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Forecast Report

# Strong Growth Amid Increased Negative Risks

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

The Vienna Institute for International Economic Studies
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# Strong Growth Amid Increased Negative Risks

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# Executive summary

**Global growth should remain fairly robust by post-crisis standards throughout the forecast period, powered above all by strong activity in the US.** Despite downgrades to its forecasts in October, the IMF projects global growth at 3.7% this year and next, which is the same as in 2017. US growth for 2018–2019 will be quite a bit better than for 2016–2017. This will continue to provide a relatively favourable backdrop for CESEE economies.

**However, challenges to global growth have increased, and the outlook is less positive than at the time of our Spring Forecast.** Tighter US monetary policy, an apparent slowdown in the pace of Chinese growth, trade tensions between the US and various international partners (in particular China) and subdued activity in some parts of the eurozone present increasing challenges for the global economy. Rising US interest rates have significantly increased the chances of an emerging markets crisis (although within CESEE we are only really concerned about Turkey in this respect). As the US Federal Reserve continues to tightening monetary policy, prices across assets classes such as equities and property (which have benefitted from almost a decade of ultra-loose monetary policy) could stagnate or fall.

**Despite a less positive outlook than at the time of our Spring Forecast, we expect most economies in CESEE to grow quite strongly by post-crisis standards in 2018-2020.** In the short term, tight labour markets will continue to push up wages, and elevated capacity-utilisation levels will support investment. However, backing from external sources for growth is already fading, and we expect this to continue. A loss of momentum in the eurozone and the advanced economies presents a challenge to growth in the CESEE economies, especially in those that are strongly integrated into the regional production chains and rely on exports in their growth models.

**Regional growth has already peaked, and will trend downwards for most countries during the forecast period.** Only a few Western Balkan economies will keep up their current pace of growth, though that will remain rather moderate and not enough for significant convergence with wealthier parts of EU-CEE or Western Europe. Convergence as a whole will continue, although at an ever-slower pace as the forecast period progresses. Weaker demand from the eurozone will become particularly apparent by the end of our forecast period: we have revised down our forecasts for 2020 for many countries, in particular for the EU-CEE sub-region.

**Turkey and Russia – the region's biggest economies – are both currently struggling with low growth, although in the medium run the outlook for the former is much more positive than for the latter.** We expect Turkey to undergo a fairly pronounced recession in the coming quarters, but to bounce back from its current difficulties by 2020. By contrast, Russia will remain the CESEE economy facing the biggest challenges, and will continue to post very disappointing growth rates during the forecast period. In part, this will reflect the impact of international sanctions, although the main reasons for Russia's weak growth performance are domestic and structural in nature. Its problems will have negative spill-over effects for the rest of the CIS region as well.

**Labour shortages are an increasing concern for growth in the region, especially in EU-CEE, and how firms respond will largely dictate the pace of future growth.** Labour shortages are nothing new, but vacancy-rate data indicate that they are becoming increasingly acute, especially in parts of EU-CEE. We are cautiously optimistic that businesses will continue to invest in productivity-enhancing capital upgrading, rather than move production away from the region – although there is a significant risk of that happening. Unlike in much of EU-CEE, labour markets in the Western Balkans are not facing significant labour shortages. In this sub-region, unemployment is generally high, employment rates are low, and most countries have a particularly high share of youth and long-term joblessness. This reflects cultural factors, a reliance on remittances and a high degree of informality.

**Despite rising wages, inflation is fairly subdued in most of the region, particularly when the effects of higher oil prices are stripped out.** This remains a complex story (and not one unique to CESEE), although we think that an increase in savings rates across much of the region is a key explanation, as higher earnings do not necessarily translate into more demand. Additionally, outflows of remittances from countries with high shares of immigrant workers may also be having an effect. Over the medium term, even in the context of fairly acute labour shortages we expect wage increases to be capped by the legacy of increased labour market flexibility in CESEE, which has reduced labour's bargaining power.

**China's Belt and Road Initiative (BRI) is important for the CESEE region, and especially the Western Balkans.** It will bring much-needed infrastructure upgrading, but also political influence, increased corruption risks, and the chances of an unsustainable rise in public debt in some countries. We think that the EU should respond with a "Big Push" investment initiative of its own, framed as a complement rather than competitor to the BRI.

**Our four new monitors attempt to track and analyse developments in CESEE convergence, the business cycle, credit and FDI.** We find that most countries are continuing to converge with Western Europe, but that the outlook is increasingly challenging. Overheating concerns have abated since our Spring Forecast, reflecting strong policy responses in Turkey (monetary) and Romania (fiscal). Across the region, potential overheating is most evident in tight labour markets, higher external debt, elevated property prices and negative real interest rates. The credit cycle is mostly picking up, helped by improved asset quality, although this reflects primarily credits to households; growth of loans to non-financial corporations has remained rather weak. Finally, FDI inflows into CESEE declined quite strongly last year, reflecting capital withdrawals by foreign investors.

**Aside from visible challenges, additional downside risks to the global economic outlook have also increased.** From the perspective of CESEE – and taking account of both likelihood and impact – we are most concerned about the structural deficiencies in the eurozone (which make a renewed crisis more likely when the next downturn hits) and a full-scale trade war between the US and China. In terms of risks emanating from the CESEE region specifically, we view a smaller post-Brexit EU budget as the biggest issue (for EU-CEE at least), and are also concerned about a further decline in the rule of law and quality of institutions. A further spike in oil prices (the subject of much recent speculation in the media) would also be a big headwind for growth in most countries in CESEE, although we regard this development as much less likely.

**More fundamentally, the post-Second World War international and political economic order is showing increasing signs of strain**, and the chances of coordinated action at the global level to restore stability are low. The peaceful political, military and economic rise of China is in no way guaranteed, particularly considering the current occupant of the White House. Globalisation appears to have stalled, and is under attack from politicians in many countries. The EU is likely to remain focused primarily on internal issues.

**Political trends in the eurozone remain concerning, and could have big negative economic implications, including for CESEE.** Hard- and far-right parties are gaining in the polls, and parliamentary representation in general is becoming more fragmented (with centrist parties losing vote share). The most problematic country is Italy, which now has an anti-establishment government with a far-right presence. This matters for three reasons: Italy is a systemically important member of the eurozone; the Italian economy is already struggling with very high public debt and decades of negligible growth; and serious eurozone reform is now much less likely.

**Brexit will not be an economic catastrophe for the EU, but the political fallout will be significant.** Although Brexit has been a powerful unifying force for the remaining 27 members (as we expected), this will not last. It is almost impossible to imagine that the high degree of consensus among the EU-27 on Brexit will be repeated on more systemically important issues like migration, reform of the eurozone and the future budget.

## COUNTRY SUMMARIES

### ALBANIA

Our forecasts are largely unchanged from the spring, and we continue to expect the economy to remain strong and grow above 4% in the medium term. Both domestic and external demand will support growth. Higher international oil prices should mean higher investments and exports in this sector. Public private partnership projects must be transparent and well monitored in order to avoid rises in public debt. Tangible progress of judicial system reform is critical for the start of EU membership talks.

### BELARUS

The economy has rebounded thanks to an improving external environment and a policy stimulus engineered through wage rises. Real disposable income rose sharply supporting an upturn in private consumption. GDP growth was entirely driven by domestic demand while net exports made a negative contribution. Recent indicators suggest that growth has passed its peak and will decelerate. In 2018 as a whole GDP could rise by 3.7%, but thereafter will likely slow down to around 3% in the following years.

### BOSNIA AND HERZEGOVINA

Political risk is unusually high following the recent election, and in particular the potential for a constitutional crisis in the Federation. This will have an impact on reforms and policy-making, but shouldn’t impact growth too much. We think that growth will remain in the range of 3-3.5% during the forecast period, with external factors such as remittances, exports and tourism likely to remain important. Inflation will stay low, while the labour market will improve slowly.

### BULGARIA

GDP grew by 3.3% in the first half of 2018 which was below the rates of growth in the three preceding years. The moderation in output growth coincided with a slowdown in exports. The labour market tightened further and labour costs continued to rise. CPI accelerated due to rising energy prices and growing cost-push inflationary pressure. We expect GDP growth for 2018 as a whole of around 3.3%, and it should stay at a similar level in the coming years.

### CROATIA

Croatia’s economy will continue its path of moderate growth, with annual GDP growth of slightly below 3% in the period 2018-2020; increasing the absorption of EU funds will be an important precondition for achieving this growth rate. Demographic changes, coupled with continued emigration of young and educated people and rising labour shortages in crucial sectors, will become a major challenge in the future.

### CZECH REPUBLIC

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

## ESTONIA

Investment activity has abated so far in 2018, following last year's peak growth induced by fresh inflows of EU funds. However, external demand continued growing at a higher pace than expected. Household consumption, backed by a considerable rise in employment and real wages, continues to be a strong driver of economic activity. We project GDP to grow at a rate of 3.5% in 2018 and 3.1% in 2019, while declining somewhat to 2.7% in 2020.

## HUNGARY

The Hungarian economy expanded by 4.8% in Q2 of 2018, reaching the zenith of the current business cycle. Growth has been driven by the extraordinarily rapid utilisation of EU cohesion policy resources. This high growth rate cannot be sustained in the next three years. A sharp decrease in EU transfers from next year on will remove an important driver of growth and there is no comparable substitute for that in sight.

## KAZAKHSTAN

GDP will grow by 4% in 2018, mainly owing to high oil prices and expansion of production in the oil sector. In 2019-2020, the economy will continue benefiting from the favourable commodity price environment and grow by about 3% annually. The main risks to the forecast are a sharp decline in global oil prices and intensifying geopolitical tensions around Russia and China.

## KOSOVO

We forecast that growth will strengthen further to above 4%. Imminent risks due to political tensions surrounding the consultations about territorial swapping with Serbia remain high. Infrastructure investments will be a major driver of growth in the medium term boosted by private and public investments. The banking sector remains solid and well capitalised and credit growth is expected to continue on its upward trend. The fiscal stance and monetary policy remain supportive of growth.

## LATVIA

Both public and private investment have kept the economy growing at a high pace in 2018 and exports evolved more strongly than expected. Household consumption is also rising rapidly; a tightening labour market and the 2018 income tax reform will provide further stimulus. While public spending is likely to expand quickly, we assume external demand growth to abate gradually. In 2018 we expect another year with high GDP growth of 4.1%, followed by a slight slowdown to 3.3% in 2019 and 2.7% in 2020.

## LITHUANIA

Public and private investment have driven growth in the Lithuanian economy for another year. A further decline in unemployment has resulted in rapid wage increases. Furthermore, the enacted income tax reform will foster steady, strong growth in household consumption. The increase in external demand has been stronger than expected in 2018, but is likely to abate slightly in the coming two years. For 2018, we expect real GDP to grow by 3.5%, followed by 3% in 2019 and 2.6% in 2020.

## MACEDONIA

The Macedonian economy started to recover in 2018 owing to a strong revival of industry and solid export performance. Real GDP is projected to grow by about 3% per year in the medium term, although the chances of political instability suggest significant downside risks. The failed referendum on the country's 'name issue' on 30 September will prolong the political crisis and may destabilise the country again with adverse economic consequences, regardless of the new name's endorsement by the parliament in October.

## MONTENEGRO

In 2018, GDP will grow by 4.2% – better than previously expected. The main driving forces behind the dynamic growth are fast growing investment and exports. High growth has brought about job creation, but unemployment remains high. The costs of the Bar-Boljare highway project have risen, which exacerbated the government debt burden. During 2019-2020, economic growth will slow down to about 3%.

## POLAND

Despite lower profits the corporate sector's financial standing and financing conditions are good. But the private domestic firms are reluctant to expand investment. The ongoing political changes destabilise 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

The Romanian economy is experiencing an unavoidable slowdown, following a boom based on fiscal stimulus of household consumption in the past two years. Economic growth is sustainable at rates somewhat below 4% over the forecast period. Business sector investment is supporting economic growth, while public investments are falling victim to fiscal rebalancing.

## RUSSIA

The Russian economy continues to grow at a slow pace. The unimpressive performance is forecast to last even in the medium term since no improvements in either domestic or external conditions for development are expected. High oil prices currently mitigate the adverse impacts of geopolitical tensions, though both investments and economic restructuring suffer. Chinese-Russian relations are likely to strengthen further.

## SERBIA

Current economic growth and the near-term outlook are as good as has been the case at any time since the global financial crisis a decade ago. A combination of FDI inflows and private consumption are likely to remain the key growth drivers. The economy continues to face challenges, although efforts to bring down public debt and clean up the banking sector have been partly successful. Over the medium term, growth will trend down towards 3%, implying very slow convergence with Western Europe.

## SLOVAKIA

Slovakia's growth accelerated in the first half of 2018 on a broad base. Forecasts for this and next year amount to 3.8% and about 4% respectively, thanks to the new Jaguar Land Rover plant. Main internal risks are growing wages and labour shortages.

### SLOVENIA

GDP growth is expected to reach 4.5% in 2018, but will slow due to lower export growth in the forecast period. Domestic demand, investments fuelled by EU funding and steady consumption growth will remain the main drivers of GDP growth. The shrinking of the working-age population and increasing labour shortages will put an upward pressure on wages.

### TURKEY

Turkey's economy is heading for recession, and is set to face at least several difficult quarters. US monetary tightening, and domestic and international political risk factors, have combined with an unbalanced and debt-reliant growth model to create a perfect storm for Turkey. The policy response by the authorities, including monetary tightening and an attempt to calm international tensions, have significantly reduced the chances of a full-blown crisis. Our core scenario is that the economy will start to recover by end-2019.

### UKRAINE

Thanks to the booming domestic demand, economic growth should exceed 3% this year but will likely decelerate somewhat in 2019 due to recent monetary policy tightening. In the face of a less supportive global environment, Ukraine has agreed on a new IMF loan, which should ensure macroeconomic stability at least in the short term. However, the social impact of the related recent hike in gas tariffs may prove politically costly for the authorities ahead of the March 2019 presidential elections.

Keywords: CESEE, economic forecast, Europe, Central and Eastern Europe, Southeast Europe, Western Balkans, new EU Member States, CIS, Russia, Ukraine, Poland, Romania, Czech Republic, Hungary, Turkey, 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, DCFTA, Belt and Road Initiative

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

**Table 1 / OVERVIEW 2016-2017 AND OUTLOOK 2018-2020**

| | | GDP real change in % against prev. year | | | | | Consumer prices change in % against prev. year | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Forecast | | | | | Forecast | | |
| | | 2016 | 2017 | 2018 | 2019 | 2020 | 2016 | 2017 | 2018 | 2019 | 2020 |
| BG | Bulgaria | 3.9 | 3.8 | 3.3 | 3.2 | 3.0 | -1.3 | 1.2 | 2.5 | 2.5 | 2.5 |
| CZ | Czech Republic | 2.5 | 4.3 | 3.3 | 3.2 | 3.1 | 0.6 | 2.4 | 2.3 | 2.3 | 2.0 |
| EE | Estonia | 3.5 | 4.9 | 3.5 | 3.1 | 2.7 | 0.8 | 3.7 | 3.3 | 2.8 | 2.7 |
| HR | Croatia | 3.5 | 2.9 | 2.5 | 2.6 | 2.7 | -0.6 | 1.3 | 1.6 | 2.0 | 2.0 |
| HU | Hungary | 2.3 | 4.1 | 4.3 | 3.0 | 2.3 | 0.4 | 2.4 | 3.1 | 3.0 | 3.0 |
| LT | Lithuania | 2.4 | 4.1 | 3.5 | 3.0 | 2.6 | 0.7 | 3.7 | 2.6 | 2.7 | 2.5 |
| LV | Latvia | 2.1 | 4.6 | 4.1 | 3.3 | 3.0 | 0.1 | 2.9 | 2.4 | 2.5 | 2.5 |
| PL | Poland | 3.1 | 4.8 | 5.0 | 3.5 | 3.3 | -0.2 | 1.6 | 2.0 | 2.1 | 1.9 |
| RO | Romania | 4.8 | 7.3 | 3.8 | 3.6 | 3.7 | -1.1 | 1.1 | 4.0 | 3.0 | 3.0 |
| SI | Slovenia | 3.1 | 4.9 | 4.5 | 3.6 | 3.5 | -0.2 | 1.6 | 1.8 | 2.0 | 2.0 |
| SK | Slovakia | 3.1 | 3.2 | 3.8 | 4.1 | 3.3 | -0.5 | 1.4 | 2.8 | 2.5 | 2.2 |
| | *EU-CEE 1)2)* | *3.2* | *4.9* | *4.2* | *3.4* | *3.2* | *-0.2* | *1.8* | *2.6* | *2.4* | *2.3* |
| | *EA-19 3)* | *1.9* | *2.4* | *2.0* | *1.7* | *1.6* | *0.2* | *1.5* | *1.6* | *1.6* | *1.6* |
| | *EU-28 3)* | *2.0* | *2.4* | *2.0* | *1.9* | *1.8* | *0.3* | *1.7* | *1.7* | *1.8* | *1.9* |
| AL | Albania | 3.4 | 3.8 | 4.1 | 4.0 | 4.0 | 1.3 | 2.0 | 2.1 | 2.5 | 2.9 |
| BA | Bosnia and Herzegovina | 3.1 | 3.1 | 3.0 | 3.4 | 3.4 | -1.1 | 1.2 | 1.2 | 1.9 | 1.9 |
| ME | Montenegro | 2.9 | 4.7 | 4.2 | 3.1 | 3.1 | 0.1 | 2.8 | 3.5 | 2.0 | 2.0 |
| MK | Macedonia | 2.9 | 0.0 | 2.9 | 2.8 | 3.1 | -0.2 | 1.4 | 1.5 | 2.0 | 2.0 |
| RS | Serbia | 3.3 | 2.0 | 4.3 | 3.4 | 2.8 | 1.1 | 3.0 | 2.3 | 2.7 | 3.0 |
| XK | Kosovo | 4.1 | 3.7 | 4.2 | 4.0 | 4.2 | 0.3 | 1.5 | 0.7 | 1.6 | 2.0 |
| | *WB 1)2)* | *3.3* | *2.5* | *3.8* | *3.5* | *3.2* | *0.5* | *2.2* | *1.9* | *2.3* | *2.6* |
| TR | Turkey | 3.2 | 7.4 | 2.5 | 1.0 | 4.0 | 7.7 | 11.1 | 16.5 | 17.0 | 12.0 |
| BY | Belarus | -2.5 | 2.4 | 3.7 | 3.0 | 2.8 | 11.8 | 6.0 | 5.0 | 7.0 | 8.0 |
| KZ | Kazakhstan | 1.1 | 4.1 | 4.0 | 3.1 | 3.0 | 14.6 | 7.4 | 6.5 | 6.0 | 5.0 |
| RU | Russia | -0.2 | 1.5 | 1.7 | 1.6 | 1.8 | 7.1 | 3.6 | 3.5 | 5.5 | 4.0 |
| UA | Ukraine | 2.4 | 2.5 | 3.3 | 2.7 | 2.0 | 13.9 | 14.4 | 10.8 | 8.9 | 5.2 |
| | *CIS + Ukraine 1)2)* | *0.1* | *1.9* | *2.2* | *1.9* | *2.0* | *8.5* | *4.9* | *4.4* | *5.9* | *4.3* |
| | *V-4 1)2)* | *2.8* | *4.5* | *4.4* | *3.4* | *3.1* | *0.0* | *1.9* | *2.3* | *2.3* | *2.1* |
| | *BALT-3 1)2)* | *2.5* | *4.4* | *3.7* | *3.1* | *2.7* | *0.6* | *3.5* | *2.7* | *2.7* | *2.5* |
| | *SEE-9 1)2)* | *4.1* | *5.1* | *3.6* | *3.4* | *3.4* | *-0.7* | *1.4* | *3.0* | *2.6* | *2.7* |
| | *NON-EU-11 1)2)* | *1.1* | *3.6* | *2.3* | *1.7* | *2.6* | *8.0* | *6.7* | *7.9* | *9.1* | *6.6* |
| | *CESEE-22 1)2)* | *1.7* | *3.9* | *2.8* | *2.2* | *2.8* | *5.6* | *5.2* | *6.4* | *7.1* | *5.3* |

**Table 1 / (ctd.)**

| | | Unemployment (LFS) rate in %, annual average | | | | | Current account in % of GDP | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Forecast | | | | | Forecast | | |
| | | 2016 | 2017 | 2018 | 2019 | 2020 | 2016 | 2017 | 2018 | 2019 | 2020 |
| BG | Bulgaria | 7.6 | 6.2 | 5.5 | 5.3 | 5.0 | 2.6 | 6.5 | 2.9 | 1.0 | 0.8 |
| CZ | Czech Republic | 4.0 | 2.9 | 2.3 | 2.2 | 2.2 | 1.6 | 1.0 | 0.6 | 0.8 | 0.7 |
| EE | Estonia | 6.8 | 5.8 | 5.5 | 5.0 | 4.5 | 2.0 | 3.2 | 1.0 | 0.2 | -0.7 |
| HR | Croatia | 13.1 | 11.2 | 9.8 | 9.0 | 8.8 | 2.6 | 4.0 | 2.7 | 1.5 | 1.3 |
| HU | Hungary | 5.1 | 4.2 | 3.6 | 3.5 | 3.5 | 6.2 | 3.2 | 2.5 | 2.7 | 2.8 |
| LT | Lithuania | 7.9 | 7.1 | 6.5 | 6.0 | 5.8 | -0.8 | 0.9 | -1.2 | -1.3 | -1.4 |
| LV | Latvia | 9.6 | 8.7 | 7.7 | 7.2 | 6.7 | 1.6 | 0.7 | 1.8 | 1.0 | 0.5 |
| PL | Poland | 6.2 | 4.9 | 3.8 | 3.7 | 3.6 | -0.5 | 0.2 | -0.4 | -1.4 | -1.5 |
| RO | Romania | 5.9 | 4.9 | 4.5 | 4.5 | 4.7 | -2.1 | -3.4 | -4.4 | -4.5 | -4.3 |
| SI | Slovenia | 8.0 | 6.6 | 5.0 | 4.5 | 4.0 | 5.5 | 7.2 | 7.3 | 6.0 | 5.1 |
| SK | Slovakia | 9.7 | 8.1 | 6.6 | 6.3 | 6.0 | -2.2 | -2.0 | -1.4 | -0.6 | -0.5 |
| | *EU-CEE* 1)2) | *6.5* | *5.3* | *4.5* | *4.3* | *4.2* | *0.6* | *0.6* | *-0.1* | *-0.5* | *-0.6* |
| | *EA-19* 3) | *10.0* | *9.1* | *8.4* | *7.9* | *7.7* | *3.4* | *3.8* | *3.4* | *3.2* | *2.9* |
| | *EU-28* 3) | *8.6* | *7.6* | *6.9* | *6.4* | *6.2* | *2.0* | *2.5* | *2.1* | *1.9* | *1.6* |
| AL | Albania | 15.2 | 13.7 | 12.4 | 12.2 | 12.0 | -7.6 | -7.5 | -8.0 | -7.2 | -6.7 |
| BA | Bosnia and Herzegovina | 25.4 | 20.5 | 18.2 | 17.6 | 17.1 | -4.7 | -4.7 | -4.6 | -4.6 | -4.5 |
| ME | Montenegro | 17.4 | 16.1 | 15.0 | 15.0 | 15.0 | -16.2 | -16.1 | -16.1 | -17.1 | -17.2 |
| MK | Macedonia | 23.7 | 22.4 | 21.0 | 20.0 | 20.0 | -2.8 | -1.0 | -0.8 | -1.0 | -1.0 |
| RS | Serbia | 15.2 | 13.6 | 13.3 | 13.0 | 12.0 | -2.9 | -5.3 | -5.1 | -4.8 | -4.6 |
| XK | Kosovo | 27.5 | 30.5 | 28.0 | 26.0 | 24.0 | -7.9 | -6.1 | -6.2 | -6.3 | -6.9 |
| | *WB* 1)2) | *18.7* | *16.9* | *15.7* | *15.3* | *14.7* | *-4.8* | *-5.6* | *-5.5* | *-5.4* | *-5.3* |
| TR | Turkey | 10.9 | 10.9 | 10.2 | 10.5 | 10.0 | -3.8 | -5.5 | -4.8 | -3.2 | -3.2 |
| BY | Belarus | 5.8 | 5.6 | 4.7 | 4.5 | 4.5 | -3.4 | -1.6 | -2.5 | -2.8 | -3.1 |
| KZ | Kazakhstan | 5.0 | 4.9 | 5.0 | 5.0 | 5.0 | -6.5 | -3.3 | -0.9 | -0.7 | -1.2 |
| RU | Russia | 5.5 | 5.2 | 5.0 | 4.9 | 4.9 | 1.9 | 2.1 | 5.9 | 4.3 | 3.3 |
| UA | Ukraine | 9.3 | 9.5 | 8.9 | 8.5 | 8.3 | -1.4 | -2.2 | -2.7 | -3.1 | -4.4 |
| | *CIS + Ukraine* 1)2) | *6.1* | *5.9* | *5.6* | *5.5* | *5.4* | *0.8* | *1.3* | *4.6* | *3.2* | *2.2* |
| | *V-4* 1)2) | *5.9* | *4.7* | *3.7* | *3.6* | *3.5* | *0.7* | *0.6* | *0.1* | *-0.2* | *-0.3* |
| | *BALT-3* 1)2) | *8.2* | *7.3* | *6.7* | *6.1* | *5.8* | *0.6* | *1.4* | *0.2* | *-0.3* | *-0.7* |
| | *SEE-9* 1)2) | *11.2* | *9.7* | *8.9* | *8.7* | *8.5* | *-1.4* | *-1.6* | *-2.7* | *-3.2* | *-3.1* |
| | *NON-EU-11* 1)2) | *7.8* | *7.5* | *7.1* | *7.1* | *6.9* | *-1.0* | *-1.0* | *1.7* | *1.3* | *0.6* |
| | *CESEE-22* 1)2) | *7.4* | *7.0* | *6.5* | *6.4* | *6.3* | *-0.4* | *-0.4* | *1.0* | *0.6* | *0.1* |

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

Source: wiiw, Eurostat. Forecasts by wiiw (October 2018).

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**The statistical data until 2017 presented in this Report are as of 15 October 2018, forecasts as of October 2018. Most data are taken from the wiiw Databases. Direct access is available at: http://data.wiiw.ac.at/.**

## ABBREVIATIONS

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

| | |
|---|---|
| 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 |
| MKD | 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 |
| 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 |
| CESEE | Central, East and Southeast Europe |
| 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 |
| EU-15 | 15 original members of the European Union |
| FDI | Foreign Direct Investment |
| FISIM | Financial Intermediation Services, Indirectly Measured |
| FW | Free Voters of Bavaria |
| GDP | Gross Domestic Product |
| GNP | gross national product |
| ICP | International Comparison Project |
| IMF | International Monetary Fund |
| LFS | Labour Force Survey |
| NACE | Nomenclature statistique des activités économiques dans la Communauté européenne (Statistical classification of economic activities in the European Community) |
| NACE Rev. 1 | first revision of the original NACE (1970) |
| NACE Rev. 2 | revised classification, introduced in 2008 |
| NB | National Bank |
| NC | national currency |
| NMS | new EU Member States |
| 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 |
| SEE | Southeast Europe |
| 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 |
| WBC | Western Balkan countries |
| WBIF | Western Balkan Investment Framework |
| WIFO | Austrian Institute of Economic Research |
| wiiw | The Vienna Institute for International Economic Studies |

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

# 1. Global economic outlook

## 1.1. GLOBAL AND EUROZONE OUTLOOK: HEADING INTO INCREASINGLY STORMY WEATHER

**by Richard Grieveson[1]**

*Despite a slightly less optimistic outlook than in the Spring, the global economy remains buoyant, powered above all by strong activity in the US. Global growth should remain fairly robust by post-crisis standards throughout the forecast period. However, the risks to the outlook have continued to rise, and are tilted heavily towards the downside. Tighter US policy, a possible Chinese slowdown, and uncertainty around Italy and the eurozone are the main things to watch.*

### 1.1.1. Global economy: growth still looks good, but risks rising

**The international environment has become more challenging since our Spring Forecast Report, reflecting tighter US monetary policy, rising trade protectionism and the impact of international tensions on economic sentiment.** As the International Monetary Fund (IMF) pointed out in its most recent World Economic Outlook (IMF, 2018), not only has global growth moderated this year, but has also become less synchronised.

**Rising US interest rates are a challenge for the global economy, and many emerging markets are already suffering as a result.** The dollar has strengthened notably since April, as higher US rates and various idiosyncratic risks have pushed investors back from emerging markets to the relative safety and now higher returns of the US (see Figure 1). Much of the global economy – and particularly corporates in emerging markets – has become addicted to cheap dollar credit, and will struggle to cope as US rates rise. Our sense remains that the exit of major central banks from ultra-loose monetary policy (the European Central Bank (ECB) will start tightening monetary policy next year, according to current projections) will continue to cause a serious amount of instability in international financial markets and will have economic consequences, including in our region.

**Higher US rates have significantly increased the chances of an emerging markets crisis, and have already (and will continue to do so) depressed growth rates in many economies.** We have seen this already in our region with Turkey (see chapter 2.1 and the Turkey country report), but others around the world, notably Argentina, have also been affected. A continued adjustment of these countries' current account deficits – already quite savage in the case of Turkey – will have to happen. Exports should provide some relief (helped by much weaker currencies and a likely expansion of the US current account deficit), but it is likely that the brunt of the adjustment will be borne by domestic consumption and investment (as is already happening in Turkey), meaning much lower growth. In

[1] The author would like to thank Peter Havlik, Mario Holzner, Gabor Hunya and Olga Pindyuk for valuable comments and suggestions on the text.

October, the IMF reduced its growth forecasts for several key emerging markets, notably India, Argentina, Brazil, Mexico, Iran and Turkey.

**Figure 1 / Trade-weighted US dollar index**

Broad measure, 1997=100

Note: Index is a weighted average of the value of the US dollar against a broad range of trading partners' currencies.
Source: St Louis Fed.

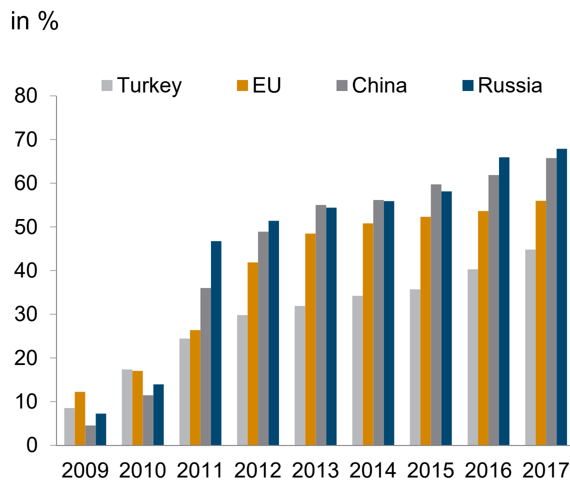
**A global trade war – which has been a risk ever since the election of Donald Trump as US president – is now partly under way, adding to the headwinds facing the world's economy.** In late September, the US imposed tariffs on US$200 billion worth of Chinese imports, and China responded with measures against the US. China so far does not appear inclined to back down, and has several incentives for not doing so (Frankel, 2018). Further exchanges of sanctions between the US and China would certainly make the situation even worse (see CESEE risk matrix). It is also clear that uncertainty about future tariff changes is negatively affecting economic sentiment and production and investment plans in many key economies.

**A full-scale US–China trade war would harm global growth, but it is important to note that in some ways this would only continue a process of increasing restrictions on trade between major economies that has been under way for almost a decade.** As Figure 2 shows, since 2009 the US has significantly increased the share of imports from other parts of the world that it subjects to 'harmful' trade restrictions. As a share of global GDP, international trade rose relentlessly from the 1980s until the time of the global financial crisis. Since then, it has largely been flat (Figure 3), albeit with a significant increase in the EU and a decline in China.[2]

[2] This is a useful illustration of how much the EU has leaned on demand from the rest of the world to drive its recovery from the crisis, and partly reflects how much domestic demand in the bloc has been compressed over the past decade.

**Figure 2 / Share of imports into the US subject to 'harmful' trade restrictions, by exporter**

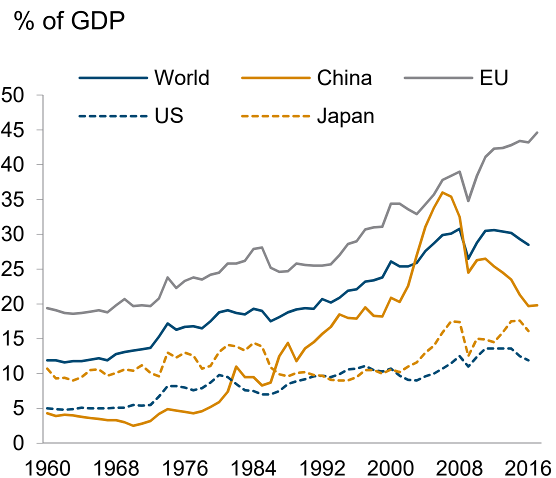
in %




Note: 'Harmful' trade restrictions include both tariffs and non-tariff measures. For a full list see Simon J. Evenett and Johannes Fritz (2017), The Global Trade Alert database handbook, Manuscript, 14 July 2017.
Source: Global Trade Alert.

**Figure 3 / Exports of goods and services**

% of GDP

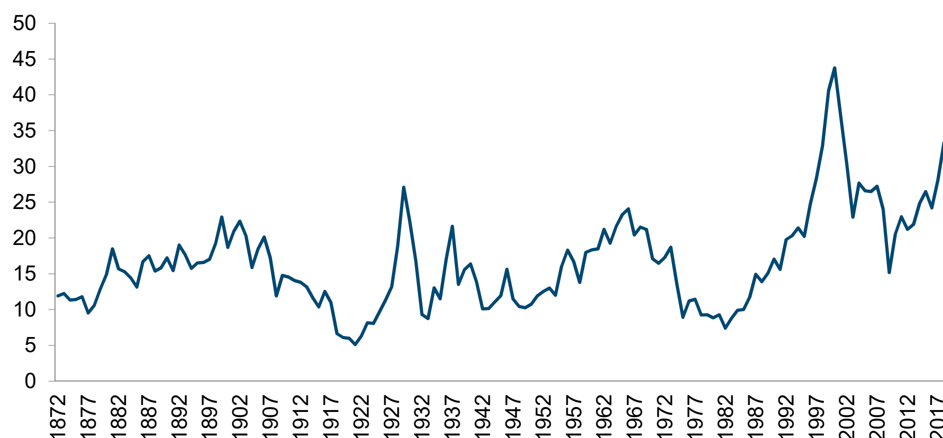



Source: World Bank.

**There are increasing signs that the Chinese economy is also slowing, which is a further issue from the perspective of global growth.** The IMF sees growth dipping to 6.2% in China next year, down 0.4 percentage points on this year's estimate, and a 0.2 percentage-point downgrade from last time. Attempts in China to deleverage the economy (and especially the shadow banking sector) after years of strong credit growth have led to weaker domestic investment activity, and as such are reducing important demand, with knock-on effects for the global economy.

**As we highlighted in our last Spring Forecast, global financial markets are signalling various reasons for concern.** A decade of ultra-loose global monetary policy has significantly pushed up prices across various asset classes, including stocks, bonds and property. The Shiller price/earnings (PE) ratio for the S&P 500 is at its second-highest level on record (see Figure 4), below only the 'dot com' bubble. However, many have been expecting a US stock market collapse for years, and have been wrong. US tightening is likely to be the trigger for any broader crisis, although this will depend very much on how fast the Fed moves. Markets more generally do appear to be suggesting the late stage of the cycle, consistent with monetary tightening in the US. Ten years after the collapse of Lehman Brothers, it may well again be reasonable to assume that the next crisis is likely to come from something that few people are currently looking at.

**Figure 4 / Shiller Cyclically Adjusted Price/Earnings Ratio (CAPE Ratio)**




Note: The CAPE ratio is the price/earnings ratio for the S&P 500 using inflation-adjusted earnings over the last 10 years. This smooths out fluctuations in earnings caused by the business cycle.
Source: Robert Shiller

**Oil prices have continued to rise this year, although it is likely that a sustained increase above US$100 a barrel (bbl) will be necessary for the global economy to be significantly negatively affected** (parts of the eurozone may be an exception to this; see chapter 1.2). It is possible that the oil price will rise further in the short term on the basis of weaker output in Iran or Venezuela. However, on the flipside, Russia and the Organization of the Petroleum Exporting Countries (OPEC) agreed in June to increase production; US shale output will likely continue to cap prices; and weaker global growth will negatively affect oil demand. OPEC has so far refrained from a further official production increase, but pressure from Mr Trump on Saudi Arabia and others for more output is likely to increase ahead of US mid-term elections, and further increases in the oil price would prompt a response from Saudi Arabia and others. Media reports indicate that Asian refiners in particular have been asking Middle Eastern suppliers for more cargoes. As a result, we currently think that oil will spend 2019 in the US$70–80/bbl range.

**While risks are clearly rising, US growth is still strong, US inflation is still relatively subdued (which will limit the pace of further monetary tightening), and China's policy-makers have the means and incentives to respond to any downturn in their country.** The IMF projects global growth at 3.7% this year and next, which is the same as in 2017. Meanwhile, US growth for 2018–19 will be quite a bit better than 2016–17. Perhaps most importantly in the case of the US, there still appears to be some slack in the labour market, which will keep a lid on inflation and make it likely that the pace of future monetary tightening is quite measured. Meanwhile, twice in the past decade the Chinese economy has been hit by external shocks (2008–09 and 2013–15) and each time the domestic policy response has been significant, with a focus on credit expansion and infrastructure investment. Although this time higher debt loads and a deleveraging cycle suggest that a policy response could be less likely, there is still room for significant fiscal easing, if required, while the pressure to deleverage has already been relaxed, and monetary policy could also be eased further if necessary.

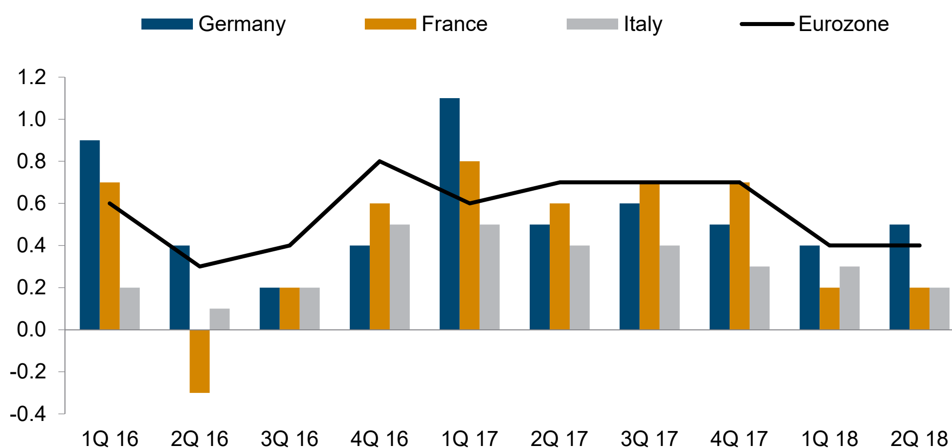
**More fundamentally the post-World War II international and political economic order is showing increasing signs of strain, and the chances of coordinated action at the global level to restore stability are low.** This is for two main reasons: a one-in-a-century rise of a new great power (China) and an erratic US president backed by a largely acquiescent Republican Party. The peaceful political, military and economic rise of China is in no way guaranteed, particularly considering the current occupant of the White House. As shown above, globalisation appears to have stalled, and is under attack from politicians in many countries. The EU is likely to remain focused on internal issues and, under German direction, appears incapable of a strategic approach to anything.

### 1.1.2. Eurozone economy: slowing, and increasing worries about Italy

**Within the eurozone, Germany is still growing strongly. However, the pronounced cyclical upswing recorded in the bloc last year has faded badly, notably in France and Italy.** For Germany, although the risks have risen (Germany is unusually open for a big economy, and so would suffer disproportionately from a downturn in global trade), the outlook is still reasonably positive. Growth has slowed a bit this year, but remains at historically strong levels (see Figure 5). However, outside Germany, momentum has slowed markedly, especially in France and Italy, the second- and third-biggest economies in the bloc.

**Figure 5 / Real GDP**

Seasonally and working-day adjusted, % change quarter on quarter




Source: Eurostat.

**There are three mains reasons for the eurozone slowdown: capacity constraints, higher oil prices and the impact on sentiment of global trade tensions.** At the turn of the year, firms were unable to keep pace with demand, and capacity constraints emerged particularly in terms of capital (although also on the labour side in some places).[3] Meanwhile, outside Germany, domestic demand appears to be too weak to allow firms to pass on higher input costs (chiefly from oil) to consumers.

[3] Sentiment surveys at that time – for example, the purchasing managers' index (PMI) compiled by IHS Markit for major eurozone economies, consistently showed significant backlogs of work, as firms struggled to keep up with orders.

**The ECB will end its asset purchase programme this year, but is likely to start tightening policy only very slowly, starting in late 2019 at the earliest.** We have already expressed our scepticism about a sharp hiking cycle. Core inflation trends, especially outside Germany, continue to look very weak. This will keep the euro weak against the dollar, which could bring some relief for eurozone exporters.

**Meanwhile, two major developments in EU and eurozone politics have continued, and will have big economic implications: the rise of the far right and the fragmentation of parliamentary representation.** European Parliament elections in May 2019 may provide a further indication of both trends. The roots of the significant political changes happening across the EU are deep and complex, but there is little indication of a 'return to normal'. A shift to the far right[4] in response to the migration crisis has been clear in many countries, and there is no real EU-wide solution in sight to this issue (see chapter 1.3). However, this is far from the whole story (see, for example, the success of the Green Party in Germany[5]). Centrist parties are losing vote share to the extremes on both the right and the left, leading to broader and messier coalition governments that will struggle to achieve meaningful reforms. Economic factors have also been important in driving increased support for non-centrist parties on both the right and the left, and in particular the austerity-dominated response to the eurozone crisis pushed by Germany and some smaller Northern European allies (see, for example, Scazzieri, 2018). The importance of supply-side reforms in Southern Europe is widely recognised – particularly the opening up of product and service markets to greater competition. However, the unwillingness of Germany to allow support from the demand side during a tough period of adjustment has needlessly made the situation worse, and could prove corrosive to the European project in the long run (Heimberger, 2017).

**As we have previously highlighted, the most problematic country is Italy, which now has an anti-establishment government with a far-right presence.** This matters for three reasons. First, Italy is a systemically important member of the eurozone, and a crisis there would be much more difficult to solve than was the case in Greece. Second, it creates additional problems for the Italian economy, which is already struggling with very high public debt and decades of negligible growth. Under the current government (which is on a collision course with the EU over its budget), a debt crisis has become much more likely (Blanchard et al., 2018). Third, it makes the chances of reform of eurozone architecture more difficult. Without progress on fiscal and banking union, we do not think it makes sense to talk about the 'eurozone crisis' in the past tense (see chapter 1.2).

### 1.1.3. Brexit: a monumental unforced error where nobody wins

**It has been over two years since the Brexit vote, and negotiations over the terms of withdrawal and future relationship have been very bruising for the UK.** The unwillingness on the part of much of the UK government to face up to the trade-offs that Brexit entails (rather than 'having our cake and eating it', in the infamous words of the hapless and destructive former UK foreign secretary, Boris Johnson) has brought the country to the brink of an economic and political crisis. From here, all options

[4] This can be seen not only in the increased vote share of hard- or far-right parties, but also in the adoption of parts of the far-right agenda by centrist parties.

[5] In the recent Bavarian election, for example, the centre-right Christian Social Union (CSU) lost more votes to the Free Voters of Bavaria (FW), the Greens and voters dying than the hard-right Alternative für Deutschland (AfD).

remain on the table, and it is not unthinkable that the UK will crash out of the EU without a deal. It is also far from impossible that this will herald a return to conflict in Northern Ireland.

**Assuming that some kind of deal is reached, there are two realistic long-term options for the UK–EU relationship: the so-called 'Canada plus' option and something like the Norway model (i.e. staying in the single market).** The first would mean significantly more restrictions on UK–EU trade than is currently the case (both for goods and, especially, services), and would require much greater checks on trade between Great Britain and Northern Ireland, something that would have significant political consequences in the UK. Meanwhile the Norway model is basically the so-called 'Brexit in name only' (BINO), which would mean the UK largely staying in the EU, but with little or no say over the rules (Wren-Lewis, 2018). On balance, the first option looks more likely, albeit with a fairly lengthy transition period, during which the whole of the UK remains in the single market and customs union. A collapse of the current government is now also far from unthinkable, and if there is then a general election and Labour comes to power, this could mean BINO becoming permanent. However, a collapse of the whole process, and a second referendum in the UK, is no longer unthinkable. Whatever happens, the scenarios for the UK economy range from somewhat negative to disastrous. Key UK trading partners in the EU, such as Germany, will also be affected, leading to knock-on effects for CESEE.

**The political fallout may be even more significant, for both sides.** It is clear that the UK's status on the world stage has been dramatically diminished by the shambles of its Brexit negotiations, and that this will take some time to recover from. Meanwhile, from the EU side, although Brexit has been a powerful unifying force (as we expected), this will not last. Brexit is in fact far from the most important issue that the EU has to deal with, and it is almost impossible to imagine that the high degree of consensus among the EU-27 on Brexit will be repeated for issues like migration, reform of the eurozone, and the future budget (see CESEE risk matrix for more details).

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## 1.2. EUROZONE REFORM: LACK OF PROGRESS LEAVES BLOC ILL-PREPARED FOR NEXT DOWNTURN

**by Philipp Heimberger**

*It is very possible that a recession will hit the Eurozone within the next three years. If a downturn were to start, the bloc could be in big trouble. The ECB would have little room to cut further to support the economy, bond markets could sell off prompting a liquidity crisis, national governments have little room for manoeuvre in fiscal policy, and a sufficient counter-cyclical response at the EU level looks highly unlikely.*

**First, the ECB has announced that it will keep interest rates at zero at least until mid-2019 to further support the eurozone economy; although this is a sensible decision, it does imply that monetary policy-makers are unlikely to have much room to cut rates when the next recession hits.** Technically, it would be possible for the ECB to experiment further with negative interest rates and other tools; however, the experience of political conflicts surrounding monetary policy measures over recent years (above all the ECB's Quantitative Easing programme) suggests that one should not expect eurozone member countries unanimously to accept extensions of the ECB's usage of 'unconventional' monetary policy tools. Hence, major political tensions among member countries may be expected during the next downturn. The conclusion to be drawn from these political economy considerations is that it remains unclear whether the single currency will hold together in its current form during the next recession.

**Second, the eurozone remains fragile to speculative sell-offs on the government bond markets that could lead to self-reinforcing liquidity crises.** The turbulence in Italy has recently brought this issue sharply back into focus. The continued fragility is due to the incompleteness of the euro area's institutional framework: individual member countries are prone to experiencing speculation against their government bonds, because they de facto have no control over the currency in which they issue debt. Hence, in principle there is an urgent need to create a eurozone safe asset that can be credibly backed by the ECB. However, despite a variety of reform proposals, the question remains politically controversial. In principle, there are even proposals on the table to create a eurozone-wide safe asset without full joint liability; and such proposals might be easier to accept for member countries in the eurozone core. However, it is still very unclear whether a political compromise on future institutional reforms of the eurozone can be reached, which would allow for the creation of a safe asset backed by the ECB to end the possibility of self-fulfilling debt crises.

**Third, at the national level the room for policy manoeuvre remains constrained; this is especially true of the southern eurozone countries hit hardest by the last crisis.** Importantly, the legacy of the crisis dynamics over the last 10 years has resulted in high public debt levels (very significantly so in some eurozone countries). European policy-makers have focused on fiscal consolidation, and by doing so have failed to allow for a proper recovery in large parts of the eurozone; this has led to a debt-deflationary spiral and further increases in public debt. In a number of eurozone countries, the banking sector has not recovered and remains fragile. Given that the European Banking Union remains incomplete, governments might again find it difficult to stabilise their banking sector over the course of the next crisis. As policy-makers have so far not managed to break the banking–sovereign nexus by

introducing institutional reforms, further ‘doom loops’ between banking-sector stress and panic-driven government debt crises in individual countries could lead to eurozone-wide contagion.

**Finally, the experience with fiscal policy coordination problems in recent years suggests that the restrictions of the EU’s fiscal regulation framework will make it difficult to engineer an appropriate anti-cyclical fiscal policy response to counteract the next crisis.** In this context, the crucial question is whether current reform discussions about implementing a common eurozone budget that would allow automatic stabilisers to be used to channel funds to stressed regions of the bloc will actually lead to substantial improvements in the eurozone architecture, or whether fiscal rules will at least be changed to allow more discretionary policy space in individual member countries.

In sum, if even a rather mild recession were to hit the eurozone within the next three years, the resilience of the single currency in its present form would again be put to the test.

## 1.3. EUROPEAN MIGRATION AND REFUGEE FLOWS: REDRAWING MIGRATION AND ASYLUM POLICY

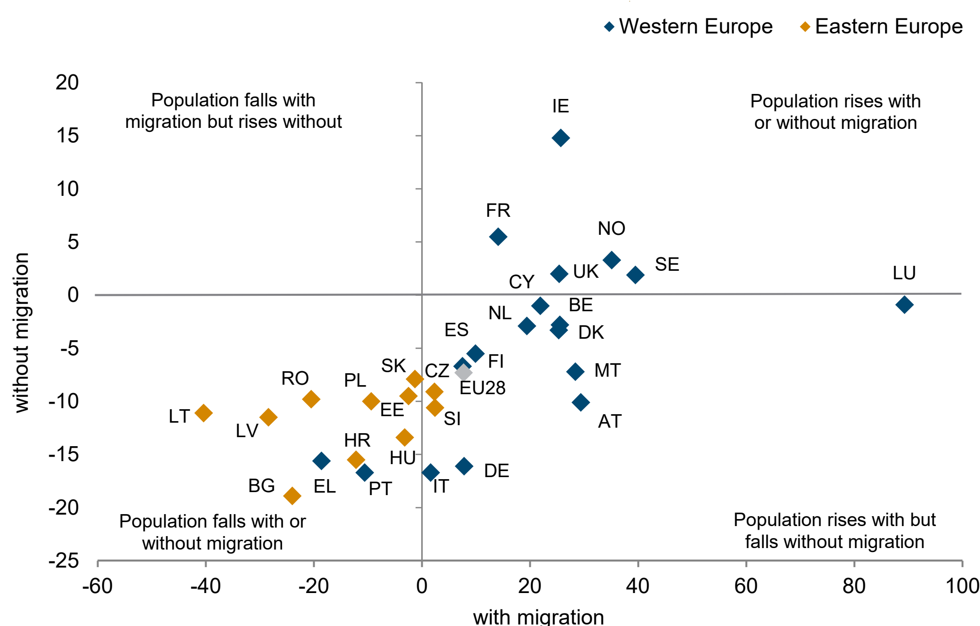
**by Michael Landesmann**

*The case for stronger EU-wide cooperation on migration policy is overwhelming. However, recent developments have been very disappointing, and the lack of tangible progress on addressing current issues has contributed to a backlash from voters. Formulating a pan-EU policy to deal with future challenges is essential, but will remain very difficult. However, while decisive steps continue to look unlikely, incremental efforts already under way could bear fruit in the long run.*

**In recent decades, Europe has become a continent that attracts similar volumes of migrants as North America**, which used to be the migration attractor *par excellence*.[6] In OECD countries in 2017, 127 million people were foreign born, representing an average of 13% of the total population (compared with 9% in 2000). Of these, 48% were living in an EU or European Free Trade Association (EFTA) country and 34% in the United States (OECD, 2018: 19). Foreign-born people also make up a very important part of the demographic dynamic of European countries: they account for close to three quarters of the total population increase in EU and EFTA countries over the period 2000–2017 (compared to one third of the increase in the United States). International students account for 9% of the total number of students enrolled in higher education institutions in OECD countries, 14% of all students attending Master's degree courses, and 24% of those enrolled in doctoral programmes.

**Figure 6 / Shrinking prospects**

Europe, population change with or without higher migration 2017-2050 forecast, %




Source: Eurostat.

6 According to the latest OECD *International Migration Outlook* (2018), the influx of permanent immigrants in 2016 to the United States was 1.2 million; to Canada – about 300,000; and to the EU as a whole, about 1.4 million from outside the EU. In addition, the intra-EU flows (benefiting from 'free mobility') were also about 1.4 million in 2016.

**From a demographic and labour market point of view, the complementarity between Europe and the Middle East and Africa is obvious.** Europe is a generally ageing continent, with a high demand for young people who either have or can acquire the necessary skills for integration into the labour markets (see Figure 6), while the neighbouring regions of the Middle East and Africa have a very young population, plus a further expected large increase in population size. The 'push' and 'pull' forces that have been (and will continue to be) at work, accentuated by often disastrous political-economic and conflict situations in Europe's neighbouring regions, guarantee that the migration issue will remain high on the political agenda of the European continent.

### 1.3.1. Is the policy-making apparatus in Europe up to this challenge?

**This seems like a rhetorical question: as any observer knows, the answer is 'no'.** There are various reasons for this. For EU economies, there are overlapping processes at work that have heightened the public's sensitivity vis-à-vis extra-EU migration.

**First, the increased pressure of migration from outside the EU during the refugee crisis of 2015 and 2016** (which led to a doubling of the influx of permanent immigrants to Germany, Sweden and Austria compared to 4–5 years previously)[7] followed a period of heightened intra-EU mobility. The last barriers to free access to the EU labour market for Romanians and Bulgarians fell in 2013; for the 2004 EU entrants, this had happened in 2011. From an economic point of view, the increased intra-EU mobility is a welcome feature of a well functioning Union with a single market. However, it may take some time for the host societies to adapt to the social and cultural changes this brings.[8] Taken together, the increased intra-EU mobility and upsurge in extra-EU migration (due to the refugee crisis) are an important factor in the strong political swing we observe in almost all European countries.

**Second, the mobility of people is a much more visible feature of international integration than the other facets of integration that impact on structural change in economies.** Thus, increased trade flows, changing global specialisation patterns, outsourcing and accompanying technological change are important features of recent decades that have required regional and labour market adjustments just as much as (or even more than) migration. However, since they live and work alongside the host population, migrants are a more 'tangible' expression of the impact of the many forces that require not only occupational and skills adjustment, but also social and cultural adaptation. Furthermore, migration affects a wider range of sectors in society, including so-called 'non-tradable' activities (such as many services provided in the domestic economy), while international integration in the form of increased trade or international investment has an impact on a narrower range of ('tradable') sectors (particularly manufacturing).

**In such periods of rapid structural adjustment, populations demand 'protection' from the political sphere that is close to them** and that provides most of the social security against shocks (the social security system is still almost 100% national in the EU). The shift toward a more 'inward-looking' political

[7] Thus the influx of permanent immigrants (including refugees who obtained a permanent residence permit) increased in Germany from about 400,000 in 2012 to 1 million in 2016; in Austria from 55,000 in 2011 to 106,000 in 2016; and in Sweden from about 70,000 in 2011 to 140,000 in 2016 (OECD, 2018: 22).

[8] Krastev (2017) also points to the traumatic 'emigration shock' in the 'net emigration' countries of Eastern Europe, which experienced a dramatic drain (especially of the young and well educated) that amounted at times to 20–25% of their populations.

dynamic – toward the nation state, thereby accentuating the different interests of EU Member States – is thus understandable. Furthermore, as the levels and forms of social security provided in the different EU Member States are extremely varied, one should not be surprised at the strong resistance to 'harmonisation', which could potentially erode existing levels of protection. Social security is well accepted at the national level as an 'insurance system', from which all participants benefit; however, this perception is not easily transferable to the European level. And nor is the extension of the system to 'newcomers' readily acceptable.

### 1.3.2. The case for an EU-wide policy

**If we look at the other side of the coin, the case for coordinated action on migration policy and for a move toward the harmonisation of policies on refugees at the EU level is very strong on the grounds of efficiency.** Even though little coordinated action has so far taken place, the argument has been recognised in some areas, including:

› Control of external borders;

› Strong engagement with neighbouring countries to gain their support in dealing with refugee inflows and illegal immigration;

› A major development initiative to support economic, social and political stabilisation in the regions that are and will continue to be the source of potentially massive migration flows into Europe.

In all these areas, the benefit arising from economies of scale (pooled resources) and the increased bargaining power for coordinated joint action is obvious. Nonetheless, although these topics are high on the agenda of many high-level EU Council meetings and are among the priorities of the current Austrian presidency of the Council, little progress has so far been made.

### 1.3.3. Why has there been so little progress on formulating an EU policy?

**At the EU level, the most concrete decisions have been taken so far in terms of controlling external borders.** A decision has been taken to increase the number of people working for Frontex to 10,000. However, the funding has still not been committed, and there are serious disputes regarding the decision-making powers of Frontex agencies vis-à-vis the national authorities of 'border states'. On the one hand, border countries in Southern Europe are worried about the loss of sovereign control over their migration and asylum policies. Until such time as schemes governing the distribution of refugees and joint responsibility for the costs of processing asylum applications are agreed across the EU Member States, they will not consent to allow Frontex to make decisions on the intake of migrants and refugees. On the other hand, there is the highly politicised stance of the Visegrád countries (and indeed others) to boycott any plans for an EU allocation scheme, or even to accept the principle of joint responsibility for any EU-wide migration and refugee policy. The divergence of positions also renders very unlikely any prospect of revising the outdated Dublin Agreement (which assigns full responsibility for processing asylum applications to the first country of entry into the EU).

**There has been little progress by the EU on active engagement with neighbouring countries.** Such a move would exploit the enhanced bargaining power of the EU as a whole and could mobilise resources for joint initiatives. But again, there are no plans for dealing in a coordinated way with migrants and refugees outside EU territory. This is a 'chicken and egg' situation: any joint initiatives in neighbouring countries to deal with migration and asylum applications require some agreement on resource sharing, and need joint rules on migration and asylum procedures to be in place. Moreover, given the huge difficulty of getting EU countries themselves to reach agreement on migration and refugee policies, neighbouring countries will be understandably reluctant to cooperate.

**Lastly, a major development policy initiative on the Middle East and Africa looks unlikely; and even were it to happen, success would by no means be assured.** Projections indicate that these neighbouring regions will be a major source of future migration flows (Africa is expected to almost double its population by 2050, to about 2 billion). First, given the current fiscal stringency in European economies, it is hardly likely that any boost to development aid will reach anything like the level of a 'Marshall Plan' for Africa and the Middle East that some commentators advocate. Nonetheless, in the forthcoming financial plan of the European Commission, more resources will be available to support neighbouring regions. Second, from the development literature it is well known that there are definite limits on the extent to which external resources can significantly contribute to the economic, social and political stabilisation of developing countries (see e.g. Easterly, 2006). Thus, although more resources will be devoted to this end, they are unlikely either to amount to a massive upgrading of development aid to Africa and the Middle East or to have a major impact on economic and political stabilisation, especially as the EU will remain a minor player in the geopolitics of both regions.

### 1.3.4. So is the whole thing hopeless?

**Let me end on a less pessimistic note.** First, we are already experiencing a strong 'ebb' in the recent economic and refugee crisis. This may calm things down politically in coming years – although we are still witnessing the delayed political effects of the refugee crisis of 2015 and 2016 (e.g. the elections in Germany, Sweden, Italy, etc.). Second, the EU has always made progress in an incremental and technocratic manner. This might not look like decisive action now, but it may be effective in the longer run. Circular migration and training schemes could be gradually negotiated, leading to the mutually beneficial development of migration policies between source and host economies. Furthermore, trade policies – especially vis-à-vis Africa – might be designed better, to emphasise the developmental potential of migration source countries. There is, furthermore, great scope to exploit complementarities between trade, international investment, local business development and joint efforts in controlled mobility and migration policies between Europe, Africa and the Middle East. Incremental efforts by private, state and EU actors will hopefully be able to tap into these.

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# 2. CESEE economic outlook

## 2.1. CESEE OVERVIEW: ROBUST GROWTH IN THE FACE OF INCREASED NEGATIVE RISKS

**by Olga Pindyuk**

› *Across most of the region, growth will still be quite strong by post-crisis standards during the forecast period. Private consumption will remain the key growth driver as tight labour markets will further push up wages. High levels of capacity utilisation will spur increases in investment.*

› *However, 2018 has brought a slowdown in the GDP dynamics of most of the countries, with Turkey standing out as the worst-performing country. All the EU-CEE economies, apart from Hungary, Poland and Slovakia, started on the path of deceleration, with the biggest adjustment in the growth rate – 3 percentage points – taking place in Romania.*

› *A loss of momentum in the eurozone and other advanced economies presents a challenge to growth in CESEE– especially in those that are strongly integrated into the regional production chains and rely on exports in their growth models. This will become particularly apparent by the end of our forecast period: we have revised down our forecasts for 2020 for many countries, in particular for the EU-CEE sub-region.*

› *Domestic factors will also contribute to lower growth rates in the CESEE region, as the currently strong (for most) cyclical upswing fades. Only a few Western Balkan economies will keep up their current pace of growth, though that will remain rather moderate and not enough for significant convergence with wealthier parts of EU-CEE or Western Europe. Turkey will also bounce back from its current difficulties by 2020.*

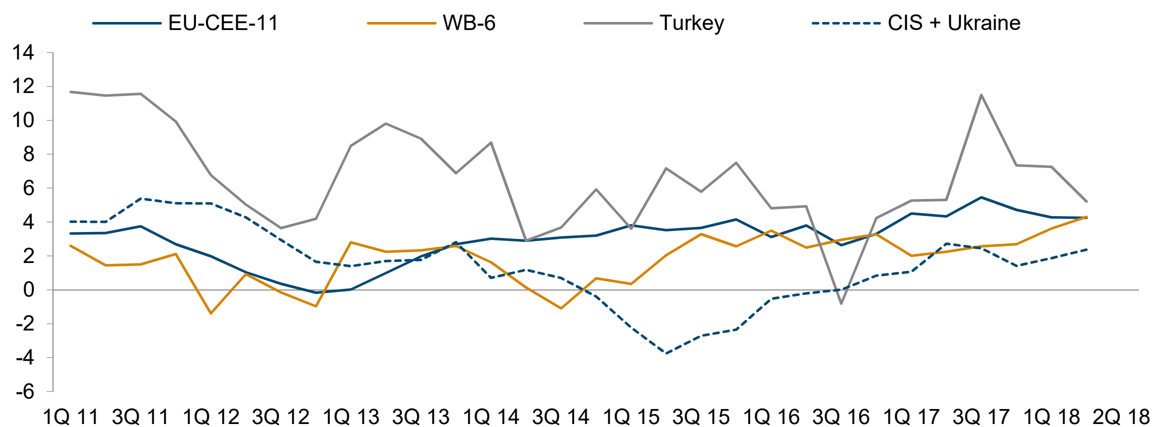
› *Russia will remain the economy facing the biggest challenges, and will continue to post very disappointing growth rates during the forecast period. In part, this will reflect the impact of international sanctions, although the main reasons for Russia's weak growth performance are domestic and structural in nature. Its problems will have negative spill-over effects for the rest of the CIS region as well.*

### 2.1.1. Still generally positive short-term trends, but regional growth will gradually tail off during the forecast period

**The recent economic dynamics have been quite robust in almost all the countries of the region.** In H1 2018, GDP growth either accelerated or remained steady across CESEE, except for Turkey. Among the EU-CEE countries, Hungary, Poland and Slovenia grew the fastest, with annual rates exceeding 4%. Croatia was an underperformer, as the only country in the group where GDP growth was below 3%. In the CIS + Ukraine group, Russia is an outlier, with persistently anaemic growth of below 2%, while the other three countries have been growing more dynamically. In most countries of the Western Balkans, growth in H1 2018 accelerated to above 4% year on year. The Serbian economy is the leader in the regional group, having expanded by around 5% year on year.

**Figure 7 / Quarterly real GDP growth of the CESEE countries**

change in % against preceding year

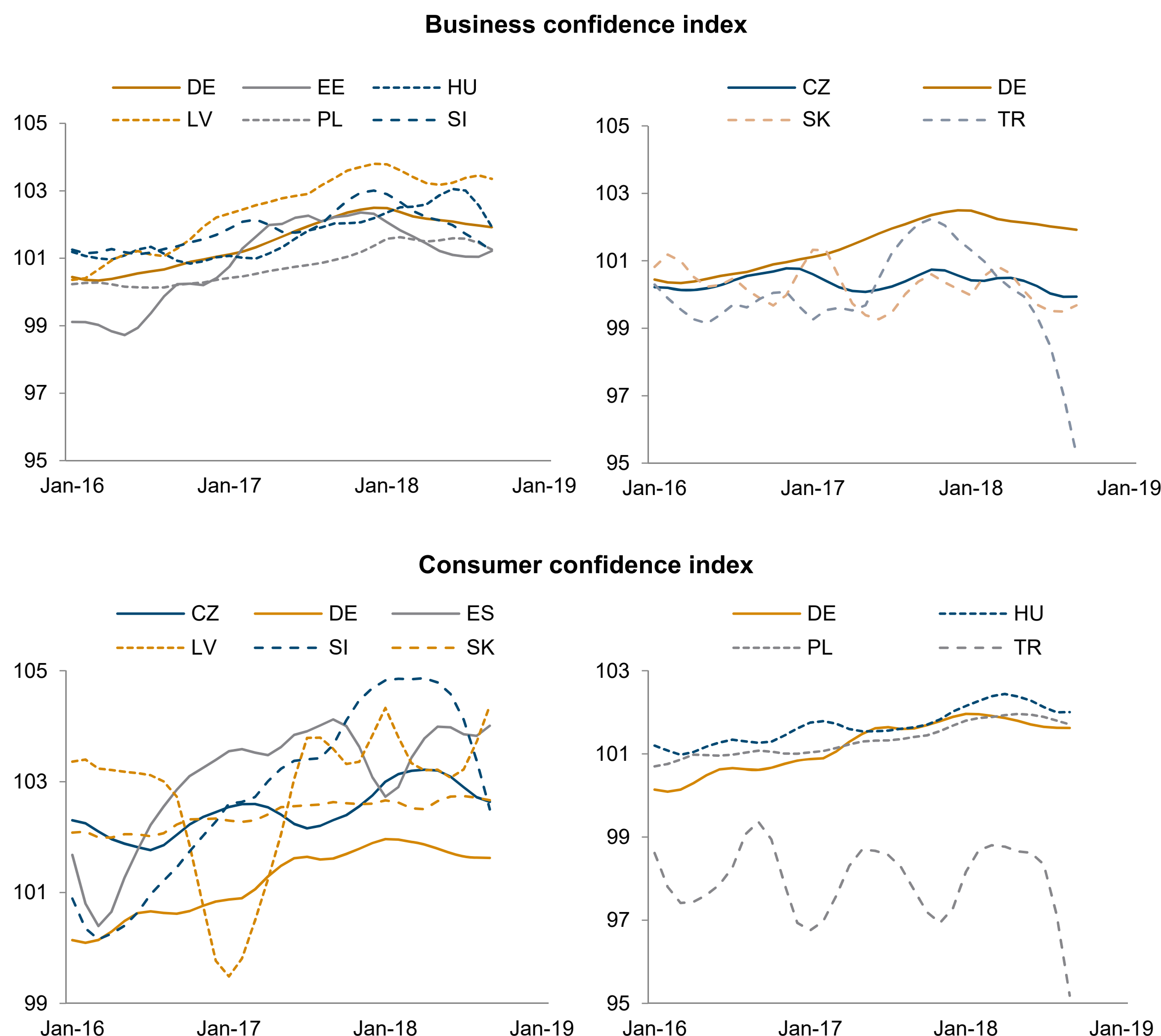



Source: wiiw Monthly Database incorporating national and Eurostat statistics, own calculation.

**Though consumers and businesses remain optimistic overall,[9] their confidence has been dwindling.** Both consumer and business confidence declined in Q2 2018, with businesses becoming on average more pessimistic than consumers about economic developments in the next 12 months. Most of the countries in our region that are covered by the OECD indices have business confidence falling below the level for Germany; moreover, companies in the Czech Republic, Slovakia and Turkey have become on average pessimistic about their prospects (their index values fell below 100). The consumer confidence index shows a different pattern – here all the countries apart from Turkey have more optimistic consumers than Germany. This probably reflects a robust growth in wages in most countries of CESEE.

[9] According to the methodology of consumer and business confidence indices, numbers above 100 suggest optimism about future business performance / economic performance, respectively.

**Figure 8 / Business and consumer confidence indices**




Source: OECD, own calculation.

**A less favourable external environment will exert negative pressure on the region's economies during the forecast period, and the current cyclical upswing will fade, but overall growth will remain robust in the medium run** (see Table 2). The EU-CEE countries appear to be the most susceptible to a weakening of global growth, as for most of them the forecasts of 2020 GDP growth were revised downwards. Still, the average growth rate of that country group will stay above 3% during 2019-2020. Economies of the Western Balkans will grow at a similar rate during this period. We expect Turkey to recover from recession by the end of 2019 and to post 4% growth in 2020. Only the CIS + Ukraine region will lag behind, with an average growth rate of about 2% in 2019–2020, although it should be noted that this is heavily influenced by Russia: Belarus and Kazakhstan in particular are set to perform reasonably well.

**Table 2 / Real GDP forecasts and revisions**

| | | Forecast, % | | | | Revisions, pp | | |
|---|---|---|---|---|---|---|---|---|
| | | 2017 | 2018 | 2019 | 2020 | 2018 | 2019 | 2020 |
| EU-CEE | BG | 3.8 | 3.3 | 3.2 | 3.0 | -0.2 | -0.2 | -0.1 |
| | CZ | 4.3 | 3.3 | 3.2 | 3.1 | -0.4 | -0.1 | -0.1 |
| | EE | 4.9 | 3.5 | 3.1 | 2.7 | 0.0 | 0.0 | -0.3 |
| | HR | 2.9 | 2.5 | 2.6 | 2.7 | 0.0 | -0.1 | -0.1 |
| | HU | 4.1 | 4.3 | 3.0 | 2.3 | 0.3 | 0.2 | -0.1 |
| | LT | 4.1 | 3.5 | 3.0 | 2.6 | 0.2 | 0.0 | 0.0 |
| | LV | 4.6 | 4.1 | 3.3 | 3.0 | 0.2 | -0.3 | -0.1 |
| | PL | 4.8 | 5.0 | 3.5 | 3.3 | 1.2 | 0.0 | 0.0 |
| | RO | 7.3 | 3.8 | 3.6 | 3.7 | -0.4 | 0.1 | -0.1 |
| | SI | 4.9 | 4.5 | 3.6 | 3.5 | -0.3 | -0.1 | -0.1 |
| | SK | 3.2 | 3.8 | 4.1 | 3.3 | 0.0 | -0.1 | 0.0 |
| Western Balkan | AL | 3.8 | 4.1 | 4.0 | 4.0 | 0.3 | -0.1 | 0.0 |
| | BA | 3.1 | 3.0 | 3.4 | 3.4 | -0.3 | 0.1 | 0.1 |
| | ME | 4.7 | 4.2 | 3.1 | 3.1 | 1.0 | -0.1 | 0.1 |
| | MK | 0.0 | 2.9 | 2.8 | 3.1 | -0.6 | -0.3 | -0.2 |
| | RS | 2.0 | 4.3 | 3.4 | 2.8 | 0.7 | 0.4 | 0.0 |
| | XK | 3.7 | 4.2 | 4.0 | 4.2 | 0.3 | 0.2 | 0.4 |
| Turkey | TR | 7.4 | 2.5 | 1.0 | 4.0 | -2.0 | -3.1 | 0.0 |
| CIS+UA | BY | 2.4 | 3.7 | 3.0 | 2.8 | -0.3 | -0.7 | -0.6 |
| | KZ | 4.1 | 4.0 | 3.1 | 3.0 | 0.0 | 0.1 | 0.0 |
| | RU | 1.5 | 1.7 | 1.6 | 1.8 | 0.2 | 0.0 | 0.1 |
| | UA | 2.5 | 3.3 | 2.7 | 2.0 | 0.0 | -0.4 | 0.0 |

Remark: Current forecast and revisions relative to the wiiw Summer Forecast 2018. Colour scale variation from the minimum (red) to the maximum (green).
Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

### 2.1.2. 2018: Poland leading the region, Turkey heading into recession

**Although aggregate growth rates will dip a bit relative to 2017, the EU-CEE countries in particular are having another good year in 2018.** We expect Poland to significantly outperform its peers in terms of economic growth in 2018. Its GDP growth rate is going to reach 5%, the best result since 2011. EU-CEE as a whole will achieve economic growth of 4.2% in 2018, closely followed by the Western Balkans with 3.8% growth. CIS + Ukraine show more modest performance, with an average growth rate of 2.2%. However, this is largely due to Russia's continuously disappointing dynamics: Belarus, Kazakhstan and Ukraine are all growing at rates of between 3% and 4%.

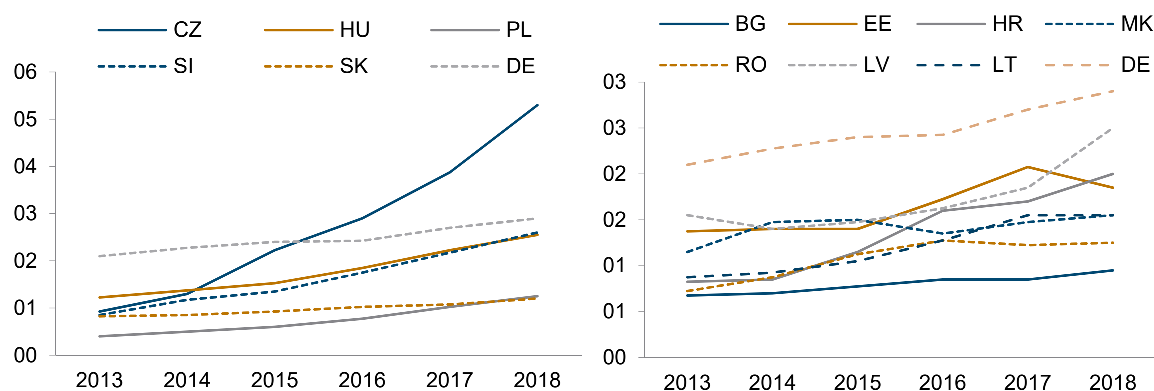
**Turkey is undergoing its worst crisis in a decade, reflecting long-standing structural vulnerabilities. It was triggered by higher US interest rates and the subsequent withdrawal of investors from the risky emerging markets.** Big external imbalances made Turkey highly vulnerable to capital flow reversals, and the Turkish lira has depreciated sharply. Growth in 2018 is going to be only modestly positive, as the economy will experience a significant drop in output in H2 2018.

**Russia and Kazakhstan are continuing to benefit from higher global oil prices, reflecting lower output in some parts of the world and still-buoyant global economic growth** (see Global and eurozone outlook). Oil output in both countries will rise to new record highs, in particular helped by an

agreement between Russia and OPEC to increase oil production. Rising export revenues are helping Russia to offset somewhat the negative effect of the newly introduced US sanctions.

**Labour shortages will be felt in many CESEE countries.** Although this is starting to feed through into quite strong wage growth, the difficulty of finding workers is an increasingly important barrier to growth. In H1 2018, job vacancy rates[10] increased in all countries for which data are available, apart from Estonia. Even in Macedonia, which suffers from extremely high unemployment, there was a slight increase in the job vacancy rate. The Czech Republic, which has moved close to full employment, had an unprecedentedly high job vacancy rate of 5.3%. Although labour shortages are not new, vacancy rates in some of the EU-CEE countries suggest a highly unusual situation that is increasingly acute. In the Western Balkans, which are characterised by extreme unemployment, a lack of skilled labour has become more prominent – largely a result of the significant emigration of high-skilled workers. Ukraine is another country that suffers from the effects of massive labour emigration.

**Figure 9 / Job vacancy rate, in %**




Remark: Data for 2018 are an average of two quarters.
Source: Eurostat.

**Increasing demand for labour, in particular for skilled labour, will continue to push real wages upward in most countries** (Astrov et al., 2016). We expect the highest real wage growth in 2018 to take place in Belarus (where the government has hiked public sector wages) and Ukraine (where the official minimum wage has been raised). In EU-CEE, real wage growth will range from 2% in Slovenia to 8.5% in Hungary, and in many countries it will be even higher than in 2017. The only exceptions to this trend are Montenegro and Turkey. Falling wages in the former country are caused primarily by the fiscal consolidation policy needed to afford an ambitious highway construction project. In Turkey, the double-digit inflation rate accompanying lira depreciation is to blame.

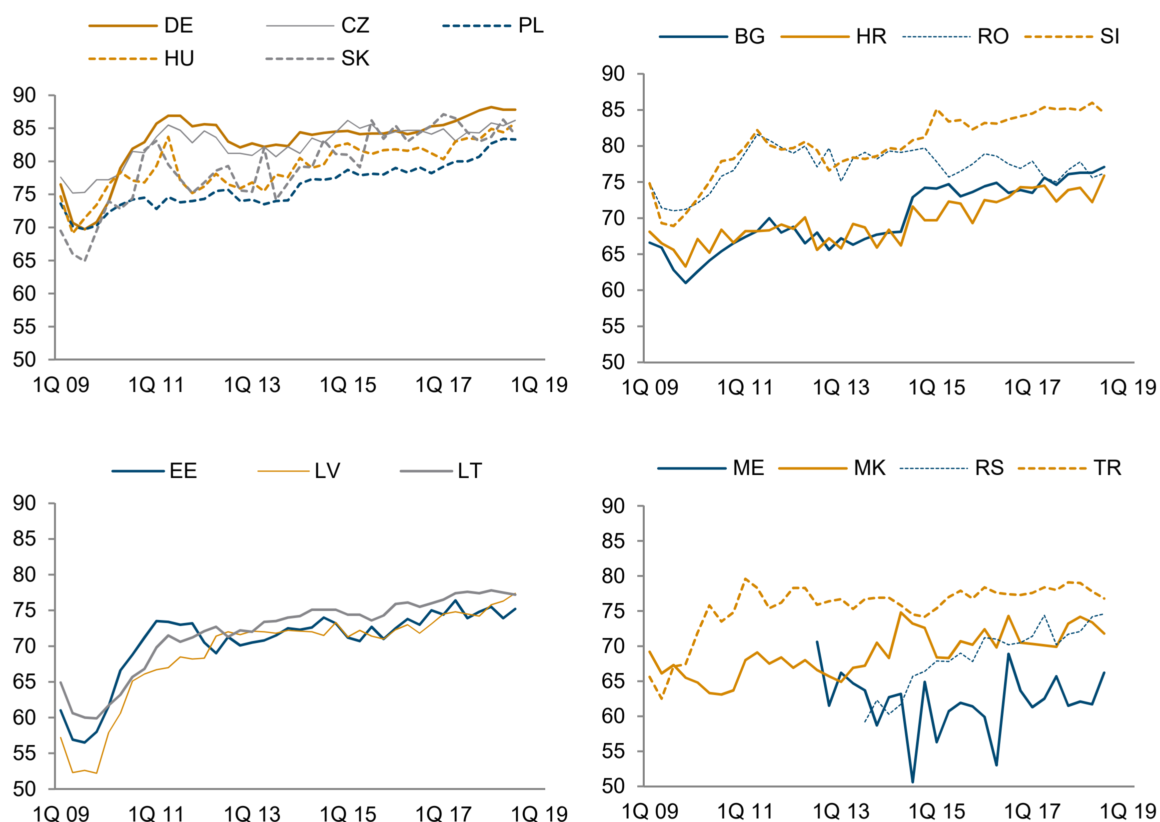
**The high level of capacity utilisation and the tight labour markets in EU-CEE are pushing companies to increase investment in capital-intensive technologies, and we are cautiously optimistic that this trend will continue** (Grieveson, 2018). Capacity utilisation has been on the rise in

[10] The job vacancy rate measures the proportion of total posts that are vacant, expressed as a percentage; it can be interpreted as an indication of unmet labour demand. Comparison of job vacancy rates across countries can be misleading, due to country-specific definitions of a job vacancy; nevertheless the within-country dynamics of the indicator is quite informative.

most of the countries and has almost reached the pre-crisis levels, with the Czech Republic nearly catching Germany up in this regard. Gross fixed capital formation has grown rapidly in 2018, supported in addition by resources from the EU Cohesion Fund – particularly important for Poland and Hungary, where the unfavourable political climate and escalating conflicts with the EU Commission are discouraging private investment; the governments have been front-loading EU fund disbursements in anticipation of future cuts (for more details, see the respective country reports).

**Figure 10 / Current level of capacity utilisation, %**

Seasonally adjusted

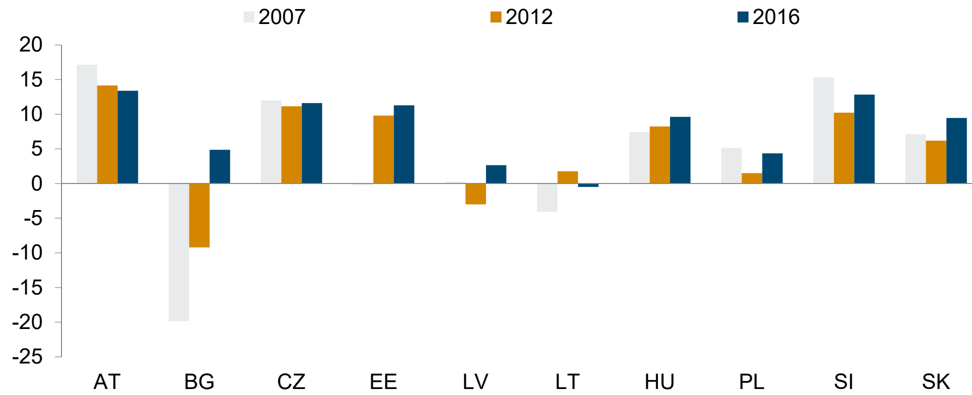



Source: Eurostat statistics.

**As has been the case in recent years, in 2018 rising wages in EU-CEE have fed through into inflation only to a limited extent.** The precise reasons for this are not fully clear, but one factor is likely to be rising household saving rates across EU-CEE (see Figure 11). In 2016, saving rates increased compared to 2012 in all EU-CEE countries apart from Lithuania, and we think that this trend has probably continued or even intensified since. Slovenia, the Czech Republic and Estonia topped the household saving rates in the regional group, reaching almost the level of Austria (which tends to have quite a high savings rate). Another contributory factor could be outflows of remittances from the countries that have large proportions of immigrant workers (who often send a significant share of their wages to their relatives back home). In addition to rising numbers of Ukrainian workers in Poland and the Czech Republic, there has been quite a big increase in intra-CESEE migration in the last few years: Serbs migrating to work in Slovakia, Bosnians to Slovenia, and so on (Podkaminer, 2018).

**Figure 11 / Gross household saving rate, %**

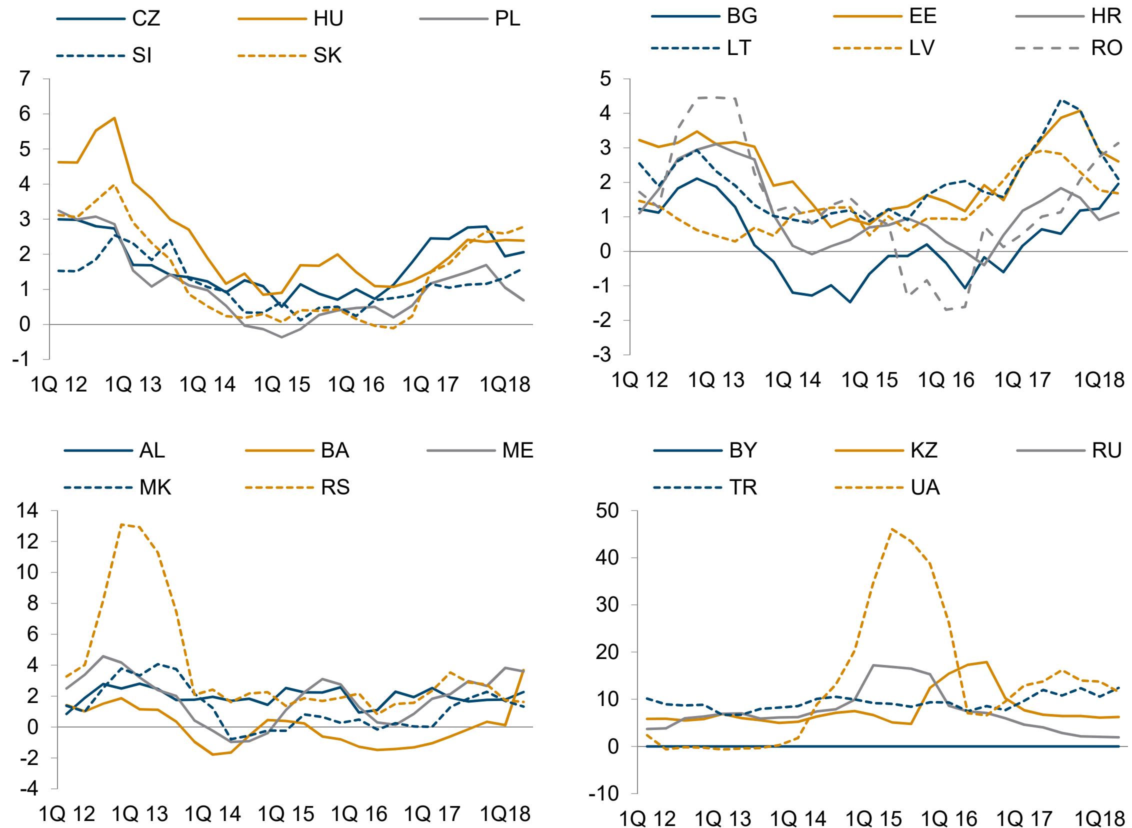
Households and non-profit institutions serving households




Source: Eurostat.

**Figure 12 / Core inflation (HICP/COICOP), overall index excluding energy**

change in % against preceding year

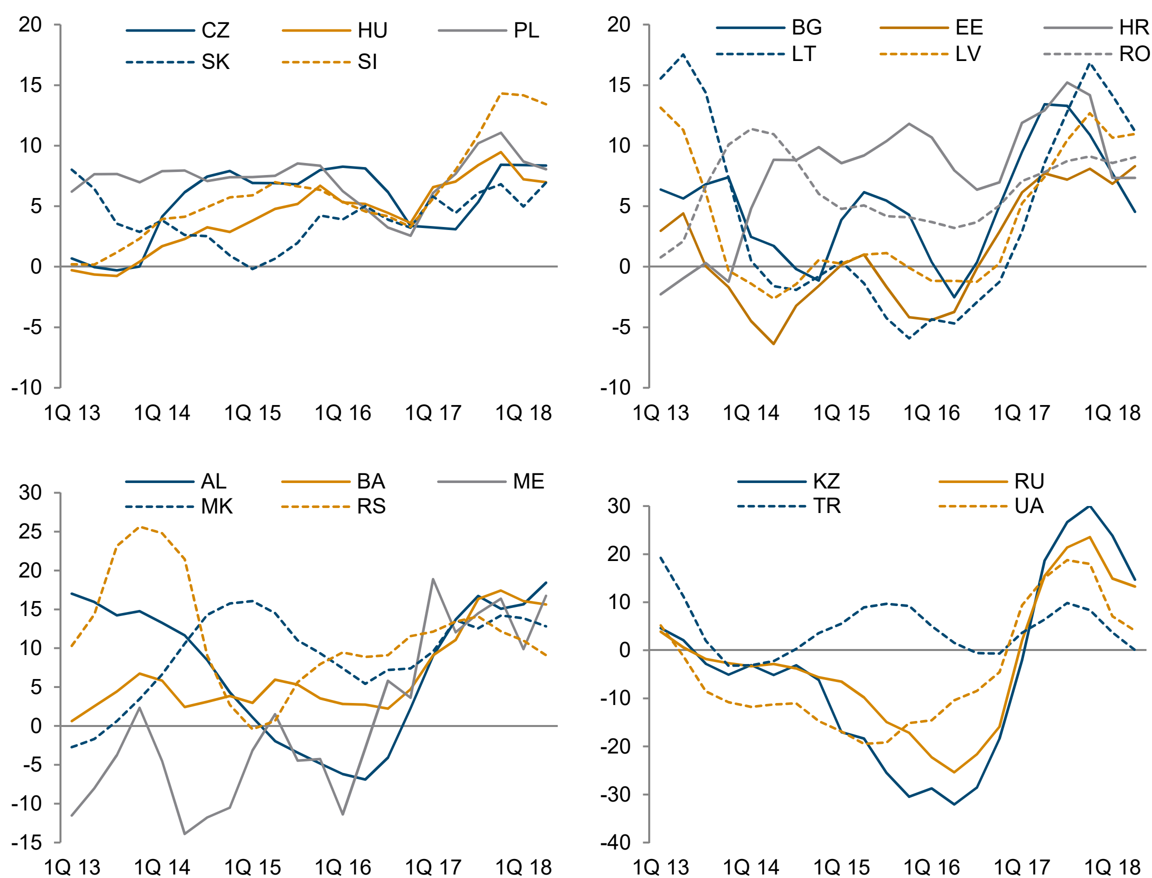



Remark: Core inflation: refers to the overall Harmonised Index of Consumer Prices (HICP), excluding energy; according to the UN Classification of Individual Consumption by Purpose (COICOP), energy comprises: 045 Electricity, gas and other fuels and 0722 Fuels and lubricants for personal transport.
Source: Eurostat and national statistics.

**Core inflation (headline inflation minus energy) remains rather low in most countries, except for Kazakhstan, Ukraine and Turkey, which have experienced depreciation of their currencies** (see Figure 12). However, energy prices have been rising strongly in a year-on-year comparison, pushing up inflation rates across much of the region. Turkey and Ukraine are expected to have double-digit annual consumer price index (CPI) growth in 2018. Romania stands out in the EU-CEE sub-region as a country with the highest inflation, the main cause being excess demand under rather loose fiscal and monetary conditions. Over the past two years, inflation-targeting central banks in EU-CEE (the Czech Republic, Hungary, Poland and Romania) have allowed real interest rates (CPI-adjusted) to trend generally downwards and into negative territory, which signals that they are not expecting inflationary pressures to rise significantly.

**Figure 13 / Exports of goods (custom statistics) growth, %**

4 quarters moving average




Source: wiiw Monthly Database incorporating national and Eurostat statistics.

**Household consumption will again make the biggest contribution to GDP growth in 2018, while net exports will contribute negatively in most countries, reflecting strong domestic demand (both consumption and investment) and some slackening of external demand.** In EU-CEE, only two countries – Slovakia and Slovenia – will have positive contributions of net exports. Still, all the countries in our region apart from Bulgaria and Kosovo will expand their exports in nominal euro terms. The most dynamic growth will be achieved in oil exporters Russia and Kazakhstan, as well as in Albania, Macedonia, Montenegro and Serbia. Albania and Montenegro have benefited from a booming tourism

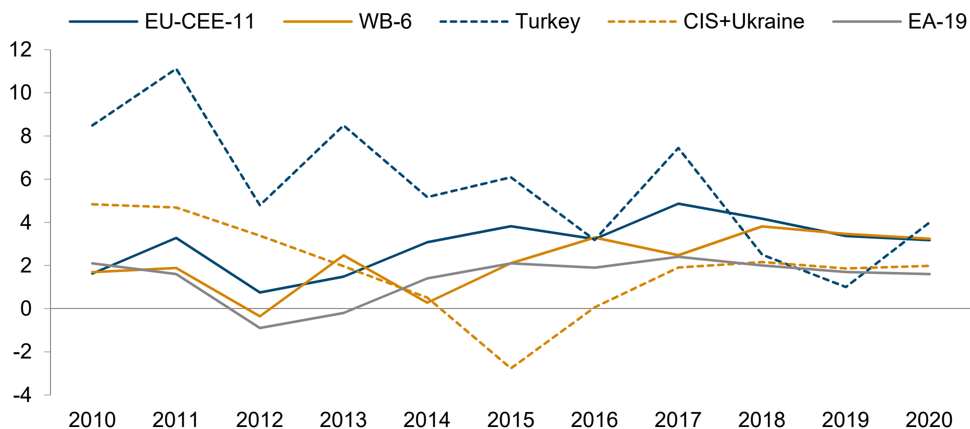
season, while in Serbia and Macedonia increased integration into European supply chains has played the biggest role. However, the nominal growth of imports will exceed that of exports in most of the countries, on the back of expanding consumer and investment demand.

### 2.1.3. Medium-term outlook: settling down with moderate growth

**In 2019–2020, most economies of the region will grow at a robust rate, but will gradually lose the impetus to growth.** Both the EU-CEE sub-region and the Western Balkans will mirror the decelerating trend of the eurozone and will grow on average at about 3% per year (see Figure 14). This is a healthy growth rate in the post-crisis context, as it exceeds the average growth rates in 2010–2017 – 2.8% for EU-CEE and 1.7% for WB; but it is significantly lower than before the global economic crisis, reflecting generally disappointing productivity growth trends over the past decade (at least partly linked to the post-crisis collapse in investment across much of the region). Growth in CIS + Ukraine will be lower than in the rest of the region, barely reaching 2% per year during 2019–2020; this will mostly be due to disappointing performance by the Russian and Ukrainian economies. Only Turkey will see its GDP grow faster in 2020 than in 2019, but this will represent a bounce-back from a short-lived crisis. Over the medium term, Turkey is also unlikely to repeat the bumper growth rates of recent years.

**Figure 14 / Real GDP growth in 2017–2020**

change in % against preceding year

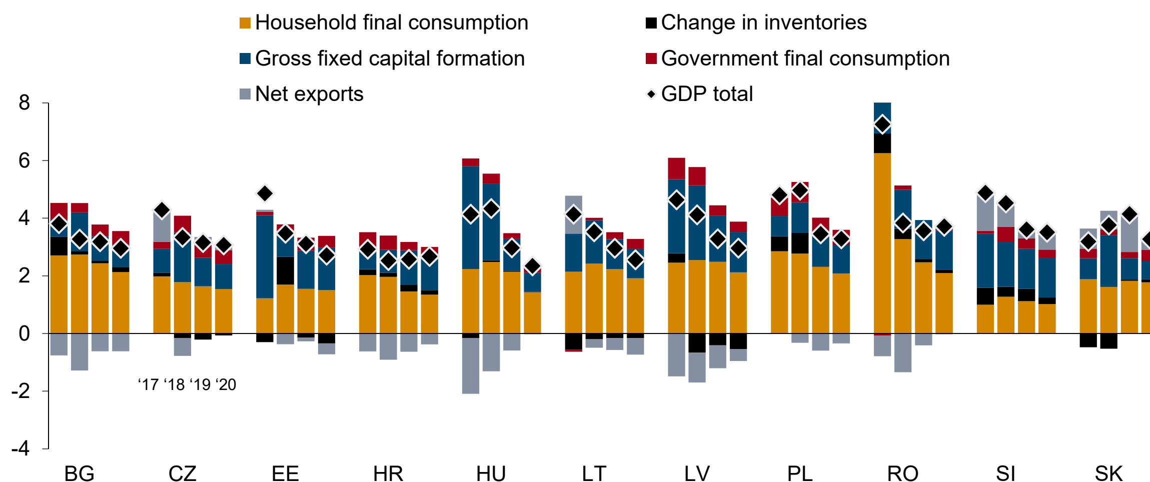


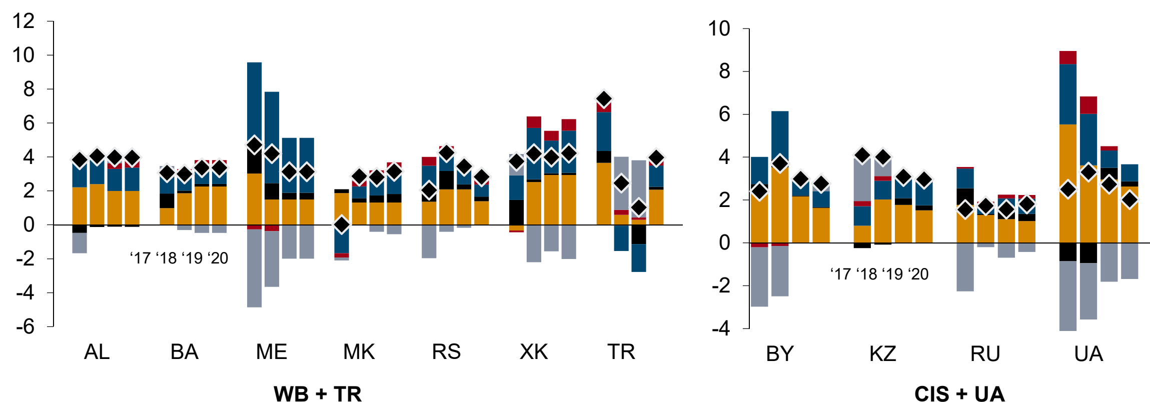

Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

**The region will grow more dynamically than the eurozone, though the growth rate differential will slowly decrease from 2.3 percentage points in 2017 to 1.6 percentage points by 2020.** This will mean deceleration of convergence of the EU-CEE countries and the Western Balkans with the more affluent EU Member States (see CESEE convergence monitor). In case of the Western Balkans, growth of 3% per annum will mean that their catching-up process will be much slower than that of the EU-CEE countries when they had similar levels of GDP per capita. This reduces the prospects of their catching up even with EU-CEE, let alone with Western Europe. Thus, the push factors of emigration are likely to remain strong in the medium run.

**Figure 15 / GDP growth in 2017–2020**

and contribution of individual demand components in percentage points




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

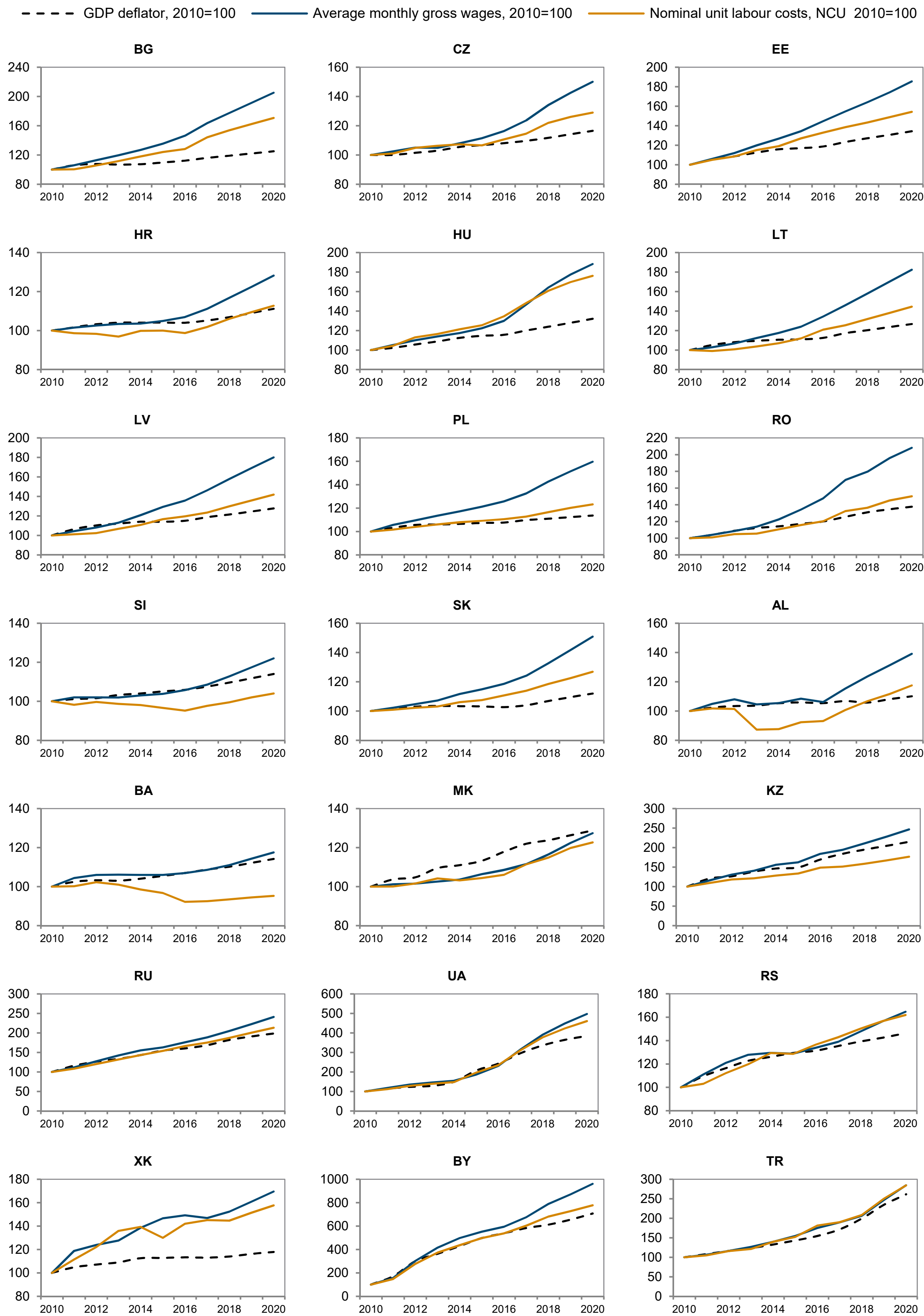
**Both domestic and external factors will play a role in the slowdown of economic growth**. Tight labour markets present a constraint on growth in EU-CEE, and judging by rising vacancy rates, an influx of immigrant workers will not be sufficient to solve the problem. The long-run impact of the effects of labour shortages depends on how strongly wages and investment in capital-intensive technologies grow in response. In the case of the Western Balkans, a skills mismatch in the labour market will become more prominent, aggravated by large-scale emigration by the most skilled workers. The positive effects of increased remittances on consumption will not compensate for the impact of structural issues. In the CIS + Ukraine, economic development is slowed by insufficient reforms, as well as by geopolitical tensions in the case of Russia. Apart from the controversial pension reform, so far there has been little progress in reforming institutions, infrastructure, innovation and the investment climate – the so-called 'four I's' – that were cornerstones of the reform programme announced 10 years ago by former President Medvedev. Growing popular dissatisfaction with economic conditions and the vested interests of the elites are likely to cause further postponement of the necessary reforms.

**The potential for a slowdown in global growth** (see Global and eurozone outlook) **will affect most strongly those economies with a high share of exports in their GDP.** In particular, this applies to the Visegrád countries, which – though heavily integrated into the German supply chain – depend mainly on global demand (Astrov et al., 2018: 12-13). Exports from these countries to Germany tend to be of intermediate goods, with the final demand being in places like China and the US. The Baltic States are also particularly open economies in the CESEE region. Russia and Kazakhstan will experience a significant decline in export growth rates, as the upward trend in world oil prices is interrupted.

**Private consumption will decelerate following wage-growth slowdown across the region, but will remain the main growth determinant through the forecast period** (to a large extent because of its high share in GDP almost everywhere). Though labour shortages will persist during 2019–2020, wage increases in EU-CEE will be constrained by increased labour market flexibility and creation of a two-tier labour market that reduces workers' bargaining power, especially among lower-skilled employees (Astrov, 2018). Labour productivity has increased as wages have risen more quickly than unit labour costs in most places (see Figure 16), especially in EU-CEE, where labour shortages are most acute. Investment in more capital-intensive technologies would help further raise productivity and might serve as a solution to the demographic trap.

**Fiscal consolidation is less of a barrier to growth than in the immediate post-crisis period, but tightening undertaken in some of the countries will be another factor to have a dampening effect on private consumption**. This will be the case in Bulgaria, Croatia, the Czech Republic, Slovakia, Slovenia and Montenegro, which are pursuing the goal of reducing the public debt. Given the relatively low shares of debt in GDP in Bulgaria, the Czech Republic and Slovakia, we consider contractionary fiscal policies to be inadvisable in a situation of economic growth slowdown.

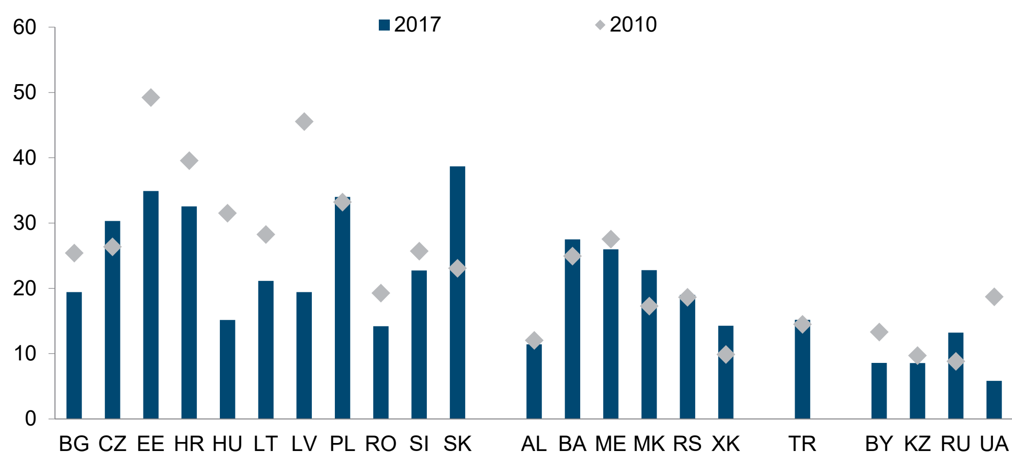
**Figure 16 / Wages, unit labour costs and inflation, 2010–2020**




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

**Loans to households will expand only moderately in most of the countries and thus will not have a significant effect on consumption**. Loan penetration remains quite low throughout the region after the post-crisis deleveraging, in particular in the Western Balkans and CIS + Ukraine. Among EU-CEE countries, only the Czech Republic, Poland and Slovakia have higher shares of loans to households in GDP than in 2010. Deleveraging in the Baltic states and Hungary has been dramatic, and their credit markets have not fully recovered yet. Only the CIS countries and Ukraine have experienced a significant increase in loans to households (see Credit monitor) – in these countries, loans are an important factor behind private consumption growth. This situation might pose risks to the sustainability of consumer-loan dynamics, especially in the case of Kazakhstan and Russia, where a rise in household consumption has largely been financed by credit.

**Figure 17 / Stock of bank loans to households, as % of GDP**




Notes: Data for BG, CZ, RO, SK, AL including non-profit institutions serving households.
Source: wiiw Monthly Database incorporating national and Eurostat statistics, own calculations.

**Over the medium term, high capacity utilisation will create a stimulus for the continuation of investment growth in most of the countries.** A particularly high contribution of gross fixed capital formation to growth will be seen in Poland, the Czech Republic, Slovenia and the Western Balkan states. Slovakia will see a marked slowdown in investment growth in 2020, as the Jaguar project is finalised. Hungary will undergo a dramatic trend reversal in 2020, as previous rapid investment growth took place primarily on the back of accelerated utilisation of EU funds, which will be exhausted by then.

**Overall, according to our forecast most of the economies in the CESEE region will grow at healthy rates of 3–4% during 2018–2020.** They will outperform the eurozone in terms of the pace of growth, but will lag behind emerging-market and developing economies, which are projected to grow at rates close to 5%.[11] The CIS + Ukraine will show the most disappointing growth dynamics, primarily due to slow progress with reforms, while Turkey will undergo a short-lived but significant economic slowdown.

[11] The forecast for emerging markets and developing economies is taken from the IMF World Economic Outlook, October 2018.

**However, negative risks to economic growth are mounting, as the external environment deteriorates** (see the CESEE risk matrix). In particular, the probability of a global trade war has been increasing, and there has been a lack of reforms in the eurozone. If those risks were to materialise, that would have a significant negative effect on the economic prospects of the CESEE region.

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## 2.2. WHY WESTERN BALKAN LABOUR MARKETS ARE DIFFERENT

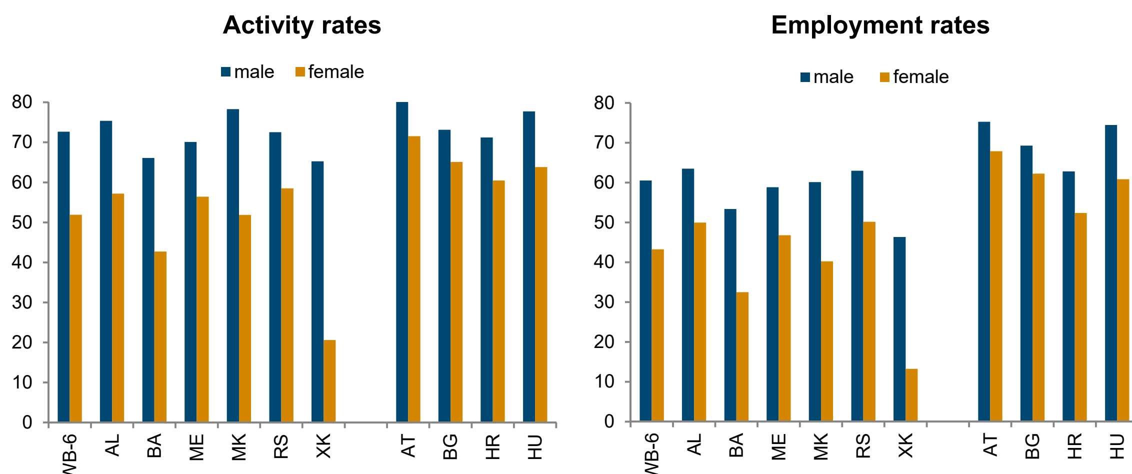
**by Hermine Vidovic**

*Unlike in much of EU-CEE, labour markets in the Western Balkans are not facing significant labour shortages. In the region, unemployment is generally high, employment rates low, and most countries have a particularly high share of youth and long-term joblessness. This reflects cultural factors, a reliance on remittances, and a high degree of informality.*

**Across most of EU-CEE, unemployment is low and labour markets are becoming increasingly tight, with quite serious labour shortages reported in many places.** However, the situation is quite different in the Western Balkan countries (Albania, Bosnia and Herzegovina, Montenegro, Macedonia, Serbia and Kosovo). For the past two years, wiiw has been working with the World Bank to study the underlying issues in the Western Balkans in more detail, and to develop policy-relevant conclusions. This cooperation has resulted in the establishment of the SEE Jobs Gateway database covering the Western Balkan labour markets, as well as in two reports that draw on this database (World Bank and wiiw, 2017; 2018).

**In the Western Balkan sub-region, labour markets are characterised by low employment rates and high (youth) unemployment,** a high and persistent share of long-term unemployment (more than 80% in some countries), as well as substantial informal-sector employment. In addition, outward migration has traditionally played an important role in cushioning the problem of unemployment, and has become an important source of income. Almost the entire sub-region – except for Albania and Kosovo – is facing an ageing and shrinking population due to low birth rates and high emigration.

**Figure 18 / Western Balkans: Activity and employment rates, by gender, 2017**



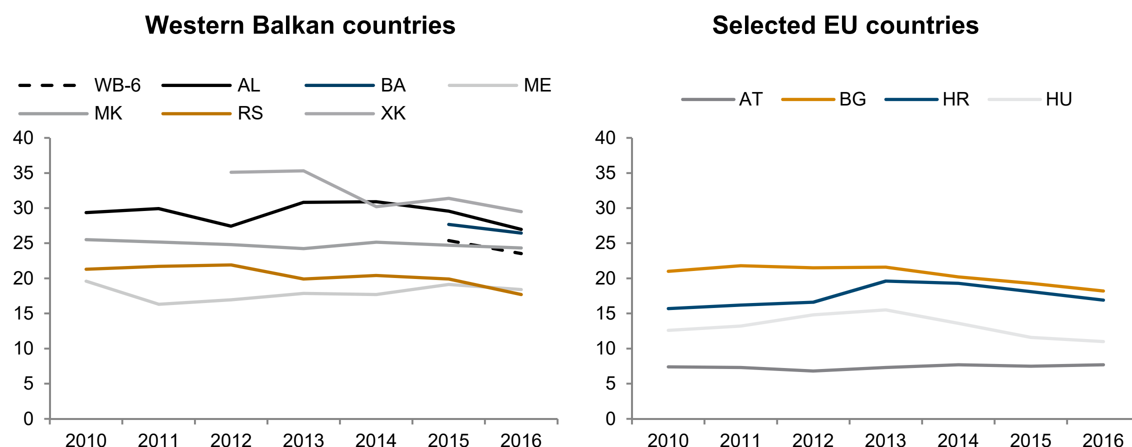

Note: Activity rate: labour force as a percentage of working-age population aged 15–64. Employment rate: employed persons as a percentage of working-age population aged 15–64 years.
Source: SEE Jobs Gateway Database, based on data provided by national statistical offices and Eurostat.

**Activity and (especially) employment rates in the Western Balkans are suppressed mainly because of low female labour market participation:** women are more likely than men to be inactive. The differences between the sexes are particularly noticeable in Kosovo (where less than 20% of

women are active in the labour market) and Bosnia and Herzegovina (where the figure is 42%). In three out of the six Western Balkan countries (Bosnia and Herzegovina, Kosovo and Serbia), the incidence of unemployment is higher among women than among men. Explanations for these disparities are manifold and include: religious and cultural reasons; traditional roles assigned to women; care responsibilities for children and older family members; living in rural areas with limited childcare facilities. In addition, a reliance on remittances and the widespread informal economy are believed to reduce employment incentives, resulting in low labour force participation, especially among women.

**As in the EU, the youth unemployment rates are double the overall unemployment rates in most Western Balkan countries.** However, young people are at much greater disadvantage in this sub-region, because the unemployment rate itself is much higher. In 2017, the youth unemployment rate averaged close to 38%, as compared to 17% in the EU. The poor labour market situation of young people in the Western Balkans is also reflected in high rates of young people who were not in education, employment or training (NEET), averaging 23.5%, compared with 11.6% in the EU.

**Figure 19 / NEET rates (15–24 years), as a percentage of the respective population**



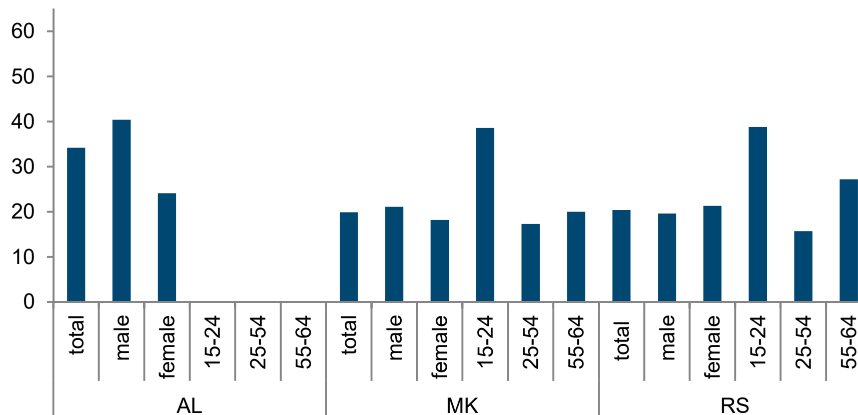

Source: SEE Jobs Gateway Database, based on data provided by national statistical offices and Eurostat.

**Informal employment is also a key challenge in the Western Balkan labour markets.** With a high proportion of long-term unemployment and youth unemployment, the informal economy functions as a social buffer for workers with few options (Hirose and Hettes, 2016). Young people and the less educated (or the medium educated in the case of Serbia) are those groups most affected by informal employment. Based on Labour Force Survey (LFS) data, Albania still has the highest share of informal-sector employment (37%), followed by Macedonia and Serbia (about 20% each). Estimates for the remaining countries put the share of workers in the informal sector at close to 30% in Bosnia and Herzegovina and about 23% in Kosovo and Montenegro (Gashi and Krstić, 2016).

**There are clearly multiple reasons for the high share of informal workers in Western Balkan labour markets.** These include high labour taxation and social security contributions (Koettl, 2012; World Bank, 2017) and strong levels of remittance inflows from abroad (Petreski et al., 2017). Apart from anything else, this has a negative impact on the amount that workers earn: the literature (UNDP, 2016; Krstić and Sanfey, 2011) suggests that informal-sector workers earn significantly less than those in the

formal sector who are 'concentrated in better paying industries and occupations and have more education and other favorable characteristics than informal sector workers' (Blunch, 2015).

**Figure 20 / Informal employment as a percentage of total employment of the respective gender and age group**




Source: SEE Jobs Gateway Database, based on data provided by national statistical offices and Eurostat.

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## 2.3. HAVE DCFTAS IN GEORGIA, MOLDOVA AND UKRAINE HAD AN IMPACT ON TRADE AND FDI?

**by Peter Havlik**

*In 2014, the EU signed DCFTAs with Georgia, Moldova and Ukraine. So far, the results in terms of trade and FDI flows have been mixed at best.*

### 2.3.1. Introduction

In recent years, the European Union has concluded association agreements (AAs) with Georgia, Moldova and Ukraine. Deep and comprehensive free trade areas (DCFTAs) are part of those AAs. The AA/DCFTAs were signed in 2014 and have been fully in force since 2016. A DCFTA covers:[12]

› Trade-related aspects: conventional free trade area aspects focusing on an (asymmetric) reduction in tariff duties and rules of origin;

› 'Deep' aspects: gradual reduction in non-tariff barriers through the adoption of EU standards, including food safety and sanitary and phytosanitary (SPS) measures, technical standards, national treatment, public procurement, services liberalisation and customs administration;

› 'Comprehensive' aspects: wide scope of approximation to EU *acquis* regarding national treatment, customs and trade facilitation, trade in services, intellectual property, e-commerce, energy market, public procurement, anti-trust and competition, etc.

The implementation of an AA/DCFTA requires from signatory countries an approximation to the EU *acquis communautaire* (both current and future). Some transitory arrangements (e.g. a special import regime for used clothing and passenger cars for Ukraine) were agreed during negotiations, and the EU provided a temporary (during 2014–2015) autonomous concession of preferential access to the EU market. Nevertheless, some obstacles to trade remain – such as tariff rate quotas, technical barriers to trade and SPS regulations. On the whole, the implementation of AA/DCFTAs is rather challenging. The costs and benefits are unevenly distributed; and the latter depend on successful implementation.[13]

This section analyses the key foreign trade and foreign direct investment (FDI) developments in Georgia, Moldova and Ukraine during the first three years of DCFTA implementation – two areas where the economic impacts can already be evaluated.

### 2.3.2. Trade reorientation

**Georgia**: Exports to the EU fell by 10% in 2014–2016, yet were up 16% in 2017 (all in nominal EUR terms). Imports from the EU were down 7% in 2014–2016 and remained flat in 2017. Georgia suffers

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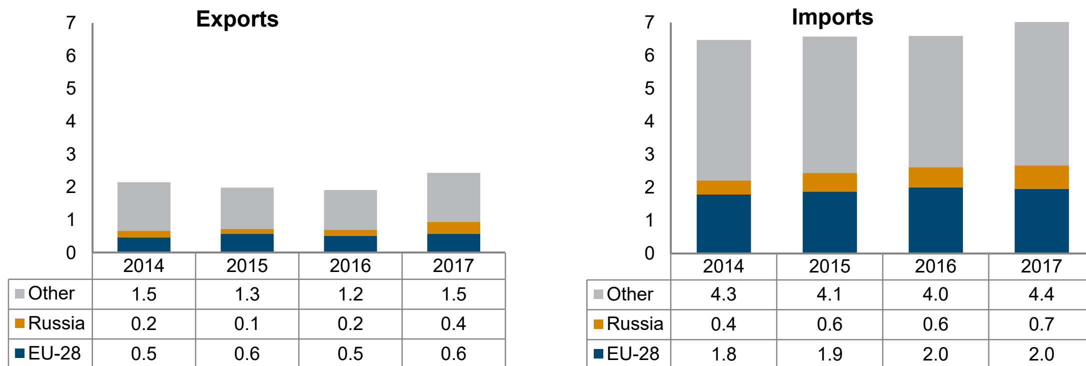
12 For a detailed description, see the handbooks recently published by CEPS: https://www.ceps.eu/blog-posts/four-books-progress-towards-good-governance-eastern-europe

13 For a comprehensive analysis, see A. Adarov, and P. Havlik (2016), 'Benefits and costs of DCFTA: Evaluation of the impact on Georgia, Moldova and Ukraine', wiiw, Vienna; and (2017), 'Challenges of DCFTAs: How can Georgia, Moldova and Ukraine succeed?', Policy Brief, wiiw and Bertelsmann Stiftung, Vienna.

from persistent trade deficits: EUR 4.5 billion in 2017 (of which EUR 1.5 billion was with the EU). The EU's share of exports increased by 2 percentage points during 2014–2017 (to 24%); Russia's share grew by 5 percentage points in the same period (see Figure 21).

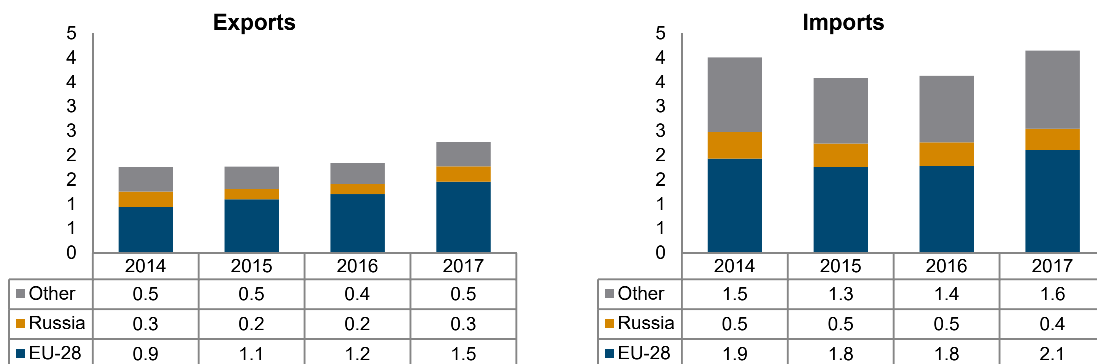
**Figure 21 / Recent foreign trade developments in Georgia (EUR billion)**




Source: National statistical office.

**Moldova** has had more success than other DCFTA countries in expanding its exports to the EU (up 28% in 2014–2016 and a further 22% in 2017).[14] Imports from the EU declined by 8% in 2014–2016, yet rose by 18% in 2017. Moldova suffers from widening trade deficits as well: the trade deficit was EUR 1.9 billion in 2017 (of which EUR 0.6 billion was with the EU). The EU's share of exports increased 10 percentage points between 2014 and 2017 (to 64%); Russia's share dropped 4 percentage points (to 14%) in the same period (Figure 22).

**Figure 22 / Recent foreign trade developments in Moldova (EUR billion)**



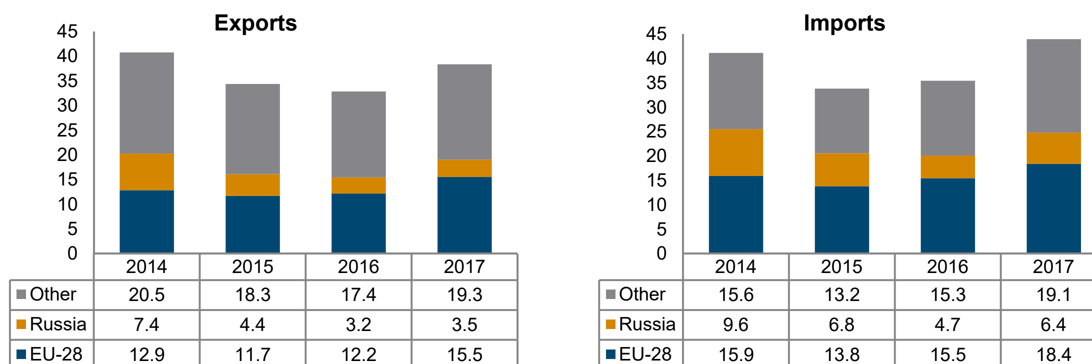

Source: National statistical office; Eurostat (2017).

**Ukraine**: Exports to the EU dropped 5% in 2014–2016, yet recovered strongly (up 27%) in 2017. Imports from the EU fell 3% in 2014–2016 as well, yet rose 19% in 2017. The trade deficit is also widening: it reached EUR 5.6 billion in 2017 (of which EUR 2.9 billion was with the EU). Exports to the EU increased

[14] In the case of Moldova, part of the remarkable increase in exports to the EU is probably attributable to statistical effects related to the treatment of Transdniestria.

by more than 21% during 2014–2017 (to 41% of the total), while exports to Russia collapsed – dropping more than 50% in the same period.

**Figure 23 / Recent foreign trade developments in Ukraine (EUR billion)**




Exports

| | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|
| Other | 20.5 | 18.3 | 17.4 | 19.3 |
| Russia | 7.4 | 4.4 | 3.2 | 3.5 |
| EU-28 | 12.9 | 11.7 | 12.2 | 15.5 |

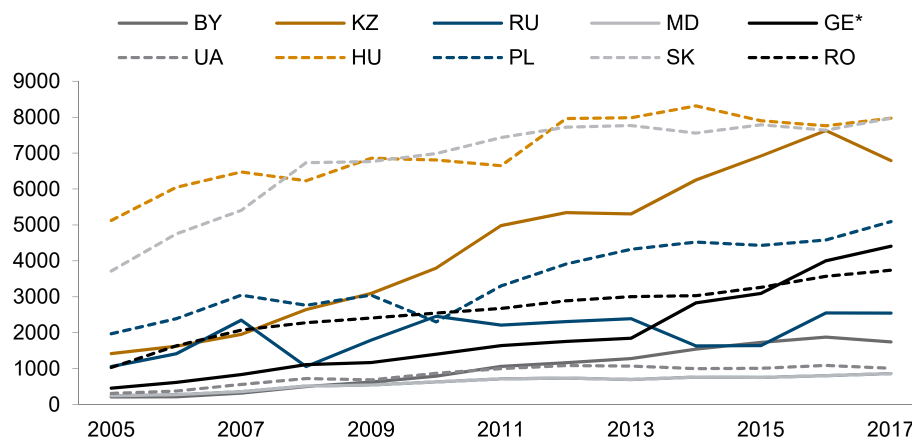
Imports

| | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|
| Other | 15.6 | 13.2 | 15.3 | 19.1 |
| Russia | 9.6 | 6.8 | 4.7 | 6.4 |
| EU-28 | 15.9 | 13.8 | 15.5 | 18.4 |

Source: wiiw Annual Database.

DCFTA countries' overall trade developments have been rather uneven in recent times. Moldovan exports both overall and to the EU performed better than those of either Georgia or Ukraine (the latter's exports have been affected by the conflict in Donbas: total exports in 2017 were still lower than in 2014). The EU's share of trade increased largely at the expense of Russia, although exports to Russia did recover a bit in 2017. Exports to the EU are highly concentrated on a few, mostly semi-processed commodities such as non-ferrous metals, basic chemicals, crops and basic iron, and are therefore highly vulnerable to fluctuating prices. The top five export commodities accounted for 71% of total Georgian exports to the EU in 2017 (Moldova: 63%; Ukraine: 56%). So far, there has been little evidence of trade restructuring towards manufactured products as a result of the DCFTAs (with the possible exception of textiles (Georgia) and insulated wires and cables (Moldova and Ukraine)). Moreover, the anticipated FDI inflows stimulated by DCFTAs have yet to materialise: FDI stocks in DCFTA countries remain low – much lower than in regional peers from Eastern Europe (except Georgia – see Figure 24).

**Figure 24 / Inward FDI stock per capita, EUR**




* Excluding data for Abkhazia and South Ossetia; cumulated inflows.
Source: wiiw FDI Database based on Direct Investment statistics of the respective National Banks.
Georgia: UNCTAD, World investment report, wiiw calculations.

# 3. CESEE risk outlook

## 3.1. CESEE RISK MATRIX: TRADE WAR, LACK OF EUROZONE REFORM AND NEXT EU BUDGET POSE BIGGEST RISKS

*Downside risks to the economic outlook in CESEE have risen over the past year, reflecting a potentially volatile mixture of regional and global factors. For the region as a whole, we are most worried about the chances of a global trade war, and the spill-overs from a re-emergence of the eurozone crisis.*

**Table 3 / Summary of risks**

| | | Impact on CESEE countries* | | |
|---|---|---|---|---|
| | | **High** | **Medium** | **Low** |
| **Likelihood** | **High** | Global trade war<br>Smaller EU budget (only EU countries)<br>No eurozone reform | Rule of law and institutions deteriorate further | |
| | **Medium** | Labour shortages stimulate higher investment | | |
| | **Low** | Formalised core/periphery in EU (only EU countries) | EM crisis affects more countries in CESEE<br>Faster-than-expected ECB tightening<br>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, 2018-20.

## Table 4 / 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, and the next Chancellor in Berlin could take a different line to Angela Merkel. | 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. |

**Table 5 / Negative risks detail**

| Risk | Likelihood | | Impact on CESEE | |
|---|---|---|---|---|
| No progress is made to reform the eurozone, such as further steps towards a banking and/or fiscal union. | High | Looking at the politics of Germany and Italy in particular, this appears more and more likely. In Germany, such reforms tend to be seen as the German taxpayer subsidising profligate Southern Europeans. The new government in Italy and its current budget plans makes this an ever harder sell in Germany. | High | This matters a lot, because the eurozone is not in great shape for the next downturn. In 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. |
| 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. Neither side appears willing to back down, so this appears to be becoming more likely. | 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. |
| 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. |
| 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. |

Table 5 / ctd.

**Table 5 / ctd.**

| Risk | Likelihood | | Impact on CESEE | |
|---|---|---|---|---|
| Hard/no-deal Brexit | Low | The likelihood of some kind of deal between the EU-27 and the UK remains quite high. There are major incentives on both sides to avoid a "hard" Brexit, and major concessions may be made in the final round of negotiations. A much more tricky issue is what happens when that deal is then put to the UK parliament. The main opposition Labour Party is desperate for a general election, and may use the opportunity to bring the government down. Meanwhile many on the right of the ruling Conservative Party may rebel against any deal that they feel keeps the UK too close to the EU. | Medium | The UK and EU-27 economies are heavily intertwined, and London has huge importance for eurozone finance. A breakdown of talks and "hard" Brexit in March 2019 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 recent months 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 is currently expected to begin cautiously tightening monetary policy by end-2019, but even this is subject to risks of further delay. Core inflation trends in much of the eurozone remain very weak, reflecting major slack in many labour markets. Meanwhile economic growth outside of Germany has slowed quite significantly this year, and is unlikely to pick up again soon. | 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: POSITIVE TRENDS BUT LONG-TERM CHALLENGES

**by Leon Podkaminer**

### 4.1.1. The income gap separating CESEE from the highly developed countries has narrowed since 2000

The first article of faith among theoreticians of economic growth is that lower-income countries will eventually catch up with higher-income ones. However, the theory does not guarantee that there will be no reversal or halt to convergence, or that some lower-income countries will not end up in a ‘medium-income trap’. Moreover, it has often been observed that the higher the income level in a ‘converging’ country, the slower it advances toward convergence (this is the gist of the ‘beta convergence’ hypothesis).[15]

Table 6 below indicates that in terms of per capita GDP (at purchasing power parity, PPS), CESEE countries still trail far behind Austria. In 2017, the Czech Republic was the most prosperous country in CESEE, with per capita GDP in PPP terms just above 69% of the Austrian level. Of the 11 EU Member States in CESEE, the poorest was Bulgaria (at 39.5% of the Austrian level). The average for these EU-CEE countries was 54.5%. Non-EU CESEE countries were much poorer in 2017 (with an average level of 43.7%). Turkey was the most affluent (50.8%) and Ukraine the poorest (16.5%).

**Table 6 / CESEE GDP per capita and compensation per employee in comparison with Austria, 2017**

| | BG | CZ | EE | HR | HU | LT | LV | PL | RO | SI | SK | EU-CEE-11 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GDP per capita at PPP, Austria=100 | 39.5 | 69.1 | 62.0 | 48.2 | 53.7 | 61.8 | 52.9 | 54.7 | 49.0 | 66.0 | 60.2 | **54.5** |
| Compensation at PPP, Austria=100 | 42.2 | 62.1 | 61.7 | 57.9 | 51.4 | 58.6 | 56.3 | 56.7 | 48.0 | 77.2 | 59.6 | **.** |
| | **AL** | **BA** | **BY** | **KZ** | **ME** | **MK** | **RS** | **RU** | **TR** | **UA** | **XK** | **NON-EU-CEE-11** |
| GDP per capita at PPP, Austria=100 | 22.8 | 24.3 | 35.9 | 51.3 | 36.4 | 28.8 | 30.6 | 49.2 | 50.8 | 16.5 | 20.7 | **43.7** |
| Compensation at PPP, Austria=100 | 22.6 | . | . | . | . | 29.5 | . | . | . | . | . | **.** |

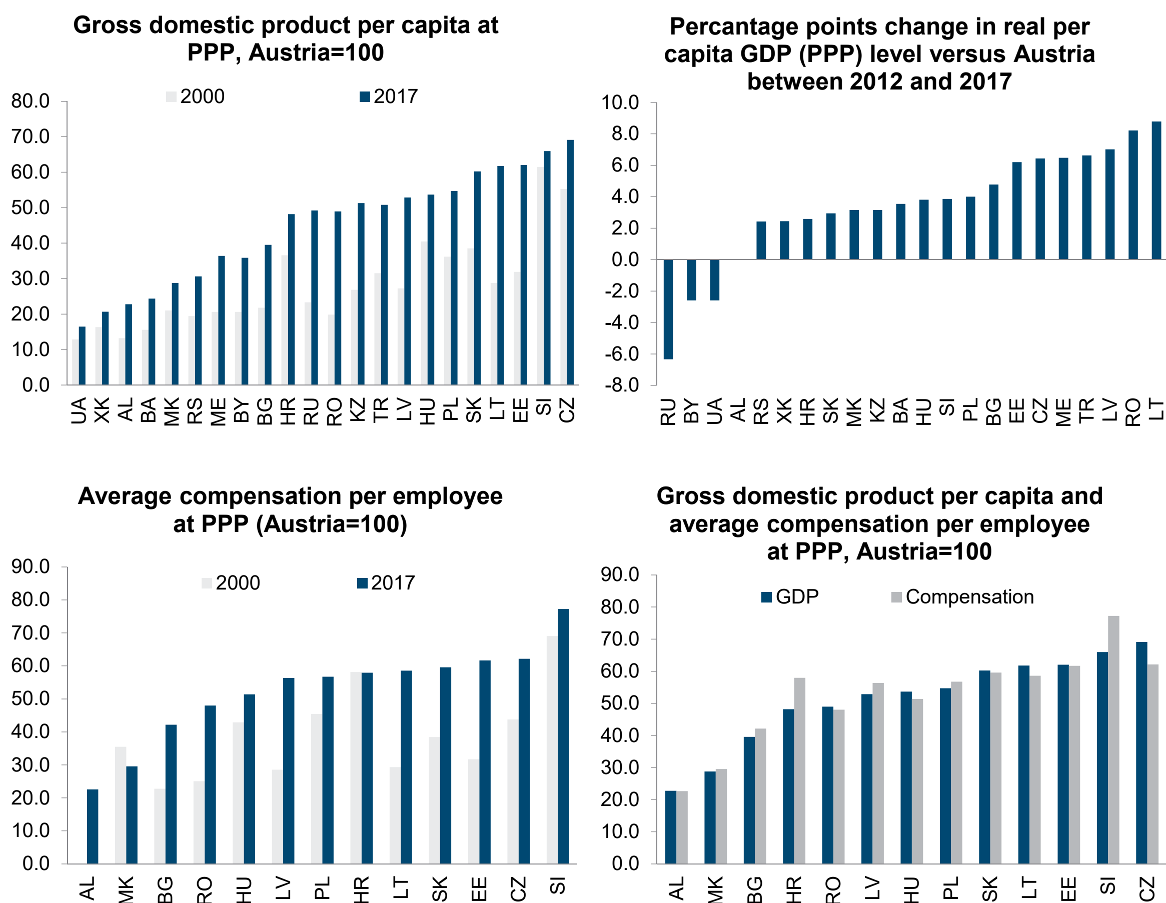
Source: wiiw Annual Database incorporating national statistics and Eurostat, AMECO.

The upper left-hand panel in Figure 25 compares the positions of CESEE countries and Austria in 2000 and 2017. As can be seen, over this period all countries narrowed the gap with Austria. The least progress was made by countries that had suffered violent political turmoil (Ukraine and Kosovo). It is quite obvious that the progress (in terms of convergence speed) made by the Czech Republic and Slovenia – the two most-developed countries in 2000 – was also rather moderate. The largest longer-term gains were made by those countries that started out from lower positions (for example, Romania,

[15] The relevance of the ‘beta convergence’ hypothesis for CESEE countries is documented in Gligorov et al. (2017).

Slovakia and the Baltic states) and that did not experience much internal or external political disruption. Some of the very low-income countries (Albania, Montenegro and Bulgaria) also advanced strongly (nearly doubling their GDP level vis-à-vis Austria). This longer-term pattern is consistent.

**Figure 25 / Convergence trends**




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

It should be remembered that convergence in per capita income levels in some CESEE countries is, to an extent, a statistical artefact reflecting fast population decline since the early 2000s, rather than a rapid rise in production and incomes. Ongoing depopulation (linked to intensified migration to the EU-15) has been quite essential for the Baltic states, Poland, Bulgaria and Romania, for instance, as well as for the Western Balkan countries. Without very large outward migration, their per capita income levels in 2017 would have been much lower (and unemployment rates much higher).[16] Also, it ought to be remembered that in many CESEE countries (especially those with lower income levels), a much-delayed structural transformation has taken place, whereby the large, backward and inefficient agricultural sector has shed excess labour. Part of that labour is then employed more productively in industry and services. For example, in Romania the share of agriculture in total employment fell from 45% in 2000 to 24% in 2016. The higher-income parts of CESEE, where the share of agriculture in employment is very low (such as the Czech Republic, where it is just 3%), do not have that sort of labour (and growth) reserve.

16 For more on this issue, see Dobrinsky and Havlik (2014).

### 4.1.2. The last five years: diverse trends indicate different stages of the business cycle, rather than changes in convergence speed

As can be seen from the upper right-hand panel in Figure 25, convergence in Russia, Belarus and Ukraine went backwards in 2012–2017. This primarily reflects the recession and stagnation suffered by each of these countries over that period – partly on account of the collapse of oil prices, but also because of unfavourable political developments (conflicts over Crimea and the Donbas area, and economic sanctions affecting Russia and indirectly Belarus).

Most EU-CEE countries, by contrast, converged with Austria by about 3.5–4 percentage points over the same period. Progress was much less impressive in Croatia, Serbia and Albania, where real GDP growth was rather weak during that period. On the other hand, a group of countries including Lithuania, Latvia, Romania, the Czech Republic and Turkey recorded rather large gains (6.5–8 percentage points) versus Austria.

The large gains made by this group of countries do not justify an expectation of accelerated convergence in the future, and likewise the moderate gains made by the majority of CESEE economies do not justify an expectation of the latter falling behind relatively speaking. The large gains made by the Czech Republic, Latvia, Lithuania and Romania represent recovery from the recessions (absolute and also in relation to Austria) suffered by these countries prior to 2012 (in most cases since 2009). By contrast, Poland, Hungary and Bulgaria did not suffer from such recessions, while Slovakia and Slovenia experienced periods of stagnation rather than recession. (In Turkey the large gains recorded were largely driven by excessive credit expansion. The credit has now dried up and the economy is going into recession, and so some of the past convergence will be undone.)

It should be remembered that shorter-term variations in the speed of catch-up are quite natural, as they can reflect differences in the phases of business cycles (still uncoordinated between countries). In reality, convergence is a long-term matter. Its analysis is most productive when conducted in the context of secular developments. One such piece of analysis (available from wiiw) indicates that it will take many decades for CESEE to approach West European income levels.[17] The box below further highlights the need for caution when projecting the convergence of the CESEE countries.

### 4.1.3. Longer-term convergence in the average ‘wage’ rates: in search of a balance between per capita GDP and average compensation levels

The lower left-hand panel of Figure 25 compares average compensation relative to Austria, at PPP. (Average compensation covers an average employee’s net wages plus employee-paid taxes, as well as social security contributions paid on his/her behalf by the employer.) Since 2000, most CESEE countries have witnessed a quite remarkable catch-up in terms of compensation level. However, in Croatia (where the compensation level was very high in 2000) there was no increase at all up to 2017, and in Macedonia the relative level of compensation even declined. Compensation gains were relatively low in Hungary, Poland and Slovenia, where the compensation levels were already quite high in 2000, and relatively large in the remaining countries, where the levels were initially depressed.

[17] See the Special Section (‘Convergence: A long-term matter’) in Gligorov et al. (2017).

Table 6 (line 2) shows the average compensation in comparison to Austria in 2017. As can be seen, in most cases previous developments have brought average compensation into a rough balance with average per capita GDP. However, for some countries the imbalance between the two items is quite remarkable: thus, in the Czech Republic, per capita GDP is over 69% of the Austrian level, whereas average compensation is only 62.1%. This 7 percentage point imbalance may indicate that Czech wage rates are still too low, and are therefore likely to experience stronger upward adjustments in the future. Such a wage push would also increase Czech gross national product (GNP), which right now falls far short of Czech GDP (the big difference between GDP and GNP representing income earned by foreign-owned firms).

In Slovenia, Bulgaria, Latvia and Croatia, average compensation in relation to Austria is much higher than per capita GDP. The reasons for this imbalance may be country specific: Slovenia and Croatia are heirs to Yugoslavia, whose economic system was based on the strong involvement of labour in the management of a company.[18] The ideology of 'labour-managed firms' may still survive in those two countries, resulting in compensation being relatively higher than elsewhere in CESEE. In addition, the relatively low level of foreign direct investment's penetration of Slovenia may be a factor.

It is less clear why rather large imbalances can be observed in Latvia and Bulgaria. Definitional differences (in the coverage of persons earning wages or in the components of compensation) may account for some of the discrepancies. Another reason may have to do with the persistent differences in economic structures. The share of farming in the total employment of Bulgaria is very high (18% in 2016). In addition, the share of retail trade in employment is also very high. 'Regular' contractual employment – typical in Austria and the Czech Republic – may not yet have developed in Bulgaria. Instead, self-employment may be more prevalent there (as in other countries with large agricultural or informal sectors), with wages playing a less important role as a GDP component. Under such circumstances, one need not expect a tight correspondence between average compensation and average GDP. Such a correspondence will probably develop over time – in parallel with the inevitable structural changes.

## References

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V. Gligorov, R. Grieveson, P. Havlik and L. Podkaminer (2017), 'CESEE back on track to convergence', wiiw Forecast Report, Autumn, Vienna.

[18] Under the Yugoslav economic system, employees participated in managerial decisions (including on investment). See, for example, Estrin (1991).

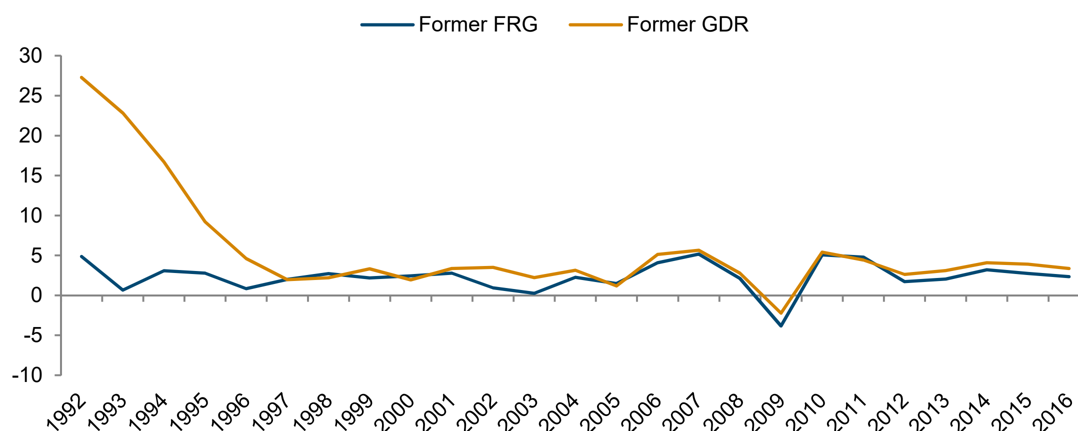
## BOX 1 / A TALE OF TWO GERMANYS: CONVERGENCE LESSONS FOR CESEE

**by Leon Podkaminer**

The income gaps separating the CESEE countries from Western Europe have narrowed substantially since the early 1990s. The catch-up is quite impressive, especially for most of the generally less-affluent CESEE countries admitted to the European Union (e.g. Romania or Poland). Economic growth in the new EU Member States is believed to have been supported not only by quite massive financial transfers 'from Brussels', but also by the institutional harmonisation involved and economic integration (including free trade, as well as free capital and labour movement within the enlarged EU). These developments seem to bode well for the future of CESEE countries, justifying the expectation of their fairly rapid convergence with Western European income levels. On the other hand, some experts invoke the propensity of middle-income countries generally to get stuck in a 'middle-income trap'. Obviously, these writers are less optimistic (see the charts and tables above).

The controversy over the future of CESEE countries' catch-up with the West is unlikely to be resolved anytime soon. But it may be instructive to reflect on what has happened to income convergence between the former East Germany (the German Democratic Republic or GDR) and the former West Germany (the Federal Republic of Germany or FRG). The German unification of 1991 was followed by the former GDR's speedy integration into the FRG – with complete liberalisation of trade, capital and labour movement – and monetary unification. These economic transitions were accompanied by the abrupt imposition of FRG institutional and economic policy frameworks on the 'new' *Länder* (federal states). Unification was also accompanied by huge financial transfers. The consensus view is that the 'new' *Länder* received the equivalent of about EUR 1,600 billion in (net) financial transfers between 1991 and 2013. That corresponds to about 57% of 2013 German GDP.

**Box Figure 1 / Growth rates of per capita nominal GDP, %, former FRG and former GDR, 1992–2016**



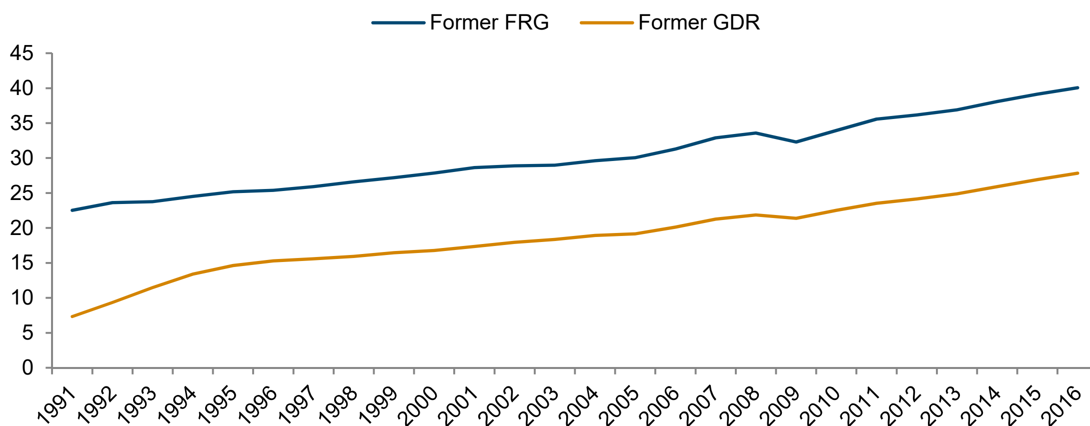

Source: Own calculations based on data from the German Statistical Office and Eurostat.

Given this, one would expect rapid convergence between the two parts of Germany. However, the facts do not support that expectation. It turns out that, although there was a period of rapid convergence, it was relatively short and had ended by the late 1990s (see Box Figure 1).

As can be seen, faster relative growth in the former GDR's nominal per capita GDP ended in 1996. Part of the initially rapid growth in the former GDR may reflect an adjustment in prices (artificially suppressed pre-1991), rather than in real output. Since 1997, the growth rates for both parts of Germany have been close to one another (average growth was about 0.7 percentage points higher in the former GDR than in the former FRG over the period). It may be added that per capita GDP growth in the former GDR came at the same time as a falling population. In the former FRG, both output and population rose over the period in question.

German unification has so far left absolute per capita income differentials roughly unchanged (see Box Figure 2). Of course, in relative terms there has been convergence (thanks to the already noted growth rate differential of about 0.7 percentage points per annum in the former GDR's favour). However, if per capita income in the former GDR continues to rise at about 3.05% per year, against the 2.32% for the former FRG (the average rates between 1997 and 2016), it will take over 50 years for complete catch-up.

**Box Figure 2 / Per capita nominal GDP (EUR 000s), former FRG and former GDR, 1991-2016**




Source: Own calculations based on data from the German Statistical Office and Eurostat.

What lessons for CESEE can be drawn from the German experience? First, it appears that huge transfers from the West – even if coupled with complete unification (institutional, as well as 'real') – are not necessarily a guarantee of fast convergence. The period of rapid convergence (in the former GDR until 1997) may might come to an end, sooner or later. Second, one wonders whether it was not the complete unification that was ultimately responsible for the failure of the German experiment. Arguably, a less radical real integration (through free trade, capital and labour flows, and monetary and economic policy unification) may have produced better end results. For example, giving GDR firms adequate protection for some time could have helped them to adapt to market conditions, restructure and develop

‘organically’, rather than end up as pieces of scrap. With a large part of the GDR’s production capacities saved from liquidation, the local labour force may have stayed in the East – instead of swelling the army of the permanently unemployed, or being induced to migrate to the West.[19]

CESEE countries have been steadily integrating into the EU’s institutional, monetary, fiscal and ‘real’ frameworks (the latter through large-scale trade and high foreign direct investment penetration by the West). In addition, most of them have drawn rather large (in relation to their GDP) funds ‘from Brussels’ – and stand ready to enjoy further cash flows in the future. Do these facts justify the expectation that CESEE countries will continue their accelerated economic convergence in the future? In the light of the GDR experience, such an expectation may be frustrated. For CESEE countries – as for any middle-income country – successful catch-up seems to require much more than a passive integration into the existing economic order.

[19] After only 11 years of separation, Saarland (under French administration after the Second World War) was returned to the FRG. Its initial reintegration took almost three years (1956–1959), during which time the Deutschmark was *not* the legal tender there, a customs border with the FRG was maintained and the freedom of foreigners (i.e. ‘Federal Germans’) to settle and acquire assets was restricted. By contrast, the GDR was annexed overnight and the GDR economy was subject to immediate takeover by the ‘West Germans’.

## 4.2. BUSINESS CYCLE MONITOR: OVERHEATING CONCERN ABATE

**by Alexandra Bykova and Richard Grieveson**

› Our headline business cycle index indicates that the CESEE region overall is not overheating (see Figure 26), particularly if one compares current levels to those of the pre-crisis period (when the economy certainly was overheating). Moreover, the headline indices are overall slightly lower than when we ran the index at the beginning of the year.

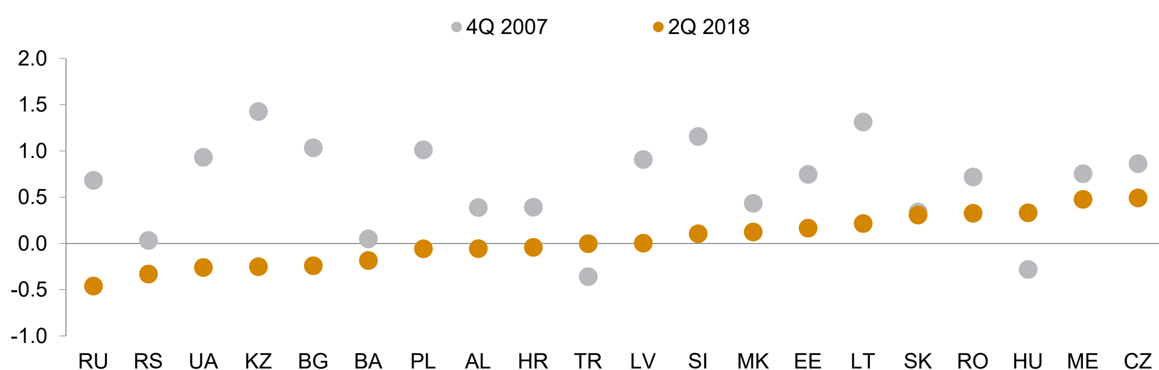
› However, there are some signs of potential overheating in particular indicators. Relative to the historical average, this is most clear in tight labour markets, higher external debt, elevated property prices, and negative real interest rates (see Table 7 and Figure 27).

› Some underheating is also visible, notably in fiscal and current account balances, and more generally in the CIS + Ukraine region.

› Based on current levels relative to regional peers (Table 8), it is no surprise to see that many indicators point to overheating in Turkey (this will now change as the economy goes into recession). Other things which jump out from the data are very negative real interest rates in the Baltics, and property prices in several EU Member States. Outside Turkey, it seems that the biggest risk for potentially destabilising imbalances to emerge is in EU-CEE.

› In some countries tending towards overheating, monetary and/or fiscal policy could be inappropriate and should be tightened. However, the continued relative absence of inflation indicates that there are fewer risks for policy-makers of staying on the loose side,[20] and the current upswing in most of the region appears still to have significant room to run.

**Figure 26 / Business cycle index**




Note: Number of standard deviations from historical mean, average of 11 indicators. Indicators are those in Table 7.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

[20] For a longer discussion of the relative absence of inflation in the region at a time of high growth and low unemployment, see the main CESEE overview section of this report.

## Table 7 / Number of standard deviations from historical mean, 2Q 2018

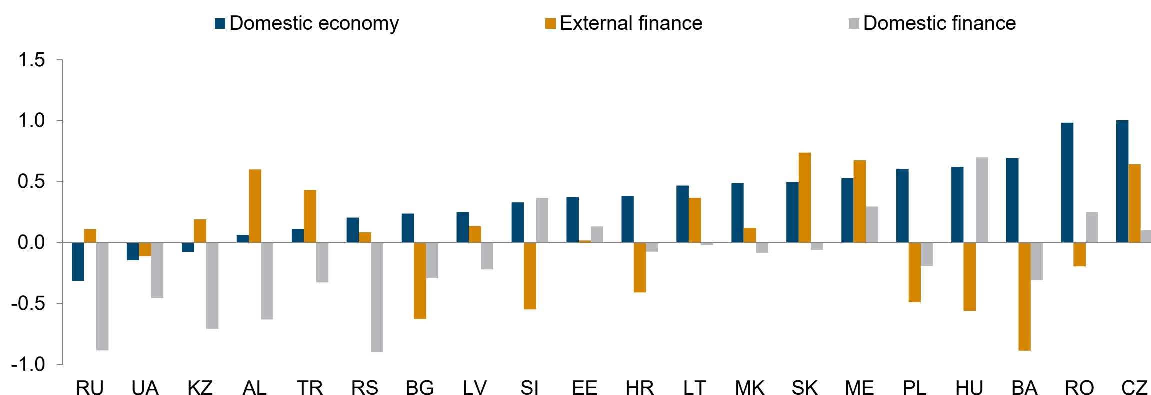
| | Domestic economy | | | External finance | | | Domestic finance | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Real GDP | Unemploy-ment | CPI | CA | RER | External debt | RIR | Private credit | Broad money | Fiscal balance | Property prices |
| BG | -0.02 | 1.35 | -0.62 | -1.19 | 0.41 | -1.10 | -0.17 | -0.50 | -0.72 | -0.34 | 0.27 |
| CZ | 0.42 | 2.52 | 0.06 | -1.19 | 0.99 | 2.13 | 0.88 | -0.52 | 0.39 | -1.72 | 1.48 |
| EE | 0.00 | 1.09 | 0.04 | -1.04 | 1.41 | -0.32 | 1.26 | -0.59 | -0.62 | 0.76 | -0.14 |
| HR | 0.26 | 1.43 | -0.53 | -1.34 | 0.21 | -0.09 | 1.01 | -0.49 | -0.69 | -2.57 | 2.37 |
| HU | 0.83 | 1.73 | -0.71 | -0.98 | -0.20 | -0.49 | 2.11 | 0.11 | 0.72 | -0.41 | 0.96 |
| LT | -0.08 | 1.11 | 0.37 | -1.06 | 1.23 | 0.93 | 1.29 | -0.41 | -0.60 | -0.67 | 0.29 |
| LV | 0.13 | 0.94 | -0.33 | -0.93 | 0.84 | 0.49 | 0.63 | -0.63 | -0.89 | -0.46 | 0.26 |
| PL | 0.81 | 1.53 | -0.52 | -1.69 | -0.53 | 0.75 | 0.99 | -0.77 | -0.89 | -2.01 | 1.72 |
| RO | 0.58 | 2.96 | -0.59 | -0.58 | -0.04 | 0.04 | 1.11 | -0.51 | -0.64 | 0.08 | 1.21 |
| SI | 0.75 | 0.80 | -0.57 | -1.91 | 0.00 | 0.27 | 1.44 | -0.21 | 0.04 | -1.28 | 1.85 |
| SK | -0.11 | 1.96 | -0.36 | -0.73 | 0.76 | 2.19 | 1.15 | -0.22 | -0.23 | -1.27 | 0.26 |
| AL | -0.18 | 1.07 | -0.70 | -1.07 | 1.63 | 1.23 | 1.62 | -0.85 | -1.76 | -1.54 | |
| BA | -0.05 | 2.46 | -0.34 | -1.19 | -1.49 | 0.01 | 0.73 | -0.25 | -0.38 | -1.33 | |
| ME | 0.59 | 1.31 | -0.32 | -0.02 | 1.01 | 1.04 | 1.40 | -0.39 | -0.29 | 0.46 | |
| MK | -0.58 | 2.22 | -0.18 | -1.15 | -0.16 | 1.67 | 0.80 | -0.77 | -0.73 | -0.07 | 0.33 |
| RS | 0.11 | 1.09 | -0.59 | -0.44 | 0.84 | -0.14 | -0.18 | -0.94 | -0.93 | -1.41 | -1.03 |
| TR | 0.59 | 0.03 | -0.28 | 0.98 | -1.70 | 2.01 | 0.70 | -0.71 | -0.51 | -0.22 | -0.88 |
| KZ | -0.70 | 1.01 | -0.53 | 0.25 | -1.04 | 1.36 | -1.47 | -0.75 | -1.53 | 0.92 | |
| RU | -0.52 | 1.34 | -1.76 | 0.72 | 0.06 | -0.45 | -1.44 | -1.03 | -1.34 | 0.29 | -0.90 |
| UA | 0.05 | -0.56 | 0.08 | 0.28 | -1.44 | 0.83 | -0.33 | -0.74 | -1.04 | 0.29 | |

overheating — > 1 SD above historical average

underheating — > 1 SD below historical average

Notes: CPI: consumer price index, CA: current account, RER: real exchange rate (EUR) CPI deflated; a value of more than 100 means appreciation, under 100 – depreciation; RIR: real interest rate CPI deflated.
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 to 2Q 2018. Calculations are based on four-quarter trailing averages.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; Bank for International Settlements.

## Figure 27 / Sub-components of the business cycle index, 2Q 2018




Note: Number of standard deviations from historical mean, average of indicators in each sub-component. Indicators are those in Table 7.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

## Table 8 / Over-/underheating in relation to regional peers, 2Q 2018 (4-q trailing average )

| | Domestic economy | | | External finance | | | Domestic finance | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Real GDP | Unemploy-ment | 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 | 3.6 | 5.7 | 1.6 | 4.2 | 98.0 | 62.8 | -1.6 | 4.2 | 8.6 | 0.6 | 8.0 |
| CZ | 4.0 | 2.5 | 2.2 | 0.6 | 107.5 | 85.2 | -1.5 | 6.2 | 8.8 | 1.1 | 9.0 |
| EE | 3.9 | 5.6 | 3.7 | 2.2 | 103.2 | 80.4 | -3.5 | 0.9 | 7.4 | -0.9 | 5.9 |
| HR | 2.7 | 9.5 | 1.5 | 1.9 | 100.8 | 79.9 | 1.5 | 0.8 | 3.6 | 1.2 | 6.1 |
| HU | 4.5 | 3.9 | 2.4 | 2.5 | 100.7 | 83.5 | -1.5 | 5.9 | 12.5 | -3.6 | 8.8 |
| LT | 3.8 | 6.6 | 3.5 | 0.8 | 103.0 | 80.4 | -3.4 | 5.1 | 7.3 | -0.6 | 7.7 |
| LV | 4.8 | 8.1 | 2.5 | 1.3 | 101.3 | 131.9 | -2.4 | -5.0 | 3.4 | -0.9 | 9.2 |
| PL | 5.0 | 4.3 | 1.3 | 0.0 | 98.0 | 65.7 | 0.2 | 4.3 | 5.8 | -0.8 | 5.0 |
| RO | 5.9 | 4.6 | 2.9 | -3.4 | 95.3 | 50.0 | -0.8 | 6.3 | 12.1 | -3.3 | 5.8 |
| SI | 4.7 | 5.8 | 1.6 | 7.5 | 99.5 | 98.3 | -1.6 | 2.4 | 7.2 | 0.4 | 11.2 |
| SK | 3.7 | 7.4 | 2.2 | -1.8 | 99.4 | 106.0 | -2.2 | 10.3 | 6.4 | -1.0 | 8.0 |
| AL | 4.0 | 13.0 | 1.9 | -6.5 | 107.8 | 66.2 | -0.7 | -0.1 | 0.2 | -2.0 | |
| BA | 2.9 | 20.0 | 1.1 | -4.6 | 97.8 | 25.9 | -1.1 | 7.2 | 9.6 | 2.7 | |
| ME | 4.5 | 15.6 | 3.4 | -20.5 | 102.0 | 51.2 | 2.6 | 7.4 | 12.3 | -5.0 | |
| MK | 1.1 | 21.7 | 1.7 | -0.1 | 99.2 | 76.6 | 1.4 | 5.3 | 7.2 | -2.1 | 3.6 |
| RS | 3.6 | 13.6 | 2.3 | -5.4 | 103.9 | 62.8 | 1.0 | 2.4 | 5.1 | 0.9 | -1.5 |
| TR | 7.8 | 10.3 | 11.5 | -6.6 | 80.3 | 55.8 | -0.9 | 19.8 | 18.2 | -2.4 | 10.8 |
| KZ | 4.1 | 4.9 | 6.9 | -1.9 | 74.4 | 97.3 | 2.7 | 1.4 | 1.2 | -2.5 | |
| RU | 1.6 | 5.0 | 2.7 | 3.7 | 104.1 | 32.0 | 4.9 | 4.9 | 7.4 | 0.2 | -2.1 |
| UA | 2.9 | 9.2 | 13.8 | -2.0 | 102.4 | 92.8 | 1.3 | 3.6 | 8.7 | -2.3 | |

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

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

## 4.3. CREDIT MONITOR: CYCLE PICKING UP AS ASSET QUALITY IMPROVES

**by Olga Pindyuk**

› Credit growth is positive across almost the whole of CESEE. Loans to households are rising everywhere apart from Latvia and loans to non-financial corporations are also growing in most places (see Table 9). Since the onset of the global financial crisis, Latvia has undergone almost uninterrupted deleveraging by both households and companies, despite negative real interest rates and low levels of NPLs.

› On a regional aggregate basis, growth in loans to households has accelerated everywhere, except Turkey (see Figure 28). These loans have grown more quickly than credits to non-financial corporations in all countries, apart from Turkey, Lithuania, Poland and Hungary. In June 2018, many countries recorded a double-digit rate of growth in the stock of household loans. CIS + Ukraine has experienced the fastest accumulation of household loans; together with sluggish household income growth in these countries, this points to potential overheating in the sector.

› Slovakia has remained the leader in EU-CEE with regard to household loan growth. Household loan penetration in the country has more than doubled since 2010 to reach the highest level of the 11 EU-CEE countries; this is potentially linked to years of ultra-loose policy by the European Central Bank. In general, eurozone countries in the region plus Romania show the most negative real interest rates.

› The growth of loans to non-financial corporations has remained rather weak in most of CESEE (Hungary is a notable exception), despite loose monetary policies (as reflected by low or negative interest rates). This is linked to the lethargic performance of the private sector in many countries over the past decade, owing to the prolonged effects of the global economic crisis. Signs of potential instability can be seen in Turkey, where a sharp lira depreciation has inflated the debt burden in local currency terms (due to the high share of forex loans).

› As of June 2018, NPLs had declined in all the countries, compared to the same month in 2017, pointing to a broad-based improvement in asset quality. In Ukraine, however, the decline has been only marginal and the country continues to struggle with an extremely high level of NPLs. Apart from Ukraine, only three countries in the region recorded double-digit shares of NPLs in June 2018 – Albania, Bulgaria and Croatia.

## Table 9 / Indicators of financial sector developments, June 2018

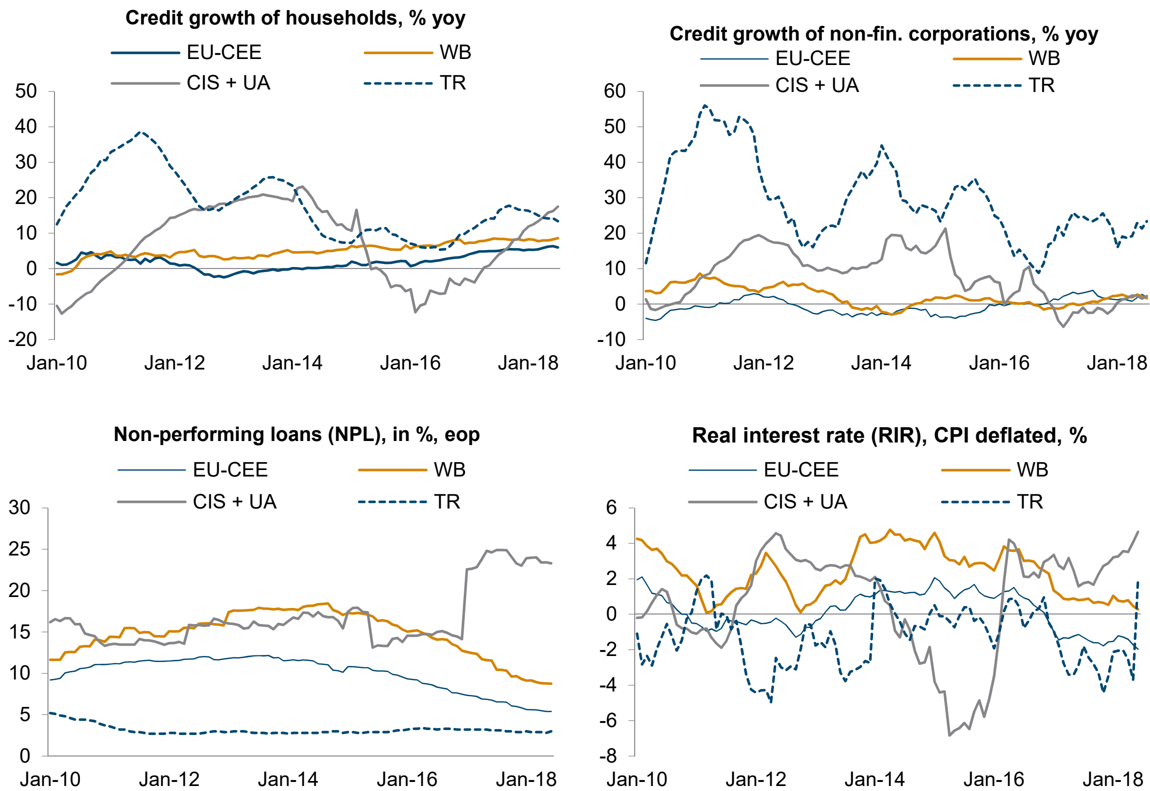
| | AL | BA | BG | CZ | EE | HR | HU | KZ | LT | LV | ME | MK | PL | RO | RS | RU | SI | SK | TR | UA |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Loans to non-fin.corporations, % yoy | -5.9 | 6.8 | 3.5 | 4.2 | -4.9 | -0.1 | 14.7 | -5.8 | 7.7 | -9.3 | 6.3 | 2.9 | 7.0 | 3.5 | 0.8 | 4.6 | -2.3 | 6.6 | 21.3 | 5.8 |
| Loans to households, % yoy | 4.9 | 7.2 | 9.2 | 7.5 | 7.0 | 3.9 | 2.1 | 14.8 | 7.0 | -0.4 | 10.4 | 9.7 | 4.8 | 10.0 | 9.0 | 18.9 | 6.3 | 12.3 | 14.2 | 15.1 |
| Real interest rate, CPI deflated, % | -1.4 | -1.9 | -2.9 | -1.4 | -3.8 | 0.8 | -2.2 | 2.8 | -2.5 | -2.6 | 2.3 | 1.6 | 0.1 | -2.1 | 0.7 | 4.7 | -2.3 | -2.8 | 2.0 | 6.5 |
| Non-performing loans (NPL), in %, eop | 13.3 | 9.3 | 13.1 | 3.4 | 0.7 | 11.2 | 4.1 | 8.8 | 3.2 | 4.2 | 7.0 | 5.0 | 6.8 | 5.7 | 7.8 | 5.4 | 2.9 | 3.6 | 3.0 | 55.7 |

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. For NPL: PL data refer to Dec. 2017, LT data refer to March 2018.
Source: wiiw Monthly Database incorporating national statistics.

## Figure 28 / Indicators of financial sector developments over time




Note: Simple averages for country aggregates. WB excluding XK, CIS excluding BY.
Source: wiiw Monthly Database incorporating national statistics.

## 4.4. FDI MONITOR[21]: INFLOWS DOWN BY ALMOST A QUARTER IN 2017

**by Gabor Hunya**

› FDI inflows into CESEE fell by around 22% in 2017, mainly on account of Russia and a number of EU-CEE countries, despite strong economic growth across much of the region (Table 10). However, this is not necessarily odd: the historical correlation between FDI and growth in CESEE is quite low. Small economies are more dependent on FDI than large ones in terms of both inflows and stocks relative to GDP (Figures 29 and 30).

› Half-year 2018 figures indicate that inflows may again decline this year, except in Albania, Belarus, Bulgaria, Croatia, Lithuania, Macedonia, Poland, Romania and Serbia.

› One major reason for the 2017 drop in FDI in EU-CEE was disinvestment – capital withdrawals by foreign investors – particularly in the Czech Republic, Hungary and Poland. Here, national capital (often with government support) took over from foreigners in banking, utilities and communications.

› Nevertheless, greenfield investment (capital in new projects) increased for the third year in a row, with a particular boom recorded in Poland. This suggests that foreign investors are so far undeterred by political developments there.

› A big constraint on future FDI in the region, however, will be labour shortages. Foreign firms will increasingly struggle to find qualified staff, and will have to pay higher wages to those that they do find. Nevertheless, this will be preferable to moving production further east, where business conditions, infrastructure and labour quality are generally worse. Moreover, foreign firms have sunk costs in EU-CEE, and value the proximity to home markets, such as Germany.

› We find that the role of tax havens such as the Netherlands and Luxembourg in FDI is significantly overstated in the data. Countries such as Germany and the US are more important sources. Austria is the third-biggest source of FDI in CESEE, and the income that Austrian firms earn in the region far outweighs the state's contribution to the EU budget.

› A high share of manufacturing in FDI stocks defines the countries of the Central European manufacturing hub (Figure 31). This has expanded to Romania, Serbia and Macedonia in recent years.

**Table 10 / FDI inflows in CESEE over time**

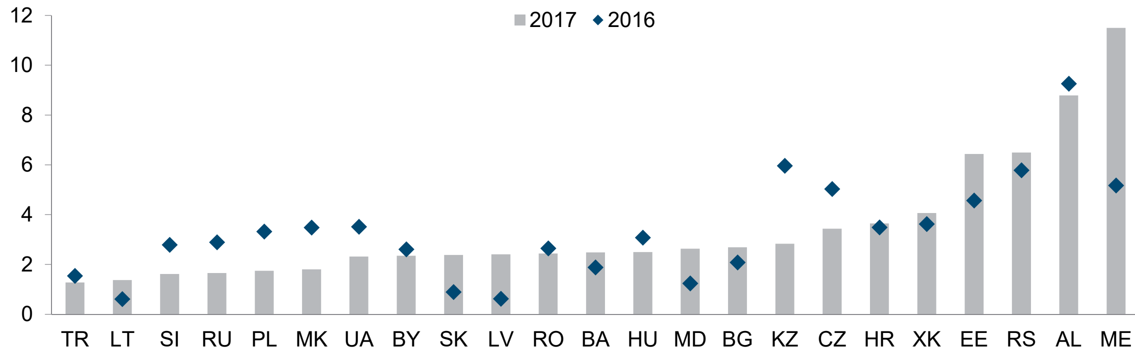
EUR million

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|
| EU-CEE | 23,278 | 25,179 | 30,022 | 13,286 | 26,354 | 25,447 | 36,946 | 31,044 |
| WB | 3,473 | 5,675 | 2,806 | 3,577 | 3,487 | 4,450 | 4,171 | 4,890 |
| TR | 6,861 | 11,576 | 10,341 | 10,212 | 9,875 | 16,225 | 12,054 | 9,639 |
| BY, KZ, MD, UA | 14,790 | 18,242 | 18,212 | 13,017 | 8,313 | 7,876 | 11,569 | 7,709 |
| RU | 23,875 | 26,476 | 23,483 | 40,196 | 22,037 | 10,664 | 33,568 | 23,102 |
| CESEE-23 1) | 72,276 | 87,149 | 84,865 | 80,288 | 70,066 | 64,662 | 98,308 | 76,383 |

1) The 22 CESEE countries covered in this report plus Moldova.
Note: Data are based on Direct Investment Statistics, excluding special purpose entities (SPEs).
Source: wiiw FDI Database.

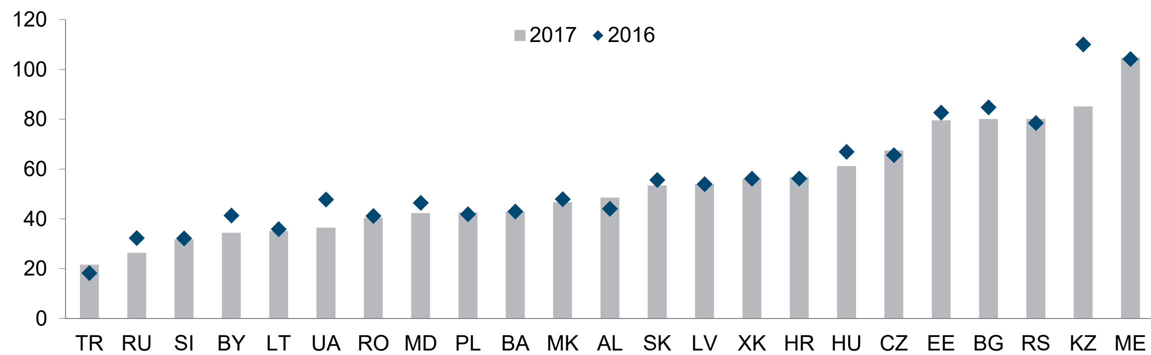
[21] This is an updated summary of the *wiiw FDI Report 2018*: https://wiiw.ac.at/declines-due-to-disinvestment-p-4548.html

**Figure 29 / FDI inflow, as a percentage of GDP**



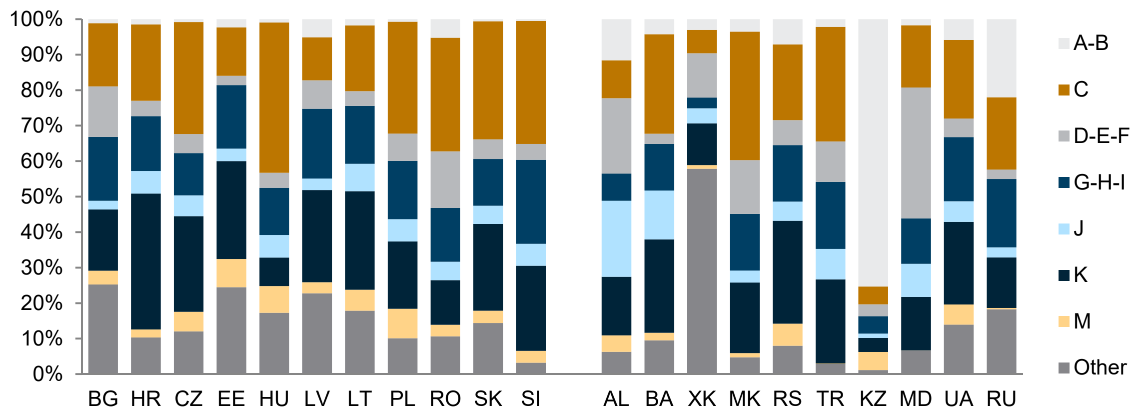

Source: wiiw FDI Database.

**Figure 30 / FDI inward stock, as a percentage of GDP**




Source: wiiw FDI Database.

**Figure 31 / Inward FDI stock by economic activities, last available year**




Note: NACE Rev. 2 activities: A-B Agriculture+Mining, C Manufacturing, D-E-F Electricity+Water+Construction, G-H-I Trade+Transport+Accommodation, J Info-communication, K Finance, M Professional.
Source: wiiw FDI Database.

# 5. Special section

## 5.1. WHAT DOES CHINA'S BELT AND ROAD INITIATIVE MEAN FOR CESEE, AND HOW SHOULD THE EU RESPOND?

**by Amat Adarov, Julia Grübler and Mario Holzner**

*China's Belt and Road Initiative is important for the CESEE region, and especially for the Western Balkans. While it will bring much-needed infrastructure upgrading, the initiative is also associated with certain risks, including increased political and economic dependence on China, and a potentially unsustainable rise in public debt levels in some countries. The EU should respond with a 'Big Push' investment initiative of its own, framed as a complement to the Belt and Road Initiative, rather than as its competitor.*

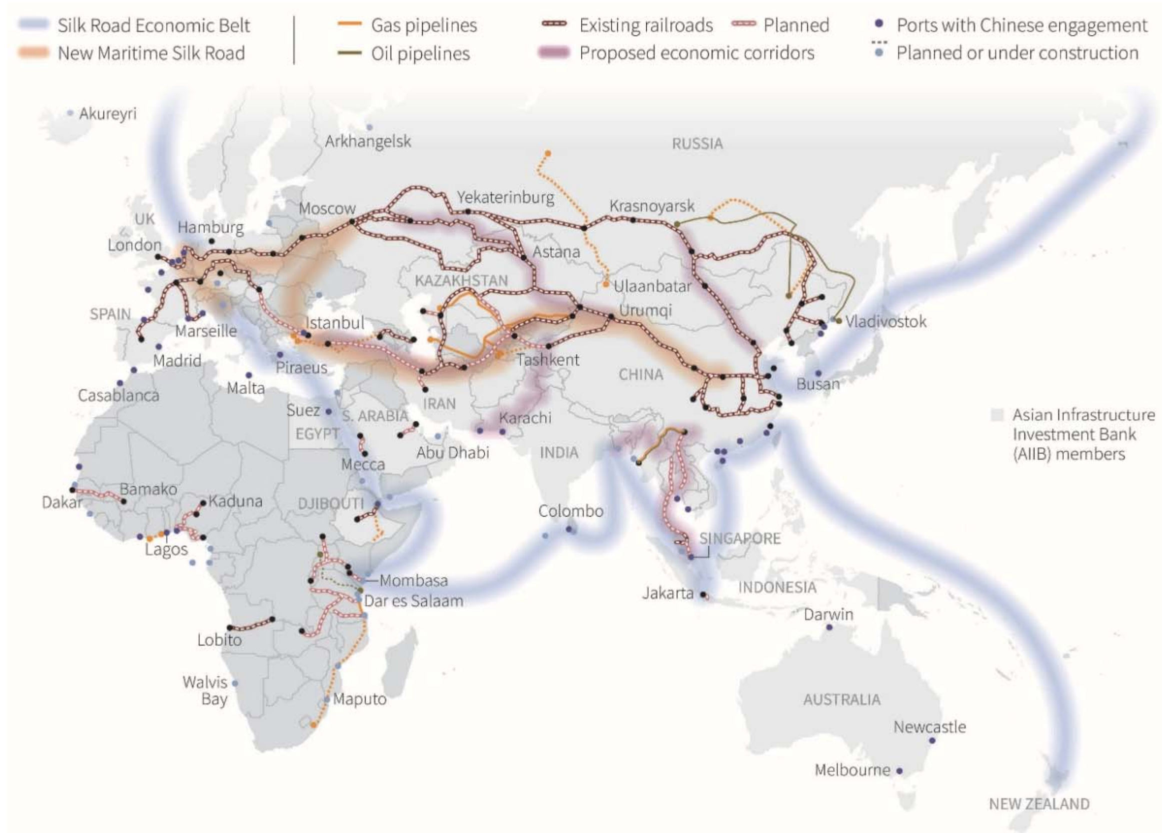
### 5.1.1. The Belt and Road Initiative in brief

Proposed by Chinese President Xi Jinping, the Belt and Road Initiative (BRI) – also known as One Belt, One Road, or the New Silk Road – celebrates its fifth anniversary this year. The ultimate goal of the BRI is to facilitate economic connectivity between Asia and Europe along two major components: the land-based Silk Road Economic Belt and the sea-based 21st Century Maritime Road (see Figure 32). The Silk Road Economic Belt will connect China to Europe via land transport corridors extending throughout Central Asia, the Middle East and Russia, while the Maritime Silk Road will link the South China Sea and the Mediterranean Sea via the Strait of Malacca, the Indian Ocean and the Suez Canal. In addition, six envisioned economic corridors will bridge the Silk Road Economic Belt and the Maritime Road: (1) China–Indochina Peninsula; (2) Bangladesh–China–India–Myanmar; (3) China–Pakistan; (4) New Eurasian Land Bridge via Kazakhstan and Russia; (5) China–Central Asia–West Asia; and (6) China–Mongolia–Russia. While the initial focus is on improving transport and energy infrastructure connectivity, the initiative also seeks closer cooperation along other dimensions, including facilitation of trade and financial policy cooperation.[22]

The BRI – which already covers 65 countries of Asia, Europe and Africa – will potentially span over 100 countries, making the endeavour truly ambitious. The undertaking is backed by financial infrastructure involving multiple sources: the Silk Road Fund (USD 40 billion), the Silk Road Gold Fund (USD 15 billion) and the China–Central and Eastern Europe Investment Cooperation Fund (USD 11 billion). In addition, the project is supported by bilateral funds (China–Russia, China–India, China–Africa development funds), recently established banks that focus on infrastructure investment (the Asian Infrastructure Investment Bank and the New Development Bank) and Chinese policy banks (the Export-Import Bank of China, the China Development Bank and the Agricultural Development Bank of China). Further support comes from complementary initiatives by the World Bank, the European Bank for Reconstruction and Development (EBRD) and other international development organisations operating in the region.

[22] See also Urban (2016) and Barisitz and Radzyner (2017) for the discussion of the BRI routes.

**Figure 32 / New Silk Road**




Source: World Economic Forum, based on Mercator Institute of China Studies.

Given its significant scale and dedicated funding, it is likely that the BRI is capable of transforming the region. At the same time, the commitment of China to the BRI is motivated by pragmatic considerations, including the need to revisit its economic development model and spur growth in its lagging regions, secure access to strategic resources and export markets, and promote the Chinese yuan and China's general economic and geopolitical influence in the region (see Adarov, 2018 for a detailed discussion).

### 5.1.2. The BRI and the '16+1' initiative place the Western Balkans in the limelight

China's interest in CESEE was revealed in 2012, with the diplomatic initiative '16+1', encompassing 11 EU Member States of Eastern Europe and five Western Balkan economies (excluding Kosovo). However, within CESEE, the region set to be most substantially impacted is Southeast Europe, and especially the Western Balkans. The Western Balkan region has recently received significant public and political attention in Europe thanks to Chinese investments. With the China Ocean Shipping Company (COSCO) acquiring a majority stake in the port of Piraeus (the biggest port in Greece), the logical overland transport connection to Western European markets runs through the Western Balkans.

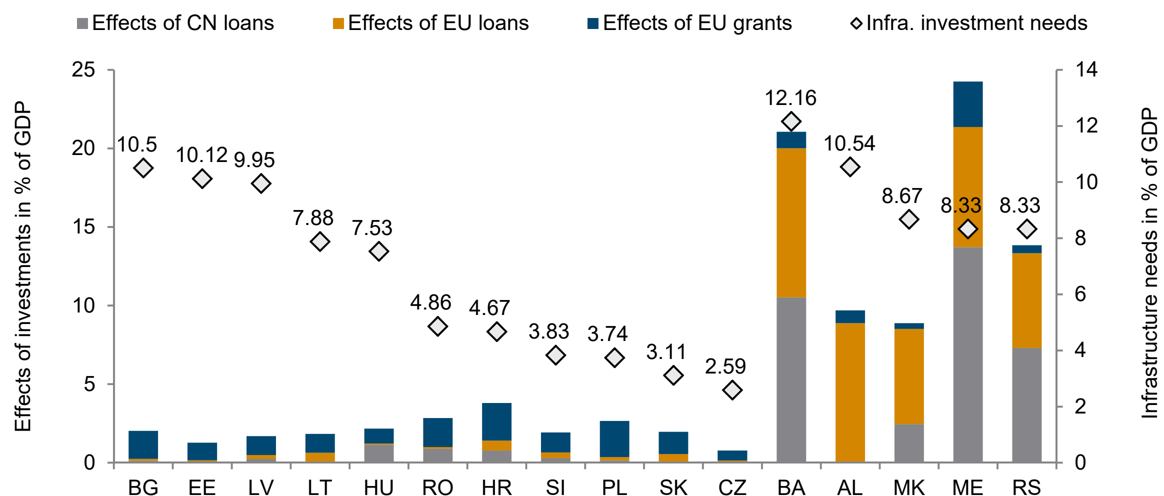
As a result, economies in the Western Balkans could turn out to be the main beneficiaries of China's BRI projects in Europe. These countries face substantial infrastructure investment needs of more than 8% of their GDP per annum over the period 2018–2022 (Figure 33; EBRD, 2017). These needs are strongest

in transport and energy infrastructure. There are barely any West–East railway links in the region, no high-speed railway lines, and the motorways are underdeveloped.

Estimating the trade-induced economic effects of infrastructure investment, a recent wiiw study found that the GDP effects of Chinese infrastructure projects are highest for Montenegro (14% of GDP), Bosnia and Herzegovina (11%) and Serbia (7%); these effects will materialise over the several years needed for the infrastructure construction work. Taken together with EU loans and grants, the GDP effects might amount to as much as 24% of GDP for Montenegro, 21% for Bosnia and Herzegovina, 14% for Serbia, 10% for Albania and 9% for Macedonia (Grübler et al., 2018).[23] Obviously, the effects would be substantially lower if those investments financed by Chinese resources used primarily Chinese production and supply networks. On the other hand, if recipient countries manage to link infrastructure construction projects to local employment, the effects could be even higher in the medium to long run, as increased employment would result in further spending – and therefore greater national income.

**Figure 33 / Western Balkans potentially benefiting most from the BRI**

Infrastructure investment needs per annum (2018–2022) contrasted with expected GDP effects of EU and Chinese infrastructure financing, as a percentage of GDP




Note: wiiw calculations of GDP effects based on European Structural Investment Funds (ESIF), Connecting Europe Facility (CEF), Trans-European Transport Network (TEN-T), Western Balkan Investment Framework (WBIF) and European Fund for Strategic Investment (EFSI) data on EU grants and loans and the China Global Investment Tracker for Chinese construction projects. Ranking according to infrastructure investment needs as a percentage of GDP for EU members and Western Balkan states.
Sources: EBRD Transition Report 2017–2018; Grübler et al. (2018).

However, despite these positives, there are three key reasons for caution in relation to CESEE (and particular Western Balkan) involvement in the BRI. First, there is an issue surrounding the transparency of public procurement in BRI projects, and compliance with EU law. The Belgrade–Budapest railway link, for example, led to a dispute between Hungary and the EU over public procurement rules. In late 2017,

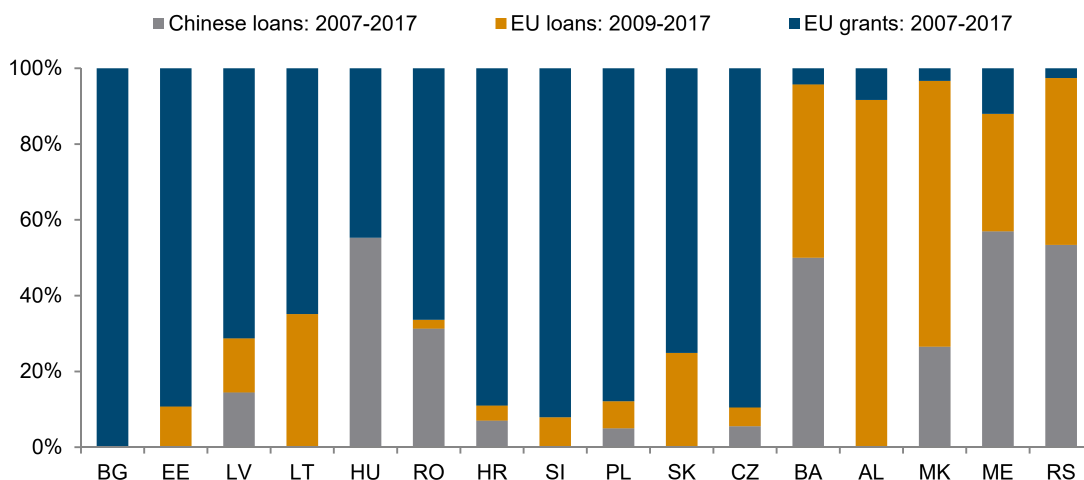
[23] The underlying model assumes 'business as usual', meaning that (i) investment funds actually turn into real investment and thus trigger demand in the construction industry and (ii) products and services needed by the construction industry are sourced from the same countries as in the past.

the case was officially solved during the 6th CEE–China summit, when the project tender was launched. However, criticism of the procurement process persists and worries remain about potential future infringement proceedings against Hungary or other economies targeted by Chinese financing.

Second, Chinese financing comes in the form of loans, which need to be paid back. In the context of discussions about the complementarity or substitutability[24] of Chinese and EU financing in the region, it is important to stress the difference between loans and grants. The former may boost growth in targeted economies, but may potentially create the risk of debt unsustainability. With grants this is not the case, as they do not have to be paid back. With EU Member States having better access to EU grants (Figure 34), but economies outside the EU primarily having to use loans (e.g. from the EU or China), the medium- to long-term effects of infrastructure financing may differ significantly for these country groups.

**Figure 34 / Debt trap of less concern within the EU**

Comparison of loans and grants provided by the EU and China for infrastructure investments




Note: 100% refers to the sum of EU and Chinese financing of infrastructure investments in the BRI investment fields of transport, energy, environment and information and communication technology (ICT).
Source: European Commission ESIF, CEF, TEN-T, WBIF, EFSI data; China Global Investment Tracker; wiiw calculations.

Third, there is a risk that these Chinese loans will contribute unsustainable public debt in some CESEE countries. There is very limited literature so far on the risk of debt default associated with loans for public infrastructure investment. Hurley et al. (2018) examined 68 countries and found that BRI infrastructure financing has severely increased the risk of debt distress in eight economies. Among these is Montenegro, due to a BRI motorway project linking the port of Bar with Serbia. The costs of the first of three phases amounted to more than USD 1 billion, or roughly a quarter of Montenegro's GDP. Without highly concessional funding for the remaining two phases, Montenegro's economy could drift towards debt default. Similar concerns led Malaysia to withdraw from three BRI projects in August of this year.

[24] Discussions on substitutability of funding intensified after statements by Hungary's Prime Minister Viktor Orbán: 'If the European Union cannot provide financial support, we will turn to China': https://bbj.hu/economy/orban-if-eu-doesnt-pay-hungary-will-turn-to-china_143836

For Sri Lanka, the concerns have become a reality: it has had to hand over its port of Hambantota and 60 square kilometres of land for 99 years to China due to payment difficulties.[25]

### 5.1.3. A European response to the BRI

How economic ties between CESEE and China evolve in the coming years will depend partly on the political and financial engagement of the EU with its neighbourhood. Some five years after the BRI was launched, the EU responded to ongoing debates in Europe by presenting an investment strategy for the Western Balkans in May (EC, 2018a), a proposal for an InvestEU Programme in June (EC, 2018b) and its vision for connectivity between Europe and Asia in September (EEAS, 2018). However, all these activities are small, compared to the global aspirations of the BRI. A more significant reaction by the EU to China's initiative has yet to materialise.

We (Holzner et al., 2018) argue for a 'Big Push' in infrastructure investments in Europe and its neighbourhood (beyond the borders of the EU), not least for the following reasons: i) the EU should respond to the BRI, in order to ensure that its own priorities are also reflected in infrastructure development in its neighbourhood; ii) the wider region has a persistent, 200-year-old infrastructure problem, and the BRI alone will not tackle this – more and better infrastructure will unlock untapped growth potential; iii) the region is economically underdeveloped, especially in terms of industrial capacities, and 'Big Push' infrastructure investment is the best way to solve this.

We propose the construction of a European Silk Road that links industrial centres in the West with densely populated, but less-developed regions in the East of the European continent, thereby providing for more growth and employment in the short, medium and long term. This initiative should not be viewed as competition to the BRI, but as a complementary project. Besides economic benefits, it would also entail important political advantages, with more cooperation thanks to transnational, joint infrastructure measures.

After its completion, the European Silk Road would extend overland for around 11,000 kilometres on a northern route from Lisbon to Uralsk (on the Russia–Kazakh border) and on a southern route from Milan to Volgograd and Baku. The central parts – which should be given priority in construction (solid lines on the map shown in Figure 35) – would be the route from Lyon to Moscow in the north, and from Milan to Constanţa in the south. The southern route would link Central Europe with the Black Sea area and the Caspian Sea littoral states. The European Silk Road would consist of a higher-tier motorway (i.e. one with fewer entries and exits than current motorways in the region, meaning faster transit) and a high-speed railway line with a string of logistics centres, seaports, river ports and airports. These would set new European standards, including in e-mobility and autonomous driving. The two routes connect the most populous regions of Europe on a West–East axis. The previously mentioned Western Balkans are not included, as they lack relevant population density and are already covered by a number of infrastructure initiatives from both the EU and outside players. Nevertheless, future extensions of the suggested European Silk Road might well include North–South connections, also covering the Balkans.

[25] See e.g. Maria Abi-Habib, 'How China got Sri Lanka to cough up a port', *New York Times*, 25 June 2018: https://www.nytimes.com/2018/06/25/world/asia/china-sri-lanka-port.html

Our cost estimates yield an investment volume of around EUR 1,000 billion for the European Silk Road, which is far below the highest estimates for the Chinese New Silk Road of up to EUR 7,000 billion. The investment costs would be offset by potential positive effects on GDP, employment and trade.

In a baseline scenario, we calculate that the European Silk Road would have the potential to increase the GDP of the countries involved by about 3.5% over an investment period of 10 years, and to increase employment by 2 million. Under particularly favourable circumstances, and with interest rates remaining low, the employment increase across Europe could be as much as 7 million. Savings in transport time – for instance, on the northern route of the European Silk Road this would average 8% – could enable the countries involved to raise their exports to Russia by more than 11%.

**Figure 35 / Proposal of a European Silk Road on a northern and southern route**

Source: GEOATLAS.com, own route design.

To expand the pan-European market, the potential for enhanced economic integration is substantial. In addition, we also propose a trust fund, designed to bridge the gaps in infrastructure in Europe and construct a European Silk Road with the aid of an infrastructure investment push. With the currently extremely low interest rates (and in view of the immense economic effects anticipated), a 'self-financed' investment might be expected (IMF, 2014).

## Conclusion

The BRI will facilitate massive improvements in cross-border infrastructure and connectivity throughout the Eurasian continent, delivering positive short- and long-run economic effects. However, it is important to be fully aware of the risks that the initiative may entail, including debt unsustainability, the long-term economic and political dependence of participating countries on China, and the use of business practices and regulations that are possibly inconsistent with EU standards and values. Assessing these

risks is vital, particularly for the Western Balkan region, which is at the core of loan-financed BRI investments in Europe (given that it has limited access to EU grants).

So far, the reaction of the EU to the BRI has been limited. We suggest a more proactive stance and practical engagement in the form of massive 'Big Push' infrastructure investment in Europe, which would also help facilitate economic development in lagging regions. Rather than a competitor to the BRI, the European Silk Road should be regarded as a complement to it – one that is better geared to the needs and goals of the EU.

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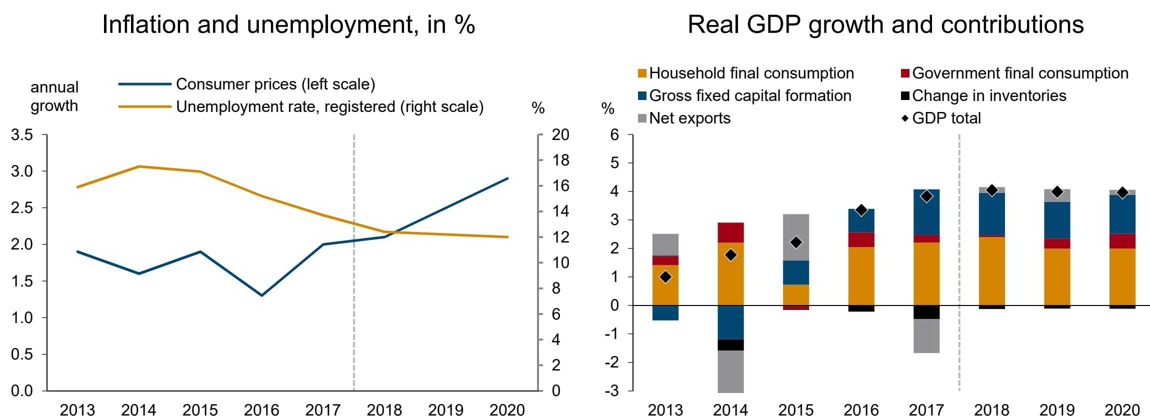
# 6. Country reports

# ALBANIA: Growth led by rebound in electricity production and exports

ISILDA MARA

**Our forecasts are largely unchanged from the spring, and we continue to expect the economy to remain strong and grow above 4% in the medium term. Both domestic and external demand will support growth. Higher international oil prices should mean higher investments and exports in this sector. Public private partnership projects must be transparent and well monitored in order to avoid rises in public debt. Tangible progress of judicial system reform is critical for the start of EU membership talks.**

**Figure 36 / Albania: Main macroeconomic indicators**




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

**The start of EU membership talks has been postponed until June 2019.** The fight against corruption and judicial system reform remain the key areas where Albania should demonstrate tangible progress according to the Commission. The implementation of a vetting law[26] in the judicial system has started. The opposition led by Lulzim Basha has asked for extending the vetting law also to politicians. A draft law has been amended and sent to the advisory body of the Council of Europe on constitutional matters known as the Venice Commission. Meanwhile, there are a number of success stories about criminal gangs being arrested and tonnes of cannabis being sequestered, especially in collaboration with international partners; a number of judges and prosecutors have been expelled from the judicial system. Nevertheless, these achievements, so far, do not suffice to ensure that the reform is properly geared towards a radical transformation of a highly corrupted judicial and political system.

[26] The vetting law is part of the judicial system reform. The law aims to rid the justice system of corrupt judges and prosecutors. This reform is one of the EU requirements for opening accession talks with Albania.

**Growth is continuing on its upward path.** In the first half of 2018 the economy grew by 4.4% year on year. The main growth driver was industrial production, especially electricity. Thanks to heavy rainfalls during the first half of 2018 electricity production doubled while its exports were five times higher than for the same period in 2017. Accordingly, the sector contributed to growth by 2.4pp. All main sectors of the economy contributed positively to growth except for construction and information and communications. The contraction of the construction sector contributed to the relatively meagre 3% year-on-year growth in gross fixed capital formation in the first half of 2018. The Trans Adriatic Pipeline (TAP) is approaching its completion and its impact on growth is therefore falling. The announcement by Deutsche Telekom that it will sell its unit in Albania is a symptom of telecommunication sector underperformance.

**Household consumption has been buoyant growing at above 3% in the first half of 2018, year on year.** Labour market indicators slightly improved in the same period. Still, in the second quarter of 2018, the unemployment rate among males rose by 0.3pp, to 12.9%. High unemployment among the youth persists, with a rate of 22.6% in Q2 2018 – despite having dropped by 4pp compared with Q2 2017. Wages rose by 2.3% in the same period, year on year. This rise can be considered more of an indexation taking into account that consumer price inflation hovered at 2.1% in January-August 2018. Actually, consumption might have been backed by rising remittances, at 11% in the first half of 2018, year on year, and this due to the revival of emigration.

**For an emerging economy such as Albania, demographics matter**. Starting with visa liberalisation in 2011, 126,000 Albanians have left the country. Net outward migration corresponds to 4.4% of the total population as of January 2018. Indirect statistics of Eurostat indicate that more than 172,000 Albanians submitted an asylum application in the EU-28 during the January 2011-August 2018 period – a rate close to 6% of the current total population.[27] According to the World Economic Forum[28], Albania has a low capacity – which is in a continuous decline – to retain, attract or efficiently use talents. Remittances are likely to grow because of this new wave of migration. Their amount was close to 70% of FDI or 6% of GDP in the first half of 2018. Therefore the government should think of introducing new policy instruments which might contribute to allocating remittances more into investments as such boosting job creation and entrepreneurship. Incentives to invest into those sectors that favour youth employment are central.

**Despite the budget surplus, the public debt-to-GDP ratio remains high**. Between January and August 2018 revenues rose by 3% (1% below expectations) while expenditures grew by 1.7% (2% below expectations). A general government budget in surplus certainly brings down the public debt. Nevertheless we expect a public debt-to-GDP ratio of 68% by the end of 2018, a ratio which is relatively high for introducing fiscal stimulus. For 2019 the government has announced a further rise in wages and cuts in personal income taxes – lower income taxes for high-income earners – and cuts in corporate income taxes down to 8% or 10% compared with the current 15% tax rate. Also, starting in 2019, a new ‘baby bonus’ has been announced aiming at tackling the decline in population growth. In October 2018 the government issued a Eurobond of EUR 500 million in international financial markets. Part of the new debt will support government finances. Another part of EUR 200 million will serve to pay back the previous debt issued in 2015. The new debt has better conditions because it was issued at a lower interest rate – 3.55% vs 5.7% – and has a longer duration – seven vs five years – than the Eurobond

[27] Source: Eurostat – Asylum and first time asylum applicants by citizenship, age and sex Monthly data (rounded) [migr_asyappctzm]. Last update: 26-09-2018.

[28] http://reports.weforum.org/global-competitiveness-index-2017-2018/countryeconomy-profiles/

issued in 2015. Certainly the lower interest rates and the appreciation of the domestic currency are expected to push down the costs of external debt.

**Despite the strong appreciation of the lek, exports picked up**. The local currency appreciated by more than 7% between the start of the year and June 2018. However, exports of goods have been recovering and rose by more than 16% in January to August 2018. A strong expansion in exports was recorded for the group 'Minerals, fuels, electricity'. Imports of goods rose by 4% and imports of machinery increased by 8% in the same period year on year. Tourism performance has been on the rise continuously – almost 2.6 million tourists in January-August 2018, a 12% increase against the same period of 2017. FDI increased by 19% in the first half of 2018, year on year, but the reason behind was mainly high disbursements for TAP in this time span. Meanwhile, Bankers Petroleum, the largest oil producer in the country, run by the Chinese company Geo-Jade has announced that in 2019 – eased by high international oil prices – it is planning to increase production and to invest USD 158 million in new wells.

**The government is progressing with the USD 1 billion programme for infrastructure in the form of public-private partnerships (PPP)**. In this frame, in June 2018 the construction of the Arbri highway was launched. This infrastructure project, worth EUR 240 million, is expected to be completed within three years. It is 75 km long and will connect the central and north-east parts of the country. The Trans Adriatic Pipeline is approaching its finalisation and gas delivery is expected to start by 2020. Accordingly, a number of project proposals, aiming at exploiting the natural gas supply through TAP, are developing. In spring 2018 the government received a project proposal by Ivicom Holding GmbH, based in Austria, to build a 500 MV power plant that will produce electricity with gas supplied via TAP. The project has gained the status of strategic investment; its estimated costs are EUR 350 million and will be privately funded.

**Loose monetary policy is expected to continue in 2019.** An unprecedented supply of euros in the domestic market – partly driven by a peak in the tourism season, FDI inflows and partly by illicit activities – resulted in a strong appreciation of the lek. During June-August 2018 the Central Bank had to intervene in order to prevent a further over-appreciation of the lek. The inflation hovered at around 2.1% – below the target level of 3% – in January-August 2018; as such it did not follow the rise in aggregate domestic demand. The loose monetary policy has not produced the desired effect on demand for credit. Against the expectations, demand for credit remained weak: among businesses it shrank by 3% in January-August 2018; among individuals it slightly recovered in July-August 2018. Nonperforming loans continued on their downward trajectory, dropping to 12.9 % in August 2018, compared to 15% recorded in August 2017. The Central Bank has announced to continue with its easing monetary policy by keeping interest rates at 1% until the second quarter of 2019.

**Overall, in the medium term we expect growth to increase further supported by stronger domestic and external demand.** Consumption is expected to remain strong boosted by improvements in the labour market and the rise in remittances. Government efforts to promote infrastructure projects via PPP need to be transparent and well monitored in order to avoid rises in public debt. Higher oil prices are expected to revive investments in the extraction industry and will push up exports in this sector. Rising tourism and a more competitive services sector are expected to boost growth. We therefore expect growth to remain strong and at above 4% in the medium term, similar to our spring forecasts.

## Table 11 / Albania: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 2,889 | 2,881 | 2,876 | 2,873 | . | . | 2,870 | 2,868 | 2,867 |
| Gross domestic product, ALL bn, nom. | 1,395 | 1,434 | 1,475 | 1,553 | 763 | 806 | 1,600 | 1,700 | 1,800 |
| annual change in % (real) | 1.8 | 2.2 | 3.4 | 3.8 | 4.1 | 4.4 | 4.1 | 4.0 | 4.0 |
| GDP/capita (EUR at PPP) | 8,300 | 8,600 | 8,500 | 8,700 | . | . | . | . | . |
| Consumption of households, ALL bn, nom. | 1,120 | 1,147 | 1,187 | 1,242 | 628 | 660 | . | . | . |
| annual change in % (real) | 2.8 | 0.9 | 2.6 | 2.7 | 2.3 | 3.2 | 3.0 | 2.5 | 2.5 |
| Gross fixed capital form., ALL bn, nom. | 337 | 350 | 362 | 386 | 170 | 174 | . | . | . |
| annual change in % (real) | -4.5 | 3.5 | 3.3 | 6.5 | 10.8 | 2.8 | 6.0 | 5.2 | 5.5 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 1.5 | -2.1 | -18.0 | -0.6 | 4.2 | 25.2 | 12.0 | 4.0 | 3.0 |
| Gross agricultural production 2) | | | | | | | | | |
| annual change in % (real) | 1.4 | 2.6 | 3.3 | 4.0 | . | . | . | . | . |
| Construction output total | | | | | | | | | |
| annual change in % (real) | 5.0 | 19.4 | 5.1 | 19.6 | 29.1 | 0.8 | . | . | . |
| Employed persons, LFS, th | 1,037 | 1,087 | 1,157 | 1,195 | 1,179 | 1,227 | 1,230 | 1,260 | 1,300 |
| annual change in % | 1.3 | 4.8 | 6.5 | 3.3 | 3.5 | 4.1 | 2.9 | 2.4 | 3.2 |
| Unemployed persons, LFS, th | 220 | 224 | 208 | 190 | 192 | 174 | 170 | 180 | 180 |
| Unemployment rate, LFS, in % | 17.5 | 17.1 | 15.2 | 13.7 | 14.1 | 12.5 | 12.4 | 12.2 | 12.0 |
| Reg. unemployment rate, in %, eop | 13.0 | 12.9 | 8.8 | 7.2 | 7.8 | 6.9 | . | . | . |
| Average monthly gross wages, ALL | 45,539 | 46,829 | 45,845 | 49,840 | 48,147 | 49,769 | 53,400 | 56,700 | 60,100 |
| annual change in % (real, gross) | -0.7 | 0.9 | -3.4 | 6.6 | 0.5 | 1.3 | 5.0 | 3.5 | 3.0 |
| Consumer prices, % p.a. | 1.6 | 1.9 | 1.3 | 2.0 | 2.2 | 2.1 | 2.1 | 2.5 | 2.9 |
| Producer prices in industry, % p.a. | -0.5 | -2.1 | -1.4 | 2.6 | 3.2 | 1.7 | 3.0 | 2.0 | 2.0 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 26.3 | 26.4 | 27.6 | 27.7 | 27.8 | 26.9 | 27.3 | 28.0 | 28.0 |
| Expenditures | 31.4 | 30.5 | 29.4 | 29.7 | 27.5 | 26.7 | 27.5 | 28.5 | 29.5 |
| Deficit (-) / surplus (+) | -5.2 | -4.1 | -1.8 | -2.0 | 0.4 | 0.2 | -0.2 | -0.5 | -1.5 |
| General gov.gross debt, nat.def., % of GDP | 70.1 | 72.7 | 72.3 | 70.1 | 65.4 | 66.7 | 68.5 | 65.0 | 64.0 |
| Stock of loans of non-fin.private sector, % p.a. | 2.4 | -2.6 | 0.2 | 0.7 | -1.5 | -2.4 | . | . | . |
| Non-performing loans (NPL), in %, eop | 22.8 | 18.2 | 18.3 | 13.2 | 15.6 | 13.3 | . | . | . |
| Central bank policy rate, % p.a., eop 3) | 2.25 | 1.75 | 1.25 | 1.25 | 1.3 | 1.0 | 1.0 | 1.0 | 1.3 |
| Current account, EUR mn | -1,076 | -884 | -812 | -866 | -413 | -338 | -990 | -960 | -950 |
| Current account, % of GDP | -10.8 | -8.6 | -7.6 | -7.5 | -7.3 | -5.5 | -8.0 | -7.2 | -6.7 |
| Exports of goods, BOP, EUR mn | 932 | 771 | 714 | 797 | 398 | 497 | 1,000 | 1,150 | 1,230 |
| annual change in % | -12.7 | -17.2 | -7.4 | 11.7 | 24.4 | 24.8 | 25.0 | 15.0 | 7.0 |
| Imports of goods, BOP, EUR mn | 3,147 | 3,070 | 3,317 | 3,621 | 1,680 | 1,795 | 4,090 | 4,500 | 4,820 |
| annual change in % | 3.9 | -2.5 | 8.0 | 9.2 | 6.6 | 6.8 | 13.0 | 10.0 | 7.0 |
| Exports of services, BOP, EUR mn | 1,881 | 2,028 | 2,396 | 2,856 | 1,270 | 1,366 | 3,260 | 3,750 | 4,200 |
| annual change in % | 9.7 | 7.8 | 18.1 | 19.2 | 26.2 | 7.5 | 14.0 | 15.0 | 12.0 |
| Imports of services, BOP, EUR mn | 1,558 | 1,503 | 1,599 | 1,774 | 786 | 846 | 2,060 | 2,260 | 2,420 |
| annual change in % | 4.6 | -3.5 | 6.4 | 11.0 | 11.0 | 7.7 | 16.0 | 9.5 | 7.0 |
| FDI liabilities, EUR mn | 869 | 890 | 943 | 900 | 386 | 494 | 880 | . | . |
| FDI assets, EUR mn | 58 | 72 | 6 | -94 | -46.5 | -21.4 | 50 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 2,142 | 2,831 | 2,889 | 2,941 | 2,760 | 2,904 | . | . | . |
| Gross external debt, EUR mn | 6,927 | 7,634 | 7,882 | 7,928 | 7,859 | 8,111 | 8,500 | 9,000 | 9,500 |
| Gross external debt, % of GDP | 69.5 | 74.4 | 73.4 | 68.5 | 67.9 | 65.1 | 68.0 | 67.0 | 67.0 |
| Average exchange rate ALL/EUR | 139.97 | 139.74 | 137.36 | 134.15 | 135.13 | 129.96 | 128.5 | 127.0 | 126.5 |

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

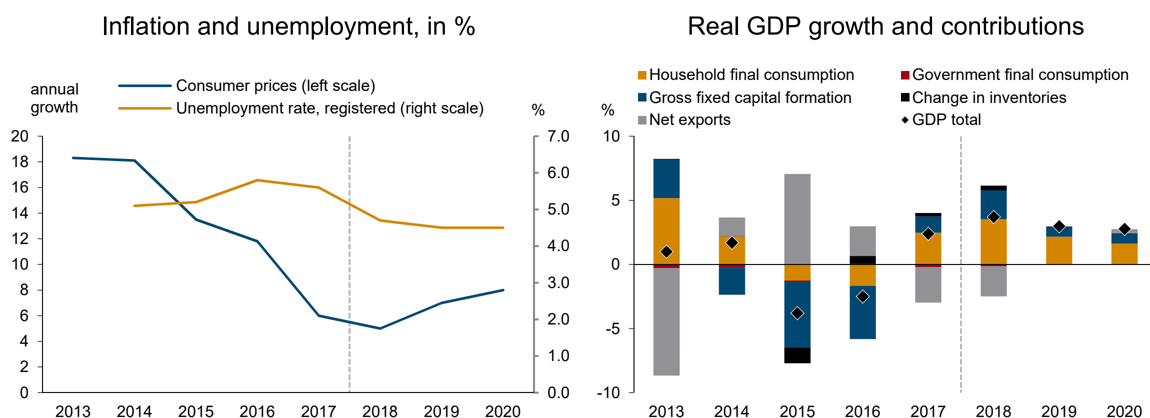
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

# BELARUS: Recovery driven by external factors and policy stimulus

RUMEN DOBRINSKY

**The economy has rebounded thanks to an improving external environment and a policy stimulus engineered through wage rises. Real disposable income rose sharply supporting an upturn in private consumption. GDP growth was entirely driven by domestic demand while net exports made a negative contribution. Recent indicators suggest that growth has passed its peak and will decelerate. In 2018 as a whole GDP could rise by 3.7%, but thereafter will likely slow down to around 3% in the following years.**

**Figure 37 / Belarus: Main macroeconomic indicators**




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

**The average rate of GDP growth in the first half of the year (4.5%) was well above expectations.** The economy rebounded strongly in the first quarter with GDP growing by 5.2% year on year, but its growth moderated to 3.9% in the second quarter. The most recent developments seem to indicate that growth may further decelerate in the short term.

**The notable recovery in output at the beginning of 2018 followed several years of sluggish economic performance.** The upturn resulted from a combination of a favourable external environment and a strong policy push. Rising oil prices and the recovery of Russian import demand supported a sharp upturn in manufacturing (gross manufacturing output grew by 7.4% year on year in January-August), as well as in merchandise exports (by 19.2% year on year in current dollar terms in January-July). Exports of services also grew strongly.

**In addition to the improving external economic environment, the recovery was also supported by policy stimulus**. This was engineered mainly by increasing wages in the public sector which started in the second half of 2017 and continued through 2018. Consequently, wage rises proliferated in the whole economy and as a result average real wages in Belarus grew by 13.4% year on year in the first half of 2018, while real disposable income grew by 7.7% year on year in January-July. The surge in real disposable income and the rising consumer sentiment produced a sharp upturn in private consumption which increased by almost 10% year on year in the first six months of 2018. Private consumption was boosted further by a significant rise in consumer credit (the stock of such credit grew by 31% year on year in September 2018).

**As an indication of the improving business expectations, gross fixed capital formation also rebounded in 2018**. It grew by an impressive 17% year on year in the first quarter and 7% in Q2, resulting in an overall year-on-year growth of 11.2% in the first six months. Improving business sentiment and the resumption of public investment projects contributed to this upturn. Thus economic growth in the first half of the year was supported by both external factors and domestic demand. In statistical terms, since the third quarter of 2017, GDP growth has been driven by domestic demand (both private consumption and fixed investment) while with the recovery of import demand, net exports have made a persistently negative contribution to GDP growth.

**However, recent short-term economic indicators suggest that GDP growth may have passed its peak, and will likely decelerate in the near future**. Growth of gross industrial output fell from 9.3% in the first quarter to 6.2% in Q2, and will probably be below 5% in the third quarter. In current dollar terms, the rate of growth of the exports of goods (balance-of-payments statistics) fell from 26.8% year on year in the first quarter to 14.6% in the second quarter. The current slowdown likely reflects the phasing out of both the windfall effect of the rising oil prices and of the push generated by the wage stimulus. Obviously, the latter should also be regarded as a one-off factor as a continuation of persistently and disproportionately rising wages could lead to macroeconomic destabilisation.

**Recently the National Statistical Committee of Belarus started publishing the results of labour force surveys conducted in accordance with the ILO methodology.** Thus, in addition to the statistics on registered unemployment, for the first time there are more reliable official estimates of the level of unemployment in the country. According to these data, the rate of unemployment in the first half of 2018 was 4.9%, down from 6% a year earlier. At the same time, all indications are that the recovery did not contribute to a significant net new job creation. This likely reflects the ongoing restructuring of some large SOEs which is associated with a lasting process of labour shedding and a concomitant shrinking of the labour force.

**So far the loosening of wage policy in Belarus has not translated into inflationary pressure**. Somewhat surprisingly, CPI growth continued to decelerate in the first half of the year and average annual inflation in 2018 will probably be the lowest on record. This was partly the result of the tight monetary stance (which has been in place during the past 3-4 years) and the continued reduction in the allocations of directed credit to state-owned firms. However, given that the rise in real wages has considerably surpassed productivity growth, it may be just a matter of time until both cost push and demand pull factors start driving inflation up.

**Belarus's current account deficit rose slightly year on year in the first half of 2018 but remains under control**. Rising domestic demand produced a deterioration in the balance of trade in goods but this was partly compensated by an improving balance on the services account. In the same period, the country's fiscal position improved mostly thanks to rising budget revenue from VAT and export taxes.

**In August, President Lukashenko, who is endowed with wide-ranging constitutional powers, executed an almost complete changeover of the government**. This included changes at the prime minster level and at most of the key ministries. The official justification of this shakeup was to revitalise the government's efforts towards implementing the policy course prescribed from the top and thus to invigorate economic performance.

**However, it is unlikely that these measures will produce the expected results**. The main problems that the authorities are facing at present seem to be associated with the policy course itself and not in the people entrusted with its implementation. In particular, the reluctance of the administration to engage in some unfinished market reforms such as the restructuring of the large state-owned enterprises and, related to that, the reform of the labour market as well as the further liberalisation of domestic markets. Due to the hesitancy of the authorities to make concrete commitments in these areas, Belarus did not manage to conclude an agreement on a new IMF-supported programme in 2017; the resumption of these negotiations is scheduled only for 2020.

**In these circumstances Belarus continues to depend on Russia to a large degree as a source of external funding**. In 2018 the two countries resumed negotiations for a new funding agreement amounting to USD 1.4bn, which is mostly intended for the refinancing of past debt. Belarus also hopes to receive the remaining USD 400m from the USD 2bn funding agreement with the Eurasian Development Bank concluded in 2016 in the final months of 2018 and the beginning of 2019. The disbursement of the last tranches was temporarily halted at the beginning of the year due to the delays on the Belarusian side in implementing some of the committed policy measures.

**During the first half of 2018 the forex market remained more or less balanced**. There were no big fluctuations in the nominal exchange rate whereas the real effective rate continued to appreciate. This reflects, among other factors, the positive net inflow of forex on the market which also contributed to a rise in international reserves.

**However, Belarus will continue to face balance-of-payments challenges in the years ahead due to the large stock of public foreign debt**. According to some estimates the annual servicing of this debt in the coming years will amount to around 7% of GDP. Therefore there will be a dire need for new external borrowing for the refinancing of the debt and most likely Belarus will need to seek access to the international financial markets.

**The short-term prospects for the Belarusian economy remain generally favourable but have deteriorated since the previous forecast**. In 2018 as a whole GDP should grow by 3.7% but growth will likely decelerate to around 3% in the following years due to the gradual phasing out of the effects generated by positive external factors and loose domestic policy. While oil prices are expected to remain at levels that are favourable for Belarus, this would not generate new impulses of economic activity. In turn, the government does not have many degrees of freedom to continue the current course of policy loosening for an extended period of time as it may endanger macroeconomic stability in the country. If policy-makers remain committed to stability (as they have been claiming recently), they will need to reduce or withdraw the stimulus altogether in the near future. This would lead to a further moderation of growth. Future growth will also depend on the situation in the world oil market and the state of the Russian economy, Belarus's main trading partner. There are no imminent risks to macroeconomic stability but inflation is likely to accelerate in the coming years.

## Table 12 / Belarus: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 January-June | 2018 January-June | 2018 Forecast | 2019 Forecast | 2020 Forecast |
|---|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 9,475 | 9,490 | 9,502 | 9,498 | . | . | 9,480 | 9,450 | 9,420 |
| Gross domestic product, BYN mn, nom. | 80,579 | 89,910 | 94,949 | 105,199 | 47,642 | 55,910 | 114,500 | 126,200 | 140,100 |
| annual change in % (real) | 1.7 | -3.8 | -2.5 | 2.4 | 1.1 | 4.5 | 3.7 | 3.0 | 2.8 |
| GDP/capita (EUR at PPP) | 13,900 | 13,900 | 13,300 | 13,700 | . | . | . | . | . |
| Consumption of households, BYN mn, nom. | 42,082 | 47,006 | 51,122 | 57,022 | 26,607 | 30,600 | . | . | . |
| annual change in % (real) | 4.3 | -2.4 | -3.2 | 4.6 | 1.2 | 9.6 | 6.5 | 4.0 | 3.0 |
| Gross fixed capital form., BYN mn, nom. | 26,772 | 25,763 | 24,155 | 26,312 | 10,253 | 12,780 | . | . | . |
| annual change in % (real) | -5.7 | -15.5 | -14.5 | 5.0 | -2.2 | 11.5 | 9.0 | 3.0 | 3.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 1.9 | -6.6 | -0.4 | 6.1 | 6.1 | 7.8 | 6.0 | 4.0 | 3.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 3.1 | -2.5 | 3.3 | 4.2 | -0.8 | 1.7 | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | -5.7 | -11.3 | -14.8 | -3.7 | . | . | . | . | . |
| Employed persons, LFS, th | . | . | 4,862 | 4,902 | . | . | 4,920 | 4,900 | 4,880 |
| annual change in % | . | . | . | 0.8 | . | . | 0.4 | -0.4 | -0.4 |
| Unemployed persons, LFS, th | 267 | 273 | 302 | 293 | 310 | 250 | 243 | 231 | 230 |
| Unemployment rate, LFS, in % | 5.1 | 5.2 | 5.8 | 5.6 | 6.0 | 4.9 | 4.7 | 4.5 | 4.5 |
| Reg. unemployment rate, in %, eop | 0.5 | 1.0 | 0.8 | 0.5 | 0.8 | 0.4 | 0.4 | 0.4 | 0.4 |
| Average monthly gross wages, BYN | 605.2 | 671.5 | 722.7 | 822.8 | 767 | 909 | 960 | 1,060 | 1,170 |
| annual change in % (real, gross) | 1.3 | -2.3 | -3.8 | 7.5 | 2.6 | 13.3 | 10.0 | 3.0 | 2.0 |
| Consumer prices, % p.a. | 18.1 | 13.5 | 11.8 | 6.0 | 6.9 | 4.7 | 5.0 | 7.0 | 8.0 |
| Producer prices in industry, % p.a. 2) | 12.4 | 17.2 | 12.0 | 9.8 | 9.1 | 7.1 | 8.0 | 9.0 | 10.0 |
| General governm.budget, nat. def., % of GDP | | | | | | | | | |
| Revenues | 38.9 | 41.3 | 40.9 | 40.7 | 42.1 | 43.7 | 41.0 | 40.0 | 39.0 |
| Expenditures | 37.8 | 39.9 | 39.4 | 37.8 | 38.9 | 37.6 | 38.0 | 38.0 | 38.0 |
| Deficit (-) / surplus (+) | 1.0 | 1.4 | 1.5 | 3.0 | 3.2 | 6.1 | 3.0 | 2.0 | 1.0 |
| General gov.gross debt, nat. def., % of GDP 3) | 38.0 | 53.0 | 53.9 | 48.0 | . | . | 47.0 | 46.0 | 45.0 |
| Stock of loans of non-fin.private sector, % p.a. | 21.1 | 19.4 | -6.2 | 7.2 | -7.5 | 10.3 | . | . | . |
| Non-performing loans (NPL), in %, eop | 4.4 | 6.8 | 12.8 | 12.9 | . | . | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 20.0 | 25.0 | 18.0 | 11.0 | 13.0 | 10.0 | 10.0 | 11.0 | 11.0 |
| Current account, EUR mn 5) | -4,057 | -1,669 | -1,465 | -761 | -308 | -684 | -1,200 | -1,400 | -1,600 |
| Current account, % of GDP | -6.7 | -3.3 | -3.4 | -1.6 | -1.3 | -2.9 | -2.5 | -2.8 | -3.1 |
| Exports of goods, BOP, EUR mn 5) | 27,492 | 23,854 | 20,988 | 25,421 | 12,503 | 13,369 | 27,100 | 29,100 | 30,300 |
| annual change in % | -0.8 | -13.2 | -12.0 | 21.1 | 28.2 | 6.9 | 6.6 | 7.4 | 4.1 |
| Imports of goods, BOP, EUR mn 5) | 29,537 | 25,807 | 23,270 | 27,956 | 13,280 | 14,521 | 30,100 | 32,200 | 33,300 |
| annual change in % | -5.3 | -12.6 | -9.8 | 20.1 | 23.3 | 9.3 | 7.7 | 7.0 | 3.4 |
| Exports of services, BOP, EUR mn 5) | 6,115 | 6,048 | 6,203 | 6,944 | 3,310 | 3,441 | 7,300 | 7,800 | 8,100 |
| annual change in % | 7.5 | -1.1 | 2.6 | 11.9 | 20.9 | 3.9 | 5.1 | 6.8 | 3.8 |
| Imports of services, BOP, EUR mn 5) | 4,449 | 4,003 | 3,950 | 4,248 | 1,932 | 2,015 | 4,400 | 4,700 | 5,000 |
| annual change in % | 11.7 | -10.0 | -1.3 | 7.5 | 5.8 | 4.3 | 3.6 | 6.8 | 6.4 |
| FDI liabilities, EUR mn 5) | 1,445 | 1,506 | 1,133 | 1,130 | 808 | 923 | 1,300 | . | . |
| FDI assets, EUR mn 5) | 57 | 97 | 112 | 60 | 30 | 12 | 100 | . | . |
| Gross reserves of NB excl. gold, EUR mn 5) | 2,820 | 2,510 | 3,071 | 4,502 | 4,233 | 4,259 | . | . | . |
| Gross external debt, EUR mn 5) | 32,982 | 34,996 | 35,930 | 33,443 | 34,119 | 33,756 | 33,500 | 33,900 | 34,200 |
| Gross external debt, % of GDP | 54.1 | 69.4 | 83.3 | 69.4 | 70.8 | 70.8 | 70.3 | 68.5 | 66.0 |
| Average exchange rate BYN/EUR | 1.3220 | 1.7828 | 2.2010 | 2.1833 | 2.0345 | 2.3969 | 2.4 | 2.6 | 2.7 |

1) Preliminary. - 2) Domestic output prices. - 3) Including publicly guaranteed debt. - 4) Refinancing rate of NB. - 5) Converted from USD.

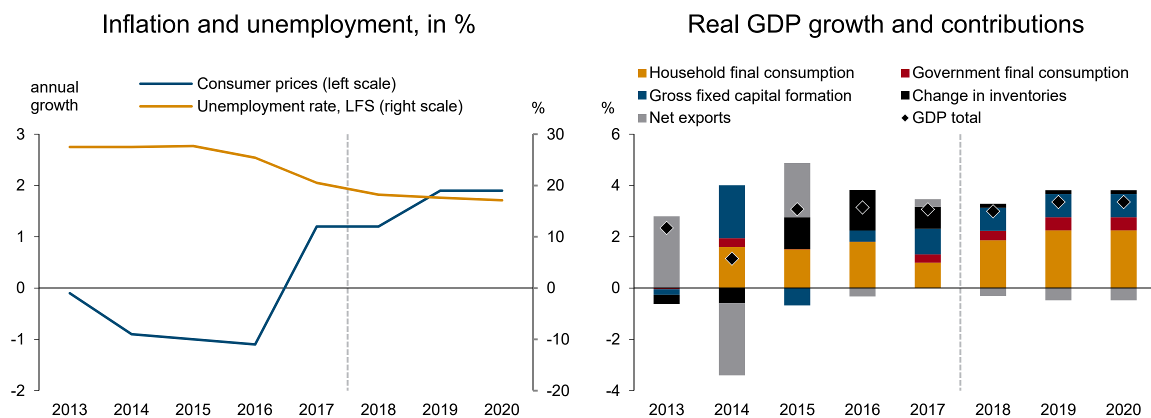
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

# BOSNIA AND HERZEGOVINA: Elevated political risk unlikely to derail growth

RICHARD GRIEVESON

**Political risk is unusually high following the recent election, and in particular the potential for a constitutional crisis in the Federation. This will have an impact on reforms and policy-making, but shouldn't impact growth too much. We think that growth will remain in the range of 3-3.5% during the forecast period, with external factors such as remittances, exports and tourism likely to remain important. Inflation will stay low, while the labour market will improve slowly.**

**Figure 38 / Bosnia and Herzegovina: Main macroeconomic indicators**




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

**The outcome of the election on 7 October was inconclusive, and as such is unlikely to ease the political crisis in Bosnia and Herzegovina (BiH).** Voters went to the polls to elect a new parliament, assemblies in both entities, ten cantonal assemblies in the Federation, and the three-member national presidency. In total 518 positions were up for election. Milorad Dodik, the nationalist president of the Republika Srpska, looks to have won the Serb seat in the tripartite national presidency. He is likely to use his position to continue to push for the separation of Republika Srpska from the rest of BiH. Šefik Džaferović won the Bosniak seat, and Željko Komšić the Croat seat.

**Political noise around elections is nothing new in BiH, but a particular issue this time is whether the results in the Federation will be accepted, and this could prolong political stasis for some time.** As a result, we think that political risks in the country are even higher than is normally the case. Currently there is no legal basis for the election of the Federation's House of Peoples, meaning that a constitutional crisis is possible. Whatever happens, this will hamper efforts to form a new government at both the Federation and national level. In addition to this constitutional uncertainty, there were allegations of fraud and manipulation in the election. Heightened political risk in the region, related to discussions over a possible land swap between Serbia and Kosovo, could also have big implications for Bosnia and Herzegovina.

**Broad financial and macroeconomic stability looks relatively secure for now.** The major rating agencies have not changed their assessments of BiH, indicating that political noise is already baked into foreign investor expectations (despite some fiscal loosening ahead of the election). Most of the funding for the country's large current account deficit is concessional and long-term in nature, further reducing stability risks. The IMF postponed disbursements under the Extended Fund Facility (EFF) programme earlier this year, reflecting pre-election reform stasis. It is likely that it will take some time to restart the EFF programme, but this is not necessarily a big problem, at least from the perspective of fiscal sustainability. The bigger issue around the EFF is that it is an important stability and reform anchor, but we expect it to eventually resume.

**The economy is doing reasonably well, and this should continue into 2019, with growth set to remain in the 3-3.5% range during the forecast period.** Private consumption will be the main driver, helped by rising wages and its particularly large share in overall GDP. High-frequency indicators suggest good underlying momentum, with industrial production, retail sales and construction output all growing at healthy rates. Meanwhile inflation remains low, and this is likely to remain the case (in line with eurozone trends), providing further support for real income growth.

**External factors have been particularly supportive in driving growth in recent years, which has been important given generally subdued trends in domestic consumption and investment.** As a result of this, the economy has become more open, with exports of goods and services now accounting for around 40% of GDP, from 25% in 2009. Latest data indicate that this is continuing: nominal euro-denominated merchandise exports increased by an average 13% year on year in the 12 months to August, with total tourist nights up 14.2% over the same period. Remittances have also risen strongly.

**The importance of external factors for driving growth insulates the economy somewhat from domestic political noise.** However, it also makes the country more exposed to an external slowdown than would otherwise have been the case. Momentum has already slowed in the EU, BiH's main export market, and the threat of a global trade war could exacerbate this. Notably, tourism sources are becoming more diversified. The latest data show that, while Croatia, Serbia, Turkey and Italy remain the main sources, inflows from countries such as China and Saudi Arabia are also growing quickly.

**Although the economy has become much more open, the export structure remains quite dominated by low value goods.** So far, BiH has had limited success in attempts to move up the value chain. Political factors may be dissuading bigger investors from committing long-term capital in the same way as has been seen in some regional peers. The strong performance of the external sector (trade, remittances and tourism) has kept the current account deficit roughly steady over the past year

(measured as the four quarters to Q2 2018 versus the same period a year earlier). A wider goods deficit (owing to the much bigger absolute size of imports versus exports) was largely offset by stronger surpluses on the services and secondary income accounts, helped by tourism and remittances, respectively.

**Decent growth trends have done little to alleviate the major structural issues in the labour market.** The unemployment rate has reached a historically low level, but still stood at 36% in July (registration data basis). Female unemployment on the same basis was 42.3%. However, while BiH is not suffering labour shortages in the same way as many other CESEE countries, skills shortages have been reported in certain sectors. The weakness of the labour market is likely to be one factor contributing to continued pessimism about the future among Bosnians. The 2018 Balkan Barometer, produced by the Regional Cooperation Council, again showed Bosnians as the region's least hopeful citizens about their economic future.

**Conditions in the banking sector should continue to improve, with decent economic growth helping to drive a further improvement in asset quality.** The ratio of non-performing loans (NPLs) to total loans fell to 9.3% in June 2018, its lowest level since 2010. Meanwhile credit growth is continuing to rise. Loans to the non-private financial sector rose by around 8% in the year to August 2018.

**In summary our forecasts are largely unchanged from our previous forecast.** We still think that a growth rate of around 3.5% during the medium term is achievable, with external factors more important than during the historical period, and very little inflation (in line with eurozone trends). The main risk to our forecast comes from political factors, with risks more elevated than usual (owing to both domestic and regional developments).

## Table 13 / Bosnia and Herzegovina: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., mid-year | 3,526 | 3,518 | 3,511 | 3,505 | . | . | 3,506 | 3,503 | 3,499 |
| Gross domestic product, BAM mn, nom. 2) | 27,359 | 28,586 | 29,900 | 31,332 | 14,892 | 15,600 | 32,700 | 34,400 | 36,200 |
| annual change in % (real) | 1.1 | 3.1 | 3.1 | 3.1 | 3.4 | 2.7 | 3.0 | 3.4 | 3.4 |
| GDP/capita (EUR at PPP) 2) | 8,300 | 8,700 | 9,000 | 9,300 | . | . | . | . | . |
| Consumption of households, BAM mn, nom. 2) | 22,830 | 23,157 | 23,653 | 24,347 | . | . | . | . | . |
| annual change in % (real) | 1.9 | 1.8 | 2.2 | 1.2 | . | . | 2.4 | 2.9 | 2.9 |
| Gross fixed capital form., BAM mn, nom. 2) | 5,330 | 5,097 | 5,189 | 5,653 | . | . | . | . | . |
| annual change in % (real) | 11.5 | -3.5 | 2.5 | 5.8 | . | . | 5.0 | 5.0 | 5.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 0.2 | 3.1 | 4.4 | 3.2 | 2.2 | 3.1 | 3.3 | 3.0 | 2.8 |
| Gross agricultural production 3) | | | | | | | | | |
| annual change in % (real) | -16.8 | 12.6 | 12.0 | 4.1 | . | . | . | . | . |
| Construction output total | | | | | | | | | |
| annual change in % (real) | 6.3 | 1.7 | -2.2 | -1.3 | -2.3 | 1.2 | . | . | . |
| Employed persons, LFS, th, April | 812.0 | 822.0 | 801.0 | 815.7 | 815.7 | 822.4 | 830 | 840 | 850 |
| annual change in % | -1.2 | 1.2 | -2.6 | 1.8 | 1.8 | 0.8 | 1.8 | 1.5 | 1.3 |
| Unemployed persons, LFS, th, April | 308.0 | 315.0 | 273.0 | 210.7 | 210.7 | 185.5 | 185 | 180 | 175 |
| Unemployment rate, LFS, in %, April | 27.5 | 27.7 | 25.4 | 20.5 | 20.5 | 18.4 | 18.2 | 17.6 | 17.1 |
| Reg. unemployment rate, in %, eop | 43.6 | 42.9 | 40.9 | 38.7 | 39.3 | 35.7 | . | . | . |
| Average monthly gross wages, BAM | 1,290 | 1,289 | 1,301 | 1,321 | 1,316 | 1,348 | 1,350 | 1,390 | 1,430 |
| annual change in % (real, gross) | 0.8 | 1.0 | 2.0 | 0.4 | 0.5 | 1.3 | 1.1 | 0.9 | 0.8 |
| Average monthly net wages, BAM | 831 | 830 | 838 | 851 | 848 | 867 | 870 | 900 | 930 |
| annual change in % (real, net) | 1.3 | 1.0 | 2.0 | 0.4 | 0.5 | 1.2 | 1.0 | 1.0 | 0.9 |
| Consumer prices, % p.a. | -0.9 | -1.0 | -1.1 | 1.2 | 1.1 | 1.1 | 1.2 | 1.9 | 1.9 |
| Producer prices in industry, % p.a. | -0.5 | 0.6 | -2.1 | 3.0 | 2.6 | 3.6 | 1.8 | 2.1 | 2.1 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 43.7 | 43.2 | 42.7 | 43.0 | . | . | 42.7 | 42.9 | 43.2 |
| Expenditures | 45.8 | 42.5 | 41.5 | 40.4 | . | . | 41.7 | 42.5 | 42.9 |
| Deficit (-) / surplus (+) | -2.0 | 0.7 | 1.2 | 2.6 | . | . | 1.0 | 0.4 | 0.3 |
| General gov.gross debt, nat.def., % of GDP | 41.6 | 41.9 | 40.5 | 36.2 | . | . | 39.9 | 39.6 | 39.7 |
| Stock of loans of non-fin.private sector, % p.a. | 1.7 | 2.0 | 3.5 | 7.3 | 6.2 | 7.0 | . | . | . |
| Non-performing loans (NPL), in %, eop | 14.2 | 13.7 | 11.8 | 10.0 | 11.1 | 9.3 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | . | . | . | . | . | . | . | . | . |
| Current account, EUR mn 5) | -1,025 | -774 | -711 | -754 | -404 | -392 | -777 | -809 | -840 |
| Current account, % of GDP | -7.3 | -5.3 | -4.7 | -4.7 | -5.3 | -4.9 | -4.6 | -4.6 | -4.5 |
| Exports of goods, BOP, EUR mn 5) | 3,501 | 3,678 | 3,936 | 4,775 | 2,221 | 2,496 | 5,040 | 5,350 | 5,680 |
| annual change in % | 3.0 | 5.1 | 7.0 | 21.3 | 20.5 | 12.4 | 5.5 | 6.1 | 6.1 |
| Imports of goods, BOP, EUR mn 5) | 7,527 | 7,355 | 7,546 | 8,551 | 4,052 | 4,332 | 8,960 | 9,430 | 9,920 |
| annual change in % | 7.1 | -2.3 | 2.6 | 13.3 | 13.2 | 6.9 | 4.8 | 5.2 | 5.2 |
| Exports of services, BOP, EUR mn 5) | 1,252 | 1,419 | 1,514 | 1,654 | 736 | 771 | 1,750 | 1,850 | 1,960 |
| annual change in % | 2.4 | 13.3 | 6.7 | 9.2 | 9.8 | 4.7 | 6.1 | 5.9 | 5.9 |
| Imports of services, BOP, EUR mn 5) | 395 | 440 | 450 | 500 | 196 | 223 | 530 | 560 | 600 |
| annual change in % | 0.8 | 11.2 | 2.3 | 11.0 | 7.6 | 13.7 | 6.0 | 6.0 | 7.0 |
| FDI liabilities, EUR mn 5) | 408 | 345 | 256 | 413 | 229 | 231 | 420 | . | . |
| FDI assets, EUR mn 5) | 7 | 85 | -1 | 83 | 33 | 13 | 34 | . | . |
| Gross reserves of NB excl. gold, EUR mn 5) | 3,908 | 4,307 | 4,768 | 5,293 | 4,735 | 5,572 | . | . | . |
| Gross external debt, EUR mn 6) | 7,470 | 7,936 | 8,378 | 8,683 | . | . | 9,080 | 9,620 | 10,199 |
| Gross external debt, % of GDP 6) | 53.4 | 54.3 | 54.8 | 54.2 | . | . | 54.3 | 54.7 | 55.1 |
| Average exchange rate BAM/EUR | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 |

1) Preliminary. - 2) According to ESA'10 (FISIM not yet reallocated to industries). - 3) Based on UN-FAO data, wiiw estimate in 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.

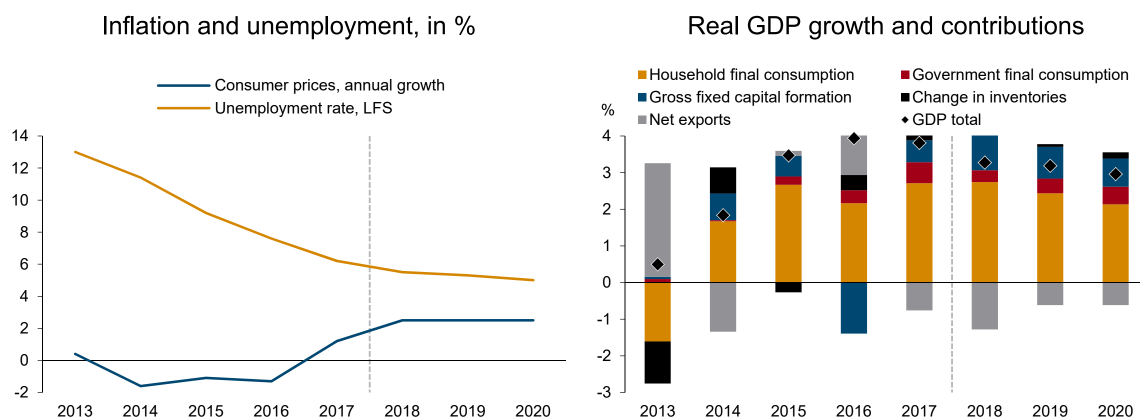
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

# BULGARIA: Further moderation of growth

RUMEN DOBRINSKY

**GDP grew by 3.3% in the first half of 2018 which was below the rates of growth in the three preceding years. The moderation in output growth coincided with a slowdown in exports. The labour market tightened further and labour costs continued to rise. CPI accelerated due to rising energy prices and growing cost-push inflationary pressure. We expect GDP growth for 2018 as a whole of around 3.3%, and it should stay at a similar level in the coming years.**

**Figure 39 / Bulgaria: Main macroeconomic indicators**




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

**Bulgaria's GDP grew by 3.2% year on year in the second quarter after rising by 3.5% in first three months.** The 3.3% average rate of GDP growth in the first half of the year was below the rates recorded in the three preceding years.

**The moderation in output growth coincided with a slowdown in export growth, which started in 2017 and continued during the first half of 2018.** This pattern of export performance reflects the combined outcome of two opposite trends: a decline in exports to non-EU countries and continued growth of exports to the EU. The reported drop in exports to the non-EU area in the second half of 2017 and the first half of 2018 is at least partly owing to a high base period, which had resulted from large one-off export deals executed in 2016. There have been signs that exports to the EU were also losing steam in the course of 2018.

**Manufacturing output in the first three months remained relatively strong, at 4% year on year.** However, its growth decelerated considerably in the following months (to 1.4% year on year in the second quarter) and recent business sentiment surveys suggest that this slowdown is likely to continue mostly due to decreasing new orders, especially for exports.

**Aggregate output growth in the first six months of 2018 was exclusively driven by domestic demand**. Both private consumption and fixed investment contributed positively to GDP growth while net exports made a large negative contribution. Gross fixed capital formation rebounded strongly in the first half of the year, reflecting the full-scale resumption of public investment programmes supported by EU funds. Thus public investment in the period January-August was up by 54.3% from the same period of the previous year. Private consumption strengthened considerably in the second quarter supported by rising real incomes and an upturn in household credit.

**There was a moderate revival in credit activity in the first half of the year**. This mostly refers to household credit the stock of which increased by 10.0% year on year at the end of July. During the same period the stock of credit to the corporate sector grew by 5.4%.

**The labour market continued to tighten and labour shortages intensified, especially for skilled labour**. According to recent reports by the Employment Agency, labour shortages are the most acute in four economic branches: mechanical engineering, electrical engineering, health care and transportation. In these sectors, the number of posted vacancies was roughly equal to the number of employed in September 2018. According to some estimates, at present about 68% of Bulgarian firms face difficulties in filling their vacancies.

**Labour shortages are already exerting visible constraints on output growth.** A clear indication of this situation is the fact that some businesses have started to turn down new orders quoting this factor as their motive. At present the business sector is lobbying the government to increase the quotas for admitting non-EU citizens to the local labour market.

**Given the situation in the labour market, it is not surprising that nominal wages continued to rise fast during the first half of 2018**. The resulting cost push effect is exerting strong inflationary pressure, and the CPI has also started to rise since the start of 2018, reversing the trends prevailing in the previous five years. Further inflationary pressure was added by higher energy and food prices (the latter was due to the poor vegetable harvest). The resurgence of inflation has somewhat dampened the rise in real wages in 2018, although the latter still remains above productivity growth.

**There have been concerns that the disproportionate rise in real unit labour costs in recent years would erode international competitiveness**. If this were indeed the case, one could have expected a worsening in the country's external balances in recent years. However, this has not been happening; on the contrary, Bulgaria recorded a record-high positive current account balance in 2017. The current account remained in the positive territory in the first half of 2018 as well, although for the year as a whole the surplus is likely to be lower than its 2017 level.

**Such dynamics of the current account balance has several possible explanations**. In the first place, the 2017 current account figure may be regarded as an outlier due to the presence of strong one-off trade effects as discussed above. Second, in absolute terms, Bulgaria's unit labour costs still remain

well below not only those of the older EU Member States but also below those in most EU-CEE countries. A third factor has been the relatively rapid growth in the exports of services in recent years: the positive balance in services trade roughly offsets the negative balance in goods trade. In any case, if real unit labour costs continue their disproportionate growth, sooner or later this will backfire in the form of inflation and widening external imbalances; hence some policy corrections may be needed at some point in the near future.

**The fiscal situation has remained comfortable thanks to rising revenue**. In the period January-August total public revenue increased by 11.6% from the same period of the previous year, a rate of growth that surpassed that of nominal aggregate output. This made it possible for the government to envisage increases in spending above the budget targets. Despite that, the cash fiscal balance until September 2018 was in positive territory, and one could expect that the accrual balance will also remain positive for 2018 as a whole.

**The authorities have made further efforts towards achieving their declared intention for Bulgaria to enter the ERM II**. Although the country formally meets all the criteria, the negotiations with the ECB and the European Commission have been difficult for a number of reasons, including the reluctance of some members of the eurozone to discuss its enlargement before reforming the single currency area itself. As per the latest semi-official communications, Bulgaria could possibly join simultaneously both the ERM II and the Banking Union in mid-2019. Whether this will happen in reality will depend not only on Bulgaria's macroeconomic fundamentals but also on the dynamics of the internal discussions on the future of the eurozone.

**The political situation in the country has been subject to growing instability**. The government comprises a heterogeneous coalition of centrist and nationalist parties and on many occasions it has been difficult to find compromise solutions. So far Boyko Borisov, the longest serving Prime Minister in Bulgaria's recent history, has been able to engineer such compromises, often thanks to ad hoc populist moves. The comfortable fiscal position generates sufficient cushions for such moves. As an example, the government has recently announced its plans to raise wages in the public sector by 10% on average in 2019.

**The prevailing expectations at present are for somewhat weak external demand and moderation of growth**. The ongoing turmoil in the Turkish financial markets may further exacerbate these effects. Thus domestic demand will remain the main growth driver in the short run but obviously it has its limits. Coupled with the effect of intensifying supply constraints caused by labour shortages, the short-term prospects are for continued moderation in economic growth.

**The average GDP growth for 2018 as a whole is expected to be around 3.3% and it should stay in the range of 3% or slightly higher in the coming years.** Inflation will remain in positive territory but should be confined to a range between 2% and 3% provided that growth in labour costs remains under control. There appear to be no imminent threats to macroeconomic stability in the short run.

## Table 14 / Bulgaria: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 7,224 | 7,178 | 7,128 | 7,076 | . | . | 7,000 | 6,950 | 6,900 |
| Gross domestic product, BGN mn, nom. | 83,756 | 88,575 | 94,130 | 101,043 | 45,277 | 48,291 | 107,000 | 113,200 | 119,500 |
| annual change in % (real) | 1.8 | 3.5 | 3.9 | 3.8 | 3.8 | 3.4 | 3.3 | 3.2 | 3.0 |
| GDP/capita (EUR at PPP) | 12,900 | 13,700 | 14,200 | 15,100 | . | . | . | . | . |
| Consumption of households, BGN mn, nom. | 51,963 | 54,831 | 56,715 | 60,694 | 27,834 | 31,146 | . | . | . |
| annual change in % (real) | 2.7 | 4.3 | 3.5 | 4.5 | 4.4 | 7.9 | 4.5 | 4.0 | 3.5 |
| Gross fixed capital form., BGN mn, nom. | 17,653 | 18,612 | 17,484 | 18,717 | 8,344 | 9,382 | . | . | . |
| annual change in % (real) | 3.4 | 2.7 | -6.6 | 3.2 | 3.3 | 8.5 | 7.0 | 4.5 | 4.0 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | 1.8 | 2.9 | 2.7 | 3.4 | 4.4 | 1.4 | 2.0 | 2.0 | 2.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -0.6 | -8.2 | 1.7 | -0.5 | . | . | . | . | . |
| Construction industry 3) | | | | | | | | | |
| annual change in % (real) | 7.0 | 11.1 | -16.7 | 4.6 | 3.4 | 3.1 | . | . | . |
| Employed persons, LFS, th, average | 2,981 | 3,032 | 3,017 | 3,150 | 3,104 | 3,128 | 3,200 | 3,230 | 3,260 |
| annual change in % | 1.6 | 1.7 | -0.5 | 4.4 | 3.3 | 0.8 | 1.5 | 1.0 | 1.0 |
| Unemployed persons, LFS, th, average | 385 | 305 | 247 | 207 | 219 | 185 | 190 | 180 | 170 |
| Unemployment rate, LFS, in %, average | 11.4 | 9.2 | 7.6 | 6.2 | 6.6 | 5.6 | 5.5 | 5.3 | 5.0 |
| Reg. unemployment rate, in %, eop | 10.7 | 10.0 | 8.0 | 7.1 | 6.8 | 5.7 | . | . | . |
| Average monthly gross wages, BGN | 821.7 | 877.9 | 948.3 | 1,060.4 | 1,023.3 | 1,100.8 | 1,150 | 1,240 | 1,330 |
| annual change in % (real, gross) | 7.5 | 7.0 | 8.9 | 9.6 | 8.0 | 5.2 | 6.0 | 5.5 | 5.0 |
| Consumer prices (HICP), % p.a. | -1.6 | -1.1 | -1.3 | 1.2 | 3.6 | 5.7 | 2.5 | 2.5 | 2.5 |
| Producer prices in industry, % p.a. | -1.2 | -2.2 | -3.1 | 5.0 | 4.7 | 4.1 | 4.0 | 3.5 | 3.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 36.6 | 39.1 | 35.2 | 35.3 | . | . | 36.5 | 36.0 | 36.0 |
| Expenditures | 42.0 | 40.7 | 35.0 | 34.4 | . | . | 36.0 | 36.0 | 36.0 |
| Net lending (+) / net borrowing (-) | -5.4 | -1.6 | 0.2 | 0.9 | . | . | 0.5 | 0.0 | 0.0 |
| General gov.gross debt, EU def., % of GDP | 26.9 | 26.0 | 29.0 | 24.8 | . | . | 24.5 | 23.0 | 21.0 |
| Stock of loans of non-fin.private sector, % p.a. | -8.2 | -1.6 | 1.0 | 3.3 | 2.1 | 3.5 | . | . | . |
| Non-performing loans (NPL), in %, eop | 16.7 | 20.4 | 18.3 | 14.8 | 17.0 | 13.1 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 0.02 | 0.01 | 0.00 | 0.00 | 0.00 | 0.00 | 0.0 | 0.0 | 0.0 |
| Current account, EUR mn | 531 | -15 | 1,244 | 3,368 | 967 | -14 | 1,600 | 600 | 500 |
| Current account in % of GDP | 1.2 | 0.0 | 2.6 | 6.5 | 4.2 | -0.1 | 2.9 | 1.0 | 0.8 |
| Exports of goods, BOP, EUR mn | 21,027 | 21,920 | 23,104 | 26,951 | 12,901 | 12,624 | 26,800 | 27,300 | 28,000 |
| annual change in % | -0.9 | 4.2 | 5.4 | 16.6 | 20.3 | -2.1 | -0.6 | 1.9 | 2.6 |
| Imports of goods, BOP, EUR mn | 23,803 | 24,542 | 24,088 | 27,716 | 13,327 | 14,282 | 29,500 | 31,000 | 32,000 |
| annual change in % | -1.4 | 3.1 | -1.8 | 15.1 | 18.1 | 7.2 | 6.4 | 5.1 | 3.2 |
| Exports of services, BOP, EUR mn | 6,787 | 6,967 | 7,688 | 7,813 | 3,126 | 3,456 | 8,200 | 8,600 | 9,000 |
| annual change in % | 15.3 | 2.7 | 10.3 | 1.6 | -3.0 | 10.5 | 4.9 | 4.9 | 4.7 |
| Imports of services, BOP, EUR mn | 4,244 | 3,964 | 4,628 | 5,048 | 2,399 | 2,448 | 5,200 | 5,400 | 5,600 |
| annual change in % | 31.2 | -6.6 | 16.8 | 9.1 | 5.0 | 2.1 | 3.0 | 3.8 | 3.7 |
| FDI liabilities, EUR mn | 803 | 2,342 | 1,390 | 1,896 | 582 | 556 | 900 | . | . |
| FDI assets, EUR mn | 657 | 101 | 774 | 817 | 162 | 506 | 600 | . | . |
| Gross reserves of NB excl. gold, EUR mn 5) | 15,276 | 19,022 | 22,475 | 22,257 | 22,555 | 22,114 | . | . | . |
| Gross external debt, EUR mn 5) | 39,338 | 33,493 | 34,221 | 33,397 | 34,220 | 33,476 | 33500 | 33000 | 32500 |
| Gross external debt, % of GDP 5) | 91.9 | 74.0 | 71.1 | 64.6 | 66.2 | 61.2 | 61.0 | 57.0 | 53.0 |
| Average exchange rate BGN/EUR | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 |

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

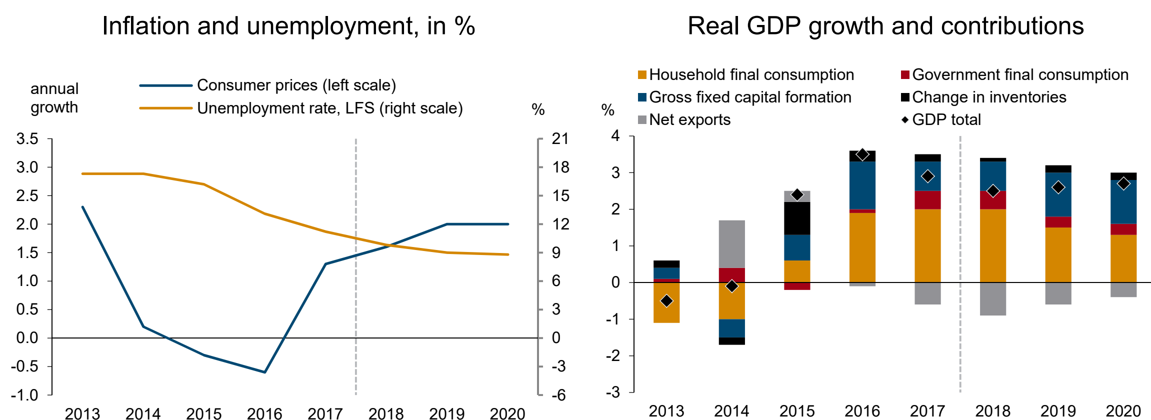
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

# CROATIA: Low absorption of EU funds holding back growth

HERMINE VIDOVIC

**Croatia's economy will continue its path of moderate growth, with annual GDP growth of slightly below 3% in the period 2018-2020; increasing the absorption of EU funds will be an important precondition for achieving this growth rate. Demographic changes, coupled with continued emigration of young and educated people and rising labour shortages in crucial sectors, will become a major challenge in the future.**

**Figure 40 / Croatia: Main macroeconomic indicators**




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

**Croatia's real GDP grew by 2.7% year on year in the first half of 2018 on the back of rising domestic demand.** Private consumption growth was mainly due to rising disposable income, i.e. growing real wages and pensions as well as increasing remittances from abroad. Gross fixed capital formation grew only moderately, indicating still low absorption of EU funds. Hence, the output growth in construction was only modest, at 2.2%. The contribution of net exports to GDP growth was negative due to rising imports. Industrial production growth was almost stagnant (0.5%) during the first six months of 2018, with most pronounced output declines in the production of fabricated metal products and of chemicals and chemical products. In shipbuilding, which has been on a downward trend for years, production shrank by one third compared to the first half of 2017. Difficulties in the shipbuilding sector became evident at the beginning of 2018 when the Croatian government gave a guarantee for a loan (EUR 96 million) to help the Uljanik shipyard stay afloat. The crisis became even more acute when the workers of the shipyard went on strike in summer because of delayed wage payments. The latter could

be secured only through a government guarantee to a state-owned bank, so that the company could pay out the salaries. But the future of the company remains uncertain. So far the restructuring plan submitted by Uljanik's management at the beginning of the year has not been approved by the European Commission. The restructuring of the shipyards was a key condition of Croatia's EU accession in 2013.

**The labour market situation has continued to improve.** According to Pension Insurance data employment increased by 1.8% during the first half of the year, while based on the Labour Force Survey employment went up by 3.4% and the unemployment rate fell to 9%. Despite these improvements the unemployment rate is still 2pp above the EU average and youth unemployment stand at about 23%, representing the third highest rate in Europe, after Spain and Cyprus. The reduction in unemployment is only partly a result of rising domestic employment. Despite improving economic conditions, outward migration continues. In Germany alone, the number of Croatian workers increased from 75,800 in July 2013, when Croatia joined the EU, to 178,000 in September 2018. The stock of Croatian employees in Austria, the second most important destination country for Croatian migrants, rose in the same period from 19,000 to 32,500 persons. Despite still high unemployment Croatia has experienced labour shortages, particularly in the tourism and construction sectors, which are mainly covered by foreign labour, especially from Bosnia and Herzegovina. In 2018 over 30,000 work permits to foreign nationals were issued. Real net wages continued to increase and were up by 3% during the first half of 2018.

**External trade in goods performed disappointingly** with exports up by a mere 3% in euro terms during the first half of the year, reflecting the poor industrial performance. The trade deficit was about EUR 370 million higher than in the same 2017 period, while the surplus in the services trade remained unchanged at EUR 2.7 billion. Earnings from tourism reached again a record high in 2018, still benefiting from political uncertainties particularly in Northern Africa, one of Croatia's main competitors. Hence, the current account will remain in surplus in 2018, at an estimated 2.7% of GDP. The inflow of FDI was by EUR 200 million higher than in 2017, at close to EUR 900 million.

**After reporting the first general government surplus in 2017 since gaining independence, fiscal consolidation continues in 2018**. The general government budget closed again with a surplus in the first half of 2018 mostly on account of rising tax revenues (VAT in particular) as well as lower expenditures, e.g. on subsidies and interest payments. For the whole year the government expects a 0.4% surplus-to-GDP ratio. This will also translate into a further reduction in public debt to about 74% of GDP. Only recently the government has proposed a package of tax changes to be implemented at the beginning of 2019. The proposal includes the lowering of the VAT rate from 25% to 13% for fresh meat, fish, fruits and eggs, reducing the income tax rate from 36% to 24% for monthly wages up to HRK 30,000 as well abolishing contributions for work safety, while increasing the contributions for health insurance. The overall VAT rate is supposed to be reduced from 25% to 24% in 2020.

**The absorption of EU funds is still very low**, due to limited administrative capacities and strategic planning as well as insufficient information of potential recipients. Although this circumstance has been known for years little has been done solving this problem so far. Only recently the Minister of Regional Development, Gabrijela Žalac, emphasised (again) the need for strengthening administrative capacities on the ground, in order to increase the absorption of EU funds. A more effective and efficient use of these funds would be the key to supporting investments and stimulating GDP growth. Up to now contracts worth 54% within the current financial perspective worth EUR 10.7 billion were signed – particularly for projects in Slavonia and the Pelješac Bridge, an important prestige project.

**In September S&P affirmed Croatia's long- and short-term local and foreign currency rating at BB+ and revised the outlook from stable to positive.** The main reasons behind this decision are expectations of further fiscal consolidation and the continuation of economic growth as well as a reduction of the risks related to Agrokor after having reached a settlement deal with a large majority of the company's creditors in July.

**Assuming that absorption of EU funds will accelerate, GDP growth may come close to 3% p.a. in the forecasting period.** Household consumption should benefit from a further gradual improvement in the labour market, while a more pronounced increase in investments should be spurred by better absorption of EU funds. The strengthening of domestic demand will lead to rising imports and consequently result in higher trade deficits. The services trade surplus, by contrast, may remain at high levels due to high earnings from tourism. Thus, the current account will remain in positive territory, but is expected to decline along with higher trade deficits. Assuming further improvement in the general government budget, public debt is expected to continue its downward path in the coming two years, but downside risks are related to guarantees provided to the Uljanik shipyard and to spending on the health sector. Demographic changes coupled with ageing of the population, continued emigration of young educated people and rising labour shortages in crucial sectors such as tourism and construction but also IT will become the major future challenges.

## Table 15 / Croatia: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 4,236 | 4,208 | 4,172 | 4,150 | 4,174 | 4,125 | 4,100 | 4,050 | 4,000 |
| Gross domestic product, HRK bn, nom. | 331.6 | 339.6 | 351.3 | 365.6 | 172.4 | 180.2 | 380.9 | 398.5 | 417.3 |
| annual change in % (real) | -0.1 | 2.4 | 3.5 | 2.9 | 3.0 | 2.7 | 2.5 | 2.6 | 2.7 |
| GDP/capita (EUR at PPP) | 16,300 | 17,200 | 17,600 | 18,400 | . | . | . | . | . |
| Consumption of households, HRK bn, nom. | 191.4 | 192.3 | 196.4 | 205.5 | 100.9 | 105.8 | . | . | . |
| annual change in % (real) | -1.6 | 1.0 | 3.4 | 3.6 | 3.6 | 3.7 | 3.5 | 2.6 | 2.4 |
| Gross fixed capital form., HRK bn, nom. | 63.8 | 66.4 | 70.4 | 73.3 | 36.3 | 37.7 | . | . | . |
| annual change in % (real) | -2.8 | 3.8 | 6.5 | 3.8 | 4.8 | 3.3 | 4.0 | 6.0 | 6.0 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | 1.2 | 2.7 | 5.3 | 1.4 | 1.7 | 0.5 | 1.0 | 2.5 | 2.5 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -6.9 | 2.9 | 6.9 | -6.0 | . | . | . | . | . |
| Construction output 2) | | | | | | | | | |
| annual change in % (real) | -6.9 | -0.5 | 3.3 | 1.7 | 2.2 | 3.0 | . | . | . |
| Employed persons, LFS, th, average | 1,566 | 1,585 | 1,590 | 1,625 | 1,589 | 1,644 | 1,650 | 1,670 | 1,690 |
| annual change in % | 2.7 | 1.3 | 0.3 | 2.2 | 0.8 | 3.4 | 1.5 | 1.0 | 1.0 |
| Unemployed persons, LFS, th, average | 327 | 306 | 240 | 205 | 227 | 161 | 180 | 170 | 160 |
| Unemployment rate, LFS, in %, average | 17.3 | 16.2 | 13.1 | 11.2 | 12.6 | 9.0 | 9.8 | 9.0 | 8.8 |
| Reg. unemployment rate, in %, eop | 19.4 | 17.6 | 14.7 | 12.0 | 10.5 | 8.8 | . | . | . |
| Average monthly gross wages, HRK 3) | 7,953 | 8,055 | 7,752 | 8,055 | 8,014 | 8,441 | 8,470 | 8,880 | 9,300 |
| annual change in % (real, gross) | 0.4 | 1.8 | 3.0 | 2.8 | 2.3 | 3.8 | 3.5 | 2.8 | 2.8 |
| Average monthly net wages, HRK 3) | 5,533 | 5,711 | 5,685 | 5,985 | 5,959 | 6,236 | 6,260 | 6,580 | 6,900 |
| annual change in % (real, net) | 0.5 | 3.7 | 2.7 | 4.1 | 3.9 | 3.2 | 3.0 | 3.0 | 3.0 |
| Consumer prices (HICP), % p.a. | 0.2 | -0.3 | -0.6 | 1.3 | 1.1 | 1.5 | 1.6 | 2.0 | 2.0 |
| Producer prices in industry, % p.a. | -2.7 | -3.8 | -4.3 | 2.0 | 1.9 | 1.8 | 2.0 | 2.0 | 2.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 42.9 | 44.8 | 46.0 | 45.7 | . | . | 44.9 | 44.0 | 43.9 |
| Expenditures | 48.1 | 48.3 | 46.9 | 45.0 | . | . | 44.5 | 44.0 | 43.4 |
| Net lending (+) / net borrowing (-) | -5.1 | -3.4 | -0.9 | 0.8 | . | . | 0.4 | 0.0 | 0.5 |
| General gov.gross debt, EU def., % of GDP | 84.0 | 83.7 | 80.2 | 77.5 | . | . | 74.0 | 72.0 | 70.0 |
| Stock of loans of non-fin.private sector, % p.a. | -2.0 | -3.1 | -4.3 | -0.1 | -1.3 | 2.2 | . | . | . |
| Non-performing loans (NPL), in %, eop | 17.1 | 16.7 | 13.8 | 11.4 | 13.2 | 11.2 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 7.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Current account, EUR mn | 858 | 2,018 | 1,206 | 1,963 | -1,357 | -1,791 | 1,400 | 800 | 700 |
| Current account, % of GDP | 2.0 | 4.5 | 2.6 | 4.0 | -5.9 | -7.4 | 2.7 | 1.5 | 1.2 |
| Exports of goods, BOP, EUR mn | 9,440 | 10,193 | 10,511 | 11,713 | 5,651 | 5,818 | 12,100 | 12,600 | 13,400 |
| annual change in % | 5.8 | 8.0 | 3.1 | 11.4 | 13.8 | 3.0 | 3.0 | 4.5 | 6.0 |
| Imports of goods, BOP, EUR mn | 15,952 | 17,168 | 17,896 | 19,966 | 10,000 | 10,539 | 21,300 | 23,000 | 24,700 |
| annual change in % | 2.8 | 7.6 | 4.2 | 11.6 | 13.3 | 5.4 | 6.5 | 8.0 | 7.5 |
| Exports of services, BOP, EUR mn | 10,237 | 11,280 | 12,273 | 13,411 | 4,568 | 4,849 | 14,100 | 15,100 | 16,200 |
| annual change in % | 4.0 | 10.2 | 8.8 | 9.3 | 12.8 | 6.2 | 5.0 | 7.0 | 7.0 |
| Imports of services, BOP, EUR mn | 2,900 | 3,274 | 3,561 | 4,093 | 1,828 | 2,104 | 4,600 | 5,000 | 5,400 |
| annual change in % | -6.1 | 12.9 | 8.8 | 14.9 | 14.5 | 15.1 | 14.0 | 8.0 | 7.0 |
| FDI liabilities, EUR mn | 2,298 | 191 | 1,757 | 1,762 | 677 | 868 | 1,300 | . | . |
| FDI assets, EUR mn | 1,608 | -43 | -177 | 582 | 282 | 206 | 300 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 12,688 | 13,707 | 13,514 | 15,706 | 14,028 | 16,694 | . | . | . |
| Gross external debt, EUR mn | 46,416 | 45,384 | 41,668 | 40,069 | 40,260 | 40,142 | 40,400 | 40,400 | 41,200 |
| Gross external debt, % of GDP | 106.9 | 101.7 | 89.3 | 81.8 | 82.2 | 78.0 | 78.5 | 75.0 | 73.0 |
| Average exchange rate HRK/EUR | 7.6344 | 7.6137 | 7.5333 | 7.4637 | 7.4488 | 7.4181 | 7.4 | 7.4 | 7.4 |

1) Preliminary. - 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.

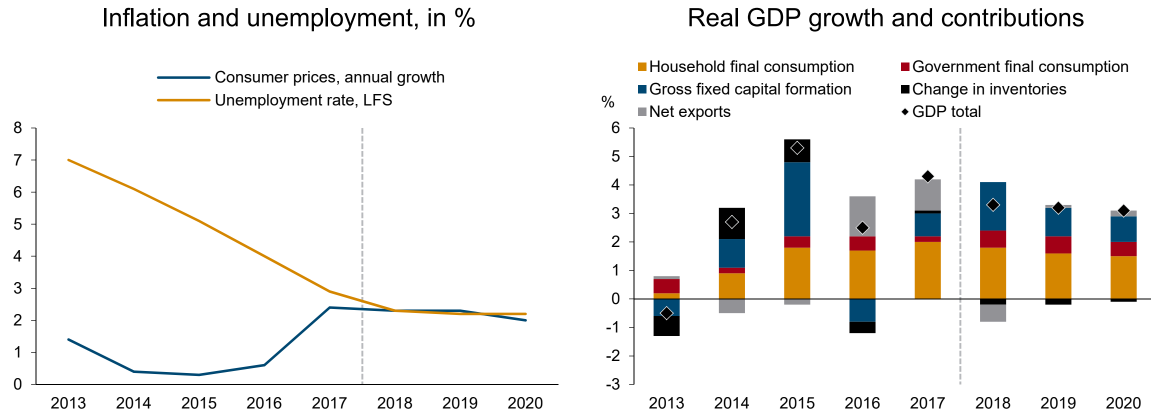
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

# CZECH REPUBLIC: Balanced but moderating growth

LEON PODKAMINER

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

**Figure 41 / 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 the second half of 2017, growth has moderated in the first and second quarters of 2018** posting (seasonally unadjusted) GDP growth rates of 3.4% and 2.7% respectively. Consumption (both household and public), however, continued to increase strongly. At the same time the gross wage bill (compensation of employees) increased in the first half of 2018 by about 7.5% in real terms – much faster than private consumption. As in Poland, the earnings of a large number of foreigners employed are sent back home (mostly to Ukraine) thereby reducing the effective domestic consumer demand in the Czech Republic. However, the widening gap between the wage bill and household consumption indicates, primarily, households' rising savings rate. Household incomes are financing investment (e.g. into real estate) to a much greater extent than in the past. Price differentials provide evidence of this. A real-estate expansion may be developing. In the first quarter of 2018 the transaction price index for housing rose by over 9% compared with the same period in 2017.

The index of asking prices for new flats in Prague rose by close to 15% (year on year) in the second quarter of 2018.

**Gross fixed capital formation (GFCF) has continued to increase strongly**, continuing the recovery that started over a year ago. Rising GFCF contributed about 2.2 percentage points (pp) to overall GDP year-on-year growth in the first half of 2018. However, a strong contraction in inventories shaved close to 1pp off the GDP growth rate. Rising private sector investment played the most important role. In the first quarter of 2018 investment by the nonfinancial corporate sector was responsible for about half of the overall rate of growth of GFCF. Household investment contributed about one third while the contribution of government investment was still marginal. In the first half of 2018 capital formation in the form of machinery and equipment rose by about 8.5% in real terms while that of dwellings by about 12% and that of ‘other buildings and structures’ by about 11%. In the second half of 2018 the strong expansion of investment may continue. A stronger drawdown of the EU funds will probably accelerate government investment growth. Household investment may go on expanding strongly not only on account of rising disposable incomes but also due to persistently low interest rates on mortgages and the continuing fast rise in the volume of housing loans. Of course, a change in the monetary policy stance could put an end to booming household investment. Also, at some point rising household debt may hinder further expansion.

**Foreign trade growth has slowed down and the trade balance has deteriorated**. In the first half of 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 9.5% a year ago to 8.7% in the first half of 2018. The foreign trade contribution to GDP growth was negative for the first time since the third quarter of 2015. Weaker external demand is one reason for lower growth in exports. As the import intensity of Czech exports is rather high, this also contributes to slower growth in imports. 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 higher imports of capital goods may thus result. A strengthening koruna (and rising unit labour costs) may also negatively affect trade performance. The koruna appreciated against the Euro by about 5% on average in the first half of 2018 (against the same period in 2017). Moreover, between April 2017 (when the National Bank gave up control of the exchange rate) and mid-April 2018, the koruna strengthened by 7% against the Euro. Since mid-April 2018, however, the koruna has depreciated by 2%. The nominal koruna was by 5% stronger on average in the first half of 2018 compared to the same period of 2017. No doubt this also negatively affected the trade performance.

**The exchange rate has not appreciated as much as expected**. Initially, the central bank’s discontinuation (in mid-April 2017) of its policy targeting the 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 forecast an average rate of 25.4 for the first quarter of 2018, followed by 24.9 for the second quarter (and for the entire 2018). However, the CZK has weakened recently. The actual average rate for the first half of 2018 is 25.5 (against the 25.15 implied by the CNB forecasts). The most recent CNB forecast (July 2018) envisages a less steep appreciation in the coming quarters. Nonetheless it maintains its earlier forecast for 2019 (24.5 CZK/EUR) and puts the forecast for 2020 at 24.2. Whether the expectation of appreciation of that size is realistic remains debatable. On the one hand, increased outflows of short-term capital (in response to financial investors’ widespread fears over prospects for emerging markets

generally) may indeed have been temporary. On the other hand, since August 2017 the CNB policy interest rates (associated with rising money market interest rates) have been gradually rising, implying widening spreads versus Euro area interest rates. In such circumstances one would expect the koruna to strengthen versus the Euro, but this has not happened recently. That would suggest that the koruna's appreciation potential is overrated. If the trade and current account balances deteriorate further, appreciation pressures may be less pronounced. (Paradoxically, the koruna continues to appreciate much more versus the US dollar, despite the fact that the interest rate spread against that currency is negative.)

**Close to full employment has added to wage pressures**. With the unemployment rate hovering at less than 2.5%, the reserves of employable domestic labour may be rather limited. Although one observes a (slow) rise in participation rates and longer working hours and a rise in various forms of informal and part-time employment (also by foreigners), labour shortages may also persist due to pronounced population aging. Strong wage pressures, higher unit labour costs and thus depressed corporate profits have shaped economic conditions so far. In the first half of 2018 the average wage increased by 8.6% in nominal terms (about 6.4% in real terms). Nominally, total employees' compensation rose over 10%, while the gross operating surplus and mixed income (representing primarily corporate profits) by a mere 1.7%.

**Inflation pickup is a possibility**. Rising unit labour costs have not yet affected core inflation, which is running at about 1%. Inflation in excess of 2% is currently due to fast rising prices of fuel and foodstuffs as well as to hikes in administered prices. In the near future rising production costs may increasingly affect overall inflation and/or depress profit margins. 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.

**Fiscal policy eyes further cuts in public debt**. Given the growth slowdown, this will not be helpful. Keeping interest rates as low as possible may be essential in helping to prevent undue currency appreciation and in encouraging further expansion of private fixed capital formation.

**Overall the Czech economy may face a period of slowing growth.** Tight labour markets and the ensuing wage push, which have supported growth recently, may now 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 the Czech goods proves insufficient and/or productivity advances are less impressive than generally assumed.

## Table 16 / Czech Republic: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 10,525 | 10,546 | 10,566 | 10,570 | . | . | 10,595 | 10,605 | 10,615 |
| Gross domestic product, CZK bn, nom. | 4,314 | 4,596 | 4,768 | 5,045 | 2,423 | 2,558 | 5,310 | 5,600 | 5,890 |
| annual change in % (real) | 2.7 | 5.3 | 2.5 | 4.3 | 3.6 | 3.0 | 3.3 | 3.2 | 3.1 |
| GDP/capita (EUR at PPP) | 23,800 | 25,300 | 25,500 | 26,400 | . | . | . | . | . |
| Consumption of households, CZK bn, nom. | 2,044 | 2,125 | 2,213 | 2,362 | 1,141 | 1,215 | . | . | . |
| annual change in % (real) | 1.8 | 3.8 | 3.6 | 4.3 | 4.1 | 3.9 | 3.8 | 3.5 | 3.3 |
| Gross fixed capital form., CZK bn, nom. | 1,084 | 1,216 | 1,189 | 1,246 | 575 | 622 | . | . | . |
| annual change in % (real) | 3.9 | 10.2 | -3.1 | 3.3 | 1.9 | 8.8 | 7.0 | 4.0 | 3.5 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 5.0 | 4.3 | 3.4 | 6.5 | 6.3 | 2.5 | 3.0 | 3.0 | 3.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 10.1 | -4.8 | 7.0 | -8.6 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 4.2 | 6.8 | -5.6 | 3.3 | 4.8 | 8.6 | . | . | . |
| Employed persons, LFS, th, average | 4,974 | 5,042 | 5,139 | 5,222 | 5,183 | 5,274 | 5,290 | 5,310 | 5,320 |
| annual change in % | 0.8 | 1.4 | 1.9 | 1.6 | 1.5 | 1.7 | 1.4 | 0.3 | 0.2 |
| Unemployed persons, LFS, th, average | 324 | 268 | 211 | 155 | 172 | 124 | 120 | 120 | 120 |
| Unemployment rate, LFS, in %, average | 6.1 | 5.1 | 4.0 | 2.9 | 3.3 | 2.3 | 2.3 | 2.2 | 2.2 |
| Reg. unemployment rate, in %, eop | 7.5 | 6.2 | 5.2 | 3.8 | 4.0 | 2.9 | . | . | . |
| Average monthly gross wages, CZK | 25,768 | 26,591 | 27,764 | 29,496 | 28,608 | 31,059 | 32,000 | 34,000 | 35,800 |
| annual change in % (real, gross) | 2.5 | 2.9 | 3.7 | 3.6 | 3.3 | 6.4 | 6.0 | 4.0 | 3.3 |
| Consumer prices (HICP), % p.a. | 0.4 | 0.3 | 0.6 | 2.4 | 2.4 | 1.9 | 2.3 | 2.3 | 2.0 |
| Producer prices in industry, % p.a. | 1.4 | -2.4 | -3.2 | 0.7 | 1.9 | -1.3 | 1.0 | 1.5 | 1.5 |
| General governm. budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 40.3 | 41.1 | 40.2 | 40.5 | . | . | 40.0 | 40.0 | 40.5 |
| Expenditures | 42.4 | 41.7 | 39.5 | 38.9 | . | . | 38.6 | 39.2 | 40.0 |
| Net lending (+) / net borrowing (-) | -2.1 | -0.6 | 0.7 | 1.6 | . | . | 1.4 | 0.8 | 0.5 |
| General gov.gross debt, EU def., % of GDP | 42.2 | 40.0 | 36.8 | 34.7 | . | . | 32.7 | 32.0 | 32.0 |
| Stock of loans of non-fin.private sector, % p.a. | 2.7 | 6.6 | 6.7 | 6.5 | 7.3 | 6.1 | . | . | . |
| Non-performing loans (NPL), in %, eop | 6.1 | 5.8 | 4.8 | 4.0 | 4.3 | 3.4 | . | . | . |
| Central bank policy rate, % p.a., eop 2) | 0.05 | 0.05 | 0.05 | 0.50 | 0.05 | 1.00 | 1.50 | 1.75 | 1.50 |
| Current account, EUR mn | 296 | 368 | 2,744 | 1,952 | 3,303 | 2,530 | 1,300 | 1,800 | 1,700 |
| Current account, % of GDP | 0.2 | 0.2 | 1.6 | 1.0 | 3.7 | 2.5 | 0.6 | 0.8 | 0.7 |
| Exports of goods, BOP, EUR mn | 110,401 | 115,573 | 118,033 | 128,344 | 65,177 | 68,987 | 136,000 | 144,200 | 152,900 |
| annual change in % | 7.0 | 4.7 | 2.1 | 8.7 | 8.1 | 5.8 | 6.0 | 6.0 | 6.0 |
| Imports of goods, BOP, EUR mn | 102,406 | 108,701 | 108,946 | 119,247 | 59,188 | 62,905 | 127,000 | 134,600 | 142,700 |
| annual change in % | 5.9 | 6.1 | 0.2 | 9.5 | 9.1 | 6.3 | 6.5 | 6.0 | 6.0 |
| Exports of services, BOP, EUR mn | 18,915 | 20,603 | 21,923 | 23,921 | 11,445 | 12,433 | 25,400 | 26,900 | 28,500 |
| annual change in % | 4.7 | 8.9 | 6.4 | 9.1 | 9.0 | 8.6 | 6.0 | 6.0 | 6.0 |
| Imports of services, BOP, EUR mn | 16,892 | 17,742 | 17,942 | 19,285 | 9,133 | 9,695 | 20,500 | 21,700 | 23,000 |
| annual change in % | 10.1 | 5.0 | 1.1 | 7.5 | 6.4 | 6.1 | 6.5 | 6.0 | 6.0 |
| FDI liabilities, EUR mn | 6,101 | 1,521 | 9,809 | 8,206 | 4,426 | 3,222 | 6,100 | . | . |
| FDI assets, EUR mn | 3,175 | 3,357 | 2,909 | 3,096 | 1,118 | 1,039 | 4,000 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 44,528 | 58,903 | 80,999 | 123,028 | 124,403 | 123,348 | . | . | . |
| Gross external debt, EUR mn | 106,303 | 115,396 | 129,448 | 171,197 | 167,870 | 168,625 | 183,200 | 193,000 | 200,600 |
| Gross external debt, % of GDP | 67.9 | 68.5 | 73.4 | 89.3 | 87.6 | 81.0 | 88.0 | 87.0 | 86.0 |
| Average exchange rate CZK/EUR | 27.54 | 27.28 | 27.03 | 26.33 | 26.79 | 25.50 | 25.50 | 25.25 | 25.25 |

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

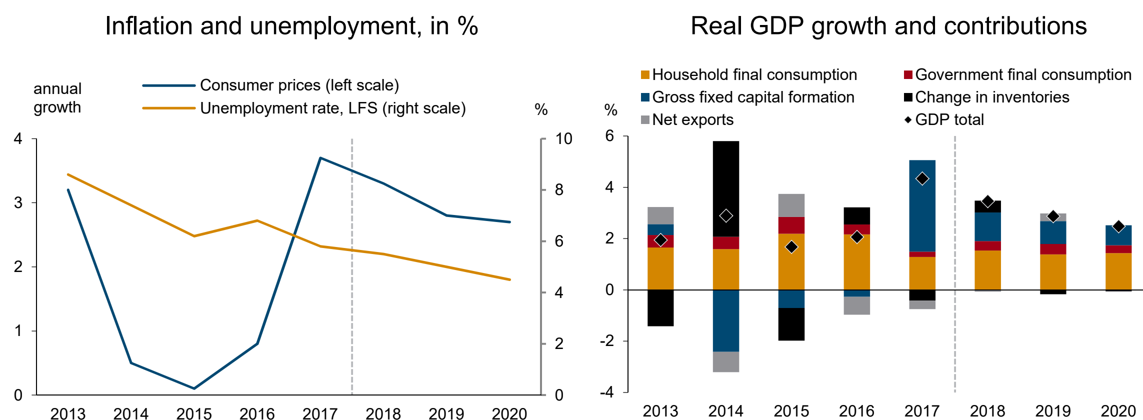
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

# ESTONIA: Tight labour market without overheating

SEBASTIAN LEITNER

**Investment activity has abated so far in 2018, following last year's peak growth induced by fresh inflows of EU funds. However, external demand continued growing at a higher pace than expected. Household consumption, backed by a considerable rise in employment and real wages, continues to be a strong driver of economic activity. We project GDP to grow at a rate of 3.5% in 2018 and 3.1% in 2019, while declining somewhat to 2.7% in 2020.**

**Figure 42 / Estonia: Main macroeconomic indicators**




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

**Export growth was quite strong in 2018, particularly towards other EU countries.** Goods exports to Russia, which increased by more than 20% nominally in 2017, however, will decline somewhat in 2018. The Estonian wood manufacturing sector has benefited in recent years from stable growth of construction in Sweden. The cooling off in the housing sector there, and the forecast price and investment decline in the Swedish housing sector, has resulted in deteriorating prospects for Estonian entrepreneurs. In general, strongly rising wages in Estonia are putting pressure on exporting firms, but moving up the value chain will require increased investment activity in manufacturing. At the moment, however, trade in electrical appliances and other higher-value goods is rather anaemic. The actual driver of nominal export growth in 2018 so far has been the rising oil price. This has supported demand for Estonian shale oil – exports are likely to increase by 30-40% in real terms this year compared to 2017. Overall, we expect real growth in goods exports to level off in 2019-2020. Given swiftly rising household incomes, imports will increase more strongly than exports. At the same time, the exports of services are

growing much more strongly than those of goods. As well as the transport and tourism sector, ICT and business services are strongly export oriented and flourishing.

**After a slowdown in 2018, growth in investment activity is expected to become stronger in 2019-2020.** In 2017, the first inflows of EU funds from the 2014-2020 programming period resulted in high growth rates. Public investment has increased at a lower rate in 2018, but in 2019, and particularly 2020, the construction of the main terminals of Rail Baltica, the high-speed train project connecting the Baltics with the Central European network, will result in a revival of investment. Given the favourable demand situation, private enterprises are increasing their investments in equipment and buildings, thus construction activity is prospering as well. Strong growth in wages and very low interest rates are driving an ongoing increase in new credits to households. Real estate prices are currently growing rapidly, and are above pre-crisis levels in Tallinn. Given the low-interest rate environment, housing construction may remain strong for a while; however the number of building permits granted shows that a levelling off is likely towards 2020.

**Throughout the year, the unemployment rate fell considerably and is expected to average 5.5% (according to LFS) for 2018 as a whole.** Given the favourable economic developments, a further gradual decline will take place. A longer term view on the development of the work force shows that a decline of about 5% is likely in the next 10 years. The employment rate will thus rise further, which at 79% (among 15-64 year-olds as of Q2/2018) is already at the level of the Scandinavian countries (which are the highest in the EU). In the 65-74 age group, 29% of the population is still working, which is much more than anywhere else in the EU and in this respect only comparable to Iceland (41%). This increases the labour supply to some extent and raises the unemployment rate temporarily, while the inactivity rate declines. Employment figures show the relatively swift restructuring of the Estonian economy towards services. In the past 10 years the number of jobs in the ICT sector doubled (4.7% of total employment) and increased much more than the EU average (3.1%). Employment growth is also strong in other high value service sectors.

**Given the tight labour market situation, wages will continue to rise strongly in the next few years.** Real gross wages picked up by another 3.7% year on year in the first half of 2018, and as a result consumer demand remains strong. Household incomes will be bolstered by a further 8% increase in the minimum wage from January 2019 onwards to EUR 540 per month, and a reduction in personal income tax. Also, after a 3.7% peak recorded last year (mostly caused by an increase in excise taxes and by rising energy prices), consumer price inflation started to decline slightly in 2018 which has further strengthened real income growth. Forward-looking consumer confidence indicators are positive and the most recent retail trade and credit statistics indicate positive sentiment among consumers.

**The draft budget of the Estonian centrist coalition government for 2019 foresees a continuation of the fiscal surplus path, without further tax changes planned for 2020.** Above average expenditure growth is planned for defence and the health and welfare sectors, including an increase in child benefits. Subsidies will be raised for public transport in order to increase the use of free buses. After having been introduced in the capital city of Tallinn in 2013, 11 of 15 counties followed in July 2018. The scheme is expected to reduce emissions slightly, but more particularly, to lower transport costs for less well-off residents. The fiscal strategy of the Estonian government is to bring public debt down to 5% of GDP over the coming three years.

**We have not altered our positive outlook for the Estonian economy compared to our previous forecast; real GDP is expected to grow by 3.5% this year.** 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 of GDP growth rates to 3.1% and 2.7% for 2019 and 2020 respectively.

## Table 17 / Estonia: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 1,315 | 1,315 | 1,316 | 1,315 | . | . | 1,318 | 1,320 | 1,322 |
| Gross domestic product, EUR mn, nom. | 20,061 | 20,652 | 21,683 | 23,615 | 11,368 | 12,259 | 25,200 | 26,700 | 28,200 |
| annual change in % (real) | 2.9 | 1.9 | 3.5 | 4.9 | 5.4 | 3.5 | 3.5 | 3.1 | 2.7 |
| GDP/capita (EUR at PPP) | 21,300 | 22,000 | 22,500 | 23,700 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. | 9,835 | 10,243 | 10,777 | 11,448 | 5,617 | 6,016 | . | . | . |
| annual change in % (real) | 3.0 | 4.3 | 4.3 | 2.5 | 1.3 | 3.9 | 3.5 | 3.2 | 3.1 |
| Gross fixed capital form., EUR mn, nom. | 5,139 | 4,872 | 4,978 | 5,770 | 2,813 | 2,748 | . | . | . |
| annual change in % (real) | -2.6 | -7.6 | 2.9 | 12.5 | 17.3 | -4.7 | 3.0 | 5.4 | 6.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 3.9 | 0.3 | 3.4 | 7.7 | 11.8 | 4.4 | 5.0 | 4.5 | 4.5 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 4.6 | 8.7 | -17.2 | 9.5 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | -2.1 | -3.5 | 4.6 | 17.7 | 18.8 | 20.5 | . | . | . |
| Employed persons, LFS, th, average | 624.8 | 640.9 | 644.6 | 658.6 | 650.2 | 658.6 | 665 | 670 | 670 |
| annual change in % | 0.6 | 2.6 | 0.6 | 2.2 | 1.0 | 1.3 | 1.0 | 0.8 | 0.0 |
| Unemployed persons, LFS, th, average | 49.6 | 42.3 | 46.7 | 40.3 | 43.7 | 41.6 | 39 | 35 | 32 |
| Unemployment rate, LFS, in %, average | 7.4 | 6.2 | 6.8 | 5.8 | 6.3 | 6.0 | 5.5 | 5.0 | 4.5 |
| Reg. unemployment rate, in %, eop 2) | 4.4 | 4.7 | 4.4 | 4.8 | 4.5 | 4.5 | . | . | . |
| Average monthly gross wages, EUR | 1,005 | 1,065 | 1,146 | 1,226 | 1,198 | 1,282 | 1,300 | 1,380 | 1,470 |
| annual change in % (real, gross) | 6.0 | 6.5 | 7.4 | 3.5 | 3.1 | 3.7 | 3.0 | 3.3 | 3.5 |
| Average monthly net wages, EUR | 799 | 859 | 924 | 985 | . | . | 1,050 | 1,120 | 1,190 |
| annual change in % (real, net) | 5.7 | 8.0 | 7.4 | 3.0 | . | . | 3.0 | 3.3 | 3.5 |
| Consumer prices (HICP), % p.a. | 0.5 | 0.1 | 0.8 | 3.7 | 3.2 | 3.3 | 3.3 | 2.8 | 2.7 |
| Producer prices in industry, % p.a. | -2.1 | -2.5 | -0.9 | 3.3 | 3.0 | 3.6 | 3.0 | 2.5 | 2.3 |
| General governm. budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 38.5 | 39.7 | 39.2 | 38.9 | . | . | 38.6 | 38.6 | 38.6 |
| Expenditures | 37.9 | 39.6 | 39.5 | 39.2 | . | . | 39.0 | 38.8 | 38.8 |
| Net lending (+) / net borrowing (-) | 0.7 | 0.1 | -0.3 | -0.3 | . | . | -0.4 | -0.2 | -0.2 |
| General gov.gross debt, EU def., % of GDP | 10.5 | 9.9 | 9.2 | 8.7 | . | . | 8.5 | 8.0 | 8.0 |
| Stock of loans of non-fin.private sector, % p.a. | 2.6 | 4.8 | 6.6 | 0.7 | 5.7 | 1.1 | . | . | . |
| Non-performing loans (NPL), in %, eop | 1.5 | 1.1 | 1.0 | 0.8 | 0.8 | 0.7 | . | . | . |
| Central bank policy rate, % p.a., eop 3) | 0.05 | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | 162 | 381 | 425 | 751 | 236 | 38 | 246 | 46 | -204 |
| Current account, % of GDP | 0.8 | 1.8 | 2.0 | 3.2 | 2.1 | 0.3 | 1.0 | 0.2 | -0.7 |
| Exports of goods, BOP, EUR mn | 11,026 | 10,689 | 11,294 | 12,022 | 5,903 | 6,140 | 12,600 | 13,200 | 13,750 |
| annual change in % | 0.5 | -3.1 | 5.7 | 6.4 | 5.6 | 4.0 | 4.8 | 4.8 | 4.2 |
| Imports of goods, BOP, EUR mn | 12,019 | 11,571 | 12,055 | 12,839 | 6,333 | 6,796 | 13,700 | 14,600 | 15,500 |
| annual change in % | 1.1 | -3.7 | 4.2 | 6.5 | 5.9 | 7.3 | 6.7 | 6.6 | 6.2 |
| Exports of services, BOP, EUR mn | 5,385 | 5,284 | 5,532 | 6,054 | 2,870 | 3,093 | 6,500 | 6,950 | 7,400 |
| annual change in % | 7.9 | -1.9 | 4.7 | 9.4 | 11.6 | 7.8 | 7.4 | 6.9 | 6.5 |
| Imports of services, BOP, EUR mn | 3,678 | 3,575 | 3,888 | 4,162 | 2,001 | 2,185 | 4,500 | 4,850 | 5,200 |
| annual change in % | 4.1 | -2.8 | 8.8 | 7.0 | 6.9 | 9.2 | 8.1 | 7.8 | 7.2 |
| FDI liabilities, EUR mn | 1,331 | -654 | 845 | 1,403 | 957 | 833 | 1403 | . | . |
| FDI assets, EUR mn | 847 | -521 | 341 | 543 | 778 | 141 | 300 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 352 | 373 | 325 | 279 | 282 | 325 | . | . | . |
| Gross external debt, EUR mn | 19,040 | 19,163 | 19,162 | 19,512 | 19,548 | 19,848 | 20,200 | 21,400 | 22,600 |
| Gross external debt, % of GDP | 94.9 | 92.8 | 88.4 | 82.6 | 82.8 | 78.8 | 80.0 | 80.0 | 80.0 |

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

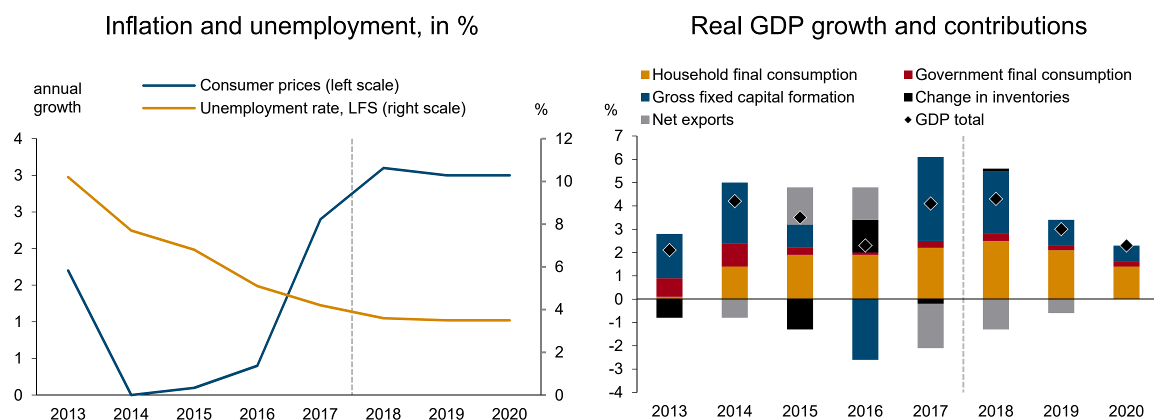
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

# HUNGARY: At the turning point of the business cycle

SÁNDOR RICHTER

**The Hungarian economy expanded by 4.8% in Q2 of 2018, reaching the zenith of the current business cycle. Growth has been driven by the extraordinarily rapid utilisation of EU cohesion policy resources. This high growth rate cannot be sustained in the next three years. A sharp decrease in EU transfers from next year on will remove an important driver of growth and there is no comparable substitute for that in sight.**

**Figure 43 / Hungary: Main macroeconomic indicators**




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

**The Hungarian economy expanded by 4.8% in the second quarter of 2018, probably reaching the zenith of the current business cycle.** GDP growth in the first half-year was 4.6% higher than in the respective period of the previous year. GDP production-side data show how tightly the growth has been related with the extraordinarily rapid utilisation of EU cohesion policy resources. Value added increased by a moderate 3.5% in industry and 3.2% in agriculture but by 24% in the construction industry, a sector closely related to EU co-financed projects. Services became a major driver of growth (4.3%) with retail trade, tourism and catering as top performers. Characteristically, value added in public administration, education, health and social services stagnated. On the utilisation side of the GDP, household consumption expanded dynamically by 5.6% in the first half-year and gross fixed capital formation by 15.8%. Nevertheless a slowdown of expansion can be observed both in consumption and investment in the second quarter compared to the first. The same is true for public consumption.

**The one-sidedness due to accelerated utilisation of EU financing is clearly visible from detailed investment data.** While investment slightly decreased in manufacturing and agriculture in the first half-year, it increased by 76% in public administration and defence and compulsory social security. Investment in transportation and storage also increased by above-average rates. Business sector investment expanded by 10% in Q2 while the respective growth rate was 44% in the public sector.

**The growth rate of exports has lagged behind that of imports.** The volume of export sales in industry (64% of all sales) increased by 1.9% while that of domestic sales (36% of all sales) grew by 6.1%. These data reflect the fact that the strongly export oriented automotive sector is experiencing a temporary slowdown, related to model changes. The labour productivity of industrial enterprises with 5 or more employees rose by 0.2% along with a 3.6% increase in the number of employees.

**The central bank reckons on reaching the medium-term inflation target (3% +/- 1pp tolerance band) in a sustainable manner from mid-2019.** September inflation amounted to 3.6% with the core inflation being lower at 2.4%. The relatively high growth of the consumer price index (CPI) was caused primarily by high fuel and unprocessed food prices. Inflationary pressure from wages was found by the central bank to be moderate. True, part of the increased household earnings was already paid before but was not reported ('whitening' of the economy) and an increasing share of household incomes finances housing expenditures which are not included in the price index calculations. The central bank wishes to maintain loose monetary conditions for some time yet. The main risks are a weakening exchange rate and an unfavourable change in the international environment.

**Hungarian Prime Minister Viktor Orbán's conflict with the EU reached a new level on 12 September.** The European Parliament (EP) voted to initiate disciplinary action against Hungary over alleged breaches of the EU's core values, including the rule of law and freedom of the media and NGOs, as well as an insufficient fight against corruption. This is a first step in a lengthy process which may lead, if approved unanimously by the European Council (which seems highly unlikely at present) to the suspension of the voting rights of Hungary.

**The EP decision may have far reaching consequences for the country.** Hungary, a major beneficiary of the EU's cohesion policy transfers, has already allocated nearly all of its available resources from the 2014-2020 financial framework. It paid enormous sums in the form of advance payments to recipients of such transfers in forint, financed from the central government budget. The underlying concept has been that transfers from the EU budget will arrive sooner or later and will counterbalance the huge (cash based) budget deficit that has been accumulated due to the accelerated advance payments. However, the respective transfers from the EU budget have already been delayed with the consequence that, as at the end of August, only 13% of the already disbursed advance payments from the national budget had been covered by transfers from the EU budget. After the EP approval of the Sargentini report, where corruption is one of the major issues, the resolution of pending cohesion policy transfer cases, which are frequently caused by irregularities being found, may become even slower. This is an additional problem for the anyhow strained (cash based) budget. Related to the increasing tension in the budget, the government ordered an immediate reduction in the rate of advanced payment from 50% to 25% for beneficiaries in the business sector and local government sector. Public sector (central government) beneficiaries still receive 50% advanced payment.

**Increased conditionality in the EU budget beyond 2020 may see Hungary receive less money.** In the initial discussion on the next 2021-2027 multiannual financial framework of the EU, the European Commission proposed the introduction of a new conditionality for the availability of cohesion policy transfers related to the rule of law in the individual Member States. From the first appearance of the proposal a fierce debate has raged over how non-compliance with the rule of law can be 'measured'. The decision of the European Parliament has now delivered a precedent for identifying such non-compliance in a Member State. The loss of all or a substantial part of its cohesion policy resources may seriously curb economic growth in Hungary as these resources are estimated to have amounted to 3-4.5% of Hungarian GDP in recent years and they have had a decisive influence on investment activities in general, and on public investment in particular.

**The Hungarian government also received a warning from the EU recently.** On 18 September the European Commission (EC) warned the government for the second time to 'correct the significant observed deviation from the adjustment path toward the medium-term budgetary objective'. The medium-term budgetary objective (MTO) is tied to the structural budget deficit (it is the difference between government revenues and expenditures corrected by the effects that could be attributed to the economic cycle and one-off events). The structural balance in 2017 deteriorated to -3.1% of the GDP from -1.8% in 2016. Hungary is now expected to implement changes in order to comply with the MTO, i.e. achieving, in the medium term, a structural deficit amounting to a maximum of -1.5% of GDP. The extent of the adjustment suggested in 2018 was originally set by the EC at 1.5pp of GDP, but then lowered to 1 percentage point.

**The high rate of economic growth (4.3%) forecast for this year will most probably not be attained in the next three years.** A sharp decrease of available EU financing from next year on and the uncertainties about the next MFF will remove an important driver of growth for a relatively long period, and there is no comparable substitute for this chunk of aggregate demand in sight. Monetary policy cannot be looser than it is now and fiscal policy has no reserves for jumping in to fill the gap. Concerning investment, the EUR 1 billion greenfield FDI initiated by the German car manufacturer BMW to build a new plant in Debrecen will give a boost to the economy, but in general FDI's role in the economy remains far away from earlier peaks. An upturn in corporate lending is encouraging but that too still remains far from its potential. Labour shortage will not ease and imported labour from abroad is blocked by ideological reasons. Raising wages will become increasingly difficult to cope with primarily by small and medium-sized Hungarian-owned firms.

## Table 18 / Hungary: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 9,866 | 9,843 | 9,814 | 9,784 | . | . | 9,750 | 9,720 | 9,700 |
| Gross domestic product, HUF bn, nom. | 32,583 | 34,379 | 35,474 | 38,355 | 17,853 | 19,506 | 41,300 | 43,900 | 46,400 |
| annual change in % (real) | 4.2 | 3.5 | 2.3 | 4.1 | 4.0 | 4.7 | 4.3 | 3.0 | 2.3 |
| GDP/capita (EUR at PPP) | 18,800 | 19,800 | 19,700 | 20,500 | . | . | . | . | . |
| Consumption of households, HUF bn, nom. | 15,875 | 16,428 | 17,033 | 18,281 | 8,887 | 9,636 | . | . | . |
| annual change in % (real) | 2.8 | 3.9 | 4.0 | 4.7 | 4.3 | 5.6 | 5.2 | 4.5 | 3.0 |
| Gross fixed capital form., HUF bn, nom. | 7,223 | 7,744 | 6,961 | 8,528 | 3,626 | 4,420 | . | . | . |
| annual change in % (real) | 12.3 | 4.7 | -11.7 | 18.2 | 22.6 | 15.8 | 12.0 | 5.0 | 3.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 7.6 | 7.4 | 0.9 | 4.7 | 5.3 | 3.5 | 4.0 | 5.0 | 6.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 11.4 | -2.4 | 9.3 | -5.2 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 13.6 | 3.0 | -18.9 | 29.7 | 27.7 | 19.1 | . | . | . |
| Employed persons, LFS, th, average | 4,101 | 4,211 | 4,352 | 4,421 | 4,394 | 4,455 | 4,470 | 4,490 | 4,490 |
| annual change in % | 5.3 | 2.7 | 3.4 | 1.6 | 2.1 | 1.4 | 1.2 | 0.5 | 0.1 |
| Unemployed persons, LFS, th, average | 343 | 308 | 235 | 192 | 202 | 172 | 170 | 160 | 160 |
| Unemployment rate, LFS, in %, average | 7.7 | 6.8 | 5.1 | 4.2 | 4.4 | 3.8 | 3.6 | 3.5 | 3.5 |
| Reg. unemployment rate, in %, eop | 8.9 | 7.6 | 6.1 | 5.6 | 6.1 | 5.2 | . | . | . |
| Average monthly gross wages, HUF 2) | 237,695 | 247,924 | 263,171 | 297,017 | 290,344 | 324,408 | 332,300 | 359,400 | 381,300 |
| annual change in % (real, gross) | 3.2 | 4.4 | 5.7 | 10.3 | 10.0 | 9.2 | 8.5 | 5.0 | 3.0 |
| Average monthly net wages, HUF 2) | 155,690 | 162,391 | 175,009 | 197,516 | 193,078 | 215,731 | 220,900 | 238,900 | 253,400 |
| annual change in % (real, net) | 3.2 | 4.4 | 7.4 | 10.3 | 10.0 | 9.2 | 8.5 | 5.0 | 3.0 |
| Consumer prices (HICP), % p.a. | 0.0 | 0.1 | 0.4 | 2.4 | 2.4 | 2.4 | 3.1 | 3.0 | 3.0 |
| Producer prices in industry, % p.a. | -0.3 | -1.1 | -1.7 | 3.3 | 3.2 | 4.4 | 4.2 | 3.0 | 3.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 46.8 | 48.1 | 44.8 | 44.3 | . | . | 47.5 | 47.7 | 47.7 |
| Expenditures | 49.4 | 50.0 | 46.5 | 46.3 | . | . | 49.5 | 50.0 | 50.4 |
| Net lending (+) / net borrowing (-) | -2.6 | -1.9 | -1.7 | -1.9 | . | . | -2.0 | -2.3 | -2.7 |
| General gov.gross debt, EU def., % of GDP | 76.6 | 76.6 | 75.9 | 73.3 | . | . | 73.3 | 71.5 | 71.0 |
| Stock of loans of non-fin.private sector, % p.a. | -0.3 | -12.3 | -1.3 | 5.5 | 2.3 | 8.6 | . | . | . |
| Non-performing loans (NPL), in %, eop | 16.7 | 13.6 | 9.3 | 5.3 | 6.7 | 4.1 | . | . | . |
| Central bank policy rate, % p.a., eop 3) | 2.10 | 1.35 | 0.90 | 0.90 | 0.90 | 0.90 | 1.00 | 1.50 | 2.00 |
| Current account, EUR mn 4) | 1,587 | 3,127 | 7,071 | 3,947 | 2,401 | 1,613 | 3,200 | 3,600 | 3,900 |
| Current account, % of GDP 4) | 1.5 | 2.8 | 6.2 | 3.2 | 4.2 | 2.6 | 2.5 | 2.7 | 2.8 |
| Exports of goods, BOP, EUR mn 4) | 73,826 | 78,477 | 80,106 | 85,566 | 43,089 | 45,719 | 89,400 | 93,900 | 98,600 |
| annual change in % | 5.1 | 6.3 | 2.1 | 6.8 | 8.0 | 6.1 | 4.5 | 5.0 | 5.0 |
| Imports of goods, BOP, EUR mn 4) | 71,701 | 74,425 | 75,482 | 83,662 | 41,623 | 45,108 | 88,700 | 94,000 | 99,000 |
| annual change in % | 7.2 | 3.8 | 1.4 | 10.8 | 12.3 | 8.4 | 6.0 | 6.0 | 5.3 |
| Exports of services, BOP, EUR mn 4) | 18,727 | 20,229 | 22,114 | 23,746 | 11,278 | 11,788 | 24,600 | 25,800 | 27,300 |
| annual change in % | 10.2 | 8.0 | 9.3 | 7.4 | 9.2 | 4.5 | 3.5 | 5.0 | 6.0 |
| Imports of services, BOP, EUR mn 4) | 14,120 | 15,302 | 15,338 | 16,394 | 7,919 | 7,927 | 16,400 | 17,100 | 18,000 |
| annual change in % | 6.7 | 8.4 | 0.2 | 6.9 | 8.9 | 0.1 | 0.1 | 4.0 | 5.0 |
| FDI liabilities, EUR mn 4) | 7,134 | 6,966 | -6,158 | 6,546 | 3,488 | 2,248 | 5,000 | . | . |
| FDI assets, EUR mn 4) | 4,186 | 5,753 | -8,467 | 4,911 | 3,804 | 1,972 | 5,000 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 34,481 | 30,226 | 24,384 | 23,261 | 23,353 | 23,955 | . | . | . |
| Gross external debt, EUR mn 4) | 121,129 | 119,339 | 110,637 | 104,941 | 111,139 | 105,322 | 107,000 | 105,000 | 101,000 |
| Gross external debt, % of GDP 4) | 114.8 | 107.6 | 97.1 | 84.6 | 89.6 | 81.6 | 82.9 | 78.2 | 71.8 |
| Average exchange rate HUF/EUR | 308.71 | 310.00 | 311.44 | 309.19 | 309.47 | 314.09 | 320 | 327 | 330 |

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

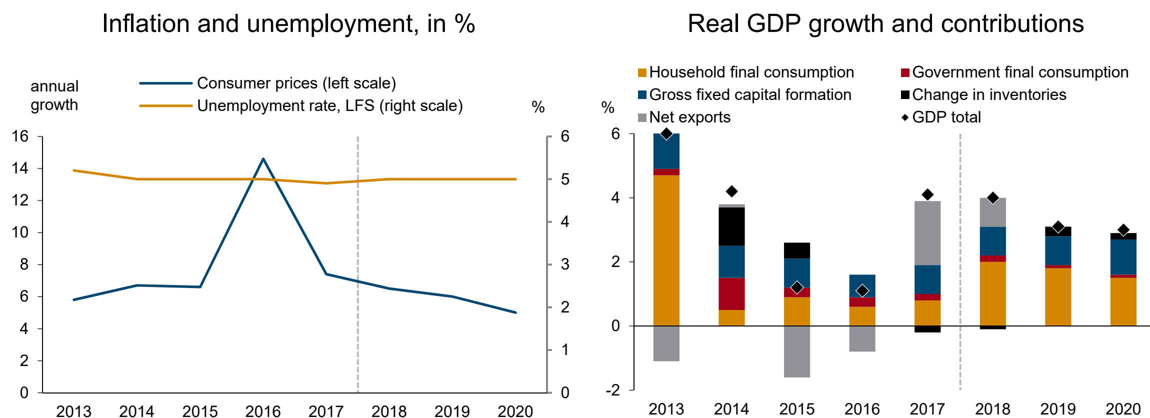
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

# KAZAKHSTAN: Further profiting from high oil prices

OLGA PINDYUK

**GDP will grow by 4% in 2018, mainly owing to high oil prices and expansion of production in the oil sector. In 2019-2020, the economy will continue benefiting from the favourable commodity price environment and grow by about 3% annually. The main risks to the forecast are a sharp decline in global oil prices and intensifying geopolitical tensions around Russia and China.**

**Figure 44 / Kazakhstan: Main macroeconomic indicators**




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

**The robust economic performance of the Kazakh economy carried on in the first half of 2018, when according to preliminary data real GDP grew by 4.2% year on year**. As previously, exports continued to be the main driving force behind economic growth – in H1 2018 merchandise exports increased in US dollar terms by 25% year on year, primarily on the back of the oil sector that has been benefiting from the favourable price environment. Exports increased in volume terms as well, as contrary to its commitments to OPEC, Kazakhstan has been steadily expanding oil production. In the second half of 2018 the economy is expected to slightly lose momentum, to a large extent due to the base effect as oil prices increased significantly in the second half of 2017, but GDP growth will still remain strong at 4% by the year-end.

**In 2019-2020, Kazakhstan will be able to further expand its oil production**, as new US sanctions on Iran and a protracted economic crisis in Venezuela are likely to tighten supply on the global market, and the capacity of the oil fields will be further expanded. The Kashagan field has been playing an

increasingly important role in the oil sector. The government expects that by the year-end the recently launched field will account for 12-15% of the total sector output. Oil production is expected to grow not only in the Kashagan oil field, but also in two other major oil fields – Karachaganak and Tengiz. The companies operating these fields have been investing heavily into modernisation and expansion of the facilities. According to government estimates, by 2025, the country's oil production will increase by about 20% as compared to the 2017 result.

**Growth this year has not been limited solely to the oil sector** – manufacturing, wholesale and retail trade, and the transport sector, have also experienced increases in production at similar rates. The results of the latest enterprises survey conducted by the National Bank of Kazakhstan (NBK) show that enterprises are moderately optimistic and expect that their output will increase in the next year. A stumbling block to manufacturing output expansion is the difficult access for enterprises to investment financing sources. The bulk of investment remains financed using own resources (72.9% of the total in January to August 2018), while bank credits with average interest rates of about 12% are prohibitively expensive for many companies.

**Imports of goods increased at a much slower pace than exports during H1 2018 – by 8.7% year on year (in US dollar terms)**. Growth was rather non-homogenous across sectors: imports of footwear fell at a double-digit rate, while machinery, equipment and vehicles imports increased by about 17% year on year, reflecting both growing investment demand and consumer demand for automobiles. In 2019-2020, imports will grow by 5-7% year on year, supported by inflows of FDI into the oil sector, expanding consumer demand, and ongoing infrastructure projects, in particular as part of the Belt and Road Initiative. The trade surplus will decrease during the forecast period, but will remain quite high, ensuring that the current account deficit will remain rather moderate at about 1% of GDP.

**The deterioration in global sentiment towards emerging markets has affected Kazakhstan, and in August the tenge depreciated by about 10%**. New US sanctions against Russia also contributed to the exchange rate volatility. The NBK has abstained from interventions so far, though it announced its readiness to intervene in the case of excessive volatility. In September the value of the tenge partially bounced back and has stabilised at a level of roughly 360 KZT/USD, about 5% higher than mid-summer.

**In light of inflationary pressures caused by the tenge depreciation, the NBK has abstained from further cutting its base rate**, which remains at 9%. During 2019-2020, a robust external balance sheet, a small current account deficit, and ongoing fiscal consolidation will support macro-financial stability in Kazakhstan. Inflation is expected to decline from 6.5% in 2018 to 5% in 2020, therefore gradual monetary loosening is likely to continue and the base rate is expected to decrease to 8% by the end of the period.

**The NBK has continued to tackle the weakness of the banking system.** As a part of these efforts, in Q3 2018, the NBK revoked the banking licences of Qazaq Bank, Eximbank Kazakhstan, and Bank of Astana, which were in violation of prudential regulations. Overall, starting from 2016, seven banks lost their licences, and currently there are 28 banks left in the country. Banks have kept on cleansing their assets through writing off non-performing loans, which are concentrated mostly in the corporate sector. As a result, in August 2018 the total stock of loans to corporate clients decreased by 7.7% year on year – notwithstanding the rapid increase in newly issued loans to corporate clients (27% year on year during January to August 2018).

**Loans to households have increased at double-digit rates both in terms of stock and flows**: the former grew by 14.8% year on year in August 2018, while newly issued loans increased during January-August 2018 by 31% year on year. Consumer loans, which account for the lion's share of newly issued loans to households, continue to be a major factor behind private consumption growth under conditions of stagnating household incomes (in the first seven months of 2018 the latter increased by a meagre 0.7% year on year). This situation poses risks to the sustainability of consumer loans dynamics, and a bubble development could take place if banks do not restrain their loan activity in this market.

**Overall, in 2019-2020 the economy will continue benefiting from the favourable commodity price environment and grow by about 3% annually**. The manufacturing and services sectors will grow concomitantly with the oil sector, but their contribution to overall growth will be less essential in the short run. Growth will be constrained by the contractionary fiscal policy, difficult access to investment financing of enterprises outside the mining sector, and weakness of the banking sector. The main risk to the forecast is a sharp decline in the global oil prices, which would cause lower export and fiscal revenues and put pressure on the tenge. Additionally, intensifying geopolitical tensions around Russia and China, which are important trade and investment partners of Kazakhstan, could also affect the economy negatively.

## Table 19 / Kazakhstan: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 17,288 | 17,543 | 17,794 | 18,038 | 17,976 | 18,215 | 18,350 | 18,600 | 18,970 |
| Gross domestic product, KZT bn, nom. | 39,676 | 40,884 | 46,971 | 53,101 | 21,546 | 24,857 | 58,500 | 63,300 | 68,400 |
| annual change in % (real) | 4.2 | 1.2 | 1.1 | 4.1 | 4.3 | 4.2 | 4.0 | 3.1 | 3.0 |
| GDP/capita (EUR at PPP) | 18,300 | 18,900 | 18,600 | 19,600 | . | . | . | . | . |
| Consumption of households, KZT bn, nom. | 18,806 | 21,492 | 25,087 | 26,839 | . | . | . | . | . |
| annual change in % (real) | 1.1 | 1.8 | 1.2 | 1.5 | . | . | 4.0 | 3.5 | 3.0 |
| Gross fixed capital form., KZT bn, nom. | 8,552 | 9,355 | 10,671 | 11,596 | . | . | . | . | . |
| annual change in % (real) | 4.4 | 4.2 | 3.0 | 4.0 | . | . | 4.0 | 4.0 | 5.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 0.3 | -1.6 | -1.1 | 7.3 | 7.8 | 5.2 | 5.0 | 4.0 | 4.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 1.0 | 3.4 | 5.4 | 3.0 | 3.3 | 4.1 | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 4.6 | 5.8 | 7.4 | 2.8 | 5.9 | 3.8 | . | . | . |
| Employed persons, LFS, th, average | 8,510 | 8,624 | 8,553 | 8,585 | 8,498 | 8,602 | 8,630 | 8,670 | 8,710 |
| annual change in % | -0.7 | 1.3 | -0.8 | 0.4 | 0.7 | 1.2 | 0.5 | 0.5 | 0.5 |
| Unemployed persons, LFS, th, average | 452 | 451 | 446 | 442 | 439 | 441 | 440 | 460 | 460 |
| Unemployment rate, LFS, in %, average | 5.0 | 5.0 | 5.0 | 4.9 | 4.9 | 4.9 | 5.0 | 5.0 | 5.0 |
| Reg. unemployment rate, in %, eop | 0.4 | 0.4 | 0.4 | 0.8 | 1.1 | 1.7 | . | . | . |
| Average monthly gross wages, KZT 2) | 121,021 | 126,021 | 142,898 | 150,827 | 145,108 | 157,597 | 163,800 | 177,100 | 191,500 |
| annual change in % (real, gross) | 3.9 | -2.3 | -1.1 | -1.7 | -2.4 | 1.9 | 2.0 | 2.0 | 3.0 |
| Consumer prices (HICP), % p.a. | 6.7 | 6.6 | 14.6 | 7.4 | 7.6 | 6.5 | 6.5 | 6.0 | 5.0 |
| Producer prices in industry, % p.a. | 9.5 | -20.5 | 16.8 | 15.3 | 20.9 | 15.9 | 16.0 | 6.0 | 2.0 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 18.5 | 18.7 | 19.8 | 21.8 | 23.3 | 21.1 | 20.0 | 19.5 | 19.5 |
| Expenditures | 21.2 | 20.9 | 21.4 | 24.5 | 23.7 | 21.4 | 21.5 | 20.5 | 20.0 |
| Deficit (-) / surplus (+) | -2.7 | -2.2 | -1.6 | -2.7 | -0.4 | -0.3 | -1.5 | -1.0 | -0.5 |
| General gov.gross debt, nat.def., % of GDP | 14.6 | 22.7 | 25.0 | 26.3 | 22.8 | 25.2 | 25.0 | 24.0 | 23.0 |
| Stock of loans of non-fin.private sector, % p.a. | 7.2 | 4.7 | 0.3 | 0.0 | 2.0 | 1.0 | . | . | . |
| Non-performing loans (NPL), in %, eop | 23.5 | 8.0 | 6.7 | 9.3 | 10.7 | 8.8 | . | . | . |
| Central bank policy rate, % p.a., eop 3) | 5.50 | 16.00 | 12.00 | 10.25 | 10.5 | 9.0 | 9.00 | 8.50 | 8.00 |
| Current account, EUR mn 4) | 4,621 | -4,632 | -8,029 | -4,770 | -2,736 | -609 | -1,300 | -1,000 | -2,000 |
| Current account in % of GDP | 2.8 | -2.8 | -6.5 | -3.3 | -4.4 | -1.0 | -0.9 | -0.7 | -1.2 |
| Exports of goods, BOP, EUR mn 4) | 60,440 | 41,961 | 33,673 | 43,772 | 21,772 | 24,293 | 48,200 | 51,900 | 53,400 |
| annual change in % | -6.2 | -30.6 | -19.8 | 30.0 | 42.1 | 11.6 | 10.1 | 7.7 | 2.9 |
| Imports of goods, BOP, EUR mn 4) | 33,162 | 30,530 | 25,366 | 28,418 | 13,913 | 13,509 | 29,000 | 31,500 | 33,700 |
| annual change in % | -13.3 | -7.9 | -16.9 | 12.0 | 22.5 | -2.9 | 2.0 | 8.6 | 7.0 |
| Exports of services, BOP, EUR mn 4) | 4,981 | 5,842 | 5,699 | 5,699 | 2,859 | 2,760 | 5,700 | 6,100 | 6,200 |
| annual change in % | 22.9 | 17.3 | -2.4 | 0.0 | 2.9 | -3.5 | 0.0 | 7.0 | 1.6 |
| Imports of services, BOP, EUR mn 4) | 9,721 | 10,448 | 9,997 | 9,610 | 4,721 | 4,314 | 9,200 | 9,700 | 9,900 |
| annual change in % | 3.6 | 7.5 | -4.3 | -3.9 | 5.5 | -8.6 | -4.3 | 5.4 | 2.1 |
| FDI liabilities, EUR mn 4) | 5,437 | 5,755 | 15,273 | 4,119 | 4,305 | 628 | 7,600 | . | . |
| FDI assets, EUR mn 4) | 1,982 | 2,992 | 3,140 | 847 | 1,381 | -2,806 | 2,100 | . | . |
| Gross reserves of NB excl. gold, EUR mn 4) | 17,920 | 18,555 | 19,191 | 15,294 | 16,527 | 14,734 | . | . | . |
| Gross external debt, EUR mn 4) | 129,438 | 140,266 | 155,980 | 140,158 | 146,829 | 141,169 | 143,200 | 149,700 | 151,100 |
| Gross external debt, % of GDP | 77.7 | 84.3 | 125.7 | 97.2 | 101.8 | 98.5 | 99.9 | 98.4 | 93.2 |
| Average exchange rate KZT/EUR | 238.10 | 245.80 | 378.63 | 368.32 | 344.64 | 395.35 | 408 | 416 | 422 |

1) Preliminary. - 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.

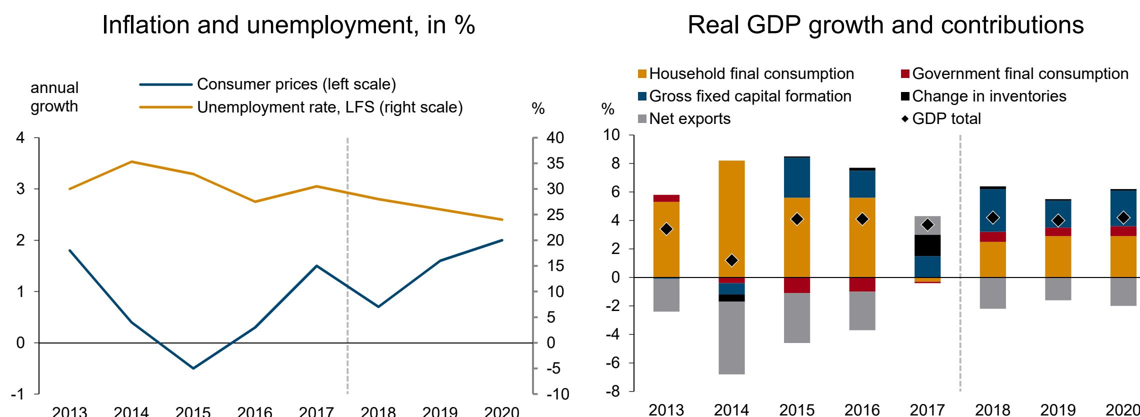
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

# KOSOVO: Plans for territorial swap with Serbia likely to be thwarted

ISILDA MARA

We forecast that growth will strengthen further to above 4%. Imminent risks due to political tensions surrounding the consultations about territorial swapping with Serbia remain high. Infrastructure investments will be a major driver of growth in the medium term boosted by private and public investments. The banking sector remains solid and well capitalised and credit growth is expected to continue on its upward trend. The fiscal stance and monetary policy remain supportive of growth.

**Figure 45 / Kosovo: Main macroeconomic indicators**




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

**The consultations around a 'territorial correction' between Serbia and Kosovo cause strains for the entire region.** In summer the presidents of both Kosovo and Serbia launched the idea of border corrections as a one-size-fits-all solution to the secular disputes between Serbia and Kosovo, the EU membership prospects for Serbia and the future of Kosovo with respect to the EU. Even though such an agreement might work on paper, it is very unrealistic on the ground. First, there is no political consensus at national, regional and international level. Second, the consultations, mediated by international partners, have been burdened by overwhelming nationalistic feelings and overreactions on both sides – e.g. the mobilisation of the Serbian army close to the Kosovo border or the attempt of the Kosovo government to amend the law on transforming the country's security forces into a regular army. Certainly, this is a very dangerous trail not only for the parties directly involved, but also for the entire region, and its implications are likely to be economic and political ones. Despite the tensions, the good

news for Kosovo is the EU Parliament's approval of visa liberalisation. Emigration might gain momentum especially among younger age cohorts, e.g. those born after the 1990s, who have been isolated ever since despite being geographically very close to the EU.

**Growth picked up to 4.7% in the second quarter of 2018, year on year.** Growth has been backed by a double-digit rise (11%) in gross fixed capital formation and strong exports of services (up 20%) during the first half of 2018 as compared with the same period of the previous year. In production terms growth benefited from the strong performance of financial activities, services and construction. Both household and government consumption have been buoyant and grew by 3% and 5% respectively in the first half of 2018, year on year. Public investments surged as capital expenditures of the central government rose by 21% in January-July 2018 as against the first half of 2017. Household consumption recovered and strengthened on the back of rising wages and inflows of remittances, each at 7%, in the first half of 2018, year on year. Also demand for credit among households rose by 11% in the same period. The manufacturing sector, after a negative first quarter of 2018, recovered and is contributing to growth again.

**FDI fell strongly during the first half of the year. The heightened uncertainly because of the political tensions may have been among the causes for the 40% decline in FDI in the first half of 2018, year on year.** Given the current internal and external political discourse the downside risks might be protracted also in the medium term. Nevertheless, starting with 2019 we expect a strong recovery of FDI owing to the new coal-fired power plant 'Kosova e Re' worth EUR 1.3 billion. Apart from the strong impact on economic growth in the medium term, its construction is expected to generate more than 10,000 new jobs. The Kosovo government and the US company ContourGlobal are in the process of selecting the construction investing company and the construction works are expected to start in the first half of 2019. Meanwhile, the World Bank has announced that it will not support the project on the grounds of environmental and economic costs. Also, in June, the Energy Community based in Vienna – which regulates the energy market of the EU and its neighbouring countries – released a note which argued that the contractual framework for the power plant 'Kosova e Re' is quite in favour of the US company ContourGlobal – protected against market and commercial risks and coupled with guaranteed and risk-free profits.[29]

**Infrastructure investments backed by public investments will also be one of the major drivers of growth in the medium term.** This year the government will complete the construction of the 'Arber Xhaferi' highway connecting Kosovo and Macedonia – a 55 km long highway which has absorbed EUR 700 million of public funding. Meanwhile, the government announced the construction of the 'Dukagjini' highway, 91 km long, to be launched in the second half of 2019.

**Jobless growth characterised the first half of 2018.** Despite economic growth of above 4%, employment prospects, especially among the youth, remain gloomy. Unemployment has been hovering at 29.4% in the second quarter of 2018, but also employment has receded in the same period. Job growth is expected to gain momentum with the start of new infrastructure projects by 2019. Nevertheless, the emigration potential remains strong. Germany is absorbing a great number of young people, including graduates, not only from Kosovo, but also from other Western Balkan countries, through a number of employment agreements recently established with the governments in the region.

[29] https://energy-community.org/news/Energy-Community-News/2018/06/14.html

**Net exports contributed positively to growth thanks to rapidly rising services exports in the first half of 2018, up 20%.** Nevertheless, the external balance deteriorated as merchandise exports shrank by 3% and consumer goods imports surged by 10%. Coupled with the 40% drop in FDI net flows, the current account deficit widened further over the first half of 2018. Exports of mineral products, base metals and related articles (accounting for more than half of goods exports) slowed down until August 2018. Imports of machinery expanded by 24%, hinting at an acceleration of private investments. In the medium term the current account deficit is expected to hover at 7%, slightly mitigated by a rise in FDI and remittances inflows but aligned with increasing consumer goods imports. Still, a current account deficit of this level is less risky than would normally be the case because it has a high share of concessional funding from international financial institutions, which tend to have low interest rates and long repayment terms.

**The general government budget is in surplus and public debt is low.** The fiscal stance in the first half of 2018 improved in the wake of rising revenues and expenditures, by 1% and 8% respectively. Still the former exceeded the latter by 8%. The rise in revenues was due to a better performance in VAT, personal and income tax collection. The marked increase in expenditures resulted from the surge in capital expenditures by 21%, social transfers by 14% and salaries by 10%. The public debt-to-GDP ratio stands at 16%, but is expected to widen because of the expansionary fiscal policy that the government is pursuing by raising further public wages, social transfers and capital investments.

**Demand for credit was quite strong in the first half of 2018.** The stock of loans to the non-financial private sector picked up by 11%, while among households the rise was at 12%. The sectors of the economy whose stock of loans expanded the most were agriculture, construction, trade and industry. The growth in wages and remittances was reflected in higher household deposits. The low level of non-performing loans, which dropped to 2.8% by June, compared to 3.9 % recorded at the end of 2017, signals a stable and well capitalised banking sector. As such the banking sector is expected to continue being supportive to growth.

**In summary, we expect the economy to accelerate further, above 4.3% in the medium term.** Growth strengthening will rest on steady growth of consumption and investments. With a number of big infrastructure projects ahead to start in 2019, private and foreign direct investments are expected to pick up and boost further growth. Nevertheless, there are downward risks to investment and growth due to the political instability in the country and the uncertainty surrounding the discourse of territorial swapping with Serbia.

## Table 20 / Kosovo: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 1,813 | 1,788 | 1,778 | 1,794 | . | . | 1,813 | 1,832 | 1,848 |
| Gross domestic product, EUR mn, nom. | 5,567 | 5,807 | 6,070 | 6,282 | 2,838 | 2,974 | 6,600 | 7,000 | 7,400 |
| annual change in % (real) | 1.2 | 4.1 | 4.1 | 3.7 | 3.6 | 4.2 | 4.2 | 4.0 | 4.2 |
| GDP/capita (EUR at PPP) | 6800 | 7400 | 7700 | 7900 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. | 4,802 | 4,943 | 5,194 | 5,271 | 2,564 | 2,645 | . | . | . |
| annual change in % (real) | 9.8 | 6.5 | 6.6 | -0.4 | -0.1 | 3.1 | 3.0 | 3.5 | 3.5 |
| Gross fixed capital form., EUR mn, nom. | 1,294 | 1,499 | 1,550 | 1,729 | . | . | . | . | . |
| annual change in % (real) | -3.3 | 12.1 | 7.3 | 5.7 | . | . | 11.0 | 7.0 | 9.0 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | 7.3 | 3.7 | -6.7 | 4.9 | . | . | 3.0 | 3.5 | 3.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | -21.4 | 13.8 | 15.2 | -8.6 | . | . | . | . | . |
| Construction output 3) | | | | | | | | | |
| annual change in % (real) | -6.1 | 15.8 | 4.5 | 12.4 | . | . | . | . | . |
| Employed persons, LFS, th, average 4) | 323.5 | 296.9 | 331.8 | 357.1 | 352.9 | 342.0 | 360 | 370 | 380 |
| annual change in % | -4.4 | -8.2 | 11.7 | 7.6 | 12.1 | -3.1 | 0.2 | 3.0 | 3.0 |
| Unemployed persons, LFS, th, average 4) | 176.7 | 145.8 | 126.1 | 156.6 | 155.3 | 133.0 | 140 | 130 | 120 |
| Unemployment rate, LFS, in %, average 4) | 35.3 | 32.9 | 27.5 | 30.5 | 30.6 | 28.0 | 28.0 | 26.0 | 24.0 |
| Reg. unemployment rate, in %, eop | . | . | . | . | . | . | . | . | . |
| Average monthly net wages, EUR | 430 | 451 | 457 | 450 | 448 | 484 | 480 | 510 | 530 |
| annual change in % (real, net) | 9.0 | 5.4 | 1.0 | -3.0 | -5.7 | 7.7 | 7.0 | 4.0 | 1.5 |
| Consumer prices, % p.a. | 0.4 | -0.5 | 0.3 | 1.5 | 1.7 | 0.3 | 0.7 | 1.6 | 2.0 |
| Producer prices, % p.a. | 1.7 | 2.7 | -0.1 | 3.4 | 0.2 | 0.9 | 2.7 | 3.0 | 2.5 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 24.2 | 29.4 | 29.3 | 30.6 | 32.0 | 29.2 | 30.0 | 30.0 | 30.0 |
| Expenditures | 27.2 | 27.8 | 29.1 | 29.2 | 28.4 | 28.8 | 30.0 | 30.5 | 31.0 |
| Deficit (-) / surplus (+) | -2.9 | 1.6 | 0.2 | 1.4 | 3.5 | 0.5 | 0.0 | -0.5 | -1.0 |
| General gov.gross debt, nat.def., % of GDP | 10.5 | 12.9 | 14.0 | 15.9 | 15.5 | 16.3 | 16.0 | 16.0 | 17.0 |
| Stock of loans of non-fin.private sector, % p.a. | 6.2 | 7.2 | 10.5 | 9.7 | 10.2 | 11.4 | . | . | . |
| Non-performing loans (NPL), in %, eop | 8.3 | 6.2 | 4.9 | 3.1 | 3.9 | 2.8 | . | . | . |
| Central bank policy rate, % p.a., eop 5) | 9.29 | 7.69 | 7.22 | 6.83 | 6.8 | 6.5 | 7.00 | 7.30 | 7.50 |
| Current account, EUR mn | -385 | -497 | -481 | -383 | -421 | -424 | -410 | -440 | -510 |
| Current account, % of GDP | -6.9 | -8.6 | -7.9 | -6.1 | -14.8 | -14.3 | -6.2 | -6.3 | -6.9 |
| Exports of goods, BOP, EUR mn | 324 | 323 | 308 | 379 | 179 | 173 | 350 | 370 | 390 |
| annual change in % | 11.3 | -0.5 | -4.5 | 23.1 | 19.4 | -3.3 | -8.0 | 7.0 | 5.0 |
| Imports of goods, BOP, EUR mn | 2,383 | 2,432 | 2,599 | 2,843 | 1,303 | 1,436 | 3,010 | 3,220 | 3,490 |
| annual change in % | 4.2 | 2.1 | 6.9 | 9.4 | 7.6 | 10.2 | 6.0 | 7.0 | 8.5 |
| Exports of services, BOP, EUR mn | 929 | 952 | 1,131 | 1,330 | 361 | 433 | 1,460 | 1,580 | 1,720 |
| annual change in % | 6.1 | 2.5 | 18.8 | 17.6 | 11.0 | 20.1 | 10.0 | 8.5 | 9.0 |
| Imports of services, BOP, EUR mn | 469 | 494 | 492 | 536 | 217 | 265 | 590 | 630 | 690 |
| annual change in % | 32.0 | 5.5 | -0.5 | 9.0 | 6.2 | 22.2 | 10.0 | 7.0 | 10.0 |
| FDI liabilities, EUR mn | 151 | 309 | 220 | 255 | 149 | 80 | 180 | . | . |
| FDI assets, EUR mn | 27 | 37 | 43 | 43 | 11.0 | 18.8 | 40 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 645 | 734 | 830 | 850 | . | . | . | . | . |
| Gross external debt, EUR mn | 1,737 | 1,932 | 2,015 | 2,089 | 2114 | 2058 | 2,100 | 2,300 | 2,400 |
| Gross external debt, % of GDP | 31.2 | 33.3 | 33.2 | 33.2 | 33.6 | 31.2 | 32.0 | 32.5 | 32.0 |

1) Preliminary. - 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).

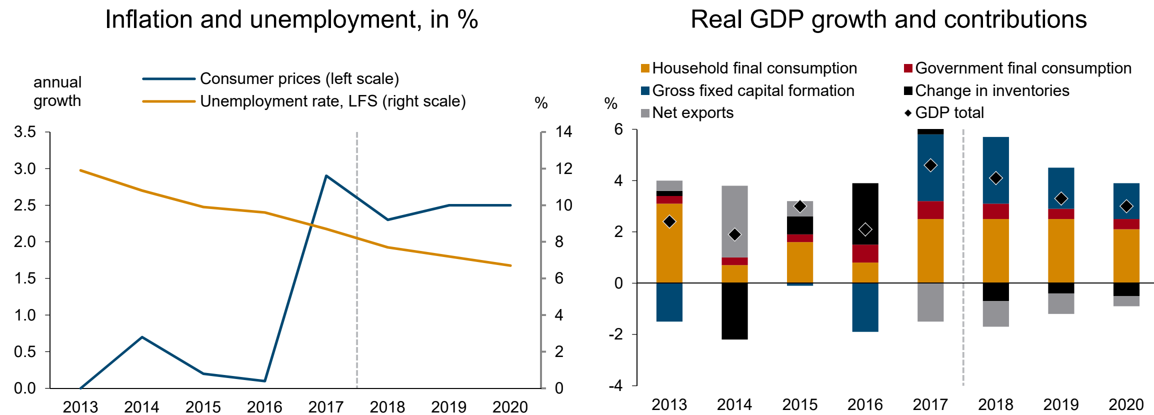
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

# LATVIA: Construction pushes growth but some slowdown ahead

SEBASTIAN LEITNER

**Both public and private investment have kept the economy growing at a high pace in 2018 and exports evolved more strongly than expected. Household consumption is also rising rapidly; a tightening labour market and the 2018 income tax reform will provide further stimulus. While public spending is likely to expand quickly, we assume external demand growth to abate gradually. In 2018 we expect another year with high GDP growth of 4.1%, followed by a slight slowdown to 3.3% in 2019 and 2.7% in 2020.**

**Figure 46 / Latvia: Main macroeconomic indicators**




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

**After a strong upturn in external trade last year, export growth subsided only slightly in 2018.** Growth in exports to Western Europe abated in general, but remained high to Sweden and Russia. The most important export sectors, wood and food, as well as metals and machinery, have reported good growth figures. 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. Low growth rates in industry, despite increasing household consumption, show the mounting problem in the manufacturing sector. Although capital investment and household consumption are rising strongly, real growth in imports declined. As a result, the current account surplus will increase this year. However, in 2019-2020 we expect net exports to become more negative, in line with a cooling of external demand activity.

**Gross fixed capital investment continues to grow at a fast pace (+17.1% year on year in H1 2018).** Fresh EU funds have started to become available on a larger scale and the government continues to invest – the Rail Baltica high-speed train project will result in higher public investment in 2019 and 2020. The current investment boom is largely confined to construction, while investment in machinery and equipment is almost stagnant. The number of building permits granted shows that a longer-term rise of construction activity is to be expected not only for infrastructure, but also for residential, office and other commercial buildings.

**Since Latvia's third largest bank, ABLV, was forced to initiate a shutdown of its operations due to allegations of institutionalised money laundering in February 2018, the Latvian banking sector has experienced a loss.** 11 banks were urged by the ECB to review their operations aimed at foreign customers. The turmoil resulted in a stronger decline of foreign deposits in the first quarter of 2018, but this then levelled off in the following months. The EU institutions pointed out that the Latvian government has to do more on anti-money laundering measures and the Latvian banks have to cut back their engagement in offshore banking services substantially.

**In the parliamentary elections that took place on 6 October, the centre-left 'Harmony Centre', which has a stronghold in the Russian-speaking minority, came first again (as in 2011 and 2014) with 23 of the 100 Saeima seats.** The liberal-conservative block of parties was completely rearranged, a phenomena that has happened quite often in Latvia in times of political scandals and turbulences. Only one of the three parties forming the previous coalition government, the populist right-wing 'National Alliance' was able to hold their relative position, while 'Union of Farmers and Greens' of Prime Minister Kučinskis was halved and 'Unity', having been the main centre-right party for about 10 years, has almost completely lost its previous electorate to newcomers due to internal fights. These are 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). Although KPV and JKP have not ruled out cooperation with 'Harmony' before the elections, the most probable outcome of the coalition talks is a centre-right government. We expect only minor changes in economic and fiscal policy from the incoming government. The medium-term budget strategy foresees substantial increases in family benefits and public health expenditure for the coming years. In the latter, they are currently the second lowest spender in the EU as a share of GDP after Cyprus. At the same time, however, the fiscal strategy foresees a reduction of the overall share of the government in GDP via gradual tax reductions.

**Job growth strongly gained momentum (+1.9% year on year in H1 2018), not only given the upswing in construction, but also in the trade and ICT sectors.** Employment rates are increasing strongly and are approaching the levels of Scandinavian countries, which are the frontrunners in the EU in this respect. We expect the unemployment rate to fall to 7.7% in 2018 on average and to further decline to about 7% by the end of the forecast period in 2020. However, regional disparities are strong: while in Riga full-employment is evident, in the old industrial regions bordering Russia the unemployment rate is 15%. In the longer term Latvia is likely to experience a major decline of the working-age population – Eurostat projections indicate that, without policy changes, the age group 15-64 could shrink by 20% compared to 2015 up to 2030. Thus, the effective pension age is likely to increase in the coming years. Moreover, depending on the composition of the new coalition, the incoming government may allow higher immigration to solve the problem of a shortage of skilled labour.

**Further tightening of the labour market resulted in strong growth of net wages, by 7.6% in the first half of 2018 year on year in real terms.** This is also an outcome of the strong increase in the minimum wage (+13%) that, inspired by the parliamentary elections, came into force in January 2018. In the coming years we expect slower but still substantial increases in household incomes. This will further

fuel household consumption which is projected to increase by about 4.2% in real terms this year. In the period 2019-2020 we expect some slowdown but consumption to still grow by 3.5% in 2020.

**Strong wage growth has not fed through into rising inflation yet.** On the contrary, low import prices have resulted in a decline in consumer price growth during 2018 so far. We expect the level of CPI inflation to remain at about 2.5% in 2019 and 2020.

**All in all, compared to our Summer Forecast we have become more optimistic, increasing our real GDP growth rate for this year to 4.1%.** Private investment activity and external demand have picked up more strongly than expected. The strong upswing in public investment, not only this year but also in 2019 and 2020, will be facilitated by increasing inflows of EU funds. Rising household incomes will help private consumption to keep on growing steadily. However, we see some cooling off in 2019 and 2020, particularly in external demand, thus we have revised our GDP growth forecasts slightly to 3.3% and 3% respectively.

## Table 21 / Latvia: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 1,994 | 1,978 | 1,960 | 1,950 | 1,942 | 1,926 | 1,930 | 1,920 | 1,915 |
| Gross domestic product, EUR mn, nom. | 23,618 | 24,320 | 25,038 | 27,033 | 12,666 | 13,755 | 28,800 | 30,500 | 32,200 |
| annual change in % (real) | 1.9 | 3.0 | 2.1 | 4.6 | 4.4 | 4.7 | 4.1 | 3.3 | 3.0 |
| GDP/capita (EUR at PPP) | 17,500 | 18,500 | 18,900 | 20,200 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. | 14,178 | 14,393 | 14,751 | 15,842 | 7,597 | 8,141 | . | . | . |
| annual change in % (real) | 1.2 | 2.7 | 1.4 | 4.2 | 2.7 | 4.6 | 4.2 | 4.1 | 3.5 |
| Gross fixed capital form., EUR mn, nom. | 5,337 | 5,385 | 4,915 | 5,651 | 2,295 | 2,760 | . | . | . |
| annual change in % (real) | 0.1 | -0.5 | -8.4 | 13.1 | 13.9 | 17.1 | 13.0 | 8.0 | 7.0 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | -1.1 | 3.6 | 5.4 | 8.3 | 9.6 | 2.1 | 2.5 | 3.0 | 2.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 4.5 | 14.0 | -7.3 | 0.0 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 10.5 | -0.6 | -16.6 | 18.7 | 11.0 | 33.3 | . | . | . |
| Employed persons, LFS, th, average | 884.6 | 896.1 | 893.3 | 894.8 | 887.1 | 903.8 | 908 | 917 | 925 |
| annual change in % | -1.0 | 1.3 | -0.3 | 0.2 | -0.8 | 1.9 | 1.5 | 1.0 | 0.9 |
| Unemployed persons, LFS, th, average | 107.6 | 98.2 | 95.3 | 85.4 | 89.0 | 77.7 | 76 | 71 | 66 |
| Unemployment rate, LFS, in %, average | 10.8 | 9.9 | 9.6 | 8.7 | 9.2 | 8.0 | 7.7 | 7.2 | 6.7 |
| Reg. unemployment rate, in %, eop 3) | 8.5 | 8.7 | 8.4 | 6.8 | 7.2 | 6.4 | . | . | . |
| Average monthly gross wages, EUR | 765.0 | 818.0 | 859.0 | 926.0 | 905.3 | 982.5 | 1,000 | 1,070 | 1,140 |
| annual change in % (real, gross) | 6.2 | 6.7 | 4.9 | 4.5 | 4.6 | 6.2 | 6.0 | 4.5 | 4.0 |
| Average monthly net wages, EUR | 560.0 | 603.0 | 631.0 | 676.0 | 662.7 | 729.0 | 730 | 780 | 830 |
| annual change in % (real, net) | 8.0 | 7.4 | 4.3 | 3.8 | 3.8 | 7.6 | 6.0 | 4.5 | 4.0 |
| Consumer prices (HICP), % p.a. | 0.7 | 0.2 | 0.1 | 2.9 | 3.1 | 2.2 | 2.3 | 2.5 | 2.5 |
| Producer prices in industry, % p.a. | 0.4 | -1.0 | -2.5 | 2.5 | 1.7 | 3.5 | 3.5 | 2.8 | 2.5 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 36.6 | 36.9 | 37.0 | 37.3 | . | . | 36.0 | 35.7 | 35.6 |
| Expenditures | 38.1 | 38.2 | 37.0 | 37.8 | . | . | 36.8 | 36.4 | 36.1 |
| Net lending (+) / net borrowing (-) | -1.5 | -1.4 | 0.1 | -0.5 | . | . | -0.8 | -0.7 | -0.5 |
| General gov.gross debt, EU def., % of GDP | 40.9 | 36.8 | 40.3 | 39.9 | . | . | 36.0 | 34.5 | 34.0 |
| Stock of loans of non-fin.private sector, % p.a. | -3.3 | -2.8 | 0.1 | -4.7 | -0.1 | -5.3 | . | . | . |
| Non-performing loans (NPL), in %, eop | 6.9 | 6.0 | 4.4 | 4.1 | 4.4 | 4.2 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 0.05 | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | -411 | -113 | 403 | 191 | 87 | 236 | 529 | 299 | 169 |
| Current account, % of GDP | -1.7 | -0.5 | 1.6 | 0.7 | 0.7 | 1.7 | 1.8 | 1.0 | 0.5 |
| Exports of goods, BOP, EUR mn | 10,242 | 10,340 | 10,411 | 11,543 | 5,447 | 5,892 | 12,470 | 13,090 | 13,710 |
| annual change in % | 4.4 | 1.0 | 0.7 | 10.9 | 11.2 | 8.2 | 8.0 | 5.0 | 4.7 |
| Imports of goods, BOP, EUR mn | 12,621 | 12,538 | 12,296 | 13,851 | 6,623 | 6,959 | 14,540 | 15,500 | 16,360 |
| annual change in % | 1.5 | -0.7 | -1.9 | 12.6 | 13.3 | 5.1 | 5.0 | 6.6 | 5.5 |
| Exports of services, BOP, EUR mn | 4,105 | 4,356 | 4,606 | 4,973 | 2,375 | 2,519 | 5,300 | 5,610 | 5,870 |
| annual change in % | 5.3 | 6.1 | 5.7 | 8.0 | 6.2 | 6.1 | 6.6 | 5.8 | 4.6 |
| Imports of services, BOP, EUR mn | 2,066 | 2,279 | 2,432 | 2,641 | 1,233 | 1,338 | 2,860 | 3,060 | 3,210 |
| annual change in % | -2.9 | 10.3 | 6.7 | 8.6 | 7.2 | 8.5 | 8.3 | 7.0 | 4.9 |
| FDI liabilities, EUR mn | 704 | 712 | 222 | 1,024 | 330 | -42 | 0 | . | . |
| FDI assets, EUR mn | 409 | 134 | 199 | 499 | 214 | -116 | 0 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 2,448 | 2,957 | 3,100 | 3,620 | 3,113 | 3,629 | . | . | . |
| Gross external debt, EUR mn | 34,035 | 34,947 | 37,289 | 37,984 | 37,621 | 35,568 | 36,000 | 36,600 | 38,600 |
| Gross external debt, % of GDP | 144.1 | 143.7 | 148.9 | 140.5 | 139.2 | 123.5 | 125.0 | 120.0 | 120.0 |

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

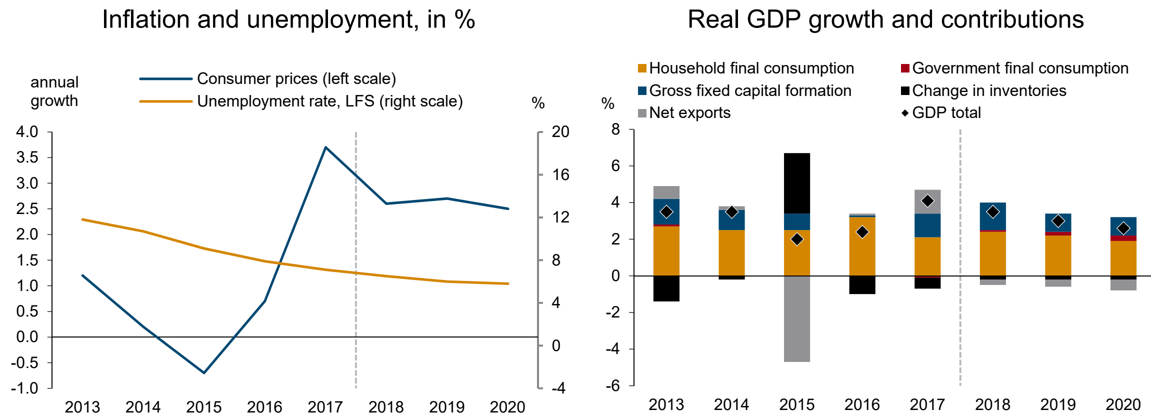
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

# LITHUANIA: Brisk domestic demand fosters growth

SEBASTIAN LEITNER

Public and private investment have driven growth in the Lithuanian economy for another year. A further decline in unemployment has resulted in rapid wage increases. Furthermore, the enacted income tax reform will foster steady, strong growth in household consumption. The increase in external demand has been stronger than expected in 2018, but is likely to abate slightly in the coming two years. For 2018, we expect real GDP to grow by 3.5%, followed by 3% in 2019 and 2.6% in 2020.

**Figure 47 / Lithuania: Main macroeconomic indicators**




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

**The strong upswing of exports in particular to Russia last year was followed by lower growth rates in 2018.** However, external demand for goods still remained strong, and is expected to increase by 6% in net terms, year on year. Growth in exports to Euro zone countries has evolved in an even more lively way. Overall trade figures are strongly driven by fluctuations in the oil price and energy demand since more than 20% of good exports of Lithuanian origin are processed petroleum products manufactured in the largest Lithuanian industrial complex, the Polish-owned OLEN Lietuva (formerly Mazeiku Nafta) refinery. The demand for other important export products of the country like foodstuffs, plastics and wood-based goods has also grown above average compared to overall trade this year. Trade in services has also continued to flourish in 2018, particularly due to transit with Russia and Western partners. Tourism is also evolving at a good pace: arrivals increased by 7% in the first half of

2018. Due to strong investment and consumption growth, imports are increasing faster than exports. As a result, the contribution of net exports to GDP growth is expected to be negative in 2018.

**Figures for the second quarter of 2018 provide a further indication that gross fixed capital investment is likely to grow by another 8% this year.** The inflow of fresh EU funds from the 2014-2020 programming period will allow the government to increase capital spending this year and during the rest of the forecast period. However, private investment has also risen strongly in 2018; the strong increases of investment in machinery and vehicles show that enterprises are upgrading their production infrastructure. The capacity utilisation rate has reached 78%, the highest level in Lithuania since independence. The construction of new dwellings rose strongly in the first half of 2018 while housing prices increased considerably in the cities. In the coming two years we expect construction growth figures to remain strong, albeit a bit below current levels, as indicated by the latest figures for building permits granted. In general, business and consumer sentiment indicators are very positive at the moment and increasing.

**We expect employment to have increased by 0.5% in 2018 as a whole.** In general, the structure of employment has been shifting somewhat faster towards higher-skilled services than the EU average since 2010. Eurostat projections on demographic developments in EU countries indicate that the loss in the working-age population (15-64) could be highest in Lithuania, with a decline of 28% projected between 2015 and 2030 if no policy changes are implemented. In order to counteract the population shrinkage, the Lithuanian government introduced general child benefits of between EUR 30 and EUR 60 per month at the beginning of 2018. Previously only low-income families were eligible to those welfare benefits. In addition, work permits are also increasingly being offered to foreign workers, for example from Ukraine. However, net international migration is only gradually moving towards a balance (having previously been negative). The unemployment rate is likely to drop to 6.5% in 2018 and 5.8% in 2020. An increase in the minimum wage by 5% to EUR 400 from January 2018 onwards will push up the overall growth rate of salaries to about 6% in real terms this year. The government indicated a stronger rise in the minimum wage of 7% from 2019, meaning that incomes will continue to rise strongly. As a result, household consumption growth is likely to be relatively high during the whole forecast period.

**In June 2018 the Lithuanian parliament adopted tax and pension reforms to be introduced in 2019.** The taxation on labour will be reduced for low-income earners and will become more progressive in general. However, the effects of the measures will only be modest in terms of reducing inequality and poverty, as even the IMF and the central bank have acknowledged. They emphasise that, in order to tackle these problems, the Lithuanian government should instead raise budget revenues. Higher social expenditures combined with lower taxes on low-income groups should also help to further reduce emigration. The proposed measure to reach this goal is, in particular, the broadening of the real estate tax base to all private residences. The enacted changes to the funded pillar of the pension system are inadequate to reduce old-age poverty.

**In July 2018 Lithuania finally joined its Baltic neighbours in the OECD.** In its latest economic survey on the country, the OECD highlighted the need for productivity catch-up, inclusiveness and tackling the problems of a rapidly ageing society. The budget plan of the Lithuanian government foresees a surplus of 0.6% of GDP for 2019; we however expect public consumption and investment to grow more swiftly towards the next parliamentary elections scheduled for 2020.

**Compared to our Summer Forecast we have become slightly more optimistic, increasing our forecast for real GDP growth to 3.5% in 2018.** Private consumption in particular has picked up strongly while exports have also performed better than expected. Private investment in residential buildings and machinery is growing swiftly and sentiment indicators show strong confidence levels among both businesses and consumers. A sustained upswing in public investment, not only this year, but also in 2019 and 2020, will be facilitated by an increasing inflow of EU funds. Rising household incomes, pushed upwards by a tightening labour market and tax cuts, will help private consumption to keep on growing steadily. In the coming two years, however, external demand is likely to lose momentum. Thus for 2019 and 2020, we forecast real GDP to grow at somewhat lower paces, by 3% and 2.6% respectively.

## Table 22 / Lithuania: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 2,932 | 2,905 | 2,868 | 2,830 | 2,826 | 2,800 | 2,800 | 2,780 | 2,760 |
| Gross domestic product, EUR mn, nom. | 36,568 | 37,434 | 38,849 | 42,191 | 19,828 | 21,134 | 44,800 | 47,400 | 49,800 |
| annual change in % (real) | 3.5 | 2.0 | 2.4 | 4.1 | 4.6 | 3.8 | 3.5 | 3.0 | 2.6 |
| GDP/capita (EUR at PPP) | 20,800 | 21,700 | 22,100 | 23,600 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. | 22,686 | 23,372 | 24,783 | 26,468 | 12,729 | 13,589 | . | . | . |
| annual change in % (real) | 4.0 | 4.0 | 5.1 | 3.4 | 4.6 | 3.9 | 3.8 | 3.5 | 3.0 |
| Gross fixed capital form., EUR mn, nom. | 6,906 | 7,330 | 7,506 | 8,098 | 3,636 | 3,933 | . | . | . |
| annual change in % (real) | 5.8 | 4.9 | 0.3 | 6.8 | 5.7 | 8.0 | 8.0 | 5.5 | 5.5 |
| Gross industrial production (sales) | | | | | | | | | |
| annual change in % (real) | 0.1 | 4.5 | 2.9 | 6.9 | 6.6 | 5.0 | 6.0 | 4.5 | 4.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 8.4 | 8.6 | -1.7 | 1.0 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 17.1 | -3.5 | -9.3 | 8.9 | 7.6 | 18.1 | . | . | . |
| Employed persons, LFS, th, average | 1,319 | 1,335 | 1,361 | 1,355 | 1,354 | 1,359 | 1,361 | 1,363 | 1,365 |
| annual change in % | 2.0 | 1.2 | 2.0 | -0.5 | -0.4 | 0.4 | 0.5 | 0.1 | 0.1 |
| Unemployed persons, LFS, th, average | 158 | 134 | 116 | 103 | 110 | 95.0 | 95 | 87 | 84 |
| Unemployment rate, LFS, in %, average | 10.7 | 9.1 | 7.9 | 7.1 | 7.6 | 6.6 | 6.5 | 6.0 | 5.8 |
| Reg. unemployment rate, in %, eop 2) | 9.3 | 9.0 | 8.5 | 8.7 | 7.3 | 8.3 | . | . | . |
| Average monthly gross wages, EUR 3) | 677.4 | 714.1 | 774.0 | 840.4 | 819.4 | 903.3 | 910 | 980 | 1,050 |
| annual change in % (real, gross) | 4.7 | 6.4 | 7.4 | 4.7 | 6.0 | 7.0 | 6.0 | 5.0 | 5.0 |
| Average monthly net wages, EUR 3) | 527.2 | 553.9 | 602.3 | 660.2 | 645.7 | 705.8 | 720 | 780 | 840 |
| annual change in % (real, net) | 5.1 | 6.1 | 7.7 | 5.7 | 7.1 | 6.1 | 6.0 | 5.3 | 5.0 |
| Consumer prices (HICP), % p.a. | 0.2 | -0.7 | 0.7 | 3.7 | 3.2 | 2.8 | 2.6 | 2.7 | 2.5 |
| Producer prices in industry, % p.a. | -5.0 | -9.7 | -4.3 | 4.9 | 6.2 | 4.0 | 6.0 | 4.0 | 2.2 |
| General goverm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 34.0 | 34.6 | 34.3 | 33.5 | . | . | 33.5 | 33.3 | 33.3 |
| Expenditures | 34.6 | 34.9 | 34.0 | 33.0 | . | . | 33.2 | 33.3 | 33.3 |
| Net lending (+) / net borrowing (-) | -0.6 | -0.2 | 0.3 | 0.5 | . | . | 0.3 | 0.0 | 0.0 |
| General gov.gross debt, EU def., % of GDP | 40.5 | 42.6 | 39.9 | 39.4 | . | . | 37.0 | 36.0 | 35.0 |
| Stock of loans of non-fin.private sector, % p.a. | -0.9 | 4.1 | 7.1 | 4.5 | 5.1 | 7.4 | . | . | . |
| Non-performing loans (NPL), in %, eop | 6.5 | 5.5 | 3.8 | 3.1 | . | . | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 0.12 | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | 1,158 | -847 | -300 | 371 | -277 | -284 | -530 | -630 | -690 |
| Current account, % of GDP | 3.2 | -2.3 | -0.8 | 0.9 | -1.4 | -1.3 | -1.2 | -1.3 | -1.4 |
| Exports of goods, BOP, EUR mn | 23,750 | 22,309 | 21,922 | 25,724 | 12,280 | 13,025 | 27,270 | 28,770 | 30,210 |
| annual change in % | -1.0 | -6.1 | -1.7 | 17.3 | 18.0 | 6.1 | 6.0 | 5.5 | 5.0 |
| Imports of goods, BOP, EUR mn | 24,686 | 24,296 | 23,690 | 27,673 | 13,383 | 14,519 | 30,200 | 32,300 | 34,100 |
| annual change in % | -0.9 | -1.6 | -2.5 | 16.8 | 17.0 | 8.5 | 9.1 | 7.0 | 5.6 |
| Exports of services, BOP, EUR mn | 5,850 | 6,011 | 6,845 | 8,405 | 3,936 | 4,536 | 9,500 | 10,300 | 11,000 |
| annual change in % | 8.5 | 2.8 | 13.9 | 22.8 | 21.5 | 15.3 | 13.0 | 8.4 | 6.8 |
| Imports of services, BOP, EUR mn | 4,212 | 4,267 | 4,602 | 5,283 | 2,513 | 2,731 | 5,800 | 6,100 | 6,500 |
| annual change in % | 4.4 | 1.3 | 7.9 | 14.8 | 15.0 | 8.7 | 9.8 | 5.2 | 6.6 |
| FDI liabilities, EUR mn | 387 | 873 | 870 | 1,024 | 193 | 334 | 1,220 | . | . |
| FDI assets, EUR mn | 382 | 164 | 732 | 474 | -157 | 366 | 800 | . | . |
| Gross reserves of NB excl. gold, EUR mn 5) | 6,991 | 1,376 | 2,263 | 3,509 | 1,093 | 4,361 | . | . | . |
| Gross external debt, EUR mn | 25,551 | 28,331 | 33,087 | 35,271 | 33,586 | 35,258 | 35,800 | 37,900 | 39,800 |
| Gross external debt, % of GDP | 69.9 | 75.7 | 85.2 | 83.6 | 79.6 | 78.7 | 80.0 | 80.0 | 80.0 |

1) Preliminary. - 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.

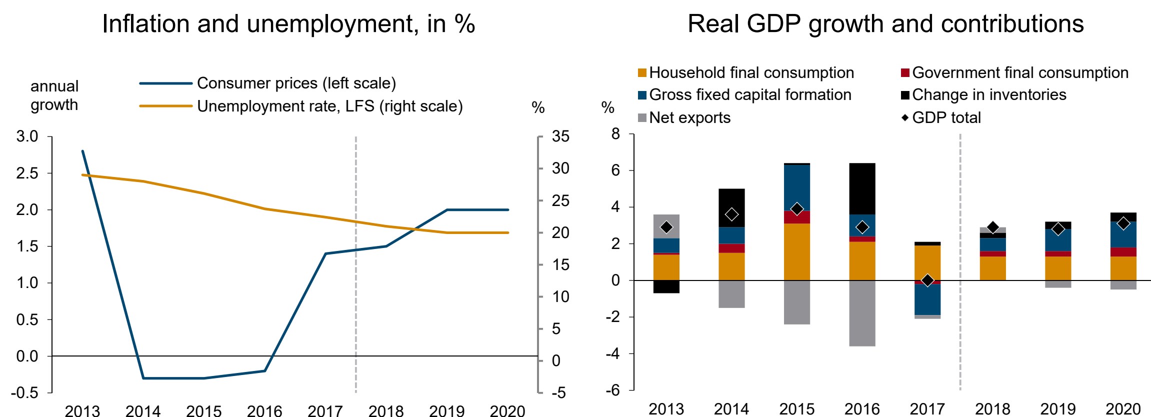
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

# MACEDONIA: Name disputes prolong uncertainty and delay hopes for growth-boosting connectivity

PETER HAVLIK

**The Macedonian economy started to recover in 2018 owing to a strong revival of industry and solid export performance. Real GDP is projected to grow by about 3% per year in the medium term, although the chances of political instability suggest significant downside risks. The failed referendum on the country's 'name issue' on 30 September will prolong the political crisis and may destabilise the country again with adverse economic consequences, regardless of the new name's endorsement by the parliament in October.**

**Figure 48 / Macedonia: Main macroeconomic indicators**




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

**After stagnation in 2017, the Macedonian economy started to recover in 2018 owing to a strong revival of industry and solid export performance.** However, construction continued to shrink in the first half of the year and investments most likely contracted as well. Curiously, apparently neither last year's crisis nor the current instability have had any effect on employment, which increased, and the rate of unemployment has declined further (though the unemployment rate remains close to 20% as of end-June 2018). After last year's parliamentary elections, the new government led by Social Democrat Prime Minister Zoran Zaev has made great strides in improving fiscal transparency and in tackling the issue of unpaid public sector liabilities. Internal political stability was partly restored towards the end of 2017 and domestic conditions supporting the economic recovery were thus established. Some progress has also been achieved in external political relations as the new government signed an agreement with Bulgaria and approached Serbia as well. Most importantly, some progress was achieved in negotiations regarding the 'name issue' with Greece.

**However, the failed referendum on the country's 'name issue' (lumped together with approving NATO and EU memberships) prolonged the political crisis** and may even lead to new parliamentary elections.[30] Although the overwhelming majority (92%) of votes cast in the 30 September referendum were in favour, the low turnout (37%) made the referendum invalid (it only had a consultative role anyway). Eventually, the name change was adopted by the parliamentary majority on 19 October (80 votes in favour out of 120). Nevertheless, after last year's violent street protests and clashes in the parliament, a repetition of a political crisis cannot be ruled out owing to numerous contrasting internal and external interests in this small Balkan country. Not only Greece, the EU, NATO and the USA, but also Russia have attempted to influence Macedonia's geopolitical orientation.[31]

**The European Commission already recommended in April 2018 to open accession negotiations with Macedonia**, even prior to any resolution of the 'name issue', anticipating Greek consent. Similarly, NATO General Secretary Jens Stoltenberg already formally invited Macedonia to launch accession negotiations[32] in July 2018. The Economic and Financial Dialogue between the EU and the Western Balkans and Turkey on 25 May 2018 provided a number of policy recommendations. Macedonia should develop a proper medium-term fiscal consolidation strategy, stabilise the public debt ratio, streamline social spending and agricultural subsidies, reduce public sector payment arrears, develop an arrears prevention strategy, improve tax collection, conduct monetary policy consistent with the exchange rate peg (to the euro) while using available space within this framework in line with safeguarding price stability, etc. In addition, a number of labour market related recommendations were suggested.[33] However, in light of sustained primary fiscal deficits and continued financing needs of state-owned enterprises, public debt stabilisation remains a challenge. In fact, the debt-to-GDP ratio is projected to increase a bit in 2018, followed by a moderate decline afterwards.

**The economy already returned to growth towards the end of last year. In 2018, real GDP is projected to increase by close to 3% and the growth will stay at this level in the coming years** – subject to obvious uncertainties related to the unstable political situation. In the baseline scenario, GDP growth will be stimulated by both domestic demand and the positive contribution of net exports. Private consumption will grow by about 2% per year thanks to rising wages, social transfers and remittances. Investments are expected to rebound strongly as well – provided political stability is maintained. With the recent completion of a 30 km highway corridor to the Greek port of Thessaloniki in April 2018, the improved connectivity in the Western Balkans and Macedonia should benefit industry, exports, tourism and employment. Inflation will stabilise at close to, or a bit above, 2% per year, with the nominal exchange rate remaining stable as well. Simultaneously – as mentioned above – a new outburst of political instability cannot be dismissed. The fragility of the new government persists and the 'name issue' remains disputed after the failed referendum. It will dominate the forthcoming early elections demanded by the opposition as diverse views on the 'name issue' between the opposition and the current government coalition persist. Notwithstanding the parliamentary confirmation of the country's new name (North Macedonia), there are still nationalist forces in Greece who oppose the suggested name compromise, the preliminary agreement between Mr Zaev and his Greek counterpart, Alexis Tsipras, from 12 June 2018 notwithstanding.

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30 https://wiiw.ac.at/macedonian-referendum-results-back-to-square-one-n-343.html

31 https://wiiw.ac.at/what-s-in-a-name-the-case-of-macedonia-n-342.html

32 https://foreignpolicy.com/2018/09/13/for-macedonia-is-joining-nato-and-the-eu-worth-the-trouble/?wpmm=1&wpisrc=nl_todayworld

33 See: http://www.consilium.europa.eu/en/press/press-releases/2018/05/25/western-balkans-and-turkey-joint-conclusions-of-the-economic-and-financial-dialogue/

## Table 23 / Macedonia: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 2,067 | 2,070 | 2,072 | 2,075 | . | . | 2,095 | 2,100 | 2,100 |
| Gross domestic product, MKD bn, nom. | 527.6 | 559.0 | 598.9 | 619.8 | 294.2 | 309.2 | 647.0 | 679.0 | 714.0 |
| annual change in % (real) | 3.6 | 3.9 | 2.9 | 0.0 | -0.7 | 1.6 | 2.9 | 2.8 | 3.1 |
| GDP/capita (EUR at PPP) | 9,900 | 10,500 | 10,900 | 11,000 | . | . | . | . | . |
| Consumption of households, MKD mn, nom. | 363.6 | 380.2 | 390.3 | 407.3 | 200.1 | 207.3 | . | . | . |
| annual change in % (real) | 2.1 | 4.5 | 3.1 | 2.9 | 3.0 | 2.1 | 2.0 | 2.0 | 2.0 |
| Gross fixed capital form., MKD mn, nom. | 123.5 | 133.3 | 143.5 | 144.1 | . | . | | | |
| annual change in % (real) | 4.0 | 10.5 | 5.1 | -7.0 | . | . | 3.0 | 5.0 | 6.0 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | 4.8 | 4.9 | 3.4 | 0.2 | 1.2 | 5.1 | 5.0 | 4.0 | 6.0 |
| Gross agricultural production 3) | | | | | | | | | |
| annual change in % (real) | 1.7 | 5.2 | 5.2 | 4.0 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | -3.4 | 40.8 | 7.2 | -27.2 | -27.7 | -18.2 | . | . | . |
| Employed persons, LFS, th, average | 690.2 | 706.0 | 723.6 | 740.6 | 737.0 | 752.5 | 750 | 770 | 780 |
| annual change in % | 1.7 | 2.3 | 2.5 | 2.4 | 2.7 | 2.1 | 1.5 | 2.0 | 1.5 |
| Unemployed persons, LFS, th, average | 268.8 | 248.9 | 225.0 | 213.6 | 217.2 | 204.6 | 200 | 190 | 200 |
| Unemployment rate, LFS, in %, average | 28.0 | 26.1 | 23.7 | 22.4 | 22.8 | 21.4 | 21.0 | 20.0 | 20.0 |
| Reg. unemployment rate, in %, eop | 23.4 | 22.1 | 21.2 | 20.1 | 20.5 | 19.5 | . | . | . |
| Average monthly gross wages, MKD | 31,325 | 32,171 | 32,821 | 33,688 | 33,292 | 35,102 | 35,200 | 37,000 | 38,500 |
| annual change in % (real, gross) | 1.3 | 3.0 | 2.2 | 1.2 | 1.4 | 3.8 | 3.0 | 3.0 | 2.0 |
| Average monthly net wages, MKD | 21,394 | 21,904 | 22,342 | 22,928 | 22,652 | 23,922 | 24,000 | 25,200 | 26,200 |
| annual change in % (real, net) | 1.5 | 2.7 | 2.2 | 1.2 | 1.3 | 4.0 | 3.0 | 3.0 | 2.0 |
| Consumer prices, % p.a. | -0.3 | -0.3 | -0.2 | 1.4 | 0.9 | 1.6 | 1.5 | 2.0 | 2.0 |
| Producer prices in industry, % p.a. | -1.9 | -3.9 | -3.1 | 4.8 | 5.3 | 1.9 | 3.0 | 3.0 | 3.0 |
| General governm. budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 29.7 | 31.0 | 30.3 | 30.9 | . | . | 31.0 | 31.0 | 32.0 |
| Expenditures | 33.9 | 34.4 | 33.0 | 33.7 | . | . | 33.0 | 33.0 | 33.0 |
| Deficit (-) / surplus (+) | -4.2 | -3.4 | -2.7 | -2.8 | . | . | -2.0 | -2.0 | -1.0 |
| General gov.gross debt, nat.def., % of GDP | 45.7 | 46.6 | 48.4 | 47.5 | 45.4 | 46.1 | 48.0 | 47.0 | 46.0 |
| Stock of loans of non-fin.private sector, % p.a. | 10.0 | 9.6 | -0.1 | 5.4 | 4.1 | 6.1 | . | . | . |
| Non-performing loans (NPL), in %, eop 4) | 10.9 | 10.4 | 6.4 | 6.2 | 6.6 | 5.0 | . | . | . |
| Central bank policy rate, %, p.a., eop 5) | 3.25 | 3.25 | 3.75 | 3.25 | 3.25 | 3.00 | 3.25 | 3.50 | 3.50 |
| Current account, EUR mn | -43 | -177 | -275 | -103 | -226 | -128 | -80 | -110 | -120 |
| Current account, % of GDP | -0.5 | -2.0 | -2.8 | -1.0 | -4.7 | -2.6 | -0.8 | -1.0 | -1.0 |
| Exports of goods, BOP, EUR mn | 2,784 | 3,047 | 3,529 | 4,074 | 1,957 | 2,237 | 4,640 | 5,200 | 5,880 |
| annual change in % | 17.2 | 9.4 | 15.8 | 15.4 | 19.4 | 14.3 | 14.0 | 12.0 | 13.0 |
| Imports of goods, BOP, EUR mn | 4,640 | 4,870 | 5,342 | 5,861 | 2,837 | 3,126 | 6,360 | 6,930 | 7,620 |
| annual change in % | 9.5 | 5.0 | 9.7 | 9.7 | 11.4 | 10.2 | 8.5 | 9.0 | 10.0 |
| Exports of services, BOP, EUR mn | 1,304 | 1,378 | 1,390 | 1,439 | 644 | 711 | 1,510 | 1,650 | 1,820 |
| annual change in % | 12.9 | 5.7 | 0.9 | 3.6 | -0.5 | 10.4 | 5.0 | 9.0 | 10.0 |
| Imports of services, BOP, EUR mn | 920 | 1,029 | 1,049 | 1,062 | 504 | 490 | 1,120 | 1,230 | 1,350 |
| annual change in % | 18.0 | 11.8 | 2.0 | 1.3 | 7.1 | -2.8 | 5.0 | 10.0 | 10.0 |
| FDI liabilities, EUR mn | 37 | 262 | 495 | 351 | 254 | 446 | 500 | . | . |
| FDI assets, EUR mn | -160 | 59 | 179 | 171 | 180 | 121 | 120 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 2,221 | 2,049 | 2,370 | 2,097 | 2,159 | 2,405 | . | . | . |
| Gross external debt, EUR mn | 5,992 | 6,291 | 7,217 | 7,372 | 7,705 | 8,433 | 8,000 | 8,400 | 8,700 |
| Gross external debt, % of GDP | 70.0 | 69.3 | 74.2 | 73.2 | 76.6 | 79.9 | 76.0 | 76.0 | 75.0 |
| Average exchange rate MKD/EUR | 61.62 | 61.61 | 61.60 | 61.57 | 61.6 | 61.5 | 61.3 | 61.3 | 61.4 |

1) Preliminary. - 2) Enterprises with 10 and more employees. - 3) wiiw estimate in 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).

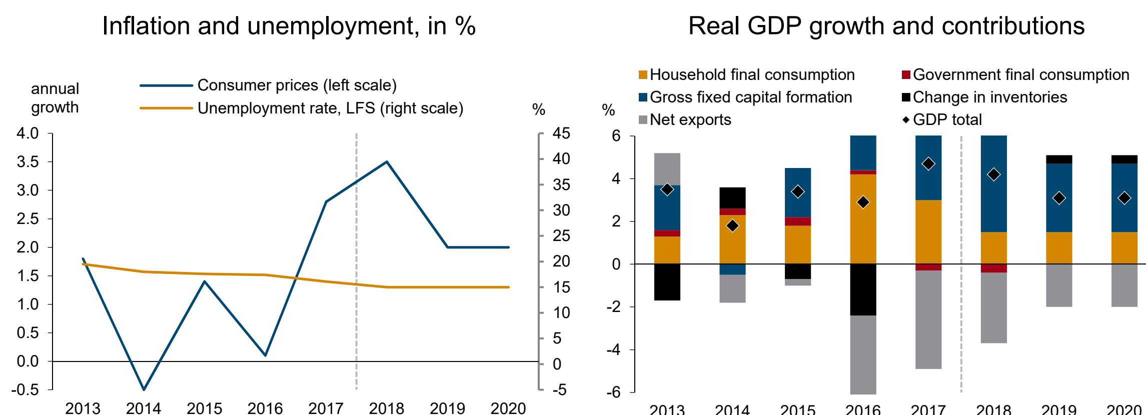
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

# MONTENEGRO: Doing well, but clouds on the horizon

OLGA PINDYUK

In 2018, GDP will grow by 4.2% – better than previously expected. The main driving forces behind the dynamic growth are fast growing investment and exports. High growth has brought about job creation, but unemployment remains high. The costs of the Bar-Boljare highway project have risen, which exacerbated the government debt burden. During 2019-2020, economic growth will slow down to about 3%.

**Figure 49 / Montenegro: Main macroeconomic indicators**




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

**Montenegro's economy has kept on growing at a fast pace** – in H1 2018, GDP grew by 4.8% year over year, which is the highest rate since the global financial crisis. The main driving forces behind the dynamic growth are soaring investments, as well as booming exports. We expect that the economy will slowly run out of steam in the next months but will still perform better than we previously expected, and the annual growth rate in 2018 will be at 4.2%.

**Exports of both services and goods grew at double-digit rates in H1 2018**. The Montenegro tourism sector broke a record this year, with the number of tourists increasing by more than 10% as compared with summer 2017. Exports of all the other services sectors – transport, construction, and other business services – rose even faster, with year-over-year growth rates ranging between 25% and 43%. Manufacturing exports, which account for about 20% of total exports, picked up as well primarily on the back of non-ferrous metals, petroleum products, electric current, and chemicals.

**Investment stayed on its growth trajectory of the last two years**, in particular owing to the Bar-Boljare highway project. Gross fixed capital formation increased in H1 2018 by 28% year over year. This was reflected in import dynamics: imports of goods increased during this period by 10% year over year, with imports of machinery and equipment growing much faster than most other sectors.

**High growth stimulated job creation in the country** – about 5,000 people were additionally employed during H1 2018 as compared with the same period of the previous year. The unemployment rate fell by 1pp during this period, but still remains quite high at a level of 15.3%. Highway construction has not brought that many jobs, as about two thirds of the about 3,000 workers employed in the project are from the Chinese company China Road and Bridge Corporation.

**The costs of the highway project have increased significantly.** As the government did not hedge against currency swings, the recent dollar appreciation has pushed up the costs of the first phase of the Bar-Bojare highway project by 13% to about EUR 900 million (more than 20% of the country's GDP). The costs of construction of the remaining part of the highway are estimated to be about USD 1.2 billion, and financing it would mean increasing the debt burden for the country. With the tightening of financial conditions for emerging markets, it could become difficult for the government to refinance its debt, which would mean a higher risk of default.

**Soaring government debt due to the loan from China forced the government to resort to fiscal consolidation**. Among the steps undertaken were hikes in the VAT rate and excises, and freezing public sector wages. In this environment, real net wages decreased by 2.1% in H1 2018. Double-digit growth in loans to households allowed for private consumption to grow, albeit at a much more modest rate than investment – by 2% year over year in H1 2018. Contractionary fiscal policies will have a dampening effect on private consumption and will restrain economic growth in the coming years.

**To make matters worse, the benefits of participation in the Belt and Road Initiative might not outweigh the related costs**. The public-private partnership with the China Road and Bridge Corporation envisages that the company will operate the highway for 30 years under a concession from the state to get a return on their investment. Additionally, there are doubts whether the highway will be able to generate a sufficient revenue stream for the project to pay off. To achieve that, according to some estimates, traffic from the capital Podgorica to the port of Bar has to increase from about 6,000 vehicles per day to more than 20,000 vehicles per day.

**During 2019-2020, economic growth will slow down to about 3%.** The ongoing fiscal consolidation and less favourable external conditions are the primary reasons for the growth slowdown. Household consumption will grow at a slow pace, and exports are expected to decelerate. The high import dependency of investment will cause a widening of the current account deficit during the forecast period. It will be partially financed through FDI, as well through external debt, which is set to rise in the next years. Inflation will be at 2.5% in 2018 as numerous tax hikes will push prices upwards. Further on CPI growth will reduce its speed to 2% per annum.

## Table 24 / Montenegro: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 [1] | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 622 | 622 | 622 | 622 | . | . | 625 | 625 | 630 |
| Gross domestic product, EUR mn, nom. | 3,458 | 3,655 | 3,954 | 4,299 | 1,770 | 1,911 | 4,600 | 4,800 | 5,000 |
| annual change in % (real) | 1.8 | 3.4 | 2.9 | 4.7 | 4.1 | 4.8 | 4.2 | 3.1 | 3.1 |
| GDP/capita (EUR at PPP) | 11,300 | 12,300 | 13,000 | 13,900 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. [2] | 2,775 | 2,893 | 3,035 | 3,216 | 1,501 | 1,579 | . | . | . |
| annual change in % (real) | 2.9 | 2.2 | 5.4 | 3.9 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Gross fixed capital form., EUR mn, nom. | 657 | 736 | 978 | 1,157 | 478 | 625 | . | . | . |
| annual change in % (real) | -2.5 | 11.9 | 38.4 | 18.7 | 5.3 | 28.1 | 20.0 | 12.0 | 12.0 |
| Gross industrial production [3] | | | | | | | | | |
| annual change in % (real) | -11.4 | 7.9 | -2.9 | -4.2 | -9.6 | 31.6 | 15.0 | 4.0 | 4.0 |
| Net agricultural production [4] | | | | | | | | | |
| annual change in % (real) | -6.1 | 9.4 | -8.5 | -3.2 | . | . | . | . | . |
| Construction output [3] | | | | | | | | | |
| annual change in % (real) | 1.9 | 5.8 | 31.5 | 51.5 | 45.3 | 40.4 | . | . | . |
| Employed persons, LFS, th, average | 216.3 | 221.7 | 224.2 | 229.3 | 228 | 233 | 234 | 236 | 238 |
| annual change in % | 7.1 | 2.5 | 1.1 | 2.3 | 3.1 | 2.2 | 2.0 | 1.0 | 1.0 |
| Unemployed persons, LFS, th, average | 47.5 | 47.2 | 48.3 | 43.9 | 44 | 42 | 40 | 40 | 40 |
| Unemployment rate, LFS, in %, average | 18.0 | 17.6 | 17.4 | 16.1 | 16.3 | 15.3 | 15.0 | 15.0 | 15.0 |
| Reg. unemployment rate, %, average | 16.1 | 16.5 | 21.9 | 21.7 | 21.3 | 19.2 | . | . | . |
| Average monthly gross wages, EUR | 723 | 725 | 751 | 765 | 766 | 766 | 770 | 790 | 810 |
| annual change in % (real, gross) | 0.1 | -1.1 | 3.5 | -1.1 | 0.3 | -3.5 | -3.0 | 1.0 | 1.0 |
| Average monthly net wages, EUR | 477 | 480 | 499 | 510 | 511 | 518 | 520 | 540 | 560 |
| annual change in % (real, net) | 0.1 | -0.8 | 3.9 | -0.8 | 0.6 | -2.1 | -2.0 | 1.0 | 1.0 |
| Consumer prices, % p.a. | -0.5 | 1.4 | 0.1 | 2.8 | 2.5 | 3.6 | 3.5 | 2.0 | 2.0 |
| Producer prices in industry, % p.a. [5] | 0.1 | 0.3 | -0.1 | 0.4 | 0.8 | 1.2 | 2.0 | 2.0 | 2.0 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 44.8 | 41.8 | 42.6 | 41.5 | 38.5 | 40.0 | 44.0 | 44.0 | 44.0 |
| Expenditures | 47.7 | 50.0 | 46.2 | 46.8 | 41.9 | 40.4 | 45.0 | 45.0 | 45.0 |
| Deficit (-) / surplus (+) | -2.9 | -8.3 | -3.6 | -5.3 | -3.4 | -0.4 | -1.0 | -1.0 | -1.0 |
| General gov.gross debt, nat.def., % of GDP [6] | 56.2 | 62.3 | 60.8 | 61.1 | 60.2 | 70.1 | 72.0 | 73.0 | 73.0 |
| Stock of loans of non-fin.private sector, % p.a. | -1.1 | 2.5 | 5.4 | 7.7 | 6.8 | 8.5 | . | . | . |
| Non-performing loans (NPL), in %, eop | 15.9 | 12.6 | 10.3 | 7.3 | 8.8 | 7.0 | . | . | . |
| Central bank policy rate, % p.a., eop [7] | 8.41 | 7.70 | 6.74 | 6.16 | 6.4 | 5.9 | 6.00 | 5.50 | 5.50 |
| Current account, EUR mn | -429 | -402 | -642 | -692 | -566 | -613 | -740 | -820 | -860 |
| Current account, % of GDP | -12.4 | -11.0 | -16.2 | -16.1 | -32.0 | -32.1 | -16.1 | -17.1 | -17.2 |
| Exports of goods, BOP, EUR mn | 357 | 330 | 351 | 382 | 166 | 210 | 450 | 480 | 510 |
| annual change in % | -9.7 | -7.6 | 6.2 | 9.0 | 7.0 | 25.9 | 17.0 | 6.0 | 6.0 |
| Imports of goods, BOP, EUR mn | 1,734 | 1,794 | 2,008 | 2,243 | 1,038 | 1,172 | 2,470 | 2,640 | 2,820 |
| annual change in % | 0.6 | 3.5 | 12.0 | 11.7 | 8.9 | 12.9 | 10.0 | 7.0 | 7.0 |
| Exports of services, BOP, EUR mn | 1,031 | 1,214 | 1,255 | 1,383 | 397 | 475 | 1,530 | 1,680 | 1,830 |
| annual change in % | 3.6 | 17.8 | 3.3 | 10.2 | 27.6 | 19.6 | 11.0 | 10.0 | 9.0 |
| Imports of services, BOP, EUR mn | 340 | 425 | 486 | 530 | 237 | 277 | 580 | 620 | 660 |
| annual change in % | -0.3 | 25.0 | 14.1 | 9.2 | 5.7 | 17.0 | 9.0 | 7.0 | 7.0 |
| FDI liabilities, EUR mn | 375 | 630 | 205 | 494 | 230 | 177 | 450 | . | . |
| FDI assets, EUR mn | 21 | 11 | -167 | 10 | 10 | 23 | 40 | . | . |
| Gross reserves of NB excl. gold, EUR mn [8] | 545 | 674 | 803 | 898 | 702 | 1,020 | . | . | . |
| Gross external public debt, EUR mn | 1,562 | 1,956 | 2,003 | 2,214 | 2,009 | 2,644 | 2,670 | 2,880 | 3,000 |
| Gross external public debt, % of GDP | 45.2 | 53.5 | 50.6 | 51.5 | 46.7 | 57.5 | 58.0 | 60.0 | 60.0 |

1) Preliminary. - 2) Including expenditures of NPISHs. - 3) Enterprises with 5 and more employees. - 4) Based on UN-FAO data, wiiw estimate in 2017. - 5) Domestic output prices. - 6) Half-year data refer to central government budget. - 7) Average weighted lending interest rate of commercial banks (Montenegro uses the euro as national currency). - 8) Data refer to reserve requirements of the Central Bank.

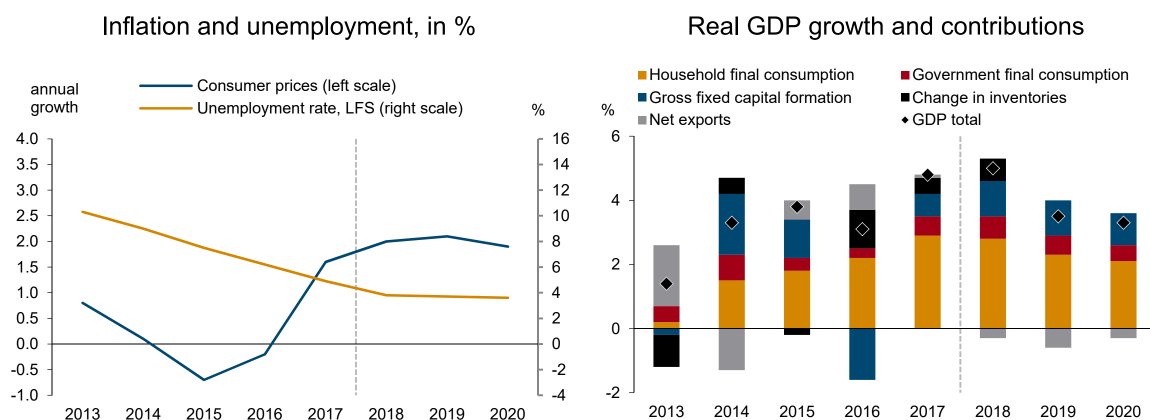
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

# POLAND: Can strong growth supported by public sector spending continue much longer?

LEON PODKAMINER

**Despite lower profits the corporate sector's financial standing and financing conditions are good. But the private domestic firms are reluctant to expand investment. The ongoing political changes destabilise 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 50 / Poland: Main macroeconomic indicators**




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

**Strong consumption-driven GDP growth continues.** Starting from the first quarter of 2017 the growth reported has been quite fast. In the first half of 2018 real GDP grew again, by a rather impressive 5.2%. Consumption, rising by 4.6%, was an essential driver of growth (with private consumption rising 4.8% and public consumption by 4%). However, much higher growth in household consumption could have been expected. In the first half of 2018 the wage bill in the enterprise sector rose by about 9% in real terms and social transfers (including pensions) by about 6%. Additionally, disposable household incomes have been increased by higher social transfers (addressed to families with children). The gap

between real household incomes and private consumption spending primarily seems to reflect rising saving propensities.[34]

**Gross fixed investment increased moderately**, by 4.5% in the second quarter of 2018 (slowing down from an 8% rate in the first quarter). Investment growth is driven almost exclusively by expanding public (governmental, including communal) investment spending. In the first quarter of 2018, public investment rose by nearly 35% while investment by the corporate sector grew weakly (by 3.3%). Investment by the private domestically-owned corporations continues to decline, quite strongly. The entire corporate sector's investment continues to be driven by the sector's 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 acceleration of investment spending – against 10% for the private domestic-owned firms. Acceleration of investment appears to be correlated with the increased utilisation of EU funds. A rather skewed structure of investment is reflected in the fact that while the investment in manufacturing is stagnating, investment in the construction and transportation sectors is booming.

**Foreign trade in goods and non-factor services is performing relatively weakly**. Growth of both exports and imports, which slowed down radically in the first quarter of 2018, strengthened somewhat in the second quarter. The negative contribution of foreign trade to the GDP growth rate was quite large (-1.2 percentage points) in the first quarter but turned into a positive small number (0.4pp) in Q2. Even if trade in services continues to perform quite well, trade in goods is less satisfactory. During the first seven months of 2018, exports of goods rose 5.7% (in current euro terms) while imports rose 8.3%. After seven months of 2018 the trade in goods registered a deficit worth some EUR 1.6bn. (In the same period of 2017, trade in goods ended in a surplus worth some EUR 1.3bn). Unfavourable terms-of-trade developments may be a part of the problem. However, the expected 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 or its external payments position.

**Output of construction and also of manufacturing are performing quite well.** The volume of sales by construction firms rose by over 20% during the first eight months of 2018. The volume of sales of civil engineering works (predominantly infrastructure-related) rose by over 26% and the number of dwellings completed by close to 11%. For manufacturing the respective rate is 6.7% (with the sales of intermediate goods rising by 7%, investment and durable consumer goods by 6% and non-durable consumer goods by 3.4 %).

**Corporate profitability is deteriorating.** Net (post-tax) profits of the corporate non-financial sector declined sharply (by close to 7%) in the first half of 2018. Profits decreased across most sectors, including the majority of branches of manufacturing, construction and services. The coal mining branch registered the steepest contraction in profits while profits increased in transportation, retail trade and food processing. Profitability developments are primarily influenced by gaps opening, despite rising labour productivity, between the producer prices received and production costs. The producer prices are rising quite weakly (in manufacturing by about 1.8% on average so far). However, production costs are rising quite strongly (under the impact of a close to 7% hike in the average nominal wage rate recorded in the first half of 2018). The ongoing gains in labour productivity (close to 4% currently) 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.

[34] The earnings of a large number of foreigners employed are sent back home (mostly to Ukraine) thereby reducing effective domestic consumer demand in Poland.

Despite reduced corporate profits the financial standing of firms is still quite satisfactory and the profitability indicators are good, by historical standards.

**Lending is expanding moderately amid banks' strongly improved profits.** The policy interest rate remains fairly low (1.5%). The interest rates charged by commercial banks on new loans are also not exorbitant (by averages of 6.4% for households and 5.1% for non-financial corporates). Despite this, loan growth is rather slow. Over one year ending 30 June 2018 the stock of loans to the non-financial corporates increased by over 6% (by less than 2% for small and medium-sized firms and by 13% for large firms) and by less than 4% to the household sector (by slightly over 3% for housing loans). 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 6.7bn in the first half on 2017 to PLN 7.8bn in the first half of 2018 (in current euro terms from 1.6bn to 1.9bn 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 higher dividends earned.

**Future growth rates will critically depend on what happens to capital formation**. Despite lower profits the corporate sector's financial standing is strong and financing conditions are encouraging. The conditions are conducive to an expansion of corporate investment. However, the private domestic non-financial firms (and especially smaller enterprises) appear reluctant to wage a stronger investment offensive. This reluctance seems to have much to do with the ongoing political changes which destabilise the country's legal framework and undermine trust in the rule of law. For the time being the overall investment spending may be supported by the public sector and by the corporations that are publicly-owned (and 'guided' by the officials). However, the investment spending by the public sector (and by the public-owned corporates) depends on the EU funds to a large extent. The escalating conflict between the European Commission and the Polish government (over the latter's moves undermining the independence of the judiciary) may lead to substantial cuts in the funds available to Poland. That would undermine public investment spending and reduce medium-term overall growth prospects. Moreover, even if the public investment spending is not reduced, the fact that the private sector's productive investment is stagnating will, most probably, have negative longer-term consequences for the country. The levels of capital formation (especially with respect to machinery and equipment) in Poland have been miserably low by international standards. Over the long term, a continuing low pace of capital accumulation (by the market-oriented private sector) may be incompatible with the upgrading (or even maintenance) of the country's competitive position[35].

[35] According to OECD comparative data for 2014 (https://stats.oecd.org/Index.aspx?DataSetCode=PPP2014) real per capita investment in machinery and equipment in Poland represented 40% of the German and 48% of the Czech levels. Since 2014 the GDP share of gross capital formation has fallen further, from 16% to 14.2% recently.

**Table 25 / Poland: Selected economic indicators**

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 38,487 | 38,458 | 38,435 | 38,400 | 38,422 | 38,413 | 38,400 | 38,400 | 38,400 |
| Gross domestic product, PLN bn, nom. | 1,720 | 1,800 | 1,861 | 1,989 | 933 | 988 | 2,110 | 2,210 | 2,310 |
| annual change in % (real) | 3.3 | 3.8 | 3.1 | 4.8 | 4.4 | 5.1 | 5.0 | 3.5 | 3.3 |
| GDP/capita (EUR at PPP) | 18,600 | 19,800 | 19,900 | 20,900 | . | . | . | . | . |
| Consumption of households, PLN bn, nom. | 1,019 | 1,038 | 1,074 | 1,151 | 574 | 609 | . | . | . |
| annual change in % (real) | 2.6 | 3.0 | 3.9 | 4.9 | 4.7 | 4.5 | 4.8 | 4.0 | 3.6 |
| Gross fixed capital form., PLN bn, nom. | 339 | 361 | 335 | 352 | 131 | 141 | | | |
| annual change in % (real) | 10.0 | 6.1 | -8.2 | 3.9 | 1.1 | 6.0 | 6.0 | 6.0 | 5.5 |
| Gross industrial production (sales) 2) | | | | | | | | | |
| annual change in % (real) | 3.5 | 4.8 | 2.8 | 6.6 | 5.8 | 6.4 | 6.0 | 5.0 | 4.8 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 6.9 | -2.6 | 8.4 | 2.8 | . | . | . | . | . |
| Construction industry 2) | | | | | | | | | |
| annual change in % (real) | 4.3 | 0.3 | -14.5 | 13.7 | 7.2 | 23.4 | . | . | . |
| Employed persons, LFS, th, average | 15,862 | 16,084 | 16,197 | 16,423 | 16,388 | 16,455 | 16,550 | 16,650 | 16,700 |
| annual change in % | 1.9 | 1.4 | 0.7 | 1.4 | 1.8 | 0.4 | 0.8 | 0.6 | 0.3 |
| Unemployed persons, LFS, th, average | 1,567 | 1,304 | 1,063 | 844 | 895 | 663 | 650 | 640 | 620 |
| Unemployment rate, LFS, in %, average | 9.0 | 7.5 | 6.2 | 4.9 | 5.2 | 3.9 | 3.8 | 3.7 | 3.6 |
| Reg. unemployment rate, in %, eop | 11.4 | 9.7 | 8.3 | 6.6 | 7.0 | 5.9 | . | . | . |
| Average monthly gross wages, PLN 3) | 3,777 | 3,908 | 4,052 | 4,272 | 4,434 | 4,572 | 4,600 | 4,880 | 5,150 |
| annual change in % (real, gross) | 3.2 | 4.5 | 4.2 | 3.5 | 3.0 | 5.7 | 5.5 | 4.0 | 3.5 |
| Consumer prices (HICP), % p.a. | 0.1 | -0.7 | -0.2 | 1.6 | 1.6 | 1.1 | 2.0 | 2.1 | 1.9 |
| Producer prices in industry, % p.a. | -1.4 | -2.2 | -0.3 | 2.7 | 3.4 | 1.2 | 1.6 | 1.8 | 1.8 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 38.6 | 38.9 | 38.7 | 39.4 | . | . | 39.5 | 40.0 | 40.0 |
| Expenditures | 42.2 | 41.5 | 41.1 | 41.1 | . | . | 42.0 | 42.5 | 42.5 |
| Net lending (+) / net borrowing (-) | -3.6 | -2.6 | -2.3 | -1.7 | . | . | -2.5 | -2.5 | -2.5 |
| General gov.gross debt, EU def., % of GDP | 50.2 | 51.1 | 54.1 | 50.5 | . | . | 50.9 | 51.1 | 51.4 |
| Stock of loans of non-fin.private sector, % p.a. | 5.8 | 7.1 | 5.3 | 3.1 | 4.0 | 5.5 | . | . | . |
| Non-performing loans (NPL), in %, eop | 8.1 | 7.5 | 7.1 | 6.8 | . | . | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 2.0 | 1.5 | 1.5 | 1.5 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 |
| Current account, EUR mn 5) | -8,529 | -2,409 | -2,240 | 706 | 1,951 | 1,152 | -2,200 | -7,100 | -8,000 |
| Current account, % of GDP 5) | -2.1 | -0.6 | -0.5 | 0.2 | 0.9 | 0.5 | -0.4 | -1.4 | -1.5 |
| Exports of goods, BOP, EUR mn 5) | 158,656 | 172,150 | 177,412 | 201,963 | 99,899 | 105,158 | 211,100 | 221,900 | 234,700 |
| annual change in % | 6.4 | 8.5 | 3.1 | 13.8 | 13.6 | 5.3 | 4.5 | 5.1 | 5.8 |
| Imports of goods, BOP, EUR mn 5) | 161,911 | 169,937 | 174,479 | 200,536 | 98,433 | 106,300 | 216,600 | 233,900 | 250,500 |
| annual change in % | 8.3 | 5.0 | 2.7 | 14.9 | 15.7 | 8.0 | 8.0 | 8.0 | 7.1 |
| Exports of services, BOP, EUR mn 5) | 36,743 | 40,663 | 44,929 | 51,883 | 24,247 | 27,317 | 56,600 | 60,600 | 64,800 |
| annual change in % | 9.4 | 10.7 | 10.5 | 15.5 | 14.9 | 12.7 | 9.0 | 7.0 | 7.0 |
| Imports of services, BOP, EUR mn 5) | 27,679 | 29,749 | 30,963 | 33,926 | 15,567 | 16,516 | 35,300 | 37,800 | 39,700 |
| annual change in % | 6.7 | 7.5 | 4.1 | 9.6 | 9.4 | 6.1 | 4.0 | 7.0 | 5.0 |
| FDI liabilities, EUR mn 5) | 14,824 | 13,534 | 16,628 | 9,292 | 1,796 | 5,121 | 9,000 | . | . |
| FDI assets, EUR mn 5) | 5,096 | 4,385 | 12,807 | 3,688 | 1,287 | -19 | 2400 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 79,379 | 83,676 | 104,440 | 90,967 | 94,360 | 89,986 | . | . | . |
| Gross external debt, EUR mn 5) | 293,510 | 303,120 | 321,305 | 318,851 | 321,834 | 311,451 | 337,600 | 364,000 | 380,500 |
| Gross external debt, % of GDP 5) | 71.4 | 70.5 | 75.3 | 68.3 | 68.9 | 62.7 | 68.0 | 70.0 | 70.0 |
| Average exchange rate PLN/EUR | 4.1843 | 4.1841 | 4.3632 | 4.2570 | 4.2685 | 4.2200 | 4.25 | 4.25 | 4.25 |

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

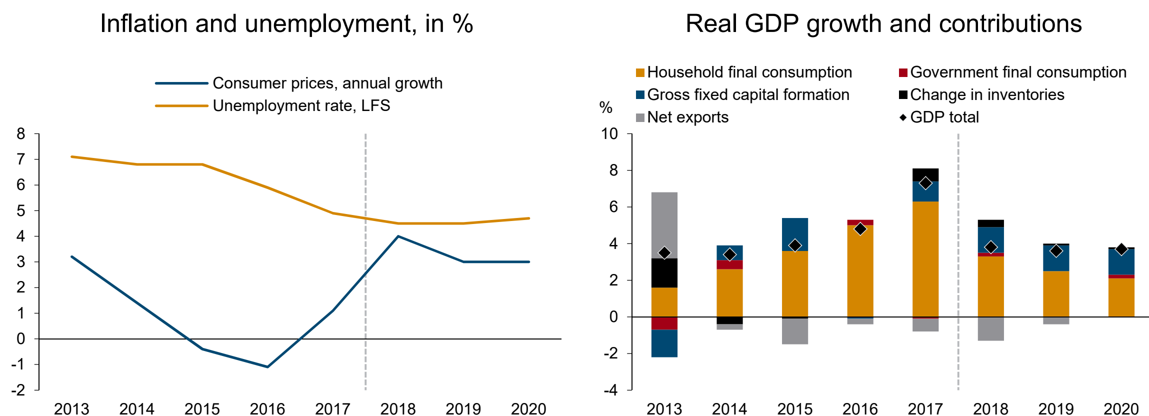
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

# ROMANIA: Slowdown continues

GÁBOR HUNYA

**The Romanian economy is experiencing an unavoidable slowdown, following a boom based on fiscal stimulus of household consumption in the past two years. Economic growth is sustainable at rates somewhat below 4% over the forecast period. Business sector investment is supporting economic growth, while public investments are falling victim to fiscal rebalancing.**

**Figure 51 / Romania: Main macroeconomic indicators**




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

**Real GDP expanded by 4% in the first half of 2018, a slowdown compared with the boom in 2017 which reduces the risk of overheating.** The one-time effects of the fiscal stimulus to household consumption provided in previous years in the form of public sector wage hikes and tax cuts are wearing off. Wage increases in the current year have not only been moderate, but also partly neutralised in real terms by inflation. As the second half of 2017 GDP growth was exceptionally strong, the base effect will further moderate the rate of economic growth to 3.8% for 2018 as a whole. Growth rates in a similar range are sustainable over the next few years, supported by investments in the business sector.

**Household consumption remained the main growth driver in the first half of 2018 (+5.5%), but expanded at a much slower pace than previously and is bound to slow further.** Net real wages will grow by around 6% in 2018 as a whole, half the rate of the previous year. The fact that real wages are still growing strongly is in part because of an increase in the minimum wage, with a further increase set for 2019. The minimum gross wage will increase by RON 150 or about 7.9% on 1 January 2019, to

RON 2,050 (EUR 440). Tight labour market conditions will further drive up wages. In industry, labour costs increased by 10.5% in the first half of 2018, far ahead of productivity growth, and prompting companies to invest in new capital.

**Investment staged a remarkable recovery in the first half of 2018, rising by 12.1% year on year, but this was concentrated almost exclusively in the expansion of inventories.** Inventories are unfinished investments and will become part of gross fixed capital formation by the end of the year. Investments in machinery and equipment have been robust as the private sector is eager to increase labour productivity. Public investments are slowing as the government is determined to keep the fiscal deficit under control which also slows down the absorption of EU funds. Private house-building has declined from the high level of the previous year.

**All sectors of production have shown lower year-on-year growth rates in the first half of 2018 than a year earlier.** Moderate growth was registered in industrial and agricultural value added (4.3% and 6.9% respectively) while construction output declined. The impacts of alternating periods of draughts and floods as well as a severe swine fever epidemic will push agricultural production into negative territory in the rest of the year, with adverse effects on the food industry and rural consumption. Expectations in the business sector remain positive as new orders growth in industry is strong, particularly for producers of capital goods.

**The negative contribution of net exports to growth has increased compared with the previous year.** The current account deficit has widened on account of worsening foreign trade balances of goods and services. The primary and secondary income balances both improved in the first half of the year, quite unexpectedly. Interest payment on debt contracted, and foreign direct investors' income was significantly lower than in the first half of 2017, despite high profits reported by several companies and banks. Lower amounts of transfers of Romanians working abroad can be explained by lower needs of family members at home on account of higher incomes. More than half of the current account deficit was financed by rising FDI and inflows on the capital account. Modernisation investments in existing foreign investment enterprises are of higher amounts than new greenfield projects in the manufacturing sector.

**The consolidated budget deficit was well above that of the first half of last year, and it could well be higher than 3% of GDP for the year as a whole.** The budget deficit of RON 14.6 billion (EUR 3.14 billion) in the first eight months of the current year, representing 1.6% of estimated GDP for the period, is the highest recorded for this period in the last eight years, both in nominal terms and as a share of GDP. The August 2018 budget rectification stipulated increases on both the revenues and the expenditure sides based on increasing revenues in the first half of the year. Revenues of the state budget stagnated while the social security budget received increased inflows. The latter was the result of the transfer of social security contributions from the employers to employees. Wages are the hard core of fiscal expenditures, and have grown as a share of expenditure, while investment outlays have been cut. The implementation of large infrastructure projects has suffered renewed delays.

**The labour market has tightened as both the working-age population and the number of economically active persons have decreased.** Nevertheless, the activity rate increased three percentage points year on year to 68.4% of the working-age population (15 to 64 years) in the second quarter of 2018. The unemployment rate fell to 4.3% in August 2018 from 4.9% a year before. Labour

shortages are widely present, demand for skilled workers being especially unsatisfied. Better job opportunities combined with higher wages may reduce the push to emigrate.

**Consumer price inflation peaked in the middle of 2018 with year-on-year rates above 5%, and will amount to at least 4% as an annual average this year.** The cyclical element of inflation is the result of excess demand, and also of rising import prices. Government-managed energy prices have increased as these are tied to the import price of gas and oil (with some delay). In response, the National Bank of Romania (BNR) has already hiked the monetary policy rate twice in 2018 – by 0.25 percentage points each time – to 2.5%, although it remains negative in real terms, suggesting still quite loose conditions. The BNR is not pushing for a further tightening in monetary conditions, but is calling for fiscal action to cool the economy and rightly so as fiscal policy caused the overheating.

**Government stability is under threat from both internal and external sources.** The Social Democratic Party (PSD), which leads a coalition with a comfortable majority in both houses of parliament, is showing signs of disintegration. The position of party boss Liviu Dragnea, who rules over the government, has been challenged as he faces new criminal investigations. In the conflict between the National Anti-corruption Directorate (DNA) and the government, the latter managed to replace the former leader and nominate its own person. This step prompted external criticism of how the government manages the judiciary. On 1 October a meeting of the European Parliament’s Committee on Civil Liberties, Justice and Home Affairs (LIBE) criticised the Romanian authorities’ initiatives to change the justice laws and criminal codes, as well as the breaching of human rights at the brutal crashing of demonstrations in Bucharest on 10 August. Deputies in the European Parliament expressed similar concerns at a plenary session on 3 October which focused on the reforms of Romania’s judicial system in the pipeline. Despite these controversies, action against Romania is not expected to escalate in the way it did in the cases of Hungary and Poland. Risks associated with domestic uncertainties in terms of government instability are far more serious.

**In summary, economic growth is expected to slow down further to 3.6-3.7% in the coming years due to fiscal consolidation measures and a growth slowdown in the EU.** Household demand will cool, but investment growth may remain robust, especially if the absorption of EU funds improves. Due to more sluggish domestic demand and further foreign investment in export-oriented production of goods and services, the current account will not deteriorate further, and net exports will make a roughly neutral contribution to GDP growth.

## Table 26 / Romania: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 19,909 | 19,815 | 19,702 | 19,650 | . | . | 19,500 | 19,400 | 19,300 |
| Gross domestic product, RON bn, nom. | 668.6 | 712.6 | 765.1 | 858.7 | 361.5 | 399.5 | 930 | 990 | 1,050 |
| annual change in % (real) | 3.4 | 3.9 | 4.8 | 7.3 | 5.9 | 4.0 | 3.8 | 3.6 | 3.7 |
| GDP/capita (EUR at PPP) | 15,200 | 16,300 | 17,000 | 18,700 | . | . | . | . | . |
| Consumption of households, RON bn, nom. | 405.7 | 432.6 | 471.9 | 530.3 | 231.0 | 252.8 | . | . | . |
| annual change in % (real) | 4.2 | 5.9 | 8.3 | 10.1 | 7.3 | 5.4 | 5.3 | 4.0 | 3.4 |
| Gross fixed capital form., RON bn, nom. | 162.4 | 176.5 | 175.0 | 193.6 | 71.3 | 76.8 | . | . | . |
| annual change in % (real) | 3.3 | 7.5 | -0.2 | 4.7 | -0.6 | 0.0 | 6.0 | 6.0 | 6.0 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | 6.0 | 2.8 | 3.1 | 7.9 | 7.0 | 4.2 | 4.0 | 4.0 | 4.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 2.9 | -6.8 | 2.5 | 14.7 | . | . | . | . | . |
| Construction industry 2) | | | | | | | | | |
| annual change in % (real) | -6.7 | 10.5 | -4.4 | -5.5 | -7.2 | -0.7 | . | . | . |
| Employed persons, LFS, th, average | 8,614 | 8,535 | 8,449 | 8,671 | 8,645 | 8,655 | 8,760 | 8,850 | 8,940 |
| annual change in % | 0.8 | -0.9 | -1.0 | 2.6 | 3.1 | 0.1 | 1.0 | 1.0 | 1.0 |
| Unemployed persons, LFS, th, average | 629 | 624 | 530 | 449 | 466 | 397 | 410 | 420 | 440 |
| Unemployment rate, LFS, in %, average | 6.8 | 6.8 | 5.9 | 4.9 | 5.2 | 4.4 | 4.5 | 4.5 | 4.7 |
| Reg. unemployment rate, in %, eop | 5.4 | 5.0 | 4.8 | 4.0 | 4.2 | 3.5 | . | . | . |
| Average monthly gross wages, RON 3)4) | 2,328 | 2,555 | 2,809 | 3,223 | 3,237 | 4,382 | 4,400 | 4,800 | 5,100 |
| annual change in % (real, gross) | 6.5 | 10.4 | 11.7 | 13.2 | 15.0 | . | . | 5.0 | 4.0 |
| Average monthly net wages, RON 4) | 1,697 | 1,859 | 2,046 | 2,338 | 2,331 | 2,636 | 2,600 | 2,800 | 3,000 |
| annual change in % (real, net) | 6.4 | 10.1 | 11.8 | 12.8 | 14.4 | 7.7 | 6.0 | 5.0 | 4.0 |
| Consumer prices (HICP), % p.a. | 1.4 | -0.4 | -1.1 | 1.1 | 0.5 | 4.1 | 4.0 | 3.0 | 3.0 |
| Producer prices in industry, % p.a. | -0.2 | -2.3 | -1.8 | 3.5 | 3.3 | 4.6 | 4.6 | 2.0 | 2.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 33.6 | 35.0 | 31.5 | 30.4 | . | . | 30.5 | 31.0 | 31.0 |
| Expenditures | 34.9 | 35.8 | 34.5 | 33.4 | . | . | 34.0 | 34.0 | 33.5 |
| Net lending (+) / net borrowing (-) | -1.3 | -0.8 | -3.0 | -2.9 | . | . | -3.5 | -3.0 | -2.5 |
| General gov.gross debt, EU def., % of GDP | 39.1 | 37.7 | 37.2 | 35.0 | . | . | 36.0 | 37.0 | 37.0 |
| Stock of loans of non-fin.private sector, % p.a. | -3.7 | 2.5 | 0.9 | 5.3 | 3.9 | 7.0 | . | . | . |
| Non-performing loans (NPL), in %, eop 5) | 13.9 | 13.5 | 9.6 | 6.4 | 8.3 | 5.7 | . | . | . |
| Central bank policy rate, % p.a., eop 6) | 2.75 | 1.75 | 1.75 | 1.75 | 1.75 | 2.50 | 2.75 | 2.75 | 2.75 |
| Current account, EUR mn | -1,004 | -1,977 | -3,496 | -6,298 | -3,526 | -3,749 | -8,700 | -9,500 | -9,500 |
| Current account, % of GDP | -0.7 | -1.2 | -2.1 | -3.4 | -4.4 | -4.4 | -4.4 | -4.5 | -4.3 |
| Exports of goods, BOP, EUR mn | 46,839 | 49,111 | 52,164 | 57,159 | 28,163 | 31,070 | 62,300 | 66,700 | 71,400 |
| annual change in % | 6.7 | 4.8 | 6.2 | 9.6 | 10.5 | 10.3 | 9.0 | 7.0 | 7.0 |
| Imports of goods, BOP, EUR mn | 53,375 | 56,896 | 61,412 | 69,067 | 33,318 | 36,947 | 76,700 | 82,500 | 88,300 |
| annual change in % | 7.4 | 6.6 | 7.9 | 12.5 | 12.4 | 10.9 | 11.0 | 7.5 | 7.0 |
| Exports of services, BOP, EUR mn | 15,104 | 16,640 | 18,006 | 20,683 | 9,847 | 10,578 | 21,700 | 23,200 | 25,100 |
| annual change in % | 12.4 | 10.2 | 8.2 | 14.9 | 14.4 | 7.4 | 5.0 | 7.0 | 8.0 |
| Imports of services, BOP, EUR mn | 9,236 | 9,849 | 10,284 | 12,752 | 5,929 | 6,856 | 13,900 | 15,000 | 16,100 |
| annual change in % | 5.8 | 6.6 | 4.4 | 24.0 | 23.4 | 15.6 | 9.0 | 8.0 | 7.0 |
| FDI liabilities, EUR mn | 2,931 | 3,885 | 5,656 | 4,378 | 1,920 | 2,593 | 5,500 | . | . |
| FDI assets, EUR mn | 227 | 930 | 1,143 | -196 | 232 | 685 | 0 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 32,216 | 32,238 | 34,242 | 33,494 | 35,208 | 31,766 | . | . | . |
| Gross external debt, EUR mn | 94,744 | 92,069 | 92,910 | 97,361 | 96,264 | 97,918 | 99,000 | 102,000 | 105,000 |
| Gross external debt, % of GDP | 63.0 | 57.4 | 54.5 | 51.8 | 51.2 | 49.1 | 49.6 | 48.4 | 47.5 |
| Average exchange rate RON/EUR | 4.4437 | 4.4454 | 4.4904 | 4.5688 | 4.5364 | 4.6545 | 4.66 | 4.70 | 4.75 |

1) Preliminary. - 2) Enterprises with 4 and more employees. - 3) In 2018 the social security contribution paid by employers was added to gross wages increasing the latter by 25%. - 4) January to June data refer to enterprises with 4 and more employees. - 5) 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). - 6) One-week repo rate.

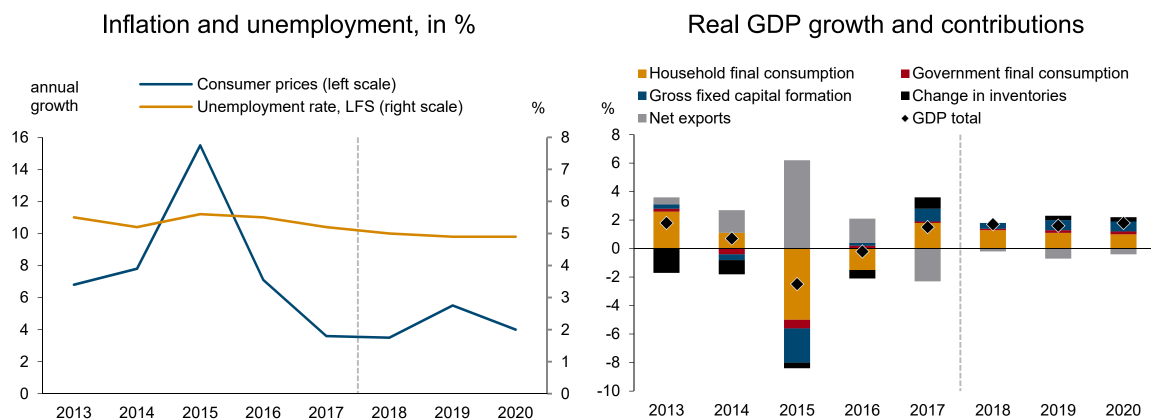
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

# RUSSIAN FEDERATION: Sailing slowly between sanctions and high oil prices

PETER HAVLIK

**The Russian economy continues to grow at a slow pace. The unimpressive performance is forecast to last even in the medium term since no improvements in either domestic or external conditions for development are expected. High oil prices currently mitigate the adverse impacts of geopolitical tensions, though both investments and economic restructuring suffer. Chinese-Russian relations are likely to strengthen further.**

**Figure 52 / Russian Federation: Main macroeconomic indicators**




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

**Russian GDP growth consolidated in 2018, yet the economic recovery remains sluggish**. Growth is well below 2% year on year, in line with earlier expectations. In the first half of 2018, GDP grew by about 1.7%. Industry (including manufacturing), as well as goods transport and retail trade, are expanding somewhat; construction is flat and the output of agriculture, affected by a drought, even fell. On the demand side, household consumption expanded by nearly 3% in the first eight months of the year – in line with similar growth of retail trade and personal services. Private consumption and retail trade were boosted by the spending of football fans attending the World Cup in June/July. A successful disinflation process from late 2017 ended in early 2018, as consumer price inflation picked up during the summer, fuelled by rouble depreciation and rising energy prices. The official inflation target of 4% for the year as a whole will probably only be missed by a small margin in 2018: the annual CPI inflation was just 3.1% in August. Yet the producer price inflation has been much higher – more than 10% year on year in

January-August 2018 – and will eventually fuel consumer prices as well (inflation will also be fuelled by the announced VAT increase by 2pp at the beginning of 2019). The Russian Central Bank promptly reacted to rising prices and inflationary expectations, increasing the key interest rate by 25 basis points (to 7.5%) in mid-September.

**The usual link between the oil price and rouble exchange rate developments seems to have reversed** owing to the recently escalating 'sanctions carrousel', as the rouble has depreciated since March, despite a simultaneous increase of oil prices. On balance, higher oil prices and the associated increase in export and budget revenues probably outweigh the adverse impact of sanctions. The state budget may even end with a small surplus in 2018, and the draft federal budget for 2019-2021 reckons with a surplus as well. In 2018, the current account surplus will surge to nearly 6% of GDP. Indeed, export revenues grew by nearly 30% in nominal USD terms in the first eight months of 2018, largely thanks to higher oil prices. At the same time, imports expanded (+11%) as well, yet their real growth was tamed by a relatively weak domestic demand and a depreciating rouble (the latter is largely unrelated to the global emerging market crisis).

**Real wages grew strongly in the first eight months of 2018; disposable income by just 2%** in the same period. Employment is essentially flat and overall labour shortages are rising, while unemployment is declining. The forthcoming pension reform – raising the retirement age – that provoked popular protests in late summer should also be viewed in this context. President Vladimir Putin's approval ratings dropped by more than 10pp after the announced pension reform in August and several pro-Kremlin nominees lost to opposition candidates in the subsequent regional elections. A revised pension reform was adopted by the Duma in September, after Mr Putin had announced adjustments to the original blueprint that will mitigate some of the adverse social impacts. According to the revised pension bill, the retirement age will be raised to 60 for women (instead of originally envisaged 63) and to 65 for men. In addition, women raising three or more children can retire earlier and seniors in the pre-retirement age (within 5 years of reaching the new retirement age) will be entitled to receive additional benefits and job protection guarantees. These amendments, adopted by the Federation Council in early October, will adversely affect part of the expected positive fiscal effects of the reform.

**After the diplomatic spat with the West related to the 'Skripals affair'** and other Russian 'malign activity' early this year, a new wave of US sanctions was announced and introduced in August. This increased uncertainty for foreign investors (the previous round of US sanctions against 'Kremlin-linked' Russian oligarchs was announced in April). As expected, EU sanctions related to Ukraine were also prolonged by another year in early September. The repeated waves of sanctions have an adverse impact on the investment climate, reduce capital inflows – including FDI -, weaken the rouble and raise inflationary expectations. Foreign investors have been selling Russian government bonds in the expectation of further US sanctions: since the beginning of the year, the share of non-residents in total Russian government bonds has dropped to 26.6% of the total – by more than RUB 440bn (about USD 33bn). External government debt dropped to USD 485.5bn as of July (about 30% of GDP). Future purchases of Russian debt instruments by foreigners will likely be even more curtailed. Sanctions are likely to stay, and the US sanctions may even be broadened in the coming months. A special department established at the Ministry of Finance at the end of September will coordinate 'anti-sanction' responses. However, the scope for Russian manoeuvre is limited except for further diplomatic and economic steps in the Chinese direction.

**Apart from the controversial pension reform mentioned above and the planned VAT increase** in 2019, there have been hardly any new reform measures so far. Instruments and policies needed for achieving the ambitious social policy goals, including economic modernisation, restructuring, diversification of exports and SME development, announced by Mr Putin after his re-election in March are yet to be elaborated. The adverse investment climate, uncertainty regarding sanctions and fluctuating oil prices are taking a toll on future growth prospects. Moreover, since the oil price is projected to decline from the current level of more than 80 USD/bbl in the next two years, the external growth drivers will weaken as well. Next year's GDP growth is expected to slow down, not least given the fact that no major push in domestic demand is expected. The forecast GDP growth rates for 2019-2020 have been adjusted downwards by a fraction of a decimal point owing to persisting uncertainties and the expected weakening of energy prices.

**Import substitution, more protectionism and the fostered trade reorientation towards the East** are the main defensive policy responses that Russia will follow with even more rigour in future. Both foreign and domestic investments will remain constrained as the Chinese investments and markets will not fully compensate for lost opportunities in Europe. With expected GDP growth rates below 2% per year even in the medium term, Russia will not meet Putin's ambitious target of becoming the 5$^{th}$ largest world economy by the end of his current presidency. On the contrary, it will fall further behind not only its peers and allies, but even behind its adversaries in the West.

## Table 27 / Russian Federation: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | Forecast | | |
| Population, th pers., average | 146,091 | 146,406 | 146,675 | 146,842 | 146,796 | 146,836 | 147,000 | 147,000 | 147,000 |
| Gross domestic product, RUB bn, nom. | 79,200 | 83,387 | 86,149 | 92,037 | 42,585 | 47,086 | 101,100 | 107,800 | 114,100 |
| annual change in % (real) | 0.7 | -2.5 | -0.2 | 1.5 | 1.6 | 1.6 | 1.7 | 1.6 | 1.8 |
| GDP/capita (EUR at PPP) | 19,000 | 18,700 | 18,300 | 18,800 | . | . | . | . | . |
| Consumption of households, RUB bn, nom. | 42,016 | 43,337 | 44,965 | 47,872 | 22,677 | 23,822 | . | . | . |
| annual change in % (real) | 2.0 | -9.4 | -2.8 | 3.4 | 2.4 | 2.6 | 2.5 | 2.2 | 2.0 |
| Gross fixed capital form., RUB bn, nom. | 16,828 | 16,942 | 18,403 | 19,967 | 7,407 | 7,930 | . | . | . |
| annual change in % (real) | -1.8 | -11.2 | 0.8 | 4.3 | 5.4 | 1.3 | 2.0 | 3.0 | 3.0 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | 1.7 | -0.8 | 2.2 | 2.1 | 3.7 | 3.0 | 3.0 | 3.0 | 3.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 3.5 | 2.6 | 4.8 | 2.4 | 0.5 | 2.2 | . | . | . |
| Construction output 3) | | | | | | | | | |
| annual change in % (real) | -2.3 | -4.8 | -2.2 | -1.4 | -3.3 | -1.0 | . | . | . |
| Employed persons, LFS, th, average | 71,539 | 72,324 | 72,393 | 72,142 | 71,722 | 72,250 | 72,300 | 72,300 | 72,300 |
| annual change in % | 0.2 | -0.4 | 0.1 | -0.3 | -0.2 | 0.5 | 0.2 | 0.0 | 0.0 |
| Unemployed persons, LFS, th, average | 3,889 | 4,264 | 4,243 | 3,967 | 4,077 | 3,733 | 3,800 | 3,700 | 3,700 |
| Unemployment rate, LFS, in %, average | 5.2 | 5.6 | 5.5 | 5.2 | 5.4 | 4.9 | 5.0 | 4.9 | 4.9 |
| Reg. unemployment rate, in %, eop 4) | 1.2 | 1.3 | 1.2 | 1.0 | 1.1 | 0.9 | . | . | . |
| Average monthly gross wages, RUB 5) | 32,495 | 34,030 | 36,709 | 39,144 | 38,029 | 42,521 | 42,500 | 46,200 | 50,000 |
| annual change in % (real, gross) | 1.2 | -9.0 | 0.7 | 3.6 | 2.7 | 9.2 | 5.0 | 3.0 | 4.0 |
| Consumer prices, % p.a. | 7.8 | 15.5 | 7.1 | 3.6 | 4.3 | 2.4 | 3.5 | 5.5 | 4.0 |
| Producer prices in industry, % p.a. 6) | 6.4 | 13.5 | 4.2 | 7.7 | 9.2 | 8.5 | 10.0 | 10.0 | 5.0 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 33.8 | 32.3 | 32.7 | 33.7 | 34.1 | 35.6 | 37.0 | 37.0 | 36.0 |
| Expenditures | 34.9 | 35.7 | 36.4 | 35.2 | 33.9 | 32.4 | 36.0 | 37.0 | 37.0 |
| Deficit (-) / surplus (+) | -1.1 | -3.4 | -3.6 | -1.5 | 0.2 | 3.2 | 1.0 | 0.0 | -1.0 |
| General gov.gross debt, nat.def., % of GDP | 13.0 | 13.1 | 12.9 | 12.6 | 12.5 | 12.0 | 14.0 | 15.0 | 16.0 |
| Stock of loans of non-fin.private sector, % p.a. | 25.9 | 7.6 | -6.9 | 3.5 | -1.4 | 8.5 | . | . | . |
| Non-performing loans (NPL), in %, eop 7) | 3.8 | 5.3 | 5.2 | 5.2 | 5.4 | 5.4 | . | . | . |
| Central bank policy rate, % p.a., eop 8) | 17.00 | 11.00 | 10.00 | 7.75 | 9.00 | 7.25 | 7.5 | 7.0 | 6.0 |
| Current account, EUR mn 9) | 43,477 | 60,952 | 22,138 | 29,472 | 21,187 | 40,790 | 79,800 | 61,400 | 49,200 |
| Current account, % of GDP | 2.8 | 5.0 | 1.9 | 2.1 | 3.1 | 6.2 | 5.9 | 4.3 | 3.3 |
| Exports of goods, BOP, EUR mn 9) | 375,561 | 307,040 | 254,371 | 313,173 | 153,895 | 173,841 | 359,500 | 372,200 | 375,900 |
| annual change in % | -4.4 | -18.2 | -17.2 | 23.1 | 33.8 | 13.0 | 14.8 | 3.5 | 1.0 |
| Imports of goods, BOP, EUR mn 9) | 232,739 | 173,585 | 172,911 | 210,932 | 98,716 | 99,780 | 213,900 | 228,100 | 239,500 |
| annual change in % | -9.4 | -25.4 | -0.4 | 22.0 | 31.7 | 1.1 | 1.4 | 6.6 | 5.0 |
| Exports of services, BOP, EUR mn 9) | 49,700 | 46,418 | 45,759 | 51,137 | 25,021 | 25,663 | 52,800 | 54,700 | 57,400 |
| annual change in % | -5.8 | -6.6 | -1.4 | 11.8 | 21.2 | 2.6 | 3.3 | 3.6 | 4.9 |
| Imports of services, BOP, EUR mn 9) | 91,487 | 79,829 | 67,331 | 78,681 | 36,898 | 37,369 | 80,500 | 87,500 | 91,900 |
| annual change in % | -5.3 | -12.7 | -15.7 | 16.9 | 21.5 | 1.3 | 2.3 | 8.7 | 5.0 |
| FDI liabilities, EUR mn 9) | 16,655 | 6,163 | 29,381 | 25,296 | 16,917 | 8,448 | 12,700 | . | . |
| FDI assets, EUR mn 9) | 43,151 | 19,861 | 20,149 | 32,559 | 14,301 | 15,192 | 33,900 | . | . |
| Gross reserves of NB excl. gold, EUR mn 9)10) | 279,383 | 292,467 | 301,871 | 297,823 | 300,675 | 325,521 | . | . | . |
| Gross external debt, EUR mn 9) | 493,861 | 474,121 | 486,489 | 433,320 | 461,363 | 421,923 | 404,400 | 397,200 | 400,100 |
| Gross external debt, % of GDP | 31.7 | 38.5 | 41.9 | 31.0 | 33.0 | 31.3 | 30.0 | 28.0 | 27.0 |
| Average exchange rate RUB/EUR | 50.77 | 67.76 | 74.26 | 65.87 | 62.70 | 71.81 | 75.0 | 76.0 | 77.0 |

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

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

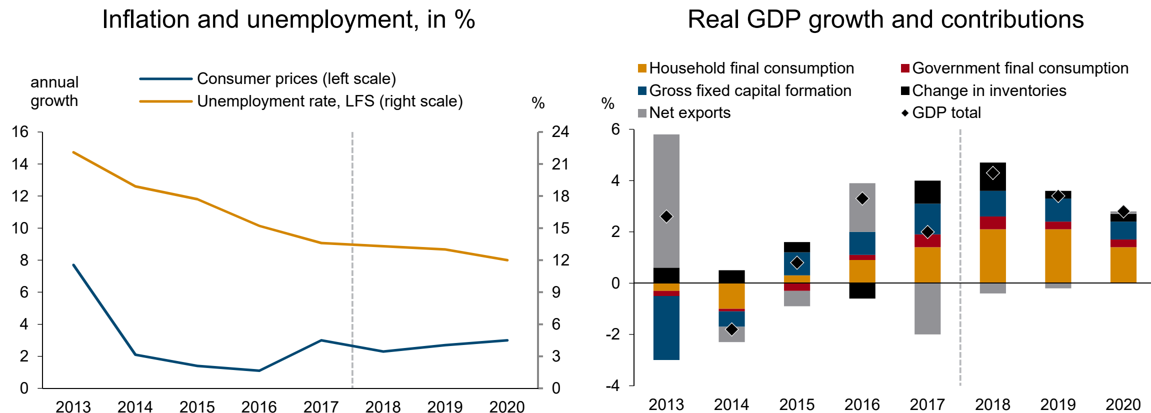
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

# SERBIA: On the crest of a wave

RICHARD GRIEVESON

**Current economic growth and the near-term outlook are as good as has been the case at any time since the global financial crisis a decade ago. A combination of FDI inflows and private consumption are likely to remain the key growth drivers. The economy continues to face challenges, although efforts to bring down public debt and clean up the banking sector have been partly successful. Over the medium term, growth will trend down towards 3%, implying very slow convergence with Western Europe.**

**Figure 53 / Serbia: Main macroeconomic indicators**




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

**Growth has picked up strongly this year, after a very weak 2017, and the near-term outlook remains positive.** The economy had expanded by just 2% last year, in part owing to a drought, but posted real GDP growth of almost 5% year on year in both Q1 and Q2, the fastest rates recorded in Serbia since before the global financial crisis. Household consumption rose by around 3% in both quarters, while government spending increased by over 5% in Q2. The most significant uptick however came from investment, which increased by 15% year on year in Q1 and 12% in Q2. Net exports made a negative contribution to growth in the first half of the year, despite robust export growth. Imports grew even more quickly on the back of rising domestic demand, and are much bigger in absolute terms. There are also signs that external demand may have slowed somewhat relative to 2017 levels, reflecting weaker momentum in the EU.

**The near-term outlook is positive, with high-frequency indicators at the start of the third quarter mostly suggesting that momentum may even have increased.** Retail sales growth in Q3 looks on course to surpass the rates of 3-3.5% year on year posted in H1, while euro-denominated merchandise export growth picked up in July-August compared with the first half of the year. Monthly employment growth remained steady at just over 3% year on year in July-August, similar to the level in the first half of the year. However, latest industrial output data suggest some reason for concern. Production excluding construction fell by almost 5% year on year in August, its first decline for over a year.

**Private consumption still accounts for over 70% of GDP, one of the highest levels in the region, and as such will remain the key determinant of growth trends in Serbia.** We expect real private consumption growth to maintain its growth rate of around 3% in real terms in the rest of 2018 and into 2019, driven by rising wages and pensions. Domestic investment should also contribute significantly to growth during the forecast period, helped by improvements in banking sector asset quality and consequently rising credit growth. The government has been focused strongly on attracting foreign direct investment (FDI) inflows to stimulate growth, and data for the first half of 2018 indicate that FDI inflows remained strong.

**The policy stance is likely to remain focused on attracting FDI inflows, which will mean that the government will continue reforms to improve the business environment.** This impression has been strengthened by the signing of a 30-month Policy Coordination Instrument (PCI) with the IMF. The PCI involves no disbursements, but is rather a signal for foreign investors that Serbia is committed to further investor-friendly reforms, with a particular focus on institutional upgrading and improvement of economic competitiveness. Meanwhile, in the background the anchor of potential EU accession is likely to remain a strong incentive to reform. We have already expressed our scepticism about the targeted 2025 EU accession date for Serbia, but our caution is chiefly owing to political factors: otherwise, momentum towards accession is solid, and new chapters continue to be opened.

**Macroeconomic stability is gradually improving, but the post-crisis clean-up in Serbia has been one of the slowest in the region, reflecting a particularly weak growth performance over the past decade.** Two things stand out: the high public debt load, and vulnerabilities in the banking sector. However, in line with stronger economic growth, both are now improving. The public debt/GDP ratio fell to 58% in 2017, down from 70% in 2014-15, which has significantly eased fiscal pressures and the negative fiscal impact on growth. Meanwhile the non-performing loan (NPL) ratio – which has been one of the region’s highest for much of the post-crisis period – dropped to 7.8% at end-June 2018, significantly below many regional peers. Serbia’s long-term sovereign credit rating was upgraded by S&P and Fitch in December 2017, and Moody’s in March 2018, reflecting positive momentum towards greater macroeconomic stability. A key risk that the agencies continue to identify are contingent liabilities from struggling state-owned Enterprises (SOEs). In August the Chinese firm Zijin bought 63% of one of these SOEs, the copper producer RTB Bor, although several others remain in state hands (and consequently a source of fiscal risk).

**Inflation is likely to rise gradually over the forecast period, although much of the current upward pressure on prices is coming from higher global energy costs.** After bottoming at 1.1% in April 2018, headline consumer price inflation increased by 2.6% in August. This is still below the midpoint of the central bank’s 1.5%-4.5% target range. We expect full-year average inflation of 2.3% this year, rising to 2.7% in 2019 and 3% in 2020. Monetary policy is likely to remain fairly loose until greater signs of

demand-pull inflationary pressures emerge, although the central bank will continue to intervene in the currency market to stabilise the dinar. Serbia has been relatively unaffected by the volatility in global markets caused by Fed tightening, and we expect this to remain the case. Stronger or quicker-than-expected monetary tightening by the ECB would have more material consequences for Serbia, but we view this is a very unlikely scenario. Our forecast is that the dinar will weaken slightly against the euro during the forecast period.

**The labour market is performing well, although employment growth is significantly lower than GDP growth, indicating improving productivity (in contrast to last year).** Relatively meagre employment growth in the first half of 2018 contributed to a rise in the unemployment rate, to 13.4% on the LFS measure (from 13.2% in the same period of 2017). However, the wage response to higher growth has been more significant, with real gross wages rising by 3.7% year on year in H1 2018, up from 1.1% in the same period of 2017. The fact that wages are increasing much more strongly than employment could indicate the emergence of labour shortages, or at least skills shortages in particular areas. Many Serbs have emigrated to other parts of EU-CEE (especially Slovakia) in response to labour shortages (and higher wages) there, which could now be having an impact on the Serbian labour market. Particularly in the construction sector, anecdotal evidence suggests that Serbia is now itself importing workers from Macedonia to fill the gap.

**There were indications over the summer that Serbia and Kosovo were moving towards a land swap deal, which would lead to a normalisation of relations and give Serbia in particular a major boost on its path towards EU accession.** We think that Serbia is capable of fulfilling the economic criteria for EU accession in the coming years, meaning that a deal with Kosovo is the main stumbling block. However, despite widespread optimism, talks appear to have broken down, in line with our expectations. We think that the chances of a workable deal involving a land swap are quite low, reflecting major domestic political impediments to making the necessary concessions on both sides. Many outside actors are also highly wary, although probably would not stand in the way if a genuine deal is arrived at between Belgrade and Pristina.

**In summary, current trends and the near-term outlook for the economy are probably as positive as they have been for a decade, justifying our optimism expressed in previous reports.** We expect real GDP growth of 4.3% this year, which would be Serbia's best performance since 2008, and make it one of the fastest growing economies in CESEE. However, we view the upswing as cyclical rather than structural at this stage, and see growth trending down to around 3% by the end of the forecast period, which will mean only very slow convergence with Western Europe (and no convergence with the wealthier parts of CESEE).

## Table 28 / Serbia: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th. pers., mid-year | 7,132 | 7,095 | 7,058 | 7,021 | . | . | 6,986 | 6,951 | 6,916 |
| Gross domestic product, RSD bn, nom. 2) | 3,908 | 4,312 | 4,521 | 4,754 | 2,082 | 2,214 | 5,100 | 5,400 | 5,700 |
| annual change in % (real) | -1.8 | 0.8 | 3.3 | 2.0 | 1.4 | 4.9 | 4.3 | 3.4 | 2.8 |
| GDP/capita (EUR at PPP) | 10,100 | 11,200 | 11,300 | 11,700 | . | . | . | . | . |
| Consumption of households, RSD bn, nom. 2) | 2,922 | 3,052 | 3,152 | 3,311 | 1,539 | 1,604 | . | . | . |
| annual change in % (real) | -1.3 | 0.4 | 1.3 | 2.0 | 1.8 | 3.1 | 3.0 | 3.0 | 2.0 |
| Gross fixed capital form., RSD bn, nom. 2) | 652 | 723 | 766 | 844 | 371 | 426 | . | . | . |
| annual change in % (real) | -3.6 | 5.6 | 5.4 | 7.3 | 2.5 | 13.5 | 5.5 | 5.0 | 4.0 |
| Gross industrial production 3) | | | | | | | | | |
| annual change in % (real) | -7.3 | 7.3 | 5.2 | 3.9 | 2.3 | 4.4 | 4.2 | 3.5 | 2.8 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 2.4 | -8.4 | 8.3 | -11.8 | . | . | . | . | . |
| Construction output | | | | | | | | | |
| annual change in % (real) | 2.5 | 20.7 | 7.2 | 8.5 | 1.1 | 26.8 | . | . | . |
| Employed persons, LFS, th, average 4) | 2,421 | 2,574 | 2,719 | 2,795 | 2,767 | 2,793 | 2,880 | 2,940 | 2,970 |
| annual change in % | 4.8 | 0.6 | 5.6 | 2.8 | 3.8 | 0.9 | 3.0 | 2.0 | 1.0 |
| Unemployed persons, LFS, th, average 4) | 563 | 552 | 489 | 435 | 418 | 430 | 440 | 440 | 410 |
| Unemployment rate, LFS, in %, average 4) | 18.9 | 17.7 | 15.2 | 13.6 | 13.2 | 13.4 | 13.3 | 13.0 | 12.0 |
| Reg. unemployment rate, in %, eop 5) | 28.4 | 26.8 | 25.7 | 22.9 | 23.8 | 21.3 | . | . | . |
| Average monthly gross wages, RSD | 61,426 | 61,145 | 63,474 | 65,976 | 64,789 | 68,198 | 70,200 | 74,300 | 78,100 |
| annual change in % (real, gross) | -1.7 | -2.4 | 2.6 | 0.9 | 1.1 | 3.7 | 4.0 | 3.0 | 2.0 |
| Average monthly net wages, RSD | 44,530 | 44,432 | 46,097 | 47,893 | 47,054 | 49,331 | 51,300 | 54,300 | 57,000 |
| annual change in % (real, net) | -1.5 | -2.1 | 2.5 | 0.9 | 1.0 | 4.2 | 3.7 | 3.0 | 2.0 |
| Consumer prices, % p.a. | 2.1 | 1.4 | 1.1 | 3.0 | 3.4 | 1.7 | 2.3 | 2.7 | 3.0 |
| Producer prices in industry, % p.a. | 1.3 | 1.0 | 0.0 | 2.3 | 3.0 | -0.2 | 2.5 | 2.9 | 3.3 |
| General governm.budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 41.5 | 39.3 | 40.8 | 41.5 | 45.8 | 45.1 | 44.0 | 44.0 | 43.0 |
| Expenditures | 48.1 | 42.8 | 41.9 | 40.4 | 43.7 | 44.8 | 44.5 | 45.0 | 45.0 |
| Deficit (-) / surplus (+) | -6.6 | -3.5 | -1.2 | 1.1 | 2.1 | 0.4 | -0.5 | -1.0 | -2.0 |
| General gov.gross debt, nat.def., % of GDP | 70.4 | 70.0 | 67.8 | 57.9 | . | . | 68.0 | 68.0 | 67.0 |
| Stock of loans of non-fin.private sector, % p.a. | 4.5 | 3.0 | 2.3 | 2.1 | 2.2 | 4.4 | . | . | . |
| Non-performing loans (NPL), in %, eop | 21.5 | 21.5 | 17.0 | 9.9 | 15.6 | 9.2 | . | . | . |
| Central bank policy rate, % p.a., eop 6) | 8.00 | 4.50 | 4.00 | 3.50 | 4.0 | 3.0 | 3.00 | 3.25 | 4.00 |
| Current account, EUR mn | -1,985 | -1,234 | -1,075 | -2,090 | -1,027 | -1,014 | -2,200 | -2,200 | -2,200 |
| Current account, % of GDP | -6.0 | -3.5 | -2.9 | -5.3 | -6.1 | -5.4 | -5.1 | -4.8 | -4.6 |
| Exports of goods, BOP, EUR mn | 10,641 | 11,454 | 12,814 | 14,090 | 6,970 | 7,504 | 16,600 | 17,800 | 19,200 |
| annual change in % | 1.2 | 7.6 | 11.9 | 10.0 | 10.9 | 7.7 | 18.0 | 7.0 | 8.0 |
| Imports of goods, BOP, EUR mn | 14,752 | 15,099 | 15,933 | 18,076 | 8,781 | 9,796 | 21,800 | 23,200 | 24,800 |
| annual change in % | 0.5 | 2.4 | 5.5 | 13.4 | 12.6 | 11.6 | 20.5 | 6.5 | 7.0 |
| Exports of services, BOP, EUR mn | 3,810 | 4,273 | 4,571 | 5,240 | 2,346 | 2,683 | 5,800 | 6,200 | 6,700 |
| annual change in % | 11.3 | 12.2 | 7.0 | 14.6 | 13.9 | 14.4 | 10.0 | 7.0 | 8.0 |
| Imports of services, BOP, EUR mn | 3,344 | 3,544 | 3,664 | 4,289 | 1,958 | 2,211 | 4,800 | 5,100 | 5,500 |
| annual change in % | 7.6 | 6.0 | 3.4 | 17.1 | 16.6 | 12.9 | 11.0 | 7.0 | 7.0 |
| FDI liabilities, EUR mn | 1,500 | 2,114 | 2,127 | 2,545 | 1,216 | 1,406 | 2,800 | . | . |
| FDI assets, EUR mn | 264 | 310 | 228 | 130 | 31.0 | 78.0 | 190 | . | . |
| Gross reserves of NB, excl. gold, EUR mn | 9,351 | 9,812 | 9,543 | 9,287 | 9,006 | 10,421 | . | . | . |
| Gross external debt, EUR mn 7) | 25,679 | 26,234 | 26,494 | 25,630 | 25,416 | 26,108 | 25,553 | 25,681 | 25,809 |
| Gross external debt, % of GDP 7) | 77.1 | 73.5 | 72.1 | 65.4 | 65.0 | 60.0 | 59.0 | 57.0 | 54.0 |
| Average exchange rate RSD/EUR | 117.31 | 120.76 | 123.12 | 121.34 | 123.39 | 118.30 | 118 | 119 | 120 |

1) Preliminary . - 2) From 2015 major GDP revisions by incorporating new data sources. Half-year data unrevised. - 3) Excluding arms industry. - 4) From 2015 adjustments according to ILO and Eurostat. - 5) From 2015 new source for labour force potential. - 6) Two-week repo rate. – 7) BOP 5th Edition.

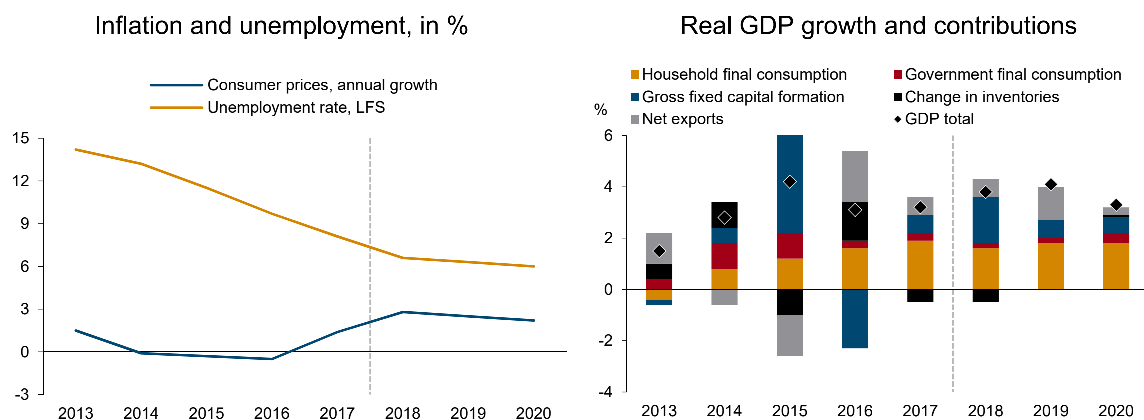
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

# SLOVAKIA: Growth fostered by automotive industry

DORIS HANZL-WEISS

**Slovakia's growth accelerated in the first half of 2018 on a broad base. Forecasts for this and next year amount to 3.8% and about 4% respectively, thanks to the new Jaguar Land Rover plant. Main internal risks are growing wages and labour shortages.**

**Figure 54 / Slovakia: Main macroeconomic indicators**




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

**Robust growth performance with accelerating tendencies**. In the first half of 2018, Slovak GDP grew by 3.9%, compared to 3.2% for the whole year 2017. Overall, growth accelerated from the first quarter to the second – from 3.6% to 4.2%. The growth pattern in the second quarter was broad-based but exhibited some surprises. Household and government consumption, gross fixed capital formation and net exports all contributed positively to growth. While the contributions from gross fixed capital formation and net exports came as a positive surprise, the trends for household consumption were more disappointing.

**Household consumption underperforming.** Overall, household consumption grew by 2.8% in the first half of 2018, less than the favourable situation on the labour market would suggest. Growth dropped from a high 3.5% in the first quarter to only 2.3% in the second. The positive situation in the labour market continued in the first half of 2018: employment increased by 1.2%, the unemployment rate (LFS) dropped further to 6.9% – a record-low rate for Slovakia. In fact, the unemployment rate reached about 14% after the crisis between 2010 and 2014 and thus has fallen by seven percentage points since then.

However, there are strong regional differences within Slovakia and high unemployment rates prevail in the East while Western Slovakia in particular (and here especially Bratislava) have the lowest unemployment rates. Due to the strong concentration of the FDI enterprises and domestic firms in Western Slovakia, there are hardly any jobs in the East.

**Tight labour market and increasing wages as main internal risks**. Labour shortages are sharply increasing in Slovakia, especially in industry. The hiring of foreign workers (e.g. Ukrainians, Serbs) is a hot topic in Slovakia and even though conditions for hiring have been somewhat eased since May, it is still seen as inflexible. The shortage of skilled labour as well as government pay increases will drive up wages. In the first half of 2018, real wages increased by 3.8% and the average monthly gross wage was above EUR 1,000 for the first time ever in the second quarter of 2018. Nominal wage increases were eaten up partly by inflation which reached 2.6% in H1. State salaries will increase by 10% in both January 2019 and January 2020, the minimum wage will rise by EUR 40 to EUR 520 in January 2019 and the government has recently proposed hiking the wages of nurses in order to keep them in Slovakia (by up to 16%).

**Hike in investments – is it sustainable?** Investments increased by 17% in the first half of 2018 due to a good performance in the first quarter (+13%) and an even stronger rise in April-June (+20%). However, this might be due to a very low comparison base in 2017 and might not be sustainable for the rest of the year. Overall, investment into other buildings & structures rose sharply in Q2. As inventories were built up, gross capital formation increased by 10% in the first half of 2018.

**Industrial production disappointing but automotive industry on the right track.** Looking at the sectoral structure, industrial production grew by only 1.7% in the first seven months of 2018. However, the main industrial sector in Slovakia – the automotive industry – picked up in the second quarter of 2018 and took over its role as a growth driver again. Production of new car models has started (e.g. the new Volkswagen Touareg generation and new models of the Kia Ceed). The new Jaguar Land Rover plant, which plans to start delivering its first cars to customers at the end of the year, will further add to industrial production and exports. The plant will produce the Land Rover Discovery model, of which the whole production will move from the Solihull plant near Birmingham to Slovakia. About 1,400 employees work in the plant, with training already ongoing on-site in a Training Academy. The plant will produce 150,000 cars per year in the first phase, with planned expansion of the number of employees to 2,800 and an expectation that annual production of cars will eventually reach 300,000. Slovakia was also on the shortlist for the new BMW car plant, but this will now be built in Hungary. As to the other sectors of manufacturing, further sectors contributing to growth in H1 were basic metals & fabricated metal products, machinery, rubber & non-metallic mineral products and food, beverages & tobacco. Production fell in the electricity, the computer, electronic & optical products, the other manufacturing & repair and in the mining & quarrying sectors. In looking at the other sectors of the economy too, value added grew strongly for construction (+10%) and agriculture, forestry & fishing (+7%). Services activity increased by around 3%.

**Slightly positive impact of the external sector on growth**. Growth of goods and services exports accelerated in the second quarter 2018. Overall, net exports contributed slightly to growth in the first half of 2018. Goods exports increased by 7%, as did imports. Goods exports to Slovakia’s main partners – Germany and the Czech Republic – expanded strongly by 19% and 5% respectively. Services exports exhibited a moderate growth rate, rising by 6% (e.g. other business services), with services imports also

up by 5.5% (e.g. transport services). Overall, the goods balance reached a positive value of EUR 700m and the services balance of EUR 400m but these were outweighed by primary and secondary income deficits (EUR 700m and EUR 800m respectively). Thus the current account was slightly in deficit in the first half of 2018.

**Fiscal consolidation slowly on track.** The government deficit figure for 2017 reached 0.8% of GDP, while the debt-to-GDP level declined slightly to 50.9%. For 2018, the planned figures are at 0.8% and 49.9% respectively, but these should be seen as lower limits rather than absolute targets. The forthcoming parliamentary elections in 2020 could also worsen deficit figures next year. From the fiscal year 2018 onwards, changes within the Fiscal Responsibility Law have to be kept in mind (the 50-60% debt-to-GDP thresholds will continuously decline by 1 percentage point to 40% by 2027). Municipal elections will take place on 10 November. There are currently ten candidates for the post of the Bratislava mayor.

**Declining but still strong household credit growth increases household indebtedness.** Private credit growth stood at 10% in the first half of 2018. Of that, strong credit growth to households (especially housing loans), which has been of major concern for a long time, has fallen slightly since the end of 2017, although it is still running at around 12% year on year. Credit growth to non-financial corporations has been fluctuating between 6% and 8% per month since the beginning of 2018. The rate of non-performing loans is low (3.6%) and falling.

**Automotive industry helps growth in the next year.** In summary, wiiw's forecasts for this year and the rest of the forecast period have not changed. Despite strong growth in the second quarter of 2018, we maintain our forecast of 3.8% for 2018 as the pattern of Q2 growth might not be sustainable. Next year, the new Jaguar Land Rover car plant will spur exports and provide a major impetus to growth, which we see accelerating to more than 4%. Moreover, growing household consumption should again contribute more substantially. The main internal risks for the future are increasing labour shortages and rising wages, with the consequences thereof. They seem to be more relevant than external risks (such as rising trade conflicts or Brexit) at the moment.

## Table 29 / Slovakia: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 5,419 | 5,424 | 5,431 | 5,430 | . | . | 5,440 | 5,440 | 5,450 |
| Gross domestic product, EUR mn, nom. | 76,088 | 79,138 | 81,226 | 84,851 | 40,535 | 43,096 | 90,500 | 96,600 | 102,000 |
| annual change in % (real) | 2.8 | 4.2 | 3.1 | 3.2 | 3.4 | 3.9 | 3.8 | 4.1 | 3.3 |
| GDP/capita (EUR at PPP) | 21,300 | 22,400 | 22,400 | 23,000 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. | 41,605 | 42,496 | 43,579 | 45,730 | 22,371 | 23,624 | . | . | . |
| annual change in % (real) | 1.4 | 2.3 | 2.9 | 3.5 | 3.5 | 2.8 | 3.0 | 3.4 | 3.3 |
| Gross fixed capital form., EUR mn, nom. | 15,772 | 19,213 | 17,280 | 18,155 | 7,712 | 9,250 | . | . | . |
| annual change in % (real) | 3.0 | 21.9 | -9.4 | 3.4 | -2.7 | 16.8 | 8.5 | 3.5 | 3.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 2.9 | 6.0 | 3.8 | 2.9 | 2.8 | 1.6 | 2.5 | 6.0 | 3.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 7.4 | -3.2 | 13.9 | -8.9 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | -4.2 | 18.1 | -10.7 | 3.0 | -2.6 | 7.0 | . | . | . |
| Employed persons, LFS, th, average | 2,363 | 2,424 | 2,492 | 2,531 | 2,520 | 2,549 | 2560 | 2580 | 2590 |
| annual change in % | 1.5 | 2.6 | 2.8 | 1.5 | 1.8 | 1.2 | 1.0 | 0.7 | 0.5 |
| Unemployed persons, LFS, th, average | 359 | 314 | 267 | 224 | 231 | 188 | 180 | 170 | 170 |
| Unemployment rate, LFS, in %, average | 13.2 | 11.5 | 9.7 | 8.1 | 8.4 | 6.9 | 6.6 | 6.3 | 6.0 |
| Reg. unemployment rate, in %, eop | 12.3 | 10.6 | 8.8 | 5.9 | 6.9 | 5.4 | . | . | . |
| Average monthly gross wages, EUR | 858 | 883 | 912 | 954 | 921 | 980 | 1020 | 1090 | 1160 |
| annual change in % (real, gross) | 4.2 | 3.2 | 3.8 | 3.3 | 3.2 | 3.8 | 4.0 | 4.2 | 3.8 |
| Consumer prices (HICP), % p.a. | -0.1 | -0.3 | -0.5 | 1.4 | 1.0 | 2.6 | 2.8 | 2.5 | 2.2 |
| Producer prices in industry, % p.a. | -3.3 | -2.9 | -3.9 | 2.5 | 2.8 | 1.3 | 2.5 | 2.5 | 2.5 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 39.3 | 42.4 | 39.3 | 39.4 | . | . | 39.8 | 40.2 | 39.5 |
| Expenditures | 42.0 | 45.1 | 41.5 | 40.5 | . | . | 40.9 | 40.7 | 39.7 |
| Net lending (+) / net borrowing (-) | -2.7 | -2.7 | -2.2 | -1.0 | . | . | -1.1 | -0.8 | -0.6 |
| General gov.gross debt, EU def., % of GDP | 53.5 | 52.2 | 51.8 | 50.9 | . | . | 50.0 | 48.9 | 46.6 |
| Stock of loans of non-fin.private sector, % p.a. | 6.7 | 9.7 | 9.3 | 9.9 | 11.7 | 10.2 | . | . | . |
| Non-performing loans (NPL), in %, eop | 6.0 | 5.2 | 4.7 | 3.9 | 4.3 | 3.6 | . | . | . |
| Central bank policy rate, % p.a., eop 2) | 0.05 | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | 871 | -1,391 | -1,756 | -1,690 | -561 | -455 | -1,300 | -600 | -500 |
| Current account, % of GDP | 1.1 | -1.8 | -2.2 | -2.0 | -1.4 | -1.1 | -1.4 | -0.6 | -0.5 |
| Exports of goods, BOP, EUR mn | 62,581 | 64,650 | 67,164 | 71,479 | 35,386 | 37,782 | 76,100 | 82,600 | 86,500 |
| annual change in % | 0.3 | 3.3 | 3.9 | 6.4 | 5.8 | 6.8 | 6.5 | 8.5 | 4.7 |
| Imports of goods, BOP, EUR mn | 59,823 | 63,601 | 65,527 | 70,789 | 34,732 | 37,085 | 75,000 | 80,700 | 84,300 |
| annual change in % | 0.5 | 6.3 | 3.0 | 8.0 | 8.2 | 6.8 | 6.0 | 7.6 | 4.5 |
| Exports of services, BOP, EUR mn | 6,889 | 7,301 | 8,350 | 9,214 | 4,373 | 4,627 | 9,800 | 10,100 | 10,400 |
| annual change in % | -1.1 | 6.0 | 14.4 | 10.3 | 9.0 | 5.8 | 6.0 | 3.0 | 3.0 |
| Imports of services, BOP, EUR mn | 6,713 | 7,144 | 7,881 | 8,334 | 3,988 | 4,207 | 8,800 | 9,200 | 9,700 |
| annual change in % | 3.6 | 6.4 | 10.3 | 5.7 | 6.9 | 5.5 | 5.0 | 5.0 | 5.0 |
| FDI liabilities, EUR mn | -324 | 1,357 | 4,326 | 5,313 | 3,195 | 2,022 | 2,000 | . | . |
| FDI assets, EUR mn | 94 | 1,266 | 3,684 | 3,603 | 2,181 | 2,328 | 2,000 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 1,165 | 1,648 | 1,624 | 1,609 | 1,613 | 3,870 | . | . | . |
| Gross external debt, EUR mn | 67,776 | 67,225 | 73,750 | 94,149 | 78,792 | 99,963 | 100,000 | 105,000 | 110,000 |
| Gross external debt, % of GDP | 89.1 | 84.9 | 90.8 | 111.0 | 92.9 | 110.5 | 110.5 | 108.7 | 107.8 |

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

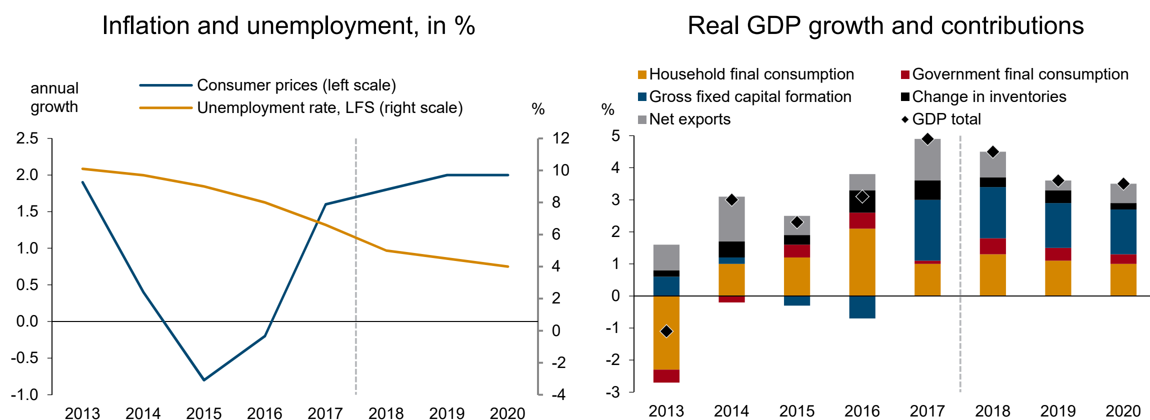
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

# SLOVENIA: Another successful year

HERMINE VIDOVIC

GDP growth is expected to reach 4.5% in 2018, but will slow due to lower export growth in the forecast period. Domestic demand, investments fuelled by EU funding and steady consumption growth will remain the main drivers of GDP growth. The shrinking of the working-age population and increasing labour shortages will put an upward pressure on wages.

**Figure 55 / Slovenia: Main macroeconomic indicators**




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

**Slovenia's GDP increased by 4.2% year on year in the first half of 2018 driven by strong domestic demand.** Private consumption growth has been formidable, supported by further improvements in labour market conditions and rising household loans. Thanks to EU co-financing also gross fixed capital formation remained on its growth path, 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. Changes in inventories as well as net exports contributed positively to the GDP expansion. Industrial output grew by close to 6% in the first half of the year, with the highest growth rates reported for the manufacturing of computers and optical equipment and car production.

**Labour Force Survey data indicate an employment increase of 3% in the first half of 2018 and a fall of the unemployment rate to 5.6%**, the lowest rate since 2008, when it amounted to only 4.4%. Average real net wages rose only moderately, by 1.5% in the first six months of the year. Taking into

account that the working-age population will decline and labour shortages will become more severe, an upward wage pressure can be expected in the coming years. The July 2018 business tendency survey among manufacturing, retail trade and construction companies reported that the share of enterprises listing shortages of skilled labour as a factor limiting production was 38%, the highest listed so far. This is also confirmed by the evolution of job vacancy rates, increasing from 2.3% in the second quarter of 2017 to 2.6% in the same period of 2018. Wage increases in the public sector are to be expected due to the relaxation of the remaining austerity measures introduced during the financial crisis.

**External trade expansion was less dynamic than a year earlier, but still at high levels.** Goods exports and imports rose by about 12% each, year on year, in the first seven months of 2018 with the trade surplus somewhat higher than a year earlier. In services trade the surplus widened even faster owing to exports – transport, travel in particular – rising ahead of lower import growth. The deficits both in the primary income and in the secondary income balance have been narrowing as compared to the first seven months of 2017. Hence, the current account surplus increased compared with 2017 and amounted to an estimated 8% of GDP on the back of deleveraging and strong private savings. Foreign direct investment inflows were higher than a year earlier, amounting to EUR 730 million in the first seven months of 2018.

**The general government budget closed with a surplus in the first half of 2018 (1% of GDP) compared to a small deficit in 2017 and is likely to remain in positive territory in the year as whole.** The turnaround was mainly made possible through a marked increase in total tax revenues and social contributions, while on the expenditure side fewer funds are earmarked for interest payments. Thus, the expectation of the Ministry of Finance ending up 2018 with a 0.4% surplus of the general government as a share of GDP, and a fall of public debt to below 70% seems to be feasible. As regards 2019, the new government has announced to adjust the budget to the commitments set out in the coalition agreement, but has also emphasised its commitment to fiscal sustainability and fiscal rule of a balanced budget.

**In August the European Commission approved a new Slovenian commitment package for Nova Ljubljanska Banka (NLB).** Accordingly Slovenia commits itself to sell a first tranche of at least 50% plus one share by the end of 2018 and the Slovenian government will reduce its share in the bank to 25% plus one share by the end of 2019. If Slovenia does not respect the deadlines, a divestiture trustee will be appointed to take over the sales process in order to prevent further delays in the restructuring process. The sale of NLB was a crucial element which allowed the Commission to approve a EUR 2.3 billion in state aid to the bank in 2013.

**Following the early parliamentary elections in June a new government came into office in mid-September, consisting of five parties, ranging from centre to left**. The coalition is headed by Marjan Šarec, leader of the same name list (LMS) and is formed by the Social Democrats (SD), the party of the previous prime minister Miro Cerar (SMC), the pensioners' party (DeSUS), and the party of Alenka Bratušek, also a former prime minister. Since the coalition does not have a majority in the parliament it has to rely on the support of the Left. Considering the large number of parties and the expectations of the respective electorate it is questionable whether the government will be in a position to implement the necessary reforms e.g. regarding the health sector and the pension system. One of the first tasks of the new government – appointing a new governor of the Bank of Slovenia – failed, since the parliament rejected Primož Dolenc, the vice governor and candidate suggested by President Pahor.

Already in April Slovenia lost its vote on the European Central Bank’s governing council, when former governor Boštjan Jazbec resigned.

**Fairly solid economic growth is expected in the period up to 2020.** wiiw expects GDP to grow at 3.5% annually backed by domestic demand and, to a lower extent, by net exports. Investments are expected to remain high, co-funded by EU transfers under the current (2014-2020) financial perspective. Household consumption will also remain an important driver, boosted by rising wages and pensions in particular. Unemployment is expected to continue its downward path, not least because of the shrinking working-age population. Given the weak stance of the new government coalition, political uncertainties remain. Similar to other EU countries, ageing of the population and a shrinking workforce coupled with rising labour shortages will become major future challenges.

## Table 30 / Slovenia: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | Forecast | | |
| Population, th pers., average | 2,062 | 2,064 | 2,065 | 2,066 | 2,065 | 2,067 | 2,066 | 2,066 | 2,066 |
| Gross domestic product, EUR mn, nom. | 37,603 | 38,863 | 40,357 | 43,000 | 20,804 | 22,206 | 45,800 | 48,400 | 51,100 |
| annual change in % (real) | 3.0 | 2.3 | 3.1 | 4.9 | 4.5 | 4.2 | 4.5 | 3.6 | 3.5 |
| GDP/capita (EUR at PPP) | 22,700 | 23,800 | 24,100 | 25,200 | . | . | . | . | . |
| Consumption of households, EUR mn, nom. | 20,137 | 20,482 | 21,187 | 21,963 | 10,357 | 10,833 | . | . | . |
| annual change in % (real) | 1.9 | 2.3 | 4.0 | 1.9 | 1.4 | 2.2 | 2.5 | 2.2 | 2.0 |
| Gross fixed capital form., EUR mn, nom. | 7,287 | 7,313 | 7,082 | 7,962 | 3,868 | 4,298 | . | . | . |
| annual change in % (real) | 1.0 | -1.6 | -3.7 | 10.7 | 11.8 | 9.1 | 8.5 | 7.5 | 7.5 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 2.3 | 5.6 | 7.1 | 7.7 | 6.6 | 6.5 | 6.5 | 5.5 | 5.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 11.1 | 6.3 | -2.9 | -9.4 | . | . | . | . | . |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 19.5 | -8.2 | -17.7 | 17.7 | 18.3 | 17.3 | . | . | . |
| Employed persons, LFS, th, average | 916.7 | 917.4 | 915.0 | 959.1 | 945.2 | 974.0 | 980 | 1,000 | 1,020 |
| annual change in % | 1.2 | 0.1 | -0.3 | 4.8 | 4.2 | 3.0 | 2.5 | 2.0 | 1.5 |
| Unemployed persons, LFS, th, average | 98.1 | 90.3 | 79.6 | 67.4 | 72.3 | 57.4 | 52 | 47 | 43 |
| Unemployment rate, LFS, in %, average | 9.7 | 9.0 | 8.0 | 6.6 | 7.1 | 5.6 | 5.0 | 4.5 | 4.0 |
| Reg. unemployment rate, in %, eop | 13.0 | 12.3 | 10.8 | 9.0 | 9.1 | 7.9 | . | . | . |
| Average monthly gross wages, EUR 2) | 1,540 | 1,556 | 1,584 | 1,626 | 1,601 | 1,658 | 1,690 | 1,760 | 1,830 |
| annual change in % (real, gross) | 0.9 | 1.2 | 1.9 | 1.3 | 0.3 | 2.0 | 2.0 | 2.0 | 2.0 |
| Average monthly net wages, EUR 2) | 1,005 | 1,013 | 1,030 | 1,062 | 1,044 | 1,076 | 1,100 | 1,140 | 1,190 |
| annual change in % (real, net) | 0.6 | 0.9 | 1.8 | 1.7 | 0.6 | 1.5 | 1.5 | 2.0 | 2.0 |
| Consumer prices (HICP), % p.a. | 0.4 | -0.8 | -0.2 | 1.6 | 1.7 | 1.8 | 1.8 | 2.0 | 2.0 |
| Producer prices in industry, % p.a. | -0.7 | -0.2 | -1.4 | 2.2 | 2.0 | 2.2 | 2.0 | 2.0 | 2.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | | |
| Revenues | 44.4 | 44.9 | 43.4 | 43.4 | . | . | 42.5 | 42.2 | 42.0 |
| Expenditures | 49.9 | 47.7 | 45.3 | 43.4 | . | . | 42.1 | 41.8 | 42.0 |
| Net lending (+) / net borrowing (-) | -5.5 | -2.9 | -1.9 | 0.0 | . | . | 0.4 | 0.4 | 0.0 |
| General gov.gross debt, EU def., % of GDP | 80.4 | 82.6 | 78.7 | 74.1 | . | . | 70.0 | 68.0 | 65.0 |
| Stock of loans of non-fin.private sector, % p.a. | -13.4 | -6.4 | -3.9 | 1.9 | 2.0 | 1.8 | . | . | . |
| Non-performing loans (NPL), in %, eop | 11.9 | 9.9 | 5.5 | 3.6 | 5.0 | 2.9 | . | . | . |
| Central bank policy rate, % p.a., eop 3) | 0.05 | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | 2,179 | 1,760 | 2,224 | 3,077 | 1,417 | 1,674 | 3,330 | 2,920 | 2,620 |
| Current account, % of GDP | 5.8 | 4.5 | 5.5 | 7.2 | 6.8 | 7.5 | 7.3 | 6.0 | 5.1 |
| Exports of goods, BOP, EUR mn | 22,961 | 24,039 | 24,991 | 28,462 | 14,000 | 15,477 | 31,310 | 33,810 | 36,350 |
| annual change in % | 5.9 | 4.7 | 4.0 | 13.9 | 12.3 | 10.6 | 10.0 | 8.0 | 7.5 |
| Imports of goods, BOP, EUR mn | 21,780 | 22,563 | 23,454 | 26,901 | 13,217 | 14,692 | 29,590 | 32,250 | 34,990 |
| annual change in % | 3.8 | 3.6 | 3.9 | 14.7 | 14.6 | 11.2 | 10.0 | 9.0 | 8.5 |
| Exports of services, BOP, EUR mn | 5,558 | 5,936 | 6,487 | 7,275 | 3,318 | 3,612 | 7,890 | 8,480 | 8,990 |
| annual change in % | 4.5 | 6.8 | 9.3 | 12.1 | 12.9 | 8.8 | 8.5 | 7.5 | 6.0 |
| Imports of services, BOP, EUR mn | 3,862 | 4,007 | 4,236 | 4,556 | 2,031 | 2,215 | 4,880 | 5,200 | 5,510 |
| annual change in % | 7.7 | 3.8 | 5.7 | 7.6 | 6.6 | 9.1 | 7.0 | 6.5 | 6.0 |
| FDI liabilities, EUR mn | 739 | 1,560 | 1,298 | 966 | 543 | 438 | 800 | . | . |
| FDI assets, EUR mn | 155 | 292 | 434 | 551 | 440 | 153 | 350 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 736 | 687 | 593 | 632 | 639 | 605 | . | . | . |
| Gross external debt, EUR mn | 47,287 | 46,627 | 44,810 | 43,813 | 44,570 | 43,535 | 43,500 | 45,000 | 47,000 |
| Gross external debt, % of GDP | 125.75 | 119.98 | 111.03 | 101.89 | 103.7 | 95.1 | 95.0 | 93.0 | 92.0 |

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

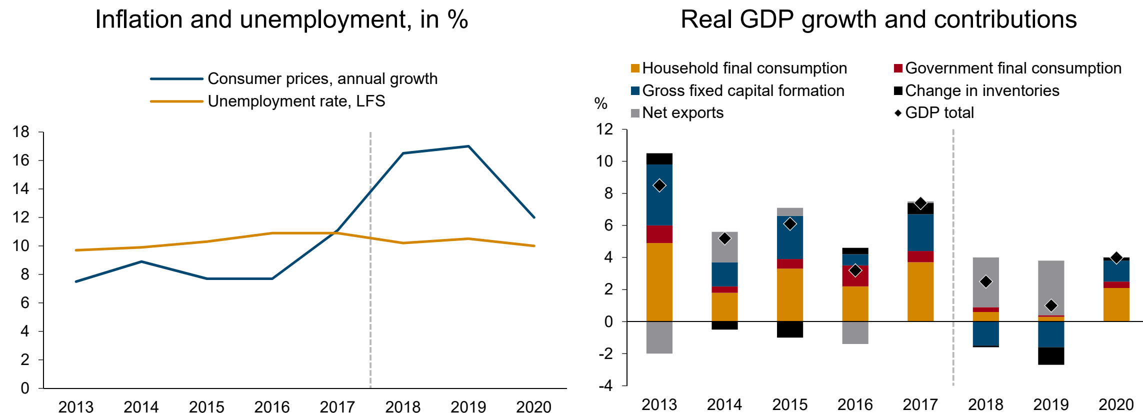
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

# TURKEY: Accepting reality and hoping for the best

RICHARD GRIEVESON

**Turkey's economy is heading for recession, and is set to face at least several difficult quarters. US monetary tightening, and domestic and international political risk factors, have combined with an unbalanced and debt-reliant growth model to create a perfect storm for Turkey. The policy response by the authorities, including monetary tightening and an attempt to calm international tensions, have significantly reduced the chances of a full-blown crisis. Our core scenario is that the economy will start to recover by end-2019.**

**Figure 56 / Turkey: Main macroeconomic indicators**




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

**The Turkish economy is undergoing its worst crisis for a decade.** Since the start of 2018 the lira has depreciated by around 50% against the euro, and consumer price inflation has rocketed to over 20%. The crisis reflects a combination of long-term structural imbalances in the economy, major external headwinds, and domestic policy missteps.

**Some of the roots of the crisis are medium-term in nature.** The most important of these is the persistently high current account deficit that Turkey has run for many years, and the fact that the majority of this has been financed by short-term capital inflows, much of which have been debt-creating. During the post-crisis period of ultra-loose global monetary conditions, Turkey has been one of the emerging markets which has seen its private sector load up on cheap foreign currency credits, predominantly in

US dollars. This very unbalanced growth model relied on net hot money inflows of 4-6% of GDP per year.

**A second medium-term risk factor which has come sharply into focus this year is the insufficient independence of institutions in general, and the central bank in particular.** Investors have long questioned the central bank's ability to respond to inflationary pressures in a timely manner. The central bank has not met its 5% inflation target since 2011, and the president, Recep Tayyip Erdoğan, has several times argued that higher interest rates cause higher inflation (something that is at odds with the thinking of most economists). Mr Erdoğan's now infamous interview with Bloomberg in London in May 2018, where he repeated this claim and hinted at taking more direct control over the central bank after the presidential election in June, appears to have particularly rattled the foreign exchange market. More generally, there have been growing questions about the capacity and independence of Turkish state institutions. According to the World Bank's governance indicators, Turkey's government effectiveness, regulatory quality, rule of law and control of corruption have all declined since 2013-14.

**In addition to medium-term structural issues, four shorter-term factors have contributed to the collapse in the lira this year.** First, while the US Federal Reserve has been tightening policy for some time now, the dollar has strengthened significantly since April, bringing emerging markets with weaker fundamentals and higher external exposure (such as Turkey or Argentina) more into the firing line. In the CESEE region, Turkey is much more exposed to the re-orientation of global capital flows than most other countries, reflecting its reliance on dollars rather than euros for most external funding (unlike the Fed, the ECB is going nowhere fast with monetary policy tightening). Second, the oil price has continued to rise, and has generally been 40-50% above equivalent 2017 levels during the year, putting additional pressure on Turkey's already strained external financing capacity. Third, domestic political risk has risen, exacerbating the general deterioration in foreign investors' willingness to finance emerging markets' external deficits. Following the election in June, a new government was announced without the reassuring presence of ministers from the previous administration who were viewed as more economically orthodox and investor friendly. Fourth, tensions with the US have risen, particularly in relation to the detention by Turkey of a US pastor. Although the pastor was released in mid-October, the potential for tensions with the US remains, not least in relation to a Turkish bank's role in helping Iran to evade US sanctions, and the general unpredictability of US policy-making under the current president.

**The authorities needed to take four steps quickly to prevent a full-blown crisis, but have so far only done two of them.** These steps were: i) a major tightening of monetary policy to support the lira; ii) produce a credible medium-term economic plan, including a tightening of fiscal policy; iii) outline steps to support the banking sector in anticipation of a sharp rise in bad loans; iv) reduce tensions with the US. The first two have largely been done (see below), and there has been welcome progress on point iv in line with our expectations. Point iii, however, is still missing.

**The central bank has finally taken decisive action to stem the chaos in the foreign exchange market.** In September the benchmark one week repo rate was hiked by 625 basis points to 24%. In some ways this was probably unnecessary: by the time of the hike the economy was likely already in recession. However, the hike was a strong statement, indicating to the market a continued ability to act independently, and a statement of intent about maintaining foreign financing of the current account deficit. We expect the hike to improve investor confidence, and it will certainly help with the financing of the external deficit. This is particularly important considering that Turkey's foreign currency reserves are inadequate according to the IMF.

**A recession is now guaranteed, and full-year growth for 2018 will only be moderately positive, while 2019 will be even worse.** The economy is heading into a deep recession, which will last until at least the middle of 2019. We expect investment and imports in particular to decline strongly, reflecting much tighter monetary policy and a collapse in domestic demand. Private consumption will also decline. On the flipside, the massive depreciation of the lira will provide some support to the export sector, and as a result external demand should contribute positively to growth for at least a few quarters.

**While the downturn will be significant and painful, we expect growth to be back in positive territory by the end of 2019.** This will reflect in part the severity of the contraction now (which means that by H2 2019 base effects will be highly supportive of growth). During the next few quarters, the Turkish economy will undergo a very significant external adjustment, with a collapse in imports and strong growth in exports set to narrow considerably the current account deficit. Certain strong domestic fundamentals will also help the recovery, or at least to mitigate the extent of the downturn. Turkey's fiscal and sovereign debt position is strong, meaning that the government is highly unlikely to run into financing difficulties (although fiscal policy will be tightened as part of the policy response).

**Two things are now key to watch: the banking sector and the relationship with the US.** In relation to the banking sector, we expect the sharp depreciation of the lira to badly affect capital levels and asset quality, reflecting the fact that many companies are highly leveraged in foreign currency but do not have offsetting dollar or euro revenue streams. The non-performing loan (NPL) ratio will certainly rise. So far, the government has not been specific on how it plans to help the banking sector if it runs into trouble. Depending on the depth and length of the crisis, this may become necessary. At the same time, the banking sector is going into the crisis with good asset quality and high capital levels – a strong starting point, which makes it much more likely that the sector will survive the downturn without suffering a major crisis. Besides, the chances of the downturn turning into a broader financial crisis have been mitigated by strong central bank action, even if this was very much delayed.

**Turkey's relationship with the US remains a downside risk factor to the economic outlook.** So far, the US has put only limited sanctions on Turkey. However, despite the release of the jailed pastor, there is a risk that tensions escalate, particularly in relation to ongoing investigations in the US concerning alleged support by Turkey to Iran to evade US sanctions on the latter. Put simply, Turkey's economy would not be able to handle anything like the sanctions that the US has put on Russia over the last few years. Turkey's large external financing needs (in contrast to Russia) mean that macroeconomic stability would be endangered, and the economy would be facing a much bigger crisis.

**Beyond the next 12-18 months, and assuming that the banking and corporate sectors can weather the current difficulties without a full-blown crisis, the outlook for Turkey is not too bad.** The challenges posed by the current downturn should not be underestimated. However, Turkey's growth potential remains good, reflecting in part a positive demographic outlook (in contrast to most of the rest of CESEE). The question is how much the authorities learn from the current recession and take the opportunity to implement a more sustainable growth model. Certainly, the current downturn will force an external adjustment. However, without greater investment in productive capacity and a shift away from debt-fuelled consumption and construction investment, as the economy recovers from late 2019 the external shortfall will simply widen again, probably financed primarily by hot money. This means that Turkey will be again exposed to external developments, which in the end will probably result in another crisis.

## Table 31 / Turkey: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | | Forecast | |
| Population, th pers., average | 77,182 | 78,218 | 79,278 | 80,313 | . | . | 80,900 | 81,700 | 82,500 |
| Gross domestic product, TRY bn, nom. | 2,044 | 2,339 | 2,609 | 3,107 | 1,384 | 1,672 | 3,700 | 4,400 | 5,100 |
| annual change in % (real) | 5.2 | 6.1 | 3.2 | 7.4 | 5.3 | 6.2 | 2.5 | 1.0 | 4.0 |
| GDP/capita (EUR at PPP) | 17,700 | 18,800 | 18,600 | 19,400 | . | . | . | . | . |
| Consumption of households, TRY bn, nom. | 1,242 | 1,412 | 1,561 | 1,834 | 831 | 996 | . | . | . |
| annual change in % (real) | 3.0 | 5.4 | 3.7 | 6.1 | 3.8 | 7.8 | 1.0 | 0.5 | 3.5 |
| Gross fixed capital form., TRY bn, nom. | 591 | 695 | 765 | 932 | 418 | 517 | . | . | . |
| annual change in % (real) | 5.1 | 9.3 | 2.2 | 7.8 | 5.9 | 5.8 | -5.0 | -5.5 | 4.2 |
| Gross industrial production 2) | | | | | | | | | |
| annual change in % (real) | 5.8 | 6.2 | 3.4 | 8.9 | 3.9 | 7.3 | 5.0 | 2.0 | 2.8 |
| Gross agricultural production 3) | | | | | | | | | |
| annual change in % (real) | -2.9 | 5.2 | 0.5 | 2.0 | . | . | . | . | . |
| Construction industry 2) | | | | | | | | | |
| annual change in % (real) | 3.0 | 1.7 | 2.9 | 3.8 | . | . | . | . | . |
| Employed persons, LFS, th, average | 25,931 | 26,619 | 27,216 | 28,197 | 27,722 | 28,652 | 29,000 | 29,400 | 30,100 |
| annual change in % | 5.4 | 2.7 | 2.2 | 3.6 | 2.1 | 3.4 | 3.0 | 1.5 | 2.5 |
| Unemployed persons, LFS, th, average | 2,854 | 3,050 | 3,332 | 3,451 | 3,563 | 3,245 | 3,290 | 3,450 | 3,340 |
| Unemployment rate, LFS, in %, average | 9.9 | 10.3 | 10.9 | 10.9 | 11.4 | 10.2 | 10.2 | 10.5 | 10.0 |
| Reg. unemployment rate, in %, eop | . | . | . | . | . | . | . | . | . |
| Average monthly gross wages, TRY 4) | 1,820 | 2,014 | 2,280 | 2,470 | . | . | 2690 | 3220 | 3710 |
| annual change in % (real, gross) | 1.3 | 2.8 | 5.2 | -2.5 | . | . | -2.0 | 2.2 | 2.8 |
| Consumer prices (HICP), % p.a. | 8.9 | 7.7 | 7.7 | 11.1 | 10.8 | 11.6 | 16.5 | 17.0 | 12.0 |
| Producer prices in industry, % p.a. 5) | 10.1 | 5.3 | 4.3 | 15.8 | 15.3 | 16.7 | 21.5 | 23.0 | 14.0 |
| General governm. budget, nat.def., % of GDP | | | | | | | | | |
| Revenues | 31.9 | 31.9 | 33.0 | 30.2 | . | . | 32.8 | 32.8 | 33.5 |
| Expenditures | 32.7 | 32.9 | 34.7 | 32.2 | . | . | 35.8 | 35.7 | 35.7 |
| Deficit (-) / surplus (+) | -0.8 | -1.0 | -1.7 | -2.0 | . | . | -3.0 | -2.9 | -2.2 |
| General gov.gross debt, nat.def., % of GDP | 28.8 | 27.6 | 28.3 | 28.3 | . | . | 27.9 | 27.7 | 28.0 |
| Stock of loans of non-fin.private sector, % p.a. | 19.4 | 19.4 | 15.2 | 19.9 | 21.6 | 19.4 | . | . | . |
| Non-performing loans (NPL), in %, eop | 2.8 | 3.1 | 3.2 | 2.9 | 3.1 | 3.0 | . | . | . |
| Central bank policy rate, % p.a., eop 6) | 8.25 | 7.50 | 8.00 | 8.00 | 8.00 | 17.75 | 24.00 | 22.00 | 15.00 |
| Current account, EUR mn | -33,010 | -28,919 | -29,917 | -41,758 | -19,556 | -25,897 | -30,200 | -19,500 | -20,900 |
| Current account, % of GDP | -4.7 | -3.7 | -3.8 | -5.5 | -5.6 | -7.7 | -4.8 | -3.2 | -3.2 |
| Exports of goods, BOP, EUR mn | 127,237 | 136,978 | 135,795 | 147,218 | 75,394 | 70,915 | 151,000 | 159,000 | 167,000 |
| annual change in % | 4.4 | 7.7 | -0.9 | 8.4 | 11.7 | -5.9 | 2.8 | 5.0 | 5.0 |
| Imports of goods, BOP, EUR mn | 175,310 | 180,353 | 172,701 | 198,906 | 96,153 | 98,702 | 197,000 | 197,000 | 207,000 |
| annual change in % | -3.7 | 2.9 | -4.2 | 15.2 | 12.2 | 2.7 | -1.0 | 0.0 | 5.0 |
| Exports of services, BOP, EUR mn | 39,175 | 42,419 | 34,125 | 38,588 | 15,432 | 16,620 | 43,000 | 46,000 | 48,000 |
| annual change in % | 7.9 | 8.3 | -19.6 | 13.1 | 5.3 | 7.7 | 11.0 | 7.0 | 5.0 |
| Imports of services, BOP, EUR mn | 19,050 | 20,563 | 20,366 | 21,250 | 10,253 | 9,865 | 21,000 | 21,000 | 22,000 |
| annual change in % | 3.2 | 7.9 | -1.0 | 4.3 | -1.6 | -3.8 | 0.0 | 0.0 | 5.0 |
| FDI liabilities, EUR mn | 9,865 | 16,216 | 12,077 | 9,643 | 4,693 | 4,022 | 7,400 | . | . |
| FDI assets, EUR mn | 5,379 | 4,595 | 2,845 | 2,418 | 1,568 | 1,664 | 2,700 | . | . |
| Gross reserves of NB excl. gold, EUR mn 7) | 88,058 | 85,355 | 87,331 | 70,119 | 79,033 | 64,804 | . | . | . |
| Gross external debt, EUR mn 7) | 334,150 | 367,651 | 388,190 | 379,226 | 385,864 | 391,972 | 407,600 | 440,000 | 445,400 |
| Gross external debt, % of GDP | 47.5 | 47.6 | 49.8 | 50.3 | 51.2 | 62.5 | 65.0 | 72.0 | 69.0 |
| Average exchange rate TRY/EUR | 2.9065 | 3.0255 | 3.3433 | 4.1206 | 3.9379 | 4.9551 | 5.90 | 7.20 | 7.90 |

1) Preliminary. – 2) Enterprises with 20 and more employees; for construction wiiw estimate in 2017 - 3) Based on UN-FAO data, wiiw estimate in 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 in 2016 and 2017. - 5) Domestic output prices. - 6) One-week repo rate. – 7) Converted from USD.

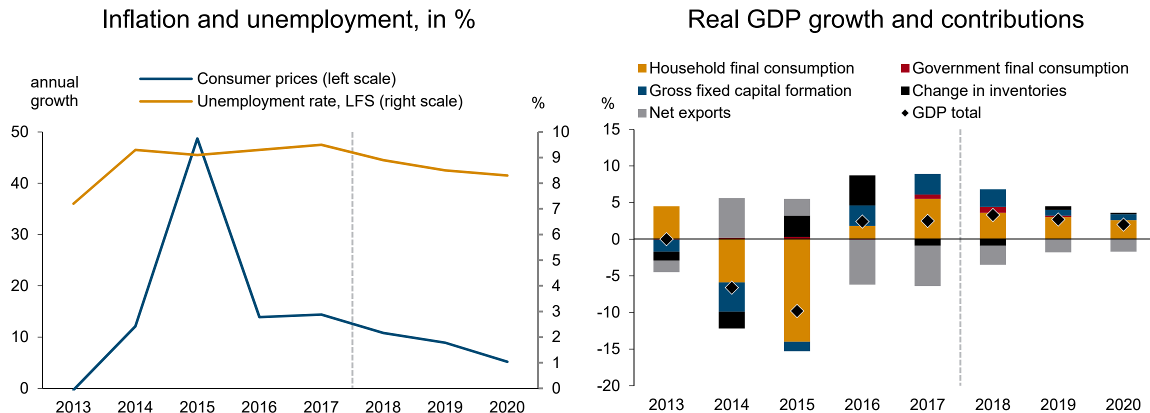
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

# UKRAINE: Lifeline from the IMF ahead of the elections

VASILY ASTROV

**Thanks to the booming domestic demand, economic growth should exceed 3% this year but will likely decelerate somewhat in 2019 due to recent monetary policy tightening. In the face of a less supportive global environment, Ukraine has agreed on a new IMF loan, which should ensure macroeconomic stability at least in the short term. However, the social impact of the related recent hike in gas tariffs may prove politically costly for the authorities ahead of the March 2019 presidential elections.**

**Figure 57 / Ukraine: Main macroeconomic indicators**




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

**In the second quarter of 2018, economic growth picked up markedly,** to 3.8% year on year (from 3.1% in the first quarter), resulting in 3.5% growth in the first half of the year. The acceleration of growth in the second quarter was largely due to the one-off effect of early harvesting, and will not be sustained throughout the remainder of the year: the grain harvest for the year as a whole is expected to be lower than in 2017. In the first eight months, agricultural production picked up by only 2%, while gross industrial output was up by 2.2% and that of construction by 5.7%. Viewed from the demand side, growth continues to be driven exclusively by domestic demand, especially private consumption and fixed capital investments; the contribution of net exports of goods and services was once again strongly negative in the first half of the year.

**Private consumption expanded by 4.9% in the first half of 2018, underpinned by a combination of three factors: (i) high wage growth, (ii) increased inflow of remittances, and (iii) resumed consumer lending.** Strong growth in real wages (by 12.8% in the first eight months, year on year) has been partly due to the enacted hike in the official minimum wage, but is more generally a reflection of mounting labour shortages, especially for highly skilled jobs. The economic recovery appears to have finally started benefiting the labour market: employment grew by 1% in the first half of the year (partly thanks to a higher participation rate), resulting in the unemployment rate falling by 0.6 pp (year on year). Another important factor behind the strong consumer demand has been remittances, which soared by 24% in the second quarter, to USD 2.8 billion (corresponding to 9.1% of GDP). The number of Ukrainians working abroad is broadly estimated at between 2 and 4 million people, including an estimated 1 million who have left since Ukraine was granted a visa-free regime with the Schengen countries in June 2017. Finally, consumer lending has picked up markedly as well: by 34% in August 2018 in nominal terms (year on year), although lending to households in general was more sluggish on account of declining mortgages. The pace of credit expansion will almost certainly decelerate in the months to come, following the recent monetary policy tightening (see below).

**Gross fixed capital formation soared by 15.4% in the first half of 2018, reflecting buoyant business confidence.** As before, the bulk of investments are domestic and largely financed from retained profits rather than by taking on credit. The badly needed inflows of FDI continue to be disappointingly low – despite the Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU, which has been in effect de facto since 2016, and some progress in the harmonisation of standards with those of the EU (including technical, sanitary and phytosanitary standards, customs procedures and rules of public procurement). In the first eight months, the inflows of FDI stood at a mere USD 1.6 billion – 20% less than in the corresponding period of 2017; in addition, around one third of recorded FDI represents conversion of foreign banks' loans to their Ukrainian subsidiaries into equity. Still, there are also niches of success, such as the car parts industry, which has managed to attract non-negligible export-oriented FDI. This applies in particular to ignition cable sets which, with a share of 7% of total exports, have become Ukraine's second biggest export item (behind corn). Since 2015, a total of 11 factories producing ignition cables and other automotive accessories have been constructed in Ukraine, making the country increasingly integrated into the Central European car manufacturing 'core'. All in all, the share of the EU in Ukraine's exports of goods has risen sharply over the past few years (mostly at the expense of Russia) and reached 37% in the first eight months of 2018.

**The boom in domestic demand implies that Ukraine's growth path continues to be unbalanced and accompanied by widening external deficits**. Despite the reasonably high prices for Ukraine's main export products (grain and metals), merchandise exports increased only by 11.6% in the first eight months (in US dollar terms) – much less than imports (+15.3%), and the trade deficit widened accordingly. The latter was partly offset by higher inflows of remittances, keeping the increase in the current account deficit in check. Following the radical methodological changes introduced by the National Bank in March 2018, the inflows of remittances turned out to be much higher, and the *levels* of current account deficits during the past few years accordingly lower (by around 2 pp of GDP), than assumed earlier. Nevertheless, the *dynamics* of current account deficits remains negative, even if so far they have been largely covered by the inflows of FDI. The likely reduction in gas transit fees charged by Ukraine, once the North Stream 2 gas pipeline circumventing Ukraine is put into operation at the beginning of 2020, could result in another blow to the country's balance of payments.

**After a prolonged period of stability, the summer months of 2018 witnessed mounting depreciation pressures …** Given its weak economic fundamentals, Ukraine has always been poised to be strongly affected by any adverse shift in global investor sentiments. Therefore, the combined impact of factors such as monetary policy tightening in the US, 'contagion' from the Turkish crisis and rising global protectionist risks on Ukraine was only a matter of time, and has been further amplified by uncertainties with respect to the continuation of the IMF loan programme and next year's presidential elections. Between the beginning of July and the beginning of October, the hryvnia weakened by 8.1% against the US dollar, fuelling depreciation expectations and giving exporters an incentive to delay the conversion of their export proceeds. Also, as some foreign investors quit the country's bond market, the borrowing costs for the government rose sharply to above 9%, up from 5% in spring this year.

**… prompting the National Bank to resort to interventions and hike the policy interest rate, to 18% p.a.** – notwithstanding the recent slowdown in inflation. These measures have stabilised the situation in the foreign exchange market, at least so far. However, as a result of repeated interventions and foreign debt repayments, the foreign exchange reserves contracted between 1 June and 1 October by USD 1.4 billion, to a mere USD 16.6 billion, corresponding to 2.8 months of future imports.

**In the face of these pressures, Ukraine has secured a new loan package from the IMF which should ensure macroeconomic stability at least in the short term.** A new 14-month stand-by agreement (SBA) worth USD 3.9 billion was announced on 19 October and will replace the previous EFF (Extended Fund Facility) programme, which effectively stalled in April 2017. It will pave the way for funding from other international donors, such as the World Bank and the EU, and will enable the placement of sovereign Eurobonds at an affordable interest rate. Still, the final approval of the SBA is reportedly subject to the adoption (in the second reading) of the government budget for 2019, in order to make sure that it is not amended afterwards in the pre-election context. The draft bill on the central budget reckons with a deficit of 2.3% of GDP – slightly below the level projected for this year. Among the important budget allocations planned for 2019 are investments into roads and energy efficiency, and a 13% hike in the minimum wage (in nominal terms); military spending is once again earmarked at 5% of GDP.

**However, the precondition for the SBA with the IMF has been the implemented 23.5% hike in domestic gas tariffs for households, effective from 1 November 2018.** The need for such a hike, which is argued by the IMF to be necessary to restore parity with import prices, is far from obvious, given that household demand for gas in Ukraine is now essentially covered by (cheap) domestic production. More importantly, another gas tariff hike – which came on top of the 9-fold increase implemented in 2014-2015 – will not improve the chances of incumbent President Poroshenko (who may not even make it into the second round, according to most polls) to be re-elected in the March 2019 elections.

**Economic growth next year is projected to slow down moderately, to below 3%.** Although fiscal policy will remain generally pro-growth, its effects will likely be counteracted by monetary policy tightening, suppressing the growth of private consumption and GDP. This should also reduce demand-side inflationary pressures, allowing the National Bank to revert to an easing cycle over time. Needless to say, this scenario assumes no major military escalation in Donbas; our baseline scenario with respect to the latter remains that of a 'semi-frozen conflict'. The recent (August 2018) assassination of the head of the self-proclaimed 'Donetsk People's Republic' Alexander Zakharchenko – irrespective of who is to

blame for it – will not improve the overall climate and will hardly help the implementation of the Minsk II agreements in the foreseeable future.

**The outcome of the March 2019 presidential election is highly uncertain**, as Ukraine's political landscape remains strongly fragmented, and even politicians with relatively high approval ratings (such as the former prime minister Yuliya Tymoshenko) also suffer from high disapproval ratings. The current two front-runners Ms Tymoshenko and the former defence minister Anatoliy Hrytsenko (according to some polls) are both 'hawkish' on the conflict in Donbas, casting further doubts over the prospects for the Minsk II agreement. At the same time, their economic policy may prove more left-wing and 'populist' than that of the current government, as suggested by the repeated harsh criticism of liberal economic reforms by Ms Tymoshenko and the anti-oligarchic rhetoric of Mr Hrytsenko. In any case, after the March 2019 elections Ukraine will almost certainly firmly stay in the western political orbit (even if cooperation with the IMF may become even more problematic under the new government). A victory of the (relatively) pro-Russian opposition figures such as Yuri Boyko in the second round appears next to impossible, especially since some of the most 'pro-Russian' provinces, such as Crimea and parts of Donbas, no longer vote in Ukraine's elections, while in many of the remaining provinces the anti-Russian sentiment is still strong.

## Table 32 / Ukraine: Selected economic indicators

| | 2014 | 2015 | 2016 | 2017 1) | 2017 | 2018 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | January-June | | Forecast | | |
| Population, th pers., average | 43,001 | 42,845 | 42,673 | 42,485 | 42,526 | 42,325 | 42,300 | 42,150 | 42,000 |
| Gross domestic product, UAH bn, nom. | 1,587 | 1,989 | 2,385 | 2,983 | 1,256 | 1,508 | 3,500 | 3,900 | 4,200 |
| annual change in % (real) | -6.6 | -9.8 | 2.4 | 2.5 | 2.7 | 3.5 | 3.3 | 2.7 | 2.0 |
| GDP/capita (EUR at PPP) | 6,400 | 6,000 | 6,100 | 6,300 | . | . | . | . | . |
| Consumption of households, UAH bn, nom. | 1,121 | 1,332 | 1,570 | 1,961 | 884 | 1,048 | . | . | . |
| annual change in % (real) | -8.3 | -19.8 | 2.7 | 8.4 | 7.8 | 4.9 | 5.5 | 4.5 | 4.0 |
| Gross fixed capital form., UAH bn, nom. | 224 | 269 | 369 | 477 | 180 | 238 | . | . | . |
| annual change in % (real) | -24.0 | -9.2 | 20.4 | 18.2 | 22.0 | 15.4 | 15.0 | 5.0 | 5.0 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | -10.1 | -13.0 | 2.8 | 0.4 | 0.3 | 2.5 | 2.5 | 3.0 | 3.0 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 2.2 | -4.8 | 6.3 | -2.7 | -2.1 | 11.4 | . | . | . |
| Construction output | | | | | | | | | |
| annual change in % (real) | -20.4 | -12.3 | 17.4 | 26.3 | 29.2 | 2.8 | . | . | . |
| Employed persons, LFS, th, average | 18,073 | 16,443 | 16,277 | 16,156 | 16,121 | 16,283 | 16,320 | 16,380 | 16,400 |
| annual change in % | -6.4 | -0.4 | -1.0 | -0.7 | -0.7 | 1.0 | 1.0 | 0.4 | 0.1 |
| Unemployed persons, LFS, th, average | 1,848 | 1,655 | 1,678 | 1,698 | 1,710 | 1,600 | 1,590 | 1,520 | 1,480 |
| Unemployment rate, LFS, in %, average | 9.3 | 9.1 | 9.3 | 9.5 | 9.6 | 9.0 | 8.9 | 8.5 | 8.3 |
| Reg. unemployment rate, in %, eop 2) | 1.7 | 1.6 | 1.5 | 1.4 | 1.3 | 1.2 | . | . | . |
| Average monthly gross wages, UAH 3) | 3,480 | 4,195 | 5,183 | 7,104 | 6,638 | 8,378 | 8,800 | 10,100 | 11,200 |
| annual change in % (real, gross) | -5.4 | -18.9 | 8.5 | 19.8 | 20.3 | 12.1 | 12.0 | 5.0 | 5.0 |
| annual change in % (real, net) | -6.5 | -20.2 | 9.0 | 19.0 | 19.7 | 12.0 | 12.0 | 5.0 | 5.0 |
| Consumer prices, % p.a. | 12.1 | 48.7 | 13.9 | 14.4 | 13.8 | 12.6 | 10.8 | 8.9 | 5.2 |
| Producer prices in industry, % p.a. 4) | 17.1 | 36.0 | 20.5 | 26.4 | 33.7 | 17.8 | 16.0 | 8.0 | 6.0 |
| General governm.budget, nat.def., % of GDP | | | | | | . | | | |
| Revenues | 28.7 | 32.8 | 32.8 | 34.1 | 39.5 | 37.6 | 36.0 | 33.7 | 33.7 |
| Expenditures | 33.3 | 34.3 | 35.1 | 35.5 | 35.3 | 36.9 | 38.6 | 36.0 | 35.7 |
| Deficit (-) / surplus (+) 5) | -4.5 | -1.6 | -2.3 | -1.4 | 4.2 | 0.7 | -2.6 | -2.3 | -2.0 |
| General gov.gross debt, nat.def., % of GDP | 69.4 | 79.1 | 80.9 | 71.8 | 65.6 | 57.1 | 65.0 | 64.0 | 65.0 |
| Stock of loans of non-fin.private sector, % p.a. | 11.8 | -2.8 | 2.4 | 1.9 | -0.2 | 7.4 | . | . | . |
| Non-performing loans (NPL), in %, eop 6) | 19.0 | 28.0 | 30.5 | 54.5 | 57.7 | 55.7 | . | . | . |
| Central bank policy rate, % p.a., eop 7) | 14.00 | 22.00 | 14.00 | 14.50 | 12.50 | 17.00 | 18.5 | 14.0 | 10.0 |
| Current account, EUR mn 8) | -3,476 | 1,457 | -1,210 | -2,165 | -282 | -293 | -3,000 | -3,500 | -5,000 |
| Current account, % of GDP | -3.4 | 1.8 | -1.4 | -2.2 | -0.6 | -0.6 | -2.7 | -3.1 | -4.4 |
| Exports of goods, BOP, EUR mn 8) | 38,235 | 31,935 | 30,309 | 35,192 | 17,569 | 17,502 | 37,700 | 41,000 | 42,600 |
| annual change in % | -14.1 | -16.5 | -5.1 | 16.1 | 28.7 | -0.4 | 7.1 | 8.8 | 3.9 |
| Imports of goods, BOP, EUR mn 8) | 43,626 | 35,050 | 36,579 | 43,758 | 20,806 | 21,000 | 48,100 | 53,300 | 55,400 |
| annual change in % | -28.7 | -19.7 | 4.4 | 19.6 | 30.3 | 0.9 | 9.9 | 10.8 | 3.9 |
| Exports of services, BOP, EUR mn 8) | 11,257 | 11,218 | 11,242 | 12,558 | 6,087 | 6,015 | 13,200 | 14,400 | 13,200 |
| annual change in % | -33.9 | -0.4 | 0.2 | 11.7 | 16.8 | -1.2 | 5.1 | 9.1 | -8.3 |
| Imports of services, BOP, EUR mn 8) | 9,350 | 10,232 | 10,801 | 11,655 | 5,703 | 5,716 | 12,000 | 13,100 | 13,700 |
| annual change in % | -23.0 | 9.4 | 5.6 | 7.9 | 14.4 | 0.2 | 3.0 | 9.2 | 4.6 |
| FDI liabilities, EUR mn 8) | 641 | 2,750 | 3,108 | 2,506 | 1,354 | 1,022 | 2,100 | . | . |
| FDI assets, EUR mn 8) | 414 | 34 | 156 | 207 | -177 | 99 | 0 | . | . |
| Gross reserves of NB excl. gold, EUR mn 8) | 5,429 | 11,320 | 13,965 | 14,872 | 14,855 | 14,559 | . | . | . |
| Gross external debt, EUR mn 8) | 102,728 | 107,663 | 107,648 | 96,741 | 99,770 | 97,456 | 97,000 | 98,000 | 99,000 |
| Gross external debt, % of GDP | 101.7 | 131.2 | 127.7 | 97.3 | 100.4 | 89.1 | 88.7 | 87.9 | 87.2 |
| Average exchange rate UAH/EUR | 15.72 | 24.23 | 28.29 | 30.00 | 28.94 | 32.42 | 32.0 | 35.0 | 37.0 |

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. - 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 nationalized 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.

# Appendix

**Table 33 / European Union-Central and Eastern Europe (EU-CEE): an overview of economic fundamentals, 2017**

| | BG | CZ | EE | HR | HU | LT | LV | PL | RO | SI | SK | *EU-CEE [1]* | *EU-28 [2]* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross domestic product | | | | | | | | | | | | | |
| EUR bn, at ER | 51.7 | 191.6 | 23.6 | 49.0 | 124.1 | 42.2 | 27.0 | 467.2 | 187.9 | 43.0 | 84.9 | *1,292* | *15,369* |
| EUR bn, at PPP | 107.2 | 280.0 | 31.2 | 76.3 | 200.9 | 66.5 | 39.2 | 804.4 | 368.3 | 52.1 | 124.9 | *2,151* | *15,369* |
| EU-28=100, at PPP | 0.7 | 1.8 | 0.2 | 0.5 | 1.3 | 0.4 | 0.3 | 5.2 | 2.4 | 0.3 | 0.8 | *14.0* | *100.0* |
| Per capita, EUR, at PPP | 15,100 | 26,400 | 23,700 | 18,400 | 20,500 | 23,600 | 20,200 | 20,900 | 18,700 | 25,200 | 23,000 | *20,800* | *30,000* |
| Per capita, EU-28=100, at PPP | 50 | 88 | 79 | 61 | 68 | 79 | 67 | 70 | 62 | 84 | 77 | *69* | *100* |
| 1990=100 [3] | 157.9 | 165.1 | 167.8 | 115.9 | 147.3 | 143.0 | 127.6 | 234.8 | 173.1 | 171.6 | 200.4 | *194.6* | *161.4* |
| 2007=100 | 120.6 | 116.1 | 107.4 | 98.5 | 111.3 | 114.0 | 100.7 | 139.2 | 127.8 | 106.3 | 126.8 | *125.2* | *109.5* |
| Price level | | | | | | | | | | | | | |
| EU-28=100 (PPP/ER) | 48 | 68 | 76 | 64 | 62 | 63 | 69 | 58 | 51 | 83 | 68 | *60* | *100* |
| Industrial production | | | | | | | | | | | | | |
| 2007=100 [4] | 98.3 | 116.5 | 130.3 | 92.1 | 116.5 | 123.9 | 122.2 | 143.8 | 147.6 | 111.9 | 146.4 | *132.2* | *100.6* |
| Population | | | | | | | | | | | | | |
| in thousand, average | 7,076 | 10,570 | 1,315 | 4,150 | 9,784 | 2,830 | 1,950 | 38,400 | 19,650 | 2,066 | 5,430 | *103,221* | *512,472* |
| Employed persons, LFS | | | | | | | | | | | | | |
| in thousand, average | 3,150 | 5,222 | 659 | 1,625 | 4,421 | 1,355 | 895 | 16,423 | 8,671 | 959 | 2,531 | *45,910* | *227,654* |
| Unemployment rate, LFS | | | | | | | | | | | | | |
| in % | 6.2 | 2.9 | 5.8 | 11.2 | 4.2 | 7.1 | 8.7 | 4.9 | 4.9 | 6.6 | 8.1 | *5.3* | *7.6* |
| Average gross monthly wages | | | | | | | | | | | | | |
| EUR | 542 | 1,120 | 1,226 | 1,079 | 961 | 840 | 926 | 1,003 | 705 | 1,626 | 954 | *935* | *2,395 [5]* |
| EU-28=100 | 22.6 | 46.8 | 51.2 | 45.1 | 40.1 | 35.1 | 38.7 | 41.9 | 29.5 | 67.9 | 39.8 | *39.0* | *100.0* |
| General government budget, EU-def., % of GDP | | | | | | | | | | | | | |
| Revenues | 35.3 | 40.5 | 38.9 | 45.7 | 44.3 | 33.5 | 37.3 | 39.4 | 30.4 | 43.4 | 39.4 | *38.7* | *44.9* |
| Expenditures | 34.4 | 38.9 | 39.2 | 45.0 | 46.3 | 33.0 | 37.8 | 41.1 | 33.4 | 43.4 | 40.5 | *39.7* | *45.8* |
| Balance | 0.9 | 1.6 | -0.3 | 0.8 | -1.9 | 0.5 | -0.5 | -1.7 | -2.9 | 0.0 | -1.0 | *-1.0* | *-0.9* |
| Public debt, EU def., % of GDP | 24.8 | 34.7 | 8.7 | 77.5 | 73.3 | 39.4 | 39.9 | 50.5 | 35.0 | 74.1 | 50.9 | *47.9* | *81.6* |
| BOP items, % of GDP | | | | | | | | | | | | | |
| Current account | 6.5 | 1.0 | 3.2 | 4.0 | 3.2 | 0.9 | 0.7 | 0.2 | -3.4 | 7.2 | -2.0 | *0.6 [6]* | *2.5 [6]* |
| Exports of goods | 52.2 | 67.0 | 50.9 | 23.9 | 69.0 | 61.0 | 42.7 | 43.2 | 30.4 | 66.2 | 84.2 | *51.2 [6]* | *32.5 [6]* |
| Imports of goods | 53.6 | 62.2 | 54.4 | 40.8 | 67.4 | 65.6 | 51.2 | 42.9 | 36.7 | 62.6 | 83.4 | *52.0 [6]* | *30.9 [6]* |
| Exports of services | 15.1 | 12.5 | 25.6 | 27.4 | 19.1 | 19.9 | 18.4 | 11.1 | 11.0 | 16.9 | 10.9 | *13.7 [6]* | *13.2 [6]* |
| Imports of services | 9.8 | 10.1 | 17.6 | 8.4 | 13.2 | 12.5 | 9.8 | 7.3 | 6.8 | 10.6 | 9.8 | *9.0 [6]* | *11.1 [6]* |
| FDI stock per capita, EUR [7] | 5,867 | 12,189 | 14,297 | 6,714 | 7,771 | 5,239 | 7,524 | 5,179 | 3,855 | 6,621 | 8,332 | *6,358* | *13,255* |

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) For Poland 1989=100 is the appropriate reference year. - 4) EU-28 working-day adjusted. - 5) Gross wages according to national accounts concept. - 6) Data for EU-CEE and EU-28 include transactions within the region (sum over individual countries). - 7) Excluding SPE. EU-28: year 2016.

Source: wiiw Annual Database, Eurostat.

**Table 34 / Western Balkans and Turkey, selected CIS countries and Ukraine: an overview of economic fundamentals, 2017**

| | AL | BA | ME | MK | RS | XK | TR | BY | KZ | RU | UA | *EU-CEE* [1] | *EU-28* [2] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross domestic product | | | | | | | | | | | | | |
| EUR bn, at ER | 11.6 | 16.0 | 4.3 | 10.1 | 39.2 | 6.3 | 753.9 | 48.2 | 144.2 | 1,397.4 | 99.4 | *1,292* | *15,369* |
| EUR bn, at PPP | 25.1 | 32.6 | 8.6 | 22.9 | 82.1 | 14.2 | 1,557.5 | 129.9 | 352.9 | 2,767.1 | 266.9 | *2,151* | *15,369* |
| EU-28=100, at PPP | 0.2 | 0.2 | 0.1 | 0.1 | 0.5 | 0.1 | 10.1 | 0.8 | 2.3 | 18.0 | 1.7 | *14.0* | *100.0* |
| Per capita, EUR, at PPP | 8,700 | 9,300 | 13,900 | 11,000 | 11,700 | 7,900 | 19,400 | 13,700 | 19,600 | 18,800 | 6,300 | *20,800* | *30,000* |
| Per capita, EU-28=100, at PPP | 29 | 31 | 46 | 37 | 39 | 26 | 65 | 46 | 65 | 63 | 21 | *69* | *100* |
| 1990=100 | 231.5 | . | . | 141.9 | . | . | 331.4 | 191.2 | 203.5 | 117.9 | 61.4 | *194.6* | *161.4* |
| 2007=100 | 135.1 | 117.2 | 122.4 | 126.2 | 110.3 | 144.9 | 162.9 | 125.9 | 148.5 | 111.0 | 84.4 | *125.2* | *109.5* |
| Price level | | | | | | | | | | | | | |
| EU-28=100 (PPP/ER) | 46 | 49 | 50 | 44 | 48 | 44 | 48 | 37 | 41 | 50 | 37 | *60* | *100* |
| Industrial production | | | | | | | | | | | | | |
| 2007=100 [3] | 243.9 | 123.9 | 64.1 | 111.7 | 103.1 | 190.2 | 164.2 | 133.1 | 129.6 | 113.2 | 68.8 | *132.2* | *100.6* |
| Population | | | | | | | | | | | | | |
| in thousand, average | 2,873 | 3,505 | 622 | 2,075 | 7,021 | 1,794 | 80,313 | 9,498 | 18,038 | 146,842 | 42,485 | *103,221* | *512,472* |
| Employed persons, LFS | | | | | | | | | | | | | |
| in thousand, average | 1,195 | 816 | 229 | 741 | 2,795 | 357 | 28,197 | 4,354 | 8,585 | 72,142 | 16,156 | *45,910* | *227,654* |
| Unemployment rate, LFS | | | | | | | | | | | | | |
| in % | 13.7 | 20.5 | 16.1 | 22.4 | 13.6 | 30.5 | 10.9 | 5.6 | 4.9 | 5.2 | 9.5 | *5.3* | *7.6* |
| Average gross monthly wages | | | | | | | | | | | | | |
| EUR at ER | 372 | 676 | 765 | 547 | 544 | 511 | 599 | 377 | 409 | 594 | 237 | *935* | *2,395* [4] |
| EU-28=100 | 15.5 | 28.2 | 31.9 | 22.8 | 22.7 | 21.3 | 25.0 | 15.7 | 17.1 | 24.8 | 9.9 | *39.0* | *100.0* |
| General government budget, nat. def., % of GDP | | | | | | | | | | | | | |
| Revenues | 27.7 | 43.0 | 41.5 | 30.9 | 41.5 | 30.6 | 30.2 | 40.7 | 21.8 | 33.7 | 34.1 | *38.7* [5] | *44.9* [5] |
| Expenditures | 29.7 | 40.4 | 46.8 | 33.7 | 40.4 | 29.2 | 32.2 | 37.8 | 24.5 | 35.2 | 35.5 | *39.7* [5] | *45.8* [5] |
| Balance | -2.0 | 2.6 | -5.3 | -2.8 | 1.1 | 1.4 | -2.0 | 3.0 | -2.7 | -1.5 | -1.4 | *-1.0* [5] | *-0.9* [5] |
| Public debt, nat. def., % of GDP | 70.1 | 36.2 | 61.1 | 47.5 | 57.9 | 15.9 | 28.3 | 48.0 | 26.3 | 12.6 | 71.8 | *47.9* [5] | *81.6* [5] |
| BOP items, % of GDP | | | | | | | | | | | | | |
| Current account | -7.5 | -4.7 | -16.1 | -1.0 | -5.3 | -6.1 | -5.5 | -1.6 | -3.3 | 2.1 | -2.2 | *0.6* [6] | *2.5* [6] |
| Exports of goods | 6.9 | 29.8 | 8.9 | 40.5 | 36.0 | 6.0 | 19.5 | 52.8 | 30.4 | 22.4 | 35.4 | *51.2* [6] | *32.5* [6] |
| Imports of goods | 31.3 | 53.4 | 52.2 | 58.2 | 46.1 | 45.3 | 26.4 | 58.0 | 19.7 | 15.1 | 44.0 | *52.0* [6] | *30.9* [6] |
| Exports of services | 24.7 | 10.3 | 32.2 | 14.3 | 13.4 | 21.2 | 5.1 | 14.4 | 4.0 | 3.7 | 12.6 | *13.7* [6] | *13.2* [6] |
| Imports of services | 15.3 | 3.1 | 12.3 | 10.6 | 10.9 | 8.5 | 2.8 | 8.8 | 6.7 | 5.6 | 11.7 | *9.0* [6] | *11.1* [6] |
| FDI stock per capita, EUR [7] | 1,958 | 1,964 | 7,231 | 2,264 | 4,486 | 1,955 | 2,020 | 1,747 | 6,765 | 2,512 | 855 | *6,358* | *13,255* |

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

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) EU-28 working-day adjusted. - 4) Gross wages according to national account concept. - 5) EU definition: expenditures and revenues according to ESA 2010, excessive deficit procedure. - 6) Data for EU-CEE and EU-28 include transactions within the region. - 7) Excluding SPE. EU-28: year 2016.

Source: wiiw Annual Database, Eurostat.

## Table 35 / GDP per capita at current PPPs (EUR), from 2018 at constant PPPs and population

| | | 1991 | 1995 | 2000 | 2005 | 2010 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | | Forecast | |
| BG | Bulgaria | 4,300 | 6,500 | 5,600 | 8,600 | 11,200 | 12,900 | 13,700 | 14,200 | 15,100 | 15,600 | 16,100 | 16,600 |
| CZ | Czech Republic | 8,800 | 11,600 | 14,200 | 18,600 | 21,100 | 23,800 | 25,300 | 25,500 | 26,400 | 27,300 | 28,200 | 29,100 |
| EE | Estonia | 5,400 | 5,300 | 8,200 | 14,000 | 16,500 | 21,300 | 22,000 | 22,500 | 23,700 | 24,500 | 25,300 | 26,000 |
| HR | Croatia | 6,600 | 7,000 | 9,400 | 13,000 | 15,100 | 16,300 | 17,200 | 17,600 | 18,400 | 18,900 | 19,400 | 19,900 |
| HU | Hungary | 6,800 | 7,700 | 10,400 | 14,500 | 16,500 | 18,800 | 19,800 | 19,700 | 20,500 | 21,400 | 22,000 | 22,500 |
| LT | Lithuania | 6,900 | 5,000 | 7,400 | 12,300 | 15,400 | 20,800 | 21,700 | 22,100 | 23,600 | 24,400 | 25,100 | 25,800 |
| LV | Latvia | 6,000 | 4,600 | 7,000 | 11,800 | 13,400 | 17,500 | 18,500 | 18,900 | 20,200 | 21,000 | 21,700 | 22,400 |
| PL | Poland | 4,600 | 6,500 | 9,300 | 11,800 | 15,900 | 18,600 | 19,800 | 19,900 | 20,900 | 21,900 | 22,700 | 23,400 |
| RO | Romania | 3,900 | 4,600 | 5,100 | 8,300 | 13,000 | 15,200 | 16,300 | 17,100 | 18,700 | 19,400 | 20,100 | 20,800 |
| SI | Slovenia | 8,800 | 11,400 | 15,800 | 20,300 | 21,200 | 22,700 | 23,800 | 24,100 | 25,200 | 26,300 | 27,200 | 28,200 |
| SK | Slovakia | 6,000 | 7,300 | 9,900 | 14,100 | 19,000 | 21,300 | 22,400 | 22,400 | 23,000 | 23,900 | 24,900 | 25,700 |
| | EU-CEE | 5,300 | 6,700 | 8,800 | 12,200 | 15,800 | 18,300 | 19,400 | 19,700 | 20,800 | 21,700 | 22,400 | 23,100 |
| AL | Albania | 1,500 | 2,000 | 3,400 | 5,000 | 7,400 | 8,300 | 8,600 | 8,500 | 8,700 | 9,100 | 9,500 | 9,900 |
| BA | Bosnia & Herzeg. | . | . | 4,000 | 5,400 | 6,900 | 8,300 | 8,700 | 9,000 | 9,300 | 9,600 | 9,900 | 10,200 |
| ME | Montenegro | . | . | 5,300 | 7,100 | 10,400 | 11,300 | 12,300 | 13,000 | 13,900 | 14,500 | 14,900 | 15,400 |
| MK | Macedonia | 4,300 | 4,000 | 5,400 | 6,700 | 8,700 | 9,900 | 10,500 | 10,900 | 11,000 | 11,300 | 11,600 | 12,000 |
| RS | Serbia | . | 3,100 | 5,000 | 7,400 | 9,200 | 10,100 | 11,200 | 11,300 | 11,700 | 12,200 | 12,600 | 13,000 |
| XK | Kosovo | . | . | 4,200 | 5,300 | 5,900 | 6,800 | 7,400 | 7,700 | 7,900 | 8,200 | 8,500 | 8,900 |
| TR | Turkey | 5,200 | 6,000 | 8,100 | 10,000 | 13,200 | 17,700 | 18,800 | 18,600 | 19,400 | 19,900 | 20,100 | 20,900 |
| BY | Belarus | 4,800 | 3,400 | 5,300 | 8,500 | 12,200 | 13,900 | 13,900 | 13,300 | 13,700 | 14,200 | 14,600 | 15,000 |
| KZ | Kazakhstan | 7,100 | 5,100 | 6,900 | 12,100 | 15,100 | 18,300 | 18,900 | 18,600 | 19,600 | 20,400 | 21,000 | 21,600 |
| RU | Russia | 6,800 | 4,700 | 6,000 | 10,000 | 15,700 | 19,000 | 18,700 | 18,300 | 18,800 | 19,100 | 19,400 | 19,700 |
| UA | Ukraine | 5,500 | 3,100 | 3,300 | 5,700 | 6,100 | 6,400 | 6,000 | 6,100 | 6,300 | 6,500 | 6,700 | 6,800 |
| AT | Austria | 18,900 | 20,000 | 25,700 | 29,800 | 32,200 | 36,000 | 37,700 | 37,500 | 38,200 | 39,300 | 40,200 | 41,000 |
| DE | Germany | 19,300 | 20,000 | 24,100 | 27,500 | 30,500 | 34,800 | 36,200 | 36,200 | 37,000 | 37,900 | 38,700 | 39,500 |
| EL | Greece | 12,900 | 13,000 | 17,100 | 21,700 | 21,500 | 19,800 | 20,200 | 19,700 | 20,100 | 20,500 | 21,000 | 21,400 |
| IE | Ireland | 13,300 | 16,000 | 26,400 | 34,400 | 33,100 | 37,800 | 51,900 | 52,200 | 54,800 | 57,900 | 60,300 | 61,500 |
| IT | Italy | 17,900 | 18,800 | 23,700 | 25,400 | 26,500 | 26,600 | 27,700 | 28,400 | 28,800 | 29,200 | 29,600 | 30,200 |
| PT | Portugal | 11,500 | 12,100 | 16,500 | 19,300 | 20,900 | 21,200 | 22,300 | 22,700 | 23,200 | 23,700 | 24,200 | 24,700 |
| ES | Spain | 13,300 | 13,700 | 18,900 | 23,500 | 24,400 | 24,900 | 26,300 | 26,700 | 27,700 | 28,500 | 29,200 | 29,800 |
| US | United States | 21,000 | 24,200 | 31,800 | 37,400 | 37,000 | 40,500 | 42,800 | 42,500 | 43,500 | 44,800 | 46,000 | 46,900 |
| | EU-28 average | 14,200 | 15,200 | 19,800 | 23,400 | 25,500 | 27,700 | 29,100 | 29,200 | 30,000 | 30,600 | 31,200 | 31,800 |

### European Union (28) average = 100

| | | 1991 | 1995 | 2000 | 2005 | 2010 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| BG | Bulgaria | 30 | 43 | 28 | 37 | 44 | 47 | 47 | 49 | 50 | 51 | 52 | 52 |
| CZ | Czech Republic | 62 | 76 | 72 | 79 | 83 | 86 | 87 | 87 | 88 | 89 | 90 | 92 |
| EE | Estonia | 38 | 35 | 41 | 60 | 65 | 77 | 76 | 77 | 79 | 80 | 81 | 82 |
| HR | Croatia | 46 | 46 | 47 | 56 | 59 | 59 | 59 | 60 | 61 | 62 | 62 | 63 |
| HU | Hungary | 48 | 51 | 53 | 62 | 65 | 68 | 68 | 67 | 68 | 70 | 71 | 71 |
| LT | Lithuania | 49 | 33 | 37 | 53 | 60 | 75 | 75 | 76 | 79 | 80 | 80 | 81 |
| LV | Latvia | 42 | 30 | 35 | 50 | 53 | 63 | 64 | 65 | 67 | 69 | 70 | 70 |
| PL | Poland | 32 | 43 | 47 | 50 | 62 | 67 | 68 | 68 | 70 | 72 | 73 | 74 |
| RO | Romania | 27 | 30 | 26 | 35 | 51 | 55 | 56 | 59 | 62 | 63 | 64 | 65 |
| SI | Slovenia | 62 | 75 | 80 | 87 | 83 | 82 | 82 | 83 | 84 | 86 | 87 | 89 |
| SK | Slovakia | 42 | 48 | 50 | 60 | 75 | 77 | 77 | 77 | 77 | 78 | 80 | 81 |
| | EU-CEE | 37 | 44 | 44 | 52 | 62 | 66 | 67 | 67 | 69 | 71 | 72 | 73 |
| AL | Albania | 11 | 13 | 17 | 21 | 29 | 30 | 30 | 29 | 29 | 30 | 30 | 31 |
| BA | Bosnia & Herzeg. | . | . | 20 | 23 | 27 | 30 | 30 | 31 | 31 | 31 | 32 | 32 |
| ME | Montenegro | . | . | 27 | 30 | 41 | 41 | 42 | 45 | 46 | 47 | 48 | 48 |
| MK | Macedonia | 30 | 26 | 27 | 29 | 34 | 36 | 36 | 37 | 37 | 37 | 37 | 38 |
| RS | Serbia | . | 20 | 25 | 32 | 36 | 36 | 38 | 39 | 39 | 40 | 40 | 41 |
| XK | Kosovo | . | . | 21 | 23 | 23 | 25 | 25 | 26 | 26 | 27 | 27 | 28 |
| TR | Turkey | 37 | 39 | 41 | 43 | 52 | 64 | 65 | 64 | 65 | 65 | 64 | 66 |
| BY | Belarus | 34 | 22 | 27 | 36 | 48 | 50 | 48 | 46 | 46 | 46 | 47 | 47 |
| KZ | Kazakhstan | 50 | 34 | 35 | 52 | 59 | 66 | 65 | 64 | 65 | 67 | 67 | 68 |
| RU | Russia | 48 | 31 | 30 | 43 | 62 | 69 | 64 | 63 | 63 | 62 | 62 | 62 |
| UA | Ukraine | 39 | 20 | 17 | 24 | 24 | 23 | 21 | 21 | 21 | 21 | 21 | 21 |
| AT | Austria | 133 | 132 | 130 | 127 | 126 | 130 | 130 | 128 | 127 | 128 | 129 | 129 |
| DE | Germany | 136 | 132 | 122 | 118 | 120 | 126 | 124 | 124 | 123 | 124 | 124 | 124 |
| EL | Greece | 91 | 86 | 86 | 93 | 84 | 71 | 69 | 67 | 67 | 67 | 67 | 67 |
| IE | Ireland | 94 | 105 | 133 | 147 | 130 | 136 | 178 | 179 | 183 | 189 | 193 | 193 |
| IT | Italy | 126 | 124 | 120 | 109 | 104 | 96 | 95 | 97 | 96 | 95 | 95 | 95 |
| PT | Portugal | 81 | 80 | 83 | 82 | 82 | 77 | 77 | 78 | 77 | 77 | 78 | 78 |
| ES | Spain | 94 | 90 | 95 | 100 | 96 | 90 | 90 | 91 | 92 | 93 | 94 | 94 |
| US | United States | 148 | 159 | 161 | 160 | 145 | 146 | 147 | 146 | 145 | 146 | 147 | 147 |
| | EU-28 average | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

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

## Table 36 / Indicators of macro-competitiveness, 2013-2020, EUR based, annual averages

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| **Bulgaria** | | | | | | | | |
| Producer price index, 2010=100 | 112.1 | 110.7 | 108.3 | 104.9 | 110.2 | 114.6 | 118.6 | 122.2 |
| Consumer price index, 2010=100 | 106.3 | 104.6 | 103.5 | 102.1 | 103.3 | 105.9 | 108.6 | 111.3 |
| GDP deflator, 2010=100 | 106.9 | 107.4 | 109.7 | 112.2 | 116.0 | 118.9 | 121.9 | 125.0 |
| Exchange rate (ER), NC/EUR | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 |
| ER, nominal, 2010=100 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Real ER (CPI-based), 2010=100 | 99.0 | 96.9 | 95.9 | 94.3 | 93.9 | 94.6 | 95.3 | 95.9 |
| Real ER (PPI-based), 2010=100 | 103.6 | 104.3 | 104.3 | 102.6 | 104.4 | 106.8 | 108.7 | 109.9 |
| PPP, NC/EUR | 0.9258 | 0.8972 | 0.9020 | 0.9325 | 0.9426 | 0.95 | 0.96 | 0.96 |
| Price level, EU28 = 100 | 47 | 46 | 46 | 48 | 48 | 49 | 49 | 49 |
| Average monthly gross wages, EUR (ER) | 396 | 420 | 449 | 485 | 542 | 590 | 630 | 680 |
| Average monthly gross wages, EUR (PPP) | 837 | 916 | 973 | 1,017 | 1,125 | 1,210 | 1,290 | 1,380 |
| GDP per employed person, 2010=100 | 106.6 | 106.8 | 108.7 | 113.5 | 112.9 | 114.7 | 117.2 | 120.0 |
| Unit labour costs, ER adj., 2010=100 | 112.2 | 118.7 | 124.6 | 128.9 | 145.0 | 154.7 | 163.3 | 171.0 |
| Unit labour costs, PPP adj., Austria=100 | 31.5 | 32.8 | 33.9 | 34.3 | 38.7 | 40.7 | 42.0 | 43.4 |
| **Czech Republic** | | | | | | | | |
| Producer price index, 2010=100 | 107.1 | 108.6 | 106.0 | 102.6 | 103.4 | 104.4 | 106.0 | 107.6 |
| Consumer price index, 2010=100 | 107.3 | 107.7 | 108.0 | 108.7 | 111.3 | 113.8 | 116.4 | 118.8 |
| GDP deflator, 2010=100 | 102.9 | 105.5 | 106.7 | 108.1 | 109.7 | 111.7 | 114.2 | 116.5 |
| Exchange rate (ER), NC/EUR | 25.98 | 27.54 | 27.28 | 27.03 | 26.33 | 25.50 | 25.25 | 25.25 |
| ER nominal, 2010=100 | 102.8 | 108.9 | 107.9 | 106.9 | 104.1 | 100.9 | 99.9 | 99.9 |
| Real ER (CPI-based), 2010=100 | 97.2 | 91.6 | 92.8 | 93.9 | 97.1 | 100.8 | 102.3 | 102.5 |
| Real ER (PPI-based), 2010=100 | 96.4 | 93.9 | 94.6 | 93.8 | 94.0 | 96.5 | 97.2 | 96.9 |
| PPP, NC/EUR | 17.41 | 17.24 | 17.24 | 17.66 | 18.02 | 18.1 | 18.1 | 18.2 |
| Price level, EU28 = 100 | 67 | 63 | 63 | 65 | 68 | 71 | 72 | 72 |
| Average monthly gross wages, EUR (ER) | 964 | 936 | 975 | 1,027 | 1,120 | 1,250 | 1,350 | 1,420 |
| Average monthly gross wages, EUR (PPP) | 1,438 | 1,495 | 1,542 | 1,572 | 1,637 | 1,770 | 1,870 | 1,970 |
| GDP per employed person, 2010=100 | 99.4 | 101.4 | 105.3 | 105.9 | 108.6 | 110.8 | 113.9 | 117.2 |
| Unit labour costs, ER adj., 2010=100 | 102.7 | 97.8 | 98.1 | 102.8 | 109.3 | 120.0 | 125.3 | 128.2 |
| Unit labour costs, PPP adj., Austria=100 | 50.0 | 47.0 | 46.3 | 47.6 | 50.6 | 54.5 | 56.4 | 56.7 |
| **Estonia** | | | | | | | | |
| Producer price index, 2010=100 | 112.5 | 110.1 | 107.4 | 106.4 | 109.9 | 113.2 | 116.0 | 118.7 |
| Consumer price index, 2010=100 | 113.0 | 113.6 | 113.7 | 114.6 | 118.8 | 122.8 | 126.2 | 129.6 |
| GDP deflator, 2010=100 | 112.4 | 115.8 | 117.0 | 118.7 | 123.3 | 127.1 | 130.6 | 134.3 |
| Real ER (CPI-based), 2010=100 | 105.3 | 105.3 | 105.4 | 105.9 | 108.0 | 109.7 | 110.8 | 111.7 |
| Real ER (PPI-based), 2010=100 | 104.0 | 103.7 | 103.4 | 104.0 | 104.1 | 105.5 | 106.3 | 106.8 |
| PPP, NC/EUR | 0.7113 | 0.7149 | 0.7140 | 0.7325 | 0.7574 | 0.77 | 0.78 | 0.78 |
| Price level, EU28 = 100 | 71 | 71 | 71 | 73 | 76 | 77 | 78 | 78 |
| Average monthly gross wages, EUR (ER) | 949 | 1,005 | 1,065 | 1,146 | 1,226 | 1,300 | 1,380 | 1,470 |
| Average monthly gross wages, EUR (PPP) | 1,334 | 1,406 | 1,492 | 1,564 | 1,619 | 1,690 | 1,780 | 1,870 |
| GDP per employed person, 2010=100 | 105.1 | 107.6 | 106.8 | 109.9 | 112.8 | 115.6 | 118.3 | 121.4 |
| Unit labour costs, ER adj., 2010=100 | 113.9 | 117.9 | 125.8 | 131.6 | 137.1 | 141.9 | 147.2 | 152.8 |
| Unit labour costs, PPP adj., Austria=100 | 54.9 | 56.1 | 58.8 | 60.2 | 62.8 | 64.0 | 65.4 | 66.7 |
| **Croatia** | | | | | | | | |
| Producer price index, 2010=100 | 112.1 | 109.1 | 104.9 | 100.4 | 102.4 | 104.5 | 106.6 | 108.7 |
| Consumer price index, 2010=100 | 108.1 | 108.3 | 108.0 | 107.3 | 108.7 | 110.5 | 112.7 | 114.9 |
| GDP deflator, 2010=100 | 104.0 | 104.1 | 104.1 | 104.0 | 105.2 | 106.9 | 109.0 | 111.1 |
| Exchange rate (ER), NC/EUR | 7.579 | 7.634 | 7.614 | 7.533 | 7.464 | 7.40 | 7.40 | 7.40 |
| ER, nominal, 2010=100 | 104.0 | 104.7 | 104.5 | 103.4 | 102.4 | 101.5 | 101.5 | 101.5 |
| Real ER (CPI-based), 2010=100 | 96.8 | 95.8 | 95.8 | 96.0 | 96.5 | 97.2 | 97.4 | 97.6 |
| Real ER (PPI-based), 2010=100 | 99.7 | 98.1 | 96.7 | 95.0 | 94.8 | 96.0 | 96.2 | 96.4 |
| PPP, NC/EUR | 4.867 | 4.808 | 4.700 | 4.797 | 4.792 | 4.79 | 4.80 | 4.81 |
| Price level, EU28 = 100 | 64 | 63 | 62 | 64 | 64 | 65 | 65 | 65 |
| Average monthly gross wages, EUR (ER) [1)] | 1,048 | 1,042 | 1,058 | 1,029 | 1,079 | 1,140 | 1,200 | 1,260 |
| Average monthly gross wages, EUR (PPP) [1)] | 1,631 | 1,654 | 1,714 | 1,616 | 1,681 | 1,770 | 1,850 | 1,930 |
| GDP per employed person, 2010=100 | 98.0 | 95.3 | 96.4 | 99.5 | 100.2 | 101.1 | 102.5 | 104.0 |
| Unit labour costs, ER adj., 2010=100 | 101.5 | 103.8 | 104.2 | 98.2 | 102.3 | 107.5 | 111.1 | 114.7 |
| Unit labour costs, PPP adj., Austria=100 | 59.3 | 59.9 | 59.1 | 54.6 | 56.9 | 58.6 | 60.0 | 60.9 |

1) From 2016 new data sources (tax records).

(Table 36 ctd.)

**Table 36 / (ctd.)**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| **Hungary** | | | | | | | | |
| Producer price index, 2010=100 | 109.3 | 109.0 | 107.8 | 106.0 | 109.5 | 114.1 | 117.5 | 121.0 |
| Consumer price index, 2010=100 | 111.7 | 111.7 | 111.8 | 112.2 | 114.9 | 118.5 | 122.1 | 125.7 |
| GDP deflator, 2010=100 | 108.8 | 112.5 | 114.6 | 115.6 | 120.1 | 124.0 | 127.9 | 132.2 |
| Exchange rate (ER), NC/EUR | 296.9 | 308.7 | 310.0 | 311.4 | 309.2 | 320 | 327 | 330 |
| ER, nominal 2010=100 | 107.8 | 112.1 | 112.5 | 113.1 | 112.2 | 116.2 | 118.7 | 119.8 |
| Real ER (CPI-based), 2010=100 | 96.5 | 92.4 | 92.1 | 91.7 | 93.0 | 91.1 | 90.2 | 90.5 |
| Real ER (PPI-based), 2010=100 | 93.8 | 91.6 | 92.2 | 91.6 | 92.4 | 91.6 | 90.7 | 90.9 |
| PPP, NC/EUR | 170.2 | 175.6 | 176.6 | 183.7 | 190.9 | 194.0 | 196.8 | 199.7 |
| Price level, EU28 = 100 | 57 | 57 | 57 | 59 | 62 | 61 | 60 | 61 |
| Average monthly gross wages, EUR (ER) | 777 | 770 | 800 | 845 | 961 | 1,040 | 1,100 | 1,160 |
| Average monthly gross wages, EUR (PPP) | 1,356 | 1,354 | 1,404 | 1,433 | 1,556 | 1,710 | 1,830 | 1,910 |
| GDP per employed person, 2010=100 | 99.2 | 98.1 | 98.9 | 97.9 | 100.3 | 103.5 | 106.2 | 108.6 |
| Unit labour costs, ER adj., 2010=100 | 106.6 | 106.7 | 110.0 | 117.4 | 130.2 | 136.4 | 140.8 | 144.7 |
| Unit labour costs, PPP adj., Austria=100 | 42.1 | 41.6 | 42.1 | 44.1 | 48.9 | 50.6 | 51.4 | 52.0 |
| **Lithuania** | | | | | | | | |
| Producer price index, 2010=100 | 116.7 | 110.9 | 100.1 | 95.8 | 100.5 | 106.6 | 110.8 | 113.3 |
| Consumer price index, 2010=100 | 108.7 | 108.9 | 108.2 | 108.9 | 113.0 | 115.9 | 119.0 | 122.0 |
| GDP deflator, 2010=100 | 109.5 | 110.6 | 111.0 | 112.5 | 117.3 | 120.4 | 123.6 | 126.6 |
| Real ER (CPI-based), 2010=100 | 101.3 | 101.0 | 100.3 | 100.7 | 102.6 | 103.5 | 104.5 | 105.2 |
| Real ER (PPI-based), 2010=100 | 107.9 | 104.4 | 96.4 | 93.7 | 95.2 | 99.4 | 101.5 | 101.9 |
| PPP, NC/EUR | 0.6036 | 0.6006 | 0.5928 | 0.6134 | 0.6341 | 0.64 | 0.65 | 0.65 |
| Price level, EU28 = 100 | 60 | 60 | 59 | 61 | 63 | 64 | 65 | 65 |
| Average monthly gross wages, EUR (ER) | 646 | 677 | 714 | 774 | 840 | 910 | 980 | 1,050 |
| Average monthly gross wages, EUR (PPP) | 1,071 | 1,128 | 1,205 | 1,262 | 1,325 | 1,420 | 1,520 | 1,610 |
| GDP per employed person, 2010=100 | 118.4 | 120.2 | 121.2 | 121.6 | 127.3 | 130.9 | 134.7 | 138.1 |
| Unit labour costs, ER adj., 2010=100 | 94.8 | 97.9 | 102.4 | 110.5 | 114.7 | 120.8 | 126.3 | 132.1 |
| Unit labour costs, PPP adj., Austria=100 | 36.1 | 36.8 | 37.8 | 40.0 | 41.5 | 43.0 | 44.4 | 45.6 |
| **Latvia** | | | | | | | | |
| Producer price index, 2010=100 | 113.2 | 113.6 | 112.5 | 109.7 | 112.4 | 116.3 | 119.6 | 122.6 |
| Consumer price index, 2010=100 | 106.6 | 107.3 | 107.6 | 107.7 | 110.8 | 113.3 | 116.2 | 119.1 |
| GDP deflator, 2010=100 | 112.1 | 114.0 | 114.0 | 115.0 | 118.7 | 121.5 | 124.5 | 127.6 |
| Real ER (CPI-based), 2010=100 | 100.3 | 100.3 | 100.5 | 100.3 | 101.5 | 102.1 | 102.8 | 103.5 |
| Real ER (PPI-based), 2010=100 | 105.7 | 107.9 | 109.2 | 108.1 | 107.4 | 109.4 | 110.5 | 111.3 |
| PPP, NC/EUR | 0.6798 | 0.6751 | 0.6645 | 0.6755 | 0.6894 | 0.69 | 0.70 | 0.70 |
| Price level, EU28 = 100 | 68 | 68 | 66 | 68 | 69 | 69 | 70 | 70 |
| Average monthly gross wages, EUR (ER) | 717 | 765 | 818 | 859 | 926 | 1,000 | 1,070 | 1,140 |
| Average monthly gross wages, EUR (PPP) | 1,053 | 1,133 | 1,231 | 1,272 | 1,343 | 1,440 | 1,530 | 1,620 |
| GDP per employed person, 2010=100 | 119.3 | 122.8 | 124.8 | 127.8 | 133.5 | 136.9 | 140.1 | 143.2 |
| Unit labour costs, ER adj., 2010=100 | 95.7 | 99.2 | 104.3 | 107.0 | 110.4 | 116.3 | 121.7 | 126.8 |
| Unit labour costs, PPP adj., Austria=100 | 47.0 | 48.1 | 49.7 | 49.9 | 51.6 | 53.5 | 55.1 | 56.4 |
| **Poland** | | | | | | | | |
| Producer price index, 2010=100 | 109.7 | 108.2 | 105.8 | 105.5 | 108.3 | 110.1 | 112.1 | 114.1 |
| Consumer price index, 2010=100 | 108.6 | 108.7 | 108.0 | 107.7 | 109.5 | 111.7 | 114.0 | 116.2 |
| GDP deflator, 2010=100 | 106.0 | 106.5 | 107.3 | 107.6 | 109.8 | 110.9 | 112.2 | 113.6 |
| Exchange rate (ER), NC/EUR | 4.198 | 4.184 | 4.184 | 4.363 | 4.257 | 4.25 | 4.25 | 4.25 |
| ER, nominal, 2010=100 | 105.1 | 104.7 | 104.7 | 109.2 | 106.6 | 106.4 | 106.4 | 106.4 |
| Real ER (CPI-based), 2010=100 | 96.3 | 96.2 | 95.5 | 91.1 | 93.3 | 93.8 | 94.0 | 94.1 |
| Real ER (PPI-based), 2010=100 | 96.6 | 97.3 | 97.3 | 94.4 | 96.3 | 96.5 | 96.5 | 96.5 |
| PPP, PLN/EUR | 2.399 | 2.398 | 2.359 | 2.429 | 2.472 | 2.46 | 2.45 | 2.43 |
| Price level, EU28 = 100 | 57 | 57 | 56 | 56 | 58 | 58 | 58 | 57 |
| Average monthly gross wages, EUR (ER) | 872 | 903 | 934 | 929 | 1,003 | 1,080 | 1,150 | 1,210 |
| Average monthly gross wages, EUR (PPP) | 1,525 | 1,575 | 1,657 | 1,668 | 1,728 | 1,870 | 2,000 | 2,120 |
| GDP per employed person, 2010=100 | 110.9 | 112.5 | 115.2 | 117.9 | 121.8 | 127.0 | 130.5 | 134.5 |
| Unit labour costs, ER adj., 2010=100 | 97.4 | 99.4 | 100.5 | 97.6 | 102.0 | 105.6 | 109.0 | 111.6 |
| Unit labour costs, PPP adj., Austria=100 | 47.9 | 48.3 | 48.0 | 45.7 | 47.8 | 48.6 | 49.6 | 49.7 |

(Table 36 ctd.)

## Table 36 / (ctd.)

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| **Romania** | | | | | | | | |
| Producer price index, 2010=100 | 114.9 | 114.7 | 112.0 | 110.0 | 113.9 | 119.1 | 121.5 | 123.9 |
| Consumer price index, 2010=100 | 112.9 | 114.5 | 114.0 | 112.8 | 114.0 | 118.6 | 122.1 | 125.8 |
| GDP deflator, 2010=100 | 112.2 | 114.2 | 117.1 | 120.0 | 125.6 | 131.0 | 134.6 | 137.7 |
| Exchange rate (ER), NC/EUR | 4.419 | 4.444 | 4.445 | 4.490 | 4.569 | 4.66 | 4.70 | 4.75 |
| ER, nominal, 2010=100 | 104.9 | 105.5 | 105.5 | 106.6 | 108.5 | 110.6 | 111.6 | 112.8 |
| Real ER (CPI-based), 2010=100 | 100.2 | 100.6 | 100.1 | 97.7 | 95.5 | 95.7 | 96.0 | 96.2 |
| Real ER (PPI-based), 2010=100 | 101.3 | 102.4 | 102.2 | 100.9 | 99.4 | 100.4 | 99.8 | 98.9 |
| PPP, NC/EUR | 2.187 | 2.209 | 2.208 | 2.281 | 2.332 | 2.39 | 2.42 | 2.43 |
| Price level, EU28 = 100 | 49 | 50 | 50 | 51 | 51 | 51 | 51 | 51 |
| Average monthly gross wages, EUR (ER) 2) | 489 | 524 | 575 | 626 | 705 | 940 | 1,020 | 1,070 |
| Average monthly gross wages, EUR (PPP) 2) | 989 | 1,054 | 1,157 | 1,232 | 1,382 | 1,840 | 1,990 | 2,100 |
| GDP per employed person, 2010=100 | 115.6 | 118.6 | 124.3 | 131.6 | 137.6 | 141.5 | 145.0 | 148.8 |
| Unit labour costs, ER adj., 2010=100 | 93.8 | 97.8 | 102.4 | 105.2 | 113.5 | 147.8 | 156.0 | 159.8 |
| Unit labour costs, PPP adj., Austria=100 | 34.8 | 35.8 | 36.8 | 37.1 | 40.0 | 51.1 | 53.3 | 53.5 |
| **Slovenia** | | | | | | | | |
| Producer price index, 2010=100 | 105.4 | 104.7 | 104.5 | 103.0 | 105.3 | 107.4 | 109.6 | 111.7 |
| Consumer price index, 2010=100 | 107.0 | 107.4 | 106.5 | 106.3 | 108.0 | 110.0 | 112.2 | 114.4 |
| GDP deflator, 2010=100 | 103.2 | 104.0 | 105.1 | 105.9 | 107.5 | 109.6 | 111.8 | 114.0 |
| Real ER (CPI-based), 2010=100 | 99.6 | 99.5 | 98.7 | 98.2 | 98.1 | 98.2 | 98.4 | 98.6 |
| Real ER (PPI-based), 2010=100 | 97.5 | 98.6 | 100.6 | 100.7 | 99.7 | 100.1 | 100.4 | 100.6 |
| PPP, NC/EUR | 0.8038 | 0.8022 | 0.7920 | 0.8127 | 0.8257 | 0.83 | 0.83 | 0.83 |
| Price level, EU28 = 100 | 80 | 80 | 79 | 81 | 83 | 83 | 83 | 83 |
| Average monthly gross wages, EUR (ER) | 1,523 | 1,540 | 1,556 | 1,584 | 1,626 | 1,690 | 1,760 | 1,830 |
| Average monthly gross wages, EUR (PPP) | 1,895 | 1,920 | 1,964 | 1,950 | 1,970 | 2,040 | 2,120 | 2,200 |
| GDP per employed person, 2010=100 | 103.3 | 105.1 | 107.4 | 111.0 | 111.1 | 113.5 | 115.4 | 117.0 |
| Unit labour costs, ER adj., 2010=100 | 98.7 | 98.0 | 96.9 | 95.5 | 97.9 | 99.6 | 102.0 | 104.7 |
| Unit labour costs, PPP adj., Austria=100 | 76.7 | 75.3 | 73.1 | 70.6 | 72.4 | 72.5 | 73.2 | 73.8 |
| **Slovakia** | | | | | | | | |
| Producer price index, 2010=100 | 105.3 | 101.8 | 98.9 | 95.0 | 97.4 | 99.8 | 102.3 | 104.9 |
| Consumer price index, 2010=100 | 109.6 | 109.5 | 109.1 | 108.6 | 110.1 | 113.2 | 116.0 | 118.6 |
| GDP deflator, 2010=100 | 103.5 | 103.3 | 103.1 | 102.6 | 103.9 | 106.8 | 109.5 | 111.9 |
| Real ER (CPI-based), 2010=100 | 102.1 | 101.4 | 101.1 | 100.3 | 100.0 | 101.1 | 101.8 | 102.2 |
| Real ER (PPI-based), 2010=100 | 97.4 | 95.9 | 95.2 | 92.9 | 92.3 | 93.1 | 93.8 | 94.4 |
| PPP NC/ EUR | 0.6687 | 0.6586 | 0.6525 | 0.6666 | 0.6793 | 0.69 | 0.69 | 0.70 |
| Price level, EU28 = 100 | 67 | 66 | 65 | 67 | 68 | 69 | 69 | 70 |
| Average monthly gross wages, EUR (ER) | 824 | 858 | 883 | 912 | 954 | 1,020 | 1,090 | 1,160 |
| Average monthly gross wages, EUR (PPP) | 1,232 | 1,303 | 1,353 | 1,368 | 1,404 | 1,480 | 1,570 | 1,670 |
| GDP per employed person, 2010=100 | 105.5 | 106.9 | 108.6 | 108.9 | 110.7 | 113.9 | 117.3 | 120.7 |
| Unit labour costs, ER adj., 2010=100 | 101.5 | 104.4 | 105.8 | 108.9 | 112.1 | 116.5 | 120.9 | 125.0 |
| Unit labour costs, PPP adj., Austria=100 | 41.1 | 41.8 | 41.6 | 41.9 | 43.2 | 44.2 | 45.2 | 45.9 |
| **Albania** | | | | | | | | |
| Producer price index, 2010=100 | 103.3 | 102.8 | 100.6 | 99.2 | 101.8 | 104.9 | 107.0 | 108.6 |
| Consumer price index, 2010=100 | 107.6 | 109.3 | 111.4 | 112.8 | 115.1 | 117.5 | 120.4 | 123.9 |
| GDP deflator, 2010=100 | 103.7 | 105.3 | 105.9 | 105.4 | 106.8 | 105.7 | 108.0 | 110.0 |
| Exchange rate (ER), NC/EUR | 140.3 | 140.0 | 139.7 | 137.4 | 134.2 | 128.5 | 127.0 | 126.5 |
| ER, nominal, 2010=100 | 101.8 | 101.6 | 101.4 | 99.7 | 97.4 | 93.3 | 92.2 | 91.8 |
| Real ER (CPI-based), 2010=100 | 98.4 | 99.7 | 101.8 | 104.6 | 107.4 | 112.5 | 114.6 | 116.3 |
| Real ER (PPI-based), 2010=100 | 93.8 | 95.3 | 95.5 | 97.3 | 99.0 | 104.8 | 106.3 | 106.4 |
| PPP, NC/EUR | 60.06 | 58.20 | 58.17 | 60.29 | 61.81 | 60.2 | 60.5 | 60.5 |
| Price level, EU28 = 100 | 43 | 42 | 42 | 44 | 46 | 47 | 48 | 48 |
| Average monthly gross wages, EUR (ER) 3) | 259 | 325 | 335 | 334 | 372 | 420 | 450 | 480 |
| Average monthly gross wages, EUR (PPP) 3) | 605 | 782 | 805 | 760 | 806 | 890 | 940 | 990 |
| GDP per employed person, 2010=100 | 119.8 | 120.3 | 117.4 | 113.9 | 114.6 | 115.9 | 117.6 | 118.6 |
| Unit labour costs, ER adj., 2010=100 | 85.7 | 107.1 | 113.1 | 116.1 | 128.5 | 142.1 | 150.4 | 158.8 |
| Unit labour costs, PPP adj., Austria=100 | 27.5 | 34.0 | 35.3 | 35.5 | 39.3 | 43.2 | 45.0 | 46.7 |

2) In 2018 the employers' social security contribution will be added to gross wages increasing the latter by 25% in NC. -
3) From 2014 new data sources (tax records) covering the whole economy, Structural Business Statistics for market producers before.

(Table 36 ctd.)

**Table 36 / (ctd.)**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| **Bosnia and Herzegovina** | | | | | | | | |
| Producer price index, 2010=100 | 104.0 | 103.5 | 104.1 | 101.9 | 105.0 | 106.9 | 109.1 | 111.4 |
| Consumer price index, 2010=100 | 105.8 | 104.8 | 103.8 | 102.6 | 103.9 | 105.1 | 107.1 | 109.1 |
| GDP deflator, 2010=100 | 103.0 | 104.1 | 105.5 | 107.0 | 108.7 | 110.2 | 112.1 | 114.1 |
| Exchange rate (ER), NC/EUR | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 |
| ER, nominal, 2010=100 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Real ER (CPI-based), 2010=100 | 98.5 | 97.1 | 96.2 | 94.8 | 94.4 | 93.9 | 94.0 | 94.1 |
| Real ER (PPI-based), 2010=100 | 96.2 | 97.5 | 100.2 | 99.6 | 99.4 | 99.7 | 100.0 | 100.3 |
| PPP, NC/EUR | 0.9342 | 0.9324 | 0.9288 | 0.9490 | 0.9600 | 0.96 | 0.96 | 0.96 |
| Price level, EU28 = 100 | 48 | 48 | 47 | 49 | 49 | 49 | 49 | 49 |
| Average monthly gross wages, EUR (ER) | 660 | 659 | 659 | 665 | 676 | 690 | 710 | 730 |
| Average monthly gross wages, EUR (PPP) | 1,382 | 1,383 | 1,388 | 1,371 | 1,376 | 1,410 | 1,450 | 1,490 |
| GDP per employed person, 2010=100 | 105.1 | 107.6 | 109.6 | 116.0 | 117.4 | 119.0 | 121.6 | 123.9 |
| Unit labour costs, ER adj., 2010=100 | 101.0 | 98.5 | 96.7 | 92.2 | 92.5 | 93.3 | 93.9 | 94.8 |
| Unit labour costs, PPP adj., Austria=100 | 46.8 | 45.1 | 43.5 | 40.6 | 40.8 | 40.5 | 40.1 | 39.8 |
| **Montenegro** | | | | | | | | |
| Producer price index, 2010=100 | 106.8 | 107.0 | 107.3 | 107.2 | 107.6 | 109.7 | 111.9 | 114.2 |
| Consumer price index, 2010=100 | 109.4 | 108.8 | 110.3 | 110.5 | 113.5 | 117.5 | 119.9 | 122.3 |
| GDP deflator, 2010=100 | 103.5 | 104.6 | 106.9 | 112.3 | 116.6 | 119.8 | 121.2 | 122.5 |
| Real ER (CPI-based), 2010=100 | 101.9 | 100.8 | 102.3 | 102.1 | 103.2 | 105.0 | 105.2 | 105.4 |
| Real ER (PPI-based), 2010=100 | 98.8 | 100.7 | 103.3 | 104.8 | 101.9 | 102.3 | 102.6 | 102.8 |
| PPP, NC/EUR | 0.4956 | 0.4909 | 0.4780 | 0.4896 | 0.4986 | 0.50 | 0.50 | 0.50 |
| Price level, EU28 = 100 | 50 | 49 | 48 | 49 | 50 | 50 | 50 | 50 |
| Average monthly gross wages, EUR (ER) | 726 | 723 | 725 | 751 | 765 | 770 | 790 | 810 |
| Average monthly gross wages, EUR (PPP) | 1,465 | 1,473 | 1,517 | 1,534 | 1,534 | 1,530 | 1,580 | 1,630 |
| GDP per employed person, 2010=100 | 107.2 | 101.8 | 102.7 | 104.6 | 107.1 | 109.9 | 111.2 | 113.9 |
| Unit labour costs, ER adj., 2010=100 | 94.7 | 99.3 | 98.7 | 100.4 | 99.9 | 98.0 | 99.3 | 99.5 |
| Unit labour costs, PPP adj., Austria=100 | 51.1 | 52.9 | 51.6 | 51.5 | 51.3 | 49.5 | 49.4 | 48.6 |
| **Macedonia** | | | | | | | | |
| Producer price index, 2010=100 | 111.9 | 109.8 | 105.5 | 102.2 | 107.1 | 110.3 | 113.6 | 117.0 |
| Consumer price index, 2010=100 | 110.3 | 110.0 | 109.7 | 109.5 | 110.9 | 112.6 | 114.9 | 117.2 |
| GDP deflator, 2010=100 | 109.5 | 111.0 | 113.2 | 117.9 | 121.9 | 123.7 | 126.3 | 128.8 |
| Exchange rate (ER), NC/EUR | 61.58 | 61.62 | 61.61 | 61.60 | 61.57 | 61.3 | 61.3 | 61.4 |
| ER, nominal, 2010=100 | 100.1 | 100.2 | 100.2 | 100.1 | 100.1 | 99.7 | 99.7 | 99.8 |
| Real ER (CPI-based), 2010=100 | 102.6 | 101.8 | 101.5 | 101.0 | 100.7 | 100.9 | 101.1 | 101.2 |
| Real ER (PPI-based), 2010=100 | 103.3 | 103.2 | 101.4 | 99.8 | 101.4 | 103.2 | 104.5 | 105.5 |
| PPP, NC/EUR | 26.01 | 25.77 | 25.83 | 26.54 | 27.06 | 27.0 | 27.1 | 27.2 |
| Price level, EU28 = 100 | 42 | 42 | 42 | 43 | 44 | 44 | 44 | 44 |
| Average monthly gross wages, EUR (ER) | 504 | 508 | 522 | 533 | 547 | 570 | 600 | 630 |
| Average monthly gross wages, EUR (PPP) | 1,193 | 1,215 | 1,246 | 1,237 | 1,245 | 1,300 | 1,360 | 1,420 |
| GDP per employed person, 2010=100 | 98.5 | 100.5 | 102.0 | 102.4 | 100.1 | 101.7 | 101.8 | 103.7 |
| Unit labour costs, ER adj., 2010=100 | 104.1 | 103.0 | 104.2 | 105.9 | 111.2 | 114.9 | 120.6 | 123.1 |
| Unit labour costs, PPP adj., Austria=100 | 42.8 | 41.8 | 41.5 | 41.3 | 43.5 | 43.9 | 45.4 | 46.1 |
| **Serbia** | | | | | | | | |
| Producer price index, 2010=100 | 123.6 | 125.2 | 126.5 | 126.5 | 129.4 | 132.6 | 136.5 | 141.0 |
| Consumer price index, 2010=100 | 128.4 | 131.1 | 132.9 | 134.4 | 138.4 | 141.6 | 145.4 | 149.8 |
| GDP deflator, 2010=100 | 122.8 | 126.1 | 129.5 | 131.3 | 135.3 | 139.2 | 142.5 | 146.4 |
| Exchange rate (ER), NC/EUR | 113.14 | 117.31 | 120.76 | 123.12 | 121.34 | 118 | 119 | 120 |
| ER, nominal, 2010=100 | 109.8 | 113.8 | 117.2 | 119.5 | 117.8 | 114.5 | 115.5 | 116.5 |
| Real ER (CPI-based), 2010=100 | 108.9 | 106.7 | 105.1 | 103.9 | 106.8 | 110.5 | 110.5 | 110.9 |
| Real ER (PPI-based), 2010=100 | 104.1 | 103.6 | 103.9 | 103.5 | 104.1 | 108.0 | 108.3 | 108.9 |
| PPP, NC/EUR | 53.54 | 54.00 | 54.31 | 56.52 | 57.92 | 58.6 | 59.0 | 59.5 |
| Price level, EU28 = 100 | 47 | 46 | 45 | 46 | 48 | 50 | 50 | 50 |
| Average monthly gross wages, EUR (ER) | 537 | 524 | 506 | 516 | 544 | 590 | 620 | 650 |
| Average monthly gross wages, EUR (PPP) | 1,134 | 1,137 | 1,126 | 1,123 | 1,139 | 1,200 | 1,260 | 1,310 |
| GDP per employed person, 2010=100 | 106.8 | 100.0 | 101.1 | 98.9 | 98.2 | 99.4 | 100.7 | 102.4 |
| Unit labour costs, ER adj., 2010=100 | 109.1 | 113.7 | 108.8 | 113.2 | 120.2 | 130.0 | 134.7 | 138.0 |
| Unit labour costs, PPP adj., Austria=100 | 41.9 | 43.1 | 40.5 | 41.3 | 43.9 | 46.3 | 47.3 | 47.9 |

(Table 36 ctd.)

## Table 36 / (ctd.)

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| **Kosovo** | | | | | | | | |
| Producer price index, 2010=100 | 109.3 | 111.1 | 114.1 | 114.0 | 117.9 | 121.1 | 124.7 | 127.8 |
| Consumer price index, 2010=100 | 112.0 | 112.4 | 111.8 | 112.2 | 113.9 | 114.7 | 116.5 | 118.8 |
| GDP deflator, 2010=100 | 109.0 | 112.6 | 112.8 | 113.3 | 113.0 | 114.0 | 116.2 | 117.9 |
| Real ER (CPI-based), 2010=100 | 104.3 | 104.2 | 103.7 | 103.7 | 103.5 | 102.4 | 102.2 | 102.4 |
| Real ER (PPI-based), 2010=100 | 101.0 | 104.6 | 109.9 | 111.4 | 111.7 | 112.9 | 114.2 | 115.0 |
| PPP, NC/EUR | 0.4476 | 0.4525 | 0.4378 | 0.4456 | 0.4432 | 0.44 | 0.44 | 0.44 |
| Price level, EU28 = 100 | 45 | 45 | 44 | 45 | 44 | 44 | 44 | 44 |
| Average monthly gross wages, EUR (ER) | 444 | 482 | 510 | 519 | 511 | 530 | 560 | 590 |
| Average monthly gross wages, EUR (PPP) | 992 | 1,065 | 1,165 | 1,165 | 1,153 | 1,200 | 1,270 | 1,340 |
| GDP per employed person, 2010=100 | 93.9 | 99.4 | 112.7 | 105.0 | 101.2 | 104.7 | 106.0 | 107.3 |
| Unit labour costs, ER adj., 2010=100 | 135.9 | 139.4 | 130.0 | 142.0 | 145.1 | 145.5 | 151.9 | 158.1 |
| Unit labour costs, PPP adj., Austria=100 | 30.1 | 30.5 | 28.0 | 29.9 | 30.6 | 30.2 | 31.1 | 31.8 |
| **Turkey** | | | | | | | | |
| Producer price index, 2010=100 | 126.1 | 138.8 | 146.1 | 152.4 | 176.5 | 214.5 | 263.8 | 300.7 |
| Consumer price index, 2010=100 | 124.8 | 135.9 | 146.4 | 157.6 | 175.1 | 204.0 | 238.7 | 267.4 |
| GDP deflator, 2010=100 | 123.5 | 132.7 | 143.0 | 154.6 | 171.4 | 199.2 | 234.5 | 261.4 |
| Exchange rate (ER), NC/EUR | 2.534 | 2.907 | 3.026 | 3.343 | 4.121 | 5.9 | 7.2 | 7.9 |
| ER, nominal, 2010=100 | 126.9 | 145.6 | 151.5 | 167.5 | 206.4 | 295.5 | 360.6 | 395.7 |
| Real ER (CPI-based), 2010=100 | 91.6 | 86.5 | 89.5 | 87.0 | 77.1 | 61.7 | 58.1 | 58.2 |
| Real ER (PPI-based), 2010=100 | 91.9 | 89.8 | 92.9 | 89.0 | 81.0 | 67.7 | 67.0 | 68.4 |
| PPP, NC/EUR | 1.457 | 1.499 | 1.593 | 1.766 | 1.995 | 2.28 | 2.69 | 2.99 |
| Price level, EU28 = 100 | 58 | 52 | 53 | 53 | 48 | 39 | 37 | 38 |
| Average monthly gross wages, EUR (ER) | 651 | 626 | 666 | 682 | 599 | 460 | 450 | 470 |
| Average monthly gross wages, EUR (PPP) | 1,132 | 1,214 | 1,265 | 1,291 | 1,238 | 1,180 | 1,200 | 1,240 |
| GDP per employed person, 2010=100 | 111.8 | 115.7 | 119.6 | 120.7 | 125.2 | 124.8 | 124.3 | 126.2 |
| Unit labour costs, ER adj., 2010=100 | 89.2 | 82.8 | 85.2 | 86.5 | 73.3 | 55.9 | 55.1 | 57.0 |
| Unit labour costs, PPP adj., Austria=100 | 31.9 | 29.3 | 29.6 | 29.5 | 25.0 | 18.9 | 18.3 | 18.5 |
| **Belarus** | | | | | | | | |
| Producer price index, 2010=100 | 337.3 | 379.1 | 444.3 | 497.7 | 546.4 | 590.1 | 643.3 | 707.6 |
| Consumer price index, 2010=100 | 288.5 | 340.8 | 386.8 | 432.4 | 458.3 | 481.2 | 514.9 | 556.1 |
| GDP deflator, 2010=100 | 363.1 | 428.9 | 497.5 | 538.9 | 583.0 | 611.9 | 654.8 | 707.2 |
| Exchange rate (ER), NC/EUR | 1.183 | 1.322 | 1.783 | 2.201 | 2.183 | 2.4 | 2.6 | 2.7 |
| ER, nominal, 2010=100 | 295.4 | 330.0 | 445.0 | 549.3 | 544.9 | 599.0 | 648.9 | 673.9 |
| Real ER (CPI-based), 2010=100 | 91.0 | 95.7 | 80.6 | 72.7 | 76.4 | 71.8 | 69.6 | 71.1 |
| Real ER (PPI-based), 2010=100 | 105.6 | 108.2 | 96.2 | 88.6 | 95.0 | 91.9 | 90.8 | 94.5 |
| PPP, NC/EUR | 0.528 | 0.610 | 0.684 | 0.751 | 0.810 | 0.84 | 0.88 | 0.93 |
| Price level, EU28 = 100 | 45 | 46 | 38 | 34 | 37 | 35 | 34 | 35 |
| Average monthly gross wages, EUR (ER) | 428 | 458 | 377 | 328 | 377 | 400 | 410 | 430 |
| Average monthly gross wages, EUR (PPP) | 959 | 991 | 982 | 963 | 1,016 | 1,150 | 1,200 | 1,250 |
| GDP per employed person, 2010=100 | 111.3 | 113.9 | 110.9 | 110.3 | 112.1 | 115.7 | 118.7 | 124.8 |
| Unit labour costs, ER adj., 2010=100 | 126.5 | 132.3 | 111.8 | 97.9 | 110.7 | 113.8 | 113.0 | 114.3 |
| Unit labour costs, PPP adj., Austria=100 | 40.5 | 41.8 | 34.7 | 29.8 | 33.7 | 34.1 | 33.6 | 32.9 |
| **Kazakhstan** | | | | | | | | |
| Producer price index, 2010=100 | 131.3 | 143.7 | 114.3 | 133.5 | 153.9 | 178.5 | 189.2 | 193.0 |
| Consumer price index, 2010=100 | 120.5 | 128.6 | 137.1 | 157.1 | 168.8 | 179.8 | 190.6 | 200.1 |
| GDP deflator, 2010=100 | 138.4 | 146.4 | 149.2 | 169.5 | 184.1 | 195.0 | 204.6 | 214.7 |
| Exchange rate (ER), NC/EUR | 202.1 | 238.1 | 245.8 | 378.6 | 368.3 | 408 | 416 | 422 |
| ER, nominal, 2010=100 | 103.3 | 121.7 | 125.6 | 193.5 | 188.2 | 208.5 | 212.6 | 215.7 |
| Real ER (CPI-based), 2010=100 | 108.7 | 98.0 | 101.1 | 75.0 | 81.5 | 77.0 | 78.7 | 80.0 |
| Real ER (PPI-based), 2010=100 | 117.5 | 111.2 | 87.6 | 67.4 | 77.4 | 79.8 | 81.5 | 80.5 |
| PPP, NC/EUR | 121.0 | 125.3 | 123.2 | 141.8 | 150.5 | 156.9 | 161.8 | 166.8 |
| Price level, EU28 = 100 | 60 | 53 | 50 | 37 | 41 | 38 | 39 | 40 |
| Average monthly gross wages, EUR (ER) | 540 | 508 | 513 | 377 | 409 | 400 | 430 | 450 |
| Average monthly gross wages, EUR (PPP) | 902 | 966 | 1,023 | 1,007 | 1,002 | 1,040 | 1,090 | 1,150 |
| GDP per employed person, 2010=100 | 112.9 | 118.4 | 118.2 | 120.5 | 125.0 | 129.3 | 132.7 | 136.1 |
| Unit labour costs, ER adj., 2010=100 | 120.6 | 108.2 | 109.4 | 79.0 | 82.6 | 78.3 | 80.9 | 84.1 |
| Unit labour costs, PPP adj., Austria=100 | 37.0 | 32.8 | 32.5 | 23.0 | 24.1 | 22.4 | 23.1 | 23.2 |

(Table 36 ctd.)

## Table 36 / (ctd.)

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| **Russia** [4)] | | | | | | | | |
| Producer price index, 2010=100 | 129.9 | 138.2 | 156.8 | 163.4 | 176.0 | 193.6 | 212.9 | 223.6 |
| Consumer price index, 2010=100 | 121.7 | 131.2 | 151.5 | 162.3 | 168.1 | 174.0 | 183.5 | 190.9 |
| GDP deflator, 2010=100 | 133.3 | 143.3 | 154.8 | 160.2 | 168.6 | 182.1 | 191.1 | 198.7 |
| Exchange rate (ER), NC/EUR | 42.27 | 50.77 | 67.76 | 74.26 | 65.87 | 75.0 | 76.0 | 77.0 |
| ER, nominal, 2010=100 | 105.0 | 126.1 | 168.3 | 184.4 | 163.6 | 186.2 | 188.7 | 191.2 |
| Real ER (CPI-based), 2010=100 | 108.0 | 96.4 | 83.4 | 81.3 | 93.4 | 83.5 | 85.3 | 86.1 |
| Real ER (PPI-based), 2010=100 | 114.4 | 103.2 | 89.7 | 86.6 | 101.9 | 96.9 | 103.4 | 105.2 |
| PPP, NC/EUR | 26.44 | 28.51 | 30.49 | 32.16 | 33.26 | 35.4 | 36.5 | 37.2 |
| Price level, EU28 = 100 | 63 | 56 | 45 | 43 | 50 | 47 | 48 | 48 |
| Average monthly gross wages, EUR (ER) [5)] | 705 | 640 | 502 | 494 | 594 | 570 | 610 | 650 |
| Average monthly gross wages, EUR (PPP) [5)] | 1,127 | 1,140 | 1,116 | 1,142 | 1,177 | 1,200 | 1,270 | 1,340 |
| GDP per employed person, 2010=100 | 116.1 | 116.7 | 112.5 | 112.2 | 114.3 | 116.0 | 117.9 | 120.0 |
| Unit labour costs, ER adj., 2010=100 | 116.7 | 105.4 | 85.8 | 84.7 | 99.9 | 93.9 | 99.1 | 104.0 |
| Unit labour costs, PPP adj., Austria=100 | 44.4 | 39.6 | 31.7 | 30.6 | 36.2 | 33.7 | 34.9 | 35.9 |
| **Ukraine** [6)] | | | | | | | | |
| Producer price index, 2010=100 | 123.3 | 144.4 | 196.3 | 236.6 | 299.0 | 346.9 | 374.6 | 397.1 |
| Consumer price index, 2010=100 | 108.3 | 121.4 | 180.6 | 205.7 | 235.3 | 260.7 | 283.9 | 298.7 |
| GDP deflator, 2010=100 | 128.6 | 149.1 | 207.1 | 242.5 | 295.9 | 336.0 | 364.6 | 385.0 |
| Exchange rate (ER), NC/EUR | 10.61 | 15.72 | 24.23 | 28.29 | 30.00 | 32.0 | 35.0 | 37.0 |
| ER, nominal, 2010=100 | 100.8 | 149.2 | 230.0 | 268.6 | 284.9 | 303.8 | 332.3 | 351.3 |
| Real ER (CPI-based), 2010=100 | 100.1 | 75.4 | 72.7 | 70.7 | 75.0 | 76.7 | 75.0 | 73.3 |
| Real ER (PPI-based), 2010=100 | 113.1 | 91.1 | 82.2 | 86.1 | 99.4 | 106.5 | 103.3 | 101.7 |
| PPP, NC/EUR | 5.082 | 5.766 | 7.732 | 9.176 | 11.175 | 12.50 | 13.32 | 13.82 |
| Price level, EU28 = 100 | 48 | 37 | 32 | 32 | 37 | 39 | 38 | 37 |
| Average monthly gross wages, EUR (ER) | 308 | 221 | 173 | 183 | 237 | 280 | 290 | 300 |
| Average monthly gross wages, EUR (PPP) | 643 | 604 | 543 | 565 | 636 | 700 | 760 | 810 |
| GDP per employed person, 2010=100 | 104.9 | 106.5 | 105.6 | 109.3 | 112.9 | 115.4 | 118.1 | 120.3 |
| Unit labour costs, ER adj., 2010=100 | 137.9 | 97.8 | 77.1 | 78.8 | 98.7 | 112.1 | 114.9 | 118.4 |
| Unit labour costs, PPP adj., Austria=100 | 49.9 | 34.9 | 27.0 | 27.1 | 33.9 | 38.7 | 38.5 | 38.4 |
| **Austria** | | | | | | | | |
| Producer price index, 2010=100 | 104.1 | 102.9 | 101.4 | 99.6 | 101.5 | 103.1 | 105.3 | 107.2 |
| Consumer price index, 2010=100 | 107.9 | 109.7 | 110.7 | 111.7 | 114.1 | 116.5 | 118.9 | 121.3 |
| GDP deflator, 2010=100 | 105.6 | 107.9 | 110.3 | 111.8 | 113.2 | 115.1 | 117.4 | 119.6 |
| Real ER (CPI-based), 2010=100 | 100.5 | 101.7 | 102.6 | 103.2 | 103.6 | 104.0 | 104.3 | 104.5 |
| Real ER (PPI-based), 2010=100 | 96.3 | 96.9 | 97.6 | 97.3 | 96.1 | 96.2 | 96.4 | 96.5 |
| PPP, NC/EUR | 1.085 | 1.084 | 1.058 | 1.088 | 1.101 | 1.102 | 1.105 | 1.106 |
| Price level, EU28 = 100 | 109 | 108 | 106 | 109 | 110 | 110 | 110 | 111 |
| Average monthly gross wages, EUR | 2,899 | 2,950 | 3,010 | 3,082 | 3,128 | 3,210 | 3,280 | 3,360 |
| Average monthly gross wages, EUR (PPP) | 2,671 | 2,721 | 2,845 | 2,834 | 2,841 | 2,910 | 2,970 | 3,040 |
| GDP per employed person, 2010=100 | 101.4 | 101.9 | 102.2 | 102.5 | 104.1 | 105.2 | 105.9 | 106.6 |
| Unit labour costs, ER adj., 2010=100 | 105.5 | 106.9 | 108.7 | 111.0 | 110.9 | 112.6 | 114.3 | 116.4 |
| Unit labour costs, PPP 2010 adjusted | 0.51 | 0.52 | 0.53 | 0.54 | 0.54 | 0.55 | 0.56 | 0.57 |

4) From 2014 including Crimean Federal District (for LFS employment and wages from 2015). - 5) From 2017 improved coverage of small enterprises. - 6) From 2014 excluding the occupied territories of Crimea and Sevastopol and from 2015 temporarily occupied territories in the Donetsk and Luhansk regions.

Notes:
From February 2018 average monthly gross wages for Austria have been changed to gross wages per employee instead of gross wages per full-time employee. This lower Austrian wage level affects the ULC comparison of CESEE countries with Austria.
Unit labour costs are defined as average gross wages per employee relative to labour productivity (real GDP per employed person, LFS). Average gross monthly wages refer to administrative data sources (business register, tax records etc.), those for Austria are based on National Accounts data (annual gross wages divided by employees (domestic concept) and by 12 months). For level comparisons, labour productivity is converted with the PPP rate 2010 (PPP adjusted).
PPP rates have been taken from Eurostat based on the benchmark results 2011. Missing data have been extrapolated by wiiw with GDP deflators. Belarus, Kazakhstan, Kosovo, Russia and Ukraine are converted from the USD parity provided by IMF (WDI).

Real exchange rates: Increasing values mean real appreciation.
ER = Exchange Rate, PPP = Purchasing Power Parity, Price level: PPP/ ER.

Sources: wiiw Annual Database incorporating national and Eurostat statistics; WIFO; IMF (WDI - World Development Indicators). wiiw estimates and forecasts.

## Table 37 / Indicators of macro-competitiveness, 2013-2020, annual changes in %

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2013-17 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | | average |
| **Bulgaria** | | | | | | | | | |
| GDP deflator | -0.7 | 0.5 | 2.2 | 2.2 | 3.4 | 2.5 | 2.5 | 2.5 | 1.5 |
| Real ER (CPI-based) | -1.1 | -2.1 | -1.1 | -1.6 | -0.5 | 0.8 | 0.7 | 0.7 | -1.3 |
| Real ER (PPI-based) | -1.4 | 0.6 | 0.0 | -1.6 | 1.7 | 2.4 | 1.7 | 1.2 | -0.1 |
| Average gross wages, real (PPI based) | 7.6 | 7.3 | 9.2 | 11.5 | 6.5 | 4.3 | 4.2 | 4.1 | 8.4 |
| Average gross wages, real (CPI based) | 5.6 | 7.7 | 8.0 | 9.4 | 10.5 | 5.8 | 5.2 | 4.6 | 8.2 |
| Average gross wages, EUR (ER) | 6.0 | 6.0 | 6.8 | 8.0 | 11.8 | 8.8 | 6.8 | 7.9 | 7.7 |
| Employed persons (LFS) | 0.0 | 1.6 | 1.7 | -0.5 | 4.4 | 1.6 | 0.9 | 0.9 | 1.4 |
| GDP per empl. person, NC at 2010 ref. pr. | 0.5 | 0.2 | 1.7 | 4.5 | -0.6 | 1.6 | 2.1 | 2.4 | 1.3 |
| Unit labour costs, ER (EUR) adjusted | 5.5 | 5.7 | 5.0 | 3.4 | 12.5 | 6.7 | 5.6 | 4.7 | 6.4 |
| **Czech Republic** | | | | | | | | | |
| GDP deflator | 1.4 | 2.5 | 1.2 | 1.3 | 1.5 | 1.9 | 2.2 | 2.0 | 1.6 |
| Exchange rate (ER), EUR/NC | -3.2 | -5.7 | 0.9 | 0.9 | 2.7 | 3.2 | 1.0 | 0.0 | -0.9 |
| Real ER (CPI-based) | -3.3 | -5.7 | 1.2 | 1.2 | 3.4 | 3.8 | 1.5 | 0.2 | -0.7 |
| Real ER (PPI-based) | -2.0 | -2.6 | 0.7 | -0.8 | 0.2 | 2.6 | 0.7 | -0.3 | -0.9 |
| Average gross wages, real (PPI based) | -1.2 | 1.5 | 5.7 | 7.9 | 5.5 | 7.4 | 4.7 | 3.7 | 3.8 |
| Average gross wages, real (CPI based) | -1.5 | 2.5 | 2.9 | 3.8 | 3.7 | 6.1 | 3.9 | 3.2 | 2.3 |
| Average gross wages, EUR (ER) | -3.3 | -2.9 | 4.2 | 5.4 | 9.1 | 11.6 | 8.0 | 5.2 | 2.4 |
| Employed persons (LFS) | 1.0 | 0.8 | 1.4 | 1.9 | 1.6 | 1.3 | 0.4 | 0.2 | 1.3 |
| GDP per empl. person, NC at 2010 ref. pr. | -1.4 | 1.9 | 3.9 | 0.5 | 2.6 | 2.0 | 2.8 | 2.9 | 1.5 |
| Unit labour costs, ER (EUR) adjusted | -1.9 | -4.7 | 0.3 | 4.8 | 6.3 | 9.8 | 4.4 | 2.3 | 0.9 |
| **Estonia** | | | | | | | | | |
| GDP deflator | 3.6 | 3.0 | 1.0 | 1.5 | 3.9 | 3.1 | 2.8 | 2.8 | 2.6 |
| Real ER (CPI-based) | 1.7 | 0.0 | 0.1 | 0.5 | 2.0 | 1.6 | 1.0 | 0.9 | 0.8 |
| Real ER (PPI-based) | 5.3 | -0.3 | -0.3 | 0.6 | 0.1 | 1.4 | 0.7 | 0.5 | 1.1 |
| Average gross wages, real (PPI based) | 1.7 | 8.2 | 8.7 | 8.6 | 3.6 | 2.9 | 3.6 | 4.1 | 6.1 |
| Average gross wages, real (CPI based) | 3.7 | 5.4 | 5.9 | 6.8 | 3.2 | 2.6 | 3.3 | 3.7 | 5.0 |
| Average gross wages, EUR (ER) | 7.0 | 5.9 | 6.0 | 7.6 | 7.0 | 6.0 | 6.2 | 6.5 | 6.7 |
| Employed persons (LFS) | 1.0 | 0.6 | 2.6 | 0.6 | 2.2 | 1.0 | 0.8 | 0.0 | 1.4 |
| GDP per empl. person, NC at 2010 ref. pr. | 0.9 | 2.3 | -0.7 | 2.9 | 2.6 | 2.5 | 2.3 | 2.6 | 1.6 |
| Unit labour costs, ER (EUR) adjusted | 6.0 | 3.5 | 6.7 | 4.6 | 4.2 | 3.5 | 3.7 | 3.8 | 5.0 |
| **Croatia** | | | | | | | | | |
| GDP deflator | 0.8 | 0.0 | 0.0 | -0.1 | 1.1 | 1.6 | 2.0 | 2.0 | 0.4 |
| Exchange rate (ER), EUR/NC | -0.8 | -0.7 | 0.3 | 1.1 | 0.9 | 0.9 | 0.0 | 0.0 | 0.2 |
| Real ER (CPI-based) | 0.0 | -1.0 | 0.0 | 0.2 | 0.5 | 0.8 | 0.2 | 0.2 | -0.1 |
| Real ER (PPI-based) | -1.0 | -1.6 | -1.4 | -1.8 | -0.2 | 1.3 | 0.2 | 0.2 | -1.2 |
| Average gross wages, real (PPI based) [1] | 1.2 | 3.0 | 5.3 | 6.5 | 1.9 | 3.1 | 2.8 | 2.7 | 3.5 |
| Average gross wages, real (CPI based) [1] | -1.5 | 0.0 | 1.6 | 2.5 | 2.6 | 3.5 | 2.8 | 2.7 | 1.0 |
| Average gross wages, EUR (ER) [1] | 0.1 | -0.6 | 1.6 | 3.0 | 4.9 | 5.6 | 5.3 | 5.0 | 1.8 |
| Employed persons (LFS) | -2.7 | 2.7 | 1.3 | 0.3 | 2.2 | 1.5 | 1.2 | 1.2 | 0.7 |
| GDP per empl. person, NC at 2010 ref. pr. | 2.3 | -2.7 | 1.1 | 3.2 | 0.7 | 0.9 | 1.4 | 1.5 | 0.9 |
| Unit labour costs, ER (EUR) adjusted | -2.2 | 2.3 | 0.4 | -0.2 | 4.2 | 5.1 | 3.4 | 3.2 | 0.9 |
| **Hungary** | | | | | | | | | |
| GDP deflator | 2.9 | 3.4 | 1.9 | 0.9 | 3.8 | 3.2 | 3.2 | 3.3 | 2.6 |
| Exchange rate (ER), EUR/NC | -2.6 | -3.8 | -0.4 | -0.5 | 0.7 | -3.4 | -2.1 | -0.9 | -1.3 |
| Real ER (CPI-based) | -2.4 | -4.3 | -0.3 | -0.4 | 1.4 | -2.0 | -1.0 | 0.3 | -1.2 |
| Real ER (PPI-based) | -1.8 | -2.4 | 0.7 | -0.7 | 0.8 | -0.9 | -1.0 | 0.3 | -0.7 |
| Average gross wages, real (PPI based) | 2.7 | 3.3 | 5.5 | 8.0 | 9.3 | 7.4 | 5.0 | 3.0 | 5.7 |
| Average gross wages, real (CPI based) | 1.7 | 3.0 | 4.2 | 5.7 | 10.2 | 8.5 | 5.0 | 3.0 | 4.9 |
| Average gross wages, EUR (ER) | 0.8 | -0.9 | 3.9 | 5.7 | 13.7 | 8.3 | 5.8 | 5.5 | 4.5 |
| Employed persons (LFS) | 1.7 | 5.3 | 2.7 | 3.4 | 1.6 | 1.1 | 0.4 | 0.0 | 2.9 |
| GDP per empl. person, NC at 2010 ref. pr. | 0.4 | -1.1 | 0.8 | -1.0 | 2.5 | 3.2 | 2.5 | 2.3 | 0.3 |
| Unit labour costs, ER (EUR) adjusted | 0.4 | 0.1 | 3.0 | 6.8 | 10.9 | 4.8 | 3.2 | 2.8 | 4.2 |
| **Lithuania** | | | | | | | | | |
| GDP deflator | 1.3 | 1.0 | 0.3 | 1.4 | 4.3 | 2.6 | 2.7 | 2.4 | 1.7 |
| Real ER (CPI-based) | -0.3 | -0.3 | -0.7 | 0.4 | 2.0 | 0.9 | 0.9 | 0.7 | 0.2 |
| Real ER (PPI-based) | -2.2 | -3.3 | -7.7 | -2.8 | 1.6 | 4.3 | 2.2 | 0.4 | -2.9 |
| Average gross wages, real (PPI based) | 7.6 | 10.3 | 16.7 | 13.3 | 3.5 | 2.2 | 3.6 | 4.8 | 10.2 |
| Average gross wages, real (CPI based) | 3.8 | 4.6 | 6.2 | 7.6 | 4.7 | 5.5 | 4.9 | 4.5 | 5.4 |
| Average gross wages, EUR (ER) | 5.1 | 4.8 | 5.4 | 8.4 | 8.6 | 8.3 | 7.7 | 7.1 | 6.4 |
| Employed persons (LFS) | 1.3 | 2.0 | 1.2 | 2.0 | -0.5 | 0.5 | 0.1 | 0.1 | 1.2 |
| GDP per empl. person, NC at 2010 ref. pr. | 2.1 | 1.5 | 0.8 | 0.4 | 4.6 | 2.9 | 2.9 | 2.5 | 1.9 |
| Unit labour costs, ER (EUR) adjusted | 2.9 | 3.3 | 4.6 | 8.0 | 3.8 | 5.3 | 4.6 | 4.5 | 4.5 |

1) From 2016 new data sources (tax records).

(Table 37 ctd.)

## Table 37 / (ctd.)

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2013-17 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | | average |
| **Latvia** | | | | | | | | | |
| GDP deflator | 1.6 | 1.8 | 0.0 | 0.9 | 3.2 | 2.3 | 2.5 | 2.5 | 1.5 |
| Real ER (CPI-based) | -2.1 | 0.0 | 0.2 | -0.2 | 1.2 | 0.6 | 0.7 | 0.7 | -0.2 |
| Real ER (PPI-based) | 1.3 | 2.1 | 1.2 | -1.0 | -0.7 | 1.9 | 1.0 | 0.7 | 0.6 |
| Average gross wages, real (PPI based) | 2.7 | 6.5 | 8.0 | 7.7 | 5.2 | 4.3 | 4.1 | 3.9 | 6.0 |
| Average gross wages, real (CPI based) | 4.6 | 6.1 | 6.7 | 4.9 | 4.8 | 5.6 | 4.4 | 3.9 | 5.4 |
| Average gross wages, EUR (ER) | 3.9 | 6.7 | 6.9 | 5.0 | 7.8 | 8.0 | 7.0 | 6.5 | 6.1 |
| Employed persons (LFS) | 2.1 | -1.0 | 1.3 | -0.3 | 0.2 | 1.5 | 1.0 | 0.9 | 0.4 |
| GDP per empl. person, NC at 2010 ref. pr. | 0.3 | 2.9 | 1.6 | 2.4 | 4.5 | 2.5 | 2.3 | 2.2 | 2.3 |
| Unit labour costs, ER (EUR) adjusted | 3.6 | 3.7 | 5.2 | 2.6 | 3.2 | 5.3 | 4.6 | 4.2 | 3.6 |
| **Poland** | | | | | | | | | |
| GDP deflator | 0.3 | 0.5 | 0.8 | 0.3 | 2.0 | 1.0 | 1.2 | 1.2 | 0.8 |
| Exchange rate (ER), EUR/NC | -0.3 | 0.3 | 0.0 | -4.1 | 2.5 | 0.2 | 0.0 | 0.0 | -0.3 |
| Real ER (CPI-based) | -1.0 | -0.1 | -0.7 | -4.6 | 2.4 | 0.5 | 0.3 | 0.1 | -0.8 |
| Real ER (PPI-based) | -1.3 | 0.7 | 0.0 | -2.9 | 2.0 | 0.2 | 0.0 | 0.0 | -0.3 |
| Average gross wages, real (PPI based) | 4.8 | 4.7 | 5.8 | 4.0 | 2.6 | 6.0 | 4.2 | 3.7 | 4.4 |
| Average gross wages, real (CPI based) | 2.8 | 3.1 | 4.2 | 3.9 | 3.8 | 5.6 | 3.9 | 3.6 | 3.6 |
| Average gross wages, EUR (ER) | 3.3 | 3.5 | 3.5 | -0.6 | 8.0 | 7.6 | 6.5 | 5.2 | 3.5 |
| Employed persons (LFS) | -0.1 | 1.9 | 1.4 | 0.7 | 1.4 | 0.8 | 0.6 | 0.3 | 1.0 |
| GDP per empl. person, NC at 2010 ref. pr. | 1.5 | 1.4 | 2.4 | 2.3 | 3.4 | 4.2 | 2.8 | 3.0 | 2.2 |
| Unit labour costs, ER (EUR) adjusted | 1.8 | 2.1 | 1.0 | -2.8 | 4.5 | 3.5 | 3.2 | 2.4 | 3.0 |
| **Romania** | | | | | | | | | |
| GDP deflator | 3.1 | 1.7 | 2.6 | 2.5 | 4.6 | 4.3 | 2.8 | 2.3 | 2.9 |
| Exchange rate (ER), EUR/NC | 0.9 | -0.6 | 0.0 | -1.0 | -1.7 | -2.0 | -0.9 | -1.1 | -0.5 |
| Real ER (CPI-based) | 2.6 | 0.3 | -0.4 | -2.4 | -2.3 | 0.3 | 0.3 | 0.1 | -0.5 |
| Real ER (PPI-based) | 2.8 | 1.1 | -0.1 | -1.3 | -1.4 | 1.0 | -0.6 | -0.9 | 0.2 |
| Average gross wages, real (PPI based) [2)] | 3.0 | 7.8 | 12.3 | 12.0 | 10.9 | 1.3 | 7.0 | 4.2 | 9.1 |
| Average gross wages, real (CPI based) [2)] | 1.6 | 6.1 | 10.2 | 11.2 | 13.5 | 1.9 | 5.9 | 3.2 | 8.4 |
| Average gross wages, EUR (ER) [2)] | 5.8 | 7.0 | 9.7 | 8.8 | 12.8 | 3.9 | 8.5 | 4.9 | 8.8 |
| Employed persons (LFS) | -0.7 | 0.8 | -0.9 | -1.0 | 2.6 | 1.0 | 1.0 | 1.0 | 0.2 |
| GDP per empl. person, NC at 2010 ref. pr. | 4.2 | 2.6 | 4.8 | 5.9 | 4.5 | 2.8 | 2.5 | 2.6 | 4.4 |
| Unit labour costs, ER (EUR) adjusted | 1.5 | 4.3 | 4.7 | 2.8 | 7.9 | 1.1 | 5.6 | 2.4 | 4.2 |
| **Slovenia** | | | | | | | | | |
| GDP deflator | 1.6 | 0.8 | 1.0 | 0.8 | 1.6 | 1.9 | 2.0 | 2.0 | 1.1 |
| Real ER (CPI-based) | 0.4 | -0.1 | -0.8 | -0.5 | -0.1 | 0.1 | 0.2 | 0.2 | -0.2 |
| Real ER (PPI-based) | 0.1 | 1.1 | 2.0 | 0.1 | -1.0 | 0.4 | 0.2 | 0.2 | 0.5 |
| Average gross wages, real (PPI based) | -0.2 | 1.8 | 0.9 | 3.3 | 0.4 | 1.9 | 2.1 | 1.9 | 1.3 |
| Average gross wages, real (CPI based) | -2.0 | 0.7 | 1.5 | 2.0 | 1.0 | 2.1 | 2.1 | 1.9 | 0.6 |
| Average gross wages, EUR (ER) | -0.2 | 1.1 | 0.7 | 1.8 | 2.7 | 3.9 | 4.1 | 4.0 | 1.2 |
| Employed persons (LFS) | -1.9 | 1.2 | 0.1 | -0.3 | 4.8 | 2.2 | 2.0 | 2.0 | 0.8 |
| GDP per empl. person, NC at 2010 ref. pr. | 0.8 | 1.8 | 2.2 | 3.3 | 0.1 | 2.2 | 1.6 | 1.4 | 1.6 |
| Unit labour costs, ER (EUR) adjusted | -1.0 | -0.6 | -1.5 | -1.5 | 2.6 | 1.7 | 2.5 | 2.6 | -0.4 |
| **Slovakia** | | | | | | | | | |
| GDP deflator | 0.5 | -0.2 | -0.2 | -0.5 | 1.2 | 2.8 | 2.5 | 2.2 | 0.2 |
| Real ER (CPI-based) | 0.0 | -0.6 | -0.3 | -0.8 | -0.3 | 1.1 | 0.7 | 0.4 | -0.4 |
| Real ER (PPI-based) | -0.9 | -1.5 | -0.7 | -2.4 | -0.7 | 0.9 | 0.7 | 0.7 | -1.3 |
| Average gross wages, real (PPI based) | 3.4 | 7.7 | 6.0 | 7.5 | 2.1 | 4.3 | 4.3 | 3.8 | 5.3 |
| Average gross wages, real (CPI based) | 0.8 | 4.2 | 3.2 | 3.8 | 3.2 | 4.0 | 4.3 | 4.1 | 3.0 |
| Average gross wages, EUR (ER) | 2.4 | 4.1 | 2.9 | 3.3 | 4.6 | 6.9 | 6.9 | 6.4 | 3.5 |
| Employed persons (LFS) | 0.0 | 1.5 | 2.6 | 2.8 | 1.5 | 1.2 | 0.8 | 0.4 | 1.7 |
| GDP per empl. person, NC at 2010 ref. pr. | 1.5 | 1.3 | 1.6 | 0.3 | 1.6 | 2.9 | 3.0 | 2.9 | 1.2 |
| Unit labour costs, ER (EUR) adjusted | 0.9 | 2.8 | 1.3 | 3.0 | 2.9 | 3.9 | 3.7 | 3.4 | 2.2 |
| **Albania** | | | | | | | | | |
| GDP deflator | 0.3 | 1.5 | 0.6 | -0.5 | 1.4 | -1.0 | 2.2 | 1.8 | 0.7 |
| Exchange rate (ER), EUR/NC | -0.9 | 0.2 | 0.2 | 1.7 | 2.4 | 4.4 | 1.2 | 0.4 | 0.7 |
| Real ER (CPI-based) | -0.4 | 1.3 | 2.1 | 2.7 | 2.7 | 4.8 | 1.9 | 1.5 | 1.7 |
| Real ER (PPI-based) | -1.2 | 1.5 | 0.3 | 1.8 | 1.8 | 5.8 | 1.4 | 0.1 | 0.8 |
| Average gross wages, real (PPI based) [3)] | -2.8 | 1.4 | 5.0 | -0.7 | 6.0 | 4.0 | 4.1 | 4.4 | 1.7 |
| Average gross wages, real (CPI based) [3)] | -5.0 | -0.7 | 0.9 | -3.3 | 6.6 | 4.9 | 3.6 | 3.0 | -0.4 |
| Average gross wages, EUR (ER) [3)] | -4.0 | 1.1 | 3.0 | -0.4 | 11.3 | 13.0 | 7.1 | 6.7 | 2.1 |
| Employed persons (LFS) | -10.2 | 1.3 | 4.8 | 6.5 | 3.3 | 2.9 | 2.4 | 3.2 | 0.9 |
| GDP per empl. person, NC at 2010 ref. pr. | 12.5 | 0.5 | -2.4 | -3.0 | 0.6 | 1.1 | 1.5 | 0.8 | 1.5 |
| Unit labour costs, ER (EUR) adjusted | -14.7 | 0.6 | 5.6 | 2.6 | 10.7 | 10.6 | 5.8 | 5.6 | 0.6 |

2) In 2018 the employers' social security contribution will be added to gross wages increasing the latter by 25% in NC. The growth here in the table refers to net wages. - 3) From 2014 new data sources (tax records) covering the whole economy, Structural Business Statistics for market producers before.

(Table 37 ctd.)

**Table 37 / (ctd.)**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2013-17 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | | average |
| **Bosnia and Herzegovina** | | | | | | | | | |
| GDP deflator | -0.2 | 1.0 | 1.4 | 1.4 | 1.7 | 1.3 | 1.7 | 1.8 | 1.0 |
| Real ER (CPI-based) | -1.6 | -1.4 | -1.0 | -1.4 | -0.5 | -0.5 | 0.1 | 0.1 | -1.2 |
| Real ER (PPI-based) | -1.7 | 1.3 | 2.9 | -0.6 | -0.2 | 0.2 | 0.3 | 0.3 | 0.3 |
| Average gross wages, real (PPI based) | 1.9 | 0.4 | -0.6 | 3.1 | -1.4 | 0.4 | 0.8 | 0.8 | 0.7 |
| Average gross wages, real (CPI based) | 0.2 | 0.8 | 1.0 | 2.0 | 0.4 | 1.0 | 1.0 | 1.0 | 0.9 |
| Average gross wages, EUR (ER) | 0.1 | -0.1 | 0.0 | 0.9 | 1.6 | 2.1 | 2.9 | 2.8 | 0.5 |
| Employed persons (LFS) | 1.0 | -1.2 | 1.2 | -2.6 | 1.8 | 1.8 | 1.2 | 1.2 | 0.0 |
| GDP per empl. person, NC at 2010 ref. pr. | 1.4 | 2.3 | 1.8 | 5.8 | 1.2 | 1.3 | 2.2 | 1.9 | 2.5 |
| Unit labour costs, ER (EUR) adjusted | -1.3 | -2.4 | -1.8 | -4.7 | 0.4 | 0.8 | 0.7 | 0.9 | -2.0 |
| **Montenegro** | | | | | | | | | |
| GDP deflator | 2.1 | 1.0 | 2.2 | 5.1 | 3.8 | 2.7 | 1.2 | 1.0 | 2.8 |
| Real ER (CPI-based) | 0.3 | -1.0 | 1.4 | -0.2 | 1.1 | 1.8 | 0.2 | 0.2 | 0.3 |
| Real ER (PPI-based) | 1.7 | 1.9 | 2.6 | 1.4 | -2.7 | 0.4 | 0.2 | 0.2 | 1.0 |
| Average gross wages, real (PPI based) | -1.7 | -0.5 | 0.0 | 3.7 | 1.5 | -1.3 | 0.6 | 0.5 | 0.6 |
| Average gross wages, real (CPI based) | -1.9 | 0.1 | -1.1 | 3.5 | -0.9 | -2.8 | 0.6 | 0.5 | -0.1 |
| Average gross wages, EUR (ER) | -0.1 | -0.4 | 0.3 | 3.6 | 1.9 | 0.7 | 2.6 | 2.5 | 1.0 |
| Employed persons (LFS) | 1.0 | 7.1 | 2.5 | 1.1 | 2.3 | 2.0 | 0.9 | 0.8 | 2.8 |
| GDP per empl. person, NC at 2010 ref. pr. | 2.6 | -5.0 | 0.9 | 1.8 | 2.4 | 2.6 | 1.2 | 2.4 | 0.5 |
| Unit labour costs, ER (EUR) adjusted | -2.6 | 4.8 | -0.6 | 1.8 | -0.5 | -1.9 | 1.4 | 0.1 | 0.5 |
| **Macedonia** | | | | | | | | | |
| GDP deflator | 4.5 | 1.4 | 2.0 | 4.1 | 3.5 | 1.4 | 2.1 | 2.0 | 3.1 |
| Exchange rate (ER), EUR/NC | -0.1 | -0.1 | 0.0 | 0.0 | 0.0 | 0.4 | 0.0 | -0.2 | 0.0 |
| Real ER (CPI-based) | 1.2 | -0.9 | -0.3 | -0.5 | -0.3 | 0.2 | 0.2 | 0.0 | -0.1 |
| Real ER (PPI-based) | -1.4 | -0.2 | -1.7 | -1.6 | 1.6 | 1.8 | 1.2 | 1.0 | -0.7 |
| Average gross wages, real (PPI based) | 2.6 | 2.9 | 6.9 | 5.3 | -2.1 | 1.4 | 2.1 | 1.0 | 3.1 |
| Average gross wages, real (CPI based) | -1.6 | 1.3 | 3.0 | 2.2 | 1.3 | 2.9 | 3.1 | 2.0 | 1.2 |
| Average gross wages, EUR (ER) | 1.1 | 0.9 | 2.7 | 2.0 | 2.7 | 4.2 | 5.3 | 5.0 | 1.9 |
| Employed persons (LFS) | 4.3 | 1.7 | 2.3 | 2.5 | 2.4 | 1.3 | 2.7 | 1.3 | 2.6 |
| GDP per empl. person, NC at 2010 ref. pr. | -1.4 | 2.0 | 1.5 | 0.4 | -2.3 | 1.6 | 0.1 | 1.8 | 0.0 |
| Unit labour costs, ER (EUR) adjusted | 2.5 | -1.1 | 1.2 | 1.6 | 5.1 | 3.3 | 5.0 | 2.1 | 1.8 |
| **Serbia** | | | | | | | | | |
| GDP deflator | 5.4 | 2.7 | 2.7 | 1.5 | 3.0 | 2.8 | 2.4 | 2.7 | 3.1 |
| Exchange rate (ER), EUR/NC | 0.0 | -3.6 | -2.9 | -1.9 | 1.5 | 2.8 | -0.8 | -0.8 | -1.4 |
| Real ER (CPI-based) | 6.1 | -2.0 | -1.5 | -1.1 | 2.8 | 3.4 | 0.0 | 0.3 | 0.8 |
| Real ER (PPI-based) | 2.8 | -0.5 | 0.3 | -0.4 | 0.6 | 3.8 | 0.3 | 0.6 | 0.5 |
| Average gross wages, real (PPI based) | 2.9 | -0.1 | -1.4 | 3.8 | 1.6 | 3.8 | 2.9 | 1.8 | 1.3 |
| Average gross wages, real (CPI based) | -1.8 | -0.9 | -1.8 | 2.7 | 0.9 | 4.0 | 3.1 | 2.1 | -0.2 |
| Average gross wages, EUR (ER) | 5.7 | -2.4 | -3.3 | 1.8 | 5.5 | 8.5 | 5.1 | 4.8 | 1.4 |
| Employed persons (LFS) 4) | 3.7 | 4.8 | 0.6 | 5.6 | 2.8 | 3.1 | 2.1 | 1.0 | 3.5 |
| GDP per empl. person, NC at 2010 ref. pr. | -1.1 | -6.3 | 6.8 | -2.2 | -0.7 | 1.2 | 1.3 | 1.8 | -0.8 |
| Unit labour costs, ER (EUR) adjusted | 6.9 | 4.2 | -9.5 | 4.1 | 6.2 | 8.1 | 3.6 | 2.4 | 2.2 |
| **Kosovo** | | | | | | | | | |
| GDP deflator | 1.8 | 3.3 | 0.2 | 0.4 | -0.2 | 0.8 | 2.0 | 1.5 | 1.1 |
| Real ER (CPI-based) | 0.3 | -0.1 | -0.5 | 0.0 | -0.2 | -1.0 | -0.2 | 0.2 | -0.1 |
| Real ER (PPI-based) | 2.6 | 3.6 | 5.0 | 1.4 | 0.2 | 1.1 | 1.2 | 0.7 | 2.5 |
| Average gross wages, real (PPI based) | 0.5 | 6.7 | 3.0 | 1.9 | -4.8 | 1.0 | 2.6 | 2.8 | 1.4 |
| Average gross wages, real (CPI based) | 1.2 | 8.1 | 6.3 | 1.5 | -3.0 | 3.0 | 4.0 | 3.3 | 2.7 |
| Average gross wages, EUR (ER) | 3.0 | 8.6 | 5.8 | 1.8 | -1.5 | 3.7 | 5.7 | 5.4 | 3.5 |
| Employed persons (LFS) | 11.7 | -4.4 | -8.2 | 11.7 | 7.6 | 0.8 | 2.8 | 2.7 | 3.4 |
| GDP per empl. person, NC at 2010 ref. pr. | -7.4 | 5.9 | 13.4 | -6.9 | -3.6 | 3.4 | 1.2 | 1.2 | 0.0 |
| Unit labour costs, ER (EUR) adjusted | 11.3 | 2.5 | -6.7 | 9.3 | 2.2 | 0.3 | 4.4 | 4.1 | 3.5 |
| **Turkey** | | | | | | | | | |
| GDP deflator | 6.3 | 7.4 | 7.8 | 8.1 | 10.8 | 16.2 | 17.7 | 11.5 | 8.1 |
| Real ER (CPI-based) | -3.3 | -5.5 | 3.5 | -2.8 | -11.4 | -20.0 | -5.8 | 0.3 | -4.0 |
| Real ER (PPI-based) | -3.3 | -2.3 | 3.4 | -4.2 | -9.0 | -16.5 | -1.0 | 2.1 | -3.1 |
| Average gross wages, real (PPI based) | 3.0 | 0.2 | 5.1 | 8.5 | -6.4 | -10.4 | -2.7 | 1.1 | 1.9 |
| Average gross wages, real (CPI based) | 1.4 | 1.3 | 2.8 | 5.1 | -2.5 | -6.5 | 2.3 | 2.9 | 1.6 |
| Average gross wages, EUR (ER) | -0.5 | -3.9 | 6.3 | 2.4 | -12.1 | -23.3 | -2.2 | 4.4 | -1.7 |
| Employed persons (LFS) 5) | 2.8 | 5.4 | 2.7 | 2.2 | 3.6 | 2.8 | 1.4 | 2.4 | 3.3 |
| GDP per empl. person, NC at 2010 ref. pr. | 5.5 | -0.2 | 3.3 | 0.9 | 3.7 | -0.3 | -0.5 | 1.6 | 2.6 |
| Unit labour costs, ER (EUR) adjusted | -5.7 | -3.6 | 2.9 | 1.5 | -15.2 | -23.7 | -1.4 | 3.4 | -4.3 |

4) From 2015 further adjustments according to ILO and Eurostat. - 5) From 2014 continuous quarterly survey (including further adjustments according to EU), based on population projections 2013.

(Table 37 ctd.)

## Table 37 / (ctd.)

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2013-17 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | | average |
| **Belarus** | | | | | | | | | |
| GDP deflator | 21.3 | 18.1 | 16.0 | 8.3 | 8.2 | 5.0 | 7.0 | 8.0 | 14.3 |
| Exchange rate (ER), EUR/NC | -8.9 | -10.5 | -25.8 | -19.0 | 0.8 | -9.0 | -7.7 | -3.7 | -13.2 |
| Real ER (CPI-based) | 6.2 | 5.2 | -15.8 | -9.7 | 5.1 | -6.1 | -3.0 | 2.2 | -2.3 |
| Real ER (PPI-based) | 3.7 | 2.5 | -11.1 | -7.9 | 7.3 | -3.3 | -1.1 | 4.1 | -1.4 |
| Average gross wages, real (PPI based) | 21.1 | 6.4 | -5.3 | -3.9 | 3.7 | 8.0 | 1.3 | 0.3 | 4.0 |
| Average gross wages, real (CPI based) | 16.4 | 1.3 | -2.2 | -3.7 | 7.4 | 11.1 | 3.2 | 2.2 | 3.6 |
| Average gross wages, EUR (ER) | 25.4 | 7.0 | -17.7 | -12.8 | 14.8 | 6.1 | 2.5 | 4.9 | 2.0 |
| Employed persons (LFS) [6] | -0.7 | -0.6 | -1.2 | -2.0 | 0.8 | 0.4 | -0.4 | -0.4 | -0.7 |
| GDP per empl. person, NC at 2010 ref. pr. | 1.7 | 2.3 | -2.6 | -0.5 | 1.6 | 3.2 | 2.6 | 5.1 | 0.5 |
| Unit labour costs, ER (EUR) adjusted | 23.3 | 4.6 | -15.5 | -12.4 | 13.0 | 2.8 | -0.7 | 1.1 | 1.5 |
| **Kazakhstan** | | | | | | | | | |
| GDP deflator | 9.5 | 5.8 | 1.9 | 13.6 | 8.6 | 5.9 | 5.0 | 4.9 | 7.8 |
| Exchange rate (ER), EUR/NC | -5.2 | -15.1 | -3.1 | -35.1 | 2.8 | -9.7 | -1.9 | -1.4 | -12.2 |
| Real ER (CPI-based) | -1.1 | -9.9 | 3.3 | -25.8 | 8.6 | -5.5 | 2.1 | 1.7 | -5.8 |
| Real ER (PPI-based) | -5.3 | -5.4 | -21.3 | -23.0 | 14.9 | 3.1 | 2.2 | -1.2 | -9.0 |
| Average gross wages, real (PPI based) | 8.1 | 1.3 | 31.0 | -2.9 | -8.5 | -6.4 | 2.0 | 6.0 | 5.0 |
| Average gross wages, real (CPI based) | 1.9 | 3.9 | -2.3 | -1.1 | -1.8 | 2.0 | 2.0 | 3.0 | 0.1 |
| Average gross wages, EUR (ER) | 2.2 | -5.9 | 0.9 | -26.4 | 8.5 | -2.3 | 7.5 | 4.7 | -5.0 |
| Employed persons (LFS) | 0.7 | -0.7 | 1.3 | -0.8 | 0.4 | 0.5 | 0.5 | 0.5 | 0.2 |
| GDP per empl. person, NC at 2010 ref. pr. | 5.2 | 4.9 | -0.2 | 2.0 | 3.7 | 3.5 | 2.6 | 2.5 | 3.1 |
| Unit labour costs, ER (EUR) adjusted | -2.8 | -10.3 | 1.1 | -27.8 | 4.6 | -5.2 | 3.3 | 4.0 | -7.8 |
| **Russia** [7] | | | | | | | | | |
| GDP deflator | 5.4 | 7.5 | 8.0 | 3.5 | 5.2 | 8.0 | 4.9 | 4.0 | 5.9 |
| Exchange rate (ER), EUR/NC | -5.5 | -16.7 | -25.1 | -8.8 | 12.7 | -12.2 | -1.3 | -1.3 | -9.5 |
| Real ER (CPI-based) | -0.6 | -10.7 | -13.5 | -2.6 | 14.9 | -10.6 | 2.3 | 0.8 | -3.0 |
| Real ER (PPI-based) | -2.3 | -9.8 | -13.1 | -3.5 | 17.7 | -4.9 | 6.7 | 1.8 | -2.7 |
| Average gross wages, real (PPI based) [8] | 8.3 | 2.5 | -7.7 | 3.5 | -0.4 | -1.3 | -1.2 | 3.1 | 1.1 |
| Average gross wages, real (CPI based) [8] | 4.8 | 1.2 | -9.3 | 0.7 | 3.6 | 4.9 | 3.0 | 4.1 | 0.1 |
| Average gross wages, EUR (ER) | 5.7 | -9.2 | -21.5 | -1.6 | 21.0 | -4.1 | 7.0 | 6.6 | -2.2 |
| Employed persons (LFS) | -0.2 | 0.2 | -0.4 | 0.1 | -0.3 | 0.2 | 0.0 | 0.0 | -0.1 |
| GDP per empl. person, NC at 2010 ref. pr. | 2.0 | 0.5 | -2.1 | -0.3 | 1.9 | 1.5 | 1.6 | 1.8 | 0.4 |
| Unit labour costs, ER (EUR) adjusted | 3.6 | -9.7 | -19.8 | -1.3 | 18.7 | -6.0 | 5.6 | 4.9 | -2.5 |
| **Ukraine** [9] | | | | | | | | | |
| GDP deflator | 4.3 | 15.9 | 38.9 | 17.1 | 22.0 | 13.6 | 8.5 | 5.6 | 19.1 |
| Exchange rate (ER), EUR/NC | -3.2 | -32.5 | -35.1 | -14.4 | -5.7 | -6.2 | -8.6 | -5.4 | -19.3 |
| Real ER (CPI-based) | -4.9 | -24.7 | -3.5 | -2.7 | 6.1 | 2.2 | -2.2 | -2.2 | -6.6 |
| Real ER (PPI-based) | -3.2 | -19.5 | -9.8 | 4.8 | 15.5 | 7.1 | -3.0 | -1.5 | -3.2 |
| Average gross wages, real (PPI based) | 8.0 | -9.5 | -11.4 | 2.5 | 8.4 | 6.8 | 6.3 | 4.6 | -0.7 |
| Average gross wages, real (CPI based) | 8.2 | -5.4 | -18.9 | 8.5 | 19.8 | 11.8 | 5.4 | 5.4 | 1.5 |
| Average gross wages, EUR (ER) | 4.4 | -28.4 | -21.8 | 5.8 | 29.2 | 18.3 | 3.6 | 3.4 | -4.4 |
| Employed persons (LFS) | 0.2 | -6.4 | -0.4 | -1.0 | -0.7 | 1.0 | 0.4 | 0.1 | -1.7 |
| GDP per empl. person, NC at 2010 ref. pr. | -0.2 | -0.2 | -9.4 | 3.5 | 3.3 | 2.2 | 2.4 | 1.8 | -0.7 |
| Unit labour costs, ER (EUR) adjusted | 4.6 | -28.3 | -13.7 | 2.2 | 25.2 | 13.6 | 2.5 | 3.0 | -3.7 |
| **Austria** | | | | | | | | | |
| GDP deflator | 1.6 | 2.2 | 2.2 | 1.4 | 1.3 | 1.7 | 2.1 | 1.9 | 1.7 |
| Real ER (CPI-based) | 0.5 | 1.2 | 0.9 | 0.6 | 0.4 | 0.4 | 0.3 | 0.2 | 0.7 |
| Real ER (PPI-based) | -0.8 | 0.7 | 0.7 | -0.3 | -1.3 | 0.1 | 0.3 | 0.1 | -0.2 |
| Average gross wages, real (PPI based) | 3.0 | 2.9 | 3.6 | 4.3 | -0.4 | 0.9 | 0.1 | 0.6 | 2.7 |
| Average gross wages, real (CPI based) | 0.1 | 0.1 | 1.1 | 1.5 | -0.6 | 0.5 | 0.1 | 0.4 | 0.4 |
| Average gross wages, EUR (ER) | 2.1 | 1.8 | 2.1 | 2.4 | 1.5 | 2.6 | 2.2 | 2.4 | 2.0 |
| Employed persons (LFS) | 0.5 | 0.2 | 0.9 | 1.7 | 0.9 | 1.9 | 1.4 | 1.4 | 0.8 |
| GDP per empl. person, NC at 2010 ref. pr. | -0.5 | 0.5 | 0.3 | 0.3 | 1.6 | 1.0 | 0.6 | 0.6 | 0.4 |
| Unit labour costs, ER (EUR) adjusted | 2.6 | 1.3 | 1.8 | 2.1 | -0.1 | 1.6 | 1.5 | 1.8 | 1.5 |

6) Until 2017 growth of registered employment. - 7) From 2014 including Crimean Federal District (for LFS employment and wages from 2016). - 8) From 2017 improved coverage of small enterprises. - 9) From 2014 excluding the occupied territories of Crimea and Sevastopol and from 2015 temporarily occupied territories in the Donetsk and Luhansk regions..

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

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

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