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# Forecast Report

# Uncertainty in Turbulent Times

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

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

# Uncertainty in Turbulent Times

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# Executive summary

**Last year, 2019, was a decent one for most of CESEE, but the slowdown from the peak year of 2017 continued for the region as a whole.** Even before coronavirus, an external slowdown was evident, driven by the US-China trade war, weaker global growth in general, and extremely sluggish performance in Germany.

**The spread of the coronavirus to Europe has already had negative economic effects, and these could intensify in the coming months.** The fallout is already impacting production networks and substantially restricting activity in sectors such as tourism, aviation and energy. The extent of the fallout is, however, highly uncertain. To reflect this uncertainty, in addition to our baseline (or pre-coronavirus) projections for the global economy and CESEE, we have produced GDP forecasts for three coronavirus scenarios: mild, medium and severe.

**Under our pre-coronavirus baseline scenario, we had projected that aggregate real GDP growth for CESEE would rise to 2.9% this year, from 2.1% in 2019, largely on account of improvements in Russia and Turkey.** In our ‘mild’ scenario, regional growth rates would be 0.2-0.6 percentage points below this baseline. For the ‘severe’ scenario, we project that growth would be around 1.1-2.5 percentage points lower. In all cases, the CIS countries and Turkey would be worst affected, with the EU member states and some Western Balkan countries faring relatively better.

**The extent of the impact will vary by country, depending on specific areas of vulnerability.** Countries with higher levels of trade integration with China (particularly CIS countries) or Italy (especially Albania, Bulgaria, Croatia, Romania and Slovenia) will be worse affected, as will those reliant on energy exports (Russia and Kazakhstan) or tourism (Croatia, Slovenia, Albania and Montenegro). The capacity of healthcare systems to cope is also likely to vary considerably across the region.

**We expect the coronavirus to have a notable negative impact on economic activity in the first half of 2020, but that this will then fade in the second half of the year.** Overall, we expect much of the GDP lost now to be made up later.We cannot exclude a more ‘severe’ and longer-lasting demand shock, and a recession in parts of CESEE.

**We are likely to see further loosening of fiscal and monetary policies in EU-CEE, in order to counteract the economic slowdown caused by the coronavirus.** The Western Balkans, Turkey, and CIS and Ukraine will be limited by considerations of macro-financial stability and will have less fiscal room for manoeuvre.

**Beyond 2020, our outlook remains broadly unchanged.** Underlying growth in the global economy was already close to its weakest level since the global financial crisis, and this will not change fundamentally during the forecast period. This is despite massive monetary stimulus in the US, Europe and Japan (which we expect to continue).

**In 2021-2022, we anticipate economic growth of below 3% in EU-CEE, whereas the Western Balkans are expected to avoid a growth deceleration during that period.** Outside EU-CEE and the Western Balkans, pre-coronavirus we had made significant upward revisions to our GDP forecasts for the bigger economies (Turkey, Russia and Ukraine), based on more expansionary fiscal and/or monetary policies. However, without structural reforms there are substantial negative risks to the sustainability of growth.

**The coronavirus has temporarily diverted the attention of economists and policy makers from fundamental issues facing CESEE.** One of the biggest issues is the shortage of labour, which is likely to become more acute and will subsequently threaten the sustainability of the region's economic model, based as it is on labour-cost advantages and participation in regional production chains.

**Digitalisation could help CESEE to increase the productivity of its economies by developing more productive service sectors and increasing the servitisation of their production processes.** The region is believed to be well equipped for further digitalisation. However, it is important to develop adequate government policies to ensure reskilling of the labour force and to support investment in new technologies.

## COUNTRY SUMMARIES[1]

### ALBANIA

Growth is expected to remain moderate in the coming two years. Private consumption on the demand side and services on the production side will continue to support growth, but at a slower pace. A devastating earthquake hit Albania on 26 November 2019. The conference of donors initiated by France raised EUR 1.15 billion, which will likely spur growth in the short term. Since the EU enlargement process is being reformed, the accession process for Albania is likely to get stricter and more rigorous.

### BELARUS

The Belarusian economy remained sluggish in 2019, with GDP growing by a meagre 1.2%. Recent performance was adversely affected by a deepening dispute with Russia over the price of imported hydrocarbons, while the domestic economic policy stance has remained relatively tight. The prospects for a favourable oil price deal with Russia are slim and no change in macroeconomic policy is likely in the near future. We therefore expect GDP growth to be around 1% in 2020, and slightly higher in the following two years.

### BOSNIA AND HERZEGOVINA

After previous setbacks following the global financial crisis, the Bosnian economy is expanding steadily, with an expected growth rate of around 2.7% in 2020 and 3% p.a. in the period 2021-2022. The official unemployment rate is expected to decline further, from 30% in 2020 to around 28.5% in 2022; however, this will partly be a result of the great 'brain drain' and the withdrawal of workers from the labour market. Even though growth continues to be stable, the newly formed central government may yet be challenged by the emergence of a potential migration crisis in spring/summer 2020.

### BULGARIA

After an upturn in the first half of 2019, economic activity subsided in the second semester. The slowdown was triggered by a weakening of external demand, while private consumption remained relatively strong. The labour market tightened further and continued to exert pressure on wages. The short-term prospects have deteriorated, and GDP growth is expected to decelerate to below 3% in 2020 – and may slow further in the coming years.

### CROATIA

Croatia's economy performed well in 2019. GDP growth will slow somewhat over the forecast period, but will remain at a relatively high level (2.7% p.a.) thanks to the country's strong tourism sector. Private consumption and investments supported by EU transfers will remain the main drivers of growth. In its quest to adopt the euro as soon as possible, the Croatian government will seek to keep the budget in balance or in surplus, and to further reduce public debt.

### CZECH REPUBLIC

GDP growth has gradually been losing momentum, as productive investment starts to decline. Labour resources are nearing depletion, but labour shortages are failing to spark intensified capital formation. Interest rates on loans are no longer as low as they used to be, and the exchange rate is becoming less

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[1] These country summaries were written before the full extent of the coronavirus became clear, and therefore reflect our pre-coronavirus assumptions. Country-specific updates following the spread of coronavirus to Europe are included in chapter 3 of this report.

stable. The recessionary tendencies in Germany are spilling over into Czech manufacturing. Consumption remains the backbone of a subdued growth in output.

### ESTONIA

Investment activity is expected to slow in 2020, following last year's strong increase. Furthermore, growth in external demand will continue to decline both this year and in 2021. Household consumption, backed by an ongoing rise in employment and real wages, continues to be a strong driver of economic activity. We project a decline in GDP growth to 2.7% in 2020, followed by a further slowdown to 2.5% in 2021 and a slight upswing to 2.7% in 2022.

### HUNGARY

With GDP growing last year by 4.9%, the Hungarian economy turned in one of the best performances in the EU. This expansion was driven by domestic demand, primarily investments. But sustainability is the critical issue highlighted here: the economy faces reduced EU transfers, uncertainties and fragile growth in the export markets, labour shortages, rapidly rising wages and a weakening of the national currency.

### KAZAKHSTAN

Economic growth will decelerate to below 4% over the forecast period, having peaked at 4.5% in 2019 on the back of extensive fiscal stimuli. Domestic demand will remain robust, but low exports, along with strong import demand for capital goods, will negatively impact economic performance. A decline in commodity prices and the slowdown in China are downside risks to export dynamics.

### KOSOVO

Great things are expected of the new government, but it faces some big challenges in consolidating the rule of law and energising the economy. Its ambitious programme is expected to stimulate private and public investment. Kosovo-Serbia dialogue is likely to be resumed, thanks to the active and leading role of the USA. In the medium term, growth will remain robust at above 4%, backed by consumption and investment, and Kosovo is likely to remain among the fastest-growing economies in CESEE.

### LATVIA

The Latvian economy experienced a soft landing in 2019. Growth in gross fixed capital investment and foreign trade has declined substantially and will remain subdued in 2020-2021. A tight labour market will keep wages rising fairly swiftly, which will lead to lively household consumption over the next two years. Export activity is likely to revive slightly this year. Despite the economic slowdown, the labour market is tightening further, with the unemployment rate set to fall to 6.3% this year and in 2021. In 2020, we expect GDP growth to decline further to 2.0%, to be followed by a slight upswing (to 2.4%) in 2021 and on to 2.6% in 2022.

### LITHUANIA

A better-than-expected export performance and still swiftly rising gross fixed capital investment propelled growth in the Lithuanian economy in 2019 to 3.9% in real terms year on year. A further minimum wage hike and a reduction in the effective income tax rate for low earners will maintain the country's remarkable increase in the purchasing power of households. Thus, private consumption will continue to encourage the rapid growth of economic activity. External demand was strong in 2019, but is likely to abate in the next two years. For 2020, we expect real GDP to grow by 2.8%, followed by a small decline to 2.6% in 2021 and then 2.7% in 2022.

### MOLDOVA

Economic growth accelerated to about 4.8% in 2019 on the back of booming investments and household consumption. In the wake of sluggish external demand and declining investment, growth is expected to hover at around 4% in the coming years. The resumption of transfers from the IMF and the EU has stabilised external financing.

### MONTENEGRO

Montenegro's economy continues to benefit from strong tourism, a rise in investments and an increase in industrial production. Economic growth will continue in 2020 at 3.3%, the same as in 2019. A fall in private and public consumption, however, will restrain growth in 2021-2022. Public debt remains the greatest medium-term risk to the economy, especially the huge investment in the Bar–Boljare motorway project. The country is still struggling with domestic problems: deindustrialisation, demographics, an inflated government apparatus and a still rigid labour market.

### NORTH MACEDONIA

After a long period of stagnation and negative development, rising investments and a boost in consumption will ensure stable GDP growth for North Macedonia in the period 2020-2022 of about 3.3% p.a. The construction industry has started to expand and recorded solid growth rates in 2019. In addition, unemployment will fall to a historical low in 2020. Despite stable projections, North Macedonia still suffers from various socioeconomic issues. Moreover, the delay to the start of EU accession talks has dampened the country's growth potential.

### POLAND

Economic growth has been losing momentum as industry starts to underperform. Household consumption is driven by sharply rising wages and social transfers. Labour shortages are becoming less acute, while moderate inflation is back, driven by a supply-side shock to agriculture. The next government may feel obliged to discontinue the country's lavish social policies.

### ROMANIA

The Romanian economy is emerging from a period of overheating and has to tackle high fiscal and current account deficits. Economic growth will cool from 4.1% in 2019 to 3.2% in 2020, and then 2.8% in 2021. Abundant financial inflows will allow a slow reduction of the twin deficits, but with increased vulnerability to financial turbulence. Political instability is expected to continue until general elections, expected to take place in mid-2020, ahead of schedule.

### RUSSIA

Last year, growth slowed to a mere 1.3% on the back of weakening private consumption and export decline. However, following a recent shift to a more expansionary fiscal and monetary policy, GDP growth is expected to pick up to above 2% in 2020-2022. The constitutional changes recently proposed by President Putin suggest that he will not seek another re-election in 2024, although he will likely retain his political influence in a different capacity.

### SERBIA

The Serbian economy is performing strongly, and after a robust 2019 outturn we have made an upward revision to our 2020 forecast. Growth is being driven above all by strong private consumption and investment, the latter supported by the construction of the TurkStream gas pipeline and FDI inflows. The outlook for regional stability is more positive after intensive US mediation, but the upcoming parliamentary election could mean somewhat higher domestic political risk.

## SLOVAKIA

Slovakia's growth halved in 2019, reaching only 2.4%. In 2020, it is forecast to increase by 2%, and by around 2.5% in the years thereafter. Overall, growth is backed by stable household consumption, while the effect of net exports is unclear. Domestic and external risks are rising.

## SLOVENIA

GDP growth will remain unchanged at 2.6% in 2020, due to sluggish external demand, but will increase slightly thereafter. Domestic consumption will remain the main driver of growth, but could be dampened by the recently adopted consumer loans restrictions. Downside risks arise from changes in global conditions and adverse demographics.

## TURKEY

Turkey has again confirmed its status as the most high-beta economy in CESEE, with a host of indicators suggesting that a 'V-shaped' recovery is in progress. The currency crisis and sharp economic downturn of 2018–2019 now seem a long time ago, following a sharp bounce-back in the second half of last year. Growth could be around 4% this year, but that will mean a return to reliance on credit growth and external imbalances, and the old familiar vulnerabilities of the Turkish economy.

## UKRAINE

Rapid macroeconomic stabilisation in 2019 allowed for a marked loosening of monetary policy. Exports showed robust growth on the back of agricultural products and services – notwithstanding hryvnia appreciation. We have revised our forecast of GDP growth upwards in the light of the positive trends. In 2020, GDP will grow by 3.6%, and in 2021-2022 growth will accelerate to 4.2% and 4.5%, respectively. A major risk to the forecast remains the inability of the government to break the oligarchs' grip on the country.

Keywords: CESEE, economic forecast, Europe, Central and Eastern Europe, Southeast Europe, Western Balkans, new EU Member States, CIS, Russia, Ukraine, Romania, Czech Republic, Hungary, Turkey, Serbia, convergence, business cycle, coronavirus, external risks, trade war, EU funds, private consumption, credit, investment, digitalisation, servitisation, exports, FDI, labour markets, unemployment, employment, wage growth, migration, inflation, central banks

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

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The statistical data until 2019 presented in this Report are as of 19 February 2020, forecasts as of March 2020. Most data are taken from the wiiw Databases. Direct access is available at: http://data.wiiw.ac.at/.

## wiiw COUNTRY GROUPS

**CESEE23 Central, East and Southeast Europe**

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

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

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

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

**SEE9 Southeast Europe**

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

**non-EU12 non-European Union CESEE countries**

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

**WB6 Western Balkans**

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

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

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

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

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

## ABBREVIATIONS

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

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

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

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

# 1. Global economic outlook

**by Julia Grübler and Richard Grieveson**

- ***The spread of the coronavirus has the potential to materially impact global economic growth.***
- ***The fallout from the virus will impact production networks, and substantially restrict activity in sectors such as tourism, aviation and energy.***
- ***The extent of the fallout is, however, highly uncertain, and depends on how quickly the virus is contained. To reflect this uncertainty, in addition to our baseline (or pre-coronavirus) projection, we have produced GDP forecasts for three coronavirus scenarios: mild, medium and severe.***
- ***The mild scenario assumes that the impact is serious but short lived, and most of the GDP currently being lost is regained next year. The severe scenario leads to a much bigger negative impact on economic activity in the global economy and CESEE.***
- ***Beyond coronavirus, our broad views on the global economy are unchanged from autumn 2019. Underlying growth is close to its weakest level since the global financial crisis, and this will not change fundamentally during the forecast period. This is despite massive monetary stimulus in the US, Europe and Japan (which we expect to continue).***
- ***Assuming that the coronavirus does not cause a global recession, we continue to see a relatively high degree of resilience to other aspects of global economic weakness in CESEE, helped by loose monetary and fiscal policy. Nevertheless, for most countries, growth will remain substantially weaker than in the peak years of 2017-2018.***
- ***Over the long run, we see a Japan-like scenario for the euro area, with persistently weak growth and inflation. That will also cap the growth potential for CESEE, although we expect some further convergence with Western Europe.***

## 1.1. CORONAVIRUS AND CHANNELS OF ECONOMIC CONTAGION

The coronavirus has continued to spread. Cases remain concentrated in China, but the virus has spread in particular to South Korea, Iran and Italy. Most European countries have now reported at least a handful of cases, and infection rates are rising. Reports from Northern Italy show a highly advanced medical system in one of the richest regions of the world being effectively overwhelmed. In that context, nothing should be ruled out for the rest of Europe and North America in the coming months.

Death rates are potentially around 10 times as high as those for common flu.[2] Politicians in Europe and the US have been at best slow to react, and at worst downright complacent about the threats posed. In countries where rates of infection appear to be slowing – for example, China and South Korea – this has

[2] The Atlantic (10 March 2020), 'Cancel Everything', https://www.theatlantic.com/ideas/archive/2020/03/coronavirus-cancel-everything/607675/

only been achieved by massively restricting social contact. Among countries in Europe and North America, only in Italy has anything comparable been enacted. As this seemingly inevitable process occurs in the world's other big economies, the extent of the economic fallout will rise markedly.

It is not easy – in fact, it is not possible – to put a number on the global economic effects that the outbreak and spread of the new coronavirus (SARS-CoV-2 – severe acute respiratory syndrome coronavirus 2) which causes the disease COVID-19[3] is going to have – for at least three reasons. First, it is still hard to know how the virus is going to spread, how easily people can be cured (but also potentially re-infected), and whether and how quickly a vaccine/medication can be developed and distributed. Second, because the economic effects depend heavily on governments' and people's (over)reactions: anxiety tends to lead to irrational behaviour, amplifying negative effects. And third, because there are so many direct and indirect effects interacting in multiple sectors that are hard to grasp numerically.

In this section, we discuss some channels through which the local disease outbreak in China is having (and will have) global economic implications.

**Production:** Naturally, we need to start in China. The new coronavirus has led to a temporary standstill in the factory of the world, affecting both Chinese and foreign firms operating in China, particularly in the sprawling city of Wuhan, in the province of Hubei. As of 10 March 2020, the World Health Organization had reported 67,760 confirmed cases of COVID-19 and 3,024 related deaths in Hubei. These figures correspond to 84% of all cases and 96% of all deaths in China, as well as 60% of all cases and 75% of all deaths globally.

The European companies or joint ventures affected by temporary factory shutdowns and related issues with supplies and logistics include big car manufacturers, such as Volkswagen. Palfinger, an Austrian lifting-equipment specialist, has been unable to operate, because workers were not allowed to return to the production site in Rudong after the Lunar New Year holidays, due to a travel ban aimed at containing the spread of the disease within China.[4]

**Growth:** According to the National Bureau of Statistics of China, the country's production index fell by more than 45% from January to February 2020. And products that are not produced cannot be shipped: indices on export orders show a very similar picture. A reduction in exports implies lower earnings for China, further curbing its economic growth.

Prior to the outbreak of the virus, the OECD forecast a global GDP growth rate of 3% for the year 2020. Assuming that the epidemic in China will peak in the first quarter of 2020, and the spread in other economies is contained, both Chinese and global GDP are expected to grow more slowly in 2020 – at 4.9% and 2.4%, respectively. However, a longer-lasting pandemic could cut global growth to 1.5% (anything below 2.5% is considered to be a global recession).

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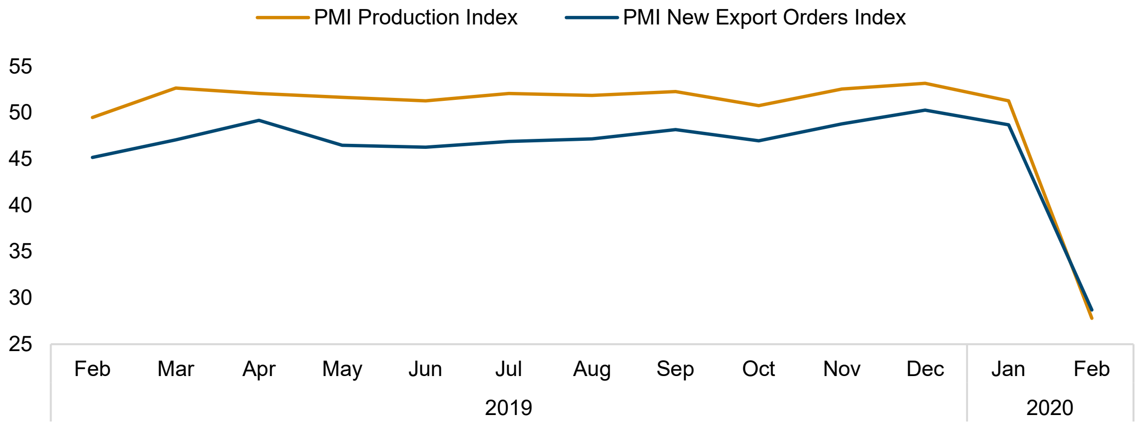
3 WHO, 'Naming the coronavirus disease (COVID-19) and the virus that causes it', https://www.who.int/emergencies/diseases/novel-coronavirus-2019/technical-guidance/naming-the-coronavirus-disease-(covid-2019)-and-the-virus-that-causes-it

4 See e.g. DW (17 February 2020), 'Coronavirus keeps VW's China factories shut', https://www.dw.com/en/coronavirus-china-vw-german-auto/a-52403626; Industriemagazin (19 February 2020), 'Coronavirus: Auch Palfinger hat Schwierigkeiten in China', https://industriemagazin.at/a/coronavirus-auch-palfinger-hat-schwierigkeiten-in-china

**Figure 1.1 / Purchasing Managers Index (PMI) for China dropping sharply in February**




Data source: National Bureau of Statistics; wiiw visualisation.

**Production networks:** The other side of the coin is that trading partners are waiting (in vain) for their imports from China. The retail sector will lose out on sales of Chinese products that are currently (or will be) missing from the shelves. Likewise, foreign producers may run short of parts produced in China. For example, Fiat Chrysler has had to suspend its car production in Serbia, as audio system parts have not been delivered. Likewise, Nissan has had to temporarily shut a factory in Japan.[5]

The United Nations Conference on Trade and Development (UNCTAD) published a note in March on which parts of the global economy would be most affected by a 2% reduction in Chinese exports of intermediate inputs. Among the 20 most affected economies, the greatest absolute damage is estimated for the European Union[6], at around USD 15.6 billion. These losses do not take account of commodities and minerals supply, nor of the effect of a slowdown in Chinese demand, nor of the damage resulting from missing deliveries (such as additional strain on healthcare systems, due to shortages of pharmaceuticals). They should thus be interpreted as lower-bound short-term economic effects.

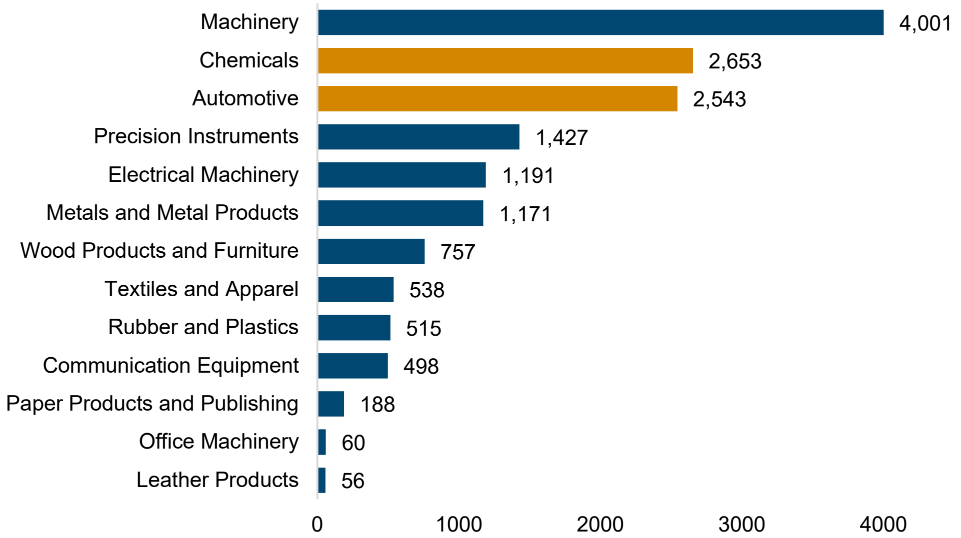
**Energy:** The massive reduction in (or even the halting of) production at many companies in China has affected energy supply industries in China and abroad. As the demand for imported raw materials and energy has dropped, so have prices. In February, the International Energy Agency expected global demand for oil to drop by 435,000 barrels per day in the first quarter of 2020, compared to the previous year, resulting in the first quarterly contraction in more than a decade. With China's daily crude oil consumption having dropped by 20%, members of the Organization of the Petroleum Exporting Countries (OPEC) were expected to undertake a massive cut in production of between 500,000 and a million barrels a day to support oil prices.[7]

5 See e.g. Reuters (14 February 2020), 'Fiat Chrysler halts production in Serbia over China disruption', https://www.reuters.com/article/us-fiat-chrysler-china/fiat-chrysler-halts-production-in-serbia-over-china-disruption-idUSKBN2081UN; BBC (11 February 2020), 'Nissan to shut Japan factory due to shortage of Chinese parts', https://www.bbc.com/news/business-51441344

6 The UNCTAD report did not include a breakdown of the effect for the European Union by Member State. Other European economies in the top-20 included Belarus, Norway, Russia, Switzerland, Turkey, Ukraine and the UK.

7 See e.g. Bloomberg (2 February 2020), 'China oil demand has plunged 20% because of the virus lockdown', https://www.bloomberg.com/news/articles/2020-02-02/china-oil-demand-is-said-to-have-plunged-20-on-virus-lockdown

**Figure 1.2 / Negative effects for the EU through missing Chinese intermediate inputs, in million USD**




Data source: UNCTAD; wiiw visualisation.

The diametrically opposite decision by OPEC on Monday, 9 March, to increase supplies, thereby accelerating the fall in prices, came as a shock to experts. The move was allegedly triggered by OPEC's ally Russia refusing to support the organisation's plan to cut total oil production by 1.5 million barrels a day in addition to existing cuts, amounting in total to 3.6 million barrels a day. Oil prices subsequently dropped by 30%, hitting all oil-exporting economies. Not least, US shale oil producers will struggle with a price of around USD 30 per barrel, given that they need a price higher than USD 40 per barrel to cover direct costs.[8]

**Aviation:** Demand for fuel has also fallen due to reductions in international flights. This comes partly in the wake of government travel bans, and is partly due to precautionary measures taken by individual travellers or airlines. Airlines and airports (including the restaurants and shops in airports) are badly affected. For some crisis-torn airlines, working hours (and correspondingly salaries) have been temporarily cut (e.g. for 7,000 Austrian Airlines personnel).

**Tourism:** This sector is likely to be the hardest hit worldwide. There will be fewer domestic and foreign tourists. Although the number of Chinese visitors was growing rapidly in recent years, they still constituted only 0.2%-1.1% of total overnight stays for EU member states. The major blow comes from the reduction in intra-EU travel. Hotels and other accommodation, restaurants, public transport and – not least – the entertainment industry will all suffer big short-term losses.

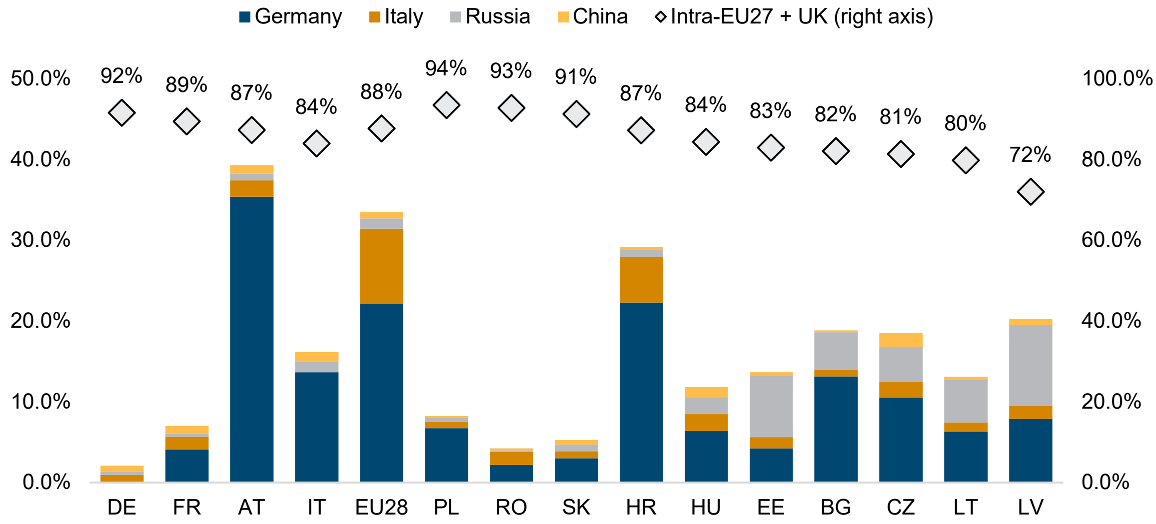
**Technology:** Demand for digital solutions for production, work platforms and communication (web conferencing tools, live streaming media, podcasts, online courses, cloud services, etc.) was already high, but it has exploded in every country where the government is recommending or restricting physical

[8] See e.g. Al Jazeera (9 March 2020), 'The oil price war is a nightmare for US shale producers', https://www.aljazeera.com/ajimpact/oil-price-war-nightmare-shale-producers-200309173245129.html

mobility. Other technological tools and upgrades that are to be expected in public places would include the more frequent use of thermal scanners to detect fever in airports, at train stations and in other places where many people gather; and motion sensors in public conveniences on toilets, taps and soap dispensers, as well as on automatic doors in general, in order to avoid transmission of the virus through people having to touch contaminated surfaces.

**Figure 1.3 / The tourism sector is particularly vulnerable to a reduction in intra-EU travel**

70% of all nights spent in 2018 concerned intra-EU tourism




Data source: Eurostat [tour_occ_ninraw]. Note: Switzerland including Liechtenstein, China including Hong Kong. Intra-country tourism (e.g. German tourists travelling within Germany) not displayed.

## 1.2. SCENARIOS FOR THE GLOBAL ECONOMY

Three broad scenarios for economic growth are possible. We define these as ‘mild’, ‘medium’ and ‘severe’.[9] Using OECD baseline projections for the key global economies, we have produced baseline estimates for the impact on growth for CESEE countries, using the World Input Output Database (WIOD).[10] A full discussion of the results and implications for CESEE is included in the CESEE Overview chapter.

In the **mild scenario**, the virus is contained quite quickly and does not spread significantly in Europe or North America. However, commodity markets remain weak, consumers save more, tourism and business travel decline, and the entertainment and hospitality and catering industries suffer. This involves a deeper contraction now, and then a recovery starting from the second half of the year. Much of the GDP that is lost in 2020 is recovered in 2021.

9 Here we follow loosely the projections of the OECD, released on 2 March, see: http://www.oecd.org/economic-outlook/

10 http://www.wiod.org/home

In the **medium scenario**, the virus spreads more in advanced economies, and therefore stricter and longer-lasting containment measures are required to bring it under control. This means the widespread closure of schools and businesses, and a bigger knock-on effect on economic activity.

In the **severe scenario**, the virus would spread significantly in Europe and North America, requiring much tougher action to contain it. This would have far more material economic implications, and would create a deeper and longer-lasting demand shock. In this scenario, we foresee a global recession, including negative growth for at least 1-2 quarters in some of the big European economies on which CESEE depends for export demand, tourism arrivals and capital inflows.

## 1.3. POLICY RESPONSE

One important area of uncertainty is the timing and scale of a policy response. Although the coronavirus is a medical emergency, policy makers have an important role to play in determining how big the economic fallout will be. Here, we outline our assumptions about what kind of policy response can be expected.

*Central banks*

The US Federal Reserve has already cut interest rates, and other central banks around the world have also responded. Political pressure is being exerted on central banks to act – not least in the US, where President Donald Trump has not been shy in demanding greater monetary easing in the past. The fact that the crisis is happening in a US election year will probably make the president even more active in this regard. The Fed’s actions should have some impact: unlike the ECB, it starts out with positive nominal rates, and so it does have some room to ease policy. Its role is also the most important, given the dollar’s central position in global trade and finance. Any dollar squeeze as a result of economic agents hoarding the currency will likely produce more aggressive action from the Fed.

The ECB has less room to act. At its meeting on 12 March, it confirmed that interest rates would remain unchanged – the interest rate on the main refinancing operations currently stands at 0.00%, the interest rate on the marginal lending facility at 0.25% and the interest rate on the deposit facility at -0.50%. However, it announced additional net asset purchases of EUR 120 billion until the end of the year.

However, even the Fed and the ECB are restricted in what they can do to limit the economic fallout from the coronavirus. Simply throwing a huge amount of liquidity at the global economy is unlikely to help very much. Central banks will need to focus on where the real areas of stress are in the financial system, and make sure they provide enough liquidity to keep markets functioning. That will be easier said than done.

At least so far, from a central bank perspective we are still far from a 2008 scenario. Then, the tight relationship between the real economy and finance (via the huge and opaque market for financial products backed by US mortgages) created a systemic risk for the global economy. This crisis does not involve such systemic risks. However, as we have repeatedly warned in previous reports, a decade of extraordinarily loose monetary policy has likely created new risks that will only become fully apparent when a new crisis hits. The fallout from the coronavirus may well expose some of the new vulnerabilities of the global economy and financial system.

*Governments*

Fiscal stimulus would be arguably a more appropriate policy response to the coronavirus than monetary loosening, and there have already been moves in this direction in many parts of the world. This could be targeted more specifically at the areas that need help, such as the tourism sector or aviation, or small businesses struggling with cashflow.

We believe that a response along these lines will be enacted almost everywhere. However, it is likely to be bigger in China and the US than in Europe. Germany and other Northern European states will be reluctant to bend EU fiscal rules significantly to contain the outbreak, although the pressure on their economies and health systems in the coming months will certainly prompt some loosening of fiscal policy.

*Longer-lasting effects*

Although the coronavirus itself should constitute a transitory crisis, there may be some important medium-term policy and business implications. First, scientists, medical professionals and economists voice the need for investments in the healthcare system. These include an increase in its physical capacity, the technological upgrading of existing infrastructure, the fostering of research (e.g. for the development of vaccines or medical tests) and ensuring a sufficient number of trained personnel.

Second, short-term responses designed to replace a physical presence with a digital one may well trigger investment in digital infrastructure that will have a lasting effect on the digital transformation of work processes.

Third, some people argue that crises spreading globally through our interconnected world will result in a deglobalisation trend. However, companies affected by supply shortages or by factory shutdowns in China might well decide to internationalise further – diversifying locations for production, in order to have recourse to alternatives, if one location is affected.

Fourth, educational campaigns on proper hand hygiene could shape people's behaviour and the general spread of germs. COVID-19 is by no means the only disease that spreads mainly from person to person through respiratory droplets. Improved behaviour with respect to coughing, sneezing and hand washing could thus contribute to better overall public health.

## 1.4. BROADER TRENDS: STABILISATION AT A LOW LEVEL

Beyond the coronavirus, we maintain most of our assumptions regarding the global and euro area economies. By post-crisis standards, 2019 was a weak year, and we expect this to remain broadly the case during the rest of the forecast period.[11] However, pre-coronavirus, we had not expected a more serious downturn. Data at the beginning of the year had indicated a stabilisation in the manufacturing sector[12], in line with our expectations. This is now obviously in doubt.

[11] See Richard Grieveson (2019), 'Global economic outlook', in *Braced for Fallout from Global Slowdown*, wiiw Autumn Forecast Report.

[12] Financial Times (26 January 2020), Signs of a global recovery in manufacturing are starting to show, https://www.ft.com/content/c44dc02c-3d2d-11ea-a01a-bae547046735

A big part of our relatively sanguine outlook on the global economy has been the stance of central banks. The US Federal Reserve, ECB and Bank of Japan have launched unprecedented monetary stimuli over the past decade. We remain concerned about what this means in the long run (owing to the inflation of asset markets); but for now, this stance (and willingness to act further when financial markets get jittery) is an important form of insurance for the global economy.

Even after coronavirus, we continue to see quite big challenges for the global economy, and much of CESEE within that. Although we do not expect the euro area to collapse, we do believe that its future may become Japan-like, with persistently low growth and inflation. The threats to the post-Second World War global trade architecture are clear and go beyond the stance of the current US government[13], with increased protectionism apparently here to stay. This will matter for Germany, in particular, given its relatively high reliance on exports.

For CESEE, the implications are quite significant. Economies in the region will need to transition away from an often high degree of dependence on exports (see CESEE Overview). A large part of the region is heavily integrated into the German automotive cluster, which is facing both cyclical challenges and a structural change towards electric cars. It is not clear that Germany and its CESEE partners are fully prepared for this. Although a large degree of fiscal and monetary stimulus – as well as the strength of domestic demand on the back of high wage growth – will allow CESEE to remain fairly resilient to these challenges, the next few years could be quite tricky for the region.

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13 Bruegel (3 February 2020), From globalization to deglobalization: Zooming into trade, https://www.bruegel.org/2020/02/from-globalization-to-deglobalization-zooming-into-trade/

# 2. CESEE Overview: Coronavirus hits; in search of new sources of growth

**by Olga Pindyuk**

- **Last year, 2019, was a decent one for most of CESEE, but the slowdown from the peak year of 2017 continued for the region as a whole. Even before coronavirus, an external slowdown was evident, driven by the US-China trade war, weaker global growth in general, and extremely sluggish performance in Germany.**
- **However, the spread of the coronavirus to Europe has already had negative economic effects, and these could intensify in the coming months, including for CESEE.**
- **The cut-off date for our Spring Forecast round was before the full impact of the coronavirus became clear. Therefore, in addition to our baseline scenario, we have produced three further real GDP projections for 2020, based on 'mild', 'medium' and 'severe' scenarios for the spread of the coronavirus.**
- **Under our baseline scenario, we project that aggregate real GDP growth for CESEE will rise to 2.9% this year, from 2.1% in 2019, largely on account of improvements in Russia and Turkey. In our 'mild' scenario, regional growth rates would be 0.2-0.6 percentage points below the baseline. For the 'severe' scenario, we project that growth would be around 1-2 percentage points lower. In all cases, the CIS countries and Turkey would be worst affected, with the EU member states and some Western Balkan countries faring relatively better.**
- **The extent of the impact will vary by country, depending on specific areas of vulnerability. Countries with higher levels of trade integration with China (particularly CIS countries) or Italy (especially Albania, Bulgaria, Croatia, Romania and Slovenia) will be worse affected, as will those reliant on energy exports (Russia and Kazakhstan) or tourism (Croatia, Slovenia, Albania and Montenegro). The capacity of healthcare systems to cope is also likely to vary considerably across the region.**
- **We expect the coronavirus to have a notable negative impact on economic activity in the first half of 2020, but that this will then fade in the second half of the year. Overall, we expect much of the GDP lost now to be made up later. However, we cannot exclude a more 'longer-lasting demand shock, and a recession in parts of CESEE.**
- **We are likely to see further loosening of fiscal and monetary policies in EU-CEE11, in order to counteract the economic slowdown caused by the coronavirus. The Western Balkans and CIS and Ukraine will be limited by considerations of macro-financial stability and will have less fiscal room for manoeuvre.**
- **Beyond 2020, our outlook remains broadly unchanged. In 2021-2022, we expect economic growth of below 3% in EU-CEE, whereas the Western Balkans are expected to avoid a growth deceleration during that period. Outside EU-CEE and the Western Balkans, pre-coronavirus we**

**had made significant upward revisions to our GDP forecasts for the bigger economies (Turkey, Russia and Ukraine), based on more expansionary fiscal and/or monetary policies. However, without structural reforms there are substantial negative risks to the sustainability of growth.**

› **The coronavirus has temporarily diverted the attention of economists and policy makers from fundamental issues facing CESEE. One of the biggest issues is the shortage of labour, which is likely to become more acute and will subsequently threaten the sustainability of the region's economic model, based as it is on labour-cost advantages and participation in regional production chains.**

› **Digitalisation could help CESEE to increase the productivity of its economies by developing more productive service sectors and increasing the servitisation of their production processes. The region is believed to be well equipped for further digitisation. However, it is important to develop adequate government policies to ensure reskilling of the labour force and to support investment in new technologies.**

## 2.1. REVIEW OF 2019: STILL STRONG PERFORMANCE IN MOST OF CESEE, BUT SIGNS OF DECELERATION STARTING TO SHOW IN THE EU MEMBER STATES

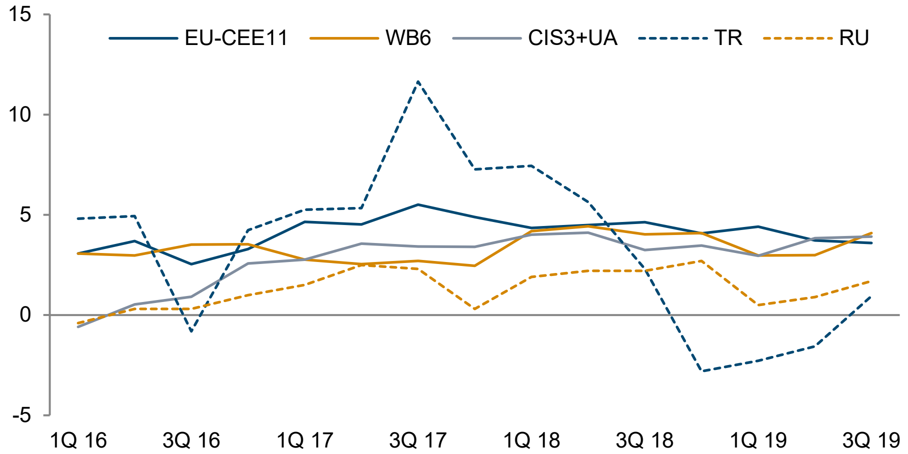
**In 2019, economic growth in CESEE slowed to 2.1%, but in 2020, thanks to a recovery in the two biggest economies, it is expected to bounce back to 2.9% and to stay at around 3% thereafter.** In 2019, EU-CEE11 saw a second consecutive year of growth deceleration from the peak of 4.9% in 2017; this time the slowdown affected all the Visegrad countries. Policy-induced recovery in Russia and Turkey will be the main reason for growth speeding up in 2020. However, a return to the growth level of 2017 is not expected in the short run, as the external environment will remain unfavourable and internal drivers of growth will have limited power.

**Economic activity in EU-CEE11 was robust in 2019, but started to show signs of slowing down.** The region remained the leader in terms of real GDP growth in 2019, but there was a continuous slowdown in GDP growth over the preceding four quarters (Figure 2.1). Within the region, the performance of individual countries varied considerably. On the one hand, strong growth was achieved in Hungary, Poland and Romania. Hungary outperformed its peers and reached almost 5% annual growth in 2019, on the back of record strong investment, supported by EU funds and robust private consumption; the latter two countries posted relatively high annual growth rates of 4.3% and 4.0%, respectively. On the other hand, GDP growth rates in the Czech Republic, Slovakia, Slovenia and Latvia were below 3%.

**Russia and Belarus were the worst-performing economies in CESEE, whereas Ukraine's economy appears to have got into better shape.** The economies of Belarus and Russia, hampered by chronic weaknesses, managed to grow at only slightly above 1% in 2019. On the other hand, Ukraine, Kazakhstan and Moldova recorded relatively rapid growth, supported by both domestic demand and exports (with the exception of Kazakhstan, which had to rely solely on domestic demand for growth, as exports stagnated in the wake of unfavourable conditions on the global oil markets).

**Figure 2.1 / Quarterly real GDP growth**

real change against preceding year in %




Source: wiiw Monthly Database incorporating national and Eurostat statistics.

**The Western Balkans showed further robust growth performance, albeit somewhat weaker than in the previous year.** Economic deceleration was noted in all the countries, apart from North Macedonia and Kosovo: the former has finally got back on the track of stable GDP growth after two years of mediocre performance, caused by shrinking investment. Serbia and Kosovo recorded the fastest real GDP growth in the region (4% and 4.1%, respectively, in annual terms) on the back of strong gross fixed capital formation.

**The Turkish economy rebounded in the second half of 2019 on the back of a new phase of a credit-driven boom, and according to its whole year results managed to avoid recession.** The country exceeded even our quite optimistic expectations and confirmed its status as the most high-beta economy in CESEE. Though the country had the lowest GDP growth in CESEE (0.5% in annual terms), a host of indicators suggests that a V-shaped recovery is in process (see Turkey report).

## 2.2. CORONAVIRUS HAS ARRIVED IN EUROPE

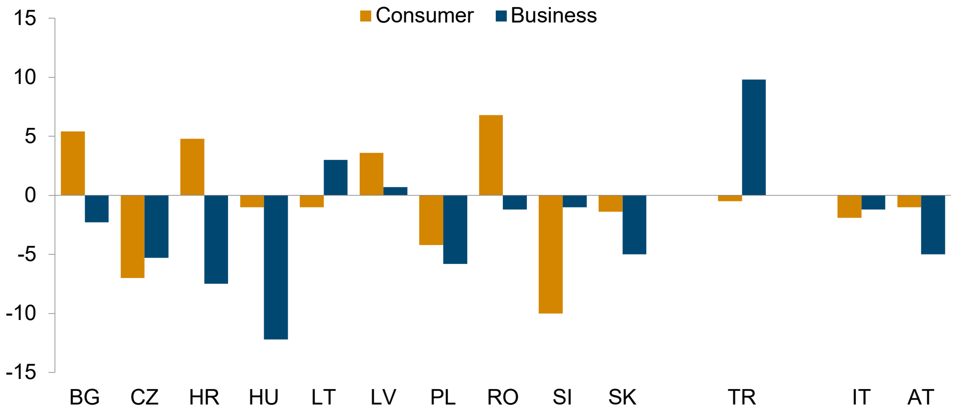
Coronavirus has already arrived in Europe – especially in Italy, but also in other countries including Germany. So far there have been relatively few cases in CESEE, but it is highly likely that the number will increase, given the large flows of tourists and labour migrants between the region and Western Europe.

It is impossible to measure fully the current economic impact of the virus outbreak, due to the lag with which most statistical data are collected, but it seems safe to say that it was not yet significant in February 2020. The European Commission’s economic sentiment indicator improved that month, rising to 103.5 from 102.6 the previous month. However, the global Purchasing Managers’ Index fell in February to 46.1 – its lowest level since 2009 – after a record decline of 6.1 points. China was at the centre of the downturn, but the US and Japan also contracted.

It is almost certain that the euro area will start contracting very soon and will drag the CESEE down with it, as Italy and Germany are important economic partners for most countries of the region. This is already reflected in the expectations of economic agents (Figure 2.2), and this will have an impact on private consumption and investment plans. Business confidence declined in February 2020 in all the countries, apart from Turkey, Latvia and Lithuania – those countries with a relatively low exposure to China, Germany and Italy. The greatest decline in business confidence was seen in the Visegrad countries and Croatia – and this seems to be a realistic assessment by businesses of the degree of exposure of those countries to the coronavirus-driven crisis.

**Figure 2.2 / Business and consumer confidence in February 2020**

change against preceding month in %




Source: CEIC Data.

## 2.3. WEAK EXTERNAL DEMAND HAS WEIGHED ON MERCHANDISE EXPORTS, BUT SERVICES EXPORTS STAY BUOYANT

**The external slowdown – driven by the US-China trade war, weaker global growth in general and extremely sluggish performance in Germany – started to be a drag on the region's growth from the end of 2018,[14] and its effects have now become clearly visible.** On top of that, the spread of the coronavirus to Europe has already had negative economic effects on CESEE, and these could intensify in the coming months. The EU-CEE countries appear to be the most susceptible to a weakening of global growth, due to their high degree of trade openness. Commodity exporters in the region are affected by falling global prices, as the demand for commodities weakens worldwide.

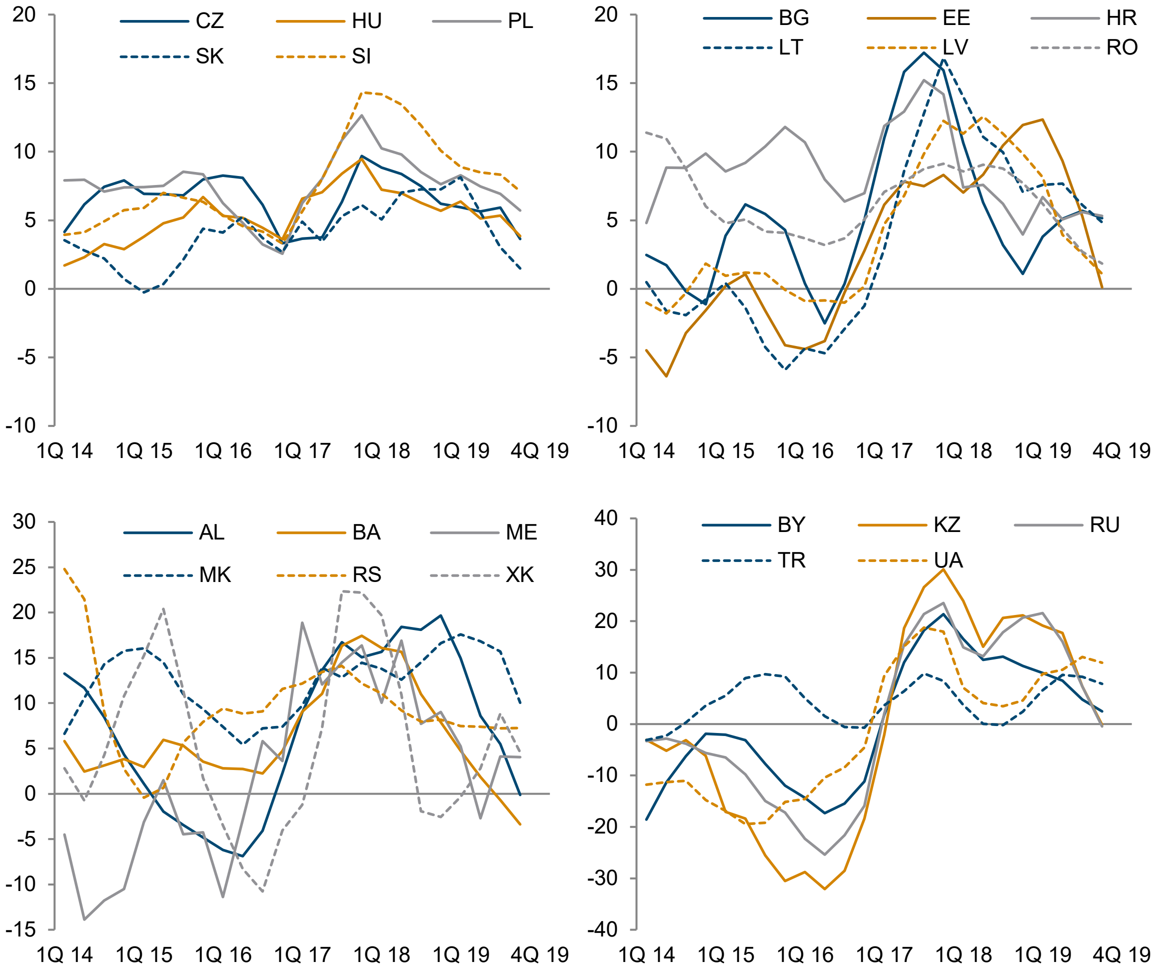
**Exports growth followed a sharp downward trend in most countries of CESEE.** In the fourth quarter of 2019, annual merchandise exports growth in EUR terms decelerated (or even turned negative) in all the countries, apart from Serbia (where it stagnated) (Figure 2.3). The oil exporters Kazakhstan and Russia were particularly hard hit, as were some of the EU-CEE11 countries that are most tightly integrated into the regional production chains: exports from Latvia and Estonia have been hurt by the slowdown in the Swedish economy, while Slovakia's exports have proved extremely

14 See Adarov et al. (2018).

vulnerable to the crisis in the German automotive sector (see Global Economic Outlook). Growth rates were still quite healthy in Ukraine, Turkey, North Macedonia and Slovenia.

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

4 quarters moving average



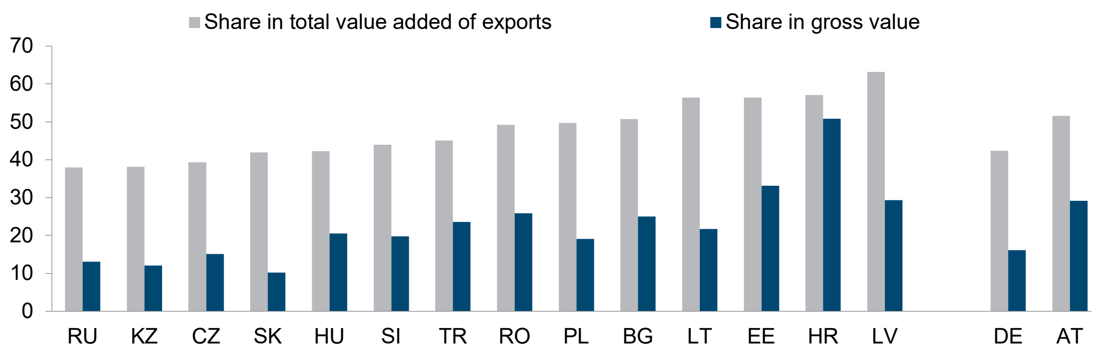

Source: wiiw Monthly Database incorporating national and Eurostat statistics.

**Industrial output has been losing momentum.** The slowdown has been most noticeable in the automotive sector and intermediate-demand goods. Capacity utilisation rates have declined in these sectors and labour shortages have become slightly less acute in Croatia, Poland, Romania and Slovenia (also helped by active government policies to attract labour immigration). Still, overall labour markets remain quite tight in most of the countries – especially when it comes to demand for skilled labour in the case of the Western Balkan countries – and constitute the major impediment to future business expansion.

## BOX 1 / CESEE EXPORTS MORE SERVICES THAN IT WOULD APPEAR AT FIRST GLANCE

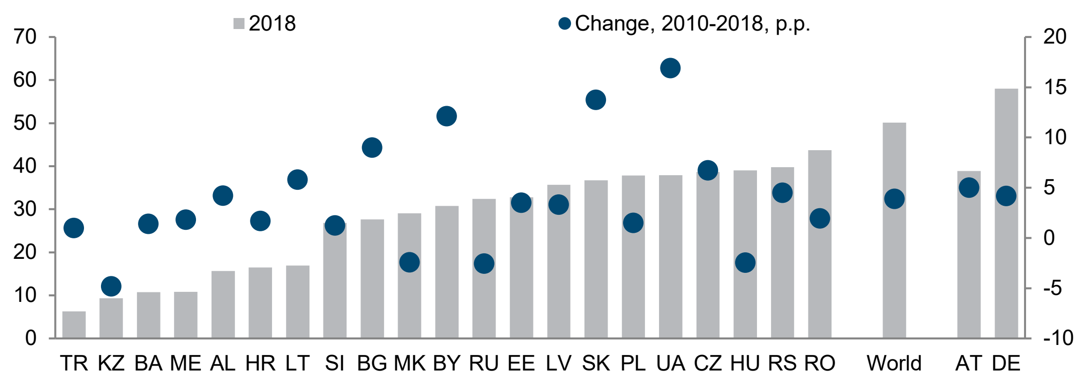
**If one accounts for intermediate linkages, the share of services in exports of the CESEE countries is significantly higher than reported in the balance-of-payments (BOP) statistics.** Ultimately it is the linkages between trade and value added that establish a relation between trade and the pattern of national income and labour market conditions. And if one takes these into account, then domestically produced services constitute between 38% of exports value added (Russia) and 63% (Latvia) (Figure 2.4). Even in the V4 countries, which are traditionally regarded as the manufacturing base of Central and Eastern Europe, services comprise between 40% and 50% of exports value added. As technological progress and fundamental changes in the structure/organisation of production alter the nature of services, the consequences of deindustrialisation and increased servitisation of manufacturing need not be seen as negative – services are increasingly more tradable, no longer characterised by low productivity, and can create 'good jobs' (Ghani and O'Connell, 2014). The increasing digitalisation of services trade in many countries (Figure 2.5) can be seen as evidence of a shift in this direction.

### Figure 2.4 / Share of services in value added and gross value of exports in 2015, %




Note: The value-added share of domestic services in gross exports is estimated as the share of value added originating from all domestic service industries in the total gross exports of a given industry.
Source: OECD TiVA dataset, own calculations.

### Figure 2.5 / Share of digitally deliverable services in total services exports, %

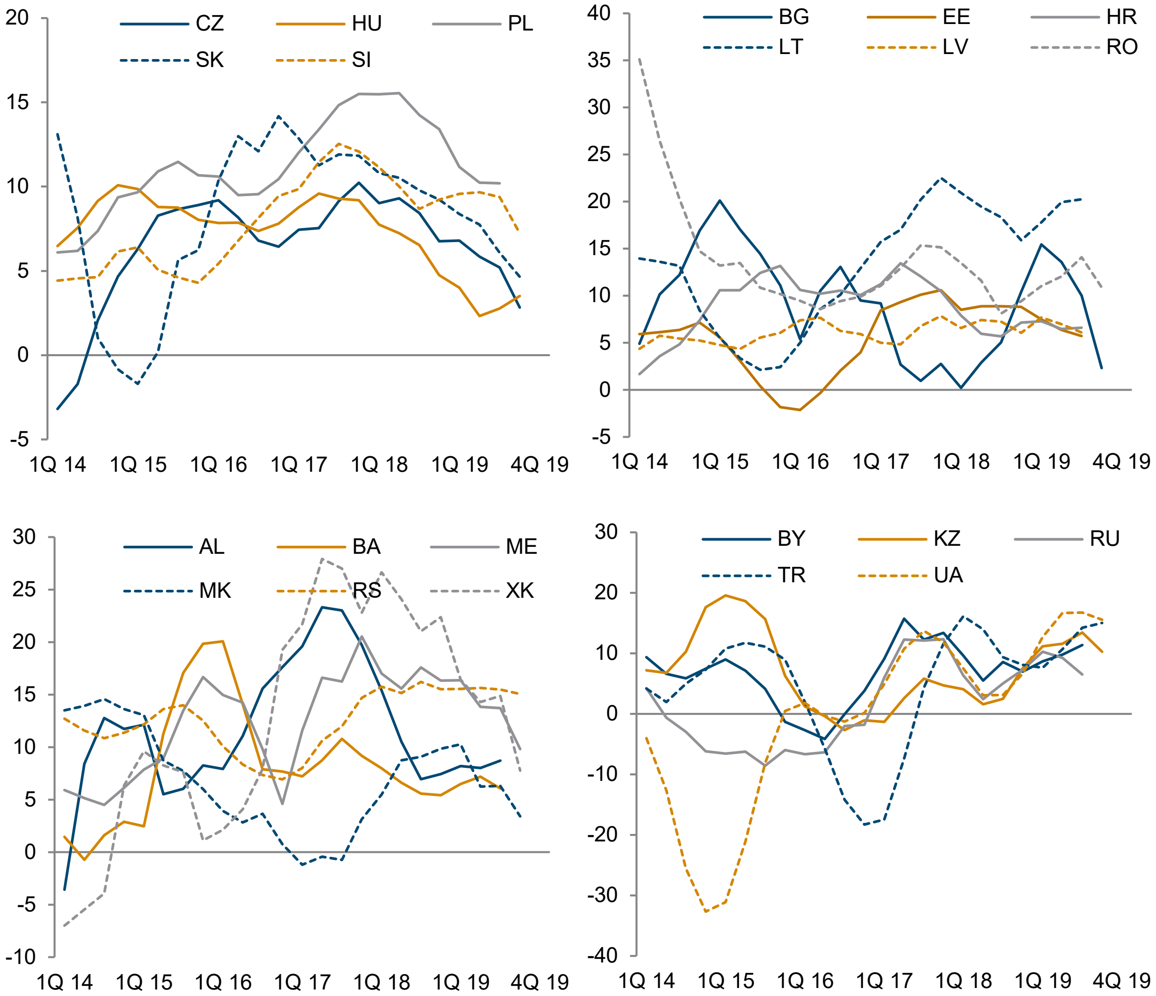



Source: UNCTADstat.

**On the other hand, services exports continued to be less vulnerable to negative external shocks.** In all the CESEE countries, apart from Bulgaria, Hungary and North Macedonia, services exports in 2019 grew faster than merchandise exports – in some cases, the difference in growth rates was measured in double digits (Figure 2.6). The most rapid expansion of services exports was in IT and business services (Lithuania, Serbia, Ukraine, Belarus and Romania) and tourism (Turkey and the Western Balkans). This relative resilience of the services sector will, however, now be severely tested by the spread of the coronavirus.

**Figure 2.6 / Exports of services (balance-of-payments statistics, EUR based), growth in %**

4 quarters moving average




Source: wiiw Monthly Database incorporating national and Eurostat statistics.

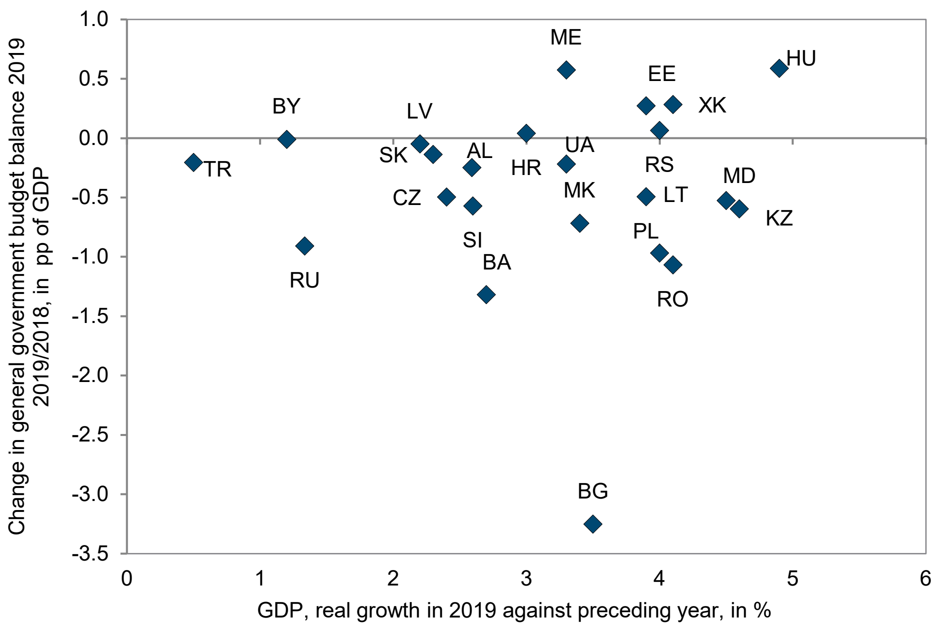
**Household consumption continued as the main driver of growth in the region last year**, supported by rapidly rising wages, fiscal measures and consumer credit (see Credit Monitor). Only in Estonia, Hungary and Romania did the contribution to GDP growth of household consumption come second to that of gross fixed capital formation, which generally had a boom year in these countries, largely on the back of EU transfers and fiscal projects. Turkey stands out as the only country with stagnating private consumption: its economic growth was generated solely through net exports. However, in H2 2019 this trend was already changing, as inflation fell and consumption rose, thanks to huge monetary easing.

**Fiscal policy was made increasingly lax in EU-CEE11, in order to stimulate growth.** The governments of many countries continued to increase the minimum wage, pensions and social transfers in order to boost private consumption, as wage growth in the private sector started to lose speed, having reached a relatively high level (this is particularly relevant for the V4 countries). Public surpluses decreased significantly in 2019 in Bulgaria, the Czech Republic, Lithuania and Slovenia (in the case of Bulgaria, the general government balance decreased by a whopping 3.3% of GDP and turned into a deficit), signalling the intention of governments to generate pro-growth impulse. Romania posted the highest public deficit in CESEE in 2019 – 4% of GDP.

**After a long period of consolidation, Russia's fiscal policy has done a U-turn** in order to provide stimulus to the ailing economy (see Russia report) – the first indications of this came back in 2019, when government expenditure as a share of GDP increased by 0.9 p.p. and the budget surplus decreased by the same amount (to 2% of GDP). The fiscal stance of a country can be roughly derived by juxtaposing the change in the government budget balance and the country's growth performance.[15] Using this method, Russian fiscal policy now can be classified as clearly expansionary (Figure 2.7). Kazakhstan and Moldova have also been pursuing expansionary fiscal policies, whereas Belarus and Ukraine, as well as the Western Balkans, lack the fiscal scope to do this.

**Figure 2.7 / Fiscal stance in CESEE countries in 2019**

change against preceding year




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

15 For the reasoning behind this, please see Astrov (2019), p. 22.

**We expect fiscal policy to become even looser soon, in order to combat the coronavirus impact on economies.** The EU-CEE11 countries will be better positioned to increase fiscal stimulus, as they generally have a bigger fiscal space and will have access to resources provided at the EU level. As of 11 March 2020, the European Commission has vowed to help member states boost their response to the coronavirus outbreak by permitting aid for struggling businesses and deploying flexibility in its budget rules to allow a surge in public spending. It has also announced the creation of an investment fund worth up to EUR 25 billion. Overall, the CESEE region will benefit from likely further interest rate cuts by the big central banks, which will push down borrowing yields even more and enable the loosening of fiscal policy.

**The Western Balkans, Turkey, CIS and Ukraine will have the least fiscal room for manoeuvre, limited as they are by macro-financial stability concerns.** In addition, they face the risk of capital flight, as investors could withdraw their capital and go back to safe havens. There are already indications of this happening, as portfolio capital flows to emerging markets securities declined significantly in February 2020: according to the Institute of International Finance, emerging markets securities – both debt and equity – attracted only USD 3.4 billion that month, a sharp drop from the USD 29.5 billion recorded in January.

## 2.4. WHAT ARE THE TRANSMISSION MECHANISMS OF UNCONVENTIONAL MONETARY POLICY?

**In the years since the global economic crisis, there has been almost unprecedented expansion of global liquidity in the world, brought about by quantitative easing.** Use of unconventional monetary policy tools appears to have brought us into uncharted waters, where the traditional monetary models no longer work. The persistently low inflation that has followed has led economists to question the ability of central banks to deliver on their mandate.

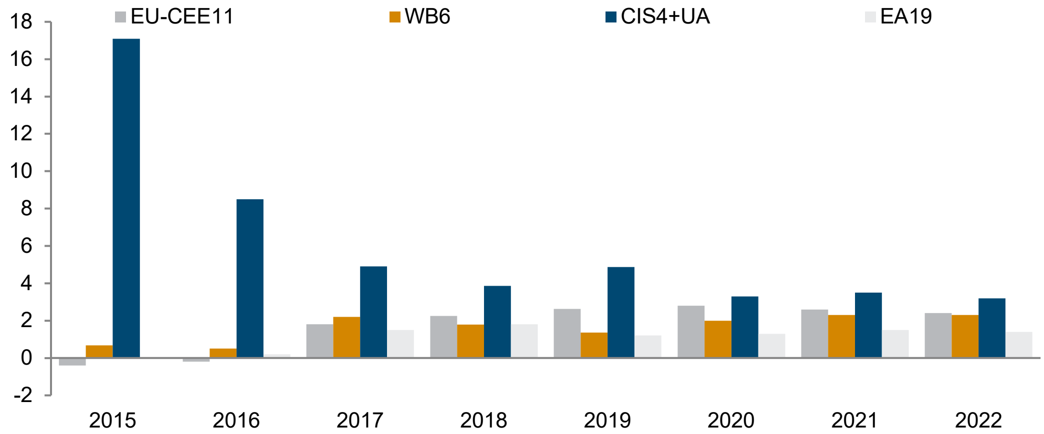
**The EU-CEE11 countries have benefited from access to cheap liquidity, which has allowed for loose monetary policy in the region, as evidenced by continually negative real interest rates in the region** (see Credit Monitor). However, negative real interest rates have not had a significant impact on inflation in most places, despite rapid wage growth; and even where inflation is back on target, it has taken several years of negative real interest rates. Several possible explanations for the ‘missing inflation’ mystery have been posited, including demographic trends, low import prices, stronger competition in the retail sector (in particular, due to e-commerce), high savings rates and outflows of remittances.[16]

**In our pre-coronavirus baseline forecast, we expect inflation rates in EU-CEE11 to pick up slightly in 2020, and then to decline to below the 2019 level by 2022.** Thus, they will be on a converging trend with inflation rates in the Western Balkans, which have rather limited fiscal and monetary space compared with EU-CEE11. In 2019, the average CPI differential between the two sub-regions was 1.2 p.p., while the average difference between the real interest rates was about 3 p.p. By 2022, the CPI levels in the two sub-regions are expected to be almost identical (Figure 2.8).

16 For a more detailed discussion, see Grieveson (2019a).

**Figure 2.8 / Consumer prices**

average change against preceding year in %



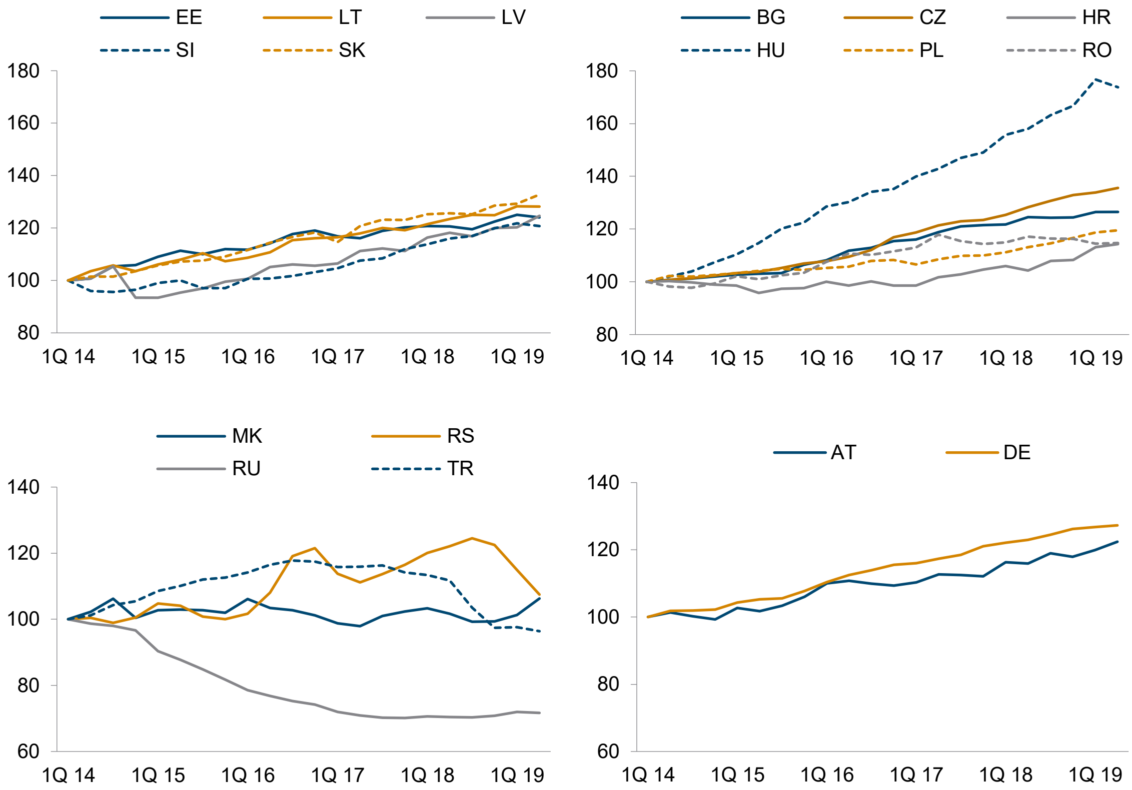

Note: Simple averages for country aggregates.
Source: wiiw Annual Database incorporating national and Eurostat statistics. Forecasts by wiiw.

**The coronavirus outbreak is likely to influence monetary policy decision making in the region.** It can mean different things for different sub-regions. It appears that central banks in EU-CEE11 are likely to reverse their course of monetary tightening to counter economic slowdown. Even Hungary, which has a rather high risk of overheating relative to its peers (see Credit Monitor), is expected to abstain from a previously flagged policy rate hike at the end of March. In the CIS and Ukraine (in particular in oil exporters Kazakhstan and Russia), as well as Turkey, considerations of macro-financial stability are likely to dominate and tightening of monetary policy appears to be on the cards. The National Bank of Kazakhstan already raised its policy rate by 2.75 percentage points to 12% on 10 March 2020 to protect the national currency from increased external risks.

**It would appear that asset prices have replaced CPI as the more important channel of monetary policy pass-through in EU-CEE11.** Real residential property prices have been increasing steadily over the past five years in the EU-CEE11 countries, both among members of the euro area and in non-euro states (Figure 2.9). A particularly strong growth in property prices has been taking place in Hungary. Meanwhile, the Czech Republic, Slovakia and Bulgaria have seen residential property prices rise faster in real terms than in Germany or Austria. In contrast, in North Macedonia, Serbia, Turkey and Russia, where real interest rates have been positive, residential property prices in 2014-2019 stagnated – or in the case of Russia actually declined.

**These trends provide yet another reason for concern over the effectiveness of extra-loose monetary policy, as it would appear that the main effect of the liquidity glut is to inflate asset prices, rather than impact on the real economy.** Historically, lower interest rates have been assumed to spur economic growth by reducing the cost of borrowing and encouraging higher spending and investment. But this mechanism appears to have become defective: real interest rates have been languishing in negative territory for a long time, as they seem to have less impact on inflation expectations.[17] Low rates of return on deposits in commercial banks and savings in pension funds act as an additional factor of rising demand for real estate.[18]

**Figure 2.9 / Index of real residential property prices, 1Q 2014=100**




Source: BIS.

## 2.5. FORECASTS FOR 2020-2022: EU-CEE11 CONTINUES TO RUN OUT OF STEAM, WHILE OTHER REGIONS MAINTAIN GROWTH ON THE BACK OF POLICY STIMULUS

**Though several of the EU-CEE11 countries finished 2019 in better shape than we expected last summer, prospects for the immediate future do not appear so bright.** As the external environment deteriorates, so the region – with its mostly export-focused economies – will struggle. In 2020, even under our pre-coronavirus baseline projections, we forecast GDP growth to slow down in all 11 countries, apart from in Slovenia (where it will stagnate) (Table 2.2). The sharpest deceleration will take place in Hungary, Estonia, Lithuania, Romania and Bulgaria, which were among the top performers in CESEE in 2019. In 2021-2022, there will be either continued deceleration of growth or a very modest increase in growth rates; as a result, all the countries, apart from Poland and Romania, will have to reckon with economic growth of below 3% in the coming years. Poland will be a leader in terms of economic growth in EU-CEE11 during the forecast period; meanwhile, Hungary and Bulgaria will become laggards in the sub-region.

17 See, for example, Gnan et al. (2018), Rehn (2020).

18 For a more detailed discussion of the effects of quantitative easing on CESEE, see Pindyuk (2019).

**Table 2.1 / OVERVIEW 2018-2019 AND OUTLOOK 2020-2022**

| | | GDP real change in % against prev. year | | | | | Consumer prices average change in % against prev. year | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Forecast | | | | | Forecast | | |
| | | 2018 | 2019 | 2020 | 2021 | 2022 | 2018 | 2019 | 2020 | 2021 | 2022 |
| BG | Bulgaria | 3.1 | 3.5 | 2.8 | 2.3 | 2.0 | 2.6 | 2.5 | 2.5 | 2.0 | 2.0 |
| CZ | Czech Republic | 2.8 | 2.4 | 2.2 | 2.4 | 2.6 | 2.0 | 2.6 | 2.5 | 2.2 | 2.0 |
| EE | Estonia | 4.8 | 3.9 | 2.7 | 2.6 | 2.7 | 3.4 | 2.3 | 2.4 | 2.5 | 2.6 |
| HR | Croatia | 2.7 | 3.0 | 2.7 | 2.7 | 2.6 | 1.6 | 0.8 | 1.5 | 1.5 | 2.0 |
| HU | Hungary | 5.1 | 4.9 | 3.3 | 2.6 | 2.2 | 2.9 | 3.4 | 3.5 | 3.5 | 3.5 |
| LT | Lithuania | 3.6 | 3.9 | 2.8 | 2.6 | 2.7 | 2.5 | 2.2 | 2.5 | 2.3 | 2.3 |
| LV | Latvia | 4.6 | 2.2 | 2.0 | 2.3 | 2.6 | 2.6 | 2.7 | 2.3 | 2.4 | 2.5 |
| PL | Poland | 5.1 | 4.0 | 3.6 | 3.3 | 3.3 | 1.2 | 2.1 | 2.8 | 2.5 | 2.2 |
| RO | Romania | 4.4 | 4.1 | 3.2 | 2.8 | 3.2 | 4.1 | 3.9 | 3.5 | 3.5 | 3.0 |
| SI | Slovenia | 4.1 | 2.6 | 2.6 | 2.7 | 2.7 | 1.9 | 1.7 | 1.8 | 2.0 | 2.0 |
| SK | Slovakia | 4.0 | 2.3 | 2.0 | 2.4 | 2.6 | 2.5 | 2.8 | 2.4 | 2.0 | 1.8 |
| | *EU-CEE11 1)2)* | *4.4* | *3.7* | *3.1* | *2.8* | *2.9* | *2.2* | *2.6* | *2.8* | *2.6* | *2.4* |
| | *EA19 3)* | *1.9* | *1.1* | *1.2* | *1.3* | *1.3* | *1.8* | *1.2* | *1.3* | *1.5* | *1.4* |
| | *EU28 3)* | *2.0* | *1.4* | *1.4* | *1.6* | *1.6* | *1.9* | *1.5* | *1.9* | *1.9* | *2.0* |
| AL | Albania | 4.1 | 2.6 | 3.2 | 3.4 | 3.4 | 2.0 | 1.4 | 1.9 | 2.2 | 2.4 |
| BA | Bosnia and Herzegovina | 3.7 | 2.7 | 2.5 | 2.8 | 2.9 | 1.4 | 0.6 | 1.3 | 1.6 | 1.7 |
| ME | Montenegro | 5.1 | 3.3 | 2.8 | 2.9 | 3.1 | 2.6 | 0.4 | 1.8 | 1.9 | 1.8 |
| MK | North Macedonia | 2.7 | 3.4 | 3.3 | 3.3 | 3.3 | 1.5 | 0.8 | 2.4 | 2.5 | 2.0 |
| RS | Serbia | 4.4 | 4.0 | 3.7 | 3.5 | 3.3 | 2.0 | 1.7 | 2.2 | 2.6 | 2.8 |
| XK | Kosovo | 3.8 | 4.1 | 4.3 | 4.2 | 4.2 | 1.1 | 2.7 | 1.5 | 1.7 | 1.5 |
| | *WB6 1)2)* | *4.0* | *3.5* | *3.4* | *3.4* | *3.3* | *1.8* | *1.4* | *2.0* | *2.3* | *2.3* |
| TR | Turkey | 2.8 | 0.5 | 3.9 | 4.1 | 4.1 | 16.3 | 15.2 | 10.2 | 8.5 | 8.0 |
| BY | Belarus | 3.1 | 1.2 | 1.0 | 1.3 | 1.3 | 4.9 | 5.6 | 5.0 | 4.5 | 4.0 |
| KZ | Kazakhstan | 4.1 | 4.5 | 3.7 | 3.8 | 3.8 | 6.0 | 5.3 | 5.2 | 5.0 | 5.0 |
| MD | Moldova | 4.3 | 4.6 | 4.0 | 4.0 | 4.0 | 2.9 | 4.8 | 4.5 | 4.5 | 4.0 |
| RU | Russia | 2.5 | 1.3 | 2.1 | 2.3 | 2.4 | 2.9 | 4.5 | 2.7 | 3.1 | 2.8 |
| UA | Ukraine | 3.3 | 3.3 | 3.6 | 4.2 | 4.5 | 10.9 | 7.9 | 5.8 | 5.0 | 5.0 |
| | *CIS4+UA 1)2)* | *2.8* | *1.8* | *2.4* | *2.6* | *2.6* | *3.9* | *4.9* | *3.3* | *3.5* | *3.2* |
| | *V4 1)2)* | *4.6* | *3.7* | *3.1* | *2.9* | *2.9* | *1.7* | *2.5* | *2.8* | *2.5* | *2.3* |
| | *BALT3 1)2)* | *4.2* | *3.4* | *2.5* | *2.5* | *2.7* | *2.7* | *2.4* | *2.4* | *2.4* | *2.4* |
| | *SEE9 1)2)* | *4.0* | *3.7* | *3.1* | *2.8* | *3.0* | *3.1* | *2.8* | *2.8* | *2.8* | *2.6* |
| | *CIS3+UA 1)2)* | *3.7* | *3.6* | *3.2* | *3.6* | *3.6* | *7.4* | *6.2* | *5.4* | *4.9* | *4.8* |
| | *non-EU12 1)2)* | *2.8* | *1.5* | *2.9* | *3.0* | *3.1* | *7.4* | *7.7* | *5.2* | *4.9* | *4.6* |
| | *CESEE23 1)2)* | *3.3* | *2.1* | *2.9* | *3.0* | *3.0* | *5.9* | *6.2* | *4.5* | *4.2* | *3.9* |

ctd.

**Table 2.1 / (ctd.)**

| | | Unemployment (LFS) rate in %, annual average | | | | | Current account in % of GDP | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Forecast | | | | | Forecast | | |
| | | 2018 | 2019 | 2020 | 2021 | 2022 | 2018 | 2019 | 2020 | 2021 | 2022 |
| BG | Bulgaria | 5.2 | 4.3 | 3.8 | 3.6 | 3.4 | 5.4 | 9.9 | 6.2 | 5.2 | 5.0 |
| CZ | Czech Republic | 2.2 | 2.0 | 2.1 | 2.2 | 2.2 | 0.3 | -0.1 | 0.3 | 0.3 | 0.4 |
| EE | Estonia | 5.4 | 4.4 | 4.8 | 4.8 | 4.8 | 2.0 | 1.7 | 1.1 | 2.3 | 1.7 |
| HR | Croatia | 8.5 | 6.5 | 6.0 | 5.5 | 5.0 | 1.9 | 2.6 | 2.1 | 2.1 | 1.9 |
| HU | Hungary | 3.7 | 3.4 | 3.5 | 3.5 | 3.5 | -0.5 | -0.3 | -0.1 | 0.0 | 0.1 |
| LT | Lithuania | 6.2 | 6.3 | 6.2 | 6.0 | 5.8 | 0.3 | 0.5 | 3.0 | 2.4 | 3.2 |
| LV | Latvia | 7.4 | 6.5 | 6.3 | 6.3 | 6.0 | -0.7 | -0.3 | -0.7 | -0.7 | -0.4 |
| PL | Poland | 3.9 | 3.5 | 3.6 | 3.7 | 3.7 | -1.0 | 1.1 | 0.2 | 0.4 | 0.6 |
| RO | Romania | 4.2 | 3.9 | 4.0 | 4.0 | 4.0 | -4.4 | -4.7 | -4.9 | -4.6 | -4.2 |
| SI | Slovenia | 5.1 | 4.6 | 4.0 | 3.8 | 3.7 | 5.7 | 6.6 | 5.9 | 5.7 | 5.6 |
| SK | Slovakia | 6.5 | 5.8 | 5.8 | 5.6 | 5.6 | -2.6 | -2.9 | -3.2 | -2.9 | -2.7 |
| | *EU-CEE11 1)2)* | *4.3* | *3.9* | *3.9* | *3.9* | *3.8* | *-0.7* | *0.2* | *-0.2* | *-0.1* | *0.1* |
| | *EA19 3)* | *8.2* | *7.6* | *7.5* | *7.4* | *7.3* | *3.6* | *2.8* | *2.7* | *2.5* | *2.4* |
| | *EU28 3)* | *6.8* | *6.4* | *6.0* | *6.0* | *5.9* | *2.2* | *1.5* | *1.4* | *1.3* | *1.2* |
| AL | Albania | 12.3 | 11.3 | 11.0 | 10.5 | 10.0 | -6.8 | -7.6 | -6.9 | -6.8 | -6.4 |
| BA | Bosnia and Herzegovina | 18.4 | 15.7 | 15.6 | 14.6 | 13.7 | -3.7 | -5.2 | -5.3 | -5.1 | -5.1 |
| ME | Montenegro | 15.2 | 14.8 | 14.1 | 14.0 | 13.8 | -17.0 | -16.7 | -17.0 | -14.8 | -12.9 |
| MK | North Macedonia | 20.7 | 17.0 | 16.7 | 16.1 | 16.0 | -0.1 | -0.7 | -0.7 | -1.0 | -1.4 |
| RS | Serbia | 12.7 | 10.7 | 10.8 | 10.3 | 9.8 | -5.2 | -6.2 | -5.7 | -5.3 | -4.9 |
| XK | Kosovo | 29.6 | 24.5 | 23.5 | 22.5 | 21.0 | -7.6 | -6.8 | -7.1 | -7.6 | -8.1 |
| | *WB6 1)2)* | *15.7* | *13.4* | *13.2* | *12.7* | *12.0* | *-5.3* | *-6.2* | *-5.9* | *-5.6* | *-5.4* |
| TR | Turkey | 10.9 | 13.7 | 13.5 | 13.4 | 11.5 | -3.4 | 0.2 | -1.3 | -2.1 | -2.6 |
| BY | Belarus | 4.8 | 4.2 | 4.5 | 4.6 | 4.7 | -0.1 | -0.5 | -1.4 | -1.3 | -0.9 |
| KZ | Kazakhstan | 4.9 | 4.8 | 4.8 | 4.8 | 4.8 | -0.2 | -3.1 | -2.4 | -2.0 | -1.7 |
| MD | Moldova | 3.0 | 5.5 | 5.0 | 5.0 | 5.0 | -10.6 | -10.7 | -8.6 | -8.4 | -7.3 |
| RU | Russia | 4.8 | 4.6 | 4.5 | 4.4 | 4.4 | 6.8 | 4.2 | 3.5 | 3.4 | 3.3 |
| UA | Ukraine | 8.8 | 8.4 | 8.1 | 7.8 | 7.6 | -3.3 | -0.7 | -3.3 | -3.0 | -2.8 |
| | *CIS4+UA 1)2)* | *5.4* | *5.2* | *5.1* | *5.0* | *5.0* | *5.3* | *3.0* | *2.3* | *2.2* | *2.3* |
| | *V4 1)2)* | *3.8* | *3.4* | *3.5* | *3.5* | *3.5* | *-0.8* | *0.3* | *-0.2* | *0.0* | *0.2* |
| | *BALT3 1)2)* | *6.4* | *5.9* | *5.9* | *5.8* | *5.6* | *0.4* | *0.6* | *1.4* | *1.5* | *1.8* |
| | *SEE9 1)2)* | *8.6* | *7.5* | *7.3* | *7.0* | *6.8* | *-2.5* | *-2.1* | *-2.7* | *-2.7* | *-2.5* |
| | *CIS3+UA 1)2)* | *6.9* | *6.5* | *6.5* | *6.4* | *6.3* | *-1.5* | *-2.0* | *-2.8* | *-2.5* | *-2.2* |
| | *non-EU12 1)2)* | *7.1* | *7.5* | *7.3* | *7.2* | *6.8* | *2.6* | *1.9* | *1.1* | *0.8* | *0.7* |
| | *CESEE23 1)2)* | *6.4* | *6.6* | *6.5* | *6.4* | *6.1* | *1.4* | *1.3* | *0.6* | *0.5* | *0.5* |

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 (February 2020).

**Table 2.2 / Baseline real GDP forecasts and revisions**

| | | Forecast, % | | | | Revisions, pp | | |
|---|---|---|---|---|---|---|---|---|
| | | 2019 | 2020 | 2021 | 2022 | 2019 | 2020 | 2021 |
| EU-CEE11 | BG | 3.5 | 2.8 | 2.3 | 2.0 | 0.0 | 0.1 | -0.1 |
| | CZ | 2.4 | 2.2 | 2.4 | 2.6 | -0.1 | -0.2 | -0.2 |
| | EE | 3.9 | 2.7 | 2.6 | 2.7 | 0.6 | 0.1 | 0.2 |
| | HR | 3.0 | 2.7 | 2.7 | 2.6 | 0.1 | 0.0 | 0.0 |
| | HU | 4.9 | 3.3 | 2.6 | 2.2 | 0.6 | 0.2 | 0.0 |
| | LT | 3.9 | 2.8 | 2.6 | 2.7 | 0.3 | 0.4 | 0.0 |
| | LV | 2.2 | 2.0 | 2.3 | 2.6 | -0.6 | -0.2 | -0.1 |
| | PL | 4.0 | 3.6 | 3.3 | 3.3 | -0.4 | 0.1 | 0.0 |
| | RO | 4.1 | 3.2 | 2.8 | 3.2 | -0.1 | -0.1 | -0.2 |
| | SI | 2.6 | 2.6 | 2.7 | 2.7 | -0.3 | -0.2 | -0.1 |
| | SK | 2.3 | 2.0 | 2.4 | 2.6 | 0.0 | -0.2 | -0.2 |
| WB6 | AL | 2.6 | 3.2 | 3.4 | 3.4 | -0.2 | -0.6 | 0.0 |
| | BA | 2.7 | 2.5 | 2.8 | 2.9 | 0.1 | -0.2 | 0.1 |
| | ME | 3.3 | 2.8 | 2.9 | 3.1 | 0.2 | -0.2 | 0.8 |
| | MK | 3.4 | 3.3 | 3.3 | 3.3 | 0.1 | -0.1 | -0.1 |
| | RS | 4.0 | 3.7 | 3.5 | 3.3 | 1.1 | 1.0 | 0.9 |
| | XK | 4.1 | 4.3 | 4.2 | 4.2 | -0.1 | 0.3 | -0.1 |
| Turkey | TR | 0.5 | 3.9 | 4.1 | 4.1 | 1.2 | 0.8 | 0.8 |
| CIS4+UA | BY | 1.2 | 1.0 | 1.3 | 1.3 | -0.1 | -0.5 | -0.4 |
| | KZ | 4.5 | 3.7 | 3.8 | 3.8 | 0.5 | 0.2 | 0.3 |
| | MD | 4.6 | 4.0 | 4.0 | 4.0 | -0.1 | 0.2 | 0.0 |
| | RU | 1.3 | 2.1 | 2.3 | 2.4 | 0.2 | 0.4 | 0.4 |
| | UA | 3.3 | 3.6 | 4.2 | 4.5 | 0.0 | 0.5 | 0.9 |

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

**The Western Balkans appear to be less vulnerable to global trade tensions, and before the coronavirus hit we had expected it to be able to avoid a deceleration of economic growth during 2020-2022.** Only the Serbian economy will lose some speed, but it will still grow much faster than we previously forecast – at above 3% per year during the forecast period. However potential growth in the region will be inhibited by uncertainty with regard to EU accession prospects[19] and by skilled labour shortages. Additional negative risk stems from a migrant crisis that could erupt in Bosnia as early as 2020 and potentially spread to other countries (see Bosnia report).

**Outside EU-CEE and the Western Balkans, pre-coronavirus we had made significant upward revisions to GDP forecasts for the bigger economies (Turkey, Russia and Ukraine).** The most important driver behind the acceleration in growth has been a switch to more expansionary fiscal and/or monetary policies, facilitated by increased appetite for emerging markets among yield-hungry investors. However, without structural reforms, these measures can provide only a short-term boost to the economies, and we see substantial negative risks to successful implementation of the reform programmes and to the sustainability of growth.

› **Turkey's** unbalanced economic growth model and the start of a new credit boom leave it exposed to external volatility and changes in investor sentiment. The government's plans to tackle this issue will yield some results; but we are sceptical that they can really engineer a fundamental change in the way the economy operates.

[19] For more details, see Grieveson (2020).

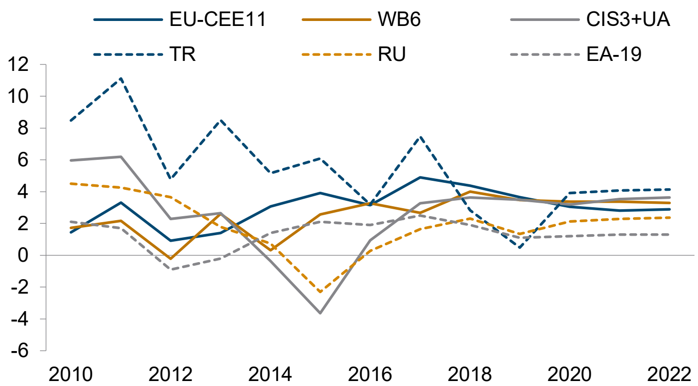
› **Russia** has started to correct for an overly restrictive fiscal and monetary stance over the past few years with significant fiscal stimulus and monetary easing. However, so far there has not been much progress in reforming the country's institutions and investment climate, which leaves its economy heavily dependent on the energy sector and thus vulnerable to global market volatility.

› **Ukraine's** new government has initiated an ambitious reform agenda, aimed at improving the business climate and attracting investment. The main risk to its successful implementation is the failure of the government to loosen the grip of the oligarchs on large sections of the economy and to limit their ability to direct policy in their own personal interests. In the worst-case scenario, the IMF could stop cooperation with the country, which could have a detrimental effect on investor confidence and macro-financial stability.

**In such conditions, the pace of income convergence with Western Europe will remain inadequate.** Moreover, it is projected to slow down in EU-CEE11 – in 2022, the GDP growth differential with the euro area will be a mere 1.6 p.p. (Figure 2.10). The Western Balkans and CIS + Ukraine will be able to achieve higher catch-up rates during 2020-2022; but given their very low levels of GDP per capita, a 2-3 p.p. growth differential with the euro area can hardly be considered sufficient.

**Figure 2.10 / Real GDP**

change in % against preceding year

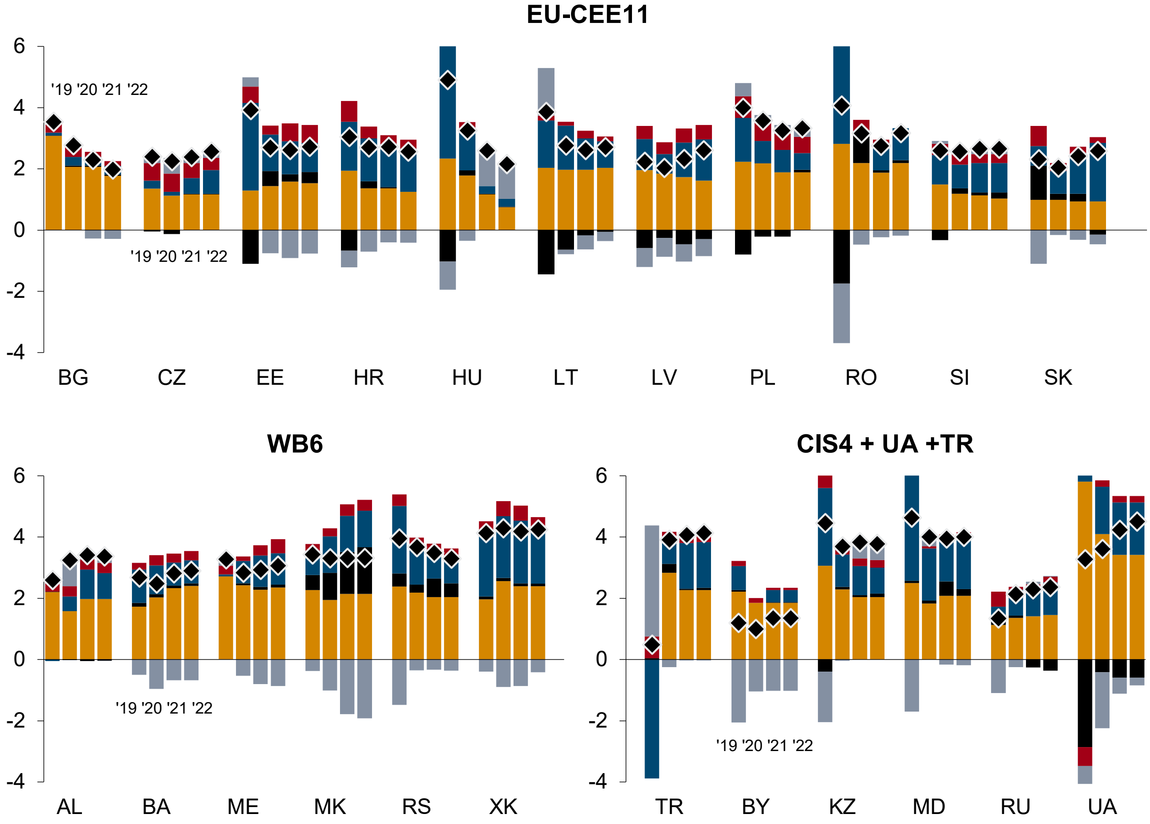



Note: Weighted averages for country aggregates.
Source: wiiw Annual Database incorporating national and Eurostat statistics. Forecasts by wiiw.

**Household consumption will continue to be the main driver of economic growth in CESEE during 2020-2022 (Figure 2.11).** However, its expansion will decelerate in all the countries, apart from Bosnia, Turkey and Russia – due to a slowdown in the growth of wages and declining consumer confidence, which will reduce the propensity to consume. The contribution of net exports to growth will be either negative or close to zero in all the countries – apart from Hungary, where it will increase and reach about 50% of the (much slower) GDP growth in 2022.

**Figure 2.11 / GDP growth in 2019-2022**

and contribution of individual demand components in percentage points




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

## 2.6. CORONAVIRUS IMPACT: SCENARIOS FOR GDP GROWTH IN 2020 AND CHANNELS OF CONTAGION

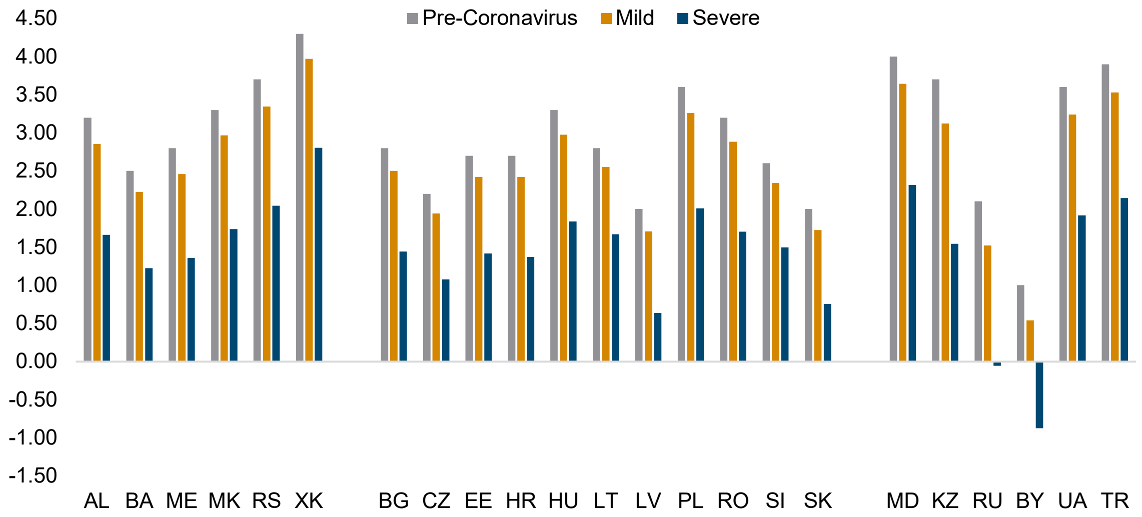
**Risks to the forecast lie mainly on the downside, and in light of the coronavirus we have calculated new real GDP growth rates based on 'mild', 'medium' and 'severe' scenarios[20] (Figure 2.12 and Table 2.3).** We took into account both the impact of a contraction of domestic and import demand and the influence of weaker domestic demand and demand for imports in key trading partners, including those worst affected (so far) by the coronavirus. Additionally, we built assumptions about the oil price into our projections for Russia and Kazakhstan. Given the extremely high level of uncertainty at present, these projections should be understood as a rough guide to the range within which the coronavirus is likely to impact CESEE economies this year.

[20] We used as benchmarks OECD scenarios for the global economy, including projections for China specifically, as well as our own assessments for the major global economies in the three scenarios. Based on these assumptions, we used the World Input Output Database to make projections for growth in CESEE countries. We also applied an extra adjustment for Russia and Kazakhstan to reflect the impact of the decline in the oil price.

**Our 'mild' (and now best-case) scenario suggests that the coronavirus will subtract 0.2-0.6 percentage points from growth in CESEE countries this year.** In terms of the change versus the pre-coronavirus baseline, we expect Russia, Kazakhstan and Belarus to be worst affected, with Lithuania suffering the least. Our 'medium' scenario suggests a GDP decline versus the baseline of 0.6-1.2 percentage points. Again, the CIS oil exporters would be the worst affected, with the region's EU Member States faring relatively better.

**In our 'severe' (worst-case) scenario, real GDP growth would be 1.1-2.5 percentage points lower than our baseline projection for this year.** Many countries would experience a technical recession (i.e. two consecutive quarters of negative growth), and both Russia and Belarus would experience full-year contractions. No country in the region would grow by more than 2.8% (Kosovo).

**Figure 2.12 / Real GDP growth projection scenarios for 2020, %**




Source: wiiw projections.

**Our current assumption is that the virus will have a 'severe' impact on economic growth in CESEE.** We expect the impact on the economies of CESEE to become much more significant than is currently visible in the headline data, but we also expect that this impact will be short lived, and that most of the GDP currently being lost will be regained in subsequent quarters. However, this is far from guaranteed.

**Table 2.3 / Real GDP growth projection scenarios for 2020, %**

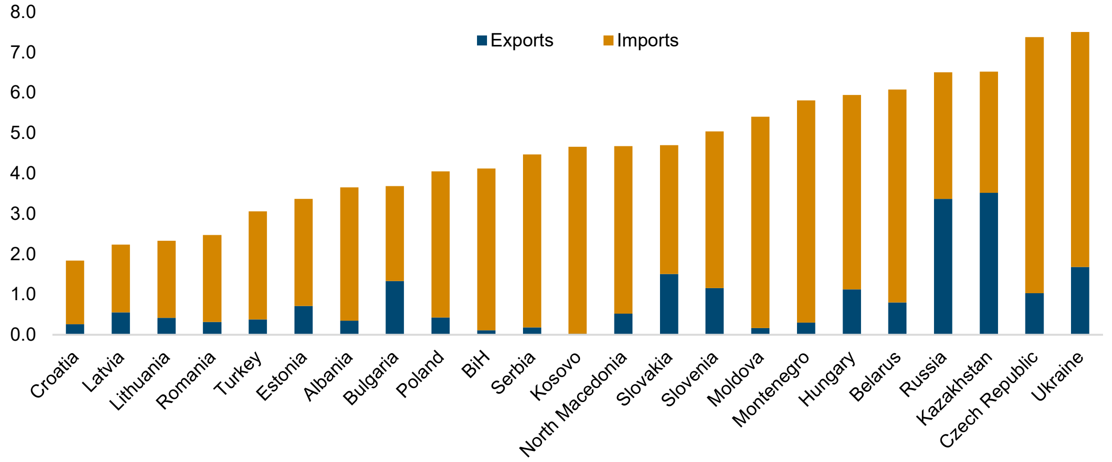
| | | Real GDP growth, %, 2020 | | | | Percentage-point change from pre-coronavirus forecasts | | |
|---|---|---|---|---|---|---|---|---|
| | Pre-coronavirus forecast | Mild | Medium | Severe | | Mild | Medium | Severe |
| AL | 3.2 | 2.9 | 2.4 | 1.7 | | -0.4 | -0.8 | -1.5 |
| BA | 2.5 | 2.2 | 1.9 | 1.2 | | -0.3 | -0.7 | -1.3 |
| ME | 2.8 | 2.5 | 2.1 | 1.4 | | -0.3 | -0.8 | -1.4 |
| MK | 3.3 | 3.0 | 2.5 | 1.7 | | -0.3 | -0.8 | -1.6 |
| RS | 3.7 | 3.3 | 2.9 | 2.0 | | -0.4 | -0.8 | -1.7 |
| XK | 4.3 | 4.0 | 3.5 | 2.8 | | -0.3 | -0.8 | -1.5 |
| | | | | | | | | |
| BG | 2.8 | 3.0 | 2.1 | 1.4 | | -0.3 | -0.7 | -1.4 |
| CZ | 2.2 | 2.0 | 1.6 | 1.1 | | -0.3 | -0.6 | -1.1 |
| EE | 2.7 | 2.4 | 2.1 | 1.4 | | -0.3 | -0.7 | -1.3 |
| HR | 2.7 | 2.4 | 2.0 | 1.4 | | -0.3 | -0.7 | -1.3 |
| HU | 3.3 | 3.0 | 2.6 | 1.8 | | -0.3 | -0.8 | -1.5 |
| LT | 2.8 | 2.6 | 2.2 | 1.7 | | -0.3 | -0.6 | -1.1 |
| LV | 2.0 | 1.7 | 1.3 | 0.6 | | -0.3 | -0.7 | -1.4 |
| PL | 3.6 | 3.2 | 2.8 | 2.0 | | -0.3 | -0.8 | -1.6 |
| RO | 3.2 | 2.9 | 2.4 | 1.7 | | -0.3 | -0.8 | -1.5 |
| SI | 2.6 | 2.3 | 2.0 | 1.5 | | -0.3 | -0.6 | -1.1 |
| SK | 2.0 | 1.7 | 1.4 | 0.8 | | -0.3 | -0.6 | -1.3 |
| | | | | | | | | |
| MD | 4.0 | 3.6 | 3.2 | 2.3 | | -0.4 | -0.9 | -1.7 |
| KZ | 3.7 | 2.8 | 2.2 | 1.2 | | -0.9 | -1.5 | -2.5 |
| RU | 2.1 | 1.5 | 0.9 | -0.1 | | -0.6 | -1.2 | -2.2 |
| BY | 1.0 | 0.5 | 0.0 | -0.9 | | -0.5 | -1.0 | -1.9 |
| UA | 3.6 | 3.2 | 2.6 | 1.9 | | -0.4 | -0.6 | -1.7 |
| | | | | | | | | |
| TR | 3.9 | 3.5 | 3.0 | 2.2 | | -0.4 | -0.9 | -1.8 |

Source: wiiw.

**As the data above show, our region is exposed in various ways to the coronavirus, and we do not expect all countries to be equally affected.** In particular, we highlight the following channels of contagion:

› **Economic integration with China:** The coronavirus has caused huge dislocation to supply chains in China. Given China's importance in the global economy, this has already had implications for many firms in Europe that rely on Chinese inputs. Within CESEE, all economies have some level of integration with China, but this is more clearly the case for some than for others (Figure 2.13). The CIS countries, Ukraine and the Czech Republic are particularly exposed. Many other EU-CEE countries have reasonably high levels of trade integration with China, reflecting their integration in global value chains more generally.

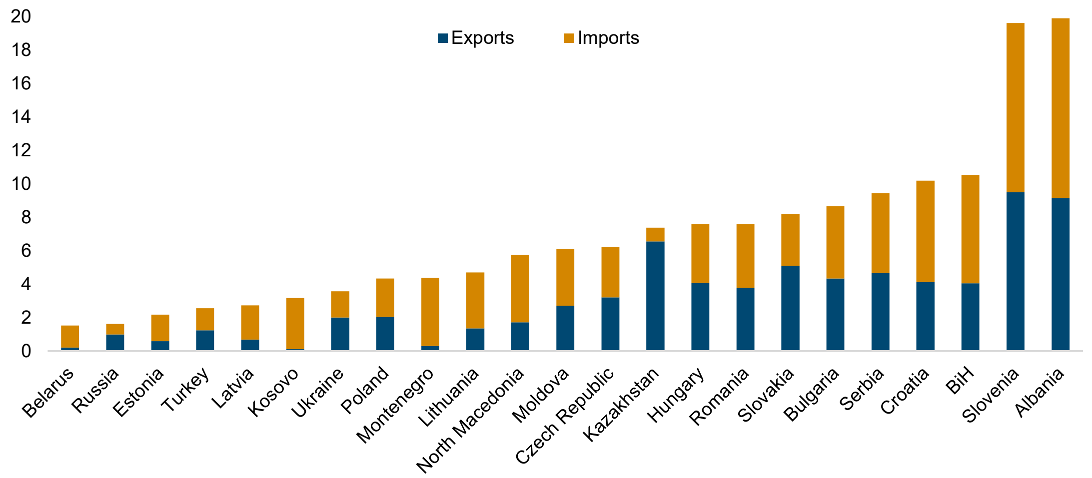
**Figure 2.13 / External trade with China, % of GDP, 2019**




Source: wiiw.

› **Economic integration with Italy:** By far the worst affected European country is Italy. Although Italy's economy has been weak for many years, and its relative importance as a trading partner for the rest of Europe has declined, it remains an important economy from the perspective of many countries in Southeast Europe (Figure 2.14). For Slovenia and Albania, trade with Italy constitutes around 20% of GDP.

**Figure 2.14 / External trade with Italy, % of GDP, 2019**

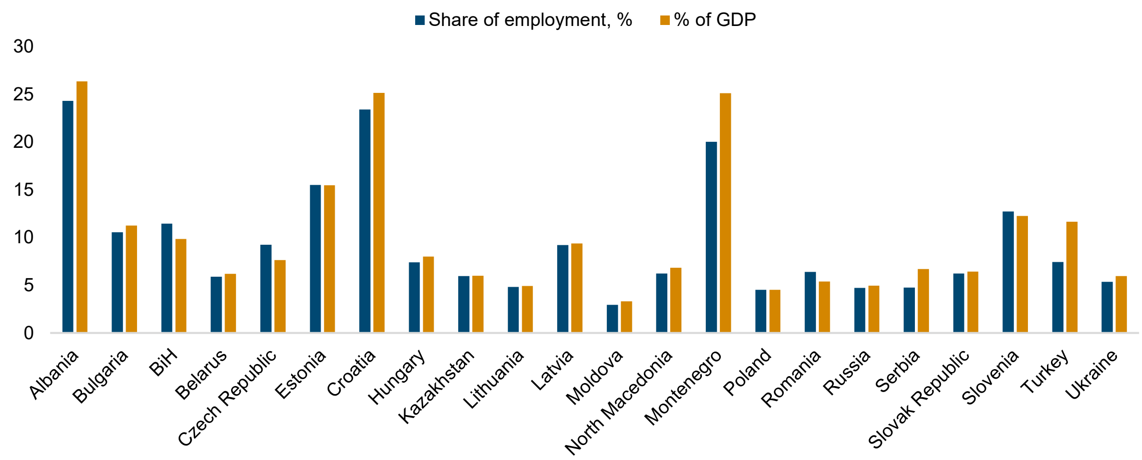



Source: wiiw.

› **Role of tourism in the economy:** Although no hard data are yet available, anecdotal evidence suggests that tourism has already been badly hit. Images in the media show empty planes and airports across Europe. Several CESEE economies, especially Croatia, Slovenia, Bulgaria, Romania, Montenegro and Albania, rely heavily on tourism in overall GDP, and for employment (Figure 2.15). Tourism has also become an increasingly important part of the Turkish growth story in recent years.

The impact may be limited somewhat if (as many experts seem to expect) the coronavirus abates in time for the peak summer tourism season.

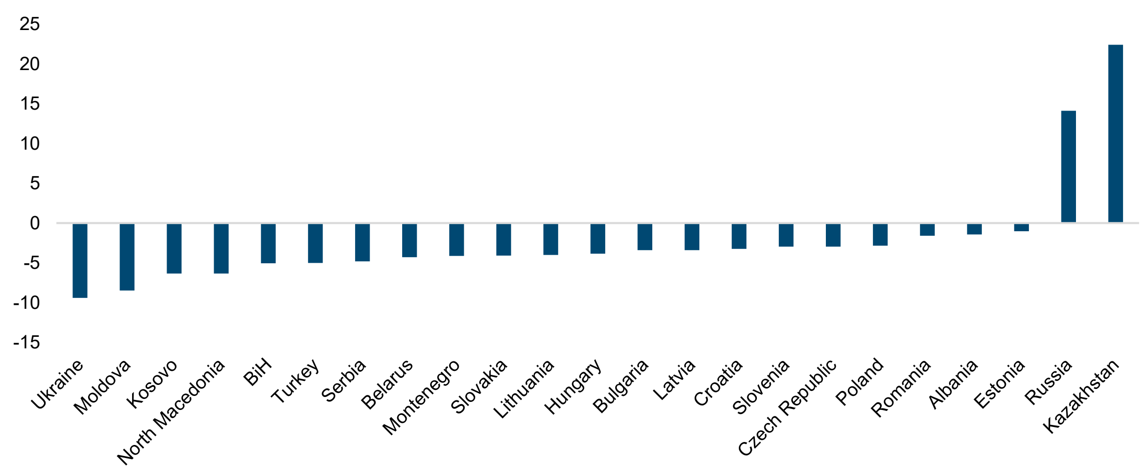
**Figure 2.15 / Role of tourism in CESEE economies, 2018**




Source: World Bank.

› **Importance of energy exports in GDP: The economies of** Russia and Kazakhstan will be hit by the collapsing global oil prices. In 2019, mineral fuels accounted for about 60% and 73% of merchandise exports, respectively, and state revenues from energy exports were the main source of financing for various national projects, in particular investment in infrastructure and support for small and medium-sized enterprises. Belarus will also be affected indirectly, through possible reduced import demand in Russia, its main trading partner.

**Figure 2.16 / Trade balance in minerals, lubricants and related materials, % of GDP, 2018**



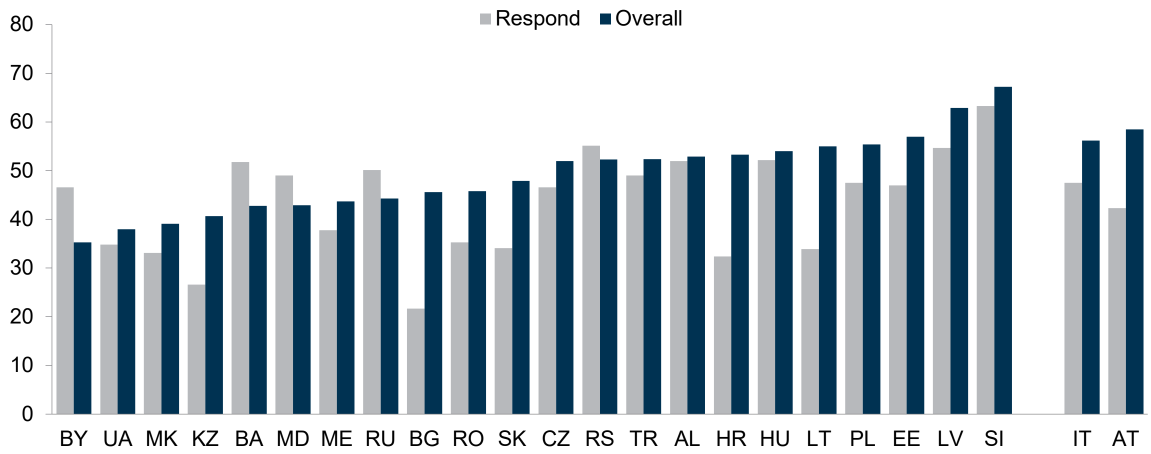

Source: wiiw.

› **Capacity of the healthcare system to react:** According to the Global Health Security (GHS) Index report (2019), around the globe international preparedness to deal with health security crises is weak.

The index's average overall score is 40.2 out of 100, and only rises to 51.9 for high-income countries. In the CESEE region, three countries perform at below the world average overall score: Belarus, Ukraine and North Macedonia (Figure 2.17). Bulgaria, Romania and Slovakia have the worst performance among the EU-CEE11 countries. The Baltic States, Poland and Slovenia appear to have the strongest health security systems in the region, with Latvia and Slovenia even outperforming Austria. An important sub-index of the GHS Index is readiness to respond rapidly and to mitigate the spread of an epidemic. It is remarkable that this sub-index is lower than overall national health security in all the CESEE countries, apart from Belarus, Moldova, Russia, Bosnia and Herzegovina, and Serbia. By this metric, the least prepared for an epidemic are Bulgaria and Kazakhstan. Croatia and Lithuania, although they have among the best overall health security systems in CESEE, perform quite badly on this score.

**Figure 2.17 / Indices of overall national health security and of readiness to respond rapidly and mitigate the spread of an epidemic**

Maximum score 100 indicates the highest health security / full readiness



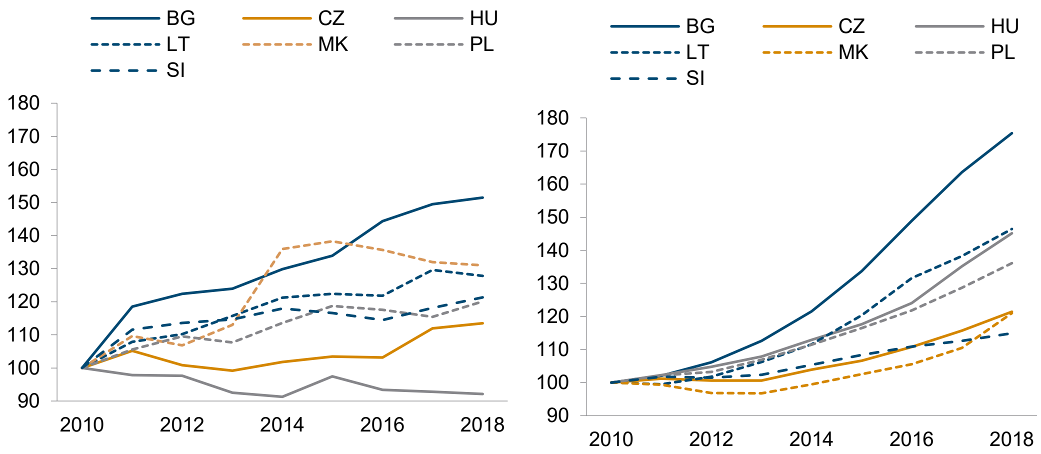

Source: GHS Index Report.

## 2.7. LABOUR SHORTAGES UNDERLINE THE NEED FOR A NEW GROWTH MODEL

**Current demographic developments in CESEE raise fundamental questions about the sustainability of the region's economic model, based as it is on labour-cost advantages and participation in regional production chains.** A slowdown in the economic growth of many countries suggests that the low-hanging fruit of economic development has already been picked. As can be seen from Figure 2.18 for selected CESEE countries, growth in labour productivity in manufacturing has been sluggish in recent years. Only Bulgaria – which is characterised by low levels of labour productivity – saw it grow relatively dynamically during 2016-2018; in other countries it basically stagnated (or even fell in Hungary and North Macedonia). In Bulgaria, Hungary, Lithuania and Poland, the growth of wages in manufacturing has significantly outpaced the growth of labour productivity – and this trend can hardly be sustainable in the future. That may limit the role of household consumption as a growth driver.

**With a projected decline in the working-age population in the near future, labour shortages are likely to become more acute and subsequently to threaten economic growth.** A recent study by Leitner and Stehrer (2019) shows that the hypothetical labour productivity growth rate required to compensate for the loss of working-age population is about 1 percentage point higher than the actual growth rate, suggesting that the current labour productivity growth rate in the EU needs to more than double.

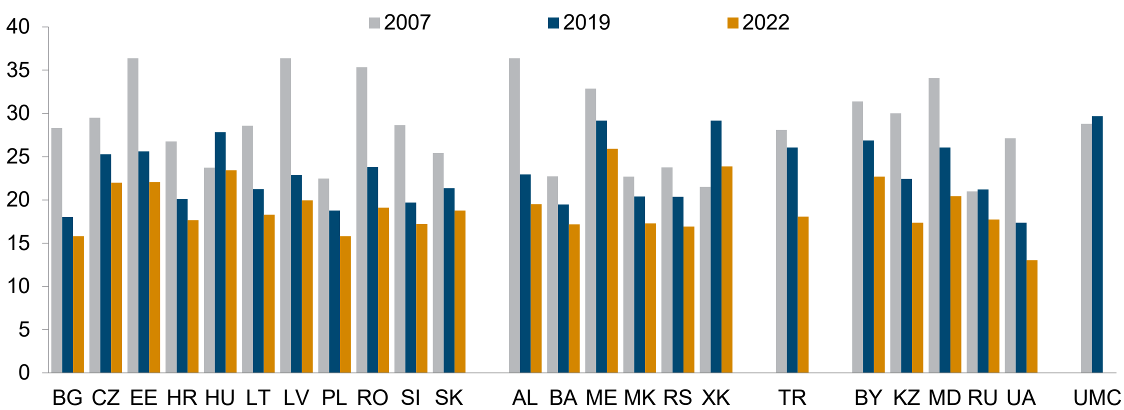
**Figure 2.18 / Index of real labour productivity and real wages in manufacturing, 2010=100**




Note: Real labour productivity is calculated as output per employee.
Source: wiiw Annual Database incorporating national and Eurostat statistics. Own calculations.

**Figure 2.19 / Gross fixed capital formation**

share in % of GDP

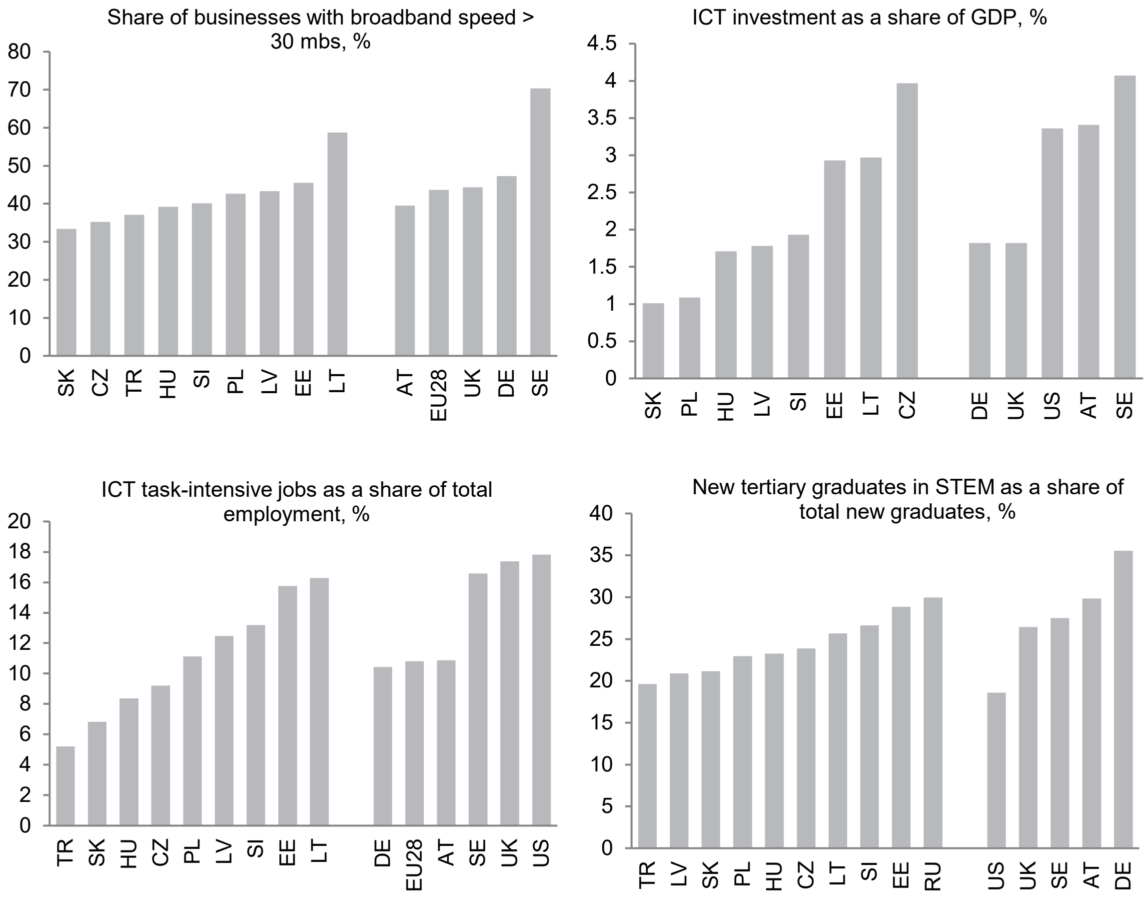



Note: UMC refers to upper-middle-income countries.
Source: wiiw Annual Database incorporating national and Eurostat statistics, OECD.

**The situation is further exacerbated by the relative undercapitalisation of the CESEE region.** All other things being equal, unfavourable demographics increase the relative importance of capital deepening, as boosting labour productivity usually requires expanding investment into new capital-intensive technologies, as well as human capital development. Most of the CESEE countries significantly cut their shares of gross fixed capital formation in GDP after the last global economic crisis – only in Hungary and Kosovo were they higher in 2019 than 2007 (Figure 2.19). During 2020-2022, shares of gross fixed capital in GDP are forecast to decline further in all the countries and to fall below 25% – to as low as 13% in Ukraine and 16% in Bulgaria and Poland. Such levels are significantly lower than the current average in the upper-middle-income economies (about 30%) and most likely are not adequate for technological modernisation of the region.

**Digitalisation could ease the pressure on labour reserves and be the next driver of sustained growth in the region.** A recent ECB survey of large companies[21] found that digitalisation is viewed as something that increases productivity, thanks to knowledge-sharing and more efficient production processes. Novak et al. (2018) estimate that about 50% of work activities could be automated using technologies available today – such as industrial robots, distributed ledger technology, 3D printing, the internet of things, artificial intelligence and big data analytics; the greatest potential for automation is to be found in manufacturing, transportation and warehousing, mining, agriculture, accommodation and food services, trade and utilities. Furthermore, Kotian et al. (2018) suggest that investments in ICT in CESEE have a bigger effect on productivity growth than investment in other infrastructure or machinery.

**Figure 2.20 / Selected indicators of digital development, 2017**




Source: OECD Going Digital Toolkit.

21 See ECB (2018).

**CESEE countries are believed to have solid foundations for further digitalisation,** such as a large STEM (science, technology, engineering and mathematics) and ICT talent pool, relatively high-quality digital infrastructure and broadband coverage, and a milder legacy ‘technology lock-in’ than Western and Northern European countries (Novak et al., 2018). Kirpalani (2012) argues that with the introduction of ICT, Eastern Europe has the potential to leapfrog stages of transition and transform itself into a new knowledge-driven economy, since it can provide the necessary skills or build them relatively easily. Figure 2.20 shows how selected CESEE countries compare with the digital frontrunners Sweden, the US and the UK:[22] though the region generally lags behind the leaders with respect to ICT investment, it can claim a relatively high importance of the ICT sector for employment, well-equipped skilled labour and decent broadband infrastructure. The region performs relatively well on average in PISA tests that evaluate pupils’ maths and science scores. Furthermore, the European Digital City Index 2016, for example, ranks Bucharest, Vilnius and Riga as the top three cities in Europe for digital infrastructure, eclipsing major innovation hubs such as London and Amsterdam.

**Digitalisation could help CESEE to increase the productivity of its economies by developing more productive service sectors and increasing the servitisation of their production processes.** Growth in the service sector is one of the foundations on which international goods production networks are built – without efficient markets for infrastructure services and business processes, it is impossible to move intermediate inputs across borders and undertake complex coordination of production processes (Pasadilla and Shepherd, 2012). Moreover, a more productive service sector is beneficial not only for those directly connected with it through investment or employment, but also for other parts of the economy that use services inputs intensively or influence productivity of a whole economy through numerous spill-over effects. This could potentially allow the countries to avoid the trap of being stuck in the production part of the (lower) value chain.

**New government policies will be needed to harness the benefits of digitalisation.** First, growing digitalisation is likely to lead to a significant shift in demand for skills – demand for technology skills, social skills and emotional skills is expected to grow the most. Thus, it is important for CESEE countries to ensure the reskilling of their workers through education policies. Second, it is important to provide incentives for businesses to invest in new technology, and also to ensure that they have the means to finance their investments, in particular through a financial sector that is capable of supporting innovation. Currently R&D spending on aggregate remains very low in CESEE compared to the leaders in Western Europe, Asia and the US, and the situation is unlikely to change without targeted government policies.

## 2.8. CONCLUSION: CORONAVIRUS UNDERSCORES STRUCTURAL ISSUES FACING CESEE ECONOMIES

In the past three decades, many of the CESEE economies have based their economic models on close integration into regional and global value chains, using their cheap labour forces as a comparative advantage. This strategy allowed them to attract large volumes of FDI to finance investment, and facilitated a rapid process of catch-up with the Western EU members. However, it appears that this model will no longer deliver such big returns. The negative aspects of over-reliance on external demand and cheap labour have become very stark of late, as this chapter has shown.

[22] See also Grieveson (2019b).

Currently CESEE economies have to deal with negative external shocks caused by the coronavirus and cyclical weakness in German industry. However, even once these have passed, the region will have to deal with possible long-term issues in globalisation patterns, structural change in the automotive industry and demographic decline. We see two possibilities for the region: either to adjust to a lower trend growth rate (and weak convergence) or to take decisive action to shift to a new growth model. In this chapter we have made some suggestions for how to do the latter.

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# 3. Special section: The impact of the Coronavirus on CESEE economies

## 3.1. CENTRAL AND EAST EUROPEAN EU MEMBER STATES

### BULGARIA

**by Rumen Dobrinsky**

Bulgaria was one of the last European countries to report a coronavirus infection, and so far the number of cases detected is limited. Immediately after the first case, the authorities introduced measures to restrict the spread of the infection, such as a ban on mass public events, including theatrical performances, cinema and sports events. Hospitals were locked down and most universities were shut. In fact, the arrival of the coronavirus coincided with a big second wave of seasonal flu, which had resulted in the temporary closure of schools. The biggest risks are associated with the deplorable state of the Bulgarian public healthcare system. A series of counterproductive reforms and lack of investment have led to its dilapidation, the degradation of health care and the departure of medical personnel. In recent years, the protests of public healthcare workers have become chronic. Private health care of better quality is available, but unaffordable to the majority of the Bulgarian population. As to the economic implications, the most visible direct negative effects will include a drop in revenue from tourism and transportation services. Disruptions to trade with Italy (a major trade partner) will also have a negative effect, but trade links with China are limited. However, the secondary effects related to reduced economic activity worldwide, and especially in the EU, could be significant.

### CZECH REPUBLIC

**by Leon Podkaminer**

The Czech public health system is better organised, managed, staffed and funded than elsewhere in the region. It should thus be able to cope with events as they unfold – unless, of course, they assume apocalyptic dimensions. The very high level of internationalisation of the Czech economy could prove troublesome now: the severance of Germany's trading links with China could magnify the problems of the Czech export sector – and thus of the economy as a whole.

### ESTONIA

**by Sebastian Leitner**

As a small, open economy with exports of goods and services accounting for a 75% or so share of GDP, Estonia will be hit by the likely downturn in trade activities in Europe. The impact via direct exports to the worst-hit countries – China and Italy – will be rather small, since only about 1.3% of goods exports are destined for the former country (and even less for Italy). Nevertheless, the indirect effects will be felt via reduced demand from Scandinavian exporters, first and foremost Sweden. In particular, the electronics sector is likely to be hit not only by reduced demand, but also by problems with delivery from the Asian producers of components. However, if the coronavirus spreads to the Scandinavian region, and if trade-inhibiting policy measures are introduced, then many more industrial sectors could face production and export problems. Estonia is, moreover, rather vulnerable due to its high share of tourism income. It is to be expected that in the near future there will be fewer tourists, both foreign and domestic. Possible restrictions on travel to/from Finland and Sweden could sharply reduce the income of the accommodation and catering sector. Another factor will be reduced consumption in general, if people are cautious and more likely to stay at home. Moreover, spending on consumer durables is particularly likely to fall at times of uncertainty. The first temporary school closure occurred in the first week of March. In general, the Estonian health system should be relatively well equipped to handle the coronavirus cases. In order to reduce the labour market impact of negative economic effects, the Estonian government may support short-time working arrangements, as is the case in German industrial sectors. There is enough room for manoeuvre to allow fiscal policies to support the economy via, for example, public investment and tax deferrals. However, the Estonian government is likely to wait for an EU coordinated policy move, instead of proceeding unilaterally.

## CROATIA

**by Hermine Vidovic**

Croatia confirmed its first case of coronavirus at the end of February. Health checks were introduced for people coming from Northern Italy, and several locations were set up for quarantine. At the time of writing, the borders are open, but it has been announced that additional epidemiological teams and health inspectors will be deployed on the borders, if necessary. Croatia's economy may be affected in two ways. First, it is heavily dependent on tourism, which accounts for about 17% of GDP or more than half of total goods and services exports. This differs significantly from most other EU-CEE countries, where services exports account for a much smaller share of total exports. Thus, depending on how long the virus lasts – especially in Italy, which is one of the main countries of origin for visitors to Croatia – there could be a far-reaching impact on the country's economy. The sectors affected most would be accommodation, restaurants, transport and travel agencies. A reduction in earnings from tourism would have a negative impact on private consumption, which has recently been one of the main drivers of economic growth. Tourism also plays an important role in offsetting the large trade deficit, and has contributed to current account surpluses in recent years. The second way in which the economy may be affected is through trade. Trade integration with Italy is very high: Italy is the main export destination for Croatian goods and the country's second most important partner in terms of imports. Trade with China is insignificant, and is almost exclusively restricted to imports.

## HUNGARY

**by Sándor Richter**

According to the 'international preparedness for pandemic' rankings, Hungary occupies one of the best positions among the countries of Central and Eastern Europe.[23] Thus, formally the institutional system is in place to face the epidemic. Whether it will be able to deal with the challenge in real life, however, is an open question.

Between 2005 and 2017, public expenditure on the healthcare sector as a percentage of GDP decreased, and at the end of that period was about 2 percentage points lower than the EU average.[24] The healthcare system has long been underfunded, with many hospitals in a desperate state in terms of both buildings and equipment. Not infrequently, hospital patients lack an adequate supply of good-

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23 Raiffeisen Research (2020), 'Special CEE: Coronavirus economic exposure', 6 March, p. 4.

24 Portfolio.hu, 3 March 2020.

quality food, while sanitary products for patients are sometimes provided by their relatives. Doctors and nurses have long been underpaid. Waiting times for medical examinations and treatment are often extremely long.

Since 2011, low wages and unresolved institutional (and other) problems have led to a mass exodus of doctors and other highly trained personnel. It is typical for the younger generation of doctors to emigrate, which leads to a high average age of practising doctors. The vacancies in hospitals and the shortage of specialists and GPs have been a cause for concern for many years, and it could now become a very serious problem, should the coronavirus epidemic spiral out of control.

Sectors that could be particularly affected include tourism, electronics and automotives. First, Hungary is an important tourist destination. Revenues from tourism are the most important item in foreign trade in services, enjoying a very positive balance. The anticipated losses may be mitigated somewhat by fewer Hungarians travelling abroad, with a corresponding upturn in domestic tourism. Second, for electronics, the lack of essential components and parts normally imported from China could lead to delays and bottlenecks in production and in the delivery of devices produced in and exported from Hungary. Third, Hungary's car sector is large and its exposure to trade with the German automotive sector is extremely high. Should the coronavirus hit Germany's car sector, the secondary impact on Hungary may be enormous.

Finally, trade links with China are important, with much greater weight on the import side: trade turnover amounts to close to 6% of GDP. Trade with Italy is similarly important, but there the trade is much more balanced.[25]

## LITHUANIA

**by Sebastian Leitner**

Of the three Baltic States, Lithuania's exports of goods and services accounted for the highest share of GDP (76%) in 2018. However, its production is less bound up with global value chains than that of other CEE countries. The export-oriented production of electronic and electrical appliances is less important than in Estonia and Latvia, while petroleum, petroleum products and downstream industries like chemicals predominate. These sectors are likely to be hit by a general slowdown in external demand; the sharp decline in oil prices is not likely to have a positive quantitative effect on demand for the sector's products. Since production is rather energy intensive in the Lithuanian economy, and since energy claims a large share of the household consumption basket, the declining oil price is likely to result in consumer price deflation. This might result in even greater restraint in private investments in the medium turn. The transport sector is expected to be hit by lower trade volumes in general, and also by reduced transit trade bound for Russia – not only from EU countries, but from around the world, including Asia. This will particularly affect cargo volumes in the ports of Lithuania. As in all other countries, we expect a decline in consumer sentiment to have a temporary negative impact on household consumption. Health care spending in Lithuania, both per capita and as a share of GDP, is among the lowest in the EU. Thus the health system is generally well equipped, but it could reach capacity fairly rapidly if there is a sharp rise in the number of coronavirus cases. Given that Lithuania has a relatively low level of public debt (35% of GDP), the government has enough wiggle room to allow fiscal policies to support the economy, through public investment and tax deferrals, for instance. However, it is likely to wait for a coordinated EU policy plan, rather than go it alone.

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[25] Raiffeisen Research (2020), 'Special CEE: Coronavirus economic exposure', 6 March, p. 4.

## LATVIA

**by Sebastian Leitner**

Although Latvia is also a small, open economy, its 60% share of exports in GDP is somewhat lower than in most other EU-CEE countries. Exports of machinery and electrical equipment are likely to be most affected, since production depends on imported inputs from Asian countries. However, a general downturn in external demand in the Baltic region will definitely also affect the most important Latvian export sector, which is wood and wooden articles. In the case of services exports, tourism is an important economic activity in the Riga region, which will be hit by a reduction in bookings. In the first week of March, the most important carrier in the Baltic States, the Riga-based Air Baltic, not only cancelled flights to Italy, but also sharply reduced its flight schedule for the coming two months. The transport sector is expected to be hit by lower trade volumes in general, and by reduced transit trade bound for Russia – not only from EU countries, but also from around the world, including Asia. This will particularly affect cargo volumes in Latvian ports. As in all other countries, we expect a decline in consumer sentiment to have a temporary negative impact on household consumption. Although Latvia ranks quite high (17th) in the Global Health Security index, health expenditure both per capita and as a share of GDP is lower than in most other EU countries. Thus the health system is generally well equipped, but it could reach capacity rather rapidly, if there is a steep rise in coronavirus cases. Given the relatively low level of public debt (36% of GDP), the Latvian government has enough room for manoeuvre to allow fiscal policies to support the economy via, for example, public investment and tax deferrals. However, it is likely to wait for a coordinated EU policy plan, rather than taking steps on its own.

## POLAND

**by Leon Podkaminer**

The authorities are beating the coronavirus drum hard, primarily through the government-controlled media. The intention is to burnish the tarnished image of President Duda ahead of the forthcoming election (10 May). The law on infectious diseases was recently revised, extending the authorities' administrative powers quite radically. So far, the number of cases confirmed is fairly low and the healthcare system seems to have been able to cope (though shortages of some equipment and pharmaceuticals have surfaced). But in general, the Polish healthcare system was in disarray before the coronavirus struck – and remains so. Aside from chronic underfunding, a recent rash 'reform' has led to a shortage of medical personnel (with those who remain severely overstretched), silly procedures, heavily indebted hospitals, etc. This does not bode well for the future, should the number of cases confirmed or suspected increase even moderately.

## ROMANIA

**by Gábor Hunya**

The authorities have made similar preparations as in other countries, and they are confident of being able to tackle the emerging problems. The current minister of health and the leader of the department coordinating action against coronavirus are well respected and trusted. But the frequent changes of government and the recent corruption charges against a former minister of heath suggest poor organisational standards in the healthcare system. Hospitals have recurrent problems with disinfection and shortage of medicines. Romania ranks last but one in the Euro Health Consumer Index 2018, which covers 25 countries, and it has the lowest per capita healthcare expenditure in the EU. The country allocates 5.2% of GDP to the health service – again, the lowest in the EU.

Romania has a large economic exposure to Italy, which is Romania's second largest export and import partner, with shares of 11.5% and 9.5%, respectively. Italy is also the fourth largest investor in Romania, with 9.5% of the stocks in 2018. Thus, the disruption of trade would seriously affect thousands of companies and workplaces. China is Romania's sixth largest import partner (with a 5.3% share of imports), but exports are much smaller (only 1% of the total). A large part of the imports consists of inputs to products assembled in Romania.

Italy hosts around 1.3 million Romanian migrants, many of whom regularly travel back and forth. The Romanian authorities have asked the diaspora not to return home for the Orthodox Easter holidays (17-20 April). Blue Air, Romania's largest airline by the number of passengers, has said it will cut back flights. Tourism is of more minor significance for Romania than the movement of migrants.

## SLOVENIA

**by Hermine Vidovic**

Slovenia confirmed its first case of coronavirus in early March. All public healthcare institutions have received guidelines on how to treat anyone suspected of being infected with coronavirus in primary health care and hospital. It is expected that checks on passengers arriving at Ljubljana airport will be introduced, as well as controls on the border with Italy. The government has announced a stimulus package worth a billion euro to mitigate the impact of the coronavirus on the economy. It includes both short- and long-term measures, such as tax deferrals, state guarantees and credit lines. Slovenia could well be hit by the coronavirus, particularly trade and tourism. Hotels are daily reporting cancellations and fewer bookings. Depending on the duration of the virus spread, it could also affect the summer season, which has become an important economic factor in recent years. Tourism accounts for 12% of GDP. Apart from tourism, trade integration with Italy is very high: it is Slovenia's second most important trading partner, accounting for almost 12% of exports and 14% of imports. Trade relations with China are negligible. Finally, transhipment volumes at the port of Koper, Slovenia's sole commercial port, are likely to be affected – in particular, container cargo and vehicles.

## SLOVAKIA

**by Doris Hanzl-Weiss**

As Slovakia is one of the most open countries in the region – with its ratio of goods and services trade to GDP standing at 189% in 2019 – it would suffer particularly badly from a slowdown caused by the coronavirus. Imports of goods from China are important (6.3% of total imports – in third place, behind imports from Germany and the Czech Republic), whereas exports to the Chinese market are smaller and account for only 2.1%. Imports of goods from Italy have a 3.4% share, while exports are quite substantial, at 4.6%. Transport and travel (tourism) are important in terms of services exports, where they each hold a share of one third of services. Several preventive measures have been taken in the meantime. Slovakia's preparedness in terms of the healthcare system seems to be not that good. Healthcare expenditure reached 6.74% of GDP in 2017, which is below the EU average. A reform of hospitals was not adopted in December 2019. There is a shortage of doctors and nurses (as many have left to work abroad).

## 3.2. WESTERN BALKANS

### ALBANIA

**by Isilda Mara**

No country is immune and no country is well prepared to deal with the new pandemic.[26] In terms of population structure, COVID-19 has been particularly affecting the age group 65+. In Albania, the population aged 65+ is estimated at 14.7% in 2020 (compared to 23.3% in Italy) – among the lowest of the European countries. Given that, we might expect the impact on the population to be less severe than in other countries where population ageing is more pronounced. Nevertheless, there are a number of structural drawbacks in Albania. Government spending on health does not exceed 4% of GDP[27] (or at least it did not between 2010 and 2017). In per capita terms, Albania has the lowest number of doctors and nurses – less than half the EU27 average.[28] The first 'patient zero' with COVID-19 in Albania was registered on 9 March – an Albanian man returning from Florence, a region of Italy that was not identified as a red zone at the end of February. Taken together, Italy and Greece host a community of Albanians that stands at more than 1 million. There is an influx into Albania of more than a thousand people a day from Italy and Greece. The risks of COVID-19 being spread are high, given the considerable mobility between the neighbouring countries. The response of the Albanian government has been swift: all flights and connections with Northern Italy – including maritime connections – have been suspended. Thousands of families risk being separated, with some members in Albania and others in Italy. It is highly probable that the COVID-19 emergency will have a domino effect on Albania's economy, given that Italy is one of its main economic partners. Italy has 27% of Albania's FDI stock, and in 2019 it was one of the main countries sending FDI to Albania. Close to half of foreign enterprises operating in Albania are Italian, and as of 2018 they accounted for 45% of all enterprises. Trade volume with Italy amounted to 48% of exports and 25% of imports in 2019. China is also an important partner, especially as concerns imports, with a share of 9.2% in 2019. The textile and garment industry is where Italian-Albanian cooperation is most intensive, and the sector is also an important source of employment. The shutdown of activity at a number of enterprises in Northern Italy will also affect a large section of the Albanian community working and living there. Consequently, there may well be a negative impact on the flow of remittances, if the COVID-19 emergency in Italy is prolonged. Italy was already close to recession prior to the COVID-19 emergency, and, if extended through much of 2020, the economic fallout would certainly also retard the Albanian economy.

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[26] The Global Health Security Index released on October 2019 pointed out that overall 'countries are not prepared for a globally catastrophic biological event, including those that could be caused by the international spread of a new or emerging pathogen or by the deliberate or accidental release of a dangerous or engineered agent or organism'. Source: Global Health Security Index 2019, page 44. https://www.ghsindex.org/wp-content/uploads/2019/10/2019-Global-Health-Security-Index.pdf

[27] http://apps.who.int/nha/database/ViewData/Indicators/en

[28] Eurostat: Health personnel by NUTS 2 regions [hlth_rs_prsrg]; Nursing and caring professionals [hlth_rs_prsns].

## BOSNIA AND HERZEGOVINA

**by Bernd Christoph Ströhm**

In response to the looming COVID-19 epidemic, BiH has introduced some precautionary measures, including an intensification of border controls and an increase in medical supplies. The central government has further advised schools to cancel trips to countries and regions with reported COVID-19 cases. Border police at the country's airports have been instructed to collect the contact details of people arriving from Iran, Italy, China and South Korea. At the beginning of March, the Bosnian carrier FlyBosnia also cancelled its Sarajevo–Rome flights to prevent the spread of coronavirus. However, the federal structure of BiH could create difficulties for the central government in effectively handling a COVID-19 outbreak, since both entities within the country have their own decentralised health ministries and healthcare systems. The uncertainty caused by the possible COVID-19 pandemic is also having an adverse effect on goods imports and exports between BiH and Italy, South Korea and Japan: these declined in the first two months of 2020, compared to the same period last year. In particular, exports from BiH to Italy dropped during this period by about EUR 8.4 million. Exports to China, however, increased slightly.

## MONTENEGRO

**by Bernd Christoph Ströhm**

Montenegro's Public Health Institute has issued recommendations for employers, colleges and schools, in order to facilitate the creation and development of prevention and treatment plans in the event of a coronavirus epidemic. The government has further announced the establishment of quarantine facilities in the Danilovgrad and Niksic municipalities, and at the former military base of Zoganje, near the town of Ulcinj, in case of a COVID-19 epidemic within the country. Especially the establishment of the quarantine zone near Ulcinj could severely damage tourism, since that is one of the country's most popular destinations. To reduce the risk of infection, Montenegrin airports have temporarily suspended flights to Northern Italy. Passengers from China and Italy arriving at the airport are routinely checked by the border police for COVID-19 symptoms. The coronavirus outbreak in China could slow down the progress of the Bar–Boljare motorway construction project, since about 800 Chinese workers engaged on the project are currently at home in China – and even if they return to Montenegro, they will not resume work immediately. The Health Ministry has furthermore announced that the 393 Chinese workers from the Chinese company CRBC who are currently working on the Bar–Boljare motorway project are being closely monitored.

## NORTH MACEDONIA

**by Bernd Christoph Ströhm**

Government preparations for a potential COVID-19 epidemic are well in hand. The Health Ministry has enforced procedures in line with the recommendations of the European Centre for Disease Prevention and Control and the World Health Organization, including the quarantining of travellers who test positive for coronavirus. At land borders, the Border Patrol is instructed to carry out heightened control checks on travellers who have been in countries with a high COVID-19 infection rate (in particular, Italy and China). Moreover, the authorities are conducting the thermal screening of passengers on all incoming flights at both Skopje International Airport and Ohrid Airport. The government has advised citizens against travelling to Italy and other countries with a high incidence of COVID-19. Following a huge upsurge in purchases of hygiene and disinfectant products in February/March, the government has urged retailers not to exploit the panic of citizens by raising the prices of certain products. Especially North Macedonia's service and tourism sector will likely suffer from the uncertainty caused by COVID-19. Shoe and textile companies that cooperate with Italy, as well as companies involved in the automotive sector, may experience a decline in demand and exports.

## SERBIA

**by Richard Grieveson**

Serbia confirmed its first case of coronavirus in early March. Increased controls have been put in place for travel to and from China and Italy, and further measures are possible. Tourism accounts for around 7% of GDP, below the CESEE average (of around 10%). Net energy imports accounted for around 5% of GDP in 2018, so Serbia should benefit from the decline in the oil price. Like most of Southeast Europe, Serbia has a fairly high level of trade integration with Italy (9.4% of GDP for exports and imports combined in 2019). The knock-on effects from economic dislocation in Italy are therefore likely to be quite significant for Serbia. Total trade with China accounts for 4.5% of GDP, but is almost entirely composed of imports. As a result, the fallout from China is likely to be largely a supply shock. In February, Fiat Chrysler halted production in Serbia in direct response to the coronavirus, saying that it could not get access to necessary parts from China.

## KOSOVO

**by Isilda Mara**

The downside effects of COVID-19 on Kosovo's economy are likely to be largely indirect, rather than direct, because of the exposure of its main economic partners – i.e. Germany, Switzerland, Italy and Albania – to the economic fallout. As in other Western Balkan countries, health expenditure is exceptionally low in Kosovo – only around 2% of GDP in 2017.[29] The quality of the healthcare services – proxied by the number of health professionals at the disposal of the population[30] – suggests inadequate coverage, especially in rural areas. So far, Kosovo has not recorded any patients infected with COVID-19, but it can only be a question of time. The government has interrupted all transport connections with Italy until the first week of April, but the risks of contamination remain high. In terms of trade relations, exports from Kosovo go mainly to European countries. As concerns imports, the downside risks are higher, since there is a dependence on both China – which has a 10% share of Kosovo's imports – and other European countries, especially Germany and Italy. The slowdown in imports is very likely to curb consumption and consequently growth. Also the tourism sector may be negatively affected, given the disruption of mobility with Italy (and some other European countries), especially if the downside effects are protracted.

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29 https://ec.europa.eu/eurostat/statistics-explained/index.php/Enlargement_countries_-_health_statistics#Public_expenditure_on_health

30 https://ask.rks-gov.net/sq/agjencia-e-statistikave-te-kosoves/add-news/statistikat-e-shendetesise-2018

## 3.3. CIS AND UKRAINE

### BELARUS

**by Rumen Dobrinsky**

The spread of the coronavirus infection in Belarus has so far been limited, mostly due to the relatively low international mobility of the population. The Soviet-type healthcare system in the country is, in principle, well developed; however, the quality of care has been deteriorating due to lack of investment. Thus, it is not clear how the system would endure a powerful shock in the event of a mass epidemic. The negative implications for the Belarusian economy are mostly related to secondary effects, such as the sharp fall in oil prices (refined oil is a major export item for Belarus) and possibly reduced import demand from the country's main trading partner, Russia. The Belarusian current account balance may also be negatively affected; this could put extra pressure on the currency, which was already being dragged down by the plunge of the Russian rouble.

### KAZAKHSTAN

**by Alexandra Bykova**

Kazakhstan's general preparedness for epidemics is rather weak, according to the Global Health Security (GHS) Index, which ranks it 83rd out of 195 countries; only three CESEE countries rank lower, and its score is only slightly above the global average. According to the GHS assessment, Kazakhstan underperforms in terms of the detection of diseases, but has above-average performance in their prevention. Currently, the government's response to the coronavirus threat focuses on prevention. This includes travel restrictions, medical checks at the border, and a 14-day quarantine or monitoring of persons entering Kazakhstan, depending on the country of origin. Passenger transportation from China was suspended relatively early on, at the beginning of February. Since 8 March, there has been a ban on the citizens of China, Iran and South Korea entering Kazakhstan.

The indicators on the physical capacity of the health system in Kazakhstan are comparable with OECD averages. Towards the end of 2018, there were 53 hospital beds and 40 doctors per 10,000 inhabitants. However, the quality of health care has suffered for years from rather low funding by international standards: according to WHO data for 2017, health expenditure amounted to 3.1% of GDP. Ongoing modernisation of the health system is slow and relies partly on international assistance (the recent EBRD confirmation that it will finance the construction of new hospitals being one example). The high prevalence of chronic conditions – especially cardiovascular and respiratory disease – is responsible for higher mortality rates and lower life expectancy than are to be found in other countries with the same income level, according to a 2018 OECD assessment. That could place an additional strain on the health system of Kazakhstan in the event of an outbreak.

The spread of coronavirus and the resultant production disruption in China have triggered the downward movement of global commodity prices, on the back of lower demand expectations. Since the export of mineral products accounted for 72.8% of Kazakhstan's total merchandise exports in 2019, this has weighed negatively on oil export revenue expectations for 2020. The oil price crash of 9 March that followed the collapse of the OPEC+ agreement on additional cuts in oil production seriously challenges the economic growth prospects of Kazakhstan this year. A decline in the volume of exported commodities as a result of possible lower demand for raw materials could amplify the negative impact.

Consequently, the worsening of the financial performance of large enterprises in mining and metallurgy will drain revenue flow to the budget and the National Oil Fund throughout the year. Simultaneously, the possible spread of the coronavirus in Kazakhstan could necessitate additional expenditure on disease prevention and health care. The difficult fiscal conditions will be accompanied by high depreciation pressure on the tenge in the aftermath of the oil price slump.

Significant vulnerabilities also arise due to Kazakhstan's high level of trade integration with China, Italy and South Korea – the countries currently worst hit by the outbreak, if measured by the number of recorded coronavirus cases. Those countries generate about a third of Kazakhstan's foreign trade, with almost equal shares of exports and imports. Apart from the country's export-related difficulties, the possible disruption of imports could have a negative economic impact. Any delay in the supply of imported goods from China, especially those with no domestic substitutes, could lead to shortages and rising prices. On 2 March, the violation of phytosanitary requirements led to a temporary ban being imposed on fruit imports from China. This could further accelerate food price inflation, which was already high even before the coronavirus outbreak. Delays in the supply of capital goods from China and South Korea could hamper infrastructure projects and the modernisation of production facilities through delays, higher investment costs and the possible 'economic contagion' effect for local partners. Such service sectors as transport and trade will be affected by disruptions to external activity. The national railway company, Kazakhstan Temir Zholy, reported a 39% decline year on year in container cargo transportation in February 2020. Additionally, the travel restrictions imposed will reduce cross-border shuttle trade by individuals (estimated at USD 2.5 billion in 2019) and could affect this source of personal income.

As a reaction to the oil price shock of 9 March, the government and the National Bank of Kazakhstan issued a joint statement announcing measures to maintain macroeconomic and social stability. The fiscal policy will reportedly be adjusted to meet social obligations. The budget, based on an oil price of USD 50–55 per barrel, is to be revised and 'non-priority' expenditure will be cut. Some investment projects will also be put on hold. Administrative control will be introduced to contain the prices of socially significant products, to avoid layoffs and ensure the timely payment of wages. It is intended to create additional public-works jobs. Large state-controlled companies have been asked to make foreign currency purchases only for their current needs, to coordinate these with the National Bank, and to postpone their investment projects. Measures to maintain banking-system stability will be introduced soon. To prevent the acceleration of inflation, the National Bank increased the policy rate to 12% on 10 March, and will carry out foreign exchange interventions to stabilise the tenge. At the end of January 2020, the assets of the National Oil Fund amounted to USD 61.1 billion. International reserves were put at the same time at USD 29.3 billion, consisting of 67% gold – a safe asset in an unstable global environment. All this offers Kazakhstan enough financial space to counteract the current economic shocks with expansionary fiscal policy, and to support the tenge with currency interventions.

## MOLDOVA

**by Gábor Hunya**

Europe's poorest country has limited means to resist an epidemic crisis. The country allocates only 4.4% of GDP to health care – lower than any country in the EU. Local health authorities have said that the country has prepared a 'pandemic plan', and it has imposed stricter border-crossing checks. A strong WHO office provides continuous support to the health authorities. Italy has been one of the main emigration destinations in recent years: it has a Moldovan population of some 130,000, and unofficial migrants also travel regularly between Moldova and Italy. Italy has an 11.4% share in Moldova's exports and a 6.8% share in its imports. China's share is 0.7% of exports and 10.4% of imports. The country has no significant tourism. But many people may want to return for the upcoming Orthodox Easter holidays (17–20 April) and they could import the virus. The temperature of people arriving is measured at the airport, but not at land border stations. People giving false information about their country of origin and their address in Moldova could present a major risk in identifying the contacts of potentially infected persons, according to local media reports.

## RUSSIA

**by Vasily Astrov**

In Russia, the spread of the coronavirus has so far been contained, not least thanks to timely warnings and outright restrictions on cross-border travel with those countries most affected by the virus, such as China, Iran and Italy. However, Russian oil exports to China dropped by around one third at the start of 2020, resulting in a 4% overall export decline. Whether lower export volumes will be sustained in the remainder of the year is, however, questionable: Russia has opposed further oil production cuts, and this has brought down the OPEC+ deal and effectively sparked a price war on the global oil market.

The main risk for the Russian economy in this context is the plunging oil price: at the time this report was finalised (9 March 2020), the price was already approaching USD 30 per barrel, and may well drop further. The effects of this are likely to be twofold. First, the Russian rouble has been depreciating in line with the oil price decline, and that will boost inflation in coming months. In these circumstances, the central bank will abstain from its easing cycle pursued so far, and may even revert to policy tightening. Second, and more importantly, given the shortfall in fiscal revenues, the sovereign National Welfare Fund will be likely used to finance the budget deficit rather than the national projects, especially those that rely heavily on investments. Instead, the government priority will be social spending and possibly 'rescue packages' for those sectors most vulnerable to the coronavirus shock, such as travel, transportation and catering. All in all, the impact of the coronavirus even in the 'mild scenario' will be a drop in real GDP growth of around 1 percentage point this year.

## UKRAINE

**by Olga Pindyuk**

As of 10 March 2020, only one COVID-19 case has been registered in Ukraine. However, given the large flows of tourists and labour migrants between Ukraine and the EU (including Italy), an increase in the number of cases is likely soon. Ukrainian airports and border checkpoints continue to take the temperature of new arrivals, but according to the WHO this measure does not help slow the spread of the coronavirus. The government has undertaken a series of preparations, such as establishing 2,000 isolation rooms in infectious disease wards throughout the country; taking delivery from the WHO of COVID-19 testing kits for about 950 people; and starting training programmes for medics, first responders, police and local authorities. But these measures are likely to be insufficient if there is a large-scale outbreak. As the recent measles epidemic showed, the country's healthcare system lacks the resources to respond to emergencies of this ilk.

The vulnerability of Ukraine's economy to the effects of the coronavirus is limited by its low level of involvement in global production chains; thus, one of the main channels for crisis transmission is likely to be through commodity prices. On the one hand, the economy will benefit from lower energy prices; on the other, a significant plunge in the prices of agricultural commodities and iron ore could wipe out the gains.

Remittances from abroad – an important source of external financing for the country – are not significantly affected at the moment, as Italy accounts for only a small share of remittances (4.4% in 2018). However, if the economic fallout from the virus becomes more pronounced in Poland and the Czech Republic, Ukraine could be severely affected through the remittances channel.

A significant risk is capital flight, which is aggravated by rising political uncertainty. The yield on government bonds has already started to increase recently, and the national currency has depreciated by 4% over the past two weeks.

## 3.4. TURKEY

by Richard Grieveson

At the time of writing, Turkey has no confirmed cases of coronavirus. However, many neighbouring countries do, and so the chances of this situation lasting look slim. The land border with Iran was closed and flights between the countries were suspended in February. And in March, the border with Iraq was closed. This is more serious from an economic perspective: Iraq is Turkey’s ninth biggest trade partner, with bilateral trade equivalent to 1.5% of Turkish GDP in 2019 (Iran, by contrast, accounts for less than half of that).

Turkey is not as vulnerable as some other parts of CESEE to the economic fallout from the virus. As a net energy importer, it stands to gain a lot from the collapse in the price of crude oil. This should also significantly curtail inflation, which is still in double digits. By CESEE standards, Turkey is also not very economically integrated with either China or Italy.

There are two key areas of potential vulnerability for Turkey. The first is tourism, which accounts for over 10% of GDP. Turkey has pitched itself as a ‘coronavirus-free’ destination for tourists, which could limit the impact for now. However, it seems very unlikely that this will last. Even if Turkey reports just a few cases, many tourists may cancel their plans, irrespective of the number of cases at their destination.

The second big risk is general capital flight in a ‘risk-off’ environment. Coronavirus comes at a time of escalating international tensions related to Turkey’s involvement in Syria. This could lead to a further depreciation of the lira, with negative knock-on effects for macroeconomic stability and growth.

# 4. CESEE risk outlook

## 4.1. CESEE RISK MATRIX

### Figure 4.1 / Summary of risks and changes since autumn 2019

New risks:

› 'Deep global recession as a result of measures to stop the spread of the coronavirus' (medium likelihood, high impact);

› 'Breakdown of UK-EU trade talks' (low/medium).

Deleted risks:

› 'Hard/no deal Brexit' (low/medium). Brexit has happened, so this risk has been replaced by 'Breakdown of UK-EU trade talks'.

| | | Impact on CESEE countries* | | |
|---|---|---|---|---|
| | | **High** | **Medium** | **Low** |
| **Likelihood** | **High** | Smaller EU budget (only EU countries) | Rule of law and quality/independence of institutions deteriorate further | |
| | **Medium** | Labour shortages stimulate higher investment<br>Significant increase in US tariffs on EU automotive exports<br>Deep global recession as a result of measures to stop the spread of the coronavirus | | |
| | **Low** | Formalised core/periphery in EU (only EU countries)<br>Renewed outbreak of EZ crisis<br>Collapse in one or more inflated asset markets<br>German consumption growth roars into life | New EM crisis affects several CESEE countries<br>Breakdown of UK-EU trade talks | Improvement in EU-Russia relations |

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

**Figure 4.2 / Positive risks detail**

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

**Figure 4.3 / Negative risks detail**

| Risk | Likelihood | | Impact on CESEE | |
|---|---|---|---|---|
| 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. |
| Rule of law and institutional quality deteriorate further in CESEE countries | High | This is already happening to an extent. In recent years, indicators of institutional and governance quality have declined for some CESEE countries, such as Turkey, Poland and Hungary. Governments in these countries look quite well entrenched, and are popular in most cases, meaning that current trends may well continue. For the EU countries, Brussels has so far shown itself largely unable to take any action. | Medium | Governments can get away with it for a while, but as the example of Turkey shows, an undermining of institutional independence can contribute to a crisis. In the case of Poland and Hungary, there are already signs that it has affected domestic private investment. Lower-quality institutions also threaten long-term growth. |
| Deep global recession as a result of measures to stop the spread of the coronavirus | Medium | Our baseline scenario for CESEE growth has already deteriorated as a result of the coronavirus and measures to restrict its spread. The global economy is experiencing both a supply and a demand shock, and economic activity is likely to be weak for at least the first half of 2020. Should the virus spread more aggressively, and possibly even mutate, the restrictive measures witnessed in China, South Korea and Italy could become common in many more places. This could tip the global economy into a fairly deep and protracted recession. | High | Almost all countries in CESEE would also enter recession. The region is heavily dependent on external trade, tourism and foreign capital inflows. As in 2008-2009, those countries with a particularly high level of exposure to external trade (e.g. the three smaller Visegrad countries) and those with particular external vulnerabilities (e.g. Turkey) could be especially affected. |
| Significant increase in US tariffs on EU automotive exports | Medium | This is probably a low likelihood before the next US election, but becomes a higher likelihood thereafter if Donald Trump wins (and so we put it at 'medium' for the whole forecast period). US President Donald Trump has made this specific threat on several occasions. | High | This is a key risk for growth in our region during the forecast period. Most economies in our region are very open in terms of exports/GDP, and many deliver inputs into the German supply chain that go direct to the US. Some of the economies of the region (CZ, HU, SK, RO, MK, RS) are especially reliant on the automotive sector. |
| 'Rings' of EU integration are formalised and most of EU-CEE is left out | Low | Irritation in some Western European capital with parts of EU-CEE has been growing for some time. This is for three main reasons: a lack of 'solidarity' on the sharing of refugees, threats to institutional independence and the rule of law, and corruption in the use of EU funds. Recent French proposals have suggested 'rings' of integration, which could lead to a more formalised 'core' and 'periphery' in the EU. | High | Any formalisation of 'core' and 'periphery' could have important political and economic consequences, particularly if it affects things like Schengen. Many EU-CEE countries could end up in the outer ring. |

contd.

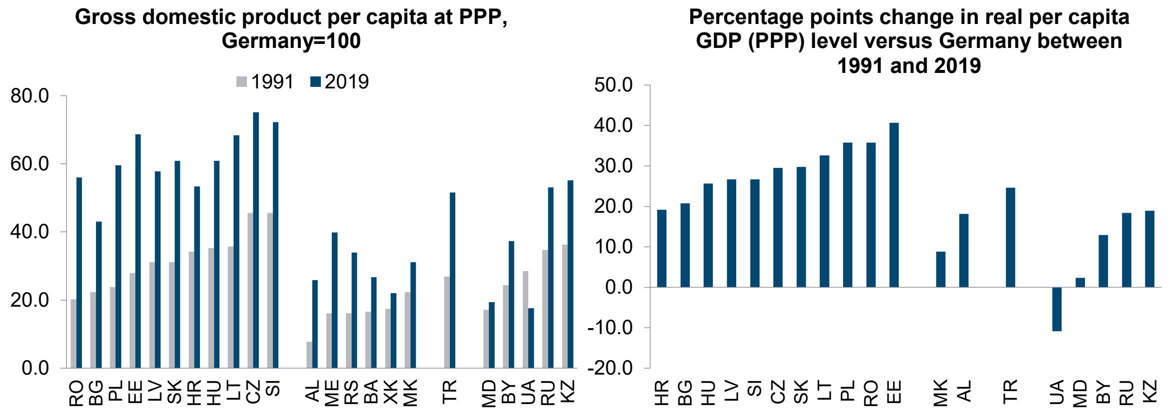
**Table 3.3 / contd.**

| Risk | Likelihood | | Impact on CESEE | |
|---|---|---|---|---|
| Collapse in one or more inflated asset markets | Low | Real estate, bond and equity markets across the world, including in much of CESEE, are inflated by historical standards. This reflects a decade of ultra-loose monetary policy. So long as central banks remain in ultra-loose mode (which seems overwhelmingly likely), it is hard to see what will deflate these asset markets. Nevertheless, as 2008-2009 showed, the financial community can be blind to certain risks in the system, which then explode without warning. | High | As the 2008-2009 financial crisis showed, the emergence of stress in the financial system can have wide-ranging effects and can quickly spill over into the real economy. It is true that the role of global central banks has increased markedly since then, which could cushion the impact somewhat, but it is hard to see how a big fall in, for example, house prices would not have a sizeable negative impact on growth. |
| Renewed outbreak of the euro area crisis | Low | Progress on reforms of the euro area to better insulate it from the next downturn in growth remains painfully slow. In Germany, such reforms tend to be seen as the German taxpayer subsidising profligate Southern Europeans. Some insurance is provided by the expanded role of the ECB in recent years, but over the medium term this may not be enough on its own to prevent a new crisis. | High | In the long run, the euro area needs a banking union and some kind of fiscal sharing to be able to ward off speculative market attacks during downturns. Any break-up of the euro area would badly affect the economies of CESEE, due to high levels of trade, investment and financial integration. |
| Breakdown of UK-EU trade talks | Low | The likelihood of some kind of deal between the EU27 and the UK remains quite high. There are major incentives for both sides to avoid a 'cliff edge'. | Medium | The UK and the EU27 economies are closely intertwined, and London has huge importance for euro area finance. A breakdown in talks 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. |
| New emerging markets crisis affects several countries in the CESEE region | Low | After a decade of ultra-loose monetary policy, levels of global liquidity are at extremely high levels. Investors need yield, and as such there are still lots of dollars and euros willing to finance even high-risk debts in CESEE. In addition, most countries have reduced private debt/GDP since the crisis, including in foreign currency, and generally external vulnerabilities are lower (current account deficits have mostly been cut or have disappeared over the past decade). Turkey seems like a big outlier in our region. | Medium | The impact of the crisis in 2018 on Turkey's currency and bond markets, and then as a follow-through on inflation and the economy, is a big warning sign to the rest of the region. However, the much lower external vulnerability of almost all other CESEE countries provides a lot of insulation. The most exposed are probably those which also tend to borrow in US dollars, specifically Ukraine and Kazakhstan. |

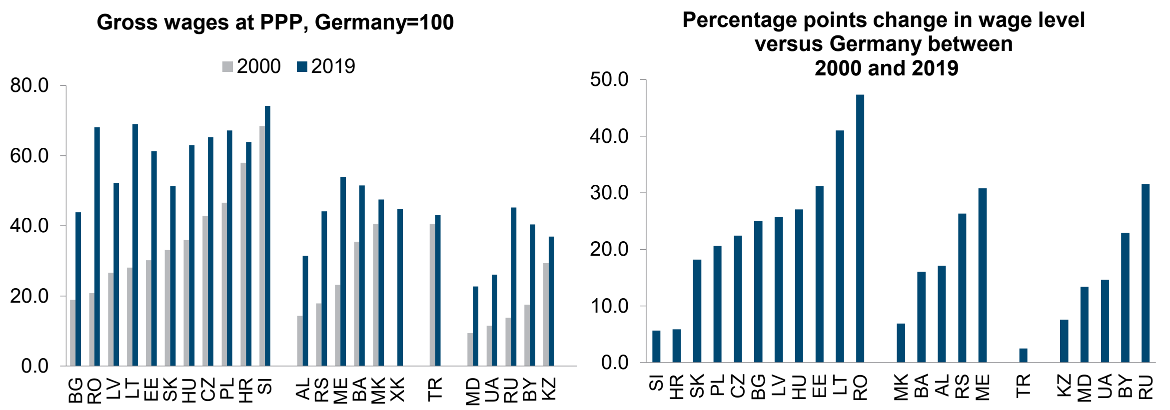
# 5. CESEE monitors

## 5.1. CONVERGENCE MONITOR

### Figure 5.1 / GDP per capita at PPP convergence against Germany




Note: Data 1990 for BA and XK refer to 2000, for ME and RS to 1995.
Source: wiiw Annual Database incorporating national statistics and Eurostat.




Note: Gross wages are based on administrative data. In 2019 Lithuanian wages include employers' social security contributions. Turkey: data 2000 refer to 2003.
Source: wiiw Annual Database incorporating national statistics and Eurostat.

**Table 5.1 / CESEE GDP per capita and gross wages per employee at PPP, 2019**

| | BG | CZ | EE | HR | HU | LT | LV | PL | RO | SI | SK | EU-CEE11 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GDP per capita | 16,600 | 29,000 | 26,500 | 20,600 | 23,500 | 26,400 | 22,200 | 22,900 | 21,600 | 27,900 | 23,500 | 23,100 |
| Gross wages | 13,849 | 22,564 | 21,197 | 22,085 | 21,783 | 23,874 | 18,072 | 23,244 | 23,559 | 25,643 | 17,750 | 21,949 |

| | AL | BA | BY | KZ | MD | ME | MK | RS | RU | TR | UA | XK | non-EU12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GDP per capita | 10,000 | 10,300 | 14,400 | 21,300 | 7,500 | 15,400 | 12,000 | 13,100 | 20,500 | 19,900 | 6,800 | 8,500 | 17,800 |
| Gross wages | 10,865 | 17,817 | 13,974 | 12,778 | 7,847 | 18,651 | 16,412 | 15,265 | 15,646 | 14,883 | 9,017 | 15,484 | 14,372 |

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

**Table 5.2 / CESEE GDP per capita and gross wages per employee EUR at ER, 2019**

| | BG | CZ | EE | HR | HU | LT | LV | PL | RO | SI | SK | EU-CEE11 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GDP per capita | 8,600 | 20,500 | 20,900 | 13,200 | 14,600 | 17,300 | 15,900 | 13,600 | 11,400 | 22,900 | 17,300 | 14,300 |
| Gross wages | 7,814 | 15,941 | 16,680 | 14,181 | 13,553 | 15,600 | 12,960 | 13,766 | 12,450 | 21,046 | 13,080 | 13,439 |

| | AL | BA | BY | KZ | MD | ME | MK | RS | RU | TR | UA | XK | non-EU12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GDP per capita | 4,800 | 5,000 | 5,900 | 8,700 | 4,100 | 7,700 | 5,300 | 6,600 | 10,300 | 8,200 | 3,300 | 4,000 | 8,300 |
| Gross wages | 5,229 | 8,720 | 5,758 | 5,195 | 4,270 | 9,276 | 7,277 | 7,656 | 7,845 | 6,134 | 4,351 | 7,200 | 6,784 |

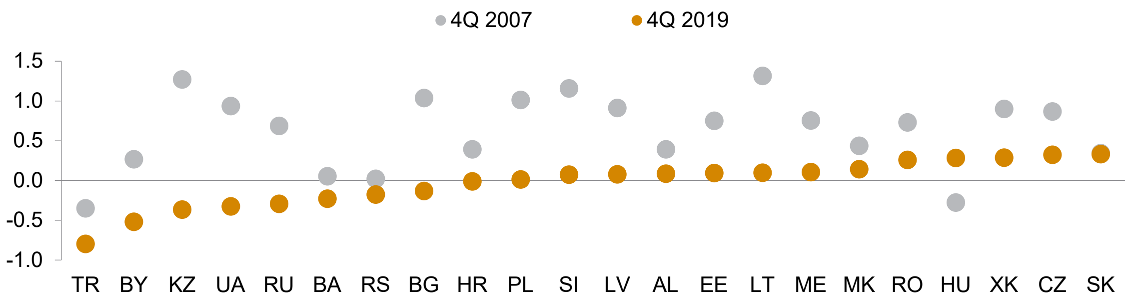
Note: Gross wages are based on administrative data. Romanian wages include employers' social security contributions.
Source: wiiw Annual Database incorporating national statistics and Eurostat.

## 5.2. BUSINESS CYCLE MONITOR: HEADLINE INDEX STABLE, WITH MIXED DYNAMICS ACROSS COUNTRIES

**by Alexandra Bykova**

- The average value of our headline business cycle index for the whole CESEE region remained at slightly below zero, only 0.01 down on our previous update. Hence, there is no obvious over- or underheating relative to the period 2000-2019. Whereas the headline index for EU-CEE11 as a region is declining (dragged down by Croatia, Hungary, Estonia and Latvia), the value of the index for CIS and Ukraine as a region is increasing, although it remains negative (see Figure 5.2).
- Overheating in CESEE labour markets is observed in all countries except Kazakhstan, Ukraine and Turkey. Compared to autumn 2019, it has deepened in two CEE countries – Bulgaria and Croatia – and in all Western Balkan countries, except Montenegro. However, for the Western Balkan countries, which have the highest unemployment in the CESEE region, moving away from their long-term averages is a positive development. Overheating remains visible in several countries in terms of property prices and real interest rates. Underheating persists for some countries for such indicators as fiscal balances and current account balances (see Table 5.3 and Table 5.4).
- The countries topping the headline business cycle index in Q4 2019 are Slovakia, the Czech Republic and Kosovo. Hungary and Romania slipped down the rankings from the top positions they occupied in autumn 2019. A halt to the overheating in GDP growth and slower broad money expansion were responsible for Hungary's lower position, while Romania's slide was caused by reduced overheating in the labour market and slower growth in property prices. Turkey, which was in recession in the first half of 2019, has the lowest score for the headline index, and underheating in that country continues in real GDP, the labour market, the current account, the real exchange rate, private credit and property prices (see Figure 5.2 and Table 5.3).
- Russia, Kazakhstan and Kosovo have seen the biggest increases in their headline scores since the autumn 2019 update, coming on the back of higher values for the external and domestic finance sub-indices. Imbalances in the external finance sub-index are present in Albania and in Bosnia and Herzegovina. While in Albania, this is due to the appreciation of the real exchange rate over the historical average, in Bosnia and Herzegovina the opposite is true: the real exchange rate is depreciating due to low inflation in the country. Overall, since our previous update, inflation has picked up only in the Czech Republic, Slovakia, Poland, Kosovo, Belarus and Russia; in other countries, inflation has decelerated (see Figure 5.3 and Table 5.4).

**Figure 5.2 / Business Cycle Index**




Note: Number of standard deviations from historical mean, average of 11 indicators. Indicators are those in Table 5.3.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

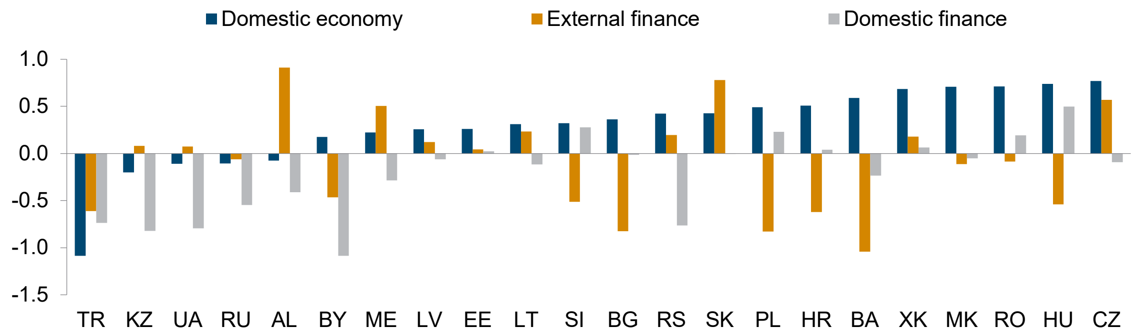
## Table 5.3 / Number of standard deviations from historical mean, 4Q 2019

| | Domestic economy | | | External finance | | | Domestic finance | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Real GDP | Unemployment | CPI | CA | RER | External debt | RIR | Private credit | Broad money | Fiscal balance | Property prices |
| BG | -0.06 | 1.52 | -0.38 | -1.67 | 0.52 | -1.33 | 0.17 | -0.35 | -0.62 | 0.63 | 0.10 |
| CZ | -0.17 | 2.14 | 0.34 | -0.78 | 1.02 | 1.47 | 0.22 | -0.55 | -0.08 | -1.29 | 1.24 |
| EE | -0.01 | 1.32 | -0.52 | -0.90 | 1.41 | -0.39 | 0.52 | -0.40 | -0.27 | 0.36 | -0.10 |
| HR | 0.33 | 2.11 | -0.91 | -1.70 | 0.01 | -0.17 | 0.62 | -0.24 | -0.55 | -1.74 | 2.11 |
| HU | 0.87 | 1.65 | -0.31 | -0.50 | -0.46 | -0.66 | 2.12 | 0.69 | -0.34 | -1.08 | 1.10 |
| LT | -0.05 | 1.08 | -0.09 | -0.85 | 1.23 | 0.32 | 0.75 | -0.45 | -0.26 | -0.85 | 0.23 |
| LV | -0.27 | 1.28 | -0.24 | -0.69 | 0.99 | 0.06 | 0.69 | -0.48 | -0.30 | -0.47 | 0.25 |
| PL | 0.13 | 1.47 | -0.13 | -2.05 | -0.71 | 0.28 | 1.22 | -0.58 | -0.03 | -1.36 | 1.90 |
| RO | 0.01 | 2.59 | -0.47 | -0.15 | 0.04 | -0.14 | 1.20 | -0.45 | -0.79 | 0.39 | 0.61 |
| SI | 0.07 | 1.42 | -0.53 | -1.70 | 0.07 | 0.09 | 1.30 | -0.09 | 0.25 | -1.11 | 1.03 |
| SK | -0.53 | 1.97 | -0.16 | -0.39 | 0.80 | 1.93 | 1.33 | -0.56 | 0.01 | -1.09 | 0.31 |
| AL | -0.87 | 1.83 | -1.18 | -0.63 | 2.54 | 0.83 | 1.26 | -0.62 | -0.91 | -1.38 | |
| BA | -0.21 | 2.54 | -0.57 | -0.92 | -1.83 | -0.38 | 0.30 | -0.35 | -0.43 | -0.45 | |
| ME | 0.09 | 1.34 | -0.77 | -0.41 | 0.72 | 1.20 | 0.23 | -0.38 | -0.81 | -0.18 | |
| MK | 0.20 | 2.53 | -0.60 | -0.90 | -0.83 | 1.40 | 0.72 | -0.57 | -0.36 | -0.19 | 0.15 |
| RS | 0.17 | 1.69 | -0.58 | -0.19 | 0.88 | -0.11 | -0.15 | -0.48 | -0.60 | -1.22 | -1.38 |
| XK | 0.03 | 1.74 | 0.28 | -0.54 | 0.69 | 0.39 | 1.45 | -0.49 | -0.35 | -0.36 | |
| TR | -1.02 | -2.19 | -0.04 | -1.76 | -2.00 | 1.92 | 0.24 | -1.53 | -0.26 | -0.04 | -2.09 |
| BY | -0.81 | 1.99 | -0.66 | -1.16 | -1.02 | 0.79 | -0.44 | -1.20 | -0.88 | -1.83 | |
| KZ | -0.57 | 0.97 | -1.00 | 0.64 | -1.13 | 0.74 | -1.62 | -0.64 | -1.36 | 0.32 | |
| RU | -0.58 | 1.44 | -1.18 | 0.61 | 0.12 | -0.91 | -0.31 | -0.70 | -1.25 | -0.11 | -0.37 |
| UA | 0.09 | 0.06 | -0.47 | 0.01 | -0.10 | 0.32 | -1.37 | -0.97 | -1.02 | 0.19 | |

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, values more than 100 means appreciation and vice versa; 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 - 4Q 2019. Calculations are based on four-quarter trailing averages.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

## Figure 5.3 / Sub-components of the Business Cycle Index, 4Q 2019




Note: Number of standard deviations from historical mean, average of indicators in each sub-component. Indicators are those in Table 5.3.
Sources: wiiw Monthly Database incorporating national statistics and Eurostat; BIS.

## Table 5.4 / Over-/under-heating in relation to regional peers, 4Q 2019 (4-q trailing average)

| | Domestic economy | | | External finance | | | Domestic finance | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Real GDP | Unemployment | CPI | CA | RER | External debt | RIR | Private credit | Broad money | Fiscal balance | Property prices |
| | % | % | % yoy | % of GDP | 2015 = 100 | % of GDP | % | % yoy | % yoy | % of GDP | % yoy |
| BG | 3.5 | 4.3 | 2.5 | 9.5 | 99.6 | 57.5 | -2.4 | 6.8 | 9.1 | -1.5 | 5.9 |
| CZ | 2.4 | 2.0 | 2.6 | -0.1 | 108.7 | 78.3 | -0.6 | 5.6 | 6.4 | 0.6 | 9.2 |
| EE | 3.9 | 4.4 | 2.3 | 1.7 | 104.8 | 78.0 | -2.2 | 4.8 | 10.4 | -0.3 | 6.6 |
| HR | 3.0 | 6.5 | 0.8 | 2.6 | 100.3 | 81.7 | 2.2 | 2.9 | 4.6 | 0.3 | 8.6 |
| HU | 4.9 | 3.4 | 3.4 | -0.3 | 98.9 | 77.2 | -2.4 | 12.4 | 7.2 | -1.7 | 13.0 |
| LT | 3.9 | 6.3 | 2.2 | 0.5 | 103.8 | 70.6 | -2.2 | 3.6 | 10.2 | 0.1 | 7.0 |
| LV | 2.2 | 6.5 | 2.7 | -0.3 | 103.0 | 117.2 | -2.7 | -2.0 | 10.6 | -0.8 | 9.3 |
| PL | 4.0 | 3.5 | 2.1 | 1.1 | 96.7 | 59.9 | -0.6 | 5.8 | 9.2 | -1.2 | 8.4 |
| RO | 4.1 | 3.9 | 3.9 | -4.7 | 96.1 | 47.3 | -1.4 | 7.1 | 9.2 | -4.0 | 3.0 |
| SI | 2.6 | 4.6 | 1.7 | 6.6 | 99.7 | 92.2 | -1.7 | 4.0 | 8.5 | 0.2 | 7.6 |
| SK | 2.4 | 5.8 | 2.8 | -2.9 | 100.9 | 109.7 | -2.7 | 7.5 | 7.5 | -1.2 | 8.5 |
| AL | 2.6 | 11.3 | 1.4 | -7.6 | 115.2 | 60.4 | -0.4 | 3.6 | 3.6 | -1.9 | |
| BA | 2.6 | 15.7 | 0.6 | -5.2 | 96.0 | 23.9 | -0.6 | 6.0 | 8.5 | 1.0 | |
| ME | 3.3 | 14.8 | 0.4 | -16.7 | 99.7 | 55.7 | 5.2 | 6.8 | -3.5 | -2.3 | |
| MK | 3.4 | 17.0 | 0.8 | -0.7 | 98.2 | 75.8 | 1.5 | 7.2 | 10.6 | -1.8 | 2.5 |
| RS | 4.0 | 10.7 | 1.9 | -6.2 | 105.3 | 60.3 | 0.8 | 9.3 | 11.9 | 0.7 | -5.9 |
| XK | 4.1 | 24.5 | 2.7 | -6.8 | 100.2 | 30.1 | 3.7 | 10.6 | 10.1 | 0.7 | |
| TR | 0.5 | 13.7 | 15.4 | 0.2 | 72.1 | 58.5 | 3.2 | 5.6 | 21.6 | -3.0 | 2.5 |
| BY | 1.2 | 4.2 | 5.6 | -0.5 | 93.2 | 60.2 | 3.8 | 10.4 | 11.8 | 4.0 | |
| KZ | 4.4 | 4.8 | 5.3 | -3.1 | 72.2 | 88.6 | 3.7 | 2.9 | 1.5 | -1.7 | |
| RU | 1.3 | 4.6 | 4.6 | 4.2 | 104.9 | 28.3 | 2.4 | 9.9 | 7.3 | 2.0 | 7.1 |
| UA | 3.2 | 8.4 | 7.9 | -0.7 | 123.8 | 77.1 | 7.8 | -4.4 | 7.6 | -2.1 | |

potential overheating/instability relative to regional peers

underheating/stability relative to regional peers

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

## 5.3. CREDIT MONITOR: HOUSEHOLD CREDIT GROWTH ACCELERATES ON THE BACK OF MONETARY EASING

**by Olga Pindyuk**

### Table 5.5 / Indicators of financial sector developments, December 2019

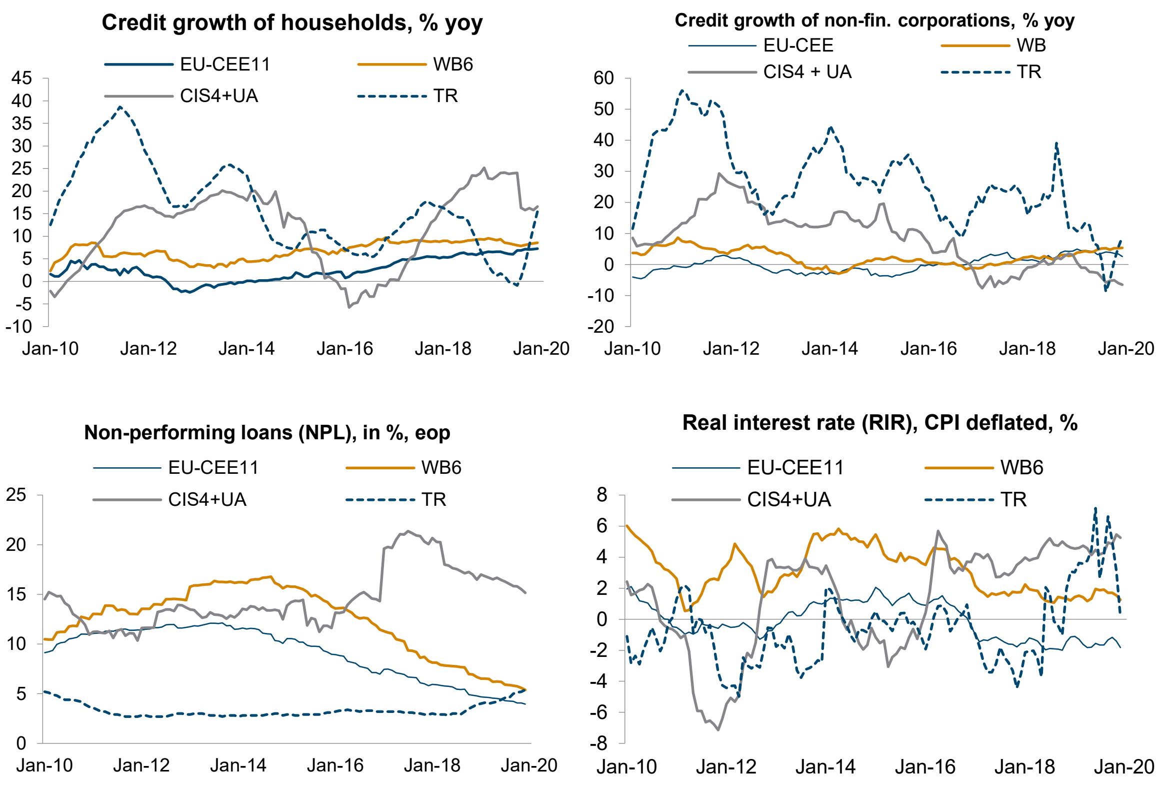
| | AL | BA | BG | BY | CZ | EE | HR | HU | KZ | LT | LV | MD | ME | MK | PL | RO | RS | RU | SI | SK | TR | UA | XK |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Loans to non-fin.corp., % yoy | 6.6 | 5.2 | 5.9 | 5.4 | 3.7 | -0.6 | -0.8 | 11.3 | -7.5 | -1.8 | -3.3 | 3.0 | 4.1 | 1.9 | 2.1 | 6.3 | 8.6 | 1.2 | 1.0 | 3.8 | 8.8 | -13.4 | 9.8 |
| Loans to households, % yoy | 6.7 | 7.9 | 9.5 | 22.0 | 6.2 | 6.5 | 6.9 | 15.6 | 25.6 | 6.8 | 0.8 | 40.2 | 8.6 | 10.5 | 6.0 | 7.6 | 9.3 | 18.5 | 5.9 | 8.0 | 15.5 | 5.7 | 10.4 |
| Real interest rate, CPI defl., % | -0.1 | -0.2 | -3.0 | 4.1 | -1.2 | -1.8 | 1.7 | -3.1 | 3.6 | -2.7 | -2.1 | -2.0 | 4.4 | 1.8 | -1.5 | -1.5 | 0.4 | 3.1 | -1.9 | -3.1 | 0.1 | 9.1 | 5.2 |
| Non-perf. loans (NPL), in %, eop | 8.4 | 7.5 | 6.5 | 5.5 | 2.5 | 0.5 | 6.0 | 4.5 | 8.1 | 2.0 | 5.8 | 8.5 | 5.0 | 4.6 | 6.4 | 4.0 | 4.8 | 5.4 | 3.4 | 2.8 | 5.4 | 48.0 | 2.0 |

potential overheating/instability relative to regional peers

underheating/stability relative to regional peers

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

### Figure 5.4 / Indicators of financial sector developments over time




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

## 5.4. FDI MONITOR: INFLOWS RISE ON ACCOUNT OF RUSSIA

**by Gábor Hunya**

› Total global FDI inflows were flat in 2019, at the previous year's level (USD 1.4 trillion).[31] Inflows to the main destinations, – USA and China – remained at the 2018 level, while EU destinations of FDI showed huge diversity, on account of some major acquisitions and divestments. Globalisation seems to have reached its limit and FDI flows may shrink in the future. This is on account of US policies, as well as the new technologies becoming available under Industry 4.0, which will benefit the reshoring of production. Increased concern over health and environmental risks will intensify the situation.

› FDI inflows into CESEE increased by an estimated 17% in 2019,[32] against the revised 2018 data.[33] The recovery was mainly on account of Russia, where inflows increased threefold in 2019, against a very low level the previous year (Table 5.6). EU-CEE11 and Turkey received rather less than in the previous year, while inflows increased to WB6 and CIS3+UA.

› We estimate that EU-CEE11 received rather less FDI in 2019 than in the previous year. The main difference compared with 2018 was that inflows to Hungary and Poland were most probably lower both nominally and in per capita terms (Figure 5.5). High divestments were recorded in Hungary in the first three quarters of the year, following the domestic takeover of foreign affiliates. Still, both countries are among the top FDI destinations in the region.

› Rising wages and labour shortages had no significant short-term impact on FDI, although some production sites were closed down in several countries, in labour-intensive clothing, shoemaking and automotive component production. The remaining companies reinvested a larger share of their profits in labour-saving technologies.

› The Western Balkans received only marginally more FDI in 2019 than in 2018, but the upward trend continued for the fourth consecutive year. Serbia has been the main host to new projects in manufacturing and export-oriented services. The other preferred target for such investments – North Macedonia – suffered a setback on account of its political instability. FDI in Turkey fell back to its lowest level since 2010, in line with investment activity generally.

› The distribution of FDI stocks by economic activity has undergone important changes in some countries in recent years (Figure 5.6). Buoyant household demand increased the share of FDI in trade, transport and accommodation in Hungary, Poland and Romania, while the share of financial intermediation shrank in the wake of domestic takeovers. Manufacturing also maintained its leading position in the Czech Republic; the large increase in Hungary was due to a reclassification of car industry holdings. Rapidly increasing FDI in Albania occurred mainly in the energy sector, while in Russia mining claimed a rising share.

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31 UNCTAD Investment Trends Monitor, January 2020.

32 FDI inflows for 2019 were estimated on the basis of data for the first three quarters of the year or, if not available, were calculated using the change in FDI liabilities in the first three quarters of 2019 against the same period in 2018. These are rough estimates, as the relationship is volatile both between FDI inflows and FDI liabilities and between sub-annual data of different years.

33 The data for 2017 and 2018 have been revised since the autumn 2019 Forecast Report.

### Table 5.6 / FDI inflow

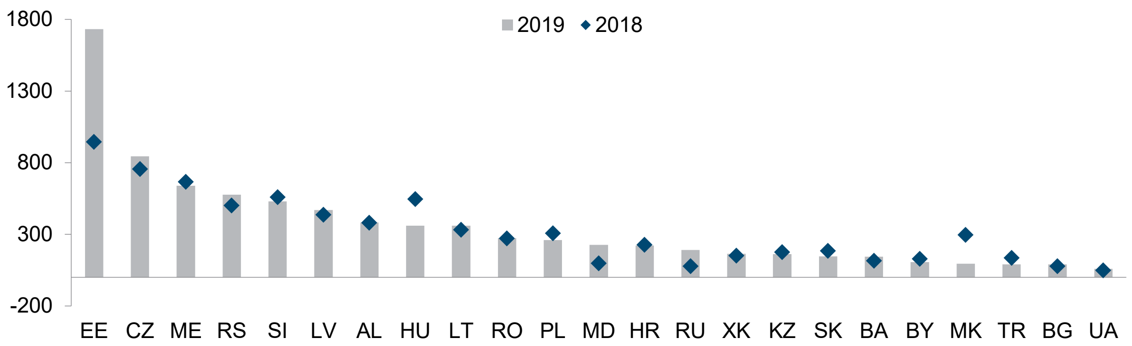
EUR mn

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| EU-CEE11 | 23,577 | 25,527 | 30,100 | 13,425 | 26,449 | 25,270 | 36,052 | 36,249 | 37,083 | 35,400 |
| WB6 | 3,473 | 5,675 | 2,806 | 3,577 | 3,487 | 4,450 | 4,198 | 4,896 | 6,289 | 6,500 |
| TR | 6,861 | 11,576 | 10,341 | 10,212 | 10,039 | 17,362 | 12,584 | 9,825 | 11,027 | 7,490 |
| CIS3+UA | 14,790 | 18,250 | 18,210 | 13,024 | 8,374 | 8,063 | 11,858 | 7,710 | 6,644 | 7,100 |
| RU | 23,875 | 26,476 | 23,483 | 40,196 | 22,037 | 10,664 | 33,568 | 22,990 | 11,222 | 28,000 |
| CESEE23 | 72,575 | 87,505 | 84,941 | 80,434 | 70,387 | 65,808 | 98,261 | 81,669 | 72,265 | 84,500 |

Note: 2019 wiiw estimates. Data are based on Direct Investment Statistics (directional principle), excluding Special Purpose Entities (SPEs); for Hungary also excluding capital in transit and restructuring of asset portfolios.
Source: wiiw FDI Database incorporating national bank statistics.

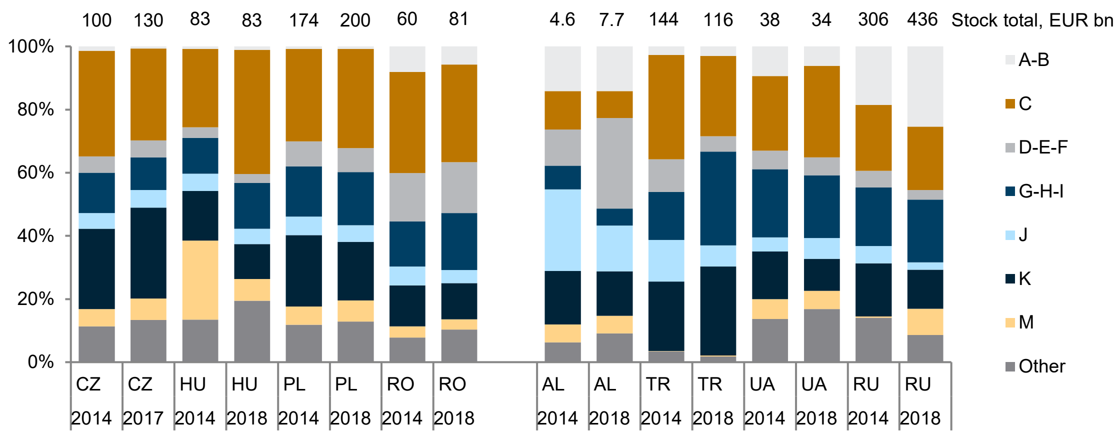
### Figure 5.5 / FDI inflow per capita, 2018 and 2019

EUR mn




Note: 2019 wiiw estimates. Data are based on Direct Investment Statistics (directional principle), excluding Special Purpose Entities (SPEs); for Hungary also excluding capital in transit and restructuring of asset portfolios.
Source: wiiw FDI Database incorporating national bank statistics.

### Figure 5.6 / Inward FDI stock by economic activities, 2014 and 2018




Note: NACE Rev. 2: 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 activities.
Source: wiiw FDI Database incorporating national bank statistics.

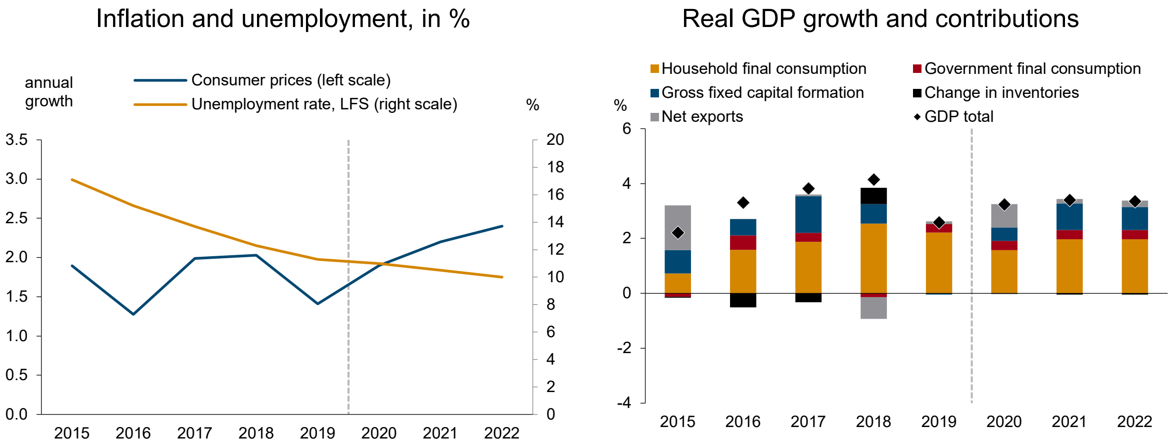
# 6. Country reports


# ALBANIA: Moderate growth and rising downside risks

ISILDA MARA

Growth is expected to remain moderate in the coming two years. Private consumption on the demand side and services on the production side will continue to support growth, but at a slower pace. A devastating earthquake hit Albania on 26 November 2019. The conference of donors initiated by France raised EUR 1.15 billion, which will likely spur growth in the short term. Since the EU enlargement process is being reformed, the accession process for Albania is likely to get stricter and more rigorous.

**Figure 6.1 / Albania: Main macroeconomic indicators**




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

**A devastating earthquake hit Albania on 26 November 2019.** In all, 51 people lost their lives and thousands were injured; thousands of buildings were damaged and the estimated cost of reconstruction is put at around EUR 1 billion. The areas worst hit by the earthquake were Durres and Tirana, where more than 50% of the Albanian economy is concentrated.[34] On the initiative of France, a conference of donors was organised in Brussels on 17 February 2020. The response of the international community has been very supportive, and EUR 1.15 billion were raised through donations, grants and soft loans. This fund will certainly help to mitigate the worst impacts of the earthquake, and through reconstruction works it will spur growth and employment, at least for the next two years.

**Growth is expected to remain moderate in the coming two years.** Tourism buttressed the economy for the third quarter of 2019, but overall growth in 2019 was weaker than in 2018. During the third quarter of 2019, real GDP growth recovered to 3.8%, following 2.56% and 2.48%, respectively, in the

[34] In 2017, the estimated GDP of Tirana and Durres at current prices corresponded to 52% of the country's total economic activity. Source: Regional Account Statistics, INSTAT, Albania. http://www.instat.gov.al/en/themes/economy-and-finance/regional-accounts-in-albania/

first and second quarters of 2019, year on year. Nevertheless, overall growth for 2019 is estimated at 2.6%, owing to the weakening of the economy in the last quarter of 2019. The growth drivers were private household consumption and services, bolstered by tourism, which is expected to continue to support growth in the coming years. Gross fixed capital formation receded into the negative zone, which is certainly linked to the completion of the Trans Adriatic Pipeline construction works on the Albanian side. In production terms, the first half of the year was particularly bad for industry – especially given the low electricity production. Consequently, high imports of electricity had an adverse impact on economic growth.

**Private consumption will continue to support growth, but at a slower pace.** Labour market indicators suggest that there have been further improvements. Employment has been rising: more than 41,000 new jobs were recorded between Q3 2018 and Q3 2019. The overall unemployment rate receded to 11.4% in Q3 2019, and youth unemployment (age 15-29) dropped to 21.4%. Gross monthly wages had risen by 4% as of Q3 2019, year on year. But this is not enough. A glance at the demographic trends indicates that emigration is continuing unabated, while the number of births and the fertility rate are declining rapidly. Another indicator – consumer confidence – has also been moving downward, declining further during Q4 2019 to stand at below its long-term average level; this trend is driven by less-optimistic expectations about the economy and the financial situation of households.

**There is growing sentiment in favour of emigration across all age groups and across the skills spectrum.** The 2019 Balkan Barometer Public Opinion Survey pointed out a strong sentiment in favour of outward mobility: 50% of Albanians would like to move abroad – more than any other country of the Western Balkans, where an average 39% would be willing to emigrate. Furthermore, among those willing to leave 10% already had concrete plans for emigration; another 22% were actively seeking to leave the country; and a further 66% were still thinking of doing so.[35] This last group of passive aspirant emigrants hints at a rising sense of discontent among Albanians. This sentiment is certainly driven by less advantageous economic prospects, but it also stems from a mistrust of public institutions. According to the 2019 Balkan Barometer Public Opinion Survey, this mistrust is shared by more than 70% of Albanians.

**Fiscal consolidation has been meagre and slower than expected.** Public debt to GDP is estimated to have contracted by only 0.5 percentage points in 2019 from the level of 67.9% recorded in 2018. Last year closed with a poor performance in terms of tax collection, which had risen by only 3% by November 2019, year on year. In contrast, overall expenditure rose by more than 5% over the same period. Capital expenditure declined further and absorbed only 15% of overall expenditure, hinting at weak investments through 2019. The effect of the earthquake will be felt through 2020 and in the next two years of general government budget planning. There will be a budget shift of EUR 200 million, to be allocated to post-earthquake reconstruction works. Half of this will fall within the 2020 general government budget, and the rest will be disbursed from the 2021 and 2022 budgets. Such shifts will certainly affect fiscal consolidation, and an annual budget deficit of 2% of GDP is estimated for 2020-2022.

**The banking sector continued to turn in a satisfactory performance.** In 2019, the level of non-performing loans dropped further to 8.4%, compared to the 18% recorded five years ago. The banking system is well capitalised and profitable. The demand for credit recovered in 2019, in contrast to the

35 Source: 2019 Balkan Barometer Public Opinion Survey, page 67. https://www.rcc.int/pubs/89/balkan-barometer-2019-public-opinion-survey

anaemic growth of the previous five years. The stock of loans to households had risen by 7% by November 2019, year on year, whereas credit to the non-financial private sector had risen by almost 5% over the same period. Nevertheless, the impact that the earthquake might have on demand for loans will depend on the response of the banking sector to ongoing credits and facilities that might be offered to those affected by the earthquake. In 2019, the inflation rate remained low – at 1.4% – and a long way from its target of 3%. Monetary policy continues to stay loose and the central bank has kept the interest rate unchanged in 2020, at 1%.

**The current account deficit deteriorated further and will stall at a similar level as in 2019.** For the first three quarters of 2019, year on year, the goods trade deficit widened, as exports shrank by 7%, while imports rose by 5%. Goods exports were especially badly hit by the negative trade balance on electricity, in huge contrast to the trade surplus of the previous year. The export of services and a very good tourist season, especially during the summer, provided a strong impetus to economic activity and generated a service trade balance in surplus. Despite the Trans Adriatic Pipeline on the Albanian side being almost completed in 2019, FDI inflows into the country stayed close to the 2018 level, and are estimated to have been EUR 1 billion in 2019. Italy more than doubled its FDI inflows into Albania: it contributed 12% of all FDI inflows for the first three quarters of 2019. FDI inflows through the Netherlands also intensified. Such investments might be attributed to Shell Upstream operating in Albania and the Norwegian company Statkraft, with headquarters in the Netherlands. The latter has constructed two hydropower plants on the Devoll River – an investment worth EUR 500 billion – which by the end of 2020 are expected to boost energy production in Albania by 18%. This company is also planning to build a floating solar power plant on the Banja hydropower reservoir. Austria is another country whose FDI inflows into Albania are rising. Chinese FDI is insignificant, despite a Chinese presence in strategic sectors such as transport and the oil extraction industry. The sectors that attracted most of the FDI inflows in 2019 were mining and quarrying, construction, and information and communication.

**Important investment infrastructure projects have been announced, but the timetable and financing sources are still uncertain.** After the failure of negotiations with a Turkish consortium, the government opened the Vlora Airport investment project up to new bids in December 2019. The rather optimistic scenario envisages the start of construction work by mid-2020, assuming that negotiations with the winning company are successful. Another important infrastructure project that is supposed to be launched in the first half of 2020 is the Llogara tunnel in southern Albania – an investment that would further boost tourism in the south of the country.

**Under the proposed new EU enlargement rules, the EU accession process for Albania will get stricter and more rigorous.** In February 2020 the European Commission presented a proposal for revising the EU enlargement methodology. The actual EU accession criteria will not change, but the process will. The EU Commission proposal envisages a more important role for fundamental reforms and their rigorous monitoring, in particular reforms aimed at the rule of law and anti-corruption. It is proposed that the 35 chapters of the acquis should be clustered into six thematic groups; interim benchmarks will be set and each cluster should be closed once the benchmarks have been met. In combination with the revised accession rules, the EU Commission also proposes an economic and investment development plan, to be authorised by the European Council. The revision of the EU enlargement process was initially proposed by France. The outlook for EU accession talks with Albania is expected to become clearer at the next European Council meeting, in March 2020, and at the summit meeting of European Union and Western Balkan countries, to be held in Zagreb in May 2020 under the patronage of the Croatian EU presidency. Because the process is getting stricter, EU support should be stronger and more concrete, taking account of the frailty of institutions in the country. In this respect, there has been some progress: reforms of the judicial system and of election law have been advancing, albeit slowly. Part of the new electoral reform under discussion includes electronic voting and votes for emigrants. Still, the political context and discourse remain dire. The head of state, Ilir Meta, has accused the current government of engaging in a putsch, arguing that the Albanian constitution has been violated by the control of the judicial system exercised by Prime Minister Edi Rama.

**In a nutshell, the devastating earthquake has had a marked and adverse effect on the economy and the psyche of Albanians.** The financial aid from international partners and a credible reconstruction plan will provide positive impetus to growth in the short run. Over the forecast period, growth is expected to be moderate, driven mainly by private consumption on the demand side and by services on the production side. Because of rising downside risks, we have revised our forecast downwards: we expect the economy to grow at slightly above 3.4% in the period 2020-2022.

## Table 6.1 / Albania: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th pers., average | 2,881 | 2,876 | 2,873 | 2,866 | 2,870 | 2,865 | 2,865 | 2,860 |
| Gross domestic product, ALL bn, nom. | 1,434 | 1,472 | 1,551 | 1,631 | 1,700 | 1,800 | 1,900 | 2,000 |
| annual change in % (real) | 2.2 | 3.3 | 3.8 | 4.1 | 2.6 | 3.2 | 3.4 | 3.4 |
| GDP/capita (EUR at PPP) | 8,800 | 8,600 | 9,100 | 9,600 | 10,000 | . | . | . |
| Consumption of households, ALL bn, nom. | 1,147 | 1,180 | 1,226 | 1,287 | 1,340 | . | . | . |
| annual change in % (real) | 0.9 | 2.0 | 2.3 | 3.2 | 2.8 | 2.0 | 2.5 | 2.5 |
| Gross fixed capital form., ALL bn, nom. | 350 | 359 | 381 | 394 | 390 | . | . | . |
| annual change in % (real) | 3.5 | 2.4 | 5.5 | 2.9 | -0.2 | 2.0 | 4.0 | 3.5 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | -2.1 | -18.0 | -0.6 | 18.5 | -2.0 | 3.0 | 4.0 | 1.0 |
| Gross agricultural production 2) | | | | | | | | |
| annual change in % (real) | 2.6 | 3.3 | 4.0 | 5.0 | 5.0 | . | . | . |
| Construction output total | | | | | | | | |
| annual change in % (real) | 19.4 | 5.1 | 19.6 | 5.6 | 6.0 | . | . | . |
| Employed persons, LFS, th | 1,087 | 1,157 | 1,195 | 1,231 | 1,275 | 1,285 | 1,290 | 1,295 |
| annual change in % | 4.8 | 6.5 | 3.3 | 3.0 | 3.6 | 0.8 | 0.4 | 0.4 |
| Unemployed persons, LFS, th | 224 | 208 | 190 | 173 | 160 | 160 | 150 | 140 |
| Unemployment rate, LFS, in % | 17.1 | 15.2 | 13.7 | 12.3 | 11.3 | 11.0 | 10.5 | 10.0 |
| Reg. unemployment rate, in %, eop | 12.9 | 8.8 | 7.2 | 5.4 | 5.6 | . | . | . |
| Average monthly gross wages, ALL | 47,900 | 47,522 | 48,967 | 50,589 | 53,600 | 56,000 | 58,400 | 61,600 |
| annual change in % (real, gross) | 3.2 | -2.0 | 1.0 | 1.3 | 4.5 | 3.0 | 2.0 | 3.0 |
| Consumer prices, % p.a. | 1.9 | 1.3 | 2.0 | 2.0 | 1.4 | 1.9 | 2.2 | 2.4 |
| Producer prices in industry, % p.a. | -2.1 | -1.4 | 2.6 | 1.7 | -1.0 | -0.5 | 1.0 | 0.4 |
| General governm.budget, nat.def., % of GDP | | | | | | | | |
| Revenues | 26.4 | 27.6 | 27.7 | 27.6 | 27.1 | 28.0 | 28.0 | 28.0 |
| Expenditures | 30.5 | 29.5 | 29.7 | 29.2 | 28.9 | 30.0 | 30.0 | 29.0 |
| Deficit (-) / surplus (+) | -4.1 | -1.8 | -2.0 | -1.6 | -1.9 | -2.0 | -2.0 | -1.0 |
| General gov.gross debt, nat.def., % of GDP | 72.7 | 72.4 | 70.1 | 67.9 | 67.5 | 67.0 | 66.0 | 65.0 |
| Stock of loans of non-fin.private sector, % p.a. | -2.6 | 0.2 | 0.7 | -3.6 | 6.6 | . | . | . |
| Non-performing loans (NPL), in %, eop | 18.2 | 18.3 | 13.2 | 11.1 | 8.4 | . | . | . |
| Central bank policy rate, % p.a., eop 3) | 1.75 | 1.25 | 1.25 | 1.00 | 1.00 | 1.0 | 1.0 | 1.0 |
| Current account, EUR mn | -884 | -812 | -866 | -866 | -1,050 | -1,020 | -1,070 | -1,060 |
| Current account, % of GDP | -8.6 | -7.6 | -7.5 | -6.8 | -7.6 | -6.9 | -6.8 | -6.4 |
| Exports of goods, BOP, EUR mn | 771 | 714 | 797 | 986 | 917 | 980 | 1,030 | 1,080 |
| annual change in % | -17.2 | -7.4 | 11.7 | 23.7 | -7.0 | 6.0 | 5.0 | 5.0 |
| Imports of goods, BOP, EUR mn | 3,070 | 3,317 | 3,621 | 3,857 | 4,050 | 4,170 | 4,320 | 4,410 |
| annual change in % | -2.5 | 8.0 | 9.2 | 6.5 | 5.0 | 3.0 | 3.5 | 2.0 |
| Exports of services, BOP, EUR mn | 2,028 | 2,396 | 2,856 | 3,073 | 3,320 | 3,550 | 3,690 | 3,810 |
| annual change in % | 7.8 | 18.1 | 19.2 | 7.6 | 8.0 | 7.0 | 4.0 | 3.2 |
| Imports of services, BOP, EUR mn | 1,503 | 1,599 | 1,774 | 1,962 | 2,100 | 2,180 | 2,270 | 2,340 |
| annual change in % | -3.5 | 6.4 | 11.0 | 10.6 | 7.0 | 4.0 | 4.0 | 3.0 |
| FDI liabilities, EUR mn | 890 | 943 | 900 | 1,020 | 1,050 | 850 | . | . |
| FDI assets, EUR mn | 72 | 6 | -94 | -3 | -50 | -30 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 2,831 | 2,889 | 2,941 | 3,342 | 3,240 | . | . | . |
| Gross external debt, EUR mn | 7,634 | 7,882 | 7,949 | 8,353 | 8,300 | 8,300 | 8,800 | 8,600 |
| Gross external debt, % of GDP | 74.4 | 73.5 | 68.7 | 65.3 | 60.0 | 56.0 | 56.0 | 52.0 |
| Average exchange rate ALL/EUR | 139.74 | 137.36 | 134.15 | 127.59 | 123.01 | 122.0 | 121.5 | 121.5 |

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

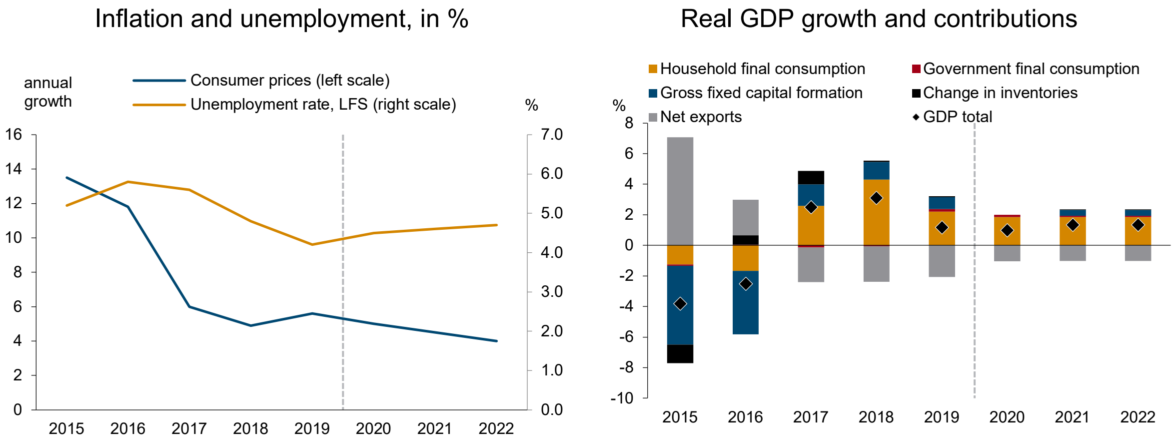
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.


# BELARUS: Economic weakness becoming a chronic challenge

RUMEN DOBRINSKY

The Belarusian economy remained sluggish in 2019, with GDP growing by a meagre 1.2%. Recent performance was adversely affected by a deepening dispute with Russia over the price of imported hydrocarbons, while the domestic economic policy stance has remained relatively tight. The prospects for a favourable oil price deal with Russia are slim and no change in macroeconomic policy is likely in the near future. We therefore expect GDP growth to be around 1% in 2020, and slightly higher in the following two years.

**Figure 6.2 / Belarus: Main macroeconomic indicators**




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

**Belarus's economic performance in 2019 remained sluggish throughout the year.** Although no technical recession was recorded, the growth of quarterly aggregate output fluctuated around the 1% mark. According to the first official estimates, the rate of GDP growth for the year as a whole was 1.2%. It is becoming clear that the years of relatively high economic growth are a thing of the past and are not likely to be repeated in the near future. Moreover, there are signs that economic weakness is becoming chronic and may continue to mark Belarus's economic performance in years to come.

**The underlying determinants of the downward shift in the growth path comprise a combination of external and domestic factors.** Belarus's economic performance has been affected by rumbling disputes with Russia over the price of imported hydrocarbons. They have resulted in chronic disruptions to the supply of subsidised oil from Russia, causing a loss of export revenues and a lasting negative shock to the Belarusian economy. Thus, in 2019 Belarus imported only 18 million tonnes of Russian oil, instead of the 24 million tonnes envisaged by the framework contract between the two countries. This impacted on the key export-oriented petrochemical industry, as well as on fiscal revenue. According to local analysts, the shock due to the reduction in oil supply in 2019 was equivalent to a loss of aggregate growth of some 0.5% of GDP.

**The core of the problem is a failure to implement in reality the integration agenda agreed by the two countries under the treaty on the Union State (which dates back to 1997).** The treaty envisaged an ambitious agenda of integrative measures, such as the establishment of a joint parliament and government, and a common currency. As part of this agenda, Belarus was granted privileged access to Russia's energy resources. However, over the years there has been little enthusiasm on the part of Belarus to move ahead with deepening the process of integration in line with the treaty. At the same time, it continued to benefit from the import of cheap hydrocarbons, which amounted to a significant direct intergovernmental subsidy. Russia has consistently voiced its dissatisfaction with the state of affairs, and has gradually been reducing the benefits. It has announced its intention of phasing out all remaining energy subsidies by 2024, unless significant progress is made on the integration agenda.

**Each move to reduce the existing privileges has been interpreted by the Belarusian side as an unjustified price rise.** This has engendered a series of trade disputes between the two countries. The current disputes started in 2018 and have not yet been fully resolved, despite several summit meetings on the issue. As part of the tit-for-tat dispute, in February 2020 Belarus raised by 6% the tariff on the transit of Russian oil through pipelines on Belarusian territory on its way to the EU.

**The vulnerability of Belarus's economy to such external shocks is indicative of its chronic structural problems.** These stem from the existence of a large unreformed state-owned sector of the economy – mostly in manufacturing, but partly in agriculture. During the years of abundant cheap energy, this sector enjoyed significant explicit and implicit subsidies which kept these unreformed firms afloat. The energy subsidies started to dry up some years ago, and this has inevitably led to a radical reduction in public support to this sector; in turn, this has resulted in lower levels of economic activity and has forced the enterprises to downsize the workforce.

**These changes in the external environment coincided with a shift in Belarus's macroeconomic policy agenda, with much greater priority assigned to macroeconomic stabilisation.** Indeed, following two decades of rampant inflation, after 2016 Belarus made remarkable progress in disinflation. This was achieved thanks to coordinated efforts to tighten both monetary and fiscal policy. One of the key factors in the new policy approach has been a resolve on the part of the authorities (undoubtedly backed at the top level of government) to reduce considerably the level of directed credit (credit allocated by state-owned banks in accordance with specific government programmes) to state-owned firms and farms. This has contributed to better control over the money supply and a reduction in the contingent fiscal liabilities generated by the practice of directed credit, both of which were sources of macroeconomic instability in the past. However, the tightening of macroeconomic policy has been another factor that has curbed domestic demand and hence economic activity in the country.

**Overall, the boom-and-bust cycles that characterised the Belarusian economy over the past decade or so seem to have been left behind.** Instead, this pattern has been replaced by a persistently sluggish economic performance, which is also affected by the weak growth in Russia, Belarus's main trading partner. This pattern prevailed in 2019, as well. Thus, gross industrial output increased by just 1.0% over the previous year; construction activity ground to a halt; real exports of goods and services (according to the national accounts definition) all but stagnated. The disruption in oil imports led to a significant decline in exports of the important oil-processing industry: in current dollar terms, the exports of mineral products in 2019 were 18.9% down on the level recorded in 2018. Among the few positive developments in 2019 was the further growth of the export-oriented IT sector, which has advanced as one of Belarus's top export earners. However, this was not sufficient to offset the drop in other important export items.

**In statistical terms, net exports made a negative contribution to GDP growth in 2019, repeating the picture of the previous year.** The only positive (albeit modest) impetus to economic growth came from domestic demand, thanks primarily to robust growth in private consumption. This was supported by the continued rise in average real disposable income, which increased by 6.0% in 2019, and by a surge in household credit (which grew by 22% year on year in 2019). The key underlying factor for these developments was the populist policy emphasis on boosting real wages well above productivity growth – the one exception to the overall tight macroeconomic policy stance. The labour market in 2019 was basically stagnant in macroeconomic terms, but at the micro level there has been an ongoing dynamic process of worker churn.

**Thanks to the tightening of macroeconomic policies, Belarus managed to eliminate its previously large external imbalances.** In 2019, the current account deficit came close to zero, repeating the outcome of the previous year. The foreign debt stayed well under control and has stabilised in absolute value. With the deterioration in relations with Russia (which remains the main foreign creditor), the Belarusian authorities have sought to diversify the sources of external finance. As regards sovereign borrowing (which accounts for 42% of the gross foreign debt), China has rapidly grown in importance: in 2019, Belarus raised USD 638 million of new credit from Chinese banks – close to the amount newly borrowed from Russian sources (USD 730 million).

**The shrinking of the oil-related fiscal revenue is having a negative impact on budgetary policy.** According to estimates by local experts, the 'loss' to the budget amounted to USD 130 million in 2019, while the 'loss' to local businesses was around USD 200 million. For the first time in six years, Belarus adopted a state budget with a planned deficit (amounting to 0.7% of GDP) for the year 2020. Given the dim prospects for a favourable agreement with Russia, the situation is likely to become further aggravated in the future.

**In fact, on 1 January 2020 Russia turned off the supply of oil to Belarus, as the intergovernmental contract governing that supply expired in 2019.** This came as a further shock to the Belarusian economy and is likely to have knock-on economic implications. Belarus has desperately been seeking new suppliers, but in the short term these can only provide a stop-gap solution. Thus, the Russian private oil conglomerate Safmar Group has pledged to supply Belarus with up to 9 million tonnes of oil in 2020 (the first deliveries were already made in January and February). Belarus also struck an experimental deal for a one-off delivery of oil from Norway (one oil tanker of 80,000 tonnes, the oil delivered to its final destination by rail). The terms and conditions of these deliveries have not been disclosed, but most probably prices were higher than those offered by Russia. In any case, Belarus is unlikely to be able (at least in the short run) to secure from other sources the quantities it needs to operate its petrochemical industry at full capacity.

**Negotiations on the supply of hydrocarbons were resumed at the top level in early February.** According to public statements, a tentative compromise deal has been reached at the political level for the year 2020, according to which Russia will supply natural gas at 2019 prices (still a significant discount), while the price of oil will be directly linked to world market prices. The details of the deal are still to be negotiated at the operational level, but on the basis of the political accord Russia resumed its supply of oil to Belarus.

**Given the current conditions and external environment, the pattern of economic sluggishness is likely to prevail in 2020 as well.** In fact, in January both aggregate output and gross industrial production fell year on year, dragged down by the problems with the oil supply, which had the effect of a new external shock. At the same time, 2020 is the year of presidential elections in Belarus, and so some populist economic policy moves seem likely, such as a further significant rise in real wages.

**Given the recent negative developments, we expect a rate of GDP growth in the range of 1% in 2020.** In the present circumstances, even if the regular supply of oil resumes, it would be hard to envisage a marked revival of economic activity in coming years. In any case, private consumption would remain the main growth driver on the demand side. The authorities seem determined to continue the disinflation strategy based on a generally tight policy stance. This will provide no additional impetus to growth, but inflation should continue to fall. Enterprise restructuring may accelerate, leading to some increase in unemployment. The medium-term prospects for the Belarusian economy will also depend on the course of economic policy after the 2020 presidential elections.

## Table 6.2 / Belarus: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 Forecast | 2022 |
|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 9,490 | 9,502 | 9,498 | 9,484 | 9,450 | 9,420 | 9,400 | 9,380 |
| Gross domestic product, BYN mn, nom. | 89,910 | 94,949 | 105,748 | 122,320 | 130,700 | 138,600 | 146,800 | 154,700 |
| annual change in % (real) | -3.8 | -2.5 | 2.5 | 3.1 | 1.2 | 1.0 | 1.3 | 1.3 |
| GDP/capita (EUR at PPP) | 13,800 | 12,900 | 13,200 | 13,900 | 14,400 | . | . | . |
| Consumption of households, BYN mn, nom. | 47,006 | 51,122 | 56,843 | 64,491 | 71,000 | . | . | . |
| annual change in % (real) | -2.4 | -3.2 | 4.8 | 8.0 | 4.2 | 3.5 | 3.5 | 3.5 |
| Gross fixed capital form., BYN mn, nom. | 25,763 | 24,155 | 27,662 | 32,081 | 35,100 | . | . | . |
| annual change in % (real) | -15.5 | -14.5 | 5.5 | 4.4 | 3.0 | 0.0 | 1.5 | 1.5 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | -6.6 | -0.4 | 6.1 | 5.7 | 1.0 | -1.0 | 1.0 | 1.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | -2.5 | 3.3 | 4.2 | -3.3 | 2.9 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | -11.3 | -14.8 | -3.7 | 2.2 | 0.1 | . | . | . |
| Employed persons, LFS, th | . | 4,862 | 4,902 | 4,897 | 4,900 | 4,890 | 4,880 | 4,860 |
| annual change in % | . | . | 0.8 | -0.1 | 0.1 | -0.2 | -0.2 | -0.4 |
| Unemployed persons, LFS, th | 273 | 302 | 293 | 245 | 226 | 230 | 235 | 240 |
| Unemployment rate, LFS, in % | 5.2 | 5.8 | 5.6 | 4.8 | 4.2 | 4.5 | 4.6 | 4.7 |
| Reg. unemployment rate, in %, eop | 1.0 | 0.8 | 0.5 | 0.3 | 0.2 | 0.3 | 0.3 | 0.3 |
| Average monthly gross wages, BYN | 671.5 | 722.7 | 822.8 | 971.4 | 1,120.0 | 1,270 | 1,420 | 1,570 |
| annual change in % (real, gross) | -2.3 | -3.8 | 7.5 | 12.5 | 9.0 | 8.0 | 7.0 | 6.0 |
| Consumer prices, % p.a. | 13.5 | 11.8 | 6.0 | 4.9 | 5.6 | 5.0 | 4.5 | 4.0 |
| Producer prices in industry, % p.a. 2) | 17.2 | 12.0 | 9.8 | 6.8 | 6.3 | 6.0 | 5.5 | 5.0 |
| General governm.budget, nat. def., % of GDP | | | | | | | | |
| Revenues | 41.3 | 40.9 | 40.5 | 41.5 | 41.0 | 41.0 | 41.0 | 41.0 |
| Expenditures | 39.9 | 39.4 | 37.6 | 37.5 | 37.0 | 39.0 | 40.0 | 40.0 |
| Deficit (-) / surplus (+) | 1.4 | 1.5 | 3.0 | 4.0 | 4.0 | 2.0 | 1.0 | 1.0 |
| General gov.gross debt, nat. def., % of GDP 3) | 53.0 | 53.5 | 53.4 | 43.7 | 42.0 | 41.0 | 40.0 | 39.0 |
| Stock of loans of non-fin.private sector, % p.a. | 19.4 | -6.2 | 7.2 | 12.7 | 10.0 | . | . | . |
| Non-performing loans (NPL), in %, eop 4) | 6.8 | 12.8 | 12.9 | 5.0 | 5.5 | . | . | . |
| Central bank policy rate, % p.a., eop 5) | 25.0 | 18.0 | 11.0 | 10.0 | 9.0 | 8.5 | 8.0 | 7.5 |
| Current account, EUR mn 6) | -1,669 | -1,464 | -843 | -29 | -300 | -800 | -700 | -500 |
| Current account, % of GDP | -3.3 | -3.4 | -1.7 | -0.1 | -0.5 | -1.4 | -1.3 | -0.9 |
| Exports of goods, BOP, EUR mn 6) | 23,854 | 20,988 | 25,405 | 28,409 | 28,900 | 28,600 | 28,800 | 29,000 |
| annual change in % | -13.2 | -12.0 | 21.0 | 11.8 | 1.7 | -1.0 | 0.7 | 0.7 |
| Imports of goods, BOP, EUR mn 6) | 25,807 | 23,270 | 28,043 | 30,536 | 32,600 | 32,600 | 32,900 | 33,200 |
| annual change in % | -12.6 | -9.8 | 20.5 | 8.9 | 6.8 | 0.0 | 0.9 | 0.9 |
| Exports of services, BOP, EUR mn 6) | 6,099 | 6,255 | 7,000 | 7,493 | 8,600 | 8,800 | 9,000 | 9,400 |
| annual change in % | -1.2 | 2.6 | 11.9 | 7.0 | 14.8 | 2.3 | 2.3 | 4.4 |
| Imports of services, BOP, EUR mn 6) | 4,025 | 3,981 | 4,274 | 4,584 | 5,200 | 5,300 | 5,400 | 5,500 |
| annual change in % | -10.0 | -1.1 | 7.4 | 7.3 | 13.4 | 1.9 | 1.9 | 1.9 |
| FDI liabilities, EUR mn 6) | 1,506 | 1,133 | 1,130 | 1,212 | 1,200 | 900 | . | . |
| FDI assets, EUR mn 6) | 97 | 112 | 60 | 47 | 100 | 100 | . | . |
| Gross reserves of NB excl. gold, EUR mn 6) | 2,510 | 3,071 | 4,502 | 4,561 | 6,265 | . | . | . |
| Gross external debt, EUR mn 6) | 34,996 | 35,930 | 33,363 | 34,307 | 35,000 | 33,000 | 32,700 | 32,000 |
| Gross external debt, % of GDP | 69.4 | 83.3 | 68.9 | 67.3 | 62.5 | 59.5 | 59.0 | 58.0 |
| Average exchange rate BYN/EUR | 1.7828 | 2.2010 | 2.1833 | 2.4008 | 2.3342 | 2.50 | 2.65 | 2.80 |

1) Preliminary and wiiw estimates. - 2) Domestic output prices. - 3) Including publicly guaranteed debt. - 4) From 2018 doubtful, bad and small part of supervised assets; previously doubtful and large part of supervised assets. - 5) Refinancing rate of NB. - 6) Converted from USD.

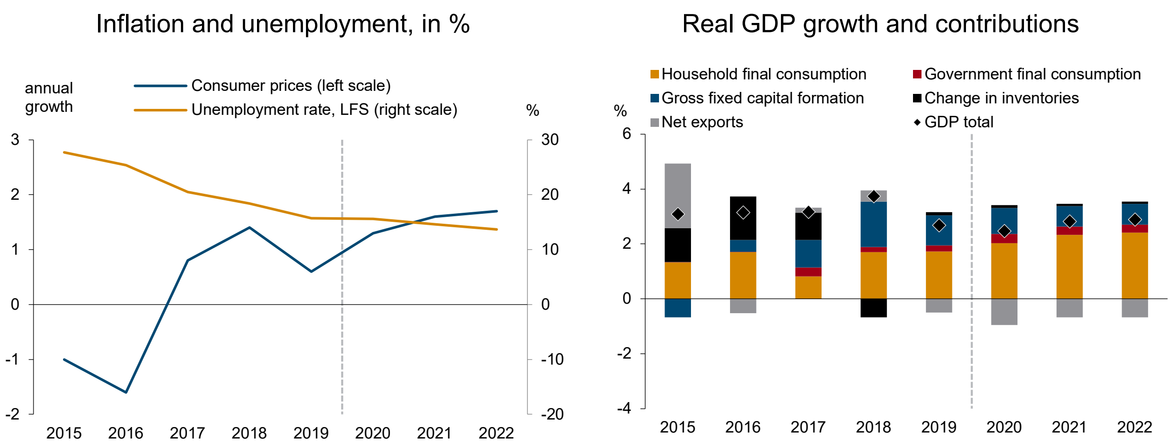
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.


# BOSNIA AND HERZEGOVINA: Fiscal consolidation amidst a potential migration crisis

BERND CHRISTOPH STRÖHM

After previous setbacks following the global financial crisis, the Bosnian economy is expanding steadily, with an expected growth rate of around 2.7% in 2020 and 3% p.a. in the period 2021-2022. The official unemployment rate is expected to decline further, from 30% in 2020 to around 28.5% in 2022; however, this will partly be a result of the great 'brain drain' and the withdrawal of workers from the labour market. Even though growth continues to be stable, the newly formed central government may yet be challenged by the emergence of a potential migration crisis in spring/summer 2020.

**Figure 6.3 / Bosnia and Herzegovina: Main macroeconomic indicators**




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

**Despite political uncertainties in 2019, economic growth remains stable.** Bosnia and Herzegovina's economy is expanding steadily, with an expected growth rate of around 2.7% in 2020 and 3% p.a. in the period 2021-2022. The economy is being driven by investments in the energy sector, construction and manufacturing. Especially remittances from abroad and tourism, combined with higher wages, will boost private consumption to an average of 3% p.a. in the period 2020-2022, which will further contribute to BiH's growth. The country's exports of goods and services will not exceed 4.5% p.a. in the period 2020-2022, due to only moderate sales of intermediate products, especially from its aluminium industry.

**The main objective of Bosnia and Herzegovina's fiscal policy in the period 2020-2022 is to strengthen fiscal stability and sustainability through a reduction in tax debt and increased taxpayer discipline, as well as through the creation of a more favourable business environment.** The adoption by the Council of Ministers of a state budget for 2020 will facilitate the arrangement with the IMF dating from 2016, and will enable the unfreezing of a EUR 553.3 million loan to support economic reforms. The IMF wants BiH to reorient its fiscal policy, by reducing current spending in order to create room for much-needed investment in infrastructure. The funds provided by the IMF lending programme will have a positive effect on the budget, which is why the deficit will narrow to an average of 0.4% of GDP in the period 2020-2022. A decline in global oil prices and higher prices for aluminium (BiH's main export good) will mean that the country's current account deficit decreases to 3.5% p.a. in 2020-2021, before rising again to 3.7% p.a. in the period 2022-2024. With high emigration and a large diaspora, remittances will remain strong and will continue to finance parts of the country's trade deficit.

**Projects to expand Bosnia and Herzegovina's transport and energy infrastructure provide incentives for foreign investments beyond 2020.** With the formation of a new government, it is now expected that government expenditure will increase by around 1.6% p.a. in 2020 and 2021. This increase in public spending will likely focus on the energy and security sectors (the National Border Police has repeatedly urged the government to invest in national security, due to the increased influx of refugees and migrants into BiH). Projects to expand the transport and energy infrastructure are attractive, thanks to funding from the European Union. The government aims at increasing the share of renewable energy. Those policies offer incentives to invest in the energy sector beyond 2020, especially to China and Russia. In 2019, Bosnia and Herzegovina started to work on an integrated National Energy and Climate Plan for the period 2021-2030, in order to align itself with EU energy and climate policies. This long-term energy strategy further facilitates major investments from the European Union and elsewhere.

**The tourism sector is expected to grow in BiH and to offer further potential in 2021-2022, with Sarajevo becoming increasingly popular with foreign visitors and investors.** It is evident that Sarajevo Canton is economically one of the strongest regions in Bosnia and Herzegovina. In the last five years, the capital has gained in popularity as a European holiday destination – including for the Arab middle class, due to its Muslim population. Tourism has been helped not just by Sarajevo's relatively favourable prices, but also by BiH's liberal visa policy, which means that people from various Arab countries (and from Russia) do not need a visa to enter the country.

**Bosnia and Herzegovina continues to suffer from negative demographic development and an exodus of workers from the country's labour market.** In the last five years, foreign investors have opened several companies in Bosnia and Herzegovina, in particular in Una-Sana Canton. However, they often struggle to find and employ skilled labour. The health sector in general also suffers from a lack of trained medical personnel, due to Bosnia's 'brain drain'. The overall problem with the withdrawal of skilled workers from Bosnia's labour market is visible not only in the shortage of labour, but also in its quality. This negative trend encourages corruption and means a lack of competition for high-end positions, which contributes to the inefficiency of both the private and the public sector. Due to the country's dysfunctional political system, the central government lacks effective policies to properly address BiH's brain drain.

**After more than a year of political deadlock, the appointment of Bosnia and Herzegovina's new government will open the way for progress towards EU candidate status and socioeconomic reforms in 2020.** However, an overblown and inefficient government apparatus means it is unlikely that those reforms will be carried out swiftly in 2020. Bosnia and Herzegovina is a potential candidate country for the EU, and its government will continue to try to fulfil all the requirements for candidate status. Nevertheless, the political disparities within BiH's separate entities – the Republika Srpska and the Federation of Bosnia and Herzegovina – and the country's constitution (which is desperately in need of reform) make it unlikely that Bosnia and Herzegovina will achieve EU candidate status in the foreseeable future.

**In 2018, the border between BiH and Croatia became one of the last gateways to northern Europe, which is why more than 60,000 migrants and refugees have registered in the country in the past two years.** It is expected that the number of migrants and refugees will increase substantially in 2020, posing a challenge to the newly formed government in the medium term. In particular the failure to form a government throughout 2019 meant that all efforts to coordinate an effective response to the increased influx of migrants and refugees failed. Due to a lack of proper communication between local administrations and central government, local authorities continue to be overwhelmed by refugees. In January 2020, the Border Police still lacked proper funding and equipment to stop migrants from illegally entering the country.

**The government faces a potential migrant crisis in 2020, aggravated by Croatia's closed-border policy.** The situation on the border with Croatia is also creating tension between the inhabitants of Una-Sana Canton (in particular the city of Bihac) and incoming refugees. The authorities are struggling to ensure proper accommodation for refugees. Tensions continue to run high between the BiH authorities and refugees, as was seen in December 2019, when the infamous Vucjak camp near the border with Croatia was closed down and migrants, eager to reach the EU, protested against their resettlement. As of 2020, the situation of refugees has improved marginally, thanks to the construction of the new Usivak camp, near Sarajevo. However, the Border Police maintains that Bosnia and Herzegovina is likely to face another migrant wave in spring. The new government has yet to develop a proper plan on how to deal with any fresh influx of migrants and refugees. A potential migration crisis could further lead to the emergence of a shadow economy: business owners may be tempted to employ refugees who are not legally able to work in BiH, paying them low wages and thereby swamping Bosnia's labour market with cheap labour.

## Table 6.3 / Bosnia and Herzegovina: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th pers., average | 3,518 | 3,511 | 3,504 | 3,496 | 3,500 | 3,490 | 3,485 | 3,480 |
| Gross domestic product, BAM mn, nom. 2) | 28,589 | 29,904 | 31,376 | 33,444 | 34,500 | 35,800 | 37,400 | 39,100 |
| annual change in % (real) | 3.1 | 3.1 | 3.2 | 3.7 | 2.7 | 2.5 | 2.8 | 2.9 |
| GDP/capita (EUR at PPP) 2) | 8,800 | 9,000 | 9,200 | 9,900 | 10,300 | . | . | . |
| Consumption of households, BAM mn, nom. 2) | 23,095 | 23,560 | 24,200 | 25,144 | 25,880 | . | . | . |
| annual change in % (real) | 1.6 | 2.1 | 1.0 | 2.2 | 2.3 | 2.7 | 3.1 | 3.2 |
| Gross fixed capital form., BAM mn, nom. 2) | 5,097 | 5,189 | 5,653 | 6,310 | 6,720 | . | . | . |
| annual change in % (real) | -3.5 | 2.5 | 5.8 | 9.2 | 5.8 | 5.0 | 4.0 | 4.0 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | 3.1 | 4.4 | 3.2 | 1.6 | -5.3 | 2.3 | 3.5 | 4.0 |
| Gross agricultural production 3) | | | | | | | | |
| annual change in % (real) | 12.6 | 12.0 | 4.1 | 2.3 | 2.0 | . | . | . |
| Construction output total | | | | | | | | |
| annual change in % (real) | 1.7 | -1.9 | -1.1 | 0.4 | -2.1 | . | . | . |
| Employed persons, LFS, th, April | 821.5 | 801.1 | 815.7 | 822.4 | 802.9 | 810 | 820 | 820 |
| annual change in % | 1.2 | -2.5 | 1.8 | 0.8 | -2.4 | 1.0 | 0.7 | 0.5 |
| Unemployed persons, LFS, th, April | 314.7 | 272.9 | 210.7 | 185.5 | 149.4 | 150 | 140 | 130 |
| Unemployment rate, LFS, in %, April | 27.7 | 25.4 | 20.5 | 18.4 | 15.7 | 15.6 | 14.6 | 13.7 |
| Reg. unemployment rate, in %, eop | 42.9 | 40.9 | 38.7 | 34.7 | 32.6 | . | . | . |
| Average monthly gross wages, BAM | 1,289 | 1,301 | 1,321 | 1,363 | 1,421 | 1,470 | 1,510 | 1,550 |
| annual change in % (real, gross) | 1.0 | 2.5 | 0.8 | 1.7 | 3.7 | 2.0 | 1.3 | 1.0 |
| Average monthly net wages, BAM | 830 | 838 | 851 | 879 | 921 | 960 | 990 | 1,020 |
| annual change in % (real, net) | 1.0 | 2.6 | 0.7 | 1.9 | 4.2 | 2.5 | 1.3 | 1.1 |
| Consumer prices, % p.a. | -1.0 | -1.6 | 0.8 | 1.4 | 0.6 | 1.3 | 1.6 | 1.7 |
| Producer prices in industry, % p.a. | 0.6 | -2.1 | 3.0 | 3.5 | 0.1 | 2.0 | 2.2 | 2.5 |
| General governm.budget, nat.def., % of GDP | | | | | | | | |
| Revenues | 43.0 | 42.7 | 43.1 | 43.1 | 42.1 | 42.5 | 42.6 | 42.6 |
| Expenditures | 42.3 | 41.5 | 40.5 | 40.7 | 41.1 | 42.0 | 42.0 | 42.0 |
| Deficit (-) / surplus (+) | 0.7 | 1.2 | 2.6 | 2.3 | 1.0 | 0.5 | 0.6 | 0.6 |
| General gov.gross debt, nat.def., % of GDP | 41.9 | 40.4 | 36.1 | 34.2 | 31.7 | 28.0 | 27.0 | 26.0 |
| Stock of loans of non-fin.private sector, % p.a. | 2.0 | 3.5 | 7.3 | 5.5 | 6.6 | . | . | . |
| Non-performing loans (NPL), in %, eop | 13.7 | 11.8 | 10.0 | 8.8 | 7.5 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | . | . | . | . | . | . | . | . |
| Current account, EUR mn 5) | -741 | -720 | -697 | -633 | -910 | -970 | -980 | -1,030 |
| Current account, % of GDP | -5.1 | -4.7 | -4.3 | -3.7 | -5.2 | -5.3 | -5.1 | -5.1 |
| Exports of goods, BOP, EUR mn 5) | 3,679 | 3,937 | 4,776 | 5,327 | 5,270 | 5,570 | 5,870 | 6,170 |
| annual change in % | 5.1 | 7.0 | 21.3 | 11.5 | -1.1 | 5.6 | 5.4 | 5.1 |
| Imports of goods, BOP, EUR mn 5) | 7,348 | 7,561 | 8,568 | 9,158 | 9,340 | 9,870 | 10,410 | 10,960 |
| annual change in % | -2.4 | 2.9 | 13.3 | 6.9 | 2.0 | 5.7 | 5.5 | 5.3 |
| Exports of services, BOP, EUR mn 5) | 1,515 | 1,621 | 1,774 | 1,876 | 1,970 | 2,130 | 2,300 | 2,480 |
| annual change in % | 20.9 | 7.0 | 9.5 | 5.7 | 5.0 | 8.3 | 8.0 | 8.0 |
| Imports of services, BOP, EUR mn 5) | 514 | 530 | 583 | 606 | 637 | 670 | 700 | 730 |
| annual change in % | 33.2 | 3.2 | 10.0 | 3.9 | 5.1 | 4.8 | 4.8 | 4.8 |
| FDI liabilities, EUR mn 5) | 345 | 284 | 415 | 412 | 450 | 450 | . | . |
| FDI assets, EUR mn 5) | 85 | 3 | 85 | -17 | 40 | 10 | . | . |
| Gross reserves of NB excl. gold, EUR mn 5) | 4,307 | 4,768 | 5,293 | 5,835 | 6,311 | . | . | . |
| Gross external debt, EUR mn 6) | 7,937 | 8,379 | 8,695 | 9,251 | 9,800 | 10,100 | 10,400 | 10,800 |
| Gross external debt, % of GDP 6) | 54.3 | 54.8 | 54.2 | 54.1 | 55.6 | 55.2 | 54.4 | 54.0 |
| Average exchange rate BAM/EUR | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 |

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

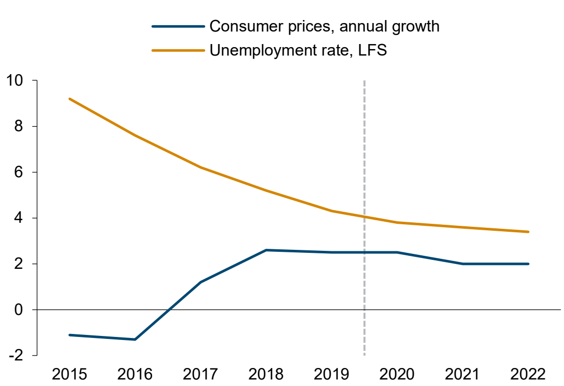
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

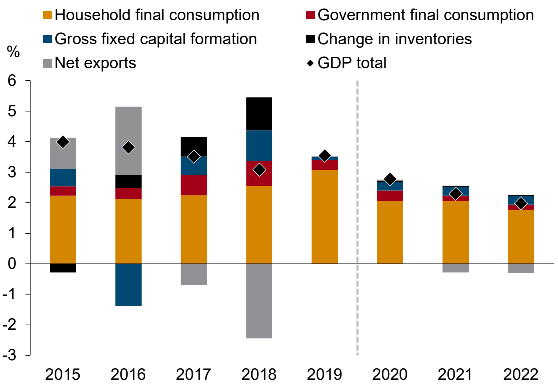

# BULGARIA: Slowdown likely to continue

RUMEN DOBRINSKY

After an upturn in the first half of 2019, economic activity subsided in the second semester. The slowdown was triggered by a weakening of external demand, while private consumption remained relatively strong. The labour market tightened further and continued to exert pressure on wages. The short-term prospects have deteriorated, and GDP growth is expected to decelerate to below 3% in 2020 – and may slow further in the coming years.

**Figure 6.4 / Bulgaria: Main macroeconomic indicators**




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

**Economic performance was uneven in the course of 2019: after an upturn in the first half of the year, economic activity slowed in the second semester.** GDP growth for the year as a whole came to 3.5%, but this was mostly due to the strong growth in the first quarter.

**The slowdown was pronounced in most sectors of economic activity.** Manufacturing output in 2019 grew by less than 2%, while the real exports of goods and services (national accounts definition) basically stagnated. The same was true of real imports, reflecting the weaker demand for intermediates and investment goods. In current euro terms, imports of goods actually shrank by some 2% in 2019.

**Among the main factors behind the slowdown was the dwindling demand in all key export markets.** Gross fixed capital formation also weakened, especially in the second half of the year. Private consumption was the main (and practically the sole) growth driver on the demand side, fuelled by the ongoing rise in real incomes.

**Last year was marked by a further tightening of the labour market.** In the third quarter of 2019, the LFS rate of unemployment fell to 3.7%, which was the lowest rate on record. Labour demand has been rising steadily in recent years: between 2015 and 2019, the total number of employed people increased by 6.7% and the employment rate rose from 63% to 71%. However, the age structure of the economically active population is highly unfavourable, and the growth in employment was almost entirely due to higher activity and employment rates among the older population. Thus, between 2015 and 2019, the share of those aged 45 and above in total employment increased from 44.6% to 48.0%. During the same period, the employment rate in the cohort aged 55-64 grew by 10.5 percentage points, from 54.6% to 65.1%. At the same time, the labour market is characterised by striking regional disparities: in 2019, employment rates across Bulgaria's districts (national territorial units) varied from 81.5% to 45.5%. So while, from the macro perspective, there are still some labour reserves, these may be difficult to mobilise, due to a mismatch between regional supply and demand, and generally low labour mobility.

**Labour shortages have become persistent, generating tensions between businesses, unions and the government.** Labour shortages are most acute in blue-collar jobs, tourism, teaching and health care. In recent business sentiment surveys, most Bulgarian firms indicate labour shortages as the main impediment to future expansion. In February 2020, the government adopted a national Plan of Action on Employment, which will seek to raise further the activity and employment rates through active labour market measures. Businesses have also been lobbying the authorities to relax the constraints on hiring personnel from third countries, especially seasonal workers. In 2019, the government adopted regulations that will speed up the issuing of visas to such workers. The government is also considering special incentives to attract young Bulgarians graduating abroad to embark on a career in Bulgaria.

**The shortages in the labour market have continued to exert pressure on wages**. Real wages grew by 7.8% in 2019, well above the rate of productivity growth. Related to that, inflation was also on the rise until mid-year. In the second semester, the cost-push factors were apparently offset by weakening domestic demand, and so the annual average rate of the HICP in 2019 was 2.5%.

**However, in December 2019 and January 2020 inflation started to pick up again, fuelled by an upsurge in food prices.** Actually, the annual average rate of growth for food prices in 2019 rose to 6.2%, up from 2.2% in 2018. One of the main factors behind this was the sharp hike in the price of pork, following a severe outbreak of African swine fever in 2019. According to tentative estimates, between 15% and 20% of the total pig population in the country were culled on infected farms and areas, in order to prevent the further spread of the infection. It remains to be seen whether the higher prices will persist in coming months.

**Credit activity in 2019 was moderate.** The stock of outstanding household credit in December 2019 was 9.5% higher than a year earlier; this was below the rate of growth in the previous year (11.2%). As for credit to non-financial corporations, that increased by 6.5% in 2019, roughly repeating the dynamics of the previous year (6.2%). In 2019, Bulgarian commercial banks continued to cleanse their balance sheets of substandard and non-performing loans. During the period 2018-2019, a total of BGN 3 billion of such assets were sold to debt collection companies. In September 2019, the share of non-performing loans in the total loan portfolio of Bulgarian commercial banks amounted to 7.5%, roughly the same level as a year earlier.

**Last year was also marked by a record high current account surplus.** This resulted, in the first place, from a combination of a shrinking deficit in the trade in goods and a further expansion of the surplus in the trade in services. The FDI inflow – which usually contributes to the negative part of the current account balance through imports of investment goods – was modest in 2019. A current account surplus of this proportion is definitely a handicap for an emerging economy such as Bulgaria's, and so policymakers may need to consider some counterbalancing measures.

**For the first time since 2015, the consolidated general government balance slid into negative territory in 2019.** The net outcome in 2019 was affected by a big one-off fiscal outlay – the purchase of eight F-16 fighter jets, worth BGN 2.1 billion. At the same time, the total revenue in the consolidated general government budget in 2019 was 13.1% higher than in 2018. This windfall triggered a massive public spending spree in December: the government allocated public spending of BGN 6.6 billion – more than double the usual monthly amount. This practice of extravagant spending of surplus revenue – bypassing parliamentary scrutiny – keeps being repeated year after year.

**Income growth is a key policy focus in the 2020 budget.** In January, the minimum wage was raised from BGN 560 to BGN 610, an increase of 8.9%. The budget also envisages an average 10% increase in public sector wages. Some categories of public sector employees will benefit from larger pay rises: school teachers will get 17.5% and social workers – 15%. A 6.7% increase in pensions is scheduled for July 2020. Other than that, the 2020 budget does not envisage any significant changes in economic policy.

**The Bulgarian authorities are maintaining their intention of applying to participate in ERM II at the earliest possible date.** In 2019 the ECB conducted an asset quality review and stress test, which found capital shortfalls at two of the six Bulgarian banks surveyed. The two banks in question have hastened to adopt action plans to cover the capital shortfalls. In February 2020, parliament passed amendments to the law governing the Bulgarian National Bank, clearing up some technical details associated with Bulgaria's participation in ERM II. Nevertheless, at the time of writing, no dates have been fixed, and it remains to be seen whether entry to ERM II will happen in 2020.

**Recent months have been marred by a series of local crises, accompanied by political scandals.** The most serious was related to a severe water shortage in Pernik, a city of 100,000 inhabitants not far from Sofia, caused by blatant mismanagement of the supply of drinking water. At almost the same time, it was also brought to the public's attention that large quantities of waste had been imported and illegally dumped at various unauthorised tips. These scandals provoked public unrest and were used by the opposition socialist party to seek a vote of no confidence in the government. However, the motion was voted down by the ruling coalition, which has a majority in parliament.

**In early February, President Rumen Radev issued a public statement effectively withdrawing his political confidence in the government, claiming a deep crisis in Bulgarian society.** While this was a purely symbolic gesture (the president has no constitutional powers to remove a government from office), it was indicative of the growing tensions both among different public institutions and within society at large. So far it appears unlikely that this will trigger early elections, but political instability has been on the rise.

**The short-term prospects for the Bulgarian economy have deteriorated.** The 2020 budget was compiled on the assumption that real GDP growth would amount to 3.3%. However, given the recent trends and the expected continued economic sluggishness in the EU, we expect a further slowdown in the Bulgarian economy in 2020 and the following years. Private consumption should remain strong, but this will not be sufficient to support robust growth. Consequently, we expect GDP to grow at below 3% in 2020. If external demand remains weak, economic growth could decelerate further in 2021 and 2022. Unless there is a policy shift to stimulate domestic demand, the economy will continue to generate large current account surpluses.

## Table 6.4 / Bulgaria: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th pers., average | 7,178 | 7,128 | 7,076 | 7,025 | 6,950 | 6,900 | 6,850 | 6,800 |
| Gross domestic product, BGN mn, nom. | 89,333 | 95,092 | 102,308 | 109,695 | 116,400 | 122,600 | 127,900 | 133,000 |
| annual change in % (real) | 4.0 | 3.8 | 3.5 | 3.1 | 3.5 | 2.8 | 2.3 | 2.0 |
| GDP/capita (EUR at PPP) | 13,800 | 14,300 | 14,900 | 15,700 | 16,600 | . | . | . |
| Consumption of households, BGN mn, nom. | 54,703 | 56,846 | 60,932 | 64,849 | 69,300 | . | . | . |
| annual change in % (real) | 3.6 | 3.5 | 3.8 | 4.3 | 5.2 | 3.5 | 3.5 | 3.0 |
| Gross fixed capital form., BGN mn, nom. | 18,684 | 17,554 | 18,795 | 20,624 | 21,000 | . | . | . |
| annual change in % (real) | 2.7 | -6.6 | 3.2 | 5.4 | 0.5 | 1.5 | 1.5 | 1.5 |
| Gross industrial production 2) | | | | | | | | |
| annual change in % (real) | 2.9 | 2.7 | 3.4 | 1.1 | 0.7 | 0.5 | 0.5 | 0.5 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | -8.2 | 1.7 | 6.3 | -0.4 | -1.9 | . | . | . |
| Construction industry 3) | | | | | | | | |
| annual change in % (real) | 11.1 | -16.7 | 4.6 | 1.6 | 3.6 | . | . | . |
| Employed persons, LFS, th, average | 3,032 | 3,017 | 3,150 | 3,153 | 3,233 | 3,250 | 3,260 | 3,270 |
| annual change in % | 1.7 | -0.5 | 4.4 | 0.1 | 2.6 | 0.5 | 0.4 | 0.3 |
| Unemployed persons, LFS, th, average | 305 | 247 | 207 | 173 | 143 | 130 | 120 | 120 |
| Unemployment rate, LFS, in %, average | 9.2 | 7.6 | 6.2 | 5.2 | 4.3 | 3.8 | 3.6 | 3.4 |
| Reg. unemployment rate, in %, eop | 10.0 | 8.0 | 7.1 | 6.1 | 5.9 | . | . | . |
| Average monthly gross wages, BGN | 878 | 948 | 1,037 | 1,146 | 1,274 | 1,370 | 1,460 | 1,550 |
| annual change in % (real, gross) | 7.0 | 8.9 | 7.2 | 7.5 | 7.8 | 5.0 | 4.5 | 4.0 |
| Consumer prices (HICP), % p.a. | -1.1 | -1.3 | 1.2 | 2.6 | 2.5 | 2.5 | 2.0 | 2.0 |
| Producer prices in industry, % p.a. | -2.2 | -3.1 | 5.0 | 3.9 | 3.0 | 2.5 | 2.0 | 2.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | |
| Revenues | 38.7 | 35.1 | 36.0 | 38.3 | 40.0 | 40.0 | 39.0 | 39.0 |
| Expenditures | 40.4 | 35.0 | 35.0 | 36.5 | 41.5 | 40.0 | 39.0 | 39.0 |
| Net lending (+) / net borrowing (-) | -1.7 | 0.1 | 1.1 | 1.8 | -1.5 | 0.0 | 0.0 | 0.0 |
| General gov.gross debt, EU def., % of GDP | 26.0 | 29.3 | 25.3 | 22.3 | 20.5 | 21.0 | 20.0 | 19.0 |
| Stock of loans of non-fin.private sector, % p.a. | -1.6 | 0.8 | 3.3 | 7.7 | 7.4 | . | . | . |
| Non-performing loans (NPL), in %, eop | 14.5 | 13.2 | 10.4 | 7.8 | 6.5 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 0.01 | 0.00 | 0.00 | 0.00 | 0.00 | 0.0 | 0.0 | 0.0 |
| Current account, EUR mn | 55 | 1,551 | 1,825 | 3,002 | 5,901 | 3,900 | 3,400 | 3,400 |
| Current account in % of GDP | 0.1 | 3.2 | 3.5 | 5.4 | 9.9 | 6.2 | 5.2 | 5.0 |
| Exports of goods, BOP, EUR mn | 21,919 | 23,104 | 26,950 | 27,744 | 28,876 | 29,500 | 30,000 | 30,500 |
| annual change in % | 4.2 | 5.4 | 16.6 | 2.9 | 4.1 | 2.2 | 1.7 | 1.7 |
| Imports of goods, BOP, EUR mn | 24,542 | 24,088 | 27,716 | 29,602 | 29,004 | 29,800 | 30,500 | 31,200 |
| annual change in % | 3.1 | -1.8 | 15.1 | 6.8 | -2.0 | 2.7 | 2.3 | 2.3 |
| Exports of services, BOP, EUR mn | 7,316 | 8,050 | 8,256 | 9,133 | 9,208 | 9,400 | 9,800 | 10,200 |
| annual change in % | 7.8 | 10.0 | 2.6 | 10.6 | 0.8 | 2.1 | 4.3 | 4.1 |
| Imports of services, BOP, EUR mn | 4,236 | 4,640 | 5,203 | 5,572 | 5,196 | 5,500 | 5,800 | 6,000 |
| annual change in % | -0.2 | 9.5 | 12.1 | 7.1 | -6.8 | 5.9 | 5.5 | 3.4 |
| FDI liabilities, EUR mn | 1,956 | 1,313 | 1,759 | 1,057 | 827 | 1000 | . | . |
| FDI assets, EUR mn | 105 | 754 | 446 | 744 | 479 | 600 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 19,022 | 22,475 | 22,257 | 23,620 | 23,072 | . | . | . |
| Gross external debt, EUR mn 5) | 33,855 | 34,655 | 34,211 | 33,156 | 34,500 | 34000 | 33500 | 33000 |
| Gross external debt, % of GDP 5) | 74.1 | 71.3 | 65.4 | 59.1 | 58.0 | 54.0 | 51.0 | 49.0 |
| Average exchange rate BGN/EUR | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 | 1.9558 |

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

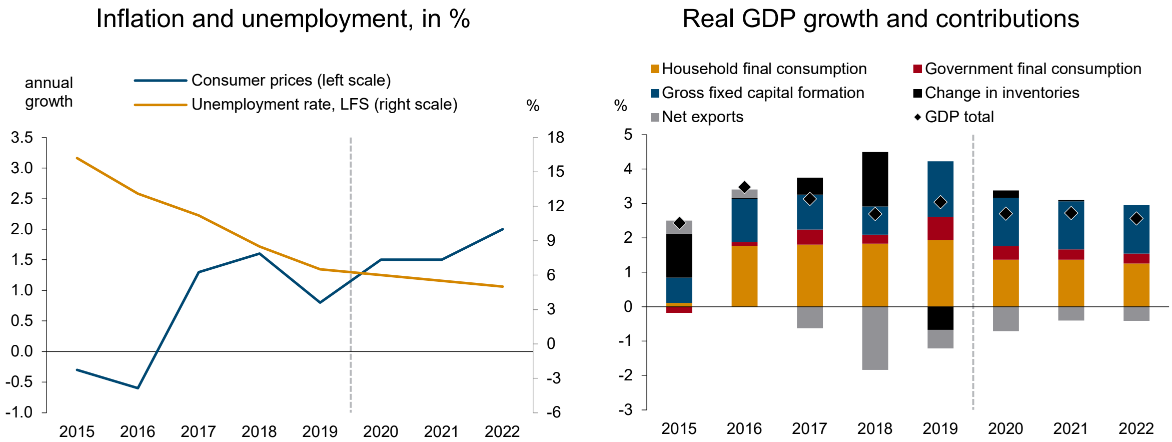
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# CROATIA: Solid growth

HERMINE VIDOVIC

Croatia's economy performed well in 2019. GDP growth will slow somewhat over the forecast period, but will remain at a relatively high level (2.7% p.a.) thanks to the country's strong tourism sector. Private consumption and investments supported by EU transfers will remain the main drivers of growth. In its quest to adopt the euro as soon as possible, the Croatian government will seek to keep the budget in balance or in surplus, and to further reduce public debt.

**Figure 6.5 / Croatia: Main macroeconomic indicators**




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

**Croatia's real GDP growth is estimated to have reached 3% in 2019, which was higher than a year earlier.** Domestic demand was the main driver behind this growth, and the rise in both consumption and gross fixed capital formation was the highest since 2007/2008. Private consumption was pushed up by rising disposable income – rising employment, growing real wages and remittances. Also construction output, which relies heavily on EU funding, reported its highest growth (9%) since the onset of the crisis. Net exports made a negative contribution to GDP growth. After a drop in 2019, industrial output grew by a mere 0.5% in 2019; only food production, the production of chemicals and pharmaceuticals, and the manufacturing of furniture showed notable output growth, while the majority of industrial branches reported declines in production. Output fell most for coke and refined petroleum products (by 24%), manufacturing of machinery and equipment (by 11%) and – most notably – shipbuilding (by a third): indeed, the Uljanik shipyard, which has tried (and failed) for some time to find a strategic investor will finally go into liquidation. Given the low competitiveness of Croatian industry, no significant improvement is expected in the near future.

***Labour market outcomes continued to improve in 2019.*** *Based on* pension insurance data, *employment* increased by 2.3%, while Labour Force Survey data indicate a smaller increase of 1.3%. The unemployment rate fell to 6.5%, and youth unemployment to 16.1% – 2 percentage points higher than the EU average. While part of this improvement is due to rising domestic employment, continued outward migration played an important role in the reduction in unemployment: some 15,000 people are leaving annually, according to the prime minister. The persistent shortage of labour in tourism, construction, transport, the metal and food industries and agriculture has been countered primarily by hiring foreign workers, particularly from Bosnia and Herzegovina. Over the past few years, the quotas for foreign workers have steadily been increased (the quota for 2020 is set at 78,470). Croatia, in common with other EU countries, wants to abandon the quota system and make the employment of third-country nationals dependent on applications from employers for the recruitment of foreigners. A draft law to this effect was recently presented to parliament. Real net wages continued to increase and were up by 2.9% in 2019, owing to public-sector wage increases and labour shortages. Consumer price inflation averaged 0.8% in 2019: this is mainly the result of a fall in the average annual growth rate of energy and food prices, and a cut in the VAT rate on some food products early in the year.

**Given the deteriorating external conditions, trade in goods and services performed relatively well in 2019.** Goods exports and imports increased by an estimated 6% and 7%, respectively. Trade in services was largely driven by tourism, reaching new heights in earnings – a somewhat unexpected development after a temporary slowdown in July. The current account surplus amounted to an estimated 2% of GDP, which is a slight improvement over the previous year.

**Croatia has likely achieved a surplus in the general government budget for the third year in a row.** The general government budget closed in 2019 with probably a small surplus (0.3% of GDP), mostly on account of an increase in revenue – due partly to rising tax revenues (VAT in particular). Expenditure rose as well on, for instance, employee compensation (following an increase in social benefits), subsidies and grants and other such expenditure. By contrast, expenditure on interest payments decreased. Public debt is estimated to have declined to 72.2% of GDP in 2019, from almost 74.4% in 2018. For 2020, the Ministry of Finance expects the general government to run a surplus of 0.2% of the projected GDP growth of 2.5%; this should increase further to 0.4% in 2021 and 0.8% in 2022 (based on 2.4% GDP growth in each year). In June 2019, the government issued a foreign bond worth EUR 1.5 billion to refinance a 15-year international bond that matured in November 2019. In addition, in November 2019 it issued two domestic bonds worth HRK 11 billion (EUR 1.4 billion). Both the foreign and the domestic bonds were issued at historically low interest rates.

**There is an ongoing process of meeting the criteria that Croatia committed to when it applied to enter the ERM II and join the banking union.** These commitments relate to the macro-prudential framework, the anti-money laundering framework, the collection, production and dissemination of statistics, public sector governance, and the reduction of the financial and administrative burden. Asset quality reviews and stress testing in systemically important Croatian banks are currently under way. The whole process is being closely monitored by the ECB and the European Commission. Once they have provided a positive assessment, a decision will be taken on the formal application by the Croatian authorities for ERM II participation. The results of the assessment are expected by late June or July, which would mean that Croatia could join the ERM II as soon as early 2021.

**Parliamentary elections will be held in autumn 2020.** Following the defeat of the incumbent president, Kolinda Grabar-Kitarovic, by the former social democratic prime minister, Zoran Milanovic, in January 2020, the parliamentary elections in autumn will be an acid test for the ruling Croatian Democratic Union (HDZ), which supported Ms Grabar-Kitarovic in her election campaign. According to the most recent opinion polls, the social democrats are in the lead, followed by the HDZ and the party of Miroslav Skoro, a right-wing populist who also ran for the presidency.

**GDP growth will slow somewhat over the forecast period, but will remain at a relatively high level (2.7% p.a.) due to Croatia's strong tourism sector.** Domestic demand will remain the main driver of growth. Household consumption should benefit from a further improvement in the labour market, rising wages and continued lending, which is also confirmed by the last consumer confidence and expectations index, which recorded a further increase. Wages will increase particularly for employees in the government sector and for teachers, following agreements between the government and the respective trade unions. The services trade surplus, by contrast, may remain at an elevated level due to high (but probably not rising) earnings from tourism. Thus, the current account will remain in positive territory, but is expected to dwindle in line with higher trade deficits. Downside risks stem from weaker demand from Croatia's main trading partners. In its quest to adopt the euro as soon as possible, the Croatian government will seek to keep the general government budget in balance or in surplus, and to further reduce public debt. The shrinkage of the working-age population due to population ageing and continued outward migration will be among the major future challenges.

## Table 6.5 / Croatia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 Forecast | 2022 |
|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 4,208 | 4,172 | 4,130 | 4,091 | 4,050 | 3,980 | 3,980 | 3,980 |
| Gross domestic product, HRK bn, nom. | 339.7 | 351.2 | 366.4 | 383.0 | 398.0 | 415 | 433 | 453 |
| annual change in % (real) | 2.4 | 3.5 | 3.1 | 2.7 | 3.0 | 2.7 | 2.7 | 2.6 |
| GDP/capita (EUR at PPP) | 17,300 | 17,800 | 18,600 | 19,500 | 20,600 | . | . | . |
| Consumption of households, HRK bn, nom. | 196.5 | 200.2 | 208.4 | 218.2 | 230.0 | . | . | . |
| annual change in % (real) | 0.2 | 3.1 | 3.2 | 3.2 | 3.4 | 2.4 | 2.4 | 2.2 |
| Gross fixed capital form., HRK bn, nom. | 66.4 | 70.4 | 73.3 | 76.7 | 80.0 | . | . | . |
| annual change in % (real) | 3.8 | 6.5 | 5.1 | 4.1 | 8.0 | 7.0 | 7.0 | 7.0 |
| Gross industrial production 2) | | | | | | | | |
| annual change in % (real) | 2.7 | 5.3 | 1.4 | -1.0 | 0.6 | 2.0 | 2.0 | 2.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | 2.9 | 6.9 | -4.9 | 6.4 | -2.6 | . | . | . |
| Construction output 2) | | | | | | | | |
| annual change in % (real) | -0.5 | 3.3 | 1.7 | 4.9 | 8.0 | . | . | . |
| Employed persons, LFS, th, average | 1,585 | 1,590 | 1,625 | 1,655 | 1,675 | 1,690 | 1,700 | 1,710 |
| annual change in % | 1.3 | 0.3 | 2.2 | 1.8 | 1.2 | 1.0 | 0.5 | 0.5 |
| Unemployed persons, LFS, th, average | 306 | 240 | 205 | 152 | 120 | 110 | 100 | 90 |
| Unemployment rate, LFS, in %, average | 16.2 | 13.1 | 11.2 | 8.5 | 6.5 | 6.0 | 5.5 | 5.0 |
| Reg. unemployment rate, in %, eop 3) | 17.6 | 14.1 | 11.2 | 8.9 | 7.9 | . | . | . |
| Average monthly gross wages, HRK 4) | 8,055 | 7,752 | 8,055 | 8,448 | 8,766 | 9,100 | 9,500 | 9,900 |
| annual change in % (real, gross) | 1.8 | 3.0 | 2.8 | 3.3 | 3.0 | 2.8 | 2.5 | 2.5 |
| Average monthly net wages, HRK 4) | 5,711 | 5,685 | 5,985 | 6,242 | 6,457 | 6,700 | 7,000 | 7,300 |
| annual change in % (real, net) | 3.7 | 2.7 | 4.1 | 2.8 | 2.7 | 2.3 | 2.3 | 2.2 |
| Consumer prices (HICP), % p.a. | -0.3 | -0.6 | 1.3 | 1.6 | 0.8 | 1.5 | 1.5 | 2.0 |
| Producer prices in industry, % p.a. | -3.8 | -4.3 | 2.0 | 2.2 | 0.8 | 1.8 | 1.9 | 2.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | |
| Revenues | 45.3 | 46.5 | 46.2 | 46.3 | 47.0 | 46.7 | 46.3 | 46.0 |
| Expenditures | 48.6 | 47.6 | 45.4 | 46.0 | 46.7 | 46.6 | 46.1 | 45.8 |
| Net lending (+) / net borrowing (-) | -3.3 | -1.1 | 0.8 | 0.3 | 0.3 | 0.1 | 0.2 | 0.2 |
| General gov.gross debt, EU def., % of GDP | 84.4 | 81.0 | 78.0 | 74.7 | 71.3 | 68.0 | 66.5 | 64.0 |
| Stock of loans of non-fin.private sector, % p.a. | -3.1 | -4.3 | -0.1 | 2.3 | 3.9 | . | . | . |
| Non-performing loans (NPL), in %, eop 5) | 16.7 | 12.2 | 8.8 | 7.6 | 6.0 | . | . | . |
| Central bank policy rate, % p.a., eop 6) | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Current account, EUR mn | 1,436 | 983 | 1,660 | 970 | 1,410 | 1,200 | 1,200 | 1,150 |
| Current account, % of GDP | 3.2 | 2.1 | 3.4 | 1.9 | 2.6 | 2.1 | 2.1 | 1.9 |
| Exports of goods, BOP, EUR mn | 10,197 | 10,512 | 11,707 | 12,240 | 12,830 | 13,500 | 14,200 | 15,100 |
| annual change in % | 8.1 | 3.1 | 11.4 | 4.6 | 4.8 | 5.0 | 5.0 | 6.0 |
| Imports of goods, BOP, EUR mn | 17,319 | 18,119 | 20,152 | 21,882 | 22,870 | 24,400 | 26,100 | 27,900 |
| annual change in % | 7.9 | 4.6 | 11.2 | 8.6 | 4.5 | 6.5 | 7.0 | 7.0 |
| Exports of services, BOP, EUR mn | 10,523 | 11,725 | 12,885 | 13,848 | 14,750 | 15,900 | 17,100 | 18,400 |
| annual change in % | 12.3 | 11.4 | 9.9 | 7.5 | 6.5 | 7.5 | 7.5 | 7.5 |
| Imports of services, BOP, EUR mn | 3,282 | 3,562 | 4,109 | 4,634 | 5,000 | 5,400 | 5,800 | 6,300 |
| annual change in % | 13.1 | 8.5 | 15.4 | 12.8 | 7.9 | 7.8 | 8.0 | 8.5 |
| FDI liabilities, EUR mn | 33 | 356 | 462 | 995 | 600 | 1,000 | . | . |
| FDI assets, EUR mn | -189 | -1,631 | -679 | 264 | 120 | 200 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 13,707 | 13,514 | 15,706 | 17,438 | 18,560 | . | . | . |
| Gross external debt, EUR mn | 48,230 | 44,714 | 43,683 | 42,710 | 43,500 | 44,900 | 45,600 | 45,900 |
| Gross external debt, % of GDP | 108.1 | 95.9 | 89.0 | 82.7 | 81.1 | 80.0 | 78.0 | 75.0 |
| Average exchange rate HRK/EUR | 7.6137 | 7.5333 | 7.4637 | 7.4182 | 7.4180 | 7.4 | 7.4 | 7.4 |

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) From 2016 new source for labour force. - 4) From 2016 data are based on tax administration data, survey data before. - 5) Loans more than 90 days overdue, and from 2016 also including loans unlikely to be paid. - 6) Discount rate of NB.

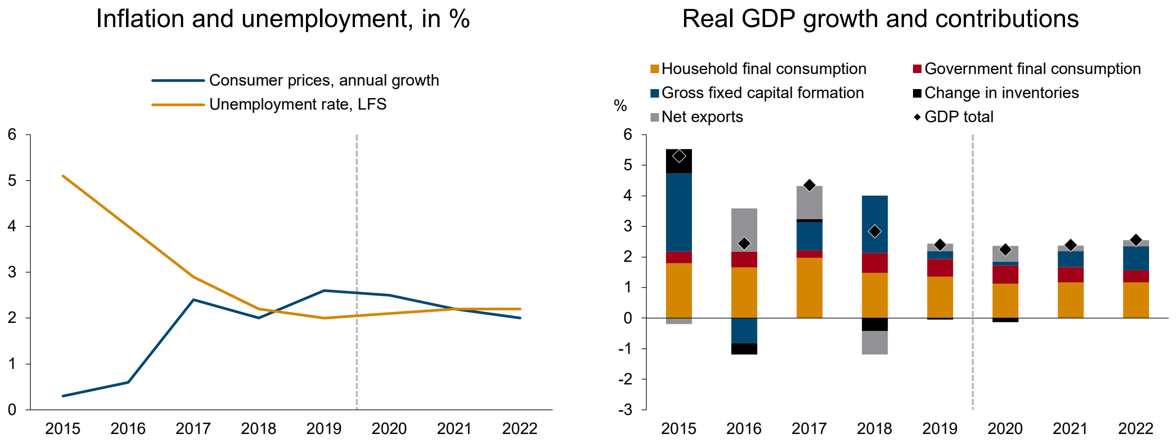
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# CZECH REPUBLIC: Weak growth at nearly full employment

LEON PODKAMINER

GDP growth has gradually been losing momentum, as productive investment starts to decline. Labour resources are nearing depletion, but labour shortages are failing to spark intensified capital formation. Interest rates on loans are no longer as low as they used to be, and the exchange rate is becoming less stable. The recessionary tendencies in Germany are spilling over into Czech manufacturing. Consumption remains the backbone of a subdued growth in output.

**Figure 6.6 / Czech Republic: Main macroeconomic indicators**




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

**GDP growth has been slowing on account of weak capital formation.** Faltering investment spending is the main demand-side factor responsible for the weakening output growth. Having increased strongly throughout 2018, gross fixed capital formation rose by only 3% in the first quarter of 2019, before stagnating (it amounted to 1.6% for the first three quarters of 2019).

**Productive (business sector) investment is particularly affected.** The volumes of investment in the form of machinery, equipment and means of transportation declined in the first three quarters of 2019. In contrast, investment in dwellings and in other buildings and structures (the latter category is primarily related to the realisation of infrastructure projects) kept rising (by 4.7% and 1.4%, respectively). Over the year, growth in public investment slowed considerably (turning slightly negative in the third quarter of 2019). This development correlates with an ongoing deceleration in the growth of investment co-financed from EU funds.

**Labour reserves may be nearing depletion.** The fairly high participation and employment rates leave room for only slightly higher employment. All the same, in terms of hours worked, total employment increased by 1.2% during the first three quarters of 2019. The scope for productive internal reallocation of labour – from lower-productivity sectors (such as agriculture) to higher-productivity sectors – appears rather limited. Agriculture (which employs slightly more than 3% of the active labour force) is still shedding employment quite vigorously – but without any perceptible easing of the employment bottlenecks in industry and trade. For various reasons (including cultural barriers), net migration is low (20,000-30,000 people a year), while the natural population increase will turn negative in the coming years. Demography is not going to be conducive to high employment dynamics, as the working-age population is expected to continue to decline (whereas the population aged 64 and over is projected to keep expanding quite strongly). Given the constraints on the supply of labour, it is vital that its productivity should increase.

**The labour shortages have not intensified fixed capital formation.** With labour shortages and rising labour costs, one might have expected greater investment in labour-saving technologies. But this does not seem to hold true in the Czech case. In fact, Czech labour productivity growth has been rather unimpressive. The attractiveness of investing in the Czech economy may have dwindled because the shortage of skilled labour is likely to persist in the future, partly on account of the adverse demographic trends. The cost/wage concerns may additionally discourage capital formation (in favour of alternative locations, such as Romania or Poland).[36]

**Interest rates on loans are no longer as low as they used to be.** Despite its 'dovish' reputation, the Czech National Bank has responded to higher inflation by gradually raising the policy interest rate. In real terms, interest rates on loans to the household sector are only moderately positive. Growth of lending to the household sector has slowed somewhat, but remains pretty strong all the same. Despite the rather low interest rates available on business loans, lending to the corporate sector slowed dramatically throughout 2019, mirroring that sector's stagnant output and investment. On the whole, it is not quite clear how higher interest rates will counteract inflation, as lending to the private sector has anyway been contracting.

**The exchange rate is becoming less stable.** Despite the growing interest-rate differentials vis-à-vis the euro area, for a long time the CZK failed to appreciate in nominal terms against the euro. The absence of pronounced nominal appreciation kept real appreciation at bay and was beneficial for foreign trade. On the other hand, this configuration proved conducive to a growing volume of domestic lending denominated in foreign currencies – something that may prove risky, should there be a stronger devaluation. The abrupt nominal appreciation of the CZK at the beginning of 2020 may represent a long-overdue response to the interest-rate disparities with the euro area. If sustained, the appreciation may have some cooling effect on inflation – but it could also negatively affect the trade balance.

**The recessionary tendencies coming to the fore in the German car industry (the key branch of the German economy) may be spilling over into Czech manufacturing**, which is tightly integrated with German industry. Brexit and the tensions disrupting global trade will also affect the Czech economy. The depressed export sales are already having repercussions for current production and employment.

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[36] The average rate of growth of labour productivity (real GDP per employed person) was 2.1% in the Czech Republic (2014-2018), compared to 2.8% in Poland and 4.3% in Romania.

More ominously, the foreign recessionary tendencies are likely to discourage investment, especially in the key automotive branch.

**Sound fiscal policy is continuing**, but the size of public sector surpluses is set to gradually diminish over the medium term. Thus fiscal policy is generating a (very) modest pro-growth impulse that is likely to compensate, at least partly, for the effects of diminished private investment spending.

**Consumption remains the backbone of the subdued output growth.** Driven by a strong rise in wages and pensions, household consumption remains the main demand-side source of output growth. But consumption growth is not excessive as (with some delay) inflation is following the rising unit labour costs. Inflation (also in administered prices) is thus eroding real disposable incomes. Moreover, the expanding disposable household incomes are partly absorbed by rising investment in housing, and also go to fuel the household demand for financial assets. Together, these two components of household saving are on the rise – not only because of short-term worries (increased levels of economic uncertainty), but also on account of long-term concerns (e.g. the ageing of Czech society).

**The longer-term prospects remain uncertain.** A strong (though structurally skewed) manufacturing base will permit balanced (both externally and internally) but unimpressive overall growth for a few more years. Once the German economy strengthens, Czech GDP growth will speed up as well. However, dwindling labour resources do not bode particularly well in the longer run. The Czech economy may need a structural change, with an aggressive technological reorientation. Whether such a move is compatible with the heavy reliance on foreign direct investment that is characteristic of the Czech economy remains an open question.

## Table 6.6 / Czech Republic: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 [1] | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th pers., average | 10,546 | 10,566 | 10,594 | 10,630 | 10,670 | 10,675 | 10,680 | 10,690 |
| Gross domestic product, CZK bn, nom. | 4,596 | 4,768 | 5,047 | 5,324 | 5,620 | 5,900 | 6,170 | 6,460 |
| annual change in % (real) | 5.3 | 2.5 | 4.4 | 2.8 | 2.4 | 2.2 | 2.4 | 2.6 |
| GDP/capita (EUR at PPP) | 25,300 | 25,600 | 26,800 | 28,000 | 29,000 | . | . | . |
| Consumption of households, CZK bn, nom. | 2,125 | 2,213 | 2,361 | 2,491 | 2,640 | . | . | . |
| annual change in % (real) | 3.8 | 3.6 | 4.2 | 3.2 | 2.9 | 2.4 | 2.5 | 2.5 |
| Gross fixed capital form., CZK bn, nom. | 1,216 | 1,189 | 1,250 | 1,364 | 1,420 | . | . | . |
| annual change in % (real) | 10.2 | -3.1 | 3.7 | 7.6 | 1.0 | 0.5 | 2.0 | 3.0 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | 4.3 | 3.4 | 6.5 | 3.1 | -0.4 | 1.5 | 2.0 | 2.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | -4.8 | 7.0 | -6.2 | -1.1 | 1.3 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | 6.8 | -5.6 | 3.3 | 9.2 | 2.3 | . | . | . |
| Employed persons, LFS, th, average | 5,042 | 5,139 | 5,222 | 5,294 | 5,303 | 5,320 | 5,330 | 5,330 |
| annual change in % | 1.4 | 1.9 | 1.6 | 1.4 | 0.2 | 0.3 | 0.2 | 0.0 |
| Unemployed persons, LFS, th, average | 268 | 211 | 155 | 122 | 109 | 110 | 120 | 120 |
| Unemployment rate, LFS, in %, average | 5.1 | 4.0 | 2.9 | 2.2 | 2.0 | 2.1 | 2.2 | 2.2 |
| Reg. unemployment rate, in %, eop | 6.2 | 5.2 | 3.8 | 3.1 | 2.9 | . | . | . |
| Average monthly gross wages, CZK | 26,591 | 27,764 | 29,638 | 31,868 | 34,100 | 36,100 | 38,000 | 39,900 |
| annual change in % (real, gross) | 2.9 | 3.7 | 4.1 | 5.3 | 4.3 | 3.3 | 3.0 | 3.0 |
| Consumer prices (HICP), % p.a. | 0.3 | 0.6 | 2.4 | 2.0 | 2.6 | 2.5 | 2.2 | 2.0 |
| Producer prices in industry, % p.a. | -2.4 | -3.2 | 0.7 | 0.7 | 1.7 | 1.5 | 1.5 | 1.0 |
| General governm. budget, EU-def., % of GDP | | | | | | | | |
| Revenues | 41.1 | 40.2 | 40.5 | 41.8 | 39.8 | 40.0 | 40.5 | 40.0 |
| Expenditures | 41.7 | 39.5 | 38.9 | 40.7 | 39.2 | 39.7 | 40.5 | 40.3 |
| Net lending (+) / net borrowing (-) | -0.6 | 0.7 | 1.6 | 1.1 | 0.6 | 0.3 | 0.0 | -0.3 |
| General gov.gross debt, EU def., % of GDP | 40.0 | 36.8 | 34.7 | 32.6 | 30.3 | 28.5 | 27.3 | 26.4 |
| Stock of loans of non-fin.private sector, % p.a. | 6.6 | 6.7 | 6.5 | 6.8 | 5.2 | . | . | . |
| Non-performing loans (NPL), in %, eop | 5.8 | 4.8 | 4.0 | 3.3 | 2.5 | . | . | . |
| Central bank policy rate, % p.a., eop [2] | 0.05 | 0.05 | 0.50 | 1.75 | 2.00 | 2.25 | 2.00 | 2.00 |
| Current account, EUR mn | 368 | 2,744 | 3,058 | 628 | -133 | 700 | 700 | 900 |
| Current account, % of GDP | 0.2 | 1.6 | 1.6 | 0.3 | -0.1 | 0.3 | 0.3 | 0.4 |
| Exports of goods, BOP, EUR mn | 115,573 | 118,033 | 129,242 | 137,024 | 138,815 | 147,000 | 154,400 | 162,100 |
| annual change in % | 4.7 | 2.1 | 9.5 | 6.0 | 1.3 | 5.9 | 5.0 | 5.0 |
| Imports of goods, BOP, EUR mn | 108,701 | 108,946 | 119,458 | 128,533 | 129,700 | 137,500 | 144,100 | 151,000 |
| annual change in % | 6.1 | 0.2 | 9.6 | 7.6 | 0.9 | 6.0 | 4.8 | 4.8 |
| Exports of services, BOP, EUR mn | 20,603 | 21,923 | 24,161 | 25,776 | 26,446 | 27,800 | 29,500 | 31,300 |
| annual change in % | 8.9 | 6.4 | 10.2 | 6.7 | 2.6 | 5.0 | 6.0 | 6.0 |
| Imports of services, BOP, EUR mn | 17,742 | 17,942 | 19,308 | 21,069 | 21,790 | 23,100 | 24,500 | 26,000 |
| annual change in % | 5.0 | 1.1 | 7.6 | 9.1 | 3.4 | 6.0 | 6.0 | 6.0 |
| FDI liabilities, EUR mn | 1,521 | 9,809 | 9,997 | 7,272 | 8,175 | 6,000 | . | . |
| FDI assets, EUR mn | 3,357 | 2,909 | 8,288 | 3,730 | 5,498 | 4,500 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 58,903 | 80,999 | 123,273 | 124,142 | 132,933 | . | . | . |
| Gross external debt, EUR mn | 115,396 | 129,448 | 171,115 | 169,308 | 175,100 | 181,200 | 184,600 | 188,200 |
| Gross external debt, % of GDP | 68.5 | 73.4 | 89.3 | 81.6 | 80.0 | 78.0 | 76.0 | 74.0 |
| Average exchange rate CZK/EUR | 27.28 | 27.03 | 26.33 | 25.65 | 25.67 | 25.4 | 25.4 | 25.4 |

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

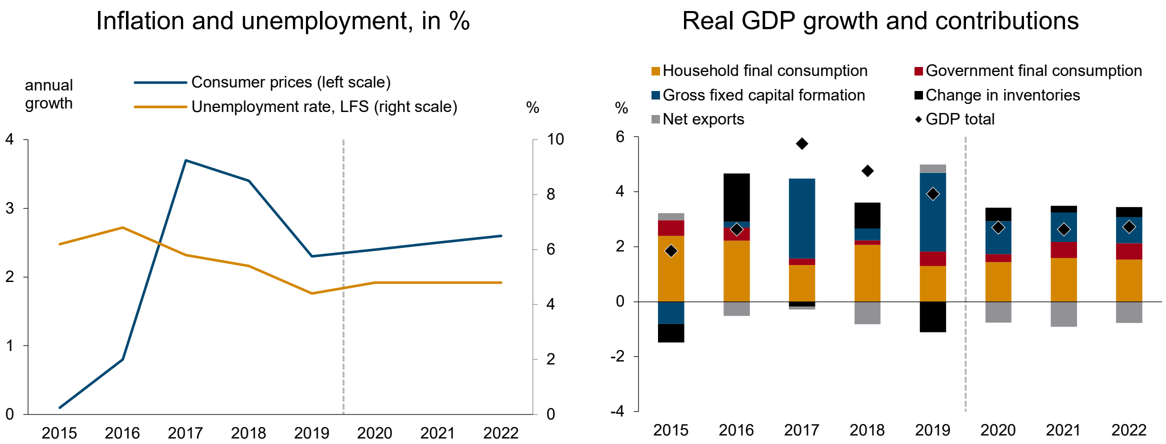
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# ESTONIA: Slowdown in external demand accompanied by deferred investment activity

SEBASTIAN LEITNER

Investment activity is expected to slow in 2020, following last year's strong increase. Furthermore, growth in external demand will continue to decline both this year and in 2021. Household consumption, backed by an ongoing rise in employment and real wages, continues to be a strong driver of economic activity. We project a decline in GDP growth to 2.7% in 2020, followed by a further slowdown to 2.5% in 2021 and a slight upswing to 2.7% in 2022.

**Figure 6.7 / Estonia: Main macroeconomic indicators**




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

**Following a year in which GDP growth was still above expectations (3.9% in real terms year on year), 2020 will see a cooling of economic activity. In the first half of 2019, goods exports were still expanding strongly; only later did the marked slowdown set in.** A relatively low price for crude oil (below USD 60 a barrel on average) resulted in a fall in foreign demand for Estonian shale oil (which is used as a substitute for petroleum) of more than 20% in nominal terms in 2019, compared to 2018. Estonian producers of electronic products suffered from ailing demand from Swedish firms. However, the Estonian ICT sector, which accounts for a growing share of total value added in the economy, reported continued growth rates in services exports.

**In the years 2020-2021, we expect real growth in goods exports to decline further.** Aside from low external demand from non-EU destinations, exports to Sweden are also sluggish due to the weak developments on the housing market there. This is having a negative impact on the manufacturing and service exports of the Estonian building sector. Slower growth in Russia already led to stagnation in Estonian exports to its neighbour last year, and this will continue in 2020. Given the swiftly rising household incomes, imports are expected to increase as strongly as exports. In general, extensive wage increases – and thus higher unit labour costs – are putting pressure on the competitiveness of the industrial sector in Estonia. A slight increase in external demand is expected to occur only in 2022, based on the assumption that the Northern European countries will see an upswing in trade volumes in line with the advanced economies in general.

**After a surge in 2019, growth in investment activity will decline substantially this year.** The 2020 government budget foresees some reduction in the ratio of public investments to GDP. However, construction of the main infrastructure of Rail Baltica – the high-speed train project connecting the Baltic states with the Central European network – should lead to a revival in 2021-2022. With the sentiments of entrepreneurs – particularly in industry and construction, but also in some service sectors – turning rather negative in recent months, we also expect growth in private investment to decline this year. A strong growth in wages and the negative real interest rates experienced for a while now are driving a continued increase in new mortgages for households (+6.4% in 2019 year on year). Real estate prices are still growing. Following an increase in the number of building permits issued for dwellings in 2019, we expect an upswing in housing construction in 2020.

**Throughout 2019, the unemployment rate continued to decline and is expected to average 4.4% for the year as a whole (according to LFS).** A further fall will not, however, occur in the near future. Job vacancy rates did not increase further in 2019 compared to the previous year and fell markedly in industry due to declining expectations for production and exports. Given the expected growth slowdown, the labour market situation is likely to remain unchanged in the coming two years, with a slight increase in unemployment due to restructuring. However, employment will rise further in the public sector, as well as in most other service sectors. Thus, we expect a further gradual increase in jobs.

**Given the still rather tight labour market situation, wages will continue to rise substantially in 2020.** Real gross wages picked up by another 4% year on year in 2019; however, last year employees started to save more of their wages. In 2020, household incomes will be bolstered by an 8% rise in the minimum wage (to EUR 584) in January 2020. Since 2017, the social partners have sought to raise the minimum wage by twice the forecast rate of labour productivity for the respective year. This path will result in the minimum wage reaching 40% of the average wage in 2021. Following a decrease to 2.3% last year, consumer price inflation is likely to decline again in 2020, mostly on account of falling prices for energy (particularly imported electricity from the country’s northern neighbours) and lower excise duty hikes. This will also result in a further strengthened real income growth. Forward-looking consumer confidence indicators and the sentiments of retail entrepreneurs suggest that household consumption will remain stable and will continue as a driver of growth in the next two years.

**On the basis of the approved budget of the government for 2020, we expect the deficit to decline to 0.2% of GDP, with a structural deficit of no more than 0.7% of GDP.** No changes in taxes are envisaged for 2020, except that there will be an increase in the non-taxable minimum income and a smaller than expected rise in excise duties. Thus, the tax burden of 33.2% of GDP will remain stable and is even likely to decline in 2022. Above-average growth in spending is planned particularly for health and social protection. The public debt level is likely to decrease to below 8% of GDP as early as 2020.The pension hike of EUR 45 per month, introduced in January 2020, has boosted the average pension by about 10% in nominal terms.

**Details of the reform of the Estonian pension system – due to be implemented in January 2021 – are still pending.** However, the plan envisages transformation of the funded second pillar from a mandatory to a voluntary system. While some commend the change for bringing greater competition to the financial markets, others point out that the reduction in the mandatory pension contributions of employers and employees is likely to increase old-age poverty in the future. Apart from greater volatility in effective retirement pay, the short-term effects of the reform are unclear. Since employees can opt out of the second pillar from 2021 onwards, there may be a small positive growth effect, if individuals use those assets for private investment or consumption purposes in 2021-2022.

**Since our 2019 Autumn Forecast, we have become slightly more optimistic, increasing the forecast GDP growth rate for 2020 from 2.6% to 2.7%** on the back of ongoing stable household investment and consumption activity. The relatively tight situation on the labour market will keep wage growth high and will thus also bolster private consumption over the next two years. While investment growth was high in 2019, a slower pace of public expenditure and a reluctance on the part of business to spend money on machines and equipment will result in anaemic overall investment growth in 2020. Although external demand activity will decline further in the next two years, over the longer term we expect export growth to increase again in 2022. Consequently, we forecast a decline in GDP growth rates to 2.5% for 2021, but a minor rally to 2.7% in 2022.

## Table 6.7 / Estonia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 Forecast | 2022 |
|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 1,315 | 1,316 | 1,317 | 1,322 | 1,328 | 1,335 | 1,340 | 1,342 |
| Gross domestic product, EUR mn, nom. | 20,782 | 21,694 | 23,776 | 26,036 | 27,700 | 29,100 | 30,600 | 32,200 |
| annual change in % (real) | 1.8 | 2.6 | 5.7 | 4.8 | 3.9 | 2.7 | 2.6 | 2.7 |
| GDP/capita (EUR at PPP) | 22,100 | 22,300 | 23,600 | 25,300 | 26,500 | . | . | . |
| Consumption of households, EUR mn, nom. | 10,329 | 10,869 | 11,566 | 12,502 | 13,100 | . | . | . |
| annual change in % (real) | 4.9 | 4.5 | 2.7 | 4.2 | 2.7 | 3.0 | 3.3 | 3.2 |
| Gross fixed capital form., EUR mn, nom. | 5,054 | 5,054 | 5,899 | 6,211 | 7,100 | . | . | . |
| annual change in % (real) | -3.2 | 0.9 | 12.5 | 1.7 | 12.0 | 5.0 | 4.5 | 4.0 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | 0.3 | 3.4 | 4.1 | 4.0 | -2.1 | 1.5 | 2.0 | 3.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | 8.7 | -17.2 | 6.5 | -6.3 | 20.6 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | -3.5 | 4.6 | 21.5 | 17.4 | 1.0 | . | . | . |
| Employed persons, LFS, th, average | 640.9 | 644.6 | 658.6 | 664.7 | 671.3 | 677 | 680 | 685 |
| annual change in % | 2.6 | 0.6 | 2.2 | 0.9 | 1.0 | 0.8 | 0.4 | 0.7 |
| Unemployed persons, LFS, th, average | 42.3 | 46.7 | 40.3 | 37.7 | 31.3 | 34 | 34 | 35 |
| Unemployment rate, LFS, in %, average | 6.2 | 6.8 | 5.8 | 5.4 | 4.4 | 4.8 | 4.8 | 4.8 |
| Reg. unemployment rate, in %, eop 2) | 4.7 | 4.4 | 4.8 | 4.8 | 4.8 | . | . | . |
| Average monthly gross wages, EUR | 1,065 | 1,146 | 1,221 | 1,310 | 1,390 | 1,470 | 1,560 | 1,650 |
| annual change in % (real, gross) | 6.5 | 7.4 | 3.5 | 3.5 | 4.0 | 3.6 | 3.4 | 3.4 |
| Average monthly net wages, EUR | 859 | 924 | 985 | 1,050 | 1,120 | 1,180 | 1,240 | 1,310 |
| annual change in % (real, net) | 8.0 | 7.4 | 3.0 | 3.2 | 4.2 | 3.3 | 2.7 | 3.0 |
| Consumer prices (HICP), % p.a. | 0.1 | 0.8 | 3.7 | 3.4 | 2.3 | 2.4 | 2.5 | 2.6 |
| Producer prices in industry, % p.a. | -2.5 | -0.9 | 3.3 | 3.9 | -0.6 | 0.0 | 2.0 | 3.0 |
| General governm. budget, EU-def., % of GDP | | | | | | | | |
| Revenues | 39.4 | 39.0 | 38.6 | 38.5 | 39.3 | 39.0 | 39.0 | 38.8 |
| Expenditures | 39.2 | 39.5 | 39.3 | 39.1 | 39.6 | 39.2 | 39.2 | 40.8 |
| Net lending (+) / net borrowing (-) | 0.1 | -0.5 | -0.8 | -0.6 | -0.3 | -0.2 | -0.2 | -0.2 |
| General gov.gross debt, EU def., % of GDP | 10.0 | 10.2 | 9.3 | 8.4 | 8.3 | 8.0 | 7.8 | 7.6 |
| Stock of loans of non-fin.private sector, % p.a. | 4.8 | 6.6 | 0.7 | 5.1 | 3.7 | . | . | . |
| Non-performing loans (NPL), in %, eop | 1.1 | 1.0 | 0.8 | 0.5 | 0.5 | . | . | . |
| Central bank policy rate, % p.a., eop 3) | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | 366 | 360 | 635 | 516 | 471 | 310 | 710 | 560 |
| Current account, % of GDP | 1.8 | 1.7 | 2.7 | 2.0 | 1.7 | 1.1 | 2.3 | 1.7 |
| Exports of goods, BOP, EUR mn | 10,692 | 11,293 | 12,029 | 12,720 | 13,336 | 13,500 | 14,550 | 15,250 |
| annual change in % | -3.0 | 5.6 | 6.5 | 5.7 | 4.8 | 1.2 | 7.8 | 4.8 |
| Imports of goods, BOP, EUR mn | 11,571 | 12,043 | 12,866 | 13,720 | 14,227 | 14,800 | 15,500 | 16,450 |
| annual change in % | -3.7 | 4.1 | 6.8 | 6.6 | 3.7 | 4.0 | 4.7 | 6.1 |
| Exports of services, BOP, EUR mn | 5,284 | 5,509 | 6,074 | 6,613 | 6,936 | 7,200 | 7,500 | 7,900 |
| annual change in % | -1.9 | 4.3 | 10.2 | 8.9 | 4.9 | 3.8 | 4.2 | 5.3 |
| Imports of services, BOP, EUR mn | 3,593 | 3,911 | 4,219 | 4,699 | 4,946 | 5,150 | 5,400 | 5,700 |
| annual change in % | -2.7 | 8.9 | 7.9 | 11.4 | 5.3 | 4.1 | 4.9 | 5.6 |
| FDI liabilities, EUR mn | -654 | 832 | 1,532 | 996 | 2,782 | 1300 | . | . |
| FDI assets, EUR mn | -522 | 315 | 606 | -221 | 1,676 | 300 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 373 | 325 | 279 | 651 | 1,259 | . | . | . |
| Gross external debt, EUR mn | 19,161 | 19,194 | 19,766 | 19,886 | 21,900 | 22,700 | 23,900 | 25,800 |
| Gross external debt, % of GDP | 92.2 | 88.5 | 83.1 | 76.4 | 79.0 | 78.0 | 78.0 | 80.0 |

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

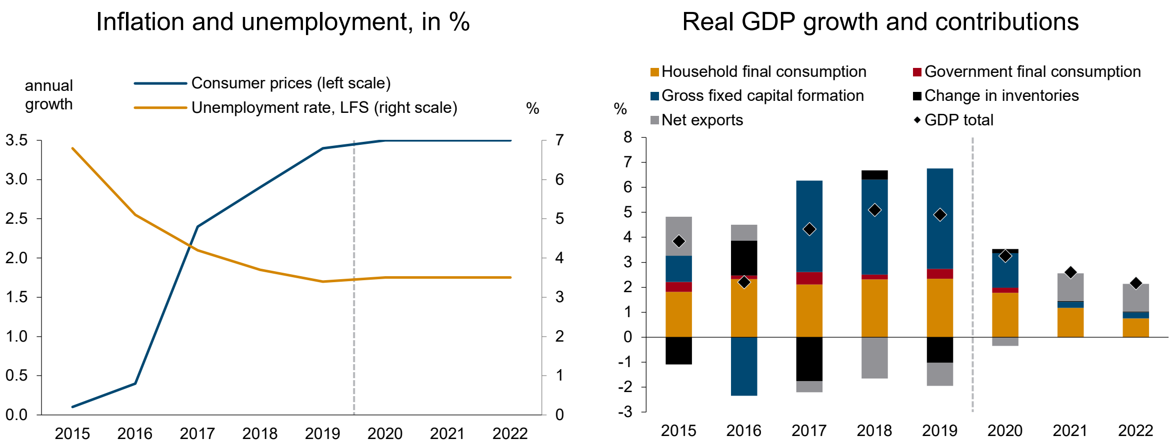
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# HUNGARY: After three years of high growth, what next?

SÁNDOR RICHTER

With GDP growing last year by 4.9%, the Hungarian economy turned in one of the best performances in the EU. This expansion was driven by domestic demand, primarily investments. But sustainability is the critical issue highlighted here: the economy faces reduced EU transfers, uncertainties and fragile growth in the export markets, labour shortages, rapidly rising wages and a weakening of the national currency.

**Figure 6.8 / Hungary: Main macroeconomic indicators**




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

**Over the past three years, the Hungarian economy has moved up a gear or two, following its weak performance in the seven years after the 2008/2009 crisis.** If we take the compound growth rate over the period 2017-2019, GDP expanded by 15%, at an equal pace to private consumption; and gross fixed capital formation increased by over 60%. External equilibrium gradually deteriorated over the same period, with the current account balance sliding from a surplus of over EUR 5 billion in 2016 to a (modest) deficit by 2018/2019. Net real wages (except for in small businesses with fewer than five employees) grew by close to 30% over those three years. This acceleration in growth was facilitated primarily by the heavily front-loaded utilisation of EU transfers, by a revival in domestic lending to both businesses and households and (last but not least) by a supportive international environment.

**But over the forecast horizon, the outlook is much less rosy.** EU transfers will plummet, due to the disproportionately heavy early utilisation of the resources from the 2014-2020 Multiannual Financial Framework of the EU and the unavoidable delay in the availability of money from the forthcoming 2021-2027 EU budget. That means that the ‘EU transfer’-component in aggregate demand (which amounted to 3.5-4% of GDP on average in the period 2017-2019) will drop by about 2 percentage points (on average) over the next three years, with 2022 being the most critical year in this respect. The consequences will show up primarily in gross fixed investments: here only a very modest expansion is forecast. The growth of private consumption is expected to slow to half of the rate experienced in the boom years. One positive side-effect of this moderating trend will be a halt to the deterioration in the external equilibrium. The relatively strong expansion of employment in recent years – an important driver of the growth we have witnessed – has reached its limit. Altogether, the compound GDP growth over the next three years will be about 8% – just over half of the increase recorded in 2017-2019.

**We can expect some moderation of real wage growth over the forecast period.** A strong deceleration in investment and a general slowdown in economic activity will go some way toward easing labour shortages on the demand side. However, a possible new wave of outward migration could mitigate this effect. After the soaring real wages of the past three years, it is almost inconceivable that many privately owned small and medium-sized enterprises (SMEs) could withstand a further strong rise in wages.

**The shortage of labour has been and, despite of some expected relief, will remain a serious challenge.** Back in 2018, the government amended the labour law to enable employers to increase the maximum number of overtime hours from 250 to 400 a year. The time frame for paying overtime compensation was also extended to 36 months. And as an alternative to paid compensation, employers could opt to provide days of leave. The move was quite extreme, as it potentially allows the reintroduction of a six-day working week. This so-called 'Slave Law' was extremely unpopular, but the (initially fierce) protests died down within a few weeks. A further response by the government to the shortage of labour has been to offer tacit support to inward labour migration. While the government's propaganda machine continues to deploy strong anti-immigration rhetoric, the government itself has opened the door wider to labour immigration. Foreign workers have been arriving mainly from the non-Middle East countries (this area being the main target for the government's anti-migration campaigns) – above all from Ukraine and Serbia, followed by China, Vietnam and India.

**The primary reaction of enterprises in sectors where the labour shortage is most acute has been to increase per capita working time.** The proper strategic response ought to be to increase productivity, but here the traditional 'duality' of the Hungarian economy plays an important role. Research by the Budapest-based Centre for Economic and Regional Studies shows that in the export-oriented part of the economy (export-oriented industries and business services) productivity has increased greatly since 1995, whereas in the domestic-oriented segment (mainly Hungarian-owned SMEs), after a dynamic increase between 1995 and 2008, productivity has stagnated.

**The weakening of the Hungarian currency has hampered the domestic-oriented sector.** In order to raise productivity, these firms would need to import machinery and production inputs – but such things have become increasingly expensive. The weak forint is assisting the export-oriented sector, in as much as rising forint wages are less of a burden for firms that calculate their revenues and costs in euro terms.

**The forint weakened further in the first two months of 2020.** There were several reasons for this: extremely low (actually negative) real interest rates (a policy rate of 0.9% and 4.7% CPI inflation in January); the evaporation of the current account surplus; and global uncertainties leading to increased risk aversion. The low interest rates promote the use of HUF in carry trade transactions, where Hungarian resources are invested in countries with high yields (e.g. Mexico). The volatility of the exchange rate has been underpinned by the central bank's rigid adherence to its ultra-loose monetary policy. Nevertheless, when the exchange rate passed HUF 340 to the euro on 12 February, the central bank took a first step towards a less relaxed monetary policy, initiating liquidity-reducing operations via FX swap tenders, leading to higher interbank rates.

**This year, we forecast that GDP growth will amount to 3.3%. This will be followed by a further moderation to 2.6% in 2021, and then 2.2% in 2022.** In particular gross fixed capital formation will be much less robust than it was in the previous three years. The current account will be close to balanced. The current acceleration in inflation will moderate over the year, and the CPI is expected to remain at around 3.5% over the forecast horizon. Uncertainties concerning the global automotive industry could influence growth prospects in either a negative or a positive way.

## Table 6.8 / Hungary: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th pers., average | 9,843 | 9,814 | 9,788 | 9,776 | 9,720 | 9,700 | 9,670 | 9,620 |
| Gross domestic product, HUF bn, nom. | 34,785 | 35,896 | 38,835 | 42,662 | 46,200 | 49,200 | 52,100 | 54,900 |
| annual change in % (real) | 3.8 | 2.2 | 4.3 | 5.1 | 4.9 | 3.3 | 2.6 | 2.2 |
| GDP/capita (EUR at PPP) | 20,100 | 19,800 | 20,600 | 21,900 | 23,500 | . | . | . |
| Consumption of households, HUF bn, nom. | 16,418 | 17,253 | 18,497 | 19,970 | 21,640 | . | . | . |
| annual change in % (real) | 3.7 | 4.9 | 4.4 | 4.9 | 5.0 | 3.8 | 2.5 | 1.6 |
| Gross fixed capital form., HUF bn, nom. | 7,750 | 7,058 | 8,632 | 10,739 | 12,860 | . | . | . |
| annual change in % (real) | 4.8 | -10.6 | 18.7 | 17.1 | 16.0 | 5.5 | 1.0 | 1.0 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | 7.4 | 0.9 | 4.7 | 3.5 | 5.4 | 5.0 | 4.0 | 4.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | -2.4 | 9.4 | -4.1 | 2.7 | -0.7 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | 3.0 | -18.9 | 29.7 | 21.2 | 22.0 | . | . | . |
| Employed persons, LFS, th, average | 4,211 | 4,352 | 4,421 | 4,470 | 4,512 | 4,530 | 4,535 | 4,540 |
| annual change in % | 2.7 | 3.4 | 1.6 | 1.1 | 1.0 | 0.3 | 0.1 | 0.1 |
| Unemployed persons, LFS, th, average | 308 | 235 | 192 | 172 | 160 | 160 | 160 | 160 |
| Unemployment rate, LFS, in %, average | 6.8 | 5.1 | 4.2 | 3.7 | 3.4 | 3.5 | 3.5 | 3.5 |
| Reg. unemployment rate, in %, eop | 7.6 | 6.1 | 5.6 | 5.2 | 5.1 | . | . | . |
| Average monthly gross wages, HUF 2) | 247,924 | 263,171 | 297,017 | 329,943 | 367,400 | 399,300 | 422,400 | 443,700 |
| annual change in % (real, gross) | 4.4 | 5.7 | 10.3 | 8.3 | 7.7 | 5.0 | 2.2 | 1.5 |
| Average monthly net wages, HUF 2) | 162,391 | 175,009 | 197,516 | 219,412 | 244,300 | 265,500 | 280,800 | 295,000 |
| annual change in % (real, net) | 4.4 | 7.4 | 10.3 | 8.3 | 7.7 | 5.0 | 2.2 | 1.5 |
| Consumer prices (HICP), % p.a. | 0.1 | 0.4 | 2.4 | 2.9 | 3.4 | 3.5 | 3.5 | 3.5 |
| Producer prices in industry, % p.a. | -1.1 | -1.7 | 3.3 | 5.6 | 2.1 | 3.2 | 3.0 | 3.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | |
| Revenues | 48.7 | 45.4 | 44.6 | 44.4 | 44.5 | 44.0 | 45.0 | 45.0 |
| Expenditures | 50.6 | 47.2 | 47.0 | 46.7 | 46.2 | 45.6 | 47.9 | 47.9 |
| Net lending (+) / net borrowing (-) | -2.0 | -1.8 | -2.4 | -2.3 | -1.7 | -1.6 | -2.9 | -2.9 |
| General gov.gross debt, EU def., % of GDP | 76.1 | 75.5 | 72.9 | 70.2 | 69.1 | 68.2 | 67.5 | 67.0 |
| Stock of loans of non-fin.private sector, % p.a. | -12.3 | -1.3 | 5.5 | 10.6 | 13.2 | . | . | . |
| Non-performing loans (NPL), in %, eop 3) | 13.6 | 10.8 | 7.5 | 5.4 | 4.5 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 1.35 | 0.90 | 0.90 | 0.90 | 0.90 | 1.20 | 1.50 | 1.70 |
| Current account, EUR mn 5) | 2,648 | 5,209 | 2,830 | -717 | -359 | -200 | 0 | 200 |
| Current account, % of GDP 5) | 2.4 | 4.5 | 2.3 | -0.5 | -0.3 | -0.1 | 0.0 | 0.1 |
| Exports of goods, BOP, EUR mn 5) | 78,477 | 78,588 | 85,555 | 88,626 | 92,563 | 96,700 | 102,500 | 107,600 |
| annual change in % | 6.3 | 0.1 | 8.9 | 3.6 | 4.4 | 4.5 | 6.0 | 5.0 |
| Imports of goods, BOP, EUR mn 5) | 74,425 | 74,630 | 83,646 | 90,280 | 94,757 | 99,900 | 105,900 | 111,200 |
| annual change in % | 3.8 | 0.3 | 12.1 | 7.9 | 5.0 | 5.4 | 6.0 | 5.0 |
| Exports of services, BOP, EUR mn 5) | 20,286 | 21,878 | 23,862 | 24,991 | 25,887 | 27,200 | 28,800 | 30,200 |
| annual change in % | 8.1 | 7.9 | 9.1 | 4.7 | 3.6 | 5.0 | 6.0 | 5.0 |
| Imports of services, BOP, EUR mn 5) | 15,378 | 15,753 | 16,618 | 17,466 | 17,753 | 18,600 | 19,700 | 20,700 |
| annual change in % | 8.4 | 2.4 | 5.5 | 5.1 | 1.6 | 5.0 | 6.0 | 5.0 |
| FDI liabilities, EUR mn 5) | 7,192 | -5,851 | 7,208 | 8,469 | 3,655 | 5,000 | . | . |
| FDI assets, EUR mn 5) | 5,753 | -8,414 | 5,044 | 5,657 | 543 | 3,000 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 30,226 | 24,384 | 23,261 | 26,273 | 27,010 | . | . | . |
| Gross external debt, EUR mn 5) | 119,339 | 110,940 | 105,583 | 107,218 | 107,000 | 107,000 | 107,000 | 107,000 |
| Gross external debt, % of GDP 5) | 106.4 | 96.3 | 84.1 | 80.1 | 75.3 | 72.9 | 69.8 | 67.2 |
| Average exchange rate HUF/EUR | 310.00 | 311.44 | 309.19 | 318.89 | 325.30 | 335 | 340 | 345 |

1) Preliminary and wiiw estimates. - 2) Enterprises with 5 and more employees. From 2019 based on tax administration data, survey data before. - 3) Loans more than 90 days overdue, and from 2016 also including loans unlikely to be paid. - 4) Base rate (two-week NB bill). - 5) Excluding SPE.

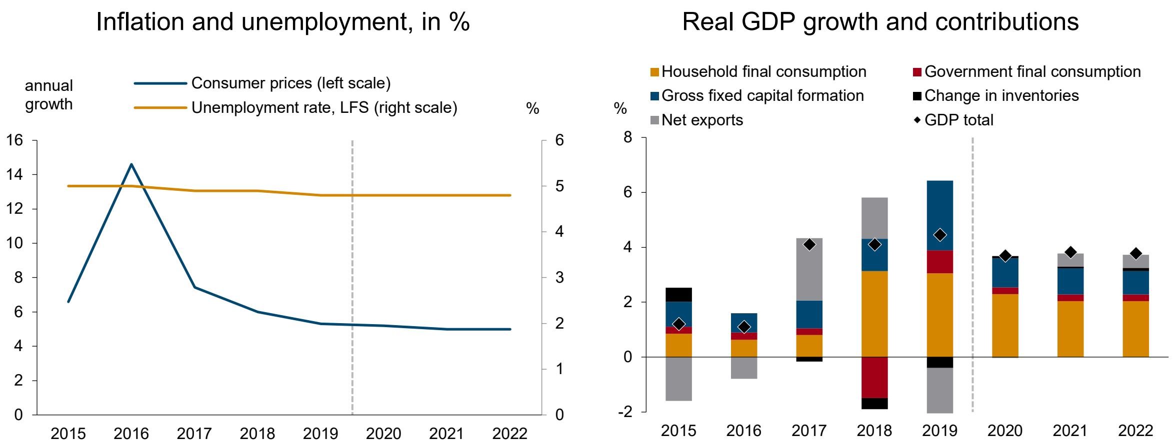
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# KAZAKHSTAN: Domestic demand spurring growth despite external headwinds

ALEXANDRA BYKOVA

Economic growth will decelerate to below 4% over the forecast period, having peaked at 4.5% in 2019 on the back of extensive fiscal stimuli. Domestic demand will remain robust, but low exports, along with strong import demand for capital goods, will negatively impact economic performance. A decline in commodity prices and the slowdown in China are downside risks to export dynamics.

**Figure 6.9 / Kazakhstan: Main macroeconomic indicators**




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

**The economy in 2019 saw the highest GDP growth rate for six years, peaking at 4.5%.** Extensive fiscal stimuli fuelled consumption to an estimated growth of 6.6%. This, together with robust fixed investment growth (projected to have been 12%), successfully counterbalanced the negative effect of an almost 10% fall last year in the average price of oil. Unsurprisingly, construction and trade were the most dynamic economic activities last year, with annual growth of 12.9% and 7.6%, respectively.

**Economic growth is likely to decelerate to below 4% for the forecast period, due to a slowdown in private consumption.** We expect any increase in real wages to be moderate. In 2019, real wages grew by 8.5% compared to the previous year, following a 50% hike in the minimum wage. We project that new policy measures will have a lower impact on consumption. A positive stimulus will come from the salary increases for teachers, which should see their pay double by 2023, compared to 2019, starting with a 25% rise in 2020. A three-year income tax exemption was introduced in January 2020 for most SMEs, along with a moratorium on tax inspection. The extent to which this will stimulate real income and self-employment is currently uncertain. Amid stricter prudential regulation and banking sector supervision, consumer lending is likely to develop at a slower pace than in 2019, when the stock of this type of loans grew by 27% and new indebtedness was up by 46% year on year in December.

**The expansion of the main oil field production capacity will be a major driver of investment in 2020-2022.** The Tengiz oil field enlargement investment project will require more funding than expected and will last longer. According to Tengizchevroil (TCO) estimates released in November last year, the start of increased oil production at the Tengiz oil field will be delayed until mid-2023, and the costs will increase by 25% (from USD 36.8 billion to USD 45.2 billion). Furthermore, modernisation and new facilities construction in the petrochemical industry will be an additional driver for investment. The recent emerging trend towards the development of the green economy is expected to continue: the construction of several renewable energy facilities will push their share of overall energy production from 1.3% in 2019 to 3% by the end of 2020.

**Public investment will be channelled to infrastructure development, especially in rural areas, road and housing construction.** The Nurly Zhol infrastructure investment programme has been extended to the period 2020-2025, with overall funding of approximately USD 16 billion – 70% financed from the budget and 26% through public-private partnerships. Modernisation and expansion of the road network will absorb 60% of the total investment volume envisaged under this programme.

**Despite an ambitious agenda of social and investment spending, a gradual non-oil deficit reduction remains a target for the 2020-2022 budget.** The digitalisation of tax and customs administration and the expansion of e-government services are gradually being introduced to boost public spending efficiency and counter corruption. Thus, the real-time electronic exchange of information between the customs services of China and Kazakhstan on the value and quantity of shipped goods and the vehicles transporting them, introduced in December 2019, enables the Kazakh customs authorities to compare that data with the information contained in customs declarations in order to detect declarations fraud, which used to cost the budget an estimated USD 500 million annually. A comprehensive package of legislation and an IT system designed for competitive public procurement have yet to be introduced.

**On the monetary policy side, there are signs of a possible loosening in the mid-term period.** On 3 February 2020, the National Bank decided to keep the policy rate unchanged, at 9.25%, to contain inflation within the target corridor of 4-6% amid short-term inflationary pressure arising from fuel excise tax rises and a hike in the tariffs for regulated services. But it flagged a possible interest rate cut, depending on the success of administrative measures to curtail the growth of tariffs and food prices. The latter has driven inflation since 2019: in January 2020, food prices rose again by 9.2% year on year. The Ministry of Trade is currently developing a policy aimed at promoting competition and price control at the regional level, with the aim of slowing food price rises. Low inflation among the country's trading partners reduces the risk of imported inflation. A shift in policy has become even more likely, after President Tokayev recently advised the National Bank to draw up a new medium-term monetary policy strategy by July 2020, which should combine macro-stability and economic growth goals. Under such circumstances, it is questionable whether the National Bank will keep its independence in policy setting.

**Banking supervision has already been transferred to a special agency, which is tasked with stepping up resolution of the long-lasting problems in the banking sector.** The deterioration in asset quality is one such: the share of non-performing loans rose from 7.4% in 2018 to 8.1% by the end of 2019. The newly established Financial Market Regulation Agency took over banking supervision from the National Bank in January 2020. It reports direct to the president and is expected to strengthen regulation in order to reduce unsecured consumer lending risks. After a comprehensive rescue package, involving a partial write-off of the debt of highly indebted low-income households (funded from the budget), the new supervision policy should ensure risk reduction within the banking system without additional state support. The asset-quality assessment of banks will soon be completed, and the risk-oriented supervision of the banking and insurance sectors is due to start in the latter half of 2020.

**Economic growth will continue to face external headwinds.** We project a slight slowdown in the growth of imports, mainly due to reduced demand for consumer goods; however, capital goods imports should remain strong, as they are underpinned by large investments. We expect merchandise exports in dollar terms to stagnate in 2020 and then to start increasing from 2021. The recent global oil price drop reflected expectations of lower oil demand due to a mild winter and the industrial disruption caused by the spread of the coronavirus in China. That is likely to have only a temporary effect in the first half of the year. On the other hand, a simultaneous decline in gas and metal prices may amplify the negative impact on exports. The possibility of offsetting the price effect with an increase in the volume of exports (as occurred in 2019 with copper) depends on the development of external demand. Economic performance in China – which accounted for 13.6% of Kazakhstan's total exports in 2019 and which is the country's second-largest export destination – is a downside risk to watch. We see a limited upside potential for diversification towards non-resource exports on markets in Central Asia, as well as in the EU after the Enhanced Partnership and Cooperation Agreement (EPCA) with Kazakhstan comes into force in March 2020. Overall, export performance perspectives are highly uncertain and are associated with commodity prices and external demand downside risks.

**The tenge has remained strong, despite a recent decline in oil prices.** The decoupling of the exchange rate from oil prices in January may be explained by the attractiveness to portfolio investors of Kazakhstan's high interest rates. Non-residents' investments in government bonds were reported to have reached USD 672 million by 6 February 2020. Nevertheless, we expect the tenge to depreciate over the coming years in the absence of any sign of improvement in the external balance.

**A parliamentary election is expected to be held by March 2021, but rumours of a snap election persist.** The ruling Nur Otan party should keep its majority. Despite a recent proposal by President Tokayev to lower the barrier for the number of party members required to register a new party, this concession is by no means an indication of a fair democratic election procedure.

**To sum up, after peaking in 2019, economic growth is projected to slow to below 4% in 2020-2022.** Downside risks stem from a decline in global commodity prices and a contraction of external demand.

**Table 6.9 / Kazakhstan: Selected economic indicators**

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 Forecast | 2022 |
|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 17,543 | 17,794 | 18,038 | 18,276 | 18,514 | 18,700 | 18,900 | 19,100 |
| Gross domestic product, KZT bn, nom. 2) | 40,884 | 46,971 | 54,379 | 61,820 | 68,639 | 74,700 | 81,400 | 88,700 |
| annual change in % (real) | 1.2 | 1.1 | 4.1 | 4.1 | 4.5 | 3.7 | 3.8 | 3.8 |
| GDP/capita (EUR at PPP) | 18,900 | 18,100 | 18,900 | 20,300 | 21,300 | . | . | . |
| Consumption of households, KZT bn, nom. 2) | 21,492 | 25,087 | 27,987 | 31,514 | 35,200 | . | . | . |
| annual change in % (real) | 1.8 | 1.2 | 1.5 | 6.1 | 6.0 | 4.5 | 4.0 | 4.0 |
| Gross fixed capital form., KZT bn, nom. 2) | 9,355 | 10,671 | 11,799 | 13,091 | 15,400 | . | . | . |
| annual change in % (real) | 4.2 | 3.0 | 4.5 | 5.4 | 12.0 | 5.0 | 4.5 | 4.0 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | -1.6 | -1.1 | 7.3 | 4.4 | 3.8 | 3.5 | 3.7 | 4.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | 3.4 | 5.4 | 3.0 | 3.5 | 0.9 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | 5.8 | 7.4 | 2.8 | 4.6 | 12.9 | . | . | . |
| Employed persons, LFS, th, average | 8,624 | 8,553 | 8,585 | 8,695 | 8,810 | 8,920 | 9,030 | 9,140 |
| annual change in % | 1.3 | -0.8 | 0.4 | 1.3 | 1.3 | 1.2 | 1.2 | 1.2 |
| Unemployed persons, LFS, th, average | 451 | 446 | 442 | 444 | 440 | 450 | 460 | 460 |
| Unemployment rate, LFS, in %, average | 5.0 | 5.0 | 4.9 | 4.9 | 4.8 | 4.8 | 4.8 | 4.8 |
| Reg. unemployment rate, in %, eop | 0.4 | 0.4 | 0.8 | 1.0 | 1.1 | . | . | . |
| Average monthly gross wages, KZT 3) | 126,021 | 142,898 | 150,827 | 162,673 | 185,500 | 202,000 | 218,500 | 236,300 |
| annual change in % (real, gross) | -2.3 | -1.1 | -1.7 | 1.7 | 8.5 | 3.5 | 3.0 | 3.0 |
| Consumer prices (HICP), % p.a. | 6.6 | 14.6 | 7.4 | 6.0 | 5.3 | 5.2 | 5.0 | 5.0 |
| Producer prices in industry, % p.a. | -20.5 | 16.8 | 15.3 | 19.0 | 5.1 | 4.0 | 3.5 | 3.0 |
| General governm.budget, nat.def., % of GDP | | | | | | | | |
| Revenues | 18.7 | 19.8 | 21.3 | 17.5 | 18.6 | 18.5 | 18.5 | 18.5 |
| Expenditures | 20.9 | 21.4 | 23.9 | 18.8 | 20.5 | 20.5 | 20.3 | 20.0 |
| Deficit (-) / surplus (+) | -2.2 | -1.6 | -2.7 | -1.3 | -1.9 | -2.0 | -1.8 | -1.5 |
| General gov.gross debt, nat.def., % of GDP | 22.7 | 25.0 | 25.7 | 26.0 | 25.2 | 25.0 | 24.5 | 24.0 |
| Stock of loans of non-fin.private sector, % p.a. | 4.7 | 0.3 | 0.0 | 3.0 | 5.9 | . | . | . |
| Non-performing loans (NPL), in %, eop | 8.0 | 6.7 | 9.3 | 7.4 | 8.0 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 16.00 | 12.00 | 10.25 | 9.25 | 9.25 | 9.00 | 8.75 | 8.50 |
| Current account, EUR mn 5) | -5,423 | -7,349 | -4,516 | -245 | -4,949 | -4,000 | -3,600 | -3,200 |
| Current account in % of GDP | -3.3 | -5.9 | -3.1 | -0.2 | -3.1 | -2.4 | -2.0 | -1.7 |
| Exports of goods, BOP, EUR mn 5) | 40,437 | 32,068 | 41,866 | 50,672 | 51,277 | 51,800 | 53,300 | 56,000 |
| annual change in % | -32.0 | -20.7 | 30.6 | 21.0 | 1.2 | 1.0 | 2.9 | 5.1 |
| Imports of goods, BOP, EUR mn 5) | 29,948 | 23,706 | 27,060 | 29,030 | 33,817 | 35,900 | 37,600 | 39,500 |
| annual change in % | -6.3 | -20.8 | 14.2 | 7.3 | 16.5 | 6.2 | 4.7 | 5.1 |
| Exports of services, BOP, EUR mn 5) | 5,573 | 5,498 | 5,757 | 6,192 | 6,835 | 7,200 | 7,600 | 8,000 |
| annual change in % | 5.7 | -1.3 | 4.7 | 7.5 | 10.4 | 5.3 | 5.6 | 5.3 |
| Imports of services, BOP, EUR mn 5) | 9,831 | 8,898 | 8,924 | 10,154 | 10,004 | 10,200 | 10,700 | 11,200 |
| annual change in % | -5.7 | -9.5 | 0.3 | 13.8 | -1.5 | 2.0 | 4.9 | 4.7 |
| FDI liabilities, EUR mn 5) | 5,934 | 15,562 | 4,171 | 181 | 3,200 | 4,500 | . | . |
| FDI assets, EUR mn 5) | 2,992 | 3,140 | 847 | -3,936 | -1,829 | 400 | . | . |
| Gross reserves of NB excl. gold, EUR mn 5) | 18,555 | 19,191 | 15,505 | 14,460 | 9,071 | . | . | . |
| Gross external debt, EUR mn 5) | 139,886 | 155,979 | 140,153 | 138,839 | 144,900 | 146,300 | 147,800 | 149,300 |
| Gross external debt, % of GDP | 84.1 | 125.7 | 94.9 | 91.3 | 90.0 | 87.0 | 82.0 | 78.0 |
| Average exchange rate KZT/EUR | 245.80 | 378.63 | 368.32 | 406.66 | 428.51 | 442 | 454 | 465 |

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

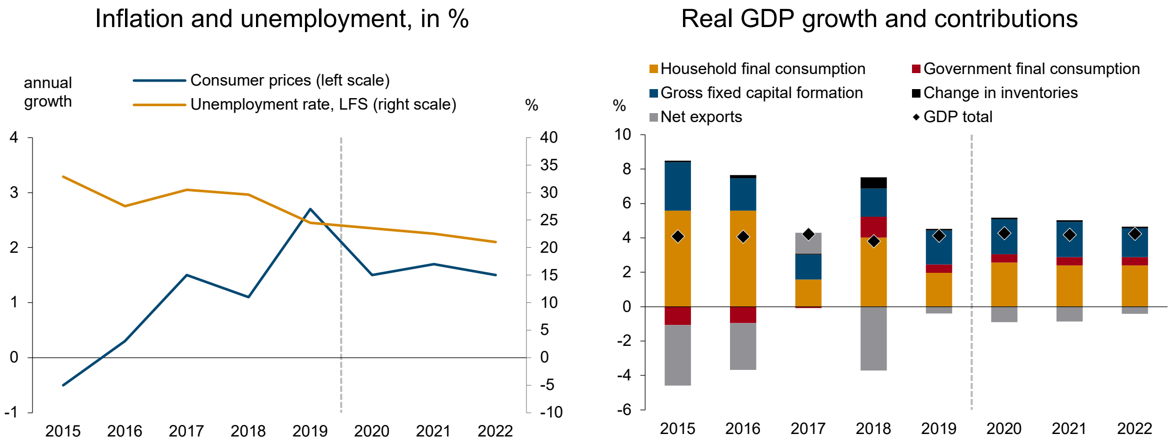
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# KOSOVO: Great expectations and major challenges facing the new government

ISILDA MARA

Great things are expected of the new government, but it faces some big challenges in consolidating the rule of law and energising the economy. Its ambitious programme is expected to stimulate private and public investment. Kosovo-Serbia dialogue is likely to be resumed, thanks to the active and leading role of the USA. In the medium term, growth will remain robust at above 4%, backed by consumption and investment, and Kosovo is likely to remain among the fastest-growing economies in CESEE.

**Figure 6.10 / Kosovo: Main macroeconomic indicators**




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

**In 2019, Kosovo was among the fastest-growing economies in the Western Balkan region.** Real GDP growth persisted at a robust rate of 4.38% in the third quarter (year on year), following 4.24% and 4.13% in the first and second quarters, respectively. The acceleration in economic activity – estimated at 4.2% for 2019 as a whole – was fuelled by consumption and investment (each contributing 2 percentage points to growth). Despite being less strong than in 2018, household consumption benefited from the marked rise in real wages, employment opportunities and remittances. Also, there was a surge in public investment and gross fixed capital formation (GFCF) expanded by more than 7% over the first three quarters of 2019, year on year. Manufacturing, construction, financial and insurance, health and social work activities were the sectors that contributed most to the economy, while agriculture affected growth negatively.

**Great things are expected of the new government; but it also faces some major challenges in terms of consolidating the rule of law and stimulating the economy.** Albin Kurti took office on 3 February 2020, after almost four months of protracted and intensive negotiations between the Self-Determination Party (Vetevendosje – LVV) and the Democratic League of Kosovo (LDK), the two biggest winners in the parliamentary elections held in October 2019. The confidence vested in the Kurti government will require it to achieve substantial transformations, especially as regards the rule of law, the fight against corruption, the consolidation of democratic institutions, energising of the economy, employment, and investment in education and health. This means enormous challenges ahead for Kurti's leadership. Whether he can succeed in meeting the electorate's expectations remains to be seen. Establishing the prerequisites for a constructive dialogue with Serbia and for achieving recognition of Kosovo also feature among the priorities of the new government. Membership of NATO and of the United Nations are on the agenda, too.

**In the medium term, the government's ambitious programme is expected to stimulate private and public investment.** An integral part of its strategy is the establishment of a Development Fund. This will have the remit of financially assisting the private sector (especially small and medium-sized enterprises) to expand their investments, production, exports and job-creation activities. In addition, the new government plans to set up a Sovereign Fund, which will aim to boost foreign investment in strategic sectors of the economy. In 2019, budget revenue performance was outstanding, and the indications are also encouraging for 2020. Last year, budget revenues rose by 11%, to the equivalent of EUR 2.2 billion (or 31% of GDP). Budget expenditure increased by 8.7%, to the equivalent of EUR 2.1 billion, with close to 20% absorbed by GFCF. Thus, 2019 closed with a slight budget surplus, which kept the public debt at a low rate of 17% of GDP. The economic platform flagged up by the Kurti government envisages a boost for public investment, active labour market policies and investment in the health and education sectors through a general government budget of EUR 3 billion for 2020. This may be rather ambitious and increases the risk of fiscal deficit, followed by an escalation of public debt.

**The Kosovo-Serbia dialogue – deadlocked since October 2018 – is likely to be resumed, thanks to the active and leading role of the USA.** The Munich Security Conference held in February 2020 presented a good opportunity for Kosovo and Serbia to sign new agreements on railways and highways; this followed an agreement to resume flights between Belgrade and Pristina, reached a few weeks previously. These agreements were concluded thanks to the mediation and direct engagement of the US special envoy for the Kosovo-Serbia dialogue, Richard Grenell, who is also the US ambassador in Berlin. The mediating role of the USA presupposes above all the development and stabilisation of economic relations between the two countries, which could further facilitate and pave the way to important political agreements, such as Kosovo's recognition. Prime Minister Kurti, upholding the fairness principle, has announced that the 100% tariff on imports from Serbia and Bosnia and Herzegovina will be abolished; the principle of reciprocity will be applied in political, economic and trade relations with those countries. In fact, the USA does not favour this approach: the US envoy has suggested that Kosovo should abolish the 100% tariff and Serbia should cease lobbying against Kosovo's recognition. EU engagement with Kosovo seems lethargic, with EU visa liberalisation for Kosovo having stalled. Thus a population of 1.9 million continues to be isolated in the middle of Europe.

**The signs from the labour market are encouraging, but employment abroad remains alluring.** There have been improvements on the labour market, reflected in rising employment. The overall unemployment rate has declined, but youth unemployment remains among the highest in the region. Remittances continue to be an important source of income, rising by a further 7% up until October 2019, year on year. In 2019, a net outflow of 30,000 Kosovars was recorded. Germany is, and will continue to be, a magnet for emigrants from Kosovo. Germany's Skilled Immigration Act, which comes into force in March 2020, aims at facilitating labour market access and the employment of highly qualified professionals from countries outside the European Union. Kosovars will not let this opportunity pass them by. Even now, Germany attracts a sizeable contingent of medical professionals from Kosovo. In

July 2019, Germany signed an agreement with the government of Kosovo to offer assistance in the training and qualification of nurses. Moreover, Germany has announced an investment of EUR 25 million for vocational training and education in the Western Balkan region, and Kosovo will certainly seek to benefit from this.

**The rate of inflation accelerated to 2.7% in 2019, in part affected by the 100% tariff imposed from October 2018 on goods from Serbia and Bosnia and Herzegovina.** Inflation-rate dynamics tend to be strongly associated with international price developments – especially in the EU, given Kosovo's high dependence on goods imported from there. In addition, the 100% tariff on goods from Serbia and Bosnia and Herzegovina and the time it necessarily takes to line up new trade partners pushed prices up in the first half of 2019. However, in the second half of the year inflation slowed, suggesting that the initial effect of the 100% tariff had levelled off.

**The expansion of the demand for credit has been remarkable and will maintain its pace.** The banking sector has high liquidity and is financially sound, with the level of non-performing loans standing at 2.3% at the end of 2019. Credit activity aimed at the non-financial private sector expanded by 10% in 2019 owing to a further easing of lending conditions. The main source of financing continues to be deposits, which rose 16% in 2019 year on year, and amounted to EUR 3.75 billion.

**The dynamics of the external sector were encouraging, thanks to a positive trade balance on services, and also secondary income.** The export of services, mainly tourism, recorded another year with double-digit growth – 12% over the first three quarters of 2019, year on year. The 100% tariff required a shift in trade partners, especially as concerns imports. North Macedonia and Slovenia benefited most, with both countries almost doubling their exports to Kosovo. As for Albania, the volume of trade did not expand so much, because of a number of non-tariff measures imposed by Albania. Still, it is worth mentioning the opening of a Kosovo customs office in Albania, at Durres harbour, in January 2019 – a step that will facilitate cooperation between the two countries. Up to November 2019, goods exports from Kosovo rose by 5% year on year, with the main destinations being Italy and Germany. FDI was buoyant – a rise of 15% year on year up to October 2019 – with investment flowing in from Germany and the USA. The Kosovo diaspora may have been an important conduit for revitalising FDI inflows, as there are large and well-established communities of Kosovars in both Germany and the USA. Also, remittances continue to be an important source of income – up to three times greater than FDI inflows.

**The 'Kosova e Re' coal-fired power plant project may gain momentum.** The new government has announced that between 2020 and 2023, 'Kosova e Re' will replace the old coal-fired power plant 'Kosova A'. However, it is uncertain under what conditions and arrangements this project will be launched, given that in the past both the LVV and the LDK opposed the previous government's agreement with US company ContourGlobal.

**In the medium term, growth will remain robust, at above 4%, backed by consumption and investment.** With the new government on board, and given its ambitious programme, it is anticipated that the economy will accelerate further. Dialogue with Serbia is expected to resume soon. Positive results are envisaged, given the active role of the USA. Given this robust growth, Kosovo is likely to maintain its position as one of the fastest-growing economies in CESEE.

## Table 6.10 / Kosovo: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th pers., average | 1,788 | 1,778 | 1,791 | 1,797 | 1,820 | 1,845 | 1,860 | 1,870 |
| Gross domestic product, EUR mn, nom. | 5,807 | 6,070 | 6,414 | 6,726 | 7,200 | 7,700 | 8,200 | 8,800 |
| annual change in % (real) | 4.1 | 4.1 | 4.2 | 3.8 | 4.1 | 4.3 | 4.2 | 4.2 |
| GDP/capita (EUR at PPP) | 7400 | 7500 | 7700 | 8100 | 8500 | . | . | . |
| Consumption of households, EUR mn, nom. | 4,943 | 5,194 | 5,370 | 5,738 | 6,000 | . | . | . |
| annual change in % (real) | 6.5 | 6.6 | 1.8 | 4.8 | 2.3 | 3.0 | 2.8 | 2.8 |
| Gross fixed capital form., EUR mn, nom. | 1,499 | 1,550 | 1,729 | 1,888 | 2,100 | . | . | . |
| annual change in % (real) | 12.1 | 7.3 | 5.7 | 6.1 | 7.0 | 7.2 | 7.3 | 6.0 |
| Gross industrial production 2) | | | | | | | | |
| annual change in % (real) | 3.7 | -6.7 | 4.9 | -1.3 | 3.5 | 3.0 | 5.0 | 3.0 |
| Gross agricultural production 3) | | | | | | | | |
| annual change in % (real) | 13.8 | 14.5 | -4.1 | -20.4 | -1.5 | . | . | . |
| Construction output 4) | | | | | | | | |
| annual change in % (real) | 15.8 | 4.5 | 8.6 | 9.3 | 8.0 | . | . | . |
| Employed persons, LFS, th, average 5) | 296.9 | 331.8 | 357.1 | 345.1 | 380.0 | 395 | 405 | 410 |
| annual change in % | -8.2 | 11.7 | 7.6 | -3.4 | 10.1 | 4.0 | 2.0 | 2.0 |
| Unemployed persons, LFS, th, average 5) | 145.8 | 126.1 | 156.6 | 145.0 | 120.0 | 120 | 120 | 110 |
| Unemployment rate, LFS, in %, average 5) | 32.9 | 27.5 | 30.5 | 29.6 | 24.5 | 23.5 | 22.5 | 21.0 |
| Reg. unemployment rate, in %, eop | . | . | . | . | . | . | . | . |
| Average monthly gross wages, EUR | 510 | 519 | 528 | 558 | 600 | 630 | 670 | 710 |
| annual change in % (real, gross) | 0.0 | 1.5 | 1.7 | 4.7 | 5.0 | 4.0 | 4.0 | 4.0 |
| Average monthly net wages, EUR | 451 | 457 | 471 | 498 | 550 | 580 | 610 | 630 |
| annual change in % (real, net) | 5.4 | 1.0 | 1.5 | 4.6 | 7.0 | 4.0 | 3.0 | 2.0 |
| Consumer prices (HICP), % p.a. | -0.5 | 0.3 | 1.5 | 1.1 | 2.7 | 1.5 | 1.7 | 1.5 |
| Producer prices, % p.a. | 2.7 | -0.1 | 0.6 | 1.4 | 1.5 | 1.5 | 1.5 | 1.5 |
| General governm.budget, nat.def., % of GDP | | | | | | | | |
| Revenues | 29.4 | 29.3 | 30.0 | 29.8 | 30.7 | 31.0 | 31.5 | 32.0 |
| Expenditures | 27.8 | 29.1 | 28.6 | 29.4 | 30.0 | 33.0 | 32.0 | 32.0 |
| Deficit (-) / surplus (+) | 1.6 | 0.2 | 1.3 | 0.4 | 0.7 | -2.0 | -0.5 | 0.0 |
| General gov.gross debt, nat.def., % of GDP | 12.9 | 14.0 | 15.5 | 16.3 | 17.2 | 17.5 | 18.0 | 18.0 |
| Stock of loans of non-fin.private sector, % p.a. | 7.2 | 10.5 | 11.6 | 10.8 | 10.0 | . | . | . |
| Non-performing loans (NPL), in %, eop | 6.2 | 4.9 | 3.1 | 2.7 | 2.0 | . | . | . |
| Central bank policy rate, % p.a., eop 6) | 7.69 | 7.22 | 6.83 | 5.99 | 6.42 | 6.00 | 5.50 | 5.50 |
| Current account, EUR mn | -497 | -481 | -349 | -509 | -490 | -550 | -620 | -710 |
| Current account, % of GDP | -8.6 | -7.9 | -5.4 | -7.6 | -6.8 | -7.1 | -7.6 | -8.1 |
| Exports of goods, BOP, EUR mn | 322 | 308 | 378 | 377 | 405 | 430 | 450 | 480 |
| annual change in % | -0.6 | -4.5 | 22.9 | -0.4 | 7.6 | 6.0 | 5.5 | 7.0 |
| Imports of goods, BOP, EUR mn | 2,432 | 2,599 | 2,843 | 3,114 | 3,300 | 3,480 | 3,650 | 3,830 |
| annual change in % | 2.1 | 6.9 | 9.4 | 9.6 | 6.0 | 5.5 | 5.0 | 5.0 |
| Exports of services, BOP, EUR mn | 952 | 1,131 | 1,359 | 1,562 | 1,750 | 1,870 | 1,980 | 2,140 |
| annual change in % | 2.5 | 18.8 | 20.2 | 14.9 | 12.1 | 7.0 | 6.0 | 8.0 |
| Imports of services, BOP, EUR mn | 494 | 492 | 531 | 706 | 800 | 870 | 930 | 1,000 |
| annual change in % | 5.5 | -0.5 | 8.1 | 32.8 | 13.4 | 9.0 | 7.0 | 8.0 |
| FDI liabilities, EUR mn | 309 | 220 | 255 | 272 | 290 | 350 | . | . |
| FDI assets, EUR mn | 37 | 43 | 43 | 46 | 20 | 30 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 708 | 605 | 683 | 769 | 863 | . | . | . |
| Gross external debt, EUR mn | 1,932 | 2,015 | 2,089 | 2,036 | 2,300 | 2,500 | 2,500 | 2,600 |
| Gross external debt, % of GDP | 33.3 | 33.2 | 32.6 | 30.3 | 32.5 | 32.0 | 31.0 | 30.0 |

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

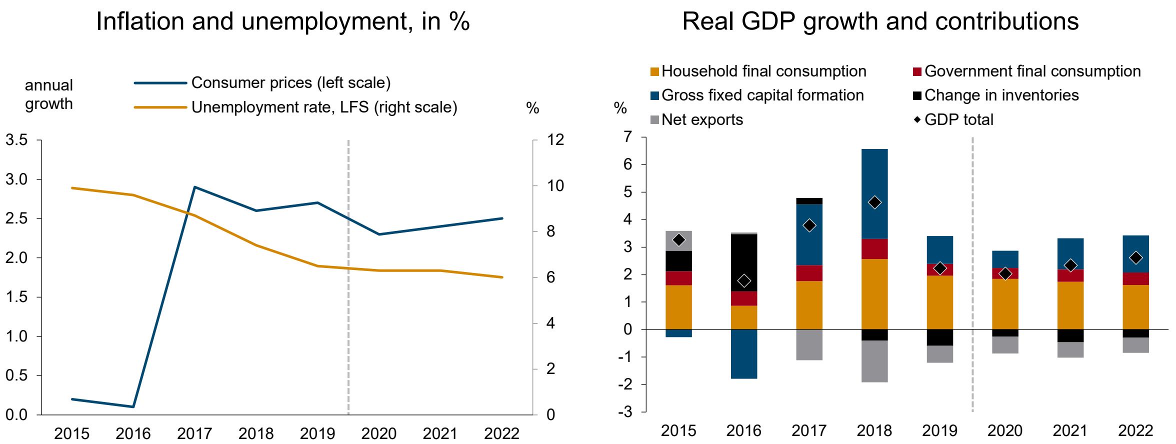
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# LATVIA: Weak investment and stuttering trade keep growth low

SEBASTIAN LEITNER

The Latvian economy experienced a soft landing in 2019. Growth in gross fixed capital investment and foreign trade has declined substantially and will remain subdued in 2020-2021. A tight labour market will keep wages rising fairly swiftly, which will lead to lively household consumption over the next two years. Export activity is likely to revive slightly this year. Despite the economic slowdown, the labour market is tightening further, with the unemployment rate set to fall to 6.3% this year and in 2021. In 2020, we expect GDP growth to decline further to 2.0%, to be followed by a slight upswing (to 2.4%) in 2021 and on to 2.6% in 2022.

**Figure 6.11 / Latvia: Main macroeconomic indicators**




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

**Weak economic activity in the fourth quarter of last year resulted in overall GDP growth for 2019 declining to 2.2% in real terms year on year. The slowdown in global economic activity resulted in Latvia's exports falling towards the end of last year and almost stagnating in 2019 as a whole, compared to 2018.** Growth in exports to Western Europe abated, while a certain revival was reported in exports to Russia, Latvia's third most important trading partner. The slowdown in the Swedish economy – and particularly the low housing production there – led to declining Latvian exports by the important wood sector and other building materials sector. In general, substantially rising wages are putting pressure on the competitive position of the Latvian manufacturing sector. As a result, growth in industrial production was – at 1% in real terms year on year – rather anaemic in 2019, despite the still strongly increasing household consumption.

**While goods exports are stagnating, the export of services is thriving.** In particular, trade in business services is growing at a good pace, while the important transport sector has reached saturation point, due to the stagnation of transit traffic in the direction of Russia. For 2020, we expect some upswing in goods exports. Agricultural exports will also increase, following a particularly good harvest in 2019. Strongly growing wages will keep the import of consumer goods flourishing in 2020. However, we expect the current account deficit to remain below -1% of GDP in the period 2020-2021.

**While the industrial sector and construction are experiencing continued low growth, the tertiary sector – particularly business and public services – is developing at a good pace.** Only the banking sector is contracting further, following necessary changes to the business model of banks in terms of services offered to foreign clients. The ECB and national banking regulators requested the introduction of anti-money-laundering practices, following the closure of two large banks in 2018 and 2019. Payments by foreign clients channelled through the Latvian banking sector and foreign deposits have both declined substantially in recent years, but foreign deposits still amounted to 19% of total deposits in December 2019.

**After two years of strong investment growth, outlays for gross fixed capital increased at a much slower pace in 2019.** Investment co-financed by EU funds has peaked and no longer provides an additional boost to investment growth. The 2020 government budget shows a reduction in public investment – from 5.5% of GDP in 2019 to 4.9% this year. However, in 2021 the start of the construction of the main tracks and infrastructure (such as bridges and stations) for Rail Baltica, the high-speed rail project, will lead to a revival of public investment growth. In 2019, construction activity generally slowed, increasing by only 2.9% in real terms year on year. For 2020, we do not anticipate much of a revival; however, the number of building permits issued shows that some upswing is likely in the housing sector, with stronger growth in the non-residential building sector. This is substantiated by the fact that, after long years of deleveraging, the stock of mortgage debt for private households started to increase again in 2019, on the back of substantial income growth and negative real interest rates. Given the limited expectations for overall GDP growth in 2020 and next year, enterprises will be reluctant to invest in machinery and equipment in the near future.

**Following two years of job growth, employment started to stagnate in 2019.** With the steady decrease in the working-age population, the unemployment rate again fell last year – to 6.5% on average. Also, rising vacancy rates highlight the tight situation in the labour market. Employers are increasingly in need of a skilled workforce. Given the likely economic slowdown in the coming two years, however, we expect employment to continue to stagnate this year and in 2021, while the unemployment rate is likely to remain at around 6.3%.

**The dwindling supply of skilled labour has also meant that gross wages have been rising rapidly – in 2019, by 5% in real terms year on year.** The minimum wage has not been increased for 2020; however, a sharp rise from EUR 430 to EUR 500 is expected from 2021. From January 2020, the non-taxable minimum was increased to EUR 300, and the governing coalition also agreed to raise this to EUR 400 in 2021 and to EUR 500 in 2022, in order to boost the budgets of low-income households.
A further proposal for changes to the tax structure would see a reduction in the VAT rates on medicines, foodstuffs, restaurant meals and newspapers from 2021. Thus, in the coming years wage earners will experience a steady rise in their real incomes. This will further fuel household consumption, which is

projected to increase by about 3.2% in real terms this year. In the period 2021-2022, we expect private consumption to continue to provide stable support for GDP growth.

**Consumer price inflation is likely to decline further, to 2.3% in 2020.** Despite the ongoing strong wage growth, inflation is being damped down by meagre increases in import prices, declining prices for food and lower tariffs for utilities. However, the January 2020 increase in fuel excise duty provides a counterbalance. In general, we expect consumer price inflation to be relatively low not only this year, but also in 2021 (when it is likely to reach 2.4%).

**All in all, since last year's Autumn Forecast we have become slightly less optimistic, and have reduced the forecast GDP growth rate for 2020 from 2.2% to 2.0%.** Private investment activity is likely to slow down more than previously expected, while external demand will grow slightly more strongly than in 2019. Rising household incomes will help private consumption to keep on growing steadily. Public investment activity will decrease in 2020; however, activity is likely to pick up in 2021-2022, when the construction of rail and road infrastructure increases, facilitated by ongoing inflows of EU funds. For 2021, international forecasters (EC, IMF) predict a more rapid rise in external demand in the advanced economies, which should also support Latvian exporters. Thus, we have revised our growth forecast for 2021 to 2.4%; in 2022, further stabilisation will result in GDP increasing by 2.6% in real terms.

## Table 6.11 / Latvia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th pers., average | 1,978 | 1,960 | 1,942 | 1,927 | 1,920 | 1,910 | 1,900 | 1,890 |
| Gross domestic product, EUR mn, nom. | 24,426 | 25,073 | 26,798 | 29,151 | 30,600 | 31,900 | 33,400 | 35,100 |
| annual change in % (real) | 3.3 | 1.8 | 3.8 | 4.6 | 2.2 | 2.0 | 2.3 | 2.6 |
| GDP/capita (EUR at PPP) | 18,700 | 18,900 | 19,900 | 21,300 | 22,200 | . | . | . |
| Consumption of households, EUR mn, nom. | 14,424 | 14,791 | 15,698 | 16,840 | 17,900 | . | . | . |
| annual change in % (real) | 2.7 | 1.5 | 3.0 | 4.4 | 3.4 | 3.2 | 3.0 | 2.8 |
| Gross fixed capital form., EUR mn, nom. | 5,368 | 4,899 | 5,554 | 6,554 | 7,000 | . | . | . |
| annual change in % (real) | -1.2 | -8.2 | 11.3 | 15.8 | 4.5 | 2.8 | 5.0 | 6.0 |
| Gross industrial production 2) | | | | | | | | |
| annual change in % (real) | 3.6 | 5.4 | 8.3 | 1.5 | 0.9 | 1.0 | 2.0 | 2.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | 14.0 | -7.3 | 1.5 | -10.0 | 21.9 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | -0.6 | -16.6 | 18.7 | 21.8 | 2.9 | . | . | . |
| Employed persons, LFS, th, average | 896.1 | 893.3 | 894.8 | 909.4 | 910.0 | 910 | 910 | 912 |
| annual change in % | 1.3 | -0.3 | 0.2 | 1.6 | 0.1 | 0.0 | 0.0 | 0.2 |
| Unemployed persons, LFS, th, average | 98.2 | 95.3 | 85.4 | 72.8 | 63.0 | 61 | 61 | 58 |
| Unemployment rate, LFS, in %, average | 9.9 | 9.6 | 8.7 | 7.4 | 6.5 | 6.3 | 6.3 | 6.0 |
| Reg. unemployment rate, in %, eop 3) | 8.7 | 8.4 | 6.8 | 6.4 | 6.2 | . | . | . |
| Average monthly gross wages, EUR | 818.0 | 859.0 | 926.0 | 1,004.0 | 1,080.0 | 1,150 | 1,230 | 1,320 |
| annual change in % (real, gross) | 6.7 | 4.9 | 4.5 | 6.0 | 5.0 | 4.5 | 4.8 | 4.5 |
| Average monthly net wages, EUR | 603.0 | 631.0 | 676.0 | 742.0 | 800.0 | 860 | 920 | 990 |
| annual change in % (real, net) | 7.4 | 4.3 | 3.8 | 7.0 | 5.0 | 4.5 | 4.5 | 4.8 |
| Consumer prices (HICP), % p.a. | 0.2 | 0.1 | 2.9 | 2.6 | 2.7 | 2.3 | 2.4 | 2.5 |
| Producer prices in industry, % p.a. | -1.0 | -2.5 | 2.5 | 4.3 | 1.8 | 1.3 | 1.5 | 2.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | |
| Revenues | 36.6 | 36.9 | 37.5 | 37.8 | 36.8 | 36.4 | 36.3 | 36.5 |
| Expenditures | 38.0 | 36.9 | 38.0 | 38.5 | 37.6 | 37.1 | 36.9 | 37.1 |
| Net lending (+) / net borrowing (-) | -1.4 | 0.1 | -0.5 | -0.7 | -0.8 | -0.7 | -0.6 | -0.6 |
| General gov.gross debt, EU def., % of GDP | 36.7 | 40.2 | 38.6 | 36.4 | 36.0 | 35.0 | 34.0 | 33.0 |
| Stock of loans of non-fin.private sector, % p.a. | -2.8 | 0.1 | -4.7 | -5.2 | 0.6 | . | . | . |
| Non-performing loans (NPL), in %, eop 4) | 6.0 | 4.4 | 4.1 | 5.3 | 5.8 | . | . | . |
| Central bank policy rate, % p.a., eop 5) | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | -216 | 360 | 273 | -198 | -105 | -235 | -235 | -135 |
| Current account, % of GDP | -0.9 | 1.4 | 1.0 | -0.7 | -0.3 | -0.7 | -0.7 | -0.4 |
| Exports of goods, BOP, EUR mn | 10,480 | 10,543 | 11,683 | 12,603 | 12,629 | 12,950 | 13,500 | 14,200 |
| annual change in % | 1.0 | 0.6 | 10.8 | 7.9 | 0.2 | 2.5 | 4.2 | 5.2 |
| Imports of goods, BOP, EUR mn | 12,721 | 12,430 | 13,905 | 14,953 | 15,112 | 15,700 | 16,400 | 17,200 |
| annual change in % | -1.0 | -2.3 | 11.9 | 7.5 | 1.1 | 3.9 | 4.5 | 4.9 |
| Exports of services, BOP, EUR mn | 4,351 | 4,601 | 4,964 | 5,268 | 5,628 | 5,800 | 6,100 | 6,500 |
| annual change in % | 6.1 | 5.7 | 7.9 | 6.1 | 6.8 | 3.1 | 5.2 | 6.6 |
| Imports of services, BOP, EUR mn | 2,334 | 2,468 | 2,702 | 2,972 | 3,120 | 3,250 | 3,400 | 3,600 |
| annual change in % | 10.4 | 5.7 | 9.5 | 10.0 | 5.0 | 4.2 | 4.6 | 5.9 |
| FDI liabilities, EUR mn | 729 | 302 | 991 | 390 | 1,008 | 500 | . | . |
| FDI assets, EUR mn | 128 | 202 | 516 | -290 | -52 | 100 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 2,957 | 3,100 | 3,620 | 3,578 | 3,700 | . | . | . |
| Gross external debt, EUR mn | 34,861 | 37,217 | 37,922 | 35,697 | 36,100 | 36,700 | 36,700 | 38,600 |
| Gross external debt, % of GDP | 142.7 | 148.4 | 141.5 | 122.5 | 118.0 | 115.0 | 110.0 | 110.0 |

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) In % of labour force (LFS). - 4) Loans more than 90 days overdue, and from 2018 also including loans unlikely to be paid. - 5) Official refinancing operation rates for euro area (ECB).

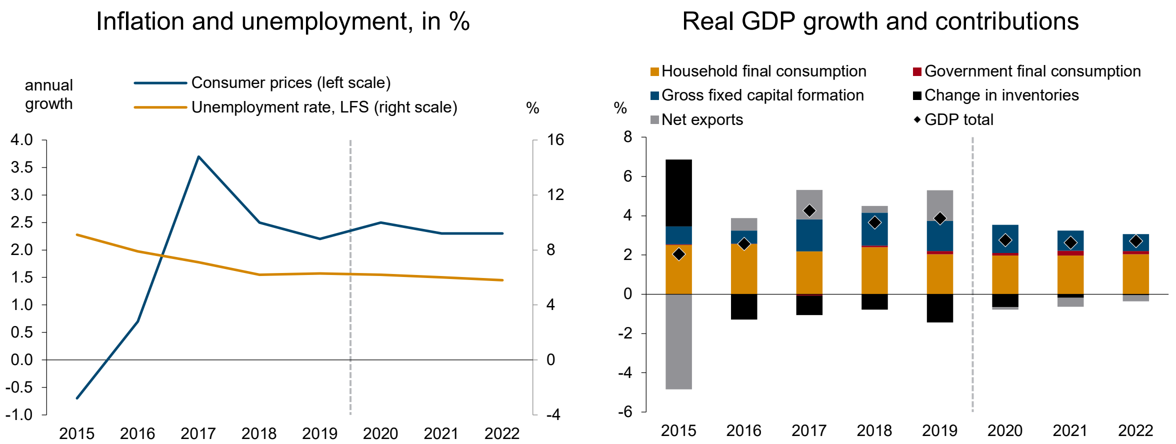
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# LITHUANIA: Continued growth, in a higher gear than expected

SEBASTIAN LEITNER

A better-than-expected export performance and still swiftly rising gross fixed capital investment propelled growth in the Lithuanian economy in 2019 to 3.9% in real terms year on year. A further minimum wage hike and a reduction in the effective income tax rate for low earners will maintain the country's remarkable increase in the purchasing power of households. Thus, private consumption will continue to encourage the rapid growth of economic activity. External demand was strong in 2019, but is likely to abate in the next two years. For 2020, we expect real GDP to grow by 2.8%, followed by a small decline to 2.6% in 2021 and then 2.7% in 2022.

**Figure 6.12 / Lithuania: Main macroeconomic indicators**




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

**The Latvian economy remained in a high gear throughout 2019. Its GDP growth rate of 3.9% in real terms year on year was even slightly above the figure for 2018. Despite a slowdown in global trade and economic activity in the euro area, exports of Lithuanian goods continued to grow by more than 6% in nominal terms in 2019.** At the same time, growth in imports declined substantially (to about 3%), due to inventory depletion throughout the year. As a result, the current account surplus exceeded 3% of GDP and the contribution of net exports to GDP growth was strongly positive. While exports to Germany, Estonia, the whole euro area and the CIS increased at above average, external demand from Latvia and Poland stagnated – and in the case of another important trade partner, Sweden, actually declined. The fall in the price of crude oil led to a growth in export volumes of refined petroleum and oil products, such as chemicals, plastics and fertilisers. Exports of services (particularly business services) are growing swiftly: in 2019, an increase of more than 20% in nominal terms was reported.

**Figures for 2019 show that gross fixed capital investment continued to grow rapidly – by 7.5% in real terms per annum.** The influx of EU funds will allow the government to lift capital spending this year, too: the government budget envisages an increase from 3.6% of GDP in 2019 to 3.8% this year. The Rail Baltica high-speed train project will move from the design to the construction phase in 2020. Growth in private investment is likely to ease somewhat this year; however, upgrading of the production infrastructure will likely continue, as the business confidence of entrepreneurs in the construction and industrial sectors has declined only slightly in recent months. At the same time, in the service sector and in retail, the forward-looking sentiments are still quite stable and positive. The construction of new dwellings declined somewhat in 2019, while house prices rose considerably in the cities. In the coming quarters of 2020 and 2021, we expect construction growth – of dwellings and non-residential buildings alike – to revive, as indicated by the latest figures for building permits issued. The stock of mortgage loans of private households also shows a steady and substantial increase. With negative real interest rates, rapidly rising incomes and buoyant house prices, real estate seems like a good investment to more and more households.

**For the first time since 1991, the resident population of Lithuania increased again in 2019 (albeit by only about 100 people).** While the natural change in the population remains negative, emigration is declining, and immigration is growing. About half of the incomers are returning Lithuanians; about half of the foreigners are from Ukraine, about 30% from Belarus and 5% from Russia. Due to demographic changes, however, the working-age population is continuing to decline, resulting in a tightening labour market.

**We expect overall employment to stagnate both in 2020 and in the following two years.** The number of jobs in ICT services, accommodation and domestic trade rose sharply last year and will continue to rise, while skilled labour is becoming ever scarcer. However, both the industrial sector and agriculture are gradually shedding jobs. The unemployment rate inched up to 6.3% in 2019. In the next two years we expect unemployment to fall only slightly towards 5.8% in 2022 on average.

**The 9.4% rise in the minimum wage (to EUR 607 a month) from January 2020 will result in gross salaries again growing by about 6% in real terms this year.** Moreover, labour taxation has been reduced by increasing the non-taxable income to EUR 400 a month from January 2020; this amount will be lifted to EUR 500 in 2021. At the same time, the rate of income tax paid by high earners (roughly 15% of taxpayers) was raised from January 2020 to 32% (the standard rate is 20%). In 2021 the income threshold for the 32% tax bracket will be lowered, thus a larger share of the population will be affected. The overall strong growth of incomes means that household consumption will remain a driver of growth not only in 2020, but throughout the forecast period 2021-2022.

**Although wages rose more rapidly, consumer price inflation fell to 2.2% in 2019.** For the year 2020, we expect a slight increase towards 2.6%, due to domestic factors. Excise duties are being raised (particularly on diesel and tobacco) and the price of electricity will rise. At the same time, however, import price inflation is expected to fall further. While the cost of services will increase more swiftly, overall consumer price inflation is expected to decline again to 2.3% in both 2021 and 2022.

**Since our 2019 Autumn Forecast, we have become more optimistic and have increased our forecast for real GDP growth from 2.4% to 2.8% in 2020.** We expect growth figures in exports to decrease only slightly compared to last year. Investment in dwellings and non-residential buildings will pick up, as will outlays on publicly financed infrastructure – not only in 2020, but also the following year. Sentiment indicators still show strong confidence levels among both businesses and consumers. Strongly rising household incomes, pushed upwards by a tightening labour market and tax cuts, will help private consumption to keep on growing steadily. Based on the assumption that the oil price remains stable, we expect export growth – particularly of the most important Lithuanian group of goods (refined petroleum products) – to lose momentum in nominal terms in 2021 and 2022. This may also result in weaker investment activity in the private sector. Thus, for 2021 and 2022, we forecast real GDP to grow at a slower pace of 2.6% and 2.7%, respectively.

## Table 6.12 / Lithuania: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th pers., average | 2,905 | 2,868 | 2,828 | 2,802 | 2,780 | 2,760 | 2,740 | 2,730 |
| Gross domestic product, EUR mn, nom. | 37,322 | 38,893 | 42,269 | 45,264 | 48,000 | 50,600 | 53,100 | 55,800 |
| annual change in % (real) | 2.0 | 2.6 | 4.2 | 3.6 | 3.9 | 2.8 | 2.6 | 2.7 |
| GDP/capita (EUR at PPP) | 21,700 | 22,100 | 23,600 | 24,900 | 26,400 | . | . | . |
| Consumption of households, EUR mn, nom. | 23,250 | 24,430 | 26,174 | 27,891 | 29,400 | . | . | . |
| annual change in % (real) | 4.1 | 4.1 | 3.5 | 3.9 | 3.6 | 3.2 | 3.2 | 3.3 |
| Gross fixed capital form., EUR mn, nom. | 7,324 | 7,723 | 8,449 | 9,300 | 10,200 | . | . | . |
| annual change in % (real) | 4.9 | 3.4 | 8.2 | 8.4 | 7.5 | 7.0 | 5.0 | 4.2 |
| Gross industrial production (sales) | | | | | | | | |
| annual change in % (real) | 4.4 | 2.8 | 7.0 | 4.8 | 3.4 | 3.0 | 3.5 | 3.7 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | 8.6 | -1.7 | 2.6 | -10.0 | 6.6 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | -3.5 | -9.3 | 8.9 | 13.8 | 8.4 | . | . | . |
| Employed persons, LFS, th, average | 1,335 | 1,361 | 1,355 | 1,375 | 1,378 | 1,380 | 1,382 | 1,385 |
| annual change in % | 1.2 | 2.0 | -0.5 | 1.5 | 0.3 | 0.1 | 0.1 | 0.2 |
| Unemployed persons, LFS, th, average | 134 | 116 | 103 | 90 | 92 | 91 | 88 | 85 |
| Unemployment rate, LFS, in %, average | 9.1 | 7.9 | 7.1 | 6.2 | 6.3 | 6.2 | 6.0 | 5.8 |
| Reg. unemployment rate, in %, eop 2) | 9.0 | 8.5 | 8.7 | 8.9 | 8.7 | . | . | . |
| Average monthly gross wages, EUR 3) | 714.1 | 774.0 | 840.4 | 924.1 | 1,300.0 | 1,410 | 1,510 | 1,630 |
| annual change in % (real, gross) | 6.4 | 7.4 | 4.7 | 6.5 | 6.0 | 6.0 | 5.0 | 5.5 |
| Average monthly net wages, EUR 3) | 553.9 | 602.3 | 660.2 | 720.0 | 810.0 | 880 | 940 | 1,010 |
| annual change in % (real, net) | 6.1 | 7.7 | 5.7 | 6.0 | 10.0 | 6.0 | 4.5 | 5.0 |
| Consumer prices (HICP), % p.a. | -0.7 | 0.7 | 3.7 | 2.5 | 2.2 | 2.5 | 2.3 | 2.3 |
| Producer prices in industry, % p.a. | -9.7 | -4.4 | 5.1 | 5.6 | 0.0 | 0.0 | 1.0 | 1.0 |
| General goverm.budget, EU-def., % of GDP | | | | | | | | |
| Revenues | 34.8 | 34.4 | 33.6 | 34.6 | 35.0 | 35.5 | 34.8 | 34.8 |
| Expenditures | 35.1 | 34.2 | 33.2 | 34.0 | 34.9 | 35.2 | 34.6 | 34.5 |
| Net lending (+) / net borrowing (-) | -0.3 | 0.2 | 0.5 | 0.6 | 0.1 | 0.3 | 0.2 | 0.0 |
| General gov.gross debt, EU def., % of GDP | 42.7 | 39.9 | 39.3 | 34.1 | 36.0 | 35.0 | 33.5 | 32.0 |
| Stock of loans of non-fin.private sector, % p.a. | 4.1 | 7.1 | 4.5 | 6.0 | 3.0 | . | . | . |
| Non-performing loans (NPL), in %, eop | 5.5 | 3.8 | 3.1 | 2.4 | 2.0 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | -910 | -434 | 213 | 131 | 233 | 1,500 | 1,300 | 1,800 |
| Current account, % of GDP | -2.4 | -1.1 | 0.5 | 0.3 | 0.5 | 3.0 | 2.4 | 3.2 |
| Exports of goods, BOP, EUR mn | 19,655 | 19,470 | 22,763 | 24,552 | 26,065 | 27,300 | 28,400 | 29,800 |
| annual change in % | -4.4 | -0.9 | 16.9 | 7.9 | 6.2 | 4.7 | 4.0 | 4.9 |
| Imports of goods, BOP, EUR mn | 21,785 | 21,362 | 24,815 | 27,333 | 28,247 | 30,000 | 31,300 | 32,700 |
| annual change in % | 0.9 | -1.9 | 16.2 | 10.1 | 3.3 | 6.2 | 4.3 | 4.5 |
| Exports of services, BOP, EUR mn | 6,030 | 6,814 | 8,349 | 9,678 | 11,679 | 13,000 | 13,700 | 14,600 |
| annual change in % | 2.5 | 13.0 | 22.5 | 15.9 | 20.7 | 11.3 | 5.4 | 6.6 |
| Imports of services, BOP, EUR mn | 4,273 | 4,619 | 5,290 | 6,018 | 7,093 | 7,700 | 8,100 | 8,500 |
| annual change in % | 2.3 | 8.1 | 14.5 | 13.8 | 17.9 | 8.6 | 5.2 | 4.9 |
| FDI liabilities, EUR mn | 942 | 1,190 | 1,204 | 1,201 | 1,362 | 1,000 | . | . |
| FDI assets, EUR mn | 325 | 842 | 353 | 844 | 739 | 800 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 1,376 | 2,263 | 3,509 | 4,831 | 4,273 | . | . | . |
| Gross external debt, EUR mn | 28,674 | 33,515 | 35,448 | 35,533 | 33,600 | 34,400 | 34,500 | 34,600 |
| Gross external debt, % of GDP | 76.8 | 86.2 | 83.9 | 78.5 | 70.0 | 68.0 | 65.0 | 62.0 |

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

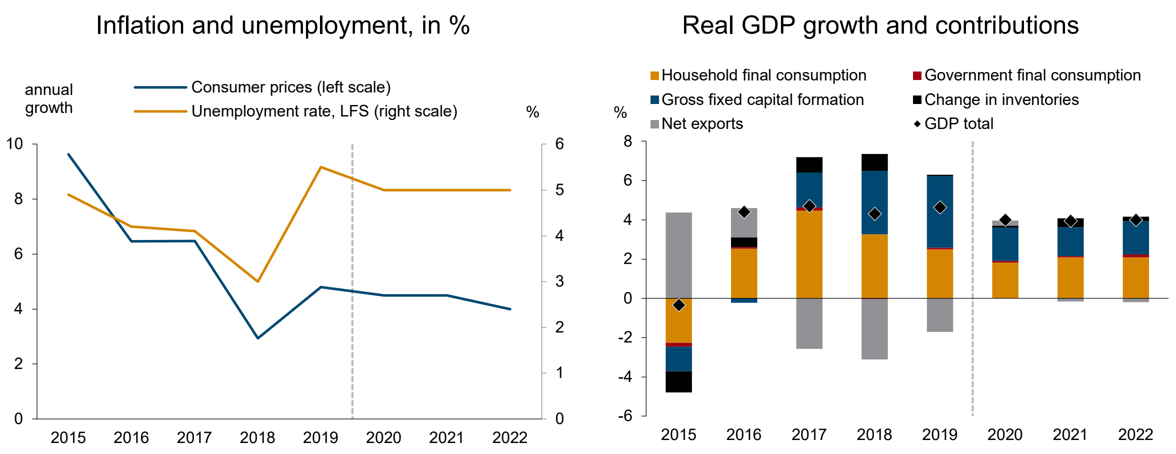
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# MOLDOVA: Solid growth amidst political consolidation

GÁBOR HUNYA

Economic growth accelerated to about 4.8% in 2019 on the back of booming investments and household consumption. In the wake of sluggish external demand and declining investment, growth is expected to hover at around 4% in the coming years. The resumption of transfers from the IMF and the EU has stabilised external financing.

**Figure 6.13 / Moldova: Main macroeconomic indicators**




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

**The economic cooled in the second half of 2019, resulting in annual GDP growth of about 4.6%.** Gross fixed capital formation was the main driver, with a rise of 15% over the previous year, thus contributing 3.6 percentage points to the economic growth. Investment outlays slowed in the second half of the year; public investment remained buoyant, but private investment became more sluggish. One third of private-sector investment went into machinery and equipment, which supported the restructuring of production and export expansion. Public investment went mainly into transport infrastructure projects.

**Household consumption made a positive contribution to growth in 2019 (2.5 percentage points), but this was less than in the previous year.** Net real wages rose by 7%, but are still the equivalent of only about EUR 300, on which score Moldova falls behind all the countries observed by wiiw. This is the main reason for emigration; the country also has the highest share of the population living and working abroad.

**The methodology for calculating population and employment data has been revised**: population data now cover only those who have lived in the country for at least nine of the previous 12 months. Accordingly, the country's population fell from 3.54 million to 2.70 million in 2018: the difference (amounting to almost a quarter) accounts for citizens living mostly abroad. The number of employed persons also fell in 2019, as those auxiliary agricultural workers producing for self-consumption only have been removed from the statistics. Thus, the participation rate of the population aged 15 years and over fell from 48.6% to 43.4% in the second quarter of 2019. The impact on the unemployment rate is also remarkable: it increased from 3% in 2018 to 5.5% in 2019.

**Industrial production slowed compared with the previous year (to 2%) – mainly on account of the extractive industry.** Manufacturing production grew by 3.1%, and the automotive industry registered the highest rate.

**Exports of goods expanded somewhat more than imports; but still, export revenues covered only about 38% of imports in 2019.** Two thirds of exports went to the EU (less than in the previous year) and 16% to the CIS (marginally more than in 2018). The share of other countries grew, mainly on account of Turkey. With 27% of the total, Romania is the single most important export destination, helped by its geographical and cultural proximity.

**Despite sluggish growth expected on foreign markets, export conditions will improve in 2020.** Duty-free food export quotas to the EU have been increased, and Russia has also eased its non-tariff barriers to agricultural products. Also, the upgrading of the commodity structure of exports offers some hope that the trade deficit may shrink in the future. Some foreign car suppliers that had invested in Romania have moved part of their production to Moldova, benefiting from lower labour costs.

**The current account deficit surpassed 10% of GDP in 2019.** External financing was provided by hidden transfers from emigrants, increasing amounts of FDI and concessionary loans by international institutions. The Moldovan leu appreciated against the euro for the third year in a row, regaining its value after the banking crisis. We expect a slow narrowing of the current account deficit and a moderate depreciation of the currency over the forecast period, provided no external or internal shocks occur.

**The government wants to run an expansionary fiscal policy to invest in infrastructure.** In 2019, the general budget had a deficit of 1.5% of GDP. Revenue collection improved and wages were paid on time. Public investment expanded by some 40%. But controversy surfaced with the IMF, which was pressing for a more balanced budget.

**The IMF mission that visited the country in February 2020 called the current three-year agreement 'broadly successful in achieving its objectives'.** Experts praised the comprehensive reforms, which rehabilitated the banking system and bolstered macro-financial stability. The improved banking system supported double-digit credit growth, which facilitated the investment boom, while public debt remained at below 30% of GDP. The current programme with the IMF expires in March of this year and the authorities in Moldova will seek a new one. At the same time, the government envisages joining the international financial markets to finance future fiscal deficits.

**After some toing and froing of political power between pro-EU and pro-Russian forces, the Russian orientation has gained the upper hand.** As a result, the country has received improved conditions for accessing the Russian market and advantageous terms of gas deliveries. More than 200 Moldovan companies have been granted concessions to export fruit and vegetables to Russia. The gas import contract with Gazprom has been extended. New pipelines will also allow future imports via Romania, thus avoiding Ukraine. At the same time, EU relations – including support for the reform programme – have not been disrupted. The EU delegation and high-level advisers are positive about the reform process, and the Moldovan government appreciates the EU's support. Rather unexpectedly, Moldova's economy proved immune to the unstable political situation through 2019. Fiscal policy was prudent and monetary policy acted as a shock absorber.

**The annual inflation rate has been on the rise, reaching 7.5% in December 2019 year on year; but it may decline to below 4% by the end of this year.** The national bank expected inflation to moderate back in December, when it cut the base rate to 5.5%, while leaving the deposit and lending facility in a symmetric corridor of ± 3 percentage points in relation to the base rate. This came as quite a surprise at the peak of inflation, following increases from 6.5% to 7% in mid-June, and to 7.5% in late September. The National Bank of Moldova seems to have adapted to the rising and falling political uncertainty during the year, thus keeping external financing flowing. The solid support for the current government has reduced risks in general, allowing for a rate cut even while inflation is still high.

**A fairly robust GDP growth rate of about 4% seems realistic for 2020 and beyond.** Investments – both foreign and domestic – will grow in order to increase productivity in a country with a declining population. But corruption, informality and the weak rule of law (as well as a large state-owned sector) place limits on productivity improvements and constitute a fiscal risk. Fiscal prudence, with a focus on investment, privatisation and reforms of the business environment, is expected to strengthen gradually. As it seeks to perform a balancing act between East and West, the current government may be successful and achieve lasting results. A political reversal, setbacks in external relations and external financial shocks are the main risks to our forecast. Foreign development partners seem committed to helping the government in its reform efforts and to mitigating possible external shocks.

## Table 6.13 / Moldova: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th pers., average 2) | 2,835 | 2,802 | 2,755 | 2,706 | 2,640 | 2,600 | 2,560 | 2,500 |
| Gross domestic product, MDL bn, nom. | 145.8 | 160.8 | 178.9 | 192.5 | 211.0 | 229 | 249 | 269 |
| annual change in % (real) | -0.3 | 4.4 | 4.7 | 4.3 | 4.6 | 4.0 | 4.0 | 4.0 |
| GDP/capita (EUR at PPP) | 5,700 | 5,800 | 6,200 | 6,700 | 7,500 | . | . | . |
| Consumption of households, MDL bn, nom. | 125.4 | 136.4 | 150.8 | 160.5 | 170.0 | . | . | . |
| annual change in % (real) | -2.5 | 2.9 | 5.3 | 3.9 | 3.0 | 2.2 | 2.5 | 2.5 |
| Gross fixed capital form., MDL bn, nom. | 35.4 | 35.7 | 39.9 | 46.8 | 55.0 | . | . | . |
| annual change in % (real) | -4.8 | -0.9 | 8.0 | 14.5 | 15.0 | 7.0 | 6.0 | 7.0 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | 0.6 | 0.9 | 3.4 | 3.7 | 2.0 | 1.0 | 2.0 | 3.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | -13.4 | 18.6 | 9.1 | 2.5 | -2.0 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | -12.7 | -8.1 | 3.6 | 10.3 | 12.0 | . | . | . |
| Employed persons, LFS, th, average 3) | 1,204 | 1,220 | 1,208 | 1,252 | 860 | 880 | 900 | 920 |
| annual change in % 3) | 1.6 | 1.3 | -1.0 | 3.7 | . | 2.0 | 2.0 | 2.0 |
| Unemployed persons, LFS, th, average 3) | 62.1 | 53.3 | 51.6 | 38.4 | 50.0 | 50.0 | 50.0 | 50.0 |
| Unemployment rate, LFS, in %, average | 4.9 | 4.2 | 4.1 | 3.0 | 5.5 | 5.0 | 5.0 | 5.0 |
| Reg. unemployment rate, in %, eop | 2.1 | 2.3 | 2.1 | 1.7 | 1.5 | . | . | . |
| Average monthly gross wages, MDL | 4,538 | 4,998 | 5,587 | 6,268 | 7,000 | 7,700 | 8,400 | 9,100 |
| annual change in % (real, gross) | 1.2 | 3.7 | 5.0 | 9.9 | 7.0 | 5.0 | 4.0 | 4.0 |
| Average monthly net wages, MDL | 3,752 | 4,103 | 4,564 | 5,142 | 5,800 | 6,400 | 7,000 | 7,600 |
| annual change in % (real, net) | 0.7 | 2.7 | 4.5 | 11.0 | 7.0 | 5.0 | 4.0 | 4.0 |
| Consumer prices, % p.a. | 9.6 | 6.5 | 6.5 | 2.9 | 4.8 | 4.5 | 4.5 | 4.0 |
| Producer prices in industry, % p.a. | 6.3 | 4.5 | 3.3 | 0.4 | 1.8 | 3.0 | 3.0 | 3.0 |
| General governm. budget, nat.def., % of GDP | | | | | | | | |
| Revenues | 30.0 | 28.6 | 29.8 | 30.1 | 29.8 | 30.0 | 30.0 | 30.0 |
| Expenditures | 31.8 | 30.1 | 30.5 | 31.0 | 31.3 | 31.0 | 32.0 | 32.0 |
| Deficit (-) / surplus (+) | -1.9 | -1.6 | -0.6 | -0.8 | -1.4 | -1.0 | -2.0 | -2.0 |
| General gov.gross debt, nat.def., % of GDP 4) | 23.3 | 31.8 | 29.1 | 27.2 | 26.3 | 25.2 | 25.2 | 25.3 |
| Stock of loans of non-fin.private sector, % p.a. | . | . | -3.3 | 6.0 | 13.9 | . | . | . |
| Non-performing loans (NPL), in %, eop 5) | 10.0 | 16.4 | 18.4 | 12.5 | 8.5 | . | . | . |
| Central bank policy rate, %, p.a., eop 6) | 19.50 | 9.00 | 6.50 | 6.50 | 5.50 | 5.00 | 4.50 | 4.00 |
| Current account, EUR mn 7) | -417 | -255 | -493 | -1026 | -1150 | -980 | -1,040 | -940 |
| Current account, % of GDP | -6.0 | -3.5 | -5.7 | -10.6 | -10.7 | -8.6 | -8.4 | -7.3 |
| Exports of goods, BOP, EUR mn 7) | 1,357 | 1,407 | 1,657 | 1,672 | 1,860 | 1,940 | 2,060 | 2,160 |
| annual change in % | -0.9 | 3.7 | 17.7 | 1.0 | 11.2 | 4.3 | 6.2 | 4.9 |
| Imports of goods, BOP, EUR mn 7) | 3,269 | 3,285 | 3,928 | 4,462 | 4,900 | 5,020 | 5,280 | 5,380 |
| annual change in % | -10.7 | 0.5 | 19.6 | 13.6 | 9.8 | 2.4 | 5.2 | 1.9 |
| Exports of services, BOP, EUR mn 7) | 884 | 964 | 1,113 | 1,250 | 1,400 | 1,480 | 1,600 | 1,670 |
| annual change in % | 2.7 | 9.0 | 15.5 | 12.3 | 12.0 | 5.7 | 8.1 | 4.4 |
| Imports of services, BOP, EUR mn 7) | 765 | 759 | 837 | 944 | 1,070 | 1,110 | 1,180 | 1,220 |
| annual change in % | 0.0 | -0.8 | 10.3 | 12.8 | 13.3 | 3.7 | 6.3 | 3.4 |
| FDI liabilities, EUR mn 7) | 203 | 80 | 137 | 264 | 490 | 450 | . | . |
| FDI assets, EUR mn 7) | 7 | 12 | 10 | 36 | 0 | 0 | . | . |
| Gross reserves of NB excl. gold, EUR mn 7) | 1,606 | 2,107 | 2,346 | 2,628 | 2,731 | . | . | . |
| Gross external debt, EUR mn 7) | 5,561 | 5,930 | 5,844 | 6,555 | 6,600 | 7,200 | 8,000 | 8,200 |
| Gross external debt, % of GDP | 79.7 | 81.3 | 68.0 | 67.6 | 63.0 | 63.0 | 64.0 | 64.0 |
| Average exchange rate MDL/EUR | 20.90 | 22.05 | 20.83 | 19.84 | 19.67 | 20.0 | 20.0 | 21.0 |

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

1) Preliminary and wiiw estimates. - 2) According to census May 2014, usual residence. - 3) From 2019 according to census May 2014 and further adjustments to international standards. Data not comparable with previous years. - 4) Excluding government guaranteed debt. - 5) Substandard, doubtful and loss credit portfolio. - 6) Overnight (refinancing) operations rate. - 7) Converted from USD.

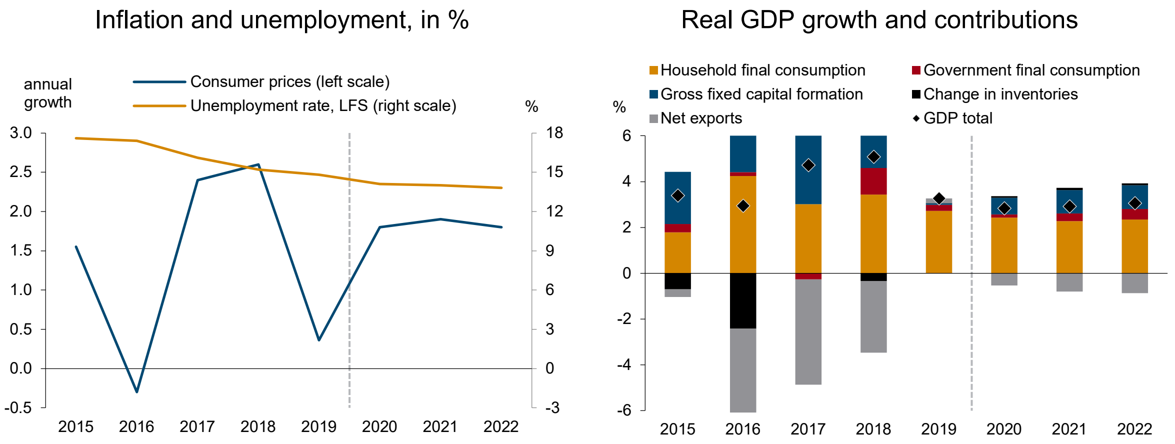
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# MONTENEGRO: Longing for European integration

BERND CHRISTOPH STRÖHM

Montenegro's economy continues to benefit from strong tourism, a rise in investments and an increase in industrial production. Economic growth will continue in 2020 at 3.3%, the same as in 2019. A fall in private and public consumption, however, will restrain growth in 2021-2022. Public debt remains the greatest medium-term risk to the economy, especially the huge investment in the Bar–Boljare motorway project. The country is still struggling with domestic problems: deindustrialisation, demographics, an inflated government apparatus and a still rigid labour market.

**Figure 6.14 / Montenegro: Main macroeconomic indicators**




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

**Constantly increasing investments and a rise in tourism will ensure Montenegro's stable growth in 2020; however, the country's growth potential will be dampened over the following two years.** In 2019, Montenegro's real GDP grew by 3.3%, and this will continue in 2020. Nevertheless, weak demographics, reduced investments and a slump in private and public consumption mean that growth will be constrained and is expected to decelerate in 2021 and 2022 to below 3%. The unemployment rate is steadily declining, but will remain high in 2020, at 14.3%. Average income will rise in 2020 and 2021 to a monthly average of EUR 800, but purchasing power remains low and private and household debt stays relatively high.

**The completion of several infrastructure projects will have an impact on Montenegro's growth.** The main reason why Montenegro was last year unable to maintain its growth rate for 2018 (which saw real GDP growth of 5.1%) is that several infrastructure projects that benefited Montenegro's growth in 2017 and 2018 had run their course. With the completion of the first section of the Bar–Boljare motorway in 2020, Montenegro will experience a further decline in investment growth, which is why GDP growth can be expected to slump to 2.9% by 2021. Other key factors that will contribute to this decrease include a tight fiscal policy and higher inflation. Consumption in 2020 will be dampened further by cutbacks in public administration and by the completion of the first section of the Bar–Boljare motorway, leading to a decrease in employment.

**Inflation will pick up again in 2020/2021.** Lower oil prices meant that inflation slumped dramatically from 2.6% in 2018 to 0.4% in 2019. But an increase in wages and strong tourism will cause inflation to pick up again to 1.4% in 2020. A rise in food and oil prices will further drive inflation to 1.6% in 2021.

**The political uncertainty is hindering potential growth.** In addition to external factors (such as a decrease in FDI), the risks to Montenegro's growth include increasing political uncertainty ahead of the 2020 parliamentary elections and the vulnerability of the country's banking sector, which in 2020 is still heavily influenced by foreign interests. This precarious situation makes the system very vulnerable to external shocks and disruptions on the global financial markets. The lack of diversification in the Montenegrin economy, which is heavily focused on its tourism sector, also limits the effects resulting from FDI, since modernisation of the former state large-scale industry is being largely neglected.

**Reforms aimed at the public sector will increase fiscal discipline.** The Montenegrin government's policies of public finance consolidation measures have influenced both the country's economic development and the reforms aimed at improving state administration, especially in the light of Montenegro's efforts to join the EU. Those measures were a response to the increase in Montenegro's public debt share, which rose from about 62% in 2015 to 78% of GDP in 2019, on account of additional investment in national infrastructure projects. Measures to reduce the country's public debt share include cutting wages, making public officials redundant and increasing VAT. The economic reform programme for the period 2018-2020 aims at further fiscal consolidation. However, it is unlikely that the initial aim of the reform programme – which sought to reduce public debt below 60% – will have been achieved by the end of 2020. Nevertheless, it may be expected that the general public finance strategy of the Montenegrin government will ensure a surplus in the period 2020-2022, with a decline in the share of public debt to about 62% of GDP in 2022.

**The composition of the current account deficit represents a risk to the Montenegrin balance of payments position.** Thanks to an increase in tourism and exports, the current account deficit is expected to narrow to an average of 15% p.a. in the period 2020-2024. However, the composition of the current account deficit and its financing represent a risk to the sustainability of the Montenegrin balance of payments position. This is particularly true for infrastructure projects such as the construction of the Bar–Boljare highway, which was largely financed by loans from the Chinese Exim Bank; Montenegro needs to start paying these back from 2021. The Exim Bank of China remains one of the largest creditors in Montenegro, with outstanding debt totalling EUR 652 million in 2019; the country's foreign debt amounts to almost 80% of GDP. Montenegro, which introduced the euro as its currency in 2002 without actually being part of the euro area, continues to be heavily dependent on foreign investments, exports and income from tourism (as well as remittances from its diaspora) to regulate its capital flows.

**Strong tourism and higher capacity in some industries will benefit exports.** Montenegro is expected to increase its exports of goods and services in 2020 by 4% – spurred by growing tourism. In addition, higher capacities in the tobacco, aluminium and pharmaceutical industries are likely to boost exports further in the period 2020-2022.

**The precarious political situation in Montenegro will remain tense in 2020, ahead of the upcoming parliamentary elections.** The political tension has been further heightened by the ruling Democratic Party of Socialists (DPS) arguing that the political opposition is unfit to govern. The DPS, which has dominated the political landscape of Montenegro for three decades, is again expected to emerge victorious in the 2020 parliamentary elections, according to polls carried out in 2019. The risk of anti-government protests remains high in 2020: towards the end of 2019, the government adopted a new law on religion, which may strip the Serbian Orthodox Church of hundreds of religious sites in the country. This new law will also create further disputes both with neighbouring Serbia and among Montenegrin parties in 2020.

**Corruption and a lack of press freedom remain stumbling blocks to proper EU accession in 2025.** Nevertheless, Montenegro is clearly oriented towards integration within the European Union. The disagreement within the European Union about opening accession talks with Albania and North Macedonia (caused by a French veto in 2019), is contributing to internal debate within Montenegro over the country's foreign policy, which has pursued the case for rapid EU accession ever since 2012. This lack of certainty has helped external actors to expand their spheres of influence – most notably Russia (which generally runs an 'anti-EU campaign' in the Western Balkans) and China. Montenegro's accession to NATO in 2017, which signalled a clear anti-Russian commitment by the country's government, is continuing to contribute towards internal division within Montenegrin society on account of the country's large ethnic Serbian community and a potent pro-Russian political opposition.

## Table 6.14 / Montenegro: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th pers., average | 622 | 622 | 622 | 622 | 625 | 625 | 630 | 630 |
| Gross domestic product, EUR mn, nom. | 3,655 | 3,954 | 4,299 | 4,663 | 4,800 | 5,000 | 5,200 | 5,400 |
| annual change in % (real) | 3.4 | 2.9 | 4.7 | 5.1 | 3.3 | 3.0 | 2.9 | 2.8 |
| GDP/capita (EUR at PPP) | 12,300 | 13,000 | 13,700 | 14,800 | 15,400 | . | . | . |
| Consumption of households, EUR mn, nom. 2) | 2,893 | 3,035 | 3,216 | 3,425 | 3,600 | . | . | . |
| annual change in % (real) | 2.2 | 5.4 | 3.9 | 4.6 | 3.7 | 3.2 | 3.0 | 3.0 |
| Gross fixed capital form., EUR mn, nom. | 736 | 978 | 1,157 | 1,364 | 1,400 | . | . | . |
| annual change in % (real) | 11.9 | 38.4 | 18.7 | 14.7 | 0.2 | 2.5 | 3.5 | 3.5 |
| Gross industrial production 3) | | | | | | | | |
| annual change in % (real) | 7.9 | -2.9 | -4.2 | 22.4 | -6.3 | 2.5 | 3.2 | 3.4 |
| Net agricultural production 4) | | | | | | | | |
| annual change in % (real) | 9.4 | -8.5 | -3.2 | 2.0 | 2.0 | . | . | . |
| Construction output 3) | | | | | | | | |
| annual change in % (real) | 5.8 | 31.5 | 51.5 | 24.9 | 18.5 | . | . | . |
| Employed persons, LFS, th, average | 221.7 | 224.2 | 229.3 | 237.4 | 246.0 | 248 | 249 | 250 |
| annual change in % | 2.5 | 1.1 | 2.3 | 3.5 | 3.6 | 1.0 | 0.4 | 0.5 |
| Unemployed persons, LFS, th, average | 47.2 | 48.3 | 43.9 | 42.5 | 40.0 | 40 | 40 | 40 |
| Unemployment rate, LFS, in %, average | 17.6 | 17.4 | 16.1 | 15.2 | 14.8 | 14.1 | 14.0 | 13.8 |
| Reg. unemployment rate, %, average | 16.5 | 19.4 | 21.7 | 18.7 | 15.2 | . | . | . |
| Average monthly gross wages, EUR | 725 | 751 | 765 | 766 | 773 | 790 | 810 | 830 |
| annual change in % (real, gross) | -1.1 | 3.5 | -1.1 | -2.6 | 0.6 | 1.0 | 0.2 | 0.2 |
| Average monthly net wages, EUR | 480 | 499 | 510 | 511 | 515 | 530 | 540 | 550 |
| annual change in % (real, net) | -0.9 | 4.2 | -0.2 | -2.3 | 0.4 | 1.0 | 0.2 | 0.2 |
| Consumer prices, % p.a. | 1.6 | -0.3 | 2.4 | 2.6 | 0.4 | 1.8 | 1.9 | 1.8 |
| Producer prices in industry, % p.a. 5) | 0.3 | -0.1 | 0.4 | 1.7 | 2.4 | 2.1 | 2.3 | 2.5 |
| General governm.budget, nat.def., % of GDP | | | | | | | | |
| Revenues | 41.8 | 42.6 | 41.5 | 42.3 | 43.0 | 42.8 | 42.0 | 41.0 |
| Expenditures | 50.0 | 46.2 | 46.8 | 45.2 | 45.3 | 42.3 | 40.6 | 40.5 |
| Deficit (-) / surplus (+) | -8.3 | -3.6 | -5.3 | -2.9 | -2.3 | 0.5 | 1.4 | 0.5 |
| General gov.gross debt, nat.def., % of GDP | 66.2 | 64.4 | 64.2 | 70.1 | 69.0 | 66.0 | 62.0 | 62.0 |
| Stock of loans of non-fin.private sector, % p.a. | 2.5 | 5.4 | 7.7 | 9.1 | 6.6 | . | . | . |
| Non-performing loans (NPL), in %, eop | 12.6 | 10.3 | 7.3 | 6.7 | 5.0 | . | . | . |
| Central bank policy rate, % p.a., eop 6) | 7.70 | 6.74 | 6.16 | 5.75 | 5.46 | 5.5 | 5.5 | 5.5 |
| Current account, EUR mn | -402 | -642 | -691 | -793 | -800 | -850 | -770 | -710 |
| Current account, % of GDP | -11.0 | -16.2 | -16.1 | -17.0 | -16.7 | -17.0 | -14.8 | -13.1 |
| Exports of goods, BOP, EUR mn | 330 | 351 | 382 | 436 | 460 | 520 | 570 | 630 |
| annual change in % | -7.6 | 6.2 | 9.0 | 14.0 | 5.6 | 14.0 | 10.5 | 10.0 |
| Imports of goods, BOP, EUR mn | 1,794 | 2,008 | 2,243 | 2,485 | 2,560 | 2,670 | 2,790 | 2,900 |
| annual change in % | 3.5 | 12.0 | 11.7 | 10.8 | 3.0 | 4.4 | 4.6 | 4.1 |
| Exports of services, BOP, EUR mn | 1,214 | 1,255 | 1,382 | 1,563 | 1,720 | 1,850 | 1,970 | 2,090 |
| annual change in % | 17.8 | 3.3 | 10.2 | 13.1 | 10.0 | 7.5 | 6.5 | 6.0 |
| Imports of services, BOP, EUR mn | 425 | 486 | 531 | 627 | 720 | 780 | 800 | 810 |
| annual change in % | 25.0 | 14.1 | 9.3 | 18.1 | 15.0 | 7.8 | 2.0 | 1.5 |
| FDI liabilities, EUR mn | 630 | 205 | 494 | 415 | 510 | 540 | . | . |
| FDI assets, EUR mn | 11 | -167 | 10 | 92 | 80 | 20 | . | . |
| Gross reserves of NB excl. gold, EUR mn 7) | 624 | 753 | 847 | 1,050 | 1,367 | . | . | . |
| Gross external public debt, EUR mn | 1,956 | 2,003 | 2,214 | 2,760 | 2,640 | 2,850 | 2,910 | 2,970 |
| Gross external public debt, % of GDP | 53.5 | 50.6 | 51.5 | 59.2 | 55.0 | 57.0 | 56.0 | 55.0 |

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

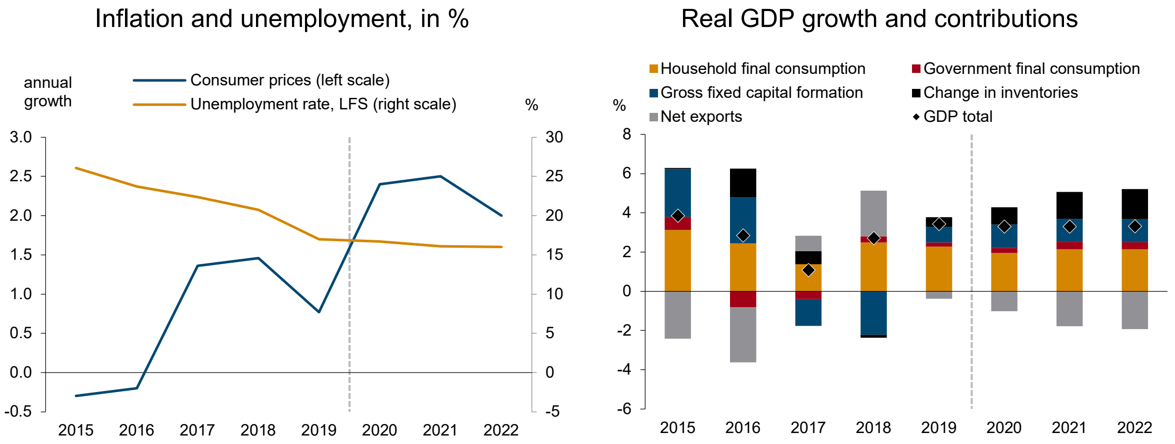
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# NORTH MACEDONIA: Lingering EU uncertainty inhibits potential growth

BERND CHRISTOPH STRÖHM

After a long period of stagnation and negative development, rising investments and a boost in consumption will ensure stable GDP growth for North Macedonia in the period 2020-2022 of about 3.3% p.a. The construction industry has started to expand and recorded solid growth rates in 2019. In addition, unemployment will fall to a historical low in 2020. Despite stable projections, North Macedonia still suffers from various socioeconomic issues. Moreover, the delay to the start of EU accession talks has dampened the country's growth potential.

**Figure 6.15 / North Macedonia: Main macroeconomic indicators**




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

**Despite political uncertainty, economic growth remains stable.** The positive trend in economic growth in the first half of 2019 was dampened by the failure to begin talks on EU accession, which created political uncertainty and deterred foreign investors. However, thanks to stimulation by private and government consumption, a stable GDP growth rate of about 3.3% p.a. is still expected in the period 2020-2022. The relaxation of the labour market, caused by a decrease in unemployment from 20.7% in 2018 to about 16.5% in 2020, as well as a growth in real wages, will likely boost private consumption to about 3.3% p.a. in the period 2020-2022. Private consumption and strong investments remain key factors that will drive growth in 2020.

**The government received substantial loans to launch several infrastructure projects.** China, in particular, is investing heavily in North Macedonia's infrastructure, as may be seen from the construction of the Kicevo–Ohrid motorway, which is valued at EUR 600 million and funded by the Chinese Exim Bank. The European Bank for Reconstruction and Development also provided loans of EUR 12 million to extend the Kriva Palanka–Deve Bair road. Those construction projects, which will be completed in 2021, will contribute to a stable investment growth of about 6% in 2020. It is expected that this trend will continue in the medium term, especially as FDIs will remain high in the period 2020-2022.

**As a consequence of falling global commodity prices, most notably oil prices, inflation remained at about 1.5% in 2019.** The expected slight (0.8%) rise in inflation on food prices, following an increase in energy prices, will not affect household consumption in 2020: it will continue to rise on account of an increase in minimum wages and falling unemployment. At the beginning of 2020, the central bank unsuccessfully reduced interest rates in order to bump inflation; however, investor enthusiasm – which is drawn to the denar's higher return on capital over the euro, combined with an appreciation of the denar against the dollar – will still result in a low inflation rate of 1% in 2020. Inflation will pick up, but lower energy prices mean it will remain low, at an average of 2% p.a. in the period 2021-2022.

**North Macedonia's productive capacity is heavily dependent on foreign investment in its industrial zones.** Germany remains the country's most important trading partner, since German investors within the automotive supply sector export their goods to Germany for further processing. However, the positive development of foreign trade depends heavily on the development of the German economy, especially in view of North Macedonia's strong connection to its automotive industry; this could become a challenge in the future. A surplus in the secondary income account, which is still influenced by remittances from workers in the diaspora, means that North Macedonia's current account deficit can be expected to increase only moderately, to about 2% of GDP annually in the period 2020-2022. In 2019, remittances totalled about EUR 295 million. Although this corresponds to 2.5% of North Macedonia's GDP, it is still relatively low in comparison to other countries in the Western Balkans.

**Regulating public debt remains an issue for North Macedonia.** Constant changes in the country's fiscal policy caused North Macedonia's public debt to rise from 21% of GDP in 2008 to 48.5% in 2018. In 2019, expenditure on pension and social transfer payments rose to 60% of the budget, while public debt amounted to 40% of GDP. The increase in public-sector wages further contributed to high government expenditure in 2019. As of 2020, North Macedonia is still struggling to regulate its public debt, which is why the government is aiming for a budget deficit of 2.3%, focusing investments on human capital. This moderate reduction in the deficit from the 2019 figure will contribute marginally to stabilisation of North Macedonia's public debt in the period 2020-2022. Recent policy measures – which saw profound reform of the country's pension system in 2019 – are also contributing to North Macedonia's fiscal discipline. In 2020, North Macedonia's budget deficit will still widen to 2.5%, since the government is aiming to increase pensions to keep pace with wage growth. However, an improvement in tax collection and reduced borrowing following the completion of several investment projects mean that the budget deficit can be expected to shrink by 2022 to about 2.2%. Fiscal projections, however, remain uncertain over the long term, due to the possible risk of an increase in public-sector wages.

**North Macedonia's legal framework continues to be favourable to foreign investors, with a ten-year tax exemption and free access to public services.** Labour costs remain low, despite an increase in real wages, since the government has provided favourable investment conditions for businesses, with the introduction of technological and industrial development zones. Labour – particularly in the prominent automotive sector – remains cost-competitive. Due to the increased 'brain drain' from the country, the shortage of skilled labour will continue to be a problem in the long term. Looking at North Macedonia's labour market, it is clear that, despite high levels of unemployment, there is a lack of skilled, technically trained workers. Emigration from North Macedonia became a viable option for many skilled workers following the easing of restrictions on the immigration of skilled workers to the EU. This applies particularly to Germany and Austria: as of 1 January 2020, qualified workers from non-EU countries have been able to apply for 56 different occupations in Austria. In March 2020, Germany will likely follow suit with a similar regulation.

**Political uncertainty has risen because of EU uncertainty.** North Macedonia has been a candidate for EU membership since 2005. But its name dispute with Greece, combined with staggering corruption and organised crime, has blocked the commencement of EU accession talks for 15 years. Under Prime Minister Zaev, however, North Macedonia resolved its name dispute and introduced reforms in the areas of administration, justice and security, in order to properly tackle corruption and organised crime. The failure to open EU accession talks in 2019, despite all these efforts by North Macedonia, has sparked an early election, to be held in April 2020. With the announcement of the snap election and the resignation of Zaev as prime minister, policy uncertainty will rise, leading to adverse effects on private and public investments in 2020. The European Council will once again consider opening accession talks in May 2020. It is likely that a further postponement of EU accession talks could weaken the momentum of public reforms in North Macedonia and damage investor confidence.

**The cancellation of the EU accession talks triggered a serious government crisis in the country.** In the forthcoming election, the right-wing VMRO-DPMNE, under the leadership of Hristijan Mickoski, could benefit from this political crisis, since it has consistently criticised the pro-European stance of the SDSM-led government. Opinion polls conducted in November 2019 showed that 22.1% of respondents opted for the Social Democrats (i.e. the SDSM), while 20.4% chose the VMRO-DPMNE. With such a narrow margin in the opinion polls, it could again be up to the ethnic Albanian party DUI to assume the role of king-maker in the formation of a new government. The SDSM, with former Prime Minister Zaev, continues to present itself as the guarantor of North Macedonia’s western integration, particularly within the European Union – a stance the Social Democrats will maintain after the election. However, the cancellation of the EU accession talks, combined with allegations of corruption levelled by the VMRO-DPMNE, means that the SDSM has lost the trust of the general populace – and that is likely to influence electoral behaviour in April 2020. Those allegations and the cancellation of the EU accession talks additionally make it more difficult for Zaev to enforce pro-EU policies and reforms, even in the case of victory.

**The Prespa Agreement remains controversial among North Macedonia’s populace.** In 2019, with ratification of the Prespa Agreement, the country’s long-running dispute with Greece was finally resolved and it officially became known as North Macedonia. In return, Greece stopped blocking North Macedonia’s accession to the EU. The VMRO-DPMNE’s critical stance towards the Prespa Agreement remains a potent ingredient in the mix: the party’s announcement that – should it gain a two-thirds majority in the forthcoming election (which seems unlikely) – it will revise the Agreement helps to bolster its popularity among EU sceptics. Nevertheless, the repercussions of such a step would be severe for North Macedonia’s western integration, as the Prespa Agreement is linked to possible EU membership. The Prespa Agreement itself continues to stir up controversy in North Macedonia. During the national referendum on the subject in 2018, 98% of those who voted approved the agreement, but overall voter turnout was only 36%. Furthermore, the ‘amnesty deal’ introduced by the Social Democrats in 2018 to gain support for ratification of the Prespa Agreement, is also perceived rather negatively by the populace, since it excuses several VMRO-DPMNE MPs over their (indirect) participation in the assault on parliament in April 2017 (which was actually staged to prevent the Social Democrats from assuming power).

## Table 6.15 / North Macedonia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 Forecast | 2022 |
|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 2,070 | 2,072 | 2,075 | 2,076 | 2,100 | 2,100 | 2,100 | 2,100 |
| Gross domestic product, MKD bn, nom. | 559.0 | 594.8 | 618.1 | 658.1 | 686.0 | 726 | 769 | 810 |
| annual change in % (real) | 3.9 | 2.8 | 1.1 | 2.7 | 3.4 | 3.3 | 3.3 | 3.3 |
| GDP/capita (EUR at PPP) | 10,400 | 10,800 | 10,900 | 11,500 | 12,000 | . | . | . |
| Consumption of households, MKD bn, nom. | 380.2 | 392.2 | 405.9 | 427.3 | 450.0 | . | . | . |
| annual change in % (real) | 4.5 | 3.6 | 2.1 | 3.8 | 3.5 | 3.0 | 3.3 | 3.3 |
| Gross fixed capital form., MKD bn, nom. | 133.3 | 145.0 | 139.0 | 130.2 | 140.0 | . | . | . |
| annual change in % (real) | 10.5 | 9.9 | -5.7 | -9.9 | 4.0 | 6.0 | 6.0 | 6.0 |
| Gross industrial production 2) | | | | | | | | |
| annual change in % (real) | 4.9 | 3.4 | 0.2 | 5.4 | 3.7 | 4.5 | 6.0 | 6.0 |
| Gross agricultural production 3) | | | | | | | | |
| annual change in % (real) | 5.2 | 5.2 | -9.9 | 5.0 | 4.0 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | 40.7 | 7.2 | -27.2 | -6.8 | 3.1 | . | . | . |
| Employed persons, LFS, th, average | 706.0 | 723.6 | 740.6 | 759.1 | 795.0 | 810 | 820 | 830 |
| annual change in % | 2.3 | 2.5 | 2.4 | 2.5 | 5.0 | 1.5 | 1.5 | 1.5 |
| Unemployed persons, LFS, th, average | 248.9 | 225.0 | 213.6 | 198.6 | 170.0 | 160 | 160 | 160 |
| Unemployment rate, LFS, in %, average | 26.1 | 23.7 | 22.4 | 20.7 | 17.0 | 16.7 | 16.1 | 16.0 |
| Reg. unemployment rate, in %, eop | 22.1 | 21.2 | 20.1 | 19.3 | 19.8 | . | . | . |
| Average monthly gross wages, MKD | 32,171 | 32,821 | 33,688 | 35,626 | 37,300 | 39,000 | 40,800 | 42,400 |
| annual change in % (real, gross) | 3.0 | 2.2 | 1.2 | 4.2 | 4.0 | 2.0 | 2.0 | 2.0 |
| Average monthly net wages, MKD | 21,904 | 22,342 | 22,928 | 24,276 | 25,100 | 26,200 | 27,400 | 28,500 |
| annual change in % (real, net) | 2.7 | 2.2 | 1.2 | 4.4 | 2.8 | 2.0 | 2.0 | 2.0 |
| Consumer prices, % p.a. | -0.3 | -0.2 | 1.4 | 1.5 | 0.8 | 2.4 | 2.5 | 2.0 |
| Producer prices in industry, % p.a. | -3.9 | -3.1 | 4.8 | 0.9 | 2.1 | 3.0 | 3.0 | 3.0 |
| General governm. budget, nat.def., % of GDP | | | | | | | | |
| Revenues | 31.0 | 30.6 | 31.0 | 30.5 | 29.0 | 32.0 | 32.0 | 32.0 |
| Expenditures | 34.4 | 33.2 | 33.8 | 31.6 | 30.8 | 33.0 | 33.0 | 33.0 |
| Deficit (-) / surplus (+) | -3.4 | -2.7 | -2.8 | -1.1 | -1.8 | -1.0 | -1.0 | -1.0 |
| General gov.gross debt, nat.def., % of GDP | 46.6 | 48.7 | 47.6 | 48.6 | 47.0 | 46.0 | 46.0 | 45.0 |
| Stock of loans of non-fin.private sector, % p.a. | 9.6 | -0.1 | 5.4 | 7.2 | 6.1 | . | . | . |
| Non-performing loans (NPL), in %, eop 4) | 10.4 | 6.4 | 6.2 | 5.1 | 4.6 | . | . | . |
| Central bank policy rate, %, p.a., eop 5) | 3.25 | 3.75 | 3.25 | 2.50 | 2.25 | 2.25 | 2.50 | 2.75 |
| Current account, EUR mn | -177 | -275 | -105 | -15 | -80 | -80 | -120 | -180 |
| Current account, % of GDP | -2.0 | -2.9 | -1.0 | -0.1 | -0.7 | -0.7 | -1.0 | -1.4 |
| Exports of goods, BOP, EUR mn | 3,047 | 3,529 | 4,075 | 4,881 | 5,515 | 5,810 | 6,090 | 6,370 |
| annual change in % | 9.4 | 15.8 | 15.4 | 19.8 | 13.0 | 5.2 | 4.8 | 4.6 |
| Imports of goods, BOP, EUR mn | 4,870 | 5,342 | 5,862 | 6,616 | 7,410 | 7,770 | 8,170 | 8,590 |
| annual change in % | 5.0 | 9.7 | 9.7 | 12.9 | 12.0 | 4.9 | 5.1 | 5.1 |
| Exports of services, BOP, EUR mn | 1,378 | 1,390 | 1,434 | 1,571 | 1,650 | 1,720 | 1,810 | 1,900 |
| annual change in % | 5.7 | 0.9 | 3.2 | 9.5 | 5.0 | 4.0 | 5.0 | 5.0 |
| Imports of services, BOP, EUR mn | 1,029 | 1,049 | 1,060 | 1,209 | 1,318 | 1,350 | 1,390 | 1,430 |
| annual change in % | 11.8 | 2.0 | 1.0 | 14.1 | 9.0 | 2.0 | 3.0 | 3.0 |
| FDI liabilities, EUR mn | 262 | 495 | 351 | 539 | 500 | 500 | . | . |
| FDI assets, EUR mn | 59 | 179 | 171 | -65 | 380 | 100 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 2,049 | 2,370 | 2,097 | 2,619 | 2,961 | . | . | . |
| Gross external debt, EUR mn | 6,291 | 7,217 | 7,372 | 7,844 | 8,300 | 9,200 | 9,300 | 9,500 |
| Gross external debt, % of GDP | 69.3 | 74.7 | 73.4 | 73.3 | 77.5 | 77.5 | 74.4 | 72.3 |
| Average exchange rate MKD/EUR | 61.61 | 61.60 | 61.57 | 61.51 | 61.50 | 61.4 | 61.4 | 61.7 |

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

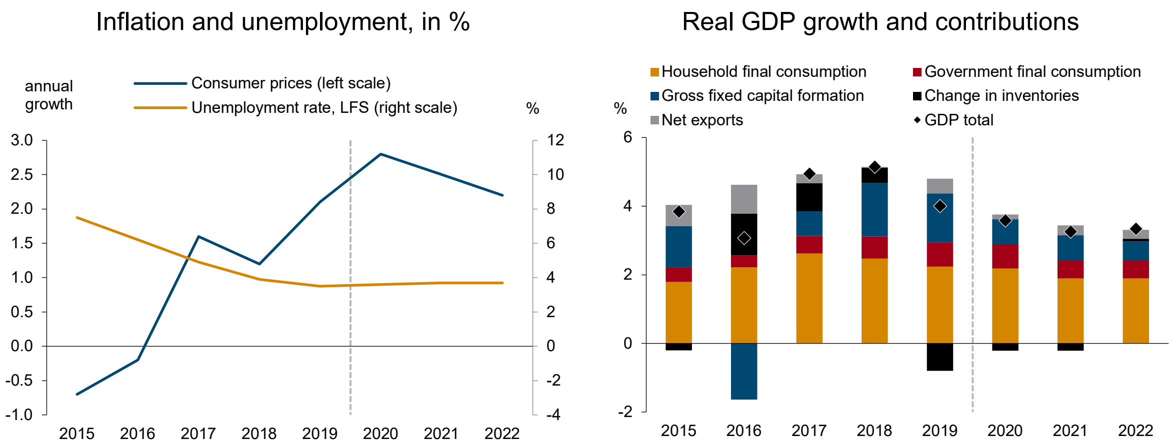
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# POLAND: Soft landing

LEON PODKAMINER

Economic growth has been losing momentum as industry starts to underperform. Household consumption is driven by sharply rising wages and social transfers. Labour shortages are becoming less acute, while moderate inflation is back, driven by a supply-side shock to agriculture. The next government may feel obliged to discontinue the country's lavish social policies.

**Figure 6.16 / Poland: Main macroeconomic indicators**




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

**Economic growth slowed** from 4.7% in the first half of 2019 to less than 3.5% in the second. Growth of private consumption was steady across the first three quarters of the year, at about 4%, but slowed down in the fourth. Gross fixed capital formation increased at double-digit rates in the first half of the year, but then its growth sagged to less than 5%. Throughout the year, inventories contracted very rapidly, resulting in additional losses to output growth. With a positive (and rising) balance of trade in goods and non-factor services, foreign trade contributed positively to the overall growth in output throughout the year (provisionally put at 4%).

**German economic stagnation is starting to affect the foreign trade aggregates.** According to provisional customs statistics, exports of goods rose by 5.5% in 2019 (in euro terms), while imports increased by 2.6%. Exports to Germany grew less (3.1%), while imports from there fell by 1.1%: the underperforming exports indicate weak German demand, while the faltering imports may represent a declining supply of intermediate inputs for goods to be finally assembled locally and then re-exported. As such, the falling imports from Germany may augur a decline in the value of (re)exports in 2020. Of course, Germany remains Poland's largest trading partner by far. Even if what happens in Germany is less important to Poland than it is to Slovakia or the Czech Republic, Poland cannot completely avoid the impacts of German stagnation. Trade with the UK brings quite large surpluses. But these may well diminish (or even vanish) once Brexit ‘is done’. All in all, foreign trade currently remains a risky business for Poland, even though for several years it has contributed positively to GDP growth.

**Industrial output growth is losing momentum.** The initially quite strong growth in industrial sales weakened progressively throughout 2019: in the first quarter, industrial sales were up 6.1%, but in the fourth the figure was 3.8%. The slowdown in manufacturing was even more pronounced: from 6.4% to 2.3%. The automotive sector started the year with a 6.3% boost to sales in the first quarter, but ended it with a 1% fall in the fourth quarter. In terms of output, those industries that manufacture capital and intermediate goods performed less dynamically than those supplying consumer goods. In 2018, the overall much faster growth in aggregate industrial output was driven primarily by expanding sales of capital and intermediate goods. Capacity utilisation in the manufacturing sector declined in 2019, while labour shortages seem to have become less of a problem. Overall, the manufacturing sector seems capable of resuming faster growth. That growth is slackening must reflect mounting uncertainty – not only as concerns the prospects for demand, but also surrounding the changing legal and tax regulations.

**Labour shortages are becoming less acute.** The number of recorded vacancies has dropped off very sharply, reflecting also the weakening growth in output and steadily increasing labour productivity.[37]

**Growth of output in the construction and assembly sector has slowed dramatically**, from close to 20% in 2018 to just 2.6% in 2019. In the first quarter of 2019, it rose by over 9%, but in the last quarter it saw a decline. The ongoing weakening of the sector’s activities affects both the construction of buildings (housing and industrial structures alike) and civil engineering works. During the first three quarters of 2019, investment outlays in the form of construction and structures increased by 18% (nominally), while outlays in the shape of machinery and technical equipment rose by 12%. Investment outlays in manufacturing increased by 14%. In real terms, the gross fixed investment in manufacturing must have contracted in 2019. On the other hand, in the first three quarters of 2019 the ‘land and pipeline transportation’ and ‘electricity and water supply’ sectors recorded very high rates of growth in total investment outlays – over 40% and 28%, respectively (in nominal terms). But those sectors with particularly high growth in investment outlays are infrastructural in character, and are run predominantly by the public authorities (and co-financed by EU funds).

**The volume of capital formation in the market-oriented private sector (and its small and medium-sized segment, in particular) has stagnated.**[38] This has obvious implications for future productive capacities. Moreover, investment propelled disproportionately by public spending may find itself constrained by budgetary considerations.

**Household consumption is driven by rising wages and social transfers.** Nominally, the average wage in the enterprise sector rose by 6.5% in 2019, and average pension by 4.7% (in real terms, 4.1% and 1.3%, respectively). Growth of the average real wage slowed throughout the year, primarily because of rising living costs.

[37] The registered unemployment rates vary considerably across regions. The low level of internal labour mobility exacerbates the labour shortages felt in the fast-growing regions, while leaving low-growth areas stuck with high unemployment. The problem is primarily to do with the poor supply of affordable housing in the fast-growth regions and inadequate public transportation.

[38] The share of foreign-owned firms in the total investment outlays (of the non-financial business sector) fell to about 40% in the first half of 2019 (from 44% a year earlier).

**The household sector has been receiving large cash transfers** that target families with children and old-age pensioners. This has supported private consumption and overall growth. Growth in household income and consumption is likely to continue in the near future, though at a more modest rate than before. The return of higher inflation and/or unemployment could erode the real value of the household sector's disposable income, while the re-emerging budgetary bottlenecks may make it harder to continue with the generous social spending.

**Moderate inflation is back.** Consumer price inflation (2.3%) emerged in 2019 because of a substantial growth in retail food prices (4.7%). The higher retail food prices followed a 3.4% decline in (gross) agricultural output, attributed to bad weather conditions (severe droughts) in the first half of the year. Consequently, the price of agricultural products rose by over 15% in 2019. On the other hand, the producer price indexes for manufacturing and most services are low and are even falling. Wages, which are rising faster than labour productivity, have been eroding the profits of the business sector. So far, this has had little effect on the prices charged by producers, but this situation is unlikely to persist. After some delay, suppliers may start demanding higher prices to compensate for higher unit labour costs. In addition, inflation may not slow in 2020 if the government imposes steep hikes in energy prices (as it has already signalled that it will).

**Monetary policy remains dovish**: the National Bank of Poland does not see any point in pre-empting inflation (and thus possibly damaging investment/consumption growth) with more restrictive policy. Quite fortunately, the exchange rate has been remarkably stable recently (possibly because of loose ECB policy). Indebtedness levels remain low and the share of non-performing loans is still small.

**The government has continued to shower the population with cash transfers of various sorts.** These are greatly appreciated, especially by those on lower incomes and with lower skills, including minimum-wage earners. The conservative-liberal opposition is trying to outdo the ruling party, with its own version of populistic promises. These tactics may prove rather unsuccessful. However, after the presidential elections (May 2020), the government may feel obliged to rein in its lavish social spending. If the government persists in its controversial 'reform' of the judicial system, the EU funds received by Poland may well be trimmed. However, both the extent and the timing of possible punitive measures remain very uncertain at present.

## Table 6.16 / Poland: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 Forecast | 2022 |
|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 38,458 | 38,435 | 38,434 | 38,423 | 38,400 | 383,385 | 38,380 | 38,380 |
| Gross domestic product, PLN bn, nom. | 1,800 | 1,861 | 1,989 | 2,115 | 2,240 | 2,390 | 2,520 | 2,660 |
| annual change in % (real) | 3.8 | 3.1 | 4.9 | 5.1 | 4.0 | 3.6 | 3.3 | 3.3 |
| GDP/capita (EUR at PPP) | 19,900 | 20,000 | 20,800 | 21,800 | 22,900 | . | . | . |
| Consumption of households, PLN bn, nom. | 1,038 | 1,074 | 1,145 | 1,213 | 1,280 | . | . | . |
| annual change in % (real) | 3.0 | 3.9 | 4.5 | 4.3 | 3.9 | 3.8 | 3.3 | 3.3 |
| Gross fixed capital form., PLN bn, nom. | 361 | 335 | 349 | 386 | 420 | . | . | . |
| annual change in % (real) | 6.1 | -8.2 | 4.0 | 8.9 | 7.8 | 4.0 | 4.0 | 3.0 |
| Gross industrial production (sales) 2) | | | | | | | | |
| annual change in % (real) | 4.8 | 2.8 | 6.6 | 5.9 | 4.1 | 3.5 | 3.9 | 3.8 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | -2.9 | 8.4 | 2.9 | -0.7 | -0.3 | . | . | . |
| Construction industry 3) | | | | | | | | |
| annual change in % (real) | 0.3 | -14.5 | 13.7 | 19.7 | 3.6 | . | . | . |
| Employed persons, LFS, th, average | 16,084 | 16,197 | 16,423 | 16,484 | 16,480 | 16,460 | 16,430 | 16,400 |
| annual change in % | 1.4 | 0.7 | 1.4 | 0.4 | 0.0 | -0.1 | -0.2 | -0.2 |
| Unemployed persons, LFS, th, average | 1,304 | 1,063 | 844 | 659 | 600 | 610 | 630 | 630 |
| Unemployment rate, LFS, in %, average | 7.5 | 6.2 | 4.9 | 3.9 | 3.5 | 3.6 | 3.7 | 3.7 |
| Reg. unemployment rate, in %, eop | 9.7 | 8.3 | 6.6 | 5.8 | 5.2 | . | . | . |
| Average monthly gross wages, PLN 3) | 3,908 | 4,052 | 4,284 | 4,590 | 4,930 | 5,250 | 5,570 | 5,860 |
| annual change in % (real, gross) 3) | 4.5 | 4.2 | 3.5 | 5.5 | 5.0 | 3.5 | 3.5 | 3.0 |
| Consumer prices (HICP), % p.a. | -0.7 | -0.2 | 1.6 | 1.2 | 2.1 | 2.8 | 2.5 | 2.2 |
| Producer prices in industry, % p.a. | -2.2 | -0.3 | 2.7 | 2.1 | 1.3 | 2.0 | 1.8 | 1.8 |
| General governm.budget, EU-def., % of GDP | | | | | | | | |
| Revenues | 39.1 | 38.7 | 39.8 | 41.4 | 41.0 | 40.5 | 40.5 | 40.5 |
| Expenditures | 41.7 | 41.1 | 41.2 | 41.6 | 42.2 | 43.0 | 43.0 | 43.0 |
| Net lending (+) / net borrowing (-) | -2.6 | -2.4 | -1.5 | -0.2 | -1.2 | -2.5 | -2.5 | -2.5 |
| General gov.gross debt, EU def., % of GDP | 51.3 | 54.2 | 50.6 | 48.9 | 47.0 | 47.1 | 47.2 | 47.4 |
| Stock of loans of non-fin.private sector, % p.a. | 7.1 | 5.3 | 3.1 | 7.1 | 4.7 | . | . | . |
| Non-performing loans (NPL), in %, eop | 7.5 | 7.1 | 6.8 | 6.8 | 6.4 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.75 | 1.50 | 1.50 |
| Current account, EUR mn 5) | -2,379 | -2,234 | 285 | -5,048 | 5,902 | 1,000 | 2,500 | 3,800 |
| Current account, % of GDP 5) | -0.6 | -0.5 | 0.1 | -1.0 | 1.1 | 0.2 | 0.4 | 0.6 |
| Exports of goods, BOP, EUR mn 5) | 172,150 | 177,412 | 201,963 | 216,924 | 229,854 | 243,100 | 257,100 | 271,900 |
| annual change in % | 8.5 | 3.1 | 13.8 | 7.4 | 6.0 | 5.8 | 5.8 | 5.8 |
| Imports of goods, BOP, EUR mn 5) | 169,937 | 174,479 | 200,536 | 221,707 | 227,399 | 241,000 | 255,500 | 271,300 |
| annual change in % | 5.0 | 2.7 | 14.9 | 10.6 | 2.6 | 6.0 | 6.0 | 6.2 |
| Exports of services, BOP, EUR mn 5) | 40,663 | 44,929 | 51,884 | 58,772 | 64,419 | 69,400 | 75,000 | 81,000 |
| annual change in % | 10.7 | 10.5 | 15.5 | 13.3 | 9.6 | 7.8 | 8.0 | 8.0 |
| Imports of services, BOP, EUR mn 5) | 29,749 | 30,963 | 33,927 | 37,116 | 40,078 | 42,500 | 45,100 | 47,800 |
| annual change in % | 7.5 | 4.1 | 9.6 | 9.4 | 8.0 | 6.0 | 6.0 | 6.0 |
| FDI liabilities, EUR mn 5) | 13,534 | 16,628 | 10,182 | 14,022 | 8,967 | 13,600 | . | . |
| FDI assets, EUR mn 5) | 4,385 | 12,807 | 3,430 | 1,593 | 3,405 | 3,000 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 83,676 | 104,440 | 90,967 | 97,633 | 104,526 | . | . | . |
| Gross external debt, EUR mn 5) | 303,120 | 321,304 | 319,716 | 314,642 | 314,100 | 316,800 | 322,300 | 327,900 |
| Gross external debt, % of GDP 5) | 70.5 | 75.3 | 68.4 | 63.4 | 60.3 | 57.0 | 55.0 | 53.0 |
| Average exchange rate PLN/EUR | 4.1841 | 4.3632 | 4.2570 | 4.2615 | 4.2976 | 4.30 | 4.30 | 4.30 |

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

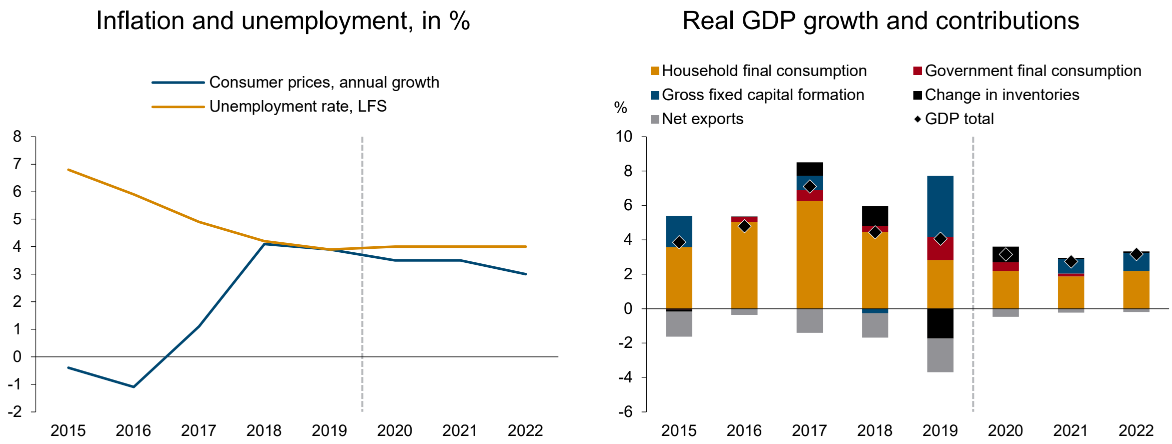
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# ROMANIA: Slowdown and twin deficits

GÁBOR HUNYA

The Romanian economy is emerging from a period of overheating and has to tackle high fiscal and current account deficits. Economic growth will cool from 4.1% in 2019 to 3.2% in 2020, and then 2.8% in 2021. Abundant financial inflows will allow a slow reduction of the twin deficits, but with increased vulnerability to financial turbulence. Political instability is expected to continue until general elections, expected to take place in mid-2020, ahead of schedule.

**Figure 6.17 / Romania: Main macroeconomic indicators**




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

**Three consecutive years of economic overheating in Romania came to an end in 2019.** During the period 2017-2019, the country's GDP grew by 16%; real net wages by as much as 35%; and investments by a more modest 20%. GDP growth was driven by public consumption and household demand; gross fixed capital formation became buoyant only in 2019, while foreign trade had a negative impact on growth. The economy received a fiscal stimulus in 2019 in the shape of increased public-sector wages and investments. These raised the general budget's cash deficit to 4.6% of GDP, while government consumption grew by some 8%. Household consumption expanded much less in 2019 than in previous years, but rapidly rising wages meant that the figure was still 4.5%. Gross fixed capital formation grew by some 17% and was the main driver of economic growth last year. Investment projects that had contributed to expanding inventories the previous year were completed in 2019. Booming domestic demand generated a growth in imports that far outstripped export growth, so that the current account deficit widened to almost 5% of GDP.

**The economy started to cool down in the middle of 2019.** Both industry and agriculture recorded negative growth in the last two quarters, while construction and services remained buoyant. The expansion of exports slowed, but the same was not true of imports. Household consumption moderated only a little, as wages and consumer credit kept growing. Wage rises in early 2020 were moderate, and thus consumption is expected to ease in the course of the year.

**Industrial production contracted in 2019 and may stay flat in 2020, if external demand remains weak.** Manufacturing production and employment peaked in February/March 2019 and have declined since then. Those industrial branches with declining production were mainly the light industries, such as textiles and leather (which could not cope with the increasing wage demands of workers) and metal production (which was hit by international oversupply). The automotive industry could still expand its production on the basis of improved labour productivity. Agricultural production fell in 2019: in particular the autumn harvest was low, after three years of increased yields.

**Companies are complaining less about labour shortages at the beginning of 2020 than a year earlier.** Employment and unemployment rates have stabilised, and the vacancy rate has declined in line with the contraction of production in several industrial activities. But labour demand in construction is still high and the general concern of companies to find qualified workforce has remained.

**The government took action in 2019 to moderate labour shortages in the short term by encouraging foreign workers.** At the beginning of the year, it increased the number of work permits issued to non-EU citizens from 10,000 in 2018 to 20,000. After a further increase to 30,000 (also the current limit for 2020), 29,681 non-EU citizens held a work permit in November 2019. Although this number was only 0.035% of the labour force, it accounted for about 30% of job vacancies. The largest numbers of workers came from China, Turkey, the Philippines and Vietnam to work mainly in construction and catering. Since the beginning of 2019, employers have been obliged to pay them at least the average wage, rather than the minimum wage (as earlier). Thus, Romania has become a more attractive destination for temporary migration from less well-to-do economies. Emigration does not seem to have declined, despite higher incomes and better job opportunities: the wage gap between Romania and the advanced EU countries is still sufficiently wide.

**Setting the minimum wage higher and higher was the main wage-policy tool of the former socialist (PSD) government, alongside public-sector wage hikes in 2018 and 2019.** In 2020, the national liberal (PNL) government has tied the minimum wage rise to a formula that includes consumer price inflation plus productivity, adjusted by the expected rate of economic growth. The result is a gross minimum monthly wage of RON 2,230 for the current year – up from RON 2,080 the previous year; this constitutes a hike of 7.2% (after 10% in 2019), of which 4% compensates for inflation. The government has also initiated a more modest wage adjustment in the public sector than before. We expect about 5% real wage growth in 2020, implying slower growth in consumption.

**Inflation rose to 4% in 2019, but is expected to drop back a little in 2020.** Consumer prices have responded to soaring demand, driven by rapid nominal wage growth. Prices for food products and telephone services have increased the fastest. The RON has appreciated in real terms, moderating the consumer price increases (especially for imported non-food products). The Central Bank forecast is for inflation to ease in the near future; accordingly, it has maintained a stable policy rate of 2.5%. We perceive there to be a risk of an inflation–devaluation spiral in the event of an external shock.

**The current account deficit deteriorated to almost 5% of GDP and the cash budget deficit to 4.6% in 2019 (about 4% in accrual terms).** The budget deficit suddenly widened after the new government, which took office in November, paid all outstanding bills to the private sector and left most of the profits of state-owned companies in those enterprises. Unlike in earlier such situations, Romanian government bonds are selling well, albeit with a 4% yield in euro terms, and government debt is still below 40% of GDP. Rating agencies have not yet changed Romania's position. We perceive high risks for the rest of the year, due to a further widening of the fiscal deficit if public incomes policy remains loose and if the new pension act is implemented.

**Pensions are due to be increased by 40% in September and child benefits are to double in August 2020.** The fiscal effect would be 2% of GDP per year, and would dramatically increase the deficits in both 2020 and 2021. The law in question is a legacy of the former socialist government, and is rightly seen as a problem by the current national liberal interim government. But it cannot afford to take unpopular measures before the national elections, originally scheduled for November.

**Early elections are regarded as a political solution to the public deficit drift.** Were the liberal and conservative parties that support the current interim government to win elections before September 2020, they could postpone the pension hike or moderate it. (Our fiscal deficit forecast for 2020 – 3.5% of GDP – assumes limited implementation of the pension law.)

**There are legal hurdles in the way of irregular elections, but the supporters of the PNL government and the president are determined to test the law to the limit.** With just four months to spare, and by a decree that may be regarded as unconstitutional, the government changed the rules for the local elections that are due in mid-June 2020. This move led to a vote of no confidence, which the government lost. The reconstituted government needs to lose another vote of no confidence before the president can initiate an early general election. All this makes the political situation over the coming months rather strained. Rule of law and the institutional environment for investors will not improve until a government is confirmed by elections. As a positive outcome, we expect a stable, business-friendly, centre-right government to embark on a four-year spell in office later this year.

**External and internal conditions will squeeze economic growth more than we forecast earlier – to 3.2% this year, and further to 2.8% in 2021.** With this still moderate slowdown, we assume a soft landing based on modest pressure to consolidate the government budget, slowly diminishing excess demand and a related stepwise improvement in the external balance. Fiscal consolidation need not be drastic, despite the excessive deficit procedure expected to be initiated by the EU. The general government debt is still below 40% of GDP and may expand with no immediate punishment by the financial markets. The risks to smooth financing would be greater in the event of financial market turbulence or if the European Commission insists on an immediate fiscal adjustment. Under such conditions, economic growth may be squeezed more than our forecast. Accelerating inflation and a more rapid currency depreciation could be associated risks.

**Future economic growth also depends on the sustainability of investments.** After correcting for the boom last year with zero growth in 2020, gross fixed capital formation may start growing again on account of the modernisation needs of the private sector and the final tranche of EU funding in the current financing period. Romania can achieve 3-4% annual economic growth, provided labour productivity increases in the wake of modernisation investment.

## Table 6.17 / Romania: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 Forecast | 2022 |
|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 19,816 | 19,702 | 19,587 | 19,466 | 19,400 | 19,300 | 19,200 | 19,000 |
| Gross domestic product, RON bn, nom. | 712.6 | 765.1 | 857.9 | 952.4 | 1,050.0 | 1,140 | 1,220 | 1,310 |
| annual change in % (real) | 3.9 | 4.8 | 7.1 | 4.4 | 4.1 | 3.2 | 2.8 | 3.2 |
| GDP/capita (EUR at PPP) | 16,300 | 17,400 | 19,000 | 20,300 | 21,600 | . | . | . |
| Consumption of households, RON bn, nom. | 432.6 | 471.9 | 533.7 | 596.3 | 660.0 | . | . | . |
| annual change in % (real) | 5.9 | 8.3 | 10.1 | 7.2 | 4.5 | 3.5 | 3.0 | 3.5 |
| Gross fixed capital form., RON bn, nom. | 176.5 | 175.0 | 192.2 | 199.7 | 250.0 | . | . | . |
| annual change in % (real) | 7.5 | -0.2 | 3.6 | -1.2 | 17.0 | 0.0 | 4.0 | 5.0 |
| Gross industrial production 2) | | | | | | | | |
| annual change in % (real) | 2.8 | 3.1 | 7.9 | 3.5 | -2.3 | 0.0 | 2.0 | 3.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | -6.8 | 2.6 | 12.5 | 7.2 | -2.3 | . | . | . |
| Construction industry 2) | | | | | | | | |
| annual change in % (real) | 10.5 | -4.4 | -5.5 | -4.1 | 27.6 | . | . | . |
| Employed persons, LFS, th, average | 8,535 | 8,449 | 8,671 | 8,689 | 8,690 | 8,690 | 8,690 | 8,690 |
| annual change in % | -0.9 | -1.0 | 2.6 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 |
| Unemployed persons, LFS, th, average | 624 | 530 | 449 | 380 | 357 | 360 | 360 | 360 |
| Unemployment rate, LFS, in %, average | 6.8 | 5.9 | 4.9 | 4.2 | 3.9 | 4.0 | 4.0 | 4.0 |
| Reg. unemployment rate, in %, eop | 5.0 | 4.8 | 4.0 | 3.3 | 3.0 | . | . | . |
| Average monthly gross wages, RON 3) | 2,555 | 2,809 | 3,223 | 4,357 | 4,923 | 5,400 | 5,800 | 6,300 |
| annual change in % (real, gross) | 10.4 | 11.7 | 13.2 | 8.0 | 8.8 | 5.0 | 3.0 | 5.0 |
| Average monthly net wages, RON | 1,859 | 2,046 | 2,338 | 2,642 | 3,036 | 3,300 | 3,500 | 3,800 |
| annual change in % (real, net) | 10.1 | 11.8 | 12.8 | 8.0 | 10.7 | 5.0 | 3.0 | 5.0 |
| Consumer prices (HICP), % p.a. | -0.4 | -1.1 | 1.1 | 4.1 | 3.9 | 3.5 | 3.5 | 3.0 |
| Producer prices in industry, % p.a. | -2.3 | -1.8 | 3.5 | 5.1 | 3.8 | 3.0 | 2.0 | 2.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | |
| Revenues | 35.5 | 31.9 | 30.9 | 32.0 | 32.5 | 32.5 | 32.5 | 33.0 |
| Expenditures | 36.1 | 34.5 | 33.6 | 34.9 | 36.5 | 36.0 | 35.5 | 36.0 |
| Net lending (+) / net borrowing (-) | -0.6 | -2.6 | -2.6 | -2.9 | -4.0 | -3.5 | -3.0 | -3.0 |
| General gov.gross debt, EU def., % of GDP | 37.8 | 37.3 | 35.1 | 34.7 | 37.0 | 38.0 | 39.0 | 39.0 |
| Stock of loans of non-fin.private sector, % p.a. | 2.5 | 0.9 | 5.3 | 7.9 | 7.0 | . | . | . |
| Non-performing loans (NPL), in %, eop | 13.5 | 9.6 | 6.4 | 5.0 | 4.0 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 1.75 | 1.75 | 1.75 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 |
| Current account, EUR mn | -949 | -2,348 | -5,239 | -8,961 | -10,478 | -11,500 | -11,300 | -10,900 |
| Current account, % of GDP | -0.6 | -1.4 | -2.8 | -4.4 | -4.7 | -4.9 | -4.6 | -4.2 |
| Exports of goods, BOP, EUR mn | 49,105 | 52,162 | 57,162 | 61,814 | 63,061 | 64,300 | 65,900 | 67,900 |
| annual change in % | 4.8 | 6.2 | 9.6 | 8.1 | 2.0 | 2.0 | 2.5 | 3.0 |
| Imports of goods, BOP, EUR mn | 56,896 | 61,475 | 69,365 | 76,617 | 80,422 | 83,600 | 86,100 | 88,700 |
| annual change in % | 6.6 | 8.0 | 12.8 | 10.5 | 5.0 | 4.0 | 3.0 | 3.0 |
| Exports of services, BOP, EUR mn | 17,173 | 18,880 | 21,730 | 23,791 | 26,323 | 28,400 | 30,700 | 33,200 |
| annual change in % | 10.0 | 9.9 | 15.1 | 9.5 | 10.6 | 8.0 | 8.0 | 8.0 |
| Imports of services, BOP, EUR mn | 10,355 | 11,000 | 13,544 | 15,431 | 17,771 | 19,200 | 20,500 | 21,900 |
| annual change in % | 8.4 | 6.2 | 23.1 | 13.9 | 15.2 | 8.0 | 7.0 | 7.0 |
| FDI liabilities, EUR mn | 3,885 | 5,656 | 5,225 | 6,205 | 6,120 | 6,000 | . | . |
| FDI assets, EUR mn | . | 1,143 | 348 | 1,259 | 859 | 500 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 32,238 | 34,242 | 33,494 | 33,065 | 32,927 | . | . | . |
| Gross external debt, EUR mn | 94,709 | 94,273 | 97,446 | 99,841 | 106,000 | 113,000 | 115,000 | 117,000 |
| Gross external debt, % of GDP | 59.1 | 55.3 | 51.9 | 48.8 | 47.9 | 47.9 | 46.4 | 44.7 |
| Average exchange rate RON/EUR | 4.4454 | 4.4904 | 4.5688 | 4.6540 | 4.7453 | 4.83 | 4.92 | 5.00 |

1) Preliminary and wiiw estimates. - 2) Enterprises with 4 and more employees. - 3) From 2018 the employers' social security contribution was transferred to the employees; real growth 2018 refers to net wages. - 4) One-week repo rate.

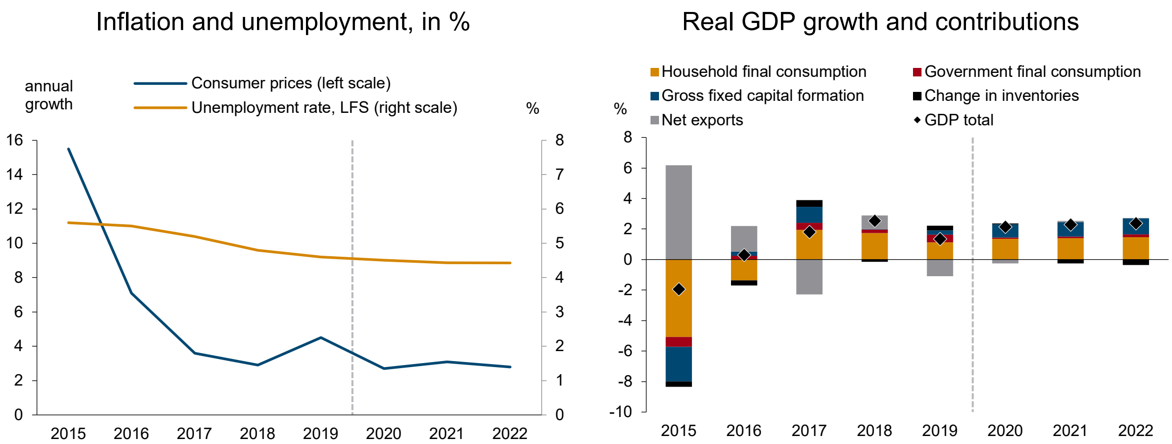
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# RUSSIA: A shift to pro-growth policies

VASILY ASTROV

Last year, growth slowed to a mere 1.3% on the back of weakening private consumption and export decline. However, following a recent shift to a more expansionary fiscal and monetary policy, GDP growth is expected to pick up to above 2% in 2020-2022. The constitutional changes recently proposed by President Putin suggest that he will not seek another re-election in 2024, although he will likely retain his political influence in a different capacity.

**Figure 6.18 / Russia: Main macroeconomic indicators**




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

**On 15 January 2020, Russian politics reverberated with President Putin's announcement of constitutional amendments and the subsequent resignation of the government headed by Dmitry Medvedev.** The proposed constitutional amendments (still to be formally approved in a popular referendum scheduled for April) include, most importantly, a prohibition on more than two presidential terms for the same person and a partial shift of presidential powers to parliament, which would obtain the right to form the government. These amendments suggest that Mr Putin will not seek re-election in 2024 (which he is not allowed to do anyway under the current constitution), but will – like Kazakhstan's president, Nursultan Nazarbayev – try to retain political influence in a different capacity, possibly as head of the State Council, whose status will be upgraded from its current advisory role.

**The government resignation is to be seen in the context of Russia's mounting economic and social problems.** With the effects of foreign policy achievements (Crimea, Syria) gradually fading, domestic economic and social problems have been coming increasingly to the fore. These have undermined support for the ruling party United Russia (which has become deeply unpopular) and were a major factor behind the wave of last year's popular protests. By and large, the Russian economy has adapted to the environment of sanctions reasonably well, and the agricultural sector, in particular, has even benefited from them, raising its output by a cumulative 15% since 2015. Macroeconomic stability and resilience to Western sanctions have crucially been helped by Russia's continuous foreign debt deleveraging and persistent external surpluses (as well as budget surpluses in the past two years), while inflation has been declining rapidly. However, these achievements have come at the expense of dismal growth performance and falling incomes. Over the five-year period 2015-2019, real GDP picked up by only 3.9%. Consumption-oriented sectors, such as the retail trade, have suffered most, mirroring the decline in real disposable incomes by a cumulative 7.5% over the same period (although real disposable incomes recovered by 0.8% last year). Parallel to that, poverty has been on the rise and now affects 14% of the population.

**In 2019, real GDP growth slowed to a mere 1.3%** (from 2.5% in 2018), albeit with some marked acceleration in the course of the year: from 0.7% in the first half of 2019 to 1.7% in the third quarter and over 2% in the fourth quarter, year on year. The main reasons for the slowdown were weakening private consumption (which grew by only 2.3%, compared with 3.3% in 2018) and declining (net) exports. Real exports (of goods and services) dropped by 2.1%, while real imports still recorded a 2.2% increase. The decline in net exports was partly due to rouble appreciation (by 2.5% in real effective terms). In nominal terms, the drop in merchandise exports last year (of 5.7% on a US dollar basis) was also due to a 9% decline in the oil price. By contrast, gross fixed capital formation rebounded by 1.4% after near-stagnation the year before, while the growth in public consumption accelerated to 2.8% (from 1.3% in 2018). On the supply side of the economy, financial services soared by nearly 10% in value-added terms last year, with all other sectors lagging far behind. Besides, the share of the extractive industry in GDP went up at the expense of manufacturing – contrary to the government's stated diversification goals.

**The main task of the new government of Prime Minister Mikhail Mishustin is to boost economic growth, which should also help tackle social problems.** This would be a welcome policy change: as we have argued on several occasions,[39] Russia's fiscal stance over the past few years has been overly restrictive and a drag on economic growth. To this end, the government is planning to step up the implementation of 12 'national projects', with envisaged combined allocations of RUB 25.7 trillion (some 23% of GDP) up until 2024 – the year of the next presidential elections. The concept of national projects dates back to 2018 and envisages increased government spending on infrastructure and social issues;[40] but their implementation has so far been lagging behind.

**The planned fiscal stimulus is to be financed from the current budget, as well as by tapping the National Welfare Fund (NWF).** In January, state expenditure was already surging by 53% year on year (albeit starting from a low basis), which may be interpreted as the first evidence of fiscal loosening. In addition to the current allocations, the government is reportedly planning to tap the unused funds from previous years, worth some 1% of GDP. As for the NWF (which accumulates windfall proceeds from energy exports), its size had reached 7.1% of GDP by 1 January. The planned allocations from the NWF for national projects for 2020-2023 are reportedly to the tune of 0.3% of GDP per year. Another 0.3% of GDP per year is to be used for social spending (such as maternal capital), financed via the purchase of a 50% stake in Sberbank from the Central Bank, using NWF funds, with the Central Bank sharing part of the proceeds with the government.[41] Thus, the overall fiscal stimulus should be at least some 0.6% of

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39 See, for instance, 'Russia: Self-inflicted stagnation', wiiw Forecast Report, Autumn 2019, pp 105-109.

40 More specifically, the 12 areas targeted by national projects include demography, health care, education, living conditions, ecology, roads, labour productivity, science, digital economy, culture, small business, and international cooperation.

41 Such a scheme should allow the 'budget rule' to be circumvented; this prohibits windfall oil revenues being used for current spending until the *liquid* part of the NWF reaches 7% of GDP (which is currently not yet the case).

GDP per year for 2020-2023, and possibly larger, although this obviously depends on progress in implementation of the planned measures.

**Monetary policy has become more pro-growth, too.** Since summer 2019, the Central Bank has cut its main policy interest rate by a combined 1.75 percentage points, to 6%, with the last cut taking place on 7 February. Officially, monetary policy easing has been justified by rapidly declining inflation. Russia has a formal inflation-targeting regime, with a target rate of 4%; but by January 2020, inflation had fallen to a mere 2.4% on an annual basis, largely on the back of depressed consumer demand. However, it is likely that concerns over the slow pace of economic growth have increasingly been playing a role behind the interest rate cuts as well – and will continue to do so even more, following President Putin's recent requirement that the government and the Central Bank should work in tandem to speed up economic growth. Therefore, even if inflation stabilises at the current (rather low) level, monetary policy easing is likely to continue, with the policy interest rate possibly lowered to 5.5% by the end of this year.

**A more pro-growth policy mix should bring Russia's growth to above 2% per year in the coming years.** However, the government target of 2.7% growth this year and 3.5% in 2021 appears unrealistic. In particular, private-sector investments may remain anaemic, dragged down by a poor investment climate, while badly needed structural reforms (notably in the areas of property rights and the legal system) are hardly on the government agenda. Even with the projected mild acceleration, the Russian economy will grow more slowly than the global economy, and will thus continue to fall behind in relative terms. Finally, as always, oil price volatility is a factor of risk for Russia, especially if the current slump in the oil price (partly related to the spread of the coronavirus) turns out to be more long-lasting than currently assumed. Should the oil price fall below the USD 40 per barrel required to balance the budget, the financing of national projects and other social spending might be endangered, with negative repercussions for economic growth this year.

**Russia's geopolitical stand-off with the West has shown fragile signs of détente recently.** Given the widening rift between the EU and the US, the rhetoric of French President Emmanuel Macron and German Chancellor Angela Merkel towards Russia has become somewhat more accommodative. At the same time, the leaders of Russia and Ukraine have at least started talking to each other, and have agreed on a prisoner swap, as well as on implementation of the so-called 'Steinmeier Formula', which stipulates the sequence of steps required for settlement of the Donbas conflict (in October 2019). Also, the latest replacement of Vladislav Surkov, a notoriously hawkish Russian official in charge of policy towards Ukraine, by the Ukrainian-born Dmitry Kozak can be interpreted as a positive sign.[42] Yet, a political solution to the Donbas conflict – and thus the possibility of EU sanctions against Russia being eased or lifted (which would have positive repercussions for the Russian economy, in terms of increased investment and technology transfer) – is still a long way off. Besides, the US sanctions against Russia are likely to stay for the foreseeable future, and may even be broadened, regardless of any EU-Russia rapprochement.[43]

[42] Mr Kozak is seen as more dovish, and is known for his plan (back in 2003) to reintegrate Transdniestria into Moldova (although the plan ultimately failed, because Moldova refused to sign under Western pressure).

[43] The construction of the Nord Stream 2 gas pipeline across the Baltic Sea, which should bring Russian gas to Europe, is an example of the divergence of interests between the United States and at least some EU member states, such as Germany, France and Austria. While the latter are interested in long-term supplies of Russian gas, the United States has sanctioned companies that are involved in Nord Stream 2 construction, resulting in delays to its completion.

## Table 6.18 / Russia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 Forecast | 2022 |
|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 146,406 | 146,675 | 146,842 | 146,831 | 146,763 | 146,700 | 146,700 | 146,700 |
| | | | | | | | | |
| Gross domestic product, RUB bn, nom. | 83,087 | 85,616 | 91,843 | 104,335 | 109,362 | 115,600 | 123,000 | 130,900 |
| annual change in % (real) | -2.0 | 0.3 | 1.8 | 2.5 | 1.3 | 2.1 | 2.3 | 2.4 |
| GDP/capita (EUR at PPP) | 18,100 | 17,200 | 18,100 | 19,900 | 20,500 | . | . | . |
| | | | | | | | | |
| Consumption of households, RUB bn, nom. | 43,456 | 45,245 | 48,178 | 51,360 | 54,969 | . | . | . |
| annual change in % (real) | -9.5 | -2.6 | 3.7 | 3.3 | 2.3 | 2.7 | 2.8 | 2.9 |
| Gross fixed capital form., RUB bn, nom. | 17,126 | 18,734 | 20,189 | 21,290 | 23,202 | . | . | . |
| annual change in % (real) | -10.6 | 1.3 | 4.7 | 0.1 | 1.4 | 4.0 | 4.5 | 5.0 |
| | | | | | | | | |
| Gross industrial production 2) | | | | | | | | |
| annual change in % (real) | -0.8 | 2.2 | 2.1 | 3.5 | 2.3 | 2.7 | 3.5 | 4.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | 2.6 | 4.8 | 2.9 | -0.2 | 4.0 | . | . | . |
| Construction output 3) | | | | | | | | |
| annual change in % (real) | -4.8 | -2.1 | -1.2 | 5.3 | 0.6 | . | . | . |
| | | | | | | | | |
| Employed persons, LFS, th, average 4) | 72,324 | 72,393 | 72,142 | 72,532 | 71,933 | 72,000 | 72,200 | 72,300 |
| annual change in % | -0.4 | 0.1 | -0.3 | 0.3 | -0.8 | 0.1 | 0.3 | 0.1 |
| Unemployed persons, LFS, th, average 4) | 4,264 | 4,243 | 3,967 | 3,658 | 3,465 | 3,400 | 3,350 | 3,350 |
| Unemployment rate, LFS, in %, average 4) | 5.6 | 5.5 | 5.2 | 4.8 | 4.6 | 4.5 | 4.4 | 4.4 |
| Reg. unemployment rate, in %, eop 5) | 1.3 | 1.2 | 1.0 | 0.9 | 0.9 | . | . | . |
| | | | | | | | | |
| Average monthly gross wages, RUB 6) | 34,030 | 36,709 | 39,167 | 43,724 | 47,400 | 50,100 | 53,700 | 57,400 |
| annual change in % (real, gross) | -9.0 | 0.8 | 2.9 | 8.5 | 3.8 | 3.0 | 4.0 | 4.0 |
| | | | | | | | | |
| Consumer prices, % p.a. | 15.5 | 7.1 | 3.6 | 2.9 | 4.5 | 2.7 | 3.1 | 2.8 |
| Producer prices in industry, % p.a. 7) | 13.5 | 4.2 | 7.7 | 11.9 | 2.0 | 4.0 | 5.0 | 4.5 |
| | | | | | | | | |
| General governm.budget, nat.def., % of GDP | | | | | | | | |
| Revenues | 32.4 | 32.9 | 33.8 | 35.8 | 35.8 | 36.0 | 36.0 | 36.0 |
| Expenditures | 35.8 | 36.6 | 35.3 | 32.9 | 33.8 | 34.8 | 35.2 | 35.3 |
| Deficit (-) / surplus (+) | -3.4 | -3.7 | -1.5 | 2.9 | 2.0 | 1.2 | 0.8 | 0.7 |
| General gov.gross debt, nat.def., % of GDP | 13.2 | 13.0 | 12.6 | 12.1 | 12.4 | 12.5 | 12.0 | 11.0 |
| | | | | | | | | |
| Stock of loans of non-fin.private sector, % p.a. | 7.6 | -6.9 | 3.5 | 13.9 | 6.5 | . | . | . |
| Non-performing loans (NPL), in %, eop 8) | 5.3 | 5.2 | 5.2 | 4.7 | 5.4 | . | . | . |
| | | | | | | | | |
| Central bank policy rate, % p.a., eop 9) | 11.00 | 10.00 | 7.75 | 7.75 | 6.25 | 5.50 | 5.00 | 4.50 |
| | | | | | | | | |
| Current account, EUR mn 10) | 60,952 | 22,094 | 28,726 | 96,254 | 63,034 | 56,400 | 56,000 | 58,300 |
| Current account, % of GDP | 5.0 | 1.9 | 2.1 | 6.8 | 4.2 | 3.5 | 3.4 | 3.3 |
| Exports of goods, BOP, EUR mn 10) | 307,040 | 254,371 | 312,779 | 375,946 | 373,112 | 380,600 | 395,800 | 415,600 |
| annual change in % | -18.2 | -17.2 | 23.0 | 20.2 | -0.8 | 2.0 | 4.0 | 5.0 |
| Imports of goods, BOP, EUR mn 10) | 173,585 | 172,911 | 211,161 | 210,995 | 227,492 | 241,200 | 253,200 | 265,900 |
| annual change in % | -25.4 | -0.4 | 22.1 | -0.1 | 7.8 | 6.0 | 5.0 | 5.0 |
| Exports of services, BOP, EUR mn 10) | 46,418 | 45,729 | 51,050 | 54,828 | 56,784 | 59,100 | 62,000 | 65,100 |
| annual change in % | -6.6 | -1.5 | 11.6 | 7.4 | 3.6 | 4.1 | 4.9 | 5.0 |
| Imports of services, BOP, EUR mn 10) | 79,829 | 67,363 | 78,716 | 80,227 | 87,765 | 93,000 | 99,500 | 106,500 |
| annual change in % | -12.7 | -15.6 | 16.9 | 1.9 | 9.4 | 6.0 | 7.0 | 7.0 |
| FDI liabilities, EUR mn 10) | 6,163 | 29,381 | 25,296 | 7,453 | 27,000 | . | . | . |
| FDI assets, EUR mn 10) | 19,861 | 20,149 | 32,559 | 26,620 | 26,000 | . | . | . |
| | | | | | | | | |
| Gross reserves of NB excl. gold, EUR mn 10)11) | 292,467 | 301,871 | 297,823 | 333,617 | 396,378 | . | . | . |
| Gross external debt, EUR mn 10) | 474,121 | 486,489 | 433,412 | 397,516 | 429,848 | 417,400 | 398,900 | 384,000 |
| Gross external debt, % of GDP | 38.7 | 42.2 | 31.1 | 28.1 | 28.5 | 26.0 | 24.0 | 22.0 |
| | | | | | | | | |
| Average exchange rate RUB/EUR | 67.76 | 74.26 | 65.87 | 73.87 | 72.51 | 72.0 | 74.0 | 75.0 |

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

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

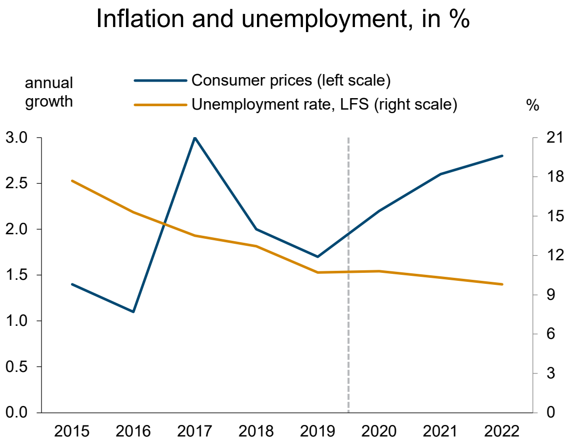
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

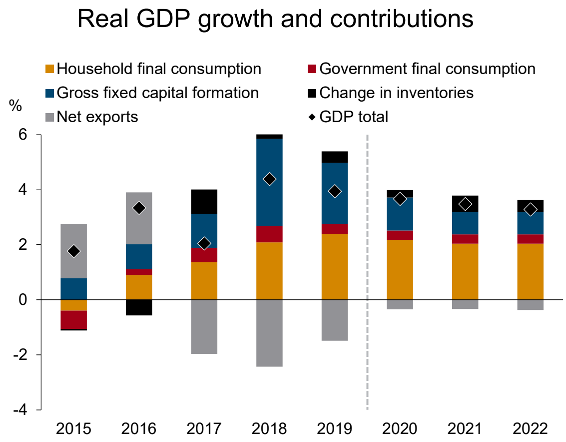

# SERBIA: Investment surge driving growth

RICHARD GRIEVESON

The Serbian economy is performing strongly, and after a robust 2019 outturn we have made an upward revision to our 2020 forecast. Growth is being driven above all by strong private consumption and investment, the latter supported by the construction of the TurkStream gas pipeline and FDI inflows. The outlook for regional stability is more positive after intensive US mediation, but the upcoming parliamentary election could mean somewhat higher domestic political risk.

**Figure 6.19 / Serbia: Main macroeconomic indicators**




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

**The economy strengthened in the middle of last year, and Q3 2019 real GDP growth was better than expected** (to a large extent due to construction of the Serbian section of the TurkStream gas pipeline). An initial estimate from the Statistics Office shows that real GDP growth was 4% in 2019, implying that the Q4 outturn was also very strong. Given the robust activity in the second half of last year, and the announcement of a major investment programme (‘Serbia 2025’ – see below), we now expect expansion of around 3.7% in 2020. Growth will be driven by firm increases in private consumption (3.2%), government spending (2%) and investment (6.5%).

**The domestic drivers of growth continue to look solid, in particular private consumption and investment.** Private consumption is being supported by wage increases on the back of a tighter labour market. Although the unemployment rate is high by CESEE standards, there are increased reports of labour shortages in some sectors and regions. Serbia has experienced substantial outward migration over recent years, and this is skewed towards people of working age. Loose credit conditions will also continue to support consumption, with year-on-year growth of loans to households in the high single digits. Meanwhile fiscal policy is also again set to add a bit to growth this year, reflecting a looser stance ahead of the parliamentary election.

**Real income growth will continue to receive an extra boost from weak inflationary trends.** We see inflation averaging around 2.2% this year, up slightly from 2019 but still low in the historical context. Having bottomed out at 1% in October, consumer price growth has firmed a bit, reaching 1.9% in December (latest data available). The volatility of the oil price on the back of developments in China creates a certain degree of uncertainty about future price trends, but our core outlook is for a very moderate firming of price pressures in the coming 12 months. Inflation is likely to remain towards the lower end of the central bank's target range, and so monetary policy will remain loose (1-2 more cuts to the policy rate are possible this year). The real CPI-adjusted policy rate is barely in positive territory (0.4% in December 2019), which is an extraordinarily supportive stance by Serbian standards.

**Despite the loose monetary policy stance, pressure on the dinar has generally been appreciatory, and we do not think this will change in 2020-2022.** Ultimately, the main driver of developments across CESEE, including in Serbia, is the ECB. We do not expect any dramatic moves from the ECB in the coming years, and see monetary tightening as highly unlikely during the forecast period. We expect further upward pressure on the dinar, and the central bank may well continue to intervene to curb appreciation (as it has been doing for some time). In addition, financing conditions in government bond markets will remain highly supportive, and portfolio investors are likely to take on ever more risk in return for a positive yield. Serbia may be upgraded to investment grade by at least one major ratings agency this year, which could further spur portfolio inflows.

**Investment has been a key driver of growth in Serbia in the last two years, and we expect this to continue, albeit at a somewhat slower rate.** Real gross fixed capital formation increased by an average 8.9% in 2015-2018, and we estimate that it grew by around 11% last year. This reflected activity on the TurkStream gas pipeline, as well as another excellent year for FDI inflows. Although 2020 may struggle to match last year in terms of investment, we still forecast a healthy growth rate of around 6.5% for gross fixed capital formation. The government announced a new investment plan called 'Serbia 2025', to be started this year. It plans to invest EUR 14 billion in total (equivalent to around 30% of 2018 GDP), to be financed by domestic and international borrowing. The government intends to invest in the upgrading of transport infrastructure, environmental protection, hospitals and schools.

**The external challenges are significant, but Serbia has so far weathered this fairly well.** Overall, the country has not been as badly affected by global trade tensions and problems in the German automotive industry as some of its regional peers. Industrial output posted positive year-on-year growth in every month during the second half of 2019, including an 8.3% expansion in December (although this was at least partly influenced by specific factors in the chemical industry). We expect exports to continue growing at a healthy rate, with potential help from a removal of tariffs on exports to Kosovo (as pledged by Kosovo Prime Minister Albin Kurti). However, robust domestic activity will also suck in imports. Overall, we see net exports making a small negative contribution to growth in both 2020 and 2021.

**Serbia's balance of payments position is likely to remain fairly stable by Western Balkan standards.** We expect a current account deficit of almost 6% of GDP this year. However, this will be comfortably covered (as in previous years) by net FDI inflows, rather than less stable forms of financing.

Serbia will continue to post a hefty merchandise goods deficit, which will be partially offset by the services surplus and secondary income inflows (remittances).

**Following intense US mediation, there have recently been key (positive) breakthroughs in the deadlock between Serbia and Kosovo.** First, the two countries agreed to resume the Pristina-Belgrade air link. Second, Kosovo agreed to drop its 100% tariff on imports from Serbia (and Bosnia and Herzegovina). These developments are economically and politically positive, and also show the continued centrality of the US as a mediator in the region.

**Ahead of the upcoming parliamentary election, the polls show a strong lead for the ruling coalition.** This reflects the good performance of the economy, but is further helped by the advantages the coalition enjoys in media access and coverage. Talks between opposition and government mediated by the European Parliament led to the upcoming election being postponed from March to April. The opposition is considering a boycott. However, it lacks a core base, is divided on many issues, and is seriously disadvantaged in terms of media representation.

**Serbia is still on course for EU accession, but this is likely to be many years hence.** It is not yet clear how French opposition to starting accession talks for North Macedonia and Albania will affect those that have already started (Serbia and Montenegro), but the overall impact is likely to be negative. We do not regard the European Commission target of accession in 2025 as realistic. The Commission has presented a new proposal and this will be discussed at the European Council at the end of March.

**In many ways, Serbia is moving away from the EU, including in its foreign policy stance and sources of FDI.** Serbia has quite strong alliances with Russia and China, both of which have been supportive over Kosovo. Links with Russia are long-standing, but were cemented by Serbia's signing of a free trade agreement with the Eurasian Economic Union last year (economically insignificant, but politically important). Meanwhile ties with China are developing strongly, emphasised above all by joint military exercises in Serbia in 2019 (the first for China anywhere in Europe). If the apparent economic and political reorientation of Serbia away from the EU continues, it may make EU accession somewhat harder in the future. It is an open secret that parts of the local elite view EU membership for Serbia as a threat to their interests.

**Beyond 2020, we retain quite a cautious outlook on Serbia's growth prospects.** The economic model focused on attracting FDI is unlikely to change significantly, and probably has further room to run. However, it is unlikely to be able to deliver the same returns as in the last couple of years. Moreover, negative demographic trends are already weighing on growth, and this will only intensify over time.

## Table 6.19 / Serbia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th. pers., mid-year | 7,095 | 7,058 | 7,021 | 6,983 | 6,950 | 6,920 | 6,880 | 6,811 |
| Gross domestic product, RSD bn, nom. | 4,312 | 4,521 | 4,754 | 5,069 | 5,400 | 5,700 | 6,100 | 6,500 |
| annual change in % (real) | 1.8 | 3.3 | 2.0 | 4.4 | 4.0 | 3.7 | 3.5 | 3.3 |
| GDP/capita (EUR at PPP) | 11,200 | 11,400 | 11,600 | 12,400 | 13,100 | . | . | . |
| Consumption of households, RSD bn, nom. | 3,052 | 3,152 | 3,311 | 3,453 | 3,600 | . | . | . |
| annual change in % (real) | -0.5 | 1.3 | 2.0 | 3.0 | 3.5 | 3.2 | 3.0 | 3.0 |
| Gross fixed capital form., RSD bn, nom. | 723 | 766 | 844 | 1,017 | 1,100 | . | . | . |
| annual change in % (real) | 4.9 | 5.4 | 7.3 | 17.8 | 11.0 | 6.0 | 4.0 | 4.0 |
| Gross industrial production 2) | | | | | | | | |
| annual change in % (real) | 7.3 | 5.2 | 3.9 | 1.3 | 0.3 | 2.5 | 2.7 | 2.5 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | -8.4 | 9.0 | -11.9 | 14.3 | 0.0 | . | . | . |
| Construction output | | | | | | | | |
| annual change in % (real) | 20.7 | 7.2 | 8.5 | 14.1 | 35.2 | . | . | . |
| Employed persons, LFS, th, average | 2,574 | 2,719 | 2,795 | 2,833 | 2,890 | 2,920 | 2,950 | 2,980 |
| annual change in % | 0.6 | 5.6 | 2.8 | 1.4 | 2.0 | 1.0 | 1.0 | 1.0 |
| Unemployed persons, LFS, th, average | 552 | 489 | 435 | 412 | 350 | 350 | 340 | 320 |
| Unemployment rate, LFS, in %, average | 17.7 | 15.3 | 13.5 | 12.7 | 10.7 | 10.8 | 10.3 | 9.8 |
| Reg. unemployment rate, in %, eop | 26.8 | 25.7 | 23.0 | 20.3 | 18.6 | . | . | . |
| Average monthly gross wages, RSD 3) | 61,145 | 63,474 | 65,976 | 68,629 | 75,200 | 79,300 | 83,900 | 88,900 |
| annual change in % (real, gross) | -2.4 | 2.6 | 0.9 | 3.9 | 7.8 | 3.2 | 3.1 | 3.1 |
| Average monthly net wages, RSD 3) | 44,432 | 46,097 | 47,893 | 49,650 | 54,400 | 56,700 | 59,300 | 62,200 |
| annual change in % (real, net) | -2.1 | 2.5 | 0.9 | 4.4 | 7.8 | 2.0 | 2.0 | 2.0 |
| Consumer prices, % p.a. | 1.4 | 1.1 | 3.0 | 2.0 | 1.7 | 2.2 | 2.6 | 2.8 |
| Producer prices in industry, % p.a. | 1.0 | 0.0 | 2.3 | 0.9 | 0.6 | 2.8 | 3.3 | 3.0 |
| General governm.budget, nat.def., % of GDP | | | | | | | | |
| Revenues | 39.3 | 40.8 | 41.5 | 41.5 | 42.2 | 44.5 | 44.5 | 44.5 |
| Expenditures | 42.8 | 41.9 | 40.4 | 40.9 | 42.4 | 45.0 | 45.0 | 45.0 |
| Deficit (-) / surplus (+) | -3.5 | -1.2 | 1.1 | 0.6 | 0.7 | -0.5 | -0.5 | -0.5 |
| General gov.gross debt, nat.def., % of GDP | 70.0 | 67.8 | 57.9 | 53.7 | 52.0 | 51.5 | 48.5 | 45.0 |
| Stock of loans of non-fin.private sector, % p.a. | 3.0 | 2.3 | 2.1 | 9.9 | 8.9 | . | . | . |
| Non-performing loans (NPL), in %, eop | 21.6 | 17.0 | 9.8 | 5.7 | 4.8 | . | . | . |
| Central bank policy rate, % p.a., eop 4) | 4.5 | 4.0 | 3.5 | 3.0 | 2.3 | 2.0 | 2.0 | 2.5 |
| Current account, EUR mn | -1,234 | -1,075 | -2,051 | -2,223 | -2,850 | -2,730 | -2,710 | -2,700 |
| Current account, % of GDP | -3.5 | -2.9 | -5.2 | -5.2 | -6.2 | -5.7 | -5.2 | -4.9 |
| Exports of goods, BOP, EUR mn | 11,454 | 12,814 | 14,066 | 15,238 | 16,600 | 17,500 | 18,400 | 19,300 |
| annual change in % | 7.6 | 11.9 | 9.8 | 8.3 | 8.9 | 5.3 | 5.1 | 5.0 |
| Imports of goods, BOP, EUR mn | 15,099 | 15,933 | 18,064 | 20,483 | 22,300 | 23,400 | 24,500 | 25,600 |
| annual change in % | 2.4 | 5.5 | 13.4 | 13.4 | 8.9 | 4.8 | 4.6 | 4.5 |
| Exports of services, BOP, EUR mn | 4,273 | 4,571 | 5,246 | 6,000 | 7,020 | 7,600 | 8,200 | 8,900 |
| annual change in % | 12.2 | 7.0 | 14.8 | 14.4 | 17.0 | 8.0 | 8.0 | 8.0 |
| Imports of services, BOP, EUR mn | 3,544 | 3,664 | 4,280 | 4,909 | 5,900 | 6,200 | 6,600 | 7,100 |
| annual change in % | 6.0 | 3.4 | 16.8 | 14.7 | 20.2 | 5.0 | 7.0 | 7.0 |
| FDI liabilities, EUR mn | 2,114 | 2,127 | 2,548 | 3,496 | 3,600 | 3,640 | . | . |
| FDI assets, EUR mn | 310 | 228 | 130 | 308 | 250 | 250 | . | . |
| Gross reserves of NB, excl. gold, EUR mn | 9,812 | 9,543 | 9,287 | 10,526 | 12,042 | . | . | . |
| Gross external debt, EUR mn 5) | 26,234 | 26,494 | 25,574 | 26,829 | 28,000 | 28,100 | 28,200 | 28,300 |
| Gross external debt, % of GDP 5) | 73.5 | 72.1 | 65.3 | 62.6 | 59.0 | 58.0 | 55.0 | 51.0 |
| Average exchange rate RSD/EUR | 120.73 | 123.12 | 121.34 | 118.27 | 117.86 | 118 | 118 | 118 |

1) Preliminary and wiiw estimates. - 2) Excluding arms industry. - 3) From 2018 based on tax administration data, before that survey data supplemented by tax administration data. - 4) Two-week repo rate. - 5) BOP 5th Edition.

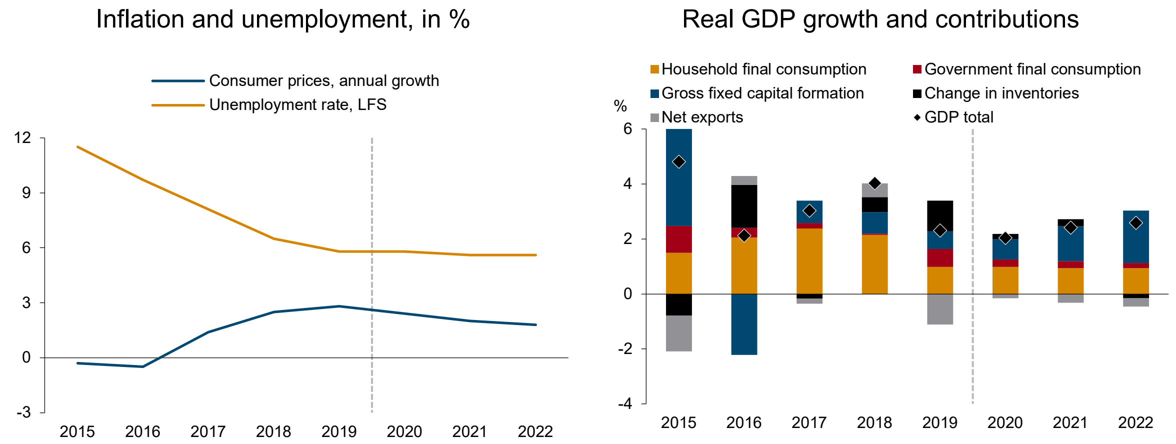
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.


# SLOVAKIA: Low and vulnerable growth

DORIS HANZL-WEISS

Slovakia's growth halved in 2019, reaching only 2.4%. In 2020, it is forecast to increase by 2%, and by around 2.5% in the years thereafter. Overall, growth is backed by stable household consumption, while the effect of net exports is unclear. Domestic and external risks are rising.

**Figure 6.20 / Slovakia: Main macroeconomic indicators**




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

**Growth halved in 2019 compared to 2018.** While Slovak GDP grew by 4% in 2018, it increased by only 2.4% in 2019. In fact, growth slowed considerably during 2019 – from 3.8% in the first quarter to 2.2% in the second quarter and to just 1.3% in the third quarter. Surprisingly, the first estimate for the last quarter again shows an upward trend of 2.1%. Positive contributions came from household consumption, government consumption and investment: household consumption rose by 2.1% during the first three quarters, and government consumption by 3.7%. Gross capital formation saw an increase of 6.4%, thanks to gross fixed capital formation (up 3.6%) and inventory build-up. However, construction declined by 3.3% in 2019 (problems with the building of motorways). Net exports had a negative impact on growth in 2019: while exports of services rose by 2.5% over the first three quarters, imports grew by 3.7%.

**The labour market is still in good shape.** While the labour market continued to enjoy favourable conditions, it failed to spur household consumption accordingly. Rather the rate of savings increased further. Over the first three quarters, employment expanded by nearly 1%. The unemployment rate seems to have reached the lowest level possible, and now stands at 5.8% (LFS). The labour shortage is becoming less acute, due to employers' lower expectations of employment growth. Still, one has to keep in mind the large regional disparities between the west of Slovakia (where there is nearly full employment) and the eastern and southern parts, where there is higher unemployment, fewer jobs and less FDI.

**Rising unit labour costs might deter future investment.** During the first three quarters of 2019, real wages rose by 5.4%. This was a pronounced increase compared to the last five years, when real wages grew at between 3% and 4% (also because of deflation, whereas inflation reached 2.8% in 2019). This movement was due on the one hand to administrative measures (surcharges for night, holiday and weekend work) and on the other hand to a shortage of labour. In January 2020, the minimum wage increased further to EUR 580 (up EUR 60): this is the biggest increase for 17 years. The minimum wage will be calculated differently from 2021 onwards: it will be at least 60% of the average gross wage over the previous two years.

**Industrial production virtually stagnated in 2019.** Slovakia's industrial production reported negligible growth of just 0.4%. From June, the country's main industry – the automotive sector – lost its position as the major growth driver (also due to the base effect), and contributed only a slightly positive figure over the whole year (2% increase). Overall, car production numbers in 2019 increased by 7,000 units to more than 1.1 million cars, allowing Slovakia to retain its title as the 'world's largest per capita car producer'. Two of the four car manufacturers published growing car production figures: PSA Peugeot-Citroën in Trnava grew by 5.4% (371,152 cars) and Kia Motors Slovakia in Žilina expanded by 4% (344,000 cars). Volkswagen Slovakia in Bratislava, the country's largest producer in 2018 (408,208) and the new Jaguar Land Rover plant (started in October 2018) have not revealed their figures. While five industries supported manufacturing growth in 2019 (including electrical equipment +21.6%; machinery and equipment +12%), eight industries declined during the year. Worst affected was the basic metals and fabricated metal products sector (-13%). US Steel Košice faced a difficult year in 2019, reporting losses and employment layoff plans, and had to defer investments.

**The external sector had a negative impact on growth in 2019, due to greater import dynamics.** During 2019, goods exports from Slovakia increased by 1.9%, while goods imports rose by 3.5%. The main products traded – machinery and transport equipment (SITC 7) – rose quite dynamically, by 5.2%, but so did imports (6.7%). Machinery and transport equipment accounted for about 63% of goods exported and 51% of goods imported. While the export dynamics was higher for non-EU countries, import growth from the EU28 was more pronounced than from abroad. Looking at Slovakia's main trading partners of Germany and the Czech Republic, exports to Germany increased by 2%, but exports to the Czech Republic were down 4.4%. On the other hand, imports from Germany fell by almost 7%, while from the Czech Republic they were up by 2%.

**Parliamentary elections are taking place on 29 February, and these have had an effect on the budget.** The plans for a balanced budget in 2019 have again been postponed. The revised plans envisaged a budget deficit of 0.68% for 2019, 0.49% for 2020 and a balanced budget for 2021. As parliamentary elections are imminent, even the figures will not hold. On the expenditure side, several social measures have been adopted (e.g. changes to minimum pensions, higher child allowance, lower VAT on certain food items). Meanwhile, the bank levy has not been terminated, as envisaged, but has instead been doubled and prolonged indefinitely. For the first time, a cap on 2020 expenditure from the general government budget was introduced in January 2020. Up to 25 parties will participate in the parliamentary elections on 29 February; of these, probably nine will cross the 5% threshold to get into parliament. The rising share of the far-right party L'SNS causes concern. It will be very difficult to form a government.

**Vulnerabilities in the housing sector are building up.** The elevated household credit growth of recent years (around 13% yearly between 2014 and 2016) declined during 2019 (from 11% in January to 8% in November), but was still at a high level, leading to growing household indebtedness (42.3% of GDP in 2018). Residential property prices accelerated further in 2019. While vulnerabilities were built up in the residential real estate sector, the European System Risk Board (ESRB) did not issue a warning in September 2019, as it considered the national bank's macroprudential policies to be adequate. Credit to corporations fluctuated strongly during the year, but also showed a decelerating trend (from 8% in January to 5% in November).

**Future growth is affected by growing domestic and external risks.** wiiw growth forecasts for Slovakia have been revised downwards for the coming years. Slovak GDP is expected to grow by 2% this year and by around 2.5% in the coming years. Household consumption will form the backbone of the country's growth in the next few years, but will provide only for a stable expansionary impulse. A stronger impulse is expected from the expansion of investment towards the end of the EU funding cycle (2021/2022). The effect of net exports remains unclear: while export growth remains dependent on external factors, imports also grew dynamically in 2019. Thus, the trend towards a greater import content of exports will be decisive in coming years. Overall, several uncertainties lie ahead: on the domestic side, there is a heavy dependence on the automotive industry, which faces several challenges (dependence on decisions from headquarters, the move towards electric vehicles), low R&D capabilities and rising unit labour costs. On the external side, there are growing risks that affect especially the Slovak automotive industry (difficulties in the world automotive industry, Trump's threats of tariffs on European cars, the Chinese slowdown due to the coronavirus). The outcome of the parliamentary elections may add to the general uncertainty, but should not have too much effect on the economy.

## Table 6.20 / Slovakia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th pers., average | 5,424 | 5,431 | 5,439 | 5,447 | 5,450 | 5,455 | 5,460 | 5,460 |
| Gross domestic product, EUR mn, nom. | 79,758 | 81,038 | 84,517 | 89,721 | 94,400 | 98,500 | 102,900 | 107,500 |
| annual change in % (real) | 4.8 | 2.1 | 3.0 | 4.0 | 2.3 | 2.0 | 2.4 | 2.6 |
| GDP/capita (EUR at PPP) | 22,500 | 21,200 | 21,500 | 22,600 | 23,500 | . | . | . |
| Consumption of households, EUR mn, nom. | 42,416 | 43,904 | 46,473 | 49,395 | 51,690 | . | . | . |
| annual change in % (real) | 2.8 | 3.9 | 4.4 | 3.9 | 1.8 | 1.8 | 1.7 | 1.7 |
| Gross fixed capital form., EUR mn, nom. | 18,919 | 17,019 | 17,965 | 19,050 | 20,170 | . | . | . |
| annual change in % (real) | 21.6 | -9.3 | 3.9 | 3.7 | 3.0 | 3.5 | 6.0 | 9.0 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | 6.7 | 4.7 | 3.2 | 4.4 | 0.4 | 2.0 | 2.0 | 3.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | -3.2 | 13.9 | -6.1 | -2.4 | -3.5 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | 18.1 | -10.7 | 3.0 | 8.5 | -3.4 | . | . | . |
| Employed persons, LFS, th, average | 2,424 | 2,492 | 2,531 | 2,567 | 2,590 | 2600 | 2600 | 2600 |
| annual change in % | 2.6 | 2.8 | 1.5 | 1.4 | 0.9 | 0.3 | 0.0 | 0.0 |
| Unemployed persons, LFS, th, average | 314 | 267 | 224 | 180 | 160 | 160 | 150 | 150 |
| Unemployment rate, LFS, in %, average | 11.5 | 9.7 | 8.1 | 6.5 | 5.8 | 5.8 | 5.6 | 5.6 |
| Reg. unemployment rate, in %, eop | 10.6 | 8.8 | 5.9 | 5.0 | 4.9 | . | . | . |
| Average monthly gross wages, EUR | 883 | 912 | 954 | 1,013 | 1,090 | 1160 | 1220 | 1280 |
| annual change in % (real, gross) | 3.2 | 3.8 | 3.3 | 3.6 | 5.1 | 3.8 | 3.2 | 3.0 |
| Consumer prices (HICP), % p.a. | -0.3 | -0.5 | 1.4 | 2.5 | 2.8 | 2.4 | 2.0 | 1.8 |
| Producer prices in industry, % p.a. | -2.9 | -3.9 | 2.5 | 2.3 | 1.9 | 2.5 | 3.0 | 3.0 |
| General governm.budget, EU-def., % of GDP | | | | | | | | |
| Revenues | 43.1 | 40.2 | 40.6 | 40.8 | 41.2 | 41.6 | 41.6 | 41.5 |
| Expenditures | 45.8 | 42.7 | 41.5 | 41.8 | 42.4 | 43.2 | 43.2 | 42.9 |
| Net lending (+) / net borrowing (-) | -2.7 | -2.5 | -1.0 | -1.1 | -1.2 | -1.6 | -1.6 | -1.4 |
| General gov.gross debt, EU def., % of GDP | 51.9 | 52.0 | 51.3 | 49.4 | 48.2 | 47.8 | 47.5 | 47.2 |
| Stock of loans of non-fin.private sector, % p.a. | 9.7 | 9.3 | 9.9 | 9.8 | 6.6 | . | . | . |
| Non-performing loans (NPL), in %, eop | 4.8 | 4.4 | 3.6 | 3.1 | 2.8 | . | . | . |
| Central bank policy rate, % p.a., eop 2) | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | -1,669 | -2,221 | -1,618 | -2,371 | -2,774 | -3,200 | -3,000 | -2,900 |
| Current account, % of GDP | -2.1 | -2.7 | -1.9 | -2.6 | -2.9 | -3.2 | -2.9 | -2.7 |
| Exports of goods, BOP, EUR mn | 64,577 | 66,686 | 70,510 | 75,698 | 78,073 | 80,300 | 83,100 | 86,400 |
| annual change in % | 3.2 | 3.3 | 5.7 | 7.4 | 3.1 | 2.8 | 3.5 | 4.0 |
| Imports of goods, BOP, EUR mn | 63,779 | 65,432 | 69,913 | 75,919 | 78,805 | 81,600 | 84,600 | 88,200 |
| annual change in % | 6.6 | 2.6 | 6.8 | 8.6 | 3.8 | 3.5 | 3.7 | 4.3 |
| Exports of services, BOP, EUR mn | 7,324 | 8,350 | 9,339 | 10,209 | 10,683 | 11,200 | 12,000 | 13,200 |
| annual change in % | 6.3 | 14.0 | 11.8 | 9.3 | 4.6 | 5.0 | 7.0 | 10.0 |
| Imports of services, BOP, EUR mn | 7,196 | 7,967 | 8,457 | 9,284 | 9,665 | 10,100 | 10,500 | 11,300 |
| annual change in % | 7.2 | 10.7 | 6.1 | 9.8 | 4.1 | 5.0 | 4.0 | 8.0 |
| FDI liabilities, EUR mn | 1,357 | 4,326 | 3,749 | 2,158 | 2,143 | 1,000 | . | . |
| FDI assets, EUR mn | 1,266 | 3,684 | 1,367 | 1,354 | 447 | 500 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 1,648 | 1,624 | 1,609 | 3,426 | 5,002 | . | . | . |
| Gross external debt, EUR mn | 67,398 | 74,917 | 94,188 | 101,914 | 105,000 | 110,000 | 110,000 | 115,000 |
| Gross external debt, % of GDP | 84.5 | 92.4 | 111.4 | 113.6 | 111.2 | 111.7 | 106.9 | 107.0 |

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

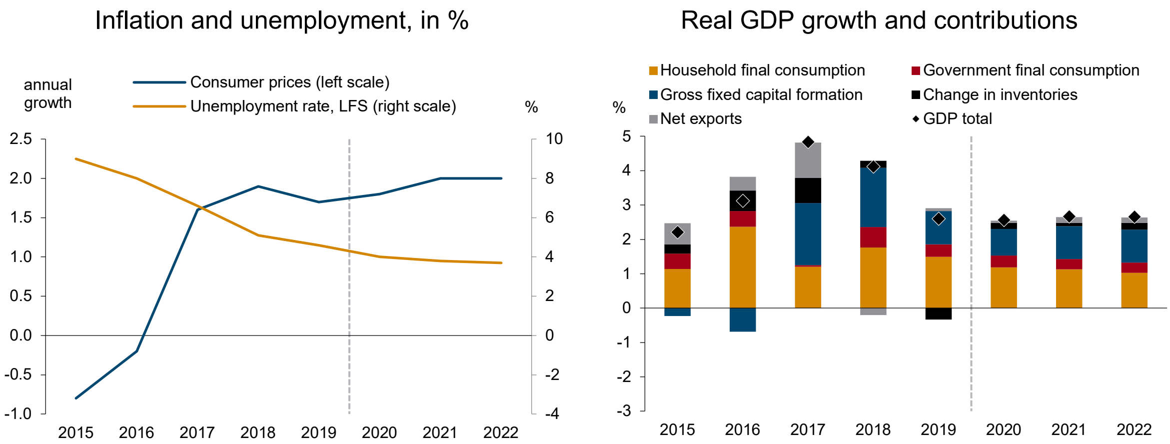
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# SLOVENIA: Decelerating growth amid political instability

HERMINE VIDOVIC

GDP growth will remain unchanged at 2.6% in 2020, due to sluggish external demand, but will increase slightly thereafter. Domestic consumption will remain the main driver of growth, but could be dampened by the recently adopted consumer loans restrictions. Downside risks arise from changes in global conditions and adverse demographics.

**Figure 6.21 / Slovenia: Main macroeconomic indicators**




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

**The Slovenian economy weakened in the second half of 2019, and the real GDP growth rate is estimated at 2.6%, slightly below our previous forecast.** This is mainly due to a slowdown in the last quarter of the year, as signalled by decelerating growth of industrial production, as well as of exports. Domestic demand was the largest contributor to growth, with rising household consumption (3.5% – thanks to increasing disposable income from wages and social transfers) and government consumption up by almost 2% against a year earlier. The growth in gross fixed capital formation moderated in the course of the year to 6%. Construction output fell for several months, but strengthened towards the end of the year, particularly in the construction of non-residential buildings. Yet, output growth of only 3% was achieved, compared to almost 20% a year earlier. Changes in inventories contributed negatively to the GDP expansion. After a solid start, industrial output growth slowed in the second half of the year, to stand at 3% for the full year; the highest growth rates were reported for the manufacturing of wood and wood products, while car production – one of the biggest exporters – stagnated.

***Labour market conditions continued to improve, but at a slower pace than a year earlier.*** Labour Force Survey data indicate an employment increase of 0.4% and a fall in the unemployment rate to 4.6%, close to the pre-crisis level. To combat labour shortages, Slovenian firms have relied on foreign workers: they account for about 10% of total employment, the majority coming from Bosnia and Herzegovina, Serbia, Croatia, Kosovo and North Macedonia; they are primarily employed in construction, manufacturing, and transport and storage. Only recently, the Slovenian Business Club (SBC) proposed measures to prevent the emigration of young educated people (between 2014 and 2018, about 11,000 young people left the country). Among other things, it suggests tax relief (e.g. untaxed performance-related bonuses and other opportunities to reduce the taxable income of top experts) and tax incentives for companies (e.g. on the construction of workforce housing). Average real gross wages rose by 2.7%, increasing faster in the public sector (3.8%) than in the private (2.3%), thanks to the 'agreement on salaries and other payments of labour costs in the public sector' reached between the government and public-sector trade unions. Wages in the private sector grew most in administrative and support service activities, accommodation and trade. Part of the increase was also due to an increase in the minimum wage. Consumer price inflation averaged 1.7% for 2019, mainly due to rising food prices.

**Growth of both exports and imports was significantly lower than a year earlier.** Goods exports and imports in 2019 rose by 2.8% and 2.2%, respectively, with the trade surplus higher than a year earlier. In terms of exports, deliveries of machinery and transport equipment to Germany declined most (this also impacted on industrial production, which experienced inadequate demand). In services, the trade surplus also widened, as exports – transport and construction services, in particular – rose ahead of lower import growth. The primary income deficit narrowed compared to a year previously, while the secondary income shortfall increased modestly. The current account surplus reached another record of an estimated EUR 3.2 billion, or 6.5% of GDP. Foreign direct investment inflows were slightly lower than a year earlier, amounting to EUR 1.2 billion in 2019.

**The general government budget surplus narrowed in 2019 to 0.2% of GDP, compared to 0.8% in 2018.** This was mainly a result of lower revenues (there were no one-off revenues such as in the previous year, with the dividend payments related to Nova Ljubljanska Banka and the delayed EU payments from the 2007-2013 multi-year budget), but lower tax revenues also played a part. Expenditure, by contrast, increased, due to rises in wages and additional employment in the public sector, as well as higher social transfers. At the beginning of January 2020, the Republic of Slovenia successfully refinanced a bond maturing on 27 January 2020 by issuing a new EUR 1.5 billion 10-year bond, thus continuing with its debt refinancing and reduction of interest payments.

In November 2019, the steady increase in consumer lending (in excess of 10%) prompted the Bank of Slovenia to impose restrictions on consumer loans, in order to curb excessive credit growth and protect borrowers from becoming over-indebted (thereby changing a former recommendation into a binding instrument). Accordingly, commercial banks, savings banks and branches of foreign banks will be required to place caps on (i) the maturity of consumer loans (seven years maximum) and (ii) the ratio of annual debt servicing costs to the borrower's net income (DSTI) (which may no longer exceed 67%). The latter applies also to housing loans. Since the announcement of these measures, the central bank has come under steady pressure – not only from the banking association, but also from politicians, who argue that the lending restrictions will affect an estimated 300,000 individuals (pensioners and low-wage earners, in particular). Initial results published by the banking association show that the number of consumer loans dropped by around 40% between October and December, and the number of housing loans fell by around 60%.

On 27 January 2020, Slovenia's Prime Minister Marjan Sarec resigned and called for early elections, because his minority government was unable to push through crucial reforms. Mr Sarec headed a five-party coalition, which together had held 43 of the 90 seats in parliament since August 2018, and which was supported by the Left Party up to November 2019. Only one month later, the right wing politician Janez Jansa, leader of the largest party in the Slovenian parliament, managed to form a new government with the centre-left Modern Centre party, the conservative New Slovenia and DeSUS, the pensioner's party. The decision of the Modern Centre Party to join the coalition with Janez Jansa is particularly controversial, as it has prompted the former Foreign Minister and party founder Miro Cerar to leave the party to protest against this move.

**The outlook remains subdued. wiiw expects GDP to grow at 2.6% in 2020 and 2.7% in 2021 and 2022, backed by domestic demand, while the contribution of net exports will turn negative.** Private consumption will remain an important driver, boosted by a continued improvement in the labour market and rising wages; but it may be dampened by the credit restrictions imposed in late 2019. Investment is expected to grow further, particularly with respect to construction, as activities strengthened again towards the end of 2019. Alongside rising employment, unemployment is expected to continue its downward path, not least because of the shrinking working-age population. The current account will remain in positive territory, but is expected to decline along with lower trade surpluses. Downside risks arise mainly from outside the country: an economic slowdown in Slovenia's major trading partners – Germany and Italy, in particular – could dampen exports. But adverse demographics will also pose challenges in the future.

## Table 6.21 / Slovenia: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 [1)] | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th pers., average | 2,064 | 2,065 | 2,066 | 2,074 | 2,080 | 2,090 | 2,090 | 2,100 |
| Gross domestic product, EUR mn, nom. | 38,853 | 40,367 | 42,987 | 45,755 | 47,700 | 49,800 | 52,100 | 54,600 |
| annual change in % (real) | 2.2 | 3.1 | 4.8 | 4.1 | 2.6 | 2.6 | 2.7 | 2.7 |
| GDP/capita (EUR at PPP) | 23,800 | 24,200 | 25,500 | 26,900 | 27,900 | . | . | . |
| Consumption of households, EUR mn, nom. | 20,640 | 21,416 | 22,278 | 23,542 | 24,600 | . | . | . |
| annual change in % (real) | 2.1 | 4.5 | 2.3 | 3.4 | 2.9 | 2.3 | 2.2 | 2.0 |
| Gross fixed capital form., EUR mn, nom. | 7,248 | 7,019 | 7,875 | 8,799 | 9,400 | . | . | . |
| annual change in % (real) | -1.2 | -3.7 | 10.4 | 9.4 | 5.0 | 4.0 | 5.0 | 5.0 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | 5.6 | 7.1 | 7.7 | 4.9 | 3.3 | 2.5 | 2.5 | 3.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | 6.4 | -3.2 | -9.5 | 26.9 | -7.2 | . | . | . |
| Construction industry | | | | | | | | |
| annual change in % (real) | -8.2 | -17.7 | 17.7 | 19.7 | 3.3 | . | . | . |
| Employed persons, LFS, th, average | 917.4 | 915.0 | 959.1 | 980.6 | 990.0 | 1,000 | 1,010 | 1,020 |
| annual change in % | 0.1 | -0.3 | 4.8 | 2.2 | 1.0 | 1.0 | 0.5 | 0.5 |
| Unemployed persons, LFS, th, average | 90.3 | 79.6 | 67.4 | 52.8 | 48.0 | 42 | 40 | 39 |
| Unemployment rate, LFS, in %, average | 9.0 | 8.0 | 6.6 | 5.1 | 4.6 | 4.0 | 3.8 | 3.7 |
| Reg. unemployment rate, in %, eop | 12.3 | 10.8 | 9.0 | 8.1 | 7.7 | . | . | . |
| Average monthly gross wages, EUR | 1,556 | 1,584 | 1,626 | 1,682 | 1,754 | 1,830 | 1,910 | 1,990 |
| annual change in % (real, gross) | 1.2 | 1.9 | 1.3 | 1.7 | 2.7 | 2.5 | 2.5 | 2.0 |
| Average monthly net wages, EUR | 1,013 | 1,030 | 1,062 | 1,093 | 1,134 | 1,180 | 1,230 | 1,280 |
| annual change in % (real, net) | 0.9 | 1.8 | 1.7 | 1.2 | 2.1 | 2.0 | 2.0 | 1.9 |
| Consumer prices (HICP), % p.a. | -0.8 | -0.2 | 1.6 | 1.9 | 1.7 | 1.8 | 2.0 | 2.0 |
| Producer prices in industry, % p.a. | -0.2 | -1.4 | 2.2 | 2.1 | 0.6 | 1.5 | 1.8 | 1.8 |
| General governm.budget, EU-def., % of GDP | | | | | | | | |
| Revenues | 45.9 | 44.3 | 44.0 | 44.3 | 44.0 | 43.9 | 43.7 | 43.5 |
| Expenditures | 48.7 | 46.2 | 44.1 | 43.5 | 43.8 | 43.6 | 43.5 | 43.5 |
| Net lending (+) / net borrowing (-) | -2.8 | -1.9 | 0.0 | 0.8 | 0.2 | 0.3 | 0.2 | 0.0 |
| General gov.gross debt, EU def., % of GDP | 82.6 | 78.7 | 74.1 | 70.4 | 68.0 | 64.8 | 62.0 | 61.5 |
| Stock of loans of non-fin.private sector, % p.a. | -6.4 | -3.9 | 1.9 | 3.0 | 3.5 | . | . | . |
| Non-performing loans (NPL), in %, eop [2)] | 9.9 | 5.5 | 8.4 | 5.6 | 3.4 | . | . | . |
| Central bank policy rate, % p.a., eop [3)] | 0.05 | 0.00 | 0.00 | 0.00 | 0.00 | . | . | . |
| Current account, EUR mn | 1,482 | 1,942 | 2,635 | 2,593 | 3,159 | 2,930 | 2,980 | 3,060 |
| Current account, % of GDP | 3.8 | 4.8 | 6.1 | 5.7 | 6.6 | 5.9 | 5.7 | 5.6 |
| Exports of goods, BOP, EUR mn | 24,039 | 24,991 | 28,478 | 31,134 | 32,002 | 33,440 | 35,110 | 36,870 |
| annual change in % | 4.7 | 4.0 | 14.0 | 9.3 | 2.8 | 4.5 | 5.0 | 5.0 |
| Imports of goods, BOP, EUR mn | 22,563 | 23,454 | 26,899 | 30,005 | 30,669 | 32,140 | 33,910 | 35,780 |
| annual change in % | 3.6 | 3.9 | 14.7 | 11.5 | 2.2 | 4.8 | 5.5 | 5.5 |
| Exports of services, BOP, EUR mn | 5,940 | 6,501 | 7,288 | 7,963 | 8,526 | 9,040 | 9,630 | 10,280 |
| annual change in % | 4.2 | 9.4 | 12.1 | 9.3 | 7.1 | 6.0 | 6.5 | 6.8 |
| Imports of services, BOP, EUR mn | 4,306 | 4,575 | 5,048 | 5,285 | 5,510 | 5,760 | 6,050 | 6,410 |
| annual change in % | 1.4 | 6.3 | 10.3 | 4.7 | 4.3 | 4.5 | 5.0 | 6.0 |
| FDI liabilities, EUR mn | 1,560 | 1,298 | 1,065 | 1,295 | 1,231 | 1,300 | . | . |
| FDI assets, EUR mn | 292 | 434 | 570 | 362 | 540 | 400 | . | . |
| Gross reserves of NB excl. gold, EUR mn | 687 | 593 | 632 | 702 | 767 | . | . | . |
| Gross external debt, EUR mn | 46,148 | 44,293 | 43,191 | 42,100 | 45,100 | 45,300 | 45,800 | 46,100 |
| Gross external debt, % of GDP | 118.8 | 109.7 | 100.5 | 92.0 | 94.5 | 91.0 | 88.0 | 84.5 |

1) Preliminary and wiiw estimates. - 2) Loans more than 90 days overdue, and from 2017 also including loans unlikely to be paid. - 3) Official refinancing operation rates for euro area (ECB).

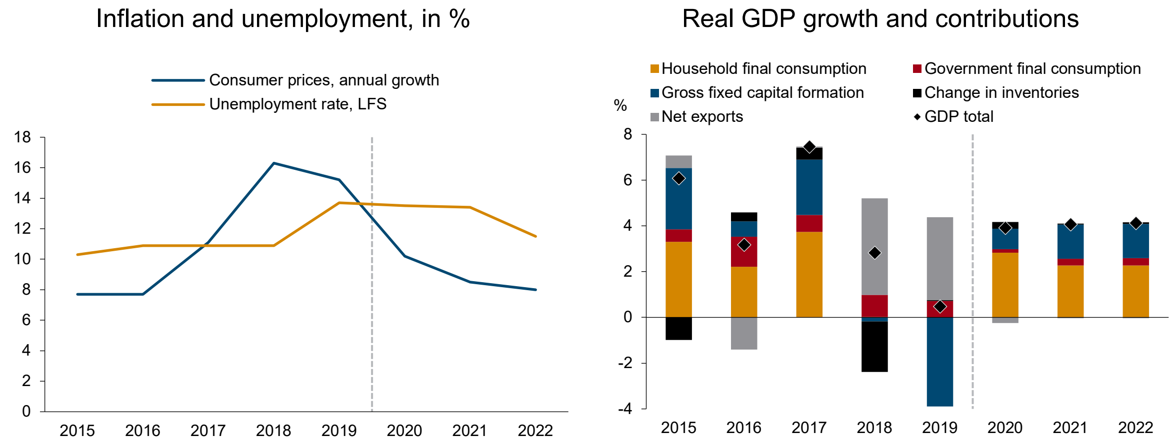
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# TURKEY: Looking good, for now

RICHARD GRIEVESON

Turkey has again confirmed its status as the most high-beta economy in CESEE, with a host of indicators suggesting that a 'V-shaped' recovery is in progress. The currency crisis and sharp economic downturn of 2018–2019 now seem a long time ago, following a sharp bounce-back in the second half of last year. Growth could be around 4% this year, but that will mean a return to reliance on credit growth and external imbalances, and the old familiar vulnerabilities of the Turkish economy.

**Figure 6.22 / Turkey: Main macroeconomic indicators**




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

**The recovery in Turkey has been even stronger than our (relatively optimistic) expectations.** For 2019 as a whole, we estimate full-year expansion of 0.5%, which if confirmed would mark an impressive outturn after the sharp contraction in the first half of 2019. Real GDP grew by 0.9% year on year in Q3 (latest data available at the time of writing), the first positive outturn since the same quarter of 2018. This was driven by private consumption (+1.5%), exports (+5.1%) and especially government spending (+7%). Investment continued to collapse in year-on-year terms (-12.6%), but quarterly data suggest a stabilisation (-0.1% relative to the previous three months) after a very tough 12 months for this component of GDP.

**More recent high-frequency data suggest that economic activity firmed in the final months of 2019 and the start of 2020, and we have therefore revised upward our 2020 forecast.** We now predict economic growth this year to reach almost 4%, and at present the risks to this are to the upside. The most important driver of growth has been the massive monetary easing over the past 12 months, and its impact on credit growth and private consumption more generally. The central bank cut its benchmark rate by a cumulative 1,200 basis points in the second half of 2019. The real policy rate (CPI-adjusted) is now back into negative territory, having been 7.2% as recently as June 2019. This is a huge amount of monetary easing over a short period, and has had a clear impact on economic activity – an impact that will continue in 2020.

**The new credit boom is pushing up short-term growth rates, but also signals new risks for the economy.** Consumer credit, in particular, has risen strongly, with loans to households rising by 11.9% year on year in November 2019. Credit to corporates has reacted more slowly, but was also growing by 5.6% as of November. The government appears determined to push this trend further, and in February 2020 cut the amount of commission that banks can charge on loans. This follows various other measures already announced to increase lending growth. We expect credit growth this year to be higher than in 2019. Although non-performing loans are at a low level (a bit above 5% at end-2019), rapid credit growth creates overheating risks and could contribute to another build-up of dangerous imbalances. The strong increase in credit has already had an impact on market sentiment, with the lira having weakened since November 2019.

**Inflation is still very high, but is well down from peak levels, and we expect a further moderate decline in the headline rate over the forecast period.** Full-year inflation was 15.2% in 2019, and fell as low as 8.6% in October, before rising again to 12.2% as of January. Part of the reason for this was higher imported inflation on the back of the weaker lira. We expect inflation to trend downward for the rest of the year, and to average 10.2% in 2020 as a whole.

**Tourism is an increasingly important part of the Turkish economy (accounting for over 10% of GDP) and significantly helped the recovery last year.** Arrivals from abroad rose strongly in 2019, including a particularly robust increase of 17% from Europe. Within this, Germans make up the single biggest group, but especially strong increases in tourists were recorded for Spain, Italy and France. The fact that tourism growth from Western European sources was so strong is particularly important, as these tourists tend to spend more money than for example Russians.

**Turkish industry has had a tough time, but started to recover at the end of last year.** Industrial production growth averaged almost 4% year on year in September-November. Survey data – for example, the purchasing managers' index (PMI) released by the Istanbul Chamber of Commerce – suggest that the industrial recovery is fairly broad-based. New orders growth was positive as of January 2020, including from abroad. This implies some degree of resilience to the weak external environment.

**For now, the major volatility in Turkish growth rates appears to be over, but there is no guarantee that this will last.** Turkey has been through extreme volatility in the last few years, with real GDP year-on-year growth rates ranging from +10.6% to -7.7% since the middle of 2017. Our baseline forecast is that growth will be around 4% during the forecast period. However, given the unbalanced nature of the Turkish growth model, in particular the reliance on (often external) credit, a return to heightened volatility cannot be excluded.

**The government is aware that the old economic growth model leaves Turkey exposed to external volatility and changes in investor sentiment, and is seeking to pursue a new strategy.** Treasury and Finance Minister Berat Albayrak has outlined a plan to make the economy more resilient, and is targeting growth of 5% per year in 2020-2022. The government wants to grow the manufacturing sector and exports, thereby reducing the large current account deficit and reliance on foreign capital inflows.

**The government's plans will produce some results, but we are sceptical that it can really engineer a fundamental change in the way that the economy operates.** We expect Turkey to return to gradually expanding external deficits in the forecast period, financed to a large extent by hot money inflows. Although the scale of the external imbalances may not be as high as in the past, the fundamental exposure to the whims of foreign investors will still be there. The lira will continue to depreciate (albeit not at the same rate as in 2017-2018), and inflation will remain relatively high.

**Turkish foreign policy has become more active and assertive, most notably with interventions in Syria and Libya.** There is a risk that these will bring Turkey into conflict with other regional or global actors. From an economic perspective, this could have damaging repercussions. The 2018 currency crisis – which was heavily influenced by a spat with the US – demonstrated the linking of geopolitical, financial and economic developments. Turkey's large external borrowing needs leave it particularly exposed to this. There are also signs that the alliance with Russia could be fraying, especially following the killing of Turkish soldiers by Russian-backed Syrian forces at the start of February.

**The massive expansion of global liquidity since the global financial crisis will act as a partial factor of stability for Turkey's external accounts.** This wall of money created by the Fed, ECB and Bank of Japan has to go somewhere. As long as foreign investors do not get too spooked by political developments, we think that a large amount of this money will continue to end up in Turkey. This is hardly a stable growth model. However, we view significant monetary tightening by the Fed or ECB (which would be highly destabilising for countries like Turkey, reliant as it is on hot money inflows) as highly unlikely during the forecast period.

## Table 6.22 / Turkey: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | |
| Population, th pers., average | 78,218 | 79,278 | 80,313 | 81,407 | 82,579 | 82,700 | 83,600 | 84,400 |
| Gross domestic product, TRY bn, nom. | 2,339 | 2,609 | 3,111 | 3,724 | 4,300 | 4,900 | 5,500 | 6,200 |
| annual change in % (real) | 6.1 | 3.2 | 7.5 | 2.8 | 0.5 | 3.9 | 4.1 | 4.1 |
| GDP/capita (EUR at PPP) | 19,300 | 18,900 | 19,600 | 19,700 | 19,900 | . | . | . |
| Consumption of households, TRY bn, nom. | 1,412 | 1,561 | 1,836 | 2,111 | 2,430 | . | . | . |
| annual change in % (real) | 5.4 | 3.7 | 6.2 | 0.0 | 0.0 | 5.0 | 4.0 | 4.0 |
| Gross fixed capital form., TRY bn, nom. | 695 | 765 | 936 | 1,114 | 1,120 | . | . | . |
| annual change in % (real) | 9.3 | 2.2 | 8.2 | -0.6 | -13.0 | 3.0 | 5.0 | 5.0 |
| Gross industrial production 2) | | | | | | | | |
| annual change in % (real) | 6.2 | 3.4 | 9.1 | 1.1 | -0.6 | 3.0 | 3.0 | 3.0 |
| Gross agricultural production 3) | | | | | | | | |
| annual change in % (real) | 5.2 | 0.5 | 2.0 | 0.5 | 0.5 | . | . | . |
| Construction industry 2) | | | | | | | | |
| annual change in % (real) | 1.7 | 2.9 | 3.8 | -5.0 | -8.0 | . | . | . |
| Employed persons, LFS, th, average | 26,619 | 27,216 | 28,197 | 28,734 | 28,081 | 27,400 | 28,100 | 28,800 |
| annual change in % | 2.7 | 2.2 | 3.6 | 1.9 | -2.3 | -2.5 | 2.5 | 2.5 |
| Unemployed persons, LFS, th, average | 3,050 | 3,332 | 3,451 | 3,535 | 4,461 | 4,280 | 4,350 | 3,740 |
| Unemployment rate, LFS, in %, average | 10.3 | 10.9 | 10.9 | 10.9 | 13.7 | 13.5 | 13.4 | 11.5 |
| Reg. unemployment rate, in %, eop | . | . | . | . | . | . | . | . |
| Average monthly gross wages, TRY 4) | 2,014 | 2,280 | 2,470 | 2,820 | 3,250 | 3680 | 4130 | 4620 |
| annual change in % (real, gross) | 2.8 | 5.2 | -2.5 | -2.0 | 0.0 | 2.8 | 3.5 | 3.5 |
| Consumer prices (HICP), % p.a. | 7.7 | 7.7 | 11.1 | 16.3 | 15.2 | 10.2 | 8.5 | 8.0 |
| Producer prices in industry, % p.a. 5) | 5.3 | 4.3 | 15.8 | 27.0 | 17.6 | 15.0 | 13.0 | 11.0 |
| General governm. budget, nat.def., % of GDP | | | | | | | | |
| Revenues | 31.9 | 33.0 | 30.1 | 30.0 | 31.0 | 32.2 | 33.5 | 33.8 |
| Expenditures | 32.9 | 34.7 | 32.1 | 32.8 | 34.0 | 35.0 | 36.2 | 36.6 |
| Deficit (-) / surplus (+) | -1.0 | -1.7 | -2.0 | -2.8 | -3.0 | -2.8 | -2.7 | -2.8 |
| General gov.gross debt, nat.def., % of GDP | 27.6 | 28.3 | 28.2 | 30.2 | 32.0 | 32.0 | 31.2 | 31.0 |
| Stock of loans of non-fin.private sector, % p.a. | 19.4 | 15.2 | 19.9 | 9.6 | 10.5 | . | . | . |
| Non-performing loans (NPL), in %, eop | 3.1 | 3.2 | 2.9 | 3.9 | 5.4 | . | . | . |
| Central bank policy rate, % p.a., eop 6) | 7.50 | 8.00 | 8.00 | 24.00 | 12.00 | 10.00 | 9.00 | 9.00 |
| Current account, EUR mn | -28,986 | -29,981 | -41,679 | -22,119 | 1,576 | -9,100 | -15,300 | -20,400 |
| Current account, % of GDP | -3.7 | -3.8 | -5.5 | -3.4 | 0.2 | -1.3 | -2.1 | -2.6 |
| Exports of goods, BOP, EUR mn | 136,978 | 135,795 | 147,218 | 148,024 | 162,699 | 167,000 | 175,000 | 184,000 |
| annual change in % | 7.7 | -0.9 | 8.4 | 0.5 | 9.9 | 2.5 | 5.0 | 5.0 |
| Imports of goods, BOP, EUR mn | 180,353 | 172,701 | 198,906 | 182,938 | 179,380 | 194,000 | 208,000 | 223,000 |
| annual change in % | 2.9 | -4.2 | 15.2 | -8.0 | -1.9 | 8.0 | 7.0 | 7.0 |
| Exports of services, BOP, EUR mn | 42,419 | 34,125 | 38,691 | 41,552 | 48,117 | 49,000 | 51,000 | 54,000 |
| annual change in % | 8.3 | -19.6 | 13.4 | 7.4 | 15.8 | 2.0 | 5.0 | 5.0 |
| Imports of services, BOP, EUR mn | 20,563 | 20,366 | 21,250 | 19,496 | 19,856 | 21,000 | 23,000 | 25,000 |
| annual change in % | 7.9 | -1.0 | 4.3 | -8.3 | 1.8 | 7.5 | 8.0 | 8.0 |
| FDI liabilities, EUR mn | 17,376 | 12,627 | 10,201 | 11,128 | 7,476 | 9,000 | . | . |
| FDI assets, EUR mn | 4,595 | 2,837 | 2,419 | 3,069 | 2,575 | 1,820 | . | . |
| Gross reserves of NB excl. gold, EUR mn 7) | 85,356 | 87,334 | 70,202 | 63,666 | 69,974 | . | . | . |
| Gross external debt, EUR mn 7) | 367,819 | 388,626 | 378,969 | 384,872 | 399,000 | 404,800 | 416,200 | 427,700 |
| Gross external debt, % of GDP | 47.6 | 49.8 | 50.2 | 59.0 | 59.0 | 57.0 | 56.0 | 54.5 |
| Average exchange rate TRY/EUR | 3.0255 | 3.3433 | 4.1206 | 5.7077 | 6.3578 | 6.90 | 7.40 | 7.90 |

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

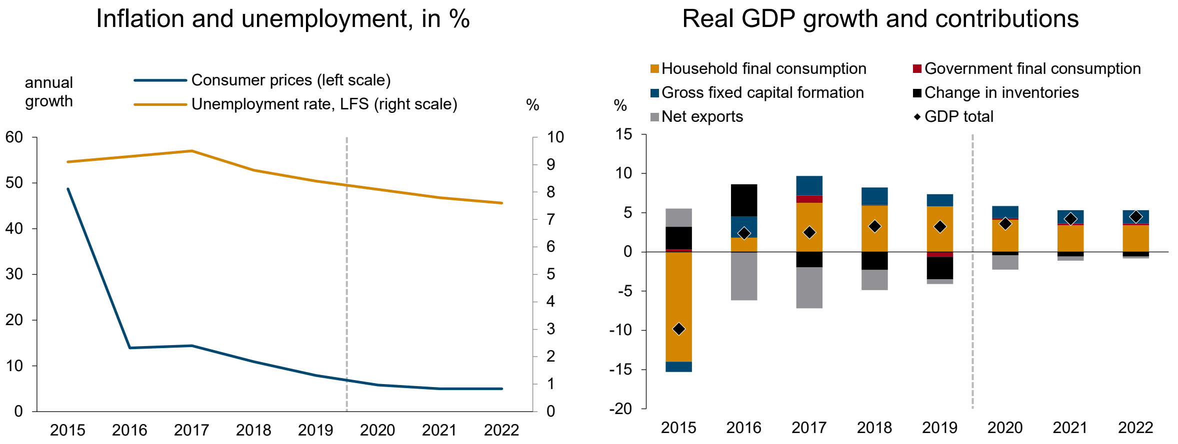
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.


# UKRAINE: All set for faster growth after a year of record performance

OLGA PINDYUK

Rapid macroeconomic stabilisation in 2019 allowed for a marked loosening of monetary policy. Exports showed robust growth on the back of agricultural products and services – notwithstanding hryvnia appreciation. We have revised our forecast of GDP growth upwards in the light of the positive trends. In 2020, GDP will grow by 3.6%, and in 2021-2022 growth will accelerate to 4.2% and 4.5%, respectively. A major risk to the forecast remains the inability of the government to break the oligarchs' grip on the country.

**Figure 6.23 / Ukraine: Main macroeconomic indicators**




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

**Economic growth exceeded expectations in 2019: according to our estimates, it achieved 3.3% year on year.** This result came on the back of strong private consumption, bolstered by rapidly growing wages and a strengthening domestic currency, and robust accumulation of gross fixed capital formation. Exports performed quite successfully as well, posting annual growth of 6.4%. This was mainly driven by a 19.0% rise in food exports; meanwhile metallurgical exports decreased by 12.3%. Ukraine has positioned itself as a leading exporter of agricultural products (in particular, grain) in the world, and has become the third-largest exporter of agri-food products to the European Union, thanks to a record harvest and improved access to the EU market under the DCFTA. Exports of services grew more dynamically than exports of goods – by 9.3% year on year, owing to a rise of 30.2% in the exports of computer services, other business services (14.8%) and travel expenditure (14.5%).

**Prudent monetary and fiscal policies resulted in rapid macroeconomic stabilisation in 2019.** Inflation decreased to 7.9% per annum, and in December the CPI achieved its lowest level for five years – 4.1% year on year. The hryvnia became the world's best-performing currency in 2019: by the end of the year it had appreciated by 19% against the US dollar, mainly thanks to a strong appetite among investors for Ukrainian bonds. The National Bank's currency reserves reached a seven-year peak of USD 26.3 billion in January 2020. These developments allowed the National Bank to reduce its policy rate even further: on 31 January 2020, it was cut by 2.5 p.p. to 11%, which is 7 p.p. lower than in January 2019.

**Further loosening of monetary policy is likely in 2020, as annual inflation is expected to remain in the target corridor.** We expect the policy rate to be further cut by 300 b.p. in 2020, and by another 100 b.p. in 2021, bringing the real interest rate down to 2% – a marked decrease from the 6.3% of 2019. However, such a loosening of monetary policy is likely to have only a limited positive effect on the credit market, as the transmission will be hampered by the continued presence of significant non-performing loans (NPLs) on banks' balance sheets and a lack of high-quality borrowers. At the end of 2019, the ratio of NPLs was still very high – 48.4%; but there was also good news, as this figure had decreased for the first time in three years – by 4.5 p.p. The issue of high proportions of NPLs mostly concerns the state-owned banks (PrivatBank, Oschadbank, Ukreximbank and Ukrgazbank), which account for three quarters of all NPLs. That said, some private banks also have very high NPL ratios, in particular some of those with Russian capital. At this stage, a high proportion of NPLs does not pose any major risks to the financial sector, since the coverage ratio exceeds 95%; but they do restrain credit growth.

**A risk here is that banks will use cheaper liquidity to further bolster already booming consumer lending, which may increase the probability of the market overheating.** In December 2019, the stock of consumer loans with maturity below five years (70% of all loans to households) showed 25.3% growth year on year. Average interest rates on consumer loans were 33.6%, but the effective interest rates are much higher (by a factor of two or three, according to local experts). The combination of all these factors could potentially create the conditions for a perfect storm on the market.

**Investors remain optimistic about Ukraine's economic prospects and there is strong demand for the country's government debt.** The yield on government bonds has declined noticeably, allowing the government to return to international capital markets: in January 2020, Ukraine raised EUR 1.25 billion issuing eurobonds at record-low borrowing costs; these bonds will yield 4.375% interest over 10 years. There has been strong demand on the part of foreign investors for hryvnia-denominated debt as well; as a result, the share of government hryvnia-denominated debt in total debt increased last year from 33% to 41%. Non-residents invested in hryvnia government bonds across all maturities up to six years, with more than 60% of bonds in the non-resident portfolio having a maturity of over two years. Though the yields on government hryvnia bonds have fallen sharply, the attraction of the bond market is expected to continue, given the lack of investment opportunities globally, in an environment of negative real interest rates.

**The risk of a build-up of external imbalances is currently low, and therefore we forecast only a slight depreciation of the hryvnia during the forecast period.** In 2019, the current account deficit narrowed to 2.6% of GDP,[44] despite the appreciating currency, driven by better terms of trade and strong export performance. In 2020-2022, the current account deficit will remain sustainable, at about 3% of GDP, despite a decrease in gas transit revenues. This comes on the back of steady export dynamics and strong inflows of remittances. External debt as a share of GDP declined slightly in 2019 to about 80%, and that trend is expected to continue. On the fiscal side, the government is pursuing a

[44] Excluding the compensation to Naftogaz from Gazprom, which was a one-off payment equivalent to about 2% of GDP.

rather restrained policy, keeping the budget deficit at about 2% of GDP and reducing public debt, which in 2019 fell by more than 10 p.p. to 50.3% of GDP. The Ministry of Finance has announced its goal of further cutting the debt to 45% by the end of 2020, and to 40% in 2024.

**A staff-level agreement with the IMF on a new USD 5.5 billion loan has provided encouraging news for investors, but there are risks involved in closing the deal.** The Ukrainian government appears to have satisfied most of the conditionalities of the Extended Fund Facility agreement, but there remains some uncertainty over finalising the deal, due to oligarch Ihor Kolomoisky's attempts to regain control of PrivatBank. In December 2019, the Cabinet of Ministers submitted a bill to parliament that would make it impossible –by either legislative or judicial means – for a bank, once declared insolvent, to be returned to its former owners. The bill was later modified, and in its current version it allows for compensation to be paid to the former owners of a failed bank – something that is strongly disapproved of by the IMF.

**Agreement with the IMF is crucial for Ukraine as it faces high debt repayments.** In 2020, Ukraine's loan repayment and servicing costs will be around USD 13.8 billion; these costs will peak in 2021, when more than USD 15.5 billion will be due to internal and external creditors.[45] Without an agreement, investors' confidence in the country might dwindle and it could face the risk of default.

**Foreign direct investment still showed only modest growth in 2019, and the government sees it as a priority to improve this situation.** Speaking during the World Economic Forum in Davos, Prime Minister Oleksiy Honcharuk promised to protect large investors in Ukraine and give them tax breaks. In particular, he promised to provide direct government guarantees to each investor who brings more than USD 100 million into Ukraine, and to give tax holidays of up to five years to investors who privatise Ukrainian enterprises worth more than USD 10 million. On 17 February 2020, Economy Minister Tymofiy Mylovanov announced an ambitious strategy 'Economic Strategy: Growth through Investment', which promises to attract USD 50 billion in FDI. To reach this goal, Mylovanov wants to improve infrastructure, sell large state-owned firms, amend Ukraine's obsolete labour code and protect local businesses from corporate raiding. The largest influx of investment is expected in agriculture, IT, infrastructure, energy and the chemical and pharma industries. At the end of December 2019, the Cabinet of Ministers approved a list of objects subject to privatisation, which are estimated to be worth about UAH 12 billion (USD 480 million); among them are regional energy companies and the alcohol monopoly UkrSpyrt. The Ministry of Infrastructure intends to use the concession mechanism to attract significant private investments to modernise infrastructure objects. In January 2020, the Qatar-based terminal operating company QTerminals won a UAH 3.4 billion (USD 138 million) concession to operate the port of Olvia in Mykolaiv region; meanwhile the development of concession projects is under way in the seaports of Odessa, Chornomorsk, Mariupol and Berdiansk. Concessions are being worked out for roads (Lviv-Stryi and Lviv-Ternopil), regional airports and train stations. On the negative side, anti-corruption and judicial reforms are progressing more slowly than expected, and land reform has already been watered down to exclude foreign investors.

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45 https://www.kyivpost.com/business/ukraine-to-pay-back-nearly-15-billion-in-public-debt-in-2019.html

**The Normandy Meeting in Paris on 9 December 2019 resulted in only limited progress in the peace negotiations regarding the Donbas military conflict.** Its main results lay in securing a ceasefire, expanding the no-contact zone and agreeing an all-for-all prisoner swap before the end of 2019. Russia and Ukraine exchanged 203 prisoners on 29 December: 76 Ukrainian citizens held in the occupied territories of Donetsk and Luhansk regions were traded for 127 Russian-aligned prisoners held in the government-controlled territory. The Ukrainian president maintained that implementation of the 'Steinmeier Formula'[46] for holding local government elections in the occupied parts of Donbas would be conditional on the complete withdrawal of all troops, and on Ukraine retaking control of the Russian-Ukrainian border.

**Ukraine has managed to secure its role as a gas transit country for the next five years, maintaining (at least partially) an important source of revenue.** On 30 December 2019, Russia and Ukraine reached a new agreement on natural gas transit for the next five years, according to which Russia will send 65 billion cubic metres through Ukraine in 2020, falling to 45 billion cubic metres thereafter; Ukraine is set to collect about USD 7.2 billion in gas transit fees by 2024 (about half of what it would have got under the terms of the old contract). Russia also agreed to pay USD 2.9 billion to Naftogaz as part of a Stockholm arbitration court ruling. In turn, Naftogaz has promised to release the seized assets of Gazprom in Europe, and both parties have agreed to drop reciprocal court claims that have not been concluded and to sign an out-of-court settlement.

**The introduction of sanctions against Nord Stream 2 by the US could be a positive thing for the economic growth of Ukraine.** The new pipeline project was supposed to be finalised by the end of 2019, and could have led to Ukraine losing its role as a gas transit country as early as 2020. However, following the announcement of sanctions, the key subcontractor of Nord Stream 2 – the Swiss-Dutch company Allseas – suspended the laying of pipes. It is not clear now when exactly the project will be finalised. US Energy Secretary Dan Brouillette said recently that he was confident that Russia would not be able to complete the Nord Stream 2 gas pipeline in the Baltic Sea, and signalled that the US would press ahead with its opposition to the project.[47] If the project is indeed delayed further, Ukraine could benefit from increased volumes of gas transiting through its territory in the future.

**In light of the positive trends, we have revised our forecast for GDP growth upwards.** In 2020, GDP will grow by 3.6%, and in 2021 and 2022 growth will accelerate to 4.2% and 4.5%, respectively, making Ukraine the fastest-growing country in 2022 in the region we cover. We assume that the expansionary monetary policy will continue and that the government will be successful in implementing a large chunk of its reforms. Strong labour demand will support wage increases, which in turn will boost private consumption. Investment, in particular FDI, will pick up as the business climate gradually improves. A major risk to the forecast remains the failure of the government to break the stranglehold of the oligarchs over large sections of the economy, and to rein in their political influence and their ability to direct policy in their own personal interests, rather than in the interests of economic development. This failure on the part of the government places cooperation with the IMF in jeopardy and could have a detrimental effect on investor confidence. This risk rose significantly with a sweeping reshuffle of the government and sacking of chief prosecutor on 4 March 2020.

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

[47] https://www.worldoil.com/news/2020/2/14/us-says-sanctions-mean-russia-can-t-finish-nord-stream-2-pipeline

## Table 6.23 / Ukraine: Selected economic indicators

| | 2015 | 2016 | 2017 | 2018 | 2019 1) | 2020 | 2021 Forecast | 2022 |
|---|---|---|---|---|---|---|---|---|
| Population, th pers., average | 42,845 | 42,673 | 42,485 | 42,270 | 42,030 | 42,050 | 41,950 | 41,800 |
| Gross domestic product, UAH bn, nom. | 1,989 | 2,385 | 2,984 | 3,559 | 3,970 | 4,400 | 4,800 | 5,300 |
| annual change in % (real) | -9.8 | 2.4 | 2.5 | 3.3 | 3.3 | 3.6 | 4.2 | 4.5 |
| GDP/capita (EUR at PPP) | 6,000 | 5,900 | 6,100 | 6,400 | 6,800 | . | . | . |
| Consumption of households, UAH bn, nom. | 1,332 | 1,570 | 1,978 | 2,431 | 2,850 | . | . | . |
| annual change in % (real) | -19.8 | 2.7 | 9.5 | 8.9 | 8.5 | 6.0 | 5.0 | 5.0 |
| Gross fixed capital form., UAH bn, nom. | 269 | 369 | 470 | 611 | 690 | . | . | . |
| annual change in % (real) | -9.2 | 20.4 | 16.1 | 14.3 | 9.0 | 9.0 | 10.0 | 10.0 |
| Gross industrial production | | | | | | | | |
| annual change in % (real) | -13.0 | 2.8 | 0.4 | 1.6 | -1.8 | 2.0 | 3.0 | 3.0 |
| Gross agricultural production | | | | | | | | |
| annual change in % (real) | -4.8 | 6.3 | -2.2 | 7.8 | 1.1 | . | . | . |
| Construction output | | | | | | | | |
| annual change in % (real) | -12.3 | 17.4 | 26.3 | 8.5 | 20.0 | . | . | . |
| Employed persons, LFS, th, average | 16,443 | 16,277 | 16,156 | 16,361 | 16,500 | 16,600 | 16,700 | 16,800 |
| annual change in % | -0.4 | -1.0 | -0.7 | 1.3 | 0.9 | 0.6 | 0.6 | 0.6 |
| Unemployed persons, LFS, th, average | 1,655 | 1,678 | 1,698 | 1,579 | 1,460 | 1,440 | 1,410 | 1,390 |
| Unemployment rate, LFS, in %, average | 9.1 | 9.3 | 9.5 | 8.8 | 8.4 | 8.1 | 7.8 | 7.6 |
| Reg. unemployment rate, in %, eop 2) | 1.6 | 1.5 | 1.4 | 1.3 | . | . | . | . |
| Average monthly gross wages, UAH 3) | 4,195 | 5,183 | 7,104 | 8,865 | 10,497 | 12,000 | 13,500 | 15,200 |
| annual change in % (real, gross) | -18.9 | 8.5 | 19.8 | 12.5 | 9.7 | 8.0 | 7.0 | 7.0 |
| annual change in % (real, net) | -20.2 | 9.0 | 19.0 | 12.5 | 9.8 | 9.0 | 8.0 | 8.0 |
| Consumer prices, % p.a. | 48.7 | 13.9 | 14.4 | 10.9 | 7.9 | 5.8 | 5.0 | 5.0 |
| Producer prices in industry, % p.a. 4) | 36.0 | 20.5 | 26.4 | 17.4 | 4.1 | 4.0 | 6.0 | 7.0 |
| General governm.budget, nat.def., % of GDP | | | | | | | | |
| Revenues | 32.8 | 32.8 | 34.1 | 33.3 | 32.5 | 33.5 | 33.5 | 33.5 |
| Expenditures | 34.3 | 35.1 | 35.5 | 35.2 | 34.6 | 35.5 | 35.5 | 35.5 |
| Deficit (-) / surplus (+) 5) | -1.6 | -2.3 | -1.4 | -1.9 | -2.1 | -2.0 | -2.0 | -2.0 |
| General gov.gross debt, nat.def., % of GDP | 79.1 | 80.9 | 71.8 | 60.9 | 50.3 | 47.0 | 45.0 | 43.0 |
| Stock of loans of non-fin.private sector, % p.a. | -2.8 | 2.4 | 1.9 | 5.6 | -9.8 | . | . | . |
| Non-performing loans (NPL), in %, eop 6) | 28.0 | 30.5 | 54.5 | 52.9 | 48.0 | . | . | . |
| Central bank policy rate, % p.a., eop 7) | 22.00 | 14.00 | 14.50 | 18.00 | 13.50 | 9.5 | 8.0 | 7.5 |
| Current account, EUR mn 8) | 1,457 | -1,210 | -2,165 | -3,696 | -957 | -4,900 | -4,700 | -4,700 |
| Current account, % of GDP | 1.8 | -1.4 | -2.2 | -3.3 | -0.7 | -3.3 | -3.0 | -2.8 |
| Exports of goods, BOP, EUR mn 8) | 31,935 | 30,309 | 35,192 | 36,677 | 41,167 | 42,400 | 44,100 | 45,900 |
| annual change in % | -16.5 | -5.1 | 16.1 | 4.2 | 12.2 | 3.0 | 4.0 | 4.1 |
| Imports of goods, BOP, EUR mn 8) | 35,050 | 36,579 | 43,758 | 47,436 | 53,618 | 56,300 | 58,600 | 60,900 |
| annual change in % | -19.7 | 4.4 | 19.6 | 8.4 | 13.0 | 5.0 | 4.1 | 3.9 |
| Exports of services, BOP, EUR mn 8) | 11,218 | 11,242 | 12,558 | 13,365 | 15,413 | 16,000 | 17,000 | 18,200 |
| annual change in % | -0.4 | 0.2 | 11.7 | 6.4 | 15.3 | 3.8 | 6.3 | 7.1 |
| Imports of services, BOP, EUR mn 8) | 10,232 | 10,801 | 11,655 | 12,226 | 13,779 | 14,500 | 15,000 | 15,700 |
| annual change in % | 9.4 | 5.6 | 7.9 | 4.9 | 12.7 | 5.2 | 3.4 | 4.7 |
| FDI liabilities, EUR mn 8) | 2,750 | 3,108 | 2,506 | 2,095 | 2,891 | 3,600 | . | . |
| FDI assets, EUR mn 8) | 34 | 156 | 207 | 98 | 655 | 400 | . | . |
| Gross reserves of NB excl. gold, EUR mn 8) | 11,320 | 13,965 | 14,872 | 15,955 | 21,590 | . | . | . |
| Gross external debt, EUR mn 8) | 107,695 | 107,648 | 96,741 | 92,352 | 109,870 | 112,500 | 116,100 | 118,800 |
| Gross external debt, % of GDP | 131.2 | 127.7 | 97.3 | 83.4 | 80.1 | 75.9 | 74.5 | 71.5 |
| Average exchange rate UAH/EUR | 24.23 | 28.29 | 30.00 | 32.14 | 28.95 | 29.7 | 30.8 | 31.9 |

Note: Excluding the occupied territories of Crimea and Sevastopol and, with the exception of the population, excluding the temporarily occupied territories in the Donetsk and Luhansk regions.

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

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

# 7. Appendix

## Table 7.1 / European Union-Central and Eastern Europe (EU-CEE11): an overview of economic fundamentals, 2019

| | BG | CZ | EE | HR | HU | LT | LV | PL | RO | SI | SK | *CEE11* [1] | *EU28* [2] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross domestic product | | | | | | | | | | | | | |
| EUR bn, at ER | 59.5 | 218.9 | 27.7 | 53.7 | 142.0 | 48.0 | 30.6 | 521.2 | 221.3 | 47.7 | 94.4 | *1,465* | *16,384* |
| EUR bn, at PPP | 115.6 | 309.9 | 35.2 | 83.6 | 228.3 | 73.5 | 42.7 | 880.1 | 418.7 | 58.1 | 128.1 | *2,374* | *16,384* |
| EU28=100, at PPP | 0.7 | 1.9 | 0.2 | 0.5 | 1.4 | 0.4 | 0.3 | 5.4 | 2.6 | 0.4 | 0.8 | *14.5* | *100.0* |
| Per capita, EUR, at PPP | 16,600 | 29,000 | 26,500 | 20,600 | 23,500 | 26,400 | 22,200 | 22,900 | 21,600 | 27,900 | 23,500 | *23,100* | *31,800* |
| Per capita, EU28=100, at PPP | 52 | 91 | 83 | 65 | 74 | 83 | 70 | 72 | 68 | 88 | 74 | *73* | *100* |
| 1990=100 [3] | 147.9 | 174.0 | 183.8 | 122.6 | 163.4 | 154.2 | 136.3 | 258.1 | 189.7 | 183.0 | 211.9 | *209.3* | *170.2* |
| 2007=100 | 129.0 | 122.3 | 116.0 | 104.0 | 123.5 | 123.0 | 107.2 | 153.0 | 140.2 | 114.3 | 134.3 | *135.9* | *116.3* |
| Price level | | | | | | | | | | | | | |
| EU-28=100 (PPP/ER) | 51 | 71 | 79 | 64 | 62 | 65 | 72 | 59 | 53 | 82 | 74 | *62* | *100* |
| Industrial production | | | | | | | | | | | | | |
| 2007=100 [4] | 100.0 | 119.6 | 128.2 | 91.7 | 127.1 | 134.3 | 125.1 | 158.5 | 149.2 | 121.3 | 155.5 | *140.2* | *102.0* |
| Population | | | | | | | | | | | | | |
| in thousand, average | 6,950 | 10,670 | 1,328 | 4,050 | 9,720 | 2,780 | 1,920 | 38,400 | 19,400 | 2,080 | 5,450 | *102,748* | *514,693* |
| Employed persons, LFS | | | | | | | | | | | | | |
| in thousand, average | 3,233 | 5,303 | 671 | 1,675 | 4,512 | 1,378 | 910 | 16,480 | 8,690 | 990 | 2,590 | *46,433* | *232,657* |
| Unemployment rate, LFS | | | | | | | | | | | | | |
| in % | 4.3 | 2.0 | 4.4 | 6.5 | 3.4 | 6.3 | 6.5 | 3.5 | 3.9 | 4.6 | 5.8 | *3.9* | *6.4* |
| Average gross monthly wages | | | | | | | | | | | | | |
| EUR [5] | 651 | 1,328 | 1,390 | 1,182 | 1,129 | 1,300 | 1,080 | 1,147 | 1,038 | 1,754 | 1,090 | *1,129* | *2,530* |
| EU28=100 | 25.7 | 52.5 | 54.9 | 46.7 | 44.6 | 51.4 | 42.7 | 45.3 | 41.0 | 69.3 | 43.1 | *44.6* | *100.0* |
| General government budget, EU-def., % of GDP | | | | | | | | | | | | | |
| Revenues | 40.0 | 39.8 | 39.3 | 47.0 | 44.5 | 34.9 | 36.9 | 41.2 | 32.5 | 44.0 | 41.2 | *39.9* | *45.0* |
| Expenditures | 41.5 | 39.2 | 39.6 | 46.7 | 46.2 | 34.8 | 37.7 | 42.4 | 36.5 | 43.8 | 42.4 | *41.2* | *45.9* |
| Balance | -1.5 | 0.6 | -0.3 | 0.3 | -1.7 | 0.1 | -0.8 | -1.2 | -4.0 | 0.2 | -1.2 | *-1.2* | *-0.9* |
| Public debt, EU def., % of GDP | 20.5 | 30.3 | 8.3 | 71.3 | 69.1 | 36.0 | 36.0 | 47.2 | 37.0 | 68.0 | 48.2 | *44.5* | *80.6* |
| BOP items, % of GDP | | | | | | | | | | | | | |
| Current account | 9.9 | -0.1 | 1.7 | 2.6 | -0.3 | 0.5 | -0.3 | 1.1 | -4.7 | 6.6 | -2.9 | *0.2* [6] | *1.7* [6] |
| Exports of goods | 48.5 | 63.4 | 48.1 | 23.9 | 65.2 | 54.3 | 41.3 | 44.1 | 28.5 | 67.1 | 82.7 | *42.9* [6] | *32.6* [6] |
| Imports of goods | 48.7 | 59.2 | 51.4 | 42.6 | 66.7 | 58.8 | 49.4 | 43.6 | 36.3 | 64.3 | 83.5 | *44.2* [6] | *31.5* [6] |
| Exports of services | 15.5 | 12.1 | 25.0 | 27.5 | 18.2 | 24.3 | 18.4 | 12.4 | 11.9 | 17.9 | 11.3 | *12.5* [6] | *14.1* [6] |
| Imports of services | 8.7 | 10.0 | 17.9 | 9.3 | 12.5 | 14.8 | 10.2 | 7.7 | 8.0 | 11.6 | 10.2 | *8.0* [6] | *12.1* [6] |
| FDI stock per capita, EUR [7] | 6,119 | 12,713 | 15,398 | 5,972 | 8,510 | 6,095 | 7,918 | 5,201 | 4,181 | 7,281 | 9,365 | *6,663* | *14,870* |

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) LT: Gross wages include employer's social security contribution (28.9%). EU28: Gross wages according to national accounts concept. - 6) Data for EU-CEE and EU-28 include transactions within the region (sum over individual countries). - 7) Excluding SPE. Year 2018 (for EU28 year 2017).

Source: wiiw Annual Database, Eurostat.

## Table 7.2 / Western Balkans and Turkey, selected CIS countries and Ukraine: an overview of economic fundamentals, 2019

| | AL | BA | ME | MK | RS | XK | TR | BY | KZ | MD | RU | UA | *CEE11* [1] | *EU28* [2] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross domestic product | | | | | | | | | | | | | | |
| EUR bn, at ER | 13.8 | 17.6 | 4.8 | 11.2 | 45.8 | 7.2 | 676.3 | 56.0 | 160.2 | 10.7 | 1,508.3 | 137.1 | *1,465* | *16,384* |
| EUR bn, at PPP | 28.7 | 36.0 | 9.7 | 25.2 | 91.3 | 15.5 | 1,641.0 | 135.9 | 394.0 | 19.7 | 3,008.3 | 284.2 | *2,374* | *16,384* |
| EU28=100, at PPP | 0.2 | 0.2 | 0.1 | 0.2 | 0.6 | 0.1 | 10.0 | 0.8 | 2.4 | 0.1 | 18.4 | 1.7 | *14.5* | *100.0* |
| Per capita, EUR, at PPP | 10,000 | 10,300 | 15,400 | 12,000 | 13,100 | 8,500 | 19,900 | 14,400 | 21,300 | 7,500 | 20,500 | 6,800 | *23,100* | *31,800* |
| Per capita, EU28=100, at PPP | 31 | 32 | 48 | 38 | 41 | 27 | 63 | 45 | 67 | 24 | 64 | 21 | *73* | *100* |
| 1990=100 | 247.2 | . | . | 152.3 | . | . | 342.5 | 199.6 | 219.0 | 82.1 | 124.1 | 65.5 | *209.3* | *170.2* |
| 2007=100 | 144.3 | 125.0 | 132.9 | 135.4 | 123.8 | 157.3 | 168.4 | 131.5 | 161.6 | 155.4 | 116.8 | 90.0 | *135.9* | *116.3* |
| Price level | | | | | | | | | | | | | | |
| EU28=100 (PPP/ER) | 48 | 49 | 50 | 44 | 50 | 47 | 41 | 41 | 41 | 54 | 50 | 48 | *62* | *100* |
| Industrial production | | | | | | | | | | | | | | |
| 2007=100 [3] | 283.2 | 119.2 | 73.5 | 122.1 | 104.8 | 194.3 | 165.3 | 142.1 | 140.4 | 125.3 | 119.9 | 68.7 | *140.2* | *102.0* |
| Population | | | | | | | | | | | | | | |
| in thousand, average | 2,870 | 3,500 | 625 | 2,100 | 6,950 | 1,820 | 82,579 | 9,450 | 18,514 | 2,640 | 146,763 | 42,030 | *102,748* | *514,693* |
| Employed persons, LFS | | | | | | | | | | | | | | |
| in thousand, average | 1,275 | 803 | 246 | 795 | 2,890 | 380 | 28,081 | . | 8,810 | 860 | 71,933 | 16,500 | *46,433* | *232,657* |
| Unemployment rate, LFS | | | | | | | | | | | | | | |
| in % | 11.3 | 15.7 | 14.8 | 17.0 | 10.7 | 24.5 | 13.7 | 4.2 | 4.8 | 5.5 | 4.6 | 8.4 | *3.9* | *6.4* |
| Average gross monthly wages | | | | | | | | | | | | | | |
| EUR at ER | 436 | 727 | 773 | 606 | 638 | 600 | 511 | 480 | 433 | 356 | 654 | 363 | *1,129* | *2,530* [4] |
| EU28=100 | 17.2 | 28.7 | 30.6 | 24.0 | 25.2 | 23.7 | 20.2 | 19.0 | 17.1 | 14.1 | 25.8 | 14.3 | *44.6* | *100.0* |
| General government budget, nat. def., % of GDP | | | | | | | | | | | | | | |
| Revenues | 27.1 | 42.1 | 43.0 | 29.0 | 42.2 | 30.7 | 31.0 | 41.0 | 18.6 | 29.8 | 35.8 | 32.5 | *39.9* [5] | *45.0* [5] |
| Expenditures | 28.9 | 41.1 | 45.3 | 30.8 | 42.4 | 30.0 | 34.0 | 37.0 | 20.5 | 31.3 | 33.8 | 34.6 | *41.2* [5] | *45.9* [5] |
| Balance | -1.9 | 1.0 | -2.3 | -1.8 | 0.7 | 0.7 | -3.0 | 4.0 | -1.9 | -1.4 | 2.0 | -2.1 | *-1.2* [5] | *-0.9* [5] |
| Public debt, nat. def., % of GDP | 67.5 | 31.7 | 69.0 | 47.0 | 52.0 | 17.2 | 32.0 | 42.0 | 25.2 | 26.3 | 12.4 | 50.3 | *44.5* [5] | *80.6* [5] |
| BOP items, % of GDP | | | | | | | | | | | | | | |
| Current account | -7.6 | -5.2 | -16.7 | -0.7 | -6.2 | -6.8 | 0.2 | -0.5 | -3.1 | -10.7 | 4.2 | -0.7 | *0.2* [6] | *1.7* [6] |
| Exports of goods | 6.6 | 29.9 | 9.6 | 49.4 | 36.2 | 5.6 | 24.1 | 51.6 | 32.0 | 17.3 | 24.7 | 30.0 | *42.9* [6] | *32.6* [6] |
| Imports of goods | 29.3 | 52.9 | 53.3 | 66.4 | 48.7 | 45.8 | 26.5 | 58.2 | 21.1 | 45.7 | 15.1 | 39.1 | *44.2* [6] | *31.5* [6] |
| Exports of services | 24.0 | 11.2 | 35.8 | 14.8 | 15.3 | 24.3 | 7.1 | 15.4 | 4.3 | 13.1 | 3.8 | 11.2 | *12.5* [6] | *14.1* [6] |
| Imports of services | 15.2 | 3.6 | 15.0 | 11.8 | 12.9 | 11.1 | 2.9 | 9.3 | 6.2 | 10.0 | 5.8 | 10.0 | *8.0* [6] | *12.1* [6] |
| FDI stock per capita, EUR [7] | 2,411 | 2,088 | 7,436 | 2,555 | 4,996 | 2,056 | 1,585 | 1,201 | 7,083 | 1,352 | 2,440 | 847 | *6,663* | *14,870* |

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

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) EU-28 working-day adjusted. - 4) Gross wages according to national account concept. - 5) EU definition: expenditures and revenues according to ESA 2010, excessive deficit procedure. - 6) Data for EU-CEE and EU-28 include transactions within the region. - 7) Excluding SPE. Year 2018 (for EU28 year 2017).

Source: wiiw Annual Database, Eurostat.

## Table 7.3 / GDP per capita at current PPPs (EUR), from 2020 at constant PPPs and population

| | | 1990 | 1995 | 2000 | 2005 | 2010 | 2015 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | | Forecast | |
| BG | Bulgaria | 4,600 | 6,500 | 5,600 | 8,700 | 11,200 | 13,800 | 14,900 | 15,700 | 16,600 | 17,100 | 17,500 | 17,800 |
| CZ | Czech Republic | 9,400 | 11,600 | 14,200 | 18,600 | 21,100 | 25,300 | 26,800 | 28,000 | 29,000 | 29,700 | 30,400 | 31,200 |
| EE | Estonia | 6,000 | 5,400 | 8,200 | 14,100 | 16,700 | 22,100 | 23,600 | 25,300 | 26,500 | 27,200 | 27,900 | 28,700 |
| HR | Croatia | 7,800 | 6,700 | 9,700 | 13,000 | 15,100 | 17,300 | 18,600 | 19,500 | 20,600 | 21,200 | 21,800 | 22,400 |
| HU | Hungary | 6,800 | 7,700 | 10,400 | 14,500 | 16,500 | 20,100 | 20,600 | 21,900 | 23,500 | 24,300 | 24,900 | 25,400 |
| LT | Lithuania | 7,000 | 5,000 | 7,400 | 12,400 | 15,300 | 21,700 | 23,600 | 24,900 | 26,400 | 27,100 | 27,800 | 28,600 |
| LV | Latvia | 6,500 | 4,600 | 7,000 | 11,800 | 13,500 | 18,700 | 19,900 | 21,300 | 22,200 | 22,700 | 23,200 | 23,800 |
| PL | Poland | 4,700 | 6,500 | 9,300 | 11,800 | 15,900 | 19,900 | 20,800 | 21,800 | 22,900 | 23,700 | 24,500 | 25,300 |
| RO | Romania | 4,200 | 4,600 | 5,100 | 8,200 | 13,000 | 16,300 | 19,000 | 20,300 | 21,600 | 22,300 | 22,900 | 23,600 |
| SI | Slovenia | 9,200 | 11,500 | 15,800 | 20,300 | 21,300 | 23,800 | 25,500 | 26,900 | 27,900 | 28,600 | 29,400 | 30,200 |
| SK | Slovakia | 6,600 | 7,300 | 10,000 | 14,100 | 19,100 | 22,500 | 21,500 | 22,600 | 23,500 | 24,000 | 24,600 | 25,200 |
| | EU-CEE11 | 5,700 | 6,700 | 8,800 | 12,100 | 15,800 | 19,500 | 20,800 | 21,900 | 23,100 | 23,800 | 24,500 | 25,200 |
| AL | Albania | 1,900 | 2,000 | 3,400 | 5,000 | 7,400 | 8,800 | 9,100 | 9,600 | 10,000 | 10,300 | 10,700 | 11,100 |
| BA | Bosnia & Herzeg. | . | . | 4,000 | 5,400 | 6,900 | 8,800 | 9,200 | 9,900 | 10,300 | 10,600 | 10,900 | 11,200 |
| ME | Montenegro | . | . | 5,300 | 7,100 | 10,400 | 12,300 | 13,700 | 14,800 | 15,400 | 15,800 | 16,300 | 16,800 |
| MK | North Macedonia | 4,400 | 4,000 | 5,400 | 6,700 | 8,700 | 10,400 | 10,900 | 11,500 | 12,000 | 12,400 | 12,800 | 13,200 |
| RS | Serbia | . | 3,200 | 5,300 | 7,800 | 9,800 | 11,200 | 11,600 | 12,400 | 13,100 | 13,600 | 14,100 | 14,600 |
| XK | Kosovo | . | . | 4,200 | 5,400 | 5,900 | 7,400 | 7,700 | 8,100 | 8,500 | 8,900 | 9,300 | 9,700 |
| TR | Turkey | 5,000 | 6,000 | 8,300 | 10,000 | 13,200 | 19,300 | 19,600 | 19,700 | 19,900 | 20,700 | 21,500 | 22,400 |
| BY | Belarus | 4,200 | 3,400 | 5,300 | 8,500 | 11,900 | 13,800 | 13,200 | 13,900 | 14,400 | 14,500 | 14,700 | 14,900 |
| KZ | Kazakhstan | 7,400 | 5,100 | 6,900 | 12,100 | 15,100 | 18,900 | 18,900 | 20,300 | 21,300 | 22,100 | 22,900 | 23,800 |
| MD | Moldova | 3,700 | 2,000 | 2,000 | 3,000 | 3,500 | 5,700 | 6,200 | 6,700 | 7,500 | 7,800 | 8,100 | 8,400 |
| RU | Russia | 6,700 | 4,700 | 6,000 | 10,100 | 15,700 | 18,100 | 18,100 | 19,900 | 20,500 | 20,900 | 21,400 | 21,900 |
| UA | Ukraine | 5,700 | 3,100 | 3,300 | 5,700 | 6,100 | 6,000 | 6,100 | 6,400 | 6,800 | 7,000 | 7,300 | 7,600 |
| AT | Austria | 17,700 | 19,900 | 25,700 | 29,800 | 32,200 | 37,600 | 38,100 | 39,400 | 40,500 | 41,000 | 41,500 | 42,300 |
| DE | Germany | 22,200 | 19,900 | 24,100 | 27,400 | 30,400 | 35,800 | 36,900 | 37,800 | 38,400 | 38,800 | 39,200 | 40,000 |
| EL | Greece | 12,100 | 13,000 | 17,100 | 21,700 | 21,500 | 20,200 | 20,300 | 21,000 | 21,900 | 22,400 | 22,800 | 23,300 |
| IE | Ireland | 12,500 | 16,000 | 26,500 | 34,400 | 33,100 | 52,000 | 54,500 | 58,600 | 62,200 | 64,400 | 66,500 | 67,800 |
| IT | Italy | 17,000 | 18,800 | 23,700 | 25,500 | 26,700 | 27,700 | 29,100 | 29,700 | 30,200 | 30,300 | 30,500 | 31,100 |
| PT | Portugal | 10,600 | 12,100 | 16,500 | 19,300 | 20,900 | 22,300 | 23,000 | 23,800 | 24,600 | 25,000 | 25,400 | 25,900 |
| ES | Spain | 12,400 | 13,700 | 18,900 | 23,500 | 24,300 | 26,300 | 27,600 | 28,100 | 28,800 | 29,300 | 29,700 | 30,300 |
| US | United States | 20,000 | 24,100 | 31,800 | 37,400 | 37,000 | 42,700 | 41,800 | 43,600 | 44,900 | 45,700 | 46,400 | 47,300 |
| | EU28 average | 13,700 | 15,200 | 19,900 | 23,400 | 25,500 | 29,100 | 30,100 | 31,000 | 31,800 | 32,200 | 32,700 | 33,200 |

**European Union (28) average = 100**

| | | 1990 | 1995 | 2000 | 2005 | 2010 | 2015 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| BG | Bulgaria | 34 | 43 | 28 | 37 | 44 | 47 | 50 | 51 | 52 | 53 | 54 | 54 |
| CZ | Czech Republic | 69 | 76 | 71 | 79 | 83 | 87 | 89 | 90 | 91 | 92 | 93 | 94 |
| EE | Estonia | 44 | 36 | 41 | 60 | 65 | 76 | 78 | 82 | 83 | 84 | 85 | 86 |
| HR | Croatia | 57 | 44 | 49 | 56 | 59 | 59 | 62 | 63 | 65 | 66 | 67 | 67 |
| HU | Hungary | 50 | 51 | 52 | 62 | 65 | 69 | 68 | 71 | 74 | 75 | 76 | 77 |
| LT | Lithuania | 51 | 33 | 37 | 53 | 60 | 75 | 78 | 80 | 83 | 84 | 85 | 86 |
| LV | Latvia | 47 | 30 | 35 | 50 | 53 | 64 | 66 | 69 | 70 | 70 | 71 | 72 |
| PL | Poland | 34 | 43 | 47 | 50 | 62 | 68 | 69 | 70 | 72 | 74 | 75 | 76 |
| RO | Romania | 31 | 30 | 26 | 35 | 51 | 56 | 63 | 65 | 68 | 69 | 70 | 71 |
| SI | Slovenia | 67 | 76 | 79 | 87 | 84 | 82 | 85 | 87 | 88 | 89 | 90 | 91 |
| SK | Slovakia | 48 | 48 | 50 | 60 | 75 | 77 | 71 | 73 | 74 | 75 | 75 | 76 |
| | EU-CEE | 42 | 44 | 44 | 52 | 62 | 67 | 69 | 71 | 73 | 74 | 75 | 76 |
| AL | Albania | 14 | 13 | 17 | 21 | 29 | 30 | 30 | 31 | 31 | 32 | 33 | 33 |
| BA | Bosnia & Herzeg. | . | . | 20 | 23 | 27 | 30 | 31 | 32 | 32 | 33 | 33 | 34 |
| ME | Montenegro | . | . | 27 | 30 | 41 | 42 | 46 | 48 | 48 | 49 | 50 | 51 |
| MK | North Macedonia | 32 | 26 | 27 | 29 | 34 | 36 | 36 | 37 | 38 | 39 | 39 | 40 |
| RS | Serbia | . | 21 | 27 | 33 | 38 | 38 | 39 | 40 | 41 | 42 | 43 | 44 |
| XK | Kosovo | . | . | 21 | 23 | 23 | 25 | 26 | 26 | 27 | 28 | 28 | 29 |
| TR | Turkey | 36 | 39 | 42 | 43 | 52 | 66 | 65 | 64 | 63 | 64 | 66 | 67 |
| BY | Belarus | 31 | 22 | 27 | 36 | 47 | 47 | 44 | 45 | 45 | 45 | 45 | 45 |
| KZ | Kazakhstan | 54 | 34 | 35 | 52 | 59 | 65 | 63 | 65 | 67 | 69 | 70 | 72 |
| MD | Moldova | 27 | 13 | 10 | 13 | 14 | 20 | 21 | 22 | 24 | 24 | 25 | 25 |
| RU | Russia | 49 | 31 | 30 | 43 | 62 | 62 | 60 | 64 | 64 | 65 | 65 | 66 |
| UA | Ukraine | 42 | 20 | 17 | 24 | 24 | 21 | 20 | 21 | 21 | 22 | 22 | 23 |
| AT | Austria | 129 | 131 | 129 | 127 | 126 | 129 | 127 | 127 | 127 | 127 | 127 | 127 |
| DE | Germany | 162 | 131 | 121 | 117 | 119 | 123 | 123 | 122 | 121 | 120 | 120 | 120 |
| EL | Greece | 88 | 86 | 86 | 93 | 84 | 69 | 67 | 68 | 69 | 70 | 70 | 70 |
| IE | Ireland | 91 | 105 | 133 | 147 | 130 | 179 | 181 | 189 | 196 | 200 | 203 | 204 |
| IT | Italy | 124 | 124 | 119 | 109 | 105 | 95 | 97 | 96 | 95 | 94 | 93 | 94 |
| PT | Portugal | 77 | 80 | 83 | 82 | 82 | 77 | 76 | 77 | 77 | 78 | 78 | 78 |
| ES | Spain | 91 | 90 | 95 | 100 | 95 | 90 | 92 | 91 | 91 | 91 | 91 | 91 |
| US | United States | 146 | 159 | 160 | 160 | 145 | 147 | 139 | 141 | 141 | 142 | 142 | 142 |
| | EU28 average | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

Sources: wiiw Annual Database incorporating national and Eurostat statistics; forecasts by wiiw and EC - Winter Report 2020.

## Table 7.4 / Indicators of macro-competitiveness, 2015-2022, annual changes in %

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2015-19 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | | average |
| **Bulgaria** | | | | | | | | | |
| GDP deflator | 2.4 | 2.5 | 3.9 | 4.0 | 2.5 | 2.5 | 2.0 | 1.9 | 3.1 |
| Real ER (CPI-based) | -1.1 | -1.6 | -0.5 | 0.7 | 1.0 | 0.6 | 0.1 | 0.0 | -0.3 |
| Real ER (PPI-based) | 0.0 | -1.7 | 1.9 | 1.0 | 2.3 | 0.7 | 0.3 | 0.0 | 0.7 |
| Average gross wages, real (PPI based) | 9.2 | 11.5 | 4.2 | 6.4 | 7.9 | 4.9 | 4.5 | 4.1 | 7.8 |
| Average gross wages, real (CPI based) | 8.0 | 9.4 | 8.1 | 7.7 | 8.4 | 4.9 | 4.5 | 4.1 | 8.3 |
| Average gross wages, EUR (ER) | 6.8 | 8.0 | 9.4 | 10.5 | 11.1 | 7.5 | 7.1 | 5.3 | 9.2 |
| Employed persons (LFS) | 1.7 | -0.5 | 4.4 | 0.1 | 2.6 | 0.5 | 0.3 | 0.3 | 1.6 |
| GDP real per employed person, NC | 2.3 | 4.3 | -0.9 | 3.0 | 0.9 | 2.1 | 2.0 | 2.0 | 1.9 |
| Unit labour costs, ER (EUR) adjusted | 4.5 | 3.5 | 10.4 | 7.3 | 10.1 | 5.4 | 4.4 | 4.1 | 7.1 |
| **Czech Republic** | | | | | | | | | |
| GDP deflator | 1.2 | 1.3 | 1.4 | 2.6 | 3.1 | 2.2 | 2.3 | -2.5 | 1.9 |
| Exchange rate (ER), EUR/NC | 0.9 | 0.9 | 2.7 | 2.6 | -0.1 | 1.1 | 0.0 | 0.0 | 1.4 |
| Real ER (CPI-based) | 1.2 | 1.2 | 3.4 | 2.7 | 1.0 | 1.7 | 0.3 | 0.0 | 1.9 |
| Real ER (PPI-based) | 0.7 | -0.9 | 0.4 | 0.5 | 0.9 | 0.8 | -0.2 | -1.0 | 0.3 |
| Average gross wages, real (PPI based) | 5.7 | 7.9 | 6.0 | 6.8 | 5.2 | 4.3 | 3.7 | 4.0 | 6.3 |
| Average gross wages, real (CPI based) | 2.9 | 3.8 | 4.2 | 5.4 | 4.3 | 3.3 | 3.0 | 2.9 | 4.1 |
| Average gross wages, EUR (ER) | 4.2 | 5.4 | 9.6 | 10.4 | 6.9 | 6.9 | 5.6 | 4.7 | 7.3 |
| Employed persons (LFS) | 1.4 | 1.9 | 1.6 | 1.4 | 0.2 | 0.7 | 0.2 | 0.0 | 1.3 |
| GDP real per employed person, NC | 3.9 | 0.5 | 2.7 | 1.4 | 2.2 | 1.5 | 2.2 | 2.6 | 2.1 |
| Unit labour costs, ER (EUR) adjusted | 0.3 | 4.8 | 6.7 | 8.8 | 4.6 | 5.4 | 3.0 | 2.3 | 5.0 |
| **Estonia** | | | | | | | | | |
| GDP deflator | 1.1 | 1.7 | 3.6 | 4.5 | 2.4 | 2.3 | 2.5 | 2.5 | 2.7 |
| Real ER (CPI-based) | 0.1 | 0.5 | 2.0 | 1.5 | 0.8 | 0.5 | 0.6 | 0.6 | 1.0 |
| Real ER (PPI-based) | -0.3 | 0.5 | 0.3 | 1.0 | -1.3 | -1.7 | 0.3 | 1.0 | 0.0 |
| Average gross wages, real (PPI based) | 8.7 | 8.6 | 3.1 | 3.3 | 6.7 | 5.8 | 4.0 | 2.7 | 6.1 |
| Average gross wages, real (CPI based) | 5.9 | 6.8 | 2.7 | 3.8 | 3.7 | 3.3 | 3.5 | 3.1 | 4.6 |
| Average gross wages, EUR (ER) | 6.0 | 7.6 | 6.5 | 7.3 | 6.1 | 5.8 | 6.1 | 5.8 | 6.7 |
| Employed persons (LFS) | 2.6 | 0.6 | 2.2 | 0.9 | 1.0 | 0.8 | 0.4 | 0.7 | 1.4 |
| GDP real per employed person, NC | -0.7 | 2.0 | 3.5 | 3.8 | 2.9 | 1.9 | 1.9 | 2.2 | 2.3 |
| Unit labour costs, ER (EUR) adjusted | 6.7 | 5.5 | 2.9 | 3.4 | 3.1 | 3.7 | 4.1 | 3.5 | 4.3 |
| **Croatia** | | | | | | | | | |
| GDP deflator | 0.1 | -0.1 | 1.2 | 1.8 | 0.9 | 1.5 | 1.6 | 2.0 | 0.8 |
| Exchange rate (ER), EUR/NC | 0.3 | 1.1 | 0.9 | 0.6 | 0.0 | 0.2 | 0.0 | 0.0 | 0.6 |
| Real ER (CPI-based) | 0.0 | 0.2 | 0.5 | 0.3 | -0.7 | -3.3 | -0.4 | 0.0 | 0.1 |
| Real ER (PPI-based) | -1.4 | -1.9 | 0.0 | -0.1 | 0.1 | 0.3 | 0.2 | 0.0 | -0.7 |
| Average gross wages, real (PPI based) | 5.3 | 6.5 | 1.9 | 2.6 | 2.9 | 2.0 | 2.4 | 2.2 | 3.8 |
| Average gross wages, real (CPI based) | 1.3 | 3.7 | 1.9 | 3.9 | 1.4 | 2.3 | 2.9 | 2.2 | 2.4 |
| Average gross wages, EUR (ER) | 1.6 | 3.0 | 4.9 | 5.5 | 3.8 | 4.1 | 4.1 | 4.7 | 3.7 |
| Employed persons (LFS) | 1.3 | 0.3 | 2.2 | 1.8 | 1.2 | 0.9 | 0.6 | 0.6 | 1.4 |
| GDP real per employed person, NC | 1.2 | 3.2 | 0.9 | 0.8 | 1.8 | 1.8 | 2.1 | 2.0 | 1.6 |
| Unit labour costs, ER (EUR) adjusted | 0.4 | -0.2 | 3.9 | 4.6 | 2.0 | 2.2 | 2.3 | 2.2 | 2.1 |
| **Hungary** | | | | | | | | | |
| GDP deflator | 2.5 | 1.0 | 3.7 | 4.5 | 3.2 | 3.1 | 3.2 | 3.1 | 3.0 |
| Exchange rate (ER), EUR/NC | -0.4 | -0.5 | 0.7 | -3.0 | -2.0 | -2.9 | -1.5 | -1.4 | -1.0 |
| Real ER (CPI-based) | -0.3 | -0.4 | 1.4 | -2.1 | -0.1 | -13.0 | 0.1 | 0.0 | -0.3 |
| Real ER (PPI-based) | 0.7 | -0.8 | 1.0 | -0.5 | -0.6 | -1.5 | -0.2 | -0.5 | 0.0 |
| Average gross wages, real (PPI based) | 5.5 | 8.0 | 9.3 | 5.4 | 9.1 | 5.3 | 2.7 | 2.0 | 7.4 |
| Average gross wages, real (CPI based) | 4.3 | 8.0 | 10.7 | 10.2 | 8.9 | 5.0 | 2.2 | 1.5 | 8.4 |
| Average gross wages, EUR (ER) | 3.9 | 5.7 | 13.7 | 7.9 | 9.2 | 5.4 | 4.2 | 4.0 | 8.0 |
| Employed persons (LFS) | 2.7 | 3.4 | 1.6 | 1.1 | 1.0 | 0.4 | 0.1 | 0.1 | 1.9 |
| GDP real per employed person, NC | 1.1 | -1.1 | 2.7 | 4.0 | 3.9 | 2.9 | 2.5 | 2.1 | 2.1 |
| Unit labour costs, ER (EUR) adjusted | 2.7 | 6.8 | 10.7 | 3.8 | 5.1 | 2.6 | 1.7 | 1.4 | 5.8 |
| **Lithuania** | | | | | | | | | |
| GDP deflator | 0.1 | 1.6 | 4.3 | 3.3 | 2.1 | 2.5 | 2.3 | 2.3 | 2.3 |
| Real ER (CPI-based) | -0.7 | 0.4 | 2.0 | 0.6 | 0.7 | -8.3 | 0.4 | 0.3 | 0.6 |
| Real ER (PPI-based) | -7.7 | -3.0 | 2.0 | 2.6 | -0.7 | -1.7 | -0.7 | -1.0 | -1.4 |
| Average gross wages, real (PPI based) | 16.7 | 13.4 | 3.3 | 4.1 | 8.4 | 8.5 | 6.0 | 6.9 | 9.1 |
| Average gross wages, real (CPI based) | 5.4 | 10.3 | 6.5 | 8.9 | 6.0 | 5.8 | 4.7 | 5.5 | 7.4 |
| Average gross wages, EUR (ER) | 5.4 | 8.4 | 8.6 | 10.0 | 8.4 | 8.5 | 7.1 | 7.9 | 8.1 |
| Employed persons (LFS) | 1.2 | 2.0 | -0.5 | 1.5 | 0.3 | 0.1 | 0.1 | 0.2 | 0.9 |
| GDP real per employed person, NC | 0.8 | 0.6 | 4.8 | 2.1 | 3.6 | 2.8 | 2.4 | 2.4 | 2.4 |
| Unit labour costs, ER (EUR) adjusted | 4.6 | 7.8 | 3.6 | 7.7 | 4.6 | 5.5 | 4.6 | 5.5 | 5.6 |

(Table 7.4 ctd.)

## Table 7.4 (ctd.)

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 Forecast | 2022 | 2015-19 average |
|---|---|---|---|---|---|---|---|---|---|
| **Latvia** | | | | | | | | | |
| GDP deflator | 0.0 | 0.9 | 3.0 | 4.0 | 2.7 | 2.2 | 2.3 | 2.4 | 2.1 |
| Real ER (CPI-based) | 0.2 | -0.2 | 1.2 | 0.7 | 1.2 | 0.4 | 0.5 | 0.5 | 0.6 |
| Real ER (PPI-based) | 1.2 | -1.1 | -0.5 | 1.4 | 1.1 | -0.5 | -0.2 | 0.0 | 0.4 |
| Average gross wages, real (PPI based) | 8.0 | 7.7 | 5.2 | 4.0 | 5.7 | 5.1 | 5.4 | 5.2 | 6.1 |
| Average gross wages, real (CPI based) | 6.7 | 4.9 | 4.8 | 5.7 | 4.7 | 4.1 | 4.4 | 4.7 | 5.4 |
| Average gross wages, EUR (ER) | 6.9 | 5.0 | 7.8 | 8.4 | 7.6 | 6.5 | 7.0 | 7.3 | 7.1 |
| Employed persons (LFS) | 1.3 | -0.3 | 0.2 | 1.6 | 0.1 | 0.0 | 0.0 | 0.2 | 0.6 |
| GDP real per employed person, NC | 1.9 | 2.1 | 3.6 | 2.9 | 2.1 | 2.0 | 2.2 | 2.5 | 2.5 |
| Unit labour costs, ER (EUR) adjusted | 4.9 | 2.9 | 4.0 | 5.3 | 5.3 | 4.4 | 4.6 | 4.7 | 4.5 |
| **Poland** | | | | | | | | | |
| GDP deflator | 0.8 | 0.3 | 1.9 | 1.1 | 1.8 | 3.0 | 2.1 | 2.2 | 1.2 |
| Exchange rate (ER), EUR/NC | 0.0 | -4.1 | 2.5 | -0.1 | -0.8 | -0.1 | 0.0 | 0.0 | -0.5 |
| Real ER (CPI-based) | -0.7 | -4.6 | 2.4 | -0.8 | -0.3 | 0.8 | 0.6 | 0.2 | -0.8 |
| Real ER (PPI-based) | 0.0 | -3.0 | 2.2 | -0.9 | -0.2 | 0.2 | 0.1 | -0.2 | -0.4 |
| Average gross wages, real (PPI based) | 5.8 | 4.0 | 2.9 | 4.9 | 6.0 | 4.4 | 4.2 | 3.3 | 4.7 |
| Average gross wages, real (CPI based) | 4.2 | 3.9 | 4.0 | 5.9 | 5.2 | 3.6 | 3.5 | 2.9 | 4.6 |
| Average gross wages, EUR (ER) | 3.5 | -0.6 | 8.4 | 7.0 | 6.5 | 6.4 | 6.6 | 4.6 | 4.9 |
| Employed persons (LFS) | 1.4 | 0.7 | 1.4 | 0.4 | 0.0 | -0.1 | -0.2 | -0.2 | 0.8 |
| GDP real per employed person, NC | 2.4 | 2.3 | 3.5 | 4.8 | 4.0 | 3.7 | 3.5 | 3.4 | 3.4 |
| Unit labour costs, ER (EUR) adjusted | 1.0 | -2.8 | 4.7 | 2.2 | 2.4 | 2.6 | 2.5 | 1.7 | 1.4 |
| **Romania** | | | | | | | | | |
| GDP deflator | 2.6 | 2.5 | 4.7 | 6.3 | 5.9 | 5.2 | 4.1 | 4.0 | 4.4 |
| Exchange rate (ER), EUR/NC | 0.0 | -1.0 | -1.7 | -1.8 | -1.9 | -1.8 | -1.8 | -1.6 | -1.3 |
| Real ER (CPI-based) | -0.4 | -2.4 | -2.3 | 0.3 | 0.4 | -0.2 | -0.3 | -0.6 | -0.9 |
| Real ER (PPI-based) | -0.1 | -1.4 | -1.2 | 0.3 | 1.1 | -0.6 | -1.5 | -1.6 | -0.3 |
| Average gross wages, real (PPI based) | 12.3 | 12.0 | 10.9 | 7.5 | 8.9 | 6.5 | 5.3 | 6.5 | 10.3 |
| Average gross wages, real (CPI based) | 10.2 | 11.2 | 13.5 | 8.5 | 8.8 | 6.0 | 3.8 | 5.5 | 10.4 |
| Average gross wages, EUR (ER) | 9.7 | 8.8 | 12.8 | 10.9 | 10.8 | 7.9 | 5.4 | 6.8 | 10.6 |
| Employed persons (LFS) | -0.9 | -1.0 | 2.6 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 |
| GDP real per employed person, NC | 4.8 | 5.9 | 4.4 | 4.2 | 4.1 | 3.2 | 2.8 | 3.2 | 4.7 |
| Unit labour costs, ER (EUR) adjusted | 4.7 | 2.8 | 8.0 | 6.4 | 6.5 | 4.5 | 2.5 | 3.6 | 5.7 |
| **Slovenia** | | | | | | | | | |
| GDP deflator | 1.0 | 0.8 | 1.6 | 2.2 | 1.6 | 1.8 | 1.9 | 2.0 | 1.4 |
| Real ER (CPI-based) | -0.8 | -0.5 | -0.1 | 0.0 | 0.2 | -0.1 | 0.1 | 0.0 | -0.2 |
| Real ER (PPI-based) | 2.0 | 0.0 | -0.8 | -0.8 | -0.1 | -0.3 | 0.1 | -0.2 | 0.1 |
| Average gross wages, real (PPI based) | 0.9 | 3.3 | 0.4 | 1.3 | 3.7 | 2.8 | 2.5 | 2.3 | 1.9 |
| Average gross wages, real (CPI based) | 1.5 | 2.0 | 1.0 | 1.5 | 2.6 | 2.5 | 2.3 | 2.1 | 1.7 |
| Average gross wages, EUR (ER) | 0.7 | 1.8 | 2.7 | 3.4 | 4.3 | 4.3 | 4.4 | 4.2 | 2.6 |
| Employed persons (LFS) | 0.1 | -0.3 | 4.8 | 2.2 | 1.0 | 1.0 | 1.0 | 1.0 | 1.6 |
| GDP real per employed person, NC | 2.1 | 3.4 | 0.0 | 1.8 | 1.6 | 1.6 | 1.6 | 1.8 | 1.8 |
| Unit labour costs, ER (EUR) adjusted | -1.4 | -1.5 | 2.6 | 1.5 | 2.6 | 2.7 | 2.7 | 2.4 | 0.8 |
| **Slovakia** | | | | | | | | | |
| GDP deflator | -0.2 | -0.5 | 1.2 | 2.0 | 2.8 | 2.1 | 1.8 | 1.8 | 1.1 |
| Real ER (CPI-based) | -0.3 | -0.8 | -0.3 | 0.6 | 1.3 | 0.5 | 0.1 | -0.2 | 0.1 |
| Real ER (PPI-based) | -0.7 | -2.5 | -0.5 | -0.6 | 1.2 | 0.7 | 1.3 | 1.0 | -0.6 |
| Average gross wages, real (PPI based) | 6.0 | 7.5 | 2.1 | 3.8 | 5.6 | 3.8 | 2.1 | 1.9 | 5.0 |
| Average gross wages, real (CPI based) | 3.2 | 3.8 | 3.2 | 3.6 | 4.7 | 3.9 | 3.1 | 3.1 | 3.7 |
| Average gross wages, EUR (ER) | 2.9 | 3.3 | 4.6 | 6.2 | 7.6 | 6.4 | 5.2 | 4.9 | 4.9 |
| Employed persons (LFS) | 2.6 | 2.8 | 1.5 | 1.4 | 0.9 | 0.4 | 0.0 | 0.0 | 1.9 |
| GDP real per employed person, NC | 2.2 | -0.7 | 1.5 | 2.6 | 1.4 | 1.9 | 2.6 | 2.3 | 1.4 |
| Unit labour costs, ER (EUR) adjusted | 0.7 | 4.0 | 3.1 | 3.5 | 6.1 | 4.4 | 2.5 | 2.6 | 3.5 |
| **Albania** | | | | | | | | | |
| GDP deflator | 0.6 | -0.6 | 1.5 | 0.9 | 1.6 | 2.6 | 2.1 | 1.8 | 0.8 |
| Exchange rate (ER), EUR/NC | 0.2 | 1.7 | 2.4 | 5.1 | 3.7 | 0.8 | 0.4 | 0.0 | 2.6 |
| Real ER (CPI-based) | 2.1 | 2.7 | 2.7 | 5.3 | 3.6 | 0.8 | 0.7 | 0.4 | 3.3 |
| Real ER (PPI-based) | 0.3 | 1.7 | 2.0 | 3.9 | 2.0 | -1.4 | -0.3 | -1.6 | 2.0 |
| Average gross wages, real (PPI based) | 7.4 | 0.7 | 0.4 | 1.6 | 7.0 | 5.0 | 3.3 | 5.1 | 3.4 |
| Average gross wages, real (CPI based) | 3.2 | -2.0 | 1.0 | 1.3 | 4.5 | 2.5 | 2.0 | 3.0 | 1.6 |
| Average gross wages, EUR (ER) | 5.4 | 0.9 | 5.5 | 8.6 | 9.9 | 5.6 | 4.3 | 6.3 | 6.0 |
| Employed persons (LFS) | 4.8 | 6.5 | 3.3 | 3.0 | 3.6 | 0.8 | 0.4 | 0.4 | 4.2 |
| GDP real per employed person, NC | -2.4 | -3.0 | 0.5 | 1.1 | -1.0 | 2.4 | 3.0 | 3.0 | -1.0 |
| Unit labour costs, ER (EUR) adjusted | 8.0 | 4.0 | 4.9 | 7.4 | 11.0 | 2.9 | 1.7 | 2.4 | 7.0 |

(Table 7.4 ctd.)

## Table 7.4 (ctd.)

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2015-19 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Forecast | | average |
| **Bosnia and Herzegovina** | | | | | | | | | |
| GDP deflator | 1.4 | 1.4 | 1.7 | 2.7 | 0.4 | 1.2 | 1.6 | 1.6 | 1.5 |
| Real ER (CPI-based) | -1.0 | -1.9 | -0.9 | -0.5 | -0.9 | -0.6 | -0.3 | -0.3 | -1.0 |
| Real ER (PPI-based) | 2.9 | -0.7 | 0.0 | 0.6 | -0.6 | 0.2 | 0.5 | 0.5 | 0.4 |
| Average gross wages, real (PPI based) | -0.6 | 3.1 | -1.4 | -0.4 | 4.2 | 1.4 | 0.5 | 0.1 | 1.0 |
| Average gross wages, real (CPI based) | 1.0 | 2.5 | 0.8 | 1.7 | 3.7 | 2.1 | 1.1 | 0.9 | 1.9 |
| Average gross wages, EUR (ER) | 0.0 | 0.9 | 1.6 | 3.1 | 4.3 | 3.2 | 2.7 | 2.6 | 2.0 |
| Employed persons (LFS) | 1.2 | -2.5 | 1.8 | 0.8 | -2.4 | 0.9 | 1.2 | 0.0 | -0.2 |
| GDP real per employed person, NC | 1.9 | 5.8 | 1.3 | 2.9 | 5.2 | 1.6 | 1.5 | 3.0 | 3.4 |
| Unit labour costs, ER (EUR) adjusted | -1.9 | -4.6 | 0.3 | 0.2 | -0.9 | 1.8 | 1.2 | -0.4 | -1.4 |
| **Montenegro** | | | | | | | | | |
| GDP deflator | 2.2 | 5.1 | 3.8 | 3.2 | -0.4 | 1.1 | 1.1 | 1.0 | 2.8 |
| Real ER (CPI-based) | 1.6 | -0.6 | 0.7 | 0.7 | -1.1 | -0.1 | 0.0 | -0.2 | 0.2 |
| Real ER (PPI-based) | 2.6 | 1.3 | -2.5 | -1.2 | 1.7 | 0.3 | 0.6 | 0.5 | 0.4 |
| Average gross wages, real (PPI based) | 0.0 | 3.7 | 1.5 | -1.5 | -1.5 | 0.1 | 0.2 | 0.0 | 0.4 |
| Average gross wages, real (CPI based) | -1.3 | 3.9 | -0.5 | -2.4 | 0.6 | 0.4 | 0.6 | 0.7 | 0.0 |
| Average gross wages, EUR (ER) | 0.3 | 3.6 | 1.9 | 0.1 | 0.9 | 2.2 | 2.5 | 2.5 | 1.3 |
| Employed persons (LFS) | 2.5 | 1.1 | 2.3 | 3.5 | 3.6 | 0.8 | 0.4 | 0.4 | 2.6 |
| GDP real per employed person, NC | 0.9 | 1.8 | 2.4 | 1.5 | -0.3 | 2.2 | 2.5 | 2.4 | 1.2 |
| Unit labour costs, ER (EUR) adjusted | -0.6 | 1.8 | -0.5 | -1.3 | 1.2 | 0.0 | 0.1 | 0.1 | 0.1 |
| **North Macedonia** | | | | | | | | | |
| GDP deflator | 2.0 | 3.5 | 2.8 | 3.6 | 0.8 | 2.5 | 2.5 | 2.0 | 2.5 |
| Exchange rate (ER), EUR/NC | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 | 0.2 | 0.0 | -0.5 | 0.0 |
| Real ER (CPI-based) | -0.3 | -0.5 | -0.3 | -0.3 | -0.7 | 0.7 | 0.6 | -0.5 | -0.4 |
| Real ER (PPI-based) | -1.7 | -1.7 | 1.8 | -1.8 | 1.4 | 1.4 | 1.3 | 0.5 | -0.4 |
| Average gross wages, real (PPI based) | 6.9 | 5.3 | -2.1 | 4.8 | 2.5 | 1.5 | 1.6 | 0.9 | 3.4 |
| Average gross wages, real (CPI based) | 3.0 | 2.2 | 1.3 | 4.2 | 3.9 | 2.1 | 2.1 | 1.9 | 2.9 |
| Average gross wages, EUR (ER) | 2.7 | 2.0 | 2.7 | 5.9 | 4.7 | 5.5 | 3.1 | 4.5 | 3.6 |
| Employed persons (LFS) | 2.3 | 2.5 | 2.4 | 2.5 | 4.7 | 1.9 | 1.2 | 1.2 | 2.9 |
| GDP real per employed person, NC | 1.5 | 0.4 | -1.3 | 0.2 | -1.3 | 1.4 | 2.0 | 2.1 | -0.1 |
| Unit labour costs, ER (EUR) adjusted | 1.2 | 1.7 | 4.0 | 5.6 | 6.1 | 3.3 | 2.5 | 1.3 | 3.7 |
| **Serbia** | | | | | | | | | |
| GDP deflator | 1.8 | 1.5 | 3.0 | 2.1 | 2.4 | 1.8 | 3.4 | 3.2 | 2.2 |
| Exchange rate (ER), EUR/NC | -2.8 | -1.9 | 1.5 | 2.6 | 0.3 | -0.1 | 0.0 | 0.0 | -0.1 |
| Real ER (CPI-based) | -1.5 | -1.2 | 2.8 | 2.7 | 0.5 | 0.2 | 0.7 | 0.8 | 0.7 |
| Real ER (PPI-based) | 0.3 | -0.5 | 0.8 | 0.6 | 0.2 | 0.9 | 1.6 | 1.0 | 0.3 |
| Average gross wages, real (PPI based) | -1.4 | 3.8 | 1.6 | 5.1 | 8.9 | 2.6 | 2.4 | 2.9 | 3.5 |
| Average gross wages, real (CPI based) | -1.8 | 2.7 | 0.9 | 3.9 | 7.7 | 3.2 | 3.1 | 3.1 | 2.6 |
| Average gross wages, EUR (ER) | -3.3 | 1.8 | 5.5 | 8.7 | 10.0 | 5.0 | 6.0 | 5.6 | 4.4 |
| Employed persons (LFS) | 0.6 | 5.6 | 2.8 | 1.4 | 2.0 | 1.0 | 1.0 | 1.0 | 2.5 |
| GDP real per employed person, NC | 1.2 | -2.2 | -0.7 | 3.0 | 1.9 | 2.6 | 2.4 | 2.3 | 0.6 |
| Unit labour costs, ER (EUR) adjusted | -4.4 | 4.1 | 6.2 | 5.6 | 7.9 | 2.6 | 3.3 | 3.6 | 3.8 |
| **Kosovo** | | | | | | | | | |
| GDP deflator | 0.2 | 0.4 | 1.4 | 1.0 | 2.8 | 2.5 | 2.2 | 3.0 | 1.2 |
| Real ER (CPI-based) | -0.5 | 0.0 | -0.2 | -0.8 | 1.2 | -0.4 | -0.2 | -0.5 | -0.1 |
| Real ER (PPI-based) | 5.0 | 1.3 | -2.3 | -1.5 | 0.8 | -0.3 | -0.2 | -0.5 | 0.6 |
| Average gross wages, real (PPI based) | 3.0 | 1.9 | 1.1 | 4.2 | 5.9 | 3.4 | 4.8 | 4.4 | 3.2 |
| Average gross wages, real (CPI based) | 6.3 | 1.5 | 0.2 | 4.5 | 4.7 | 3.4 | 4.6 | 4.4 | 3.4 |
| Average gross wages, EUR (ER) | 5.8 | 1.8 | 1.7 | 5.7 | 7.5 | 5.0 | 6.3 | 6.0 | 4.5 |
| Employed persons (LFS) | -8.2 | 11.7 | 7.6 | -3.4 | 10.1 | 3.9 | 2.5 | 1.2 | 3.3 |
| GDP real per employed person, NC | 13.4 | -6.9 | -3.2 | 7.4 | -5.5 | 0.1 | 1.9 | 3.1 | 0.8 |
| Unit labour costs, ER (EUR) adjusted | -6.7 | 9.3 | 5.1 | -1.6 | 13.7 | 4.9 | 4.4 | 2.8 | 3.7 |
| **Turkey** | | | | | | | | | |
| GDP deflator | 7.8 | 8.1 | 11.0 | 16.4 | 14.9 | 9.7 | 7.8 | 8.3 | 11.6 |
| Real ER (CPI-based) | 3.5 | -2.8 | -11.4 | -17.6 | 1.9 | -0.4 | -0.7 | -0.8 | -5.6 |
| Real ER (PPI-based) | 3.4 | -4.3 | -8.8 | -10.9 | 4.8 | 4.1 | 3.6 | 1.9 | -3.3 |
| Average gross wages, real (PPI based) | 5.1 | 8.5 | -6.4 | -10.1 | -2.0 | -1.5 | -0.7 | 0.8 | -1.2 |
| Average gross wages, real (CPI based) | 2.8 | 5.1 | -2.5 | -1.8 | 0.0 | 2.8 | 3.4 | 3.6 | 0.7 |
| Average gross wages, EUR (ER) | 6.3 | 2.4 | -12.1 | -17.6 | 3.5 | 3.7 | 5.7 | 3.6 | -4.0 |
| Employed persons (LFS) [5)] | 2.7 | 2.2 | 3.6 | 1.9 | -2.3 | -2.4 | 2.6 | 2.5 | 1.6 |
| GDP real per employed person, NC | 3.3 | 0.9 | 3.7 | 0.9 | 2.8 | 6.4 | 1.5 | 1.7 | 2.3 |
| Unit labour costs, ER (EUR) adjusted | 2.9 | 1.5 | -15.3 | -18.3 | 0.6 | -2.0 | 3.0 | 3.1 | -6.2 |

(Table 7.4 ctd.)

## Table 7.4 (ctd.)

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 Forecast | 2022 | 2015-19 average |
|---|---|---|---|---|---|---|---|---|---|
| **Belarus** | | | | | | | | | |
| GDP deflator | 16.0 | 8.3 | 8.7 | 12.2 | 5.6 | 5.0 | 4.6 | 4.0 | 10.1 |
| Exchange rate (ER), EUR/NC | -25.8 | -19.0 | 0.8 | -9.1 | 2.9 | -6.6 | -5.7 | -5.4 | -10.7 |
| Real ER (CPI-based) | -15.8 | -9.7 | 5.1 | -6.4 | 7.0 | -3.8 | -3.3 | -3.5 | -4.4 |
| Real ER (PPI-based) | -11.1 | -8.0 | 7.5 | -5.6 | 8.6 | -2.7 | -2.1 | -2.6 | -2.1 |
| Average gross wages, real (PPI based) | -5.3 | -3.9 | 3.7 | 10.5 | 8.5 | 7.0 | 6.0 | 5.3 | 2.5 |
| Average gross wages, real (CPI based) | -2.2 | -3.7 | 7.4 | 12.5 | 9.2 | 8.0 | 7.0 | 6.3 | 4.4 |
| Average gross wages, EUR (ER) | -17.7 | -12.8 | 14.8 | 7.4 | 18.6 | 6.3 | 5.9 | 3.7 | 0.9 |
| Employed persons (LFS) | -1.2 | -2.0 | 0.8 | -0.1 | 0.1 | -0.2 | -0.2 | -0.4 | -0.5 |
| GDP real per employed person, NC | -2.6 | -0.5 | 1.7 | 3.2 | 1.1 | 1.4 | 1.3 | 1.5 | 0.6 |
| Unit labour costs, ER (EUR) adjusted | -15.5 | -12.4 | 12.9 | 4.0 | 17.3 | 4.4 | 4.1 | 3.1 | 0.4 |
| **Kazakhstan** | | | | | | | | | |
| GDP deflator | 1.8 | 13.6 | 8.4 | 9.2 | 6.3 | 4.9 | 5.0 | 5.0 | 7.8 |
| Exchange rate (ER), EUR/NC | -3.1 | -35.1 | 2.8 | -9.4 | -5.1 | -3.1 | -2.6 | -2.4 | -11.1 |
| Real ER (CPI-based) | 3.3 | -25.8 | 8.6 | -5.8 | -1.5 | 0.1 | 0.3 | 0.5 | -5.1 |
| Real ER (PPI-based) | -21.3 | -23.1 | 15.1 | 4.7 | -1.0 | -0.9 | -0.9 | -1.4 | -6.3 |
| Average gross wages, real (PPI based) | 31.0 | -2.9 | -8.5 | -9.4 | 8.5 | 4.7 | 4.5 | 5.0 | 2.7 |
| Average gross wages, real (CPI based) | -2.3 | -1.1 | -1.8 | 1.7 | 8.3 | 3.5 | 3.0 | 3.0 | 0.9 |
| Average gross wages, EUR (ER) | 0.9 | -26.4 | 8.5 | -2.3 | 8.2 | 6.3 | 4.3 | 6.3 | -3.2 |
| Employed persons (LFS) | 1.3 | -0.8 | 0.4 | 1.3 | 1.3 | 1.2 | 1.2 | 1.2 | 0.7 |
| GDP real per employed person, NC | -0.1 | 1.9 | 6.4 | 2.8 | 3.1 | 2.4 | 2.5 | 2.6 | 2.8 |
| Unit labour costs, ER (EUR) adjusted | 1.0 | -27.8 | 1.9 | -5.0 | 4.9 | 3.1 | 2.7 | 3.0 | -5.8 |
| **Moldova** | | | | | | | | | |
| GDP deflator | 9.6 | 5.7 | 6.3 | 3.2 | 4.8 | 4.4 | 4.6 | 3.9 | 5.9 |
| Exchange rate (ER), EUR/NC | -10.8 | -5.2 | 5.9 | 5.0 | 0.9 | -1.6 | 0.0 | -4.8 | -1.1 |
| Real ER (CPI-based) | -2.3 | 0.6 | 10.9 | 6.0 | 4.1 | 0.9 | 2.6 | -2.9 | 3.8 |
| Real ER (PPI-based) | -3.1 | 0.4 | 6.2 | 2.4 | 2.0 | -0.4 | 1.3 | -3.8 | 1.5 |
| Average gross wages, real (PPI based) | 4.4 | 5.4 | 8.2 | 11.7 | 9.7 | 6.8 | 5.9 | 5.2 | 7.8 |
| Average gross wages, real (CPI based) | 1.2 | 3.4 | 5.0 | 9.0 | 6.6 | 5.3 | 4.4 | 4.2 | 5.0 |
| Average gross wages, EUR (ER) | -1.1 | 4.3 | 18.4 | 17.7 | 12.6 | 9.6 | 7.7 | 2.4 | 10.1 |
| Employed persons (LFS) | 1.6 | 1.3 | -1.0 | 3.7 | . | 2.3 | 2.3 | 2.2 | . |
| GDP real per employed person, NC | -1.9 | 3.0 | 5.7 | 0.6 | . | 1.6 | 1.7 | 1.8 | . |
| Unit labour costs, ER (EUR) adjusted | 0.8 | 1.3 | 12.0 | 17.1 | . | 6.5 | 7.3 | 1.4 | . |
| **Russia** | | | | | | | | | |
| GDP deflator | 7.2 | 2.7 | 5.4 | 10.8 | 3.4 | 3.5 | 4.0 | 3.9 | 5.9 |
| Exchange rate (ER), EUR/NC | -25.1 | -8.8 | 12.7 | -10.8 | 1.9 | 0.7 | -2.7 | -1.3 | -6.9 |
| Real ER (CPI-based) | -13.5 | -2.6 | 14.9 | -10.0 | 4.9 | 1.5 | -1.6 | -0.6 | -1.8 |
| Real ER (PPI-based) | -13.1 | -3.6 | 17.9 | -3.0 | 3.2 | 2.9 | 0.5 | 1.1 | -0.2 |
| Average gross wages, real (PPI based) | -7.4 | 3.5 | -0.9 | -0.2 | 6.3 | 1.6 | 2.1 | 2.3 | 0.1 |
| Average gross wages, real (CPI based) | -9.0 | 0.7 | 3.0 | 8.5 | 3.7 | 2.9 | 4.0 | 4.0 | 1.2 |
| Average gross wages, EUR (ER) | -21.3 | -1.6 | 20.3 | -0.5 | 10.4 | 7.1 | 4.3 | 5.5 | 0.5 |
| Employed persons (LFS) | -0.4 | 0.1 | -0.3 | 0.3 | -0.8 | 0.1 | 0.3 | 0.1 | -0.2 |
| GDP real per employed person, NC | -1.6 | 0.2 | 2.1 | 2.2 | 2.2 | 2.0 | 2.0 | 2.3 | 1.0 |
| Unit labour costs, ER (EUR) adjusted | -20.0 | -1.8 | 17.8 | -2.6 | 8.1 | 4.3 | 2.2 | 3.1 | -0.5 |
| **Ukraine** | | | | | | | | | |
| GDP deflator | 38.9 | 17.1 | 22.0 | 15.5 | 8.0 | 7.0 | 4.7 | 5.7 | 19.9 |
| Exchange rate (ER), EUR/NC | -35.1 | -14.4 | -5.7 | -6.7 | 11.0 | -2.5 | -3.6 | -3.4 | -11.5 |
| Real ER (CPI-based) | -3.5 | -2.7 | 6.1 | 1.6 | 18.0 | 1.2 | -0.6 | -0.6 | 3.6 |
| Real ER (PPI-based) | -9.8 | 4.7 | 15.7 | 6.5 | 14.8 | -0.4 | 0.5 | 1.3 | 6.0 |
| Average gross wages, real (PPI based) | -11.4 | 2.5 | 8.4 | 6.3 | 13.7 | 9.9 | 6.1 | 5.2 | 3.6 |
| Average gross wages, real (CPI based) | -18.9 | 8.5 | 19.8 | 12.5 | 9.7 | 8.1 | 7.1 | 7.2 | 5.4 |
| Average gross wages, EUR (ER) | -21.8 | 5.8 | 29.2 | 16.5 | 31.5 | 10.3 | 10.0 | 9.1 | 10.4 |
| Employed persons (LFS) | -0.4 | -1.0 | -0.7 | 1.3 | 0.9 | 0.6 | 0.6 | 0.6 | 0.0 |
| GDP real per employed person, NC | -9.4 | 3.4 | 3.3 | 2.0 | 2.4 | 3.0 | 3.6 | 3.9 | 0.2 |
| Unit labour costs, ER (EUR) adjusted | -13.7 | 2.3 | 25.2 | 14.2 | 28.3 | 8.2 | 4.7 | 4.6 | 10.1 |
| **Austria** | | | | | | | | | |
| GDP deflator | 2.3 | 1.7 | 1.1 | 1.7 | 1.7 | 1.8 | 1.7 | 1.6 | 1.7 |
| Real ER (CPI-based) | 0.9 | 0.6 | 0.4 | 0.1 | 0.0 | -0.4 | -0.3 | -0.4 | 0.4 |
| Real ER (PPI-based) | 0.7 | -0.4 | -1.1 | -0.5 | -0.6 | 0.0 | 0.0 | -0.4 | -0.4 |
| Average gross wages, real (PPI based) | 3.6 | 4.2 | -0.2 | 0.4 | 2.8 | 0.5 | 0.4 | 0.2 | 2.1 |
| Average gross wages, real (CPI based) | 1.1 | 1.4 | -0.4 | 0.8 | 1.4 | 0.8 | 0.5 | 0.1 | 0.9 |
| Average gross wages, EUR (ER) | 2.1 | 2.3 | 1.6 | 2.8 | 2.9 | 2.3 | 2.1 | 1.7 | 2.4 |
| Employed persons (LFS) | 0.9 | 1.7 | 1.0 | 1.4 | 0.7 | 0.9 | 1.1 | 0.9 | 1.1 |
| GDP real per employed person, NC | 0.1 | 0.3 | 1.5 | 1.0 | 0.9 | 0.3 | 0.3 | 0.5 | 0.8 |
| Unit labour costs, ER (EUR) adjusted | 1.9 | 2.0 | 0.1 | 1.8 | 2.1 | 1.9 | 1.8 | 1.2 | 1.6 |

For country-specific notes please see the respective country table (especially for LT 2019, RO 2018, MD 2019).
Positive growth of real exchange rates means real appreciation. Unit labour costs are defined as average gross wages per employee relative to labour productivity (real GDP per employed person, LFS).

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

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