BUSINESS BRIEFING
March 2016 | Vienna, Austria

GROWTH STABILISES: INVESTMENT A MAJOR DRIVER, EXCEPT IN COUNTRIES PLAGUED BY RECESSION

A Midterm Outlook for Central, East and Southeast Europe

GDP growth in the EU Member States of Central and Eastern Europe (EU-CEE), the Western Balkans (WB) and Turkey will remain stable or even increase. The trend growth path will be around 3 %. EU-CEE countries will thus continue to catch up to the EU average, however at low speed. Russia and Ukraine, on the other hand, will show a considerably worse performance: growth will return in 2017 at the earliest.

Medium-term outlook: less divergence in terms of growth

The duality in terms of growth performance between the EU-CEE and WB countries on the one hand and the CIS-3 (Russia, Kazakhstan and Belarus) and Ukraine on the other is set to continue in 2016 and beyond. The wiiw forecast (Table 1) is based on constant and (relative to previous years) low oil prices. It is thus up to the countries themselves and their ability to adjust and make the best of the situation or reduce the negative impact. The difference between the two country groups, however, will not become more pronounced, the best performing economies will experience some slowdown and the recession will slow down or bottom out in the worst performing countries.

In 2016, Russia and Belarus will be facing yet another year of recession, while the Ukrainian economy is expected to bottom out. As usual, structural change and institutional reforms will be slow and half-hearted in Russia, incapable of compensating for the losses caused by low fuel prices. Ukraine, on the other hand, has by and large completed the adjustment that was triggered by its having decoupled from Russia and the occupied territories. While politically unacceptable, the Russian annexation of the Crimea and the frozen conflict in East-Ukraine may prove lasting. Lost export markets will not be regained nor will the volume of exports to the EU increase either.

In 2016, economic growth is expected to decelerate somewhat in most of Central Europe, yet recover in the Baltic States. The latter economies will digest the Russian shock and return to a 2-3 % GDP growth rate. Another country displaying more rapid growth will be Romania that has introduced fiscal measures that boost consumption, thus postponing the slowdown for another year. In other countries in the region, the end to the consumption boom and the temporary decline in EU transfers have given rise to deceleration. Bulgaria, the Czech Republic, Hungary and Slovakia will be the countries most affected by the loss of the EU-funded engine of growth in 2016. (The Juncker Plan may only marginally be available of the EU-CEE.) As for 2017 and 2018, the EU-CEE will pick up some speed based on new investments funded via EU transfers. Romania will be the only country in which we expect slower growth in 2017, by which time the impact of the current tax cuts will have faded out and fiscal policy will adopt a course heading towards stabilisation.

Uncertainties concerning the global economy, in particular the EU core-economies, do not allow us to predict a return to more rapid export-led growth in

Table 1

OVERVIEW 2014-2015 AND OUTLOOK 2016-2018

	GDP real change in % against prev. year					Consumer prices change in % against prev. year					Unemployment (LFS) rate in %, annual average					Current account in % of GDP				
			Forecast					Forecast					Forecast					Forecast		
	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018
EU-CEE																				
Bulgaria	1,5	3,0	2,5	2,5	2,7	-1,6	-1,1	1,0	1,0	1,5	11,4	9,3	9,0	8,5	8,0	1,2	1,2	0,7	0,0	-0,4
Croatia	-0,4	1,5	1,4	1,8	2,0	0,2	-0,3	0,5	1,0	1,0	17,3	16,6	16,5	16,0	16,0	0,8	4,6	3,4	2,2	1,9
Czech Republic	2,0	4,3	2,4	2,3	2,4	0,4	0,3	1,5	1,7	1,9	6,1	5,1	5,0	4,9	4,9	0,6	1,7	0,5	0,0	-0,5
Estonia	2,9	1,2	2,2	2,4	2,6	0,5	0,1	0,5	1,5	2,5	7,4	6,2	6,2	5,9	5,5	1,0	2,5	-0,2	-1,9	-3,5
Hungary	3,7	2,9	2,2	2,3	2,9	0,0	0,1	1,7	2,5	3,0	7,7	6,8	6,5	6,3	6,1	2,3	5,0	4,4	4,1	4,0
Latvia	2,4	2,7	3,0	3,2	3,5	0,7	0,2	0,5	1,8	2,1	10,8	9,9	9,3	8,9	8,6	-2,0	-1,2	-3,6	-3,8	-3,6
Lithuania	3,0	1,6	3,0	3,4	3,5	0,2	-0,7	0,1	2,1	2,3	10,7	9,1	8,5	8,0	7,5	3,6	-2,5	-2,6	-3,0	-3,3
Poland	3,3	3,6	3,4	3,2	3,4	0,1	-0,7	1,2	1,8	2,0	9,0	7,5	7,0	6,5	6,5	-2,0	-0,2	-1,5	-2,0	-3,5
Romania	3,0	3,7	4,0	3,0	3,5	1,4	-0,4	0,0	2,0	2,5	6,8	6,8	6,7	6,6	6,5	-0,5	-1,1	-1,7	-1,9	-2,3
Slovakia	2,5	3,6	3,0	3,2	3,3	-0,1	-0,3	0,6	1,5	1,8	13,2	11,5	10,6	10,0	9,7	0,1	-1,2	-1,6	-2,0	-2,0
Slovenia	3,0	2,9	2,0	2,3	2,8	0,4	-0,8	0,5	1,0	1,0	9,7	9,0	8,5	8,0	7,5	7,0	7,3	5,3	4,7	4,0
EU-CEE 1)2)	2,8	3,4	3,0	2,9	3,1	0,3	-0,4	0,9	1,8	2,1	9,0	7,9	7,5	7,2	7,0	-0,1	0,8	-0,2	-0,7	-1,5
EA-19	0,9	1,6	1,7	1,9	-	0,4	0,0	0,5	1,5	-	11,6	11,0	10,5	10,2	-	3,0	3,7	3,6	3,4	-
EU-28	1,4	1,9	1,9	2,0	-	0,5	0,0	0,5	1,6	-	10,2	9,5	9,0	8,7	-	1,6	2,1	2,1	2,0	-
Western Balkans																				
Albania	2,0	2,6	3,2	3,5	3,6	1,6	1,9	2,3	2,5	2,8	17,5	17,0	16,8	16,5	16,4	-12,9	-10,0	-9,9	-9,8	-9,3
Bosnia and Herzegovina	1,1	2,3	2,9	2,9	3,1	-0,9	-1,0	1,0	2,0	2,0	27,5	27,7	27,2	26,1	25,0	-7,8	-7,0	-8,0	-8,0	-7,0
Kosovo	1,2	3,7	3,9	4,3	4,0	0,4	-0,5	1,0	2,0	3,0	35,3	34,0	34,0	33,0	32,0	-7,8	-8,2	-9,0	-8,6	-8,3
Macedonia	3,5	3,5	3,4	3,1	3,1	-0,3	-0,3	1,0	2,0	2,0	28,0	27,0	27,0	26,0	25,0	-0,8	0,0	-4,0	-4,0	-4,0
Montenegro	1,8	3,4	2,8	2,8	3,1	-0,5	1,4	2,0	2,0	2,0	18,0	18,0	17,5	17,0	16,5	-15,2	-14,6	-14,6	-14,6	-14,0
Serbia	-1,8	0,7	1,6	1,7	2,0	2,9	1,9	2,0	3,0	3,0	19,4	17,0	17,0	17,0	16,0	-6,0	-6,0	-6,0	-6,0	-6,0
WB 1)2)	0,3	2,0	2,5	2,6	2,8	1,3	0,9	1,7	2,5	2,6	22,5	21,1	21,0	20,6	19,8	-7,2	-6,6	-7,5	-7,1	-6,9
Turkey	2,9	3,3	3,2	3,1	3,0	8,9	7,7	8,2	7,4	6,8	9,9	10,6	10,3	10,2	10,1	-5,9	-4,6	-5,2	-5,0	-5,0
Belarus 3)	1,7	-3,9	-2,6	0,5	1,5	18,1	13,5	14,0	13,0	12,0	0,5	1,0	2,0	2,5	2,5	-6,9	-2,0	-2,5	-2,7	-2,9
Kazakhstan	4,1	1,2	1,0	2,5	3,5	6,7	6,6	12,0	7,0	6,0	5,0	5,0	5,2	5,0	5,0	2,6	-2,9	-3,2	-2,9	-2,6
Russia 4)	0,8	-3,7	-0,8	0,8	1,8	7,8	15,5	10,0	6,0	6,0	5,2	5,6	5,3	5,3	5,3	2,9	5,0	4,8	4,2	4,9
Ukraine 5)	-6,6	-10,5	0,0	1,9	2,5	12,1	48,7	17,0	8,0	6,0	9,3	10,0	11,0	11,0	10,0	-3,4	-0,2	-0,1	-0,1	-0,9

Source: wiiw (data until 2015 as of February 2016), Eurostat. Forecasts by wiiw (Feb 2016) and European Commission for EU and euro area (European Economic Forecast, Winter 2016).

Note: LFS: Labour Force Survey. EU-CEE: European Union-Central and Eastern Europe. EA: Euro area. WB: Western Balkans.
1) wiiw estimates.
2) Current account data include transactions within the region (sum over individual countries).
3) Unemployment rate by registration.
4) From 2014 including Crimea.
5) From 2014 excluding Crimea and parts of Donbas.

the medium term as indicated in the figures forecast for 2018. Countries with low debt, a strong export sector and greater catching-up potential will achieve 3-3.5 % growth (Poland, Slovakia, Latvia, Lithuania and Romania), while those falling short in terms of one or the other feature will languish in the 2-3 % bracket or even lower (Croatia).

The growth differential between the EU-CEE and the euro area will narrow in the years to come. The EU Commission forecasts modest acceleration for the euro area, while the wiiw forecast for the EU-CEE average shows a deceleration from 3.4 % in 2015 to 3 % in 2016 – and then to 2.9 % in 2017. This implies certain reservations concerning the transmission of growth from the euro area and scepticism about drivers of longer-term growth in the region.

Growth will continue in the WB countries. Some acceleration is expected in Albania, Bosnia and Herzegovina and Kosovo, while Macedonia and Montenegro will experience a slowdown. However unimpressive compared to their backward position, average growth in the WB will not lag a lot behind that in the EU-CEE.

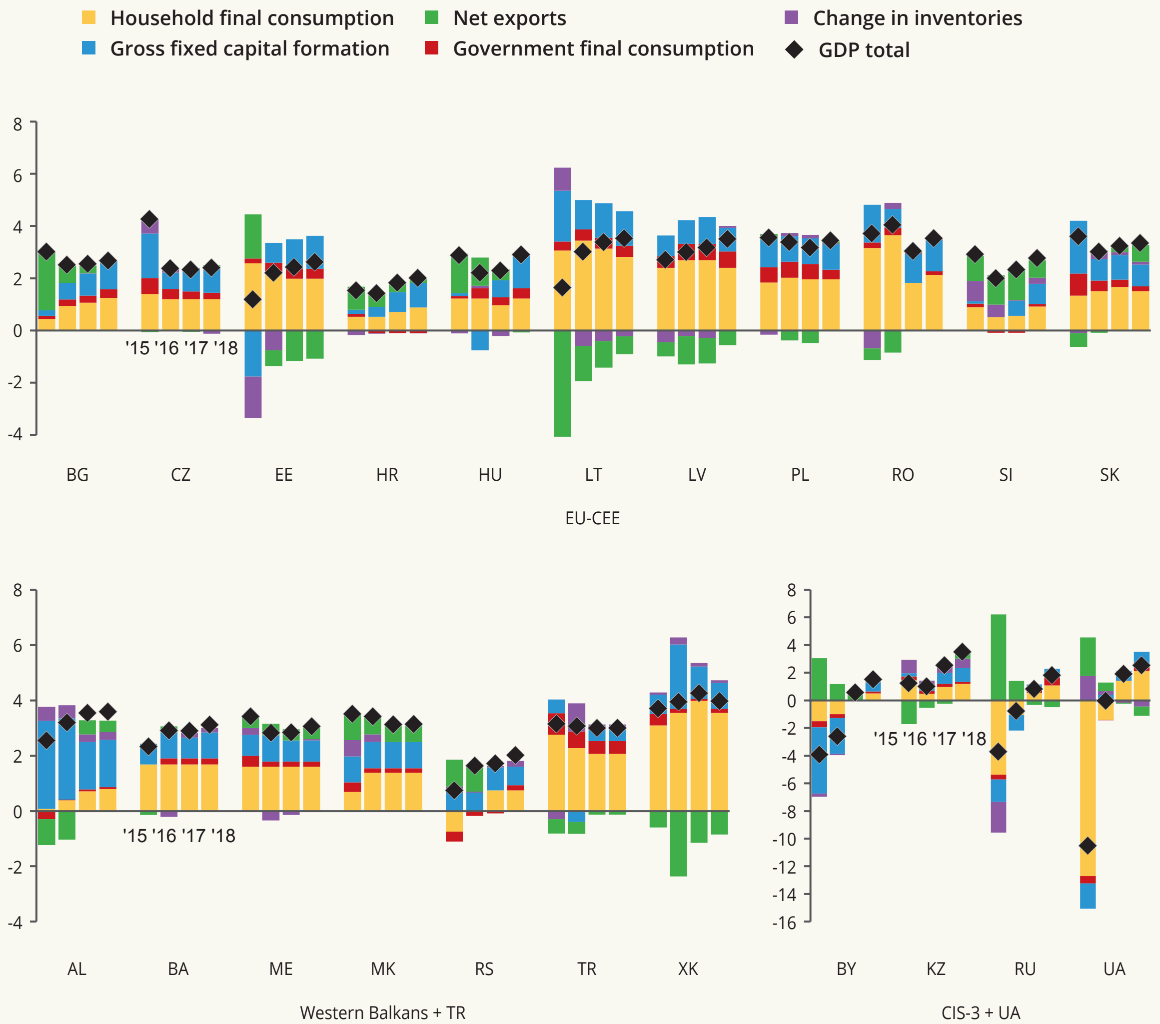
Turkey will continue down its growth path, with GDP rates somewhat above 3 %. It seems the country will maintain its fragile stability at the cost of relatively high inflation and a current account deficit, while facing increasing challenges emerging, for instance, from the war in Syria, the refugee crisis and the loss of export and tourism revenue owing to the Russian trade sanctions. Those sanctions will restrict growth performance, but the rise in minimum wages at the beginning of the current year and the government's ongoing spending spree can offset the loss in demand.

The main demand components: Household consumption currently dominant, but investments may pick up in the future

The leading role attributed to household demand is expected to continue in 2016 and the years to come, but greater space will be accorded to investments. Household consumption remained the main catalyst of economic growth in the EU-CEE and WB in 2015 (as can be seen from Figure 2). It contributed positively to GDP growth in all countries except Serbia, and contributed more than half in countries such as Poland, Romania, the Baltic States, Turkey and Kosovo. In some economies, government measures such as the increase in minimum wages in Turkey or the VAT-cuts in Romania had a major impact on household demand.

Gross fixed capital formation was the most significant engine of growth in Albania and the Czech Republic. In 2015 it contributed positively to growth in most other countries, even if only marginally in Hungary. Its contribution was negative in Estonia and Slovenia, which had already invested a significant portion of their EU transfers earlier, as well as in Turkey where increasing economic and political uncertainties discouraged private investors. Bulgaria, Croatia and Hungary are expected to implement more investments in 2017-2018 than before, still they will remain in the group of slow-growth countries. In countries such as Poland, Slovakia and Romania, which have already attained and will maintain a GDP growth rate of 3 % or more over the forecast period, the contribution of gross fixed capital formation will be stronger, about 0.8-1 pp.

Figure 2
GDP growth, 2015-2017 and contribution of individual demand components in percentage points



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

Changes in inventories (i.e. unsold goods and construction work in progress) might also contribute significantly to GDP and signal changes in aggregate demand. An excessive depletion of inventories may indicate that aggregate demand is bound to increase, together with the production of goods and services. That proved to be the case in Estonia, Lithuania, Latvia and Russia where producers had apparently been overoptimistic about their markets in 2014 and built up stocks accordingly, which were then depleted, thus depressing GDP growth in 2015.

In the years to come, exports may well expand still more, if external demand recovers and imports of inputs will also increase. In general, in the catching-up economies net exports are not a strong growth driver in years when consumption and investments are expanding. A trade deficit, especially one related to investment goods, supports growth over the longer term. In fact, net exports contribute negatively to growth in countries such as Latvia, Romania, Kosovo and Kazakhstan where consumption has been overstretched or export problems were mounting.

Increasing the trade deficit is less of an option for high-debt countries such as Bulgaria, Croatia, Hungary and Slovenia that need to earn revenue on their trade balance in order to service their debt. They need to go for less household consumption and perhaps also less investment (and hence fewer imports) than the more balanced economies.

Scope for fiscal expansion will emerge over the forecast period. Government consumption made a minor, but positive contribution to growth in 2015, signalling the end of fiscal austerity in the EU-CEE and WB countries. The exception was Serbia, which is still intent on implementing fiscal stabilisation. Other highly indebted countries, including Croatia and Hungary, at least managed to adopt a neutral fiscal stance. Most countries have further room for government consumption making a positive contribution to growth. Well balanced and low-debt countries, including the Czech Republic, Estonia, Poland and Latvia, could well pursue a fiscal policy contributing 0.4–0.6 pp to GDP growth in the course of the forecast period. The WB countries usually have small budgets and limited fiscal space in which to manoeuvre, thus government consumption will hardly stimulate growth. Turkey, on the other hand, will remain on the track with positive government contribution to demand.

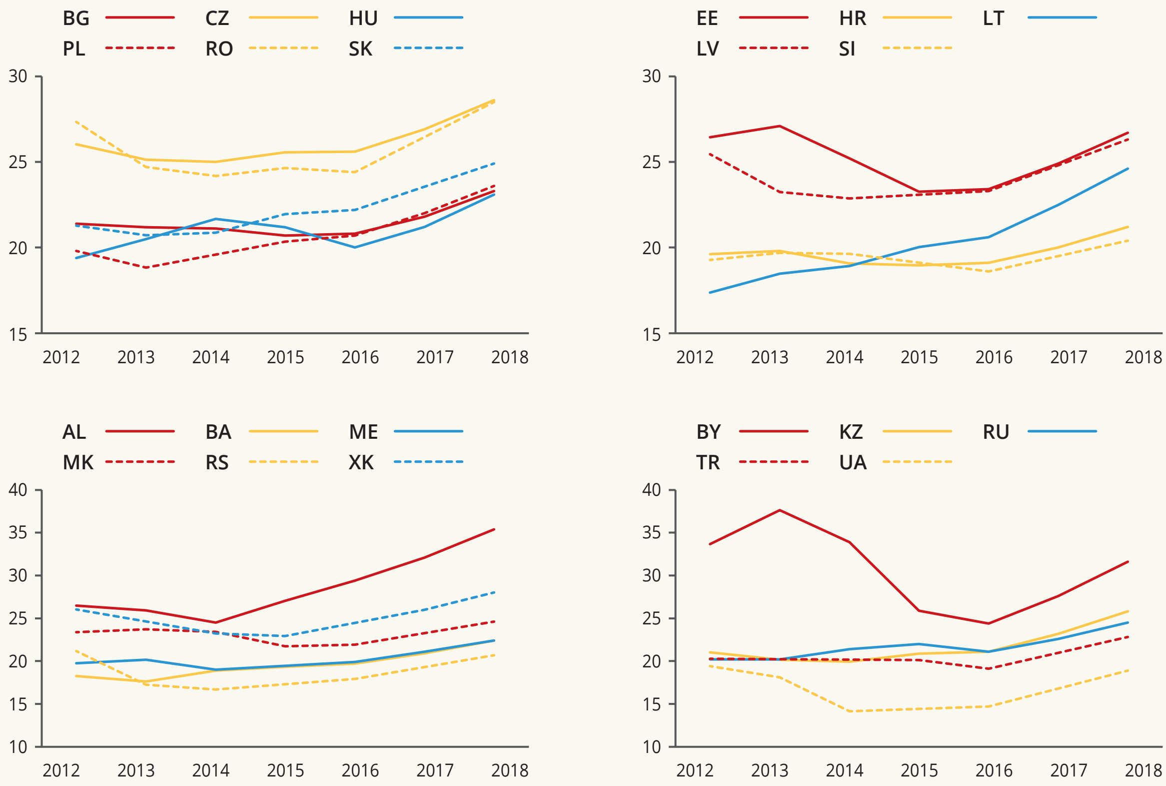
The crisis in Russia, Belarus and Ukraine will ease in 2016 and consumption may recover in 2017. In 2015, a drop in household consumption and a contraction of both gross fixed capital formation and government spending were partly offset by increasing net exports in the light of plummeting imports. Subdued investment activity will remain a major obstacle to medium-term growth and the much needed structural change.

Investments to underpin growth

The sustainability of economic growth hinges on investments. Provided foreign markets and domestic household consumption expand, new production capacities will be needed to meet demand. Further investments are also needed to improve the infrastructural network.

Gross fixed capital formation declined as a share of GDP in the crisis-period 2009-2012, but it has either moved upwards in recent years or is expected to recover over the forecast period. This pattern (see Figure 3) is valid for most of the EU-CEE and WB countries, but the magnitude of change will vary. The development of investments is smoother in the six Central European countries than elsewhere. But some of those countries may suffer a setback in 2016 owing to the lull in EU transfers and despite improving financial conditions for investments. EU transfers are expected to have the most pronounced impact in Hungary: negative in 2016, but positive thereafter. Croatia and Slovenia, on the other hand, will continue to suffer from both slow economic growth and a low rate of investment because of the volume of EU funds in those countries being lower than in most other EU-CEE countries. In Croatia, this is due to its having just entered ‘the game’, while in Slovenia the determining factor is the country’s relatively high level of development which does not make it eligible to EU funds as high as the less developed Member States.

Figure 3
Gross fixed capital formation, in % of GDP



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

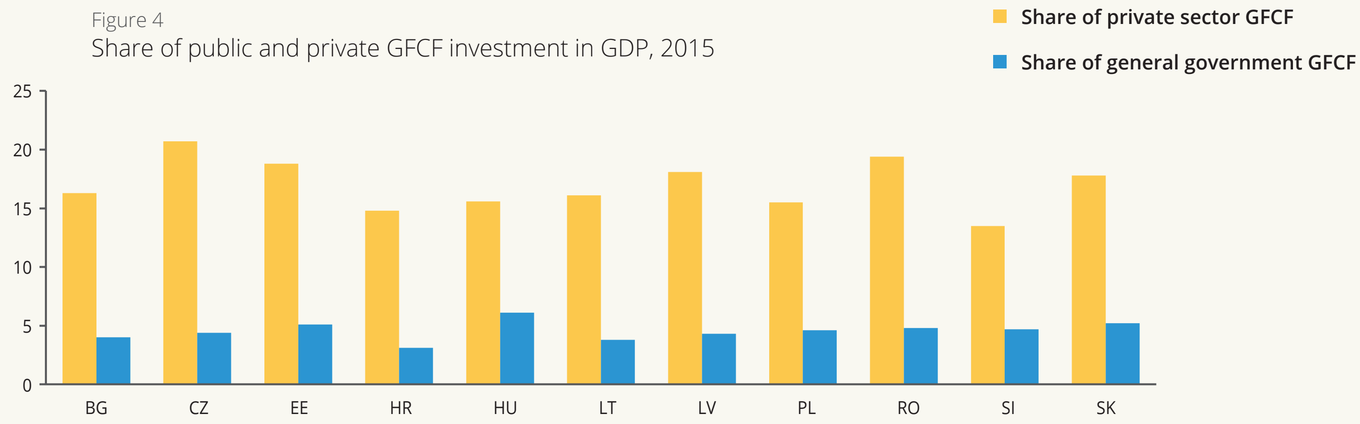
Albania is the 'shooting star' among the Western Balkan countries owing to the boom in infrastructural investments. Kosovo is also about to follow a similar pattern. In those countries, EU funds are limited, but money from a host of other international donors is quite abundant. Other WB countries, albeit starting from a much lower level, will also enjoy an increase in investments. Of those countries, Serbia's prospects of mobilising internal financial resources are the worst, but it may attract foreign investment on a larger scale owing to its geographic location and cheap workforce.

In Russia and Kazakhstan, the setback in investments is only marginally more marked than the decline in GDP, whereas in Ukraine investments have plunged sharply. At present, Ukraine has the lowest investment rate of all the CESEE economies and this is expected to persist despite a marginal degree of recovery over the forecast horizon. It is difficult to assess the potential growth of FDI which, once basic political and economic stability is assured, may be quite high.

The extraordinarily high investment rates in Belarus may not be comparable to those in other countries, whereas the current downward trend is fully in line with the country's distressed situation.

On average, close to 80 % of the gross fixed capital formation derives from private-sector investments, which are thus becoming more important than government investments. Country-specific differences (see Figure 4, partly estimated 2015 data, available for the EU-CEE countries only) have been quite stable over time; countries with larger government sectors (viz. Hungary and Slovenia) have a smaller share of private investments in total gross fixed capital formation. The conditions for private investments depend on a number of factors related to demand, capacity utilisation, financing conditions and the framework for the conduct of business. Taking for granted the expansion in demand shown in the euro area forecast, financing conditions come to the fore.

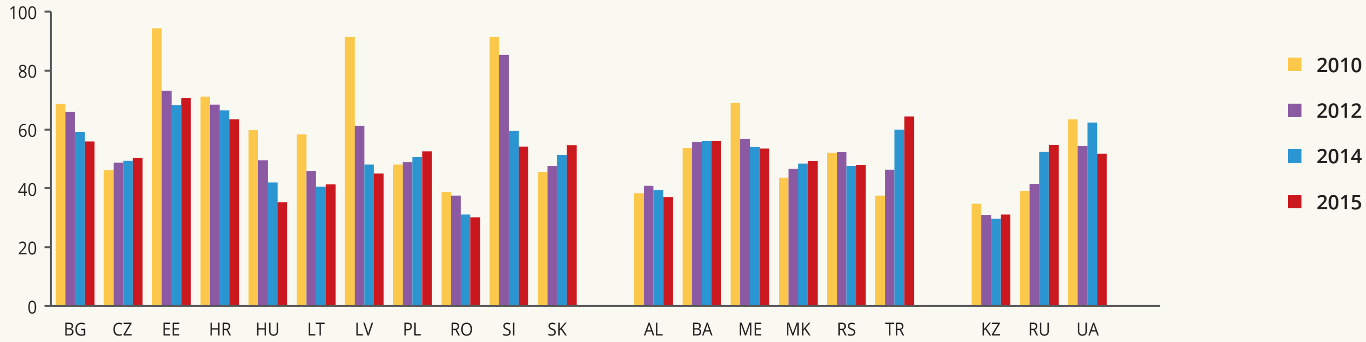
Figure 4
Share of public and private GFCF investment in GDP, 2015



Source: National and Eurostat statistics, wiiw own calculations.

Conditions for financing private investments have improved in the EU-CEE countries. Falling input prices in the manufacturing sector may have allowed for higher profits. The indebtedness of the private sector has declined and new credits are more readily available on less restrictive terms. All these factors constitute improvements in comparison to the credit conditions that prevailed two or three years earlier; they do not, however, reflect a return to the lax banking practices of the pre-crisis era that are unlikely to return. There are initial signs of FDI recovering as well.

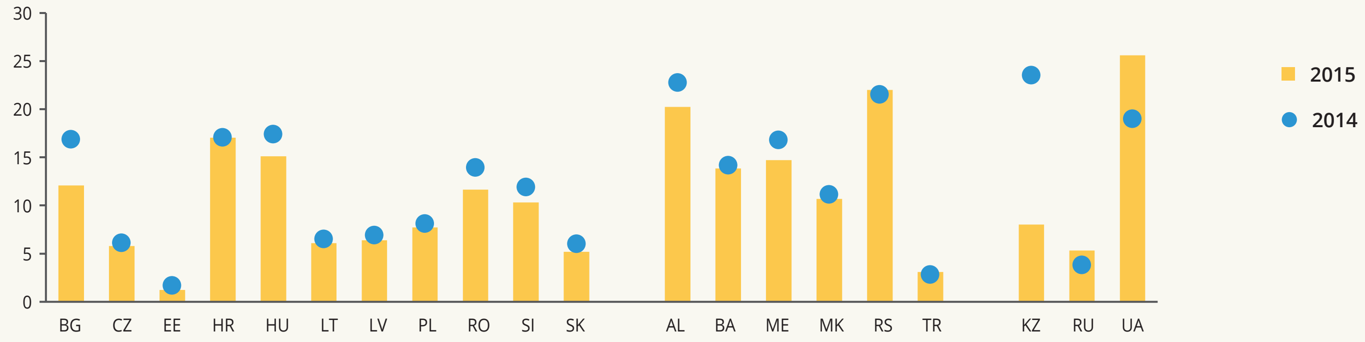
Figure 5
Stock of private bank loans, in % of GDP, 2010-2015



Note: Private bank loans comprise loans of non-financial corporations and households taken from banking statistics.
Source: National Bank statistics, wiiw own calculations.

Banks in the EU-CEE and WB countries have by and large finished restructuring their portfolios by reducing the volume of outstanding credit and the number of non-performing loans. Over the past few years, the stock of private-sector bank loans (see Figure 5) has declined at a particularly rapid rate in Hungary and Romania, as has the share of non-performing loans (see Figure 6). Non-performing loans none the less remain a problem, while in GDP terms bank financing in both countries has shrunk to the lowest level of all EU-CEE countries. Slovenia and Bulgaria are other countries set on a path towards deleveraging. Poland and Slovakia as well as Turkey, however, are in a completely different situation; loan volumes are rising and non-performing loans are at a very low level. In these countries, conditions are conducive to business expansion.

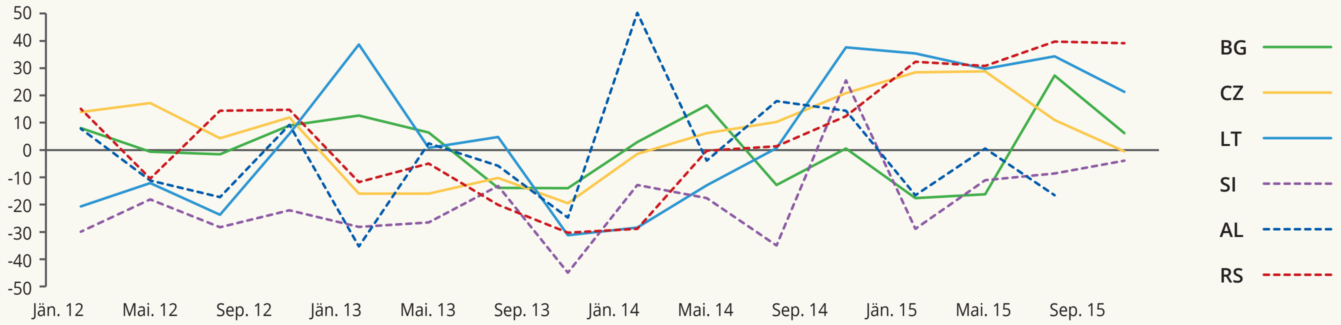
Figure 6
Bank non-performing loans, % of total loans, 2014 and 2015



Note: Loans more than 90 days overdue. EE, LT – Loans that are more than 60 days overdue. RU – According to Russian Accounting Standards overdue debt is defined as debt service overdue, therefore the data are not fully comparable with other countries.
Source: National Bank statistics, wiiw own calculations.

New bank loans to the non-financial private sector (businesses and households) have switched to the positive in a number of countries. Even Slovenia has recorded a positive change of late (see Figure 7 covering countries with available data). Increasing crediting is expected across the EU-CEE and WB as the consequence of relatively low interest rates and improving favourable general credit conditions. This can be the case also in countries where the overall amount of private loans keeps shrinking.

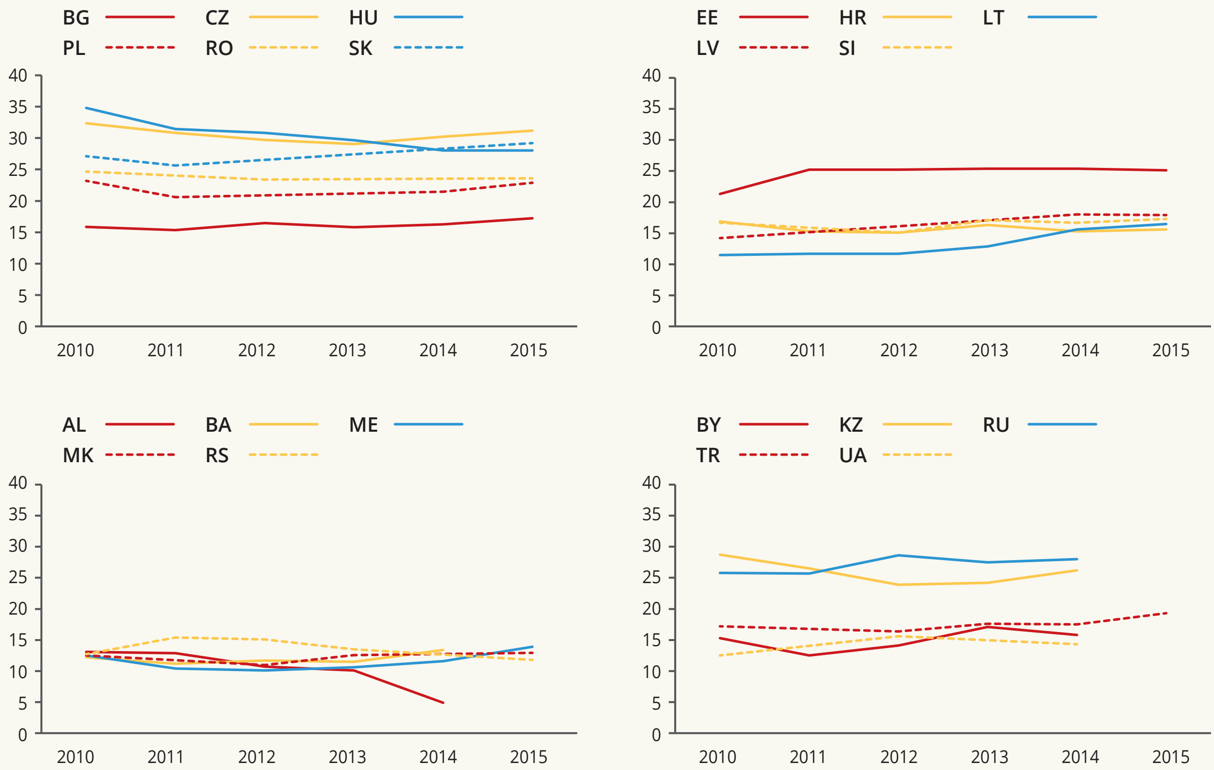
Figure 7
New bank loans to non-financial private sector (non-financial corporations and households), change in % against preceding year



Source: National Bank statistics, wiiw own calculations.

Foreign currency denominated credits to the non-government sector (companies and households), which prior to the crisis mushroomed in those CESEE countries which were not in the euro area, will diminish. Previously, the differences in interest rates encouraged people to take out foreign currency loans, while banks and borrowers alike underestimated the exchange-rate risks associated with such an approach. As a consequence, by 2010 in at least half of the CESEE countries, more than 60 % of all private debt was in foreign currencies. Depreciation of domestic currencies against currencies with low interest rates, CHF in particular, immobilised debt servicing. Of late, improvements are to be observed in all respects. With the convergence of interest rates, foreign currency borrowing has declined, while both banks and customers have become extremely cautious. Policy steps have also been taken. Hungary obliged banks to convert foreign exchange loans into domestic currency and thus eliminated the problem in 2015. In Croatia, a government programme helped households to switch from CHF loans to loans denominated in EUR. Even in Romania, foreign currency denominated debt declined, it being left to the banks to work non-performing loans and offer households ways of converting their debts. The share of forex loans has since dropped to less than 50 % of all loans and is negligible where new loans are concerned. The proportion of forex loans has remained at about 70 % in Croatia and Serbia, both of which are also highly euroised in terms of deposits, while forex loans are treated as domestic loans and duly indexed.

Figure 8
Share of capital goods imports, in % of total imports, 2010-2015

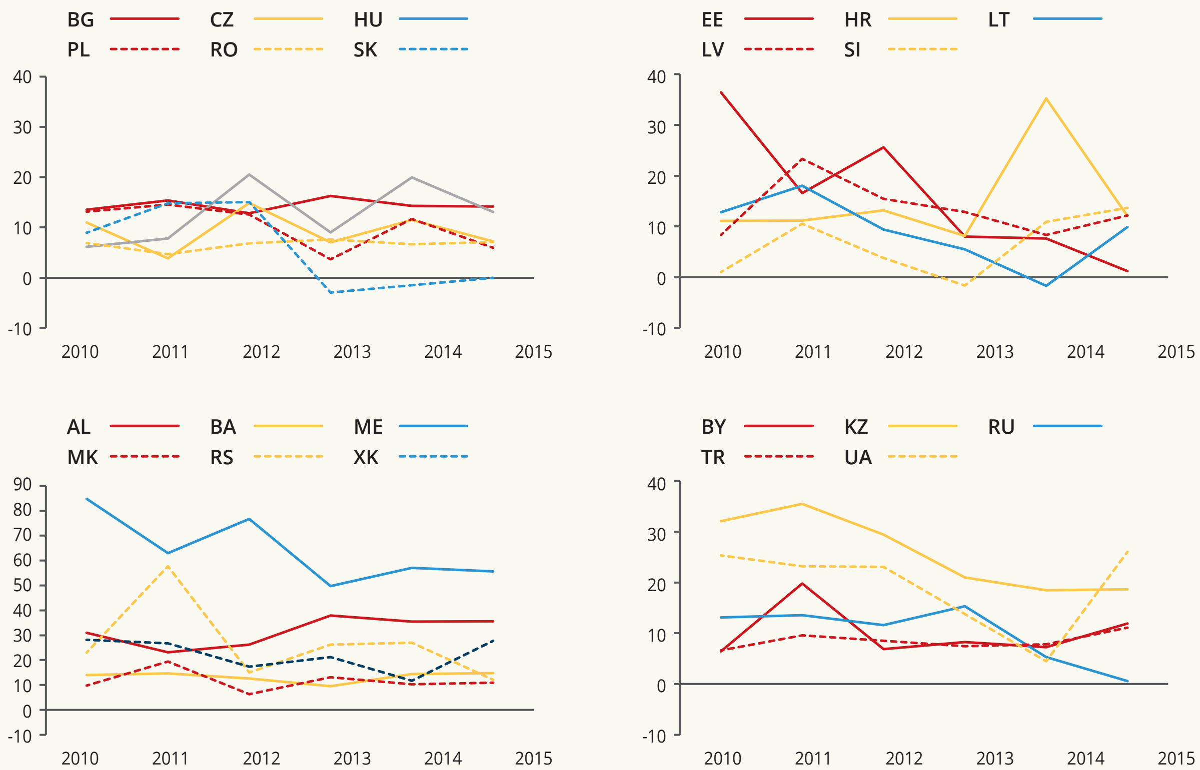


Note: Capital goods as defined in the Classification by Broad Economic Categories. Data for 2015 refer to 11 months.
Source: Eurostat and own calculations.

From the viewpoint of investments, capital goods imports, which have hardly changed over the past few years, play an important role. Groups of countries differ widely in terms of their shares of capital goods imports (see Figure 8). That particular indicator currently stands at about 30 % in the Czech Republic, Hungary and Slovakia, and only in the Czech Republic did it increase in 2015. Poland and Estonia comprise another group of countries where the share stands at about 25 %, while the average share for all other EU-CEE and WB countries is about 15 % (no 2015 data are available for the CIS-3); promising increases were to be observed in Latvia, Montenegro and Turkey in 2015. High/growing shares may indicate strong/increasing corporate investment activity.

The inflow of foreign direct investment fluctuates greatly from one year to the next. The number of countries reporting increases and decreases in 2015 was almost equal compared to the previous year. Figure 9 (2015 data are either preliminary or estimated) shows FDI inflows as a percentage of gross fixed capital formation[1]. The typical order of magnitude for FDI inflows in the EU-CEE countries is 10 % of gross fixed capital formation, less than half of the volume recorded prior to the financial crisis. Inflows recovered recently from very low levels in Lithuania and Slovakia, while Romania reported a notable increase in 2015. Some WB countries report much higher inflows per GFCF than the EU-CEE, the most notable being Montenegro (56 %) and Albania (36 %), but both Kosovo and Bosnia and Herzegovina are also on the high side. Those poor countries have a relatively low level of domestic savings, thus imported capital takes on greater importance than in the more affluent countries.

Figure 9
FDI inflow/liabilities in % of GFCF



Note: FDI data based mainly on BPM6 directional principle; BG, SK on BPM5; Hungary excluding capital in transit.
Source: wiiw FDI Database incorporating national bank statistics.

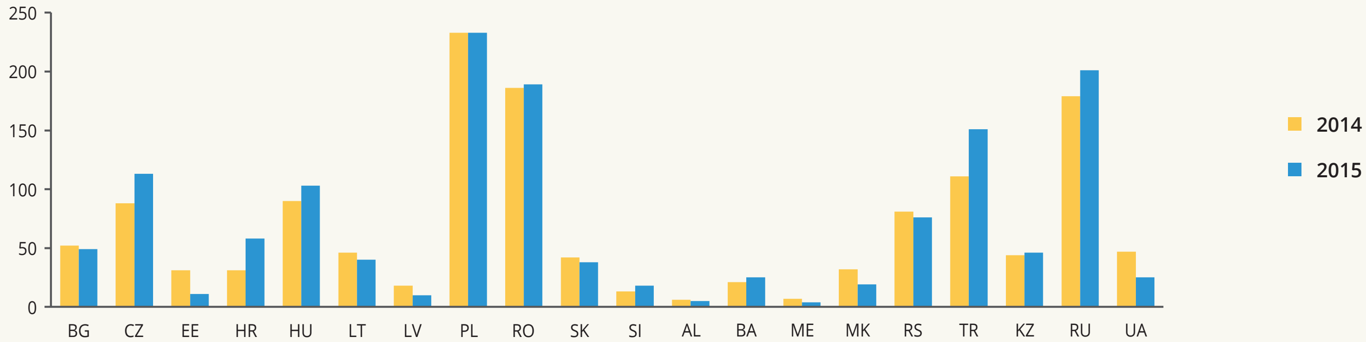
FDI inflows to Russia were decimated as the 'round-trip' that domestic capital used to undertake to Cyprus and other offshore tax havens has come almost to a standstill thanks to anti-offshoring legislation and international sanctions. The sharp increase reported by Ukraine, FDI inflows amounting to EUR 2.8 billion, is only partly due to the drop in overall investments. Although large enough to constitute a recovery, it was less than the amount the country received in 2013, in addition to being

[1] *This indicator is used to obtain internationally comparable data, but should not imply that all FDI inflows go into gross fixed capital formation, as a major part of FDI inflows finance takeovers or put into reserves of subsidiaries.*

mainly funded by the EBRD. Ukraine offers a host of untapped opportunities for foreign investors although political risks and institutional conditions inhibit larger FDI inflows at present, despite wages being much lower than in the country's western neighbours. A number of car component manufacturers and producers of consumer goods have already ventured into Ukraine, but the majority are waiting in the wings until rule of law improves.

After years of stagnation, the CESEE countries witnessed an increase in the number of greenfield FDI projects publicly announced in 2015 [2]: a clear indicator of investor confidence in a host country. Five of the EU-CEE destinations and Turkey hosted more new investment projects than before, while Poland registered the same number as in 2014 (see Figure 10). Russia still boasts a relatively high and increasing number of investment projects, especially in the manufacturing sector. This shows that the country has not lost the trust of foreign investors – at least in terms of good intentions. China ranks second among the investors in new FDI projects in Russia just behind Germany. Ukraine has registered only a few projects of very low value, thus implying that most of the reported FDI inflows must have been related either to take-overs or financial flows that did not really add to gross fixed capital formation. A major change compared with the previous year was the drop in retail investments: something that was most probably due to the slump in consumption.

Figure 10
Number of new greenfield investment projects, 2014 and 2015



Note: 2015 incomplete, subject to revision
Source: fdimarkets.com

Manufacturing accounted for the bulk of the overall increase in the number of greenfield projects compared to the previous year. The manufacturing sector was the focus of attention in Russia, Turkey, Hungary and Serbia. In the Baltic countries and Macedonia, projects in advanced services sectors took precedence, accounting for one third of the total number of greenfield projects.

Owing to the sluggish investment activity across Europe as a whole, FDI in the EU-CEE is not expected to become a major engine of growth in the way it used to be before the financial crisis. Foreign companies are still rather reluctant to invest, although the host countries' attractiveness persists. Even if the amount of FDI inflows is not expected to boom, modest increases in the course of the overall European recovery are very likely to occur. Saturation has set in as most markets have been captured by foreign banks or retailers. Only Croatia, Romania and Slovenia have relatively low stocks of FDI, which may yield further opportunities. Given that foreign ownership is

[2] *The number of projects announced has proved to be a more useful indicator than the pledged amount of capital which would be invested over several years.*

dominant in most segments of the EU-CEE economies, any new FDI will depend mainly on growth in demand across Europe. Relocation of capacities will continue, even if no direct link can be discerned between the opening of a new plant in an EU-CEE country and the closure of capacities in an 'old' Member State (viz. the recent example of the Jaguar plant in Slovakia). Inflows of new FDI into shared service and consumer service centres will continue in those CESEE countries that offer competitive wages for high-skill labour (Bulgaria, Romania). Potentially Ukraine is the most promising location in the region, given its size and low wage-levels, provided it manages to stabilise and improve the legal and other business conditions.

Gross fixed capital formation in the private sector, both domestic and foreign, thus has good prospects of contributing to economic growth in most of the CESEE countries. Public investments, which have been the major drivers of change in gross fixed capital formation, may add to this trend, provided the fiscal stance that the countries adopt is not restrictive.

Country codes (in alphabetic order) and abbreviations

AL	Albania	ME	Montenegro
BA	Bosnia and Herzegovina	MK	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

CESEE	Central, East and Southeast Europe
CIS	Commonwealth of Independent States
EFSI	European Fund for Strategic Investments
EU-CEE	European Union – Central and Eastern Europe

Imprint

This briefing was prepared for 21st Austria by Gábor Hunya[3], Economist at the Vienna Institute for International Economic Studies (wiiw).

Hunya's research focuses on Romania, Bulgaria; privatisation and foreign direct investment in Central, East and Southeast Europe.

You can reach Gábor Hunya at hunya@wiiw.ac.at

For further information about 21st Austria, please contact:

Verena Nowotny, M.A.

E: verena.nowotny@gaisberg.eu

W: **www.21st-austria.at**

[3] *The author is grateful to Amat Adarov, Vasily Astrov, Vladimir Gligorov, Peter Havlik, Mario Holzner, Leon Podkaminer, Sándor Richter, Robert Stehrer, Hermine Vidovic, and the statistics department (all wiiw) for valuable comments and inputs.*