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Growth Stabilises: Investment a Major Driver, Except in Countries Plagued by Recession

Economic Analysis and Outlook for Central, East and Southeast Europe

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Growth Stabilises: Investment a Major Driver, Except in Countries Plagued by Recession

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Executive summary

For the CESEE countries, it is crucially important that the prospects of growth in the euro area continue to improve (albeit at a slower pace than previously hoped for). Growth in the euro area is based on a mix of private and public consumption, as well as investment expansion, supported by a further easing of the European Central Bank's monetary policy and fiscal relaxation. The recent collapse of all major commodity prices not only reflects a lack of demand and an oversupply in the respective markets, but also a shift in the financial cycle from a bull to a bear market. Increasing price volatility has also reached the international stock markets. Additional factors contributing to the uncertainty are related, inter alia, to the Brexit referendum, the ongoing conflict in Ukraine and war in Syria (and the related refugee and migrant crisis), as well as the deteriorating relations between Turkey and Russia.

The divergence of economic performance between the EU Member States in Central and Eastern Europe (EU-CEE) and the Western Balkans (WB) plus Turkey on the one hand and Belarus, Kazakhstan and Russia (CIS-3) and Ukraine on the other hand will continue in 2016 and beyond. The difference between the two large country groups, however, will not take on more pronounced dimensions.

In 2015, the **EU-CEE** group registered the highest rate of economic growth since the outbreak of the financial crisis (see Table 1). In **2016-2017 the group will experience some modest growth deceleration** on account of the recent consumption boom coming to an end and a temporary decline in EU transfers. Growth will be most robust in Romania and Poland, given the solid household consumption in both countries; growth will also recover in the Baltic States that have since digested the Russian shock, yet most other countries will experience some slowdown on account of the lower volume of EU transfers. As for 2018, the EU-CEE countries will pick up some speed thanks to the inflow of new investments and EU transfers.

Countries in the **Western Balkans** also picked up speed in 2015 and will thus maintain **positive growth rates in 2016 and beyond**. They will grow at an average rate of 3%, except for Serbia where growth will be depressed on account of stabilisation. However unimpressive it may be compared to their need for catching-up, the average growth rate in the WB countries (excl. Serbia) will not lag behind that in the EU-CEE countries. **Turkey will continue down its modest growth path**. It will maintain its fragile stability, despite relatively high inflation and a high 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.

Russia and Belarus will face yet another year of recession in 2016. Russia will continue to suffer from low oil prices, high inflation, currency depreciation, sanctions and fiscal austerity. As usual, structural change and institutional reforms will be slow and half-hearted, incapable of offsetting the losses. **Ukraine's economic growth, after the dramatic fall over the past years, will stabilise as the country will by and large have completed the adjustment process** that was triggered by the country decoupling from Russia and the occupied territories. The Russian annexation of the Crimea and the conflict in East-Ukraine look set to last. Export markets lost will not be regained even in the medium term, nor will the volume of exports to the EU increase.

The leading role attributed to household demand is driving economic growth in the EU-CEE and WB countries in 2016 and beyond. Deflationary expectations have not come to the fore; consumers took advantage of lower prices rather than postponing consumption in anticipation of even lower prices. With commodity prices levelling out, inflation will return to modestly positive rates. **Population decline and ageing is a widespread problem** that may curtail economic growth. Employers started to offer higher wages to overcome labour shortage. Unemployment is on the decline but still stubbornly high in regions with competitiveness problems especially in the WB.

Overall, the wiiw forecast is upbeat about the medium-term investment revival in most of the CESEE countries in both the public and private sectors. FDI has already shown some signs of emerging from stagnation in the EU-CEE and WB countries. Conditions for sustained private investment growth have started to improve in most countries owing to: (i) falling input prices in the manufacturing sector that allow for higher profits; (ii) declining private sector debt; (iii) shrinking non-performing loans; (iv) conversion of foreign currency loans; and (v) increasing availability of new credits on better terms. However, a return to the lax banking practices of the pre-crisis era is unlikely.

As fiscal consolidation and more rapid economic growth have been achieved, fiscal space has widened in several countries, thus granting governments more room in which to implement and support investments. Even highly indebted countries managed to adopt a less restrictive fiscal stance. The CIS-3 and Ukraine are outliers in this respect as well; they have started cutting back on expenditures so as to reduce their fiscal deficits.

In the years to come, exports may well expand with external demand recovering, but imports may grow even more rapidly as consumption and investment expand in the EU-CEE and WB economies. Thus net exports will not be a strong driver of economic growth. Meanwhile, foreign investors' income may rise again. Remittances to the Western Balkan countries and labour income from abroad in the EU-CEE countries are increasingly important sources of current account revenues. The present relatively low current account deficits may increase in the future without major problems in being financed.

Due also to uncertainties concerning the global economy, in particular the EU core-economies, GDP growth will be centred on a **3% trend growth path in the EU-CEE and WB until 2018**, thus the rate of catching-up to the EU average will stay at 1-2 percentage points. **The forecasts for the CIS-3 and Ukraine have been revised downwards and predict only anaemic growth to return in 2017 the earliest.**

Special sections of this report are devoted to the following topical issues:

› **Oil prices likely to stay low.** Global crude oil prices continued to slide downwards in 2015 and at the beginning of 2016 they were still soft. This trend seems to be primarily driven by the excessive supply of oil, while demand remains weak. The effect of plummeting oil prices is apparently asymmetric for net importers and exporters of petroleum in the CESEE region. On the one hand, Russia plunged into a deep recession and the economy of Kazakhstan decelerated markedly. On the other hand, the impact on net oil importers is less clear: while low oil prices stimulate private consumption, deflationary risks may increase.

- **The Juncker Initiative will not take the place of EU transfers.** In 2016 and 2017, cohesion-policy related transfers to the EU-CEE countries will decline sharply compared to 2015 owing to the cyclic pattern of payments. The EUR 315 billion European Fund for Strategic Investment (EFSI) launched by EU President Juncker is designed to provide preferential investment credit as partial relief. To date, the EU-CEE countries have hardly availed themselves of EFSI. They either had no eligible projects or did not want to take out loans in the hope they would be able to finance investment projects by drawing on grants in 2018 and later, when cohesion funds would start to flow abundantly again.

- **Outmigration and demography are leading to labour shortages in EU-CEE.** On account of demographics and migration patterns, the EU-CEE countries are shrinking rapidly in terms of population. Outflows from Romania and Bulgaria to other EU Member States accounted in the case of Romania and Bulgaria for 3.5% and 2.2% of the working-age populations in 2009-2014, respectively; they were also substantial in the Baltic States. The very same countries that registered the highest levels of outmigration have also experienced a drop in their unemployment rates. Vacancy rates, which are negatively correlated with unemployment rates, rose most rapidly in the Baltic States, followed by Hungary, Czech Republic and Romania. Bottlenecks are building up in respect of jobs that call for highly skilled workers.

- **Refugees may, in the medium term, put pressure on existing migrant workers in Austria.** The flow of EU-CEE migrants to Austria increased following the EU enlargement (in 2004 and 2007) and gained impetus once restrictions on labour market access were lifted in 2011 and 2013. Since 2011, the number of employed persons from those countries has almost doubled: a trend that coincided with a rise in unemployment in Austria. The relationship between the two phenomena is not straightforward, because the occupation structure of migrants diverges significantly from that of the domestic unemployed. Moreover, recognition of refugee status and integration of new arrivals in the labour market will take quite some time.

COUNTRY SUMMARIES

ALBANIA

Investment will continue to be a major component of growth whereas household consumption will recover only slowly. Exports will continue to be negatively affected by the fall in international oil prices. For the next three years, foreign direct investments and other capital inflows will support a growth rate of more than 3%.

BELARUS

Belarus plunged into deep recession; GDP slumped by 4% in 2015. The crisis struck hard across the board, affecting all aspects of economic life, while policy-makers had little manoeuvring space in which to soften the blow. Short-term prospects are bleak as recession is likely to persist throughout 2016. A modest recovery may start in 2017, but it will be conditional on the revival of key export markets.

BOSNIA AND HERZEGOVINA

Growth should pick up speed, driven by investments and exports, as long as the political climate continues to improve, regardless how slowly. Our forecast hints at medium-term growth close to 3% – higher than the regional average.

BULGARIA

Driven by a combination of positive domestic and external factors, GDP growth in 2015 outperformed expectations. The economy, however, is mired in chronic structural problems that policy-makers have systematically neglected. While GDP is expected to continue growing at a rate of 2-3% per annum over the short term, the absence of policy reforms may lead to an accumulation of macroeconomic imbalances.

CROATIA

In 2015 Croatia's economy returned to mild growth. The turnaround was backed by a rise in external demand and a modest recovery in household consumption and investments. EU-funded investments and the continuation of private consumption recovery should help to stimulate GDP growth, which, however, will remain relatively weak, 1.7% on average, over the period 2016-2018. Fiscal consolidation coupled with high public debt will remain the main impediments to sustainable growth.

CZECH REPUBLIC

The recent expansion of infrastructural investment is not going to extend into the years ahead. However, in the light of the low level of debt in the private sector and pursuit of monetary policy conducive to growth, further moderate recovery, with growth averaging 2.4%, should be assured over the period 2016-2018, notwithstanding the uncertainties that persist concerning the future course of fiscal policy and foreign trade performance given the (expected) strengthening of the domestic currency.

ESTONIA

Household consumption remains the strongest driver of economic activity in Estonia, the major push factor being the rapid growth in both minimum and overall real wages. For the coming two years, we expect trade destined for Western countries to recover, while the decline in exports to Russia should come to a halt. Moreover, an upswing in public investments should also lead to GDP growth picking up speed slightly: to 2.2% and 2.4% in 2016 and 2017, respectively.

HUNGARY

In 2015, Hungarian GDP increased by 2.9%, aided by a peak inflow of cohesion policy transfers from the EU. In 2016, EU transfers will decline sharply. Despite government measures to offset the anticipated negative impact, the outcome will be deceleration of economic growth in the current year, followed by slow recovery in 2017 and 2018.

KAZAKHSTAN

In 2016, GDP growth in Kazakhstan will slow down still further to 1% as the global oil prices are expected to be lower than they were on average in 2015. Growth is projected to pick up speed in the period 2017-2018, primarily on the back of a rise in investment. Poor performance in the oil sector has put a strain on public finance and the government has had to adopt various fiscal consolidation measures. Tight monetary policy and dollarisation of deposits has squeezed liquidity in the banking sector, thus giving rise to a credit crunch.

KOSOVO

Despite hefty political infighting, the economy of Kosovo is growing at a rate of almost 4% per annum. The dynamics might even accelerate in the years to come. The major growth drivers are remittances and foreign direct investment. However, still more growth will be needed, if mass unemployment is to be reduced substantially as the population is young and ever-increasing.

LATVIA

For 2016, we have slightly raised our GDP growth forecast for Latvia to 3%. As expected, the slump in Russian demand can be offset by growth in exports to the EU and Asian markets. Whereas household consumption will develop markedly and rapidly, investment growth will remain comparatively low. Improvements in the labour market and a rapid rise in real wages will keep households in a buoyant mood in terms of spending. We expect an upswing in GDP growth to 3.2% in 2017 and 3.5% in 2018, driven by stronger external demand and greater investment activity in both the public and private sectors.

LITHUANIA

The introduction of the euro and the management of the difficult geo-economic situation were arguably the major features of the Lithuanian economy in 2015. The successful reorientation of trade towards the West softened the negative demand shocks emanating from Russia. As household consumption increases, it will put the economy on a growth path leading from a GDP growth rate of 1.6% in 2015 to one of 3% over the years to come.

MACEDONIA

Growth over the medium term should settle at just above 3%, with investment and exports as the driving forces. As democratisation takes hold, political stability should in all likelihood firm up and growth accelerate somewhat, especially if growth in the region as a whole picks up speed.

MONTENEGRO

Growth of up to 3% per year is expected, with investments and exports acting increasingly as the main drivers. The upcoming elections and joining NATO should prove stabilising factors, while improved regional cooperation should have the same effect.

POLAND

The current moderate and broadly based growth will continue over the period 2016-2018 – with GDP growth averaging 3.4%. There is, however, every reason to expect less dynamic growth in terms of investment. 2017 will prove critical, unless the increase in social spending is offset by higher tax revenue.

ROMANIA

In 2015 economic growth accelerated. In 2016 GDP will expand further by some 4%. Private consumption will enjoy a pro-cyclical boost thanks to tax-cuts and wage increases in the public sector, while fixed investments will also recover. For the most part, the impact of the fiscal stimulus will be short-lived; economic growth may well slow down in 2017.

RUSSIAN FEDERATION

Contrary to earlier expectations, the Russian economy will remain in recession in 2016. With oil prices having plunged anew at the beginning of 2016, export and budget revenues will drop. The envisaged cuts in expenditure will affect both consumption and investments. Barring additional external shocks, the economy may stabilise in 2017. Given the absence of reforms and investments for diversification and modernisation, economic growth will remain sluggish – even in the medium term.

SERBIA

Slow recovery in tandem with investment and export growth is to be expected over the medium term. Growth over the next three years or so should reach 2% or slightly more, if the fiscal consolidation programme and structural reforms are put into effect. Industrial production, in particular manufacturing, should grow, as should certain exportable services. Growth in wages and consumption, however, should be only relatively slow.

SLOVAKIA

Strong growth in terms of gross fixed capital formation helped GDP to soar upwards by 3.6% in 2015. For the period 2016-2018, growth will range around 3%, with a slight upward trend in the latter years and backed by domestic demand.

SLOVENIA

Having increased by 2.9% in 2015, GDP growth in Slovenia will slacken to about 2% in both 2016 and 2017 on account of the drop in volume of EU-funded investments at the outset of the new financial framework. More solid growth is forecast for 2018. Exports and the gradual recovery of household consumption will remain the main drivers of growth. Government consumption is expected to remain subdued in the wake of budget consolidation measures.

TURKEY

Owing to both a 30% net rise in minimum wages and the current generous government spending, we expect GDP to expand by 3.2% in 2016. Given the ongoing tensions along the Turkish-Syrian border and with the decline in oil prices finally bottoming out, a recovery of (net) external demand is unlikely in 2016. As for 2017 and 2018, we expect GDP to grow by 3.1% and 3.0%, respectively, owing to the recovery of foreign demand following a steady depreciation process and positive but lower growth rates of consumer loans, ultimately leading to a firm policy stance being adopted by the Central Bank of the Republic of Turkey.

UKRAINE

Barring a resumption of large-scale fighting in Donbas, the economic decline has now most probably bottomed out. However, given the depressed domestic demand and the new restrictions on trade with Russia, which will not be offset by the newly established ‘deep and comprehensive free trade’ area with the EU, we forecast zero growth for the current year, followed by gradual acceleration to around 2% over the period 2017-2018.

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

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

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

	GDP real change in % against prev. year					Consumer prices change in % against prev. year					Unemployment (LFS) rate in %, annual average					Current account in % of GDP				
			Forecast					Forecast					Forecast					Forecast		
	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018
EU-CEE																				
Bulgaria	1.5	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

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.

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

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TABLES AND FIGURES

The statistical data until 2015 presented in this Report are as of 23 February 2016, forecasts as of March 2016. Most data are taken from the wiiw Databases. Direct access is available at: http://data.wiiw.ac.at/.

ABBREVIATIONS

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

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

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

bbl	barrel
BPM5	Balance of Payments Manual Fifth Edition
BPM6	Balance of Payments and International Investment Position Manual Sixth Edition
BOP	balance of payments
CESEE	Central, East and Southeast Europe
CIS	Commonwealth of Independent States
CIS-STAT	Interstate Statistical Committee of the Commonwealth of Independent States
CPI	consumer price index
EA-19	euro area 19 countries
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
EFSI	European Fund for Strategic Investments
EIB	European Investment Bank
ER	exchange rate
ESA'95	European system of national and regional accounts, ESA 1995
ESA 2010	European system of accounts, ESA 2010
EU-28	European Union 28 countries
EU-15	15 original members of the European Union
ESIF	European Structural and Investment Funds
FDI	Foreign Direct Investment
FISIM	Financial Intermediation Services, Indirectly Measured
GFCF	gross fixed capital formation
GDP	Gross Domestic Product
ICP	International Comparison Program
IMF	International Monetary Fund
LFS	Labour Force Survey
MFF	Multiannual Financial Framework
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne (Statistical classification of economic activities in the European Community)
NACE Rev. 1	first revision of the original NACE (1970)
NACE Rev. 2	revised classification, introduced in 2008
NB	National Bank
NC	national currency
OECD	Organisation for Economic Co-operation and Development
OPEC	Organisation of the Petroleum Exporting Countries
pp	percentage points
PPI	producer price index
PPP	Purchasing Power Parity
SME	small and medium-sized enterprise
SNA	System of National Accounts
SPE	Special Purpose Entity
VAT	value added tax
WB	Western Balkans
WIFO	Austrian Institute of Economic Research
wiiw	The Vienna Institute for International Economic Studies

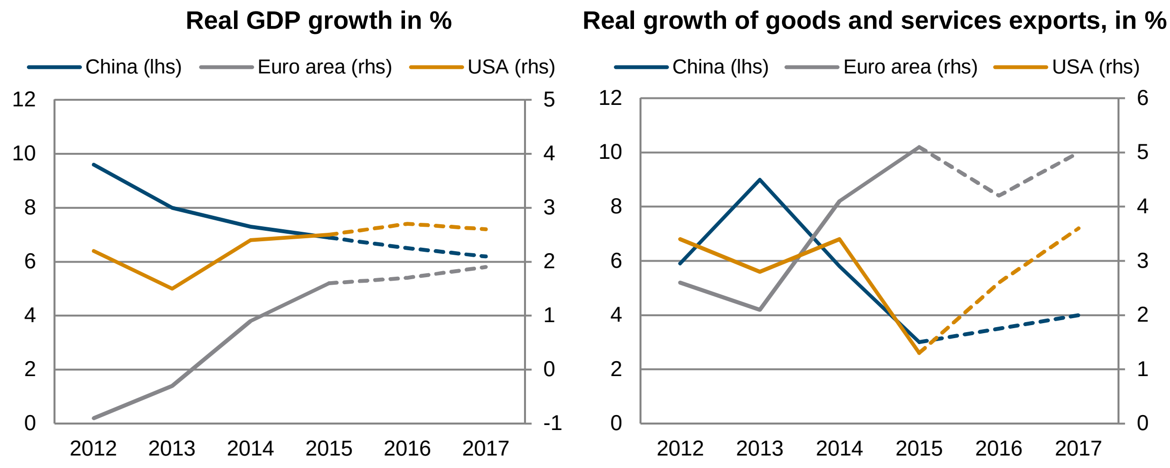
.	not available (in tables)
bn	billion
mn	million
mom	month-over-month
lhs	left-hand side axis/panel
p.a.	per annum
rhs	right-hand side axis/panel
sa	seasonally adjusted
saar	seasonally adjusted annualised rate
qoq	quarter-over-quarter
yoy	year-over-year

International environment: moderate recovery amid major uncertainties

BY MARIO HOLZNER

Prospects of growth in the euro area continue to improve, albeit at a slower pace than previously hoped for. The European Commission's (EC) latest winter forecast foresees GDP growing in both 2016 (1.7%) and 2017 (1.9%) – only slightly faster than in 2015 (1.6%). Nevertheless that is a marked improvement when compared to earlier years that were characterised by near-stagnation or outright recession. Growth in the euro area is based on a mix of private and public consumption, as well as investment expansion, supported by a further easing of the European Central Bank's (ECB) monetary policy and an end to strict fiscal austerity in most Member States. Global growth is also expected to pick up by a few tenths of a percentage point, reaching about 3.5% in 2017. While the United States will also maintain its comparatively high growth rate of some 2.5% in the near future, China will face further deceleration from the extremely high growth rates of former times to a rate of just above 6% per annum (see Figure 1, left panel).

Figure 1 / International GDP and export trends



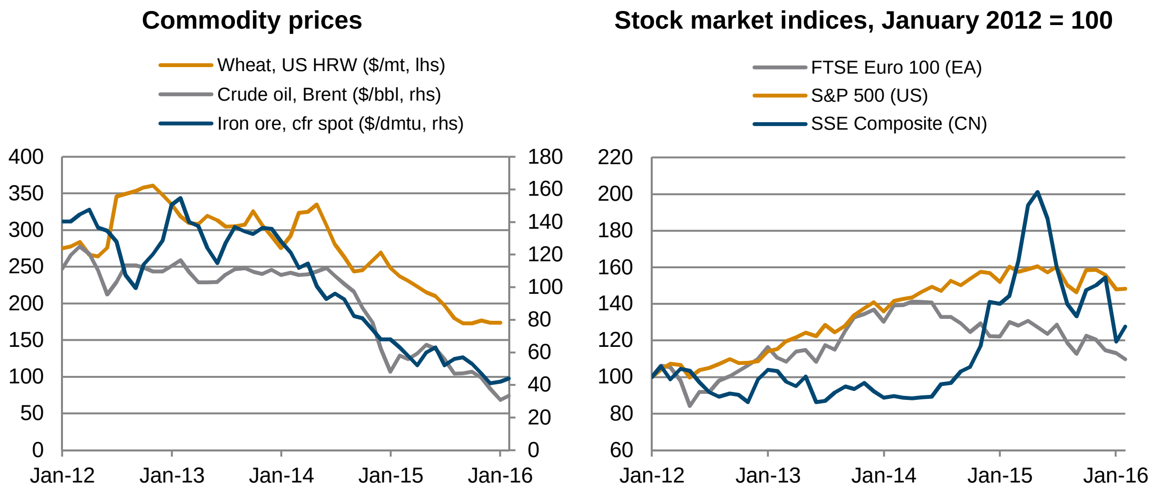
Source: EC Winter Forecast 2016.

Robust export growth in the euro area will be maintained at a real rate of around 4-5%. The US is expected to register gains in terms of export dynamism in both 2016 and 2017 (see Figure 1, right panel). Furthermore, China's export growth should once more show a slight improvement after two years of deceleration. However, that growth will still lag behind the export drive in the euro area, as the Chinese economy rebalances from export- to consumption-driven economic development. The EU Commission expects global real export growth rates overall to increase from less than 3% in 2015 to more than 4% in 2017, reflecting the increase in world GDP growth that it had previously forecast. However, the downside risks associated with those forecasts have increased substantially.

Consequently, the Commission has been revising its forecasts slightly downward for both GDP growth and export growth compared to its autumn forecast.

The recent collapse of all major commodity prices not only reflects a lack of demand and an oversupply in the respective markets, but also a shift in the financial cycle from a bull to a bear market. Compared to a year ago, current oil prices have almost halved. Compared to a year and a half ago, they are barely a quarter of their original value (see Figure 2, left panel). Similarly, the nominal price of iron ore has dropped by some two thirds since early 2014. Over the same time span, wheat prices have approximately halved. For the forecast period, however, we expect commodity prices to stabilise at a slightly higher rebound value. We also expect Brent oil to hold an average price of around USD 35 per barrel at an exchange rate of about 1.1 USD/EUR. Nevertheless, low commodity prices are also ingredients favouring a rise in real wages (and hence consumption) and a weak EUR against the USD promotes exports in the euro area. At the same time, the increased volatility on global markets also bears repercussions for investment decisions in the real sector. In that respect, recent stock market developments have not been helpful either.

Figure 2 / International commodity prices and stock market indices



Source: World Bank Commodity Price Data (The Pink Sheet).

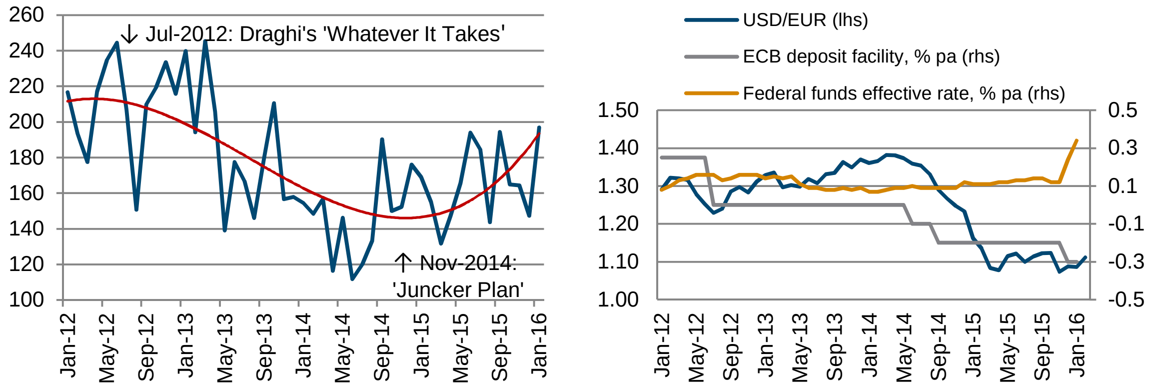
Source: Yahoo! Finance, own calculations.

Increasing price volatility has also reached the international stock markets, another worrying signal for investors in the real economy. Similar to the oil price decline, stock quotes of the most important blue-chip companies in the euro area have started to drop ever since the summer of 2014. Since then the FTSE Euro 100 Index has lost about 20% in value (see Figure 2, right panel). About half of that drop only occurred in recent months, when the US stock market also turned south. The Shanghai stock exchange has gone on a particularly volatile ‘roller coaster ride’ with its Composite Index increasing by 126% in the period May 2014 to May 2015 only to falling by more than 36% thereafter. The financial system’s volatility is correlated with a high degree of perceived uncertainty, complexity and systemic ambiguity. Current economic policy does not necessarily help to foster confidence in future developments.

Recently, European policy-related economic uncertainties have been on the rise as well. The European news-based Economic Policy Uncertainty Index is a normalised (to a mean of 100 prior to 2011) index measuring the volume of news articles in major European newspapers discussing economic policy uncertainties. Despite many ups and downs mostly related to the Greek crisis, the index had been on a secular downward trend since the summer of 2012, when the ECB President Mario Draghi declared in a speech at a conference on 26 July 2012 that '[…] the ECB is ready to do whatever it takes to preserve the euro' (see Figure 3, left panel). A certain reversal of that trend is to be observed as of autumn 2014. Interestingly, this coincides (no causality is implied) with the EC President Jean-Claude Juncker announcing his 'Investment Plan for Europe' at a speech on 26 November 2014. To date the plan has failed to lend substantial support to ailing European investment on account of the fact that, inter alia, it is mostly credit-based and does not involve genuine investment funds (see special section II). Compared to European fiscal policy, European monetary policy has been much more relaxed and has acted as a stabilising factor. On 11 July 2012 the ECB deposit facility rate was reduced to zero and has ventured deeper into negative territory ever since (see Figure 3, right panel). Since 9 December 2015 it has been standing at -0.3% per annum. However, it appears that easy monetary policy alone will not restore investor confidence. In conjunction with (and in expectation of) the US Federal Reserve Bank gradually tightening monetary policy, the USD/EUR nominal exchange rate has softened appreciably since mid-2014 from a level of about 1.37 to about 1.11 more recently (a drop of some 20%). While this mitigates some of the (positive) effects of falling commodity prices, it also helps European exporters. Nevertheless, periods of excessive exchange rate volatility are generally deemed less supportive in terms of improving the investment climate.

Figure 3 / The rise of uncertainty and monetary policy

European Economic Policy Uncertainty index **ECB and FED interest and exchange rates**



Source: www.PolicyUncertainty.com, own calculations. Source: ECB, FED, own calculations.

Additional factors contributing to uncertainty are related, inter alia, to the Brexit referendum, the ongoing wars in Ukraine and Syria (and the related refugee crisis), as well as the sharply deteriorating relations between Turkey and Russia. A potentially negative outcome of the referendum on the United Kingdom's continued membership in the EU (scheduled for 23 June 2016) and the subsequent withdrawal would bear unpredictable repercussions for the European integration project as a whole. While the war in Ukraine seems to be abating into a frozen conflict, the conflict in Syria has been escalating. The resultant wave of refugee and migrants (see special section IV) headed for Austria, Germany and Sweden has had a major impact on both national politics in the host countries and European political affairs in general. Moreover, it has called into question the Schengen Agreement and more generally the intra-European border regime, as well as the notion of European solidarity. These developments are correlated with a rise in nationalism and authoritarian impulses, particularly in certain EU-CEE. The worsening relations between the NATO partner country Turkey and Russia following the Turkish downing of a Russian bomber near the Syria-Turkey border on 24 November 2015 is only one additional worrying element in the sphere of geo-strategic uncertainties besetting Europe.

In substance, a collective fiscal policy response should offer a way out of the persistent Europe-wide restraint on investment. The OECD also offered the same policy advice in its recent Interim Economic Outlook from February 2016: ‘A stronger collective policy response is needed to strengthen demand. Monetary policy cannot work alone.’ This view is also borne out by the empirical findings on the positive effects of increased (and debt-financed) public investment (especially during periods of weak growth) contained in the International Monetary Fund’s World Economic Outlook report issued in October 2014. However, the fiscal stance in the EU countries has mostly been restrictive or neutral to date.

Growth stabilises: investment a major driver, except in countries plagued by recession – overview

BY GÁBOR HUNYA[1]

GDP GROWTH IN 2015: PEAKS AND TROUGHS

In 2015 economic developments in the countries of Central, Eastern and South-east Europe (CESEE) varied greatly between those countries that had benefited from cheap oil and those that had been negatively affected. Three countries – Belarus, Russia and Ukraine – registered a negative change in their GDP, while severe slowdowns occurred in Kazakhstan, Lithuania and Estonia. In all the other countries in the region, growth picked up, fuelled as it was by household demand and EU-funded investments. (See Table 1 for an overview of the main economic indicators.)

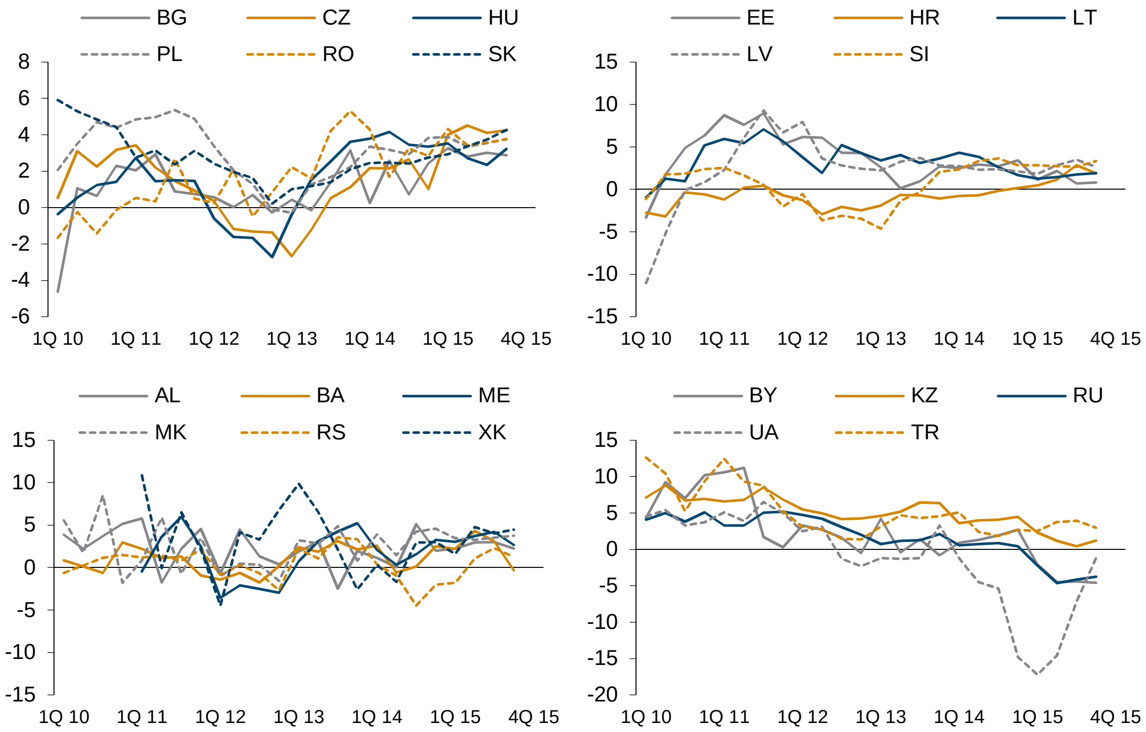
The primary oil-price related losers were Russia and Kazakhstan, followed by those economies that depended on them. The latter included Belarus, Ukraine and, to a certain extent, the Baltic States as well. The situation in the latter countries was further aggravated by the recession in Russia and the sanctions that restricted trade between Russia and the West. The slump in Ukraine was attributable to the conflict with Russia, the trade restrictions associated therewith and the slow process of reform. Ukraine is currently undergoing a second wave of transition-related recession, similar to the situation in the countries of Central Europe in the early 1990s, when their trade with the former Soviet Union collapsed. For all the above countries, the main question is the extent to which they can cope with the dual challenge posed by trade diversion and revenue decline.

Acceleration of growth or the continuation of relatively high growth rates characterised the other Central and East European EU Member States (EU-CEE) and countries in the Western Balkans (WB) and Turkey, most of which had benefited from low oil prices. In 2015 eight countries registered growth of more than 3%, whereas only three had surpassed that mark the previous year. Only Poland, Romania and Macedonia achieved at least 3% growth in both years; growth acceleration is thus a new and probably short-lived development. (In 2014, a similar instance of a one-year recovery had occurred in Estonia and Hungary only to be followed by deceleration in 2015.) The best performer WB countries are Kosovo, which is on track to establishing a functioning market economy, and Macedonia, which could improve its net exports. Meanwhile, the previous worst performers also reported good news in 2015: Croatia and Serbia emerged from recession after several years of negative growth – mainly on account of their exports having improved. For the most part, quarterly data show improving short-term growth trends that, however, may well not last long. Given all the fluctuations in growth, the main question relates to the feasibility of sustaining future growth.

[1] 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.

The cross-country gap between the quarterly year-on-year GDP growth rates has been closing recently. As shown in Figure 4, with the exception of Russia, Ukraine and Belarus, all economies tended to grow within a band of 2-4% in the second half of 2015. The current recovery in the six of the EU-CEE (Figure 4 top left) is stronger than the short-term recovery attained during the recovery after the global financial crisis in 2010-2011, which came to an end when the euro-crisis hit hard the following year. The 2014-2015 recovery has since reached Latvia, Croatia and Slovenia that had been laid low by continuing recession (Figure 4 top right). The WB countries are pursuing growth patterns of their own, displaying a higher degree of fluctuation than the EU-CEE (Figure 4 bottom left) because in very small economies such as those one or the other new production facility or investment project can have a major short-term impact on growth. The three members of CIS, Belarus, Kazakhstan and Russia, as well as Ukraine enjoyed remarkable growth back in 2011, but have since embarked on a downward trend or even slid into depression of late (Figure 4 bottom right). The Turkish economy maintains a biannual cycle: slow growth in 2012 and 2014 followed by firmer growth in 2013 and 2015.

Figure 4 / Quarterly real GDP growth of the CESEE countries
change in % against preceding year



Source: National and Eurostat statistics.

Given the slow growth across the globe and in Europe, as well as other severe external risks outlined in a previous section, the medium-term wiiw forecast does not count on growth accelerating. The forecast does, however, reveal one trend. Future growth in both the EU-CEE and WB countries will be based more on investments than on consumption, while the recession in the CIS-3 and Ukraine will level out. Although double the euro area average, the projected 3% growth rate is rather modest for the catching-up countries, especially where the lesser developed WB countries are concerned.

Table 2 / Real GDP growth forecast and revisions

		Forecast, %				Revisions, pp		
		2015	2016	2017	2018	2015	2016	2017
EU-CEE	BG	3.0	2.5	2.5	2.7	0.7	-0.1	-0.5
	HR	1.5	1.4	1.8	2.0	0.8	0.2	0.2
	CZ	4.3	2.4	2.3	2.4	0.4	0.0	0.0
	EE	1.2	2.2	2.4	2.6	-0.7	-0.4	-0.4
	HU	2.9	2.2	2.3	2.9	0.0	0.1	0.3
	LV	2.7	3.0	3.2	3.5	0.3	0.0	0.2
	LT	1.6	3.0	3.4	3.5	0.0	0.0	0.0
	PL	3.6	3.4	3.2	3.4	0.1	0.1	-0.1
	RO	3.7	4.0	3.0	3.5	0.3	0.3	0.3
	SK	3.6	3.0	3.2	3.3	0.4	0.0	0.3
	SI	2.9	2.0	2.3	2.8	0.2	-0.2	0.0
Western Balkans	AL	2.6	3.2	3.5	3.6	0.0	0.0	-0.1
	BA	2.3	2.9	2.9	3.1	0.5	0.6	0.5
	XK	3.7	3.9	4.3	4.0	-0.6	0.4	0.2
	MK	3.5	3.4	3.1	3.1	0.1	0.7	0.0
	ME	3.4	2.8	2.8	3.1	1.0	0.2	0.0
	RS	0.7	1.6	1.7	2.0	0.6	0.7	0.3
Turkey	TR	3.3	3.2	3.1	3.0	0.3	0.1	0.0
CIS-3	BY	-3.9	-2.6	0.5	1.5	-0.1	-2.6	-0.9
	KZ	1.2	1.0	2.5	3.5	-0.3	-1.5	-1.0
	RU	-3.7	-0.8	0.8	1.8	0.0	-1.8	-0.6
Ukraine	UA	-10.5	0.0	1.9	2.5	1.0	0.0	0.1

Note: Current forecast and revisions relative to the wiiw Autumn 2015 Forecast Report. Colour scale reflects variation from the minimum (red) to the maximum (green) values.
Source: wiiw forecast

The growth findings for 2015 surprised most observers. It transpired that for most CEE and WB countries as well as Turkey, economic growth had been better than expected in the autumn 2015 wiiw forecast, while in the case of the CIS-3 the projections had to be revised downwards. As for the 2016 forecast, things have changed to a lesser extent. wiiw experts have become more optimistic concerning growth in the WB and more pessimistic about developments in the CIS-3. The following sections as well as the country reports provide detailed explanations.

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 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 – see special section II.) 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 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.

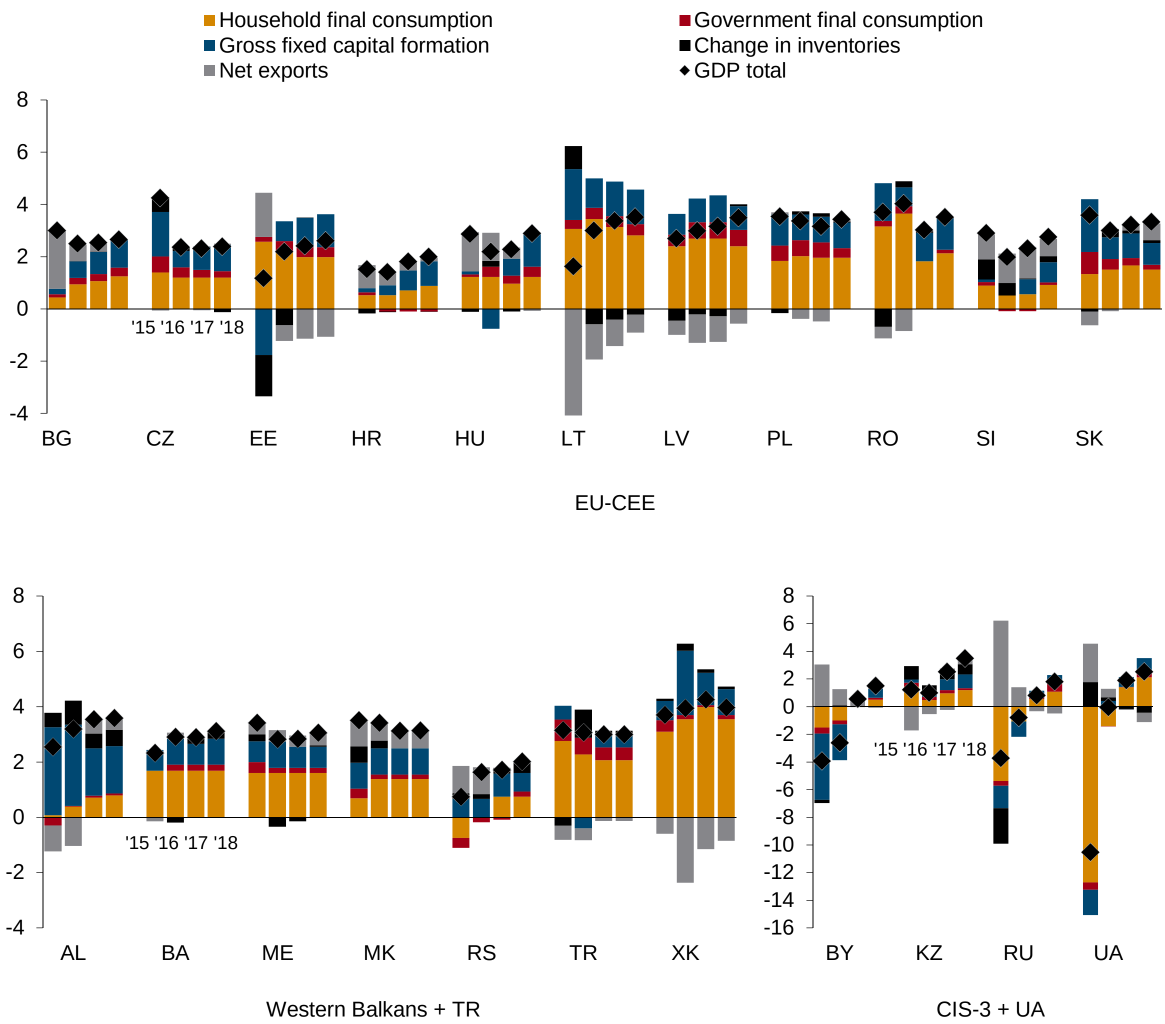
Turkey will continue down its growth path, with GDP rates somewhat above 3%. It seems the country will maintain its fragile stability at the cost of relatively high inflation and a current account deficit, while facing increasing challenges emerging, for instance, from the war in Syria, the refugee crisis 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 5). 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 5 / GDP growth, 2015-2018
and contribution of individual demand components in percentage points



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

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. (See section on fiscal space.)

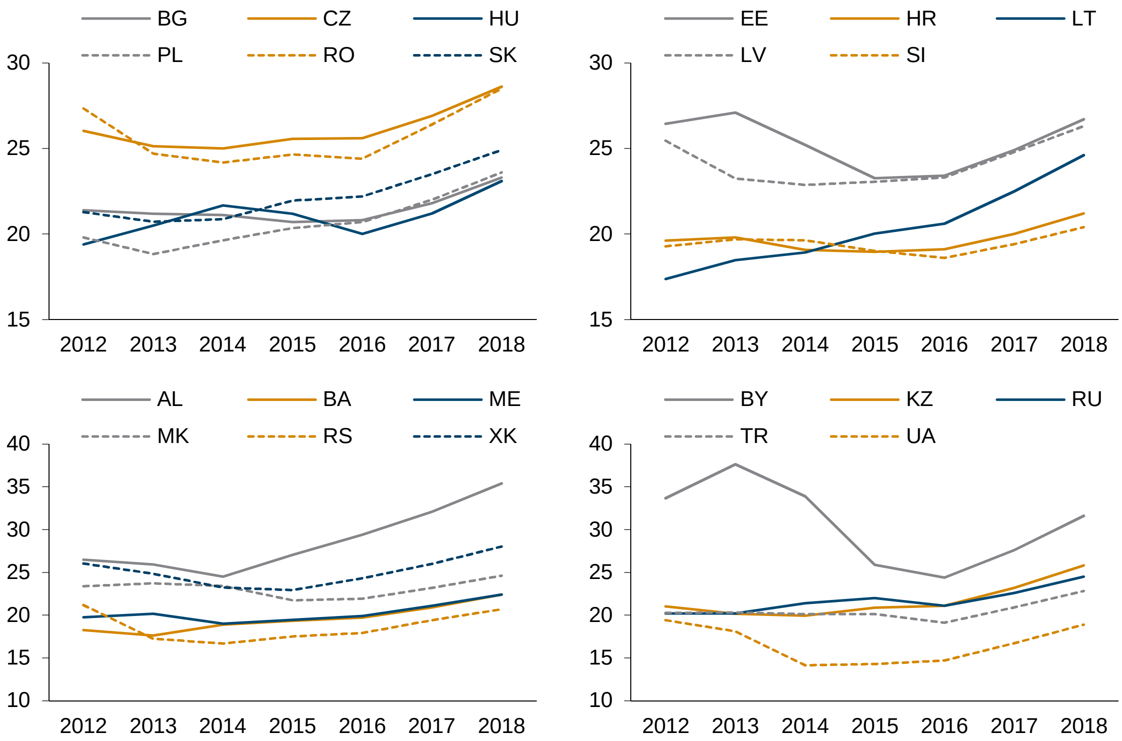
The crisis in Russia, Belarus and Ukraine will ease in 2016 and consumption may recover in 2017. In 2015, a drop in household consumption and a contraction of both gross fixed capital formation and government spending were partly offset by increasing net exports in the light of plummeting imports. Subdued 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 6) 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 6 / 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.

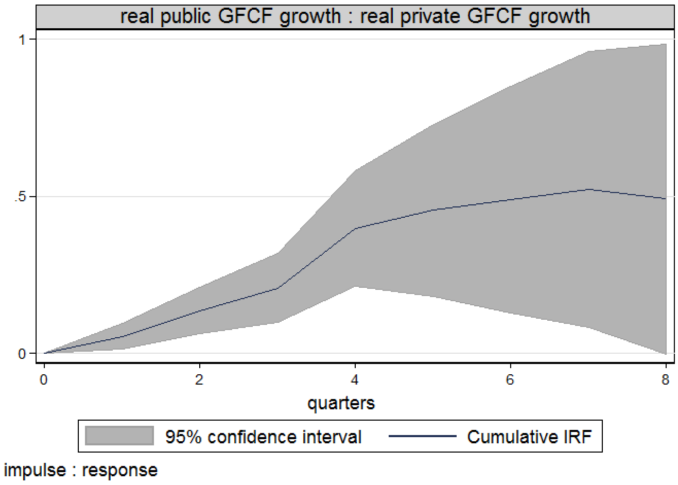
BOX 1 / PUBLIC INVESTMENT KICK-STARTING PRIVATE INVESTMENT

by Mario Holzner

Empirical analysis for 18 EU countries shows that an increase in public investment is followed by an increase in private investment. An even more pronounced effect can be observed for a sub-set of five EU countries from Central and Eastern Europe (EU-CEE), comprising Croatia, the Czech Republic, Estonia, Poland and Romania, for which the respective quarterly data on sectoral real gross fixed capital formation (GFCF) growth are available. Those data support other evidence that investment multiplier effects are typically stronger in emerging markets. As can be seen from the impulse response function (IRF) in the Box-Figure 1, the cumulative effect of a one percentage point (pp) increase in EU-CEE-5 public investment growth on private investment growth over a period of one year is in the order of about 0.4 pp. Hence, a substantial increase in public investment, for instance, in the order of 10 pp is followed one year later by a cumulative increase in private investment of some 4 pp. Given that the average EU-CEE share of private GFCF in GDP stands at about 20 percent, while public investment in GDP accounts for only about 4 percent, the volume effect is quite strong. Possible explanations include a push in prices and hence lower real interest rates, induced by public investment, or simply a push in aggregate demand and a spur of investor confidence and expectations. Historical evidence would thus suggest the pursuit of a more pronounced (and possibly co-ordinated) public investment policy in order to kick-start much needed private investment.

Box Figure 1 / Cumulative impulse response function for EU-CEE-5 real public GFCF growth on real private GFCF growth

pp effects of a 1 pp impulse after up to 8 quarters, q1 2000-q3 2015

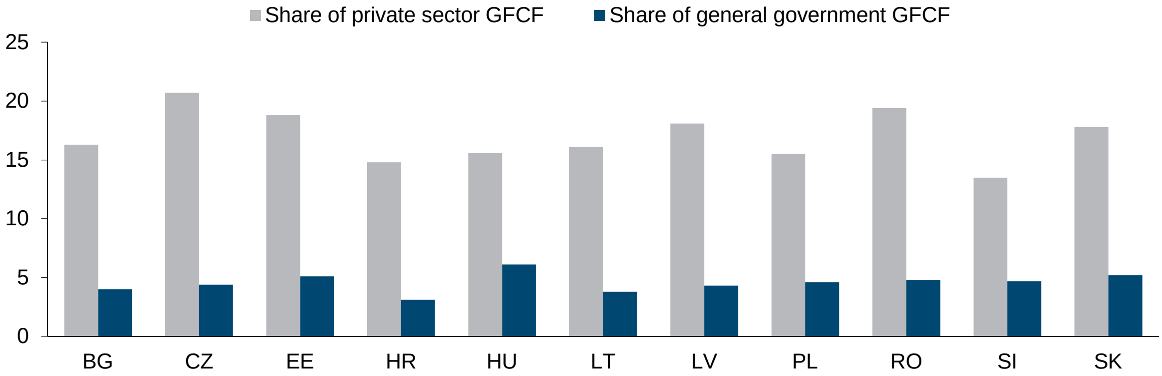


Source: Eurostat, own calculations.

Data and methodological issues: Quarterly, nominal public and private GFCF (year-on-year) growth data for only 18 EU economies are available from Eurostat. They were deflated using the overall GFCF deflator. The maximum time span of 63 quarters ranging from the first quarter of 2000 to the third quarter of 2015 was applied. The above results were obtained using a (GMM-based, unbalanced) panel vector auto-regression (VAR) model (with seven lags as suggested by the coefficient of determination). Various panel unit-root tests suggest that the underlying time-series are stationary. The estimated panel VAR satisfies the stability condition. A subsequent Granger test indeed shows a positive and Granger causal effect of real public investment growth on private growth (the Granger causality feedback effect of private investment on public investment is only weakly significant).

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 7, 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.

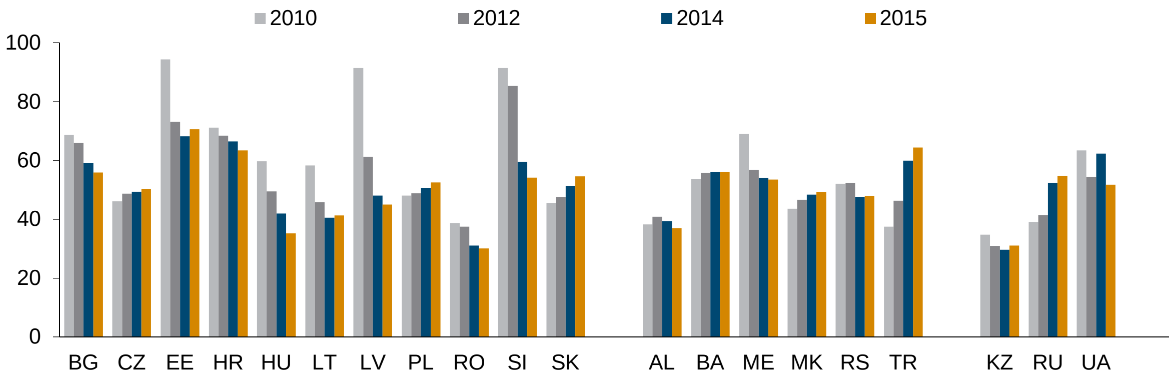
Figure 7 / Share of public and private GFCF investment in GDP, 2015



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.

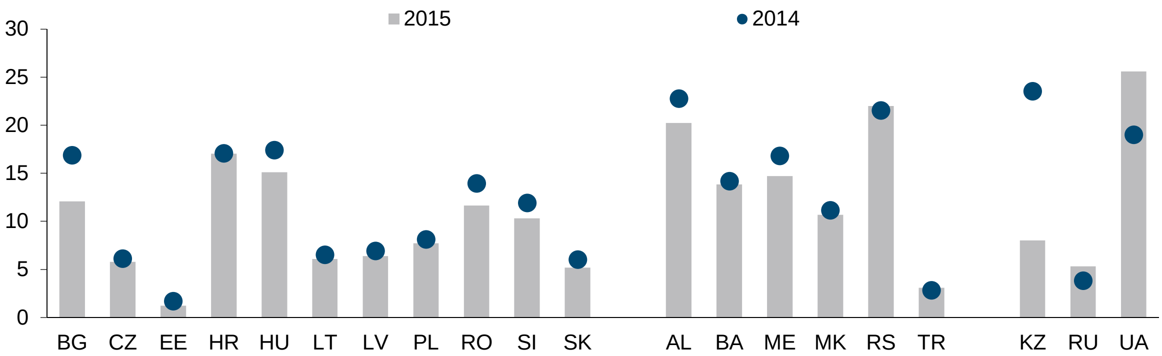
Figure 8 / Stock of private bank loans, in % of GDP, 2010-2015



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 8) has declined at a particularly rapid rate in Hungary and Romania, as has the share of non-performing loans (see Figure 9). 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.

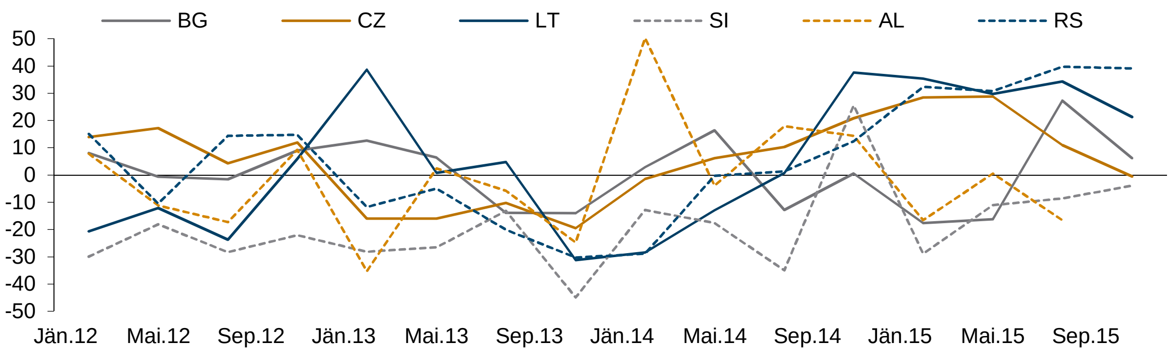
Figure 9 / Bank non-performing loans, % of total loans, 2014 and 2015



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 10 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.

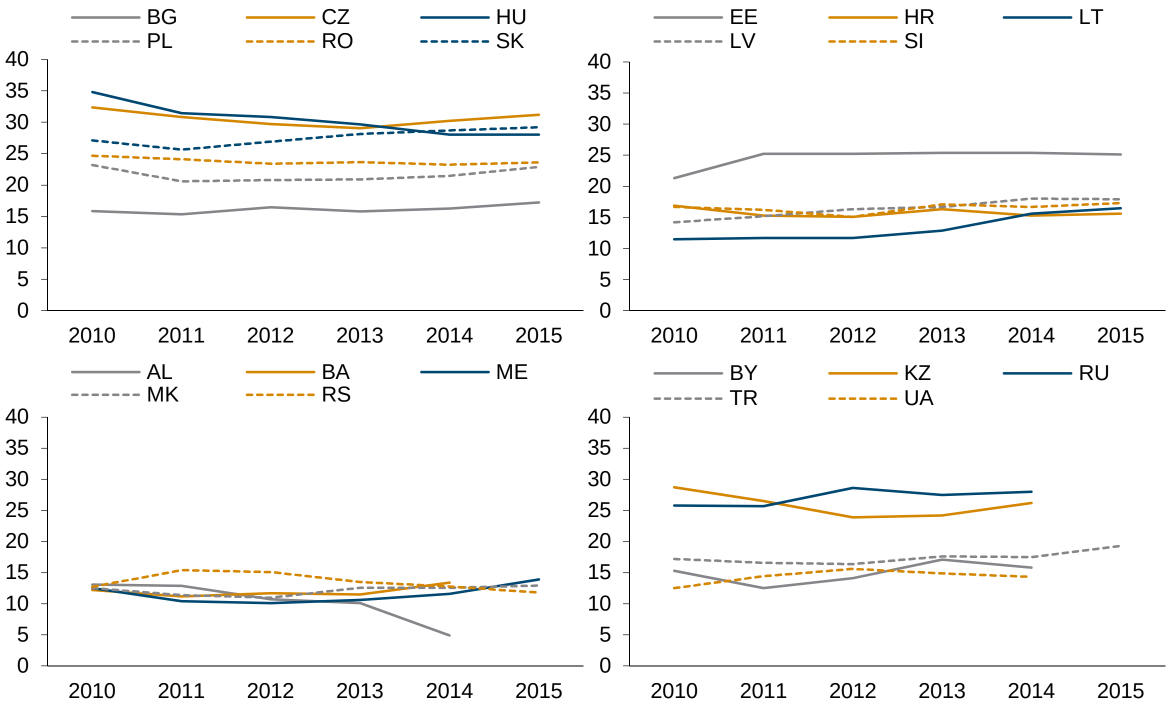
Figure 10 / New bank loans to non-financial private sector (non-financial corporations and households), change in % against preceding year



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 11 / Share of capital goods imports, in % of total imports, 2010-2015



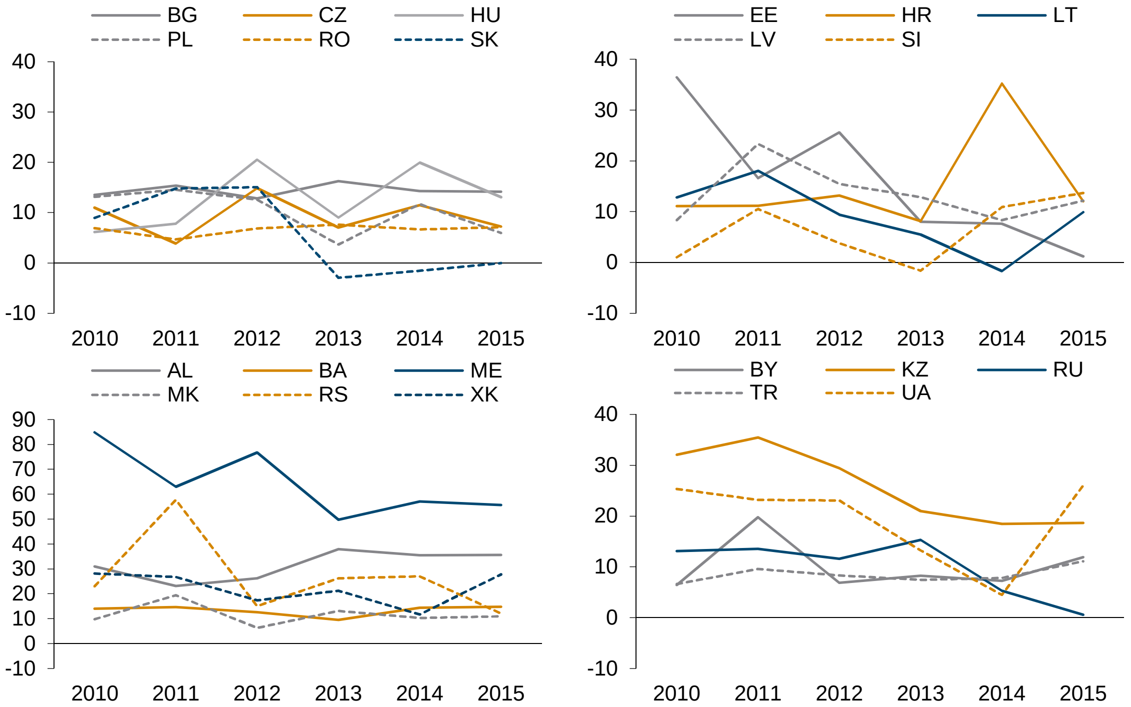
Note: Capital goods as defined in the Classification by Broad Economic Categories. Data for 2015 refer to 11 months.
Source: Eurostat and own calculations.

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 11). 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 12 (2015 data are either preliminary or estimated) shows FDI inflows as a percentage of gross fixed capital formation[2]. 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 12 / 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.

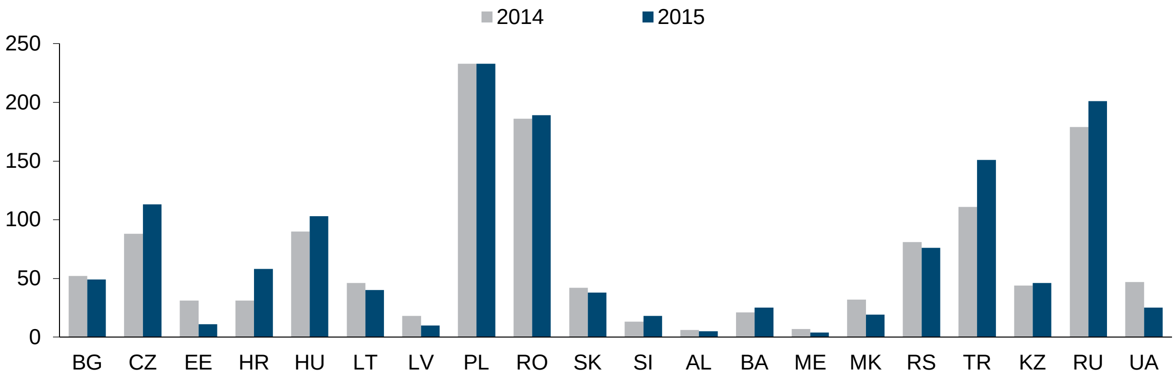
FDI inflows to Russia were decimated as the 'round-trip' that domestic capital used to undertake to Cyprus and other offshore tax havens has come almost to a standstill thanks to anti-offshoring legislation and international sanctions. The sharp increase reported by Ukraine, FDI inflows amounting to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

[2] 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.

enough to constitute a recovery, it was less than the amount the country received in 2013, in addition to being 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 [3]: 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 13). 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 13 / 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

[3] 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.

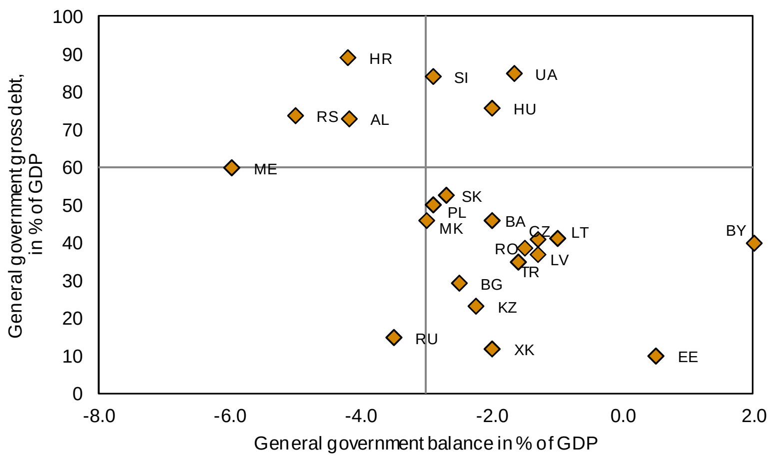
by foreign banks or retailers. Only Croatia, Romania and Slovenia have relatively low stocks of FDI, which may yield further opportunities. Given that foreign ownership is dominant in most segments of the EU-CEE economies, any new FDI will depend mainly on growth in demand across Europe. Relocation of 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.

Fiscal space for growth stimulation exists in at least half of the countries

Fiscal policy is a tool for stimulating growth and structural change that governments often leave untapped. In countries that have adopted the euro or pursue a fixed exchange rate regime, fiscal policy is the only tool they can use, whereas other countries may also resort to the use of monetary policy. In terms of scope, fiscal policy is often not a matter of choice. Its use is restricted in countries with high debts and onerous debt-service burdens or simply by virtue of EU regulations. In fact, even countries with high government debt can shape the structure of their budgets in order to attain their economic or social goals instead of being guided by inertia and vested interests.

Figure 14 / Fiscal stance of the CESEE countries, 2015



Note: Axes denote the limits included in the EU Excessive Deficit Procedure: for debt 60% of GDP, for deficits 3% of GDP.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

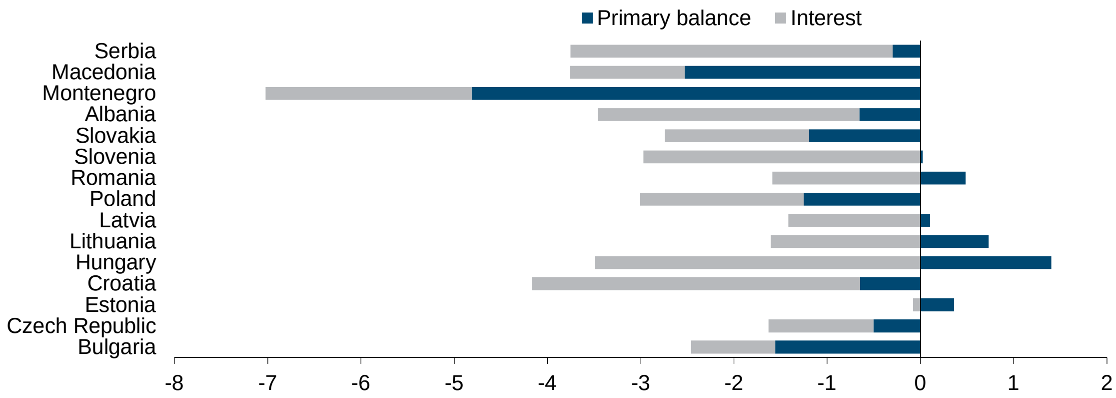
In the wake of fiscal consolidation over the past few years and thanks to faster economic growth, countries with high debt and high fiscal deficits have diminished in number. Assuming we regard as meaningful the EU limits on debt (60% of GDP) and general government deficits (3% of GDP), Croatia, Serbia, Albania and Montenegro, the four countries in the upper left quarter of Figure 14, faced excessive debt and deficit levels in 2015 . Slovenia, Hungary and Ukraine, the three countries in the upper right segment of Figure 14, reported high debts, but moderate fiscal deficits. The remaining countries in the lower right segment are safe as long as GDP is on the rise.

Ukraine is practically insolvent; it is reliant on international support and cuts in expenditures. With its GDP falling, it is caught in a typical downward spiral resulting in an ever-higher deficit in relation to GDP, moderated by severe austerity measures that the government has introduced. Despite the deep recession, the budget deficit was reduced by about 3 pp of GDP to 1.7% in 2015, achieved mostly by freezing social spending in nominal terms in a period of soaring inflation. With effect from 1 January 2016, the government has introduced a new tax code designed to reduce the overall size of the budget.

Russia has lost a considerable portion of its fiscal revenues in the wake of dwindling oil revenues. It will curtail deficits in 2016 by cutting expenditures by 10%. It also plans to cut back investments and curtail wages funded via the federal budget, as well as increase revenues from privatisation. Those measures notwithstanding, the government budget deficit is expected to increase in proportion to the contracting GDP. Unlike Ukraine, Russia is solvent; austerity is thus a matter of policy choice.

Improving financing conditions of both outstanding debts and new deficits as well as switching partially to domestic financing has reduced the default risk – even in high-debt countries. None the less, highly indebted countries are compelled to spend a considerable (albeit declining) portion of their fiscal expenditures on servicing their debts, which in 2015 accounted for 3.5% of GDP in Croatia, Serbia and Hungary, and close to 3% in Albania and Slovenia. Of those five countries only Hungary and Slovenia have since generated a positive primary balance (Figure 15); the other three have only reduced their deficits.

Figure 15 / General government net lending (+) or net borrowing (-), in % of GDP, 2015

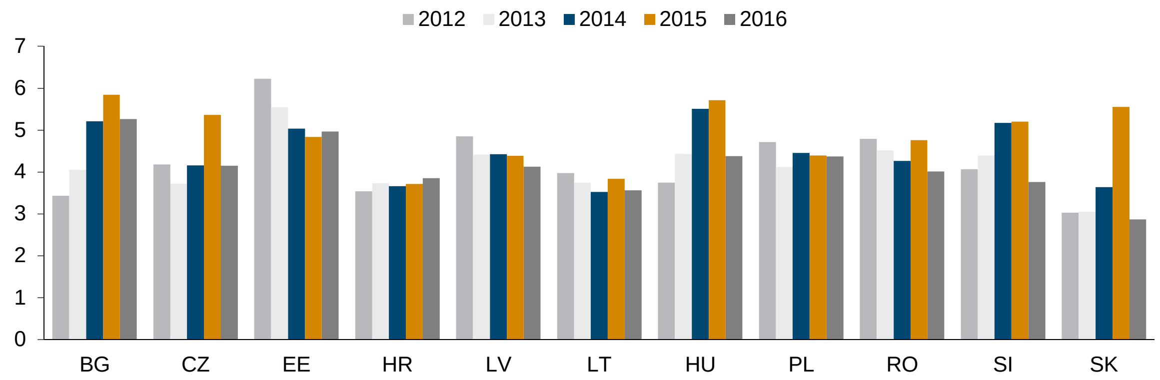


Source: AMECO.

Countries with low government debt and low deficits enjoy some fiscal manoeuvring space, but only Romania plans to make increasing use thereof. In 2015 Romania still had a primary surplus (see Figure 15), but as of 2016 its course is set on fiscal expansion, the ultimate target being a general government deficit of close to 3% of GDP. The deficit in Bulgaria, Poland and Slovakia came close to the 3% limit in 2015, half of which was primary deficit supporting domestic demand. The Baltic States continue to produce primary surpluses in periods of low overall fiscal deficits not warranted by their debt levels. The Czech Republic might well have some fiscal manoeuvring space as well that it could use to good effect by boosting economic growth via public spending.

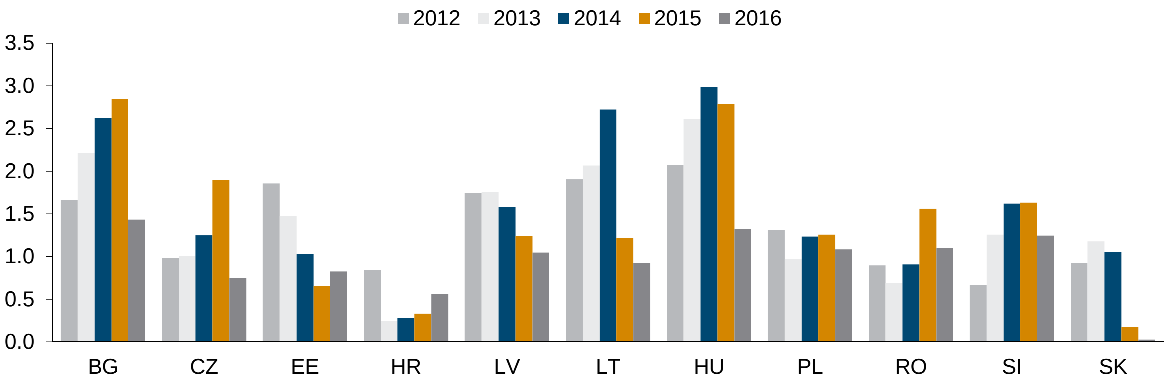
Apart from Romania, Hungary and Poland are also among those countries whose governments are actively introducing novel features in their fiscal systems. In 2016 Hungary will lessen the fiscal burden on banks, introduce measures to support private investment via low interest loans and increase housing grants. Poland's new government is about to follow the earlier example of Hungary by levying extra taxes on financial institutions and supermarket chains. Generous social programmes could be financed by drawing on profits accruing to the national bank in 2016, an additional fiscal gap of about 1% of GDP may open up the following year.

Figure 16 / General government gross fixed capital formation, in % of GDP



Source: AMECO.

Figure 17 / General government capital transfers received, in % of GDP



Source: AMECO.

Public investment in the EU-CEE depends, to a considerable extent, on EU transfers, thus it will go into decline in 2016. General government gross fixed capital formation exceeded 5% of GDP in those years when capital transfers peaked (see Figure 16). In Estonia and Latvia they peaked in 2012, while in the Czech Republic, Romania and Slovakia they peaked in 2015. It transpired that the peak for Romania was lower than in other countries as the government was unable to disburse about 20% of the eligible funds under the 2007-2013 financial framework, especially those devoted to government-financed infrastructure projects. As can be seen in Figure 17, high-disbursement years are usually followed by a low-transfer year 2016. The exceptions are Estonia, which is already disbursing 2014-2020 funds, and Croatia, which joined the EU at a later juncture and has just started receiving transfers from the EU budget.

EMPLOYMENT, UNEMPLOYMENT, WAGES AND PRICES – LABOUR SHORTAGES AS BRAKES ON INVESTMENTS?

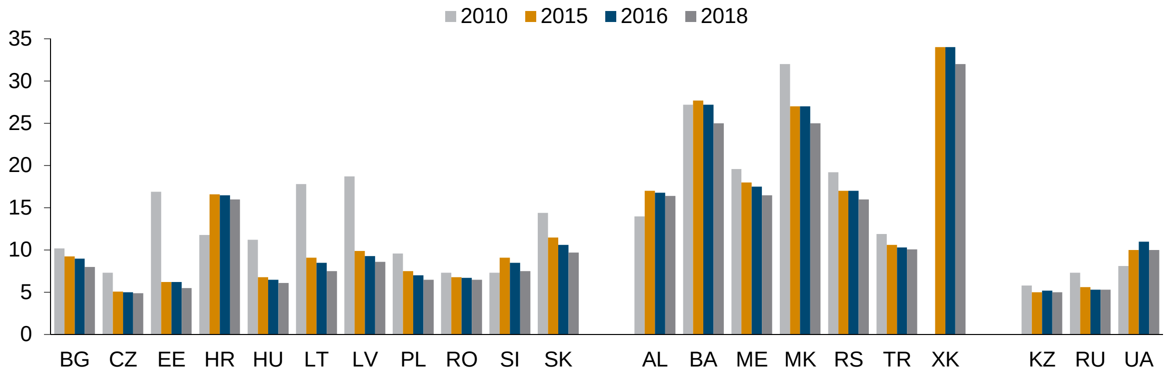
Population decline and ageing is a widespread problem that may curtail economic growth, especially in the EU-CEE. It imposes a strain on the pension and healthcare systems and can lead to labour shortages in times of economic upturn. Population decline was common to most EU-CEE countries owing to negative demographic trends and migration flows over the past five years. In the period 2010-2015, Latvia and Lithuania lost about 6% of their respective populations, while Bulgaria, Estonia, Hungary and Romania forwent about 2. Slight increases were to be observed in the Czech Republic and Poland owing to a very modest natural increase. (See more in the special section III on the labour market and migration.)

Migration policy in the EU-CEE countries generally aims at avoiding an influx of refugees from the Middle East and Africa – mainly for cultural reasons. They, however, are not averse to immigration. Both Poland and the Czech Republic have hosted migrants from Ukraine, Romania is open to Moldovan citizens of Romanian descent and Hungary has taken in fellow Hungarians from neighbouring countries. That notwithstanding and given the current rate of economic growth, the labour markets in most EU-CEE countries are greatly strained owing to permanent emigration or temporary workforce absences.

In certain other countries, economic growth is too slow to provide adequate employment for ever-increasing populations or raise per capita incomes and so discourage emigration. The predominantly Muslim countries are distinct from the all others on account of their high rates of natural population growth: more than 12 per 1,000 in Kazakhstan, Kosovo and Turkey. Despite losses due to migration, the population in Kazakhstan and Turkey has increased by more than 7% over the past five years and in Kosovo by 3%. In Albania the population is stagnant on account of the equilibrium struck between natural population growth and emigration.

In terms of unemployment rates, a long-term pattern is visible, even though almost all EU-CEE and WB countries in 2015 reported lower rates than in previous years. In 2014 five EU-CEE countries were still reporting unemployment rates in excess of 10%, whereas by 2015 only Croatia and Slovakia were left (see Figure 18). The most pronounced drops in unemployment were reported in Bulgaria, Estonia and Hungary: countries that boosted employment more than their CESEE counterparts. It is quite unusual for unemployment to respond so massively to a minor acceleration in economic growth as happened in several CESEE countries in 2015. The explanation might be that expanding household consumption increased the demand for labour-intensive services. Exceptions to the general trend with a slight increase in unemployment in 2015 were Bosnia and Herzegovina, which has the second highest unemployment rate after Kosovo (27% and 34%, respectively), and Romania, which has one of the lowest rates (7%).

Figure 18 / Unemployment rate, selected years 2010-2018



Source: wiiw Annual Database incorporating national and Eurostat statistics.

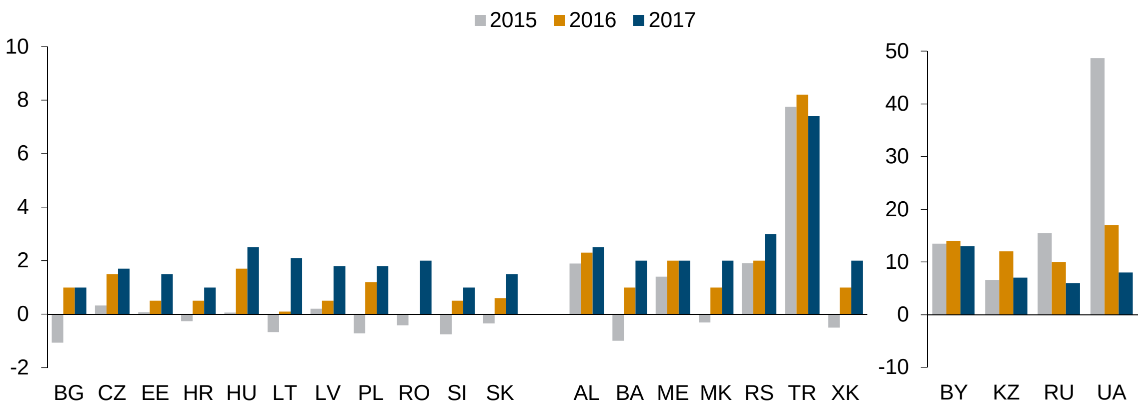
One can expect a further positive labour-market response to economic growth in the years to come. Countries with low rates such as Poland or Romania may experience but little change, similar to the WB with their notoriously high rates of unemployment. The drop in unemployment, however, will be not as rapid as that observed in 2015 as employers may not find adequate workforce. Labour shortages in certain economic activities may well aggravate matters and constrain investment growth. A large proportion of the workers in the construction and health sectors, together with professionals from the countries of Central Europe have taken jobs in Western Europe over the past few years. They are now sorely missed in their home countries that are embarking on their economic take-off.

The labour markets in the CIS-3 and Ukraine have distinctly different features, mainly because employment and unemployment data hardly react to changes in economic growth. All the same, employment has declined and unemployment increased markedly in Ukraine, yet hardly in Russia and Kazakhstan. Belarus has no comparable labour statistics, but the media have reported on the widespread practice of reduced working hours and unpaid leave. This is also the case in Russia and Kazakhstan, both of which report very low unemployment rates. Ukraine took a different tack with its unemployment rate hitting the 10% threshold in 2015 despite the public sector continuing to hoard labour. The outlook is far from positive; unemployment may well increase before it can stabilise. Any deeper structural reform may result in more unemployment – at least over the short term.

Even among the EU-CEE countries, real wage developments have varied greatly, despite inflation being very low or even negative throughout the region in 2015. Major increases in real wages (6-9%) that bolstered rapid growth in household consumption occurred in Bulgaria, Romania and the Baltic States, as well as in Kosovo. Other governments, including those of Croatia, the Czech Republic, Poland, Slovakia and Slovenia, favoured wage restraint and thus relied less on consumption-generated growth. The difference between the two country groups is expected to persist either on account of labour market fundamentals or owing to policies shaping public-sector wages. In Romania and Slovakia, for instance, pre-election policies may lend a boost to wages in 2016, but the subsequent return to higher inflation will have a sobering effect on the generous wage rises. Serbia is still set on a stabilisation course; inflation is close to 2% and real wages are declining despite the early elections that have been called for March 2016.

The CIS-3 countries stand out on account of the decline in real wages attributable mainly to the high rate of inflation. In 2015 real wages in Russia fell by almost 10%, in Belarus and Kazakhstan by 2.5% and in Ukraine by as much as 18.5%. The rate of inflation accelerated (see Figure 19) mainly on account of currency depreciation. Depreciation ahead of inflation tempered the appetite for imports and offset some of the other negative effects on the current account. Employment and wage developments indicate that the crisis incurred severe hardship for the population. More moderate inflation will mitigate the decline in real wages both this year and next, but the financial situation in most households will remain strained.

Figure 19 / CPI inflation forecast 2015, 2016, 2017



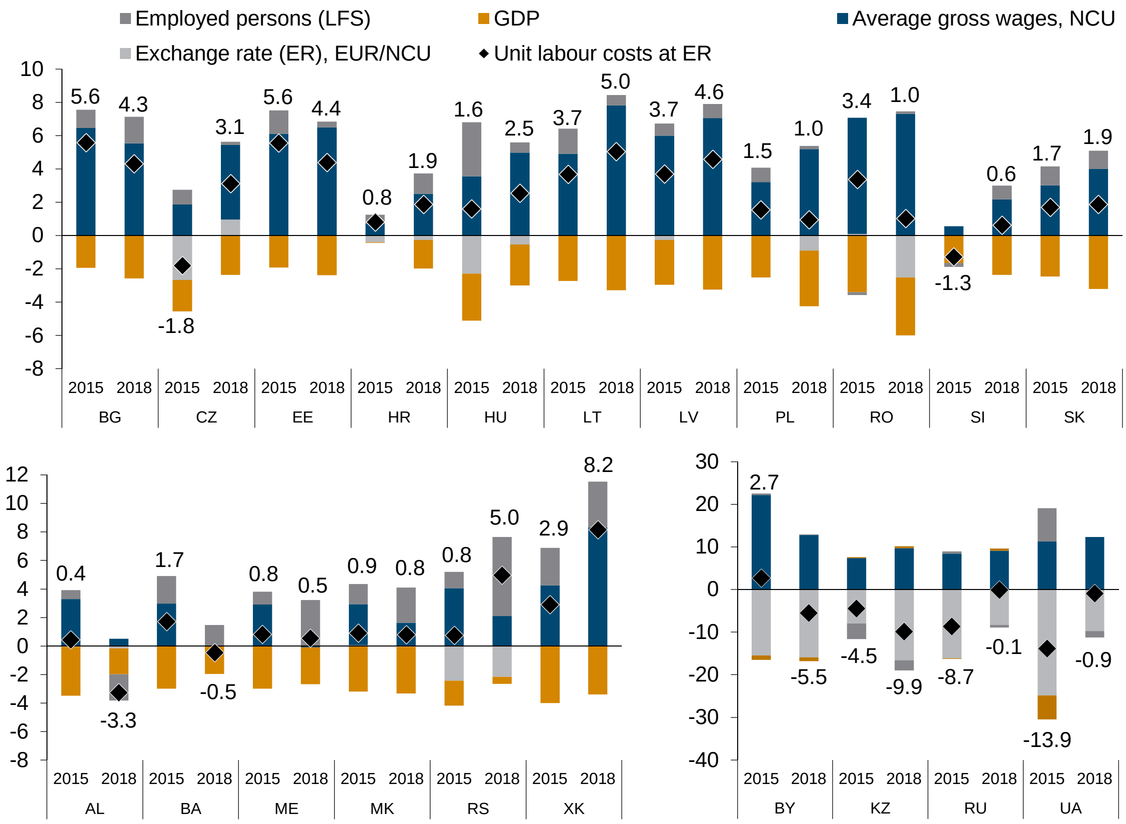
Source: wiiw Annual Database incorporating national and Eurostat statistics.

An inflation rate of 10% and still more currency depreciation will stay with the CIS-3 and Ukraine for some time to come. An inflation rate of about 15% will persist in Belarus which is in need of substantial and painful reforms if it shifts towards a functioning market economy that is triggering wide-spread price adjustments. Turkey will remain a case unto itself with consumer prices hardly reacting to import prices, while inflation will continue to hover around 7-8%. Monetary policy in high-inflation countries is focused on mitigating depreciation and limiting the money supply by hiking policy rates. Both Russia and Turkey pursued that policy in 2014, as did Ukraine in 2015.

In 2015 deflation or very low inflation emerged in most EU-CEE, as well as in some of the WB countries, but deflationary expectations have not come to the fore; consumers took advantage of lower prices rather than postponing consumption in anticipation of even lower prices. The rate of inflation in the EU-CEE countries will return to about 1% in 2016 and 2% in 2017. Romania is an exception in that respect as following the cuts in the statutory VAT rate as of 1 January 2016, the average inflation rate may stay at zero and only rebound next year. In general, expanding domestic demand will support a return to a higher rate of inflation over the forecast period. Were oil prices to recover, it would lend renewed momentum to prices in the net importer countries.

The rise in private consumption in tandem with higher real wages and modest inflation can also have a positive impact on investments and economic growth in general. More economic growth may, however increase the current account deficits. This in turn will to a considerable extent depend on the foreign trade balance and also linked competitiveness.

Figure 20 / Unit Labour Cost (ULC)
annual average changes in %, growth contributions of ULC components



Note: 2015 means average of 2013-2015, 2018 means average of 2016-2018.
Source: wiiw Annual Database incorporating national and Eurostat statistics, wiiw forecasts.

Cost competitiveness will remain an important factor in achieving higher economic growth through exports. Unit labour costs (ULCs) measure the average cost of labour (nominal wages per employment) per unit of output (GDP) calculated as the ratio of labour costs to real productivity growth. It is adjusted for the exchange rate of the NCU/EUR. The numbers in Figure 20 indicate the average annual change in ULCs over the past three years and in the three years to come. In the earlier period, several countries, including the Czech Republic and Hungary, improved their competitiveness by allowing their floating currencies to depreciate. This will no longer be the case in the Czech Republic, hence ULCs will increase in concert with rising real wages. ULCs will rise most rapidly and pose a challenge in the Baltic States, whereas Poland, Slovakia and Slovenia will be only moderately affected. The current level of ULCs in the Western Balkan countries is expected to remain almost unchanged, thus improving those countries' position relative to the EU-CEE countries: a development that may prove advantageous in the competition for FDI.

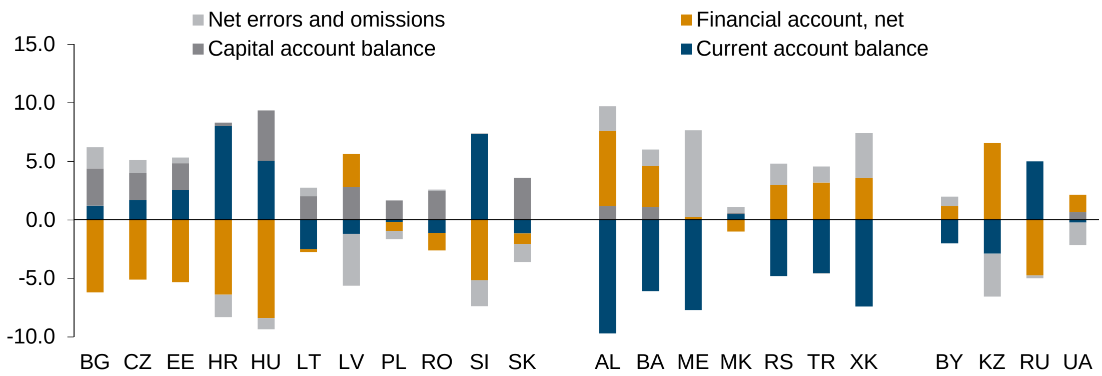
Firm balance of payments positions in most countries, but several vulnerable components

The relative importance of the balance of payments positions reveals significant structural differences and specific vulnerabilities to one or the other forms of international financial flows[4].

4 Data refer to BPM6 using assets/liability principle. Transactions in the balance of payments are organised in two different accounts, the current account and the capital and financial account, whose sum, in principle, should be zero

High current account deficits make the Western Balkan countries vulnerable to the stability of financial inflows (Figure 21). High current account surpluses offset by financial account outflows is not a winning equation either as it drains resources from Hungary or Croatia, for example, that they would otherwise need to support their economic growth.

Figure 21 / BOP components, in % of GDP, 2015



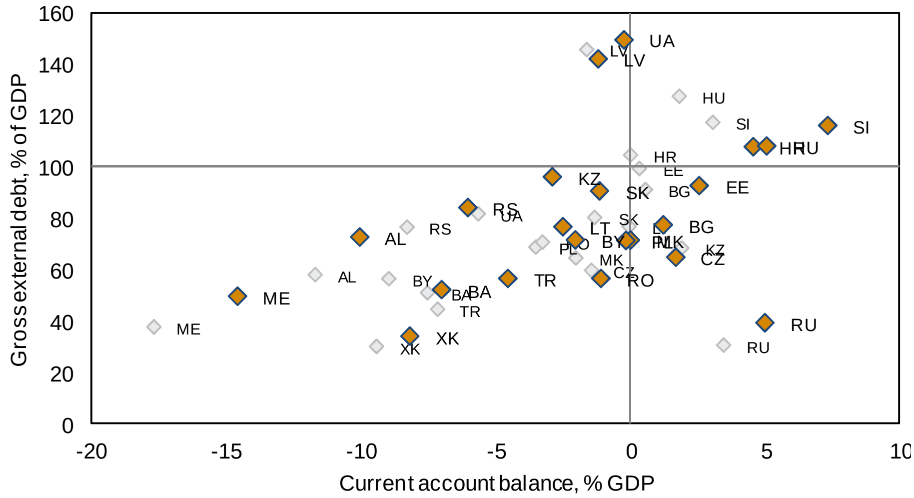
Note: Data 2015 for HR, AL, BA, ME, MK, RS, XK, BY refer to 3 quarters.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

The main differences between CESEE countries in terms of their current account balances tend not to change significantly over time. The EU-CEE countries are inclined to have current account surpluses or only minor deficits. This has also been the case in Russia and recently in Kazakhstan as well. The remaining CESEE countries, especially the Western Balkan countries, tend to have high current account deficits offset by major inflows in the financial account. Capital account surpluses are high in those EU-CEE countries that have received transfers from the EU budget under the structural and investment funds. In 2015, those transfers accounted for more than 3% of GDP in Hungary and Latvia, and varied between 2% and 3% in Lithuania, Bulgaria, Poland and Romania. The EU-CEE countries booked net outflows under the financial account and the WB countries net inflows. Capital outflows under the financial account also balanced the current account surplus in Russia.

Current account deficits have diminished over the past few years and external debt has also declined (see Figure 22). (In the past high current account surpluses or low deficits in the EU-CEE countries were the result of stabilisation policies and slow economic growth.) Even countries with high external debts such as Croatia, Hungary and Slovenia can recently rely on abundant external financing and relax their external positions. Countries with current account surpluses in 2015 will either reduce the surplus as a percentage of GDP (viz. Hungary and Slovenia) or their balance will turn negative (viz. the Czech Republic and Estonia). Smaller deficits will increase to as much as 3-5% of GDP in Latvia and Lithuania, for instance.

(https://stats.oecd.org/glossary). When all balance of payments entries are totalled, the resulting balance will almost inevitably show a net asset or a net liability, which is the result of ‘errors and omissions’, an offset to the overstatement or understatement of the recorded components. While the presence of this item is unavoidable, extremely high errors and omissions may indicate problems in the statistical methodology applied. For the past number of years, the countries most affected (with errors and omissions amounting to more than 3% of GDP) have been Montenegro, Kosovo, Slovakia and Kazakhstan; in 2014 they were joined by Bulgaria and Latvia. Therefore one has to treat the above countries’ balance-of-payments statistics with caution.

Figure 22 / Current account balance versus external debt, 2010-2015



Note: Orange dots: 2015. Grey dots: 2010-2014 average.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

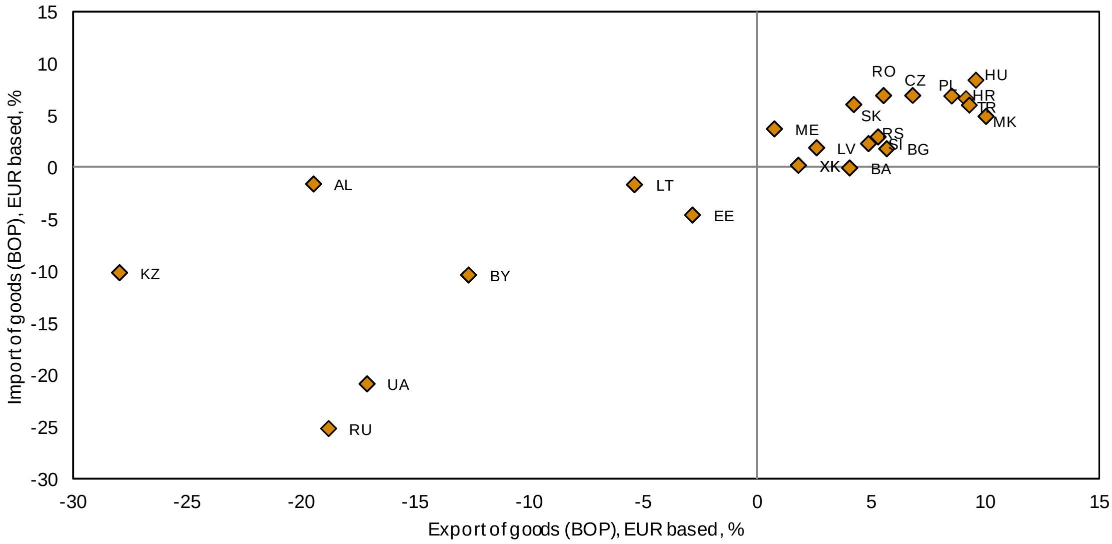
Large current account deficits in the WB countries have also declined. Most countries in the region still lack an export sector capable of supporting economic growth, while financial inflows are relatively high, especially where FDI in the real estate sector is concerned. The improvements expected in all related areas in Albania will result in lower current account deficits.

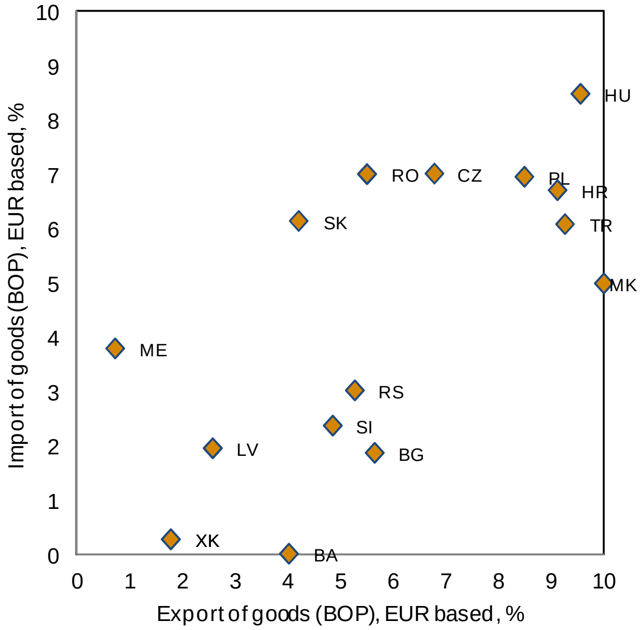
Ukraine and Belarus have found themselves compelled to adopt stabilisation measures and reduce their current account deficits that emerged on account of export shortfalls and for want of foreign funding. In 2015 Ukraine defaulted with Russia and restructured its sovereign debt with private-sector creditors. Should financing improve in the years ahead, both countries should be able to live with larger current account deficits.

Trade in goods and services grew but both deficits and surpluses narrowed in 2015. Imports forged ahead of exports in countries where household consumption expanded appreciably. Although export growth outstripped import growth in the WB countries, it could do little to curtail the inordinately high deficits. Export markets were not very dynamic either and conditions deteriorated for those countries that had extensive trade relations with Russia. In a period of more rapid growth mainly fuelled by domestic demand, the trade component in the current account was bound to deteriorate.

Countries with strong export-oriented manufacturing sectors will remain in a position to expand exports, mainly through international production networks established via FDI or other linkages. A number of countries outside the CIS, including Hungary, Poland, Croatia, Turkey and Macedonia, achieved high levels of export growth of 5-10% in 2015. As to the other countries, restructuring of the shipbuilding industry in Croatia has yielded its first benefits in terms of export earnings. In Macedonia, foreign subsidiaries in manufacturing have been boosting exports for the past few years. Imports have usually grown in tandem with exports (Figure 23), the governing factor being either an increase in the import of components for use in the export sector or rapid growth in household consumption.

Figure 23 / Growth of exports and imports of goods, EUR based, in %, 2015 (Upper right segment enlarged below)





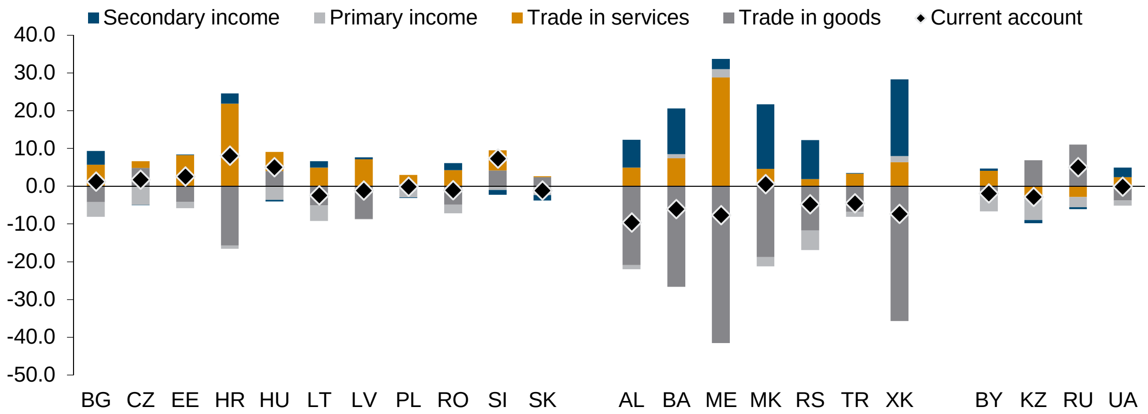
Source: wiiw Annual Database incorporating national and Eurostat statistics.

Although the Baltic States adjusted to the negative effects of the Russian crisis in 2015, their exports cannot be expected to recover before 2017. The adjustment entailed a palpable drop in exports to their eastern neighbour in 2015: about 30% in the case of Estonia, 25% in Latvia and 14% in Lithuania. Only part of the exports could be redirected towards the EU or other destinations. As a consequence, total exports in Estonia and Lithuania also dropped in nominal EUR terms.

Their high dependency on oil hit the exports of Russia and Kazakhstan and, to some extent, those of Albania and Belarus as well. The contraction in Russian trade accelerated in 2015 as a result of tumbling oil prices, the devaluation of the rouble and sanctions imposed by the West. Exports declined by 19% and imports by 25% (preliminary data in EUR terms) and trade with the EU went down in particular. 2016 will bring no improvements as the year started with yet another plunge in oil prices and the RBL depreciated still further. Even if international agreement is reached on cutting back oil production and oil prices stabilise at their current level, the related loss in export volumes will still curtail export revenues (see special section on oil price). In addition, the imposition of economic sanctions following the Turkish downing of a Russian jet in November 2015 has resulted in Russia restricting imports from Turkey. The impact will be felt primarily in the supply of consumer goods in Russia and the loss of an important tourist destination. In 2015 Kazakhstan's exports fell by 31% and imports by 7.5% (in EUR terms). Kazakhstan abandoned its fixed exchange rate regime in August 2015, resulting in a depreciation of the domestic currency. The impact in 2016 will be a still more marked decline in imports and stabilisation of exports. Revival of both exports and imports is forecast to start in 2017 in both Russia and Kazakhstan, by which time the current price shock will have been accommodated.

Imports of mineral fuel and crude materials declined moderately in those countries that benefited from the drop in international prices, but overall import volumes increased on account of the boost in consumption attributable to lower prices. (See figure 24.) Imports of consumer goods also expanded rapidly in Romania, Slovakia and many other countries. As pointed out earlier, imports of capital goods increased in those countries that enjoyed a recovery in private investments.

Figure 24 / Components of the current account balance, in % of GDP, 2015

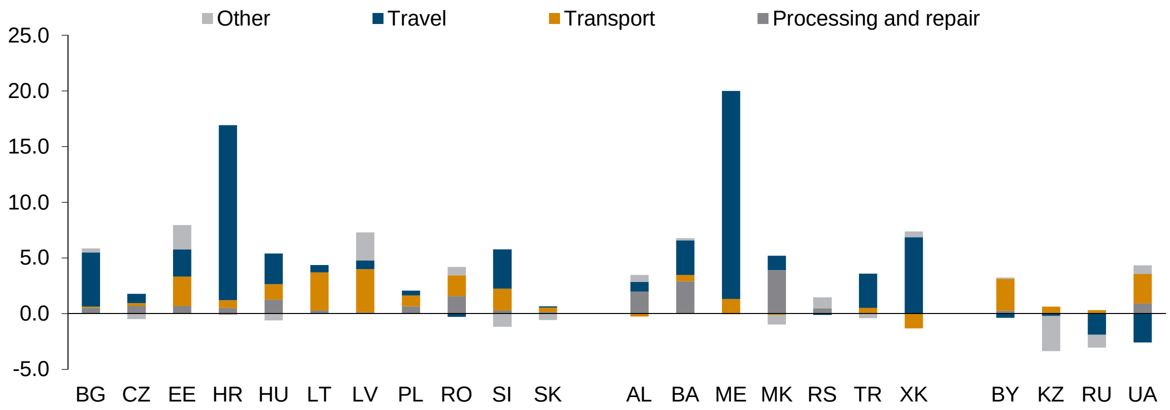


Note: Data 2015 for HR, AL, BA, ME, MK, RS, XK, BY refer to 3 quarters.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

A surplus in the trade of goods usually coincides with a negative balance of the primary income, indicating that exports are generated by foreign investors whose income is a major component of the primary income. But the primary income shows a smaller negative balance than the income of foreign investors because the compensation of employees, a positive item comprising the income of persons working, but not permanently living abroad, is also registered under the primary income balance. (Most EU-CEE citizens retain their permanent residence in their home countries while working abroad.) On the other hand, people from the Western Balkan countries living as permanent residents in a host country send home remittances that constitute part of the secondary income balance.

The exports of services take on the greatest importance for countries with a strong tourism sector. (Figure 25 – no 2015 data available to date). This holds true for Montenegro (surplus of 20% of GDP in 2014) and Croatia (17%). Revenues derived from tourism (and booked under 'travel' in the services account) are also significant for Bulgaria and Slovenia, Bosnia and Kosovo. In some other countries, the domestic tourism sectors are underdeveloped. In Ukraine and Russia, for example, the sums their citizens spend abroad are greater than the tourism revenue generated at home. Recent devaluations and wage restraint, however, have decimated tourist expenditures abroad. The Russian embargo imposed on Turkey will generate losses in tourism revenue for the latter in the order of some USD 4 billion some of which may add to the revenues of other countries including Bulgaria.

Figure 25 / Components of the services balance, in % of GDP, in 2014



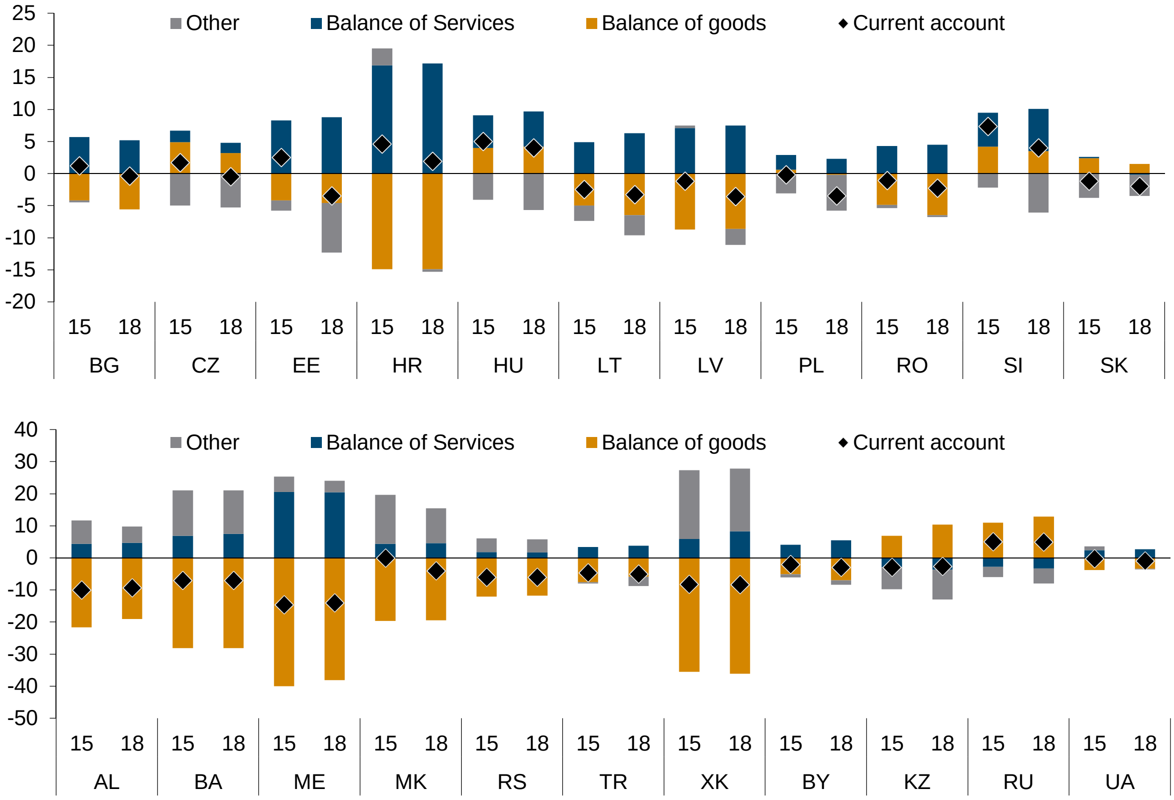
Note: Data 2015 for HR, AL, BA, ME, MK, RS, XK, BY refer to 3 quarters.
Remark: “Processing and repair” stands for “Manufacturing services on physical inputs owned by others” and “Maintenance and repair services”.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

Processing and repair (i.e. mainly contract manufacturing) is widespread services trade position in the WB countries: notably in Macedonia, Bosnia and Herzegovina (3.9% and 2.9% of GDP, respectively, in 2014) followed by Albania, Romania and Hungary (2% of GDP). This specific form of trade constitutes a rudimentary integration of companies into international networks; it triggers high dependence on specific contractor(s) and usually implies lower service fees.

Transportation revenues take on particular importance in transit countries; the latter have shown themselves to be especially vulnerable to the recent decline in Russian exports (viz. the Baltic States and Ukraine). Other countries benefiting from transportation services, such as Romania and Slovenia, have harbours or large fleets of trucks. For Romania, road haulage is one of the most dynamic export items as international hauliers have taken up residence there in order to derive maximum benefit from the low wages paid to truck drivers.

The services balance is going to improve over the forecast period while the goods balance will worsen and account for a major part of the deterioration in the current account balance (see Figure 26). Other balance of payment items (primary and secondary income) will be increasingly negative in the EU-CEE countries, mainly on account of higher income of foreign investors, while it will become even more positive in the WB countries that will continue to receive high remittances from their nationals working and living abroad.

Figure 26 / Main components of the current account in % of GDP, 2015 and 2018



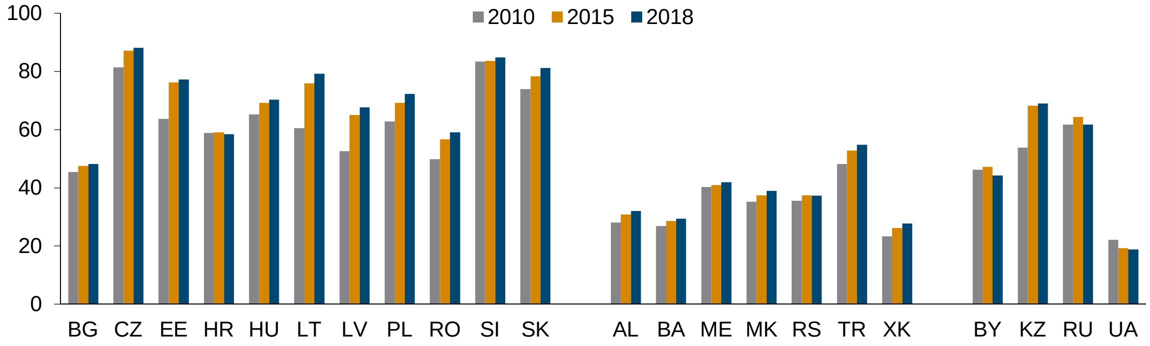
Source: wiiw Annual Database incorporating national and Eurostat statistics, wiiw forecasts.

MOST COUNTRIES ON CATCHING-UP TRAJECTORIES

Our forecast concludes that divergences are to persist in the pace of economic growth relative to the EU average. First of all, a difference will be visible between the catching-up countries and those that have become bogged down in the catching-up process (Croatia and Serbia) or have broken away from an earlier more promising growth pattern (Russia). Up until 2015, the gaps between the various groups had been widening, but convergence may well set in in the future. On the one hand, Russia, Belarus and Ukraine will return to moderate growth; on the other hand, the rest of the CESEE will maintain their rate of growth without acceleration. Belarus, Kazakhstan and Russia will overcome the current recession, while Ukraine will hang back at about 20% of the EU-28 average, behind Kosovo, unless a miracle happens.

The EU-CEE and WB countries as well as Turkey will continue to catch up with the EU-28 average. In 2018 the Czech Republic will be the most advanced country in the CESEE region. It will have reached almost 90% of the EU-28 average in terms of per capita GDP at PPS (Figure 27). Slovenia had already yielded its prime position to the Czech Republic in 2015. Slovakia will advance to third place, hotly pursued by Estonia and Latvia (about 80% of the EU-28 average). Bulgaria will be the least developed EU-CEE country (less than 50% of the EU-28 average). The Western Balkan countries will still hover at about one third of the EU-28 average.

Figure 27 / GDP per capita at PPS
EU-28 average = 100



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

Of the countries exporting processed goods, once again two groups of countries can be discerned: (a) those exporting relatively advanced or high- and medium-skill products; and (b) those exporting mainly semi-processed or low-skill manufacturing products. The first group, for the most part the EU-CEE, is closely integrated into international production networks via FDI. The advanced exporters in the group will have to improve their competitiveness constantly, in terms of both labour productivity and technological development. Their problem may well be that the main exporting firms are foreign subsidiaries competing within multinational networks where they may not always manage to expand their scope of production. The relatively poor performance of domestic SMEs and low R&D intensity may be further major obstacles to growth. The wiiw forecast reckons with continuing moderate growth in those countries, bearing in mind that they will still not be among those reaping windfall profits from technological development. The second group, for the most part lesser-developed countries from the Western Balkans, will require major FDI inflows in the tradable sector as well as stronger domestic corporate growth. Some of the countries are fortunate enough to earn tourism revenues that may be used for investment in other sectors.

The wiiw forecast is optimistic about the revival of investments in most of the CESEE countries. Current conditions are not very promising, but certain positive changes can be identified. The expectation is that deleveraging in the banking sector is coming to an end and credits to the private sector will increase. FDI has already shown some signs of emerging from stagnation. Moreover, gross fixed capital formation can be seen to be responding more to the transfer of EU funds than to the improvements in the terms and conditions for funding private investments. EU transfers will decline in 2016 compared to earlier years, but they will recover later, once access to funds provided under the 2014-2020 financing framework has been secured.

Turmoil in the countries close to Europe and incipient cracks in the EU integration framework pose threats to stability and growth. All regions to the east and south of the EU and the Western Balkans (the Middle East, the CIS and North Africa) are seized by the scourge of war and local conflicts that are spilling over in the form of waves of migration and loss of trade opportunities. Closer EU integration would thus be the natural response. However, divergence of interests among Member States on a growing number of issues is hampering closer economic integration. Crippling the Schengen agreement is one such issue, launching the British referendum is another. In the meantime, a number of EU-CEE countries have shown a preference for protecting national interests rather than securing common European solutions. A discussion on the future transfer of EU funds is evolving which might ultimately incur further risks to growth in the beneficiary countries.

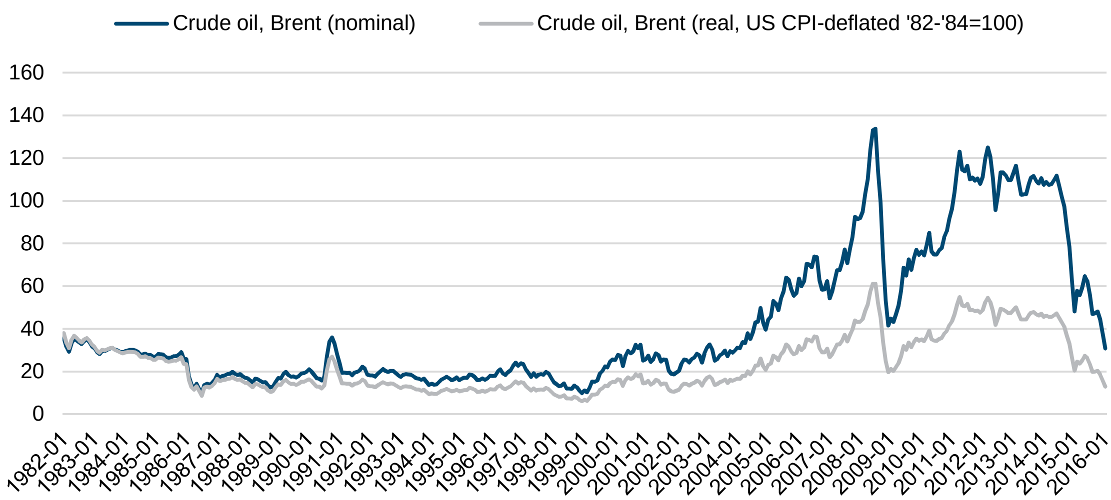
Special section I: Oil price plunge, its causes and implications for the CESEE countries

AMAT ADAROV

Recent developments in the global oil market

Global crude oil prices continued to slide downwards in 2015, although there was a short-lived upturn in the first half of 2015 (Figure 28). By December 2015 the world benchmark, the price of Brent crude, had dropped to a monthly average of USD 37.7 per barrel – down by almost 70% from the 2014 high of USD 112 per barrel. The experts' widespread expectations that the price would bottom out towards the end of 2015 failed to materialise, and at the beginning of 2016 oil prices are still soft, with Brent crude trading at around USD 30 per barrel (occasionally even below), thus reaching a 12-year low.

Figure 28 / Oil price, 01/1982 – 01/2016, USD/bbl



Source: World Bank.

Low oil price levels are not a unique phenomenon per se: for instance, in the 1990s oil was also trading at less than USD 40 per barrel[5]. The continuous fast increase in prices occurred during the 'Great Moderation' period in the 2000s characterised by high economic growth in emerging markets, while production of oil was effectively managed by OPEC. The overall increasing trend in oil prices was occasionally affected by business cycle fluctuations and supply disruptions due to geopolitical shocks and regional conflicts in the Middle East. Unlike the declines in oil prices observed earlier in the 2000s, which were associated with global and regional economic downturns and were followed by fast

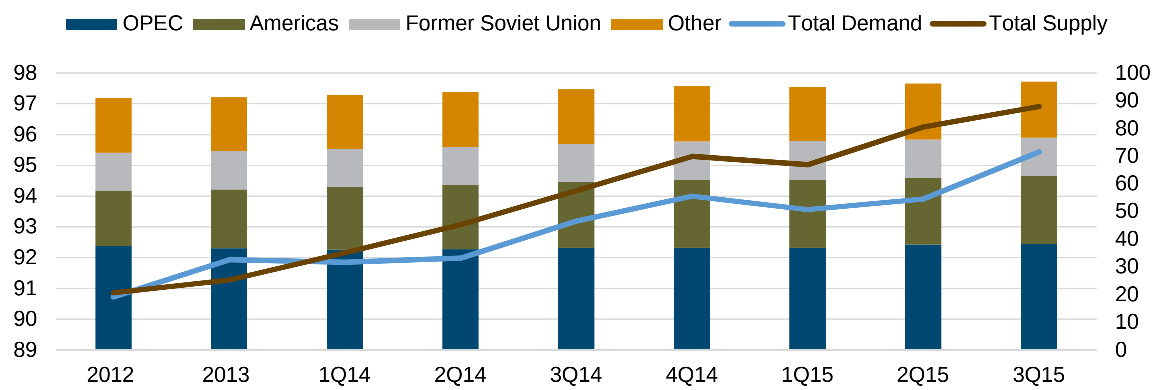
5 For a detailed discussion of historical developments in oil prices see, e.g., Hamilton (2009), Killian (2008, 2009).

rebounds, the recent slump in oil prices is associated with profound changes in the composition of the global oil market and may have long-run consequences.

What is driving low oil prices now?

Whereas the recent decline in oil prices reflects both fundamental supply- and demand-side developments that are factored in by the oil markets, it is the supply side that is playing the critical role, also bearing equilibrium implications that could well extend into the long term. The world economy is still in a rather weak state and downside risks persist. The demand prospects in commodity markets are not particularly promising, especially if account is taken of the slowdown that major importers of commodities have suffered, notably China, which consumes more than 10% of global oil production. Amid such weak demand conditions and appreciating US dollar, the global supply of petroleum is ample. Over the past two years, the excess supply of oil has been exerting downward pressure on oil prices (Figure 29). According to the International Energy Agency, it is estimated that the global daily supply of oil exceeds demand by approximately 1.8 million barrels.

Figure 29 / Global oil demand and supply
million barrels per day, 2012-2015

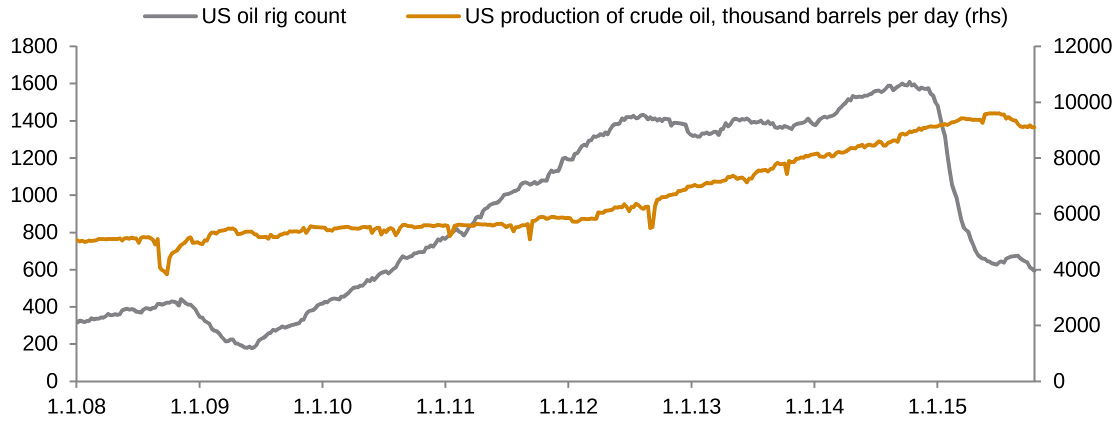


Note: Global oil supply and demand (lines, lhs), supply of oil by region (bars, rhs).
Source: calculations based on International Energy Agency data.

These conditions were initially triggered by advances in oil-extraction technology. Hydraulic fracturing (fracking) has changed the landscape of the global petroleum market by unlocking the possibility of extracting oil from shale deposits that had previously been inaccessible using conventional drilling techniques. The breakthrough has since contributed markedly to the global supply of oil. As long as prices remained high, shale-oil production in the United States was profitable and expanded dramatically, doubling over the course of several years before 2014. In an attempt to defend its market share, OPEC responded by boosting its oil supply to record levels pumping out some 30 million barrels per day, thereby inducing downward pressure on oil prices. Although the strategy worked in general, and some of the oil producers facing higher production costs found themselves being squeezed out of the market, shale-oil production proved to be more resilient than expected. While the oil rig count in the United States declined significantly, the supply of crude oil nevertheless remained high (Figure 30). At the beginning of 2016 shale oil producers continued to gain efficiency: if at the dawn of shale technology the breakeven price levels were reaching USD 100 per barrel, now many shale wells remain profitable at

USD 70 per barrel and as low as USD 20-30 in some cases. This however still significantly exceeds the costs of conventional onshore extraction (e.g. an estimated marginal production cost in Saudi Arabia is below USD 5 per barrel).

Figure 30 / US production of crude oil and oil rig count, 2008-2015



Note: Oil rig count – the number of active drilling rigs.
Source: World Bank and US Energy Information Administration.

Hence, unlike the previous structure of the global oil market in which OPEC could exercise significant control over the prices by managing the supply of oil, the present market has become more competitive. It is likely to remain so as the shale extraction technology gains efficiency. Should preserving market shares remain the oil producers' priority, the supply of oil will remain high over the medium term. Although this strategy comes at costs to petroleum exporters, which also includes less affluent OPEC members, attempts to coordinate a decrease in the production of crude oil have not proved successful to date.[6] The lifting of sanctions will permit another major player, Iran, to add to the global supply of oil – estimates range between 0.5-1 million barrels per day. The argument that were the net oil-exporting countries to breach the fiscal breakeven points, it would put an end to the downward slide of oil prices has proved fallacious. Thus, given the oil producers' commitment to preserving their market shares, oil prices will in all likelihood remain at depressed levels relative to the 2000s. However, the actual new equilibrium price is rather difficult to predict and the experts' guesstimates range widely.

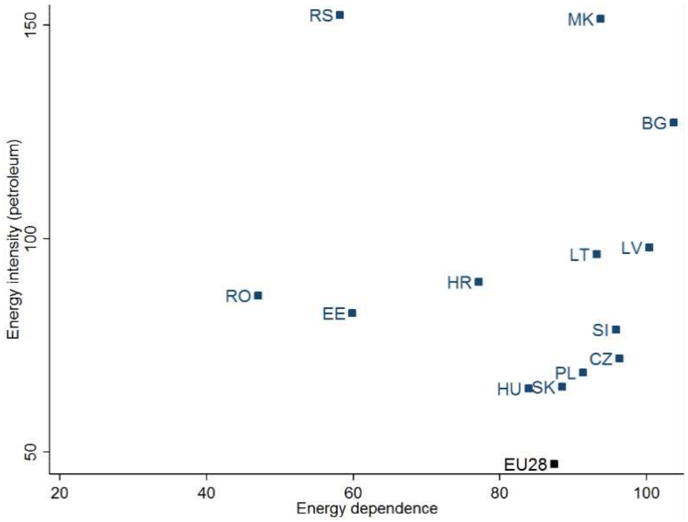
Implications for the CESEE countries

While the decline in oil prices brings about a redistribution of wealth from oil-exporting economies to net oil importers, the net impact on the world economy and Europe is generally seen as positive (see, for instance, IMF, 2015; World Bank, 2016; European Commission, 2016). The recently observed decline in oil price may well contribute as much as 0.5 pp to global economic growth over 2015-2016 (according to Husain et al., 2015).[7]

6 The 'deal' led by Russia and Saudi Arabia in February 2016 was merely aimed at freezing production at the current elevated levels rather than cut, thus not addressing the problem of an oil supply glut.

7 A similar result in obtained in Vrontisi et al. (2015): a 50% drop in oil price would lead to a 0.7 pp boost to world GDP growth and to EU-28 growth.

Figure 31 / Exposure to oil prices in the CESEE countries, 2013



Note: Eurostat definitions are used. Energy intensity in petroleum products – gross inland consumption of petroleum products divided by GDP (kg of oil equivalent per 1000 EUR). Energy dependence on petroleum products – a measure of dependence on imports: net imports divided by the sum of gross inland consumption plus bunkers (%). Gross inland consumption is calculated as follows: primary production + recovered products + total imports + variations of stocks – total exports – bunkers.[8]
Source: Eurostat, own calculations.

Apparently, for the CESEE countries the impact will be highly asymmetric for net importers and exporters of petroleum. On the one hand, the economies of two oil exporting countries – Russia and Kazakhstan – have already come up against the profound negative consequences of oil price declines. Russia plunged into a severe recession in 2015 registering a decline in real GDP of 3.7%, while Kazakhstan's economy slowed down from 4.3% in 2014 to 1.2% in 2015. With the oil price unlikely to rebound to the highs registered in the 2000s, the medium-term prospects of the commodity-based economies are dim. Accumulated sovereign oil funds and a sharp depreciation of both the rouble and the tenge (the latter was also set to float freely in 2015 giving in to the pressure on international reserves to maintain a fixed exchange rate regime) helped to mitigate the oil price shock to some extent. However, the loss of confidence in the local currencies bore drastic ramifications for the financial sector, while the high exchange rate pass-through to inflation eroded the purchasing power of households.

On the other hand, the impact on net oil importers, given the significant intensity of oil utilisation relative to the EU-28 average and high dependence on imports (Figure 31), is also likely to be important. As discussed in the wiiw Spring 2014 Forecast Report (see Adarov et al., 2014), the ultimate impact on real GDP growth is likely to be positive, although its order of magnitude is rather unclear in the light of a host of other macroeconomic and geopolitical factors affecting recent growth developments in Europe and the high uncertainty regarding oil price forecasts per se. Low oil prices may help to boost the purchasing power of households and lower production costs by easing energy and transportation costs, although such factors as administrative controls on utility prices, subsidies and general nominal price rigidities may reduce the pass-through to retail energy prices and dampen the ultimate positive effect[9]. However,

[8] For details on methodology see Eurostat, the Statistical Office of the European Union, energy statistics section.

[9] For further discussion of the macroeconomic channels of oil shock transmission see, e.g., Blanchard and Gali (2008), Hamilton (2008, 2009), Killian (2008, 2009, 2014).

sustained declines in oil prices also constitute risks contributing to downward price pressures in the current already low-inflation environment. In fact, the decline in inflation has been pronounced in the majority of the CESEE countries and the risks of deflation have materialised for some in 2015. This weighs negatively on private investment decisions, which still remains a lacking ingredient in the recipe to accelerate economic growth in the region.

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Special section II: The 'Juncker initiative': a substitute for dwindling cohesion-policy transfers in the EU-CEE?

SÁNDOR RICHTER

Uneven distribution of cohesion-policy transfers over the seven-year financial period

Cohesion-policy transfers from the European Union (EU) budget, officially known as transfers from the European Structural and Investment Funds (ESIF),[10] amount to about 0.4% of the Union's GDP. Those transfers follow a distinct cyclic pattern. At the beginning of the seven- year Multi-annual Financial Framework (MFF) period, Member States are required to submit very detailed national programmes. Not only do the latter have to be thoroughly prepared by the applicants, but they also have to be approved by the EU Commission, both procedures being very time-consuming and rigid. Whereas applications for project financing can only be submitted up until the end of the final year of any seven-year MFF period, actual payments from that same MFF may ensue during the two years thereafter. This explains why the bulk of the cohesion policy-related EU transfers disbursed in the first two years of any MFF are predominantly payments relating to the previous MFF. The final deadline for payments under the 2007-2013 MFF was end-2015.

Table 3 / Average net financial position of the EU-CEE-10 in 2007-2014
in per cent of the aggregate EU-CEE-10 GDP

Period	per cent of GDP
2007-2008	1.35
2009-2011	2.51
2012-2014	3.20

Note: Net financial position is defined as the operating budgetary balance calculated by the European Commission. The EU-CEE-10 aggregate does not include Croatia.
Source: http://ec.europa.eu/budget/figures/2007-2013/index_en.cfm

Just as the rate at which transfers are disbursed is slow at the beginning of any new MFF, it picks up speed towards the end of the same (see Table 3). This explains the record level of cohesion-related payments in 2014 and 2015, when the peak disbursements under the 2007-2013 MFF coincided with the initial, albeit very modest payments under the 2014-2020 MFF. In keeping with this cyclic pattern, 2016 and, to a lesser extent, 2017 will be meagre years in terms of cohesion-policy transfers.

[10] The ESIF include the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF).

Disbursements relating to the 2007-2013 MFF have come to an end, while payments pertaining to the current MFF have far from reached full speed.

Cohesion-policy transfers fund a considerable share of domestic demand in the EU-CEE and impose their cyclic behaviour on the economy in general. If circumstances are favourable, a sudden surge in cohesion-policy transfers can augment investment and consumption in a period of recession or weak economic growth. In less favourable circumstances, a temporary lull in cohesion-policy transfers may coincide with recession or anaemic economic performance, the result being a most unwelcome pro-cyclical effect.

As none of the EU-CEE is currently in recession, the unfavourable circumstances hinted at above poses no real threat. However, a sudden drop in EU transfers would, without doubt, have a negative impact on domestic demand – and, in turn, on the growth performance of the EU-CEE economies. Drawing on data from previous years (Table 3), the EU-CEE net financial positions may decline to 1-2.5% of GDP in 2016, with major variances across individual countries.

This gives rise to the question whether the plan of the President of the EU Commission, Jean-Claude Juncker, to promote investment in Europe over the period 2015-2017 can make up for the momentary drop in cohesion-policy transfers in the EU-CEE?

The European Fund for Strategic Investments (EFSI): President Juncker's EUR 315 billion initiative[11]

The investment plan for Europe announced by Jean-Claude Juncker at the end of 2014 was designed to remedy the problem of insufficient investment activity in Europe.[12] Gross fixed capital formation in the EU-28 continues to lag behind pre-crisis levels. While financial institutions and corporations dispose of sufficient liquidity, this is not being put to productive use.

As a means of implementing the Juncker plan, the European Fund for Strategic Investments (EFSI) was established under the auspices of the European Investment Bank (EIB) with the aim of generating EUR 315 billion additional investment in the EU-28 over the period 2015-2017. Its mission is to make better use of public money and attract additional private investors. The EFSI is expected to add EUR 330-410 billion to the EU GDP and create 1-1.3 million new jobs through: (a) mobilising investment finance without creating new public debt; (b) supporting investment in infrastructure, education, research and innovation; and (c) removing sector-specific and other financial and non-financial barriers to investment.[13]

On establishing the EFSI, a guarantee of EUR 16 billion was appropriated under the EU budget and the EIB committed an additional EUR 5 billion. With the initial combined contribution of EUR 21 billion the Commission hopes to generate EUR 315 billion additional funding. Of this sum, it is assumed that EUR 240 billion will be spent on large, long-term strategic investments and EUR 75 billion will be allocated to financing SME investments. The role of the EFSI is to mobilise that additional private funding by

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11 We first addressed the Juncker plan in our Spring Forecast 2015 (pp. 27-30). This chapter relies partly on that text.

12 European Commission COM (2014) 903 final, p. 4.

13 European Commission, http://ec.europa.eu/priorities/jobs-growth-investment/plan/documents/index_en.htm, Factsheets 1 and 2

attaining a multiplier effect of 1:15 – a ratio based on the historical experience of both the EU programmes and the EIB.[14]

The EFSI and the EU-CEE

On 21 January 2016 a list of 42 major projects (23 approved and 19 already signed) was posted on the EIB website that reported on the initiative's progress up to the end of 2015. The allocation of large projects by country was all but encouraging for the EU-CEE. Of the 42 projects, only Croatia, Poland and Slovakia were shown as having one project each; the other EU-CEE did not feature on the list.

In an update in February the website reported project funding approvals/signatures to the value of EUR 9 billion, culminating in the generation of EUR 61.6 billion investment: equivalent to 19.5% of the target for the first three years. Taking into consideration both the major projects and operations in the SME sector, 22 of the 28 Member States are now involved. Five of the six countries not yet involved are EU-CEE.[15]

A striking difference between the ESIF (traditional cohesion policy-related transfers) and EFSI (loans in the context of the Juncker initiative) is that the former funds are so allocated that proportionally the relatively less developed EU-CEE receive far more funding than the highly developed Member States. Under the current 2014-2020 MFF, the EU-CEE may receive EUR 230 billion: about 51% of the total EUR 453 billion made available for the EU-28 under the reformed cohesion policy.[16] Contrary to the deliberately stronger support lent to the EU-CEE in the traditional cohesion policy, the Juncker initiative (EFSI) prescribes no proportions for the allocation of resources across Member States. Projects are judged solely on their merits.

Were the allocation by Member States to be roughly proportional to their economic weight[17], the EU-CEE would receive 12.9% of the total EFSI resources available: in money terms EUR 40.6 billion. Given the very modest participation of the EU-CEE in the EFSI up to early 2016, that sum may be regarded as a fairly optimistic target for the EU-CEE up until end-2017.

Since the total EFSI resources correspond to about 2.1% of the 2015 EU-28 GDP and those resources have only been marginally utilised in the first year, we can work on the assumption that in 2016 and 2017 EFSI resources equivalent to some 1% of the Member States' aggregate GDP may be made available each year, provided the allocations across Member States roughly match the size of the participant economies' GDP. Even if we calculate a lower rate of participation on the part of the EU-CEE based on the experience of EFSI utilisation in 2015, preferential loans in the order of 0.5% to 1% of GDP may be drawn down by firms in the EU-CEE this year and next. That could well offset to a significant degree the losses due to the lull in cohesion policy-related transfers.[18]

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14 Ibid.

15 http://www.eib.org/efsi/efsi_dashboard_en.jpg

16 http://ec.europa.eu/regional_policy/archive/what/future/index_en.cfm#_ftnref1

17 GDP at purchasing power parity.

18 Under specific circumstances, combining resources from ESIF and EFSI is permitted, if the exclusion of double-financing is guaranteed. For details, see European Commission: European Structural and Investment FUNDS and European Fund for Strategic Investments complementarities. February 2016.

Those calculations notwithstanding, one major issue has been ignored to date. For the most part, cohesion policy-related transfers are grants, even if they also require national co-financing on the part of the recipient government or firm. Although business-sector recipients account for the highest share of national co-financing, grants can be more advantageous than preferential loans provided under the EFSI. Unlike the highly developed Member States which have but a minuscule share of cohesion policy-related resources and hence practically no occasion to mull over which funding route to take, the EU-CEE have a real option where picking the better financial construction is concerned. For the EU-CEE, a project funded via the EFSI under near-market conditions may be less advantageous than taking out an ESIF grant in order to realise the same project, although, admittedly, it might incur a delay of one, two or three years. Even though, for the EU-CEE economies, the EFSI has the potential to soften the impact of a lull in cohesion policy-related EU transfers, it is justifiably doubtful whether those countries will take up that option.

An unorthodox plan from Hungary to solve the problem posed by the lull in transfers

Hungary's net financial position vis-à-vis the EU budget was over 5% of GDP in both 2013 and 2014: it will probably rise to 6% in 2015. The drop in 2016 and 2017 threatens to be especially large. This explains the government's intention to make every effort to pay out by early 2019 all the cohesion policy-related transfers earmarked for Hungary in the 2014-2020 MFF. That would help diminish the looming drop in domestic demand and foster growth. Technically, the government would provide advance payments for the respective projects and collect the support funds from the EU budget later, as permitted under the normal procedure. Whereas this may lend a substantial boost growth in the period concerned, the economic consequences of the strategy may prove devastating in the period 2019-2022 when practically no cohesion policy resources will be left to support growth.

Special section III: Outmigration and labour shortage in the EU-CEE

ISILDA MARA

As a result of EU enlargement and opening up labour markets to nationals from Member States in Central and Eastern Europe (EU-CEE), flows of outward migration from the latter countries towards other EU Member States have ensued on a massive scale, ranging from 0.4% up to 1.5% per year in the period 2008-2013.[19] In absolute terms, the number of Central and Eastern Europeans of working age population residing[20] in other EU countries has reached 4.2 million, following a net emigration flow[21] of almost 1 million in the period 2009-2014.[22] For countries such as Romania and Bulgaria, those outflows towards the EU account for 3.5% and 2.2%, respectively, of their working-age populations. They have been particularly high also for all three Baltic States, while for Hungary they represent slightly more than 1%. Other EU-CEE lost less than 1% of their working-age populations. (Fewer than 10% of all migrants return home within a year.)[23]

On account of demographics and migration patterns, the EU-CEE countries are shrinking rapidly in terms of population. By 2050 countries such as the Czech Republic, Hungary and Poland will have suffered the largest population losses.[24] Not only are populations declining, they are also ageing – the economic dependency ratio[25] is expected to increase from 1.4 in 2014 to 1.6 by 2060, provided the rate of employment has not reached 75% by 2020.

Outmigration over the past ten years has been especially intensive among the highly qualified. This phenomenon is particularly marked in Romania. It has lost 9% of its highly educated nationals, while Lithuania and Slovakia have recorded losses close to 7%.[26] Not only has the supply of labour diminished in quantitative terms, but it has also deteriorated in qualitative terms.

Employment growth keeps pace with the business cycle. Since the onset of the post-crisis economic recovery in 2011, unemployment has declined more rapidly in the EU-CEE countries than in the EU-28

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19 Source: The latest available Eurostat Population and Emigration Statistics, downloaded in February 2016. Of the EU-CEE countries, Slovakia is the one that has experienced the lowest rate of emigration in terms of population share, with an annual average of 0.06% in the period 2008 - 2013, whereas Lithuania has the highest rate of emigration: 1.5% (peaking at 2.7% in 2010).

20 The figures relating to the number of EU-CEE nationals in the EU-28 has been obtained from Eurostat. It refers to the non-national population by group of citizenship, age and gender but it does not distinguish between economic migrants, refugees or asylum seekers.

21 Net emigration flow is the stock of migrants in 2014 minus the stock in 2009.

22 Ibid.

23 Source: European Commission (2015), 'Employment and social developments in Europe 2015', http://europa.eu/

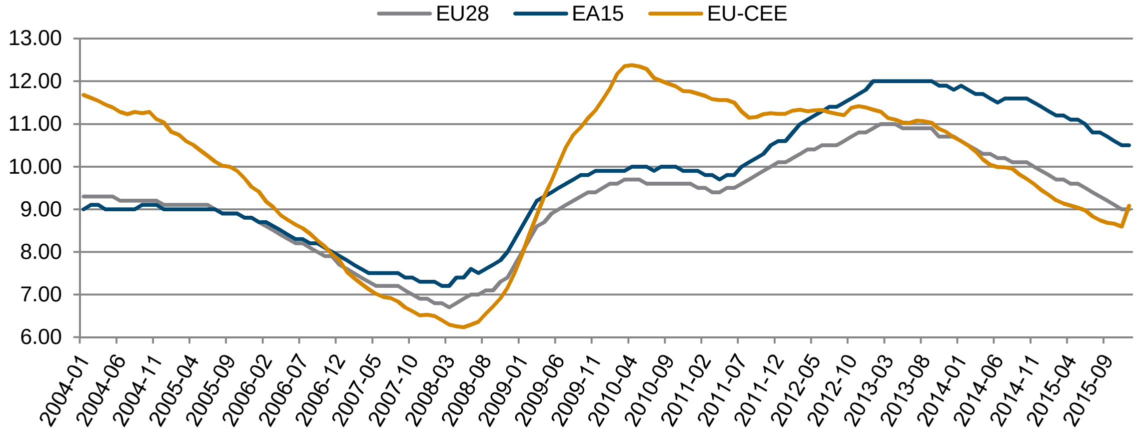
24 Source: the latest available Eurostat Population and Emigration Statistics, downloaded in February 2016.

25 Economic dependency ratio is defined as the ratio of the total inactive population to people employed.

26 Source: European Commission (2015), 'Employment and social developments in Europe 2015', http://europa.eu/

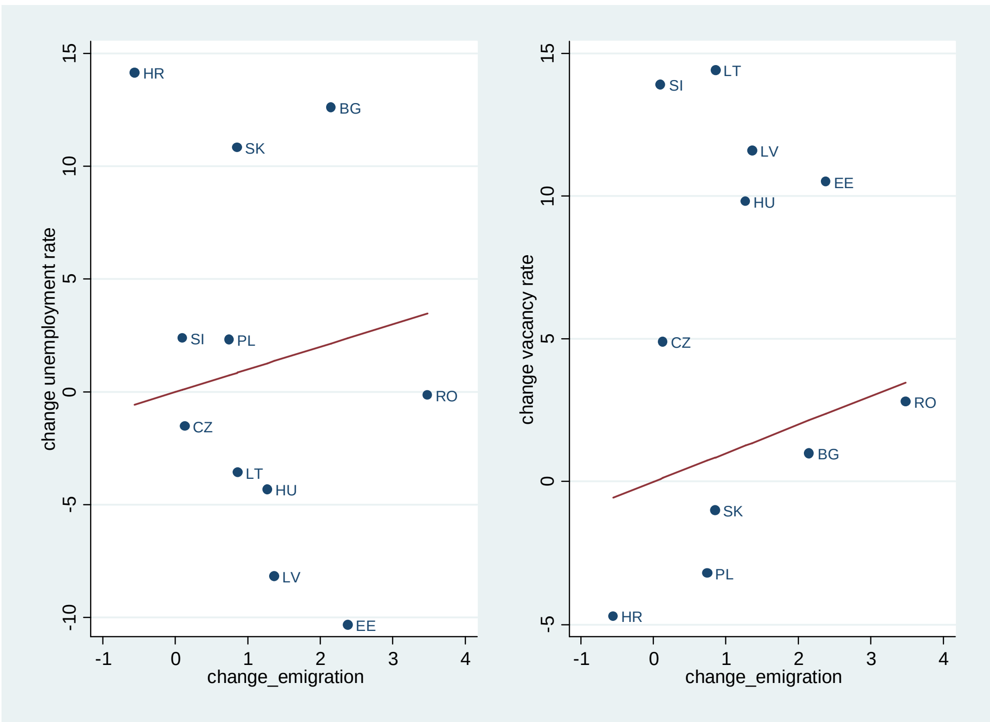
(see Figure 32). The most significant reductions in unemployment were to be seen in the Baltic States, as well as in Hungary and Romania.

Figure 32 / Unemployment rates in the EU and sub-groups, 2004-2015



Source: Own calculations using Eurostat Statistics.

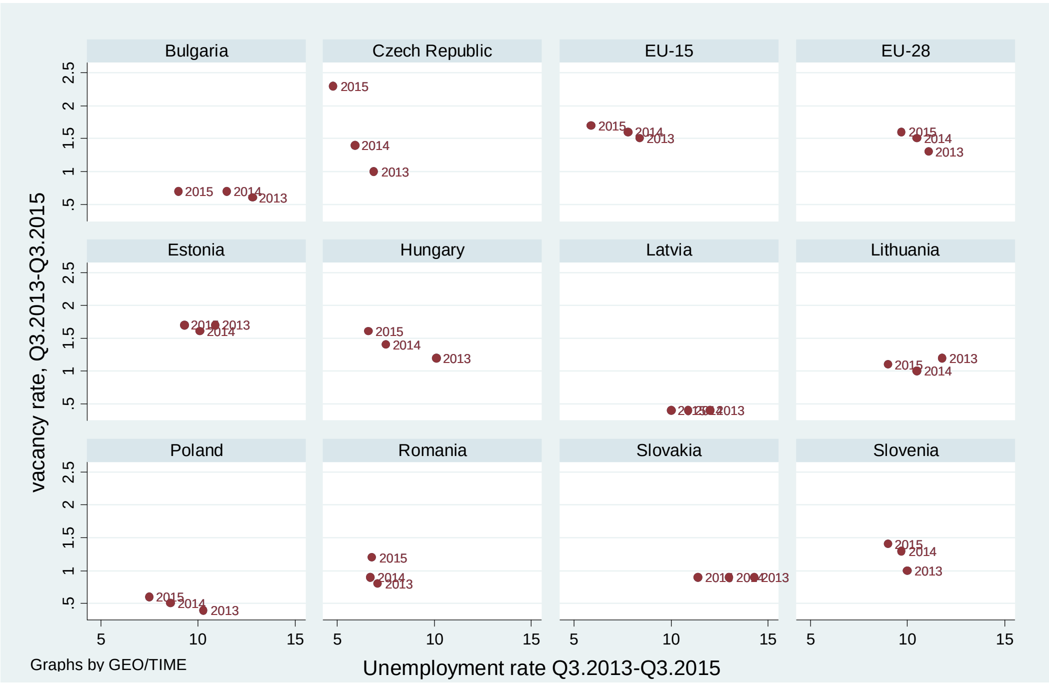
Figure 33 / Average annual change in unemployment, vacancy rates vs. changes in net emigration



Note: Change in the unemployment rate refers to the average annual growth rate, 2010-2014. Vacancy rate change refers to average annual growth rate, 2010-2014. Change in emigration refers to net emigration as a share of population aged 15-64, 2010-2014.
Source: wiiw database and Eurostat.

At the same time, the very same EU-CEE countries are among those that have registered the highest levels of outmigration; this hints at emigration having possibly contributed to reducing excessive labour supply. As a consequence, vacancy rates, which are negatively correlated with unemployment rates, rose most rapidly in in the Baltic States, followed by Hungary, Czech Republic and Romania (see Figure 33).

Figure 34 / Beveridge curve, unemployment rate vs. vacancy rate
3rd quarter 2013 – 3rd quarter 2015, seasonally adjusted



Source: Eurostat.

The Beveridge curve (Figure 34) is an indicator not only of labour market efficiency, but also of the state of the economy itself. It shows shifts in the matching of supply and demand on the labour market. In Hungary, but particularly the Czech Republic, the respective Beveridge curves have been moving toward the origin and upwards. A drop in the unemployment rate combined with an increase in the vacancy rate is typical of a tight labour market where it is difficult for demand to find a supply match. The distinctive feature of a second cluster of countries – Slovenia, Estonia and, to a certain extent, Lithuania – is high unemployment accompanied by increasing vacancy rates, another indicator of pronounced labour market mismatches. Latvia, Slovakia, Bulgaria and Poland differ in that their Beveridge curves have been shifting towards the centre, yet the decrease in unemployment and the low vacancy rates would indicate an improvement in terms of demand matching supply. In Romania, vacancies increased more than unemployment decreased. At the same time, Romania and Poland are two countries that have experienced high emigration rates ever since the EU enlargement. This would suggest that outmigration might have reduced both the excessive supply of labour and unemployment.

Given the extent of outmigration in the EU-CEE countries, not only are private companies in particular, but public institutions as well, finding it difficult to fill job vacancies. Bottlenecks are building up in respect of jobs that call for highly skilled workers, but on occasion for workers with low skills as well. Companies are grumbling about the difficulties of meeting demand in both quantitative and qualitative terms. The most recent Talent Shortage Survey (2015)[27] revealed that companies in the EU-CEE countries are facing enormous difficulties (far more than in other EU Member States) to fill jobs that were in demand. Of the companies complaining, the share is highest in Romania (61%), followed by Bulgaria (50%) and Hungary (47%). A comparison of between 2014 and 2015 shows an interesting development. In 2014, labour shortages in the EU-CEE countries were on average the main reason for the failure to fill vacancies (37%), while skill shortages ranked second (24%). In 2015, the situation was completely reversed with skills shortage being the primary reason for the failure to fill vacancies. Of the skills in high demand, skilled tradesmen appear to be those most sought after, followed by engineers, sales representatives and drivers. For instance, Bulgarian companies are primarily short of engineers, and the demand for highly skilled workers remains also acute. Other countries lack medium skilled level workers most of all, followed by highly skilled workers, (Table 4). On average, jobs for workers with both low and high skills are hard to fill.

Table 4 / Top five hardest jobs to fill in the EU-CEE 2015

	1	2	3	4	5
Bulgaria	engineers	skilled trades	management/ executive	IT personnel[28]	accounting and finance staff
Czech Republic	skilled trades[29]	sales representatives	Accounting and finance staff	engineers	technicians
Hungary	skilled trades	drivers[30]	engineers	accounting and finance staff[31]	IT personnel
Poland	skilled trades	engineers[32]	technicians	IT personnel	drivers
Romania	skilled trades	engineers	drivers	management, executive	IT personnel
Slovakia	skilled trades	drivers	sales representatives	IT personnel	engineers
Slovenia	skilled trades	labourers	engineers	drivers	sales representatives
EU	skilled trades	engineers	sales representatives	drivers	management, executive
Global	skilled trades	sales representatives	engineers	technicians	drivers

Source: Own elaboration using *manpowergroup.com/talentshortage2015.*

27 The 2015 Talent Shortage Survey interviewed 20,000 employers in Austria, Belgium, Bulgaria, Czech Republic, Finland, France, Germany, Greece, Hungary, Ireland, Israel, Italy, Netherlands, Norway, Poland, Romania, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Turkey and U.K. See: *manpowergroup.com/talentshortage2015*

28 Especially developers and programmers, database administrators, and IT leaders and managers.

29 Skilled trade workers include especially chefs/bakers/butchers, mechanics and electricians.

30 Especially truck/lorry/heavy goods drivers, delivery/courier drivers, heavy equipment/construction drivers.

31 Especially bookkeepers, certified accountants and financial analysts.

32 Especially mechanical, electrical and civil engineers.

In order to meet their needs companies mainly employ one of two strategies: ‘people practices’ and ‘talent sources’. The first strategy mainly consists of improving the skills of the incumbent staff, while the second comprises hiring people from outside who have the potential to acquire adequate skills and grow within the firm. Here too, hiring from other regions or other countries is an option. Despite all the difficulties they faced, in the period 2014-2015 only 2% of the employers looked to other countries in their quest for new staff. Recruitment from abroad thus does not appear to be an option for companies, even if part of the labour shortage they face is due to emigration. The future supply of labour is a highly complex issue for companies, given that the skill shortages they face are attributable not only to outmigration and demographic trends, but also to technological advances. In the future, companies will need jobs that are distinctly different to those existing today.

In its most recent projections relating to the demand for jobs, the European Centre for the Development of Vocational Training (CEDEFOP)[33] pointed out that in the EU-28, including the EU-CEE countries, demand would continue to increase primarily for labour with a high level of skills, while demand for medium- or low-skilled workforce would also grow. In relative terms, demand would be more pronounced for highly skilled ‘professional’ occupations, in particular in Hungary, Croatia, Latvia, Poland and Romania. At the same time, demand for ‘elementary’ jobs is expected to grow, particularly in Bulgaria, Hungary, Croatia and Slovenia.

Under such conditions, the EU-CEE should not sit on their hands. Their frail economic recovery may well be in jeopardy, if the shifts in the employment landscape are ignored. Strategies that mitigate labour market shortages, both at the extensive and intensive margin should be introduced. Immigration from outside the EU could be part of the new agenda. Talent shortages could be tackled by adopting new strategies. Given that immigrants often take jobs below inappropriate to their qualifications, employers and employment exchanges alike could train and direct them towards occupations that truly match their qualifications.

33 http://www.cedefop.europa.eu/en/publications-and-resources/data-visualisations/job-opportunities

Special section IV: EU-CEE mobile workers and recent refugees in Austria

HERMINE VIDOVIC

In view of the uninterrupted influx of EU-CEE nationals in search of work in Austria and the high inflow of refugees from non-EU countries, the question arises whether recognised refugees will ultimately crowd EU-CEE or other migrant workers out of the Austrian labour market in the foreseeable future. The flow of EU-CEE migrants to Austria has consistently increased since 2004; it gained momentum after restrictions on access to the Austrian labour market were lifted in 2011 and 2013. The number of EU-CEE nationals residing in Austria has increased from 158,000 in 2004 to 364,000 in 2015. Over the same period, the number of employees from those countries rose from 90,000 to 231,000; the latter figures include both those workers resident in Austria and commuters.

As of 2015, an increasing number of refugees, for the most part from Syria, Afghanistan, Iraq and Iran, have arrived in Austria. Given that the group of newcomers who arrived in Austria in 2015 was composed of relatively young people, about two thirds of whom were between 16 and 46 years old, it is to be expected that once they are granted refugee status, they will enter the labour market in ever larger numbers.

Labour market integration will, however, depend largely on the refugees' qualifications that differ significantly by country of origin. According to initial findings,[34] most of the recognised refugees from Iran, as well as Iraq and Syria, tend to have a university degree or are, at least, high school graduates, whereas the refugees from Afghanistan are the least qualified, about 30% of whom have not received any education at all. The proportion of those with vocational training varies between 2% in the case of Afghans and 18% in the case of Iraqis. By way of contrast, some 37% of the EU-CEE nationals residing in Austria have undergone vocational training, about half of them are high school and university graduates, while 13% have finished compulsory schooling.

With regard to the structure of employees[35], the majority of the EU-CEE nationals in 2015 were employed in tourism, 'other economic services', construction, manufacturing and trade, accounting for about 70% of all EU-CEE employees in Austria. Agriculture is still an important activity for Romanian and Polish nationals. The employment pattern of employees from Afghanistan, Iran, Iraq and Syria shows even higher numbers of them working in tourism, trade and 'other economic services', but a strikingly low proportion employed in construction and manufacturing (see Figure 35). It can thus be seen that in

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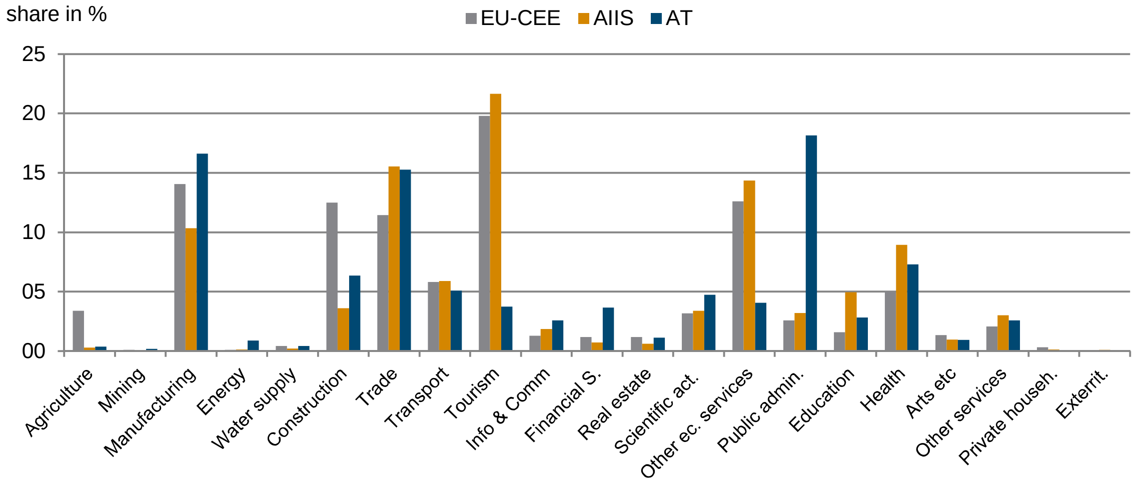
[34] Data refer to the results of the competence checks carried out by the Public Employment Service in the second half of 2015.

[35] Information on employment is based on social insurance data. The shares cited here may serve only as guideline indicators. Figures refer to a total of 231,000 employees from the EU-CEE countries and 7,700 employees from Afghanistan, Iran, Iraq and Syria.

tourism, trade and ‘other economic services’ (mostly temporary agency workers and cleaners) an overlap exists between EU-CEE nationals and citizens from Afghanistan, Iran, Iraq and Syria currently employed in Austria.

Figure 35 / Employment by activity of EU-CEE, AIIS and Austrian citizens, 2015



Note: EU-CEE-11; AIIS = Afghanistan, Iran, Iraq, Syria.
Source: BaliWeb.

For the time being, asylum seekers can only gain access to the labour market by taking on seasonal work (restricted to tourism, agriculture and forestry) after a waiting period of three months starting from the date on which they submitted their asylum applications. Entry into the labour market is further restricted by the imposition of a labour market test, which requires the presentation of demonstrable evidence that the vacancy under consideration cannot be filled by an Austrian, an EU/EEA/Swiss citizen or another integrated third-country national. In contrast thereto, recognised refugees and persons under subsidiary protection are on equal footing with Austrian nationals in terms of labour market regulations. Taking into account the increasing length of time it takes to complete asylum proceedings, as well as to acquire the requisite language skills and supplementary qualifications, integrating recognised refugees into the Austrian labour market will take years as evidenced by other countries’ experience.

The experience of Germany is particularly telling in this respect. A recent IAB report[36] on the experience gained during earlier major inflows of refugees indicates that within the first year of arrival, fewer than 10% of the refugees found work; 50% were first employed after five years and some 60% only after ten. In general, it takes much more time to integrate refugees into the labour market than it does with other migrants. The differences between the two groups only disappear after some 15 years. Wages paid to refugees, however, remain permanently below the average wages paid to other migrant groups. Competition between German nationals and refugees is considered a minor issue given the divergent patterns of employment. Another study[37] on the labour market integration of refugees in Switzerland

[36] IAB – Institut für Arbeits- und Berufsforschung (2015), ‘Flüchtlinge und andere Migranten auf dem deutschen Arbeitsmarkt: Der Stand im September 2015‘.

[37] KEK-CDC Consultants (2014), ‘Erwerbsbeteiligung von anerkannten Flüchtlingen und vorläufig Aufgenommenen auf dem Schweizer Arbeitsmarkt’, p. 29.

shows maximum employment rates of about 25% within three years of arrival, slightly over 40% after seven years and 60% after ten years. Past experience in Austria shows that a high inflow of refugees, for instance, at the beginning of the nineties, increased the competition among low skilled workers, mostly between the 'new' and 'established' migrants[38]: a trend that was also confirmed by the Swiss study.

Given the lengthy asylum procedures, the need for additional qualifications (viz. language skills, but in some cases primary education as well) and the past experience of labour market integration in countries such as Germany and Switzerland, we do not expect the migrants of old to be crowded out by the recent refugees over the short term. Over the long term, however, the ever-greater volume of low skilled workers in Austria might ultimately lead to certain crowding-out effects. Competition might well arise between (recognised) refugees and EU-CEE migrants in activities such as trade, tourism and 'other economic sectors' on account of the overlaps already observed. However, even in those sectors employment could be split between the two groups. Given the different employment structure, it does not appear that the majority of Austrian nationals will be exposed to this kind of competition, although exceptions might occur in trade and certain manufacturing sectors.

[38] Biffl, G. (2002), 'Ausländische Arbeitskräfte auf dem österreichischen Arbeitsmarkt', *WIFO Monatsberichte* 8/2002, p. 549.

Country reports

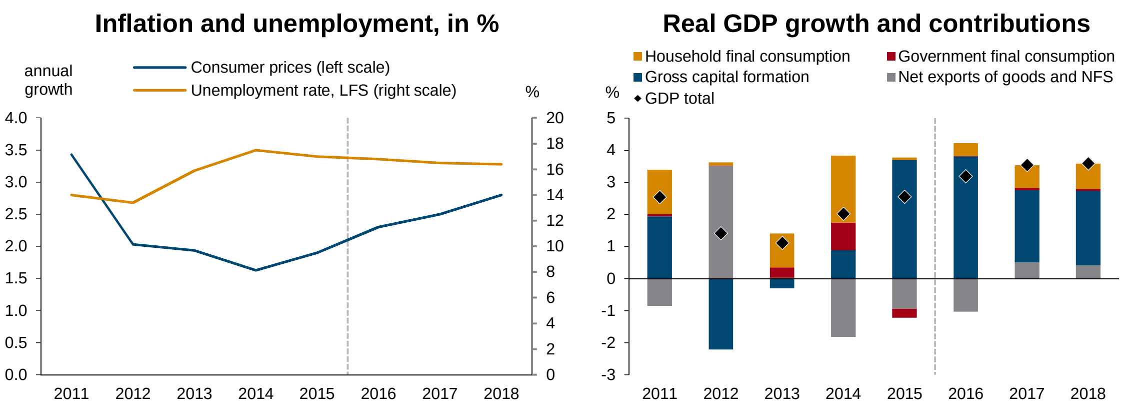
The data provided in the following country reports were directly extracted from the wiiw Annual Database.
Direct access is available at: http://data.wiiw.ac.at

ALBANIA: Higher growth despite headwinds

ISILDA MARA

Investment will continue to be a major component of growth whereas household consumption will recover only slowly, in parallel with improvements in employment and consumer confidence. Exports will continue to be negatively affected by the fall in international oil prices. For the next three years, foreign direct investments and other capital inflows will support a growth rate of more than 3%.

Figure 36 / Albania: main macroeconomic indicators



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

Albanian economic dynamics improved despite fiscal under-performance and international headwinds. Real GDP growth for the third quarter of 2015 reached 2.98% year on year, indicating an upward trend following rates of 2.14% and 2.96%, respectively, in the preceding quarters. The main drivers of growth during 2015 were gross fixed capital formation (GFCF) and, to a certain extent, household consumption. Growth was restrained by falling government consumption and a sharp decline in exports of the extraction and energy-related industries (in both nominal and real terms). Furthermore, a negative impact arose from agriculture, which has been continuously suffering from floods and droughts. The international oil price turmoil and a strong cut in base metal prices of chrome and cooper reduced not only exports (by 25% in nominal terms and by 11% in real terms) but also imports of this sector (by 33% and 8.6%, respectively).

The judicial reform is dominating the political discourse. It is a precondition for the opening of negotiations for EU accession. The government has announced to finalise the reform in March 2016. By December 2015 a 'decriminalisation' law was passed. On paper, the law prohibits Albanian criminals – 'Malavitas' – to become part of politics and public administration. The litmus test will be next year's parliamentary elections and the list of candidates which will be presented beforehand. Another law approved by parliament (only with the votes of the left-wing government coalition) but not ratified by the president (the latter – elected during the former right-wing coalition government – has sent the issue to the Constitutional Court) is the Property Restitution Law. This law intends to compensate Albanians for their properties expropriated during communism, but according to the president the established compensation is symbolic, around ALL 50 billion for a total of 74,000 hectares of land within the next ten years. Nevertheless, the law has high potential to finally resolve the enormous disputes over ownership and may thus pave the way for further private and foreign investments.

The results of the reform in the energy sector (such as the liberalisation of the sector, the campaign against electricity theft, the completion of the South Ring interconnection line) are encouraging, but the 'campaign against informality' seemingly proceeds in a quite chaotic way, without much substance. From September 2015 small businesses were subject to tough inspections, but starting from January 2016 tax exemptions and simplifications apply. Small businesses with an annual turnover below ALL 5 million are exempted from income taxes; for businesses with an annual turnover between ALL 5 and 8 million an income tax of 5% applies. This manoeuvre may have certain side effects for fiscal revenues. While it might reduce tax evasion among small businesses, it might also increase tax avoidance among big companies, which could be tempted to fragment their activities in order to benefit from tax simplification. Last but not least, the Constitutional Court has frozen the new law on fines on informality on the grounds of those being excessively high and disproportionate.

Tax revenues during 2015 have been below expectations. Customs offices in particular have been underperforming, mostly as concerns excise and VAT tax – also due to the decline in imports – despite assistance by Crown Agent, a British company hired by the government to support the customs administration in the past two years. Government expenditures continued to shrink in 2015, by at least 1% year on year. Capital expenditures stood at almost the same level as in 2014. In 2016 a further reduction is expected, hinting at a meagre contribution of public investments to growth for the coming period. However, a good step forward for government finances has been the settlement of 95% of arrears which opens up the possibility for new productive activities to be financed. Accordingly, the public deficit in 2015 was kept at a lower level compared with 2014, at -4.2%, and public debt expanded further by 1 pp to almost 73% of GDP. Last November, the government issued EUR 450 million five-year Eurobonds which will help to restructure old debt. On the one hand, public debt depending mainly on foreign liabilities makes the country vulnerable to international exposure and particularly to exchange rate risks. On the other hand, there is the advantage of the domestic credit market not being overburdened. The reviews of the IMF Mission in February 2016 were successfully closed with the disbursement of the next tranche according to the agreement. Standard & Poor's upgraded Albania's credit rating from B to B+ affirming a stable outlook, supported by the IMF programme.

In January 2016, the inflation rate stood at 1.5%. In spite of a record low interest rate of 1.75%, the credit market is hardly growing. In order to tackle the structural challenge of non-performing loans, a high-level working group with representatives from the Central Bank, the government but also private stakeholders and international partners has been established. An action plan which revisits the bankruptcy law, debt restructuring, and the execution of collaterals has been implemented. Accordingly, compared to the end of 2014 the level of NPLs was reduced by 5.1 pp to about 17.7% in the last quarter of 2015. This decline occurred mainly due to the reduction of sub-standard loans by 2.3 pp (NPLs that do not exceed 12 months). Lost loans were reduced by only 2.4 pp, suggesting that the restructuring process of longer-term NPLs is moving slowly.

Public investments are going to be modest during 2016, but are expected to recover in 2017 and 2018. Private investments in the form of FDI will keep on sustaining the economy. This year, the Trans Adriatic Pipeline (TAP) and the Hydropower stations of Banja and Moglica in Devoll, EUR 1 billion each, enter their intensive implementation phase. They are expected to cover a large part of the current account deficit and to generate new jobs in the years to come. The government has also announced to build a number of hydropower stations along the Vjosa river, in the South of Albania, and another two in Skavica, along the Black Drin river, in the North of the country. These investments will further boost electricity production in Albania but there is much discussion going on about the economic, social and environmental impact of such investments. According to the World Bank, the climate change and related disasters (droughts, floods, but also earthquakes) are going to affect Albania in the future. Therefore, projects with a long-term impact should be implemented with this outlook in mind.

Household consumption recovered only in the third quarter of 2015 but with an overall effect on growth almost negligible. Real wage growth – at least in the public sector – had not been more than 0.1% in 2014. The minimum wage was raised, but government expenditure on wages increased only moderately, by 1.4%. In addition, overall employment increased by 1.7% while unemployment rose by 3.2% in the first three quarters of 2015, year on year. Remittances recovered by at least 4% in the same period, year on year, but are still far from the 2008 level; they contributed to revitalising household consumption. The increase in household credit demand occurred mainly for buying houses/properties and less for consumption funding. Credit demand of businesses rose as well, particularly among small and medium-sized enterprises. The easing of the credit criteria by the banks contributed to the rise in demand for credits. The expectations are that this trend will continue during 2016.

The increase in unemployment was mainly driven by the age group 30-64. In contrast, youth unemployment fell by 1.5 pp between the fourth quarter of 2014 and the third quarter of 2015 but is still relatively high, at 32.3%. At the same time the labour force shrank by 1.3% and inactivity by 0.6%, which might be due to high emigration in 2015. According to INSTAT, net migration in 2015 stood at -17,076 (42,922 emigrants vs 25,846 immigrants). The contingent of involuntary returnees among Albanian asylum seekers in the EU is expected to increase since Albania has been included in the list of safe countries.

External sector imbalances have been a source of instability to the Albanian economy. In nominal terms both overall exports and imports were shrinking by 11.5% and 12.5%, respectively, during the past five years, 2011-2015. Compared to five years ago, exports of goods have almost halved. By contrast, exports of services are expanding, having reached a share of two thirds of total exports. Exports of goods are dominated by garment industry products and minerals – accounting for a share of almost two thirds. Along this trend, imports of minerals, electricity and fuels dropped by 33%, but also those of wood manufacturing and construction materials declined slightly. Imports of machinery and equipment continue to go up – having reached a 22% share in total imports – suggesting that private investments are flourishing. The main trading partners continue to be the EU countries and more specifically Italy, Greece and Spain. In 2015, exports to Italy declined by 7% (industrial products exports halved) while imports decreased slightly (industrial products imports declined by 11%).

The international oil and basic metals price turmoil caused a reduction of exports and imports of the sector, both in nominal and real terms. In particular, the Canadian company Bankers Petroleum – accounting for 85% of Albanian oil production – has decided to suspend drilling activities until the international oil prices turn cost-effective. However, good news for the sector is that the Dutch company Shell has agreed to buy the shares of Petromanas, another Canadian company operating in Albania, confirming the high potential of oil extraction in Albania.

Overall, gross fixed capital formation will continue to be a major growth driver whereas household consumption will pick up slowly in parallel with a recovery in employment and consumer confidence. Improvements in the business environment and the easing of lending conditions of the banking sector will contribute positively to the development of domestic demand. External demand will continue to be negatively affected by the decline in international oil prices. Accordingly, our forecast for the next years assumes that external sources of financing such as foreign direct investments and other capital inflows will support further growth at above 3%.

Table 5 / Albania: selected economic indicators

	2011	2012	2013	2014	2015 [1)]	2016	2017 Forecast	2018
Population, th pers., average	2,905	2,900	2,897	2,894	2,889	2,886	2,880	2,870
Gross domestic product, ALL bn, nom.	1,301	1,333	1,351	1,401	1,460	1,540	1,630	1,740
annual change in % (real)	2.5	1.4	1.1	2.0	2.6	3.2	3.5	3.6
GDP/capita (EUR at exchange rate)	3,200	3,300	3,300	3,500	3,600	3800	4100	4300
GDP/capita (EUR at PPP)	7,300	7,800	7,700	8,300	8,800	.	.	.
Consumption of households, ALL bn, nom.	1,012	1,032	1,052	1,105	1,130	.	.	.
annual change in % (real)	1.8	0.1	1.4	2.7	0.1	0.5	0.9	1.0
Gross fixed capital form., ALL bn, nom.	382	353	350	343	395	.	.	.
annual change in % (real)	5.9	-7.9	-2.1	-3.9	13.0	12.0	7.0	7.0
Gross industrial production								
annual change in % (real)	19.0	15.7	28.3	1.6	-5.0	2.0	3.0	2.0
Gross agricultural production								
annual change in % (real)	4.8	5.7	-3.4	2.0	2.9	.	.	.
Construction output total								
annual change in % (real)	-1.1	-11.4	-13.0	5.0	18.0	.	.	.
Employed persons, LFS, th [2)]	1,160	1,140	1,024	1,037	1,080	1,090	1,100	1,100
annual change in %	.	-1.8	-10.2	1.3	4.1	0.9	0.9	0.2
Unemployed persons, LFS, th [2)]	189	176	194	220	224	212	208	204
Unemployment rate, LFS, in % [2)]	14.0	13.4	15.9	17.5	17.0	16.8	16.5	16.4
Reg. unemployment rate, in %, end of period	13.1	12.8	13.5	13.0	13.2	.	.	.
Average monthly gross wages, ALL	36,482	37,534	36,332	36,997	38,100	39,500	41,100	42,000
annual change in % (real, gross)	1.5	0.8	-5.0	0.2	1.0	1.3	1.5	1.0
Consumer prices, % p.a.	3.4	2.0	1.9	1.6	1.9	2.3	2.5	2.8
Producer prices in industry, % p.a.	2.6	1.1	-0.4	-0.5	-2.0	-0.4	-0.2	-0.2
General governm.budget, nat.def., % of GDP								
Revenues	25.4	24.8	24.2	26.2	26.2	26.5	27.0	27.0
Expenditures	28.9	28.2	29.2	31.3	30.3	29.6	29.0	29.0
Deficit (-) / surplus (+)	-3.5	-3.4	-5.0	-5.1	-4.2	-3.1	-2.0	-2.0
Public debt, nat.def., % of GDP	59.4	62.1	69.5	71.2	73.0	72.0	70.0	68.0
Central bank policy rate, % p.a., end of period [3)]	4.75	4.00	3.00	2.25	1.75	1.75	1.75	1.75
Current account, EUR mn [4)]	-1,225	-978	-1,049	-1,287	-1,050	-1,100	-1,150	-1,150
Current account, % of GDP [4)]	-13.2	-10.2	-10.9	-12.9	-10.0	-9.9	-9.8	-9.3
Exports of goods, BOP, EUR mn [4)]	1,406	1,526	1,051	932	783	740	770	800
annual change in %	20.0	8.5	-31.1	-11.3	-16.0	-5.0	4.0	4.0
Imports of goods, BOP, EUR mn [4)]	3,647	3,525	3,030	3,147	3,052	3,080	3,110	3,170
annual change in %	12.1	-3.4	-14.0	3.9	-3.0	1.0	1.0	2.0
Exports of services, BOP, EUR mn [4)]	1,747	1,673	1,715	1,881	2,005	2,050	2,110	2,190
annual change in %	-0.2	-4.2	2.5	9.7	6.6	2.0	3.0	4.0
Imports of services, BOP, EUR mn [4)]	1,612	1,460	1,489	1,558	1,550	1,570	1,590	1,610
annual change in %	6.2	-9.5	2.0	4.6	-0.5	1.0	1.0	1.0
FDI liabilities (inflow), EUR mn [4)]	630	666	945	869	1,000	.	.	.
FDI assets (outflow), EUR mn [4)]	21	18	22	58	30	.	.	.
Gross reserves of NB excl. gold, EUR mn	1,851	1,909	1,971	2,142	2,831	.	.	.
Gross external debt, EUR mn [4)]	4,958	5,513	6,368	6,927	7,630	7,860	8,250	8,580
Gross external debt, % of GDP [4)]	53.5	57.5	66.1	69.2	73.0	71.0	70.0	69.0
Average exchange rate ALL/EUR	140.33	139.04	140.26	139.97	139.74	139	139	140
Purchasing power parity ALL/EUR	61.57	58.64	60.67	58.25	57.74	.	.	.

1) Preliminary and wiiw estimates. - 2) In 2011 survey done once a year, quarterly thereafter. - 3) One-week repo rate. -
4) From 2013 based on BOP 6th edition, 5th edition before.

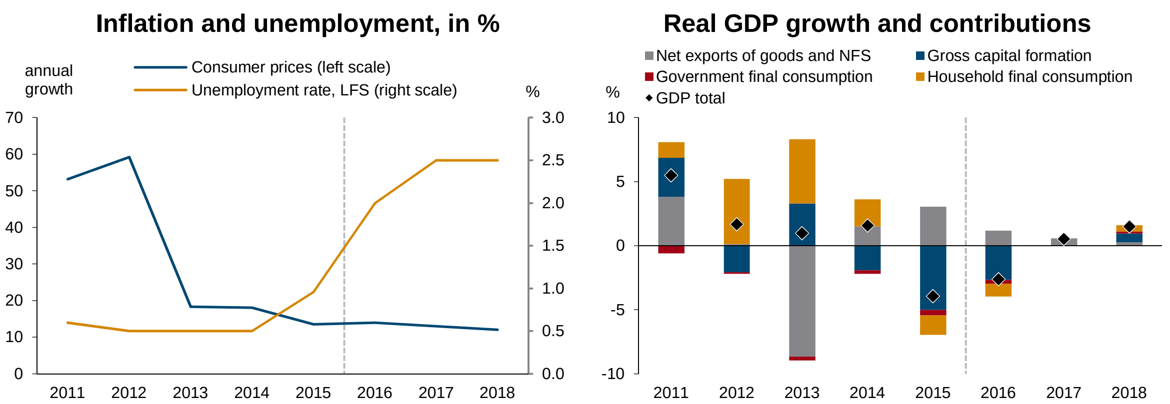
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

BELARUS: Recession continues

RUMEN DOBRINSKY

Belarus plunged into deep recession; GDP slumped by 4% in 2015. The crisis struck hard across the board, affecting all aspects of economic life, while policy-makers had little manoeuvring space in which to soften the blow. Short-term prospects are bleak as recession is likely to persist throughout 2016. A modest recovery may start in 2017, but it will be conditional on the revival of key export markets.

Figure 37 / Belarus: main macroeconomic indicators



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

The economy of Belarus slid into a deep recession in 2015 with GDP dropping by almost 4% for the year as a whole. The immediate causes of the crisis were external shocks originating in the plunge in the Russian economy and other key markets and mainly associated with the plummeting oil prices. At the same time, the depth of the recession revealed major vulnerabilities of the Belarusian economy related to chronic macroeconomic distortions which make it rather susceptible to such shocks.

The crisis struck hard across the board, affecting all sectors of economic activity and all aspects of economic life. In current dollar terms, total Belarusian exports fell by 26% in 2015, reflecting a plunge by 32% of exports to Russia and drops of similar magnitude in exports to other CIS countries. Apart from shrinking export demand, Belarusian exports were adversely affected by trade protection measures which were reportedly introduced by neighbouring countries, in the first place Russia, apparently in violation of the Eurasian Economic Union regulations.

As regards the real economy, the important manufacturing sector was most affected as it was directly exposed to the demand shock due to the shrinking exports to Russia. Production in sectors such as textiles, leather and footwear, plastics and rubber, pulp and paper fell by some 10-15% in 2015 while flagship sectors such as machine engineering and transport equipment experienced output drops by some 20-25%. There was also a significant drop (by some 10%) in construction output. Domestic demand was also seriously hit, with gross fixed capital formation plunging by 15% and private consumption by 3%.

The crisis brought severe distress to the population, which had enjoyed a decade and a half of relatively steady growth. Average real consumer wages in 2015 declined for the first time in more than 15 years. Moreover, due to the sharp exchange rate depreciation, average dollar wages in 2015 fell by 30%. The situation on the labour market also deteriorated considerably although the absence of LFS statistics makes it impossible to see a more accurate picture. The Belarusian media reported the widespread practice of reduced working hours (and hence lower pay) at manufacturing plants, a practice tolerated by the authorities in an attempt to prevent massive open layoffs. Registered unemployment also rose although reported levels can hardly be taken as meaningful.

Given the plunging exports, Belarus was faced with acute balance of payments constraints. Plus, it also faced increasing fiscal constraints both due to the recession but also due to lower oil duty revenue associated with the drop in the prices of oil products.[39] Faced with revenue shortages, the government kept curbing budgetary spending by introducing tight wage controls in the public sector and cutting public investment and government support to the state-owned industrial sector. Directed lending[40], which has for long been a source of implicit government subsidies for selected state-owned companies, started to decline: from a level of some 6% of GDP in 2013 and 2014 it fell to 5% in 2015 and is expected to drop further in 2016.

The authorities also applied a range of monetary measures in an attempt to curb macroeconomic imbalances. In 2015, the Belarusian National Bank introduced major changes in its monetary policy objectives and instruments. It switched from a quasi-fixed exchange rate regime to monetary targeting and a managed float based on a basket of three currencies (dollar, euro and Russian rouble). Within this change, the central bank policy rate should gradually become the main monetary policy instrument whereas interventions on the foreign exchanges market are to be considerably reduced. The declared longer-term policy objective of the central bank is to switch to inflation targeting at some future point. The practice of directed credit is basically incompatible with such monetary arrangements so the Belarusian National Bank has suggested its gradual phasing out. However, it remains to be seen whether the government will be ready to give up this instrument for direct intervention in the economy.

Under the new policy regime, the Belarusian rouble depreciated sharply in the course of 2015 and this trend continued in the first months of 2016. At the same time, the Belarusian National Bank considerably tightened the money supply with the aim to prevent inflationary spillovers through the exchange rate pass-through. The combination of monetary tightening and rigid wage controls did indeed curb domestic

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39 In accordance with the existing bilateral agreements, Belarus imports crude oil from Russia at preferential prices and re-exports refined oil products to both Russia but also to Western Europe. Oil duties have been a main source of budget revenue in Belarus.

40 Directed lending in Belarus refers to a peculiar form of state support through preferential loans earmarked for selected economic sectors and activities (as identified in governmental programmes) at subsidised interest rates.

demand and helped prevent the outburst of very high inflation in 2015, in contrast to previous episodes of rouble depreciation.

The crisis was a major blow to policy-makers in a year when key presidential elections were held. Besides, unlike other past episodes of financial turmoil that Belarus had experienced, this time policy-makers had very little, if any at all, policy degrees of freedom to moderate the negative effects of the shocks. The habitual way of mitigating balance-of-payments strain in the past was larger foreign borrowing, mostly from Russia, and such resources were then used as a cushion for the economy and the population. An important difference in 2015 was that this time the shocks came from the East with the Russian economy itself in a deep recession and under severe financial constraints. Plus, the growing public foreign debt itself restrained the zeal of the authorities to seek additional debt on the international financial markets.

In 2015, Belarus continued to fund most of the balance of payments gap through official borrowing but at considerably lower levels than in previous years. In the first half of 2015, Belarus managed to raise some USD 2.5 billion from Russian sources (the Russian government and Sberbank); however, further attempts in the second half were futile. Belarus also officially requested financial support from the Stabilisation and Development Fund of the Eurasian Development Bank. The initial request for USD 3 billion was subsequently reduced to USD 2 billion but nevertheless, as of the moment of writing, the two sides had not yet reached an agreement on the terms of the loan. In May 2015, Belarus concluded a framework agreement with China on credit lines totalling USD 7 billion. However, up till now progress in the absorption of this funding has been rather limited. The lifting of the EU sanctions may ease Belarus's access to financial markets but high borrowing costs will continue to be a deterrent to such financing. It is thus becoming increasingly clear that, in order to address the persistent macroeconomic imbalances, policy needs to tackle the structural problems that give rise to such distortions.

In November, Belarus opened negotiations with the IMF on a new economic programme that could be supported by IMF financial assistance. Negotiations are still in their initial phases and it is by far not clear whether they will be concluded successfully. A key stumbling block is the reluctance by the authorities to take tough radical reform measures as well as the absence of clearly formulated positions of the authorities on the negotiations. While the government and the central bank are leaning towards a more pragmatic approach, including the acceptance of some of the long-standing IMF requirements such as speedy privatisation, elimination of directed credit and abandoning of wage targets, the influential presidential administration (without whose sanction no deal can be made) seems still to be very much against any radical moves in the policy course.

The internal policy disputes surfaced clearly in January 2016, when the government came up with an anti-crisis plan and a medium-term reform programme which was to some extent tuned to the IMF's requirements. The draft programme was not made public but reportedly it proposed a series of reform measures aimed at the establishment of a competitive environment on the domestic markets, including the restructuring and financial rehabilitation of the state-owned firms (as a preparatory step towards their privatisation), support to private entrepreneurship and small businesses and reduction of direct public intervention into the economy. However, these proposals were summarily discarded by the presidential administration; instead, the president came up with a counter directive targeting 'economic security', which in the main amounts to just some cosmetic changes to the present policy course of muddling through. Subsequently, the government came up with an amended programme reflecting the presidential directive in which the planned reforms were toned down considerably. It does envisage the reduction of directed credit to some 3% of GDP and the privatisation of about 60 state-owned firms in 2016; however, its main thrust is again the state patronage over the economy. It remains to be seen how long such a course can be sustained or whether it will be overtaken by events. At the same time, the administration does not seem to be willing to sacrifice the course towards macroeconomic stabilisation advocated by the central bank.

The short-term prospects for the Belarusian economy remain bleak and recession will likely persist in 2016. The balance of payments and fiscal constraints are likely to remain binding as regards the degrees of policy freedom therefore limiting the capacity of the authorities to pursue pro-active policies. Thus it can be expected that the course of fiscal and monetary austerity will be continued in the foreseeable future. Coupled with the ongoing downturn in export markets, this would result in a continuing slump in overall final demand. The forecast envisages a gradual and moderate recovery starting in 2017 which, however, will be conditional on the eventual revival of the key export markets.

Sustaining Belarus's macroeconomic stability in the long run hinges on the undertaking of deep and painful structural reforms. Despite the current reluctance of the authorities, the shift towards a more radical policy reform course seems inevitable; the main unknown is the timing of when this will happen.

Table 6 / Belarus: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017 Forecast	2018
Population, th pers., average	9,473	9,465	9,466	9,475	9,493	9,510	9,530	9,550
Gross domestic product, BYR bn, nom. 2)	297,158	530,356	649,111	778,095	869,702	965,500	1,097,000	1,247,400
annual change in % (real) 2)	5.5	1.7	1.0	1.7	-3.9	-2.6	0.5	1.5
GDP/capita (EUR at exchange rate)	3,900	5,200	5,800	6,200	5,100	4,200	4,300	4,400
GDP/capita (EUR at PPP)	12,500	13,100	13,300	13,700	13,500	.	.	.
Consumption of households, BYR bn, nom. 2)	139,955	244,863	318,332	392,116	442,000	.	.	.
annual change in % (real) 2)	2.3	10.8	10.9	4.3	-3.0	-2.0	0.0	1.0
Gross fixed capital form., BYR bn, nom. 2)	113,230	178,455	244,296	263,693	225,000	.	.	.
annual change in % (real) 2)	13.9	-11.3	9.6	-5.3	-15.0	-8.0	0.0	2.0
Gross industrial production								
annual change in % (real)	9.1	5.8	-4.9	2.0	-6.6	-4.0	0.0	2.0
Gross agricultural production								
annual change in % (real)	6.6	6.6	-4.2	2.9	-2.8	.	.	.
Construction industry								
annual change in % (real)	6.7	-8.6	4.6	-5.7	-10.0	.	.	.
Reg. employment, th, average	4,691	4,612	4,578	4,551	4,470	4,400	4,350	4,350
annual change in %	-0.3	-1.7	-0.7	-0.6	-1.8	-1.6	-1.1	0.0
Reg. unemployed persons, th, end of period	28.2	24.9	21.0	24.2	43.3	90.0	110.0	110.0
Reg. unemployment rate, in %, end of period	0.6	0.5	0.5	0.5	1.0	2.0	2.5	2.5
Average monthly gross wages, ths BYR	1,900	3,676	5,061	6,052	6,700	7,600	8,600	9,700
annual change in % (real, gross)	1.9	21.5	16.4	1.3	-2.5	-1.0	0.0	1.0
Consumer prices, % p.a.	53.2	59.2	18.3	18.1	13.5	14.0	13.0	12.0
Producer prices in industry, % p.a. 3)	71.4	76.0	13.6	12.8	16.8	18.0	16.0	14.0
General governm.budget, nat. def., % of GDP								
Revenues	38.7	38.5	40.3	38.7	41.0	40.0	39.0	39.0
Expenditures	35.9	37.7	40.1	37.3	39.0	39.0	38.0	38.0
Deficit (-) / surplus (+)	2.8	0.8	0.2	1.3	2.0	1.0	1.0	1.0
Public debt, EU-def., % of GDP	45.9	38.5	37.6	39.8	40.0	40.0	40.0	40.0
Central bank policy rate, % p.a., end of period 4)	45.0	30.0	23.5	20.0	25.0	24.0	22.0	20.0
Current account, EUR mn 5)	-3,518	-1,446	-5,737	-4,034	-1,000	-1,000	-1,100	-1,200
Current account, % of GDP 5)	-9.5	-2.9	-10.5	-6.9	-2.0	-2.5	-2.7	-2.9
Exports of goods, BOP, EUR mn 5)	28,499	35,391	27,701	27,492	24,000	23,500	23,300	23,500
annual change in %	55.6	24.2	-21.7	-0.8	-12.7	-2.1	-0.9	0.9
Imports of goods, BOP, EUR mn 5)	30,913	34,952	31,183	29,537	26,500	25,800	26,000	26,400
annual change in %	22.4	13.1	-10.8	-5.3	-10.3	-2.6	0.8	1.5
Exports of services, BOP, EUR mn 5)	3,906	4,901	5,690	6,113	6,000	5,900	6,000	6,200
annual change in %	9.0	25.5	16.1	7.4	-1.8	-1.7	1.7	3.3
Imports of services, BOP, EUR mn 5)	2,334	3,140	3,983	4,424	4,000	3,900	3,800	3,900
annual change in %	3.9	34.5	26.8	11.1	-9.6	-2.5	-2.6	2.6
FDI liabilities (inflow), EUR mn 5)	2,787	1,137	1,703	1,445	1,500	.	.	.
FDI assets (outflow), EUR mn 5)	87	121	199	57	100	.	.	.
Gross reserves of NB, excl. gold, EUR mn 5)	4,648	4,390	3,589	2,820	2,510	.	.	.
Gross external debt, EUR mn 5)	26,305	25,518	28,807	32,982	35,100	32,200	31,700	31,200
Gross external debt, % of GDP	71.3	51.9	52.5	56.0	72.0	80.0	78.0	75.0
Average exchange rate BYR/EUR	8,051	10,778	11,834	13,220	17,828	24,000	27,000	30,000
Purchasing power parity BYR/EUR	2,504	4,283	5,145	5,985	6,771	.	.	.

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

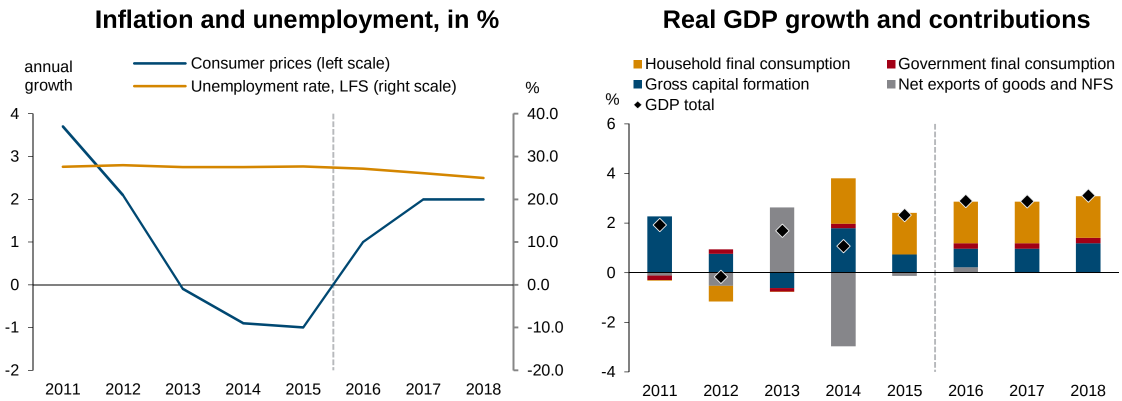
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

BOSNIA AND HERZEGOVINA: Changing slowly

VLADIMIR GLIGOROV

Growth should pick up speed, driven by investments and exports, as long as the political climate continues to improve, regardless how slowly. Our forecast hints at medium-term growth close to 3% – higher than the regional average.

Figure 38 / Bosnia and Herzegovina: main macroeconomic indicators



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

Growth rebounds and should accelerate further in the medium term. Last year's performance was better than expected due to a recovery of investments. In 2014, floods had set the economy back, while repairing the damage lifted the growth rate in 2015. Investments are expected to continue to grow quite strongly accompanied by increased consumption in the medium term. The country is not facing fiscal austerity measures, so public consumption will not decline, which also means public wages, while remittances and other transfers should continue to support private consumption.

Asymmetries in the prospects of the two entities are considerable. There are two entities, or federal units, one of which, Republika Srpska, is doing worse than the other, the Federation of Bosnia and Herzegovina. The reason is that the former has been resisting intra-state integration in practically all ways possible. During good times, that is before 2008, it relied on support from Serbia and until recently from Russia too, but these sources of investments and businesses have dried up. The government has been running debts, but that has probably reached the limit of sustainability. In addition, the mood has changed in this entity due to strong resentment of the widespread corruption at the top of the government. This is not to say that there is no perception of corruption throughout the country. It is just that it is having a stronger political influence in Republika Srpska at this moment. The reason is that the entity has been run by the same person, Milorad Dodik, currently the President, and his party for much too long.

The decreasing popularity was addressed with calls for secession. In the last general elections, the opposition in Republika Srpska did well and though it did not take over the government in the entity, its candidate became the member of the collective presidency of the state and they joined the governing coalition. That made it possible to reignite the aspiration to advance in the process of EU integration. The president and the government in Republika Srpska attempted to counter with an intensification of secessionist threats, in which they gained open support from Russia. Various referenda were announced, but failed to secure the support from the Serbian government and did not unite the governing party and the opposition. On the contrary, Bosnia and Herzegovina submitted an application for membership in the European Union in February of 2016.

Things move forward, but very slowly. The key weakness of the country's set-up is its constitution, forged in Dayton, Ohio, in 1995. It is based on ethnic representation, which makes democratic representation quite difficult, as ethnic parties have a clear advantage over any emerging opposition. A change of the constitution can only be conceivably expected within the process of EU integration. The latter has been very slow basically because constitutional change, at least a partial one, has been made a precondition to any forward move. In addition, the secession of Republika Srpska has been a threat whenever an initiative to change the constitution emerged. For the threat to be taken seriously, Serbia needed to be ready to implicitly promise that it will be ready to annex the seceding entity. In the past, the Serbian official position was one of ambiguity, while Russia was not supportive of secession. Currently, Serbia is against, while Russia is supportive. In the meantime, however, the support for the secessionists has weakened, which is why slow change towards more internal integration and towards the EU has become possible. The EU has also dropped the condition of prior constitutional change, so there is a new momentum for Bosnia and Herzegovina.

The country is almost landlocked (access to the sea is limited to a tiny strip and a port). It is also a mountainous country. So, from a geographical point of view, industry is the comparative advantage. However, industry contributes about 15% to the total value added and manufacturing about 10%. Energy production and mining are not insignificant, with water and wood being abundant, but also with some better-quality coal. However, manufacturing needs to be lifted up significantly. Indeed, industrial production has been growing and is expected to continue to grow in the medium run. In addition, tourism is performing well, as visitors are attracted for cultural and the usual reasons for vacationing.

Consumption is much too high while investment is catching up. The trade deficit is very high even though exports are increasing. The current account deficit is much lower, due to remittances. Consumption is 110% of GDP and investment about 20%. Overall foreign debt is still not too high, though the aggregate figure is not known with certainty. Still, this is clearly unsustainable, which means that even in the medium run some rebalancing will be needed. That will sap the actual growth rate to up to 3% over the next few years. An improved relationship with the EU and investments within the so-called Berlin Process (a framework for investment support and coordination in the Western Balkans) should help, especially as infrastructure investments are crucial to this mountainous and internally and externally not well connected country.

Table 7 / Bosnia and Herzegovina: selected economic indicators

	2011	2012	2013	2014	2015 [1]	2016	2017	2018
							Forecast	
Population, th pers., mid-year [2]	3,840	3,836	3,832	3,827	3,820	3,820	3,820	3,820
Gross domestic product, BAM mn, nom. [3]	26,210	26,193	26,743	27,304	27,900	29,000	30,400	32,000
annual change in % (real)	0.9	-0.9	2.4	1.1	2.3	2.9	2.9	3.1
GDP/capita (EUR at exchange rate) [3]	3,500	3,500	3,600	3,600	3,700	3,900	4,100	4,300
GDP/capita (EUR at PPP) [3]	7,100	7,300	7,400	7,700	8,200	.	.	.
Consumption of households, BAM mn, nom. [3]	21,927	22,337	22,515	22,886	23,300	.	.	.
annual change in % (real)	0.0	-0.8	0.0	2.2	2.0	2.0	2.0	2.0
Gross fixed capital form., BAM mn, nom. [3]	4,750	4,783	4,714	5,159	5,400	.	.	.
annual change in % (real)	6.2	2.2	-1.0	10.1	4.0	5.0	4.0	5.0
Gross industrial production								
annual change in % (real)	2.4	-3.9	5.2	0.2	3.1	5.0	5.0	5.0
Gross agricultural production [4]								
annual change in % (real)	1.8	-10.0	15.3	0.0	5.0	.	.	.
Construction output total								
annual change in % (real)	-5.6	-3.1	-2.3	6.8	0.0	.	.	.
Employed persons, LFS, th, April	816.0	813.7	821.6	812.0	822.0	830	850	870
annual change in %	-3.2	-0.3	1.0	-1.2	1.2	1.0	2.0	2.0
Unemployed persons, LFS, th, April	310.9	316.6	311.5	308.0	315.0	310	300	290
Unemployment rate, LFS, in %, April	27.6	28.0	27.5	27.5	27.7	27.2	26.1	25.0
Reg. unemployment rate, in %, end of period	43.9	44.6	44.5	43.6	42.7	.	.	.
Average monthly gross wages, BAM	1,271	1,290	1,291	1,290	1,289	1,320	1,360	1,400
annual change in % (real, gross)	0.7	-0.5	0.2	0.8	1.0	1.0	1.0	1.0
Average monthly net wages, BAM	816	826	827	831	830	850	880	910
annual change in % (real, net)	-1.4	-0.8	0.2	1.3	1.0	1.0	1.0	1.0
Consumer prices, % p.a.	3.7	2.1	-0.1	-0.9	-1.0	1.0	2.0	2.0
Producer prices in industry, % p.a.	5.5	0.3	-1.8	-0.5	0.6	1.0	2.0	2.0
General governm.budget, nat.def., % of GDP								
Revenues	43.3	43.8	42.6	43.9	44.0	44.0	44.0	44.0
Expenditures	44.6	45.8	44.8	45.9	46.0	46.0	46.0	46.0
Deficit (-) / surplus (+)	-1.2	-2.0	-2.1	-2.0	-2.0	-2.0	-2.0	-2.0
Public debt, nat.def., % of GDP [5]	40.8	43.6	41.6	44.8	46.0	46.0	46.0	46.0
Central bank policy rate, % p.a., end of period [6]	.	.	.	.	.	.	.	.
Current account, EUR mn [7]	-1,270	-1,185	-751	-1,092	-1,000	-1,150	-1,200	-1,150
Current account, % of GDP [7]	-9.5	-8.8	-5.5	-7.8	-7.0	-8.0	-8.0	-7.0
Exports of goods, BOP, EUR mn [7]	2,953	2,988	3,286	3,385	3,520	3,700	3,900	4,100
annual change in %	21.0	1.2	10.0	3.0	4.0	6.0	6.0	6.0
Imports of goods, BOP, EUR mn [7]	7,085	7,079	7,027	7,528	7,530	7,900	8,300	8,700
annual change in %	13.6	-0.1	-0.7	7.1	0.0	5.0	5.0	5.0
Exports of services, BOP, EUR mn [7]	1,343	1,324	1,311	1,345	1,410	1,500	1,600	1,700
annual change in %	-4.7	-1.4	-1.0	2.5	4.9	5.0	5.0	5.0
Imports of services, BOP, EUR mn [7]	399	404	385	397	420	440	460	480
annual change in %	-2.9	1.1	-4.6	3.2	5.7	5.0	5.0	5.0
FDI liabilities (inflow), EUR mn [7]	340	305	257	371	400	.	.	.
FDI assets (outflow), EUR mn [7]	-4	46	61	4	50	.	.	.
Gross reserves of NB excl. gold, EUR mn	3,207	3,246	3,530	3,908	4,307	.	.	.
Gross external debt, EUR mn [5]	6,553	6,991	7,138	7,245	7,500	7,650	7,800	8,250
Gross external debt, % of GDP [5]	48.9	52.2	52.2	51.9	52.6	51.6	50.2	50.4
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.96	1.96	1.96
Purchasing power parity BAM/EUR	0.9622	0.9321	0.9369	0.9218	0.8957	.	.	.

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

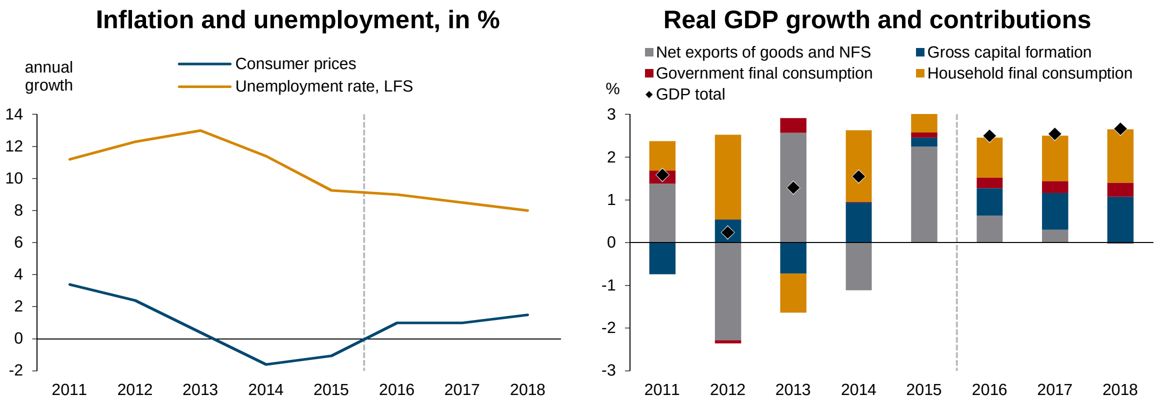
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

BULGARIA: Growth in 2015 exceeds expectations, but can it be sustained?

RUMEN DOBRINSKY

Driven by a combination of positive domestic and external factors, GDP growth in 2015 outperformed expectations. The economy, however, is mired in chronic structural problems that policy-makers have systematically neglected. While GDP is expected to continue growing at a rate of 2% to 3% per annum over the short term, the absence of policy reforms may lead to an accumulation of macroeconomic imbalances.

Figure 39 / Bulgaria: main macroeconomic indicators



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

In 2015 Bulgaria's economy performed significantly better than had been expected a year earlier: for the year as a whole, the rate of GDP growth was by some 1.0-1.5 percentage points above the ex-ante expectations of both the government and the majority of analysts. Moreover, for the first time in years, growth in 2015 was relatively balanced in the sense that it was supported by both domestic and external factors. In statistical terms, all three main components of final demand: private consumption, gross fixed capital formation and net export made positive contributions to GDP growth.

The relative weight of the main drivers of GDP growth was changing in the course of the year: in the first half, it was the unexpected surge in exports that gave the most significant boost to overall economic activity. Later on, while exports were losing steam in the second half, domestic demand (both private consumption and fixed investment) started picking up, thereby contributing to a relatively even pace of overall macroeconomic activity.

On the other hand, when analysing the current macroeconomic data one needs to factor in some purely statistical effects: recent backward revisions of Bulgaria's national accounts by the National Statistical Institute resulted in lower 2014 numbers and therefore produced an additional 'statistical boost' to the 2015 growth figures. This can be traced when comparing the revised quarterly national accounts for 2015 with the earlier published statistics for the first half of the year. In turn, the unusual export boom of the first months of 2015 partly reflected seasonal factors related to the schedule of export shipments contracted back in 2014.

One additional factor that may have added a further upward statistical bias was the massive emigration of Greek businesses to Bulgaria. Reportedly, many small businesses are opting to transfer their legal headquarters from Greece to Bulgaria mostly for tax purposes and to escape growing administrative hurdles in the home country. According to anecdotal evidence, some 60,000 small Greek businesses migrated to Bulgaria in 2015 alone.

Be that as it may, all indications are that the Bulgarian economy was recovering in 2015. According to monthly statistics, manufacturing output consistently reported positive growth in 2015, repeating the same pattern of the previous year. The picture is identical as regards engineering construction. Importantly, the 2015 average LFS rate of unemployment fell below 10% for the first time since 2009. The economic upturn also contributed to a better than earlier expected fiscal outturn: according to preliminary estimates, the deficit for the year as a whole should be below the 3% mark.

Private consumption started recovering in 2015 despite the continuing deflationary trend. Consistently rising real wages and incomes undoubtedly contributed to such an outcome. The upturn in gross fixed capital formation in the second half of the year was largely driven by a recovery in public investment which, in turn, was boosted by a notable improvement in the absorption of EU structural funds. For the year as a whole, public capital expenditure backed by EU funds in nominal terms was some 60% higher than in 2014. There was also a modest revival in credit activity both to corporate customers and households although the recent monetary statistics are difficult to interpret due to the statistical effect of the closure of the big Corporate Commercial Bank (CCB) in 2014. The significant upturn in exports (mostly due to a surge in exports to the EU) contributed to maintaining a positive current account balance in 2015 and a further reduction in the gross external debt.

However, these positive outcomes need to be considered against the background of the overall economic environment. In particular, despite the recent slight improvement, the budgetary statistics reveal a considerable loosening of the fiscal stance in 2014-2015. While the huge deficit incurrent in 2014 (5.8%) was largely due to the budgetary implications of the CCB failure in 2014 (more specifically, the large-scale fiscal commitments undertaken by the public sector in the context of the ensuing bankruptcy procedure), the recognition of such an ad hoc liability seems to have incited an atmosphere of moral hazard giving rise to a spree of claims to the public sector that the government did not manage to resist.

A clear sign of the deteriorating fiscal management was the revision of the 2015 budget voted in December (together with the 2016 budget) which, as per the remarks by government officials, was undertaken due to considerable overspending by various ministries and regions. The revision allowed for BGN 880 million additional spending (some 3% of total expenditure) in 2015. Luckily for the government, windfall public revenue – likely reflecting cyclical effects – contributed to curbing the overall fiscal deficit.

Another example of the overall fiscal loosening was the adoption by parliament, under strong pressure from the government, of a medium-term public sector borrowing programme covering the period

2015-2017 allowing the government to borrow a total of BGN 16 billion (some EUR 8 billion) in this period. What is peculiar in this case is that the government was granted such borrowing options without linking them to any specific spending programme or purpose: de facto, the parliament signed the government a blank cheque amounting to a stunning 18% of GDP.

Apart from the visible signs of fiscal laxity, there are risks to public sector finances coming from some chronic but concealed threats. The most conspicuous among these is the energy sector. This sector, which is still largely in public hands (through publicly owned energy companies), has been persistently generating losses which are equivalent to contingent fiscal liabilities. These losses are rooted in different sources, including government guarantees, explicit and implicit price subsidies, government support for the development of renewable energy sources, etc. According to some estimates, these contingent fiscal liabilities at present amount to more than BGN 4 billion (nearly 5% of GDP) and keep growing. These have been piling over the years, with different governments taking various commitments to the energy sector and passing these to subsequent governments. However, this cannot go on forever and at some point, the government in office will need to address the fiscal implications of reckless past and current energy policies.

Such systemic vulnerabilities are indicative of the general failure by the Borisov government to tackle chronic structural problems in the economy despite the generous promises for reforms at the beginning of its term in office. Being a heterogeneous and large coalition, the political forces behind the government find it increasingly difficult to agree on a common denominator for policy reforms: all policy-related legislation that has been adopted since the 2014 elections have only been superficial and cosmetic in nature. One key problem is the absolute lack of declared vision and objectives as regards the future directions of Bulgaria's policy course. Most of the policy moves undertaken by the government are only of a passive nature, in response to acute emergencies and are often of populist character. In turn, this governance style tends to generate political tensions within the coalition, resulting in frequent ministerial changes.

The 2016 budget adopted in December was also indicative of the eclectic nature of the current policy course. The budgetary legislation did not formulate any clear policy objectives, thereby protracting a non-reform agenda; at the same time, the parliament again signed a blank cheque to the government for generous non-targeted borrowing which, as per previous experience, is mostly used for ad hoc populist moves. Such a setting is a recipe for perpetuating the current fiscal laxness.

In the absence of reforms and targeted policies, the Bulgarian economy will continue to be driven by domestic inertia and external factors. The current forecast assumes that both recovering domestic demand and exports will continue to give a moderate positive impetus to economic growth. These, however, will hardly be sufficient for further invigoration of economic activity – moreover, given that some of the 2015 growth factors were of a one-off nature. Thus the surge of public investment based on EU funds reflected a late start of the new EU financing cycle whereas there are no signs of recovery in private fixed investment. The export surge in the first half of 2015 partly reflected a statistical effect related to seasonal factors whereas exports in the second half nearly came to a standstill. The expected gradual recovery in the EU economy will likely contribute to positive export growth in 2016 but it would not be realistic to expect a repeat of the 2015 figures. So in general the expectations are for a continuing moderate recovery in the Bulgarian economy both in 2016 and in the two following years with an annual GDP growth rate in the range between 2% and 3%. While there are no visible imminent threats to macroeconomic stability, the chronic structural problems do suggest possible increasing risks in the medium term.

Table 8 / Bulgaria: selected economic indicators

	2011	2012	2013	2014	2015 [1)]	2016	2017 Forecast	2018
Population, th pers., average	7,348	7,306	7,265	7,224	7,200	7,150	7,100	7,050
Gross domestic product, BGN mn, nom.	80,100	81,544	81,971	83,612	87,000	90,100	93,300	97,300
annual change in % (real)	1.6	0.2	1.3	1.5	3.0	2.5	2.5	2.7
GDP/capita (EUR at exchange rate)	5,600	5,700	5,800	5,900	6,200	6,400	6,700	7,100
GDP/capita (EUR at PPP)	11,800	12,200	12,200	12,800	13,600	.	.	.
Consumption of households, BGN mn, nom.	49,582	53,022	50,906	52,207	53,100	.	.	.
annual change in % (real)	1.1	3.2	-1.4	2.7	0.7	1.5	1.7	2.0
Gross fixed capital form., BGN mn, nom.	16,896	17,443	17,365	17,653	18,000	.	.	.
annual change in % (real)	-4.4	1.8	0.3	3.4	1.0	3.0	4.0	5.0
Gross industrial production [2)]								
annual change in % (real)	5.8	-0.4	-0.1	1.8	2.8	3.0	3.0	3.0
Gross agricultural production								
annual change in % (real)	-2.5	-10.0	14.2	-0.6	-10.2	.	.	.
Construction industry [3)]								
annual change in % (real)	-12.8	-0.8	-3.7	1.8	-1.5	.	.	.
Employed persons, LFS, th, average [4)]	2,950	2,934	2,935	2,981	3,032	3,080	3,130	3,180
annual change in %	-3.4	-1.1	0.0	1.6	1.7	1.5	1.5	1.5
Unemployed persons, LFS, th, average [4)]	372	410	436	385	305	300	290	280
Unemployment rate, LFS, in %, average [4)]	11.2	12.3	13.0	11.4	9.3	9.0	8.5	8.0
Reg. unemployment rate, in %, end of period	10.4	11.4	11.8	10.7	10.0	.	.	.
Average monthly gross wages, BGN	685.8	731.1	775.1	821.7	882.0	940	990	1,030
annual change in % (real, gross)	1.5	3.5	5.1	7.5	7.4	5.0	4.0	3.0
Consumer prices (HICP), % p.a.	3.4	2.4	0.4	-1.6	-1.1	1.0	1.0	1.5
Producer prices in industry, % p.a.	9.2	4.4	-1.5	-1.2	-2.0	1.0	1.0	1.5
General governm.budget, EU-def., % of GDP								
Revenues	32.1	34.0	36.9	36.3	37.0	37.0	37.0	37.0
Expenditures	34.1	34.7	37.6	42.1	39.5	40.0	40.0	40.0
Net lending (+) / net borrowing (-)	-2.0	-0.6	-0.8	-5.8	-2.5	-3.0	-3.0	-3.0
Public debt, EU-def., % of GDP	15.3	17.6	18.0	27.0	29.4	30.5	32.4	34.1
Central bank policy rate, % p.a., end of period [5)]	0.22	0.03	0.02	0.02	0.01	.	.	.
Current account, EUR mn	375	-108	765	495	542	300	0	-200
Current account in % of GDP	0.9	-0.3	1.8	1.2	1.2	0.7	0.0	-0.4
Exports of goods, BOP, EUR mn	19,056	19,668	21,208	21,017	22,265	22,600	23,000	23,500
annual change in %	34.4	3.2	7.8	-0.9	5.9	1.5	1.8	2.2
Imports of goods, BOP, EUR mn	21,704	23,615	24,099	23,752	24,150	24,800	25,500	26,300
annual change in %	22.5	8.8	2.0	-1.4	1.7	2.7	2.8	3.1
Exports of services, BOP, EUR mn	6,471	6,845	6,860	6,749	6,744	6,800	6,900	7,000
annual change in %	6.0	5.8	0.2	-1.6	-0.1	0.8	1.5	1.4
Imports of services, BOP, EUR mn	3,571	4,114	4,124	4,219	4,194	4,200	4,300	4,400
annual change in %	3.5	15.2	0.3	2.3	-0.6	0.1	2.4	2.3
FDI liabilities (inflow), EUR mn	1,537	1,383	1,509	1,486	1,573	.	.	.
FDI assets (outflow), EUR mn	348	315	266	650	62	.	.	.
Gross reserves of NB excl. gold, EUR mn	11,788	13,935	13,303	15,276	19,022	.	.	.
Gross external debt, EUR mn [6)]	36,295	37,714	36,936	39,356	34,600	33000	32000	31000
Gross external debt, % of GDP [6)]	88.6	90.5	88.1	92.1	77.8	72.0	67.0	62.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
Purchasing power parity BGN/EUR	0.9261	0.9167	0.9224	0.9039	0.8887	.	.	.

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) All enterprises in public sector, private enterprises with 5 and more employees. - 4) From 2012 according to census February 2011. - 5) Base interest rate. This is a reference rate based on the average interbank LEONIA rate of previous month (Bulgaria has a currency board). -
6) BOP 5th edition.

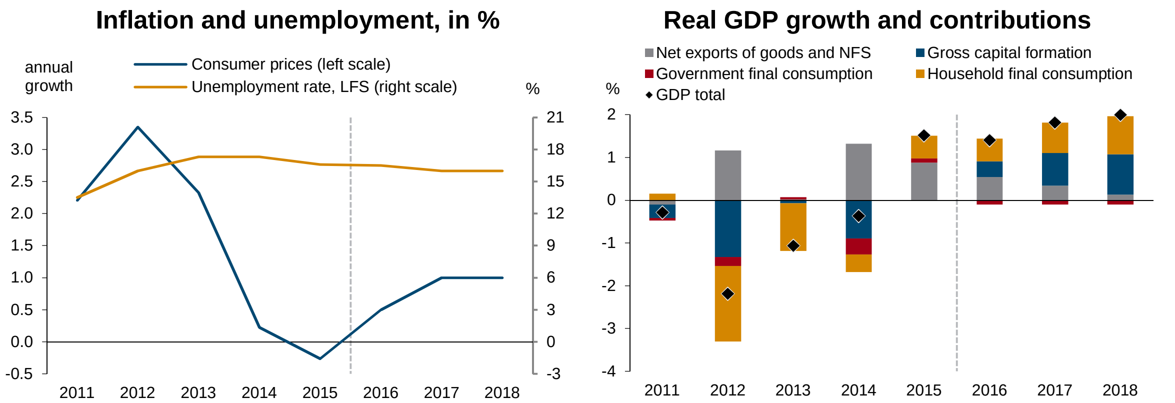
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

CROATIA: Slow return to growth

HERMINE VIDOVIC

Croatia's economy has returned to a mild growth path in 2015. The turnaround was backed by a rise in external demand and a modest recovery in household consumption and investments. EU-funded investments and the continuation of private consumption recovery should help to stimulate GDP growth, which, however, will remain relatively weak, 1.7% on average, over the period 2016-2018. Fiscal consolidation coupled with high public debt will remain the main impediments to sustainable growth.

Figure 40 / Croatia: main macroeconomic indicators



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

After six years of recession, Croatia's economy returned to growth in 2015. The 1.5% GDP growth was backed both by foreign and domestic demand. Household consumption grew for the first time since 2011 owing to a mild recovery in the labour market, real wage increases and a reduction of personal income tax introduced at the beginning of the year. Thanks to an improved absorption of EU funds, gross fixed capital formation rose for the first time since 2009 (the only exception being a temporary increase in 2013), but was not strong enough to put a brake on the protracted decline in construction activities. The rise in investments[41] is mainly associated with public sector activities, but there are also some signs of recovery in private sector investment. Growth of industrial production took off in the course of the year and increased by 2.7%, with a further rise in labour productivity due to continued layoffs. Though improving somewhat, the unemployment rate remained high (16.6%) compared with other EU countries,

[41] Croatian National Bank, Bulletin 220, December 2015, p. 10.

ranking third after Greece and Spain. Also youth unemployment is still among the highest in the EU, at 44% in December 2015. In terms of employment, Pension Insurance data report a 0.5% rise during the first nine months of the year, while Labour Force Survey data indicate an increase by 1.6%. Both real gross and net wages increased, by 1.7% and 3.5% respectively, in 2015.

Foreign trade performed dynamically in 2015 with goods exports (up 9%) rising ahead of imports (up 6.7%, both in nominal euro terms). The trade deficit increased slightly against 2014. Trade with EU countries performed above average, while deliveries to CEFTA countries decreased slightly, primarily on account of a remarkable export decline in trade with Bosnia and Herzegovina, Croatia's major trading partner in the region. Trade with Russia shrank significantly both in terms of exports (by 30%) and imports (by 48%). After years of restructuring-related declines, exports of the shipbuilding industry were 2.5 times higher in 2015 than a year earlier; exports of car parts, pharmaceutical and leather products reported far above average growth rates. The strong growth of the current account surplus to 4.6% of GDP is mainly due to the conversion effect of Swiss franc loans on the declining deficit in the primary income, the growing surplus in services trade and the transfer of EU funds.

Following the parliamentary elections held on 8 November 2015, a new government came into office on 25 January 2016 after protracted and difficult coalition negotiations. The government consists of a coalition between the Croatian Democratic Union (HDZ) and Most, a new party of municipal politicians and independents formed prior to the elections. It is headed by Tihomir Orešković, holding Croatian and Canadian citizenship and serving formerly as chief financial officer of the Teva pharmaceutical company. In his first speech to the parliament the new prime minister stressed that, in order to achieve sustainable economic growth (over 3%) and a sound fiscal position (budget deficit below 3% in 2017 and public debt lower than 80% of the GDP by 2020), five major areas have to be tackled: efficiency of the public sector, business competitiveness, investments and EU funds, public debt management and the reform of the educational and health systems. Considering the fragile coalition, it remains to be seen whether these announcements will be put into practice or remain lip service as has frequently happened in the past.

The analysis of the fiscal stance in 2015 is impeded by methodological changes. Available data for the central government budget for the whole year indicate that the general government deficit may have decreased to an estimated 4.2% of the GDP and public debt has increased less dramatically than originally expected. This was mainly made possible by higher than expected revenues owing to stronger GDP growth. The budget for 2016 is still under preparation due to the change in government. According to the prime minister, the major objective will remain the further reduction of the budget deficit. Initial information indicates that programmes worth about EUR 500 million should be activated to stimulate growth of small and medium-sized enterprises, and also EU funding should support GDP growth. Investments in tourist facilities should continue, e.g. in the airport Mali Lošinj, Hotel Park Rovinj or the Costabella Resort in Rijeka.[42] Investments are also envisaged in strategic public companies such as the electric power provider HEP. The reduction of the number of (currently 20) counties, which has been considered by experts as an important prerequisite for the efficient use of EU funds, is according to the prime minister not a priority, while the minister of economy announced a 'public debate about the right model' on how to (re)organise regions. There are also diverging views among the members of the government on the introduction of a property tax, e.g. to tax unused property or to abolish other taxes or

42 The government envisages investing EUR 2.2 billion in tourist infrastructure (mostly in hotels) up to 2020; in 2016 alone investments in tourism will account for EUR 670 million. https://vlada.gov.hr/news/prime-minister-oreskovic-expects-further-increase-in-interest-in-tourism-investment/18396

contributions instead. The 2016 budget, which will be presented on 10 March, might be seen as a first indicator of the policy direction of the new government. Overall, it seems that there is not much room to manoeuvre since the government will have to comply with the recommendations under the excessive deficit procedure.

Improving credit ratings is another important goal of the new government. Only in January 2016, Standard & Poor's affirmed Croatia's long-term and short-term credit ratings at 'BB' and 'B', respectively. The outlook on the ratings remains negative. The main reasons behind are weak GDP growth, poor public finances and delayed reform planning due to the long-lasting coalition talks. This rating was also confirmed by Fitch.

First results regarding the conversion of Swiss franc loans into euro-denominated loans – the legislation of which was adopted in September 2015 – show that the differences between the annuities for these two types of loans turned out to be relatively small due to the effects of previous interventions, such as the one-year freezing of the exchange rate for these loans at 6.39 kuna per Swiss franc in January 2015 and the setting of a maximum interest rate at 3.23% effective from the beginning of 2014[43]. At the end of January 2016, six out of eight banks providing Swiss franc loans in the past decided to stick to the fixed exchange rate for clients who have agreed to convert their loans. Recently, some irregularities in the calculation of conversions have been reported.

Regarding the economic prospects for the coming years, Croatia will continue to experience moderate GDP growth (at 1.7% p.a.) over the period 2016-2018; that growth will become more robust and will be backed by (public) investments supported by EU funds and a gradual recovery of private sector investments. Sustained recovery of household consumption should also help to initiate a new period of growth. GDP growth is expected to translate into a steady rise of employment and decreasing unemployment. Assuming slightly lower growth of both exports and imports of goods and services, the current account is expected to remain in surplus over the period 2016-2018. The downside risks to the outlook are: long-lasting fiscal consolidation coupled with high public debt. In addition, the new Croatian government will need to demonstrate its commitment to fiscal consolidation and related reforms.

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[43] EIZ, Croatian Economic Outlook, December 2015, p. 9.

Table 9 / Croatia: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017 Forecast	2018
Population, th pers., average	4,283	4,269	4,254	4,236	4,220	4,220	4,220	4,220
Gross domestic product, HRK mn, nom.	332,587	330,456	329,571	328,431	334,000	340,400	350,000	360,600
annual change in % (real)	-0.3	-2.2	-1.1	-0.4	1.5	1.4	1.8	2.0
GDP/capita (EUR at exchange rate)	10,400	10,300	10,200	10,200	10,400	10,500	10,800	11,100
GDP/capita (EUR at PPP)	15,500	15,900	15,800	16,100	16,900	.	.	.
Consumption of households, HRK mn, nom.	195,325	195,623	195,623	193,524	195,700	.	.	.
annual change in % (real)	0.3	-3.0	-1.9	-0.7	0.9	0.9	1.2	1.5
Gross fixed capital form., HRK mn, nom.	67,471	64,820	65,257	62,639	63,300	.	.	.
annual change in % (real)	-2.7	-3.3	1.4	-3.6	0.9	2.0	4.0	5.0
Gross industrial production 2)								
annual change in % (real)	-1.2	-5.5	-1.8	1.2	2.7	2.8	2.8	3.0
Gross agricultural production								
annual change in % (real)	-4.7	-9.4	4.2	-7.0	-0.2	.	.	.
Construction output 2)								
annual change in % (real)	-11.3	-12.7	-4.7	-7.2	-0.5	.	.	.
Employed persons, LFS, th, average 3)	1,493	1,566	1,524	1,566	1,590	1,610	1,630	1,650
annual change in %	-3.2	-3.6	-2.7	2.7	1.6	1.5	1.5	1.5
Unemployed persons, LFS, th, average 3)	232	297	318	327	315	320	310	310
Unemployment rate, LFS, in %, average 3)	13.5	16.0	17.3	17.3	16.6	16.5	16.0	16.0
Reg. unemployment rate, in %, end of period	18.7	21.1	21.6	19.6	17.9	.	.	.
Average monthly gross wages, HRK	7,796	7,875	7,939	7,953	8,054	8,200	8,400	8,700
annual change in % (real, gross)	-0.8	-2.3	-1.4	0.4	1.8	1.8	2.0	2.0
Average monthly net wages, HRK	5,441	5,478	5,515	5,533	5,710	5,900	6,100	6,300
annual change in % (real, net)	-0.4	-2.6	-1.5	0.5	3.7	2.5	2.5	2.5
Consumer prices (HICP), % p.a.	2.2	3.4	2.3	0.2	-0.3	0.5	1.0	1.0
Producer prices in industry, % p.a.	7.0	5.1	-0.4	-2.7	-3.9	-2.0	1.0	1.0
General governm.budget, EU-def., % of GDP								
Revenues	41.0	41.7	42.5	42.6	43.4	43.4	43.8	44.0
Expenditures	48.8	47.1	47.8	48.2	47.6	47.4	47.3	47.0
Net lending (+) / net borrowing (-)	-7.8	-5.3	-5.4	-5.6	-4.2	-4.0	-3.5	-3.0
Public debt, EU-def., % of GDP	63.7	69.2	80.8	85.1	86.0	88.0	89.0	90.0
Central bank policy rate, % p.a., end of period 4)	7.0	7.0	7.0	7.0	3.0	3.0	3.0	3.0
Current account, EUR mn	-316	-21	443	364	2,000	1,500	1,000	900
Current account, % of GDP	-0.7	0.0	1.0	0.8	4.6	3.4	2.2	1.9
Exports of goods, BOP, EUR mn	8,742	8,673	8,924	9,761	10,650	11,400	12,200	13,200
annual change in %	8.5	-0.8	2.9	9.4	9.1	7.0	7.0	8.0
Imports of goods, BOP, EUR mn	15,124	14,969	15,511	16,116	17,200	18,200	19,100	20,200
annual change in %	8.2	-1.0	3.6	3.9	6.7	6.0	5.0	6.0
Exports of services, BOP, EUR mn	9,367	9,641	9,839	10,268	10,700	11,100	11,500	12,000
annual change in %	4.7	2.9	2.1	4.4	4.2	4.0	4.0	4.0
Imports of services, BOP, EUR mn	3,172	3,127	3,061	3,029	3,290	3,500	3,700	3,900
annual change in %	-0.1	-1.4	-2.1	-1.1	8.6	5.0	5.5	5.5
FDI liabilities (inflow), EUR mn	1,018	1,136	710	2,896	1,000	.	.	.
FDI assets (outflow), EUR mn	-169	-64	-118	1,586	400	.	.	.
Gross reserves of NB excl. gold, EUR mn	11,195	11,236	12,908	12,688	13,707	.	.	.
Gross external debt, EUR mn	46,397	45,297	45,958	46,664	47,500	48,500	49,500	50,500
Gross external debt, % of GDP	103.7	103.0	105.6	108.4	108.2	109.0	108.5	107.5
Average exchange rate HRK/EUR	7.4342	7.5173	7.5735	7.6300	7.6096	7.65	7.67	7.67
Purchasing power parity HRK/EUR	5.0066	4.8716	4.8939	4.8133	4.6913	.	.	.

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) From 2012 according to census April 2011. - 4) Discount rate of NB.

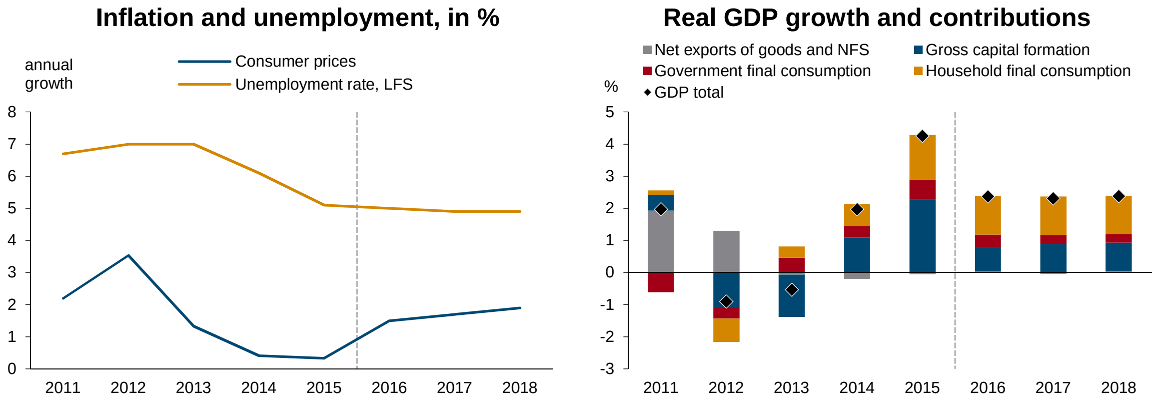
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

CZECH REPUBLIC: Back to normal

LEON PODKAMINER

The recent expansion of infrastructural investment is not going to extend into the years ahead. However, in the light of the low level of debt in the private sector and the pursuit of monetary policy conducive to growth, further moderate recovery, with growth averaging 2.4%, should be assured over the period 2016-2018, notwithstanding the uncertainties that persist concerning the future course of fiscal policy and foreign trade performance given the (expected) strengthening of the domestic currency.

Figure 41 / Czech Republic: main macroeconomic indicators



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

According to very first provisional estimates, GDP grew by 3.9% (seasonally adjusted, year-on-year) in the last quarter of 2015. That rate is a clear disappointment as a growth rate well in excess of 5% was generally expected. The composition of growth in the fourth quarter is yet unknown. Very possibly lower growth was due to a decisive slowdown of growth of gross fixed capital formation financed from EU transfers earmarked under the financial perspective for 2007-2013 (with its disbursement period ending in 2015).

In the third quarter, household consumption continued to grow by about 3% while government consumption rose by 4.4% – much faster than in the first half of the year. During that period the dynamics of exports and imports was quite impressive (even by Czech standards). Volumes of exports and imports (of goods and non-factor services combined) rose by 8.2% and 9.1% respectively (year-on-year). The tendency of import volumes to grow faster than export volumes had set in in the second half of 2013. Nominally, the (positive) trade balance was almost unchanged and quite high – also on account of falling import prices of raw materials (and of energy carriers in particular). But its real-term contraction had an impact on the GDP growth rate: foreign trade contributed negatively to GDP growth (by -0.2 percentage points). Gross fixed capital formation rose unusually strongly – by about 6.8%, contributing about 2 percentage points to the overall GDP growth of 4.7% recorded in the third quarter. Expanding inventories appear to have been important contributors to GDP growth (adding over 0.5 percentage points to overall growth).

In the third quarter of 2015 investment in ICT, machinery, equipment, weapon systems etc., constituting about one third of the entire gross fixed capital formation (GFCF), increased by 4.4% in real terms. Residential investment (about 13% of total GFCF) remained stagnant. Strong growth (by 15.3%) was recorded for transport equipment (representing about 12% of total GFCF).

However, the greatest impact has had the 12.5% growth in investments assuming the form of ‘other buildings and structures’ (whose GFCF share is 30%). The infrastructural investments, broadly understood, included in this category had been declining since 2007, by 22% cumulatively. The current sharp rebound (which was visible already in the second quarter of 2015) – actually not expected even by the Czech authorities – represents a ‘last-moment’ attempt to tap the EU funds earmarked under the previous financial perspective.

The past years’ failure to draw available funds from the EU resources need not be attributed to the Czech side’s ‘technical’ unpreparedness. During the four-year fiscal consolidation period (2000-2013) public spending – including the co-financing of EU-financed infrastructural projects – was suppressed. The fiscal relaxation that had started in 2014 allowed meaningful government investment and consumption spending in 2015.

While the government-driven investment ‘boom’[44] cannot be expected to extend into 2016, there is some uncertainty as concerns the private sector’s investment growth. There are reasons to believe that the private corporate sector’s investment will return to its ‘normal’ anaemic speed experienced since 2010 – and that although the circumstances seem conducive to fast growth. Interest rates on loans to the sector are quite low, the sector’s profitability and liquidity are quite high and its debt is relatively low. Sales prospects are improving (demand deficiency is becoming less of a problem), the capacity utilisation ratio is relatively high (as compared e.g. to Poland) while the labour availability barrier is not yet a serious issue. The reason why – despite all that – the dynamics of investment continues to be moderate may have something to do with the ownership structure of the Czech economy. To a much higher degree than e.g. Poland’s, it is an economy dominated by large foreign firms.[45] It is natural that these firms are not constrained by the national borders while choosing the optimal (in terms of taxation, labour and other costs) locations for their new investments. Actually, since 2013 the Czech Republic has been a net lender to the rest of the world. In 2015 net lending may have reached as much as 3.8% of GDP. A part (possibly a major one) of that lending may well have represented new fixed assets of the corporate sector acquired abroad rather than on Czech territory.

[44] Also the purchase of military aircrafts realised in 2015 is not going to be repeated anytime soon. Investment in these aircrafts may have added up to 1 percentage point to GDP growth in 2015.

[45] Curiously, information on the ownership structure of the Czech non-financial corporate sector is difficult to come by. (The Czech sources do not conceal data on the foreign ownership of the banking sector, whose share in the entire sector is over 80% – more than in Poland, but less than in Hungary.) The scale of FDI involvement in the Czech economy can be gauged by the size of the country’s primary balance (or the difference between GDP and GNI – i.e. the part of GDP amassed by non-residents). That difference has been approaching 8% of GDP.

The general government deficit (slightly over 1% of GDP) was associated with a public debt/GDP ratio falling in 2015 to about 41%. The ongoing reduction in the debt/GDP ratio, achieved quite 'painlessly', would indicate that supportive fiscal policy could continue to be fairly relaxed also in the future. However, the most recent (April 2015) governmental Convergence Programme envisages renewed fiscal consolidation in 2016-2018, with progressively falling public sector expenditures and fiscal deficits. According to the Programme, the fiscal deficit is to fall to 0.6% of GDP in 2018 (with a primary surplus of about 0.5% of GDP) and the public debt/GDP ratio to fall to 40.2%. It is perhaps not surprising that – consistent with its vision of fiscal policy – the Programme does not promise too much as far as growth prospects are concerned. Actually, for the coming years it envisages steady growth *slowdown* to little over 2% in 2018. Of course, if the ambitious consolidation plans are put into action, the eventual GDP growth may well fall short of the magnitude expected. The government's intentions could pose a threat to the mid-term economic prospects. So far there are no indications that the government means to deviate from the Programme. According to the most recent Macroeconomic Forecast presented by the Czech Finance Ministry, government consumption is to rise by 2.1% in 2016, 1.5% in 2017 and only 1.3% later on. For comparison, in 2014 government consumption rose by 1.8% and in 2015 by 3.2%. A recent analysis available from the Czech National Bank suggests that the primary fiscal balance of the general government will reach a surplus of 0.6% of GDP in 2016, to be followed by a surplus of 1% in 2017. That compares with a deficit of 0.6% of GDP in 2014 and (an estimated) deficit of 0.1% in 2015.

The output recovery (most pronounced in the manufacturing and construction sectors) has supported labour market improvements. A part of the improvement observed may have been due to demography as the ageing of the Czech population is very pronounced. Despite the marked labour market improvements, consumer price inflation is very low (while producer prices continue to fall rather strongly). These developments are partly attributed to low energy prices and the strengthening domestic currency. The revealed insensitivity of inflation to the apparent tightening of the labour market conditions seems to suggest that consumer demand continues to be depressed – possibly on account of a rather low GDP share of wages (the GDP share of compensation is about 40%) and the Czech households' saving habits[46].

The extremely relaxed monetary policy, which prevented the consolidation-driven recession from assuming devastating dimensions in 2012-2013, is very likely to remain unchanged for the time being. The very low policy interest rate (two-week repo rate) of 0.05% in force since early November 2012 has had no perceptible impact on inflation. The devaluation of the Czech currency enforced by the National Bank in November 2013 has also proved unable to activate inflationary tendencies. Right now the National Bank seems to believe that inflation will be gradually recovering in 2016. By that time the Bank may also give up its resolution to keep the CZK/EUR exchange rate above 27. Whether the floating CZK will resume its earlier appreciation tendency is hard to predict now. During the closing months of 2015 the National Bank had to intervene massively to prevent the CZK/EUR rate from strengthening above the declared rate of 27.[47]

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46 The Czech household sector has been saving about 11% of its disposable income.

47 The government and the National Bank have recently jointly reiterated their intention to stay clear of the euro area. Formally the country does not satisfy the exchange-rate (Maastricht) criterion. However, the aversion to the idea of euro adoption seems to have deeper motives. The authorities may rightly realise that the common currency may be hardly compatible with the country's real convergence. Besides, participation in the euro area does not seem to have offered any obvious advantages (at least not since 2008).

Interest rates on loans to private households have remained moderate (though falling somewhat recently). The shares of non-performing loans extended to households (and firms) are quite low and falling. However, borrowing by both households and business has continued to expand rather reluctantly so far. The private sector's bank deposits still exceed the volume of loans extended. This structural regularity is unlikely to change anytime soon. Consumption and private investment will continue growing at moderate speeds.

The unexpected acceleration of public (mostly infrastructural) investment in 2015 is unlikely to have significant demand-, or supply-side consequences, at least in the medium run. The economy is expected to grow rather moderately in 2016-2018. In addition, inventories – whose expansion in 2014 and 2015 added to the reported GDP growth – are likely to stagnate (or even get downsized) thereby reducing growth in 2016.

No major imbalances could be identified even if growth of aggregate demand were to be stronger than could be realistically expected. As in the past, the monetary policy is likely to support stable growth while the fiscal policy's declared intentions suggest the possibility of a return of unnecessary fiscal austerity. Not unlike Germany, with which the Czech Republic shares some structural and economic policy similarities, the country's growth may remain steady, if fairly unimpressive.

Table 10 / Czech Republic: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017	2018
							Forecast	
Population, th pers., average	10,496	10,511	10,514	10,525	10,525	10,525	10,525	10,525
Gross domestic product, CZK bn, nom.	4,023	4,042	4,077	4,261	4,460	4,640	4,830	5,040
annual change in % (real)	2.0	-0.9	-0.5	2.0	4.3	2.4	2.3	2.4
GDP/capita (EUR at exchange rate)	15,600	15,300	14,900	14,700	15,500	16,500	17,300	18,100
GDP/capita (EUR at PPP)	21,600	21,700	22,200	23,200	24,900	.	.	.
Consumption of households, CZK bn, nom.	1,957	1,971	2,001	2,042	2,110	.	.	.
annual change in % (real)	0.3	-1.5	0.7	1.4	2.9	2.5	2.5	2.5
Gross fixed capital form., CZK bn, nom.	1,069	1,052	1,025	1,065	1,140	.	.	.
annual change in % (real)	1.1	-3.3	-2.7	2.0	6.8	2.5	3.5	4.0
Gross industrial production								
annual change in % (real)	5.9	-0.8	-0.1	5.0	4.4	4.5	4.5	4.0
Gross agricultural production								
annual change in % (real)	8.6	-5.8	6.0	9.9	-6.1	.	.	.
Construction industry								
annual change in % (real)	-3.6	-7.6	-6.7	4.3	5.5	.	.	.
Employed persons, LFS, th, average 2)	4,904	4,890	4,937	4,974	5,020	5,030	5,040	5,050
annual change in %	0.4	0.4	1.0	0.8	0.9	0.2	0.2	0.1
Unemployed persons, LFS, th, average 2)	354	367	369	324	268	260	260	260
Unemployment rate, LFS, in %, average 2)	6.7	7.0	7.0	6.1	5.1	5.0	4.9	4.9
Reg. unemployment rate, in %, end of period 3)	8.6	9.4	8.2	7.5	6.2	.	.	.
Average monthly gross wages, CZK	24,455	25,067	25,035	25,607	26,500	27,600	28,800	30,100
annual change in % (real, gross)	0.6	-0.8	-1.5	1.9	3.0	2.5	2.5	2.5
Consumer prices (HICP), % p.a.	2.2	3.5	1.3	0.4	0.3	1.5	1.7	1.9
Producer prices in industry, % p.a.	3.7	2.4	0.7	1.0	1.0	1.3	1.5	1.6
General governm. budget, EU-def., % of GDP								
Revenues	40.2	40.5	41.3	40.6	41.1	41.0	40.0	40.0
Expenditures	42.9	44.5	42.6	42.6	42.4	42.3	41.0	41.5
Net lending (+) / net borrowing (-)	-2.7	-4.0	-1.3	-1.9	-1.3	-1.3	-1.0	-1.5
Public debt, EU-def., % of GDP	39.9	44.7	45.2	42.7	41.0	40.5	40.5	40.5
Central bank policy rate, % p.a., end of period 4)	0.75	0.05	0.05	0.05	0.05	0.25	1.0	1.0
Current account, EUR mn	-3,466	-2,518	-829	958	2,745	870	0	-950
Current account, % of GDP	-2.1	-1.6	-0.5	0.6	1.7	0.5	0.0	-0.5
Exports of goods, BOP, EUR mn	99,123	104,336	103,184	110,524	118,362	124,000	130,000	135,000
annual change in %	14.1	5.3	-1.1	7.1	7.1	5.0	4.5	4.0
Imports of goods, BOP, EUR mn	96,048	99,413	96,735	101,841	110,367	117,000	123,000	129,000
annual change in %	12.6	3.5	-2.7	5.3	8.4	6.0	5.5	5.0
Exports of services, BOP, EUR mn	17,923	18,863	18,059	18,956	20,294	21,000	22,000	23,000
annual change in %	8.1	5.2	-4.3	5.0	7.1	4.5	3.5	4.0
Imports of services, BOP, EUR mn	14,614	15,776	15,346	16,925	17,379	18,000	19,000	20,000
annual change in %	8.4	8.0	-2.7	10.3	2.7	4.0	3.5	4.0
FDI liabilities (inflow), EUR mn	3,025	7,348	5,544	3,679	1,970	.	.	.
FDI assets (outflow), EUR mn	1,161	2,531	5,831	-1,181	2,875	.	.	.
Gross reserves of NB excl. gold, EUR mn	30,675	33,550	40,459	44,547	59,190	.	.	.
Gross external debt, EUR mn	89,627	96,826	99,652	103,035	106,600	112,700	116,600	118,000
Gross external debt, % of GDP	54.8	60.3	63.5	66.6	65.2	65.0	64.0	62.1
Average exchange rate CZK/EUR	24.59	25.15	25.98	27.54	27.28	26.75	26.50	26.50
Purchasing power parity CZK/EUR	17.76	17.70	17.49	17.44	17.03	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2012 according to census March 2011. - 3) From 2013 available job applicants 15-64 in % of working age population 15-64, all available job applicants in % of labour force before. - 4) Two-week repo rate.

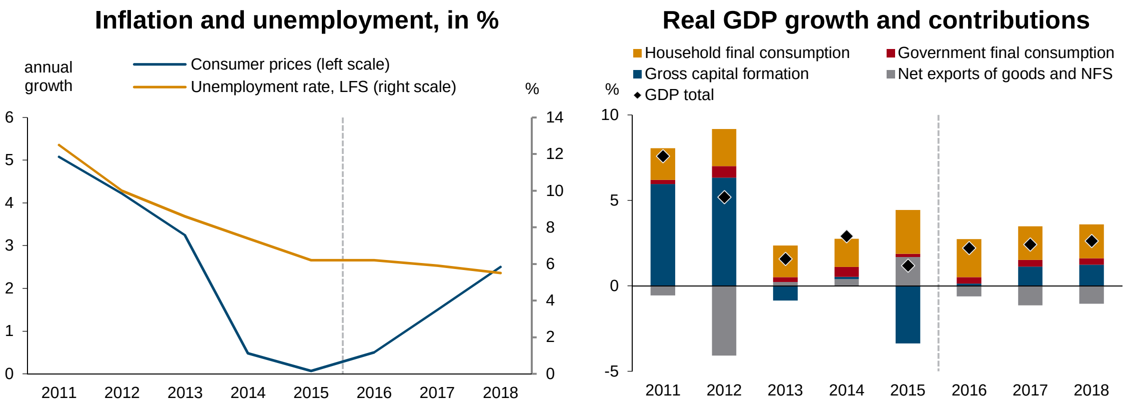
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ESTONIA: Exports and investment to recover slightly

SEBASTIAN LEITNER

Household consumption remains the strongest driver of economic activity in Estonia, the major push factor being the rapid growth in both minimum and overall real wages. For the coming two years, we expect trade destined for Western countries to recover, while the decline in exports to Russia should come to a halt. Moreover, an upswing in public investments should also lead to GDP growth picking up speed slightly: to 2.2% and 2.4% in 2016 and 2017, respectively.

Figure 42 / Estonia: main macroeconomic indicators



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

Although the Russian economy is expected to stabilise towards the end of 2016, Estonia's goods and services exports to the Eastern neighbour, slumping by more than a third in 2015, will grow only in 2017. Thus, the transport and tourism sectors will also continue to suffer from the Russian recession this year. In addition, the ongoing stagnation in Finland drags down exports and the slump in the price of crude oil results in the Estonian shale oil production being inefficient. However, exports to the rest of the European Union are on the upswing. Although foreign demand from Sweden developed below potential in 2015, the expected 3% GDP growth rate of the Scandinavian neighbour in 2016 gives rise to hope. Overall, we expect exports to rise again slightly this year, as well as imports, however at a lower rate given the reduced average price of oil in 2016 and the still low investment activity.

On account of the overall rather sluggish growth of external demand and industrial production, investment activity of the enterprise sector will recover only marginally in 2016 after declining in the past two years – there is still idle capacity in the manufacturing sector. Also, construction output will only stabilise this year. The number of building permits and mortgage loans indicates that dwelling construction will rise only slightly in 2016. However, public investments will gain momentum towards the end of 2016 and in 2017, when EU funds will allow their financing.

The number of employed rose by 2.6% in 2015, year on year. This strong increase was driven by the introduction of the new employment register that forces enterprises to register their workers before employment starts. Thus the employment rate of the population aged 15-64 years reached the pre-crisis level of 70% and the unemployment rate fell to 6.2% in 2015. Nevertheless, towards the end of the year the declining economic activity in manufacturing, transport and construction resulted in rising registered unemployment. Given the only slight upswing in economic growth, we expect job growth to come to a halt this year and to be slightly positive only from 2017 onwards. However, labour supply will gradually decline due to the decrease in the working-age population.

The rise in employment and the strong increase in real net wages pushed household consumption. Forward-looking sentiment indicators of households remained stable towards the beginning of 2016 and most recent retail and credit figures show an increasing spending propensity. Thus we expect growth of household consumption to remain lively also in 2016 and thereafter. Minimum wages have been increased by 10% at the beginning of this year and will be hiked by the same amount in 2017. Furthermore, the labour tax burden will be reduced slightly. However, in the coming years, stagnant employment will most probably reduce the strong dynamism of household spending.

The decline in import prices particularly of oil and gas as well as home-produced food (caused inter alia by the Russian embargo) led to consumer price stagnation throughout 2015. The strong growth in wages has raised core inflation to more than 1% only in the last quarter of the past year. The further fall in the oil price level will still keep inflation subdued in 2016. Only thereafter consumer prices will rise again more swiftly, driven inter alia by hikes in excise taxes.

The Estonian government attained a budget surplus of 0.3% of GDP in 2015, driven mainly by strongly increasing VAT income, but also by the hike in employment figures, which resulted in social security contributions rising by more than 7% year on year. Although public investment is planned to increase and the tax burden to be reduced, we expect a budget deficit of not more 0.3% of GDP in 2016. Also thereafter fiscal policies will follow the close-to-balance approach. The 2016 budget plan foresees an increase in the personal income tax-exempt threshold, a rise in pensions by 5.5% on average and higher child benefits – measures which will keep household consumption developing at a good pace.

Our forecast for GDP growth in 2016 has been slightly revised downwards to 2.2% in real terms, particularly due to lower expectations for external demand from Finland and Russia. For 2017 and 2018, we forecast a meagre upswing to 2.4% and 2.6%, respectively. We expect a recovery of external demand mostly from Western trading partners, while the decline in exports to Russia should come to a halt. An upswing in investments will be facilitated by public investments co-financed by EU funds.

Table 11 / Estonia: selected economic indicators

	2011	2012	2013	2014	2015 [1]	2016	2017	2018
							Forecast	
Population, th pers., average	1,327	1,323	1,318	1,315	1,312	1,310	1,305	1,300
Gross domestic product, EUR mn, nom.	16,668	18,006	19,015	19,963	20,200	20,700	21,500	22,600
annual change in % (real)	7.6	5.2	1.6	2.9	1.2	2.2	2.4	2.6
GDP/capita (EUR at exchange rate)	12,500	13,600	14,400	15,200	15,400	15,800	16,500	17,400
GDP/capita (EUR at PPP)	18,000	19,600	20,000	20,900	21,800	.	.	.
Consumption of households, EUR mn, nom.	8,195	8,850	9,463	9,861	10,400	.	.	.
annual change in % (real)	3.6	4.4	3.8	3.3	5.2	4.5	4.0	4.0
Gross fixed capital form., EUR mn, nom.	4,367	4,761	5,153	5,033	4,700	.	.	.
annual change in % (real)	34.4	6.7	3.2	-3.1	-7.0	3.0	4.5	5.0
Gross industrial production								
annual change in % (real)	19.9	1.1	4.1	1.9	-2.2	3.0	4.0	3.0
Gross agricultural production								
annual change in % (real)	9.7	5.6	4.7	4.6	4.0	.	.	.
Construction industry								
annual change in % (real)	27.3	16.6	-0.1	-2.6	-5.0	.	.	.
Employed persons, LFS, th, average [2]	609.1	614.9	621.3	624.8	641.0	641	645	648
annual change in %	6.7	1.9	1.0	0.6	2.6	0.0	0.6	0.5
Unemployed persons, LFS, th, average [2]	86.8	68.5	58.7	49.6	41.0	42	40	38
Unemployment rate, LFS, in %, average [2]	12.5	10.0	8.6	7.4	6.2	6.2	5.9	5.5
Reg. unemployment rate, in %, end of period [3]	7.4	6.2	5.3	4.4	4.7	.	.	.
Average monthly gross wages, EUR	839	887	949	1,005	1,060	1,120	1,190	1,280
annual change in % (real, gross)	0.9	1.7	4.1	6.0	6.0	5.0	4.5	5.0
Average monthly net wages, EUR	672	706	757	799	855	910	970	1,040
annual change in % (real, net)	0.5	1.1	4.3	5.7	7.5	6.0	4.5	5.0
Consumer prices (HICP), % p.a.	5.1	4.2	3.2	0.5	0.1	0.5	1.5	2.5
Producer prices in industry, % p.a.	4.2	2.6	7.3	-2.7	-3.0	-2.0	1.0	2.0
General governm. budget, EU-def., % of GDP								
Revenues	38.6	38.8	38.1	38.7	39.0	38.7	38.5	38.6
Expenditures	37.4	39.1	38.3	38.0	38.5	39.0	38.7	38.6
Net lending (+) / net borrowing (-)	1.2	-0.3	-0.1	0.7	0.5	-0.3	-0.2	0.0
Public debt, EU-def., % of GDP	5.9	9.5	9.9	10.4	10.1	10.0	9.0	8.0
Central bank policy rate, % p.a., end of period [4]	1.00	0.75	0.25	0.05	0.05	.	.	.
Current account, EUR mn	223	-438	-20	205	515	-50	-400	-800
Current account, % of GDP	1.3	-2.4	-0.1	1.0	2.5	-0.2	-1.9	-3.5
Exports of goods, BOP, EUR mn	10,384	11,104	11,624	11,430	11,035	11,500	12,000	12,350
annual change in %	38.8	6.9	4.7	-1.7	-3.5	4.2	4.3	2.9
Imports of goods, BOP, EUR mn	10,735	12,283	12,522	12,429	11,875	12,230	12,800	13,400
annual change in %	36.1	14.4	1.9	-0.7	-4.5	3.0	4.7	4.7
Exports of services, BOP, EUR mn	4,040	4,486	4,876	5,320	5,304	5,480	5,770	6,000
annual change in %	13.3	11.0	8.7	9.1	-0.3	3.3	5.3	4.0
Imports of services, BOP, EUR mn	2,734	3,131	3,556	3,639	3,633	3,690	3,840	4,000
annual change in %	22.9	14.5	13.6	2.3	-0.2	1.6	4.1	4.2
FDI liabilities (inflow), EUR mn	818	1,394	664	1,172	166	.	.	.
FDI assets (outflow), EUR mn	-951	996	578	617	68	.	.	.
Gross reserves of NB excl. gold, EUR mn	150	218	222	352	373	.	.	.
Gross external debt, EUR mn	16,721	17,957	17,455	18,902	18,800	19,500	19,800	20,800
Gross external debt, % of GDP	100.3	99.7	91.8	94.7	93.1	94.0	92.0	92.0
Purchasing power parity EUR/EUR	0.6948	0.6944	0.7195	0.7252	0.7047	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2012 according to census March 2011. - 3) In % of labour force (LFS) and according to census March 2011. - 4) Official refinancing operation rate for euro area (ECB).

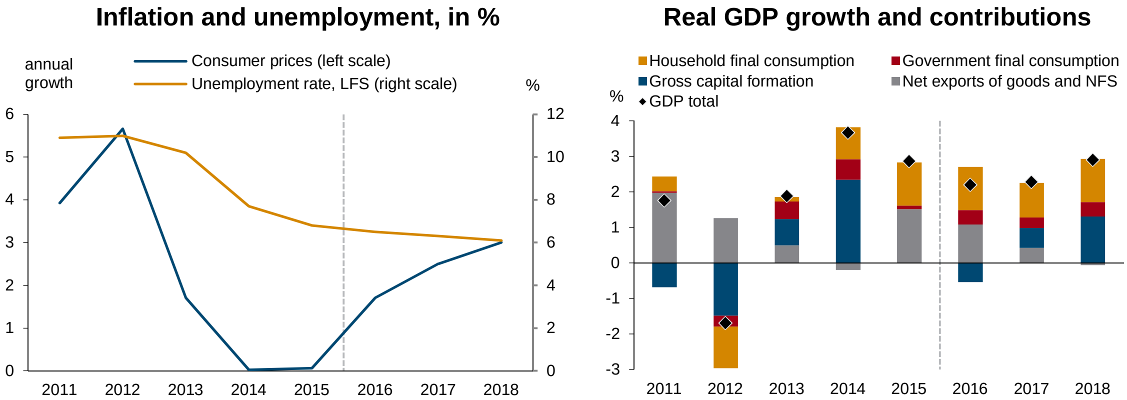
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

HUNGARY: Cold turkey after EU bonanza?

SÁNDOR RICHTER

In 2015 Hungarian GDP increased by 2.9%, aided by a peak inflow of cohesion policy transfers from the EU. In 2016, EU transfers will decline sharply. Despite government measures to offset the anticipated negative impact, the outcome will be deceleration of economic growth in the current year, followed by slow recovery in 2017 and 2018.

Figure 43 / Hungary: main macroeconomic indicators



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

The Hungarian GDP increased by 2.9% in 2015. This is a much better result than the last five years' average performance, but it lags behind the 3.7% GDP expansion in 2014 and it is also less impressive than the growth rates in the Visegrad group peer countries. Also the nature of economic growth in 2015 was different from that in the previous year. In 2014 gross capital formation had been the most important driver of expansion, followed by private consumption, and the contribution of net exports turned slightly negative. In 2015 private consumption remained as relevant as in the previous year, but the role of net exports shifted strongly to the positive field, while gross fixed capital formation did not contribute to economic growth at all. Provisional data indicate that economic growth was broadly based last year, encompassing all major branches except for agriculture.

Developments in the Hungarian economy in 2013-2015 were heavily influenced by the inflow of EU transfers: The typical cyclicality of cohesion policy related disbursement of EU transfers has been especially strong in the case of Hungary. After very modest beginnings due to the reorganisation of the institutional background of EU payments, there came a highly successful finish in 2013-2015. Net transfers from the EU amounted to 5.4% and 5.3% of GDP in 2013 and 2014, respectively, and may have reached 6% in 2015. The exceptionally high GDP growth in 2014 was fostered by the coincidence of EU co-financed investments with an investment boom in the predominantly foreign-owned automobile cluster. In 2015 this latter component was missing, and the attitude towards investing of the predominantly domestically owned firms in the SME sector remained as reluctant as in the past five years. EU co-financed capital transfers for the public sector have financed at least half of public investment in Hungary since 2011; the respective share in the private sector has remained below 10%. According to central bank estimations, EU transfers disbursed to the government in 2015 amounted to about 3% of the GDP (central government 1.7%, municipalities 1.3%). Further transfers, amounting also to close to 3% of GDP, were absorbed by the non-financial business sector (2.2%) and the non-profit sector plus households (0.7%). These figures also reveal how EU transfers helped keep the general government deficit at about 2% relative to GDP last year. *Ceteris paribus*, the budget deficit would have been around 5% of GDP without the EU transfers, while keeping the deficit at the 2% level would have required cancelling about half of the public investment projects.

The expected decline in EU transfers by 1.5% to 2.5% of GDP will have a decisive influence on growth in 2016. The key question therefore is to what extent the government will be able to offset this loss by economic policy measures.

The government announced an unusual plan to mitigate the problem: all potentially available EU resources under the 2014-2020 MFF will have to be allocated by early 2019. That means that the potential disbursement period 2016-2022 will be compressed to three years (2016-2018). As the EU transfers cannot be drawn so quickly, beneficiaries would receive payments from the national budget and the respective sum would be collected later from the EU budget. Whether the realisation of this plan would allow keeping the general government deficit below 3% in the critical years remains an open question, just as whether the administrative capacities are prepared for the efficient management of such an accelerated pace of disbursements. Not less important are the doubts concerning the capacity of the economy to absorb and efficiently utilise such an immense inflow within a very short period. The biggest problem, however, will emerge in the medium term: the ‘cold turkey’ effect that will set in unavoidably in the years 2020-2022 when practically nothing would be left of the EU resources. However, this problem lies beyond the horizon of the current legislative period.

The government also has other weapons to deploy against the negative impact of the low tide of EU transfers. The first is a new family housing allowance. Those undertaking to have three children may receive a HUF 10 million (about EUR 32,000) grant for buying a new home or buying or refurbishing used apartments. Beyond that grant, families with three or more children will have access to a state-subsidised housing loan of up to HUF 10 million with an interest rate of 3% at most. Applicants are expected to have a job or another insured status and may have no criminal record. Important details of the scheme are not cleared yet, but it may give a boost to real estate transactions and the construction industry. A big unknown of the generous scheme is its impact on the budget.

By another measure aimed at boosting growth, the levy on banks has been lowered from 0.53% to 0.31% in 2016, resulting in an approximately 40% decrease of the respective burden on the banks. The government also promised to refrain from policy measures with a negative impact on banking sector profitability, including any new debt relief schemes. In addition, the central bank initiated its new Market-Based Lending Programme, which will prize actively lending banks with higher deposit interest rates, preferential capitalisation requirements and high interest rate swaps (HIRS). The central bank expects an 8% to 10% upturn in loans for the SME sector; this would be a better performance than the one achieved through its earlier Credit for Growth Scheme.

The situation in the labour market is fairly complex. Employment has been on the rise and the unemployment rate is sinking. While this is to a considerable extent explained by the increasing number of participants in public workfare and by counting a part of the persons working abroad as a constituent of the domestically employed, there has in fact been a significant expansion of employment in the business sector as well. A relatively new but rapidly growing concern is the chronic shortage of labour. In 2015, more than 20% of enterprises/institutions in the manufacturing and health care sectors reported that they could not fill vacancies due to the insufficient number and/or qualification of available labour force. Over 10% is the respective rate in the transport, construction, tourism and catering sectors.[48] This is especially critical for regions relatively close to the Austrian border, where commuting is easy and attainable wages in Austria are much higher. Due to low intra-country mobility, job vacancies in the West of Hungary are not filled by migrants from the Eastern part of the country. The low wages in Hungary, which may attract foreign investment, induce well-skilled persons to seek better-paid jobs abroad. The Hungarian educational system (both the secondary and the tertiary levels) produces young adults with a knowledge that is in many cases inconsistent with the needs of the business sector. There is no sign of the hoped-for deceleration of outward migration, and this, coupled with the unfavourable demographic trends and the government's strong opposition to inward migration, projects growing tensions on the Hungarian labour market in the years ahead.

Despite all the government programmes, economic growth in 2016 will be 0.7 percentage points lower than the year before, at around 2.2%. In 2017 and 2018 investment will gain momentum as again more EU transfers will arrive. This will help attain a somewhat higher GDP growth rate in both years. Nevertheless, we deem the extreme acceleration of cohesion policy related disbursements envisioned by the government as unrealistic. As to foreign trade, 2015 was an exceptionally good year in this respect, with a record trade surplus thanks to the favourable external environment, good performance of the foreign capital dominated automotive cluster and improving terms of trade due to depressed prices of imported energy. In 2016 net exports will remain an important pillar of growth, even if to a smaller extent than last year. Household consumption may grow at the same pace as in 2015 on account of modestly expanding employment, lower credit burden on households after the settlement of foreign exchange loans and the continuous increase in transfers from Hungarians working abroad.

A downward risk to medium-term growth is the government's recently announced intention to approach a zero budget deficit in 2017. The 2015 convergence programme still projected a GDP-proportional deficit of 1.7% for 2017 and 1.6% for 2018. Not even the IMF urges the government to achieve a zero deficit as early as 2017. Any steps taken to realise this plan would have a negative impact on aggregate demand, employment and economic growth.

[48] Index, 2 November 2015.

Table 12 / Hungary: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017 Forecast	2018
Population, th pers., average	9,972	9,920	9,893	9,863	9,830	9,810	9,800	9,780
Gross domestic product, HUF bn, nom.	28,134	28,628	30,065	32,180	33,600	35,200	37,000	39,200
annual change in % (real)	1.8	-1.7	1.9	3.7	2.9	2.2	2.3	2.9
GDP/capita (EUR at exchange rate)	10,100	10,000	10,200	10,600	11,000	11,400	12,000	12,700
GDP/capita (EUR at PPP)	17,100	17,200	17,700	18,600	19,800	.	.	.
Consumption of households, HUF bn, nom.	14,341	14,889	15,226	15,651	16,300	.	.	.
annual change in % (real)	0.8	-2.3	0.2	1.8	2.5	2.5	2.0	2.5
Gross fixed capital form., HUF bn, nom.	5,569	5,548	6,160	6,971	7,120	.	.	.
annual change in % (real)	-1.3	-4.4	7.3	11.2	0.5	-3.5	3.0	6.0
Gross industrial production								
annual change in % (real)	5.6	-1.8	1.1	7.7	7.5	4.5	6.0	7.0
Gross agricultural production								
annual change in % (real)	11.1	-10.0	12.4	11.1	-3.1	.	.	.
Construction industry								
annual change in % (real)	-8.0	-6.6	8.4	13.6	3.0	.	.	.
Employed persons, LFS, th, average 2)	3,812	3,827	3,893	4,101	4,211	4,250	4,270	4,290
annual change in %	0.8	1.8	1.7	5.3	2.7	1.0	0.5	0.5
Unemployed persons, LFS, th, average 2)	468	473	441	343	308	300	290	280
Unemployment rate, LFS, in %, average 2)	10.9	11.0	10.2	7.7	6.8	6.5	6.3	6.1
Reg. unemployment rate, in %, end of period	12.4	12.7	9.2	8.7	7.5	.	.	.
Average monthly gross wages, HUF 3)	213,094	223,060	230,714	237,695	247,784	257,500	270,500	286,700
annual change in % (real, gross)	1.3	-0.9	1.7	3.2	4.3	2.2	2.5	2.9
Average monthly net wages, HUF 3)	141,151	144,085	151,118	155,690	162,300	168,900	177,500	188,100
annual change in % (real, net)	2.4	-3.4	3.1	3.2	4.3	2.3	2.5	2.9
Consumer prices (HICP), % p.a.	3.9	5.7	1.7	0.0	0.1	1.7	2.5	3.0
Producer prices in industry, % p.a.	4.1	4.1	0.6	-0.4	-0.9	0.5	1.5	2.0
General governm.budget, EU-def., % of GDP								
Revenues	44.3	46.3	47.0	47.4	48.2	47.5	47.5	47.5
Expenditures	49.7	48.6	49.5	49.9	50.2	50.0	50.4	50.4
Net lending (+) / net borrowing (-)	-5.5	-2.3	-2.5	-2.5	-2.0	-2.5	-2.9	-2.9
Public debt, EU-def., % of GDP	80.8	78.3	76.8	76.2	75.5	75.3	74.0	73.0
Central bank policy rate, % p.a., end of period 4)	7.00	5.75	3.00	2.10	1.35	1.35	1.70	2.00
Current account, EUR mn 5)	754	1,752	4,036	2,356	5,474	4,900	4,800	5,000
Current account, % of GDP	0.7	1.8	4.0	2.3	5.0	4.4	4.1	4.0
Exports of goods, BOP, EUR mn	71,793	69,961	72,000	74,768	80,868	86,500	92,600	99,100
annual change in %	8.6	-2.6	2.9	3.8	8.2	7.0	7.0	7.0
Imports of goods, BOP, EUR mn	68,868	67,028	68,603	72,167	76,544	81,400	87,200	93,900
annual change in %	8.4	-2.7	2.4	5.2	6.1	6.3	7.1	7.7
Exports of services, BOP, EUR mn	16,039	16,060	17,039	18,623	19,481	20,500	21,300	22,300
annual change in %	9.5	0.1	6.1	9.3	4.6	5.0	4.0	4.5
Imports of services, BOP, EUR mn	12,752	12,263	13,047	13,514	13,926	14,500	14,900	15,400
annual change in %	6.2	-3.8	6.4	3.6	3.0	4.0	3.0	3.5
FDI liabilities (inflow), EUR mn	4,429	4,405	4,834	6,309	966	1,000	.	.
FDI assets (outflow), EUR mn	3,458	2,310	3,807	3,587	1,665	1,000	.	.
Gross reserves of NB, excl. gold, EUR mn	37,655	33,757	33,696	34,481	30,226	.	.	.
Gross external debt, EUR mn 5)	135,351	127,667	119,727	119,382	117,600	112,900	109,200	105,800
Gross external debt, % of GDP	134.4	129.0	118.2	114.5	108.5	101.0	93.0	85.0
Average exchange rate HUF/EUR	279.37	289.25	296.87	308.71	310.00	315	315	315
Purchasing power parity HUF/EUR	165.46	168.07	171.31	174.90	172.63	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2012 according to census 2011. - 3) Enterprises with 5 and more employees. - 4) Base rate (two-week NB bill). - 5) Excluding SPE - valid for all BOP items and gross external debt.

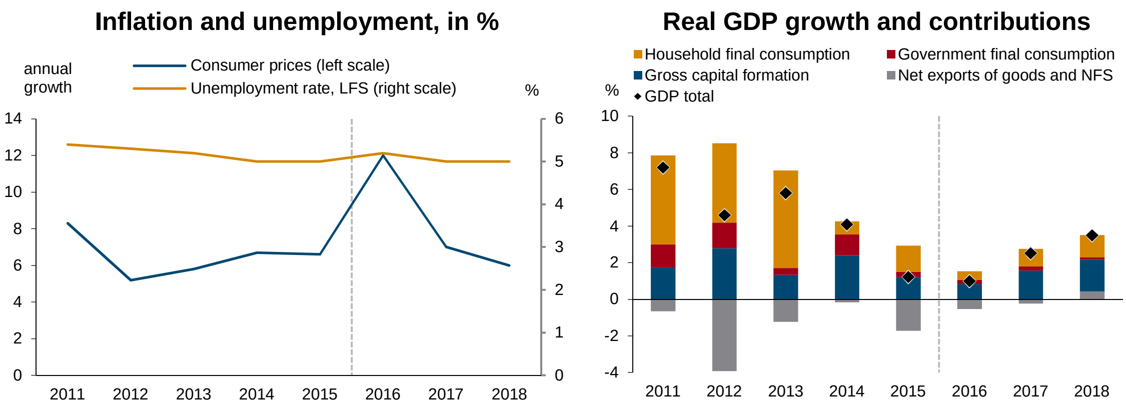
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

KAZAKHSTAN: Switching to the crisis mode

OLGA PINDYUK[49]

In 2016, GDP growth in Kazakhstan will slow down still further to 1% as the global oil prices are expected to be lower than they were on average in 2015. Growth is expected to pick up speed in the period 2017-2018, primarily on the back of a rise in investment. Poor performance in the oil sector has put a strain on public finance and the government has had to adopt various fiscal consolidation measures. Tight monetary policy and dollarisation of deposits has squeezed liquidity in the banking sector, thus giving rise to a credit crunch.

Figure 44 / Kazakhstan: main macroeconomic indicators



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

According to preliminary data, GDP grew by 1.2% in 2015 – this was the lowest growth rate since 2009. The primary reason for the sluggish economic performance has been unfavourable external conditions: a dramatic fall in the global prices of oil and other commodities, recession in Russia, and China's slowdown. As a result, the country's merchandise exports in 2015 fell by 42% year on year in USD terms. Merchandise imports decreased at a pace significantly slower than exports in 2015 – by 23% year on year in USD terms. The National Bank had to spend increasingly more of its foreign exchange reserves to support the KZT/USD exchange rate. In these circumstances, the fixed exchange rate regime was no longer deemed sustainable by the government, and starting from August 2015 the

[49] With contributions by Alexandra Bykova.

tenge was allowed to float freely. As a consequence, the national currency experienced a dramatic depreciation and lost about half of its value with respect to the US dollar by the end of January 2016.

In 2016, surging prices of imported goods and a scaling-back of the investment plans, in particular in the extractive industries, will cause a further double-digit drop in imports. Exports are expected to decline again in 2016, as oil prices are assumed to be lower than on average in 2015. A revival of both exports and imports is forecasted to start in 2017. Exports will pick up on the back of an increase in the volume of oil production, especially owing to the envisaged start of operation of the Kashagan oil field. Imports will grow primarily in the segment of investment goods, provided the investment plans of the government are realised, while growth of consumer demand will be weak. The current account balance will remain negative during the forecasting period, but will gradually improve.

The poor performance of the oil sector put a strain on public finance as budget revenues shrank significantly in 2015, and the government had to increase transfers from the National Oil Fund to make ends meet. Oil-related revenues normally account for about half of the total budget revenues; last year they dropped by about 50% year on year. The budget expenditures plan for 2015 had to be revised downwards, with the biggest cuts in the part of capital expenditures. As a result of the higher transfers, the assets of the National Oil Fund decreased by 13% in 2015. This was a serious warning sign for the government and it triggered a wide range of reforms in order to sustain fiscal consolidation and avoid further loss of assets in the future.

On the expenditure side, President Nazarbayev demanded that withdrawals from the oil fund are to be capped by a fixed amount, forbidding any additional withdrawals (this includes both on- and off-budget expenditures; the latter reached about 2.5% of GDP in 2015 as the government had to help the state oil-and-gas company Kazmunaygaz repay its external debt). Overall the government announced a switch to a ‘thrifty use of budget resources’, which implies identifying and eliminating inefficient expenditures and expenditures that can be financed by the private sector. On-budget investment spending will be gradually scaled down, but the counter-cyclical fiscal stimulus package ‘Nurly Zhol’ (Path to the Future) will continue running. The government plans to rely increasingly more on public-private partnerships in financing investment. Joint investment projects in the energy sector, the manufacturing industry and in infrastructure development have been negotiated with multinational companies; it is expected that agreements will be signed soon.

The envisaged measures to boost budget revenues include a simplification of the tax regime and improving tax collection discipline. The customs and tax codes will be merged, the amount of taxes will be reduced and the VAT is going to be replaced by a sales tax, as the latter is expected to be less cumbersome for businesses. The property legalisation campaign, supposed to bring additional revenues to the budget, has been prolonged until the end of 2016.

Besides, ambitious plans to privatise some of the largest state enterprises to investors were announced; the share of state ownership in the economy is envisaged to decrease substantially (currently it is estimated to be at about 40%). However, the timing of privatisation is unfavourable as investors are in general perceiving emerging markets as highly risky, and Kazakhstan’s S&P debt rating was lowered in February 2016 to BBB- on a negative outlook due to concerns about inflation, exchange rate pressures and banking sector stability. These factors can put a downward pressure on the potential prices of the state companies; therefore, if the government wants to sell the assets at reasonably high prices, it might need more time than currently expected.

In order to help financing the budget deficit, a new regulation of the country's Pension Fund was adopted, according to which the fund's assets have to be used partially to finance the budget deficit (around KZT 400 billion or 1% of GDP), and partially for long-term investment projects (around KZT 600 billion). The three-year central government budget plan for 2016-2018 was adopted in November 2015 with a budget deficit of 1.6% of GDP on the assumptions of a GDP growth of 2% in 2016, an oil price of 40 USD/barrel, an inflation in the range of 6-8%, and an exchange rate of 300 KZT/USD. As these assumptions are no longer considered realistic, the budget needs to be amended by the end of February 2016.

The National Bank has had to manoeuvre between Scylla and Charybdis – surging inflation and anaemic credit growth. Inflation continues to climb after the sharp depreciation of the national currency. In January 2016, CPI reached 14.4% year on year; imposing administrative controls on the food prices prevented an even bigger hike of inflation. On 1 February 2016, the Bank decided to raise its policy rate from 16% to 17%, to an unprecedentedly high level.

The tight monetary policy was accompanied by dollarisation of the deposits, which account for about 75% of the banking sector liabilities. At the end of 2015, 69% of total deposits were denominated in foreign exchange; in the deposits of individuals, the share of foreign exchange deposits reached 79%. As a result, the credit activity has been hindered: in December 2015, the total stock of loans in national currency had decreased by 2% compared with December 2014; for loans in foreign currency the drop was at about 45%. As a part of the loans stock decrease took place due to the writing-off of non-performing loans, the analysis of newly issued loans is more informative: in 2015, the amount of issued loans was 9% lower than in 2014, for loans to households this indicator was at -21%.

The authorities have been trying to stimulate credit growth through softening of capital requirements for banks, extending subsidised credit programmes, and launching programmes for mortgage refinancing and purchases of domestically assembled cars. However, it is likely that these measures will not be sufficient to fully offset the effects of the tight monetary policy in the short run. Besides, the increased uncertainty regarding economic growth and real estate prices is likely to make banks more cautious in credit allocation.

A continuing slump in industrial activity in 2016 will lead to an even worse overall performance than in 2015 – the growth rate is forecasted to reach only 1%. GDP will speed up its growth in 2017-2018 to 2.5% and 3.5%, respectively, primarily owing to rising investment as government investment programmes and joint investment projects with foreign companies are expected to take effect. Household consumption will grow at a slower pace than investment, as it will be constrained by a slow real income increase and limited access to credit.

Table 13 / Kazakhstan: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017 Forecast	2018
Population, th pers., average	16,557	16,791	17,035	17,289	17,544	17,800	18,100	18,350
Gross domestic product, KZT bn, nom.	29,380	32,194	37,085	40,755	40,761	43,200	46,900	51,500
annual change in % (real)	7.2	4.6	5.8	4.1	1.2	1.0	2.5	3.5
GDP/capita (EUR at exchange rate)	8,700	10,000	10,800	9,900	9,500	6,000	6,300	6,600
GDP/capita (EUR at PPP)	16,700	17,600	18,200	19,000	19,500	.	.	.
Consumption of households, KZT bn, nom.	11,569	13,623	17,535	19,565	21,500	.	.	.
annual change in % (real)	10.9	11.0	12.6	1.5	3.0	1.0	2.0	2.5
Gross fixed capital form., KZT bn, nom.	5,772	6,761	7,473	8,123	8,500	.	.	.
annual change in % (real)	3.9	9.1	4.9	4.4	1.2	2.0	4.0	5.0
Gross industrial production								
annual change in % (real)	3.8	0.7	2.5	0.3	-1.6	-2.0	2.0	3.0
Gross agricultural production								
annual change in % (real)	26.8	-17.8	11.7	1.0	4.4	.	.	.
Construction industry								
annual change in % (real)	2.8	3.1	3.5	4.6	4.3	.	.	.
Employed persons, LFS, th, average 2)	8,302	8,507	8,571	8,510	8,560	8,600	8,640	8,680
annual change in %	1.1	1.0	0.7	-0.7	0.6	0.5	0.5	0.5
Unemployed persons, LFS, th, average 2)	473	475	471	452	447	470	450	460
Unemployment rate, LFS, in %, average 2)	5.4	5.3	5.2	5.0	5.0	5.2	5.0	5.0
Reg. unemployment rate, in %, end of period	0.4	0.4	0.3	0.4	0.4	.	.	.
Average monthly gross wages, KZT 3)	90,028	101,263	109,141	120,455	125,335	137,600	151,600	167,100
annual change in % (real, gross)	7.1	7.0	1.9	3.9	-2.4	-2.0	3.0	4.0
Consumer prices (HICP), % p.a.	8.3	5.2	5.8	6.7	6.6	12.0	7.0	6.0
Producer prices in industry, % p.a.	27.2	3.5	-0.3	9.5	-20.5	-5.0	3.0	5.0
General governm.budget, nat.def., % of GDP								
Revenues	18.3	18.1	17.2	18.0	18.7	18.0	18.5	18.5
Expenditures	20.2	20.8	19.1	20.6	21.0	20.0	20.5	20.5
Deficit (-) / surplus (+)	-1.9	-2.8	-1.9	-2.7	-2.2	-2.0	-2.0	-2.0
Public debt, nat.def., % of GDP	11.5	12.3	12.2	14.2	22.8	25.0	27.0	28.0
Central bank policy rate, % p.a., end of period 4)	7.5	5.5	5.5	5.5	16.0	16.0	15.0	14.0
Current account, EUR mn 5)	7,326	823	646	4,511	-4,808	-3,400	-3,300	-3,200
Current account in % of GDP 5)	5.1	0.5	0.4	2.6	-2.9	-3.2	-2.9	-2.6
Exports of goods, BOP, EUR mn 5)	61,198	67,629	64,435	60,418	41,720	36,600	38,400	41,500
annual change in %	32.4	10.5	-4.7	-6.2	-30.9	-12.3	4.9	8.1
Imports of goods, BOP, EUR mn 5)	28,985	37,954	38,244	32,800	30,324	26,000	27,000	28,900
annual change in %	17.0	30.9	0.8	-14.2	-7.5	-14.3	3.8	7.0
Exports of services, BOP, EUR mn 5)	3,116	3,756	3,988	4,945	5,833	6,100	6,400	6,700
annual change in %	0.5	20.5	6.2	24.0	18.0	4.6	4.9	4.7
Imports of services, BOP, EUR mn 5)	7,882	9,925	9,379	9,727	10,671	10,200	10,600	11,200
annual change in %	-7.9	25.9	-5.5	3.7	9.7	-4.4	3.9	5.7
FDI liabilities (inflow), EUR mn 5)	9,885	10,618	7,536	5,306	5,428	6,300	.	.
FDI assets (outflow), EUR mn 5)	3,719	1,394	1,488	1,756	1,547	1,800	.	.
Gross reserves of NB excl. gold, EUR mn	19,477	16,665	13,940	17,920	18,739	.	.	.
Gross external debt, EUR mn 5)	96,951	103,150	109,137	129,324	160,000	163,700	171,700	180,300
Gross external debt, % of GDP 5)	67.4	61.4	59.5	75.6	96.5	152.2	151.0	148.3
Average exchange rate KZT/EUR	204.11	191.67	202.09	238.10	245.80	402	413	424
Purchasing power parity KZT/EUR 6)	106.27	109.07	119.93	123.75	119.06	.	.	.

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

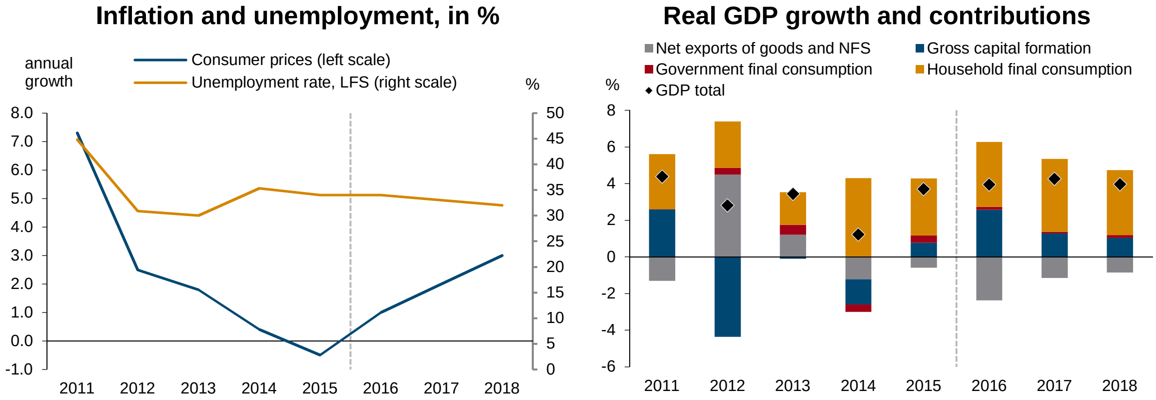
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

KOSOVO: A long passage to prosperity

MARIO HOLZNER

Despite hefty political infighting, the economy of Kosovo is growing at a rate of almost 4% per annum. The dynamics might even accelerate in the years to come. The major growth drivers are remittances and foreign direct investment. However, still more growth will be needed if mass unemployment is to be reduced substantially as the population is young and ever-increasing.

Figure 45 / Kosovo: main macroeconomic indicators



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

The economy of Kosovo is performing surprisingly well despite considerable headwinds in the political and economic sphere. The opposition is organising anti-government protests on a regular basis. Moreover, the opposition's nationalist MP's have repeatedly violently interrupted parliament sessions, inter alia by releasing canisters of tear gas or by using pepper spray. They demand the abandonment of a deal signed in August 2015 which gives the Serb minority greater autonomy as well as of an agreement on the border demarcation between Kosovo and Montenegro. They also violently reject the parliament's planned election of Foreign Minister Hashim Thaci as new President of the Republic. It is feared that the political unrest in the country will hinder foreign direct investment. In particular, the implementation of the large Brezovica winter tourism FDI project (in the order of 3% of GDP split over the next years) might be at risk.

However, in the first eleven months of 2015 cumulated FDI inflows almost doubled as compared to the same period a year earlier. The main sectors targeted were finance, construction, real estate, renting and business activities. The investors seemingly have confidence in the country's successful cooperation with the international community. In late January 2016, the European Parliament gave its consent to the EU-Kosovo Stabilisation and Association Agreement. This agreement constitutes an important first formal step in Kosovo's integration into Europe. The Parliament's decision paved the way for the European Council of Ministers to formally conclude the agreement and enable its entry into force in the next months. Earlier in January the IMF's Executive Board completed the first review of Kosovo's economic performance under the Stand-By Arrangement, which gave a green light to the disbursement of the second tranche of the funds agreed. The IMF mission's overall assessment was mostly positive.

Kosovo's goods export sector, which is dominated by mining and manufacturing of metals, has recently suffered from a strong decline in metals prices. According to the World Bank's aggregate commodity price indices, the year 2015 saw a drop in metals prices by more than 20%. However, apart from the fact that Kosovo's export sector is still tiny and of only limited importance for the overall economic development (according to the balance of payments, goods exports were less than 6% of GDP in 2015), it is remarkable to notice that the nominal values of total exports have not changed in 2015 as compared to 2014. Hence it is fair to assume that in real terms the country's export industry is expanding quite substantially, a trend that should continue over the next few years also given the expected stabilisation of commodity prices.

A strong economic boost to growth is the positive development of remittances. Inflows from January to November 2015 show a 9% increase as compared to a year earlier. Given the improving GDP growth for Germany and Switzerland (the main destination countries for Kosovo migrants) it can be expected that this trend will even intensify. Apart from consumption, remittances typically support also household investment, which is expected to pick up as well.

Another factor that is likely to boost investments (despite the government's rather modest investment plans which include a railway line to the Macedonian border and a large-scale irrigation project) is the strongly falling interest rates on new investment loans to the economy. These dropped from 9.3% in December 2014 to 7.2% in December 2015. Over the same period, total new loans for investment increased by more than 20% and new household mortgage loans soared by almost 28%. These encouraging developments occur against the backdrop of a stable banking sector. In November 2015 the share of nonperforming loans stood at 6.5% and the capital adequacy ratio at 18.9%. The loan loss provisions to nonperforming loans were at 116.7%.

Hence overall prospects for the economy of Kosovo are rather favourable. Based on a broad range of dynamic contributions of household consumption, investment and exports, the overall GDP growth is expected to accelerate to almost 4% in 2016. This rate might be even surpassed in the following years. However, it has to be noticed that this development started from a very low level and that growth is still not strong enough to substantially reduce the extremely high unemployment rate. This is also due to the fact that Kosovo's young population is still growing and new age cohorts pour each year into the tight labour market. Emigration is often seen as the sole option to improve life conditions. The growing anti-immigration mood throughout Europe is of little help in this respect and might hence have also repercussions on the already fragile political climate in this small Balkan country.

Table 14 / Kosovo: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017	2018
							Forecast	
Population, th pers., average	1,796	1,807	1,818	1,813	1,830	1,847	1,860	1,880
Gross domestic product, EUR mn, nom.	4,815	5,059	5,327	5,567	5,800	6,100	6,500	7,000
annual change in % (real)	4.4	2.8	3.4	1.2	3.7	3.9	4.3	4.0
GDP/capita (EUR at exchange rate)	2700	2800	2900	3100	3200	3,300	3,500	3,700
GDP/capita (EUR at PPP)	6200	6500	6700	7000	7500	.	.	.
Consumption of households, EUR mn, nom.	4,142	4,458	4,652	4,926	5,100	.	.	.
annual change in % (real)	3.5	2.9	2.0	4.9	3.5	4.0	4.5	4.0
Gross fixed capital form., EUR mn, nom.	1,476	1,317	1,323	1,294	1,330	.	.	.
annual change in % (real)	8.1	-13.6	-0.2	-3.3	3.0	10.0	5.0	4.0
Gross industrial production 2)								
annual change in % (real)	-5.7	14.9	6.5	-1.3	5.0	6.0	5.0	4.0
Gross agricultural production 2)								
annual change in % (real)	0.2	-8.5	1.4	0.8	-3.0	.	.	.
Construction output 2)								
annual change in % (real)	18.0	-8.5	2.6	-6.1	4.0	.	.	.
Employed persons, LFS, th, average 3)	280	303	338	324	333	340	350	360
annual change in %	.	.	11.7	-4.4	2.9	3.0	4.0	3.0
Unemployed persons, LFS, th, average 3)	228	136	145	177	170	180	170	170
Unemployment rate, LFS, in %, average 3)	44.8	30.9	30.0	35.3	34.0	34.0	33.0	32.0
Unemployment rate, reg., in %, end of period	.	.	.	.	.	.	.	.
Average monthly net wages, EUR 4)	348	354	356	416	450	460	480	510
annual change in % (real, net)	13.4	-0.8	-1.2	16.4	9.0	2.0	3.0	4.0
Consumer prices, % p.a.	7.3	2.5	1.8	0.4	-0.5	1.0	2.0	3.0
Producer prices, % p.a.	4.5	1.9	2.5	1.7	4.0	2.0	3.0	3.0
General governm.budget, nat.def., % of GDP								
Revenues	27.2	27.3	25.5	24.2	26.0	27.0	28.0	29.0
Expenditures	28.3	28.6	28.0	27.2	28.0	28.0	30.0	30.0
Deficit (-) / surplus (+)	-1.1	-1.2	-2.5	-2.9	-2.0	-1.0	-2.0	-1.0
Public debt, nat.def., % of GDP	5.3	8.1	8.9	10.5	12.0	12.4	13.6	13.7
Central bank policy rate, % p.a., end of period 5)	13.3	12.2	10.9	9.3	8.0	6.0	6.0	5.0
Current account, EUR mn	-658	-380	-339	-437	-475	-550	-560	-580
Current account, % of GDP	-13.7	-7.5	-6.4	-7.8	-8.2	-9.0	-8.6	-8.3
Exports of goods, BOP, EUR mn	317	282	292	324	330	360	390	420
annual change in %	5.8	-10.9	3.4	11.3	1.8	9.1	8.3	7.7
Imports of goods, BOP, EUR mn	2,364	2,332	2,287	2,383	2,390	2,600	2,780	2,950
annual change in %	15.8	-1.3	-1.9	4.2	0.3	8.8	6.9	6.1
Exports of services, BOP, EUR mn	625	641	633	767	790	850	1,050	1,130
annual change in %	8.9	2.6	-1.4	21.3	3.0	7.6	23.5	7.6
Imports of services, BOP, EUR mn	369	318	320	431	450	490	520	550
annual change in %	-7.4	-13.9	0.9	34.6	4.3	8.9	6.1	5.8
FDI liabilities (inflow), EUR mn	384	229	280	151	370	.	.	.
FDI assets (outflow), EUR mn	5	16	30	27	30	.	.	.
Gross reserves of NB excl. gold, EUR mn	573	840	800	747	900	.	.	.
Gross external debt, EUR mn	1,428	1,517	1,608	1,737	2,000	2,100	2,300	2,500
Gross external debt, % of GDP	29.7	30.0	30.2	31.2	34.5	35.0	35.0	36.0
Purchasing power parity EUR/EUR	0.433	0.431	0.436	0.437	0.424	.	.	.

1) Preliminary and wiiw estimates. - 2) According to gross value added (manufacturing industry for industrial production). -
3) Population 15-64. From 2012 new improved sample survey based on census 2011, not comparable with previous years. -
4) Net wages in state administration. - 5) Average weighted effective lending interest rate (Kosovo uses the euro as national currency).

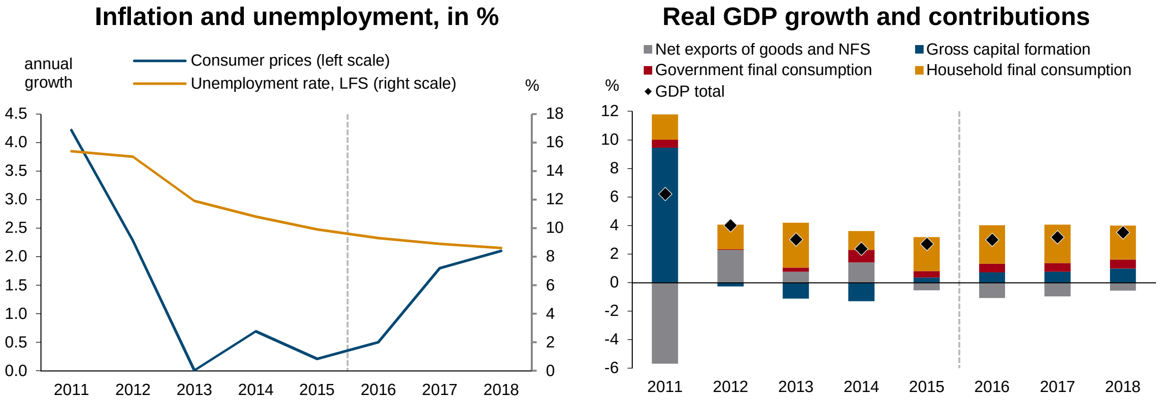
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

LATVIA: Growing wages push domestic demand

SEBASTIAN LEITNER

For 2016, we have slightly raised our GDP growth forecast for Latvia to 3%. As expected, the slump in Russian demand can be offset by growth in exports to the EU and Asian markets. Whereas household consumption will develop markedly and rapidly, investment growth will remain comparatively low. Improvements in the labour market and a rapid rise in real wages will keep households in a buoyant mood in terms of spending. We expect an upswing in GDP growth to 3.2% in 2017 and 3.5% in 2018, driven by stronger external demand and greater investment activity in both the public and private sectors.

Figure 46 / Latvia: main macroeconomic indicators



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

The ongoing recession in Russia drags on Latvia's trade balance. Exports to the Eastern neighbour fell by about 25% in 2015, year on year, in nominal terms. We expect the negative impact to decrease, however, a revival of trade with the CIS countries will not happen before 2017. External demand of the euro area countries and other EU Member States was obviously not too lively, but exports to the rest of the world acted as a counterbalancing force, expanding by 22% in nominal terms in 2015, year on year; however, only about 15% of the goods exports are destined for non-EU and non-CIS countries. Production and exports of foodstuffs are ailing due to the Russian downturn and embargo, and those of mineral products suffer from the low oil price. However, good news comes from the increasingly important machinery sector, reporting strong export growth figures. For 2016 we expect external demand to become more lively again.

In the steel industry, production at Liepajas metalurgs, the largest company in the sector, is still suffering from low prices driven down by Chinese producers flooding the world market. The company welcomes the European Commission's anti-dumping probes into steel imports from China and urges the government to subsidise its production – which is, however, very unlikely to happen. Thus temporary production halts are expected also in 2016 and gas and electricity utilities may again refrain from supplying energy.

Given the low growth of external demand, capacity utilisation remained almost stagnant in 2015. Thus we do not expect a strong upswing of private fixed capital investments this year; the same applies to public investments. The availability of fresh EU funds will not, according to the 2016 government budget, result in public investments growing swiftly but will be used only later, from 2017 onwards. The pessimistic sentiments of entrepreneurs in the construction sector are understandable if we look at the recently declining numbers of building permits for non-residential buildings, while households will keep on raising their credit-funded expenditures for the acquisition of dwellings. Overall, we expect total gross fixed investment to continue growing at a low rate both in 2016 and 2017.

The significant decrease in oil prices will keep consumer inflation almost stagnant also in 2016. The wage growth increased core inflation. However, only in 2017 and thereafter will rising prices in the services sector and an upswing of external demand result in consumer inflation rising to about 2%.

Employment growth attained 1.2% in 2015 and will continue at the same rate also this year. The declining activity in the transport sector and partly also in construction will result in lower employment there, while particularly services sectors will provide for ongoing job creation. However, demographic developments – including net emigration – result in a further decline in the working-age population, thus growth in employment will decrease as well. Towards the end of 2015 the unemployment rate returned to single digits for the first time since the outbreak of the global financial crisis in 2008. This year and in 2017 we expect a more gradual reduction to 9.3% and 8.9%, respectively.

The improvement of the labour market situation and the increase in the minimum wage from EUR 320 to EUR 360 resulted in real net wages growing by more than 7% in 2015. In January 2016 minimum wages have again been raised, but only slightly, to EUR 370 per month. We therefore expect that household incomes will grow at a somewhat slower pace this year. Consumer confidence indicators increased slightly towards the end of 2015 and households plan to invest more in consumer durables. Benefiting from still low inflation, households will increase their consumption in 2016 even slightly more than last year. Thus domestic demand will keep the Latvian economy developing at a good pace.

In February this year a new government led by Prime Minister Māris Kučinskis, a member of the agrarian 'Union of Greens and Farmers', was appointed; the coalition remained unchanged, comprising also the centre to right wing conservative parties 'Unity' and 'National Alliance'. Former Prime Minister Laimdota Straujuma had stumbled over teacher strikes and disagreements in the coalition on hikes in defence expenditures, ongoing immigration issues and state assistance to the ailing national airline Air Baltic. However, no change in economic and fiscal policies is to be expected. The government budget for 2016 foresees an increase in the defence budget of 45% to 1.4% of GDP with a medium-term target of 2% for 2018. The introduced changes in income taxation (a solidarity tax for the upper 0.6% of income earners and the change from the non-taxable personal allowance to an income-dependent declining amount) turns the flat tax system slightly more progressive. Public wage growth will, as in recent years, remain below the one of the private sector. The budget deficit of 1.3% of GDP in 2015 was slightly above the planned 1% but is expected to move towards the target this year and the next.

Despite the persisting Russian economic downturn, we forecast the GDP to rise by 3% in 2016. Given the expected speed-up in demand in the EU and a rise in domestic investment activity driven by the inflow of EU funds, we have slightly increased our forecast for the upswing in overall economic activity to 3.2% for 2017 and 3.5% for 2018.

Table 15 / Latvia: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017	2018
							Forecast	
Population, th pers., average	2,060	2,034	2,013	1,994	1,979	1,965	1,950	1,945
Gross domestic product, EUR mn, nom.	20,244	21,811	22,763	23,581	24,300	25,200	26,500	28,000
annual change in % (real)	6.2	4.0	3.0	2.4	2.7	3.0	3.2	3.5
GDP/capita (EUR at exchange rate)	9,800	10,800	11,300	11,800	12,300	12,800	13,600	14,400
GDP/capita (EUR at PPP)	14,700	16,000	16,600	17,500	18,600	.	.	.
Consumption of households, EUR mn, nom.	12,246	13,020	13,733	14,148	14,700	.	.	.
annual change in % (real)	2.9	2.9	5.3	2.2	4.0	4.5	4.5	4.0
Gross fixed capital form., EUR mn, nom.	4,501	5,551	5,291	5,394	5,600	.	.	.
annual change in % (real)	24.1	14.4	-6.0	0.4	3.5	4.0	4.5	4.0
Gross industrial production 2)								
annual change in % (real)	9.0	6.2	-0.9	-1.1	3.6	5.0	4.0	5.0
Gross agricultural production								
annual change in % (real)	2.8	17.3	3.4	3.1	8.7	.	.	.
Construction industry								
annual change in % (real)	12.4	13.7	8.1	7.9	-1.2	.	.	.
Employed persons, LFS, th, average 3)	970.5	875.6	893.9	884.6	895.0	905	912	918
annual change in %	3.1	1.6	2.1	-1.0	1.2	1.1	0.8	0.7
Unemployed persons, LFS, th, average 3)	176.4	155.1	120.4	107.6	100.0	90	90	90
Unemployment rate, LFS, in %, average 3)	15.4	15.0	11.9	10.8	9.9	9.3	8.9	8.6
Reg. unemployment rate, in %, end of period 3)4)	11.5	10.5	9.5	8.5	8.7	.	.	.
Average monthly gross wages, EUR	660.2	684.4	715.7	765.0	815.0	870	930	1,000
annual change in % (real, gross)	-0.1	1.4	4.6	6.2	6.3	6.0	5.5	5.2
Average monthly net wages, EUR	469.5	488.0	515.4	560.0	600.0	640	680	730
annual change in % (real, net)	0.1	1.6	5.6	8.0	7.0	5.5	5.0	5.0
Consumer prices (HICP), % p.a.	4.2	2.3	0.0	0.7	0.2	0.5	1.8	2.1
Producer prices in industry, % p.a.	7.7	4.1	1.7	0.4	-1.1	-1.0	1.0	1.5
General governm.budget, EU-def., % of GDP								
Revenues	35.6	36.2	36.0	35.8	36.0	36.0	36.0	36.0
Expenditures	39.0	37.0	36.9	37.3	37.3	37.1	37.0	36.5
Net lending (+) / net borrowing (-)	-3.4	-0.8	-0.9	-1.6	-1.3	-1.1	-1.0	-0.5
Public debt, EU-def., % of GDP	42.8	41.4	39.1	40.8	37.0	36.0	35.0	34.0
Central bank policy rate, % p.a., end of period 5)	3.50	2.50	0.25	0.05	0.05	.	.	.
Current account, EUR mn	-573	-719	-544	-467	-291	-900	-1,000	-1,000
Current account, % of GDP	-2.8	-3.3	-2.4	-2.0	-1.2	-3.6	-3.8	-3.6
Exports of goods, BOP, EUR mn	8,300	9,645	9,810	10,180	10,281	10,860	11,510	12,200
annual change in %	24.7	16.2	1.7	3.8	1.0	5.6	6.0	6.0
Imports of goods, BOP, EUR mn	10,743	12,208	12,351	12,454	12,394	13,200	13,860	14,600
annual change in %	31.9	13.6	1.2	0.8	-0.5	6.5	5.0	5.3
Exports of services, BOP, EUR mn	3,471	3,768	3,900	3,853	3,985	4,320	4,670	5,000
annual change in %	13.8	8.6	3.5	-1.2	3.4	8.4	8.1	7.1
Imports of services, BOP, EUR mn	1,991	2,145	2,127	2,107	2,251	2,470	2,690	2,900
annual change in %	13.8	7.7	-0.8	-0.9	6.8	9.7	8.9	7.8
FDI liabilities (inflow), EUR mn	1,075	840	743	661	700	.	.	.
FDI assets (outflow), EUR mn	75	127	373	428	0	.	.	.
Gross reserves of NB excl. gold, EUR mn 6)	4,666	5,373	5,565	2,448	2,957	.	.	.
Gross external debt, EUR mn	29,603	30,254	30,501	33,542	34,600	35,300	36,600	39,200
Gross external debt, % of GDP	147.0	137.6	133.7	142.2	142.4	140.0	138.0	140.0
Average exchange rate EUR-LVL/EUR 7)	1.0050	0.9922	0.9981	1.0000	1.0000	1	1	1
Purchasing power parity EUR-LVL/EUR	0.6698	0.6711	0.6793	0.6750	0.6587	.	.	.

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) From 2012 according to census March 2011. - 4) In % of labour force (LFS). - 5) From 2014 official refinancing operation rate for euro area (ECB), refinancing rate of National Bank before. - 6) From January 2014 (Euro introduction) only foreign currency reserves denominated in non-euro currencies. - 7) Euro fixed series.

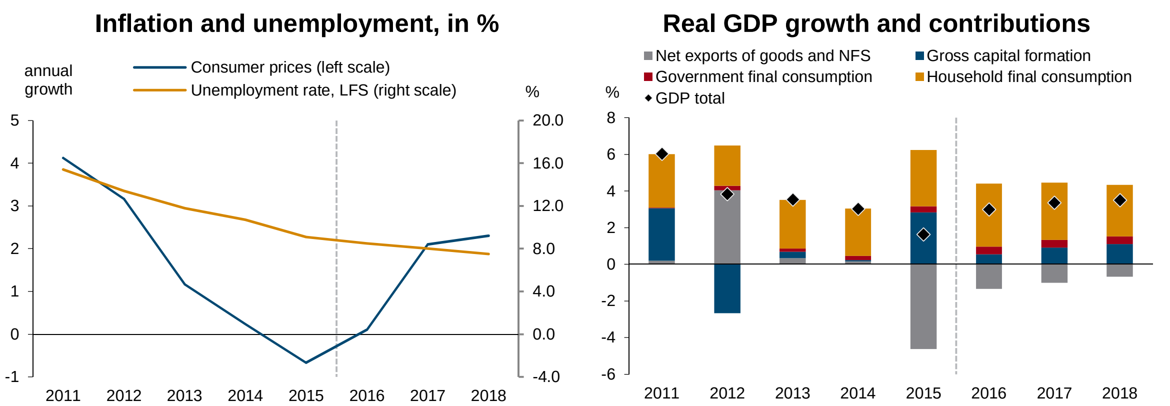
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

LITHUANIA: Successful reorientation

SIMONA JOKUBAUSKAITĖ

The introduction of the euro and the management of the difficult geo-economic situation were arguably the major features of the Lithuanian economy in 2015. The successful reorientation of trade towards the West softened the negative demand shocks emanating from Russia. As household consumption increases, it will put the economy on a growth path leading from a GDP growth rate of 1.6% in 2015 to one of 3% over the years to come.

Figure 47 / Lithuania: main macroeconomic indicators



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

Although the first quarter of 2015 was marked by the lowest growth in five years (1.3%), GDP showed resilience to the negative external demand shocks. Despite the decrease in exports to Russia, GDP grew by 2% in the last quarter. Exports declined by more than 5% in nominal terms, but due to plummeting oil prices and their effect on production costs, as well as on the final demand of exported goods, a real decline was hardly present. The share of total exports to Russia declined steadily throughout the year and has reached 14% – the ten-year rock bottom. Local producers and firms were looking for new export markets and as a result exports to the EU grew by 6%. The shrinkage of imports was close to 1% in nominal terms. Due to import price deflation, real growth is estimated to be around 7%. Trade in services moved in a similar pattern last year. In spite of strong dependence on the CIS, exports of services grew by 6%. The value exported to the CIS decreased by 23%, but increased by 17% to the EU. Dwindling trade ties with the East and an improving situation in trade with the EU are expected to diminish the effect of decreasing Russian demand on the Lithuanian economy in 2016.

Since 2009 unemployment has been declining constantly. Despite the increasing wages, net emigration accelerated again, by 85% last year. The drop in unemployed persons per free vacancy will improve the bargaining power of employees even more. After being increased in January 2016, the minimum wage will be raised again in July, resulting in a 17% gain. It is expected that the overall real wage will increase by 6% this year. As households' confidence remains positive, their consumption is expected to rise by more than 5% this year and it will remain the main driver of economic growth in the foreseeable future.

To hinder the formation of a new real estate price bubble and to reduce the risk of high household indebtedness, the Lithuanian Central Bank introduced changes in the lending regulations to households. Those changes came into force in November 2015. The maturity of credit has been shortened to 30 years and the financial burden has to be calculated more strictly. Since the measures had been announced already by the end of March 2015, household borrowing began to grow in April, peaking at 66% in July and declining by 3% in December. In total, new euro loans to households rose by 33% last year.

Consumer price deflation amounted to 0.7% last year, which was induced by the plummeting energy prices. Their 12% drop was partially offset by the inflation in services. Not only the rounding of prices after the euro introduction, but also the growth in wages led to a 3.4% increase in services prices. Core inflation is estimated to be 1.2%. Continuously increasing wages in 2016 will raise consumer demand, as well as the prices of services. The bottom-low oil prices are expected to have weaker but still dragging effects on inflation. Therefore, slightly positive inflation should be present this year. The change in producer prices will remain negative, as they are more affected by oil prices than by growing wages.

Gross industrial production grew by 5% last year and was mainly driven by export-intensive industries. Real growth of exported Lithuanian origin goods was 8% in 2015. Lithuanian manufacturers of wood and furniture products accounted for about one third of total growth of industrial production. The highest increase in demand for furniture and wood was observed in Sweden, Norway, Denmark and the Netherlands. Secondly, a significant role in growth of industrial production was played by the pharmaceutical industry. It expanded by a stunning 70%. In 2004, Sicor Biotech/Teva Baltics became a part of Teva – the largest generic drug manufacturer in the world. Only 1-2% of its products are sold in Lithuania, the rest is exported mainly to the United States and Japan. Last year, the products of Teva Baltics were introduced also into the Turkish market. South Africa and New Zealand are the countries targeted next. Favourable production tendencies are expected to prevail in the forthcoming years and industrial production should grow by 4-5% per annum.

The situation in the construction industry in 2015 was slightly worrying. Value added decreased gradually and employment growth was negative in the third quarter. However, the increase in building permits and high demand for construction workers show that the construction industry should recover this year. Last year's investment growth was driven by the private sector, which increased its investments by about 15%. Though the transportation and storage industry was hit by the Russian crisis, the slump was compensated by growth in other sectors. Manufacturers invested widely and generated about one third of total investment growth. Private investment into equipment, machinery and transport vehicles grew by about 17% in 2015 as compared to the year earlier. Also, renovation of residential buildings picked up last year: the number of buildings renovated was 3.5 times higher than in the entire last decade. The lack of qualified labour and the pressure of rising wages will push firms to optimise their production lines and to invest more into personnel training. Positive private investment tendencies will prevail in 2016 and investment growth should be at about 6%.

On 9 October 2016 parliamentary elections will be held. In correlation with the forthcoming elections, the government budget deficit is expected to increase. On 1 January 2016 not only minimum wages were increased, but also the non-taxable income bracket was raised by 20%, pensions by 3%. Expenditures on defence are planned to rise again by 30%. The increase in expenditures will be partly offset by rising revenues. As the economic and political situation is stable, the Social Democrats are expected to remain the dominating party, followed by the Homeland Union and the Liberal Movement. Due to many controversies, neither of the latter two parties will want to form a coalition with the first one. On the other hand, the current coalition partners of the Social Democrats (the Labour Party, Order and Justice) are losing voters' trust and thus the same coalition structure as before will not be possible. In any case, we do not expect any major economic or political changes caused by the election outcome.

In the forthcoming years, household consumption will remain the driving force of positive GDP development. Also, the net export situation should improve as trade becomes more country-diversified. The GDP forecasts for 2016-2017 remain unchanged – 3% and 3.4%, respectively. We expect economic development to remain stable also in 2018 with an annual growth rate of around 3.5%.

Table 16 / Lithuania: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017	2018
							Forecast	
Population, th pers., average	3,028	2,988	2,958	2,932	2,905	2,880	2,860	2,840
Gross domestic product, EUR-LTL mn, nom.	31,263	33,335	34,962	36,444	37,190	38,300	40,400	42,800
annual change in % (real)	6.0	3.8	3.5	3.0	1.6	3.0	3.4	3.5
GDP/capita (EUR at exchange rate)	10,300	11,200	11,800	12,400	12,800	13,300	14,100	15,100
GDP/capita (EUR at PPP)	17,000	18,500	19,600	20,600	21,700	.	.	.
Consumption of households, EUR-LTL mn, nom.	19,471	20,786	21,885	22,817	23,714	.	.	.
annual change in % (real)	4.6	3.6	4.3	4.2	4.9	5.5	5.0	4.5
Gross fixed capital form., EUR-LTL mn, nom.	5,781	5,788	6,457	6,894	7,706	.	.	.
annual change in % (real)	20.1	-1.8	8.3	5.4	10.3	6.0	7.0	7.0
Gross industrial production (sales)								
annual change in % (real)	6.4	3.7	3.3	-0.1	4.9	5.0	5.0	4.0
Gross agricultural production								
annual change in % (real)	10.3	14.2	-1.8	8.4	5.3	.	.	.
Construction industry								
annual change in % (real)	22.1	-7.1	11.3	17.0	-3.5	.	.	.
Employed persons, LFS, th, average 2)	1,371	1,276	1,293	1,319	1,335	1,345	1,355	1,360
annual change in %	2.0	1.8	1.3	2.0	1.2	0.7	0.7	0.4
Unemployed persons, LFS, th, average 2)	249	197	173	158	134	125	118	110
Unemployment rate, LFS, in %, average 2)	15.4	13.4	11.8	10.7	9.1	8.5	8.0	7.5
Reg. unemployment rate, in %, end of period 3)	12.0	11.4	11.1	9.3	9.0	.	.	.
Average monthly gross wages, EUR-LTL 4)	593	615	646	677	710	760	820	890
annual change in % (real, gross)	-1.2	0.7	4.0	4.7	6.0	6.5	6.0	5.7
Average monthly net wages, EUR-LTL 4)	462	478	501	527	550	590	640	690
annual change in % (real, net)	-1.3	0.5	3.8	5.1	5.8	6.3	5.8	5.3
Consumer prices (HICP), % p.a.	4.1	3.2	1.2	0.2	-0.7	0.1	2.1	2.3
Producer prices in industry, % p.a.	13.9	5.0	-2.4	-4.9	-9.7	-3.5	2.5	3.5
General goverm.budget, EU-def., % of GDP								
Revenues	33.5	33.0	32.9	34.1	34.6	34.8	34.4	34.0
Expenditures	42.5	36.1	35.6	34.8	35.6	36.0	35.0	34.5
Net lending (+) / net borrowing (-)	-8.9	-3.1	-2.6	-0.7	-1.0	-1.2	-0.6	-0.5
Public debt, EU-def., % of GDP	37.2	39.8	38.8	40.7	42.5	42.0	40.0	39.0
Central bank policy rate, % p.a., end of period 5)	1.24	0.52	0.27	0.12	0.05	.	.	.
Current account, EUR mn	-1,209	-393	539	1,305	-934	-1,000	-1,200	-1,400
Current account, % of GDP	-3.9	-1.2	1.5	3.6	-2.5	-2.6	-3.0	-3.3
Exports of goods, BOP, EUR mn	19,422	22,427	23,998	23,750	22,544	23,100	24,300	25,500
annual change in %	30.4	15.5	7.0	-1.0	-5.1	2.5	5.0	5.0
Imports of goods, BOP, EUR mn	21,487	23,530	24,918	24,686	24,412	25,300	26,700	28,300
annual change in %	29.9	9.5	5.9	-0.9	-1.1	3.5	5.5	6.0
Exports of services, BOP, EUR mn	4,033	4,793	5,390	5,850	6,201	6,700	7,400	8,300
annual change in %	17.8	18.8	12.5	8.5	6.0	7.5	10.0	12.5
Imports of services, BOP, EUR mn	2,766	3,404	4,033	4,212	4,377	4,600	5,000	5,600
annual change in %	20.2	23.1	18.5	4.4	3.9	6.0	9.0	11.0
FDI liabilities (inflow), EUR mn	1,095	454	531	270	557	.	.	.
FDI assets (outflow), EUR mn	94	215	322	433	97	.	.	.
Gross reserves of NB excl. gold, EUR mn 6)	6,120	6,203	5,705	6,991	1,376	.	.	.
Gross external debt, EUR mn	25,149	26,031	24,596	25,723	28,700	29,200	30,000	30,900
Gross external debt, % of GDP	80.4	78.1	70.4	70.6	77.2	76.0	74.0	72.0
Average exchange rate EUR-LTL/EUR	1.0000	1.0000	1.0000	1.0000	1.0000	1	1	1
Purchasing power parity EUR-LTL/EUR	0.6071	0.6027	0.6042	0.6033	0.5896	.	.	.

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

1) Preliminary and wiiw estimates. - 2) From 2012 according to census March 2011. - 3) In % of working age population. -
4) Including earnings of sole proprietors. - 5) From 2015 official refinancing operation rate for euro area (ECB), VILIBOR one-month interbank offered rate before (Lithuania had a currency board until Euro introduction). - 6) From January 2015 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.

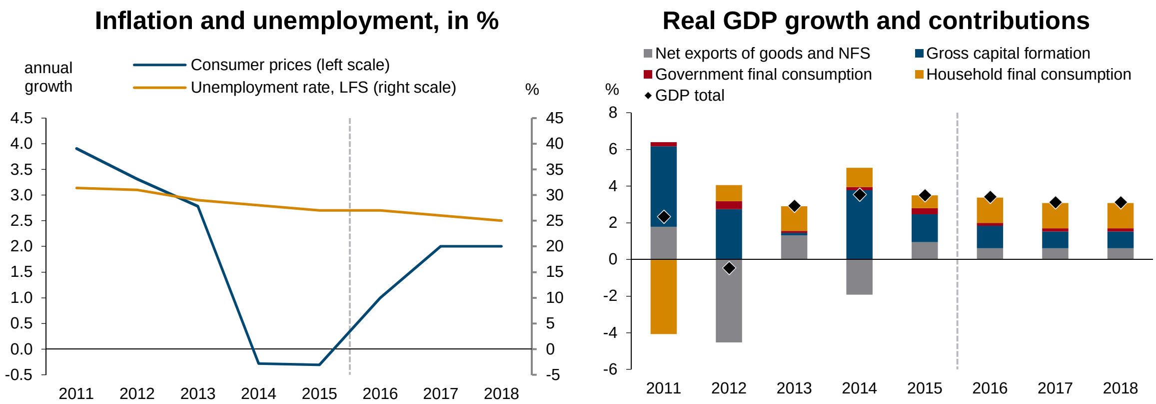
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

MACEDONIA: Change is in the air

VLADIMIR GLIGOROV

Growth over the medium term should settle at just above 3%, with investment and exports as the driving forces. As democratisation takes hold, political stability should in all likelihood firm up and growth accelerate somewhat, especially if growth in the region as a whole picks up speed.

Figure 48 / Macedonia: main macroeconomic indicators



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

Economic performance continues to improve with decent prospects in the medium term. Last year's growth rate was 3.5%, and for the next few years growth rates above 3% are forecasted. The unemployment rate has continued to decline, though at 27% it is still among the highest in the region and almost anywhere. Growth has been driven by investment and consumption. Like in most of the region, consumption is almost 90% of GDP. But investment at 25% of GDP is much higher than in most other countries in the region. The trade deficit is high, though exports are also higher, as a share of GDP, compared to the region average. Finally, on most rankings of institutional development and business friendliness, Macedonia does better too.

The political climate, however, has been worsening with a legitimacy crisis erupting last year. The reason is that the current government coalition has been in power for quite some time and there is abundant evidence that it has become unusually corrupt, that is has shown blatant disregard for the rule of law, and that is has tempered with elections. There have been quite a few early elections since 2008 which failed to produce a change. The dissatisfied opposition took to the streets last year and an agreement was forged with the mediation by the EU that new early elections will be held before the end of April this year – now postponed until June. Subsequent negotiations had been contentious, as was to be expected, so it is not clear whether these elections will be held as scheduled. The outcome, if indeed there are elections, is hard to predict. Given the evidence of the government's misbehaviour, the opposition should win. However, given that the economy and employment are improving, change may not happen. That, if it does happen, will not mean stabilisation, because the governing parties will only tighten the grip on the country, while all the grievances will remain unheeded.

The refugee crisis may help the government in the upcoming elections. One of the main routes of the refugees who are on the way to Germany and Scandinavia goes through Macedonia. That has created problems on the border with Greece and may also create problems on the Serbian border in the future. The refugees do not incite too much dissatisfaction because they are just in transit. That may change if borders start closing all over Europe and within the Balkans too. In any case, the risk to stability, real or fanciful, will tend to work for the government and against change in trying times.

Exports of goods and services are increasing as are public investments. Originally, the policy framework was designed to support export-based growth. The fixed exchange rate is still in place; however, the tight fiscal policy, which used to be adhered to almost up to the outbreak of the global financial crisis in 2008-2009, has been relaxed with some support for wage growth and even more for public investments. This was possible because debt levels, whichever one cared to look at, were relatively low and sustainable. In addition, monetary policy, which used to be quite tight in order to support the fixed exchange rate, could be relaxed due to very low interest rates in the euro area. So, both fiscal and monetary policy have been supportive, at least compared to their tightness before the crisis. It could be argued that as much as it was unfortunate before the crisis, the tight policy mix could be relaxed in the aftermath and thus support investments, growth, and the labour markets.

Structural reforms and pro-business measures have been introduced already before the crisis. Unlike most countries in the region, which tended to erode their competitiveness with real exchange rate appreciation, this was not the case with the Macedonian economy. Indeed, wages stagnated for years before the crisis, often because those in the public sector were frozen as part of the programmes with the IMF. With a depressed labour market, that meant that real wages tended to decline relative to those in the region. In addition, as part of the strategy of reliance one external demand, measures to support foreign investments were constantly introduced. Macedonia is not the best location, as this is a small, landlocked country in a depressed and volatile region, so it is hard to see that investors will rush to put their money there. In any case, the pro-business measures that had been taken before and preserved competitiveness, i.e. no need for structural reforms in the middle of a crisis, did help growth and investments.

Change would be helpful to internal stability and could rekindle the stalled process of EU integration. The economy is strong enough that it could sustain some much-needed democratic change. Also, inter-ethnic relations are calm enough for that to be sustainable. In addition, the new government could have a chance to reset the relationship with the EU and with Greece in particular. However, for the current government too much is at stake to be ready to accept that change is what is needed.

Investment should continue to be the driving force of growth assuming political stability is preserved.

Table 17 / Macedonia: selected economic indicators

	2011	2012	2013	2014	2015 [1]	2016	2017 Forecast	2018
Population, th pers., mid-year	2,059	2,061	2,064	2,067	2,080	2,085	2,090	2,095
Gross domestic product, MKD mn, nom.	464,186	466,703	501,891	525,620	565,900	591,000	622,000	654,000
annual change in % (real)	2.3	-0.5	2.9	3.5	3.5	3.4	3.1	3.1
GDP/capita (EUR at exchange rate)	3,700	3,700	3,900	4,100	4,400	4,600	4,800	5,100
GDP/capita (EUR at PPP)	8,800	9,000	9,500	10,100	10,700	.	.	.
Consumption of households, MKD mn, nom.	339,177	340,875	355,959	363,521	366,100	.	.	.
annual change in % (real)	-5.4	1.2	1.9	1.5	1.0	2.0	2.0	2.0
Gross fixed capital form., MKD mn, nom.	109,219	109,071	119,003	123,115	123,000	.	.	.
annual change in % (real)	13.3	6.5	3.5	14.3	4.0	4.0	4.0	4.0
Gross industrial production [2]								
annual change in % (real)	6.9	-2.7	3.2	4.8	4.9	5.0	5.0	5.0
Gross agricultural production [3]								
annual change in % (real)	-0.4	-5.6	6.4	3.0	3.0	.	.	.
Construction industry								
annual change in % (real)	28.5	8.1	43.1	-3.4	35.0	.	.	.
Employed persons, LFS, th, average	645.1	650.6	678.8	690.2	700.0	710	720	730
annual change in %	1.1	0.8	4.3	1.7	1.4	1.0	1.0	1.0
Unemployed persons, LFS, th, average	295.0	292.5	277.2	268.8	260.0	260	250	240
Unemployment rate, LFS, in %, average	31.4	31.0	29.0	28.0	27.0	27.0	26.0	25.0
Reg. unemployment rate, in %, end of period	29.9	25.8	22.8	23.4	22.0	.	.	.
Average monthly gross wages, MKD	30,602	30,669	31,025	31,325	32,200	32,800	33,800	34,800
annual change in % (real, gross)	-2.6	-3.0	-1.6	1.3	3.0	1.0	1.0	1.0
Average monthly net wages, MKD	20,847	20,902	21,145	21,394	22,000	22,400	23,100	23,800
annual change in % (real, net)	-2.4	-2.9	-1.6	1.5	3.0	1.0	1.0	1.0
Consumer prices, % p.a.	3.9	3.3	2.8	-0.3	-0.3	1.0	2.0	2.0
Producer prices in industry, % p.a.	11.9	1.4	-1.4	-1.9	-3.9	1.0	2.0	2.0
General governm. budget, nat.def., % of GDP								
Revenues	31.7	32.1	30.1	29.8	31.0	31.0	31.0	31.0
Expenditures	34.2	36.0	34.1	34.0	34.0	33.0	33.0	33.0
Deficit (-) / surplus (+)	-2.6	-3.9	-4.0	-4.2	-3.0	-2.0	-2.0	-2.0
Public debt, nat.def., % of GDP	32.0	38.3	40.2	45.9	46.0	46.0	46.0	46.0
Central bank policy rate, %, p.a., end of period [4]	4.00	3.73	3.25	3.25	3.25	3.25	3.50	3.50
Current account, EUR mn	-189	-240	-134	-69	0	-380	-400	-430
Current account, % of GDP	-2.5	-3.2	-1.6	-0.8	0.0	-4.0	-4.0	-4.0
Exports of goods, BOP, EUR mn	2,396	2,307	2,375	2,780	3,057	3,240	3,400	3,570
annual change in %	21.0	-3.7	2.9	17.0	10.0	6.0	5.0	5.0
Imports of goods, BOP, EUR mn	4,301	4,315	4,238	4,635	4,867	5,110	5,370	5,640
annual change in %	22.4	0.3	-1.8	9.4	5.0	5.0	5.0	5.0
Exports of services, BOP, EUR mn	1,045	1,067	1,155	1,277	1,380	1,460	1,530	1,610
annual change in %	39.8	2.1	8.2	10.6	8.0	6.0	5.0	5.0
Imports of services, BOP, EUR mn	686	757	780	919	975	1,020	1,070	1,120
annual change in %	11.4	10.5	2.9	17.9	6.0	5.0	5.0	5.0
FDI liabilities (inflow), EUR mn	370	265	302	37	300	.	.	.
FDI assets (outflow), EUR mn	26	134	73	-160	0	.	.	.
Gross reserves of NB, excl. gold, EUR mn	1,802	1,918	1,803	2,221	2,049	.	.	.
Gross external debt, EUR mn	4,847	5,172	5,220	5,992	6,600	6,700	6,800	6,900
Gross external debt, % of GDP	64.2	68.2	64.0	70.3	71.9	70.0	67.0	65.0
Average exchange rate MKD/EUR	61.53	61.53	61.58	61.62	61.61	61.50	61.50	61.50
Purchasing power parity MKD/EUR	25.59	25.08	25.61	25.18	25.48	.	.	.

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) In 2014 wiiw estimate. -
4) Central Bank bills (28-days).

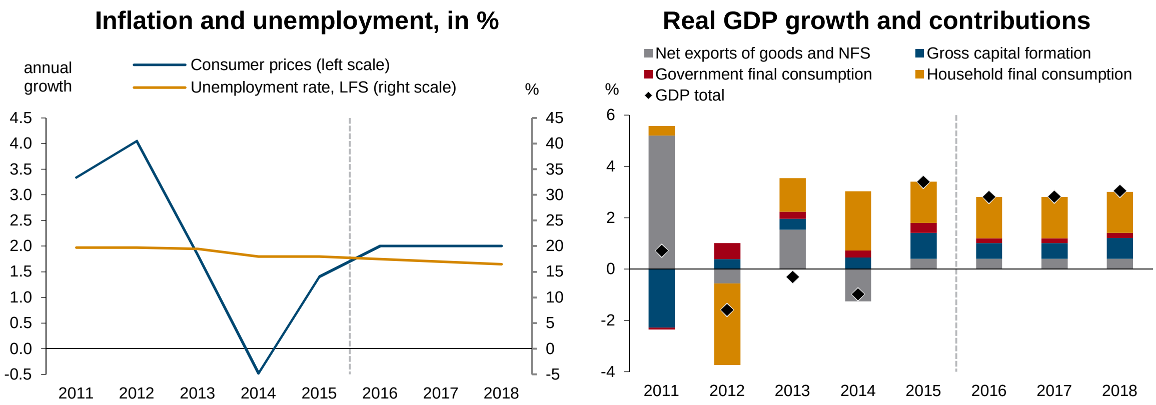
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

MONTENEGRO: Maintaining stability

VLADIMIR GLIGOROV

Growth of up to 3% per year is expected, with investments and exports acting increasingly as the main drivers. The upcoming elections and joining NATO should prove stabilising factors, while improved regional cooperation should have the same effect.

Figure 49 / Montenegro: main macroeconomic indicators



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

Growth should remain to be above the average for the region. Last year's growth at 3.4% has already been high by regional standards. It was driven by exports of services (tourism) and by investments. In addition, consumption has continued to increase, public as well as private. Consumption is around 100% of GDP and its share will have to decline in order for the drivers of growth to be rebalanced. In the medium term, growth should slow down somewhat to accommodate the rebalancing. Still, growth rates of around 3% should not be unattainable.

Foreign investments are expected to continue to pour in, but the government plans to boosts its investments too. Tourism continues to be the most important economic activity and the main sector in which is being invested. The coastal area is still relatively underdeveloped, given its potential, e.g. if neighbouring Croatia or Greece are considered. Also, the potential of the ports and other maritime resources are far from developed. One constraint is the connection with the hinterland of the country and beyond. Regional differences in this tiny country are large in part because of its poor inland connections. That motivates the government's programme of investments in roads, railroads, and in energy generation. Developmental advantages are unmistakable, the concern, raised by the IMF among others, is that foreign debt may increase beyond what can be sustained. So, there are some risks to this strategy of development, but it is not as if there is any good alternative.

Regional recovery should prove supportive of growth and development. Much of the investment comes from far-away countries, from the Gulf countries to Canada. However, a significant number of tourists come from the region. Improved regional infrastructure and connectivity, e.g. supported by the Berlin Process (a framework supporting and coordinating investment in the Western Balkans), which targets precisely that, will certainly be helpful. Also, improved prospects in neighbouring countries will be supportive of economic activity. The same goes for improved prospects in the EU, which may spur investments in real estate in addition to spending on summer and winter tourism.

Regional stability is crucial, especially improved relations with neighbouring Serbia. Currently, official relations with Serbia have been better than any time since the first half of the 1990s and certainly since the declaration of independence in 2006. The Serbian government is refraining from interference in the internal affairs of Montenegro, which is very supportive of the latter country's stability. Also, improved relations in the region and good relations with neighbouring Kosovo and Albania are helpful. All the neighbours have the capacity to destabilise Montenegro if they choose to do so, which is why their restraint and cooperation has been quite positive.

The upcoming accession to NATO is raising issues with Russia, however. Montenegro has been looking to join NATO since its independence. This has been recognised by the majority of political parties as needed for stability and security of this small country in a volatile region. At the end of last year, NATO invited Montenegro to join and negotiations have started and are expected to be concluded quite speedily. In the current security state of affairs, Russia has expressed strong objections to this development. It worries that other countries in the region, and Serbia in particular, may follow suit, at some time in the future, while Macedonia is in the waiting room anyway and it is only for the Greek veto that it is staying out. Finally, where Serbia goes, Bosnia and Herzegovina will follow, which would mean that all the Balkan countries will be members of NATO.

Political instability is looming ahead of the elections. The issue of the membership in NATO has been taken up by the opposition, which has also received strong support by Moscow, in its attempts to question the legitimacy of the government. Its attempts to stage a legitimacy crisis by non-parliamentary contests by protests and meetings have so far failed. However, the parliamentary majority broke up and a new one was patched up. All of that will have to be resolved in the elections which should take place before summer. It is not likely that the Serbian pro-Russian opposition will do particularly well, in part because it is not supported by official Serbia. It is hard to say how much of an influence Russian support will have.

Longer-term stability depends on the solution to the succession problem. Montenegro has been run by Milo Djukanovic since its independence. He was its leader even before, but had to share the power with Serbian authorities as Montenegro was in a Union with Serbia. Still, inevitably, the criticism of the opposition is directed at him, and his long tenure is creating problems within his own party too as well as with his traditional coalition partners. There is no doubt that the succession problem is becoming ever more prominent, and will have to be addressed at some point in the medium run.

The economy will continue to recover at moderate speed, NATO membership will be stabilising, once it happens, but political transition will remain a problem.

Table 18 / Montenegro: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017	2018
							Forecast	
Population, th pers., mid-year	620	621	621	622	625	625	625	625
Gross domestic product, EUR mn, nom.	3,265	3,181	3,362	3,458	3,600	3,800	4,000	4,200
annual change in % (real)	3.2	-2.7	3.5	1.8	3.4	2.8	2.8	3.1
GDP/capita (EUR at exchange rate)	5,200	5,100	5,400	5,600	5,800	6,100	6,400	6,700
GDP/capita (EUR at PPP)	10,700	10,400	10,800	11,200	11,700	.	.	.
Consumption of households, EUR mn, nom. 2)	2,663	2,632	2,724	2,775	2,900	.	.	.
annual change in % (real)	0.5	-3.9	1.6	2.9	2.0	2.0	2.0	2.0
Gross fixed capital form., EUR mn, nom.	637	628	678	657	700	.	.	.
annual change in % (real)	-7.2	-2.4	10.7	-2.5	4.0	5.0	4.0	4.0
Gross industrial production								
annual change in % (real)	-10.3	-7.0	10.6	-11.4	8.2	5.0	5.0	5.0
Net agricultural production								
annual change in % (real)	9.5	-12.7	5.0	3.0	3.0	.	.	.
Construction output 3)								
annual change in % (real)	15.9	-11.9	1.2	2.2	4.0	.	.	.
Employed persons, LFS, th, average 4)	195	200	202	216	221	223	225	227
annual change in %	.	2.4	1.0	7.1	2.2	1.0	1.0	1.0
Unemployed persons, LFS, th, average	48	49	49	48	50	50	50	40
Unemployment rate, LFS, in %, average	19.7	19.7	19.5	18.0	18.0	17.5	17.0	16.5
Reg. unemployment rate, %, average	15.9	15.3	15.8	16.1	18.0	.	.	.
Average monthly gross wages, EUR	722	727	726	723	725	750	770	790
annual change in % (real, gross)	-2.3	-3.2	-1.9	0.1	-1.1	1.0	1.0	1.0
Average monthly net wages, EUR	484	487	479	477	480	490	500	520
annual change in % (real, net)	-2.2	-3.3	-3.4	0.1	-0.8	1.0	1.0	1.0
Consumer prices, % p.a.	3.3	4.0	1.8	-0.5	1.4	2.0	2.0	2.0
Producer prices in industry, % p.a. 5)	3.2	1.9	1.6	0.1	0.3	2.0	3.0	2.0
General governm.budget, nat.def., % of GDP								
Revenues	39.3	35.4	37.0	39.1	39.0	40.0	38.0	40.0
Expenditures	43.0	41.9	40.7	42.1	45.0	43.0	40.0	42.0
Deficit (-) / surplus (+)	-3.7	-6.5	-3.7	-3.0	-6.0	-3.0	-2.0	-2.0
Public debt, nat.def., % of GDP	45.6	53.4	55.7	56.2	60.0	60.0	60.0	60.0
Central bank policy rate, % p.a., end of period 6)	9.06	8.83	8.68	8.50	8.53	8.0	8.0	8.0
Current account, EUR mn	.	.	-487	-526	-525	-555	-585	-590
Current account, % of GDP	.	.	-14.5	-15.2	-14.6	-14.6	-14.6	-14.0
Exports of goods, BOP, EUR mn	.	.	396	357	360	380	400	420
annual change in %	.	.	.	-9.7	0.7	5.0	5.0	5.0
Imports of goods, BOP, EUR mn	.	.	1,724	1,734	1,800	1,870	1,940	2,020
annual change in %	.	.	.	0.6	3.8	4.0	4.0	4.0
Exports of services, BOP, EUR mn	.	.	994	1,031	1,110	1,170	1,230	1,290
annual change in %	.	.	.	3.6	7.7	5.0	5.0	5.0
Imports of services, BOP, EUR mn	.	.	341	340	370	390	410	430
annual change in %	.	.	.	-0.3	8.7	5.0	5.0	5.0
FDI liabilities (inflow), EUR mn	.	.	337	375	390	.	.	.
FDI assets (outflow), EUR mn	.	.	13	21	20	.	.	.
Gross reserves of NB, excl. gold, EUR mn 7)	303	348	424	545	674	.	.	.
Gross external public debt, EUR mn	1,064	1,295	1,433	1,562	1,800	1,900	2,000	2,100
Gross external public debt, % of GDP	32.6	40.7	42.6	45.2	50.0	50.0	50.0	50.0
Purchasing power parity EUR/EUR	0.4910	0.4907	0.5015	0.4964	0.4909	.	.	.

1) Preliminary and wiiw estimates. - 2) Including expenditures of NPISHs. - 3) According to gross value added. -
4) According to census April 2011. - 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 Central Bank.

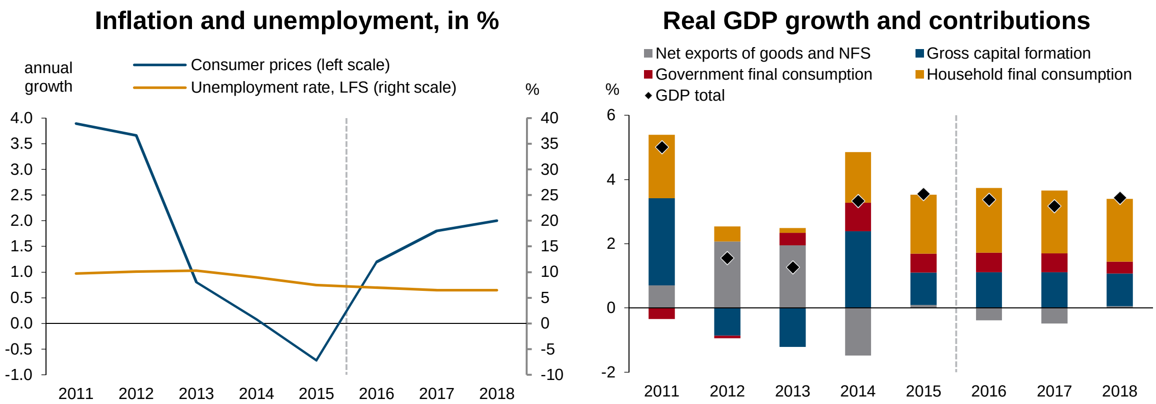
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

POLAND: Keeping generous promises will not be easy

LEON PODKAMINER

The current moderate and broadly based growth will continue over the period 2016-2018, with GDP growth averaging 3.4%. There is, however, every reason to expect less dynamic growth in terms of investment. 2017 will prove critical, unless the increase in social spending is offset by higher tax revenue.

Figure 50 / Poland: main macroeconomic indicators



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

According to provisional estimates, GDP grew by 3.6% in 2015. Rising household consumption contributed 1.8 percentage points (p.p.) to the overall growth, public consumption 0.7 p.p., gross fixed capital formation 1.2 p.p. and foreign trade (in goods and services) 0.3 p.p. As inventories contracted quite strongly in 2015, their contribution was negative (-0.4 p.p.). Gross value added rose strongly in industry and construction (by 5.4% and 4.4% respectively) and much weaker in the services sectors.

GDP growth accelerated from the second quarter of 2015, peaking (at about 3.8%) in the fourth. There are many indications that the first two quarters of 2016 may still see a continuation of GDP growth at rather high rates. However, the dynamics of gross fixed capital formation (GFCF) slowed down already in 2015: from 8.5% in the first half of the year to about 4.7% in the second. Quite likely the investment growth speed-up in early 2015 was due to a hasty spending of the last tranches of EU funds earmarked for 2007-2013. It will take some time before public investment spending out of EU funds earmarked for 2014-2020 regains momentum.

Overall GFCF in 2016 will primarily depend on the intentions of the private business sector. In 'material terms' these conditions are looking quite good. While nominally the net profits of the non-financial corporate sector have stagnated recently (during the first three quarters of 2015), they are still quite high and – given the deflation in producer prices – still rising in real terms. The sector's indebtedness is quite low (with its bank deposits alone not much lower than its credit liabilities) and the financial liquidity correspondingly very high and rising.[50] The median interest rates on loans (still above, but close to, 3%) are not permissively low – but nonetheless much lower than in 2014 (when investment growth was much stronger). The availability of bank credit is high: the share of credit applications accepted by banks is high and rising (while the demand for credit has been rather stagnant). On the other hand, the capacity utilisation index is relatively low (about 80% in manufacturing) which is generally believed to discourage aggressive business investment in fixed assets. However, at approximately the same level of capacity utilisation, business investment expanded much more strongly in 2014 and 2011.[51] All in all, the 'material' conditions seem conducive to a stronger expansion of business investment. Nevertheless, business opinion polls (and the evidence on the demand for credit) suggest that investment growth in 2016 may not be much higher than in 2015 – and possibly even somewhat weaker.

The genuine reason why the conditions that are 'materially supportive' may not yet translate into a stronger acceleration of business investment seems to have to do with a strong increase in uncertainty. The uncertainty in question is not over a 'normal' economic uncertainty (over sales or prices) though. Instead it seems to relate to the lack of certainty concerning the future course of policy towards the business sector. The fears about unpredictable changes in business taxation and legal or other regulations (including administrative – possibly arbitrary – intrusions) seem now well grounded. After many months of 'bad business bashing', which was an element of the election campaign of the victorious Law and Justice (PiS) party, the level of trust the business circles have in the stability and predictability of policy seems to be rather low. Naturally, a high level of trust is a central criterion when it comes to investment decisions.[52]

The government formed by PiS, in office since early November 2015, has already proved capable of legislating whatever serves its own preferences, without paying attention to anything else. That was possible as PiS chose to ignore the existence of the Constitutional Court. It has also conducted a wholesale purge of functionaries of the public administration apparatus and firms partly owned by the state. In June 2016 the PiS nominees will finally come to rule the National Bank of Poland. After taking over the public media, PiS seems poised now to 'tame' the private media as well.

Taking advantage of its parliamentary majority, the 'friendliness' of the President and the timidity of the media, the government wastes no time and is passing a number of laws. One law, already in force, burdens the financial sector's larger firms (including banks) with an extra tax (0.44%) on most of their

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50 See e.g. the January 2016 business climate survey of the National Bank of Poland: http://www.nbp.pl/home.aspx?c=/ascx/koniunktura_prezentacja.ascx

51 At about 20%, Poland's GFCF/GDP ratio has been singularly low. The stock of fixed productive capital seems to be rather low and may need to rise secularly.

52 Foreign-owned firms (especially banks and retail trade organisations) have been the favourite targets of 'business bashing'. But the foreign-owned corporations account for about 50% of total corporate sector investment in fixed assets. It is quite likely that these corporations may now be less inclined to expand their investment activities. The recent Standard & Poor's decision to downgrade Poland's credit rating from A- to BBB+ is likely to have some sobering effect on potential new FDI entrants as well. (S&P motivates their move by '... the view that Poland's system of institutional checks and balances has been eroded significantly ...'.)

assets. The law, introducing an extra tax (0.7-1.3%) on the turnover of larger retail trade firms (believed to be capable of bringing PLN 2-3 billion sums in additional tax revenue), has been officially motivated by the desire to extract a 'fair amount' of tax revenue from large foreign-owned supermarket chains. In actual fact the new tax would primarily affect the local small retail business operating under franchise contracts with large organisations, as well as the local suppliers of large supermarket chains. Amid massive protests of native shopkeepers, the law is now being 'reconsidered'. But there is little doubt that sooner or later the government will try to find additional tax revenue needed to cover the expenses of the costly social programmes which PiS promised to introduce during its election campaign. Some of that revenue will be reducing corporate disposable income – and thus also the profitability of newly installed pieces of productive assets.

The major of the social programmes promised has already been signed into law. It provides for the payment of PLN 500 (roughly EUR 115) monthly per each child (in families with two or more children). The programme, to become effective as of 1st April, will cost about PLN 17 billion (about 1% of GDP) in 2016. The financing of that amount may be possible without additional taxation because of large one-off fiscal revenues (PLN 8 billion profit made in 2015 by the National Bank and PLN 9.2 billion earned on LTE frequencies auctioned off last October). However, in 2017 the cost of the programme may reach PLN 22 billion while the additional revenue due to the tax on the financial institutions is unlikely to generate much more than (an estimated) PLN 5 billion. Obviously an additional – and large – financing gap will appear in 2017 – even if the government manages to collect more in the value added and the corporate income taxes due.[53] That financing gap may assume even larger dimensions should other election promises be fulfilled. These promises include a massive increase in the tax-free personal income threshold, free-of-charge pharmaceuticals for seniors aged 75 or more, lower retirement age, additional public support to the loss-making coal-mining sector etc. The most costly – and consequential – would be a programme of a substantial 'easing of the burden' of servicing debt denominated in Swiss francs that many (well-off) households voluntarily incurred when that currency's worth was very low vs. the Polish zloty.

Additional handouts to families with children will certainly be supporting growth in private consumption in 2016. Whether they will have that effect later on is less obvious if only because the additional tax burden placed on the business sector may well lead to higher inflation which then would be eroding the real purchasing power of households' disposable incomes.

The changing perceptions of Poland's economic and political environments, as well as the prospects of possibly rising public sector deficits, have weakened the national currency. Although this implies some losses on foreign debts service (including on mortgages denominated in Swiss francs) it will be advantageous to the foreign trade sector in 2016 – and very likely also in 2017. It may be expected that under the new monetary authorities the monetary policy will be relaxed. That should be also preventing a stronger zloty appreciation.

On 16th February 2016 the Minister of Development unveiled 'The Economic Long-Term Plan for Balanced Development'. All this is wishful thinking. The Plan lacks coherence and is empty of any details. One remembers plenty of such 'long-term plans' from the era of 'central planning'. They used to

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53 According to the government, the revenue losses due to tax evasion are gigantic (PLN 10-40 billion in corporate income taxes and PLN 35-45 billion in value added taxes). The details of the calculations behind these estimates are not known. Statistics show that generally the VAT and CIT taxes actually collected do not tend to fall behind the values planned.

be announced, with fanfares, just to ‘boost the moods of the masses’, or to compensate for the sorry state of everyday reality – but not to guide the actual policy.

2017 is going to be critical not only as far as fiscal developments go. Very likely the public sector revenues due to extraordinary tax burdens placed on the business sector will not be sufficient to cover the costs of expanded social spending. Excessive public sector deficits may not be acceptable to the European Commission (which does not belong to the fans of the PiS rule). Making use of the National Bank’s ‘printing press’ is also outlawed under the EU Treaties. The government is unlikely to wage an open war with the EU – just because it will need its money more than ever. The remaining options would be risky politically as they would stipulate either higher general taxation (for example higher VAT rates) or a downsizing of the spending programmes. It is to be feared that, in order to make the necessary fiscal tightening less visible to the public, PiS could then stage large-scale public spectacles over issues such as the predecessors’ (or political opponents’) ‘corruption’, ‘treason of national interests’, ‘bad morality’, ‘complicity in the plot to assassinate the former State President Lech Kaczynski’ or even their ‘incorrect ethnic provenience’[54].

Summing up, Poland’s economic forecast is still positive, with GDP expected to rise by 3.4% per annum over 2016-2018. However, rather large fiscal imbalances likely to emerge in 2017 may necessitate adjustments that can slow down growth in 2017-2018.

[54] In 2007, only after two years in power, PiS staged such a fascinating public spectacle (lavishly reported, on line, by the media). The role of the chief villain was assigned to Andrzej Lepper, the charismatic leader of the populist ‘Samoobrona’ party, and – at that time – formally Deputy Prime Minister in the PiS-led coalition government. The PiS functionaries in charge of the Justice and Secret Police departments (currently both back in their former offices) concocted a plot to discredit the ‘inconvenient’ Mr Lepper. The plot misfired as Mr Lepper proved less corrupt than believed. The affair resulted in the collapse of the government and the new elections (lost by PiS miserably).

Table 19 / Poland: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017 Forecast	2018
Population, th pers., average	38,534	38,536	38,514	38,487	38,525	38,500	38,550	38,560
Gross domestic product, PLN bn, nom.	1,567	1,629	1,656	1,719	1,770	1,850	1,940	2,050
annual change in % (real)	5.0	1.6	1.3	3.3	3.6	3.4	3.2	3.4
GDP/capita (EUR at exchange rate)	9,900	10,100	10,200	10,700	11,000	11,000	11,700	12,400
GDP/capita (EUR at PPP)	16,800	17,600	17,900	18,600	19,800	.	.	.
Consumption of households, PLN bn, nom.	948.7	988.2	994.1	1,019.3	1,040.0	.	.	.
annual change in % (real)	3.3	0.8	0.2	2.6	3.1	3.4	3.3	3.3
Gross fixed capital form., PLN bn, nom.	324.1	322.5	311.7	337.5	360.0	.	.	.
annual change in % (real)	8.8	-1.8	-1.1	9.8	6.0	5.0	5.0	5.0
Gross industrial production (sales) 2)								
annual change in % (real)	6.8	1.3	2.3	3.4	4.9	5.0	4.5	5.0
Gross agricultural production								
annual change in % (real)	0.1	1.2	0.7	6.6	-2.8	.	.	.
Construction industry 2)								
annual change in % (real)	15.3	-5.2	-10.3	4.3	0.3	.	.	.
Employed persons, LFS, th, average 3)	16,131	15,591	15,568	15,862	16,000	16,100	16,100	16,100
annual change in %	1.1	0.2	-0.1	1.9	0.9	0.5	0.3	0.3
Unemployed persons, LFS, th, average 3)	1,723	1,749	1,793	1,567	1,308	1,210	1,120	1,120
Unemployment rate, LFS, in %, average 3)	9.7	10.1	10.3	9.0	7.5	7.0	6.5	6.5
Reg. unemployment rate, in %, end of period	12.5	13.4	13.4	11.4	9.8	.	.	.
Average monthly gross wages, PLN	3,404	3,530	3,659	3,777	3,880	4,100	4,300	4,500
annual change in % (real, gross)	1.4	0.1	2.8	3.2	3.5	3.5	4.0	3.5
Consumer prices (HICP), % p.a.	3.9	3.7	0.8	0.1	-0.7	1.2	1.8	2.0
Producer prices in industry, % p.a.	7.3	3.3	-1.2	-1.3	-2.1	0.0	1.5	1.5
General governm.budget, EU-def., % of GDP								
Revenues	38.8	38.9	38.4	38.8	38.6	39.5	39.0	39.0
Expenditures	43.6	42.6	42.4	42.1	41.5	42.4	42.5	42.5
Net lending (+) / net borrowing (-)	-4.9	-3.7	-4.0	-3.3	-2.9	-2.9	-3.5	-3.5
Public debt, EU-def., % of GDP	54.4	54.0	55.9	50.4	51.7	52.5	53.3	54.0
Central bank policy rate, % p.a., end of period 4)	4.5	4.3	2.5	2.0	1.5	1.0	1.5	2.0
Current account, EUR mn	-19,647	-14,458	-5,028	-8,298	-710	-6,400	-9,000	-16,700
Current account, % of GDP	-5.2	-3.7	-1.3	-2.0	-0.2	-1.5	-2.0	-3.5
Exports of goods, BOP, EUR mn	132,420	141,026	149,113	158,657	171,715	183,700	192,900	202,500
annual change in %	12.1	6.5	5.7	6.4	8.2	7.0	5.0	5.0
Imports of goods, BOP, EUR mn	145,709	149,156	149,448	161,911	169,115	181,000	191,900	203,400
annual change in %	12.9	2.4	0.2	8.3	4.4	7.0	6.0	6.0
Exports of services, BOP, EUR mn	29,370	31,949	33,592	36,279	39,199	40,800	42,400	44,100
annual change in %	9.8	8.8	5.1	8.0	8.0	4.0	4.0	4.0
Imports of services, BOP, EUR mn	24,206	25,947	25,948	27,705	29,301	30,500	31,700	33,000
annual change in %	3.2	7.2	0.0	6.8	5.8	4.0	4.0	4.0
FDI liabilities (inflow), EUR mn	13,274	5,771	658	12,826	6,532	.	.	.
FDI assets (outflow), EUR mn	3,415	1,055	-2,524	4,609	148	.	.	.
Gross reserves of NB excl. gold, EUR mn	71,691	78,403	74,257	79,379	83,676	.	.	.
Gross external debt, EUR mn	250,947	279,739	278,948	291,878	303,400	306,200	329,300	348,000
Gross external debt, % of GDP	66.0	71.9	70.7	71.0	71.7	72.0	73.0	73.0
Average exchange rate PLN/EUR	4.1206	4.1847	4.1975	4.1843	4.1841	4.35	4.30	4.30
Purchasing power parity PLN/EUR	2.4226	2.3978	2.4087	2.4059	2.3259	.	.	.

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) From 2012 according to census March 2011. -
4) Reference rate (7-day open market operation rate).

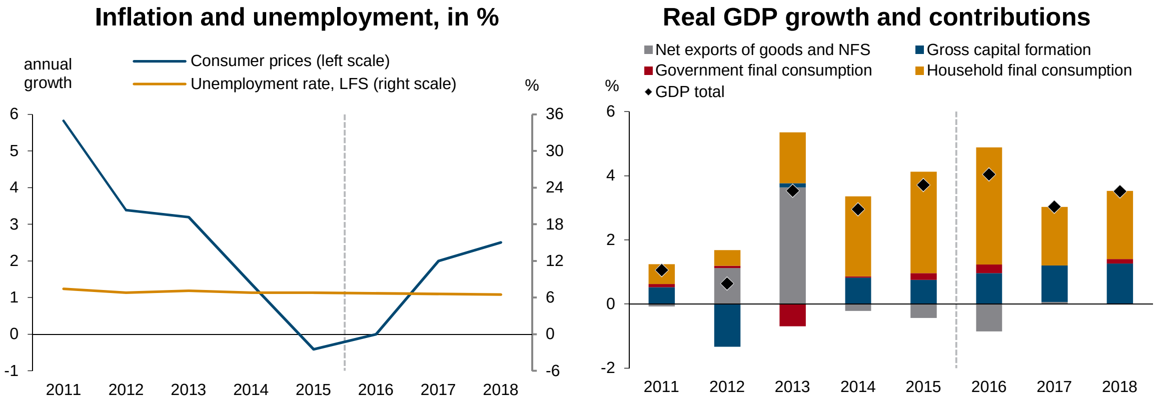
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ROMANIA: Pro-cyclical fiscal loosening

GÁBOR HUNYA

In 2015 economic growth accelerated. In 2016 GDP will expand further by some 4%. Private consumption will enjoy a pro-cyclical boost thanks to tax cuts and wage increases in the public sector, while fixed investments will also recover. For the most part, the impact of the fiscal stimulus will be short-lived; economic growth may well slow down in 2017.

Figure 51 / Romania: main macroeconomic indicators



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

Economic growth was ahead of expectation in 2015 (3.7%) and it is assumed to accelerate further, to about 4% this year. Household demand has been the main driver of growth; VAT cuts for food products, wage rises and negative inflation in 2015 have stimulated consumption. As to 2016, a general VAT cut from 24% to 20% is effective as of 1 January and a minimum wage hike is planned for May. The pro-cyclical boost was given to the economy by the previous Socialist government and the current care-taker government was obliged to implement it in the 2016 budget, increasing the general government deficit target to 2.95% of GDP. As public debt is below 40% of GDP, the current account nearly balanced and inflation negative, no immediate risk of overheating emerges although the country's vulnerability to external shocks may increase.

Good news is that gross fixed capital formation also recovered in 2015. The construction of new buildings and housing units took off and the increase in the number of construction permits suggests that the trend continues. But large infrastructure projects such as motorways, although swallowing funds, are in delay. The highway connection of Bucharest with the Western border will be completed only in 2023.

Delays are mainly due to the inability to draw EU funds, which is the result of institutional inefficiency and increased risk of punishment for corrupt practices. It is estimated that the absorption rate was 70% at the end of 2015, thus about EUR 5-6 billion of the financial allocation earmarked for 2007-2013 will be lost. The spending under the new financing period has hardly started and it is up to new EBRD, EIB and WB programmes to provide expertise and local co-financing.

The GDP growth in 2015 was achieved despite a dismal autumn harvest. Value added in agriculture was 10.5% lower than in the previous year and its contribution to GDP fell below 5%. But the population dependent on income from agriculture has declined in recent years. Thus the impact of harvest results on consumption has become smaller than a decade ago when weather conditions had a strong bearing on economic cycles.

Booming economic sectors in 2015 were first of all construction, hotels and restaurants and info-communication. Surprisingly slow growth was registered in industrial production (2.7%), but there should be no concern seeing how individual branches developed. It was mainly the low-skill industries that suffered setbacks of about 10% each: mining, textile, apparel, leather, chemicals, and other manufacturing. At the same time, production increased in industries benefiting from the construction boom such as the production of non-metallic minerals, fabricated metals and furniture, as well as in the export-oriented medium-high- and high-skill industries including the manufacturing of motor vehicles and of electrical equipment. The commodity structure of goods exports shifted towards transport equipment, which contributed more than 44% to total exports; additional one third is provided by electrical equipment and other manufactured goods. These products are increasingly exported within corporate networks to the EU, a destination which takes already three quarters of the total exports.

Consumer price inflation was negative (-0.4%), but leaving aside the impact of the VAT rate cut, it would have run close to 2% according to the calculation of the National Bank. The annual inflation rate is expected to move again into negative territory following the lowering of the standard VAT rate. But the effects of the rate cut for foodstuffs will fade out in the second half of the year and vigorous household demand may push inflation into the positive again. The effects of this year’s VAT cuts will expire in 2017 and inflation may return to the normal level of 2-3%.

The dynamics of credit to the private sector advanced into positive territory in 2015, solely on account of the faster growth of RON-denominated loans and declining lending in foreign currency. New credits to businesses and households as well as loan conversion both contributed. Loans in domestic currency surpassed 50% of the loan stock, up from 36% three years before. The share of non-performing loans declined; they were partly sold by commercial banks to other institutions. Foreign financing of domestic banks dropped and was compensated by domestic deposits. It seems that the banking sector is well on its way to neutralise the effects of the financial crisis.

There has been no positive labour market effect of the current economic recovery yet. Contrary to expectation, employment declined and unemployment stagnated at the level of the previous year. An explanation could be that wage increases put limits to the appetite to hire. Labour shortages in construction and some other activities may increase both hiring and wages in 2016. One of the large supermarket chains has recently implemented extraordinary wage rises.

The current account deficit widened in 2015 but still remained within a range of 1% of GDP. Imports grew ahead of exports on account of booming consumption and despite falling fuel prices. The deficit on goods trade was almost offset by the surpluses generated in services. There were two important items in services trade producing the surplus: transport services, which boomed, and ‘manufacturing services performed on physical inputs owned by others’ (processing trade), which was stagnating. The main novelty against previous years was that the primary income deficit (mainly the income of foreign investors) grew faster (by 66%) than the surplus in secondary income (50% growth) in which remittances remained flat. The widening gap between the two income categories constituted the overwhelming part of the current account deficit. FDI inflow in Romania (calculated according to the directional principle) increased by about 25%, to EUR 3 billion, over the previous year. The inflow was in the form of equity investment, implying that the country is considered an attractive destination for business investors.

The short-term forecast for Romania is dominated by the growth-stimulating effects of the fiscal relaxation. In 2017, when the one-time effects of tax cuts and wage corrections expire, a slowdown in economic growth will set in. Household demand will cool down, while net exports may recover. Due to the ongoing structural change in the Romanian economy, future growth will depend less on agriculture and more on the euro-area GDP. If the latter keeps growing at the current rate, Romania may attain some 3.5-4% GDP growth in the medium term.

Installing a non-partisan transitory government has proved a good idea up until now, calming public frustration over the political class. But controversies will surface again when the local elections scheduled for May 2016 will draw near and especially in the autumn, ahead of the parliamentary elections scheduled for November. The current transitory solution benefits the president first of all and probably also the National Liberal Party close to him. It is still too early to speculate on the outcome of these elections, in particular as several new parties have appeared across the whole political spectrum. Quite certainly, economic policy alternatives will not provide a topic for the election campaign and also the forthcoming government will lack longer-term visions and reform programmes.

Table 20 / Romania: selected economic indicators

	2011	2012	2013	2014	2015 [1]	2016	2017 Forecast	2018
Population, th pers., average	20,148	20,058	19,984	19,904	19,880	19,830	19,780	19,700
Gross domestic product, RON bn, nom.	565.1	595.4	637.5	667.6	710.0	750	800	850
annual change in % (real)	1.1	0.6	3.5	3.0	3.7	4.0	3.0	3.5
GDP/capita (EUR at exchange rate)	6,600	6,700	7,200	7,500	8,000	8,200	8,400	9,000
GDP/capita (EUR at PPP)	13,300	14,300	14,400	15,200	16,200	.	.	.
Consumption of households, RON bn, nom.	347.7	366.2	385.5	406.2	440.0	.	.	.
annual change in % (real)	1.0	0.8	2.6	4.1	5.2	6.0	3.0	3.5
Gross fixed capital form., RON bn, nom.	153.0	162.8	157.5	161.4	175.0	.	.	.
annual change in % (real)	2.9	0.1	-5.4	2.5	6.0	3.0	4.5	5.0
Gross industrial production [2]								
annual change in % (real)	7.5	2.4	7.9	6.1	2.8	4.0	4.0	5.0
Gross agricultural production								
annual change in % (real)	8.9	-21.9	24.5	2.9	-10.5	.	.	.
Construction industry [2]								
annual change in % (real)	2.7	1.4	-0.6	-6.7	10.4	.	.	.
Employed persons, LFS, th, average [3]	9,138	8,605	8,549	8,614	8,560	8,600	8,600	8,600
annual change in %	-1.1	0.9	-0.7	0.8	-0.6	0.5	0.0	0.0
Unemployed persons, LFS, th, average [3]	730	627	653	629	626	620	610	600
Unemployment rate, LFS, in %, average [3]	7.4	6.8	7.1	6.8	6.8	6.7	6.6	6.5
Reg. unemployment rate, in %, end of period	5.2	5.5	5.7	5.4	5.0	.	.	.
Average monthly gross wages, RON	1,980	2,063	2,163	2,328	2,525	2,700	2,900	3,100
annual change in % (real, gross)	-1.6	0.8	0.8	6.5	9.1	7.0	4.0	5.0
Average monthly net wages, RON	1,444	1,507	1,579	1,697	1,838	2,000	2,100	2,300
annual change in % (real, net)	-1.9	1.0	0.8	6.4	9.0	6.8	3.8	4.8
Consumer prices (HICP), % p.a.	5.8	3.4	3.2	1.4	-0.4	0.0	2.0	2.5
Producer prices in industry, % p.a.	7.1	5.3	2.0	-0.2	-2.0	1.0	2.0	2.5
General governm.budget, EU-def., % of GDP								
Revenues	33.7	33.3	33.0	33.5	34.0	33.0	33.0	33.0
Expenditures	39.1	36.5	35.2	34.9	35.5	36.0	35.5	35.5
Net lending (+) / net borrowing (-)	-5.4	-3.2	-2.2	-1.4	-1.5	-3.0	-2.5	-2.5
Public debt, EU-def., % of GDP	34.2	37.4	38.0	39.8	38.7	38.0	38.0	38.5
Central bank policy rate, % p.a., end of period [4]	6.00	5.25	4.00	2.75	1.75	2.00	2.25	3.00
Current account, EUR mn	-6,594	-6,394	-1,542	-677	-1,757	-2,800	-3,200	-4,000
Current account, % of GDP	-4.9	-4.8	-1.1	-0.5	-1.1	-1.7	-1.9	-2.3
Exports of goods, BOP, EUR mn	40,102	39,855	43,893	46,832	49,103	51,600	54,200	56,900
annual change in %	22.6	-0.6	10.1	6.7	4.8	5.0	5.0	5.0
Imports of goods, BOP, EUR mn	49,474	49,114	49,709	53,167	56,868	61,400	64,500	68,400
annual change in %	16.9	-0.7	1.2	7.0	7.0	8.0	5.0	6.0
Exports of services, BOP, EUR mn	8,688	9,868	13,434	15,102	16,294	17,300	18,200	19,100
annual change in %	11.0	13.6	36.1	12.4	7.9	6.0	5.0	5.0
Imports of services, BOP, EUR mn	7,031	7,392	8,733	9,236	9,426	10,200	10,700	11,200
annual change in %	11.0	5.1	18.1	5.8	2.1	8.0	5.0	5.0
FDI liabilities (inflow), EUR mn	1,712	2,380	2,894	2,931	3,425	.	.	.
FDI assets (outflow), EUR mn	19	-175	-24	227	663	.	.	.
Gross reserves of NB excl. gold, EUR mn	33,193	31,206	32,525	32,216	32,238	.	.	.
Gross external debt, EUR mn	99,926	100,857	98,069	94,744	90,896	89,700	95,000	100,900
Gross external debt, % of GDP	75.0	75.5	68.0	63.1	56.9	55.0	57.0	57.0
Average exchange rate RON/EUR	4.2391	4.4593	4.4190	4.4437	4.4454	4.60	4.80	4.80
Purchasing power parity RON/EUR	2.1096	2.0753	2.2083	2.2120	2.2069	.	.	.

1) Preliminary and wiiw estimates. - 2) Enterprises with 4 and more employees. - 3) From 2012 according to census October 2011. - 4) One-week repo rate.

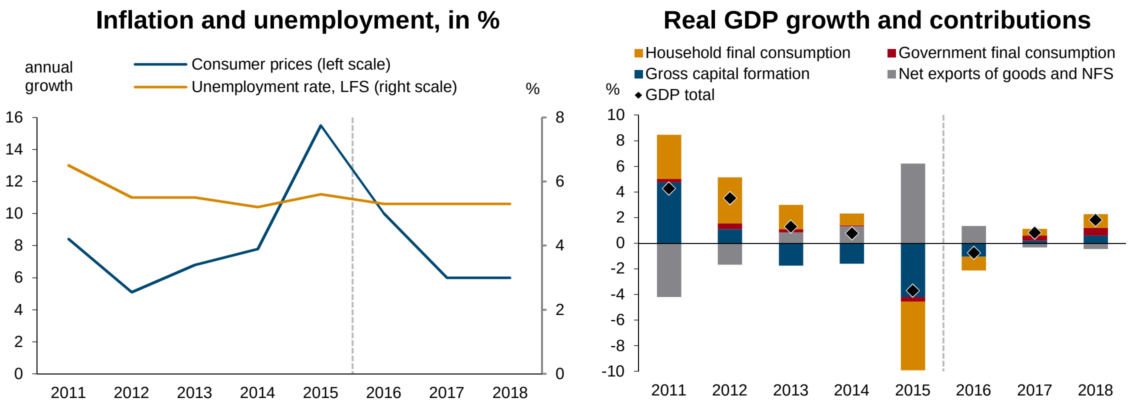
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

RUSSIAN FEDERATION: Recession not yet over

PETER HAVLIK

Contrary to earlier expectations, the Russian economy will remain in recession in 2016. With oil prices having plunged anew at the beginning of 2016, export and budget revenues will drop. The envisaged cuts in expenditure will affect both consumption and investments; net exports will suffer as well. Barring additional external shocks, the economy may stabilise in 2017. Given the absence of reforms and investments, economic growth will remain sluggish – even in the medium term.

Figure 52 / Russian Federation: main macroeconomic indicators



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

The Russian economy plunged into recession in 2015. The combined effect of a prolonged reform stalemate, the collapse in oil prices and the subsequent devaluation of the rouble, as well as the imposition of Western sanctions and Russian counter-sanctions, has resulted in an unprecedented drop in Russian exports and – even more so – in imports.[55] Inflation shot up to double digits, the real effective exchange rate fell by 28% with respect to US dollar (and by 14% with respect to the euro) on annual average in 2015. Multiple shocks have hit domestic demand: real household consumption shrank by 10%, yet investments were cut even by 17% (inventories were sharply curtailed; gross fixed investments fell by 'only' 7.6%). The recession has not apparently affected the labour market so far; both employment and unemployment remain more or less flat and workers are sent on unpaid leave instead of being dismissed. However, the situation of migrant workers has markedly deteriorated. In addition to

55 Both in nominal terms. Export volume (oil) increased by 3% and Russia suffered huge terms of trade losses.

heightened anti-migrant rhetoric and more restrictive registration rules, the economic crisis and rouble devaluation resulted in an exodus of migrants: while thousands have left for home, those who remain suffer severe income losses.[56]

External shocks and related overall adjustments have been most spectacular in trade with the EU: already in 2014 EU exports to Russia had declined by 14% (German exports fell by 18%: all in current EUR terms). The trade decline accelerated dramatically in 2015 as the impact of collapsing oil prices, sanctions and the devaluation of the rouble struck home: preliminary data for 2015 indicate an additional huge drop not only in overall Russian exports (-19%), but especially in imports (-25%, again both in EUR terms).[57] Once again, trade with the EU suffered more than average: Russian imports from the EU fell by 35% in 2015, while those from Germany, Hungary, Poland and Slovakia dropped by close to 40%.[58]

In addition, FDI inflows nearly dried out in the course of 2015 and FDI stocks were drastically reduced: inward FDI stocks fell by USD 186 billion (-33%), outward stocks by USD 100 billion (-20%) between January 2014 and July 2015. Simultaneously, the external debt was cut (by more than USD 200 billion during 2014-2015) as refinancing became more difficult due to the sanctions, and the outflow of capital diminished considerably last year. The reduction in FDI flows results from recession, the Western financial sanctions and the associated worsening of the investment climate; part of the disinvestment can also be attributed to the official 'de-offshorisation' campaign launched in 2014 and implemented since the beginning of 2015.[59]

The year 2016 started with another plunge in the oil price and a complementary rouble devaluation. The Russian government, domestic and foreign think tanks and analysts reacted with another downward revision of economic forecasts. Scenarios which were considered pessimistic just a few months ago (based on an oil price below USD 40/bbl) represent now a baseline and the former crisis scenarios (with an oil price ranging between USD 20 and 30/bbl) have become more realistic. In either case, the bottoming-out of recession with subsequent stagnation in the course of 2016 – as was expected in wiiw's Autumn 2015 Forecast – will be delayed by at least one year. Moreover, the new external risks (Syria, the conflict with Turkey, further frictions with Ukraine, etc.) will lead to additional costs in terms of growth, investment and trade. The self-imposed ban on Turkish imports (food, textiles, construction and travel) will result in additional hardship for Russian consumers while prospects for import substitution from domestic or other sources are bleak due to the lack of investment resources and other bottlenecks – even in the medium term.[60]

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[56] The associated fall in remittances will have a severe impact on several countries, mainly Kyrgyzstan, Tajikistan, Uzbekistan, Moldova and Ukraine.

[57] Owing to EUR/USD fluctuations the decline in trade was more pronounced in USD terms.

[58] The number of imported passenger cars fell by half in 2015, imports of trucks by two thirds. Russia de facto stopped importing meat, fish, milk, fruits and vegetables from the EU. Export losses suffered by many EU countries are already close to the 'extreme' scenario elaborated in November 2014 (which reckoned with a 50% export drop).

[59] The lion's part of disinvestment was recorded vis-à-vis offshore tax havens (Cyprus: -USD 80 bn, British Virgin Islands: -USD 12 bn, Bermuda: -USD 14 bn, Bahamas: -USD 8bn, United Kingdom: - USD 12bn and USA: - USD 15 bn). For more details on the 'de-offshorisation' law, which has been in force since April 2015, see http://www.step.org/russia%E2%80%99s-duma-passes-de-offshoring-bill.

[60] Turkey accounted for 5.7% of Russian exports but just 2.2% of imports in 2015. Russian exports (mostly gas) are not (yet) affected by the conflict while import restrictions will have some (minor) adverse impact on Russian consumers, holiday makers and the construction industry.

Government anti-crisis plans for 2016 are largely pro-cyclical; budget expenditures will be cut by at least 10% and some taxes will increase. In February 2016, the Ministry of Economy elaborated its baseline GDP growth forecast (a drop by 0.8%) on the basis of an oil price of USD 40/bbl. It reckons with a deficit of the federal budget at 5.1% of GDP, a drop in investments by 6% and in real incomes by 4%. In a 'conservative' scenario (with an oil price of USD 25/bbl) there would be a higher budget deficit (6-7%) and a steeper fall in GDP. In both scenarios, the expected revenue shortfall should be partly offset by the imposition of new or higher taxes, additional privatisation revenues (RUB 1,000 billion), tapping the Reserve Fund (RUB 2,100 billion) and issuing new government debt (RUB 400 billion). Needless to say, each of these measures is controversial and will be subject to adjustments in the course of the forthcoming budgetary hearings in April.

In view of the new external shocks and the associated worsening of investment prospects, the revised wiiw forecast reckons with another fall of GDP in 2016 and stabilisation cum stagnation in the course of 2017 and thereafter. More than is usually the case, this baseline forecast is subject to significant downward risks, not only due to uncertain developments in the oil price and heightened geopolitical tensions. In alternative scenarios, the 2016 recession may be deeper and last longer. On the other hand, the recent alleged deal with Saudi Arabia to freeze oil production at the January 2016 level may push up the oil price and perhaps also prop up Russian economic growth. Nevertheless, there seems to be a consensus that Russia is facing a prolonged period of stagnation in both economic and societal developments. Turning inwards and continuing with more assertive policies is not helpful. Changing the pivot to China cannot substitute for trade with and investments from the EU, and the damaged links with most of the near neighbourhood both west and south (Ukraine and Turkey in particular) will be hard to restore. Moreover, even the Eurasian Economic Union flagship project has been adversely affected by these policies and other ill-considered unilateral steps on the part of Russia.

Table 21 / Russia: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017 Forecast	2018
Population, th pers., average	142,961	143,202	143,507	146,091	146,394	146,500	146,500	146,500
Gross domestic product, RUB bn, nom. 2)	55,967	66,927	71,055	77,893	80,413	87,000	93,000	100,000
annual change in % (real)	4.3	3.5	1.3	0.8	-3.7	-0.8	0.8	1.8
GDP/capita (EUR at exchange rate) 2)	9,600	11,700	11,700	10,500	8,100	7,700	7,700	7,800
GDP/capita (EUR at PPP) 2)	17,000	19,100	17,800	18,700	18,400	.	.	.
Consumption of households, RUB bn, nom. 2)	27,193	34,334	38,068	41,436	43,301	.	.	.
annual change in % (real)	6.8	7.4	3.7	1.7	-10.1	-2.0	1.0	2.0
Gross fixed capital form., RUB bn, nom. 2)	11,950	13,522	14,357	16,652	17,696	.	.	.
annual change in % (real)	9.1	6.0	0.9	-0.6	-7.6	-5.0	1.0	3.0
Gross industrial production 3)								
annual change in % (real)	5.0	3.4	0.4	1.7	-3.4	3.0	4.0	5.0
Gross agricultural production								
annual change in % (real)	23.0	-4.8	5.8	3.5	3.0	.	.	.
Construction output								
annual change in % (real)	5.1	2.5	0.1	-2.3	-7.0	.	.	.
Employed persons, LFS, th, average	70,857	71,545	71,391	71,524	72,324	72,500	73,000	73,500
annual change in %	1.3	1.0	-0.2	0.2	-0.4	0.2	0.7	0.7
Unemployed persons, LFS, th, average	4,922	4,131	4,138	3,889	4,264	4,100	4,100	4,100
Unemployment rate, LFS, in %, average	6.5	5.5	5.5	5.2	5.6	5.3	5.3	5.3
Reg. unemployment rate, in %, end of period 4)	1.7	1.4	1.2	1.2	1.2	.	.	.
Average monthly gross wages, RUB	23,369	26,629	29,792	32,495	33,925	36,200	39,500	44,000
annual change in % (real, gross)	2.8	8.4	4.8	1.2	-9.5	-3.0	3.0	5.0
Consumer prices, % p.a.	8.4	5.1	6.8	7.8	15.5	10.0	6.0	6.0
Producer prices in industry, % p.a. 5)	17.3	6.8	3.4	6.1	12.4	8.0	5.0	5.0
General governm.budget, nat.def., % of GDP								
Revenues	37.3	34.5	34.4	34.4	32.9	30.0	33.0	35.0
Expenditures	35.7	34.1	35.6	35.4	36.4	35.0	36.0	38.0
Deficit (-) / surplus (+)	1.5	0.4	-1.2	-1.1	-3.5	-5.0	-3.0	-3.0
Public debt, nat.def., % of GDP 6)	9.0	9.3	9.8	10.8	10.8	14.0	15.0	15.0
Central bank policy rate, % p.a., end of period 7)	8.00	8.25	5.50	17.00	11.00	8.0	6.0	5.0
Current account, EUR mn 8)	69,855	55,452	26,197	44,171	59,174	54,200	48,200	55,300
Current account, % of GDP 8)	5.1	3.3	1.6	2.9	5.0	4.8	4.2	4.9
Exports of goods, BOP, EUR mn 8)	370,131	410,300	393,911	376,284	305,404	293,300	309,800	338,800
annual change in %	25.0	10.9	-4.0	-4.5	-18.8	-4.0	5.6	9.4
Imports of goods, BOP, EUR mn 8)	228,764	261,202	256,951	232,852	174,465	167,500	178,700	191,800
annual change in %	23.5	14.2	-1.6	-9.4	-25.1	-4.0	6.7	7.3
Exports of services, BOP, EUR mn 8)	41,680	48,495	52,787	49,700	44,695	46,100	48,700	50,800
annual change in %	12.5	16.4	8.8	-5.8	-10.1	3.1	5.6	4.3
Imports of services, BOP, EUR mn 8)	65,706	84,736	96,643	91,487	78,060	81,300	85,900	87,900
annual change in %	15.8	29.0	14.1	-5.3	-14.7	4.2	5.7	2.3
FDI liabilities (inflow), EUR mn 8)	39,557	39,353	52,107	17,304	1,500	1,000	.	.
FDI assets (outflow), EUR mn 8)	48,008	37,980	65,120	42,630	15,000	10,000	.	.
Gross reserves of CB, excl. gold, EUR mn 9)	350,786	367,323	341,787	279,383	292,467	.	.	.
Gross external debt, EUR mn 8)	416,416	480,440	530,481	493,153	471,163	451,900	374,300	340,900
Gross external debt, % of GDP 8)	30.4	28.7	31.6	32.1	39.7	40.0	33.0	30.0
Exchange rate RUB/EUR, average	40.9	39.9	42.3	50.8	67.8	77.0	82.0	88.0
Purchasing power parity RUB/EUR 10)	23.0	24.4	27.8	28.6	29.8	.	.	.

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

1) Preliminary and wiiw estimates. - 2) From 2012 according to SNA'08. - 3) Excluding small enterprises. - 4) In % of labour force (LFS). -
5) Domestic output prices. - 6) wiiw estimate. - 7) From 2013 one-week repo rate, refinancing rate before. -
8) Converted from USD. - 9) Including part of resources of the Reserve Fund and the National Wealth Fund of the Russian Federation. -
10) wiiw estimates based on the 2011 International Comparison Project benchmark.

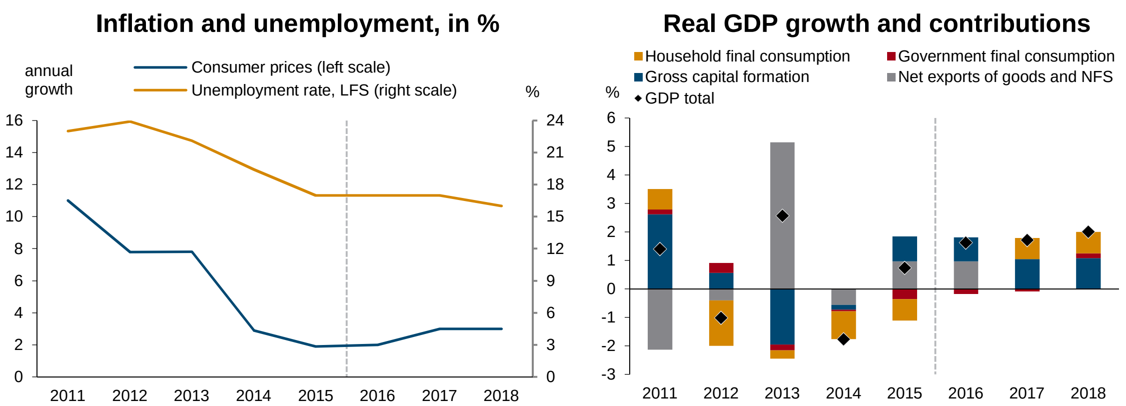
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SERBIA: Early elections and reforms

VLADIMIR GLIGOROV

Slow recovery in tandem with investment and export growth is to be expected over the medium term. Growth over the next three years or so should reach 2% or slightly more, if the fiscal consolidation programme and structural reforms are put into effect. Industrial production, in particular manufacturing, should grow, as should certain exportable services. Growth in wages and consumption, however, should be only relatively slow.

Figure 53 / Serbia: main macroeconomic indicators



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

After a slow recovery last year, some acceleration is expected in the medium term. In 2015 the economy saw a return to growth – the preliminary rate is 0.7%. This, if it survives revisions, is higher than forecasted due primarily to somewhat higher investments. Still, this was mainly due to the rather deep recession in the previous year. Besides investment, net exports contributed positively to growth, while consumption was down on account of fiscal consolidation efforts and the decline in real wages by about 2.5% year on year. On the supply side, industrial production increased, though less due to manufacturing and more because of the recovery of production of energy, which had been strongly affected by the floods in the previous year. The rest of the economy stagnated at best.

Employment continues to increase, and unemployment to decline. Informal employment is apparently growing, but so is the formal one. The unemployment rate has declined substantially in the last years or so. With recession in 2014 and almost stagnation in 2015, new employment indeed needs to be taking place in activities with below-average productivity. The unemployment rate remains high at around 17%.

The government would like to see growth accelerating to above 3% by 2018. The forecast remains rather cautious in the medium term mainly because consumption is not expected to increase due to continued fiscal consolidation and the announced reforms of the public sector, which will mean declining employment and additional pressure on wages and compensations. The speed-up of growth has to come from investment and exports. The former should increase by 6% per year on average, while there is uncertainty about the development of net exports. Imports tend to increase significantly with the acceleration of growth especially if it is financed by foreign investments. Even if exports are mostly aimed at, it will take some time before that translates into continued contribution of net exports to overall growth. Also, exports of commodities will continue to face low world prices, which will affect negatively exports of raw materials and agricultural products.

Public investments are to increase. So far, as in some other countries in the region, public investment has underperformed. The government is unable to spend all the money that it sets aside on infrastructure investments primarily. This may change in the medium term, and that would certainly contribute to growth and employment.

The reforms as designed have not been popular. The Serbian reform programme has been praised because it has centred on fiscal consolidation and structural reform. When it comes to the latter, so far that just meant a change in the labour law to make firing (and hiring) easier. That has proved to be unpopular as expected, but as it affected the private sector it did not matter much because neither firing nor hiring have met with much legal rigidity under the old law either (with an unemployment rate at 24% at the time of the passing, the old law clearly did not provide for much workers' protection). Fiscal adjustment is another matter because compensations and pensions were cut nominally, by 10%, with an exemption for the recipients of low pensions. These unpopular measures made it well-nigh impossible to implement additional structural reforms in the public as well as in the private sectors. This is one problem with the strategy of fiscal consolidation cum structural reforms: if reforms come before austerity, the strategy may work, if not, the loss of support may kill them.

Early elections were announced to gain a mandate and time to restart the programme of structural reforms. The government enjoys popular support and in part the opposition is disorganised and without a political programme. It seems clear that the governing parties cannot do better if they waited for the regular elections in two years' time. In addition, they hope to strengthen the control on the provincial and local levels (local elections are held at the same time as the general one). If indeed the support is such that they will have a secure majority without the need to broaden the governing coalition, they will have four years to rekindle the reform programme.

In foreign policy, strategic ambiguity is to be followed. In the last few years, since 2012 in any case, the government has been strategically ambiguous with accession to the European Union being the main goal, but close relationship with Russia being also maintained. The latter was expected to be beneficial in economic terms, with hopes riding high that Serbian exports would benefit from the regime of sanctions and countersanctions. Serbia has a free trade agreement with Russia, though exports to that market were hardly ever above 10% of total exports. These hopes did not materialise due to a sharp drop of demand for imports in Russia itself. However, there is some political constituency for closer political and military ties with Russia, so the ambiguity in foreign policy will remain, even though there is practically nothing that Russia can offer in return.

Regional recovery and the recovery in the EU should prove supportive of some speed-up of growth. The neighbouring countries are important trading partners, and not only those in the Western Balkans, but also Hungary and Romania. As most of them are expected to do better in the medium term, exports to these markets should help the recovery. The same goes for the EU, except that demand is less of a problem than supply of exportable goods when it comes to that market. Serbia is a very small economy, so the quantity of its exports to the EU, where its producers are price takers, is not really limited by market demand.

Table 22 / Serbia: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017 Forecast	2018
Population, th. pers., mid-year	7,237	7,201	7,167	7,132	7,040	7,010	7,000	7,000
Gross domestic product, RSD bn, nom.	3,408	3,584	3,876	3,908	4,000	4,100	4,300	4,500
annual change in % (real)	1.4	-1.0	2.6	-1.8	0.7	1.6	1.7	2.0
GDP/capita (EUR at exchange rate)	4,600	4,400	4,800	4,700	4,700	4,600	4,800	4,900
GDP/capita (EUR at PPP)	9,500	9,800	10,100	10,200	10,700	.	.	.
Consumption of households, RSD bn, nom.	2,596	2,728	2,886	2,922	2,900	.	.	.
annual change in % (real)	0.9	-2.1	-0.4	-1.3	-1.0	0.0	1.0	1.0
Gross fixed capital form., RSD bn, nom.	627	759	668	652	700	.	.	.
annual change in % (real)	4.6	13.2	-12.0	-3.6	4.0	4.0	5.0	4.0
Gross industrial production 2)								
annual change in % (real)	2.5	-2.2	5.3	-6.5	8.2	5.0	5.0	5.0
Gross agricultural production								
annual change in % (real)	0.9	-19.5	21.7	2.1	-8.0	.	.	.
Construction output 3)								
annual change in % (real)	5.9	-9.8	-3.9	-1.5	20.5	.	.	.
Employed persons, LFS, th, average 4)	2,253	2,228	2,311	2,544	2,620	2,650	2,680	2,710
annual change in %	-6.0	-1.1	3.7	10.1	3.0	1.0	1.0	1.0
Unemployed persons, LFS, th, average 4)	671	701	656	613	530	540	550	520
Unemployment rate, LFS, in %, average 4)	23.0	23.9	22.1	19.4	17.0	17.0	17.0	16.0
Reg. unemployment rate, in %, end of period	27.6	28.6	29.1	28.4	28.0	.	.	.
Average monthly gross wages, RSD	52,733	57,430	60,708	61,426	61,145	63,300	65,900	68,600
annual change in % (real, gross)	0.1	1.0	-1.9	-1.7	-2.4	1.0	1.0	1.0
Average monthly net wages, RSD	37,976	41,377	43,932	44,530	44,432	45,800	47,600	49,500
annual change in % (real, net)	0.2	1.1	-1.5	-1.5	-2.1	1.0	1.0	1.0
Consumer prices, % p.a.	11.0	7.8	7.8	2.9	1.9	2.0	3.0	3.0
Producer prices in industry, % p.a.	12.7	6.8	2.7	1.3	1.0	2.0	2.0	2.0
General governm.budget, nat.def., % of GDP								
Revenues	40.0	41.1	39.7	41.5	40.0	40.0	40.0	40.0
Expenditures	44.8	47.9	45.1	48.1	45.0	44.0	43.0	42.0
Deficit (-) / surplus (+)	-4.8	-6.8	-5.5	-6.6	-5.0	-4.0	-3.0	-2.0
Public debt, nat.def., % of GDP	45.4	56.2	59.6	70.4	73.8	80.0	85.0	85.0
Central bank policy rate, % p.a., end of period 5)	9.75	11.25	9.50	8.00	4.50	5.0	5.0	5.0
Current account, EUR mn	-3,656	-3,671	-2,098	-1,985	-2,000	-2,100	-1,900	-2,000
Current account, % of GDP	-10.9	-11.6	-6.1	-6.0	-6.0	-6.0	-6.0	-6.0
Exports of goods, BOP, EUR mn	8,118	8,376	10,515	10,641	11,200	11,800	12,400	13,000
annual change in %	18.4	3.2	25.5	1.2	5.3	5.0	5.0	5.0
Imports of goods, BOP, EUR mn	13,614	14,011	14,674	14,752	15,200	15,700	16,300	17,100
annual change in %	17.6	2.9	4.7	0.5	3.0	3.0	4.0	5.0
Exports of services, BOP, EUR mn	3,027	3,093	3,422	3,810	4,200	4,400	4,600	4,800
annual change in %	13.8	2.2	10.6	11.3	10.2	5.0	5.0	5.0
Imports of services, BOP, EUR mn	2,873	2,981	3,109	3,344	3,600	3,800	4,000	4,200
annual change in %	7.6	3.8	4.3	7.6	7.6	5.0	5.0	5.0
FDI liabilities (inflow), EUR mn	3,544	1,009	1,548	1,500	700	.	.	.
FDI assets (outflow), EUR mn	225	256	250	264	100	.	.	.
Gross reserves of NB, excl. gold, EUR mn	11,497	10,295	10,734	9,351	9,812	.	.	.
Gross external debt, EUR mn 6)	24,123	25,645	25,738	25,741	28,000	29,000	30,000	31,000
Gross external debt, % of GDP 6)	72.2	80.9	75.1	77.3	84.5	89.0	89.0	90.0
Average exchange rate RSD/EUR	101.95	113.13	113.14	117.31	120.76	126	128	130
Purchasing power parity RSD/EUR	49.67	50.64	53.64	53.77	53.16	.	.	.

1) Preliminary and wiiw estimates. - 2) Excluding arms industry. - 3) According to gross value added. - 4) Until 2013 survey of April and October, quarterly thereafter. From 2013 based on census 2011. - 5) Two-week repo rate. - 6) BOP 5th Edition.

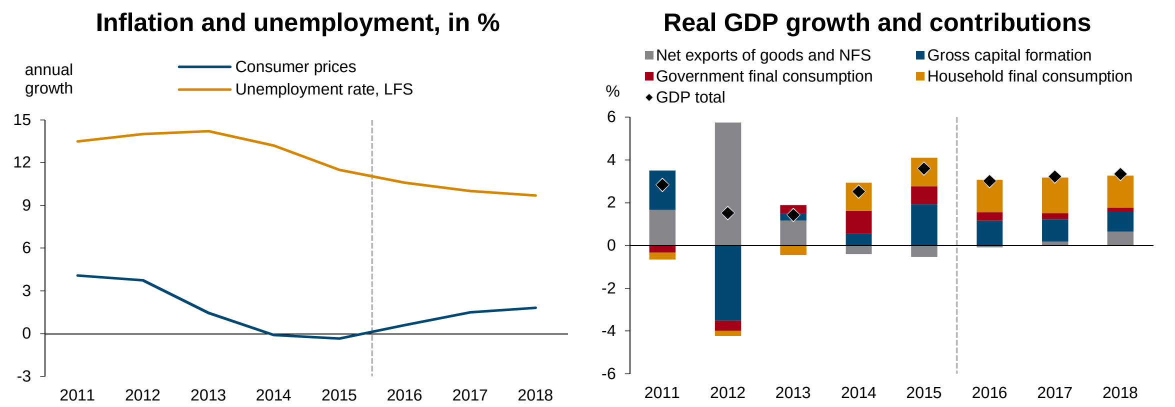
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SLOVAKIA: Domestic demand gaining importance

DORIS HANZL-WEISS

Strong growth in terms of gross fixed capital formation helped GDP to soar upwards by 3.6% in 2015. For the period 2016-2018, growth will range around 3%, with a slight upward trend in the latter years and backed by domestic demand.

Figure 54 / Slovakia: main macroeconomic indicators



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

Preliminary estimates show that Slovak GDP grew by 3.6% in 2015, the strongest increase in the past four years. This was due to a large surge in gross fixed capital formation (by 11% in the first three quarters; mainly in transport infrastructure), which benefited from the speeding-up of EU structural spending at the end of the drawing period of the 2007-2013 financial framework. In addition, household consumption grew as well (by 2.2%), but less than suggested by the pronounced improvements in the labour market and real wage growth. Consumer prices fell for the second year running, declining by 0.3% in 2015. In addition, government consumption contributed to growth. By contrast, net exports had a negative effect on growth. While goods exports rose by 5% (nominally) in 2015, goods imports increased by 7.5%. The trade balance was positive and reached EUR 3.3 billion but was 1.3 billion lower than in 2014. Together with a highly negative primary and secondary income balance (of about more than EUR 3 billion) this will push the current account into negative territory, after having achieved small positive figures in the previous three years. About 85% of goods were exported to the European Union, with goods exports to Germany – Slovakia's main export partner – rising by 8% (January to November 2015 as compared to the same period of 2014), and those to the Czech Republic, Slovakia's second most important export partner, by 2%. Deliveries to the former promising export markets Russia and China dropped by 30% each, while exports to the United States expanded by 17% (mainly cars).

Looking at sectoral trends, industrial production saw a pronounced surge in 2015 and increased by 6%. This was due to the automotive industry – the largest sector of Slovak manufacturing – taking over its role as a growth driver since mid-year again. The three main car manufacturers, Volkswagen Bratislava, KIA Motors and PSA Peugeot-Citroën, for the first time produced more than 1 million cars in 2015, boosting the country's position as the largest car producer per capita in the world (184 per 1,000 inhabitants). KIA raised car production by 4.4%, PSA Peugeot-Citroën by 19%. Despite the emission scandal striking Volkswagen in the United States in September 2015 and Volkswagen producing about 40% of all cars in Slovakia (about 400,000 in 2014), recent automotive industry figures of production and new orders have not shown signs of a slump – on the contrary, figures soared in November and December. In addition, another positive news was announced in December, when the final agreement for the arrival of a fourth car producer in Slovakia was signed: Jaguar Land Rover's new plant will be built near Nitra, the investment sum totals more than EUR 1 billion. Construction will start in 2016 and production should begin in late 2018. The initial annual production capacity will be 150,000 cars (up to 300,000 cars later on) while about 2,800 persons will be employed.

Declining for six years in a row, the construction sector finally recovered in 2015 and grew for the first time since the beginning of the economic crisis (by 18%, year on year). It was the main beneficiary of the speeding-up of EU structural funds towards the end of 2015. Overall, construction of civil engineering works increased by as much as 55% (data for the first eleven months of 2015), while construction of buildings grew only by 3%.

Labour market developments have been very favourable in 2015. Employment rose by about 2%, the fastest growth since the outbreak of the global financial crisis. The unemployment rate declined to 11.5%, which is very low for Slovak standards but still high compared to neighbouring countries (Slovakia suffers particularly from high levels of long-term and youth unemployment). Large regional disparities exist (unemployment is highest in the East and Central-South parts of Slovakia, featuring also the highest shares of Roma population) and are targeted under Prime Minister Fico's second social package. Average monthly real wages increased by 3% in 2015, the minimum wage rose again by EUR 25 to EUR 405 at the beginning of 2016, and salaries of civil servants were raised by 4%. Nevertheless, teachers and nurses have protested since the end of 2015 for higher salaries and better conditions in the education and health care systems. Teachers went on strike in January 2016 and nurses handed in notices.

The Slovak budget deficit hovered between -2.6% and -2.8% of GDP in the last three years, with the debt to GDP ratio falling slightly below 53% in 2015. This is important with respect to Slovakia's Fiscal Responsibility Act, featuring a 53% threshold.[61] Revenues and expenditures in 2015 were strongly affected by the drawing of EU funds, as the drawing period for transfers under the 2007-2013 financial framework was coming to an end. Although the drawing was speeded up, Slovakia was less successful than other countries and may face a loss of EUR 1 billion as compared to the earmarked potential sum of EUR 11.5 billion. Government policies and expenditures are shaped by the approaching parliamentary elections on 5 March 2016. In December 2015, Fico announced the third social

[61] Between 53% and 55% of GDP, the government must submit to the parliament a proposal of measures for debt reduction and the wages of government members are frozen to the level of the previous fiscal year.

package.[62] It promises the creation of 100,000 new jobs, construction of apartments for young families and teachers, Christmas bonuses for pensioners, building of roads and security measures. At the beginning of 2016, a range of measures under the second social package became effective, comprising a reduction of the VAT rate of basic foodstuff from 20% to 10% (fresh meat and freshwater fish, butter, fresh bread and milk) and the introduction of free bank accounts and those for a monthly fee of 3 euro, respectively. Gas rebates will be paid out at the beginning of the year. New government investment projects in the pipeline include the repair of roads in Bratislava before July, when Slovakia takes over its first Presidency of the Council of the European Union, and the Bratislava ring road (‘Bratislava bypass’). By the end of 2015, Italy’s Enel sold its 66% stake in the Slovenské Elektrárne energy utility to the Czech EPH (the Slovak government was heavily interested in this deal and still has an option to increase its minority stake to 51% in the second stage of this deal).

For the period 2016 to 2018, Slovak growth is forecasted to range around 3% per year, with a slight upward trend in the latter years provided constant developments on global markets. The 2015 growth impetus of soaring gross fixed capital formation will not continue, as the effects of the next planning period for structural funds is going to take off only in the years ahead. However, private investment will be pushed up by the new plant construction by Jaguar Land Rover, while loans to corporations also started to increase at the end of 2015. Household consumption will be the main driver of growth in the following three years and should speed up, backed by favourable labour market developments. Strong growth of loans to households (above 13% in 2015, year on year) may be seen as one internal risk, but is being only slowly reflected in property prices. The upcoming parliamentary elections, to take place on 5 March, shape policies at the moment but no major changes are to be expected from these elections. The Social Democrats (SMER), led by Robert Fico, lead in opinion polls, while the other parties are small and dispersed. Thus, a continuation of Fico’s policy can be expected (i.e., continuation of debt reduction, selective social measures and possibly increasing state influence in the energy sector). Net exports, which had been the major growth driver in the years after the crisis, have lost momentum and do not contribute to growth any longer. Imports are expected to increase with growing household consumption, while export growth is constrained by missing export locomotives. New capacities in the automotive industry might provide some impetus from 2018/2019 onwards, when the new Jaguar Land Rover plant will start car production.

[62] The first social package was announced in June 2014 (worth EUR 250 million), the second one in May 2015 (worth EUR 200 million). The third social package includes measures worth EUR 1 billion and should be introduced as of 2017.

Table 23 / Slovakia: selected economic indicators

	2011	2012	2013	2014	2015 [1]	2016	2017	2018
							Forecast	
Population, th pers., average	5,398	5,408	5,413	5,419	5,424	5,429	5,434	5,439
Gross domestic product, EUR mn, nom.	70,444	72,420	73,835	75,561	77,900	80,700	84,500	88,900
annual change in % (real)	2.8	1.5	1.4	2.5	3.6	3.0	3.2	3.3
GDP/capita (EUR at exchange rate)	13,000	13,400	13,600	13,900	14,400	14,900	15,600	16,300
GDP/capita (EUR at PPP)	19,000	19,700	20,200	21,100	22,400	.	.	.
Consumption of households, EUR mn, nom.	39,667	40,868	41,083	42,010	42,900	.	.	.
annual change in % (real)	-0.6	-0.4	-0.8	2.4	2.4	2.7	3.0	2.7
Gross fixed capital form., EUR mn, nom.	16,946	15,405	15,292	15,766	17,100	.	.	.
annual change in % (real)	12.7	-9.2	-1.1	3.5	9.7	4.0	4.5	4.0
Gross industrial production								
annual change in % (real)	5.3	7.9	4.9	4.0	5.9	4.0	4.0	5.0
Gross agricultural production								
annual change in % (real)	8.7	-5.7	6.7	7.4	-4.8	.	.	.
Construction industry								
annual change in % (real)	-1.8	-12.5	-5.3	-4.1	17.9	.	.	.
Employed persons, LFS, th, average [2]	2,351	2,329	2,329	2,363	2,410	2450	2470	2490
annual change in %	1.5	0.6	0.0	1.5	2.0	1.5	1.0	0.7
Unemployed persons, LFS, th, average [2]	368	378	386	359	314	290	270	270
Unemployment rate, LFS, in %, average [2]	13.5	14.0	14.2	13.2	11.5	10.6	10.0	9.7
Reg. unemployment rate, in %, end of period	13.6	14.4	13.5	12.3	10.6	.	.	.
Average monthly gross wages, EUR	786	805	824	858	880	910	950	990
annual change in % (real, gross)	-1.6	-1.2	1.0	4.2	3.0	3.0	2.5	2.0
Consumer prices (HICP), % p.a.	4.1	3.7	1.5	-0.1	-0.3	0.6	1.5	1.8
Producer prices in industry, % p.a.	4.5	1.9	-1.0	-3.5	-3.0	0.1	1.0	1.5
General governm.budget, EU-def., % of GDP								
Revenues	36.4	36.0	38.4	38.9	40.8	39.3	38.5	37.9
Expenditures	40.5	40.1	41.0	41.6	43.5	41.7	40.5	39.7
Net lending (+) / net borrowing (-)	-4.1	-4.2	-2.6	-2.8	-2.7	-2.4	-2.0	-1.8
Public debt, EU-def., % of GDP	43.3	51.9	54.6	53.5	52.7	52.6	52.3	52.0
Central bank policy rate, % p.a., end of period [3]	1.00	0.75	0.25	0.05	0.05	.	.	.
Current account, EUR mn	-3,497	684	1,446	100	-897	-1,300	-1,700	-1,800
Current account, % of GDP	-5.0	0.9	2.0	0.1	-1.2	-1.6	-2.0	-2.0
Exports of goods, BOP, EUR mn	54,673	60,159	62,145	62,581	65,919	68,600	71,300	74,900
annual change in %	17.6	10.0	3.3	0.7	5.3	4.0	4.0	5.0
Imports of goods, BOP, EUR mn	54,709	57,653	59,097	59,722	64,029	66,900	70,100	73,600
annual change in %	17.4	5.4	2.5	1.1	7.2	4.5	4.8	5.0
Exports of services, BOP, EUR mn	5,228	6,049	6,892	6,833	7,184	7,400	7,600	8,000
annual change in %	8.1	15.7	13.9	-0.8	5.1	3.0	3.0	5.0
Imports of services, BOP, EUR mn	5,498	5,628	6,481	6,749	7,026	7,400	7,800	8,200
annual change in %	0.2	2.4	15.2	4.1	4.1	5.0	5.0	5.0
FDI liabilities (inflow), EUR mn	3,961	1,356	757	27	1,695	.	.	.
FDI assets (outflow), EUR mn	1,962	-958	976	184	1,147	.	.	.
Gross reserves of NB excl. gold, EUR mn	659	620	670	1,165	1,648	.	.	.
Gross external debt, EUR mn	55,312	54,882	60,444	67,776	70,900	72,600	74,400	76,500
Gross external debt, % of GDP	78.5	75.8	81.9	89.7	91.0	90.0	88.0	86.0
Purchasing power parity EUR/EUR	0.6873	0.6787	0.6741	0.6616	0.6417	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2012 data according to census May 2011. - 3) Official refinancing operation rates for euro area (ECB).

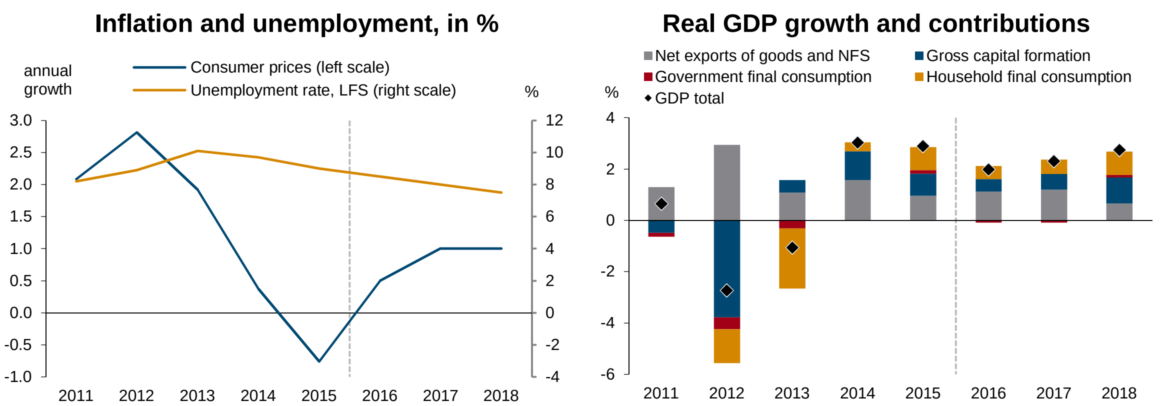
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

SLOVENIA: Almost back to normal

HERMINE VIDOVIC

Having increased by 2.9% in 2015, GDP growth in Slovenia will slacken to about 2% in both 2016 and 2017 on account of the drop in the volume of EU-funded investments at the outset of the new financial framework. More solid growth is forecast for 2018. Exports and the gradual recovery of household consumption will remain the main drivers of growth. Government consumption is expected to remain subdued in the wake of budget consolidation measures.

Figure 55 / Slovenia: main macroeconomic indicators



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

Slovenia's GDP continued to grow in 2015 albeit at a slightly slower pace than a year earlier. Growth was driven by rising net exports, and also inventories contributed positively to GDP growth. Household consumption growth gained momentum from quarter to quarter, while government consumption remained stagnant. Gross fixed capital formation grew only moderately. Over the period 2008-2014, gross fixed capital formation as a share of the GDP fell by almost 8 percentage points, to slightly below 20%. This was reflected primarily in the drop in construction activities, which in 2014 had shown signs of temporary recovery from a sharp contraction, but fell again in 2015. Survey results from the manufacturing sector suggest that in 2015 the most stimulating factors to investment were, among others, demand, the availability of financial resources and expected profits while the influence of other factors, such as uncertainties about the economic situation, was limiting.[63]

[63] http://www.stat.si/StatWeb/en/show-news?id=5617&idp=16&headerbar=7

In 2015 industrial production recorded the highest growth rate since 2010, with the most favourable results reported for the manufacture of ‘other transport equipment’ and car manufacturing, with output rising by 29% and 15%, respectively. The relatively high GDP growth translated into an only marginal rise in employment (based on Labour Force Survey data) and the unemployment rate fell only slightly, to 9.3% in 2015; about one third of the employment increase was due to rising self-employment. Wage growth continued to be moderate, with average monthly gross wages increasing by 1% in real terms.

Growth of external trade decelerated during 2015, with exports and imports up by a mere 4.5% and 2.9%, respectively. As a result, the trade surplus rose by EUR 300 million compared to 2014. Also the surplus in services trade was higher than in 2014, due to rising exports (mainly tourism and transport) along with moderate import growth. By contrast, the net outflow of primary and secondary income was larger than a year earlier. The widening of the deficit in primary income occurred mainly on account of the net outflow of direct investment income, while the rise in the deficit in secondary income can be attributed to the lower inflows of EU subsidies. The FDI inflow was somewhat higher than in 2014, totalling close to EUR 1 billion in 2015. Overall, the current account ended up with a surplus of EUR 2.8 billion, i.e. EUR 200 million more than in 2014.

The consolidated general government deficit is expected to have further tightened to 2.9% of the GDP in 2015, from 5% in 2014. This was largely resulting from increased tax revenues – value added and corporate income taxes – and social insurance contributions due to the improvement on the labour market and a broadening of the contribution base. Expenditures were somewhat lower than in 2014, with the most remarkable declines in spending on investments, interest payments and subsidies. Net receipts from the EU budget were slightly smaller than in 2014 due to lower receipts under the Common Agricultural and Fisheries Policies and from the Structural Funds.

The budgets for 2016 and 2017, approved in November, envisage a further reduction of the deficit – in compliance with the EU Stability Pact and the fiscal rule implementation – to 2.1% and 1.7% of the GDP, respectively. Compared to the draft budget adopted by the government in September, spending for 2016 was raised by an additional EUR 123 million for refugee-related costs. Priority is given to the police and military (refugee crisis), flood safety and the judiciary. The budget foresees the prolongation of temporary measures approved in recent years to keep expenditures under control and enhance revenues, while easing the public sector wage bill. Regarding revenues, the temporary increase in the VAT rate to 22% in 2013 becomes permanent as of 2016. Measures to fight the grey economy, such as the introduction of cash registers, have been adopted. On the expenditure side, measures to control public sector wages have been prolonged, including e.g. the freeze of the holiday bonus and additional pension insurance. Following an agreement between the government and the trade unions, public sector wages will be increased by 3.47% in 2016 and the freeze on promotions will be relaxed. According to the European Commission, the budgetary plan for 2016 is broadly compliant with the requirements under the Stability and Growth Pact, and Slovenia can expect the excessive deficit procedure to end in 2016 provided a correction of the excessive deficit is achieved.[64] The further spending cuts, however, may result in lower than expected GDP growth, taking into account that also withdrawals of EU funds under the new financial framework (which may support economic growth) will start only with some delay.

[64] Eurogroup, Commission Staff Working Document, Analysis of the 2016 Draft Budgetary Plan of Slovenia, Brussels, 17 November 2015.

The volume of total loans continued to decrease, falling by 5.4% between December 2014 and November 2015, mainly due to continued deleveraging of enterprises and NFIs. Lending to households, housing loans in particular, increased slightly, while lending to the government fell by another 5.2%. Corporate deleveraging has been continuing at domestic banks, but at a slower pace than in the past years.

The privatisation of 15 enterprises, approved by the previous government in 2013, is proceeding slowly. As of January 2016 only seven companies – coating manufacturer Helios, laser producer Fotona, Ljubljana airport, the food processing company Zito, Aerodrom Ljubljana, Nova Kreditna Banka Maribor, Airways Tehnika and the tissue maker Paloma – have been sold. The sale of Telekom Slovenija and the chemical-processing company Cinkarna Celje failed. The privatisation of the country's largest bank, Nova Ljubljanska Banka (NLB), and the second largest bank, Abanka, is expected to be finalised by 2017 and 2019, respectively.

GDP growth is expected to slow down slightly, to about 2% in the coming two years, owing to lower disbursements of EU structural funds at the beginning of the new financial framework – but will gain momentum thereafter. Given the improving situation on the labour market coupled with rising disposable income, household consumption together with net exports will remain the key drivers of economic growth. Private investments will only gradually gain momentum due to ongoing deleveraging. Government consumption will remain subdued owing to budget consolidation measures. Supported by continued economic recovery, public debt is expected to decline over the forecasting period to below 80% of the GDP. The current account is likely to remain in surplus. One of the biggest downside risks to growth would be a weakening of external demand.

Table 24 / Slovenia: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017 Forecast	2018
Population, th pers., average	2,053	2,057	2,060	2,062	2,063	2,063	2,063	2,063
Gross domestic product, EUR mn, nom.	36,896	35,988	35,908	37,303	38,543	39,500	40,800	42,400
annual change in % (real)	0.7	-2.7	-1.1	3.0	2.9	2.0	2.3	2.8
GDP/capita (EUR at exchange rate)	18,000	17,500	17,400	18,100	18,700	19,100	19,800	20,600
GDP/capita (EUR at PPP)	21,500	21,500	21,500	22,600	23,900	.	.	.
Consumption of households, EUR mn, nom.	20,338	20,117	19,437	19,553	19,667	.	.	.
annual change in % (real)	0.0	-2.4	-4.2	0.6	1.7	1.0	1.1	1.8
Gross fixed capital form., EUR mn, nom.	7,451	6,934	7,069	7,324	7,469	.	.	.
annual change in % (real)	-4.9	-8.8	1.6	3.2	0.5	0.0	3.0	4.0
Gross industrial production								
annual change in % (real)	1.3	-1.1	-0.9	2.2	5.0	4.0	4.5	4.5
Gross agricultural production								
annual change in % (real)	0.6	-11.0	-2.0	12.8	4.4	.	.	.
Construction industry 2)								
annual change in % (real)	-24.8	-16.8	-2.5	19.5	-7.3	.	.	.
Employed persons, LFS, th, average	936	924	906	917	917	920	930	940
annual change in %	-3.1	-1.3	-1.9	1.2	0.1	0.5	1.0	1.0
Unemployed persons, LFS, th, average	83	90	102	98	90	90	80	80
Unemployment rate, LFS, in %, average	8.2	8.9	10.1	9.7	9.0	8.5	8.0	7.5
Reg. unemployment rate, in %, end of period	12.1	13.0	13.5	13.0	12.3	.	.	.
Average monthly gross wages, EUR 3)	1,525	1,525	1,523	1,540	1,556	1,580	1,620	1,660
annual change in % (real, gross)	0.2	-2.4	-2.0	0.9	1.2	1.0	1.5	1.5
Average monthly net wages, EUR 3)	987	991	997	1,005	1,013	1,030	1,050	1,070
annual change in % (real, net)	0.3	-2.1	-1.2	0.6	0.9	0.7	1.0	1.0
Consumer prices (HICP), % p.a.	2.1	2.8	1.9	0.4	-0.8	0.5	1.0	1.0
Producer prices in industry, % p.a.	4.6	0.9	0.0	-0.7	-0.2	0.5	1.0	1.0
General governm.budget, EU-def., % of GDP								
Revenues	43.4	44.4	45.3	44.8	44.8	44.0	43.5	43.0
Expenditures	50.0	48.6	60.3	49.8	47.7	46.5	45.5	44.9
Net lending (+) / net borrowing (-)	-6.6	-4.1	-15.0	-5.0	-2.9	-2.5	-2.0	-1.9
Public debt, EU-def., % of GDP	46.4	53.7	70.8	80.8	83.5	81.0	80.0	79.0
Central bank policy rate, % p.a., end of period 4)	1.00	0.75	0.25	0.05	0.05	.	.	.
Current account, EUR mn	70	930	2,023	2,607	2,810	2,100	1,900	1,700
Current account, % of GDP	0.2	2.6	5.6	7.0	7.3	5.3	4.7	4.0
Exports of goods, BOP, EUR mn	21,042	21,256	21,692	22,989	24,035	25,000	26,100	27,400
annual change in %	12.9	1.0	2.1	6.0	4.5	4.0	4.5	5.0
Imports of goods, BOP, EUR mn	22,016	21,337	20,983	21,779	22,422	23,200	24,400	25,900
annual change in %	13.6	-3.1	-1.7	3.8	3.0	3.5	5.0	6.0
Exports of services, BOP, EUR mn	4,906	5,107	5,314	5,555	5,966	6,300	6,700	7,100
annual change in %	5.4	4.1	4.1	4.5	7.4	5.0	6.0	6.0
Imports of services, BOP, EUR mn	3,500	3,596	3,552	3,819	3,917	4,000	4,100	4,300
annual change in %	1.6	2.7	-1.2	7.5	2.6	2.5	3.0	4.0
FDI liabilities (inflow), EUR mn	637	28	71	746	937	.	.	.
FDI assets (outflow), EUR mn	-4	-439	24	146	52	.	.	.
Gross reserves of NB excl. gold, EUR mn	642	593	580	736	687	.	.	.
Gross external debt, EUR mn	41,669	42,872	41,658	46,314	44,723	44,200	43,700	42,800
Gross external debt, % of GDP	112.9	119.1	116.0	124.2	116.0	112.0	107.0	101.0
Purchasing power parity EUR/EUR	0.8356	0.8121	0.8117	0.7997	0.7804	.	.	.

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

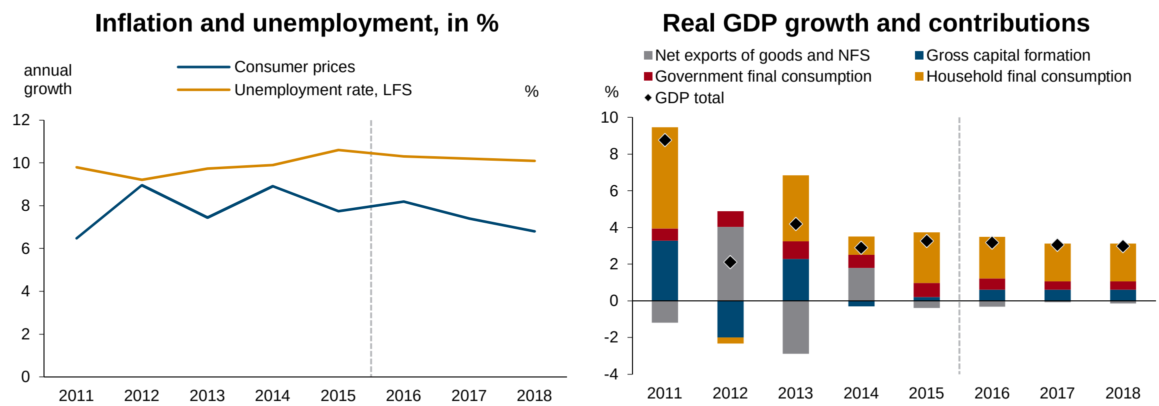
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

TURKEY: Strong domestic demand offsets external sector weakness

SERKAN ÇIÇEK

Owing to both a 30% net rise in minimum wages and the current strong government spending, we expect GDP to expand by 3.2% in 2016. Given the ongoing tensions along the Turkish-Syrian border and with the decline in oil prices finally bottoming out, a recovery of (net) external demand is unlikely in 2016. As for 2017 and 2018, we expect GDP to grow by 3.1% and 3.0%, respectively, owing to the recovery of foreign demand following a steady depreciation process and positive but lower growth rates of consumer loans, ultimately leading to a firm policy stance being adopted by the Central Bank of the Republic of Turkey.

Figure 56 / Turkey: main macroeconomic indicators



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

The rising tensions both in the Kurdish-majority region in Turkey after the collapse of the Kurdish peace process in mid-2015 and along the southern border of Turkey because of the ongoing war in Syria have been raising both social and political uncertainties. The downing of a Russian war plane by the Turkish Air Force in November 2015 at the Syrian border increased the risks by deteriorating the political and economic relations between Turkey and Russia. Moreover, the conflict between the Turkish government and the United States on the issue of the Democratic Union Party (PYD) – the only reliable ally of the USA fighting against ISIS in Syria but a terrorist organisation in the eyes of the Turkish government – brought Turkey closer to the Syrian conflict. Since it is not clear whether the Turkish government will be able to restore stability in its external relations, these developments compound the uncertainties affecting the Turkish economy.

Despite these developments, GDP increased by 3.4% in the first nine months of 2015 as compared to the same period of the previous year. Economic growth was still following its steady-state equilibrium, at around 3-4% since 2011. Although the political tensions and uncertainties remained high from mid-2015 onwards, GDP growth accelerated in the third quarter of the year: this was mainly on account of a hike in government spending and a rise in private consumption, which grew by 7.8% and 3.4%, respectively, year on year. Capital transfers, purchases of goods and services and compensation of employees were the main drivers of the hike in government expenditures in the first three quarters of 2015, with growth rates of 30.1%, 15.3% and 12.6%, respectively. On the private consumption side, sales of durable goods, in particular automobiles, continued to underpin the growth of household consumption. A rise in hourly wages in real terms was the major driving force of private domestic demand during 2015. We expect both private and public demand to have continued expanding at a moderate pace in the rest of the year and hence we estimate a GDP growth of 3.3% for 2015.

Central government expenditures in nominal terms increased by 12.8% in 2015, year on year, which is far from the 5.5% target of the medium-term programme of the government. But the central government budget deficit slightly narrowed by registering a deficit of TRY 22.6 billion (close to 1.5% of GDP) since revenues increased by 13.6%, primarily due to strong tax revenues. On the expenditure side, purchases of goods and services and compensation of employees were the main items in primary expenditures, increasing by 15.3% and 12.6%, respectively. On the tax revenue side, the collection of consumption-based taxes and income tax recorded an upsurge in 2015. As income tax revenues are largely provided through withholding taxes on salaries and wages, the strong increase in minimum wages in 2015 improved the collection of income taxes. The hike in sales of automobiles was the other main driver behind the surge in tax revenues in the first half of 2015. For 2016, we expect both the government's personal income tax revenues and consumption-based tax revenues to increase owing to higher minimum wage and the expansion in private consumption. We therefore forecast a slight improvement in the budget deficit as a share of GDP in 2016 and the years to come.

Despite lower energy prices throughout 2015, the annual inflation rate was 8.8% (end-of-period). The ongoing depreciation of the domestic currency both pushed the prices of core goods up and restricted the positive effect of the decline in energy prices. Additionally, prices of unprocessed food accelerated in the third and fourth quarters of 2015. The following three main developments are likely to play a crucial role for inflation in 2016. First, we are at the end of falling oil prices because the key OPEC and non-OPEC oil producers (Russia and Saudi Arabia) have reached an agreement on freezing the oil production. Second, the prices of unprocessed food might remain volatile because of the ongoing volatility of global food prices. And third, domestic demand may continue to rise due to the minimum wage hiked by 30% at the beginning of 2016. Therefore, we forecast average inflation rates to remain high, reaching 8.2% in 2016. For the years to come, our expectations of declining inflation are grounded on the following three reasons. First, we expect that the Central Bank of the Republic of Turkey (CBRT) will keep its tight policy stance in favour of price stability. Second, the exchange rate pass-through will decelerate due to the base effect since the nominal exchange rate significantly depreciated in 2015. And third, the slowdown in growth rates of consumer loans will restrict the growth rate of domestic demand and hence the inflation rate.

On the monetary policy side, the CBRT has been following a policy of flat interest rates since the beginning of 2015. It is unlikely that the CBRT will loosen its monetary policy unless they see positive developments in the inflation outlook. Against the backdrop of the uncertainty around the global markets and the volatility in food and energy prices which may lead to high prices in 2016, we assume that the CBRT will keep the policy rate at the current level rather than raising it in 2016. Since our inflation expectations up to 2018 are gradually decreasing, we forecast a moderate fall in the policy rates from 7.5% in 2016 to 6.5% in 2018.

The Turkish lira weakened, especially against the US dollar, in the first three quarters of 2015. After reaching an all-time low against the USD by ending the day at 3.06 TRY per USD on 15 September, the exchange rate stood at around 2.90 TRY per USD in the last quarter of 2015 and at around 3 TRY per USD so far in the current year. One of the main reasons behind the settling-down of the exchange rate depreciation is the improvement in the current account deficit with the help of lower oil prices and restrictions on consumer loans. Since tensions are high both in the southern part of the country and along Turkey's border with its neighbours including Russia, and the current account deficit is still high in spite of lower energy prices, we forecast a steady depreciation for the current year and the years to come.

The current account deficit decreased from USD 43.5 billion in 2014 to 32.2 billion in 2015. The trade deficit also narrowed in 2015. The main drivers behind the decline in the trade deficit are the change in the parity of the US dollar to the euro, the depreciation of the domestic currency and the sharp drop in energy and commodity prices. In 2015, cumulative exports declined by 8.7% in US dollars, but rose by 9.3% in euro terms in comparison with 2014; there was almost no change in export volumes. The share of the euro-area and EU countries in total exports increased while the share of Middle East countries was falling. Since the economic outlook for the euro-area countries and the EU is turning positive, we expect Turkey's exports to recover in 2016 in euro terms.

Trade relations with Russia are likely to play a crucial role in the goods and services trade deficit, hence also in the current account deficit. Russia was one of Turkey's largest trading partners. The economic slowdown in Russia already affected the trade relations in 2015. The share of Russia in Turkey's total exports was 3.8% in 2014 but decreased to 2.5% in 2015. The sanctions imposed after a Russian jet had been shot down by a Turkish fighter jet at the Syrian border will restrict Turkey's exports of goods (foodstuffs) and services (tourism, construction) to Russia. The first effect of the sanctions was the reduction of Turkish total export to Russia by 39% in December 2015, year on year. We forecast the main impact of the economic sanctions to be on tourism revenues in the summer of 2016. Russian travel agencies restricted selling tour packages to Turkey on the request of the Kremlin. The number of Russian tourist therefore fell by 47% in December 2015 and by 81% in January 2016. Since the share of Russian tourists in Turkey's total tourist number has been high (12.2% in 2013 and 2014, 10.1% in 2015), the effects of a Russian boycott of Turkish resorts will be substantial. We expect the share of Russian tourists in Turkey's total tourist number to be 6.4% in 2016. The civil war in Iraq and Syria and frictions with Egypt also restrict Turkey's exports to the region although the sanctions on Iran have been lifted. Despite those negative developments in the South-East in the context of the trade deficit, the improvement in Europe might help Turkey's exports to remain stable.

Cumulative imports declined by 14.4% in US dollar terms, but rose by 2.3% in euro terms, with no change in the import volume. We expect the decline in dollar imports to stop because OPEC and non-

OPEC oil producers are likely to reach an agreement on freezing the oil production which will probably result in the fall in oil prices coming to a halt. Therefore, the current account deficit is anticipated to slightly recover this year and to decline from 5.2% in 2016 to 5% of GDP in 2017.

Gross fixed capital formation rose by 2.5% in the first three quarters of 2015. The hike in private investment dominated the growth performance of gross fixed capital formation. In detail, machinery and equipment expenditures grew by 6%, but turned out to be negative in the third quarter with a growth rate of -2%. On the public side, machinery and equipment expenditures showed -0.3% growth whereas construction activities decreased by 3% in the first three quarters of 2015, year on year.

While the economic sanctions against Turkey might restrict the growth performance of the economy in 2016, the hike in minimum wages at the beginning of the current year and the ongoing strong government spending might offset the negative impact. Because of the persisting tensions along the Turkish-Syrian border and the bottoming-out of the oil price decline, a recovery of (net) external demand is unlikely in 2016. We therefore project GDP growth to expand by 3.2% in 2016. As for the years to come, we expect GDP to grow by 3.1% and 3.0%, respectively, owing to the recovery of foreign demand following a steady depreciation process and positive but lower growth rates of consumer loans with the effect of a tight policy stance of the CBRT.

Table 25 / Turkey: selected economic indicators

	2011	2012	2013	2014	2015 1)	2016	2017 Forecast	2018
Population, th pers., average	74,224	75,176	76,148	77,182	78,500	79,400	80,400	81,400
Gross domestic product, TRY bn, nom. 2)	1,298	1,417	1,567	1,747	1,940	2,200	2,400	2,600
annual change in % (real)	8.8	2.1	4.2	2.9	3.3	3.2	3.1	3.0
GDP/capita (EUR at exchange rate) 2)	7,500	8,100	8,100	7,800	8,200	8,400	8,700	8,900
GDP/capita (EUR at PPP) 2)	13,300	13,900	14,100	14,500	15,100	.	.	.
Consumption of households, TRY bn, nom. 2)	924	994	1,110	1,204	1,350	.	.	.
annual change in % (real)	7.7	-0.5	5.1	1.4	3.9	3.3	3.0	3.0
Gross fixed capital form., TRY bn, nom. 2)	283	287	319	352	390	.	.	.
annual change in % (real)	18.0	-2.7	4.4	-1.3	2.5	-2.0	2.0	2.0
Gross industrial production								
annual change in % (real)	10.1	2.5	3.0	3.6	3.2	3.1	3.0	3.0
Gross agricultural production 3)								
annual change in % (real)	5.2	5.5	2.8	2.0	2.0	.	.	.
Construction industry								
annual change in % (real)	11.5	0.8	7.7	2.9	0.7	.	.	.
Employed persons, LFS, th, average	24,100	24,820	25,520	25,931	26,600	27,200	27,800	28,400
annual change in %	6.7	3.0	2.8	1.6	2.6	2.2	2.1	2.0
Unemployed persons, LFS, th, average	2,616	2,517	2,750	2,854	3,150	3,120	3,160	3,190
Unemployment rate, LFS, in %, average	9.8	9.2	9.7	9.9	10.6	10.3	10.2	10.1
Reg. unemployment rate, in %, end of period	.	.	.	.	.	.	.	.
Average monthly gross wages, TRY	.	.	.	.	.	.	.	.
annual change in % (real, gross)	.	.	.	.	.	.	.	.
Consumer prices (HICP), % p.a.	6.5	9.0	7.5	8.9	7.7	8.2	7.4	6.8
Producer prices in industry, % p.a.	13.0	5.3	5.9	10.9	5.4	6.0	5.5	5.0
General governm. budget, nat.def., % of GDP								
Revenues	34.6	35.7	37.8	37.3	36.9	37.5	37.5	37.5
Expenditures	35.9	37.7	39.2	38.2	38.5	39.0	39.0	39.0
Deficit (-) / surplus (+)	-1.3	-2.0	-1.5	-0.9	-1.6	-1.5	-1.5	-1.5
Public debt, nat.def., % of GDP 4)	39.1	36.2	36.1	33.5	35.0	35.0	35.0	35.0
Central bank policy rate, % p.a., end of period 5)	5.75	5.50	4.50	8.25	7.50	7.50	7.25	6.50
Current account, EUR mn	-53,828	-37,659	-48,752	-35,179	-29,186	-35,000	-35,000	-36,000
Current account, % of GDP	-9.7	-6.1	-7.9	-5.9	-4.6	-5.2	-5.0	-5.0
Exports of goods, BOP, EUR mn	102,365	126,137	121,819	127,237	133,031	146,000	161,000	177,000
annual change in %	12.0	23.2	-3.4	4.4	4.6	10.0	10.0	10.0
Imports of goods, BOP, EUR mn	166,271	177,043	182,049	175,303	181,799	194,000	208,000	224,000
annual change in %	24.1	6.5	2.8	-3.7	3.7	6.5	7.0	7.5
Exports of services, BOP, EUR mn	29,561	34,078	35,506	38,142	41,634	45,000	49,000	53,000
annual change in %	6.7	15.3	4.2	7.4	9.2	9.0	8.5	8.0
Imports of services, BOP, EUR mn	15,191	16,472	18,290	19,152	20,082	22,000	24,000	26,000
annual change in %	1.2	8.4	11.0	4.7	4.9	8.0	7.0	7.0
FDI liabilities (inflow), EUR mn	11,679	10,303	9,359	9,474	14,944	.	.	.
FDI assets (outflow), EUR mn	1,724	3,167	2,716	5,377	4,603	.	.	.
Gross reserves of NB excl. gold, EUR mn	60,531	75,749	80,435	88,058	85,355	.	.	.
Gross external debt, EUR mn 6)	234,873	256,955	282,109	331,508	365,000	386,700	403,500	426,100
Gross external debt, % of GDP 6)	42.3	42.0	45.6	55.1	56.9	58.0	58.0	59.0
Average exchange rate TRY/EUR	2.34	2.31	2.53	2.91	3.03	3.30	3.45	3.60
Purchasing power parity TRY/EUR	1.31	1.36	1.46	1.56	1.63	.	.	.

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

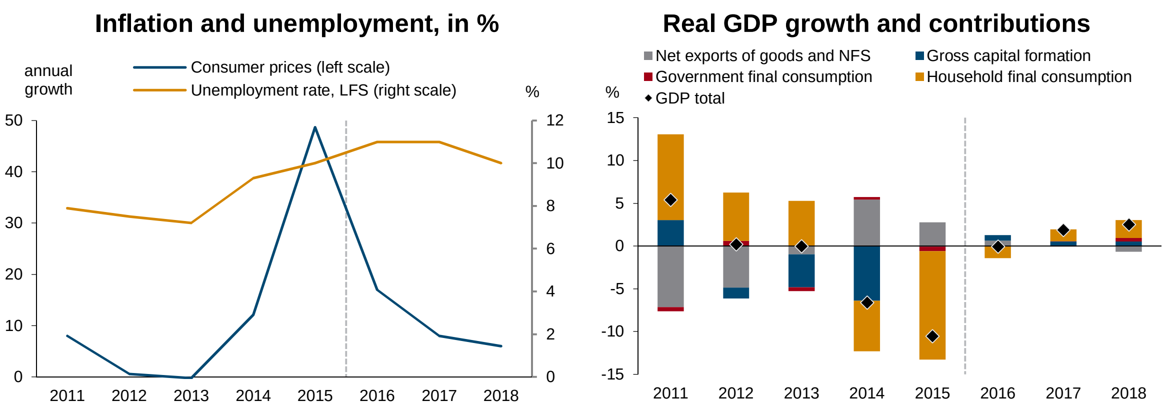
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

UKRAINE: A 'deep free trade' EU partner

VASILY ASTROV

Barring a resumption of large-scale fighting in Donbas, the economic decline has now most probably bottomed out. However, given the depressed domestic demand and the new restrictions on trade with Russia, which will not be offset by the newly established 'deep and comprehensive free trade' area with the EU, we forecast zero growth for the current year, followed by gradual acceleration to around 2% over the period 2017-2018.

Figure 57 / Ukraine: main macroeconomic indicators



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

On 1 January 2016, Ukraine entered the Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU, which is an important part of a broader Association Agreement signed after the Maidan revolution. However, the majority of Ukrainian exports had enjoyed free access to EU markets already since April 2014 (except for some agricultural products which are subject to tariff quotas). Therefore, the entry of the DCFTA into force effectively meant the liberalisation of access to the Ukrainian market for EU exporters (albeit with 3-10 years transitory periods for some products such as cars). On top of that, the DCFTA requires Ukraine to progressively adopt EU standards and regulations (some 60% of the EU's *acquis communautaire*) in a broad range of areas, including technical regulations, sanitary and phytosanitary standards, customs procedures, competition and public procurement rules, intellectual property rights, energy law, etc.[65]

In the short run, the DCFTA will not bring any substantial economic benefit to Ukraine. It is indicative that so far, Ukrainian producers could not take full advantage of the (nearly) free access to EU markets: in 2015, Ukraine's exports to the EU fell by 27% (in US dollar terms), mostly on account of lower commodity prices, while export diversification towards more sophisticated products is hampered by the existing gap in standards and the lack of investments. On the other hand, the influx of European goods to Ukraine is likely to be mitigated by the weakness of the Ukrainian hryvnia, even with no import duties in place. In the medium and long run, compliance with EU standards could boost the competitiveness of Ukrainian products in EU markets. However, their implementation will take a long time, prove rather costly,[66] and will ultimately hinge on substantial inflows of FDI.

At the same time, following the failure of trilateral Ukraine-EU-Russia talks on alleviating the potential repercussions of the Ukraine-EU DCFTA on Russia, Russia retaliated with a number of measures effective from January 2016: it revoked the existing free trade agreement with Ukraine (implying that Ukrainian exports to Russia are now subject to the 'most-favoured-nation' WTO clause),[67] imposed an embargo on Ukrainian food, and restricted the transit of Ukrainian goods to third countries (mostly Central Asia and the Southern Caucasus) across Russian territory.[68] The losses for Ukraine resulting from the Russian food embargo should be rather modest (some USD 300 million, since Ukraine is now exporting only 2% of its agricultural output to Russia, mostly meat), but taking into account the higher Russian import duties on other products, the transit restrictions and other 'non-tariff barriers', the overall losses may reach according to some estimates up to USD 2 billion, or about 2% of GDP. Overall, and despite the recent slump, Russia is still Ukraine's single most important export destination, accounting for some 12% of its goods exports in 2015.

Under these conditions, the expected main engine of Ukraine's economic recovery this year – exports – may not run. In 2015 GDP declined by an estimated 10.5%. In the course of the year, however, the recession slowed down markedly: from -17.2% in the first and -14.6% in the second quarter to -7.2% in the third and -1.2% in the fourth quarter. This reflected above all a lower statistical base (the unfolding of the crisis already by the end of 2014), but also positive growth on a quarterly (seasonally adjusted) basis: 0.5% in the third and an impressive 1.5% in the fourth quarter of 2015.

The economic decline can be only partly blamed on the military conflict in Donbas: from 2015 onwards, statistics exclude territories under the rebels' control, which prior to the conflict used to account for some 8% of Ukraine's GDP. (Still, in the parts of the Donetsk and Luhansk regions which are under Kyiv's control, industrial production dropped by 35% and 66%, respectively, in 2015.) A more important driver of recession has been the dramatic slump in private consumption in the country in general: retail trade

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65 The DCFTA is yet to be ratified by all 28 EU Member States. Most importantly, the Netherlands will hold a referendum on this issue on 6 April 2016.

66 The Ukrainian National Academy of Sciences estimated earlier that cumulated costs may add up to some EUR 160 billion over a period of ten years (based on the earlier experience of Visegrad countries and adjusting for the backwardness of the Ukrainian economy).

67 Belarus, Kazakhstan and other members of the CIS FTA have not followed Russia's example and maintain the free trade agreement with Ukraine.

68 Ukraine responded by imposing an import embargo on a number of Russian products, such as food, chemicals and railway equipment.

turnover declined by 21% last year, largely on account of the hryvnia depreciation, which eroded the purchasing power of households. At the same time, the fiscal austerity steps – first of all the nominal freeze of public sector wages and pensions up until September 2015 under conditions of very high inflation, reaching up to 60% on an annual basis – suppressed aggregate demand still further. It is telling that despite the deep recession (and the related operation of automatic stabilisers on the fiscal side), the budget deficit was actually *reduced* by about 3 pp of GDP, to an estimated 1.7% last year. While budget revenues declined only by 4% in real terms, expenditures dropped by 13%, with social protection, health and education all recording over-proportionate declines. On top of that, another 3 pp of GDP were 'saved' via a marked reduction in energy subsidies (which are not part of the government budget), as retail gas tariffs were hiked four times in April 2015.

In line with the IMF demands, the 2016 central budget targets a deficit of 3.7% of GDP and is based on a new tax code. The flat tax on personal incomes has been reinstated and set at 18% (instead of the progressive rate of 15-20% before).[69] The excise taxes on gasoline, tobacco and alcohol have been hiked but the 5-10% import surcharge imposed last year to improve the balance of payments has been now abolished. Most importantly, the single social contribution (payroll tax) paid by employers has been cut from an average rate of 41% to a flat rate of 22%, while the 3.6% single social contribution paid by employees has been abolished altogether. The idea behind is to create incentives to declare wages and thus to 'de-shadow' the economy. However, since other factors behind the widespread tax evasion – above all the reluctance to be exposed to the corrupt and arbitrary state apparatus – are arguably more critical than tax rates *per se*, tax compliance may not increase all that much. Therefore, the likely outcome will be a larger deficit of the Pension Fund and of the government budget as a consequence. On the expenditure side, public sector wages and pensions are to be indexed in two steps by a total of 12.5%, i.e. in line with the expected inflation, while debt service and defence spending are earmarked at 5% of GDP each. The latter is deemed necessary to finance the army, whose size has doubled over the past two years: from 146 to 280 thousand soldiers.

In December 2015, Ukraine defaulted on its USD 3 billion debt to Russia, and the dispute is subject to international arbitration. However, this is no longer an obstacle for the continuation of the USD 17 billion IMF Extended Fund Facility (EFF) programme, after the IMF has changed its rules allowing countries to be in arrears to official creditors. The EFF loan programme in place is one of the reasons why the National Bank has so far been successful in preserving relative exchange rate stability (another reason is extensive capital controls, including a 75% surrender requirement for export proceeds). The arriving IMF funds are virtually the only source of replenishing the foreign exchange reserves, as long as the current account is balanced and the inflows of private capital remain meagre. However, because of the disagreements over the 2016 budget and the slow reform progress, Ukraine has so far received only USD 6.7 billion within the EFF framework (instead of USD 10 billion originally earmarked for 2015), and any further delays – which are now highly likely following the collapse of the government coalition in February 2016 – will put downward pressure on the exchange rate.

Facing the generally depressed domestic demand and the new restrictions in trade with Russia, which are unlikely to be offset by increased exports elsewhere (at least in the short run), the recovery prospects are not very encouraging. We forecast zero growth this year, followed by gradual acceleration to around 2% in 2017-2018. On the other hand, the 'bottom' of economic decline has now probably been

[69] On top of that, personal incomes are subject to a 1.5% 'military tax', initially imposed to finance the 'anti-terrorist operation' in Donbas.

reached – barring a resumption of large-scale fighting in Donbas. The implementation of the political part of the Minsk-II ceasefire agreement, which was signed in February 2015 and was supposed to settle the conflict, has meanwhile been officially postponed until the end of 2016. Still, it is not clear how this can be accomplished, given that the agreement is very vague on political issues and open to contrasting interpretations, particularly when it comes to the sequencing of individual steps (constitutional reform, local elections, amnesty, and the restoration of control over the border with Russia by Ukraine) to be undertaken by the two sides. With no political settlement in place, the conflict is likely to become 'frozen' for the years to come.

Table 26 / Ukraine: selected economic indicators

	2011	2012	2013	2014	2015 [1]	2016	2017 Forecast	2018
Population, th pers., average	45,706	45,593	45,490	43,001	42,845	42,770	42,720	42,670
Gross domestic product, UAH bn, nom.	1,349	1,459	1,505	1,587	1,860	2,200	2,400	2,600
annual change in % (real)	5.4	0.2	0.0	-6.6	-10.5	0.0	1.9	2.5
GDP/capita (EUR at exchange rate)	2,700	3,100	3,100	2,300	1,800	1,800	1,900	2,000
GDP/capita (EUR at PPP)	6,500	6,600	6,600	6,600	5,500	.	.	.
Consumption of households, UAH bn, nom.	906	1,002	1,100	1,121	1,367	.	.	.
annual change in % (real)	15.7	8.4	7.7	-8.3	-18.0	-2.0	2.0	3.0
Gross fixed capital form., UAH bn, nom.	248	283	273	224	265	.	.	.
annual change in % (real)	6.5	3.3	-6.5	-24.0	-13.0	3.0	5.0	7.0
Gross industrial production								
annual change in % (real)	8.0	-0.5	-4.3	-10.1	-13.4	1.0	2.5	3.5
Gross agricultural production								
annual change in % (real)	19.9	-4.5	13.3	2.2	-4.8	.	.	.
Construction output								
annual change in % (real)	18.6	-8.3	-14.5	-20.4	-14.9	.	.	.
Employed persons, LFS, th, average	20,324	20,354	20,404	18,073	16,200	16,000	16,000	16,200
annual change in %	0.3	0.1	0.2	-6.4	-10.4	-1.2	0.0	1.3
Unemployed persons, LFS, th, average	1,733	1,657	1,577	1,848	1,800	2,000	2,000	1,800
Unemployment rate, LFS, in %, average	7.9	7.5	7.2	9.3	10.0	11.0	11.0	10.0
Reg. unemployment rate, in %, end of period [2]	1.8	1.8	1.8	1.7	1.6	.	.	.
Average monthly gross wages, UAH [3]	2,633	3,026	3,265	3,480	4,195	4,800	5,300	5,800
annual change in % (real, gross)	8.9	14.3	8.2	-5.4	-18.9	-2.0	2.0	4.0
annual change in % (real, net)	8.7	14.4	8.2	-6.5	-20.2	-2.0	2.0	4.0
Consumer prices, % p.a.	8.0	0.6	-0.3	12.1	48.7	17.0	8.0	6.0
Producer prices in industry, % p.a. [4]	19.0	3.7	-0.1	17.1	36.0	15.0	6.0	6.0
General governm.budget, nat.def., % of GDP								
Revenues	29.5	30.5	29.4	28.7	35.1	29.0	29.0	29.0
Expenditures	31.2	34.0	33.6	33.3	36.7	32.7	32.5	32.5
Deficit (-) / surplus (+) [5]	-1.7	-3.5	-4.2	-4.5	-1.7	-3.7	-3.5	-3.5
Public debt, nat.def., % of GDP	35.1	35.3	38.8	69.4	84.5	89.0	89.0	85.0
Central bank policy rate, % p.a., end of period [6]	7.75	7.50	6.50	14.00	22.00	15.0	12.0	10.0
Current account, EUR mn [7]	-7,351	-11,153	-12,441	-3,476	-184	-100	-100	-700
Current account, % of GDP [7]	-6.0	-7.9	-8.8	-3.4	-0.2	-0.1	-0.1	-0.9
Exports of goods, BOP, EUR mn [7]	44,812	50,127	44,518	38,235	31,677	31,700	32,300	33,600
annual change in %	25.7	11.9	-11.2	-14.1	-17.2	0.0	2.0	4.0
Imports of goods, BOP, EUR mn [7]	57,764	67,124	61,185	43,626	34,567	33,900	34,600	36,300
annual change in %	34.8	16.2	-8.8	-28.7	-20.8	-2.0	2.0	5.0
Exports of services, BOP, EUR mn [7]	15,278	17,186	17,032	11,257	11,056	11,100	11,700	12,300
annual change in %	10.6	12.5	-0.9	-33.9	-1.8	0.0	5.0	5.0
Imports of services, BOP, EUR mn [7]	9,613	11,351	12,141	9,350	9,213	9,200	9,700	10,200
annual change in %	0.4	18.1	7.0	-23.0	-1.5	0.0	5.0	5.0
FDI liabilities (inflow), EUR mn [7]	5,177	6,360	3,396	641	2,854	3,000	.	.
FDI assets (outflow), EUR mn [7]	138	762	324	414	96	300	.	.
Gross reserves of NB excl. gold, EUR mn	23,593	17,186	13,592	5,429	11,320	.	.	.
Gross external debt, EUR mn [7]	97,940	102,120	102,852	103,557	115,000	120,000	123,000	125,000
Gross external debt, % of GDP [7]	80.5	71.9	72.5	102.6	149.8	163.6	164.0	158.7
Average exchange rate UAH/EUR	11.092	10.271	10.612	15.716	24.229	30.0	32.0	33.0
Purchasing power parity UAH/EUR [8]	4.547	4.814	5.011	5.621	7.861	.	.	.

1) Preliminary and wiiw estimates. - 2) In % of working age population. - 3) Enterprises with 10 and more employees. - 4) Domestic output prices. From 2013 according to NACE Rev. 2. - 5) Without transfers to Naftohaz and Pension Fund and costs of bank recapitalisation. - 6) Discount rate of NB. - 7) Converted from USD. - 8) wiiw estimates based on the 2011 International Comparison Project benchmark.

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

Appendix

Most data provided in the following tables were directly extracted from the wiiw Annual Database.

Direct access is available at: http://data.wiiw.ac.at

Table 27 / European Union – Central and Eastern Europe (EU-CEE): an overview of economic fundamentals, 2015

	Bulgaria	Croatia	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	EU-CEE [1]	EU-28 [2]
GDP in EUR at exchange rates, EUR bn	44.5	43.9	163.5	20.2	108.4	24.3	37.2	423.0	159.7	77.9	38.5	1,141	14,624
GDP in EUR at PPP, EUR bn	97.9	71.2	261.9	28.7	194.6	36.9	63.1	761.0	321.7	121.4	49.4	2,008	14,624
GDP in EUR at PPP, EU-28=100	0.7	0.5	1.8	0.2	1.3	0.3	0.4	5.2	2.2	0.8	0.3	13.7	100.0
GDP in EUR at PPP, per capita	13,600	16,900	24,900	21,800	19,800	18,600	21,700	19,800	16,200	22,400	23,900	19,300	28,600
GDP in EUR at PPP per capita, EU-28=100	48	59	87	76	69	65	76	69	57	78	84	67	100
GDP at constant prices, 1990=100	144.3	106.7	152.1	154.6	136.6	120.5	133.0	217.3 [3]	152.2	186.0	159.8	177.5	152.0
GDP at constant prices, 2007=100	109.2	90.7	106.9	98.9	103.2	95.1	106.1	127.9	112.4	118.0	99.0	114.5	103.5
Industrial production real, 2007=100 [4]	92.6	86.2	105.9	112.1	110.4	107.0	114.9	131.4	132.4	137.6	96.7	120.7	95.1
Population, thousands, average	7,200	4,220	10,525	1,312	9,830	1,979	2,905	38,525	19,880	5,424	2,063	103,863	511,481
Employed persons, LFS, thousands, average	3,032	1,590	5,020	641	4,211	895	1,335	16,000	8,560	2,410	917	44,611	219,847
Unemployment rate, LFS, in %	9.3	16.6	5.1	6.2	6.8	9.9	9.1	7.5	6.8	11.5	9.0	7.9	9.5
General gov. revenues, EU-def., in % of GDP	37.0	43.4	41.1	39.0	48.2	36.0	34.6	38.6	34.0	40.8	44.8	39.5	45.0
General gov. expenditures, EU-def., in % of GDP	39.5	47.6	42.4	38.5	50.2	37.3	35.6	41.5	35.5	43.5	47.7	41.8	47.5
General gov. balance, EU-def., in % of GDP	-2.5	-4.2	-1.3	0.5	-2.0	-1.3	-1.0	-2.9	-1.5	-2.7	-2.9	-2.3	-2.5
Public debt, EU def., in % of GDP	29.4	86.0	41.0	10.1	75.5	37.0	42.5	51.7	38.7	52.7	83.5	50.8	87.2
Price level, EU-27=100 (PPP/exch. rate)	45	62	62	70	56	66	59	56	50	64	78	57	100
Compensation per employee, monthly, in EUR [5]	606	1,316	1,238	1,472	973	1,127	1,097	1,068	700	1,281	2,071	1,034	3,101
Compensation per employee, monthly, EU-28=100	19.5	42.4	39.9	47.5	31.4	36.4	35.4	34.4	22.6	41.3	66.8	33.3	100.0
Exports of goods in % of GDP	50.1	24.3	72.4	54.6	74.6	42.3	60.6	40.6	30.7	84.6	62.4	51.4 [6]	31.6 [6]
Imports of goods in % of GDP	54.3	39.2	67.5	58.8	70.6	51.0	65.6	40.0	35.6	82.2	58.2	51.7 [6]	29.9 [6]
Exports of services in % of GDP	15.2	24.4	12.4	26.3	18.0	16.4	16.7	9.3	10.2	9.2	15.5	12.4 [6]	12.3 [6]
Imports of services in % of GDP	9.4	7.5	10.6	18.0	12.8	9.3	11.8	6.9	5.9	9.0	10.2	8.7 [6]	10.5 [6]
Current account in % of GDP	1.2	4.6	1.7	2.5	5.0	-1.2	-2.5	-0.2	-1.1	-1.2	7.3	0.8 [6]	2.1 [6]
FDI stock per capita in EUR (excl. SPE), 2014	5,322	5,880	9,498	12,363	8,263	6,083	4,404	4,396	3,031	8,085	4,911	5,480	11,411

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

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

Source: wiiw Annual Database, Eurostat, AMECO.

Table 28 / Western Balkans, selected CIS countries and Ukraine: an overview of economic fundamentals, 2015

	Albania	Bosnia - Herzegovina	Kosovo	Macedonia	Monte-negro	Serbia	Turkey	Belarus	Kazakhstan	Russia [1]	Ukraine [2]	*EU-CEE* [3]	*EU-28* [4]
GDP in EUR at exchange rates, EUR bn	10.4	14.3	5.8	9.2	3.6	33.1	641.2	48.8	165.8	1,186.7	76.8	*1,141*	*14,624*
GDP in EUR at PPP, EUR bn	25.3	31.2	13.7	22.2	7.3	75.2	1,187.3	128.4	342.4	2,698.4	236.6	*2,008*	*14,624*
GDP in EUR at PPP, EU-28=100	0.2	0.2	0.1	0.2	0.05	0.5	8.1	0.9	2.3	18.5	1.6	*13.7*	*100.0*
GDP in EUR at PPP, per capita	8,800	8,200	7,500	10,700	11,700	10,700	15,100	13,500	19,500	18,400	5,500	*19,300*	*28,600*
GDP in EUR at PPP per capita, EU-28=100	31	29	26	37	41	37	53	47	68	64	19	*67*	*100*
GDP at constant prices, 1990=100	217.2	.	.	137.3	.	.	257.8	191.3	192.1	114.2	58.0	*177.5*	*152.0*
GDP at constant prices, 2007=100	126.9	109.3	133.7	122.1	113.1	104.5	128.7	126.0	140.2	107.5	79.7	*114.5*	*103.5*
Industrial production real, 2007=100 [5]	290.7	115.0	196.5	107.7	69.1	95.7	125.7	126.0	122.1	104.8	65.9	*120.7*	*95.1*
Population, thousands, average	2,889	3,820	1,830	2,080	625	7,040	78,500	9,493	17,544	146,394	42,845	*103,863*	*511,481*
Employed persons, LFS, thousands, average	1,080	822	333	700	221	2,620	26,600	4,470	8,560	72,324	16,200	*44,611*	*219,847*
Unemployment rate, LFS, in %	17.0	27.7	34.0	27.0	18.0	17.0	10.6	1.0 [6]	5.0	5.6	10.0	*7.9*	*9.5*
General gov. revenues, nat. def., in % of GDP	26.2	44.0	26.0	31.0	39.0	40.0	36.9	41.0	18.7	32.9	35.1	*39.5* [7]	*45.0* [7]
General gov. expenditures, nat. def., in % of GDP	30.3	46.0	28.0	34.0	45.0	45.0	38.5	39.0	21.0	36.4	36.7	*41.8* [7]	*47.5* [7]
General gov. balance, nat. def., in % of GDP	-4.2	-2.0	-2.0	-3.0	-6.0	-5.0	-1.6	2.0	-2.2	-3.5	-1.7	*-2.3* [7]	*-2.5* [7]
Public debt, nat. def., in % of GDP	73.0	46.0	12.0	46.0	60.0	73.8	35.0	40.0	22.8	10.8	84.5	*50.8* [7]	*87.2* [7]
Price level, EU-28=100 (PPP/exch. rate)	41	46	42	41	49	44	54	38	48	44	32	*57*	*100*
Average gross monthly wages, EUR at exchange rate	273	659	450 [8]	523	725	506	675 [9]	376	510	501	173	*1,034* [9]	*3,101* [9]
Average gross monthly wages, EU-28=100	8.8	21.3	14.5	16.9	23.4	16.3	21.8 [9]	12.1	16.4	16.1	5.6	*33.3* [9]	*100.0* [9]
Exports of goods in % of GDP	7.5	24.7	5.7	33.3	10.0	33.8	20.7	49.2	25.2	25.7	41.3	*51.4* [10]	*31.6* [10]
Imports of goods in % of GDP	29.2	52.8	41.2	53.0	50.0	45.9	28.4	54.3	18.3	14.7	45.0	*51.7* [10]	*29.9* [10]
Exports of services in % of GDP	19.2	9.9	13.6	15.0	30.8	12.7	6.5	12.3	3.5	3.8	14.4	*12.4* [10]	*12.3* [10]
Imports of services in % of GDP	14.8	2.9	7.8	10.6	10.3	10.9	3.1	8.2	6.4	6.6	12.0	*8.7* [10]	*10.5* [10]
Current account in % of GDP	-10.0	-7.0	-8.2	0.0	-14.6	-6.0	-4.6	-2.0	-2.9	5.0	-0.2	*0.8* [10]	*2.1* [10]
FDI stock per capita in EUR (excl. SPE), 2014	1,574	1,556	1,641	1,945	6,413	3,418	1,885	1,545	6,038	1,989	1,228	*5,480*	*11,411*

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

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

Source: wiiw Annual Database, Eurostat, AMECO.

Table 29 / GDP per capita at current PPPs (EUR), from 2016 at constant PPPs and population

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

European Union (28) average = 100

	1991	1995	2000	2005	2010	2012	2013	2014	2015	2016	2017	2018
Bulgaria	31	34	28	37	45	46	46	47	48	48	48	48
Croatia	48	46	48	58	59	60	59	59	59	59	59	58
Czech Republic	62	76	72	80	81	82	83	85	87	88	88	88
Estonia	39	35	44	60	64	74	75	76	76	77	77	77
Hungary	48	50	54	63	65	65	66	68	69	69	70	70
Latvia	45	33	36	51	53	60	62	64	65	66	67	68
Lithuania	50	34	39	53	60	70	73	75	76	77	78	79
Poland	32	42	47	50	63	66	67	68	69	70	71	72
Romania	28	32	26	34	50	54	54	55	57	58	58	59
Slovakia	41	47	49	59	74	74	76	77	78	79	80	81
Slovenia	60	74	79	86	83	81	81	82	84	84	84	85
EU-CEE	38	44	44	52	62	65	65	66	67	68	68	69
Albania	10	13	18	22	28	29	29	30	31	31	32	32
Bosnia & Herzeg.	.	.	20	23	27	28	28	28	29	29	29	29
Kosovo	.	.	.	22	23	25	25	26	26	27	27	28
Macedonia	30	26	28	30	35	34	36	37	37	38	38	39
Montenegro	.	.	29	30	40	39	40	41	41	41	41	42
Serbia	.	.	26	32	36	37	38	37	37	37	37	37
Turkey	26	28	40	41	48	52	53	53	53	54	54	55
Belarus	.	21	26	35	46	49	50	50	47	45	44	44
Kazakhstan	.	25	19	31	54	66	68	69	68	68	68	69
Russia	48	31	30	43	62	72	67	68	64	63	62	62
Ukraine	25	16	16	21	22	25	25	24	19	19	19	19
Austria	134	132	131	125	126	131	131	130	125	125	124	124
Germany	133	128	119	118	122	125	124	126	123	123	122	122
Greece	91	85	86	92	87	74	74	73	70	68	68	68
Ireland	91	103	131	146	130	131	131	134	137	141	143	143
Italy	124	122	118	106	104	101	98	96	93	93	92	92
Portugal	77	75	79	80	81	77	77	78	76	76	75	75
Spain	94	90	96	100	98	92	91	91	90	91	92	91
USA	148	160	161	159	145	147	146	149	146	147	148	148
EU-28 average	100	100	100	100	100	100	100	100	100	100	100	100

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

Table 30 / Indicators of macro-competitiveness, 2011-2018, EUR based, annual averages

	2011	2012	2013	2014	2015	2016	2017	2018
							Forecast	
Bulgaria								
Producer price index, 2010=100	109.2	114.0	112.3	110.9	108.7	109.8	110.9	112.6
Consumer price index, 2010=100	103.4	105.9	106.3	104.6	103.5	104.5	105.5	107.1
GDP deflator, 2010=100	106.9	108.5	107.7	108.2	109.4	110.5	111.6	113.4
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.3	100.0	98.9	96.8	95.8	96.4	95.8	95.5
Real ER (PPI-based), 2010=100	103.7	105.3	103.8	104.5	104.8	104.7	104.1	103.8
PPP, NC/EUR	0.9261	0.9167	0.9224	0.9039	0.8887	0.89	0.88	0.88
Price level, EU28 = 100	47	47	47	46	45	45	45	45
Average monthly gross wages, EUR (ER)	351	374	396	420	451	480	510	530
Average monthly gross wages, EUR (PPP)	741	798	840	909	993	1,060	1,120	1,170
GDP per employed person, 2010=100	105.1	105.9	107.3	107.2	108.6	109.6	110.5	111.7
Unit labour costs, ER adj., 2010=100	100.6	106.5	111.5	118.2	125.4	132.3	138.3	142.3
Unit labour costs, PPP adj., Austria=100	25.5	26.2	26.8	27.9	29.1	30.5	32.0	32.4
Croatia								
Producer price index, 2010=100	107.0	112.4	111.9	108.9	104.7	102.6	103.6	104.6
Consumer price index, 2010=100	102.2	105.6	108.1	108.3	108.0	108.6	109.7	110.8
GDP deflator, 2010=100	101.7	103.3	104.1	104.1	104.3	104.9	105.9	107.0
Exchange rate (ER), NC/EUR	7.434	7.517	7.574	7.630	7.610	7.65	7.67	7.67
ER, nominal, 2010=100	102.0	103.2	103.9	104.7	104.4	105.0	105.3	105.3
Real ER (CPI-based), 2010=100	97.2	96.8	96.8	95.8	95.8	95.4	94.6	93.8
Real ER (PPI-based), 2010=100	99.6	100.6	99.6	97.9	96.6	93.1	92.3	91.6
PPP, NC/EUR	5.007	4.872	4.894	4.813	4.691	4.66	4.64	4.60
Price level, EU28 = 100	67	65	65	63	62	61	60	60
Average monthly gross wages, EUR (ER)	1,049	1,048	1,048	1,042	1,058	1,070	1,100	1,130
Average monthly gross wages, EUR (PPP)	1,557	1,617	1,622	1,652	1,716	1,760	1,810	1,890
GDP per employed person, 2010=100	103.0	96.0	97.6	94.6	94.6	94.2	95.2	95.9
Unit labour costs, ER adj., 2010=100	96.6	103.6	101.9	104.5	106.1	108.0	109.1	112.2
Unit labour costs, PPP adj., Austria=100	52.3	54.4	52.3	52.6	52.7	53.2	53.8	54.0
Czech Republic								
Producer price index, 2010=100	103.7	106.2	106.9	107.9	109.0	110.4	112.1	113.9
Consumer price index, 2010=100	102.2	105.8	107.2	107.7	108.0	109.6	111.5	113.6
GDP deflator, 2010=100	99.8	101.2	102.6	105.1	105.7	107.4	109.3	111.3
Exchange rate (ER), NC/EUR	24.59	25.15	25.98	27.54	27.28	26.75	26.50	26.50
ER nominal, 2010=100	97.3	99.5	102.8	108.9	107.9	105.8	104.8	104.8
Real ER (CPI-based), 2010=100	101.9	100.5	97.1	91.5	92.7	95.5	96.5	96.6
Real ER (PPI-based), 2010=100	101.3	98.6	96.2	93.3	97.4	99.5	100.4	100.2
PPP, NC/EUR	17.76	17.70	17.49	17.44	17.06	17.1	17.2	17.2
Price level, EU28 = 100	72	70	67	63	63	64	65	65
Average monthly gross wages, EUR (ER)	995	997	964	930	971	1,030	1,090	1,140
Average monthly gross wages, EUR (PPP)	1,377	1,416	1,431	1,468	1,554	1,610	1,680	1,750
GDP per employed person, 2010=100	101.6	101.0	99.5	100.7	103.9	106.2	108.4	110.8
Unit labour costs, ER adj., 2010=100	103.7	104.6	102.7	97.9	99.1	103.0	106.2	108.7
Unit labour costs, PPP adj., Austria=100	47.2	46.1	44.3	41.4	41.3	42.6	43.9	44.3
Estonia								
Producer price index, 2010=100	104.2	107.0	114.8	111.6	108.3	106.1	107.2	109.3
Consumer price index, 2010=100	105.1	109.5	113.1	113.6	113.7	114.3	116.0	118.9
GDP deflator, 2010=100	105.3	108.1	112.4	114.7	114.6	114.9	116.5	119.4
Real ER (CPI-based), 2010=100	101.9	103.5	105.3	105.2	105.3	105.4	105.3	106.0
Real ER (PPI-based), 2010=100	99.0	98.8	106.1	105.1	104.4	101.2	100.6	100.8
PPP, NC/EUR	0.6948	0.6944	0.7195	0.7252	0.7047	0.70	0.70	0.70
Price level, EU28 = 100	69	69	72	73	70	70	70	70
Average monthly gross wages, EUR (ER)	839	887	949	1,005	1,060	1,120	1,190	1,280
Average monthly gross wages, EUR (PPP)	1,208	1,277	1,319	1,386	1,504	1,600	1,710	1,820
GDP per employed person, 2010=100	100.8	105.1	105.6	108.1	106.7	109.0	110.9	113.3
Unit labour costs, ER adj., 2010=100	105.0	106.6	113.4	117.4	125.4	129.7	135.4	142.6
Unit labour costs, PPP adj., Austria=100	47.3	46.5	48.4	49.1	51.7	53.2	55.2	57.3

(Table 30 / ctd.)

(Table 30 / ctd.)

	2011	2012	2013	2014	2015	2016	2017 Forecast	2018
Hungary								
Producer price index, 2010=100	104.1	108.4	109.1	108.7	107.7	108.2	109.9	112.1
Consumer price index, 2010=100	103.9	109.8	111.7	111.7	111.8	113.7	116.5	120.0
GDP deflator, 2010=100	102.2	105.8	109.0	112.6	114.2	117.1	120.3	123.9
Exchange rate (ER), NC/EUR	279.4	289.3	296.9	308.7	310.0	315	315	315
ER, nominal 2010=100	101.4	105.0	107.8	112.1	112.5	114.3	114.3	114.3
Real ER (CPI-based), 2010=100	99.4	98.8	96.5	92.3	92.0	91.7	92.5	93.6
Real ER (PPI-based), 2010=100	97.5	95.4	93.6	91.3	92.2	90.2	90.1	90.3
PPP, NC/EUR	165.5	168.1	171.3	174.9	172.6	175.0	177.0	179.0
Price level, EU28 = 100	59	58	58	57	56	56	56	57
Average monthly gross wages, EUR (ER)	763	771	777	770	799	820	860	910
Average monthly gross wages, EUR (PPP)	1,288	1,327	1,347	1,359	1,435	1,470	1,530	1,600
GDP per employed person, 2010=100	100.9	98.8	99.0	97.4	97.7	98.9	100.7	103.1
Unit labour costs, ER adj., 2010=100	102.8	106.1	106.8	107.5	111.3	112.5	116.0	120.1
Unit labour costs, PPP adj., Austria=100	37.0	37.1	36.5	36.0	36.8	37.0	37.9	38.6
Latvia								
Producer price index, 2010=100	107.7	112.2	114.0	114.5	113.3	112.1	113.2	114.9
Consumer price index, 2010=100	104.2	106.6	106.6	107.4	107.6	108.1	110.1	112.4
GDP deflator, 2010=100	106.4	110.2	111.6	113.0	113.3	114.1	116.3	118.7
Real ER (CPI-based), 2010=100	101.4	102.4	100.3	100.2	100.5	100.5	100.7	101.0
Real ER (PPI-based), 2010=100	102.7	105.3	106.5	108.7	110.1	107.8	107.2	106.8
PPP, NC/EUR	0.6698	0.6711	0.6793	0.6750	0.6587	0.66	0.66	0.66
Price level, EU28 = 100	67	68	68	67	66	66	66	66
Average monthly gross wages, EUR (ER)	657	690	717	765	815	870	930	1,000
Average monthly gross wages, EUR (PPP)	986	1,020	1,054	1,133	1,237	1,330	1,410	1,520
GDP per employed person, 2010=100	103.0	118.7	119.8	123.9	125.8	128.1	131.3	134.9
Unit labour costs, ER adj., 2010=100	101.6	92.5	95.3	98.3	103.2	108.2	112.8	118.0
Unit labour costs, PPP adj., Austria=100	46.0	40.6	40.9	41.3	42.8	44.6	46.2	47.7
Lithuania								
Producer price index, 2010=100	113.9	119.6	116.7	111.0	100.2	96.7	99.1	102.6
Consumer price index, 2010=100	104.1	107.4	108.7	108.9	108.2	108.3	110.6	113.1
GDP deflator, 2010=100	105.2	108.0	109.4	110.7	111.2	111.2	113.4	116.1
Real ER (CPI-based), 2010=100	101.0	101.5	101.2	100.9	100.2	99.9	100.4	100.9
Real ER (PPI-based), 2010=100	108.2	110.5	108.0	104.5	96.6	92.2	93.0	94.6
PPP, NC/EUR	0.6071	0.6027	0.6042	0.6033	0.5896	0.58	0.59	0.59
Price level, EU28 = 100	61	60	60	60	59	58	59	59
Average monthly gross wages, EUR (ER)	593	615	646	677	710	760	820	890
Average monthly gross wages, EUR (PPP)	976	1,021	1,070	1,123	1,204	1,300	1,400	1,510
GDP per employed person, 2010=100	103.9	116.0	118.5	119.7	120.1	122.7	126.1	129.9
Unit labour costs, ER adj., 2010=100	99.0	92.1	94.7	98.3	102.7	107.5	112.9	119.0
Unit labour costs, PPP adj., Austria=100	34.4	31.1	31.2	31.8	32.7	34.1	35.6	36.9
Poland								
Producer price index, 2010=100	107.3	110.8	109.5	108.0	105.8	105.8	107.3	108.9
Consumer price index, 2010=100	103.9	107.7	108.6	108.7	107.9	109.2	111.1	113.4
GDP deflator, 2010=100	103.2	105.7	106.1	106.6	106.6	107.8	109.5	111.9
Exchange rate (ER), NC/EUR	4.121	4.185	4.198	4.184	4.184	4.35	4.30	4.30
ER, nominal, 2010=100	103.2	104.8	105.1	104.7	104.7	108.9	107.6	107.6
Real ER (CPI-based), 2010=100	97.7	97.2	96.2	96.0	95.4	92.4	93.7	93.9
Real ER (PPI-based), 2010=100	98.8	97.7	96.3	97.1	97.3	92.6	93.6	93.3
PPP, PLN/EUR	2.423	2.398	2.409	2.406	2.340	2.34	2.34	2.35
Price level, EU28 = 100	59	57	57	57	56	54	54	55
Average monthly gross wages, EUR (ER)	826	844	872	903	927	940	1,000	1,050
Average monthly gross wages, EUR (PPP)	1,405	1,472	1,519	1,570	1,658	1,750	1,840	1,920
GDP per employed person, 2010=100	103.9	109.2	110.7	112.3	114.6	117.7	121.6	125.7
Unit labour costs, ER adj., 2010=100	98.5	95.7	97.6	99.6	100.2	99.2	101.9	103.2
Unit labour costs, PPP adj., Austria=100	44.7	42.1	41.9	42.0	41.7	40.9	41.8	41.9

(Table 30 / ctd.)

(Table 30 / ctd.)

	2011	2012	2013	2014	2015	2016	2017	2018
							Forecast	
Romania								
Producer price index, 2010=100	107.1	112.7	115.0	114.8	112.5	113.6	115.9	118.8
Consumer price index, 2010=100	105.8	109.4	112.9	114.5	114.0	114.0	116.3	119.2
GDP deflator, 2010=100	104.7	109.6	113.4	115.3	118.3	120.2	124.4	127.7
Exchange rate (ER), NC/EUR	4.239	4.459	4.419	4.444	4.445	4.6	4.80	4.80
ER, nominal, 2010=100	100.6	105.9	104.9	105.5	105.5	109.2	114.0	114.0
Real ER (CPI-based), 2010=100	102.0	97.7	100.2	100.4	100.0	96.2	92.6	93.2
Real ER (PPI-based), 2010=100	101.0	98.3	101.3	102.4	102.7	99.2	95.4	96.1
PPP, NC/EUR	2.110	2.075	2.208	2.212	2.207	2.22	2.26	2.28
Price level, EU28 = 100	50	47	50	50	50	48	47	47
Average monthly gross wages, EUR (ER)	467	463	489	524	568	590	600	650
Average monthly gross wages, EUR (PPP)	939	994	979	1,052	1,144	1,220	1,280	1,360
GDP per employed person, 2010=100	102.2	109.2	113.8	116.3	121.3	125.6	129.3	133.8
Unit labour costs, ER adj., 2010=100	101.2	93.8	95.3	99.8	103.7	103.5	103.5	106.9
Unit labour costs, PPP adj., Austria=100	35.2	31.6	31.4	32.2	33.0	32.9	32.3	33.4
Slovakia								
Producer price index, 2010=100	104.5	106.5	105.4	101.7	98.7	98.8	99.8	101.3
Consumer price index, 2010=100	104.1	108.0	109.6	109.4	109.1	109.7	111.4	113.4
GDP deflator, 2010=100	101.6	102.9	103.5	103.3	103.0	103.6	105.1	107.0
Real ER (CPI-based), 2010=100	101.0	102.0	102.0	101.3	101.0	101.2	101.1	101.1
Real ER (PPI-based), 2010=100	99.3	98.4	97.5	95.8	95.1	94.2	93.6	93.3
PPP NC/ EUR	0.6873	0.6787	0.6741	0.6616	0.6417	0.64	0.64	0.64
Price level, EU28 = 100	69	68	67	66	64	64	64	64
Average monthly gross wages, EUR (ER)	786	805	824	858	880	910	950	990
Average monthly gross wages, EUR (PPP)	1,144	1,186	1,222	1,297	1,371	1,430	1,490	1,550
GDP per employed person, 2010=100	101.4	103.9	105.4	106.5	108.0	109.4	111.8	114.9
Unit labour costs, ER adj., 2010=100	100.8	100.8	101.7	104.8	106.0	108.2	110.5	112.1
Unit labour costs, PPP adj., Austria=100	38.0	36.8	36.3	36.7	36.6	37.2	37.7	37.7
Slovenia								
Producer price index, 2010=100	104.6	105.5	105.5	104.8	104.5	105.1	106.1	107.2
Consumer price index, 2010=100	102.1	105.0	107.0	107.4	106.6	107.1	108.2	109.2
GDP deflator, 2010=100	101.1	101.4	102.2	103.1	103.5	104.0	105.0	106.1
Real ER (CPI-based), 2010=100	99.0	99.2	99.6	99.4	98.7	98.8	98.2	97.4
Real ER (PPI-based), 2010=100	99.3	97.4	97.6	98.7	100.8	100.2	99.6	98.8
PPP, NC/EUR	0.8356	0.8121	0.8117	0.7997	0.7804	0.78	0.77	0.77
Price level, EU28 = 100	84	81	81	80	78	78	77	77
Average monthly gross wages, EUR (ER)	1,525	1,525	1,523	1,540	1,556	1,580	1,620	1,660
Average monthly gross wages, EUR (PPP)	1,825	1,878	1,876	1,926	1,994	2,040	2,100	2,170
GDP per employed person, 2010=100	103.9	102.4	103.3	105.2	108.2	110.1	111.4	113.2
Unit labour costs, ER adj., 2010=100	98.2	99.7	98.6	98.0	96.2	96.0	97.3	98.1
Unit labour costs, PPP adj., Austria=100	70.1	69.0	66.8	65.0	63.0	62.5	62.9	62.5
Albania								
Producer price index, 2010=100	102.6	103.8	103.3	102.9	100.8	100.4	100.2	100.0
Consumer price index, 2010=100	103.4	105.5	107.6	109.3	111.4	114.0	116.8	120.1
GDP deflator, 2010=100	102.3	103.4	103.6	105.3	107.3	109.7	112.2	115.6
Exchange rate (ER), NC/EUR	140.3	139.0	140.3	140.0	139.7	139.0	139.0	140.0
ER, nominal, 2010=100	101.8	100.9	101.8	101.6	101.4	100.9	100.9	101.6
Real ER (CPI-based), 2010=100	98.5	98.8	98.4	99.6	101.7	104.2	105.1	105.4
Real ER (PPI-based), 2010=100	95.7	95.0	93.9	95.4	95.8	94.9	93.2	90.7
PPP, NC/EUR	61.57	58.64	60.67	58.25	57.74	58.4	58.8	59.5
Price level, EU28 = 100	44	42	43	42	41	42	42	42
Average monthly gross wages, EUR (ER)	260	270	259	264	273	280	300	300
Average monthly gross wages, EUR (PPP)	593	640	599	635	660	680	700	710
GDP per employed person, 2010=100	103.2	106.5	119.9	120.8	118.6	121.3	124.4	128.9
Unit labour costs, ER adj., 2010=100	99.9	100.5	85.6	86.7	91.1	92.8	94.2	92.3
Unit labour costs, PPP adj., Austria=100	30.4	29.6	24.7	24.5	25.4	25.3	26.3	25.0

(Table 30 / ctd.)

(Table 30 / ctd.)

	2011	2012	2013	2014	2015	2016	2017	2018
							Forecast	
Bosnia and Herzegovina								
Producer price index, 2010=100	105.5	105.8	104.0	103.4	104.0	105.1	107.2	109.3
Consumer price index, 2010=100	103.7	105.9	105.8	104.8	103.8	104.8	106.9	109.1
GDP deflator, 2010=100	102.5	103.4	103.1	104.1	104.0	105.0	107.0	109.3
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.6	100.1	98.5	97.1	96.1	96.7	97.0	97.2
Real ER (PPI-based), 2010=100	100.2	97.8	96.1	97.4	100.3	100.2	100.6	100.8
PPP, NC/EUR	0.9622	0.9321	0.9369	0.9218	0.8957	0.89	0.90	0.90
Price level, EU28 = 100	49	48	48	47	46	46	46	46
Average monthly gross wages, EUR (ER)	650	660	660	659	659	670	700	720
Average monthly gross wages, EUR (PPP)	1,321	1,384	1,378	1,399	1,439	1,480	1,520	1,560
GDP per employed person, 2010=100	104.2	103.5	105.0	107.4	108.5	110.4	111.4	112.1
Unit labour costs, ER adj., 2010=100	100.2	102.4	101.1	98.7	97.6	98.3	100.4	102.7
Unit labour costs, PPP adj., Austria=100	42.8	42.4	41.0	39.2	38.2	38.0	39.1	39.4
Kosovo								
Producer price index, 2010=100	104.5	106.5	109.2	111.0	115.5	117.8	121.3	124.9
Consumer price index, 2010=100	107.3	110.0	112.0	112.4	111.8	113.0	115.2	118.7
GDP deflator, 2010=100	104.8	107.1	109.0	112.6	111.2	112.5	115.0	119.0
Real ER (CPI-based), 2010=100	104.1	103.9	104.2	104.1	103.6	104.2	104.6	105.8
Real ER (PPI-based), 2010=100	99.2	98.4	100.9	104.5	111.3	112.3	113.8	115.2
PPP, NC/EUR	0.4330	0.4310	0.4360	0.4370	0.4240	0.42	0.43	0.43
Price level, EU28 = 100	43	43	44	44	42	42	43	43
Average monthly gross wages, EUR (ER) [1)]	348	354	356	416	450	460	480	510
Average monthly gross wages, EUR (PPP) [1)]	804	821	817	952	1,061	1,080	1,120	1,170
GDP per employed person, 2010=100	106.5	101.4	93.9	99.4	101.9	103.4	105.3	106.0
Unit labour costs, ER adj., 2010=100	114.2	122.0	132.6	146.3	154.4	155.6	159.3	168.2
Unit labour costs, PPP adj., Austria=100	18.9	19.6	20.8	22.5	23.4	23.4	23.9	24.8
Macedonia								
Producer price index, 2010=100	111.9	113.4	111.8	109.7	105.4	106.5	108.6	110.8
Consumer price index, 2010=100	103.9	107.3	110.3	110.0	109.7	110.8	113.0	115.3
GDP deflator, 2010=100	103.7	104.8	109.5	110.8	115.3	116.4	118.8	121.2
Exchange rate (ER), NC/EUR	61.53	61.53	61.58	61.62	61.61	61.5	61.5	61.5
ER, nominal, 2010=100	100.0	100.0	100.1	100.2	100.2	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.8	101.4	102.6	101.7	101.4	102.2	102.6	102.8
Real ER (PPI-based), 2010=100	106.2	104.8	103.3	103.1	101.4	101.5	101.9	102.1
PPP, NC/EUR	25.59	25.08	25.61	25.18	25.48	25.5	25.6	25.6
Price level, EU28 = 100	42	41	42	41	41	41	42	42
Average monthly gross wages, EUR (ER)	497	498	504	508	523	530	550	570
Average monthly gross wages, EUR (PPP)	1,196	1,223	1,211	1,244	1,264	1,290	1,320	1,360
GDP per employed person, 2010=100	101.2	99.9	98.5	100.3	102.3	104.3	106.0	107.8
Unit labour costs, ER adj., 2010=100	100.0	101.6	104.1	103.2	104.0	104.1	105.5	106.8
Unit labour costs, PPP adj., Austria=100	36.4	35.8	35.9	34.9	34.7	34.3	34.8	34.9
Montenegro								
Producer price index, 2010=100	103.2	105.1	106.8	106.9	107.3	109.4	112.7	114.9
Consumer price index, 2010=100	103.3	107.5	109.5	109.0	110.5	112.7	115.0	117.3
GDP deflator, 2010=100	101.2	101.4	103.5	104.6	106.3	109.1	111.8	113.8
Real ER (CPI-based), 2010=100	100.2	101.6	101.9	100.9	102.3	103.9	104.3	104.5
Real ER (PPI-based), 2010=100	98.0	97.1	98.8	100.7	103.4	100.1	100.5	100.4
PPP, NC/EUR	0.4910	0.4907	0.5015	0.4964	0.4909	0.50	0.50	0.50
Price level, EU28 = 100	49	49	50	50	49	50	50	50
Average monthly gross wages, EUR (ER)	722	727	726	723	725	750	770	790
Average monthly gross wages, EUR (PPP)	1,471	1,482	1,448	1,456	1,477	1,500	1,530	1,570
GDP per employed person, 2010=100	110.0	104.5	107.2	101.8	102.1	103.9	105.9	108.6
Unit labour costs, ER adj., 2010=100	91.8	97.3	94.7	99.3	99.3	101.0	101.7	101.8
Unit labour costs, PPP adj., Austria=100	45.9	47.1	44.9	46.1	45.5	46.0	46.0	45.4

1) Net wages in state administration.

(Table 30 / ctd.)

(Table 30 / ctd.)

	2011	2012	2013	2014	2015	2016	2017	2018
							Forecast	
Serbia								
Producer price index, 2010=100	112.7	120.4	123.6	125.2	126.5	129.0	131.6	134.2
Consumer price index, 2010=100	111.0	119.7	129.0	132.7	135.3	138.0	142.1	146.4
GDP deflator, 2010=100	109.6	116.4	122.7	126.1	128.1	129.3	133.3	136.8
Exchange rate (ER), NC/EUR	101.95	113.13	113.14	117.31	120.76	126	128	130
ER, nominal, 2010=100	98.9	109.8	109.8	113.8	117.2	122.3	124.2	126.2
Real ER (CPI-based), 2010=100	108.8	103.0	109.4	108.0	106.9	104.0	103.8	103.4
Real ER (PPI-based), 2010=100	108.2	101.3	104.1	103.6	104.0	100.6	99.4	98.1
PPP, NC/EUR	49.67	50.64	53.64	53.77	53.16	53.0	53.8	54.3
Price level, EU28 = 100	49	45	47	46	44	42	42	42
Average monthly gross wages, EUR (ER)	517	508	537	524	506	500	510	530
Average monthly gross wages, EUR (PPP)	1,062	1,134	1,132	1,142	1,150	1,190	1,220	1,260
GDP per employed person, 2010=100	107.8	107.9	106.8	95.2	93.1	93.5	94.0	94.8
Unit labour costs, ER adj., 2010=100	104.2	102.1	109.1	119.5	118.1	116.7	118.9	120.8
Unit labour costs, PPP adj., Austria=100	37.3	35.5	37.1	39.8	38.8	37.9	38.2	38.8
Belarus								
Producer price index, 2010=100	171.4	301.7	342.7	386.6	451.5	532.8	618.0	704.5
Consumer price index, 2010=100	153.2	243.9	288.5	340.8	386.7	440.9	498.2	558.0
GDP deflator, 2010=100	171.3	300.5	364.2	429.3	499.2	569.0	643.3	720.7
Exchange rate (ER), NC/EUR	8,051	10,778	11,834	13,220	17,828	24,000	27,000	30,000
ER, nominal, 2010=100	200.9	269.0	295.4	330.0	445.0	599.0	673.9	748.8
Real ER (CPI-based), 2010=100	74.0	85.7	90.9	95.6	80.5	67.9	67.1	66.4
Real ER (PPI-based), 2010=100	81.0	103.6	107.3	110.3	97.8	84.8	86.1	86.7
PPP, NC/EUR	2504	4283	5145	5985	6771	7633.4	8494.0	9347.6
Price level, EU28 = 100	31	40	43	45	38	32	31	31
Average monthly gross wages, EUR (ER)	236	341	428	458	376	320	320	320
Average monthly gross wages, EUR (PPP)	759	858	984	1,011	990	1,000	1,010	1,040
GDP per employed person, 2010=100	105.8	109.4	111.3	113.9	111.4	109.3	112.1	113.8
Unit labour costs, ER adj., 2010=100	73.4	102.6	126.5	132.3	111.0	95.4	93.5	93.5
Unit labour costs, PPP adj., Austria=100	20.1	27.2	32.8	33.6	27.8	24.0	23.3	22.6
Kazakhstan								
Producer price index, 2010=100	127.2	131.7	131.3	143.7	114.3	108.6	111.8	117.4
Consumer price index, 2010=100	108.3	113.9	120.5	128.6	137.1	153.6	164.3	174.2
GDP deflator, 2010=100	119.1	124.7	135.8	143.4	141.8	148.8	157.6	167.2
Exchange rate (ER), NC/EUR	204.1	191.7	202.1	238.1	245.8	402	413	424
ER, nominal, 2010=100	104.3	98.0	103.3	121.7	125.6	205.4	211.1	216.7
Real ER (CPI-based), 2010=100	100.7	109.9	108.7	97.9	101.1	68.9	70.7	71.7
Real ER (PPI-based), 2010=100	115.8	124.2	117.5	111.2	87.7	50.4	49.7	49.9
PPP, NC/EUR	106.3	109.1	119.9	123.8	116.8	121.2	126.3	131.7
Price level, EU28 = 100	52	57	59	52	48	30	31	31
Average monthly gross wages, EUR (ER)	441	528	540	506	510	340	370	390
Average monthly gross wages, EUR (PPP)	847	928	910	973	1,073	1,140	1,200	1,270
GDP per employed person, 2010=100	110.5	112.9	118.5	124.2	124.9	125.6	128.1	132.0
Unit labour costs, ER adj., 2010=100	100.6	118.0	114.9	102.7	102.9	68.7	72.2	75.3
Unit labour costs, PPP adj., Austria=100	31.1	35.4	33.7	29.5	29.2	19.2	20.4	20.6
Russia								
Producer price index, 2010=100	117.3	125.3	129.5	137.4	154.5	166.8	175.2	183.9
Consumer price index, 2010=100	108.4	113.9	121.7	131.2	151.5	166.6	176.6	187.2
GDP deflator, 2010=100	115.9	125.5	131.6	143.1	153.6	167.5	177.6	187.6
Exchange rate (ER), NC/EUR	40.87	39.94	42.27	50.77	67.76	77	82	88
ER, nominal, 2010=100	101.5	99.2	105.0	126.1	168.3	191.2	203.6	218.5
Real ER (CPI-based), 2010=100	103.6	108.5	107.9	96.3	83.4	80.4	78.7	76.4
Real ER (PPI-based), 2010=100	109.8	116.7	114.1	102.7	88.5	83.2	80.7	77.6
PPP, NC/EUR	22.99	24.41	27.75	28.57	29.80	32.1	33.6	34.8
Price level, EU28 = 100	56	61	66	56	44	42	41	40
Average monthly gross wages, EUR (ER)	572	667	705	640	501	470	480	500
Average monthly gross wages, EUR (PPP)	1,016	1,091	1,074	1,137	1,138	1,130	1,180	1,260
GDP per employed person, 2010=100	102.9	112.5	114.2	114.9	109.3	108.2	108.3	109.5
Unit labour costs, ER adj., 2010=100	106.8	113.9	118.6	107.1	88.0	83.5	85.5	87.8
Unit labour costs, PPP adj., Austria=100	37.1	38.4	39.1	34.6	28.0	26.4	26.8	27.2

(Table 30 / ctd.)

(Table 30 / ctd.)

	2011	2012	2013	2014	2015	2016	2017	2018
							Forecast	
Ukraine								
Producer price index, 2010=100	119.0	123.4	123.3	144.4	196.3	225.8	239.3	253.7
Consumer price index, 2010=100	108.0	108.6	108.3	121.4	180.6	211.3	228.2	241.9
GDP deflator, 2010=100	114.2	123.3	127.2	147.4	209.9	248.2	265.8	280.9
Exchange rate (ER), NC/EUR	11.09	10.27	10.61	15.72	24.23	30.0	32.0	33.0
ER, nominal, 2010=100	105.3	97.5	100.8	149.2	230.0	284.8	303.8	313.3
Real ER (CPI-based), 2010=100	99.5	105.3	100.1	75.4	72.7	68.4	68.2	68.8
Real ER (PPI-based), 2010=100	107.3	116.9	113.1	91.1	82.3	75.6	73.9	74.6
PPP, NC/EUR	4.547	4.814	5.011	5.621	7.787	9.11	9.60	9.97
Price level, EU28 = 100	41	47	47	36	32	30	30	30
Average monthly gross wages, EUR (ER)	237	295	308	221	173	160	170	180
Average monthly gross wages, EUR (PPP)	579	629	652	619	539	530	550	580
GDP per employed person, 2010=100	105.1	105.1	104.9	107.7	98.9	100.2	102.0	103.3
Unit labour costs, ER adj., 2010=100	106.2	131.9	137.9	96.7	82.3	75.1	76.4	80.1
Unit labour costs, PPP adj., Austria=100	37.7	45.3	46.4	31.9	26.8	24.3	25.2	26.0
Austria								
Producer price index, 2010=100	104.0	104.9	104.0	102.9	101.4	103.3	105.0	106.9
Consumer price index, 2010=100	103.2	105.8	107.9	109.6	110.6	112.3	114.2	116.2
GDP deflator, 2010=100	101.9	103.9	105.5	107.2	109.2	111.2	113.1	115.1
Real ER (CPI-based), 2010=100	100.1	100.0	100.5	101.6	102.5	103.5	103.6	103.6
Real ER (PPI-based), 2010=100	98.8	96.9	96.2	96.9	97.7	98.5	98.5	98.5
PPP, NC/EUR	1.107	1.084	1.088	1.086	1.076	1.085	1.085	1.085
Price level, EU28 = 100	111	108	109	109	108	108	109	108
Average monthly gross wages, EUR	3,178	3,278	3,346	3,418	3,466	3,510	3,560	3,640
Average monthly gross wages, EUR (PPP)	2,870	3,023	3,075	3,148	3,220	3,240	3,280	3,360
GDP per employed person, 2010=100	101.9	101.9	101.7	101.9	101.8	102.5	103.3	104.2
Unit labour costs, ER adj., 2010=100	100.4	103.6	105.9	108.0	109.6	110.2	110.9	112.5
Unit labour costs, PPP 2010 adjusted	0.56	0.58	0.59	0.61	0.61	0.62	0.62	0.63

Notes:
Benchmark PPP results for 2011 were applied (published by Eurostat, OECD and CIS Stat in December 2013).

Employment data and related indicators (e.g. Unit labour costs) may be affected by the new population census data.

Unit labour costs are defined as average gross wages per employee relative to labour productivity (real GDP per employed person, LFS). For level comparisons, labour productivity is converted with the PPP rate 2010 (PPP adjusted).

PPP rates have been taken from Eurostat based on the benchmark results 2011. Missing data have been extrapolated by wiiw with GDP deflators. Kazakhstan, Russia and Ukraine are estimated by wiiw using the OECD and CIS PPP benchmark results 2011.

Real exchange rates: Increasing values mean real appreciation.

ER = Exchange Rate, PPP = Purchasing Power Parity, Price level: PPP/ ER.

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

Table 31 / Indicators of macro-competitiveness, 2011-2018, annual changes in %

	2011	2012	2013	2014	2015	2016	2017 Forecast	2018	2011-15 average
Bulgaria									
GDP deflator	6.9	1.6	-0.7	0.4	1.1	1.0	1.0	1.5	1.8
Real ER (CPI-based)	0.3	-0.3	-1.1	-2.1	-1.0	0.6	-0.6	-0.3	-0.9
Real ER (PPI-based)	3.7	1.5	-1.4	0.6	0.3	-0.1	-0.6	-0.3	0.9
Average gross wages, real (PPI based)	-3.1	2.1	7.6	7.3	9.5	5.5	4.3	2.5	4.6
Average gross wages, real (CPI based)	2.3	4.1	5.6	7.7	8.5	5.5	4.3	2.5	5.6
Average gross wages, EUR (ER)	5.8	6.6	6.0	6.0	7.3	6.4	6.3	3.9	6.4
Employed persons (LFS)	-3.4	-1.1	0.0	1.6	1.7	1.6	1.6	1.6	-0.3
GDP per empl. person, NC at 2010 ref. pr.	5.1	1.4	1.3	0.0	1.2	1.0	0.8	1.1	1.8
Unit labour costs, ER (EUR) adjusted	0.6	5.2	4.7	6.0	6.0	5.5	4.5	2.9	4.5
Croatia									
GDP deflator	1.7	1.6	0.8	0.0	0.2	0.5	1.0	1.0	0.9
Exchange rate (ER), EUR/NC	-2.0	-1.1	-0.7	-0.7	0.3	-0.5	-0.3	0.0	-0.9
Real ER (CPI-based)	-2.8	-0.4	0.1	-1.1	0.0	-0.4	-0.8	-0.8	-0.9
Real ER (PPI-based)	-0.4	1.1	-1.1	-1.7	-1.3	-3.6	-0.8	-0.8	-0.7
Average gross wages, real (PPI based)	-5.1	-3.9	1.2	3.0	5.3	3.9	1.4	2.5	0.0
Average gross wages, real (CPI based)	-0.7	-2.3	-1.5	0.0	1.5	1.4	1.4	2.5	-0.6
Average gross wages, EUR (ER)	-0.5	-0.1	0.1	-0.6	1.5	1.1	2.8	2.7	0.1
Employed persons (LFS)	-3.2	-3.6	-2.7	2.7	1.6	1.9	0.6	1.2	-1.1
GDP per empl. person, NC at 2010 ref. pr.	3.0	1.5	1.7	-3.0	-0.1	-0.5	1.1	0.7	0.6
Unit labour costs, ER (EUR) adjusted	-3.4	-1.5	-1.6	2.5	1.5	1.8	1.0	2.8	-0.5
Czech Republic									
GDP deflator	-0.2	1.4	1.4	2.5	0.5	1.6	1.8	1.9	1.1
Exchange rate (ER), EUR/NC	2.8	-2.2	-3.2	-5.7	0.9	2.0	0.9	0.0	-1.5
Real ER (CPI-based)	1.9	-1.4	-3.4	-5.8	1.3	3.1	1.0	0.1	-1.5
Real ER (PPI-based)	1.3	-2.6	-2.5	-3.0	4.4	2.2	0.8	-0.2	-0.5
Average gross wages, real (PPI based)	-1.2	0.1	-0.8	1.3	2.5	2.8	2.8	2.9	0.4
Average gross wages, real (CPI based)	0.3	-1.0	-1.4	1.9	3.2	2.6	2.6	2.6	0.6
Average gross wages, EUR (ER)	5.4	0.2	-3.3	-3.5	4.5	6.0	5.8	4.6	0.6
Employed persons (LFS)	0.4	0.4	1.0	0.8	0.9	0.2	0.2	0.2	0.7
GDP per empl. person, NC at 2010 ref. pr.	1.6	-1.3	-1.5	1.2	3.2	2.2	2.1	2.2	0.6
Unit labour costs, ER (EUR) adjusted	3.7	1.5	-1.9	-4.7	1.2	3.9	3.2	2.3	0.0
Estonia									
GDP deflator	5.3	2.7	4.0	2.0	-0.1	0.3	1.4	2.5	2.8
Real ER (CPI-based)	1.9	1.5	1.7	-0.1	0.1	0.1	-0.1	0.7	1.0
Real ER (PPI-based)	-1.0	-0.1	7.4	-0.9	-0.7	-3.1	-0.6	0.2	0.9
Average gross wages, real (PPI based)	1.6	3.0	-0.3	8.9	8.7	7.8	5.2	5.5	4.3
Average gross wages, real (CPI based)	0.8	1.4	3.6	5.4	5.4	5.1	4.7	4.9	3.3
Average gross wages, EUR (ER)	5.9	5.7	7.0	5.9	5.5	5.7	6.3	7.6	6.0
Employed persons (LFS)	6.7	1.9	1.0	0.6	2.6	0.0	0.6	0.5	2.5
GDP per empl. person, NC at 2010 ref. pr.	0.8	3.2	0.5	2.3	-1.3	2.1	1.8	2.1	1.1
Unit labour costs, ER (EUR) adjusted	5.0	2.4	6.4	3.5	6.8	3.4	4.4	5.4	4.8
Hungary									
GDP deflator	2.2	3.5	3.1	3.2	1.5	2.5	2.8	3.0	2.7
Exchange rate (ER), EUR/NC	-1.4	-3.4	-2.6	-3.8	-0.4	-1.6	0.0	0.0	-2.3
Real ER (CPI-based)	-0.6	-0.6	-2.4	-4.3	-0.3	-0.3	0.9	1.2	-1.7
Real ER (PPI-based)	-2.5	-2.2	-1.9	-2.4	1.0	-2.2	-0.1	0.2	-1.6
Average gross wages, real (PPI based)	1.0	0.5	2.8	3.4	5.2	3.4	3.5	3.9	2.6
Average gross wages, real (CPI based)	1.2	-0.9	1.7	3.0	4.2	2.2	2.5	2.9	1.8
Average gross wages, EUR (ER)	3.8	1.1	0.8	-0.9	3.8	2.6	4.9	5.8	1.7
Employed persons (LFS)	0.8	1.8	1.7	5.3	2.7	0.9	0.5	0.5	2.5
GDP per empl. person, NC at 2010 ref. pr.	0.9	-3.4	0.2	-1.6	0.2	1.3	1.8	2.4	-0.7
Unit labour costs, ER (EUR) adjusted	2.8	4.7	0.6	0.7	3.6	1.0	3.2	3.5	2.5
Latvia									
GDP deflator	6.4	3.6	1.3	1.2	0.3	0.7	1.9	2.1	2.5
Real ER (CPI-based)	1.4	0.9	-2.1	0.0	0.2	0.1	0.2	0.3	0.1
Real ER (PPI-based)	2.7	2.6	1.2	2.0	1.3	-2.1	-0.6	-0.3	1.9
Average gross wages, real (PPI based)	-3.2	-0.4	2.9	6.5	7.7	7.8	5.8	5.9	2.6
Average gross wages, real (CPI based)	0.0	1.3	4.6	6.2	6.3	6.2	5.0	5.3	3.7
Average gross wages, EUR (ER)	4.6	5.0	3.9	6.7	6.5	6.7	6.9	7.5	5.4
Employed persons (LFS)	3.1	1.6	2.1	-1.0	1.2	1.1	0.8	0.7	1.4
GDP per empl. person, NC at 2010 ref. pr.	3.0	2.4	0.9	3.4	1.5	1.8	2.5	2.8	2.2
Unit labour costs, ER (EUR) adjusted	1.6	2.6	3.0	3.2	4.9	4.8	4.3	4.6	3.0

(Table 31 / ctd.)

(Table 31 / ctd.)

	2011	2012	2013	2014	2015	2016	2017	2018	2010-14
							Forecast		average
Lithuania									
GDP deflator	5.2	2.7	1.3	1.2	0.4	0.0	2.0	2.4	2.1
Real ER (CPI-based)	1.0	0.5	-0.3	-0.3	-0.7	-0.3	0.5	0.5	0.0
Real ER (PPI-based)	8.2	2.1	-2.3	-3.2	-7.6	-4.5	0.9	1.7	-0.7
Average gross wages, real (PPI based)	-9.7	-1.1	7.7	10.2	16.1	10.9	5.3	4.9	4.2
Average gross wages, real (CPI based)	-1.2	0.6	3.9	4.6	5.5	6.9	5.7	6.1	2.6
Average gross wages, EUR (ER)	2.9	3.8	5.1	4.8	4.8	7.0	7.9	8.5	4.3
Employed persons (LFS)	2.0	1.8	1.3	2.0	1.2	0.7	0.7	0.4	1.7
GDP per empl. person, NC at 2010 ref. pr.	3.9	2.0	2.2	1.0	0.4	2.2	2.7	3.0	1.9
Unit labour costs, ER (EUR) adjusted	-1.0	1.8	2.8	3.8	4.4	4.8	5.0	5.3	2.3
Poland									
GDP deflator	3.2	2.4	0.4	0.4	0.0	1.1	1.6	2.2	1.3
Exchange rate (ER), EUR/NC	-3.1	-1.5	-0.3	0.3	0.0	-3.8	1.2	0.0	-0.9
Real ER (CPI-based)	-2.3	-0.6	-1.0	-0.2	-0.7	-3.1	1.4	0.2	-0.9
Real ER (PPI-based)	-1.2	-1.1	-1.4	0.8	0.2	-4.9	1.1	-0.3	-0.5
Average gross wages, real (PPI based)	-1.6	0.4	4.9	4.6	4.9	5.7	3.3	3.1	2.6
Average gross wages, real (CPI based)	1.6	0.1	2.8	3.1	3.5	4.4	3.0	2.6	2.2
Average gross wages, EUR (ER)	2.3	2.1	3.3	3.5	2.7	1.4	6.4	5.0	2.8
Employed persons (LFS)	1.1	0.2	-0.1	1.9	0.9	0.6	0.0	0.0	0.8
GDP per empl. person, NC at 2010 ref. pr.	3.9	1.4	1.4	1.4	2.1	2.7	3.3	3.4	2.0
Unit labour costs, ER (EUR) adjusted	-1.5	0.8	1.9	2.1	0.6	-1.1	2.7	1.2	0.8
Romania									
GDP deflator	4.7	4.7	3.4	1.7	2.6	1.6	3.6	2.7	3.4
Exchange rate (ER), EUR/NC	-0.6	-4.9	0.9	-0.6	0.0	-3.4	-4.2	0.0	-1.1
Real ER (CPI-based)	2.0	-4.3	2.6	0.3	-0.4	-3.8	-3.8	0.7	0.0
Real ER (PPI-based)	1.0	-2.7	3.1	1.1	0.3	-3.5	-3.8	0.7	0.5
Average gross wages, real (PPI based)	-2.8	-1.0	2.8	7.8	10.7	5.9	5.3	4.3	3.4
Average gross wages, real (CPI based)	-1.6	0.8	1.6	6.2	8.9	6.9	5.3	4.3	3.1
Average gross wages, EUR (ER)	3.4	-1.0	5.8	7.0	8.4	3.9	1.7	8.3	4.7
Employed persons (LFS)	-1.1	0.9	-0.7	0.8	-0.6	0.5	0.0	0.0	-0.1
GDP per empl. person, NC at 2010 ref. pr.	2.2	-0.3	4.2	2.2	4.3	3.5	2.9	3.5	2.5
Unit labour costs, ER (EUR) adjusted	1.2	-0.7	1.5	4.7	3.9	-0.2	0.0	3.3	2.1
Slovakia									
GDP deflator	1.6	1.3	0.5	-0.2	-0.3	0.6	1.5	1.8	0.6
Real ER (CPI-based)	1.0	1.1	0.0	-0.6	-0.3	0.2	-0.1	0.0	0.2
Real ER (PPI-based)	-0.7	-0.9	-0.9	-1.8	-0.7	-1.0	-0.6	-0.3	-1.0
Average gross wages, real (PPI based)	-2.2	0.5	3.4	7.9	5.7	3.3	3.4	2.7	3.0
Average gross wages, real (CPI based)	-1.8	-1.3	0.9	4.2	2.9	2.8	2.9	2.4	1.0
Average gross wages, EUR (ER)	2.2	2.4	2.4	4.1	2.6	3.4	4.4	4.2	2.7
Employed persons (LFS)	1.5	0.6	0.0	1.5	2.0	1.7	0.8	0.8	1.1
GDP per empl. person, NC at 2010 ref. pr.	1.4	0.9	1.4	1.1	1.4	1.3	2.2	2.8	1.2
Unit labour costs, ER (EUR) adjusted	0.8	1.5	0.9	3.0	1.2	2.1	2.1	1.4	1.5
Slovenia									
GDP deflator	1.1	0.3	0.8	0.8	0.4	0.5	1.0	1.1	0.7
Real ER (CPI-based)	-1.0	0.2	0.4	-0.2	-0.7	0.1	-0.6	-0.8	-0.3
Real ER (PPI-based)	-0.7	-1.9	0.1	1.1	2.1	-0.6	-0.6	-0.8	0.1
Average gross wages, real (PPI based)	-2.5	-0.8	-0.2	1.8	1.3	1.0	1.5	1.5	-0.1
Average gross wages, real (CPI based)	-0.1	-2.7	-2.0	0.7	1.8	1.0	1.5	1.5	-0.5
Average gross wages, EUR (ER)	2.0	0.1	-0.2	1.1	0.7	1.5	2.5	2.5	0.7
Employed persons (LFS)	-3.1	-1.3	-1.9	1.2	0.1	0.3	1.1	1.1	-1.0
GDP per empl. person, NC at 2010 ref. pr.	3.9	-1.4	0.9	1.8	2.8	1.7	1.2	1.7	1.6
Unit labour costs, ER (EUR) adjusted	-1.8	1.5	-1.0	-0.7	-2.1	-0.2	1.3	0.8	-0.8
Albania									
GDP deflator	2.3	1.0	0.2	1.6	1.9	2.2	2.3	3.0	1.4
Exchange rate (ER), EUR/NC	-1.8	0.9	-0.9	0.2	0.2	0.5	0.0	-0.7	-0.3
Real ER (CPI-based)	-1.5	0.3	-0.4	1.3	2.1	2.4	0.9	0.3	0.3
Real ER (PPI-based)	-4.3	-0.7	-1.2	1.6	0.5	-1.0	-1.8	-2.7	-0.9
Average gross wages, real (PPI based)	2.3	1.8	-2.8	2.3	5.1	4.1	4.3	2.4	1.7
Average gross wages, real (CPI based)	1.5	0.8	-5.0	0.2	1.1	1.3	1.5	-0.6	-0.3
Average gross wages, EUR (ER)	3.0	3.8	-4.0	2.0	3.2	2.7	7.1	0.0	1.6
Employed persons (LFS)	-0.6	-1.8	-10.2	1.3	4.1	0.9	0.9	0.0	-1.5
GDP per empl. person, NC at 2010 ref. pr.	3.2	3.2	12.6	0.7	-1.8	2.3	2.6	3.6	3.5
Unit labour costs, ER (EUR) adjusted	-0.1	0.6	-14.8	1.3	5.0	1.9	1.5	-2.1	-1.9

(Table 31 / ctd.)

(Table 31 / ctd.)

	2011	2012	2013	2014	2015	2016	2017 Forecast	2018	2010-14 average
Bosnia and Herzegovina									
GDP deflator	2.5	0.9	-0.3	1.0	-0.1	1.0	1.9	2.1	0.8
Real ER (CPI-based)	0.6	-0.5	-1.6	-1.4	-1.0	0.6	0.4	0.2	-0.8
Real ER (PPI-based)	0.2	-2.4	-1.7	1.3	3.0	-0.1	0.4	0.2	0.1
Average gross wages, real (PPI based)	-1.0	1.2	1.9	0.4	-0.6	1.4	1.0	0.9	0.4
Average gross wages, real (CPI based)	0.7	-0.5	0.2	0.8	1.0	1.4	1.0	0.9	0.4
Average gross wages, EUR (ER)	4.4	1.5	0.1	-0.1	0.0	1.7	4.5	2.9	1.2
Employed persons (LFS)	-3.2	-0.3	1.0	-1.2	1.2	1.0	2.4	2.4	-0.5
GDP per empl. person, NC at 2010 ref. pr.	4.2	-0.6	1.4	2.3	1.1	1.7	0.9	0.6	1.7
Unit labour costs, ER (EUR) adjusted	0.2	2.2	-1.3	-2.4	-1.1	0.7	2.1	2.3	-0.5
Kosovo									
GDP deflator	4.8	2.2	1.8	3.3	-1.3	1.2	2.2	3.6	2.1
Real ER (CPI-based)	4.1	-0.1	0.3	-0.1	-0.5	0.6	0.4	1.2	0.7
Real ER (PPI-based)	-0.8	-0.9	2.6	3.6	6.4	0.9	1.4	1.2	2.2
Average net wages, real (PPI based) [1]	16.4	-0.2	-1.9	14.9	4.0	0.2	1.3	3.2	6.4
Average net wages, real (CPI based) [1]	13.4	-0.8	-1.2	16.4	8.7	1.2	2.3	3.2	7.1
Average net wages, EUR (ER) [1]	21.7	1.7	0.6	16.9	8.2	2.2	4.3	6.3	9.5
Employed persons (LFS) [2]	-2.0	1.4	11.7	-4.4	2.9	2.1	2.9	2.9	1.8
GDP per empl. person, NC at 2010 ref. pr.	6.5	1.4	-7.4	5.8	2.5	1.5	1.9	0.6	1.6
Unit labour costs, ER (EUR) adjusted	14.2	0.3	8.6	10.4	5.5	0.7	2.4	5.6	7.7
Macedonia									
GDP deflator	3.7	1.0	4.5	1.2	4.0	1.0	2.1	2.0	2.9
Exchange rate (ER), EUR/NC	0.0	0.0	-0.1	-0.1	0.0	0.2	0.0	0.0	0.0
Real ER (CPI-based)	0.8	0.6	1.2	-0.9	-0.3	0.8	0.4	0.2	0.3
Real ER (PPI-based)	6.2	-1.4	-1.4	-0.2	-1.6	0.1	0.4	0.2	0.3
Average gross wages, real (PPI based)	-9.5	-1.1	2.6	3.0	6.9	0.9	1.0	0.9	0.2
Average gross wages, real (CPI based)	-2.6	-3.0	-1.6	1.2	3.1	0.9	1.0	0.9	-0.6
Average gross wages, EUR (ER)	1.2	0.2	1.1	0.9	2.8	1.4	3.8	3.6	1.2
Employed persons (LFS)	1.1	0.8	4.3	1.7	1.4	1.4	1.4	1.4	1.9
GDP per empl. person, NC at 2010 ref. pr.	1.2	-1.3	-1.4	1.8	2.0	1.9	1.7	1.7	0.5
Unit labour costs, ER (EUR) adjusted	0.0	1.5	2.5	-0.9	0.8	0.1	1.4	1.2	0.8
Montenegro									
GDP deflator	1.2	0.2	2.1	1.0	1.7	2.7	2.4	1.8	1.2
Real ER (CPI-based)	0.2	1.4	0.3	-1.0	1.4	1.6	0.4	0.2	0.5
Real ER (PPI-based)	-2.0	-0.9	1.7	1.9	2.7	-3.2	0.4	-0.2	0.7
Average gross wages, real (PPI based)	-2.1	-1.2	-1.7	-0.5	0.0	1.4	-0.3	0.6	-1.1
Average gross wages, real (CPI based)	-2.3	-3.2	-1.9	0.1	-1.1	1.4	0.7	0.6	-1.7
Average gross wages, EUR (ER)	1.0	0.7	-0.1	-0.4	0.3	3.4	2.7	2.6	0.3
Employed persons (LFS)	0.8	2.4	1.0	7.1	2.2	0.9	0.9	0.9	2.7
GDP per empl. person, NC at 2010 ref. pr.	2.4	-5.0	2.6	-5.0	0.2	1.8	1.9	2.5	-1.0
Unit labour costs, ER (EUR) adjusted	-1.4	6.0	-2.6	4.8	0.1	1.6	0.7	0.1	1.3
Serbia									
GDP deflator	9.6	6.3	5.4	2.7	1.6	0.9	3.1	2.6	5.1
Exchange rate (ER), EUR/NC	1.1	-9.9	0.0	-3.6	-2.9	-4.2	-1.6	-1.5	-3.1
Real ER (CPI-based)	8.8	-5.4	6.2	-1.3	-1.0	-2.7	-0.2	-0.4	1.3
Real ER (PPI-based)	8.2	-6.4	2.8	-0.5	0.5	-3.3	-1.2	-1.3	0.8
Average gross wages, real (PPI based)	-1.4	2.0	2.9	-0.1	-1.5	1.5	2.1	2.1	0.4
Average gross wages, real (CPI based)	0.1	1.0	-1.9	-1.7	-2.3	1.5	1.1	1.1	-1.0
Average gross wages, EUR (ER)	12.3	-1.9	5.7	-2.4	-3.3	-1.3	2.0	3.9	1.9
Employed persons (LFS)	-6.0	-1.1	3.7	10.1	3.0	1.1	1.1	1.1	1.8
GDP per empl. person, NC at 2010 ref. pr.	7.8	0.1	-1.1	-10.9	-2.2	0.5	0.6	0.9	-1.4
Unit labour costs, ER (EUR) adjusted	4.2	-1.9	6.8	9.5	-1.1	-1.2	1.9	1.6	3.4
Belarus									
GDP deflator	71.3	75.5	21.2	17.9	16.3	14.0	13.1	12.0	37.9
Exchange rate (ER), EUR/NC	-50.2	-25.3	-8.9	-10.5	-25.8	-25.7	-11.1	-10.0	-25.8
Real ER (CPI-based)	-26.0	15.8	6.1	5.1	-15.8	-15.7	-1.1	-1.0	-4.2
Real ER (PPI-based)	-19.0	27.9	3.6	2.8	-11.3	-13.3	1.5	0.8	-0.4
Average gross wages, real (PPI based)	-8.9	9.9	21.2	6.0	-5.2	-3.9	-2.5	-1.1	4.0
Average gross wages, real (CPI based)	1.9	21.5	16.4	1.3	-2.5	-0.5	0.1	0.7	7.3
Average gross wages, EUR (ER)	-22.3	44.5	25.4	7.0	-17.9	-14.9	0.0	0.0	4.3
Employment registered	-0.3	-1.7	-0.7	-0.6	-1.8	-0.7	-2.0	0.0	-1.0
GDP per empl. person, NC at 2010 ref. pr.	5.8	3.4	1.7	2.3	-2.2	-1.9	2.6	1.5	2.2
Unit labour costs, ER (EUR) adjusted	-26.6	39.7	23.3	4.6	-16.1	-14.1	-1.9	0.0	2.1

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

(Table 31 / ctd.)

(Table 31 / ctd.)

	2011	2012	2013	2014	2015	2016	2017	2018	2010-14
							Forecast		average
Kazakhstan									
GDP deflator	19.1	4.7	8.9	5.6	-1.1	4.9	5.9	6.1	7.2
Exchange rate (ER), EUR/NC	-4.1	6.5	-5.2	-15.1	-3.1	-38.9	-2.7	-2.6	-4.5
Real ER (CPI-based)	4.3	9.1	-1.1	-9.9	3.3	-31.8	2.5	1.4	0.9
Real ER (PPI-based)	0.7	7.2	-5.3	-5.4	-21.2	-42.5	-1.3	0.5	-5.3
Average gross wages, real (PPI based)	-8.8	8.7	8.1	0.8	30.9	15.6	7.0	5.0	7.2
Average gross wages, real (CPI based)	7.1	6.9	1.9	3.4	-2.4	-2.0	3.0	4.0	3.3
Average gross wages, EUR (ER)	11.2	19.8	2.2	-6.3	0.8	-33.3	8.8	5.4	5.2
Employed persons (LFS)	1.1	1.0	0.7	-0.7	0.6	0.5	0.5	0.5	0.5
GDP per empl. person, NC at 2010 ref. pr.	6.1	3.6	5.0	4.8	0.5	0.5	2.0	3.0	4.0
Unit labour costs, ER (EUR) adjusted	4.9	15.6	-2.6	-10.6	0.2	-33.2	5.1	4.2	1.1
Russia									
GDP deflator	15.9	8.3	4.8	8.8	7.3	9.1	6.0	5.6	9.0
Exchange rate (ER), EUR/NC	-1.5	2.3	-5.5	-16.7	-25.1	-12.0	-6.1	-6.8	-9.9
Real ER (CPI-based)	3.6	4.8	-0.6	-10.7	-13.5	-3.6	-2.0	-3.0	-3.6
Real ER (PPI-based)	9.8	6.3	-2.2	-10.0	-13.8	-6.0	-3.0	-3.9	-2.4
Average gross wages, real (PPI based)	-4.9	6.7	8.2	2.8	-7.1	-1.2	3.9	6.1	0.9
Average gross wages, real (CPI based)	2.9	8.4	4.8	1.2	-9.6	-3.0	2.9	5.1	1.3
Average gross wages, EUR (ER)	9.9	16.6	5.7	-9.2	-21.8	-6.1	2.1	4.2	-0.8
Employed persons (LFS)	1.3	1.0	-0.2	0.2	-0.4	0.2	0.7	0.7	0.4
GDP per empl. person, NC at 2010 ref. pr.	2.9	2.4	1.5	0.6	-3.4	-1.0	0.1	1.1	0.8
Unit labour costs, ER (EUR) adjusted	6.8	13.9	4.1	-9.7	-19.0	-5.1	2.3	2.7	-1.5
Ukraine									
GDP deflator	14.2	8.0	3.1	15.9	42.4	18.3	7.1	5.7	16.0
Exchange rate (ER), EUR/NC	-5.0	8.0	-3.2	-32.5	-35.1	-19.2	-6.3	-3.0	-15.3
Real ER (CPI-based)	-0.5	5.8	-4.9	-24.7	-3.5	-5.9	-0.3	1.0	-6.2
Real ER (PPI-based)	7.3	8.9	-3.2	-19.5	-9.7	-8.1	-2.2	1.0	-3.8
Average gross wages, real (PPI based)	-1.2	10.8	8.0	-9.0	-11.4	-0.5	4.2	3.2	-0.9
Average gross wages, real (CPI based)	8.9	14.3	8.2	-4.9	-18.9	-2.2	2.2	3.2	0.7
Average gross wages, EUR (ER)	11.7	24.1	4.4	-28.4	-21.8	-7.6	6.3	5.9	-4.1
Employed persons (LFS)	0.3	0.1	0.2	-6.4	-10.4	-1.2	0.0	1.3	-3.3
GDP per empl. person, NC at 2010 ref. pr.	5.1	0.0	-0.2	-0.2	-8.2	1.3	1.8	1.2	-0.8
Unit labour costs, ER (EUR) adjusted	6.2	24.1	4.6	-28.3	-14.8	-8.7	1.7	4.8	-3.4
Austria									
GDP deflator	1.9	2.0	1.5	1.6	1.9	1.9	1.7	1.8	1.8
Real ER (CPI-based)	0.1	-0.1	0.5	1.1	0.9	1.0	0.1	0.0	0.5
Real ER (PPI-based)	-1.2	-1.9	-0.8	0.7	0.9	0.8	0.1	0.0	-0.5
Average gross wages, real (PPI based)	-1.7	2.3	3.0	3.3	2.9	-0.6	-0.2	0.5	1.9
Average gross wages, real (CPI based)	-0.9	0.6	0.1	0.5	0.5	-0.2	-0.3	0.4	0.2
Average gross wages, EUR (ER)	2.3	3.1	2.1	2.2	1.4	1.3	1.4	2.2	2.2
Employed persons (LFS)	0.9	0.8	0.5	0.2	0.8	1.0	1.0	0.9	0.6
GDP per empl. person, NC at 2010 ref. pr.	1.9	0.0	-0.2	0.2	0.0	0.7	0.8	0.8	0.4
Unit labour costs, ER (EUR) adjusted	0.4	3.2	2.3	2.0	1.4	0.6	0.6	1.4	1.8

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