. Fuelled by EU transfers, investments are expected to remain high. Private consumption will also remain an important driver, boosted by a continued improvement in the labour market, rising wages due to increasing labour shortages and continued credit growth. Labour market conditions will improve further, but at a slower pace than in recent years. Along with rising employment, unemployment is expected to continue its downward path, not least because of the shrinking working-age population. The strengthening of domestic demand will lead to rising imports and consequently result in lower trade surpluses. The services trade surplus, by contrast, may remain stable. Thus, the current account will remain in positive territory, but is expected to decline along with lower trade surpluses. Downside risks come mainly from outside: an economic slowdown in Slovenia’s major trading partners, e.g. Italy, could dampen exports.

Table 6.21 / Slovenia: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020 Forecast	2021
Population, th pers., average	2,062	2,064	2,065	2,066	2,070	2,070	2,070	2,070
Gross domestic product, EUR mn, nom.	37,603	38,863	40,357	43,000	45,800	48,100	50,400	52,900
annual change in % (real)	3.0	2.3	3.1	4.9	4.5	3.2	3.0	2.9
GDP/capita (EUR at PPP)	22,700	23,800	24,100	25,500	27,000	.	.	.
Consumption of households, EUR mn, nom.	20,137	20,482	21,187	21,963	22,800	.	.	.
annual change in % (real)	1.9	2.3	4.0	1.9	1.7	2.0	1.8	1.8
Gross fixed capital form., EUR mn, nom.	7,287	7,313	7,082	7,962	9,000	.	.	.
annual change in % (real)	1.0	-1.6	-3.7	10.7	11.0	7.5	7.5	6.0
Gross industrial production								
annual change in % (real)	2.3	5.6	7.1	7.7	4.5	5.5	5.0	4.5
Gross agricultural production								
annual change in % (real)	11.1	6.4	-3.2	-9.7	17.5	.	.	.
Construction industry								
annual change in % (real)	19.5	-8.2	-17.7	17.7	19.8	.	.	.
Employed persons, LFS, th, average	916.7	917.4	915.0	959.1	983.0	1,000	1,020	1,030
annual change in %	1.2	0.1	-0.3	4.8	2.5	2.0	1.5	1.0
Unemployed persons, LFS, th, average	98.1	90.3	79.6	67.4	56.0	47	43	43
Unemployment rate, LFS, in %, average	9.7	9.0	8.0	6.6	5.4	4.5	4.0	4.0
Reg. unemployment rate, in %, eop	13.0	12.3	10.8	9.0	8.1	.	.	.
Average monthly gross wages, EUR [2]	1,540	1,556	1,584	1,626	1,682	1,750	1,820	1,870
annual change in % (real, gross)	0.9	1.2	1.9	1.3	1.7	2.0	2.0	1.0
Average monthly net wages, EUR [2]	1,005	1,013	1,030	1,062	1,093	1,130	1,170	1,220
annual change in % (real, net)	0.6	0.9	1.8	1.7	1.2	2.0	2.0	2.0
Consumer prices (HICP), % p.a.	0.4	-0.8	-0.2	1.6	1.9	1.8	1.8	2.0
Producer prices in industry, % p.a.	-0.7	-0.2	-1.4	2.2	2.1	2.0	2.0	2.0
General governm.budget, EU-def., % of GDP								
Revenues	44.4	44.9	43.4	43.2	42.9	42.2	42.0	41.5
Expenditures	49.9	47.7	45.3	43.2	42.1	41.8	41.8	41.5
Net lending (+) / net borrowing (-)	-5.5	-2.8	-1.9	0.1	0.8	0.4	0.2	0.0
General gov.gross debt, EU def., % of GDP	80.4	82.6	78.7	74.1	70.2	66.0	63.0	61.0
Stock of loans of non-fin.private sector, % p.a.	-13.4	-6.4	-3.9	1.9	3.0	.	.	.
Non-performing loans (NPL), in %, eop	11.9	9.9	5.5	3.7	2.5	.	.	.
Central bank policy rate, % p.a., eop [3]	0.05	0.05	0.00	0.00	0.00	.	.	.
Current account, EUR mn	2,179	1,760	2,224	3,077	3,375	3,260	3,100	3,130
Current account, % of GDP	5.8	4.5	5.5	7.2	7.4	6.8	6.2	5.9
Exports of goods, BOP, EUR mn	22,961	24,039	24,991	28,462	31,151	33,640	35,990	38,330
annual change in %	5.9	4.7	4.0	13.9	9.4	8.0	7.0	6.5
Imports of goods, BOP, EUR mn	21,780	22,563	23,454	26,901	29,927	32,620	35,390	38,220
annual change in %	3.8	3.6	3.9	14.7	11.2	9.0	8.5	8.0
Exports of services, BOP, EUR mn	5,558	5,936	6,487	7,275	8,016	8,620	9,220	9,870
annual change in %	4.5	6.8	9.3	12.1	10.2	7.5	7.0	7.0
Imports of services, BOP, EUR mn	3,862	4,007	4,236	4,556	4,867	5,180	5,520	5,850
annual change in %	7.7	3.8	5.7	7.6	6.8	6.5	6.5	6.0
FDI liabilities, EUR mn	739	1,560	1,298	966	1,282	.	.	.
FDI assets, EUR mn	155	292	434	551	150	.	.	.
Gross reserves of NB excl. gold, EUR mn	736	687	593	632	702	.	.	.
Gross external debt, EUR mn	47,287	46,627	44,810	43,813	42,567	42,300	42,800	43,400
Gross external debt, % of GDP	125.8	120.0	111.0	101.9	92.9	88.0	85.0	82.0

1) Preliminary and wiiw estimates. - 2) From 2015 new data sources in public sector. - 3) Official refinancing operation rates for euro area (ECB).

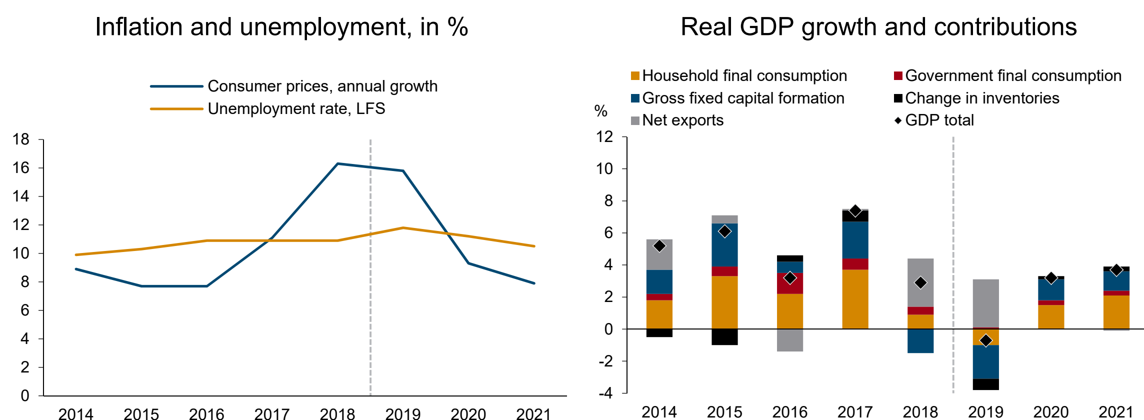
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

TURKEY: A tough adjustment and a challenging year ahead

RICHARD GRIEVESON

The worst of the crisis may have passed, assuming that the government does not attempt any radical measures and that relations with the US do not deteriorate. However, the economy will have a difficult year in 2019. Things should improve by 2020, with the economy bouncing back to reasonable growth. External risks remain, but the current account deficit has shrunk considerably, reducing vulnerabilities, and a more dovish US Federal Reserve provides important support.

Figure 6.22 / Turkey: Main macroeconomic indicators



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

The Turkish economy faced a big external shock in the middle of 2018, but in the end the necessary policy response arrived and the worst of the crisis is likely to have passed. After the lira collapsed, inflation rocketed and capital outflows increased sharply, the central bank responded with a hefty tightening of monetary policy. The lira has since stabilised and even recovered, and foreign investor confidence appears to have returned somewhat.

The economy has already undergone a strong external adjustment, with imports falling sharply and exports growing strongly. Investment has collapsed and private consumption is also struggling. Business and consumer sentiment has taken a knock from the spike in inflation, weaker lira, and much higher domestic interest rates. Even though economic growth was still very strong at the start of 2018, overall real GDP growth last year is likely to have only been around 3%, indicating a sharp slowdown in the final quarter of the year in particular.

The economy is now in recession, and will remain so for at least 1-2 more quarters, indicating that overall growth in 2019 is likely to be negative. The impact of the shocks that hit the economy in 2018 is still making its way through the system. Investment and private consumption are likely to struggle for several quarters at least. Real interest rates will remain firmly in positive territory this year, with the central bank set to remain wary of renewed lira volatility, which will weigh on investment. Turkey's labour market is suffering, with employment growth now negative for the first time since 2009, led above all by a collapse in construction jobs (the construction boom is firmly over). Employment growth in services and industry has also weakened.

The main support to growth will come from net exports, with weak domestic demand set to constrain imports, and exports likely to continue to perform well on the back of the weaker lira and Turkish firms' historic strength in reorienting sales towards pockets of stronger foreign demand. However, by CESEE standards Turkey is a fairly closed economy, which will limit the impact of the net export adjustment on headline real GDP growth. The government will keep fiscal policy as loose as it can get away with, but the contribution from this to overall growth will be quite limited.

We now expect a full-year contraction of 0.7% this year, down from our previous forecast of 0.5% growth. Predicting the extent of the downturn is tricky, given the scale of the shocks that have hit the economy, but it is clear that this year will be a difficult one for Turkey. Ahead of March's local election, the government loosened fiscal policy somewhat in late 2018 in an attempt to shore up support. However, the most recent leading indicators, such as retail sales and industrial output, suggest that the economy is in the midst of a fairly deep downturn. Both fell by around 7.5% year on year in the final quarter of 2018.

The risks of a return to the huge volatility of mid-2018 cannot be ruled out, but several stabilising factors suggest that these risks are lower than was the case last year. First, the improvement in relations with the US has been key, helped above all by the release of a jailed US pastor in Turkey. The risk of a broader economic conflict between the two countries, including the chances of serious US sanctions on Turkey, was a major factor behind the volatility of mid-2018 in our view. Turkey could not have withstood a barrage of US sanctions in the same way as Russia did. The second major stabilising factor is the much more dovish tone from the US Federal Reserve in recent months, with monetary tightening now set to continue at a much slower pace than previously expected (if at all). Third, Turkey's external borrowing needs will be much reduced relative to previous years, on the back of a smaller current account deficit (although rollover of existing external debt commitments remain significant). Finally, high domestic real interest rates will be a source of stability for the external accounts, and support continued capital inflows.

Some other factors could mitigate the downturn in economic growth this year. The recovery in and relative stability of the lira could support consumer and business confidence. Tourism has recovered strongly, and 2019 should be another good year of inflows. Meanwhile lower oil prices should help with the general easing of inflation that we expect during the year, thereby lending some support to private consumption.

Our view remains that the recession will be quite brief, and that the economy will return to growth in 2020. We have become slightly less optimistic about the scale of the bounce-back in 2020, but still forecast real GDP growth of a bit over 3% next year, and then around 3.7% in 2021, both

respectable rates of expansion in the CESEE context. Oil prices will stay low, supporting real incomes and consumption. The weaker lira will help further growth of exports. The central bank will ease monetary policy as early as it can (meaning maybe 2019 but certainly by 2020), supporting a revival in credit growth. Meanwhile, unlike most countries in CESEE, Turkey's positive demographics will provide an underlying driver of economic growth.

A key reason that we are slightly less optimistic about 2020 than we were in the autumn is that Turkey is now operating in a different global economy. Over recent months it has become clear how much the global economy has slowed. By 2020, the US and China will be doing less well, and the eurozone is likely to continue to bump along the bottom. From the Turkish perspective, this is probably a net positive in terms of macroeconomic stability (as it suggests the monetary policy of the big central banks will be looser for longer), but negative from the perspective of external demand.

For 2019 and 2020, we see several big risks that will be key to determining the fortunes and stability of the Turkish economy. First, it will be important to see how well the banking sector can hold up, amid an expected deterioration in asset quality on the back of lira depreciation and recession. Although the starting point in terms of non-performing loans and capital levels appears to be sound, this will certainly be affected by the scale of the shocks of 2018. Second, relations with the US will remain key. US President Donald Trump's public utterances should always be treated cautiously, but this threat in January to 'devastate Turkey economically' if the country's military attacks US-backed Kurdish forces in Syria caused understandable concern. Any renewed downturn in relations between the two countries could increase speculation of new US sanctions on Turkey, thereby negatively affecting investor confidence and willingness to finance Turkish debt rollovers. Third, there remains the question of the economy's ability to meet its still-significant external debt rollover needs more generally (short-term foreign exchange debt totalled around USD 116bn at end-2018, equivalent to around 16% of last year's GDP).

Regarding external debt rollovers, recent developments appear supportive, with a more dovish Fed set to mean strong dollar liquidity conditions. Foreign inflows into Turkish equities, for example, were very strong at the start of 2019, implying returning investor confidence in Turkey. The government remains able to borrow in foreign currency, and the central bank dollar swap arrangement with Qatar has boosted reserves. The final risk is that, encouraged by the more dovish Fed, and under political pressure, the central bank loosens monetary policy prematurely. This could lead to renewed capital outflows and difficulties in rolling over external debt. Although probably only a small risk in the near term, given that the memory of the 2018 crisis is so fresh (and the central bank was quite strong and hawkish in its wording in January), as time passes, and if volatility remains low, this could become more tempting for the authorities.

A final medium-term concern is the decline in the quality of the business environment, including in regard to institutions. Turkey is hardly alone in this: institutional de-convergence with Western Europe has been apparent across much of CESEE in the past decade. Moreover, in terms of levels Turkey is far from the worst in the region (its institutions are generally much better than those of the CIS, for example). Nevertheless, on at least some measures, trends in Turkey (along with Hungary) appear to be particularly concerning. Turkey's scores for the World Bank Governance Indicators related to corruption, government effectiveness, the rule of law, regulatory quality and voice and accountability all

deteriorated notably between 2007 and 2017. Transparency International's Corruption Perceptions Index also shows a decline for Turkey in recent years.

A decline in the quality of institutions and the business environment more generally will make it even more difficult for Turkey to shift to a more sustainable FDI-driven growth model. This means there are really only two alternatives for the Turkish economy in the medium term. First, Turkey can continue to rely on hot money flows to fund consumption and investment. This means that much of the time growth could be quite strong, but also that Turkey will be exposed to changes in foreign investor sentiment, and meaning that it will always face the risk of harsh adjustments like the one it is currently going through. If US rates continue to rise, this model will become even more problematic. Second, if hot money is not available, and with Turkey having such a low level of domestic savings, a much lower rate of growth than in the historical period will become almost inevitable. The first scenario looks more likely, but the cycles of boom and bust could become shorter.

Table 6.22 / Turkey: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020	2021
							Forecast	
Population, th pers., average	77,182	78,218	79,278	80,313	81,407	81,900	82,700	83,600
Gross domestic product, TRY bn, nom.	2,044	2,339	2,609	3,107	3,700	4,300	4,900	5,500
annual change in % (real)	5.2	6.1	3.2	7.4	2.9	-0.7	3.2	3.7
GDP/capita (EUR at PPP)	17,700	19,300	19,200	19,900	20,400	.	.	.
Consumption of households, TRY bn, nom.	1,242	1,412	1,561	1,834	2,170	.	.	.
annual change in % (real)	3.0	5.4	3.7	6.1	1.6	-1.7	2.5	3.5
Gross fixed capital form., TRY bn, nom.	591	695	765	932	1,030	.	.	.
annual change in % (real)	5.1	9.3	2.2	7.8	-5.0	-7.0	4.2	4.0
Gross industrial production [2]								
annual change in % (real)	5.8	6.2	3.4	8.9	1.7	-1.0	2.8	3.0
Gross agricultural production [3]								
annual change in % (real)	-2.9	5.2	0.5	2.0	0.5	.	.	.
Construction industry [2]								
annual change in % (real)	3.0	1.7	2.9	3.8	-5.0	.	.	.
Employed persons, LFS, th, average	25,931	26,619	27,216	28,197	28,734	28,700	29,400	30,100
annual change in %	5.4	2.7	2.2	3.6	1.9	0.0	2.5	2.5
Unemployed persons, LFS, th, average	2,854	3,050	3,332	3,451	3,535	3,840	3,710	3,530
Unemployment rate, LFS, in %, average	9.9	10.3	10.9	10.9	10.9	11.8	11.2	10.5
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.	.
Average monthly gross wages, TRY [4]	1,820	2,014	2,280	2,470	2,690	3120	3510	3920
annual change in % (real, gross)	1.3	2.8	5.2	-2.5	-2.0	0.0	2.8	3.5
Consumer prices (HICP), % p.a.	8.9	7.7	7.7	11.1	16.3	15.8	9.3	7.9
Producer prices in industry, % p.a. [5]	10.1	5.3	4.3	15.8	27.0	22.2	13.5	10.2
General governm. budget, nat.def., % of GDP								
Revenues	31.9	31.9	33.0	30.2	30.0	31.0	32.2	33.5
Expenditures	32.7	32.9	34.7	32.2	33.3	34.0	34.5	35.7
Deficit (-) / surplus (+)	-0.8	-1.0	-1.7	-2.0	-3.3	-3.0	-2.3	-2.2
General gov.gross debt, nat.def., % of GDP	28.8	27.6	28.3	28.3	30.5	31.0	31.0	30.5
Stock of loans of non-fin.private sector, % p.a.	19.4	19.4	15.2	19.9	9.6	.	.	.
Non-performing loans (NPL), in %, eop	2.8	3.1	3.2	2.9	3.9	.	.	.
Central bank policy rate, % p.a., eop [6]	8.25	7.50	8.00	8.00	24.00	22.00	15.00	13.00
Current account, EUR mn	-33,010	-28,919	-29,917	-41,758	-22,628	-2,500	-9,900	-15,100
Current account, % of GDP	-4.7	-3.7	-3.8	-5.5	-3.5	-0.4	-1.4	-1.9
Exports of goods, BOP, EUR mn	127,237	136,978	135,795	147,218	148,101	158,000	162,000	170,000
annual change in %	4.4	7.7	-0.9	8.4	0.6	7.0	2.5	5.0
Imports of goods, BOP, EUR mn	175,310	180,353	172,701	198,906	182,729	179,000	190,000	203,000
annual change in %	-3.7	2.9	-4.2	15.2	-8.1	-2.0	6.0	7.0
Exports of services, BOP, EUR mn	39,175	42,419	34,125	38,588	40,680	44,000	45,000	47,000
annual change in %	7.9	8.3	-19.6	13.1	5.4	7.0	2.0	5.0
Imports of services, BOP, EUR mn	19,050	20,563	20,366	21,250	19,519	19,000	20,000	22,000
annual change in %	3.2	7.9	-1.0	4.3	-8.1	-3.0	7.5	8.0
FDI liabilities, EUR mn	9,865	16,216	12,077	9,643	11,224	.	.	.
FDI assets, EUR mn	5,379	4,595	2,845	2,418	3,071	.	.	.
Gross reserves of NB excl. gold, EUR mn [7]	88,055	85,356	87,334	70,202	63,666	.	.	.
Gross external debt, EUR mn [7]	334,184	367,716	388,243	379,454	395,400	423,100	432,400	471,400
Gross external debt, % of GDP	47.5	47.6	49.8	50.3	61.0	61.0	60.0	60.0
Average exchange rate TRY/EUR	2.9065	3.0255	3.3433	4.1206	5.7077	6.20	6.80	7.00

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

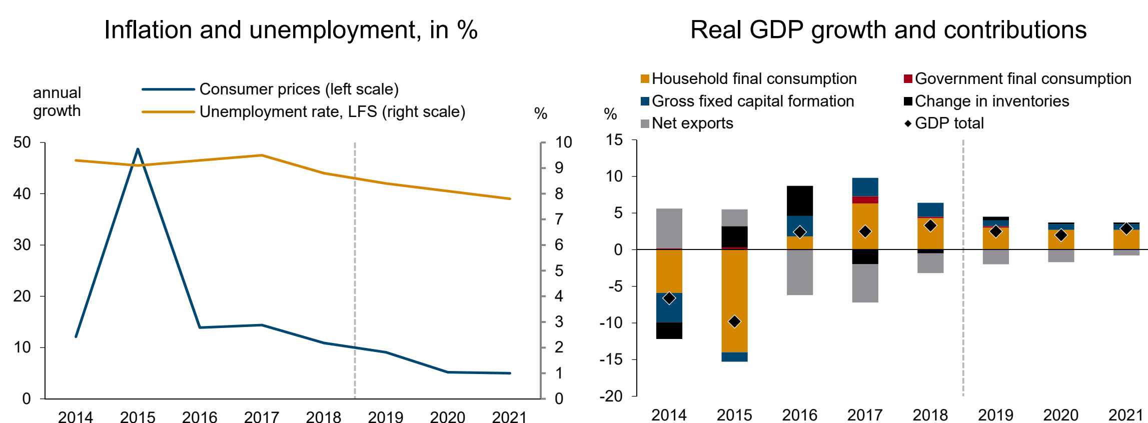
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

UKRAINE: Growth slowdown on the horizon

VASILY ASTROV

In 2018, Ukraine's economy recorded its highest growth since 2011 thanks to robustly rising wages and remittances, currency stability, and a record grain harvest. However, growth is projected to lose steam this year on the back of monetary tightening and a lower harvest, and owing to reduced gas transit revenues next year. The forthcoming presidential elections may result in more populist economic policies, but will not change the country's current EU and NATO integration efforts.

Figure 6.23 / Ukraine: Main macroeconomic indicators



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

In 2018, Ukraine's economy recorded its highest growth since 2011, driven entirely by domestic demand. According to the preliminary estimate, GDP growth in 2018 was around 3.3%. The main growth drivers were robust wage growth, rising remittances, exchange rate stability, and a record harvest of grains and oilseeds. Thanks to the latter, agricultural production surged by 7.8%, partly on account of the low statistical base. The dynamics in other sectors was less impressive: the growth of construction output decelerated markedly (to 4.4%) after the boom observed in the two previous years, whereas industrial output picked up by only 1.1%, after near-stagnation the year before.

Retail trade turnover – a proxy for private consumption – picked up by 6.1% last year, backed by the strong growth in wages, pensions, and remittances. Real wages soared by 12.5%, partly thanks to the hike in the minimum wage (by 16% in nominal terms starting from January 2018), which led to a corresponding indexation of wages and salaries in the public sector. More generally, the strong wage growth reflected progressive tightening of the labour market and the emerging shortages in some of the labour market segments, particularly for high-skilled jobs. The unemployment rate (according to the LFS definition) probably declined below 9%. This decline can be attributed above all to the rising demand for

labour: employment recorded positive dynamics for the first time since 2013, outpacing the growth of labour supply which was constrained by the sharply increased outward labour migration. The latter has gained momentum since the EU Schengen area abolished the visa regime for Ukrainians (in June 2017) and a number of Central European countries, such as Poland and the Czech Republic, launched recruitment efforts of Ukrainian workers to alleviate domestic labour shortages.

At the same time, net exports became even more of a drag on growth, mostly due to disappointing export performance. Real exports of goods and services probably declined by some 4% last year, partly on account of transportation bottlenecks in the Azov Sea and maintenance works at several metallurgical plants. In nominal (US dollar) terms, export dynamics was positive (+9.5%) thanks to an increase in commodity prices, but still lagging behind that of imports (+12.8%). As a result, the current account deficit widened noticeably, from 2.2% of GDP in 2017 to an estimated 3.6% last year – even despite the strong increase in the inflow of remittances (by 18.7% in US dollar terms). The widening of the external deficit was partly the consequence of real currency appreciation: the real effective exchange rate strengthened by 13.2% last year, according to the National Bank's calculations.

About half of currency appreciation has been on account of the high inflation. Last year, the CPI index reached 9.8% on an end-year basis (producer price inflation was even higher), suggesting only a minor disinflation compared to the previous years. Thus, the National Bank's inflation target set for 2018 (6±2%) was missed once again – despite the progressive tightening of monetary policy: since October 2017, the key policy rate has been raised six times by a total of 5.5 percentage points, to 18%. The high inflation is to a large extent a reflection of strongly growing wages and unit labour costs, but also of the hikes of administrative prices and tariffs (which went up by 18% last year) as well as rising energy prices.

In December 2018, Ukraine received a new stand-by agreement (SBA) from the IMF worth USD 3.9 billion, of which USD 1.4 billion was immediately disbursed. The SBA agreement is less demanding on 'structural' benchmarks and has only a 14-months duration, but should allow Ukraine to sail safely through the politically turbulent year 2019, when both presidential and parliamentary elections will be held (in March and October, respectively). Indeed, the SBA has proved crucial in stabilising exchange rate expectations and allowed the National Bank to substantially liberalise, as of February 2019, foreign exchange transactions, which – despite certain incremental relaxations – have remained heavily regulated since 2015.[34] Besides, the new agreement with the IMF has enabled Ukraine to attract funding from other sources such as Deutsche Bank (EUR 349 million) and the EU (EUR 500 million under a new MFA programme), and allowed the government to resume borrowing from international financial markets. However, the 9-9.75% yield on the newly issued sovereign (US dollar-denominated) Eurobonds is very high (as recently as in spring 2018 it stood at around 5%) – a reflection of broad perceptions of the country's macroeconomic fragility.

The current pace of economic expansion will not be sustained in the years to come. In 2019, it is projected to slow down to some 2.5%, primarily on the back of a less abundant harvest as well as recent monetary policy tightening. This should constrain bank lending to households (from a rather high level: last year, it grew by 31.4% in nominal terms) and suppress private consumption and, to a lesser

[34] Among the newly introduced measures are the extension of the time limit for settlements under foreign trade contracts (from 180 to 365 days), lifting of the registration requirement for cross-border loans and of financial monitoring for foreign exchange transactions of less than UAH 150,000, relaxation of access for non-residents to Ukrainian accounts, etc.

degree, investments (the bulk of which are financed from profits rather than by taking credit). At the same time, fiscal policy will remain generally lax in the pre-election context. Among the pre-election ‘carrots’ approved by the government as of 1 March are (i) an ‘automatic’ 17% indexation of pensions for more than 10 million pensioners, (ii) a lump-sum extra payment to pensioners of some USD 90 paid over March-April 2019, and (iii) monetisation of gas subsidies, which should benefit some 4 million families. All in all, the 2019 budget law envisages a 32% hike in social spending (in nominal terms), resulting in a likely widening of the fiscal deficit to 2.3% of GDP, after 1.9% of GDP in 2018.

For 2020, GDP growth may slow down further, to around 2%. In the baseline scenario, the main reason for this is the expected drastic reduction of transit of Russian gas to Europe via Ukraine, depriving Ukraine of the bulk of gas transit fees (which are to the tune of 2% of GDP). The current ten-year transit contract with Russia’s Gazprom expires at the end of 2019, and its prolongation is highly uncertain, since Russia is planning to divert a large part of its gas destined for Europe to the North Stream 2 pipeline (across the Baltic Sea) as well as the newly built Turkish Stream pipeline (across the Black Sea). Although Russia may still agree to retain the bulk of gas transit through Ukrainian territory, such a decision will depend above all on political factors (including the verdict of the Arbitration Court in Stockholm in a dispute between Russia’s Gazprom and Ukraine’s Naftogaz) and will be taken after the presidential elections.

The outcome of the presidential election has become more uncertain …, with the former twice prime minister Yuliya Tymoshenko no longer being the overwhelming favourite. Unlike in previous elections, even the outcome of the first round (which will take place on 31 March 2019) is highly uncertain, with incumbent President Petro Poroshenko, Ms Tymoshenko, and comedian Volodymyr Zelenskiy (who is believed to have strong ties to oligarch Ihor Kolomoyski, now in opposition) all having nearly equal chances of making it into the second round. The rating of Mr Poroshenko has benefited recently from the official split of the Ukrainian Orthodox church from the Russian church and the newly introduced constitutional amendments stating Ukraine’s aspirations to join the EU and NATO. This, and arguably the imposition of one-month martial law in ten regions of the country following the military clash with Russia in the Kerch Straits in November 2018,[35] has helped Mr Poroshenko to improve his image among nationalistic circles and boosted his chances of making it into the second round, which is scheduled for 21 April 2019.

… but no turnaround in Ukraine’s pro-Western foreign and security policies is to be expected. The country will almost certainly remain in the Western political orbit, and any future president will have to reckon in the foreseeable future with pronounced anti-Russian sentiment in the majority of the Ukrainian society (with the exception of the Southeast, but voters’ turnout there is expected to be low). This implies that the chances for the implementation of the Minks-2 ceasefire agreement, which involves granting autonomy status to the rebel-held areas of Donbas and amnesty to the rebel fighters, will continue to be low. Therefore, our baseline scenario with respect to Donbas remains that of a lasting ‘semi-frozen conflict’. At the same time, there may be some important changes in economic policy, especially in the case of victory by Ms Tymoshenko, who has a history of populist and erratic policies and is now promising to lower gas tariffs for households and boost spending on health and education. This would be a major departure from the current, generally rather liberal, policy course, which could make future cooperation with the IMF even more problematic.

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[35] For our assessment of the implications of the Kerch Straits incident, see https://wiiw.ac.at/the-kerch-straits-clash-another-spiral-in-the-russia-ukraine-conflict-n-352.html

Table 6.23 / Ukraine: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020	2021
							Forecast	
Population, th pers., average	43,001	42,845	42,673	42,485	42,270	42,150	42,050	41,950
Gross domestic product, UAH bn, nom.	1,587	1,989	2,385	2,984	3,500	3,900	4,200	4,500
annual change in % (real)	-6.6	-9.8	2.4	2.5	3.3	2.5	2.0	2.9
GDP/capita (EUR at PPP)	6,400	6,000	6,000	6,100	6,400	.	.	.
Consumption of households, UAH bn, nom.	1,121	1,332	1,570	1,978	2,340	.	.	.
annual change in % (real)	-8.3	-19.8	2.7	9.5	6.5	4.5	4.0	4.0
Gross fixed capital form., UAH bn, nom.	224	269	369	470	620	.	.	.
annual change in % (real)	-24.0	-9.2	20.4	16.1	12.0	5.0	5.0	5.0
Gross industrial production								
annual change in % (real)	-10.1	-13.0	2.8	0.4	1.1	2.5	3.0	3.5
Gross agricultural production								
annual change in % (real)	2.2	-4.8	6.3	-2.2	7.8	.	.	.
Construction output								
annual change in % (real)	-20.4	-12.3	17.4	26.3	4.4	.	.	.
Employed persons, LFS, th, average	18,073	16,443	16,277	16,156	16,340	16,450	16,500	16,550
annual change in %	-6.4	-0.4	-1.0	-0.7	1.1	0.7	0.3	0.3
Unemployed persons, LFS, th, average	1,848	1,655	1,678	1,698	1,580	1,510	1,450	1,400
Unemployment rate, LFS, in %, average	9.3	9.1	9.3	9.5	8.8	8.4	8.1	7.8
Reg. unemployment rate, in %, eop [2]	1.7	1.6	1.5	1.4	1.3	.	.	.
Average monthly gross wages, UAH [3]	3,480	4,195	5,183	7,104	8,865	10,300	11,400	12,600
annual change in % (real, gross)	-5.4	-18.9	8.5	19.8	12.5	7.0	5.0	5.0
annual change in % (real, net)	-6.5	-20.2	9.0	19.0	12.5	7.0	5.0	5.0
Consumer prices, % p.a.	12.1	48.7	13.9	14.4	10.9	9.1	5.2	5.0
Producer prices in industry, % p.a. [4]	17.1	36.0	20.5	26.4	17.4	8.0	6.0	6.0
General governm.budget, nat.def., % of GDP								
Revenues	28.7	32.8	32.8	34.1	33.8	33.7	33.7	33.7
Expenditures	33.3	34.3	35.1	35.5	35.8	36.0	35.7	35.7
Deficit (-) / surplus (+) [5]	-4.5	-1.6	-2.3	-1.4	-1.9	-2.3	-2.0	-2.0
General gov.gross debt, nat.def., % of GDP	69.4	79.1	80.9	71.8	62.0	62.0	62.0	59.0
Stock of loans of non-fin.private sector, % p.a.	11.8	-2.8	2.4	1.9	5.6	.	.	.
Non-performing loans (NPL), in %, eop [6]	19.0	28.0	30.5	54.5	54.0	.	.	.
Central bank policy rate, % p.a., eop [7]	14.00	22.00	14.00	14.50	18.00	15.0	12.0	10.0
Current account, EUR mn [8]	-3,476	1,457	-1,210	-2,165	-3,938	-4,200	-6,000	-7,100
Current account, % of GDP	-3.4	1.8	-1.4	-2.2	-3.6	-3.8	-5.3	-6.0
Exports of goods, BOP, EUR mn [8]	38,235	31,935	30,309	35,192	36,678	40,300	41,900	43,200
annual change in %	-14.1	-16.5	-5.1	16.1	4.2	9.9	4.0	3.1
Imports of goods, BOP, EUR mn [8]	43,626	35,050	36,579	43,758	47,640	52,800	55,000	57,500
annual change in %	-28.7	-19.7	4.4	19.6	8.9	10.8	4.2	4.5
Exports of services, BOP, EUR mn [8]	11,257	11,218	11,242	12,558	13,259	14,800	13,700	14,100
annual change in %	-33.9	-0.4	0.2	11.7	5.6	11.6	-7.4	2.9
Imports of services, BOP, EUR mn [8]	9,350	10,232	10,801	11,655	12,022	13,100	13,700	14,200
annual change in %	-23.0	9.4	5.6	7.9	3.1	9.0	4.6	3.6
FDI liabilities, EUR mn [8]	641	2,750	3,108	2,506	2,107	.	.	.
FDI assets, EUR mn [8]	414	34	156	207	107	.	.	.
Gross reserves of NB excl. gold, EUR mn [8]	5,429	11,320	13,965	14,872	15,955	.	.	.
Gross external debt, EUR mn [8]	102,728	107,663	107,648	96,741	98,000	98,500	99,500	100,500
Gross external debt, % of GDP	101.7	131.2	127.7	97.3	90.0	88.4	87.7	84.9
Average exchange rate UAH/EUR	15.72	24.23	28.29	30.00	32.14	35.0	37.0	38.0

Note: excluding the occupied territories of Crimea and Sevastopol and from 2015 (except for population) temporarily occupied territories in the Donetsk and Luhansk regions.

1) Preliminary and wiiw estimates. - 2) In % of working age population. - 3) Enterprises with 10 and more employees. - 4) Domestic output prices. - 5) Without transfers to Naftohaz and other bail-out costs, in 2014 including VAT refund via issued government bonds. - 6) From 2017 including NPLs of the nationalised Privatbank and changes in rules of credit risk assessment. - 7) Discount rate of NB. - 8) Converted from USD.

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

7. Appendix

Table 7.1 / European Union – Central and Eastern Europe (EU-CEE11): An overview of economic fundamentals, 2018

	BG	CZ	EE	HR	HU	LT	LV	PL	RO	SI	SK	*EU-CEE11* [1)]	*EU28* [2)]
Gross domestic product													
EUR bn, at ER	54.6	207.4	25.2	51.5	130.1	44.8	29.0	497.5	204.1	45.8	90.2	*1,380*	*15,905*
EUR bn, at PPP	109.2	296.8	32.7	79.7	211.5	69.6	41.2	853.4	388.3	55.8	131.1	*2,269*	*15,905*
EU28=100, at PPP	0.7	1.9	0.2	0.5	1.3	0.4	0.3	5.4	2.4	0.4	0.8	*14.3*	*100.0*
Per capita, EUR, at PPP	15,600	27,900	24,800	19,400	21,700	24,900	21,300	22,200	19,900	27,000	24,100	*22,000*	*31,000*
Per capita, EU28=100, at PPP	50	90	80	63	70	80	69	72	64	87	78	*71*	*100*
1990=100 [3)]	144.6	170.2	174.3	119.0	154.4	148.0	133.7	246.8	181.8	179.3	208.6	*201.7*	*164.4*
2007=100	124.3	119.6	111.5	101.1	116.7	118.0	105.5	146.3	134.3	111.1	132.0	*130.8*	*111.6*
Price level													
EU28=100 (PPP/ER)	50	70	77	65	62	64	70	58	53	82	69	*61*	*100*
Industrial production													
2007=100 [4)]	99.1	120.0	135.8	91.2	120.7	129.7	124.0	152.3	152.7	117.0	149.6	*137.5*	*102.3*
Population													
in thousand, average	7,000	10,640	1,320	4,100	9,750	2,800	1,930	38,400	19,500	2,070	5,445	*102,955*	*513,771*
Employed persons, LFS													
in thousand, average	3,153	5,294	665	1,650	4,470	1,366	910	16,550	8,690	983	2,560	*46,290*	*230,431*
Unemployment rate, LFS													
in %	5.2	2.2	5.5	8.8	3.7	6.4	7.4	3.8	4.2	5.4	6.5	*4.3*	*6.8*
Average gross monthly wages													
EUR	580	1,248	1,310	1,139	1,035	920	1,010	1,070	964	1,682	1,010	*1,044*	*3,279* [5)]
EU28=100	17.7	38.0	39.9	34.7	31.6	28.1	30.8	32.6	29.4	51.3	30.8	*31.8*	*100.0*
General government budget, EU-def., % of GDP													
Revenues	39.0	39.8	39.5	45.7	47.5	34.5	36.5	40.5	30.0	42.9	39.8	*39.4*	*44.8*
Expenditures	38.0	38.4	39.5	45.4	49.5	34.2	37.3	42.0	32.9	42.1	40.7	*40.3*	*45.5*
Balance	1.0	1.4	0.0	0.3	-2.0	0.3	-0.8	-1.5	-2.9	0.8	-0.9	*-0.9*	*-0.7*
Public debt, EU def., % of GDP	22.6	33.3	8.5	73.3	70.9	36.5	37.0	50.9	35.0	70.2	48.7	*46.2*	*81.4*
BOP items, % of GDP													
Current account	4.6	0.7	1.2	2.7	1.3	0.9	-0.5	-0.7	-4.6	7.4	-2.5	*-0.3* [6)]	*2.0* [6)]
Exports of goods	50.2	66.1	50.0	23.9	69.3	61.3	41.7	43.0	30.3	68.0	84.8	*50.9* [6)]	*32.9* [6)]
Imports of goods	54.3	61.6	54.8	41.2	69.9	67.2	50.6	44.0	37.6	65.3	84.8	*52.9* [6)]	*31.6* [6)]
Exports of services	15.5	12.2	25.8	27.6	18.8	21.4	18.0	11.7	10.8	17.5	10.9	*13.9* [6)]	*13.2* [6)]
Imports of services	9.4	10.0	18.3	9.0	12.6	12.7	9.8	7.3	6.8	10.6	10.0	*9.0* [6)]	*11.1* [6)]
FDI stock per capita, EUR [7)]	5,867	12,189	14,252	6,779	7,766	5,275	7,550	5,179	3,885	6,616	8,332	*6,370*	*14,863*

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

Source: wiiw Annual Database, Eurostat.

Table 7.2 / Western Balkans and Turkey, selected CIS countries and Ukraine: An overview of economic fundamentals, 2018

	AL	BA	ME	MK	RS	XK	TR	BY	KZ	MD	RU	UA	EU-CEE11 [1]	EU28 [2]
Gross domestic product														
EUR bn, at ER	12.5	16.7	4.6	10.4	43.1	6.6	648.2	50.6	144.6	9.7	1,402.9	108.9	*1,380*	*15,905*
EUR bn, at PPP	26.1	33.9	9.0	23.2	86.2	14.5	1,664.2	132.7	362.4	17.9	2,794.8	272.2	*2,269*	*15,905*
EU28=100, at PPP	0.2	0.2	0.1	0.1	0.5	0.1	10.5	0.8	2.3	0.1	17.6	1.7	*14.3*	*100.0*
Per capita, EUR, at PPP	9,700	9,700	14,300	11,100	12,300	8,000	20,400	14,000	19,800	5,100	19,000	6,400	*22,000*	*31,000*
Per capita, EU28=100, at PPP	31	31	46	36	40	26	66	45	64	16	61	21	*71*	*100*
1990=100	241.0	.	.	144.9	.	.	341.0	197.1	209.5	78.3	121.3	63.4	*201.7*	*164.4*
2007=100	140.7	120.7	127.3	128.8	119.0	150.6	167.6	129.8	154.6	148.2	114.2	87.1	*130.8*	*111.6*
Price level														
EU28=100 (PPP/ER)	48	49	51	45	50	45	39	38	40	54	50	40	*61*	*100*
Industrial production														
2007=100 [3]	273.1	125.9	78.4	117.7	104.5	195.9	167.0	140.7	134.9	122.9	116.5	69.6	*137.5*	*102.3*
Population														
in thousand, average	2,866	3,500	625	2,095	6,986	1,813	81,407	9,484	18,276	3,540	146,837	42,270	*102,955*	*513,771*
Employed persons, LFS														
in thousand, average	1,234	822	234	750	2,850	358	28,734	4,336	8,720	1,270	72,532	16,340	*46,290*	*230,431*
Unemployment rate, LFS														
in %	12.1	18.4	14.8	21.0	12.6	29.0	10.9	4.8	4.8	3.0	4.8	8.8	*4.3*	*6.8*
Average gross monthly wages														
EUR at ER	426	697	766	579	580	530	471	396	402	318	588	276	*1,044*	*3,279* [4]
EU28=100	13.0	21.2	23.4	17.7	17.7	16.2	14.4	12.1	12.3	9.7	17.9	8.4	*31.8*	*100.0*
General government budget, nat. def., % of GDP														
Revenues	28.1	43.9	42.9	31.3	42.0	31.5	30.0	41.8	18.4	30.2	35.6	33.8	*39.4* [5]	*44.8* [5]
Expenditures	29.7	41.1	45.8	33.3	41.8	31.0	33.3	37.7	19.8	31.0	32.5	35.8	*40.3* [5]	*45.5* [5]
Balance	-1.7	2.8	-2.9	-2.0	0.2	0.5	-3.3	4.1	-1.4	-0.8	3.1	-1.9	*-0.9* [5]	*-0.7* [5]
Public debt, nat. def., % of GDP	72.8	31.7	70.0	48.5	58.0	17.0	30.5	44.0	27.3	27.9	12.1	62.0	*46.2* [5]	*81.4* [5]
BOP items, % of GDP														
Current account	-6.4	-4.5	-17.2	-0.8	-5.2	-6.5	-3.5	-2.0	0.5	-7.2	6.9	-3.6	*-0.3* [6]	*2.0* [6]
Exports of goods	7.4	30.7	9.5	44.7	35.3	5.5	22.8	55.3	36.3	18.6	26.8	33.7	*50.9* [6]	*32.9* [6]
Imports of goods	31.5	54.2	54.0	61.3	47.5	46.6	28.2	60.4	20.2	46.5	15.1	43.8	*52.9* [6]	*31.6* [6]
Exports of services	25.8	10.6	34.0	14.6	13.9	21.5	6.3	14.2	4.1	13.4	3.9	12.2	*13.9* [6]	*13.2* [6]
Imports of services	15.4	3.2	13.6	10.8	11.4	8.6	3.0	8.9	6.5	9.3	5.8	11.0	*9.0* [6]	*11.1* [6]
FDI stock per capita, EUR [7]	1,958	1,964	7,174	2,264	4,476	1,961	2,020	1,747	6,765	861	2,512	855	*6,370*	*14,863*

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

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) EU28 working-day adjusted. - 4) Gross wages according to national account concept. 5) EU definition: expenditures and revenues according to ESA 2010, excessive deficit procedure. - 6) Data for EU-CEE and EU28 include transactions within the region. - 7) Excluding SPE. Year 2017.

Source: wiiw Annual Database, Eurostat.

Table 7.3 / GDP per capita at current PPPs (EUR), from 2019 at constant PPPs and population

		1991	1995	2000	2005	2010	2015	2016	2017	2018	2019	2020	2021
												Forecast	
BG	Bulgaria	4,300	6,500	5,600	8,600	11,200	13,700	14,200	14,800	15,600	16,000	16,400	16,800
CZ	Czech Republic	8,800	11,600	14,200	18,600	21,100	25,300	25,600	26,900	27,900	28,600	29,400	30,200
EE	Estonia	5,400	5,300	8,200	14,000	16,500	21,900	22,500	23,600	24,800	25,500	26,100	26,700
HR	Croatia	6,600	7,000	9,400	13,000	15,100	17,300	17,900	18,500	19,400	19,900	20,400	20,900
HU	Hungary	6,800	7,700	10,400	14,500	16,500	19,800	19,500	20,300	21,700	22,400	22,900	23,300
LT	Lithuania	6,900	5,000	7,400	12,300	15,400	21,700	22,000	23,500	24,900	25,600	26,300	26,900
LV	Latvia	6,000	4,600	7,000	11,800	13,400	18,600	18,800	20,000	21,300	22,000	22,700	23,300
PL	Poland	4,600	6,500	9,300	11,800	15,900	19,900	19,900	20,900	22,200	23,000	23,800	24,600
RO	Romania	3,900	4,600	5,100	8,300	13,000	16,300	17,400	18,800	19,900	20,500	21,100	21,800
SI	Slovenia	8,800	11,400	15,800	20,300	21,200	23,800	24,100	25,500	27,000	27,900	28,700	29,500
SK	Slovakia	6,000	7,300	9,900	14,100	19,000	22,300	22,500	22,900	24,100	25,000	25,800	26,400
	EU-CEE	5,400	6,700	8,800	12,200	15,800	19,500	19,800	20,800	22,000	22,700	23,400	24,100
AL	Albania	1,500	2,000	3,400	5,000	7,400	8,800	8,700	9,100	9,700	10,100	10,500	10,900
BA	Bosnia & Herzeg.	.	.	4,000	5,400	6,900	8,800	9,000	9,300	9,700	9,900	10,200	10,500
ME	Montenegro	.	.	5,300	7,100	10,400	12,300	13,000	13,700	14,300	14,700	15,000	15,300
MK	North Macedonia	4,300	4,000	5,400	6,700	8,700	10,400	10,800	10,800	11,100	11,400	11,700	12,100
RS	Serbia	.	3,200	5,000	7,800	9,800	11,200	11,400	11,600	12,300	12,700	13,100	13,500
XK	Kosovo	.	.	4,200	5,300	5,900	7,400	7,600	7,700	8,000	8,300	8,600	8,900
TR	Turkey	5,200	6,000	8,300	10,000	13,200	19,300	19,200	19,900	20,400	20,300	20,900	21,700
BY	Belarus	4,700	3,300	5,300	8,500	12,200	13,800	13,200	13,400	14,000	14,300	14,600	14,900
KZ	Kazakhstan	7,000	5,100	6,900	12,100	15,100	18,800	18,400	19,100	19,800	20,400	21,000	21,600
MD	Moldova	2,700	1,600	1,600	2,500	3,500	4,500	4,600	4,800	5,100	5,300	5,500	5,700
RU	Russia	6,700	4,700	6,000	10,000	15,700	18,600	18,000	18,400	19,000	19,300	19,600	20,000
UA	Ukraine	5,500	3,100	3,300	5,700	6,100	6,000	6,000	6,100	6,400	6,600	6,700	6,900
AT	Austria	19,000	19,900	25,700	29,800	32,200	37,500	37,600	38,100	39,300	40,100	40,900	41,700
DE	Germany	19,300	19,900	24,100	27,500	30,500	36,100	36,300	37,100	37,700	38,400	39,100	39,900
EL	Greece	12,900	13,000	17,100	21,700	21,500	20,200	19,800	20,200	20,600	21,000	21,400	21,800
IE	Ireland	13,300	16,000	26,400	34,400	33,100	51,900	51,700	54,300	58,500	61,100	63,400	64,700
IT	Italy	17,900	18,800	23,700	25,400	26,500	27,700	28,400	28,900	29,200	29,600	30,000	30,600
PT	Portugal	11,500	12,100	16,500	19,300	20,900	22,300	22,600	23,000	23,500	23,900	24,300	24,800
ES	Spain	13,300	13,700	18,900	23,500	24,400	26,300	26,700	27,600	28,300	28,900	29,500	30,100
US	United States	20,800	24,100	31,800	37,400	37,000	42,600	42,000	42,200	43,400	44,500	45,300	46,200
	EU28 average	14,300	15,200	19,800	23,400	25,500	29,100	29,300	30,000	31,000	31,600	32,200	32,700

European Union (28) average = 100

		1991	1995	2000	2005	2010	2015	2016	2017	2018	2019	2020	2021
BG	Bulgaria	30	43	28	37	44	47	48	49	50	51	51	51
CZ	Czech Republic	62	76	72	79	83	87	87	90	90	91	91	92
EE	Estonia	38	35	41	60	65	75	77	79	80	81	81	82
HR	Croatia	46	46	47	56	59	59	61	62	63	63	63	64
HU	Hungary	48	51	53	62	65	68	67	68	70	71	71	71
LT	Lithuania	48	33	37	53	60	75	75	78	80	81	82	82
LV	Latvia	42	30	35	50	53	64	64	67	69	70	70	71
PL	Poland	32	43	47	50	62	68	68	70	72	73	74	75
RO	Romania	27	30	26	35	51	56	59	63	64	65	66	67
SI	Slovenia	62	75	80	87	83	82	82	85	87	88	89	90
SK	Slovakia	42	48	50	60	75	77	77	76	78	79	80	81
	EU-CEE	38	44	44	52	62	67	68	69	71	72	73	74
AL	Albania	10	13	17	21	29	30	30	30	31	32	33	33
BA	Bosnia & Herzeg.	.	.	20	23	27	30	31	31	31	31	32	32
ME	Montenegro	.	.	27	30	41	42	44	46	46	47	47	47
MK	North Macedonia	30	26	27	29	34	36	37	36	36	36	36	37
RS	Serbia	.	21	25	33	38	38	39	39	40	40	41	41
XK	Kosovo	.	.	21	23	23	25	26	26	26	26	27	27
TR	Turkey	36	39	42	43	52	66	66	66	66	64	65	66
BY	Belarus	33	22	27	36	48	47	45	45	45	45	45	46
KZ	Kazakhstan	49	34	35	52	59	65	63	64	64	65	65	66
MD	Moldova	19	11	8	11	14	15	16	16	16	17	17	17
RU	Russia	47	31	30	43	62	64	61	61	61	61	61	61
UA	Ukraine	38	20	17	24	24	21	20	20	21	21	21	21
AT	Austria	133	131	130	127	126	129	128	127	127	127	127	128
DE	Germany	135	131	122	118	120	124	124	124	122	122	121	122
EL	Greece	90	86	86	93	84	69	68	67	66	66	66	67
IE	Ireland	93	105	133	147	130	178	176	181	189	193	197	198
IT	Italy	125	124	120	109	104	95	97	96	94	94	93	94
PT	Portugal	80	80	83	82	82	77	77	77	76	76	75	76
ES	Spain	93	90	95	100	96	90	91	92	91	91	92	92
US	United States	145	159	161	160	145	146	143	141	140	141	141	141
	EU28 average	100	100	100	100	100	100	100	100	100	100	100	100

Source: wiiw Annual Database incorporating national and Eurostat statistics; forecasts by wiiw and EC - Autumn Report 2018.

Table 7.4 / Indicators of macro-competitiveness, 2014-2021, annual changes in %

	2014	2015	2016	2017	2018	2019	2020 Forecast	2021	2014-18 average
Bulgaria									
GDP deflator	0.5	2.2	2.2	3.4	2.6	2.5	2.5	2.5	2.2
Real ER (CPI-based)	-2.1	-1.1	-1.6	-0.5	0.7	0.7	0.6	0.6	-0.9
Real ER (PPI-based)	0.6	0.0	-1.7	1.9	1.0	1.7	1.1	1.1	0.4
Average gross wages, real (PPI based)	7.3	9.2	11.5	4.2	5.3	4.7	4.2	3.7	7.5
Average gross wages, real (CPI based)	7.7	8.0	9.4	8.1	6.7	5.7	4.7	4.2	8.0
Average gross wages, EUR (ER)	6.0	6.8	8.0	9.4	9.4	8.6	6.3	7.5	7.9
Employed persons (LFS)	1.6	1.7	-0.5	4.4	0.1	0.2	0.3	0.3	1.4
GDP real per employed person, NCU	0.2	1.7	4.5	-0.6	2.9	2.6	2.1	2.3	1.7
Unit labour costs, ER (EUR) adjusted	5.7	5.0	3.4	10.0	6.3	5.6	5.2	4.4	6.1
Czech Republic									
GDP deflator	2.5	1.2	1.3	1.4	2.3	2.2	2.1	2.1	1.7
Exchange rate (ER), EUR/NC	-5.7	0.9	0.9	2.7	2.6	0.6	0.4	0.0	0.3
Real ER (CPI-based)	-5.7	1.2	1.2	3.4	2.7	0.9	0.6	0.1	0.5
Real ER (PPI-based)	-2.6	0.7	-0.9	0.4	0.5	0.3	0.1	-0.7	-0.4
Average gross wages, real (PPI based)	1.5	5.7	7.9	5.5	7.7	5.0	4.6	4.8	5.6
Average gross wages, real (CPI based)	2.5	2.9	3.8	3.7	6.4	4.4	4.0	4.0	3.9
Average gross wages, EUR (ER)	-2.9	4.2	5.4	9.1	11.4	7.4	6.7	5.6	5.3
Employed persons (LFS)	0.8	1.4	1.9	1.6	1.4	0.5	0.4	0.2	1.4
GDP real per employed person, NCU	1.9	3.9	0.5	2.7	1.6	2.1	2.3	2.6	2.1
Unit labour costs, ER (EUR) adjusted	-4.7	0.3	4.8	6.2	9.6	5.0	4.2	3.4	3.1
Estonia									
GDP deflator	3.0	1.0	1.5	3.9	2.7	3.7	2.6	2.3	2.4
Real ER (CPI-based)	0.0	0.1	0.5	2.0	1.5	1.0	0.8	0.6	0.8
Real ER (PPI-based)	-0.3	-0.3	0.5	0.3	1.0	0.8	0.6	0.3	0.2
Average gross wages, real (PPI based)	8.2	8.7	8.6	3.6	2.8	3.4	3.2	3.2	6.3
Average gross wages, real (CPI based)	5.4	5.9	6.8	3.2	3.3	3.2	3.0	2.9	4.9
Average gross wages, EUR (ER)	5.9	6.0	7.6	7.0	6.9	6.1	5.8	5.4	6.7
Employed persons (LFS)	0.6	2.6	0.6	2.2	1.0	0.5	0.6	-0.3	1.4
GDP real per employed person, NCU	2.3	-0.7	2.9	2.6	2.9	2.6	1.6	2.6	2.0
Unit labour costs, ER (EUR) adjusted	3.5	6.7	4.6	4.2	3.8	3.4	4.1	2.8	4.6
Croatia									
GDP deflator	0.0	0.0	-0.1	1.1	1.6	1.8	1.8	1.5	0.5
Exchange rate (ER), EUR/NC	-0.7	0.3	1.1	0.9	0.6	0.2	0.0	0.0	0.4
Real ER (CPI-based)	-1.0	0.0	0.2	0.5	0.3	-4.3	-0.1	-0.4	0.0
Real ER (PPI-based)	-1.6	-1.4	-1.9	0.0	-0.1	0.5	0.2	0.1	-1.0
Average gross wages, real (PPI based)	3.0	5.3	6.5	1.9	2.6	2.8	2.9	2.3	3.8
Average gross wages, real (CPI based)	-0.4	1.3	3.7	1.9	3.9	3.0	3.1	2.8	2.1
Average gross wages, EUR (ER)	-0.6	1.6	3.0	4.9	5.5	5.4	5.0	4.0	2.9
Employed persons (LFS)	2.7	1.3	0.3	2.2	1.5	1.2	1.2	1.2	1.6
GDP real per employed person, NCU	-2.7	1.1	3.2	0.7	1.2	1.3	1.3	1.3	0.7
Unit labour costs, ER (EUR) adjusted	2.3	0.4	-0.2	4.2	4.3	3.7	3.6	3.0	2.2
Hungary									
GDP deflator	3.4	1.9	0.9	3.8	3.1	3.1	3.3	3.2	2.6
Exchange rate (ER), EUR/NC	-3.8	-0.4	-0.5	0.7	-3.0	-1.6	-1.5	-0.9	-1.4
Real ER (CPI-based)	-4.3	-0.3	-0.4	1.4	-2.1	-11.2	-0.5	0.2	-1.2
Real ER (PPI-based)	-2.4	0.7	-0.8	1.0	-0.5	-0.4	-0.4	0.2	-0.4
Average gross wages, real (PPI based)	3.3	5.5	8.0	9.3	5.2	5.0	3.0	1.5	6.2
Average gross wages, real (CPI based)	2.4	4.3	8.0	10.7	10.0	5.0	3.0	1.5	7.0
Average gross wages, EUR (ER)	-0.9	3.9	5.7	13.7	7.7	6.3	4.5	3.5	5.9
Employed persons (LFS)	5.3	2.7	3.4	1.6	1.1	0.5	0.0	0.0	2.8
GDP real per employed person, NCU	-1.1	0.8	-1.0	2.5	3.8	2.8	2.3	1.9	1.0
Unit labour costs, ER (EUR) adjusted	0.1	3.0	6.8	10.9	3.8	3.5	2.1	1.7	4.9
Lithuania									
GDP deflator	1.0	0.3	1.4	4.3	2.6	2.3	2.4	2.3	1.9
Real ER (CPI-based)	-0.3	-0.7	0.4	2.0	0.6	-8.4	0.5	0.4	0.4
Real ER (PPI-based)	-3.3	-7.7	-2.9	1.8	2.5	-0.8	-1.3	0.1	-2.0
Average gross wages, real (PPI based)	10.3	16.7	13.3	3.5	3.8	6.5	6.5	4.5	9.4
Average gross wages, real (CPI based)	4.2	5.4	10.3	6.5	8.4	5.1	4.6	4.2	6.9
Average gross wages, EUR (ER)	4.8	5.4	8.4	8.6	9.5	7.6	7.1	6.6	7.3
Employed persons (LFS)	2.0	1.2	2.0	-0.5	0.8	0.5	0.4	0.1	1.1
GDP real per employed person, NCU	1.5	0.8	0.4	4.6	2.7	2.4	2.2	2.5	2.0
Unit labour costs, ER (EUR) adjusted	3.3	4.6	8.0	3.8	6.6	5.1	4.8	4.0	5.2

(Table 7.4 ctd.)

Table 7.4 / ctd.

	2014	2015	2016	2017	2018	2019	2020	2021	2014-18
							Forecast		average
Latvia									
GDP deflator	1.8	0.0	0.9	3.2	2.4	4.3	2.4	2.3	1.6
Real ER (CPI-based)	0.0	0.2	-0.2	1.2	0.7	0.6	0.5	0.4	0.4
Real ER (PPI-based)	2.1	1.2	-1.1	-0.5	1.4	0.2	0.6	0.6	0.6
Average gross wages, real (PPI based)	6.5	8.0	7.7	5.2	4.6	4.8	3.9	3.5	6.4
Average gross wages, real (CPI based)	6.1	6.7	4.9	4.8	6.3	4.4	4.0	3.7	5.8
Average gross wages, EUR (ER)	6.7	6.9	5.0	7.8	9.1	6.9	6.5	6.1	7.1
Employed persons (LFS)	-1.0	1.3	-0.3	0.2	1.7	1.1	0.5	0.5	0.4
GDP real per employed person, NCU	2.9	1.6	2.4	4.5	3.0	2.2	2.6	1.8	2.9
Unit labour costs, ER (EUR) adjusted	3.7	5.2	2.6	3.2	5.8	4.7	3.8	4.2	4.1
Poland									
GDP deflator	0.5	0.8	0.3	2.0	1.4	2.3	1.1	2.2	1.0
Exchange rate (ER), EUR/NC	0.3	0.0	-4.1	2.5	-0.1	-0.9	0.0	-1.1	-0.3
Real ER (CPI-based)	-0.1	-0.7	-4.6	2.4	-0.8	-0.5	0.2	-1.1	-0.8
Real ER (PPI-based)	0.7	0.0	-3.0	2.2	-0.9	-0.9	0.0	-1.2	-0.2
Average gross wages, real (PPI based)	4.7	5.8	4.0	2.6	4.6	5.3	4.3	3.7	4.3
Average gross wages, real (CPI based)	3.1	4.2	3.9	3.8	5.5	4.9	4.0	3.5	4.1
Average gross wages, EUR (ER)	3.5	3.5	-0.6	8.0	6.6	6.5	6.1	4.1	4.2
Employed persons (LFS)	1.9	1.4	0.7	1.4	0.8	0.6	0.3	0.2	1.2
GDP real per employed person, NCU	1.4	2.4	2.3	3.4	4.3	3.1	3.0	3.1	2.8
Unit labour costs, ER (EUR) adjusted	2.1	1.0	-2.8	4.5	2.3	3.1	3.1	1.2	1.4
Romania									
GDP deflator	1.7	2.6	2.5	4.7	6.4	5.5	3.7	3.9	3.6
Exchange rate (ER), EUR/NC	-0.6	0.0	-1.0	-1.7	-1.8	-2.0	-1.5	-1.6	-1.0
Real ER (CPI-based)	0.3	-0.4	-2.4	-2.3	0.3	-1.3	-0.4	-0.6	-0.9
Real ER (PPI-based)	1.1	-0.1	-1.4	-1.2	0.3	-0.8	-0.3	-0.6	-0.3
Average gross wages, real (PPI based)	7.8	12.3	12.0	10.9	7.5	3.8	3.2	2.8	10.1
Average gross wages, real (CPI based)	6.1	10.2	11.2	13.5	8.5	4.3	3.2	2.8	9.9
Average gross wages, EUR (ER)	7.0	9.7	8.8	12.8	10.9	4.7	5.0	3.8	9.8
Employed persons (LFS)	0.8	-0.9	-1.0	2.6	0.2	0.2	0.0	0.0	0.3
GDP real per employed person, NCU	2.6	4.8	5.9	4.3	4.0	2.6	3.0	3.2	4.3
Unit labour costs, ER (EUR) adjusted	4.3	4.7	2.8	8.2	6.7	2.1	1.7	0.9	5.3
Slovenia									
GDP deflator	0.8	1.0	0.8	1.6	1.9	1.8	1.7	2.0	1.2
Real ER (CPI-based)	-0.1	-0.8	-0.5	-0.1	0.0	0.0	-0.1	0.1	-0.3
Real ER (PPI-based)	1.1	2.0	0.0	-0.8	-0.8	0.2	0.2	0.1	0.3
Average gross wages, real (PPI based)	1.8	0.9	3.3	0.4	1.3	2.0	2.0	0.7	1.5
Average gross wages, real (CPI based)	0.7	1.5	2.0	1.0	1.5	2.2	2.2	0.7	1.4
Average gross wages, EUR (ER)	1.1	0.7	1.8	2.7	3.4	4.1	4.0	2.7	1.9
Employed persons (LFS)	1.2	0.1	-0.3	4.8	2.5	1.7	1.5	1.0	1.6
GDP real per employed person, NCU	1.7	2.2	3.3	0.1	2.0	1.4	1.6	1.8	1.9
Unit labour costs, ER (EUR) adjusted	-0.6	-1.5	-1.5	2.6	1.4	2.6	2.3	0.9	0.1
Slovakia									
GDP deflator	-0.2	-0.2	-0.5	1.2	2.1	2.6	2.3	2.3	0.5
Real ER (CPI-based)	-0.6	-0.3	-0.8	-0.3	0.6	0.8	0.4	0.4	-0.3
Real ER (PPI-based)	-1.5	-0.7	-2.5	-0.5	-0.6	0.7	0.6	1.1	-1.2
Average gross wages, real (PPI based)	7.7	6.0	7.5	2.1	3.5	4.3	3.9	2.2	5.3
Average gross wages, real (CPI based)	4.2	3.2	3.8	3.2	3.3	4.2	4.1	2.9	3.5
Average gross wages, EUR (ER)	4.1	2.9	3.3	4.6	5.9	6.9	6.5	5.2	4.2
Employed persons (LFS)	1.5	2.6	2.8	1.5	1.2	0.8	0.4	0.0	1.9
GDP real per employed person, NCU	1.3	1.6	0.3	1.6	2.9	3.0	2.3	2.6	1.5
Unit labour costs, ER (EUR) adjusted	2.8	1.3	3.0	2.9	2.9	3.8	4.0	2.6	2.6
Albania									
GDP deflator	1.5	0.6	-0.5	1.4	-1.0	2.4	2.0	2.1	0.4
Exchange rate (ER), EUR/NC	0.2	0.2	1.7	2.4	5.1	2.5	0.4	0.4	1.9
Real ER (CPI-based)	1.3	2.1	2.7	2.7	5.3	3.1	1.1	1.3	2.8
Real ER (PPI-based)	1.5	0.3	1.7	2.0	4.0	2.3	0.6	0.3	1.9
Average gross wages, real (PPI based)	1.4	5.0	-0.7	6.0	7.2	4.4	3.6	3.1	3.7
Average gross wages, real (CPI based)	-0.7	0.9	-3.3	6.6	7.0	3.6	3.0	2.1	2.0
Average gross wages, EUR (ER)	1.1	3.0	-0.4	11.3	14.8	7.9	6.5	6.1	5.8
Employed persons (LFS)	1.3	4.8	6.5	3.3	3.3	2.1	3.2	1.5	3.8
GDP real per employed person, NCU	0.5	-2.4	-3.0	0.6	0.8	1.7	0.6	1.8	-0.7
Unit labour costs, ER (EUR) adjusted	0.6	5.6	2.6	10.7	13.8	6.9	5.5	3.4	6.6

(Table 7.4 ctd.)

Table 7.4 / ctd.

	2014	2015	2016	2017	2018	2019	2020 Forecast	2021	2014-18 average
Bosnia and Herzegovina									
GDP deflator	1.0	1.4	1.4	1.7	1.3	1.4	1.8	1.5	1.4
Real ER (CPI-based)	-1.4	-1.0	-1.9	-0.9	-0.5	-0.3	-0.3	-0.5	-1.1
Real ER (PPI-based)	1.3	2.9	-0.7	0.0	0.6	0.3	0.3	0.2	0.8
Average gross wages, real (PPI based)	0.4	-0.6	3.1	-1.4	-0.4	1.4	0.7	0.6	0.2
Average gross wages, real (CPI based)	0.8	1.0	2.5	0.8	1.7	1.9	1.2	1.3	1.4
Average gross wages, EUR (ER)	-0.1	0.0	0.9	1.6	3.1	3.3	2.8	2.7	1.1
Employed persons (LFS)	-1.2	1.2	-2.6	1.8	0.8	0.9	1.2	1.2	0.0
GDP real per employed person, NCU	2.3	1.8	5.8	1.3	2.1	1.7	1.4	1.3	2.7
Unit labour costs, ER (EUR) adjusted	-2.4	-1.8	-4.7	0.3	1.1	1.7	1.5	1.4	-1.5
Montenegro									
GDP deflator	1.0	2.2	5.1	3.8	2.9	1.8	1.9	2.0	3.0
Real ER (CPI-based)	-1.2	1.6	-0.6	0.7	0.7	0.1	-0.1	0.0	0.2
Real ER (PPI-based)	1.9	2.6	1.3	-2.5	-1.2	-0.3	-0.3	-0.4	0.4
Average gross wages, real (PPI based)	-0.5	0.0	3.7	1.5	-1.5	1.6	1.0	1.0	0.6
Average gross wages, real (CPI based)	0.3	-1.3	3.9	-0.5	-2.4	1.2	0.7	0.6	0.0
Average gross wages, EUR (ER)	-0.4	0.3	3.6	1.9	0.1	3.1	2.5	2.5	1.1
Employed persons (LFS)	7.1	2.5	1.1	2.3	2.0	0.9	0.8	0.4	3.0
GDP real per employed person, NCU	-5.0	0.9	1.8	2.4	1.9	1.6	1.4	1.5	0.4
Unit labour costs, ER (EUR) adjusted	4.8	-0.6	1.8	-0.5	-1.7	1.5	1.1	0.9	0.7
North Macedonia									
GDP deflator	1.4	2.0	3.5	3.4	1.5	2.0	2.0	1.9	2.4
Exchange rate (ER), EUR/NC	-0.1	0.0	0.0	0.0	0.1	0.3	-0.2	0.0	0.0
Real ER (CPI-based)	-0.9	-0.3	-0.5	-0.3	-0.3	0.5	-0.1	0.1	-0.4
Real ER (PPI-based)	-0.2	-1.7	-1.7	1.8	-1.8	1.5	1.0	1.1	-0.7
Average gross wages, real (PPI based)	2.9	6.9	5.3	-2.1	4.8	1.9	1.0	1.1	3.5
Average gross wages, real (CPI based)	1.3	3.0	2.2	1.3	4.2	2.9	2.0	2.1	2.4
Average gross wages, EUR (ER)	0.9	2.7	2.0	2.7	5.9	5.3	3.3	4.8	2.8
Employed persons (LFS)	1.7	2.3	2.5	2.4	1.5	2.0	2.0	1.3	2.1
GDP real per employed person, NCU	1.9	1.5	0.4	-2.1	0.4	1.0	1.0	1.7	0.4
Unit labour costs, ER (EUR) adjusted	-1.0	1.2	1.7	4.8	5.4	4.3	2.8	2.4	2.4
Serbia									
GDP deflator	2.6	1.8	1.5	3.0	2.7	2.4	2.6	2.3	2.3
Exchange rate (ER), EUR/NC	-3.6	-2.8	-1.9	1.5	2.6	-0.6	-0.8	0.0	-0.9
Real ER (CPI-based)	-2.0	-1.5	-1.2	2.8	2.7	0.3	0.0	0.9	0.1
Real ER (PPI-based)	-0.5	0.3	-0.5	0.8	0.6	0.5	0.6	1.4	0.1
Average gross wages, real (PPI based)	-0.1	-1.4	3.8	1.6	5.1	2.8	2.7	2.6	1.8
Average gross wages, real (CPI based)	-0.9	-1.8	2.7	0.9	3.9	3.0	3.2	3.1	0.9
Average gross wages, EUR (ER)	-2.4	-3.3	1.8	5.5	8.7	5.1	4.9	6.3	2.0
Employed persons (LFS)	4.8	0.6	5.6	2.8	2.0	2.1	1.0	1.0	3.1
GDP real per employed person, NCU	-6.1	1.2	-2.2	-0.7	2.4	1.3	1.9	1.9	-1.1
Unit labour costs, ER (EUR) adjusted	3.9	-4.4	4.1	6.2	6.2	3.8	3.3	4.0	3.1
Kosovo									
GDP deflator	3.3	0.2	0.4	-0.2	1.1	1.9	1.6	1.4	0.9
Real ER (CPI-based)	-0.1	-0.5	0.0	-0.2	-0.8	-0.2	-0.3	-0.3	-0.3
Real ER (PPI-based)	3.6	5.0	1.3	0.4	0.1	0.2	-0.3	-0.7	2.1
Average gross wages, real (PPI based)	6.7	3.0	1.9	-4.8	0.7	5.4	3.7	3.8	1.4
Average gross wages, real (CPI based)	8.1	6.3	1.5	-3.0	2.6	5.9	3.6	3.3	3.0
Average gross wages, EUR (ER)	8.6	5.8	1.8	-1.5	3.7	7.5	5.3	5.0	3.6
Employed persons (LFS)	-4.4	-8.2	11.7	7.6	0.2	2.0	1.4	1.4	1.1
GDP real per employed person, NCU	5.9	13.4	-6.9	-3.6	3.7	2.2	2.4	2.4	2.3
Unit labour costs, ER (EUR) adjusted	2.5	-6.7	9.3	2.2	0.0	5.2	2.8	2.6	1.3
Turkey									
GDP deflator	7.4	7.8	8.1	10.8	15.7	17.0	10.4	8.2	9.9
Real ER (CPI-based)	-5.5	3.5	-2.8	-11.4	-17.6	4.7	-2.2	2.9	-7.1
Real ER (PPI-based)	-2.3	3.4	-4.3	-8.8	-10.9	10.5	1.6	5.1	-4.7
Average gross wages, real (PPI based)	0.2	5.1	8.5	-6.4	-14.2	-5.1	-0.9	1.3	-1.7
Average gross wages, real (CPI based)	1.3	2.8	5.1	-2.5	-6.4	0.2	2.9	3.5	0.0
Average gross wages, EUR (ER)	-3.9	6.3	2.4	-12.1	-21.4	6.1	4.0	7.7	-6.3
Employed persons (LFS) 5)	5.4	2.7	2.2	3.6	1.9	-0.1	2.4	2.4	3.2
GDP real per employed person, NCU	-0.2	3.3	0.9	3.7	1.0	-0.6	0.8	1.2	1.7
Unit labour costs, ER (EUR) adjusted	-3.6	2.9	1.5	-15.2	-22.1	7.4	1.8	7.2	-7.9

(Table 7.4 ctd.)

Table 7.4 / ctd.

	2014	2015	2016	2017	2018	2019	2020	2021	2014-18
							Forecast		average
Belarus									
GDP deflator	18.1	16.0	8.3	8.7	11.6	7.0	8.1	8.0	12.5
Exchange rate (ER), EUR/NC	-10.5	-25.8	-19.0	0.8	-9.1	-5.9	-5.6	-6.9	-13.2
Real ER (CPI-based)	5.2	-15.8	-9.7	5.1	-6.4	-1.0	0.1	-1.3	-4.7
Real ER (PPI-based)	2.5	-11.1	-8.0	7.5	-5.6	0.8	2.0	0.5	-3.2
Average gross wages, real (PPI based)	6.4	-5.3	-3.9	3.7	8.1	2.4	1.2	0.2	1.6
Average gross wages, real (CPI based)	1.3	-2.2	-3.7	7.4	10.1	4.3	3.1	2.0	2.4
Average gross wages, EUR (ER)	7.0	-17.7	-12.8	14.8	5.0	6.1	4.8	2.3	-1.5
Employed persons (LFS)	-0.6	-1.2	-2.0	0.8	0.4	-0.4	-0.4	0.0	-0.5
GDP real per employed person, NCU	2.3	-2.6	-0.5	1.7	2.6	3.1	2.6	2.5	0.7
Unit labour costs, ER (EUR) adjusted	4.6	-15.5	-12.4	12.9	2.3	1.9	2.5	0.1	-2.2
Kazakhstan									
GDP deflator	5.8	1.8	13.6	8.6	6.3	5.5	3.5	6.5	7.2
Exchange rate (ER), EUR/NC	-15.1	-3.1	-35.1	2.8	-9.4	-2.2	-2.8	-4.3	-13.1
Real ER (CPI-based)	-9.9	3.3	-25.8	8.6	-5.8	1.8	0.6	-0.9	-6.7
Real ER (PPI-based)	-5.4	-21.3	-23.1	15.1	4.7	-13.6	-3.6	-5.1	-7.1
Average gross wages, real (PPI based)	1.3	31.0	-2.9	-8.5	-8.9	22.5	7.6	7.6	1.4
Average gross wages, real (CPI based)	3.9	-2.3	-1.1	-1.8	2.3	4.0	3.0	3.0	0.2
Average gross wages, EUR (ER)	-5.9	0.9	-26.4	8.5	-1.8	7.0	7.0	4.3	-5.7
Employed persons (LFS)	-0.7	1.3	-0.8	0.4	1.6	1.0	1.0	1.0	0.3
GDP real per employed person, NCU	4.9	-0.1	1.9	3.7	2.5	1.9	2.0	2.0	2.6
Unit labour costs, ER (EUR) adjusted	-10.3	1.0	-27.8	4.6	-4.2	5.7	3.6	2.1	-8.1
Moldova									
GDP deflator	6.4	9.6	5.7	6.3	3.2	3.9	4.0	4.9	6.2
Exchange rate (ER), EUR/NC	-10.2	-10.8	-5.2	5.9	5.0	4.4	0.0	-5.0	-3.4
Real ER (CPI-based)	-6.2	-2.3	0.6	10.9	6.0	6.7	2.1	-2.1	1.6
Real ER (PPI-based)	-3.6	-3.1	0.4	6.2	2.4	4.7	1.1	-4.0	0.4
Average gross wages, real (PPI based)	5.5	4.4	5.4	8.2	12.7	11.7	6.5	5.7	7.2
Average gross wages, real (CPI based)	5.9	1.2	3.4	5.0	9.9	9.5	5.5	3.7	5.1
Average gross wages, EUR (ER)	-0.1	-1.1	4.3	18.4	18.7	19.3	10.5	2.4	7.7
Employed persons (LFS)	1.0	1.6	1.3	-1.0	5.2	3.1	2.3	2.2	1.6
GDP real per employed person, NCU	3.9	-1.9	3.0	5.7	-1.1	0.6	1.3	1.3	1.9
Unit labour costs, ER (EUR) adjusted	-3.9	0.8	1.3	12.0	20.0	18.3	8.3	2.1	5.7
Russia									
GDP deflator	7.5	8.0	3.2	5.3	10.0	6.0	4.0	4.0	6.8
Exchange rate (ER), EUR/NC	-16.7	-25.1	-8.8	12.7	-10.8	-0.2	-1.3	-3.8	-10.6
Real ER (CPI-based)	-10.7	-13.5	-2.6	14.9	-10.0	3.4	0.7	-1.9	-4.9
Real ER (PPI-based)	-9.8	-13.1	-3.6	17.9	-3.0	5.9	1.7	-0.9	-2.9
Average gross wages, real (PPI based)	2.5	-7.7	3.5	-0.4	-1.8	0.6	3.1	3.1	-0.9
Average gross wages, real (CPI based)	1.2	-9.3	0.7	3.6	6.8	3.0	4.1	4.1	0.4
Average gross wages, EUR (ER)	-9.2	-21.5	-1.6	21.0	-2.0	8.8	6.3	4.4	-3.6
Employed persons (LFS)	0.2	-0.4	0.1	-0.3	0.3	-0.2	0.0	0.0	0.0
GDP real per employed person, NCU	0.5	-2.1	-0.2	2.0	2.0	2.0	1.7	1.9	0.4
Unit labour costs, ER (EUR) adjusted	-9.7	-19.8	-1.4	18.6	-3.9	6.3	5.0	2.1	-4.0
Ukraine									
GDP deflator	16.0	38.9	17.1	22.0	13.5	8.7	5.6	4.1	21.2
Exchange rate (ER), EUR/NC	-32.5	-35.1	-14.4	-5.7	-6.7	-8.2	-5.4	-2.6	-19.9
Real ER (CPI-based)	-24.7	-3.5	-2.7	6.1	1.6	-1.6	-2.3	0.3	-5.3
Real ER (PPI-based)	-19.5	-9.8	4.7	15.7	6.5	-2.6	-1.5	1.3	-1.3
Average gross wages, real (PPI based)	-9.5	-11.4	2.5	8.4	6.3	7.6	4.4	4.3	-1.1
Average gross wages, real (CPI based)	-5.4	-18.9	8.5	19.8	12.5	6.5	5.2	5.3	2.3
Average gross wages, EUR (ER)	-28.4	-21.8	5.8	29.2	18.3	3.6	6.9	6.5	-2.0
Employed persons (LFS)	-6.4	-0.4	-1.0	-0.7	1.1	0.7	0.3	0.3	-1.5
GDP real per employed person, NCU	-0.2	-9.4	3.4	3.3	2.2	1.7	1.7	2.6	-0.3
Unit labour costs, ER (EUR) adjusted	-28.3	-13.7	2.3	25.2	14.0	4.9	2.9	4.9	-2.0
Austria									
GDP deflator	2.2	2.2	1.4	1.3	1.6	2.1	2.1	1.9	1.7
Real ER (CPI-based)	1.2	0.9	0.6	0.4	0.1	0.3	0.1	0.1	0.6
Real ER (PPI-based)	0.7	0.7	-0.4	-1.1	-0.5	0.3	0.2	0.0	-0.1
Average gross wages, real (PPI based)	2.9	3.6	4.3	-0.4	0.1	0.5	0.1	0.5	2.1
Average gross wages, real (CPI based)	0.1	1.1	1.5	-0.6	0.5	0.5	0.1	0.4	0.5
Average gross wages, EUR (ER)	1.8	2.1	2.4	1.5	2.5	2.6	2.1	2.4	2.0
Employed persons (LFS)	0.2	0.9	1.7	0.9	1.4	1.4	1.4	1.4	1.0
GDP real per employed person, NCU	0.5	0.3	0.3	1.6	1.3	0.6	0.4	0.1	0.8
Unit labour costs, ER (EUR) adjusted	1.3	1.8	2.1	-0.1	1.2	1.9	1.7	2.3	1.2

For country-specific notes see the respective country table.

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

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

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Herausgeber, Verleger, Eigentümer und Hersteller:
Verein „Wiener Institut für Internationale Wirtschaftsvergleiche“ (wiiw),
Wien 6, Rahlgasse 3

ZVR-Zahl: 329995655

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

Nachdruck nur auszugsweise und mit genauer Quellenangabe gestattet.

Offenlegung nach § 25 Mediengesetz: Medieninhaber (Verleger): Verein "Wiener Institut für Internationale Wirtschaftsvergleiche", A 1060 Wien, Rahlgasse 3. Vereinszweck: Analyse der wirtschaftlichen Entwicklung der zentral- und osteuropäischen Länder sowie anderer Transformationswirtschaften sowohl mittels empirischer als auch theoretischer Studien und ihre Veröffentlichung; Erbringung von Beratungsleistungen für Regierungs- und Verwaltungsstellen, Firmen und Institutionen.

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ISBN-978-3-85209-064-1