AUTUMN 2014

Forecast Report

On Thin Ice

CESEE Core Resilient in the Face of EU Stagnation and the Ukraine Crisis

Economic Analysis and Outlook for Central, East and Southeast Europe

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

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CESEE Core Resilient in the Face of EU Stagnation and the Ukraine Crisis

SÁNDOR RICHTER
VASILY ASTROV
VLADIMIR GLIGOROV
DORIS HANZL-WEISS
PETER HAVLIK
MARIO HOLZNER
HERMINE VIDOVIC

et al. (including Serkan Çiçek, Rumen Dobrinsky, Gábor Hunya, Sebastian Leitner, Olga Pindyuk and Leon Podkaminer)

The authors of this report wish to thank Alexandra Bykova, Simona Jokubauskaitė, Beate Muck, Renate Prasch, Hana Rusková, Monika Schwarzhappel and Galina Vasaros for statistical assistance, as well as Peter Lillie and Eva Strobl for language editing and proof reading and Michaela Bönisch for text processing.

Press date: 13 November 2014

CONTENTS

TABLES AND FIGURES

The statistical data until 2013 presented in this Report are as of 16 October 2014, forecasts as of November 2014. Most data are taken from the wiiw Databases. Direct access is available here: http://data.wiiw.ac.at/.

ABBREVIATIONS

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

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
LTL	Lithuanian litas
MKD	Macedonian denar
PLN	Polish zloty
RON	Romanian leu
RSD	Serbian dinar
RUB	Russian rouble
TRY	Turkish lira
UAH	Ukrainian hryvnia
USD	US dollar

BOP	balance of payments
CEE	Central and Eastern Europe
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	Euro area 18 countries
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
ER	exchange rate
ESA’95	European system of national and regional accounts
EU	European Union
FDI	Foreign Direct Investment
FISIM	Financial Intermediation Services, Indirectly Measured
GDP	Gross Domestic Product
ICP	International Comparison Project
IMF	International Monetary Fund
LFS	Labour Force Survey
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne (Statistical classification of economic activities in the European Community)
NACE Rev. 1	first revision of the original NACE (1970)
NACE Rev. 2	revised classification, introduced in 2008
NB	National Bank
NC	national currency
NMS	new EU Member States
OECD	Organisation for Economic Co-operation and Development
OMS	old EU Member States
pp	percentage points
PPI	producer price index
PPP	Purchasing Power Parity
SEE	Southeast Europe
SME	small- and medium-sized enterprises
SNA	System of National Accounts
SPE	Special Purpose Entity
TCB	Turkish Central Bank
VAT	value added tax
WBC	Western Balkan countries
WIFO	Austrian Institute of Economic Research
wiiw	The Vienna Institute for International Economic Studies

.	not available (in tables)
bn	billion
mn	million
p.a.	per annum

Executive summary

The international environment shows signs both of recovery and uncertainty. Overall recovery in the United States is expected in the medium term. Developments in the European Union and the euro area have been somewhat divergent. In part, this divergence is due to a more rapid recovery in the United Kingdom, as well as to near-recessionary developments in some core-countries in the euro area. However, peripheral EU economies are registering growth once again. The developments in the rest of the world are not altogether discouraging and the cautiously positive trends should be sustained by moderation in the energy and commodity markets. The political developments, primarily in Ukraine but also in the Middle East and North Africa region, may tilt the risks downwards.

By the end of 2014, of the 21 countries in the CESEE region 15 will have managed in GDP terms to make up for the losses they suffered during the crisis. Among the economies that have not managed to overcome the GDP loss are Estonia and Latvia, which experienced a most severe economic slump in 2009 due to an overheated economy before the crisis. Of the others, Hungary, Croatia, Slovenia and Ukraine have been struggling with structural problems over a protracted period of time. The CESEE countries typically coped with the crisis primarily by adopting a behaviour that made for simultaneous net export growth and investment shrinkage in parallel to a certain measure of stability in the levels of household consumption. Under those conditions, the export boom in most of the CESEE countries must have occurred without any significant modernisation of production capacities.

Compared to the first six months of the previous year, the average economic growth of the CESEE countries amounted to 1.8% in the first half of 2014. This pace of expansion was slightly more rapid than the GDP growth rate of 1.5% in the EU-28. The best performers (with growth higher than 3%) were Poland, Lithuania and Macedonia, the regional success stories, as well as Kazakhstan that relied on its natural resources and Hungary, where one off factors played an important role.

Exports have become a somewhat less important driver of growth than in previous years. For the most part, the patterns are similar across the region. In 2010 we can see rapidly rising exports indicating the bounce-back effect from the steep drop in the wake of the crisis in 2009. Over the period 2012-2014 there has been a remarkable slowdown in the region, to some extent reflecting developments in world trade.

For the new EU Member States (NMS) net transfers from the EU budget became an integral and increasingly important part of their aggregate demand. 2013 and 2014 are among the strongest years where transfers in the framework of the EU cohesion policy are concerned. In terms of their impact, EU transfers are comparable to fiscal stimulus, albeit better inasmuch as they do not give rise to new debt. A disadvantage compared to fiscal stimuli is that transfers have no steerable relation to business cycles.

The fiscal deficits in the region are generally moderate. With a few exceptions, public debt levels and changes do not seem to be altogether dramatic. In the NMS, the development of gross external debt shows diverging tendencies, yet it is improving in some cases. In the Western Balkans, overall external debt levels are lower, but the current account positions are much worse than in the NMS.

There seems to be a justified concern over the region having entered a period of 'creditless recovery'. The global financial crisis shattered the rapid expansion of financial intermediation in nearly all of the countries in the region and recovery of crediting activities is still fragmentary and weak. High levels of NPLs are a major concern throughout much of the region. A 'creditless recovery' threatens to be much slower than a recovery with strong credit growth.

25 years after the fall of the Iron Curtain, the current crisis in relations between Russia and the West represents not only a major setback, but it is also evolving into a dangerous geopolitical conflict. Western sanctions were first introduced in March 2014 only to be followed by more sanctions later. Russia has been reacting with countermeasures ever since. In Ukraine, the main victim of the conflict, the economy may decline by up to 8% over the current year. In Russia, the costs of the conflict are estimated to be to the tune of about 1% of GDP, primarily on account of increased investment risks.

The effects of the Russia-Ukraine crisis on the individual EU countries differ depending on their exposure to the Russian market. The Baltic States and some other NMS will be those most affected on account of their trade channels. It is estimated that losses will be in the order of up to 0.4% of GDP, assuming a 10% drop in exports to Russia. The impact on Austria is expected to be relatively modest – less than 0.1% of GDP. An escalation of the conflict and a more pronounced trade decline would obviously result in greater losses.

Of the three types of 'sectoral' sanctions imposed on Russia – financial sanctions, a military embargo and an export ban on oil-drilling equipment – the financial sanctions are arguably hitting hardest. For the Russian companies on the sanctions list, outstanding debt obligations to their Western creditors are serviced as before; however, their refinancing via the same sources has now become impossible. This is exerting downward pressure on the rouble. The restricted ability to borrow in tandem with higher domestic interest rates could contribute to a further decline in investment in Russia.

The outlook for GDP growth is fairly diversified. The general medium-term trend for the NMS as a whole is seen to be positive: in most of the countries we expect a gradual acceleration of economic growth similar to that in the current year. For the current year, the assumption is that the NMS will grow by 1.8 pp higher than expansion in the euro area and 1.3 pp above the EU-28 average. In 2015, the gap in favour of NMS growth performance will grow somewhat narrower: 1.5 pp relative to the euro area and 1.1 pp to the EU-28 average. For some of the countries in the Western Balkans growth prospects will only improve over the period 2015-2016, closely related with the damage caused by the floods this summer. Turkey's economic growth will remain formidable. Growth performance in Kazakhstan, Russia and Ukraine will be worse in the current year than in 2013; the medium-term outlook in Russia and Ukraine is fairly uncertain. As for our forecasts for 2015 and 2016, a further weakening of performance in the euro area as well as a further escalation of the Ukraine conflict pose a downward risk, while a longer lasting drop in oil prices will pose an upward risk, except for energy exporters Russia and Kazakhstan.

COUNTRY SUMMARIES

BULGARIA

Bulgaria's economic and political scene has been recently dominated by the early elections due in October and the collapse of the Corporate Commercial Bank. Somewhat ironically, economic activity had been on the rise in recent months and GDP growth for 2014 as a whole may thus come close to 2%. The expectations are that the upcoming elections will bring about a paradigmatic change in terms of power and policies. Solving the situation created by the Corporate Commercial Bank will also have to await the election of a new parliament and the appointment of a new government.

CROATIA

Croatia remains bogged down in recession for the sixth consecutive year. Fiscal consolidation and the overly indebted enterprise sector are the key obstacles to growth. Household consumption remains depressed owing to high and persistent unemployment and continuing deleveraging. Economic recovery will depend primarily on external demand, a revival of private sector investment and increased absorption of EU funds.

CZECH REPUBLIC

The Czech economy is finally recovering from the effects of fiscal consolidation. Given the relatively low levels of debt burdening both the government and the private sector (corporate as well as household debts) coupled with growth-friendly monetary and fiscal policies, recovery over the biennium 2014-2015 seems assured. Acceleration of growth, however, may only be gradual as fixed investment is unlikely to expand at a markedly high rate. Doubts have recently arisen about the country's foreign trade performance in the years to come.

ESTONIA

In Estonia the prospects facing exporters are slim where the neighbouring countries to the east and the north are concerned. Household consumption provides life support to GDP growth estimated at 1.7% for 2014, while the current account deficit remains low at 1.6% of GDP. The government's hesitant expenditure policy will result in a budget close to balance.

HUNGARY

Economic growth in Hungary accelerated still more in the second quarter of 2014, driven by a robust take-off in investment and an increase in household consumption for the first time in many years. However, the looming scarcity of EU-financed projects, the prevailing legal uncertainties and an ailing financial system may well render the current boom unsustainable.

LATVIA

The slowdown of external demand in the Baltic region will have a negative impact on the pace of the Latvian economy, whereas the large rises in wages will keep the spending mood alive and well among households. Although the prospects for entrepreneurs are subdued, private investment has revived compared to last year; it will permit the GDP to grow by 2.5% over the current year.

LITHUANIA

While the economic tide is low in the countries bordering the Baltic Sea, the economy of Lithuania will continue to grow at a stable rate of 3% in 2014. Rising employment and wages are backed by public investment; things are encouraging and conducive to keeping households in a good spending mood. Nonetheless, the trade sanctions on Russia will pose a threat to the economic viability of a number of exporters in the agro-food sector.

POLAND

Driven by a major increase in gross capital formation, the Polish economy has entered a phase of relatively rapid growth, which is likely to extend into the biennium 2015-2016. Nonetheless, some economic and non-economic risks still persist. Apart from uncontrollable external and domestic (political) risks, problems are also posed by the pursuit of a monetary policy with too restrictive an orientation.

ROMANIA

In Romania, the growth setback following last year's bumper harvest and export boom seems to be more severe than expected. The decline in investments, both private and public, has accelerated. Alongside exports, the recovery of private consumption, benefiting from fiscal support, has become the new driver of economic growth. The government intends to continue down this track in defiance of IMF recommendations. Improved political stability under a new president to be elected in November may improve the efficiency of the country's administration. Being one of the countries least dependent on trade with Russia, Romania lends full support to EU sanctions.

SLOVAKIA

In the course of the current year, domestic demand has been taking over the role of the main engine of growth in Slovakia; it is expected to continue as such over the next two years. Growing household consumption will foster import growth, while global uncertainties will restrain export growth. The contribution of net exports will thus turn negative. For the three years to come, we expect the GDP to grow by about 2.5% annually.

SLOVENIA

Increased foreign demand and rising investments supported by EU funds helped Slovenia to return to a growth path, at least temporarily, after the crisis. GDP growth in 2014 could come close to 2%, but will weaken again in the two years thereafter on account of dwindling investment activities and subdued economic growth being registered by its main trading partners. The newly elected government will have to continue its fiscal consolidation policy, including speeding up privatisation. Company deleveraging will also continue in the foreseeable future and remain an impediment to growth.

ALBANIA

Albania's GDP growth rates are expected to hover around 1% in the years to come. Weak domestic demand, especially due to fiscal austerity measures, is the main reason for the sluggish development that is a far cry from pre-crisis economic dynamics. The signals emanating from the private sector are contradictory and do not make for a more optimistic outlook at present.

MACEDONIA

Macedonia continues to do better than most other Balkan countries. It does so by riding on the back of the country's public investment and export performance. This should continue over the medium term. Political risks are increasing owing to the current government having been so long in office. Moreover, the fact that EU integration has stalled hardly helps. The Russian connection does not play much of a role; hence, the current tensions are mainly inconsequential.

MONTENEGRO

In Montenegro, growth will slow down over the current year owing to poor performance in terms of industrial production and investment. In the medium term, public investment and tourism should make for some acceleration of growth. The rift with Russia over the sanctions, which Montenegro introduced in view of its being a candidate country, has not had any appreciable negative impact to date.

SERBIA

In Serbia, where fiscal adjustment is urgently required, this year's recession may at best be followed by stagnation or slow growth in the medium term. The risks are on the downside owing to the need to cut public expenditures rather significantly, the sole dilemma being whether fiscal consolidation will have to be frontloaded. Consumption, investment, and employment will depend on that issue. A certain increase in exports to Russia is forecast; this year, however, exports have in fact declined to date. The regime of sanctions currently emerging in Europe is exposing Serbia to growing pressure from Russia, which the country will find difficult to resist.

TURKEY

The Turkish economy performed reasonably well in the first half of 2014 despite the turmoil in the wake of the FED announcing a tapering of its monetary policy. Given both the continuing acceleration in internal demand sparked by the 'dovish' policy stance adopted by the Central Bank to the political pressure and expansionary fiscal policy caused by the elections and the rebalancing of external demand following the depreciation of the Turkish lira, the economy is expected to grow by 3.7% in 2014. Further credit growth will be difficult to forge. Given that constraint and the tensions on Turkey's southern borders, we expect economic growth to decelerate to 2.7% and 2.8% in 2015 and 2016, respectively.

BOSNIA AND HERZEGOVINA

Bosnia and Herzegovina was enjoying respectable growth before being hit by floods in May and June. As a consequence, it is quite likely that no growth will be registered for the current year as a whole. If industrial production and exports hold up, risks may prove to be on the upside. In the medium term, acceleration of growth will hinge on two factors: the efficiency of the reconstruction efforts and the outcome of the crucial parliamentary elections on 12 October. The President of Republika Srpska secured Putin's support, thus making the polls a highly competitive affair. The outcome in that entity proved mixed, with predictable outcomes in the rest of the country, so politics will continue to be a drag on economic recovery.

KOSOVO

Despite a politically disputatious environment, economic growth in Kosovo is expected to home in on some 4% in both the current year and the two years thereafter. Owing to the marked wage increases in the period leading up to the parliamentary elections in June 2014, growth in the current year is even expected to surpass 4%. Growth prospects depend on developments in Germany and Switzerland, the two top remittance- sending countries for Kosovan migrants.

BELARUS

Growth in Belarus was sluggish in the first half of 2014. It seems, however, that a modest upturn has now set in; it should contribute to an average GDP growth of close to 2% for the year as a whole. At present, policy is focused on preserving a teetering macroeconomic equilibrium, which is being bolstered by mobilising short-term external financial resources. This course is likely to linger on up until the presidential elections scheduled for mid-2015, the outcome of which will play a key role in determining the country's political landscape.

KAZAKHSTAN

Kazakhstan's economic growth will drop to an annual rate of 4.5-5% over the period 2014-2016 owing to the delay in the launch of the Kashagan oil field and weaker external demand. The recent devaluation of the national currency appears to have had a net negative impact on the country's economy, while the improvement in the current account balance will be only temporary. The banking sector in Kazakhstan continues to struggle with an excessive number of non-performing loans

RUSSIAN FEDERATION

The Russian economy is languishing in a prolonged slump. The country was already 'stuck in transition and stagnation' before the outbreak of the Ukraine crisis. The current sanctions deter investments, foster capital outflows and boost inflation. Turning inwards and developing import substitution strategies using accumulated domestic resources may prevent an outright recession, but it will not kick-start the requisite modernisation drive. The wiiw baseline scenario – assuming no further escalation of the Ukraine conflict – reckons with a meagre acceleration of GDP growth based on a gradual revival of investment. The above notwithstanding, the conflict over Ukraine will have a lasting impact on trade, investments and integration with Europe.

UKRAINE

In Ukraine, the ongoing military conflict in Donbass, curtailed trade relations with Russia and weakening private consumption are pushing the economy ever deeper into recession. Although the collapse in domestic demand combined with currency depreciation has brought about a marked rebalancing towards net exports, the balance-of-payments pressure remains strong owing to the current capital flight. Under the prevailing circumstances, were the GDP to stagnate next year, it could well be seen as a major achievement. That, however, hinges crucially on the prospects for a lasting peace settlement in Donbass, as well as a revival of trade with Russia.

Keywords: Central and East European new EU Member States, Southeast Europe, Balkans, Russia, Ukraine, Kazakhstan, Turkey, economic forecasts, employment, foreign trade, competitiveness, debt, financial crisis, deleveraging, exchange rates, fiscal consolidation, Ukraine conflict

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

Table 1 / Overview 2012-2013 and outlook 2014-2016

	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		
	2012	**2013**	**2014**	**2015**	**2016**	**2012**	**2013**	**2014**	**2015**	**2016**	**2012**	**2013**	**2014**	**2015**	**2016**	**2012**	**2013**	**2014**	**2015**	**2016**
NMS-11																				
Bulgaria	0.6	0.9	1.9	2.3	2.6	2.4	0.4	-1.0	1.0	2.0	12.3	13.0	12.0	11.5	11.0	-1.1	2.1	1.7	0.7	0.0
Croatia	-2.2	-0.9	-0.8	0.0	1.0	3.4	2.3	0.5	1.0	1.0	15.9	17.2	17.5	17.5	17.0	-0.2	0.9	0.5	0.2	0.0
Czech Republic	-0.8	-0.7	2.5	2.4	2.6	3.5	1.4	0.5	1.8	1.5	7.0	7.0	6.4	6.3	6.3	-1.3	-1.4	-0.5	-1.2	-1.6
Estonia	4.7	1.6	1.7	2.0	2.9	4.2	3.2	0.4	1.5	2.2	10.0	8.6	7.5	7.0	6.5	-2.1	-1.4	-1.6	-2.0	-2.9
Hungary	-1.5	1.5	3.0	2.2	2.0	5.7	1.7	0.3	2.0	3.0	10.9	10.2	8.5	8.3	8.0	1.9	4.1	3.6	3.2	2.8
Latvia	4.8	4.2	2.5	2.7	3.0	2.3	0.0	0.6	1.6	2.2	15.0	11.9	10.7	10.0	9.5	-3.2	-2.3	-2.9	-3.2	-3.4
Lithuania	3.7	3.3	3.0	3.2	3.4	3.2	1.2	0.3	1.2	1.8	13.4	11.8	11.5	10.6	9.8	-1.2	1.6	1.1	-0.4	-0.5
Poland	2.0	1.6	3.3	3.2	3.1	3.7	0.9	0.3	1.5	2.0	10.1	10.3	10.0	10.0	10.0	-3.6	-1.3	-1.0	-2.0	-2.5
Romania	0.6	3.5	2.2	2.7	3.0	3.4	3.2	2.0	3.0	3.5	7.0	7.3	7.0	7.0	6.8	-4.4	-1.1	-2.0	-2.2	-2.4
Slovakia	1.8	0.9	2.4	2.5	2.6	3.7	1.5	0.2	1.5	2.5	14.0	14.2	13.5	13.0	12.0	2.2	2.1	1.5	1.0	0.1
Slovenia	-2.6	-1.0	1.8	1.5	1.5	2.8	1.9	0.7	1.0	1.0	8.9	10.1	10.0	9.8	9.6	2.8	5.8	5.3	4.7	4.4
NMS-11 1)	*0.8*	*1.4*	*2.6*	*2.6*	*2.7*	*3.7*	*1.5*	*0.6*	*1.8*	*2.2*	*9.9*	*10.0*	*9.5*	*9.3*	*9.1*	*-1.8*	*0.0*	*-0.1*	*-0.8*	*-1.2*
EA-18 2)	*-0.7*	*-0.5*	*0.8*	*1.1*	*1.7*	*2.5*	*1.4*	*0.5*	*0.8*	*1.5*	*11.3*	*11.9*	*11.6*	*11.3*	*10.8*	*1.9*	*2.4*	*2.5*	*2.6*	*2.5*
EU-28 1)2)	*-0.4*	*0.0*	*1.3*	*1.5*	*2.0*	*2.6*	*1.5*	*0.6*	*1.0*	*1.6*	*10.4*	*10.8*	*10.3*	*10.0*	*9.5*	*1.0*	*1.4*	*1.4*	*1.5*	*1.5*
Candidate countries																				
Albania	1.6	0.5	1.3	1.5	0.9	2.0	1.9	1.0	1.0	1.0	13.4	15.6	18.0	18.0	19.0	-10.2	-10.6	-10.0	-9.3	-8.3
Macedonia	-0.4	2.9	3.0	3.0	3.0	3.3	2.8	0.5	1.5	2.0	31.0	29.0	28.0	27.0	27.0	-3.0	-1.9	-4.0	-4.0	-4.0
Montenegro	-2.5	3.3	2.1	2.9	3.0	4.1	2.2	0.0	1.0	2.0	19.7	19.5	19.0	19.0	19.0	-18.7	-14.6	-15.4	-15.9	-15.4
Serbia	-1.5	2.5	-1.0	0.0	1.0	7.8	7.8	2.0	4.0	3.0	23.9	22.1	21.0	23.0	23.0	-12.3	-6.5	-6.2	-6.0	-6.0
Turkey	2.1	4.1	3.7	2.7	2.8	9.0	7.5	8.6	7.4	6.1	9.2	9.7	9.2	9.5	9.1	-6.0	-7.9	-6.0	-5.9	-6.2
Potential candidate countries																				
Bosnia and Herzegovina	-1.2	2.1	0.0	1.0	2.0	2.0	0.2	0.0	1.0	2.0	28.0	27.5	27.0	27.0	27.0	-9.2	-5.9	-8.0	-7.0	-8.0
Kosovo	2.8	3.4	4.7	3.8	3.7	2.5	1.8	1.0	2.0	2.0	30.9	30.0	30.0	29.0	29.0	-7.5	-6.4	-8.9	-10.2	-11.3
Kazakhstan	5.0	6.0	4.5	4.5	5.0	5.2	5.8	9.0	6.0	6.0	5.3	5.2	5.1	5.0	5.0	0.5	0.5	1.3	-0.1	-1.3
Russia	3.4	1.3	0.5	1.3	1.9	5.1	6.8	7.5	7.0	6.0	5.5	5.5	5.3	5.2	5.0	3.6	1.6	3.1	3.4	3.0
Ukraine	0.2	0.0	-8.0	-1.1	1.8	0.6	-0.3	11.0	9.7	4.5	7.5	7.2	9.4	10.0	10.0	-7.9	-8.8	-3.8	-3.2	-3.7

Note: GDP data are already reported according to ESA 2010 for the following countries: HR, CZ, EE, HU, LV, SI, AL, XK, KZ, UA as well as EA-18 and EU-28.
1) wiiw estimate. - 2) Current account data include transactions within the region (sum over individual countries).
Source: wiiw (data until 2013 as of 16, Oct 2014), Eurostat. Forecasts by wiiw (Nov 2014) and European Commission for EU and euro area (Autumn Report, November 2014).

Table 2 / Central and East European new EU Member States (NMS-11): an overview of economic fundamentals, 2013

	Bulgaria	Croatia	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	*NMS-11* [1]	*EU-28* [2]
GDP in EUR at exchange rates, EUR bn	39.9	43.6	157.3	18.7	100.5	23.3	34.6	389.7	142.2	72.1	36.1	*1,058*	*13,069*
GDP in EUR at PPP, EUR bn	87.0	67.1	227.3	25.3	174.5	34.7	56.5	673.5	278.3	106.2	44.9	*1,775*	*13,069*
GDP in EUR at PPP, EU-28=100	0.7	0.5	1.7	0.2	1.3	0.3	0.4	5.2	2.1	0.8	0.3	*13.6*	*100.0*
GDP in EUR at PPP, per capita	12,300	15,700	22,100	19,600	17,800	17,700	19,500	17,700	14,400	19,700	21,800	*17,000*	*25,700*
GDP in EUR at PPP per capita, EU-28=100	48	61	86	76	69	69	76	69	56	77	85	*66*	*100*
GDP at constant prices, 1990=100	131.6	105.6	142.9	153.9	127.7	117.1	126.8	203.6 [3]	140.8	172.6	150.9	*166.1*	*145.9*
GDP at constant prices, 2007=100	104.1	89.8	100.4	95.3	96.8	92.6	101.1	120.1	105.6	111.1	93.5	*107.8*	*99.6*
Industrial production real, 2007=100 [4]	88.4	82.9	96.6	111.1	95.4	104.4	109.6	121.2	121.4	124.8	90.0	*110.8*	*92.0*
Population, thousands, average	7,265	4,254	10,514	1,318	9,894	2,013	2,958	38,514	19,981	5,413	2,060	*104,185*	*508,102*
Employed persons, LFS, thousands, average	2,935	1,390	4,937	621	3,938	894	1,293	15,568	9,247	2,329	906	*44,059*	*217,292*
Unemployment rate, LFS, in %	13.0	17.2	7.0	8.6	10.2	11.9	11.8	10.3	7.3	14.2	10.1	*10.0*	*10.8*
General gov. revenues, EU-def., in % of GDP	37.2	40.8	38.9	37.5	46.4	35.3	32.2	37.5	32.7	35.9	43.6	*36.4*	*45.7*
General gov. expenditures, EU-def., in % of GDP	38.7	45.7	40.3	37.7	48.7	36.2	34.4	41.9	35.0	38.7	58.0	*39.3*	*49.1*
General gov. balance, EU-def., in % of GDP	-1.5	-4.9	-1.4	-0.2	-2.3	-0.9	-2.2	-4.3	-2.3	-2.8	-14.4	*-2.9*	*-3.3*
Public debt, EU def., in % of GDP	18.9	66.7	43.8	9.8	77.3	38.2	39.4	57.0	38.4	55.4	70.0	*51.9*	*87.1*
Price level, EU-27=100 (PPP/exch. rate)	46	65	69	74	58	67	61	58	51	68	81	*60*	*100*
Compensation per employee, monthly, in EUR [5]	500	1,435	1,281	1,306	961	1,011	990	975	691	1,227	2,013	*984*	*2,956*
Compensation per employee, monthly, EU-28=100	16.9	48.5	43.3	44.2	32.5	34.2	33.5	33.0	23.4	41.5	68.1	*33.3*	*100.0*
Exports of goods in % of GDP	55.8	22.5	64.9	61.2	72.0	42.2	69.3	38.2	34.9	89.2	60.9	*52.2* [6]	*31.7* [6]
Imports of goods in % of GDP	61.8	37.0	60.3	66.5	68.5	53.1	72.0	38.0	37.3	83.3	59.2	*51.9* [6]	*32.9* [6]
Exports of services in % of GDP	14.4	21.8	10.7	25.3	16.7	16.8	15.6	8.7	7.6	7.8	14.8	*10.9* [6]	*11.5* [6]
Imports of services in % of GDP	8.7	6.3	9.4	18.8	12.7	9.1	11.6	6.6	5.7	7.6	9.4	*8.1* [6]	*9.2* [6]
Current account in % of GDP	2.1	0.9	-1.4	-1.4	4.1	-2.3	1.6	-1.3	-1.1	2.1	5.8	*0.0* [6]	*1.8* [6]
FDI stock per capita in EUR, 2013	5,266	5,546	9,383	11,821	8,163	5,732	4,210	4,686	3,076	7,903	5,360	*5,533*	*11,616*

Note: GDP data are already reported according to ESA 2010 for the following countries: Croatia, Czech Repulic, Estonia, Hungary, Latvia and Slovenia (EU-28 still refers to ESA 1995).
NMS-11: 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 NMS-11 and EU-28 include transactions within the region (sum over individual countries).
Source: wiiw Annual Database, Eurostat, AMECO.

Table 3 / Southeast Europe and selected CIS countries: an overview of economic fundamentals, 2013

	Macedonia	Monte-negro	Serbia	Turkey	Albania	Bosnia - Herzegovina	Kosovo	Kazakhstan	Russia	Ukraine	*NMS-11* [1]	*EU-28* [2]
GDP in EUR at exchange rates, EUR bn	7.7	3.3	32.0	617.8	9.8	13.4	5.3	168.9	1,579.3	141.9	*1,058*	*13,069*
GDP in EUR at PPP, EUR bn	18.6	6.7	66.5	1,070.3	22.0	27.7	10.7	297.0	2,598.5	305.7	*1,775*	*13,069*
GDP in EUR at PPP, EU-28=100	0.1	0.05	0.5	8.2	0.2	0.2	0.1	2.3	19.9	2.3	*13.6*	*100.0*
GDP in EUR at PPP, per capita	9,200	11,200	9,200	14,100	7,800	7,300	5,800	18,300	18,600	7,000	*17,000*	*25,700*
GDP in EUR at PPP per capita, EU-28=100	36	44	36	55	30	28	23	71	72	27	*66*	*100*
GDP at constant prices, 1990=100	123.8	.	.	242.4	206.6	.	.	183.9	117.7	69.5	*166.1*	*145.9*
GDP at constant prices, 2007=100	112.8	107.5	103.7	121.0	120.7	105.5	127.4	134.2	110.8	95.8	*107.8*	*99.6*
Industrial production real, 2007=100 [3]	97.9	72.1	95.5	117.5	304.3	111.3	.	123.5	106.7	84.7	*110.8*	*92.0*
Population, thousands, average	2,064	622	7,164	76,148	2,897	3,832	1,829	17,035	143,507	45,490	*104,185*	*508,102*
Employed persons, LFS, thousands, average	679	202	2,311	25,520	992	822	303	8,571	71,391	20,404	*44,059*	*217,292*
Unemployment rate, LFS, in %	29.0	19.5	22.1	9.7	15.6	27.5	30.0	5.2	5.5	7.2	*10.0*	*10.8*
General gov. revenues, nat. def., in % of GDP	29.6	37.4	40.6	37.6 [4]	23.9	43.4	35.0	18.7	36.6	29.4	*36.4* [4]	*45.7* [4]
General gov. expenditures, nat. def., in % of GDP	33.7	41.0	45.6	39.3 [4]	28.8	45.6	37.0	20.7	37.9	33.6	*39.3* [4]	*49.1* [4]
General gov. balance, nat. def., in % of GDP	-4.1	-3.6	-5.0	-1.7 [4]	-4.9	-2.2	-2.0	-2.1	-1.3	-4.2	*-2.9* [4]	*-3.3* [4]
Public debt, nat. def., in % of GDP	36.0	56.3	63.7	34.6 [4]	70.0	42.5	8.9	13.3	10.4	38.8	*51.9* [4]	*87.1* [4]
Price level, EU-28=100 (PPP/exch. rate)	41	50	48	58	44	48	50	57	61	46	*60*	*100*
Average gross monthly wages, EUR at exchange rate	504	726	537	664 [5]	291	660	364 [6]	540	709	308	*984* [5]	*2,956* [5]
Average gross monthly wages, EU-28=100	17.0	24.6	18.2	22.5 [5]	9.9	22.3	12.3	18.3	24.0	10.4	*33.3* [5]	*100.0* [5]
Exports of goods in % of GDP	31.0	12.1	34.3	19.9	18.0	20.8	5.7	38.1	24.9	31.4	*52.2* [7]	*31.7* [7]
Imports of goods in % of GDP	55.2	52.1	46.7	29.7	35.6	50.6	43.1	22.6	16.3	43.1	*51.9* [7]	*32.9* [7]
Exports of services in % of GDP	14.9	31.8	10.7	5.8	17.0	11.2	11.7	2.3	3.3	12.0	*10.9* [7]	*11.5* [7]
Imports of services in % of GDP	10.1	12.3	9.7	2.9	17.1	2.7	5.9	5.4	6.1	8.6	*8.1* [7]	*9.2* [7]
Current account in % of GDP	-1.9	-14.6	-5.0	-7.9	-10.6	-5.9	-6.4	0.5	1.6	-8.8	*0.0* [7]	*1.8* [7]
FDI stock per capita in EUR, 2013	1,925	6,290	2,968	1,376	1,278	1,566	1,517	5,259	2,870	1,223	*5,533*	*11,616*

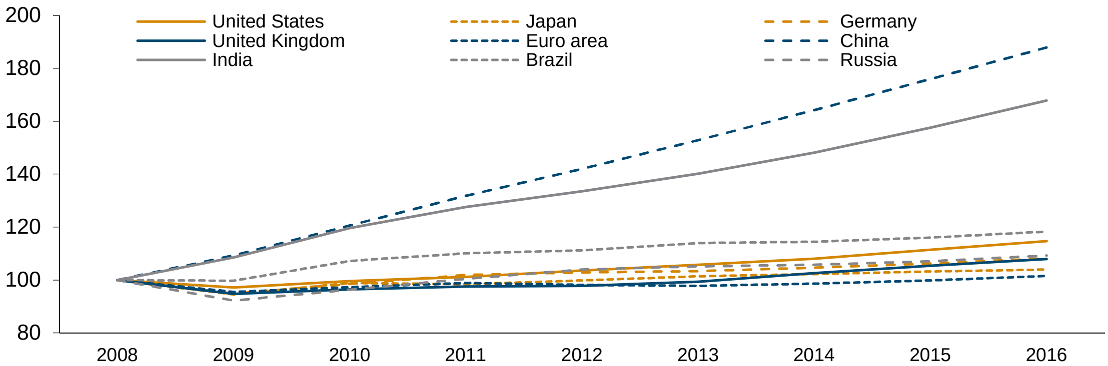
Note: GDP data are already reported according to ESA 2010 for the following countries: Albania, Kosovo, Kazakhstan and Ukraine (EU-28 still refers to ESA 1995).
NMS-11: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia. PPP: Purchasing power parity, wiiw estimates for Kazakhstan, Russia and Ukraine; IMF for Kosovo.
1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) EU-28 working-day adjusted. - 4) EU definition: expenditures and revenues according to ESA'95, excessive deficit procedure. -
5) Gross wages plus indirect labour costs, according to national account concept. - 6) Average net monthly wages. - 7) Data for NMS-11 and EU-28 include transactions within the region.
Source: wiiw Annual Database, Eurostat, AMECO.

International environment: recovery and uncertainty

VLADIMIR GLIGOROV

To get a sense of global growth prospects (Figure 1)**, four issues have to be considered: (i) recovery in the United States; (ii) near-stagnation in the euro area; (iii) expectations as to developments in the rest of the world; and (iv) growing uncertainties.** All four issues will be influenced by: developments in the global markets, such as energy and commodity prices; financial challenges; and developments affecting political stability. The risks on the upside are that the US recovery will prove stronger than forecast, while the slowdown in emerging economies, especially in China, will either not occur or be quite gradual. If that is the case, the euro area could well avoid its third recession; something that would also help the emerging economies in Europe. By way of contrast, the risks on the downside are those of a persistently weak performance in the euro area and a more pronounced slowdown in China, coupled with increased political uncertainties, slowing down the global recovery.

Figure 1 / Overview of the World Economic Outlook projections, development of GDP, 2008 = 100



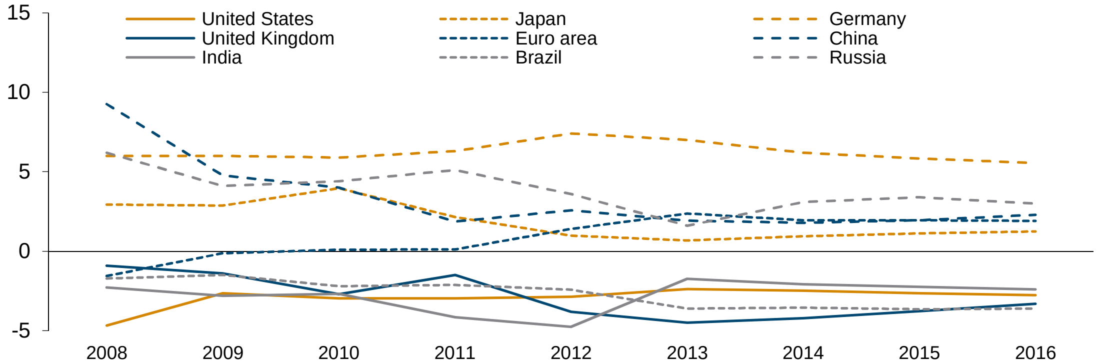
Source: wiiw Annual Database and wiiw forecasts for Russia. IMF, World Economic Outlook, October 2014.

Overall recovery in the United States is expected in the medium term, but not in the guise of a boom or a bubble. Most discussions on the short- and medium-term prospects for growth in the United States focus on the behaviour of the monetary authorities: more specifically, when and how the FED will decide to change its current monetary regime. There is hardly any reason to expect that it will happen soon. Certainly the change will not be dramatic because not only is the inflation rate low relative to the target, but also the output gap is still negative (see Kocherlakota, 2014). Furthermore, on the positive side, energy and other commodity prices are falling. As for fiscal policy, not much help can be expected from that quarter, especially in light of the outcome forecast for the mid-term elections in early November.

The developments in the European Union and the euro area have diverged somewhat. In part this is due to a more rapid recovery in the United Kingdom, as well as to near-recessionary developments in some core-countries in the euro area. However, peripheral economies are registering growth once again, as are new Member States (or at least, for the most part). Another positive feature is also the depreciation of the euro vis-à-vis the dollar; this reflects a divergence in the expectations concerning the monetary policy stance of the ECB compared to that of the FED. Given the very low rate of inflation and slow growth in the euro area, the ECB should continue its highly accommodative monetary policy, even if the FED decides to start hiking interest rates: a measure it may not take before the middle of next year at the earliest. In all likelihood the ECB will not go full tilt for quantitative easing, but will continue to push for it as long as the EU's and the euro Member States' fiscal stance remains unchanged (Draghi, 2014). Such a change is unlikely, even though a further push for additional fiscal consolidation is equally improbable. In fact, support is growing for an increase in public investments, probably targeted ones, as counselled by the IMF, both across the EU as a whole and in individual member-states (IMF, 2014a). Those investments will not necessarily speed up recovery to any marked degree over the short term, but they will have a positive impact on the potential growth rate in the medium term. Thus, in the short and medium term, slow recovery is to be expected in the EU, particularly in the euro area. The prospects for potential growth will possibly improve, provided: (i) an active monetary policy is maintained, (ii) the exchange rate continues to support exports; (iii) and public investments are increased.

The developments in the rest of the world are not altogether discouraging. Even though a slowdown in China has been forecast for some time now, it has yet to happen. To the extent that it is already happening, it is comparatively gradual (however, see Pritchett and Summers, 2014). By way of contrast, the news from India is encouraging. The rest of the developing world also continues to post positive growth rates, partly on account of growing commodity exports. Thus, assuming that the situation in Japan, China and India will remain as it is, it should support commodity exports from Africa and Latin America; that, in turn, should have an overall positive effect on the prospects for global growth. The latter countries as well as the developed countries should also benefit from the decline in external imbalances as current account deficits and surpluses have shrunk since the advent of the crisis (Figure 2, IMF, 2014b). All that militates against exchange rate crises that have so often interrupted recoveries in the developing world, although monetary policies may well be put to the test in some countries, as evidenced during last year's episode sparked by the FED announcing its tapering of monetary policy.

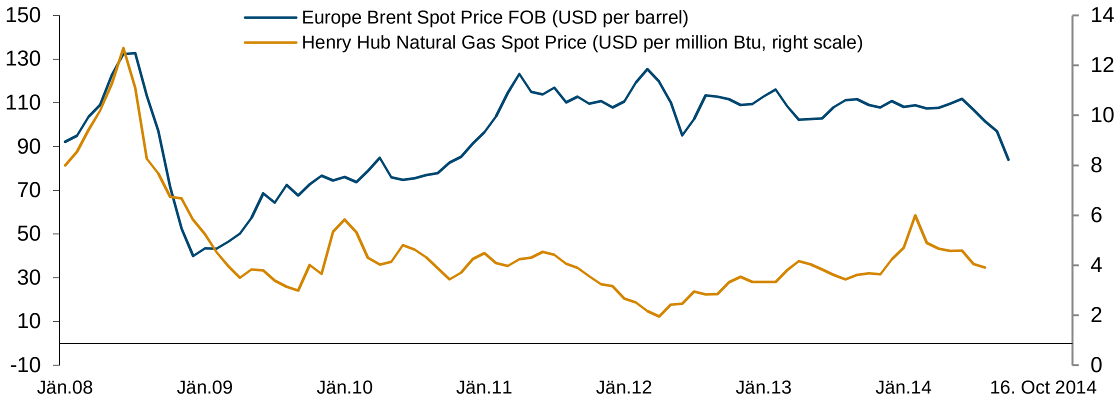
Figure 2 / Current account, % of GDP



Source: wiiw Annual Database and wiiw forecasts for Russia. IMF, World Economic Outlook, October 2014.

These cautiously positive trends should be sustained by moderation in the energy and commodity markets. In fact, the price of oil has dropped sharply in recent months (Figure 3); that seems to reflect a pronounced growth in supply rather than a decline in demand (IMF, 2014b). The period of high energy prices seems to have led to both technological innovations and the diversification of sources of energy. To the extent that this holds true, it will have a positive impact on overall growth. The decline in energy prices may also reflect in part the appreciation of the dollar, thus possibly modifying expectations of a positive effect on the net importers with depreciating currencies. The overall impact of the decline in commodity prices, especially for oil and, in the longer term, for gas as well, should prove positive for global growth as well as for growth in the developed countries – albeit to the detriment of the oil-producing countries (e.g. Russia).

Figure 3 / Development of oil and gas price, 2008-2014



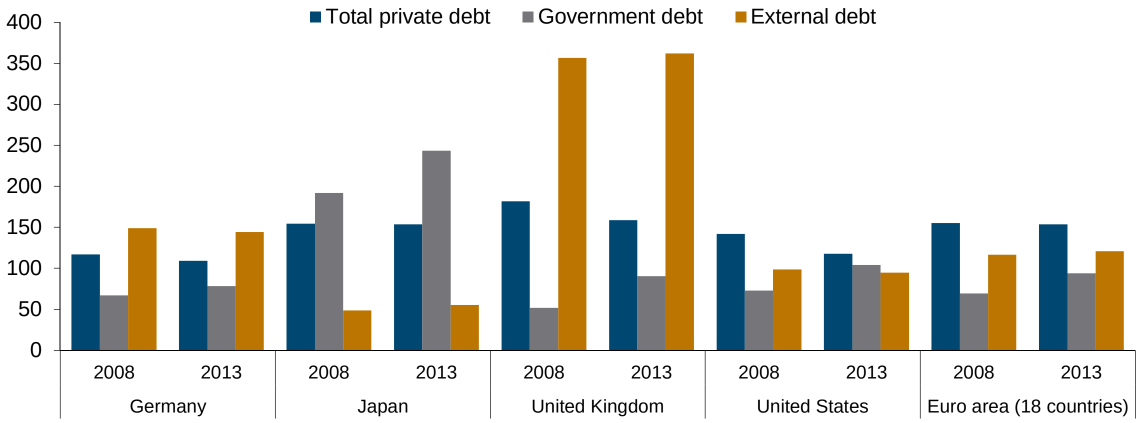
Source: Energy Information Administration (EIA, US – http://www.eia.gov).

The political developments, primarily in Ukraine but also in the Middle East and North Africa region (MENA), may tilt the risks downwards. In the MENA region, the Arab Spring has yielded disappointing results. Apart from that, as it was probably unrealistic to expect the region to undergo a radical transformation, certain realignments have contributed to stability and new sources of instability alike. A certain consensus prevails in the international community on the need to work for the region's stability or rather for a sustainable level of instability, so things should not be expected to spin out of control. The Ukrainian crisis is different. It signals a return to geopolitics in Europe and an increase in uncertainty overall. For the most part, Russia finds itself on the horns of a dilemma. Should its aim be to annex territories or to benefit from economic cooperation with the EU? At the moment, most forecasts assume that Russia's geopolitical cravings will recede. The regime of mutual sanctions will be gradually dismantled followed by a return to the cooperation mode (IMF, 2014b). By way of contrast, there are worries that the conflict over the territories in Eastern Ukraine will continue, thus inflicting severe damage on European cooperation and partnership for an extended period of time. The economic costs of such a development are asymmetric, with Russia being more affected in the medium and long term. However, Russia might see the short-term political costs of restraint as being too high, because they would involve some internal political adjustments that may not be all that easy to implement. For example, it may require the return of the so-called liberals, who at present are very much on the receiving end in the public political arena. The chances are that the damage to economic and political cooperation between Russia and the EU will be long-lasting with a heightened level of uncertainty brought about by the prolonged crisis in Ukraine.

Finally, the risk persists that political developments in the EU may take a negative turn. The EU has been very successful in substituting market integration for concerns over territorial control. It has calmed nationalist urges; it has also projected integration as an instrument of security and stability in Southern and Eastern Europe. It has, however, failed to go much beyond market integration; it has not developed institutions focused on sharing risks and stabilising business cycles (Farhi and Werning, 2014). In fact, the lack of the latter institutions has merely prolonged the crisis and contributed to the increased attractiveness of nationalist policies. Thus, the risks for the monetary union have been high, as well as being equally high for the membership and the very character of the European Union itself. Interestingly enough, interest in the monetary union has not waned in the countries most affected by the crisis and more countries have joined the euro area in the past few years. This, of course, may change if efforts to create the banking union and promote public investments fail. The key challenge comes from the nationalist parties that have been gaining ground in recent national and EU elections. However, were a referendum to be held on the United Kingdom leaving the EU, the outcome would be uncertain; similarly, the extent to which nationalist parties can continue to grow is equally unclear. Generally, once such parties no longer serve as vehicles for protest voters, they will have to weigh the costs and benefits of disintegration in the EU, hardly a positive prospect. That being said, the nationalist challenge to the EU is not certainly going to fade away any time soon. None the less, if and when it comes, the more robust recovery of the EU economy should prove a stabilising factor.

How far has the global economy managed to extricate itself from the financial crisis? One indicator is the progress achieved in terms of deleverage (Figure 4). Prior to the crisis, debt in the private sector rose to relatively high levels only to have some of it absorbed by increases in public debt. This particular balance-sheet crisis should thus have led to deleverage and repair of the balance sheets. Globally, however, this does not seem to have happened – at least not to any significant extent; outside the USA and the UK (Geneva Report 16, 2014). This has given rise to a measure of concern, although it is not clear how risky this development might prove to be (IMF, 2014b sees growing risks from the rapid increase in shadow banking). It may incur secular stagnation because of a persistent weakness in terms of private investments; this might explain why recovery has been rather weak with every expectation of its remaining so.

Figure 4 / Debt (loans) 2008 and 2013, in % of GDP



Source: Eurostat, World Bank, own calculations.

Overall, the risks may prove to be balanced or perhaps slightly on the upside. Positive trends in the United States and the rest of the world may well outweigh weaknesses in the EU and the euro area. Barring surprising developments, those trends may also offset any negative political shocks. Recovery, however, will continue to be weak and slow.

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CESEE core resilient in the face of EU stagnation and the Ukraine crisis

SÁNDOR RICHTER*

2007 AND 2014: A SOBERING COMPARISON

On 31 December 2014, seven years will have passed since the crisis erupted in 2008. Before entering into the details of the current economic situation and discussing the short- and medium-term outlook in the CESEE countries, it is worth taking a brief glimpse of the changes in the macroeconomic aggregates in those countries. Figure 5 shows the cumulative changes in GDP growth and its components over the seven years.

By the end of 2014, of the 21 countries in the region 15 will have managed in GDP terms to make up for the losses they suffered during the crisis. Kazakhstan, Kosovo, Turkey, Poland and Albania have already managed to surpass their 2007 GDP levels by more than 20%; Macedonia, Slovakia and Russia by over 10%. Seven other countries recorded more moderate growth performance, while at the end of the year Hungary, Estonia, Slovenia, Latvia, Ukraine and Croatia will have still been unable to offset the damage they endured at the time of the crisis.

A decomposition of GDP growth shows that household consumption has been much more crisis-resistant than gross fixed capital formation (investment) (see Figure 5, upper section). Even in those economies with negative shifts in their GDP, the drop in cumulative household consumption remained moderate, with Croatia attaining a maximum of 12%. In a few cases, household consumption was either well ahead of GDP growth (Kazakhstan and Romania) or stood in marked contrast to GDP decline (Ukraine). The crisis left its most painful traces in investment. Of the 21 economies analysed, only six countries registered a positive cumulative change in investment over the period 2008-2014. The really striking feature, however, is the extent of the slump in investment, ranging from the most severe (58% in Ukraine, 40% in Latvia and 34% in Slovenia) to the least (somewhat below 10% in Albania, Bosnia-Herzegovina, the Czech Republic and Serbia). Altogether in 18 of the 21 countries in the region the investment/GDP ratio contracted, sorely impairing the growth prospects of the economies concerned.

Typically, the CESEE countries reacted to the crisis through external trade channels (see Figure 5, lower section). In all 21 countries except Russia and Ukraine, cumulative net exports were positive. In Russia, import growth was much stronger than GDP growth, while export growth was far less. In Ukraine, the decline in both exports and imports was greater than that of the GDP, with exports declining more sharply than imports. In 15 of the CESEE countries, the increase in exports was far greater than

* The author is grateful for valuable comments by Vasily Astrov, Vladimir Gligorov, Peter Havlik, Gábor Hunya, Mario Holzner, Michael Landesmann, Sebastian Leitner, Leon Podkaminer and Hermine Vidovic (all wiiw) and for the valuable support by the wiiw Statistics Department, first of all by Beate Muck.

either GDP or import growth. This pattern was to be observed in all NMS and three countries in the Western Balkans, as well as in Turkey. Two major economies, Poland and Turkey, proved crisis-resistant: both countries recorded moderate net export growth and their household consumption and investment growth rates did not diverge radically from their overall GDP growth. Slovenia, Croatia and Latvia were severely affected by the crisis. Although net exports grew at a remarkable rate in all three countries, export growth was matched by a steep drop in investment. In summary, the CESEE countries typically coped with the crisis in the region primarily by adopting a behaviour that made for simultaneous net export growth and investment shrinkage in parallel to a certain measure of stability in the levels of household consumption. Under those conditions, the export boom to be observed in most of the CESEE countries must have occurred without any significant modernisation of production capacities. The same analysis for the EU-15 shows that the changes relating to investment and external trade in the GIIPS countries[1] were very similar to those in the NMS; that finding, however, does not apply to the rest of the EU-15. The highly developed core-economies in the EU suffered a somewhat more moderate decline in investment and registered import growth rates were higher than export growth rates over the period concerned. Cases in point are Austria, Belgium, Germany, Finland, France, Luxembourg and Sweden.

Figure 5 / Cumulative change of GDP growth components, 2014, 2007=100

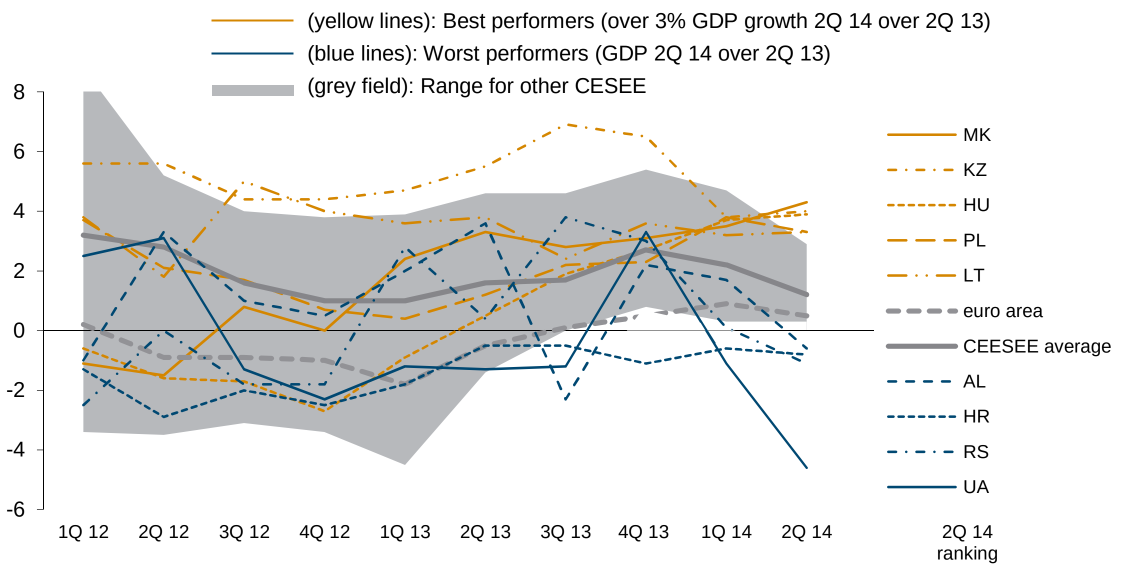
Note: 2014 wiiw forecast.
Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculations.

[1] Greece, Ireland, Italy, Portugal and Spain.

RECENT GDP DEVELOPMENTS ANAEMIC

Compared to the first six months of the previous year, the average economic growth of the CESEE countries amounted to 1.8% in the first half of 2014.[2] This pace of expansion was slightly more rapid than the GDP growth rate of 1.5% in the EU-28. Five of the region's economies ranked among the best performers (recording growth rates higher than 3% in the first six months of 2014). Macedonia is the success story in the Western Balkans, registering a remarkable growth performance since early 2013 and displaying good prospects for the whole forecast period. With its special economic structure based on natural resources and its export markets located largely outside the troubled CIS-countries, Kazakhstan has enjoyed stable 4-7% economic growth over the past few years. Hungary seems to have put behind itself a longer period of poor economic performance, nevertheless important one-off elements are looming in the backdrop to the current upturn (such as increased investment attributable to election-related government spending as well as a temporary peak in EU co-financed projects). The latter will fade away over the next two years, whereas the legal insecurity prevailing in the country does not bode well for a lasting recovery. Of the countries among the NMS, Poland has remained the most successful for the past five years, despite the deceleration of growth in late 2012 and early 2013 attributable to fiscal consolidation. The country's growth prospects for 2015 and 2016 are solid. Lithuania has recorded stable economic growth over the past two and a half years; it will be the third Baltic country in a row to introduce the euro (scheduled for January 2015).

Figure 6 / Development of quarterly GDP, real change in % against preceding year



Source: National and Eurostat statistics.

Three countries in the region have seen their economy decline in the first six months of the current year. It comes as no surprise that Ukraine is among the worst performers; its economic growth rate dropped by close to 5% in the first half of 2014. Russia, the other country directly involved in the conflict, registered quarterly growth rates that were weaker than previously, whereas its economy

2 This year for the first time we have included a country report on Belarus (see p. 107). However, Belarus is not to be found among the countries analysed in the overview.

continued to expand despite deteriorating external circumstances. Over the past two and a half years, Serbia has had a mixed record of decline and expansion. It is estimated that after sliding into decline in the second quarter of 2014, its GDP growth will hover between -1% and +1% over the coming two years as well. Croatia has been firmly rooted in the negative sector since the first quarter of 2009 (with only a brief interruption in early 2011); however, the trend is slowly changing and the country may attain modest growth by 2016.

MIXED GROWTH IN INDUSTRY AND CONSTRUCTION

In the twelve months between the second quarter of 2013 and the second quarter of 2014 gross industrial output increased in 12 of the 20 countries[3] in the region. Hungary, Romania, the Czech Republic and Macedonia reported industry growth rates in excess of 5%.[4] At the other end of the scale, eight countries in the region reported a decline in gross industrial output. Also remarkable is the underperformance of the countries in the Western Balkans. Montenegro reported a contraction of over 25% (owing to the insolvency of an aluminium plant); Serbia, Bosnia-Herzegovina and Albania registered a decline of some 5%.[5]

Construction activities show a much broader spectrum of growth performance than industry. Pronounced expansion was reported in Slovenia, Hungary, Latvia and Lithuania, as well as dynamic expansion in Poland. In Slovenia and Hungary the current boom is bouncing back after several years of depression. The growth-supporting effect of the final dash for the mobilisation of EU resources within the framework of the cohesion policy is clearly visible in all five countries. A strange combination can be observed in the case of Romania and Slovakia. Despite the satisfactory growth in output achieved in industry, output in the construction sector declined. The decline was considerable in Romania, yet less so in Slovakia, although both countries are technically in the final rounds of mobilising EU transfers just like the countries listed above that had registered a much more dynamic expansion of construction activities. Apart from Romania, the other laggards in the construction sector are two countries in the Western Balkans: Albania and Montenegro with a decline of more than 30% and 26%, respectively. The situation in the construction sector in Croatia and Ukraine is also on the decline.

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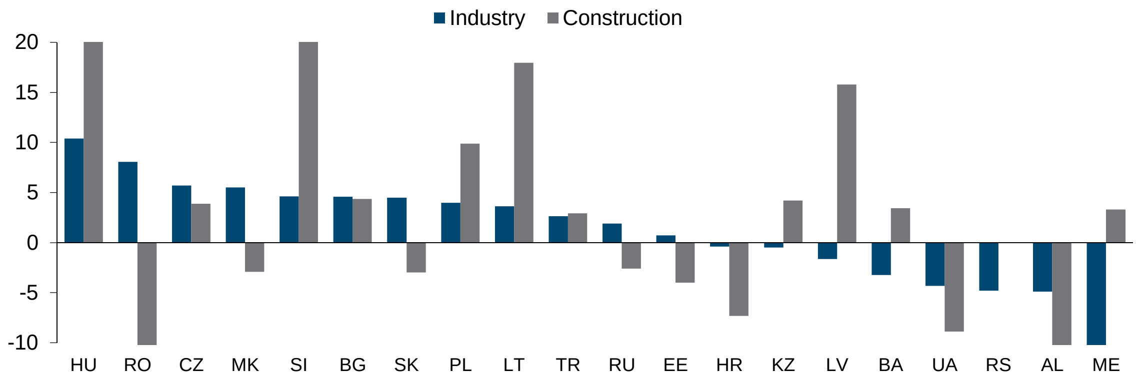
3 No data are available for Kosovo.

4 Main drivers of growth was manufacture of transport equipment in Hungary, the Czech Republic and Macedonia; manufacture of computer, electronic and optical products in Romania and the Czech Republic, manufacture of machinery and equipment in Macedonia and Romania. In countries with less dynamic overall industrial growth or no growth at all, the expansion of output of computer, electronic and optical products was also exceptionally strong in Latvia, Lithuania, Slovenia, Croatia and Bulgaria. The same applies to Bulgaria, Bosnia and Herzegovina and Romania in the product group transport equipment; for Croatia, Romania, Estonia, Bulgaria and Kazakhstan in the product group machinery and equipment.

5 In Serbia output of computer electronic and optical products declined by close to 25%, that of machinery and equipment by over 20%; however, in the production of transport equipment an expansion of 4% was reported. Remarkable is also the shrinking output in Estonia in the sector of computer, electronic and optical products and that of Latvia and Lithuania in transport equipment (19% and 30%, respectively).

Figure 7 / Gross industrial production and construction output, 2Q 2014, change in % against preceding year



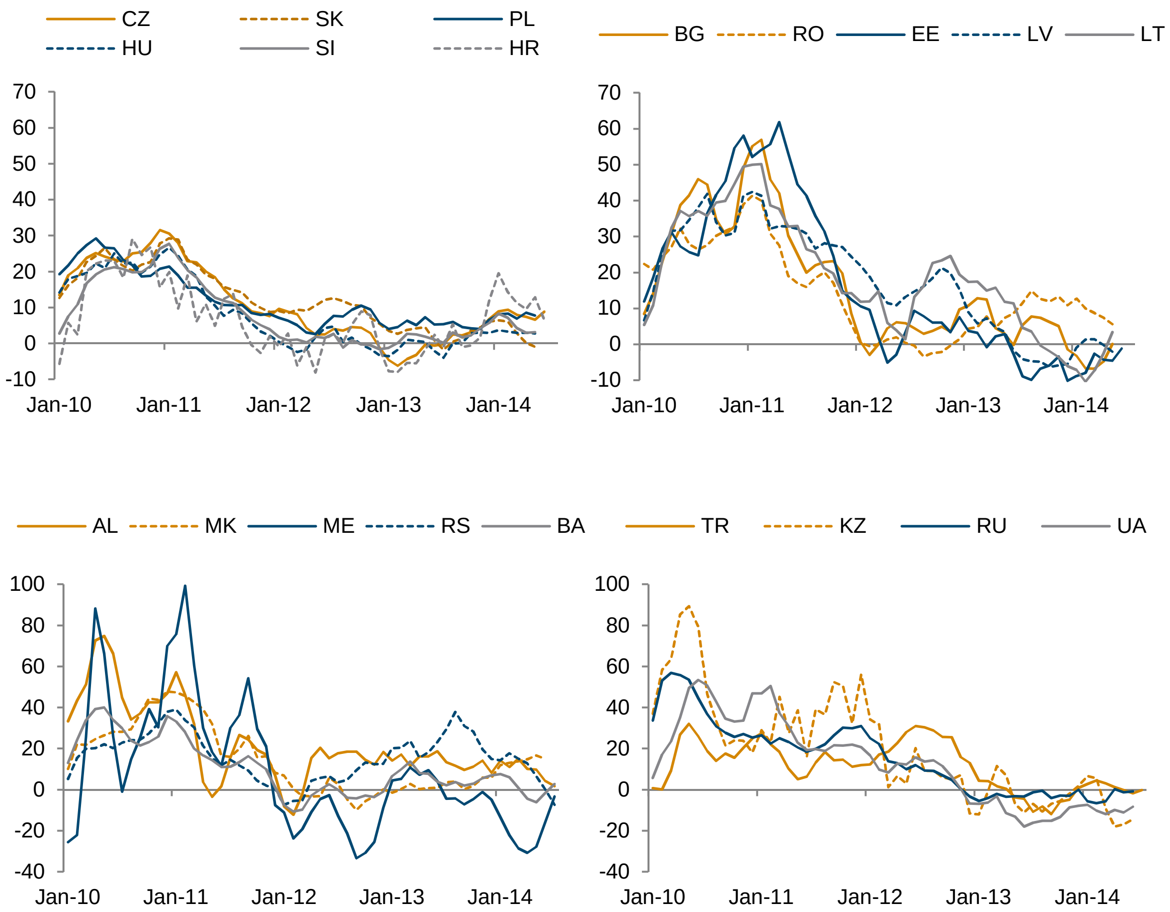
Note: RU, KZ, UA cumulated growth of 1-2Q 2014.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

EXPORTS LOSING WEIGHT AS AN ENGINE OF GROWTH

Exports have become a somewhat less important driver of growth than in earlier years. Figure 8 shows the monthly developments of exports in the CESEE economies over the period 2010 to mid-2014. For the most part, the patterns are similar across the region. In 2010 we can see rapidly rising curves indicating the bounce-back effect from the steep drop in the wake of the crisis in 2009. Remarkably, the peak achieved is much higher in two countries in the Eastern Balkans, Bulgaria and Romania, and in the three Baltic States than in the countries of Central Europe. The explanation for this difference may lie in the more pronounced decline in exports in the first group of countries during the crisis that ultimately led to a stronger bounce-back effect. The similarity of development in the Central European economies over the period 2012-2014 is remarkable, with export growth rates sinking to the range of 0% to 10%, in some cases even turning negative for some months. In the Eastern Balkans and the Baltic States, apart from the overall diminution of the export dynamics, the differences across countries remained larger, with individual countries displaying more extreme positive and negative performances than in the Central European group. The economies in the Western Balkans followed the general downward pattern of export growth rates over the period concerned, but with major differences between countries. Turkey, Kazakhstan, Russia and Ukraine also displayed fairly individual export development paths. A specific common feature of the members of the latter group, however, is that their exports registered an appreciable decline in 2013 and early 2014. Export developments in the countries of the region certainly depend on the expansion of main import markets. In 2010 world trade registered a recovery from the crisis only to flatten out in the biennium 2011-2012. It recorded a slight recovery over 2013 only to drop sharply in late 2013 and early 2014, followed by a rapid recovery in mid-2014.[6] This latter upward movement is not necessarily reflected in the export performance of the CESEE region.

6 IMF World Economic Outlook, October 2014, p. 3.

Figure 8 / Exports of goods (nominal, euro-based), change in % against preceding year, 3-month moving average



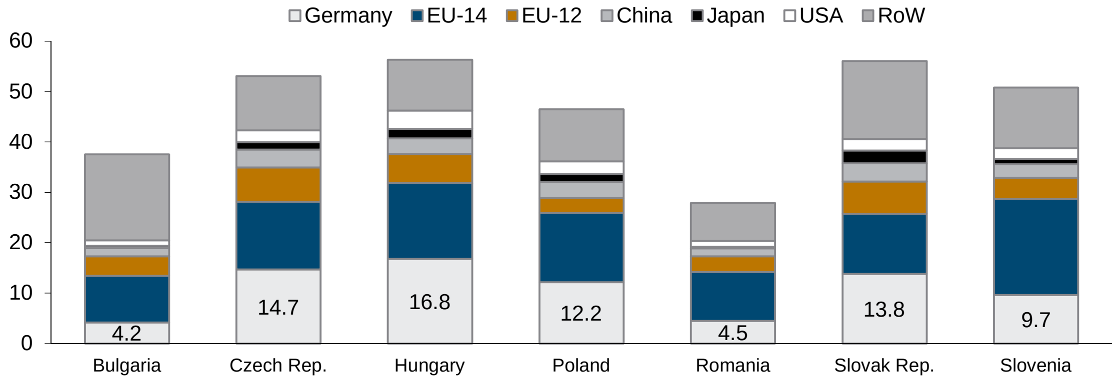
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

BOX 1 / THE AUTOMOTIVE INDUSTRY IN THE REGION

BY DORIS HANZL-WEISS

The automotive industry is of paramount importance to the region in terms of production, employment and trade. Foreign direct investment played an important role and transformed the sector into a competitive and export-oriented industry. The automotive sector (NACE Rev. 2 C29, including car components) is in fact the largest manufacturing segment in Slovakia, the Czech Republic, Hungary and Romania, with shares in manufacturing production of 32%, 22%, 19%, and 16% in 2012. In Poland and Slovenia the automotive sector also accounts for large shares of about 11% and is the third largest industry there. The automotive industry is of minor importance in Bulgaria and Croatia; it is also small in Serbia (accounting for only 4% of manufacturing turnover there). Over the period 2005-2012, the most impressive structural shift in favour of the automotive industry occurred in Slovakia and Romania, while the sector lost slightly in terms of its relative significance in Poland and Slovenia. This was due to new greenfield-FDI plants taking up production in the countries mentioned above during that period (Toyota Peugeot-Citroën and Hyundai in the Czech Republic, PSA Peugeot-Citroën and Kia in Slovakia and Mercedes-Benz in Hungary), whereas in Poland one of the main investors – Daewoo of Korea – collapsed. Renault, which has been engaged in both Slovenia and Romania since the 1990s, was successful in Romania with its production of cheap motor cars (Dacia), while in Slovenia the automotive industry has yet to recover from the 2008-crisis. Automotive exports play a major role as foreign investors most often use their plants in the region as export bases. At the same time, imports are very important owing to their being integrated into supply-chains with countries in Western Europe, primarily Germany. Thus, the foreign value-added content of exports is above 50% in the most highly integrated countries, i.e. the Czech Republic, Hungary and Slovakia, while conversely, the domestic value added content is above 60% in Bulgaria and 70% in Romania (see Figure 9). The foreign value added content increased up until the crisis, but declined thereafter.

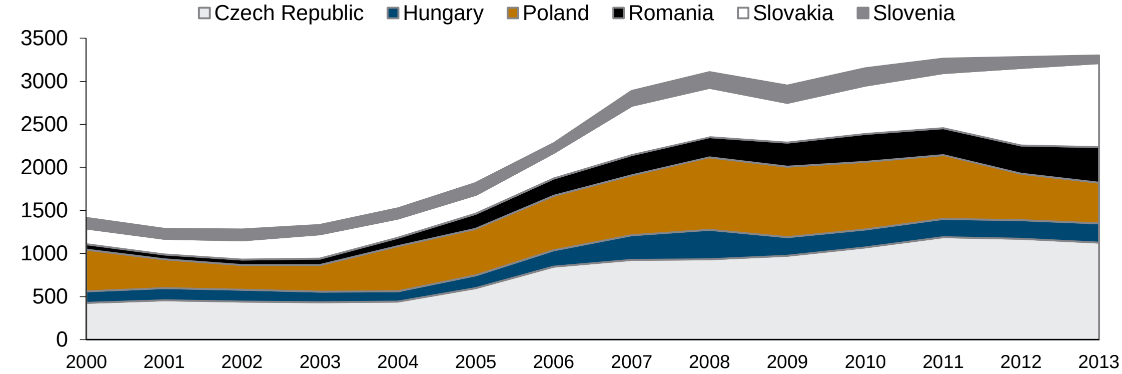
Figure 9 / Foreign value-added content of transport equipment exports (NACE Rev. 1, divisions 34&35), 2011, in % of gross exports



Notes: EU-14 is EU-15 without Germany; EU-12 means NMS without the respective country.
Source: World Input-Output Database (WIOD).

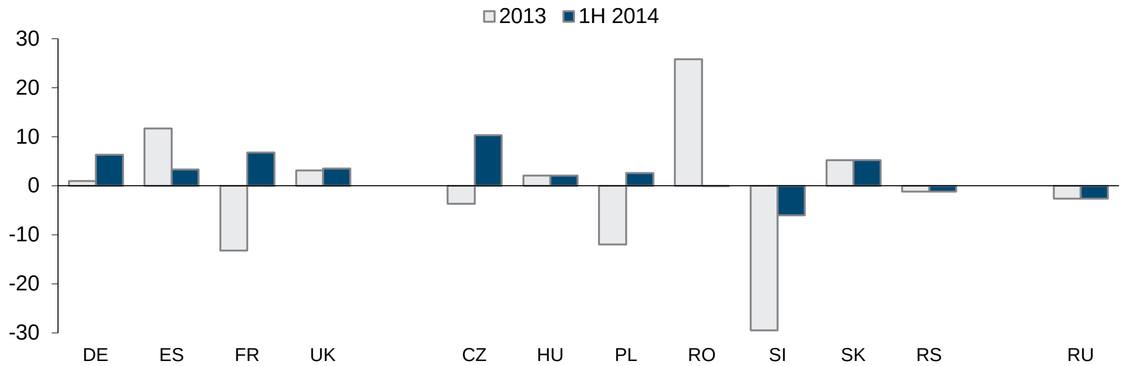
The growing importance of the automotive industry together with its linkages to Western Europe exposes the region to cyclical trends in those countries. We thus looked at recent growth rates of passenger car production in both the largest countries in Western Europe and the CESEE countries (see Figure 10 below). In the first half of 2014 (compared to the first half of 2013), German car production picked up by 6%. In the region, Romania experienced a boom in car production in 2013 and production has remained stable in the first half of 2014. Car production in the Czech Republic grew by 10%, the most rapid growth among the CESEEs, owing to weak performance in the previous year. In Slovenia, the earlier huge drop came to a halt and positive news prevailed. However, the latest data from Germany show that industrial production in the automotive sector dropped by about 25% in August compared to a drop of 5% in total manufacturing, thus blurring the positive picture.

Figure 10 / Passenger car production, in thousands



Source: International Organization of Motor Vehicle Manufacturers (OICA).

Figure 11 / Passenger car production, change in % against preceding year



Source: International Organization of Motor Vehicle Manufacturers (OICA).

Using a simple Vector Autoregressive Model (VAR)[7] we estimated the relationship between the automotive industry in the CESEE region and the automotive industry in Germany. Results show that indeed the Hungarian, Polish and Slovak automotive industries reacted to German automotive production with certain lags, while surprisingly the results for the Czech Republic were found to be statistically insignificant. Thus, if it turns out that the most recent slump in German automotive production data is only the beginning of a prolonged downturn, we will most likely see negative effects in several of the NMS as well.

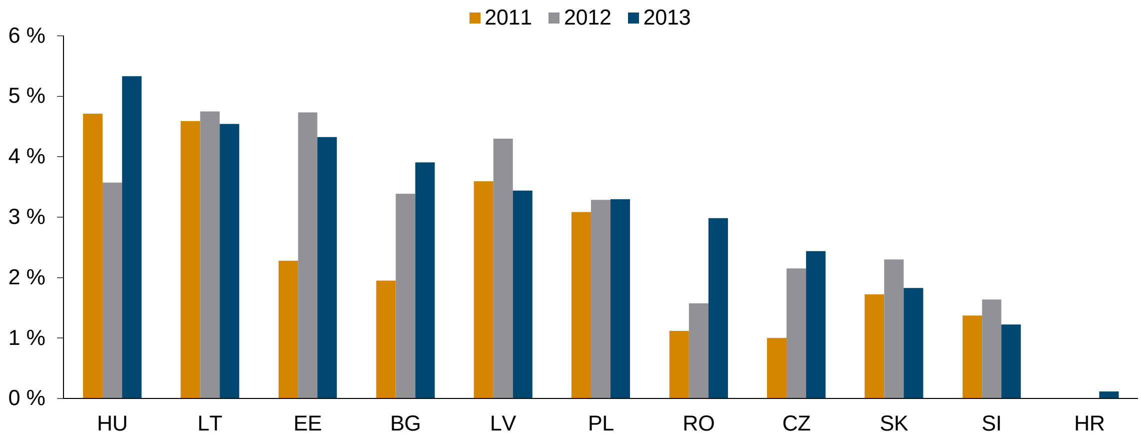
7 A Vector Autoregressive Model (VAR) was estimated for the annualised growth rates of the monthly production index of Germany and the respective NMS for the period of January 2001 to August 2014 for the NACE Rev. 2 categories C29_C30 'Manufacture of motor vehicles, trailers, semi-trailers' and 'other transport equipment' (Data was taken from Eurostat and national statistics for Slovakia and Slovenia). The optimal number of lags was defined in each model according to the Akaike information criteria (AIC).

EU TRANSFERS IMPORTANT FOR AGGREGATE DEMAND

For the NMS economies, transfers from the EU budget, which substantially exceed these countries' contributions to the EU budget, became an integral part of their aggregate demand. Nevertheless, those transfers do not reach the recipient countries in equal tranches each year (the sole exception being direct payments to farmers). In the seven-year Multiannual Financial Framework, the official title of the medium-term EU budget (MFF), actual payments in the initial years are much lower than in the closing years or in the two supplementary years when payments relating to the seven-year period already completed are still possible. As the net transfers for individual NMS are huge (see Figure 12), this uneven distribution may bring about considerable changes in aggregate demand from one year to the next and so exert an effect on economic growth that is not to be ignored.

2013, the final year of the 2007-2013 Multiannual Financial Framework, and 2014, the first of the two add-on years for payments, are among the strongest years where transfers in the framework of the EU cohesion policy are concerned. We have no data for 2014 as yet, but Figure 12 shows the growing significance of those inflows up to 2013. In 2011-2013 annual or bi-annual increment in aggregate demand due to rising EU transfers amounted to 2.5 percentage points of the GNI for Estonia, 2.4pp for the Czech Republic and between 1pp and 2pp for Bulgaria, Romania and Hungary. For other NMS, the changes are less dramatic and even their direction is ambiguous. Nevertheless, Figure 13 shows that as of April 2014, cohesion policy payments rates were rather low for most of the NMS, thus making it very likely that major efforts will have to be undertaken this year to draw down the remaining available resources – and to a lesser extent next year as well. This means that 2014 will be an outstanding year in terms of EU transfers fostering economic growth. This positive effect will have already weakened somewhat by 2015 and a sudden drop is expected for 2016, when payments from the 2007-2013 period will have run out, but those from the 2014-2020 MFF will not have gained momentum. This pattern will, no doubt, leave its traces on the growth performance of the economies concerned.

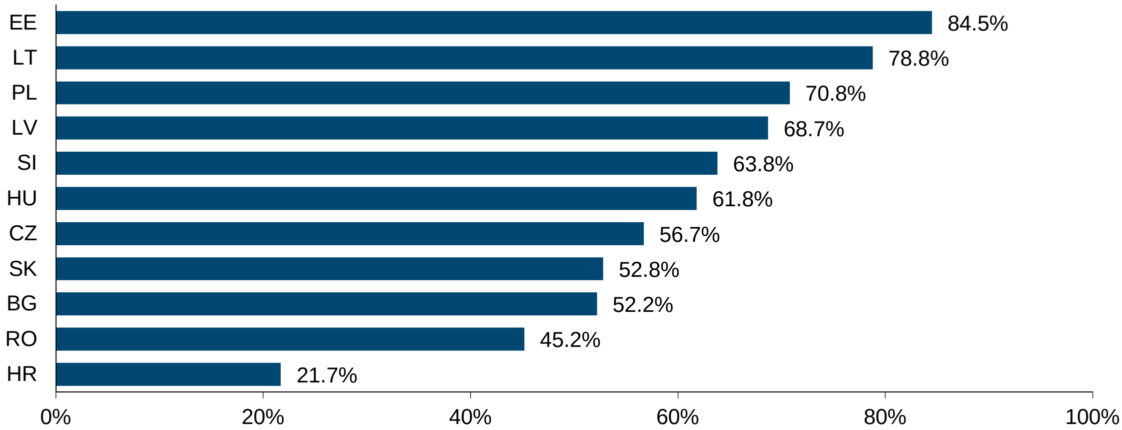
Figure 12 / Net financial position of NMS vis-à-vis the EU budget, % GNI



Source: European Commission.

The cohesion policy support for the NMS is mostly spent on investments, while to a lesser extent it covers initial operational costs of newly established institutions. A considerable portion is spent on imports. In terms of its impact, it is comparable to a fiscal stimulus, albeit better inasmuch as it does not create new debt. It is to be hoped that the projects screened by the European Commission are more useful and more efficiently organised than the average investment projects with exclusively domestic funding. One disadvantage of EU transfers compared to fiscal stimuli is that they have no steerable relation to business cycles. Their pattern follows the allocation logic of the seven-year MFF, which is indifferent to business-cycles. However, given that domestic investment in the region is generally extremely pro-cyclical, the non-cyclicality of the EU funds might also be seen as an additional advantage in economically strained times.

Figure 13 / Cohesion policy* payment rates for NMS as of 15 April 2014, in % of total available resources



Note: * Combined value of payments from the European Regional Development Fund, the Cohesion Fund and the European Social Fund.
Source: European Commission.

PUBLIC INVESTMENT TO PUSH PRIVATE INVESTMENT[8]

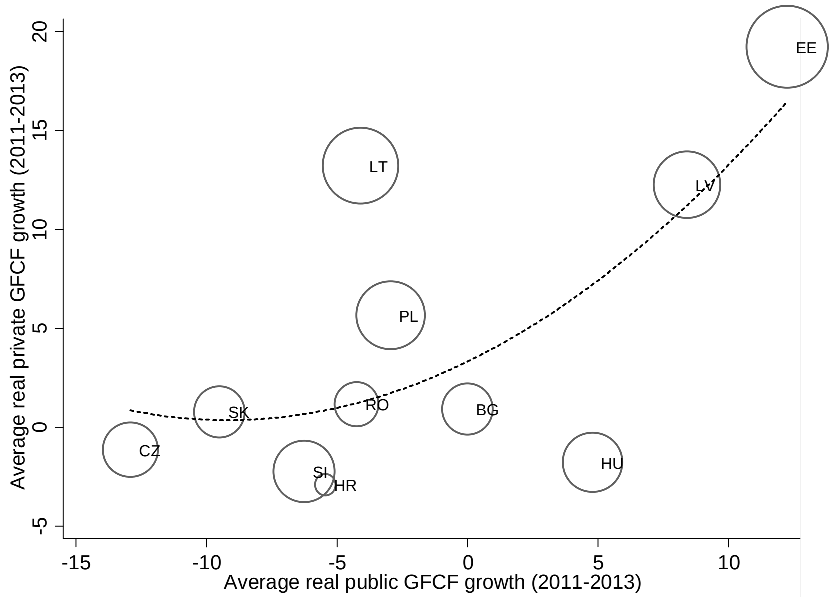
Public investment is an efficient component of an anti-cyclical economic policy toolkit. This is also confirmed in a widely discussed study in the IMF's October 2014 World Economic Outlook report. The empirical study finds that increased public investment raises GDP in the short term by boosting demand (especially in countries that are stuck in a low growth and high unemployment rut) and in the long term by increasing productive capacity. In addition, the boost to GDP that an economy gets from raising public investment offsets the rise in debt. Hence, public investment that is financed by issuing debt is superior in terms of efficiency to financing via a hike in taxes or cuts in other expenditures. However, in recent years, investments, both public and private, have proven insufficient in most of the CESEE countries. In Figure 14 the relationship of average real private and public investment (GFCF) growth over the period 2011-2013 is shown for the NMS-11. While there is clearly a strong positive correlation between the growth of public and private investment (with a correlation coefficient of 66%), the relationship does not appear to be perfectly linear.

The ability of the NMS to draw on the EC's cohesion policy co-financing is of crucial importance to investment growth. The size of the country circles in Figure 14 is related to the EC cohesion policy

[8] The author of this section is Mario Holzner.

payment rates. They are the shares paid in the total funds allocated per Member State as of 15 April 2014. Croatia as a recent member has only been able to draw on 22% of the allocated funds. It is therefore surprising that Romania, Bulgaria and even more so Slovakia, the Czech Republic and Hungary have been able to acquire only between 45% and 62% of the funds in the final year of the EU Multiannual Financial Framework. The statistics are led by Slovenia, Latvia, Poland, Lithuania and Estonia that were able to attain rates ranging between 64% and 85%. The dotted regression line in the figure was plotted using a quadratic prediction. It is striking that the ability to use EU co-financing allows public investment to correlate strongly and positively with private investment (upward sloping part of the regression line), while inability to do so leaves public investment growth too weak to drive private investment (flat part of the regression line).[9] However, by the end of 2013 all the Member States had made additional efforts to exhaust the EU funds remaining. It is thus fair to expect a boost in co-financed investment during the remaining disbursement period 2014-2015. In fact, anecdotal evidence, for instance, from Hungary shows that this is exactly what happened during the first quarters of the current year.

Figure 14 / Public and private investment growth and the EU cohesion policy payment rates



Note: The size of the circles corresponds to the squared EC cohesion policy payment rates as a percentage of the total funds allocated per Member State as of 15 April 2014.
Source: National and Eurostat statistics, EC, wiiw own calculations.

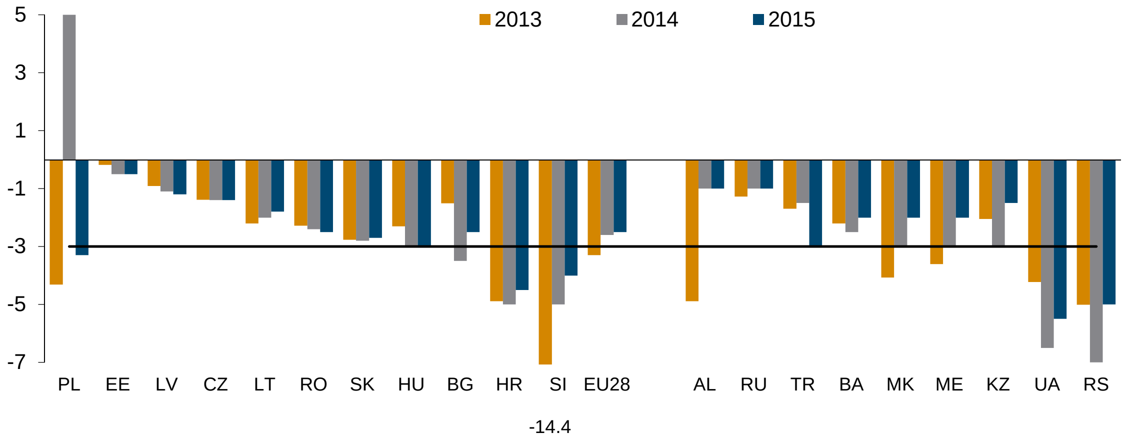
FISCAL DEFICIT AND PUBLIC DEBT MOSTLY ACCEPTABLE

Fiscal balance and public debt bear different significance for EU Member States in the region and the non-EU Member States. EU Member States are obliged to observe the thresholds for fiscal deficits

9 A simple, robust regression for all the EU countries (except for Malta due to missing private investment data) shows that public investment growth, the cohesion policy payment rate, as well as their interaction term positively influence private investment growth at the 10% level of significance. For the NMS-11 the regression basically shows the same results, with only the payment rate being significant at the 5% level. However, the small number of observations in both regressions most likely explains the borderline values of significance of the coefficients.

(3% of GDP) and public debt (60% of GDP) of the Stability and Growth Pact (SGP), the rule-based framework for the coordination of national fiscal policies in the European Union. A breach of those rules triggers the Excessive Deficit Procedure (EDP), which compels the Member States involved to take steps to improve their fiscal stance. Non-compliance is sanctioned, even more so under the new 2014-2020 MFF, incurring painful fines and cuts in cohesion policy transfers. This may prove counterproductive, as it weakens the growth potential of the countries involved.[10] Currently, three economies in the region are involved in an ongoing EDP: Croatia, Slovenia and Poland. In the case of two other countries, the Czech Republic and Slovakia, the Council closed the EDP this summer. For Slovenia and Poland the deadline for correction is 2015 and for Croatia 2016.

Figure 15 / Fiscal balance, in % of GDP



Note: 2014 and 2015 wiiw forecast.
Source: wiiw Database incorporating national and Eurostat statistics. Forecasts by wiiw and European Commission.

The fiscal deficits in the region are generally moderate (Figure 15 includes forecasts for 2014 and 2015). Data show that Slovenia is taking resolute steps to reduce its fiscal deficit, with corresponding losses in aggregate demand. It will, however, not have achieved the targeted 3% deficit/GDP ratio by 2015. In the case of Croatia, although the initial deficit level in 2013 was lower than in Slovenia, we do not expect any reduction of the deficit as required by the EU; the forecast deficit will remain above the threshold in 2016 as well. Of the other NMS, the Czech Republic, Hungary and Slovakia will be close to the threshold, but are expected not to exceed it. Figure 15 testifies to the fact that only the three Baltic States, especially Estonia and Latvia, have sufficient room for fiscal relaxation under the SGP rules to stimulate their economy. In the past, the three countries were reluctant to employ such measures, partly for ideological reasons, partly in the light of their efforts to join the euro area. With this latter condition now fulfilled, we see signs at least of previously diminished government-funded social allowances being reconstructed (see country reports Estonia, Latvia and Lithuania). Poland's huge fiscal surplus this year is due to a one-off effect: a change in the country's pension system as a large portion of the assets held by the private pension funds have been renationalised. For the non-EU Member States among the CESEE countries, no compelling external rules exist[11] – although EU candidate countries would be better advised to follow the development of their general government balance, should they wish to join the EU sooner rather than far later. In the Western Balkans, fiscal deficits are generally shrinking and/or

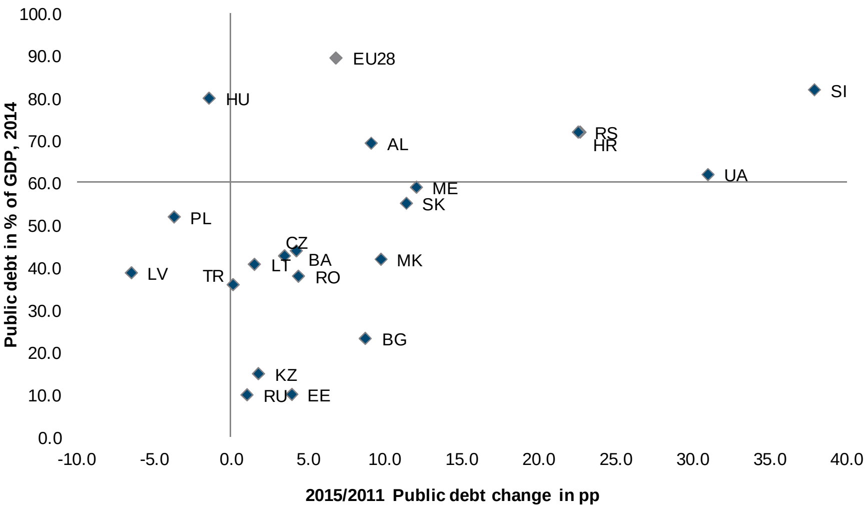
10 See S. Richter, 'Macroeconomic conditionality: a threat to cohesion policy transfers from 2014 onwards?', *wiiw Current Analyses and Forecasts*, No. 12, July 2013, pp 50-55.

11 Nevertheless, Ukraine has been involved in an IMF programme where general government balance is one of the lead indicators to be monitored.

are low, except for Serbia. Turkey is an exception where the 2015 elections may nudge the fiscal deficit upwards. The conflict in East-Ukraine and between Ukraine and Russia is expected to take its toll in terms of an increased fiscal deficit in Ukraine, but not in Russia, where income from energy exports helps to keep the fiscal deficit low, although the possibility of global oil prices remaining low over a longer period bear the risk of the country's fiscal stance deteriorating.

With few exceptions, public debt levels and changes do not seem to be altogether dramatic. According to the SGP, EU Member States' public debt must not exceed 60% of GDP (or at least it should diminish sufficiently towards the 60% level). Figure 16 demonstrates that the EU as a whole (combined data of the 28 Member States) is far from fulfilling this criterion. Moreover, compared to the 2011 public debt/GDP ratio of the EU 28, a deterioration is expected: in the order of some 7pp. Five CESEE countries (2 NMS, 2 countries in the Western Balkans and Ukraine) have a public debt/GDP ratio higher than 60% projected for 2014, as well as an increase in the public debt/GDP ratio expected for the period 2011-2015. The rise in the public debt/GDP ratio is assumed to be dramatic in the case of Slovenia, Ukraine, Croatia and Serbia, ranging from 22pp (Serbia) to 38pp (Slovenia). In the case of Ukraine, a deep recession and sharp depreciation of the national currency are the main reasons, further to which the IMF loan has since become part of the public debt. In Slovenia, the high consolidation costs of the banking sector explain the shift. In Croatia, persistent contraction of the GDP and the inclusion of state-owned companies' debt are responsible for the rise of the public debt/GDP ratio, while in Serbia the causes are weak growth performance and repeatedly large fiscal deficits over the years. More than half of the region's economies are in the lower right sector of the graph, with a relatively moderate (less than 12pp) assumed increase in GDP/public debt ratio and below 60% expected public debt/GDP levels in 2014. Slovakia and the Czech Republic, among the best performers in the NMS group, are forecast to record an increase in public debt/GDP ratio of about 10pp and 5pp, respectively, but the fact that they were released from the EDP this summer shows that both countries managed to consolidate their public finance balances; they may well remain below the 60% threshold in the near future.

Figure 16 / Public debt in 2014 and change in public debt between 2011 and 2015 (forecast)



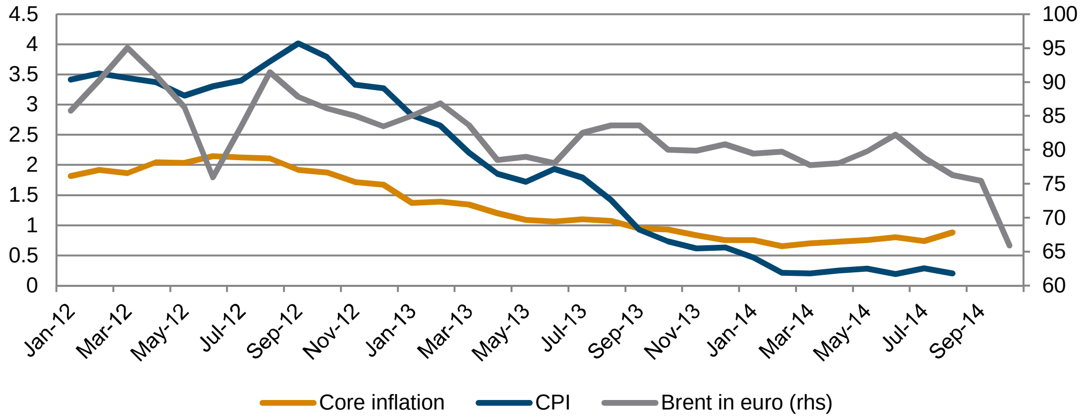
Note: 2014 and 2015 wiiw forecast.
Source: wiiw Database incorporating national and Eurostat statistics. Forecasts by wiiw and European Commission.

BOX 2 / THREAT OF DEFLATION AVERTED?

by MARIO HOLZNER

A decade ago a barrel of Brent oil could be bought for some 35 euro. In early 2012, the price peaked at about 95 euro. Since then it has hovered around 80 euro, but tending towards 70 euro and less. More recently the price has dropped sharply (see Figure 17). There are a number of reasons for this trend. Apart from a global slowdown in demand, the supply of oil and other energy products increased significantly in response to the high energy prices in recent years. In particular, the output of shale oil in the United States grew rapidly. One argument in favour of a further drop in oil prices is that the break-even costs for shale oil production are still much lower than current price levels, while in any event output would only react to price changes with a time lag of up to a year or more. An argument against a further drop in oil prices would be that commodity prices typically overshoot and subsequently rebound – at least in the short term.

Figure 17 / Headline and core inflation in the NMS-11 in % and the price for Brent crude oil in euro



Note: Core inflation reflects the unweighted average annual rate of change of the Harmonised Index of Consumer Prices excluding energy, food, alcohol and tobacco for the NMS-11; CPI is related to the unweighted annual rate of change of the Consumer Price Index of the NMS-11; Brent oil marks the average Europe Brent spot price fob in euro per barrel (the value for October 2014 corresponds to the price on 16 October 2014).
Source: wiiw Monthly Database, Eurostat, EIA, wiiw own calculations.

With a certain time lag, energy price developments feed into the Consumer Price Index (CPI) of the NMS-11, which last peaked in late 2012 with an unweighted average annualised monthly inflation rate of 4%. Since then the CPI has fallen constantly not only as a consequence of the drop in international commodity prices, but also owing to weak domestic demand. By mid-2014 the average CPI of the NMS-11 dropped to below 0.2% and has recovered only slightly since then.[12] Excluding energy, food, alcohol and tobacco from the CPI reveals more about whether domestic demand in the NMS has started to pull the economy effectively out of the slump. Core inflation peaked in the NMS-11 by mid-2012 at values above 2% on average and dropped to a minimum of less than 0.7% in early 2014. Since then

[12] The situation is quite different in the Western Balkans, where disinflation or, in most cases, outright deflation persists, as well as in the CIS where, inter alia, pronounced exchange rate devaluations have induced a marked increase in the rate of inflation.

core inflation has been inching up towards 1%. Has the risk of deflation been averted? Has a turnaround towards more healthy levels of inflation been achieved? Apart from indicating shrinking aggregate demand, negative inflation rates pose an especial threat for indebted public and private households, as those very rates increase the latter's real debt stocks.

Applying a structural break analysis [13] for the disinflationary period since mid-2012, it is possible to establish whether the recent turnaround in core inflation is statistically significant. The test was performed separately for each of the 11-NMS on the basis of the monthly annual change series of the Harmonised Index of Consumer Prices (excluding energy, food, alcohol and tobacco) as issued by Eurostat. The period of analysis ran over a two-year period: July 2012 to August 2014. Except for Slovenia, all NMS registered a first statistically significant breakpoint that occurred sometime between late-2012 and late-2013. In many cases, the differenced series displayed a downward trend in the second half of 2012 followed by a period of stagnation during most of 2013. However, only in seven NMS could we detect a second statistically significant breakpoint between mid-2013 and mid-2014. Moreover, of those countries only four (Bulgaria, Hungary, Lithuania and Slovakia) displayed an upward trend in the differenced series after the second breakpoint. It is thus difficult to make any generalisations about the region as a whole. Despite the structural breaks, we cannot reject the test's null hypothesis of non-stationarity[14] in any of the core inflation series for the 11-NMS. This is quite typical for this kind of economic data, where shocks tend to have permanent effects. In all likelihood, aggregate demand shocks stronger than those currently observed will be needed, if the NMS are to break out from the vicious circle of disinflation and, in some cases, outright deflation on a permanent basis.

FOREIGN FINANCIAL POSITION LARGELY UNDER CONTROL

In the NMS, the development of gross external debt shows diverging tendencies, yet it is improving in some cases (see Figure 18). In five of the eleven economies, gross external debt declined, in four cases it increased and in two cases there has been no clear change in direction. In all but one of the NMS economies whose external debt declined, the external debt/GDP ratio in 2009 exceeded 100%, ranging from 108% (Bulgaria) to 155% (Latvia) of the GDP. In 2013, the respective indicators ranged from 93% to 131%. Of the countries whose external debt increased in the period concerned, the Czech Republic, Poland and Slovakia had a relatively low initial debt level; that fact and the extent of the rise in external debt are no cause for concern. Croatia's initial debt level was higher; however, in this instance the radically improving current account may help to stabilise the external debt, just as it may in Slovenia. Nevertheless, a note of caution with respect to both countries: without robust economic growth, playing on the growth of net exports alone will not stabilise or improve external debt/GDP ratios over the longer term.

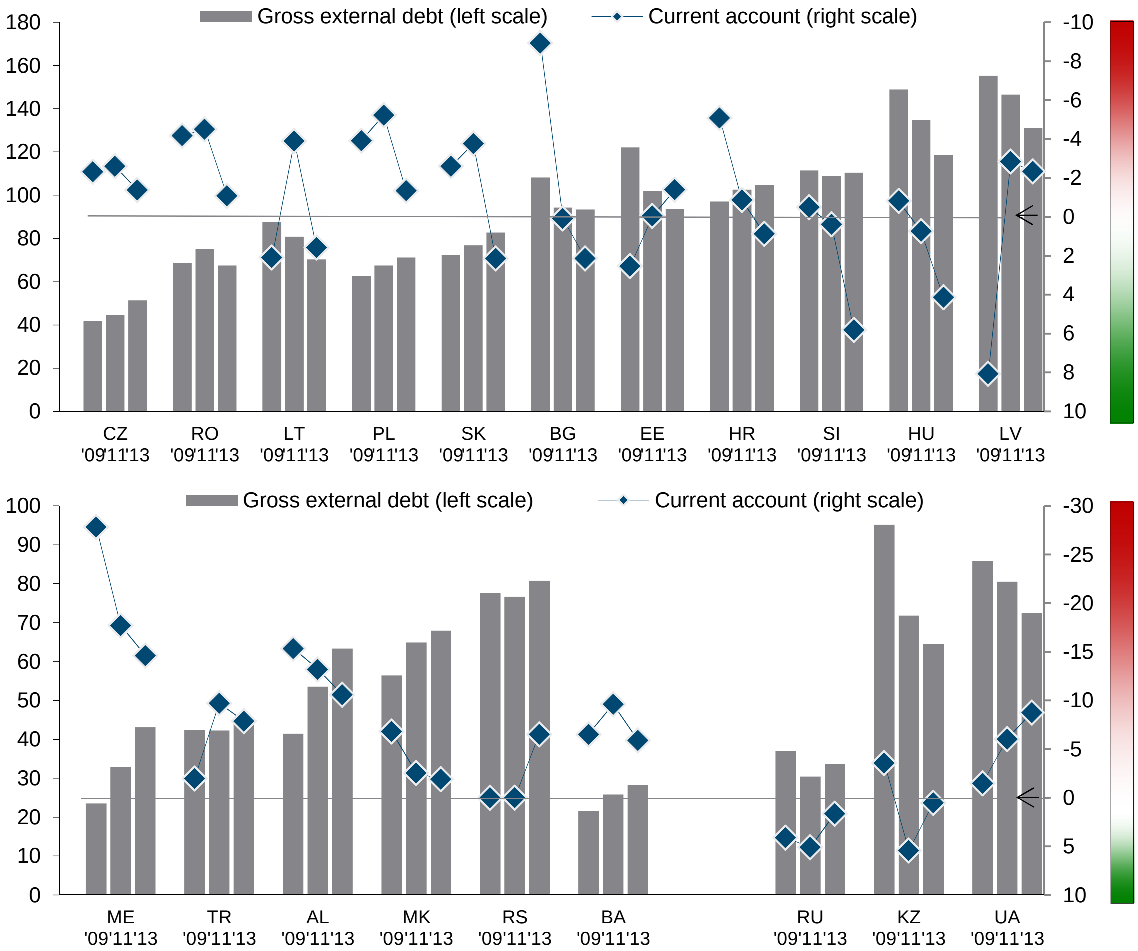
In the Western Balkans, overall external debt levels are lower, but the current account positions are much worse than in the NMS. Debt was on the rise in all the five countries. No change in direction

[13] We employ a double additive outlier test for unit roots (see J. Clemente, A. Montañés and M. Reyes, 1998, 'Testing for a unit root in variables with a double change in the mean', Economics Letters, Vol. 59, pp. 175-182). Hence, this is a test for non-stationarity in the presence of a double structural break in the series.

[14] Non-stationary processes can be driven by trends, cycles, random walks or combinations of the three and cannot be predicted in most cases. By contrast, a stationary process reverts around a constant long-term mean and has a constant variance independent of time.

was to be seen in Turkey. In Albania and Montenegro, the countries with the worst current account position in 2009, the situation improved substantially by 2013. None the less, improvements were far from sufficient to check the rapid rise in external debt. In the CIS group, external debt declined in Kazakhstan and Ukraine. In the latter case, this would appear to be unsustainable given the consequences of the war.

Figure 18 / Foreign financial position, 2009, 2011, 2013, in % of GDP

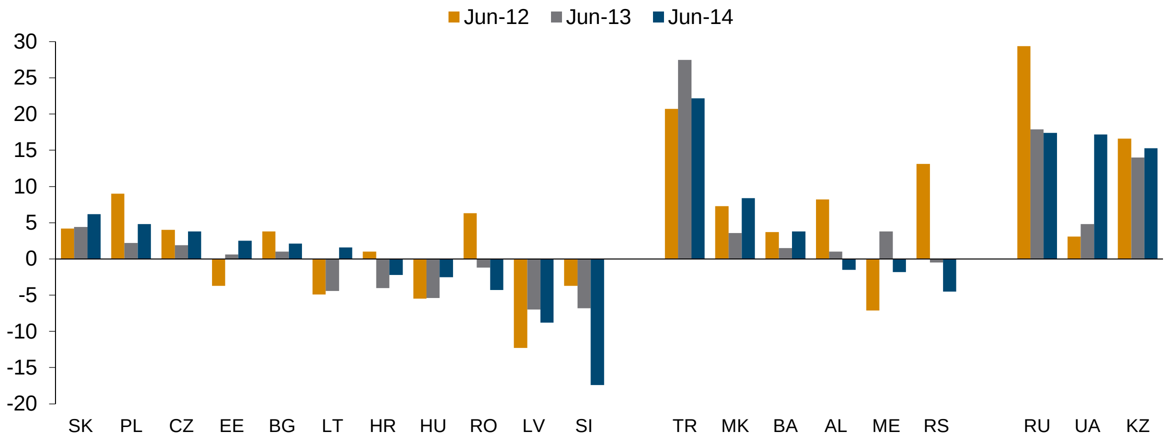


Note: Higher (lower) gross external debt levels and current account deficits are associated with red (green) colour.
Current account: EE, HU, LV, LT, PL (2011, 2013), MK, RS (2013), BA, KZ, RU, UA data according to BOP 6th edition.
Gross external debt: EE, HU, LV, LT, RU (2011, 2013), UA (2011, 2013) data according to BOP 6th edition.
Source: wiiw Annual Database incorporating national and Eurostat statistics, World Bank.

LOANS GROWTH STILL WEAK AND NPLS HIGH

The global financial crisis broke the rapid expansion of financial intermediation in nearly all of the countries in the region and recovery of crediting activities is still fragmentary and weak (see Figure 19). Of the NMS, Slovakia, Poland, the Czech Republic, Estonia and Bulgaria were able to secure an increase in loans over the past three years; Lithuania entered the positive zone this year. In all the above instances, the pace of expansion remained well below that of the pre-crisis era. In Hungary, the pace of decline has lessened, but given the government's intention to impose further burdens on the banks, the outlook is by no means auspicious. Loans are rapidly sinking in Romania, and the situation is critical in Latvia and Slovenia where the past three years have yielded nothing but major declines each year. In the case of Latvia, loans to both households and non-financial corporations have declined steeply, while in Slovenia moderate shrinkage in terms of household credit has been coupled with a major drop in loans to the business sector.

Figure 19 / Bank loans to the non-financial private sector (non-financial corporations and households), change in % against preceding year

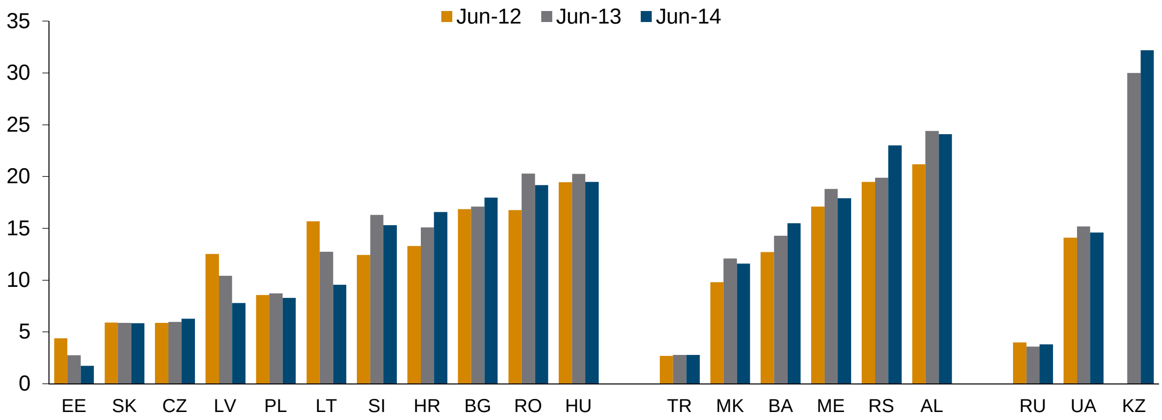


Source: National Bank statistics, wiiw own calculations.

Of the non-EU countries in the region, we see a clear deterioration in Albania and Serbia, while in the other economies in the Western Balkans financial intermediation has only expanded moderately. Turkey alone has seen loans expand by more than 20% over the past three years; despite the political turbulences in both the country and its geographical neighbours. In the CIS, Russia's relatively good stance is likely to be reversed given the financial sanctions recently imposed by the EU and the United States. Even without the sanctions, were the central bank to introduce a higher policy rate to defend the rouble exchange rate, it would put a brake on further rapid expansion. In Ukraine, loans are apparently growing dynamically, but this is a purely statistical phenomenon following the major devaluation of the national currency, while forex credits account for about 30% of all credits. Kazakhstan maintains in a special status, defined as it is by the country's relative independence from the main tendencies in the region thanks to its abundant income derived from the export of fuels. While loans are increasing rapidly, non-performing loans (NPLs) have hovered around 30% over the past two years.

High levels of NPLs are a major concern throughout much of the region (see Figure 20). In Bulgaria, Romania and Hungary, they range from 15% to 20%; rapid NPL growth is to be discerned primarily in Croatia. The good news comes from the Baltic States, each of which has managed to decrease their NPL levels spectacularly. In addition to the latter, Slovakia, the Czech Republic and Poland have maintained satisfactory NPL levels. Turkey boasts a combination of strong credit growth and a very low NPL level, while all the smaller countries in the Western Balkans display a deteriorating trend, even if as in the case of both Macedonia and Bosnia-Herzegovina, the starting point is relatively low. Russia maintains a low level of NPLs; in Ukraine, NPLs account for some 15% of the total loans, but their volume has not been increasing. However, given Ukraine's current circumstances, things are unlikely to remain that way.

Figure 20 / Share of non-performing loans in % of total loans, end of period



Note: Definition of non-performing loans: Loans that are more than 90 days overdue.
Estonia, Lithuania: Loans more than 60 days overdue. – Hungary: wiiw calculations; 2014 data as of Dec 2013. – Russia: According to Russian Accounting Standards overdue debt is defined as debt service overdue, therefore the data are not fully comparable with other countries; 2014 data as of May 2014.
Source: National Bank statistics, wiiw own calculations.

Whereas in the years preceding the international financial crisis economists expressed concern over the negative impact of 'jobless growth', there now seems to be a justified concern that the region has entered a period of 'creditless recovery'.[15] The latter concern is associated with prolonged periods of slow increases in output and employment. Such factors as the generally modest growth of loans, continued deleverage and a stubbornly high share of non-performing loans in many countries in the region, as well as the persistent weak performance of some key Western European banks, parents to the financial institutions operating in the region, make it all the more likely that the past few years and the years to come will be termed 'the period of creditless recovery'. Private investment on the part of non-financial corporations will have to be heavily financed via cash flow.

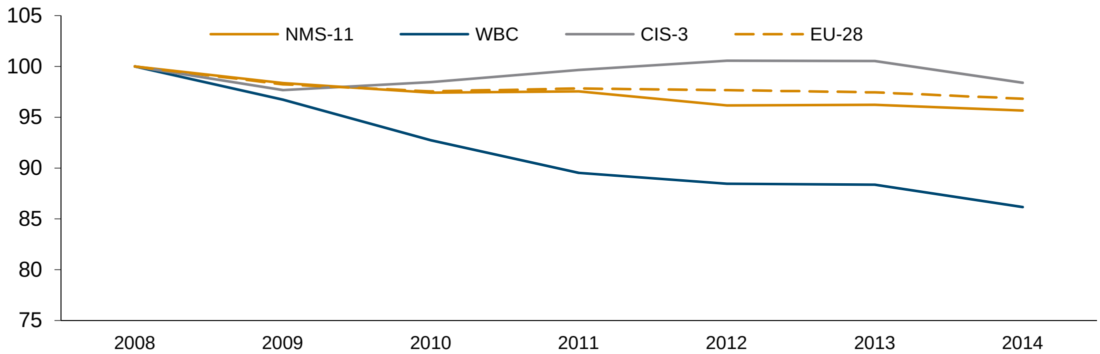
15 N. Sugawana and J. Zalduendo, 'Credit-less Recoveries. Neither a Rare nor an Insurmountable Challenge', Policy Research Working Paper 6459, The World Bank, May 2013.

BOX 3 / LABOUR MARKET AND WAGES

by HERMINE VIDOVIC

The labour market situation has improved slightly in the CESEE countries compared to 2013, but large differences in labour market performance still persist. Almost 15.1 million people in the region are currently unemployed (of which 4.6 million in the NMS, 4.3 million in the Western Balkans (WBC) and 6.2 million in the CIS-3, comprising Kazakhstan, Russia and Ukraine): some 1.3 million more than before the crisis in 2008. In the first half of 2014 unemployment rates ranged from 6.4% in the Czech Republic to 28.3% in Macedonia. Among the NMS, the incidence of unemployment is highest in Croatia, Slovakia and Bulgaria, while six countries (Czech Republic, Estonia, Hungary, Poland, Romania and Slovenia) report unemployment rates below the EU-28 average. In the Western Balkans unemployment remains stubbornly high, at about 26% on average, while it is comparatively low in Russia and Kazakhstan (5% each). With the exception of Albania and Ukraine, unemployment rates fell in all countries as against the first half of 2013, most notably so in Serbia and Hungary. In the latter countries, but also in the Baltic States, Romania and Bulgaria, labour migration – apart from the rise in GDP – has helped to reduce unemployment. Russia by contrast has become one of the major destination countries for labour migrants; it currently employs an estimated 10 million workers mainly from the former Soviet republics. Taking into account the recent inflow of Ukrainian refugees (estimated at 900,000) the overall figure is expected to increase still further. The unemployment rate among young people, which reached unprecedented levels during the crisis, is now on a downward path in most CESEE countries, but has remained exceptionally high in the Western Balkans (Macedonia: 55% and Serbia: 52%).

Figure 21 / Employment development, 2008=100



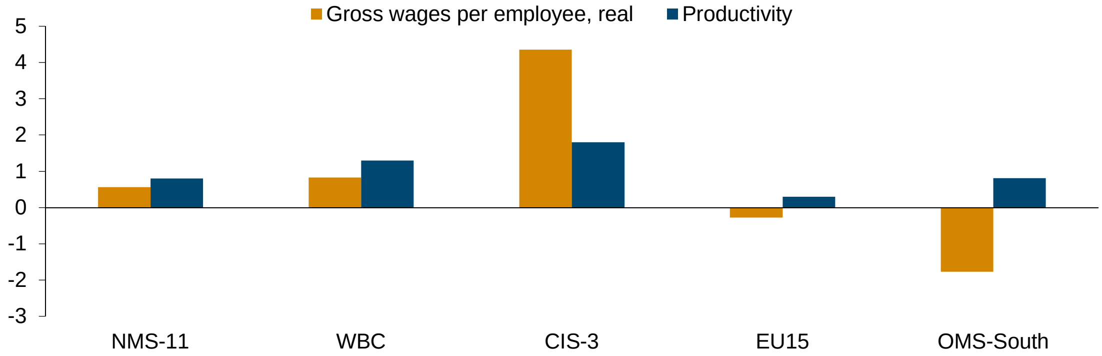
Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation.

In the first half of 2014, employment grew in almost all CESEE countries, the exceptions being Croatia, Estonia, Albania and Ukraine. However, employment levels are far from the pre-crisis levels in all country groups (Figure 21) and there are major divergences across individual countries. Four countries – Hungary, Macedonia, Turkey and Kazakhstan – report higher employment levels than in 2008, while the gaps are most pronounced in Latvia and Bosnia and Herzegovina where the employed population shrank by 20% in both countries over the period 2008-2014, while in Serbia and Lithuania it dropped by 15%. Employment rates remained below the levels reached in 2008 in half of the countries in the region: The decline was particularly steep in Slovenia, albeit from an initially high level, followed by Croatia and Bulgaria (4-5pp), with an even more pronounced decline in youth employment rates in Slovenia (14pp) and Croatia 10pp).

Overall, disinflation in most of the countries has allowed an increase of real wages at given nominal wages. This resulted – at least in the short term – in an increase in the purchasing power of wage income and thus helped to increase household consumption. Following the improvement in labour market conditions, the rebound in real wages that had started in 2013 continued in the Baltic countries. Furthermore, in most of the other CESEE countries suppressed wage dynamics came to a halt with real wage growth averaging 3-4% in 2014. Exceptions are Croatia, which reported real wage losses for the sixth consecutive year, and Serbia, where real wages fell for the second year in a row. In Ukraine, currently facing an ever-deepening recession, public sector wages were cut and minimum wages have been frozen in line with the IMF austerity package, hinting at a remarkable decline in real wages on account of the high (and rising) inflation.

Over the period 2009-2014 real wages grew less than productivity in most countries in the region, suggesting that real unit labour costs have been declining. As illustrated in Figure 22 productivity growth exceeded real wage growth in the NMS and in the Western Balkan countries, while in the CIS-3 countries real wages grew much faster than productivity, reflecting sectoral and regional labour shortages particularly in Russia. As regards the NMS, productivity growth has been higher than real wage growth in the majority of the countries. This was not the case in Bulgaria, the Czech Republic, Hungary and Slovenia. Bulgaria is a special case; for the period 2009-2014 it reported rapidly rising unemployment coupled with strong average real wage growth, the latter being much more pronounced than growth in productivity. The increase in real wages (albeit from a very low level) reflects compositional changes in employment and the impact of rising minimum social security thresholds. The latter thresholds limit downward wage flexibility and were introduced to combat the grey economy and improve tax collection. Of the Western Balkan countries, only Serbia reported remarkable productivity gains alongside declining real wages, while the opposite is the case in other Western Balkan countries. By way of contrast, in the EU-15 positive productivity growth has been coupled with a fall in real wages, which is particularly pronounced in the southern EU countries comprising Greece, Portugal, Spain and Italy.

Figure 22 / Real wages and labour productivity, 2009-2014, average annual growth rate in %



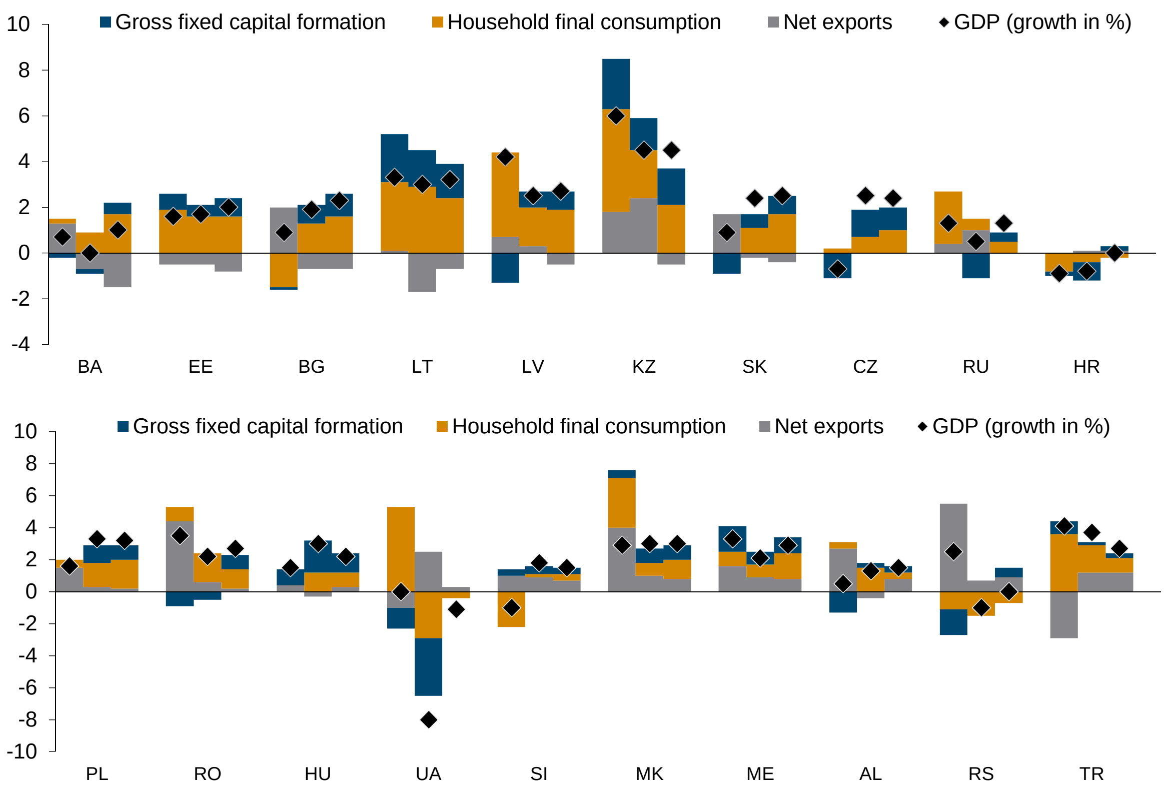
Note: OMS-South comprises Greece, Portugal and Spain.
Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation.

Given the diversified economic outlook for the CESEE region, employment generation in 2014 is expected to remain subdued in most countries or even fall, as has been the case in Estonia for demographic reasons (a drop in the working age population) and particularly in Ukraine, owing to war-driven emigration. Employment is set to expand in Serbia, Turkey, Macedonia and Slovenia. With the exception of Turkey and to a lesser extent Macedonia, employment growth will, however, remain limited throughout the forecasting period up until 2016.

CONTRIBUTIONS TO GDP 2013-2015 REARRANGED

The components of GDP change are undergoing a major rearrangement, with the positive role of net exports in supporting economic growth losing weight over the period over 2013-2015 (see Figure 23). In 15 of the 20 economies[16] in the region, this loss of weight is very much in evidence. Exceptions are: the Czech Republic and Croatia where net exports play a neutral role; Hungary and Ukraine where the direction of change is ambiguous; and Ukraine where the exact opposite is taking place, i.e. the contribution of net exports to GDP growth is shifting from markedly negative to positive. In the fortunate instances, this shift means that investment has assumed the role of a growth driver, as has been the case in Bulgaria, Lithuania, Slovakia, Poland and Macedonia. The less fortunate version of this shift is a deterioration in growth performance, as in Serbia. An interesting 'mix' is the case of Romania, where investment has taken over the role of growth driver only to fail to compensate fully for the huge drop in the contribution of net exports. As a consequence, GDP growth decelerates. As discussed earlier, over the period 2008-2014 the economies in the region responded primarily by promoting export growth and reducing investments: a combination which may even constitute a sound survival strategy in the short term, but it will inevitably prove futile in the longer term. Without the necessary impact from investment, the countries in the region are finding it increasingly difficult to keep pace with modernisation based competitiveness in the global markets. The shift referred to above is perhaps the first sign of a move in the right direction.

Figure 23 / GDP growth in 2013-2015, and contribution of individual demand components in percentage points



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

16 There are no respective data for Kosovo.

DEVIATIONS FROM THE 2014 SPRING FORECAST

Compared to our Spring Forecast, considerable changes are to be expected in terms of GDP growth rates: positive for the core NMS, negative for the countries associated with the conflict in the neighbouring countries to the east. Of the 21 economies in the region, the outlook for only two countries remains unchanged for the whole forecasting period. Focusing on changes in the GDP forecasts for 2014, substantial upward revisions in excess of 0.5pp have occurred in five countries (see Table 4). In the case of Slovenia and Hungary, a successful last-minute dash to mobilise EU transfers still available under the closing 2007-2013 MFF explains why the growth prospects are better than previously assumed. For the most part, this change is to be found in the more rapid expansion of investments, primarily public investments. The Czech Republic has emerged earlier than assumed from the recession induced by fiscal consolidation. In the Czech Republic and especially in Poland, the positive change of inventories has added an additional and previously unexpected impetus to growth. In Turkey, a forceful economic policy focused on economic growth in the period leading up to the general elections next year is the main explanation for the upward revision in our forecast. Similarly, the temporary upturn in elections-related investment has also played a role in Hungary, which currently displays a better than assumed growth performance in 2014.

Table 4 / Forecasted GDP improvement compared with the wiiw Spring Forecast 2014, in percentage points

	2014	2015	2016
	Improvement		
Slovenia	**2.3**	1.0	0.1
Hungary	**1.6**	0.1	0.0
Turkey	**1.5**	-0.8	-1.7
Czech Republic	**1.1**	0.0	-0.4
Poland	**0.9**	0.0	0.0
	Minor change		
Bulgaria	**0.4**	0.0	-0.1
Slovakia	**0.0**	-0.5	-0.6
Macedonia	**0.0**	0.0	0.0
Montenegro	**0.0**	0.0	0.0
Romania	**-0.2**	0.0	0.0
Kosovo	**-0.3**	-0.2	-0.3
Albania	**-0.4**	0.0	-0.1
Serbia	**-0.5**	-1.0	-0.9
	Deterioration		
Lithuania	**-0.6**	-0.6	-0.6
Croatia	**-0.8**	-1.0	-0.5
Estonia	**-0.9**	-1.0	-0.3
Russia	**-1.1**	-1.0	-1.1
Kazakhstan	**-1.5**	-2.0	-0.5
Latvia	**-1.7**	-1.4	-0.9
Bosnia and Herzegovina	**-1.9**	-2.0	-1.0
Ukraine	**-6.9**	-2.0	0.0

Note: Ranking by improvement 2014.
Source: wiiw.

Eight countries have registered substantial downward revisions in their GDPs, in excess of 0.5pp, for 2014. Armed conflict and sanctions, coupled with persistent economic problems from earlier days, are the reasons for the decline in Russia and Ukraine; the three Baltic States have been hit by the EU sanctions and Russian counter-sanctions, the primary impact being on trade channels and the increasing reluctance to invest. Insufficient investment, attributable to continuing deleveraging and underutilisation of potentially available EU funds, is responsible for the worsening outlook in Croatia. Kazakhstan's outlook has changed for the worse on account of the delay in the launch of a major new oil field and a weakening in external demand making itself felt earlier than expected. In Bosnia-Herzegovina, the early summer floods impaired the 2014 growth outlook to an appreciable extent. It is remarkable that of the forty-two GDP growth rates forecast for 2015 and 2016, 25 changed for the worse and only four for the better. Most of the forecasts that have deteriorated relate to countries that are substantially affected by the Russia-Ukraine conflict.

A MIXED OUTLOOK FOR 2015-2016

The outlook for GDP growth in 2014 is fairly diversified. Compared to 2013, economic growth performance is expected to improve in twelve and deteriorate in nine of the twenty-one countries in the region (see Overview Table 1 on p. VII).

The economies in Central Europe show encouraging signs. In the current year economic expansion will be stronger throughout Central Europe, the sole exception being Croatia. Even there, the news is encouraging: the decline over the current year will be somewhat slower than in 2013. In the course of 2014 improvements are to be expected also in Bulgaria, whereas Romania will display weaker growth compared to 2013. The same will hold true for Latvia and Lithuania, where the repercussions arising out of the conflict in the neighbouring countries to the east will be more pronounced than in other NMS. For the NMS as a whole, the general medium-term trend is seen to be positive. In most of the countries in the group except three, we expect a gradual acceleration of economic growth in 2015 and 2016 – or, at least, no deceleration. The exceptions are: (i) Hungary, where one-off factors fostering growth this year will fade away; (ii) Slovenia, where the determinant factors are expiry of EU co-financed investments and insufficiency of external demand; and (iii) Poland, which will attain a relatively high growth rate in the current year only to remain practically at that level throughout the forecast period. For the current year, the assumption is that the NMS will grow by 2.6%, 1.8pp higher than expansion in the euro area and 1.3pp above the EU-28 average. In 2015, the gap in favour of NMS growth performance will grow somewhat narrower: 1.5pp relative to the euro area and 1.1pp to the EU-28 average.

In the Western Balkans, expansion will pick up speed in Albania, Macedonia and Kosovo over the course of the current year, while expansion in Montenegro, Serbia and Bosnia-Herzegovina will be slower than in 2013. Of the economies in this group, only Bosnia-Herzegovina and Montenegro suggest a clearly improving growth outlook for the period 2015-2016. However, the constant 3% growth forecast for Macedonia is a sign that the country continues to rule the roost among the countries in the group. Of the economies in the Western Balkans, it is assumed that Macedonia, Montenegro and Kosovo will record GDP growth rates that surpass the NMS average in 2015-2016. In the near future, Turkey's economic growth will remain formidable, despite the slight drop that is to be expected once the elections-related growth stimulus begins to wane.

Growth performance in Kazakhstan, Russia and Ukraine will be worse this year than in 2013. Closely related to the conflict with Russia, Ukraine's economy will decline by 8% or more, while GDP growth in Russia may remain in the positive domain, despite deceleration.

As for the forecasts for 2015 and 2016, a further weakening of performance in the euro area poses a downward risk, while a longer lasting drop in oil prices will pose an upward risk in terms of our current forecasts. The drop in oil prices will certainly have an inverse impact on the energy-exporting countries, Russia and Kazakhstan.

Throughout the region, inflation will remain very low (less than 1%) in 2014, with the exception of Romania, Serbia, Kosovo, Turkey and the CIS countries. Bulgaria will register deflation. NMS average inflation in 2014 will be somewhat higher (0.6%) than the euro area average (0.5%). Over the forecast period, a growing inflationary trend will emerge in the NMS and Western Balkans: a positive development given the risk of possible deflation. In the three CIS countries, it is assumed that by 2016 the currently high price increases will have dropped gradually by some 1.5-6.5pp.

Over the period 2014-2016, the unemployment rate will decline moderately in the NMS group, albeit from fairly different initial 2014 levels. In the current year, the average unemployment rate in the NMS will be 2.1pp better than that of the euro area, the difference dropping very slightly to 2pp in 2015. In the Western Balkans unemployment rates are, traditionally, much higher than those in the NMS group, ranging from 19 to 30%. The established rates would appear to remain stable; a marginal improvement may be reckoned with in Macedonia and Kosovo. In the three CIS economies observed, it is assumed that unemployment rates will remain low and sink only marginally, the exception being Ukraine.

In all eleven NMS we expect deterioration of the current account balances. This development is closely related to the countries' increased import activities that are linked to the upturn in investment and household consumption – and hence with the narrowing net export gap in GDP. In the Western Balkans current account balances are deeply negative in each country. For the period 2014-2016, it is assumed that this situation will remain unchanged, except in Albania (improvement) and Kosovo (deterioration).

Special section: Economic consequences of the Ukraine conflict

PETER HAVLIK AND VASILY ASTROV

A DANGEROUS GEOPOLITICAL CONFLICT IN THE OFFING[17]

25 years after the fall of the Iron Curtain, the current crisis in relations between Russia and the West represents not only a major setback, but is also evolving into a dangerous geopolitical conflict. The economic consequences of the conflict are equally serious: not only for Russia (and, of course, for Ukraine in particular), but they also pose a potential threat to the still frail economic recovery in Europe. In Russia, which was already 'stuck in transition and stagnation' before the current crisis erupted, the repercussions of the conflict (not only those directly related to the conflict in Ukraine and Western sanctions) are hampering the inflow of urgently needed investments and GDP growth, hindering economic restructuring and modernisation.[18] The present note attempts to assess the trade-related economic consequences of the conflict on Russia, the European Union and its Member States, focusing on the new Member States (NMS).[19]

Needless to say, the main victim of the conflict is Ukraine where, apart from the human and material losses already incurred, a severe economic recession has set in. Prospects of an enduring civil war, culminating in a 'frozen conflict' in eastern Ukraine similar to that in Transnistria, Abkhazia, South Ossetia or Nagorno-Karabakh (albeit on a much larger scale) cannot be entirely dismissed. In the sections below, we will discuss the economic aspects of the crisis: the sanctions and trade exposure of the parties involved, as well as the overall economic impact expected.

SANCTIONS IN BRIEF

In March 2014 the United States, followed soon thereafter by the EU and other G7 countries, imposed sanctions on Russia after the latter's annexation of Crimea.[20] According to H. van Rompuy, President of the EU Council, *'sanctions are not a question of retaliation; they are a foreign policy tool … our goal is to stop Russian action against Ukraine, to restore Ukraine's sovereignty … we need a negotiated solution … engage in a meaningful dialogue involving Ukraine and Russia …'*. Largely symbolic in character initially, the spiral of sanctions rapidly escalated in the subsequent weeks and

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[17] The first part of this Special Section was written by Peter Havlik (wiiw and IIASA). The author wishes to thank Vasily Astrov, Vladimir Gligorov, Mario Holzner and Sándor Richter for valuable comments on an earlier draft as well as Alexandra Bykova, Beate Muck and Robert Stehrer for valuable statistical assistance. The views expressed in this note are those of the author and cannot be attributed either to wiiw or IIASA.

[18] See the author's regular country reports in *wiiw Forecast Report* No. 13 (March 2014) and *wiiw Monthly Report* No. 7/8 (July/August 2014).

[19] For a more detailed assessment of Russia and Ukraine see the respective country reports in this Forecast.

[20] See Decision of the Council of the European Union, 8049/14, Brussels, 21 March 2014.

months.[21] As of October 2014, the following sanctions, as well as Russian retaliatory measures, had been put in place:[22]

BOX 4 / SANCTIONS AND RETALIATORY MEASURES AS OF OCTOBER 2014

March 2014:

USA imposes a ban on travel and transactions on 11 Russian and Ukrainian politicians involved in the annexation of Crimea, in addition to freezing their assets;

EU imposes a ban on travel and transactions of another 21 Russian and Ukrainian politicians involved in the annexation of Crimea, as well as suspending negotiations on the liberalisation of visas;

G7 suspends Russia's G8 membership; OECD suspends activities related to the accession process of Russia to the OECD;

USA imposes a ban on travel and transactions of yet another 19 Russian politicians and businessmen, in addition to freezing their assets, as well as imposing a ban on US dollar transactions with Bank Rossiya.

April 2014:

USA imposes a ban on travel and transactions of 18 more Russian politicians, in addition to banning US dollar transactions involving Chernomorneftegaz and 15 other companies in Crimea.

June 2014:

USA imposes a ban on travel and transactions for an additional 7 Russian politicians and Ukrainian separatists, in addition to freezing their assets;

President Poroshenko imposes a ban on military and dual-use exports to Russia on 16 June 2014.

July 2014:

USA imposes a ban on travel and transactions of another 5 Russian politicians and Ukrainian separatists and 2 entities, in addition to freezing their assets; it also imposes a ban on US dollar transactions with six military, oil and Crimea-based companies, as well as a ban on new equity or debt transactions over 90 days involving the Bank of Moscow, Gazprombank, Russian Agricultural Bank, VEB, VTB, Novatek and Rosneft;

EU imposes a ban on travel and transactions of 23 Russian politicians, Ukrainian separatists, 9 political and military entities, 9 Crimean enterprises and 3 Russian enterprises, in addition to freezing their

[21] For the sake of completeness, we recall that a deterioration of Russian-US/EU relations with selective travel bans and boycotts started much earlier (the Magnitsky Law in the US, Chodorkovsky and Pussy Riot trials, unofficial Western boycott of Sochi Olympic Winter Games, etc.). Russia’s practice to use trade restrictions as a means of imposing political pressure started much earlier (with respect to Georgia, Moldova and Ukraine – see Havlik, 2013).

[22] Some Russian companies affected by sanctions (e.g. Rosneft and Sberbank) turned to the European Court of Justice. For the political aspects of sanctions against Russia see Raik et al. (2014).

assets; it also prohibits new equity or debt securities transactions over 90 days involving major Russian banks (Gazprombank, Rosselhozbank, Sberbank, VEB and VTB);

Both the financing by EBRD and EIB of new projects in Russia and the implementation of EU bilateral and regional cooperation programmes are suspended (although projects dealing exclusively with cross-border cooperation and civil society are maintained).

August 2014:

EU imposes an embargo on military and dual-use equipment trade with Russia;

On 7 August Russia imposes a one-year ban on imports of a wide range of food products from Canada, Australia, EU, Norway and USA.

12 September 2014:

EU imposes a ban on travel and transactions of further persons involved in the Russia-Ukraine crisis, in addition to freezing their assets; it prohibits new equity or debt transactions over 30 days involving Gazprombank, Rosselhozbank, Sberbank, VEB, VTB, Rosneft, Gazpromneft and Transneft (previously permitted syndicated lending is also banned and permissible maturity reduced, while extending the ban on oil companies); the ban on trade in dual-use technologies is also extended; and the provision of services for deep-water oil exploration and production, Arctic oil exploration and production and shale oil projects is prohibited;

USA imposes a ban on new equity or debt transactions over 30 days involving the Bank of Moscow, Gazprombank, Russian Agricultural Bank, Sberbank, VEB and VTB, as well as on new debt transactions over 90 days with Gazprom, Gazprom Neft, Rosneft, Novatek, and Transneft;

New debt transactions over 30 days with Rostech as well as transactions in goods, services or technology for deep-water, Arctic offshore and shale oil projects with Gazprom, Gazprom Neft, Lukoil, Rosneft, Surgutneftegaz are prohibited.

Sources: Adapted from the EBRD Office of the Chief Economist (September 2014); Fact sheet on EU restrictive measures, EU Official Journal, Vol. 57, 12 September 2014; www.government.ru (7 August 2014); US Department of the Treasury (www.treasury.gov), 16 July 2014.

ASYMMETRIC TRADE EXPOSURE TO RUSSIA: MAJOR POLICY IMPLICATIONS

Trade exposure between the EU and Russia is hugely asymmetric (as it is in the trade relations between the EU and Ukraine, as well as between Russia and Ukraine). Whereas in 2013 the EU was Russia's main trading partner accounting for 53% of Russian exports and 39% of Russian imports (the comparable figures being 54% of exports and 42% of imports in the first half of 2014), EU exports to Russia in the same year accounted for only 2.6% of the total (EUR 120 billion) and imports for 4.6% of the total (EUR 207 billion).[23] About 4.5% of the Russian exports and 5% of its imports were traded with

[23] For the sake of comparison, the US exports to Russia were just 0.7% of the total (EUR 8 billion), US imports from Russia only 1.3% of the total (EUR 23 billion) in 2012.

Ukraine, whereas EU trade with Ukraine was negligible (just 0.5% of EU exports and 0.3% of EU imports in 2012).[24] Up until recently, as far as Ukraine is concerned, both Russia and the EU took on roughly equal importance in terms of trading partners: in 2012 about 25% of Ukraine's exports and more than 30% of its imports were traded with either Russia or the EU (however, significant differences were to be seen in terms of commodity composition, with Ukraine's exports to Russia being more 'sophisticated' than exports to the EU – see Havlik, 2013).

The above asymmetries bear a number of important policy implications, not least regarding the implementation of the Association Agreement/Deep and Comprehensive Free Trade Agreement (AA/DCFTA) with the EU and Ukraine's trade relations with the Russian-led Customs Union.[25] In the current context of mutual sanctions, one of the implications of the conflict is that given the differences in trade volume and economic magnitude, any trade measures have a greater impact on Russia (which is more dependent on the EU market than vice versa). Furthermore, the Russian economy is much smaller – a mere fifth of the EU GDP, even at purchasing power parity; it urgently needs Western technology, if it is to modernise. On average, EU trade exposure to Russia is relatively low, yet a number of EU countries trade quite extensively with Russia: the Baltic States (especially Lithuania) and other new EU Member States (NMS), as well as Finland (Figure 24). Austria, for instance, is not overly exposed in respect of exports to Russia: just 1.4% of Austrian GDP in terms of (gross) goods and 0.4% of services is exported to Russia (those shares are smaller in terms of domestic value-added of exports). Cyprus, the United Kingdom, Portugal and Spain have minimal trade in goods with Russia.[26]

Figure 24 / Share of gross exports to Russia in % of GDP

Source: wiiw Annual Database, Eurostat Comext, Eurostat Trade in Services.

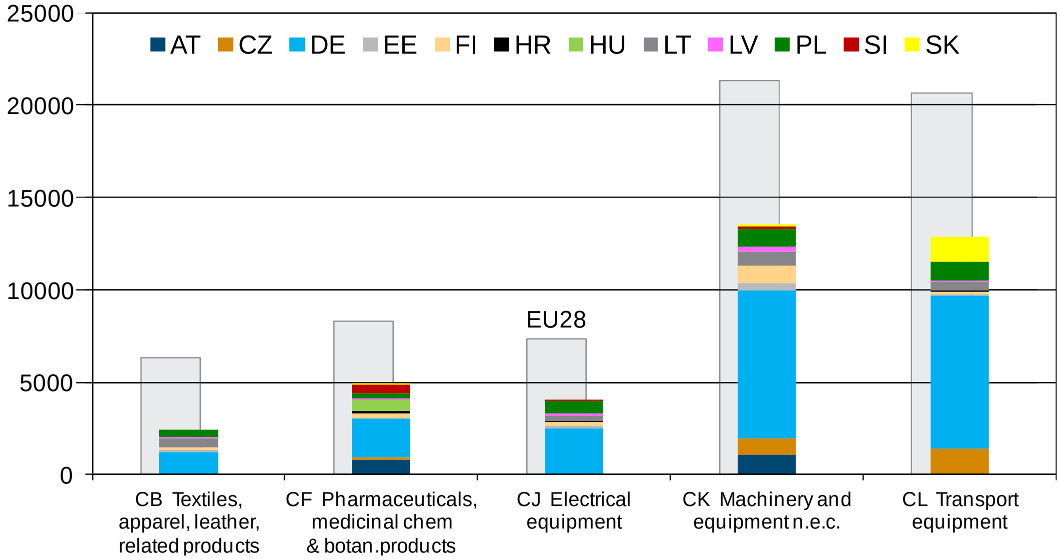
24 US trade with Ukraine was marginal: just 0.12% of US exports and 0.06% of US imports were traded with Ukraine in 2012 (Havlik, 2013).

25 Russia succeeded in negotiating a postponement in the implementation of the AA/DCFTA regarding Ukraine's customs-free imports from the EU until end-2015. Moreover, Russia demands a renegotiation of the DCFTA and threatens to revoke the existing free trade agreement and impose import duties on Ukraine's exports if the latter starts to implement the DCFTA (*Financial Times*, 26 September 2014, p. 1).

26 However, we get a different picture in trade with services. Available balance of payments data (for 2012) show that Cyprus (and Lithuania), with a 25% share in total services exports, is most exposed to Russia. On the EU average, transport, tourism and construction services exports to Russia accounted for more than 3% of the total.

In terms of sectoral trade exposure, there are five 2-letter NACE industries where the share of (gross) exports to Russia was higher than 3% of the EU-average: textiles, pharmaceuticals, electrical equipment, machinery and equipment and transport equipment. Figure 25 illustrates the size of those sectors for 12 major EU exporters to Russia. In absolute terms, machinery and transport equipment are the most important export branches exposed to Russia (with more than EUR 20 billion each in 2013), followed by electrical equipment. Germany is by far the most important exporter to the Russian market. In Austria, it is machinery and equipment (6% of total machinery exports) and pharmaceuticals (11% of total pharmaceuticals exports) that play the key role in exports to Russia. It is also interesting to note that agro-food products exports (banned by Russia as a retaliatory measure as of 7 August 2014) do not feature prominently among EU exports to Russia, although they are of importance to some EU countries (especially the Baltic States and Poland – see below).[27] As for trade in services, the available data suggest that travel (tourism) and transportation exports from the EU to Russia are significant, in particular for Cyprus, Lithuania, Estonia, Bulgaria and Greece (Figure 26).

Figure 25 / EU goods exports to Russia: 5 key industries, 12 major exporting countries, EUR million, 2013



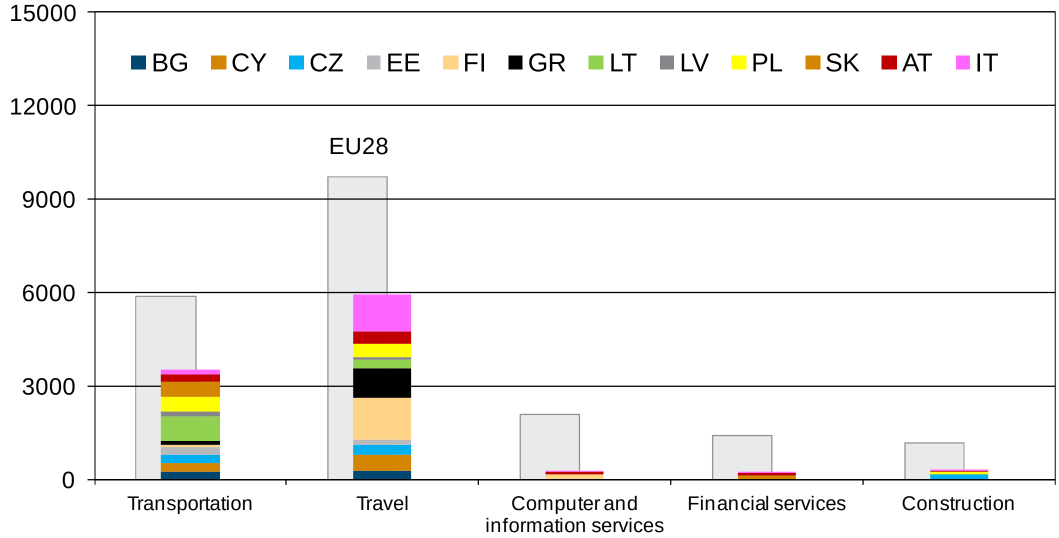
Source: wiiw Annual Database, Eurostat Comext.

As far as imports are concerned, the exposure of individual EU countries to Russia also differs widely. Lithuania imports nearly 30% of all its imported goods from Russia, Bulgaria and Finland nearly 20% and Greece 14%. The bulk of these imports – 80% on EU average – consists of energy (crude oil, natural gas and refined petroleum – see Figure 27).[28]

27 Less than 3% of EU agro-food exports went to Russia in 2013. For more details on Russia's ban on agro-food imports see EBRD News, 9 September 2014; European Commission Information Note, 3 September 2014; Russian Government Decree from 7 August 2014 (www.government.ru).

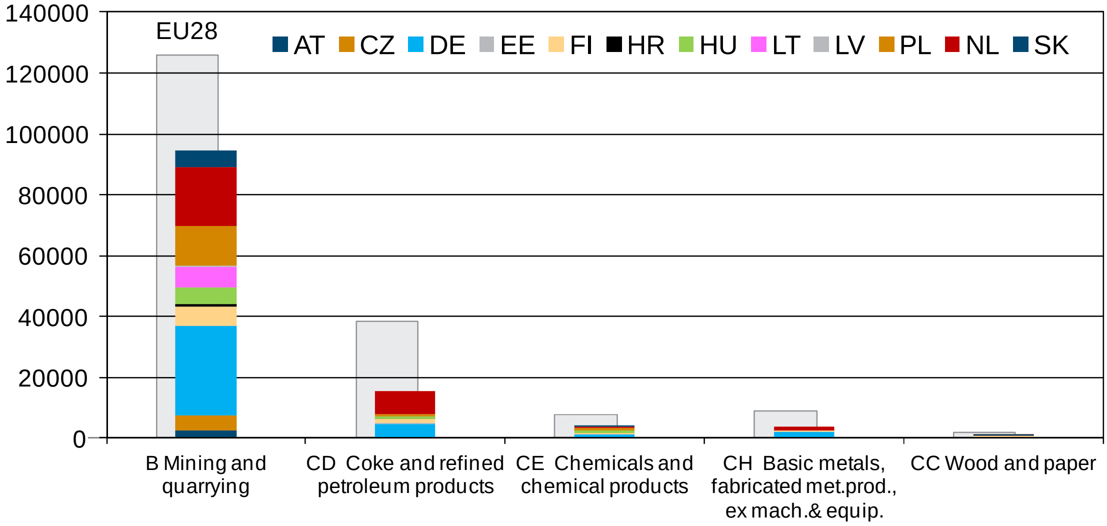
28 Austrian imports from Russia reported by Eurostat contain a gap of about EUR 2 billion in 2013, which is presumably attributable to gas imports. Similar reporting gaps exist also in Germany and the Netherlands.

Figure 26 / EU services exports to Russia: 5 key industries and 12 major exporting countries, EUR million, 2012



Source: wiiw Annual Database, Eurostat Trade in Services.

Figure 27 / EU imports from Russia: 5 key industries and 12 major importing countries, EUR million, 2013



Note: Mining and quarrying (oil and gas): Austria, Germany and Netherlands estimated.
Source: wiiw Annual Database, Eurostat Comext.

AN ASSESSMENT OF THE ECONOMIC IMPACT OF THE CONFLICT

It is not easy to estimate the direct economic impact of the sanctions separately. We, thus, consider the ‘effects of the conflict’ in more general terms. In so doing, we focus solely on trade channels.[29]

Russia

As far as Russia is concerned, sanctions undoubtedly augmented the negative economic developments resulting from the combined effect of the deteriorating investment climate, depreciation of the rouble, capital flight and reform setbacks. Growth prospects were scaled down accordingly; GDP growth forecasts were slashed down by about 1 percentage point for the period 2014-2016 (compared to the pre-crisis forecast scenario). The EBRD recently undertook similar downward revisions, as did the World Bank and the IMF.[30] A crude estimate of economic effects owing to lower GDP growth yields a GDP loss of close to EUR 20 billion in 2014 and more than EUR 30 billion in 2015 (see the country report for more details).

The European Union

The economies of individual EU countries are affected to differing degrees by the conflict owing to the variance in their trade and sectoral exposure (as well as other economic linkages) to the Russian (and Ukrainian) market. The differentiation in the economic impact and other (historical) factors also explains in part certain features of the comparatively heterogeneous stance adopted by the individual EU countries with respect to sanctions and other EU policies towards Russia, Ukraine and the neighbouring countries to the east. In general, the Baltic States (as well as Finland) and other NMS are affected more than others (see Figures 24-27 above). At the same time, the Baltic States (and Poland) have adopted a much ‘tougher’ attitude towards Russia given their historical experience, whereas Hungary, Bulgaria, Slovakia, the Czech Republic (as well as Austria, Greece and Cyprus) generally favour a ’softer’ approach to sanctions.

In order to assess the economic impact of the conflict, we take into account the varying trade exposure of individual EU countries in terms of the value-added shares of domestic and indirect (other countries’) exports to Russia in GDP.[31] Two alternative scenarios are considered:

(I) exports to Russia decline by 10%;

(II) exports to Russia decline by 50%.

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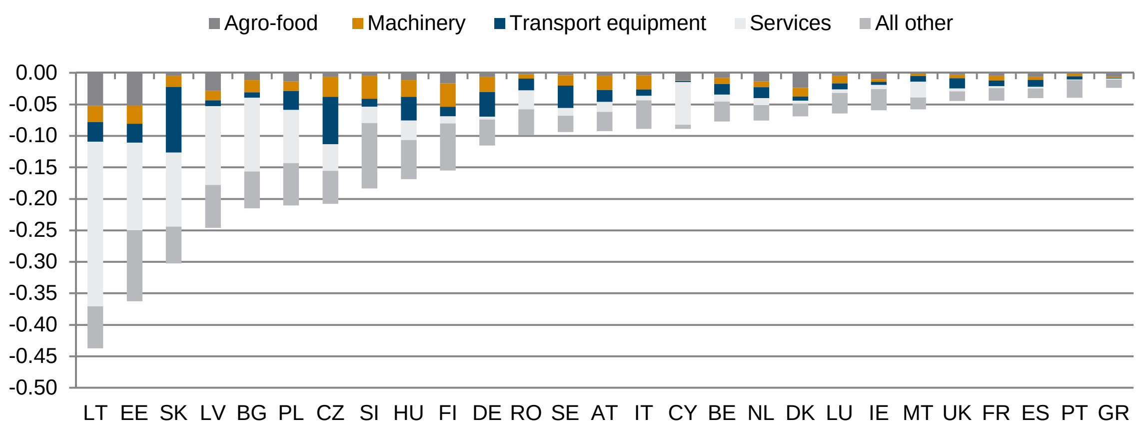
29 Beyond purely economic effects, concerning the effectiveness of sanctions in terms of changing policies – a halt to Russian intervention in eastern Ukraine and the return of Crimea – the results so far have been rather disappointing for the initiators. Note that we distinguish between the impact and efficiency of sanctions, where the latter should be assessed in terms of the purposes of the sanctions (cf. Gaddy and Ickes, 2014). Regarding the effectiveness of sanctions in general see, for example, DIW Roundup, 22 July 2014; for political aspects see Raik et al. (2014).

30 See EBRD Press Office, 18 September 2014 and The World Bank, 24 September 2014; IMF, 1 October 2014 (http://www.imf.org/external/np/ms/2014/100114.htm); (http://www.worldbank.org/en/country/russia/publication/russian-economic-report-32). In a pessimistic scenario, the Russian government reckons with a GDP drop of 10% in 2015.

31 Calculations by Robert Stehrer (wiiw) based on WIOD data for 2011. See Benkovskis et al. (2014) for more details on trade linkages between Russia and the EU.

Scenario (I) corresponds more or less to the present situation on the Russian market with Russian imports from the EU dropping by 9% in nominal EUR terms in the first half of 2014.[32] Scenario (II) would illustrate an extreme escalation of the conflict with far-reaching economic and political consequences. This scenario would most likely be associated with the interruption of gas supplies to the EU, confiscation of some Western assets in Russia, wholesale travel bans and similar measures. Contrary to other sources (Moody's, 2014; EBRD, 2014a; Deutsche Bank Research, 2014; Kholodilin et al., 2014), we take into account trade in both goods and services, but do not consider sector-specific effects (e.g. tourism or financial flows) owing to major uncertainties and/or the lack of data.[33] However, we illustrate the effects separately for broad economic sectors and also show the impact of the agro-food import ban that Russia introduced as a retaliatory measure on 7 August 2014. The results are shown in Figures 28-29 and summarised in Table 5.

Figure 28 / Estimated loss of GDP (in %) if gross exports to Russia drop by 10%



Source: WIOD database, calculations by R. Stehrer (wiiw).

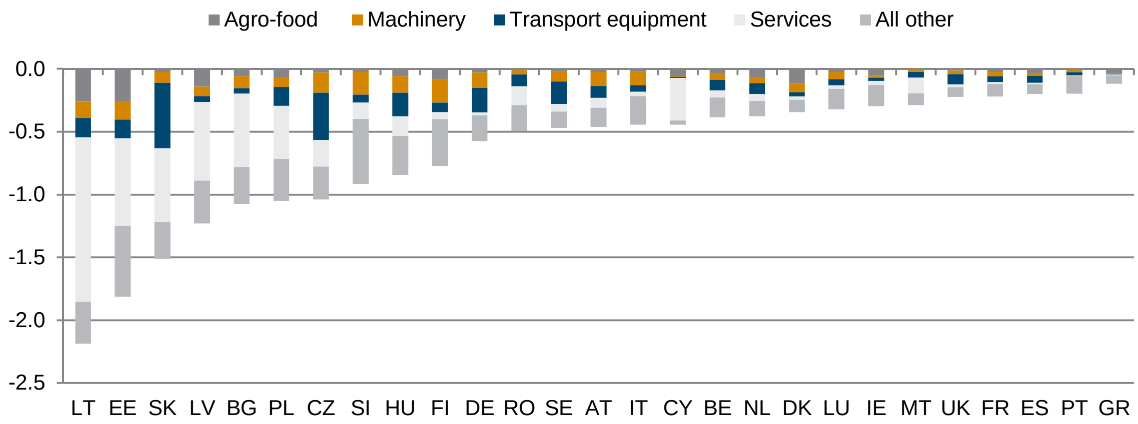
The estimated loss in Scenario I, expressed in terms of GDP, is highest in Lithuania (-0.44%), followed by Estonia (-0.36%) and Slovakia (-0.3%). Austria would only lose some 0.1% of GDP – less than EUR 300 million: an amount that is comparable in relative terms to the EU average. Regarding the sectoral composition of estimated GDP losses, services in the Baltic States and transport equipment in Slovakia and the Czech Republic are disproportionally affected. In Scenario II, the combined effect of a 50% loss in gross exports of both goods and services to Russia is shown in Figure 29 (see also Table 5). Lithuania and Estonia would lose around 2% of their GDP; a number of other NMS more than 1%. Austria would lose less than 0.5% of its GDP, largely on account of a drop in machinery exports. Last but not least, a total loss of all agro-food exports would hit Lithuania hardest – both would lose more than 2% of their GDP on account of that loss alone. However, the losses originating from Russia's retaliatory measures – the one-year ban on meat, dairy products, fruit, vegetables and fish imports

[32] This decline resulted not solely and directly from Western sanctions, but represented a combination of lower domestic demand, currency depreciation by nearly 20%, etc. There seems to be some indication that Russian imports started to diversify from the EU, Customs Union and Ukraine in 2014.

[33] The exposure of major Austrian banks (UniCredit Bank Austria and Raiffeisen Bank International) to Russian counterparts amounted to nearly EUR 30 billion in 2013 according to their annual reports quoted by the Austrian National Bank (OeNB).

introduced on 7 August 2014 – are less for the majority of EU countries (Table 5).[34] According to the EU Commission, the products banned accounted for more than EUR 5 billion of EU exports to Russia, with Lithuania, Poland, Germany and Netherlands exporting most in absolute terms. Austrian exports of banned agro-food products amounted to EUR 100 million in 2013. In the event of an upward spiral in sanctions, Russia is mooting the imposition of an embargo on car imports from the EU; it may also restrict state purchases of pharmaceuticals, impose additional travel bans or even freeze some Western assets in Russia.

Figure 29 / Estimated loss of GDP (in %) if gross exports to Russia drop by 50%



Source: WIOD database, calculations by R. Stehrer (wiiw).

CONCLUSIONS

The Ukraine conflict bears serious consequences not only for Russia and Ukraine, but it also poses a potential threat to the still frail economic recovery in Europe. In Ukraine, which is the main victim of the conflict, the war-related damage in Donbass is currently estimated at 6% of GDP, and the economy may decline by 8% in the course of the current year. In Russia, the costs of the conflict are estimated to be to the tune of 1% of GDP in 2014-2016, primarily on account of the heightened investment risks. The effect on the individual EU countries differs depending on their exposure to the Russian market: the Baltic States and several other new EU Member States (NMS) are generally those most affected, with estimated losses in the order of up to 0.4% of GDP assuming a 10% drop in gross exports of goods and services to Russia. The impact on Austria is expected to be relatively modest – less than 0.1% of GDP in this scenario. Needless to say, a more pronounced decline in trade would obviously result in correspondingly greater losses.

[34] See Government Decree No. 778 of 7 August 2014 as well as EBRD (2014b).

Table 5 / EU trade exposure towards Russia and estimated effects of the conflict

	Exports of goods EUR mn gross	Share of RU in total exports gross (%)	Exports of services EUR mn 2012	Share of RU in total (%)	Goods exports (gross) in % of GDP	Services exports in % of GDP 2012	Value added (VA) exports domestic in % of GDP	Value added (VA) exports other count. in % of GDP	VA exports total in % of GDP	Scenario (I) Exports -10% Value added total GDP loss in %	GDP loss EUR mn	Scenario (II) Exports -50% Value added total GDP loss in %	GDP loss EUR mn	Agro-food exports banned by Russia EUR mn	Agro-food import ban in % of GDP
EU28	119763	2.62	29309	1.99	0.92	0.22	.	.	. .	-0.08	-10953	-0.42	-54766	5098	0.04
AT	4313	3.28	1087	2.31	1.38	0.35	0.57	0.35	0.92	-0.09	-290	-0.46	-1448	104	0.03
BE	5117	1.45	797	1.01	1.34	0.21	0.42	0.35	0.77	-0.08	-294	-0.38	-1471	281	0.07
BG	569	2.56	590	10.28	1.42	1.48	1.89	0.26	2.15	-0.22	-86	-1.08	-429	8	0.02
CY	24	1.62	1543	25.02	0.14	9.35	0.81	0.08	0.89	-0.09	-15	-0.44	-73	12	0.07
CZ	4475	3.68	643	3.74	2.99	0.43	1.57	0.51	2.08	-0.21	-311	-1.04	-1555	12	0.01
DE	36095	3.30	4710	2.24	1.32	0.17	0.90	0.26	1.16	-0.12	-3159	-0.58	-15795	594	0.02
DK	1562	1.87	876	1.70	0.63	0.35	0.47	0.22	0.69	-0.07	-172	-0.34	-858	341	0.14
EE	1404	11.44	482	11.33	7.62	2.61	3.22	0.40	3.62	-0.36	-67	-1.81	-334	60	0.33
ES	2818	1.18	1805	1.68	0.28	0.18	0.26	0.14	0.40	-0.04	-411	-0.20	-2055	326	0.03
FI	5354	9.58	2070	9.43	2.77	1.07	1.29	0.25	1.54	-0.15	-300	-0.77	-1498	274	0.14
FR	7721	1.77	2095	1.24	0.37	0.10	0.30	0.14	0.44	-0.04	-908	-0.22	-4539	233	0.01
UK	4667	1.14	2380	1.04	0.25	0.13	2.29	0.15	2.44	-0.04	-846	-0.22	-4230	21	0.00
GR	406	1.48	1147	4.17	0.22	0.63	0.17	0.07	0.24	-0.02	-44	-0.12	-218	114	0.06
HR	282	3.16	260	2.80	0.65	0.60	.	.	. .	. .	.	.		7	0.02
HU	2537	3.12	196	1.24	2.59	0.20	1.22	0.47	1.69	-0.17	-166	-0.84	-828	78	0.08
IE	633	0.74	-332	-0.37	0.39	-0.20	0.33	0.26	0.59	-0.06	-97	-0.30	-486	70	0.04
IT	10797	2.77	1721	2.10	0.69	0.11	0.72	0.17	0.89	-0.09	-1388	-0.44	-6940	163	0.01
LT	4870	19.83	1132	24.67	14.06	3.27	4.12	0.25	4.37	-0.44	-151	-2.19	-757	922	2.66
LU	156	1.13	233	0.41	0.34	0.51	0.12	0.52	0.64	-0.06	-29	-0.32	-147	5	0.01
LV	1749	16.04	301	8.47	7.49	1.29	2.19	0.28	2.47	-0.25	-58	-1.23	-288	67	0.29
MT	36	1.35	67	1.76	0.50	0.93	0.32	0.26	0.58	-0.06	-4	-0.29	-21	0	0.00
NL	7940	1.59	1215	1.17	1.32	0.20	0.45	0.30	0.75	-0.08	-456	-0.38	-2281	523	0.09
PL	8110	5.33	1109	3.76	2.08	0.28	1.79	0.31	2.10	-0.21	-819	-1.05	-4095	840	0.22
PT	264	0.56	142	0.74	0.16	0.09	0.27	0.13	0.40	-0.04	-65	-0.20	-327	13	0.01
RO	1382	2.79	88	1.05	0.97	0.06	0.77	0.22	0.99	-0.10	-141	-0.49	-704	1	0.00
SE	2728	2.16	482	0.87	0.65	0.11	0.66	0.28	0.94	-0.09	-395	-0.47	-1975	13	0.00
SI	1190	4.63	104	2.01	3.37	0.29	1.49	0.34	1.83	-0.18	-65	-0.92	-323	10	0.03
SK	2564	3.95	519	9.32	3.55	0.72	2.54	0.48	3.02	-0.30	-218	-1.51	-1092	6	0.01

Sources: wiiw estimates based on Eurostat Comext, Eurostat Trade in Services and WIOD databases.

FINANCIAL SANCTIONS: RUSSIA HARDEST HIT[35]

Of the three types of 'sectoral' sanctions imposed on Russia – financial sanctions, a military embargo and an export ban on oil-drilling equipment – the financial sanctions are arguably hitting hardest, at least in the short term.[36] They represent a ban on medium- and long-term borrowing, i.e. credits with a maturity of more than 30 days, for the state-owned Russian banks (first and foremost Sberbank, VTB, Gazprombank, VEB and Rosselkhozbank) and a number of companies (including most notably the oil companies Rosneft, Transneft and Gazpromneft).[37] Although the ban does not apply to all Russian borrowers, the banks and companies currently sanctioned constitute part of the backbone of the country's economy. This holds particularly true for the major state-owned banks: the medium-sized banks in Russia simply cannot 'absorb' the volume of credit previously extended to the larger banks.

For the Russian companies on the sanctions list, outstanding debt obligations to their European and US creditors are serviced as before; however, their refinancing from the same source has now become impossible. This reduces the supply of foreign exchange and is exerting downward pressure on the rouble, which, since the end of June 2014, has lost around 25% of its value against the US dollar (Figure 30). Via the price increases and restricted supply of imported goods, depreciation is contributing towards an acceleration of consumer inflation; by the end of October 2014, it had already reached 8.4% (year-on-year).[38] The reduced availability of capital is also driving interest rates upwards – despite the authorities taking extra steps to provide extra liquidity to the troubled banks and companies (more on that see below).[39]

These developments cannot be blamed on the sanctions alone. As shown in Figure 30, the rouble started to dip as far back as the beginning of 2014, and interest rates began to rise three to four months later, i.e. well before the western sanctions were imposed. Initially, the depreciation of the rouble went hand in hand with that of many other 'emerging' currencies (India, Brazil, Indonesia and Turkey, to name but a few) after the US Fed announced a gradual phasing-out of its quantitative easing (QE-3) programme, thus putting the brakes on the supply of US dollars. Furthermore, the conflict building up in Ukraine, the related rise in political uncertainties and the acceleration of capital flight from Russia contributed to the depreciation of the rouble. To defend the rouble, the Central Bank raised its key policy rate (one-week repo rate) from 5.5 to 7% in March 2014, followed by three further (largely inflation-motivated) hikes over the subsequent months. All in all, the policy rate has been adjusted by a total of 4 percentage points in the course of the current year, bringing it to the present level of 9.5%. As can be

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35 The following part of this Special Section was written by Vasily Astrov. The author thanks Peter Havlik, Mario Holzner, Michael Landesmann, Sándor Richter and particularly Leon Podkaminer, all wiiw, for valuable comments and suggestions on an earlier draft.

36 Since Russia is a net exporter of weapons, the military embargo is largely symbolic. The restrictions on exports of oil-drilling technologies – if they stay in place – will potentially have more serious consequences for the country's economy (Russia crucially needs foreign technologies to develop its off-shore and shale oil deposits), but only in the medium and long run.

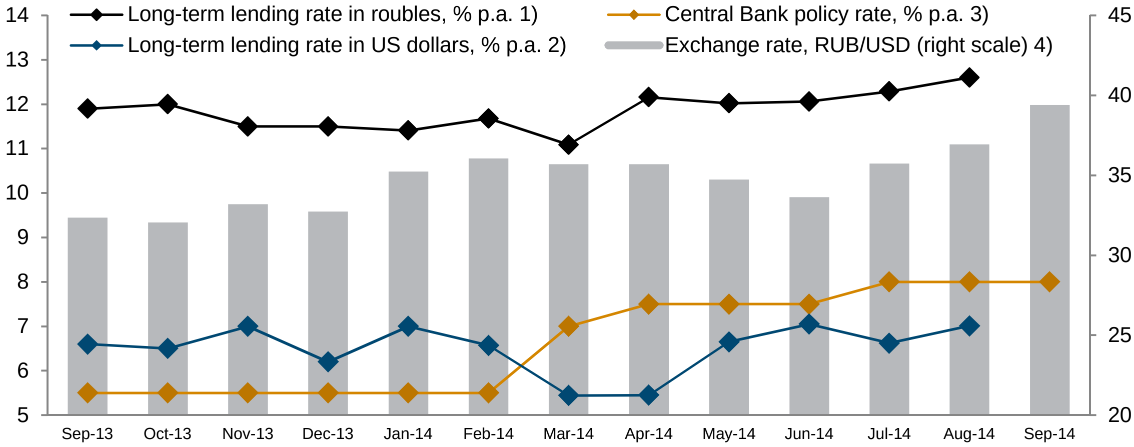
37 For a detailed list of imposed sanctions, see Box 4.

38 Another reason for the acceleration of inflation has been the enacted ban on food imports. According to the Central Bank's estimations, the food import ban will contribute a total of 1.5 percentage points to CPI inflation over the period of 2014-2015.

39 Besides, the niche previously occupied by Western lenders could be partly filled by China: the first agreements in this vein were concluded with China's Eximbank in mid-October. However, since the borrowed funds are to be used to pay for Chinese imports, the net effect on the Russian balance of payments and the exchange rate are likely to be modest.

seen from Figure 30, in April and July, hikes in the policy rate were mirrored in similar rises in lending rates for the corporate sector. Interestingly, in August the lending rates continued their upward trend *despite* the Central Bank leaving its policy rate unchanged. In all likelihood, this reflects the impact of the sanctions imposed at the beginning of the month (interest rates on US dollar loans predictably went up as well).

Figure 30 / Interest and exchange rates in Russia, monthly



Note: 1) Average weighted interest rate on corporate loans in roubles with over 1 year maturity (without Sberbank). - 2) Average weighted interest rate on corporate loans in US dollars with over 1 year maturity. – 3) One week repo rate, end of month. – 4) End of period.
Source: Russian Central Bank.

FULL IMPACT OF THE SANCTIONS YET TO COME

Almost certainly, the full impact of the sanctions has yet to be fully felt. For instance, in September the Western financial sanctions were tightened and, if the developments in August are any indication, they will translate into a further rise in borrowing costs for the real sector (the Central Bank data for September are not available yet, but anecdotal evidence suggests that this must have been the case) as will the latest hike in the Central Bank's policy rate by 1.5pp on 31 October 2014. Furthermore, given the lag in the pass-through of the exchange rate to inflation, the full inflationary impact of the recent depreciation, which deepened in the first weeks of October, with the rouble falling to levels of 40-41 RUB per USD,[40] has yet to come. The Russian Central Bank now reckons that the CPI will not peak before the beginning of next year.

It is somewhat ironic that Russia, a country that has constantly enjoyed sizeable (and even now rising) current account surpluses and is a net creditor to the rest of the world should be dependent on external borrowing to such an extent. One reason is that the bulk of the country's energy revenues, which generate the external surpluses, has been accumulated in the form of Central Bank foreign exchange reserves and government fiscal (sovereign) funds, thus leaving the corporate sector with little alternative but to borrow abroad. Since Russia is an overall 'surplus' country, the shortage of foreign financing could, in principle, be offset by the authorities adopting a more accommodating monetary policy. They could tap into their foreign reserves to meet the needs of the

[40] In October, the rouble depreciation was mainly fuelled by the falling oil price.

domestic economy (a few welcome steps in this direction have been already taken).[41] Another reason for credit shortages, capital flight within the private sector, is more 'fundamental' and poses a major problem. Disregarding the introduction of capital controls, advocated, for example, by S. Glazyev, an advisor to the President, no simple solution presents itself, except to start improving the domestic investment climate and focus primarily on ensuring the security of property rights: something that is currently not in sight.

The restricted ability to borrow in tandem with higher domestic interest rates could contribute to a further decline in investment in Russia. Meanwhile the depreciation of the rouble and the related spike in inflation will further undermine the purchasing power of households and private consumption: the main engine of growth over the past few years. However, the financial sanctions imposed on Russia are not without cost for the other side either. For western creditors, potential losses take the form of earnings (and profits) forgone – especially given the relatively high interest rates in Russia, at least compared to advanced economies. Potential losses clearly vary by bank and by country, and it is impossible to assess their precise magnitude without detailed knowledge of the banks' balance sheets and their business strategies. However, as a first approximation, it is safe to assume that western countries, whose banks are those most exposed to Russian borrowers, will be affected most – if only because they will not be able to roll over outstanding loans.

France is the country most exposed to the Russian credit market: Table 6 shows the extent to which banks in individual countries are exposed to Russian borrowers, based on the most recent data from the Bank of International Settlements (BIS).[42] French banks alone account for nearly one-quarter of the total claims on Russia, with another quarter split between Italy and the United States. As of 2012, Austria no longer reports to the BIS; that notwithstanding, evidence from other quarters points to Austria's substantial banking exposure to Russia. For instance, Austria's Raiffeisen was one of the five European banks to include Russia in its top ten list of country exposures; at the end of June 2014 it had a total of EUR 20.5 billion in Russian claims (the other four banks being: Italy's UniCredit with EUR 18.6 billion; France's Société Générale with EUR 22.4 billion; Hungary's OTP Bank with EUR 4.4 billion; and the Bank of Cyprus with EUR 1.6 billion).[43] Those figures suggest the relative vulnerability of Austria to the sanctions, which might be affected not only directly (largely through Raiffeisen) but also indirectly, since UniCredit's presence in Russia ensues via Bank Austria. On the other hand, the financial sanctions should only affect the CESEE countries to a limited degree, with the possible exception of Hungary.

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41 The Central Bank has increased its refinancing of banks and launched a forex repo programme, while the government has tapped into the National Welfare Fund (one of the two sovereign funds) to recapitalise the sanctioned banks and companies, and expressed readiness to place its temporary forex liquidity on banking deposits.

42 The BIS compiles data from 25 reporting countries only and therefore does not give a full picture of cross-border banking exposures. This is confirmed by the huge discrepancy between the combined banking exposure to Russia as indicated by the BIS (some USD 200 billion) and the stock of Russia's external debt calculated by the Russian Central Bank (more than USD 700 billion), as well as by the notorious omission from the BIS database of important 'off-shore' creditor countries such as Cyprus.

43 Reuters, 'European banks' exposure to Russia', 21 August 2014, http://uk.reuters.com/article/2014/08/21/russia-banking-idUKL5N0QR2OJ20140821

Table 6 / Foreign banking exposure to Russia at the end of June 2014, by creditor country, in USD billion, on ultimate risk basis

	Banks	Public sector	Non-bank priv. sector	Total foreign claims [1)]	Other potential exposures [2)]
Total	**47.9**	**17.7**	**141.2**	**207.6**	**155.6**
France	6.8	3.9	37.0	47.8	11.3
Italy	2.0	2.0	23.7	27.7	6.3
United States	7.5	3.6	14.9	26.1	83.5
Japan	3.4	3.2	11.8	18.4	1.9
Germany	10.5	0.3	6.9	17.7	3.1
Netherlands	.	.	.	15.7	0.0
United Kingdom	4.4	3.0	6.9	14.3	30.9
Sweden	.	.	.	9.1	0.0
South Korea	0.9	0.1	1.1	2.1	0.4
Spain	0.1	.	1.0	1.2	0.2
India	.	.	.	0.7	0.0
Belgium	0.6	.	0.1	0.7	0.2
Turkey	0.4	.	0.2	0.6	0.0
Canada	.	.	.	0.6	0.0
Greece	.	.	.	0.4	0.0
Portugal	.	.	.	0.3	0.0
Switzerland	.	.	.	0.0	0.6

1) Cross-border claims and claims of local offices of foreign banks.
2) Derivatives contracts, extended guarantees and credit commitments.
Source: Bank for International Settlements.

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Country reports

Table 7 / Bulgaria: Selected Economic Indicators

	2010	2011	2012	2013 [1]	2013	2014	2014	2015	2016
					January-June			Forecast	
Population, th pers., average [2]	7,396	7,348	7,306	7,265	.	.	7,270	7,250	7,230
Gross domestic product, BGN mn, nom.	70,511	75,308	78,089	78,115	35,592	35,614	78,800	81,400	85,200
annual change in % (real)	0.4	1.8	0.6	0.9	0.3	1.8	1.9	2.3	2.6
GDP/capita (EUR at exchange rate)	4,900	5,200	5,500	5,500	.	.	5,500	5,700	6,000
GDP/capita (EUR at PPP)	11,000	11,700	12,100	12,300	.	.	.	.	.
Consumption of households, BGN mn, nom.	43,990	46,725	51,056	48,926	23,588	23,301	.	.	.
annual change in % (real)	0.0	1.5	3.7	-2.3	-2.7	1.9	2.0	2.5	3.0
Gross fixed capital form., BGN mn, nom.	16,077	16,225	16,701	16,170	7,019	7,037	.	.	.
annual change in % (real)	-18.3	-6.5	4.0	-0.3	-4.9	3.9	4.0	5.0	6.0
Gross industrial production [3]									
annual change in % (real)	2.1	5.8	-0.3	-0.1	-1.9	3.9	3.5	4.5	6.0
Gross agricultural production									
annual change in % (real)	-6.0	-2.5	-10.0	0.4	.	.	.	.	.
Construction industry [4]									
annual change in % (real)	-14.9	-12.8	-0.7	-5.3	-3.8	4.2	.	.	.
Employed persons, LFS, th, average [5]	3,053	2,950	2,934	2,935	2,898	2,937	2,960	2,990	3,020
annual change in % [5]	-6.2	-3.4	-1.1	0.0	0.5	1.4	1.0	1.0	1.0
Unemployed persons, LFS, th, average [5]	348	372	410	436	446	407	400	390	370
Unemployment rate, LFS, in %, average [5]	10.2	11.2	12.3	13.0	13.4	12.2	12.0	11.5	11.0
Reg. unemployment rate, in %, end of period	9.2	10.4	11.4	11.8	10.7	10.7	.	.	.
Average monthly gross wages, BGN	648.1	685.8	731.1	807.5	788.7	806.5	.	.	.
annual change in % (real, gross)	3.9	1.5	3.5	9.5	1.1	4.5	.	.	.
Consumer prices (HICP), % p.a.	3.0	3.4	2.4	0.4	1.6	-1.7	-1.0	1.0	2.0
Producer prices in industry, % p.a.	8.5	9.2	4.4	-1.5	0.4	-2.0	.	.	.
General governm.budget, EU-def., % of GDP									
Revenues	34.3	33.6	35.0	37.2	40.7	44.1	.	.	.
Expenditures	37.4	35.6	35.8	38.7	39.1	43.1	.	.	.
Net lending (+) / net borrowing (-)	-3.1	-2.0	-0.8	-1.5	1.6	1.0	-3.5	-2.5	-2.0
Public debt, EU-def., % of GDP	16.2	16.3	18.4	18.9	17.5	20.3	23	25	26
Central bank policy rate, % p.a., end of period [6]	0.18	0.22	0.03	0.02	0.01	0.05	.	.	.
Current account, EUR mn	-534	33	-454	857	205	-66	700	300	0
Current account, % of GDP	-1.5	0.1	-1.1	2.1	1.1	-0.4	1.7	0.7	0.0
Exports of goods, BOP, EUR mn	15,562	20,265	20,771	22,271	10,643	10,290	22,200	22,800	23,500
annual change in %	33.0	30.2	2.5	7.2	7.7	-3.3	-0.3	2.7	3.1
Imports of goods, BOP, EUR mn	18,326	22,421	24,231	24,701	11,909	11,898	25,000	26,000	27,000
annual change in %	15.4	22.3	8.1	1.9	-0.5	-0.1	1.2	4.0	3.8
Exports of services, BOP, EUR mn	5,012	5,354	5,696	5,739	2,216	2,473	6,000	6,100	6,200
annual change in %	2.0	6.8	6.4	0.8	-2.5	11.6	4.5	1.7	1.6
Imports of services, BOP, EUR mn	3,143	3,037	3,426	3,476	1,622	1,768	3,500	3,600	3,700
annual change in %	-13.1	-3.4	12.8	1.5	-1.8	9.0	0.7	2.9	2.8
FDI inflow (liabilities), EUR mn	1,152	1,330	1,142	1,157	825	751	1,200	1,300	1,500
FDI outflow (assets), EUR mn	174	117	270	183	81	96	.	.	.
Gross reserves of NB excl. gold, EUR mn	11,612	11,788	13,936	13,303	13,406	13,085	.	.	.
Gross external debt, EUR mn	37,026	36,295	37,714	37,335	37,544	37,043	.	.	.
Gross external debt, % of GDP	102.7	94.3	94.5	93.5	94.0	91.9	.	.	.
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
Purchasing power parity BGN/EUR	0.8680	0.8780	0.8817	0.8982	.	.	.	.	.

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

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

BULGARIA: In limbo, expecting a reset

RUMEN DOBRINSKY

Bulgaria's economic and political scene has been recently dominated by the early elections due in October and the collapse of the Corporate Commercial Bank. Somewhat ironically, economic activity had been on the rise in recent months and GDP growth for 2014 as a whole may thus come close to 2%. The expectations are that the upcoming elections will bring about a paradigmatic change in terms of power and policies. Solving the situation created by the Corporate Commercial Bank will also have to await the election of a new parliament and the appointment of a new government.

During the summer months, Bulgaria's economic and political scene was dominated by two main developments: the early elections due in October and the repercussions of the failure of the Corporate Commercial Bank (CCB). Actually, the dynamics of these two developments were closely linked in a one-way causal relationship: the power vacuum after the resignation of the government prevented an immediate bailout action and in all likelihood made any possible subsequent intervention by the authorities more expensive.

The caretaker government that took office in August, after the decision to dissolve the parliament, has no mandate to introduce policy changes, or intervene in the CCB debacle. The economy has been driven by the policy inertia left behind the outgoing centre-left government. On the positive side, there were some favourable carry-over effects of the fiscal stimulus introduced in the previous months that contributed to a modest economic upturn in the course of 2014. GDP growth actually accelerated in the second quarter of 2014 to 2.1% year-on-year, after the 1.4% rate of growth recorded in the first quarter. On the demand side, this upturn was supported by a modest recovery in exports while imports were on a downward trend. Consequently, net exports made a positive contribution to GDP growth in the second quarter, in contrast to a significant negative contribution in the first quarter. Both private consumption and gross fixed capital formation made positive contributions to GDP growth in the second quarter.

Some of these demand-side developments resulted from changes in the environment (both external and internal); others partly contain policy-related effects. The ongoing recovery in total exports was largely due to an upturn in import demand on the part of traditional EU markets while exports to third countries actually dropped from their 2013 levels. The opposite trends in exports and imports are also consistent with price-related real exchange rate developments: in 2013-2014, Bulgaria experienced a very pronounced deflation (one of the strongest within the EU) which was equivalent to a depreciation of the real exchange rate. On the policy side, although the previous government could not put in place a formal reindustrialisation programme, as had been the intention, some public support measures effectuated through the Development Bank (such as promotional export credit as well as subsidised credit to SMEs) also contributed to the recovery in exports. Public investment expenditure continued to expand in the second quarter, supported by better absorption of EU funds, and contributed to the overall recovery in fixed investment while the rise in pensions introduced in January supported the modest upturn in private consumption.

On the other hand, the lingering political uncertainties that overshadowed the functioning of the centre-left government from the moment of its inception in mid-2013 had lasting negative implications affecting, in particular, investor and consumer confidence. Among other things, this – together with the deflationary pressure – triggered wage restraint in 2014: average nominal monthly wages in the first half of 2014 were below their average for 2013 as a whole. However, given the recorded deflation, real wages in the first half of 2014 were above their level in the same period of the previous year.

The lacuna in the policy process may have negative implications for the fate of the CCB which was placed under conservatorship by the Bulgarian National Bank (BNB) in June.[44] CCB is one of the big players in the Bulgarian financial system and the only one in this class in which domestic investors have a controlling stake. While the Bulgarian banking system as a whole was and remains in good financial health, in recent years CCB governance has been gradually taking the wrong course.

CCB was for years the darling of the Bulgarian ruling elite, no matter which party was in power at any given moment. Thanks to cosy relations with the political establishment, the CCB managed to establish a dominant position in servicing state-owned companies. At one point in time it was estimated that some 75% of the deposits of state-owned companies were concentrated in CCB. On average, these were large funds of a long-term nature which, on the one hand, created an unfair advantage of CCB within the banking system and, on the other hand, established an environment inciting opportunistic behaviour both for bank insiders and the political establishment. Apparently, over time this led to distorted insider lending practices which gradually eroded the quality of the bank asset portfolio.

Still, probably the situation would not have been totally out of control if it had not been for a clash between two personalities: the main CCB shareholder (a physical person) and a local oligarch who was a key client of the bank. The dispute started in late 2013 and escalated over time; in the end, the oligarch, who controls a local media empire, started an open media campaign against the bank. The upshot was a run on the bank in late spring of 2014 and, consequently, the CCB was placed under conservatorship by BNB.

BNB was in favour of a quick bailout solution involving public intervention, dividing CCB into two banks: ‘good’ and ‘bad’, arguing (probably correctly) that a quick solution would be cheaper than a delayed one. However, under the currency board, BNB has no instruments of direct intervention; it cannot even extend short-term liquidity support to any bank. So any bailout solution by definition would involve the government and, in case of extraordinary public borrowing, the parliament as well. Unfortunately, the timing of this proposal coincided with the last days of the parliament which were marred by bitter political infighting. Incidentally, no such decision was reached before the resignation of the government and the dissolution of the parliament. Subsequently, BNB tried also the other possible option to save the bank: coordinating, through moral suasion, the main shareholders in a dialogue on a bailout option through a

44 Conservatorship implies the removal of the previous bank management, appointment of syndics as transient management (with the main task to undertake a detailed audit) and the temporary suspension of all bank operations.

new capital injection. However, so far this has not produced workable outcomes as shareholders insisted on government involvement in the bailout and the parallel injection of public funds.

Thus, at the moment of writing, the CCB case was still hanging in the air, awaiting the election of a new parliament and the appointment of a new government. An internal audit (part of the conservatorship action) was still under way but the extent of the CCB problems (including its solvency) was still unclear, partly due to major flaws in internal book-keeping at the bank, as revealed by the audit. In the meantime, depositors whose money remained blocked in the CCB became more and more nervous, staging various protests and demonstrations.[45] Given the present deadlock they cannot even withdraw the guaranteed part of their deposits (EUR 100,000 in accordance with EU rules): for this to happen, the bank must be declared insolvent. In any case BNB is reluctant to take such a critical decision on its own in the absence of a working parliament and functioning government.

Given this unstable and uncertain environment, it is somewhat ironic that economic activity in the country has been on a rising course. One might even speculate that the political lacuna relieved businesses from some hampering administrative controls and intrusions. Also ironically, the Russian sanctions on the EU will probably have a negligible effect on the Bulgarian economy, as during the past couple of decades Bulgaria has lost almost completely its share on the Russian market for agro food products. Anyhow, the country is likely to remain in limbo until there will be a new government following the October elections. The prevailing expectations are for a return to power of GERB[46] (on their own, or in coalition), which ruled the country until February 2013. In any case, the government changeover is likely to bring about a reset in the paradigm of power and changes in the policy course.

At the economy-wide level, the dynamics of total bank deposits during and after the CCB failure was an indication that the public still has confidence in the banking system as a whole. After a general wave of panic withdrawals at the time of the CCB failure, money started to flow back to the banks and, according to preliminary estimates, by September the level of deposits in the banking system as a whole had recovered.

Overall, GDP growth in 2014 is likely to be marginally higher than that recorded in the previous two years. Deflation is also likely to feature throughout the year and be reflected in the average annual figures, impacting negatively, among other things, on fiscal revenues. Given that a public intervention in some form of a bailout of CCB seems inevitable, the fiscal outcome for 2014 (and probably 2015 as well) is likely to deteriorate further. Depending on the extent and timing of the bailout, the deficit can be higher than indicated in the table.

The recent dynamics of trade flows discussed above suggests a positive current account balance in 2014 and probably in 2015 as well. Developments in 2015 and 2016 will very much depend not only on the external environment (which remains precarious) but also on the policy course that will be followed by the new government. The GDP growth forecasts for these years reflected in the table can be regarded as optimistic in the sense that they assume a continued moderate upturn in domestic demand (both private consumption and fixed investment) and uninterrupted modest rise in exports.

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45 The CCB failure also revealed that Bulgarian deposit insurance regulations are not aligned with the respective EU directives, due to which the EC alerted the government of possible infringement proceedings against Bulgaria.

46 The Bulgarian acronym for the name of the centre-right party ‘Citizens for European Development in Bulgaria’.

Table 8 / Croatia: Selected Economic Indicators

	2010	2011	2012	2013 [1]	2013	2014	2014	2015	2016
					January-June		Forecast		
Population, th pers., average [2]	4,296	4,283	4,269	4,254	4,253	.	4,250	4,250	4,250
Gross domestic product, HRK mn, nom. [3]	328,041	332,587	330,456	330,135	158,864	157,098	329,100	332,400	339,100
annual change in % (real) [3]	-1.7	-0.3	-2.2	-0.9	-1.1	-0.7	-0.8	0.0	1.0
GDP/capita (EUR at exchange rate)	10,500	10,400	10,300	10,200	.	.	10,100	10,200	10,400
GDP/capita (EUR at PPP)	14,900	15,400	15,700	15,700	.	.	.	.	.
Consumption of households, HRK mn, nom. [3]	190,237	195,325	195,623	196,885	97,713	96,695	.	.	.
annual change in % (real) [3]	-1.5	0.3	-3.0	-1.3	-1.5	-0.5	-0.6	-0.3	0.5
Gross fixed capital form., HRK mn, nom. [3]	69,784	67,471	64,820	63,732	31,791	30,146	.	.	.
annual change in % (real) [3]	-15.2	-2.7	-3.3	-1.0	-0.7	-4.5	-4.0	1.0	3.0
Gross industrial production [4]									
annual change in % (real)	-1.4	-1.2	-5.5	-1.8	-0.5	0.1	0.0	2.0	2.5
Gross agricultural production									
annual change in % (real)	-8.2	-1.0	-9.9	1.4	.	.	.	.	.
Construction output [4]									
annual change in % (real)	-15.8	-8.5	-11.1	-4.1	-3.9	-7.8	.	.	.
Employed persons, LFS, th, average [5]	1,541	1,493	1,446	1,390	1,507	1,538	1,550	1,550	1,560
annual change in %	-4.0	-3.2	-3.1	-3.9	.	2.1	.	0.0	0.5
Unemployed persons, LFS, th, average [5]	206	232	272	288	316	329	.	.	.
Unemployment rate, LFS, in %, average [5]	11.8	13.5	15.9	17.2	17.4	17.8	17.5	17.5	17.0
Reg. unemployment rate, in %, end of period	18.8	18.7	21.1	21.6	18.6	18.3	21.3	21.0	20.5
Average monthly gross wages, HRK	7,679	7,796	7,875	7,939	7,946	7,939	.	.	.
annual change in % (real, gross)	-1.5	-0.8	-2.3	-1.4	-2.1	-0.2	.	.	.
Average monthly net wages, HRK	5,343	5,441	5,478	5,515	5,506	5,506	.	.	.
annual change in % (real, net)	-0.5	-0.4	-2.6	-1.5	-2.3	-0.2	.	.	.
Consumer prices (HICP), % p.a.	1.1	2.2	3.4	2.3	3.2	0.2	0.5	1.0	1.0
Producer prices in industry, % p.a. [6]	4.3	7.0	5.4	-0.3	1.4	-2.6	1.0	1.0	1.0
General governm.budget, EU-def., % of GDP									
Revenues	40.0	39.8	40.5	40.8	.	.	.	.	.
Expenditures	46.3	47.5	45.5	45.7	.	.	.	.	.
Net lending (+) / net borrowing (-)	-6.3	-7.7	-4.9	-4.9	.	.	-5.0	-4.5	-3.5
Public debt, EU-def., % of GDP	44.4	51.4	55.6	66.7	.	.	72.0	74.0	75.0
Central bank policy rate, % p.a., end of period [7]	9.0	7.0	7.0	7.0	7.0	7.0	.	.	.
Current account, EUR mn	-502	-388	-86	381	-1,635	-1,825	200	100	0
Current account, % of GDP	-1.1	-0.9	-0.2	0.9	-7.8	-8.9	0.5	0.2	0.0
Exports of goods, BOP, EUR mn	9,064	9,773	9,803	9,790	4,450	5,030	10,900	11,700	12,500
annual change in %	18.1	7.8	0.3	-0.1	-4.4	13.0	11.0	7.0	7.0
Imports of goods, BOP, EUR mn	14,809	15,922	15,856	16,137	7,916	8,257	16,800	17,500	18,200
annual change in %	-0.5	7.5	-0.4	1.8	-0.5	4.3	4.3	4.0	4.0
Exports of services, BOP, EUR mn	8,651	8,989	9,256	9,508	3,159	3,146	9,500	9,700	9,800
annual change in %	0.1	3.9	3.0	2.7	3.5	-0.4	0.0	2.0	1.5
Imports of services, BOP, EUR mn	2,876	2,787	2,848	2,754	-1,311	-1,266	2,700	2,800	2,900
annual change in %	-2.5	-3.1	2.2	-3.3	-2.6	-3.4	-3.0	2.0	3.0
FDI inflow (liabilities), EUR mn	378	1,070	1,076	525	572	2,176	.	.	.
FDI outflow (assets), EUR mn	-119	36	-39	-131	42	1,706	.	.	.
Gross reserves of NB excl. gold, EUR mn	10,660	11,195	11,236	12,908	12,021	12,335	.	.	.
Gross external debt, EUR mn	46,527	45,901	44,861	45,631	45,956	45,957	.	.	.
Gross external debt, % of GDP	103.3	102.6	102.1	104.7	105.4	106.1	.	.	.
Average exchange rate HRK/EUR	7.2862	7.4342	7.5173	7.5735	7.57	7.62	7.63	7.64	7.64
Purchasing power parity HRK/EUR	5.1340	5.0537	4.9167	4.9168	.	.	.	.	.

1) Preliminary. - 2) According to census April 2011. - 3) According to ESA'10. - 4) Enterprises with 20 and more employees. - 5) Half-year data and forecast according to census April 2011. - 6) Domestic output prices. From 2011 total output prices. - 7) Discount rate of NB.

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

CROATIA: Recession continues

HERMINE VIDOVIC

Croatia remains bogged down in recession for the sixth consecutive year. Fiscal consolidation and the overly indebted enterprise sector are the key obstacles to growth. Household consumption remains depressed owing to high and persistent unemployment and continuing deleveraging. Economic recovery will depend primarily on external demand, a revival of private sector investment and increased absorption of EU funds.

Croatia's economy has remained in recession for the sixth consecutive year, with GDP down by 0.6% in the first half of 2014. Both household consumption and gross fixed capital formation continued to decline; government consumption, after showing an upward trend in 2013, fell again in the first half of this year. Only foreign demand contributed positively to GDP growth. The continued drop in investment has affected construction in particular, recording a decline for the sixth year in a row. After five years of contraction, industrial production stagnated in the first seven months of 2014, while manufacturing reported a modest 2% increase. Within manufacturing, above-average output growth was registered among others for the production of leather, wearing apparel, pharmaceuticals and rubber and plastic products, while the production of shipbuilding continued to shrink. Labour productivity continued to increase due to further layoffs. In mid-September the Croatian government eventually adopted a draft industrial strategy for 2014-2020 which had been announced at the beginning of the year. The document envisages a very ambitious programme: average annual industrial growth of 2.85% and the creation of 85,000 new jobs. Strategic industries identified are: generic pharmaceutical products, finished metal products, computers, electronic and optical products, electrical equipment, machines and devices, computer programming, consulting, food, and furniture.

The labour market situation has remained tight in 2014. Employment has been on the decline since 2009 and contracted, according to Pension Insurance data, by another 2.5% in the first half of the year. With the exception of accommodation, real estate and education, all sectors were affected by employment losses, mostly so manufacturing, trade, public administration, defence and social insurance. In August registered unemployment stood at 17.5%. Labour Force Survey data are not comparable with previous years: Starting from 2014 the LFS has been adjusted to the 2011 census, while previous data were based on the 2001 census. The adjustment resulted in a significant increase in the number of both employed and unemployed persons and a remarkable decline of the inactive population. Consequently employment and activity rates were revised upwards, while the unemployment rate remained almost unchanged. Both real gross and net wages have been on the decline since 2009/2010 and producer prices are on a deflationary path. Consumer price inflation is close to zero, mainly as a result of lower food and energy prices and particularly due to the low domestic demand.

Since Croatia's EU accession in July 2013, trade data have been subject to several revisions following the adoption of the Eurostat methodology in data compilation.[47] Hence, information on external trade has to be treated with caution as data, especially those on imports, are not comparable with previously reported figures. Based on current account statistics, the revised data indicate an increase in both goods exports and imports measured in euro terms, by 13% and 4% respectively, in the first half of 2014. As a result the trade deficit declined compared with the same period in 2013. Deliveries expanded both to EU and CEFTA countries, by 19% and 11% respectively. Detailed data show that the growth in exports was driven mainly by commodity groups such as paper, wearing apparel, textiles, rubber, chemicals and furniture, while exports of ships shrank by 60% and those of pharmaceutical products by 15%. Services trade, by contrast, reported a contraction in both exports and imports with the trade surplus remaining almost unchanged year-on-year. Differences compared to a year earlier were also recorded for the income balance, reporting a higher deficit, and the balance of transfers, showing a lower surplus. As a result the current account deficit has widened by about EUR 200 million as against the first half of 2013. With regard to FDI, both inflows and outflows were exceptionally high in the first half of 2014, suggesting that the large transactions were actually round-tripping *(*a Croatian company sending FDI funds to its subsidiary abroad and then channelling it back*).*

In January 2014 the European Council opened an excessive deficit procedure against Croatia. The Convergence Programme submitted by the Croatian government in April envisages the gradual reduction of the general government deficit to below 3% of GDP by 2016 – the deadline for the correction of the deficit. Fiscal policy implementation will be monitored not only by the European Commission but also by the newly established Fiscal Policy Commission (Fiscal Council). In order to reduce the deficit, the government approved a budget revision in April (including cuts of expenditures for investment projects and subsidies and a rise in revenues, e.g. by increasing health care contributions, withdrawals of profits from state-owned companies and energy excises) and announced that a further budget revision will become necessary during autumn. Only recently the government has announced changes in the tax system as of December 2014: the level of non-taxable income should be raised from HRK 2200 to HRK 2600, while the threshold for the highest income tax rate of 40% is announced to rise from currently HRK 8,800 to HRK 13,200 (gross). A tax on savings interest at a rate of 12% will be launched starting from 2015, while the introduction of a property tax is planned to become effective from 2016.

It is assumed that the government might launch a new Eurobond issue of at least EUR 1 billion by the end of 2014 to secure the pre-financing of the budget for the beginning of 2015 when a EUR 750 million Eurobond falls due.

At the end of June 2014 the ratio of non-performing loans to total loans was 16.6% (up from 15.7% in December). Out of the loans provided to the corporate sector, 29.6% were categorised as non-performing; the ratio of non-performing loans in total household loans was 11.6%. During the first seven months of 2014 bank lending fell both to the non-financial corporate sector and to private households, in the latter case reflecting the long-lasting deleveraging process but also the tight labour market situation.

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[47] Since the EU accession data on foreign trade in goods are acquired from two different sources: Intrastat for the trade in goods between EU Member States and the Single Administrative Document for trade in goods with non-EU countries (Extrastat).

Based on the results for the first half of the year, wiiw has revised its GDP growth forecast downwards from minus 0.5% to minus 0.8% for the whole year 2014. The revision became necessary due to lower than expected investment activities of the corporate sector in particular, but also as a consequence of fiscal consolidation measures. Given a continuation of the latter and lower growth in the EU, wiiw expects the GDP to stagnate in 2015, while a modest economic recovery in 2016 will primarily depend on a revival of external demand and private sector investment and increased absorption of EU funds. Downside risks remain high: household consumption will remain subdued because of high and persistent unemployment and private sector deleveraging may last longer than currently projected.

Table 9 / Czech Republic: Selected Economic Indicators

	2010	2011	2012	2013 [1]	2013	2014	2014	2015	2016
					January-June			Forecast	
Population, th pers., average [2]	10,474	10,496	10,511	10,514	10,512	10,519	10,550	10,580	10,610
Gross domestic product, CZK bn, nom. [3]	3,954	4,022	4,048	4,086	1,962	2,062	4,230	4,390	4,550
annual change in % (real) [3]	2.3	2.0	-0.8	-0.7	-2.0	2.5	2.5	2.4	2.6
GDP/capita (EUR at exchange rate)	14,900	15,600	15,300	15,000	.	.	.	.	.
GDP/capita (EUR at PPP)	20,600	21,400	21,800	22,100	.	.	.	.	.
Consumption of households, CZK bn, nom. [3]	1,920	1,957	1,970	1,999	968	981	.	.	.
annual change in % (real) [3]	1.0	0.3	-1.8	0.4	-0.6	1.1	1.5	2.0	2.0
Gross fixed capital form., CZK bn, nom. [3]	1,066	1,069	1,055	1,019	471	496	.	.	.
annual change in % (real) [3]	1.3	1.1	-2.9	-4.4	-7.5	4.2	5.0	4.0	4.0
Gross industrial production									
annual change in % (real)	8.6	5.9	-0.9	0.0	-4.3	6.4	5.0	5.0	5.0
Gross agricultural production									
annual change in % (real)	-7.0	8.6	-5.8	6.4	.	.	.	.	.
Construction industry									
annual change in % (real)	-7.4	-3.6	-7.7	-6.6	-11.6	5.7	.	.	.
Employed persons, LFS, th, average [4]	4,885	4,904	4,890	4,937	4,919	4,943	4,960	4,970	4,980
annual change in %	-1.0	0.4	0.4	1.0	1.2	0.5	0.5	0.2	0.2
Unemployed persons, LFS, th, average [4]	384	354	367	369	375	338	.	.	.
Unemployment rate, LFS, in %, average [4]	7.3	6.7	7.0	7.0	7.1	6.4	6.4	6.3	6.3
Reg. unemployment rate, in %, end of period [5]	9.6	8.6	9.4	8.2	7.3	7.4	7.6	7.5	7.2
Average monthly gross wages, CZK	23,864	24,455	25,067	25,078	24,467	25,159	.	.	.
annual change in % (real, gross)	0.7	0.6	-0.8	-1.3	0.4	2.8	2.0	2.0	1.5
Consumer prices (HICP), % p.a.	1.2	2.2	3.5	1.4	1.6	0.3	0.5	1.8	1.5
Producer prices in industry, % p.a.	0.1	3.7	2.3	0.7	0.5	1.2	1.2	1.5	1.5
General governm. budget, EU-def., % of GDP									
Revenues	37.5	38.0	38.3	38.9	.	.	.	.	.
Expenditures	41.9	41.0	42.3	40.3	.	.	.	.	.
Net lending (+) / net borrowing (-)	-4.5	-3.0	-4.0	-1.4	.	.	-1.4	-1.4	-1.4
Public debt, EU-def., % of GDP	36.8	39.4	43.9	43.8	.	.	42.8	42.8	42.8
Central bank policy rate, % p.a., end of period [6]	0.75	0.75	0.05	0.05	0.05	0.05	0.25	0.50	0.8
Current account, EUR mn	-5,894	-4,247	-2,040	-2,150	-153	1,392	-800	-2,000	-2,800
Current account, % of GDP	-3.8	-2.6	-1.3	-1.4	-0.2	1.9	-0.5	-1.2	-1.6
Exports of goods, BOP, EUR mn	86,083	97,972	103,252	102,103	50,536	57,032	111,000	117,000	122,000
annual change in %	21.3	13.8	5.4	-1.1	-3.7	12.9	9.0	5.0	4.0
Imports of goods, BOP, EUR mn	83,991	94,298	97,342	94,849	46,065	51,830	103,000	108,000	112,000
annual change in %	24.1	12.3	3.2	-2.6	-5.5	12.5	9.0	5.0	4.0
Exports of services, BOP, EUR mn	15,812	16,646	17,726	16,869	8,188	8,450	17,000	18,000	18,000
annual change in %	13.6	5.3	6.5	-4.8	-2.0	3.2	1.0	3.0	2.0
Imports of services, BOP, EUR mn	12,839	14,262	15,249	14,829	7,088	7,347	15,000	15,000	15,000
annual change in %	15.4	11.1	6.9	-2.8	0.5	3.7	1.0	3.0	2.0
FDI inflow (liabilities), EUR mn	4,644	1,632	6,211	3,783	3,028	2,050	6,000	.	.
FDI outflow (assets), EUR mn	882	-231	1,394	2,491	1,616	-1,160	1,300	.	.
Gross reserves of NB excl. gold, EUR mn	31,357	30,675	33,550	40,459	33,028	42,880	.	.	.
Gross external debt, EUR mn	70,498	72,770	77,664	80,764	78,691	82,401	.	.	.
Gross external debt, % of GDP	45.1	44.5	48.3	51.3	49.5	53.5	.	.	.
Average exchange rate CZK/EUR	25.28	24.59	25.15	25.98	25.70	27.44	27.50	26.75	26.00
Purchasing power parity CZK/EUR	18.30	17.90	17.71	17.98	.	.	.	.	.

1) Preliminary. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) From 2012 according to census March 2011. - 5) From 2013 available job applicants 15-64 in % of working age population 15-64, available job applicants in % of labour force before. - 6) Two-week repo rate.

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

THE CZECH REPUBLIC: The second dip about to be left behind

LEON PODKAMINER

The Czech economy is finally recovering from the effects of fiscal consolidation. Given the relatively low levels of debt burdening both the government and the private sector (corporate as well as household debts) coupled with growth-friendly monetary and fiscal policies, recovery over the biennium 2014-2015 seems assured. Acceleration of growth, however, may only be gradual as fixed investment is unlikely to expand at a markedly high rate. Doubts have recently arisen about the country's foreign trade performance in the years to come.

GDP grew by 2.7%, year-on-year, in the second quarter of 2014. The moderate recovery which started in the last quarter of 2013 has still left the quarterly GDP short of its levels registered in 2008, prior to the outbreak of the global crisis. Growth in consumption (both private and public) turned out to be slightly faster than generally expected (about 1.9% and 2.3% respectively). Gross fixed capital formation rose by 6.9%, also much stronger than expected. However, the current volume of GFCF is still about 15% below the level recorded in early 2008. Inventories, which had decreased strongly in the first quarter of 2014 (as also throughout much of 2013), showed a considerable increase in the second quarter. The contribution of rising inventories to GDP growth equals, approximately, 0.9 percentage points. In the second quarter of 2014 foreign trade (in goods and services) stopped contributing to GDP growth positively. The volume of exports rose by 8.9% while that of imports by 11.3%: the overall contribution of foreign trade to GDP growth was minus 1.2 percentage points, unexpectedly negative.

The changing orientation of the fiscal policy seems to be playing an important role in the strengthening of consumption growth – and partly also of fixed capital formation. After four years of fiscal consolidation (2010-2013) the public sector deficit/GDP ratio had been suppressed from 5.8% to about 1.5%. The deficit ratio is expected to stay at that level, although it is likely to rebound to close to 2% in 2014-2015 if GDP growth turns out to be weak (thus resulting in lower tax revenue). Public consumption is to rise by about 2% in 2014. The wage bill for the public administration sector is to be increased in 2015.[48] Most importantly, government spending on gross fixed capital formation has been planned to jump by close to 30% (after still contracting, by 12%, in 2013). Higher public investment spending is complementing investment spending financed out of the unutilised means still available under the EU programmes for 2007-2013. The fiscal relaxation underway – while clearly supporting GDP growth – is nonetheless

[48] In addition, the official minimum monthly wage is to rise in 2015 from an equivalent of approximately 310 to 334 euro.

expected to further suppress the public debt/GDP ratio in 2014 (to less than 45%, from 46% estimated for 2013).[49]

The extremely relaxed monetary policy, which probably prevented the consolidation-driven recession from assuming devastating dimensions in 2012-2013, is unlikely to be changed in the near future. The very low policy interest rate (two-week repo rate) of 0.05%, in force since early November 2012, has not induced any inflationary tendency. Actually, the consumer price index is quite close to zero now. Also, low policy interest rates have had little impact on commercial lending rates. Average interest rates on loans to the private domestic sector have remained close to 6% for household loans and over 3% for loans to corporate clients. The volume of lending to the domestic private non-financial sector has been contracting and the volume of lending to the household sector has been rising very slowly (primarily on account of housing loans). At the same time the corporate sector's deposits increase quite strongly (with the household sector's deposits also rising, but at a slower pace). The shares of non-performing loans are low and falling (or at worst stable) at 7.4% and 5.2% for the corporate and household sectors respectively. The loans/deposits ratios (65% for the household sector, 117% for the non-financial corporate sector) are much lower than elsewhere (and in the euro area in particular). The commercial banks seem quite resilient to unfavourable shocks – not only on account of their clients' borrowing and depositing habits, but also due to the banks' high capital adequacy and the relatively low shares of their domestic assets denominated in foreign currencies. All in all, the private sector's saving propensities remain high, which could be a rational attitude given the deflationary risks and fresh memories of the recent recession.

Raising the policy interest rates would make no sense in the current circumstances. Raising that rate carries the risk of provoking a still further strengthening of the commercial rates and could only strengthen the deflationary tendency – while certainly exerting a negative impact on lending to the private sector (and on its spending).

Most importantly, higher interest rates could be rather incompatible with the strategy of keeping – through foreign exchange interventions – the CZK/EUR exchange rate over 27. The strategy of targeting a 'competitive' exchange rate level (while at the same time formally sticking to inflation targeting) has so far proven to be a success.[50] Although the strategy has not visibly accelerated the return of inflation to the desirable level (which is the 'official' justification of the strategy) it may have been beneficial with respect to foreign trade developments (and in particular for the restriction of price-competitive imports) recorded in the fourth quarter of 2013 and the first quarter of 2014.

The most recent trade developments may suggest that the impact of the enforced devaluation of the Czech koruna could be fairly limited and transient yet. As already mentioned, the real growth rates of exports and imports for the second quarter 2014 are not looking all that good. Also in nominal terms growth of exports has now been outpaced by growth of imports. Consequently, while the trade balance rose to CZK 83.4 billion in the first quarter of 2014 (from 57.2 billion in the same period of 2013), in the

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49 According to the Finance Ministry, the fiscal effort (the increase in GDP shares of the general government *structural* balance) is to become negative (-1 percentage point) – meaning actual relaxation of the fiscal policy. (During the fiscal consolidation period 2010-2013 the fiscal effort was positive, averaging 1.1 pp per year.)

50 The strategy was inaugurated in early November 2013. So far it has 'cost' the National Bank some EUR 7.5 billion, initially placed on the foreign exchange market. No further interventions have followed: the participants of the foreign exchange markets do not seem to doubt the CNB resolve to keep the CZK/EUR rate above 27.

second quarter it has risen much less impressively, to CZK 77.2 billion from 69 billion respectively. It may be added that the relative deterioration in trade balances is due primarily to the greatly diminished surplus of trade in services.[51]

While the decision to start targeting a weaker exchange rate has had positive effects so far (i.e. possibly preventing a more discomforting performance in foreign trade) it may be too early to pass a definitive judgement on that decision's longer-term consequences. In any case the expectations, nurtured until quite recently, concerning the positive role to be played by foreign trade may need to be qualified. The reliance of the relatively unsophisticated export sector on 'competitive' labour costs may make it difficult for the Czech economy to combine fast growth in domestic demand with excellent performance in foreign trade. In any case, the continuing weakness of the euro area and the Ukraine-related turmoil does not make the situation any easier.

When all is said and done, the verdict on the near-term prospects of the Czech economy is positive. The economy is finally recovering after the period of disrupting fiscal consolidation. Given the relatively low levels of debt burdening, the government and the private sector (both corporate and households) and growth-friendly monetary and fiscal policies, the recovery in 2014-2015 seems assured. But the growth speed-up can be gradual as fixed investment (especially in housing) is unlikely to expand further at the very high rate observed most recently. It will take more time before investment enters a path of fast and sustained growth. Moreover there are doubts now – hopefully transient – about the performance of foreign trade in the coming years.

[51] The trade balances referred to above are in current (domestic) prices. Given the fact that the CZK/euro rates in the first two quarters of 2014 are close to 7% higher than in the same quarters of 2013, the growth rates of the trade surpluses are correspondingly lower when measured in the current euro.

Table 10 / Estonia: Selected Economic Indicators

	2010	2011	2012	2013 1)	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., average 2)	1,331	1,327	1,323	1,318	.	.	1,310	1,305	1,300
Gross domestic product, EUR mn, nom. 3)	14,708	16,404	17,637	18,739	9,084	9,450	19,100	19,800	20,800
annual change in % (real) 3)	2.5	8.3	4.7	1.6	2.3	1.4	1.7	2.0	2.9
GDP/capita (EUR at exchange rate)	11,000	12,400	13,300	14,200	.	.	.	.	.
GDP/capita (EUR at PPP)	16,100	17,700	18,700	19,600	.	.	.	.	.
Consumption of households, EUR mn, nom. 3)	7,482	8,054	8,759	9,373	4,638	4,862	.	.	.
annual change in % (real) 3)	-1.6	2.3	5.1	3.8	4.6	3.6	3.2	3.1	3.0
Gross fixed capital form., EUR mn, nom. 3)	3,125	4,226	4,759	5,118	2,187	2,319	.	.	.
annual change in % (real) 3)	-2.6	33.0	10.4	2.5	1.5	4.9	2.0	3.0	5.0
Gross industrial production									
annual change in % (real)	23.6	19.9	1.0	2.9	3.3	-0.2	0.3	2.0	3.0
Gross agricultural production									
annual change in % (real)	-4.0	9.7	5.6	2.8	.	.	.	.	.
Construction industry									
annual change in % (real)	-8.5	27.3	16.5	0.8	0.9	-3.8	.	.	.
Employed persons, LFS, th, average 4)	570.9	609.1	614.9	621.3	621.1	615.1	615	610	605
annual change in %	-4.2	6.7	1.9	1.0	1.9	-1.0	-1.0	-0.8	-0.8
Unemployed persons, LFS, th, average 4)	115.9	86.8	68.5	58.7	61.3	51.6	50	46	42
Unemployment rate, LFS, in %, average 4)	16.9	12.5	10.0	8.6	9.0	7.7	7.5	7.0	6.5
Reg. unemployment rate, in %, end of period	10.2	7.4	6.2	5.3	5.6	4.4	.	.	.
Average monthly gross wages, EUR	792	839	887	949	938	994	.	.	.
annual change in % (real, gross)	-1.8	0.9	1.7	4.0	3.8	5.7	.	.	.
Average monthly net wages, EUR	637	672	706	757	750	790	.	.	.
annual change in % (real, net)	-2.9	0.5	1.1	4.9	4.0	5.1	.	.	.
Consumer prices (HICP), % p.a.	2.7	5.1	4.2	3.2	3.8	0.9	0.4	1.5	2.2
Producer prices in industry, % p.a.	3.2	4.2	2.6	7.3	7.8	-3.2	.	.	.
General governm. budget, EU-def., % of GDP									
Revenues	39.7	38.2	38.7	37.5	.	.	37.2	37.2	37.2
Expenditures	39.5	37.1	39.0	37.7	.	.	37.7	37.7	37.3
Net lending (+) / net borrowing (-)	0.2	1.1	-0.2	-0.2	.	.	-0.5	-0.5	-0.1
Public debt, EU-def., % of GDP	6.5	6.0	9.7	9.8	.	.	10.1	9.9	9.5
Central bank policy rate, % p.a., end of period 5)	0.92	1.00	0.75	0.25	0.50	0.15	.	.	.
Current account, EUR mn 6)	265	-6	-364	-261	-110	-122	-300	-400	-600
Current account, % of GDP	1.8	0.0	-2.1	-1.4	-1.2	-1.3	-1.6	-2.0	-2.9
Exports of goods, BOP, EUR mn 6)	7,482	10,228	11,340	11,460	5,785	5,681	11,500	12,500	13,200
annual change in %	41.3	36.7	10.9	1.1	6.5	-1.8	0.0	9.0	6.0
Imports of goods, BOP, EUR mn 6)	7,887	10,839	12,414	12,466	6,253	6,142	12,500	13,700	14,800
annual change in %	31.0	37.4	14.5	0.4	5.2	-1.8	0.0	10.0	8.0
Exports of services, BOP, EUR mn 6)	3,567	4,083	4,461	4,746	2,236	2,398	4,900	5,120	5,500
annual change in %	7.9	14.4	9.3	6.4	5.0	7.3	3.0	4.0	7.0
Imports of services, BOP, EUR mn 6)	2,226	2,746	3,137	3,520	1,660	1,744	3,700	4,100	4,500
annual change in %	18.5	23.4	14.2	12.2	14.2	5.0	5.0	11.0	10.0
FDI inflow (liabilities), EUR mn 6)	1,587	941	1,293	674	591	520	700	.	.
FDI outflow (assets), EUR mn 6)	437	-900	1,005	508	411	268	400	.	.
Gross reserves of NB excl. gold, EUR mn 7)	1,904	150	218	222	196	309	.	.	.
Gross external debt, EUR mn 6)	16,492	16,721	17,966	17,540	17,738	18,948	.	.	.
Gross external debt, % of GDP	112.1	101.9	101.9	93.6	94.7	99.2	.	.	.
Purchasing power parity EUR/EUR	0.6871	0.6967	0.7136	0.7398	.	.	.	.	.

1) Preliminary. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) From 2012 according to census March 2011. - 5) From 2011 official refinancing operation rates for euro area (ECB), TALIBOR one-month interbank offered rate before (Estonia had a currency board). - 6) BOP 6th edition. - 7) From January 2011 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.

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

ESTONIA: Will the tide come in again?

SEBASTIAN LEITNER

In Estonia the prospects facing exporters are slim where the neighbouring countries to the east and the north are concerned. Household consumption provides life support to GDP growth estimated at 1.7% for 2014, while the current account deficit remains low at 1.6% of GDP. The government's hesitant expenditure policy will result in a budget close to balance.

In the first half of 2014 exports kept on falling. Not only trade with Russia remained low, due to the sluggish economic activity in the neighbouring country, but also exports to Finland. The latter country, being Estonia's second most important trading partner, has been in recession since 2012 and is expected to escape the crisis only in the course of 2015. The austerity policy of the government in Finland – a country that is also hit hard by the Russian sanctions – lowers the export chances of Estonian producers. Meanwhile exports to Sweden, Estonia's most important trading partner, started to grow again in the second quarter of this year. The Swedish GDP is still expected to rise by 1.7% in 2014 and gain momentum in the coming year. The incoming left-wing coalition government in Sweden is likely to raise public investment in 2015. Overall we expect Estonian export dynamics to remain negative in the second half of the year. The Russian economic sanctions will particularly hit the dairy sector (24% of total exports of this industry were directed to Russia in 2013) and, to a smaller extent, meat and fish producers. However, also the transport and wholesale sectors will be affected negatively by lower direct exports and transit trade. In addition, demand from the euro area countries remains sluggish.

Although consumer demand continues to grow swiftly, imports of goods and services are on the decline. The main reason for this is the restraint of producers to invest. Although the capacity utilisation rate has increased to almost 75% recently, the prospects of exporting firms are, as already mentioned, further deteriorating. Likewise, the public sector remains reluctant to invest and will remain so during 2015. The only sector increasing its investment outlays is for the time being the household sector. Households started to increase their loan burden in order to invest in real estate.

While overall growth in economic activity slowed down the unemployment rate kept on falling and will continue to do so throughout 2014 and in the coming two years alike. The working-age population is expected to fall by about 3% within the next five years, equivalent to 30 thousand persons. The negative migration balance adds to the natural decrease of the population. This will aggravate particularly the scarcity of the highly skilled labour force. Nevertheless, participation rates of both men and women could still be increased. Another effect of the shrinking working-age population is the ongoing rise in wage levels. In the first half of 2014 monthly wages increased by 5.7% in real terms on average and particularly strongly in the private and public service sectors.

At the same time consumer price inflation has turned negative in the most recent months. The Russian sanctions on meat, fruits and dairy products will lead to higher competition and thus also price levels are to fall further for food and beverages this year and throughout 2015.

Low consumer inflation and strongly rising incomes keep households in a good spending mood. Retail figures show an upswing in the acquisition of consumer durables that are also financed by consumer credits. Although we expect the increase in gross wages to abate slightly in the coming months, household consumption will remain the main driver of Estonia's economic growth up to 2016.

In September the government agreed upon a draft budget for 2015 foreseeing a structural surplus of 0.6% of GDP. The flat income tax rate is planned to be reduced by 1 percentage point to 20% from January next year onwards, while the unemployment insurance contribution will decline from 3% to 2.4%. On the expenditure side, above-average increases are foreseen for the ministries of defence (whose budget exceeds 2% of GDP) and internal affairs, while the budget proposal includes a doubling of the monthly child benefits and an increase in minimum pensions by 6% nominally to EUR 374 per month.

The next parliamentary elections are scheduled for March 2015. According to the latest polls the ruling centre-right Reform Party and its coalition partner, the Social Democrats, are running head to head; the Centre Party has been in opposition in the past three years. However, a change in government will not lead to significant modifications of the economic and fiscal policies conducted.

More lively household consumption and lower import activity than expected result in an upward revision of the GDP forecast for 2014 to 1.7%. In the coming two years, the government of Estonia –the country with the highest per capita allocations from EU funds in the period 2014-2020 – will be eager to use the resources as soon as possible for public infrastructure. Thus public investment activity is expected to rise already towards the end of 2015 and particularly in 2016. In both years however, household consumption will still remain the most important driver of economic activity. For 2015 we expect GDP to grow by 2% and in 2016 by 2.9%.

HUNGARY: Formidable take-off with limited expiration date

SÁNDOR RICHTER

Economic growth in Hungary accelerated still more in the second quarter of 2014, driven by a robust take-off in investment and an increase in household consumption for the first time in many years. However, the looming scarcity of EU-financed projects, the prevailing legal uncertainties and an ailing financial system may well render the current boom unsustainable.

With economic growth further accelerating in the second quarter of 2014, Hungary's GDP expanded by 3.8% in the first half of the year. The take-off spread to nearly each sector of the economy, even if the rate of expansion varied substantially. Construction increased by over 20%, industry over 9%, and despite the high basis due to the good harvest in the previous year, the expansion was considerable in agriculture as well. Growth has been substantially weaker in services, the largest sector of the economy. Within services, real estate and financial and insurance services continued to decline.

On the demand side of the GDP, the biggest item, household consumption, increased by 2%, but the really positive news has been the robust, 17% take-off in gross fixed capital formation. A decomposition of GDP growth displays the positive contributions of consumption and gross capital formation in the proportion 1:3. Accelerating consumption and especially investment have taken their toll in the foreign trade flows (as registered in the national account statistics). For the first time in years net export had only a marginal positive contribution to GDP growth.

The accelerating economic growth is partly explained by one-off factors. 2014, the last but one year for payments out of the 2007-2014 Multiannual Financial Framework of the EU, brought a real bonanza in EU co-financed investments. In the first half of the year the forint equivalent of EUR 3 billion was paid from this pot, and approximately as much will still be paid until the end of this year. That means that EU resources, primarily for investment, will amount to 5% to 6% of the GDP, about twice as much as the average in the period 2007-2013. That is a huge invigorating injection into domestic demand. 2014 has also been a year of three elections: parliamentary elections, those for the European Parliament, and municipal ones. The election campaign-related acceleration of long neglected projects explains the boom in several spectacular public investment projects (in nearly all cases EU-co-financed), implemented both by the central and by the local governments.

The National Bank's preferential credit line opened for SMEs also made a positive contribution to the upturn of investments. Still, the lending activity of the financial sector is further on fairly restrained, and without the preferential credit line the figures would be even worse. Deleveraging has been continuing, and the credit/deposit ratio may soon reach 100%.

Table 11 / Hungary: Selected Economic Indicators

	2010	2011	2012	2013 1)	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., average 2)	10,000	9,948	9,920	9,894	.	.	9,850	9,830	9,810
Gross domestic product, HUF bn, nom. 3)	26,946	28,035	28,549	29,846	13,661	14,506	31,400	32,900	34,400
annual change in % (real) 3)	0.8	1.8	-1.5	1.5	-0.2	3.8	3.0	2.2	2.0
GDP/capita (EUR at exchange rate)	9,800	10,100	9,900	10,200	.	.	.	.	.
GDP/capita (EUR at PPP)	16,400	17,100	17,300	17,800	.	.	.	.	.
Consumption of households, HUF bn, nom. 3)	13,679	14,292	14,880	15,254	7,339	7,533	.	.	.
annual change in % (real) 3)	-2.8	0.8	-2.0	0.1	-0.3	2.0	2.3	1.8	1.3
Gross fixed capital form., HUF bn, nom. 3)	5,492	5,552	5,458	5,949	2,082	2,450	.	.	.
annual change in % (real) 3)	-9.5	-2.2	-4.2	5.2	0.7	16.8	10.0	6.0	5.0
Gross industrial production									
annual change in % (real)	10.5	5.6	-1.8	1.1	-1.7	9.4	7.5	6.0	6.0
Gross agricultural production									
annual change in % (real)	-11.1	11.1	-9.8	12.4	.	.	.	.	.
Construction industry									
annual change in % (real)	-10.4	-8.0	-6.7	8.5	6.0	22.8	14.0	8.0	7.0
Employed persons, LFS, th, average	3,781	3,812	3,878	3,938	3,875	4,100	3,980	4,020	4,060
annual change in %	0.0	0.8	1.7	1.6	1.1	5.8	1.0	1.0	1.0
Unemployed persons, LFS, th, average	475	468	476	449	479	364	.	.	.
Unemployment rate, LFS, in %, average	11.2	10.9	10.9	10.2	11.1	8.2	8.5	8.3	8.0
Reg. unemployment rate, in %, end of period	13.3	12.4	12.8	9.3	11.2	10.0	.	.	.
Average monthly gross wages, HUF 4)	202,525	213,094	223,060	230,664	228,063	235,040	.	.	.
annual change in % (real, gross)	-3.4	1.3	-0.9	1.7	1.1	3.2	.	.	.
Average monthly net wages, HUF 4)	132,604	141,151	144,085	151,085	149,381	153,951	.	.	.
annual change in % (real, net)	1.8	2.4	-3.4	3.1	2.4	3.2	.	.	.
Consumer prices (HICP), % p.a.	4.7	3.9	5.7	1.7	2.3	0.2	0.3	2.0	3.0
Producer prices in industry, % p.a.	4.0	4.1	4.1	0.6	0.2	-0.8	.	.	.
General governm.budget, EU-def., % of GDP									
Revenues	44.8	53.5	45.8	46.4	.	.	.	.	.
Expenditures	49.2	49.3	47.9	48.7	.	.	.	.	.
Net lending (+) / net borrowing (-) 5)	-4.3	4.2	-2.1	-2.3	.	.	-3.0	-3.0	-3.0
Public debt, EU-def., % of GDP	80.8	81.0	78.4	77.3	.	.	78.0	77.5	77.0
Central bank policy rate, % p.a., end of period 6)	5.75	7.00	5.75	3.00	4.3	2.3	.	.	.
Current account, EUR mn 7)	274	754	1,873	4,162	1,681	1,876	3,600	3,300	3,100
Current account, % of GDP	0.3	0.8	1.9	4.1	3.6	4.0	3.6	3.2	2.8
Exports of goods, BOP, EUR mn 7)	66,130	71,793	70,299	72,409	35,562	37,600	76,200	81,400	87,100
annual change in %	16.4	8.6	-2.1	3.0	1.2	5.7	5.3	6.8	7.0
Imports of goods, BOP, EUR mn 7)	63,514	68,868	67,261	68,822	33,884	36,051	73,000	78,100	83,200
annual change in %	17.2	8.4	-2.3	2.3	1.0	6.4	6.1	7.0	6.5
Exports of services, BOP, EUR mn 7)	14,650	16,039	16,125	16,788	8,008	8,176	17,600	18,700	19,600
annual change in %	10.1	9.5	0.5	4.1	4.8	2.1	5.0	6.0	5.0
Imports of services, BOP, EUR mn 7)	12,005	12,752	12,327	12,751	6,052	6,149	13,100	13,600	14,000
annual change in %	-1.0	6.2	-3.3	3.4	3.8	1.6	3.0	4.0	3.0
FDI inflow (liabilities), EUR mn 7)	1,358	4,429	4,366	4,063	2,219	219	.	.	.
FDI outflow (assets), EUR mn 7)	597	3,458	2,345	3,689	2,688	1,542	.	.	.
Gross reserves of NB, excl. gold, EUR mn	33,667	37,242	33,783	33,696	34,238	35,985	.	.	.
Gross external debt, EUR mn 7)	140,558	135,351	127,230	119,148	126,693	121,294	.	.	.
Gross external debt, % of GDP	143.7	134.9	128.9	118.5	125.7	118.6	.	.	.
Average exchange rate HUF/EUR	275.48	279.37	289.25	296.87	296	307	315	315	315
Purchasing power parity HUF/EUR	164.54	164.39	166.35	171.01	.	.	.	.	.

1) Preliminary. - 2) From 2011 according to census October 2011. - 3) Annual data based on ESA 2010, quarterly data still on ESA 1995. - 4) Enterprises with 5 and more employees. - 5) In 2011 including one-off effects. Without those effects general government budget balance is estimated to have attained -4.6% of GDP (Source: Portfolio.hu). - 6) Base rate (two-week NB bill). - 7) BOP 6th edition.

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

The Hungarian financial sector has remained in poor shape, with gigantic losses foreseen for this and the next year. In the framework of a 'compensation for unfair contractual terms' banks will have to refund clients (a) for too large exchange rate bid-ask spreads calculated in foreign exchange credit transactions and (b) for unilateral contract modifications (typically higher interest rates charged without the client's consent). Total costs of the reparation to be paid by the banks may amount to HUF 900 billion, 3% of the GDP according to the estimation of the central bank. The government also announced that foreign exchange credits will have to be converted to HUF credits next year, but here the details are not known yet. That will hit the financial sector hard as well. Of the eight large banks in Hungary with an altogether 80% market share, three (Erste, Raiffeisen, CIB) will need considerable capital injections from their foreign parent banks in order to further on maintain the required capital adequacy ratio. The government makes no secret of its intention to reach a higher share of domestic (private or state) ownership in the financial sector even if this is achieved via the exit of foreign-owned banks. The government's recent purchase of MKB, one of the eight large banks, from the Bayerische Landesbank should be seen as been part of this process.

The expansion of the economy has had a positive impact on the labour market – even if public work schemes and tricks with calculating part of the outward migrants as domestic employment help inflate employment data. The unemployment rate declined to a six-year low, and jobs have been added in the business sector as well. Rocketing public investments have obviously had their secondary positive impact on sub-contractors in the business sector, generating additional employment. Due to the unexpectedly low CPI inflation real wages increased by over 3% in the first six months, more than double the rate in the previous year. The 2% expansion of household consumption reflects both the improved employment situation and the increase in real wages.

The escalating conflict in Hungary's eastern neighbourhood, the already introduced and potential further EU sanctions and counter-sanctions by Russia raise the question of possible effects on the Hungarian economy. The structure of Hungarian exports to and imports from Russia display completely different features. In exports, the share of machinery and transport equipment is 45%, that of manufactured products 44%. Food and beverages make up somewhat less than 10%. In imports, fuels account for 90% while other commodity groups are of limited relative importance.

The strongest impact of the counter-sanctions introduced by Russia may appear in the agricultural sector. Hungary's agricultural exports to Russia are relatively modest, amounting to EUR 266 million in 2013, about 4% of total Hungarian exports of this commodity group. The really sensitive exports are those of meat (pork and poultry) and fruits and vegetables (mainly apples). Losses in the pork sector will be minimal as exports have already been prohibited by Russia earlier, with reference to the pig pest. The fruit and vegetable sector will be the real concern. The main problem is not so much the loss of revenues from exports to Russia, but the indirect impact. Other traditional EU suppliers of Russia (Polish, Baltic and German exporters) will appear with their now superfluous produce as strong competitors to Hungarian fruits and vegetables in Hungary's traditional export markets for this commodity group. Another, even if limited, indirect negative impact on domestic producers may be the imports of cheap grain from Ukraine, due to the loss of Ukraine's export market in Russia.

Another impacted sector may be car manufacturing where Russia may introduce import restrictions. Magyar Suzuki, Audi Hungaria in the first line, but also Opel and Mercedes deliver to the Russian market partly from Hungary. Smaller difficulties have already emerged, and there is a fear that other difficulties may follow if the EU bans exports of automobile components with dual (civil and military) use to Russia. That may hurt a couple of important Hungarian car component producers (e.g. Knorr-Bremse, Rába).

Nevertheless, the really big issue of the Hungarian-Russian economic relations is the reconstruction and enlargement of the nuclear power station Paks. Hungary agreed to raise a credit from Russia in the value of EUR 10 billion to finance this project. The details of the agreement are confidential, but allegedly it ensures that a substantial part of the construction activities will be implemented by Russian firms. This giant project will further increase Hungary's long-term dependence on Russia in the field of electricity generation, beyond the already existing dependence on Russian gas and oil deliveries. It is still an open question how the EU will judge these plans in the current circumstances. A critical point is not only the growing physical, and through the giant credit also financial, dependence on Russia but the non-transparent credit agreement and the related public procurement procedures as well.

How lasting may the current take-off in the Hungarian economy be? The public investment bonanza will fade away in the next and the following year as the EU-related inflows from the 2007-2013 financial framework runs out and those from the 2014-2020 financial framework will still be relatively moderate. The compensation of banks' clients for 'unfair practices', as mentioned above, may create additional purchasing power for the households involved, thus supporting domestic demand. The key issue, however, is the prospective behaviour of domestic and foreign investors in the business sector. In this respect optimism is not really justified. Legal uncertainty, arbitrary changes in taxation, and hardly disguised cronyism in public procurement have all become chronic problems under the Orbán government. Though Hungary was ranked 63rd in the World Economic Forum's ranking of 148 countries by international competitiveness, in areas such as the burden of government regulation, efficiency of the legal framework challenging regulations, and transparency of government policy-making, Hungary's ranking proved to be disastrous: 140th, 138th, and 132nd respectively. These figures do not predict a massive future inflow of foreign direct investment, nor vigorous domestic investment activities. A well-functioning, growth-friendly financial system is not in sight either. Foreign-owned banks struggle for survival, and the government-promoted extension of a half market-based, half politically dominated Hungarian-owned segment is everything but a guarantee for an early consolidation in the financial transmission. For all these reasons, wiiw regards the current acceleration of economic growth as temporary and forecasts a return to lower GDP growth rates (2.2% and 2.0%) in 2015 and 2016.

LATVIA: Economic activity is losing steam

SEBASTIAN LEITNER

The slowdown of external demand in the Baltic region will have a negative impact on the pace of the Latvian economy, whereas the large rises in wages will keep the spending mood alive and well among households. Although the prospects for entrepreneurs are subdued, private investment has revived compared to last year; it will permit the GDP to grow by 2.5% over the current year.

Export developments remained sluggish in the first half of 2014. While external demand of the EU trading partners still increased by almost 5% nominally, trade with Russia declined already considerably before August this year. In the second half of the year the Russian ban on agricultural products will hit dairy and meat production as well as export volumes of fish. The transport and wholesale sectors will also face losses due to reduced direct and transit trade. Overall the value added is expected to be about 0.5% lower due to the current sanctions.

Although the deleveraging process of the households has not yet come to an end, household investment in dwellings has increased and has positively affected construction production, which is on the upswing. Enterprise investments particularly in the manufacturing sector remained lively, while public investments slowed down, except in the railway sector.

The decrease in industrial production is predominantly driven by the losses of Liepajas Metalurgs, the only metallurgical plant in the Baltics. At the beginning of October 2013 the company, which had become insolvent, had to be supported by the government; in spring 2014 production was halted. The company was sold to the Ukrainian metal producer KVV for EUR 107 million. Thus the government will be able to recover all the funds it invested in the enterprise in the past two years. The KVV group intends to invest another EUR 30 million into the metallurgic plant, which in 2012 was still the largest Latvian company in heavy industry, employing close to 2,500 workers. Production is expected to resume at the end of 2014, which should induce a substantial increase in total industrial production.

Consumer prices remained almost stable in the course of the year driven by low prices of imported energy and food. The Russian sanctions will foster competition within the EU, resulting in falling prices of agro-food products.

Table 12 / Latvia: Selected Economic Indicators

	2010	2011	2012	2013 [1]	2013	2014	2014	2015	2016
					January-June			Forecast	
Population, th pers., average [2]	2,098	2,060	2,034	2,013	.	.	2,005	1,995	1,987
Gross domestic product, EUR-LVL mn, nom. [3]	18,166	20,297	22,043	23,222	10,892	11,305	23,900	24,900	26,200
annual change in % (real) [3]	-2.9	5.0	4.8	4.2	3.9	2.5	2.5	2.7	3.0
GDP/capita (EUR at exchange rate)	8,600	9,800	10,900	11,600	.	.	11,900	12,500	13,200
GDP/capita (EUR at PPP)	13,400	15,000	16,300	17,700	.	.	.	.	.
Consumption of households, EUR-LVL mn, nom. [3]	11,421	12,457	13,226	14,092	6,969	7,170	.	.	.
annual change in % (real) [3]	3.3	2.8	2.7	6.1	7.1	2.5	2.8	3.2	3.2
Gross fixed capital form., EUR-LVL mn, nom. [3]	3,469	4,494	5,548	5,401	2,166	2,298	.	.	.
annual change in % (real) [3]	-20.0	24.2	14.5	-5.2	-8.6	5.0	3.0	3.5	4.0
Gross industrial production [4]									
annual change in % (real)	14.9	9.0	6.1	-0.8	-2.0	-1.8	-1.5	5.0	6.0
Gross agricultural production									
annual change in % (real)	-2.4	2.8	17.4	-3.7	.	.	.	.	.
Construction industry									
annual change in % (real)	-23.4	12.5	13.5	8.3	8.8	18.9	.	.	.
Employed persons, LFS, th, average [5]	940.9	970.5	875.6	893.9	884.6	885.4	895	898	900
annual change in %	-4.3	3.1	1.6	2.1	3.2	0.1	0.1	0.3	0.2
Unemployed persons, LFS, th, average [5]	216.1	176.4	155.1	120.4	123.1	112.5	110	100	90
Unemployment rate, LFS, in %, average [5]	18.7	15.4	15.0	11.9	12.2	11.3	10.7	10.0	9.5
Reg. unemployment rate, in %, end of period [5]	14.3	11.5	10.5	9.5	9.6	8.9	.	.	.
Average monthly gross wages, EUR-LVL	633.2	660.2	684.4	715.7	702.0	751.0	.	.	.
annual change in % (real, gross)	-2.4	-0.1	1.4	4.6	4.1	6.4	.	.	.
Average monthly net wages, EUR-LVL	449.6	469.5	488.0	515.4	505.8	550.5	.	.	.
annual change in % (real, net)	-6.5	0.1	1.6	5.6	4.9	8.3	.	.	.
Consumer prices (HICP), % p.a.	-1.2	4.2	2.3	0.0	0.1	0.6	0.6	1.6	2.2
Producer prices in industry, % p.a.	2.4	7.7	4.1	1.7	2.1	0.7	.	.	.
General governm.budget, EU-def., % of GDP									
Revenues	35.3	34.9	35.1	35.3	.	.	34.5	33.9	33.5
Expenditures	43.5	38.4	36.5	36.2	.	.	35.6	35.1	34.7
Net lending (+) / net borrowing (-)	-8.1	-3.5	-1.4	-0.9	.	.	-1.1	-1.2	-1.2
Public debt, EU-def., % of GDP	44.6	42.0	40.9	38.2	.	.	38.8	35.5	33.0
Central bank policy rate, % p.a., end of period [6]	3.50	3.50	2.50	0.25	2.5	0.2	.	.	.
Current account, EUR mn [7]	421	-572	-719	-543	-239	-411	-700	-800	-900
Current account, % of GDP	2.3	-2.8	-3.2	-2.3	-2.2	-3.6	-2.9	-3.2	-3.4
Exports of goods, BOP, EUR mn [7]	6,657	8,300	9,645	9,810	4,660	4,803	10,010	10,450	10,980
annual change in %	32.8	24.7	16.2	1.7	6.7	3.1	2.0	4.4	5.1
Imports of goods, BOP, EUR mn [7]	8,145	10,743	12,208	12,351	5,928	-6,034	12,560	13,260	14,170
annual change in %	24.6	31.9	13.6	1.2	2.7	1.8	1.7	5.6	6.9
Exports of services, BOP, EUR mn [7]	3,050	3,471	3,767	3,900	1,836	1,828	3,900	4,110	4,370
annual change in %	-3.3	13.8	8.5	3.5	2.3	-0.5	0.0	5.4	6.3
Imports of services, BOP, EUR mn [7]	1,749	1,991	2,145	2,127	991	979	2,130	2,240	2,350
annual change in %	1.5	13.8	7.8	-0.8	-1.5	-1.1	0.1	5.2	4.9
FDI inflow (liabilities), EUR mn [7]	286	1,045	863	680	294	82	.	.	.
FDI outflow (assets), EUR mn [7]	14	44	150	310	153	55	.	.	.
Gross reserves of NB excl. gold, EUR mn [8]	5,472	4,666	5,412	5,565	5,551	2,383	.	.	.
Gross external debt, EUR mn [7]	30,119	29,603	30,254	30,501	31,391	32,483	.	.	.
Gross external debt, % of GDP	167.2	146.6	136.2	131.1	135.2	135.9	.	.	.
Average exchange rate EUR-LVL/EUR	1.0084	1.0050	0.9922	0.9981	0.9964	1.0000	1.0000	1.0000	1.0000
Purchasing power parity EUR-LVL/EUR	0.6441	0.6566	0.6629	0.6692	.	.	.	.	.

Note: Latvia has introduced Euro from 1 January 2014. Up to and including 2013 all time series in LVL as well as the exchange rates and PPP rates have been divided for statistical purposes by the conversion factor 0.702804 (LVL per EUR) to achieve euro-fixed series (EUR-LVL).
1) Preliminary. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) Enterprises with 20 and more employees. -
5) From 2012 according to census March 2011. - 6) From 2014 official refinancing operation rate for euro area (ECB), refinancing rate of the National Bank before. - 7) BOP 6th edition. - 8) From January 2014 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

In the parliamentary elections that took place on 4 October 2014 all three ruling coalition parties – ‘Unity’, ‘Union of Farmers and Greens’ and ‘National Alliance’ – won additional seats. Prime Minister Laimdota Straujuma announced to renew the collaboration with her partners. As in the past elections of 2011, the leftist ‘Harmony Centre’, which is supported particularly by the Russian-speaking minority, came in first with 24 of the 100 Saeima seats. Due to its passive position on the Russian aggression in Ukraine the party however lost support in the Latvian-speaking community and thus 7 seats. It will again not be able to find a coalition partner.

Overall employment is stagnating, but increasing in the sectors of construction, transport and health services. A decline in the number of jobs is to be observed in wholesale and retail trade. Although the employment rate is continuing to rise, employment figures will decline in the coming years. The demographic development and the ongoing net outward migration will result in a gradual decrease of the working-age population. Given the skills mismatch on the labour market, the unemployment rate will however decline less swiftly in the coming quarters and fall below 10% during 2015.

An increase in the minimum wage and the shortage of high-skilled labour induced a rise in net wages by more than 8% in real terms in the first half of 2014. Next year household incomes are due to increase further on, given the plan to lift the minimum wage by another 5% and reduce the flat personal income tax rate by 1 percentage point to 23% from January 2015. A further reduction by 1 percentage point is planned for the beginning of 2016.

In spite of incomes increasing more swiftly, the growth rate of household consumption slowed down in the past quarters. Nevertheless, the development of confidence indicators drives expectations that the spending mood of consumers will rise again towards the end of 2014 and next year.

The slowdown of external demand expansion in the Baltic region will cause the Latvian economy to lose steam in 2014 and in the two years ahead, respectively. Thus overall GDP growth will decline to 2.5% this year. In 2015 and 2016 household consumption will remain the most important driver of growth, while exports will recover only gradually. GDP growth will thus remain lower as compared to the more recent period of recovery, at 2.7% next year and 3% in 2016.

Table 13 / Lithuania: Selected Economic Indicators

	2010	2011	2012	2013 [1]	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., average [2]	3,097	3,028	2,988	2,958	.	.	2,928	2,900	2,875
Gross domestic product, LTL mn, nom.	95,676	106,893	113,735	119,575	56,776	59,055	123,500	129,000	135,800
annual change in % (real)	1.6	6.0	3.7	3.3	3.7	3.3	3.0	3.2	3.4
GDP/capita (EUR at exchange rate)	8,900	10,200	11,000	11,700	.	.	.	.	.
GDP/capita (EUR at PPP)	15,100	16,900	18,300	19,500	.	.	.	.	.
Consumption of households, LTL mn, nom.	61,285	66,894	71,709	75,870	36,470	38,424	.	.	.
annual change in % (real)	-3.7	4.8	3.9	4.7	4.1	5.2	4.5	3.8	3.5
Gross fixed capital form., LTL mn, nom.	15,589	19,270	18,934	21,913	9,408	10,523	.	.	.
annual change in % (real)	1.9	20.7	-3.6	12.8	9.3	9.8	9.0	8.0	9.0
Gross industrial production (sales)									
annual change in % (real)	6.4	6.4	3.7	3.4	7.9	-2.3	2.0	6.0	7.0
Gross agricultural production									
annual change in % (real)	-7.2	10.3	14.2	-1.6	.	.	.	.	.
Construction industry									
annual change in % (real)	-7.3	22.1	-7.3	11.5	2.8	23.1	.	.	.
Employed persons, LFS, th, average [3]	1,344	1,371	1,276	1,293	1,282	1,302	1,308	1,320	1,328
annual change in %	-5.1	2.0	1.8	1.3	1.1	1.6	1.2	0.9	0.6
Unemployed persons, LFS, th, average [3]	291	249	197	173	182	174	170	157	144
Unemployment rate, LFS, in %, average [3]	17.8	15.4	13.4	11.8	12.4	11.8	11.5	10.6	9.8
Reg. unemployment rate, in %, end of period [3)4)]	14.4	11.0	11.4	11.1	10.2	8.6	.	.	.
Average monthly gross wages, LTL [5]	1,988	2,046	2,124	2,232	2,243	2,336	.	.	.
annual change in % (real, gross)	-4.6	-1.2	0.7	4.0	2.8	4.0	.	.	.
Average monthly net wages, LTL [5]	1,552	1,595	1,651	1,730	1,738	1,818	.	.	.
annual change in % (real, net)	-4.3	-1.3	0.5	3.8	2.5	4.4	.	.	.
Consumer prices (HICP), % p.a.	1.2	4.1	3.2	1.2	1.8	0.3	0.3	1.2	1.8
Producer prices in industry, % p.a.	10.3	13.9	5.0	-2.4	-1.4	-4.0	.	.	.
General goverm.budget, EU-def., % of GDP									
Revenues	35.0	33.2	32.7	32.2	.	.	32.0	31.5	31.4
Expenditures	42.3	38.7	36.1	34.4	.	.	34.0	33.3	33.2
Net lending (+) / net borrowing (-)	-7.2	-5.5	-3.3	-2.2	.	.	-2.0	-1.8	-1.8
Public debt, EU-def., % of GDP	37.8	38.3	40.5	39.4	.	.	40.8	39.8	39.0
Central bank policy rate, % p.a., end of period [6]	1.07	1.24	0.52	0.27	0.38	0.26	.	.	.
Current account, EUR mn [7]	-92	-1,202	-396	549	142	263	400	-150	-200
Current account, % of GDP	-0.3	-3.9	-1.2	1.6	1.8	1.7	1.1	-0.4	-0.5
Exports of goods, BOP, EUR mn [7]	14,891	19,422	22,427	23,998	11,611	11,187	23,600	25,200	27,000
annual change in %	34.7	30.4	15.5	7.0	15.7	-3.7	-1.7	6.8	7.1
Imports of goods, BOP, EUR mn [7]	16,539	21,487	23,530	24,918	11,857	11,882	24,700	26,700	28,800
annual change in %	35.3	29.9	9.5	5.9	9.0	0.2	-0.9	8.1	7.9
Exports of services, BOP, EUR mn [7]	3,423	4,033	4,793	5,390	2,523	2,826	5,500	5,800	6,300
annual change in %	16.7	17.8	18.8	12.5	10.6	12.0	2.0	5.5	8.6
Imports of services, BOP, EUR mn [7]	2,301	2,766	3,404	4,033	1,881	2,074	4,200	4,500	5,000
annual change in %	3.7	20.2	23.1	18.5	23.2	10.2	4.1	7.1	11.1
FDI inflow (liabilities), EUR mn [7]	653	1,095	454	537	185	-534	200	.	.
FDI outflow (assets), EUR mn [7]	46	94	215	213	149	95	150	.	.
Gross reserves of NB excl. gold, EUR mn	4,788	6,120	6,203	5,705	5,431	6,009	.	.	.
Gross external debt, EUR mn [7]	24,015	25,041	25,921	24,358	24,857	24,821	.	.	.
Gross external debt, % of GDP	86.7	80.9	78.7	70.3	71.8	69.3	.	.	.
Average exchange rate LTL/EUR	3.4528	3.4528	3.4528	3.4528	3.4528	3.4528	3.45	3.45	3.45
Purchasing power parity LTL/EUR	2.0416	2.0842	2.0816	2.1173	.	.	.	.	.

1) Preliminary. - 2) According to census March 2011. - 3) From 2012 according to census March 2011. - 4) In % of working age population. - 5) Annual data including earnings of sole proprietors. - 6) VILIBOR one-month interbank offered rate (Lithuania has a currency board). - 7) BOP 6th edition.

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

LITHUANIA: Headwinds from the east

SEBASTIAN LEITNER

While the economic tide is low in the countries bordering the Baltic Sea, the economy of Lithuania will continue to grow at a stable rate of 3% in 2014. Rising employment and wages are backed by public investment; things are encouraging and conducive to keeping households in a good spending mood. Nonetheless, the trade sanctions on Russia will pose a threat to the economic viability of a number of exporters in the agro-food sector.

Lithuania, apart from Finland, will be the EU country hit hardest by the Russian economic sanctions enacted in August 2014 in terms of declining trade volumes. Close to 20% of Lithuanian exports are destined for the neighbouring country. However, about 80% of those goods are re-exported from other EU countries, thus the effective reduction in Lithuanian value added will be much lower. Estimations for the negative impact of the current sanctions range between 0.6% and 1% of GDP. The highest losses will be faced by meat and dairy producers, as well as the wholesale and transport sectors. In general, growth of export to the EU has not been less disappointing than trade with the Eastern neighbourhood. Since import activity lost momentum in line with exports, the current account remained in surplus in the first half of this year and is expected to move into deficit not earlier than next year.

Growth of investment is taking place in all sectors of the economy. While Lithuania's external conditions are not conducive to fostering growth prospects, a strong impulse stems from public outlays in infrastructure, which translates into higher investment activity in most industries and particularly in manufacturing. Furthermore, the deleveraging process of firms and households in the case of mortgage loans has come to an end. Construction volumes are increasing not only concerning non-residential buildings and infrastructure but particularly in the case of dwellings. Figures for granted building permits give rise to expectations that the development of construction activity will remain lively in the coming quarters.

Lively economic activity will keep employment growing by more than 1% in 2014. Particularly construction and agriculture create new jobs this year. In addition household incomes are increasing due to net wages rising significantly, by 4.4% on average in real terms in the first half of the year. Also remittances have kept on growing ever since emigration has peaked in 2010. A rise in the minimum monthly wage, which is expected to amount to between 5% and 10% in 2015, and the planned rise in the non-taxable income threshold will further prop up the purchasing power of the citizens.

Thus household consumption, which increased by more than 5% in the first half of 2014, will remain the most significant driver of GDP growth in Lithuania also in the coming two years. Retail trade figures show that household expenses are swiftly rising for consumer durables and services.

The general budget deficit is expected to decline further, to 2% in 2014. In the medium run the share of public expenditures is expected to fall towards the pre-crisis level of 33% of GDP, the lowest rate in the European Union.

In January 2015 Lithuania will finally become the 19th member of the euro area. A significant influx of additional foreign direct investment due to the accession is not likely. Long-term interest rates for 10-year government bonds already declined to 2.6% in August 2014. A remarkable further reduction of refinancing costs for the public debt is not to be expected.

In 2014 the Lithuanian economy is expected to expand at a stable growth rate of 3% in real terms. In the two years thereafter consumption of households will remain the main driver of growth, supported by public investments in transport and energy infrastructure. Although predictions about the development in the relations between Russia and the EU in the coming year are difficult, we suppose that the trade sanctions will not be broadened. A slight upswing of external demand in the EU countries is far from certain, but our baseline scenario. Thus we keep our forecasts for the coming two years almost unchanged and expect GDP growth to rise to 3.2% in 2015 and 3.4% in 2016.

POLAND: A number of short-term risks

LEON PODKAMINER

Driven by a major increase in gross capital formation, the Polish economy has entered a phase of relatively rapid growth, which is likely to extend into the biennium 2015-2016. Nonetheless, some economic and non-economic risks still persist. Apart from uncontrollable external and domestic (political) risks, problems are also posed by the pursuit of a monetary policy with too restrictive an orientation.

Moderate (by Polish standards) GDP expansion continued in the second quarter of 2014, reaching a growth rate of 3.3%. Growth in household consumption continued to accelerate, approaching a speed last time recorded three years ago. But growth of public consumption came close to a standstill (after ranging between 2% and 4% for more than a year). In contrast, growth of gross fixed capital formation remained very high. Most probably part of that acceleration was due to the speeding-up of EU co-financed spending. Simultaneously there was an abrupt increase in inventories whose contribution to overall GDP growth rose from minus 0.1 percentage points in the first quarter to (plus) 1.7 percentage points in the second. Such a massive rise in inventories might be only natural to expect (given the fact that previously the inventories had been contracting for 8 consecutive quarters). But it is rather hard to expect further, similarly large, increases in inventories to continue for much longer.

While growth of exports of goods and non-factor services slowed down (from 7.6% in the first quarter to 5.9% in the second), growth of imports sped up from 6.9% to 9.8% respectively. All of a sudden foreign trade became a major drag on overall GDP growth. After 13 consecutive quarters featuring positive (and generally large) contributions of foreign trade to GDP growth, in the second quarter of 2014 that contribution was negative and rather large (-1.6 percentage points).

In the first half of 2014 investment outlays taking the form of an increase in the stocks of buildings and structures rose by close to 16% in real terms while those into machinery and equipment (other than means of transport) by 10%. Investment in the stock of machinery and equipment accounts for the bulk (over 49%) of total investment outlays. Investment outlays in manufacturing (accounting for a third of the total) rose by about 13%.

Outlays in transportation-and-storage rose by more than 24% and in waste collection, recycling etc. by more than 32%. Most likely the increased investment into these sectors has only been possible due to a generous support by transfers from EU funds. The infrastructural sectors (water supply, land transportation etc.) also feature prominently in the recent statistics on the estimated value of newly started investment projects.

Table 14 / Poland: Selected Economic Indicators

	2010	2011	2012	2013 1)	2013	2014	2014	2015	2016
					January-June			Forecast	
Population, th pers., average 2)	38,184	38,534	38,536	38,514	38,465	38,487	38,530	38,525	38,500
Gross domestic product, PLN bn, nom.	1,417	1,528	1,596	1,636	774.7	810.9	1,690	1,770	1,860
annual change in % (real)	3.9	4.5	2.0	1.6	0.8	3.5	3.3	3.2	3.1
GDP/capita (EUR at exchange rate)	9,200	9,600	9,900	10,100	.	.	.	.	.
GDP/capita (EUR at PPP)	15,400	16,400	17,100	17,700	.	.	.	.	.
Consumption of households, PLN bn, nom.	856.2	921.6	967.5	981.2	494.1	510.1	1,010	1,060	1,110
annual change in % (real)	3.1	2.7	1.2	0.7	0.0	2.4	2.5	3.0	3.0
Gross fixed capital form., PLN bn, nom.	281.3	308.7	306.6	301.2	109.9	118.4	320	340	360
annual change in % (real)	-0.4	8.5	-1.6	-0.2	-3.1	9.4	6.0	5.0	5.0
Gross industrial production (sales) 3)									
annual change in % (real)	11.1	6.7	1.2	2.3	-0.2	4.5	5.0	4.5	5.0
Gross agricultural production									
annual change in % (real)	-3.2	0.1	1.2	0.9	.	.	.	.	.
Construction industry 3)									
annual change in % (real)	3.9	15.3	-5.3	-10.2	-20.1	9.8	.	.	.
Employed persons, LFS, th, average 4)	15,961	16,131	15,591	15,568	15,410	15,683	15,600	15,680	15,760
annual change in % 4)	0.6	1.1	0.2	-0.1	-0.6	1.8	0.2	0.5	0.5
Unemployed persons, LFS, th, average 4)	1,699	1,723	1,749	1,793	1,878	1,716	1,730	1,740	1,750
Unemployment rate, LFS, in %, average 4)	9.6	9.7	10.1	10.3	10.9	9.9	10.0	10.0	10.0
Reg. unemployment rate, in %, end of period	12.4	12.5	13.4	13.4	13.2	12.0	12.5	11.5	11.5
Average monthly gross wages, PLN	3,224	3,404	3,530	3,650	3,760	3,913	3,770	3,940	4,140
annual change in % (real, gross)	1.4	1.4	0.1	2.5	2.1	3.5	3.0	3.0	3.0
Consumer prices (HICP), % p.a.	2.7	3.9	3.7	0.9	0.9	0.5	0.3	1.5	2.0
Producer prices in industry, % p.a.	1.8	7.3	3.3	-1.2	-1.2	-1.1	-1.0	1.5	2.0
General governm.budget, EU-def., % of GDP									
Revenues	37.5	38.4	38.3	37.5	.	.	46.5	36.9	37.0
Expenditures	45.4	43.4	42.2	41.9	.	.	41.5	40.3	40.0
Net lending (+) / net borrowing (-)	-7.8	-5.1	-3.9	-4.3	.	.	5.0	-3.3	-3.0
Public debt, EU-def., % of GDP	54.9	56.2	55.6	57.0	.	.	52.0	52.5	52.0
Central bank policy rate, % p.a., end of period 5)	3.5	4.5	4.3	2.5	2.8	2.5	2.0	2.0	2.5
Current account, EUR mn 6)7)	-19,665	-19,398	-13,697	-5,245	-2,430	-1,956	-4,000	-8,500	-11,200
Current account, % of GDP	-5.5	-5.2	-3.6	-1.3	-1.3	-1.0	-1.0	-2.0	-2.5
Exports of goods, BOP, EUR mn 6)	117,938	132,277	140,812	148,855	72,231	77,455	159,300	170,500	182,400
annual change in %	.	12.2	6.5	5.7	4.7	7.2	7.0	7.0	7.0
Imports of goods, BOP, EUR mn 6)	128,334	144,728	147,958	148,220	72,257	77,225	158,600	170,500	182,400
annual change in %	.	12.8	2.2	0.2	-1.7	6.9	7.0	7.5	7.0
Exports of services, BOP, EUR mn 6)	26,714	29,337	32,019	33,792	16,110	16,113	34,100	36,100	38,300
annual change in %	.	9.8	9.1	5.5	6.7	0.0	1.0	6.0	6.0
Imports of services, BOP, EUR mn 6)	23,390	24,151	25,810	25,768	11,765	12,416	26,800	28,400	30,100
annual change in %	.	3.3	6.9	-0.2	-0.1	5.5	4.0	6.0	6.0
FDI inflow (liabilities), EUR mn 6)7)	13,356	13,274	5,634	70	346	5,824	.	.	.
FDI outflow (assets), EUR mn 6)7)	6,590	3,170	445	-2,770	-2,545	3,039	.	.	.
Gross reserves of NB excl. gold, EUR mn	66,253	71,028	78,403	74,257	78,879	71,484	.	.	.
Gross external debt, EUR mn 6)	238,421	250,248	278,037	277,495	275,863	285,293	288,000	305,000	.
Gross external debt, % of GDP	67.2	67.5	72.9	71.2	70.8	70.9	.	.	.
Average exchange rate PLN/EUR	3.9947	4.1206	4.1847	4.1975	4.1781	4.1755	4.20	4.15	4.15
Purchasing power parity PLN/EUR	2.3872	2.4242	2.4199	2.4288	.	.	.	.	.

1) Preliminary. - 2) From 2011 according to census March 2011. - 3) Enterprises with 10 and more employees. - 4) From 2012 according to census March 2011. - 5) Reference rate (7-day open market operation rate). - 6) BOP 6th edition. - 7) Including Special Purpose Entities (SPEs).

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

The investment acceleration has added strength to the growth of output of manufacturing, with the output of investment goods rising by 8.7% in the first seven months of 2014. Output of manufactured intermediate inputs increased by 7.4% while the sales of consumer durables rose by 4.5% and of consumer non-durables by 2.4%. In real terms, sales of output of the construction sector increased by over 7% in the first half of 2014. Sales of civil engineering and of specialised construction activities rose by over 13% while the sales of activities related to the construction of residential buildings contracted by close to 2%.

The growth acceleration observed in the first half of 2014 has been combined with a deflationary tendency. With the unemployment rate persisting at over 10% and labour productivity growth still outpacing the rates of growth of wage rates by a large margin, producer prices have been following a deflationary path. Consumer price inflation has been very close to zero and still falling, across a wide spectrum of goods and services. In August the CPI turned negative. This (long unanticipated) development has had some positive aspects. With nominal wage rates following their ‘natural’ upward trends the unplanned disinflation has been a source of additional gains in the purchasing power of wage incomes. That has certainly helped – even if temporarily – to support the growth in household demand.

The inflation target of the National Bank of Poland (CPI of 2.5% with 1 percentage point tolerance band) has been missed by a wide margin. To some extent this has been the outcome of the monetary policy which continues – for hardly understandable reasons – a fairly restrictive course. The NBP policy interest rate of 2.5% has been maintained for a year and a half now.[52] That may have affected the levels (much higher of course) of interest rates charged by banks on their loans to the non-financial corporate sector and to households. While the high real interest rates on loans have not precluded the rise in capital formation (still financed primarily out of own resources, not by loans), high interest rates are unwelcome for another reason. They may have had something to do with the continuing strength of the Polish currency. For a long time this has not be harming the performance of foreign trade. But the recent foreign trade developments seem to indicate that the currency overvaluation may be hard to square with an acceleration of growth of domestic demand. The risk to foreign trade – and to the economy at large – following too strong a currency may finally induce those in charge of Poland’s monetary policy to move the interest rates closer to those prevailing internationally. Before that change materialises, the Polish monetary policy course exposes the economy to serious risks.

The trade performance in the second quarter, which seems to be the first consequence of the currency overvaluation (and indirectly of too high interest rates), is unlikely to improve in the coming months. If anything, because of the importance of Russia and Ukraine to Poland’s exporters, trade may continue to be a drag on growth.[53] Also, while there are some grounds for optimism concerning gross fixed investment it is less clear what is going to happen with respect to the inventories. All in all, growth may slow down in the second half of 2014. This opinion seems to be supported by the most recent statistics

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[52] On 9 October 2014 the policy rate was lowered to 2%.

[53] According to the customs statistics, the share of Eastern Europe (consisting of Russia, Ukraine, Belarus and Moldova) in Poland’s merchandise exports fell to 7.5% in the first seven months of 2014 (from 9.1% in the same period of 2013). For merchandise imports the respective rates are 12.9% and 13.7%. So far the declines in trade with Eastern Europe have not had perceptible effects on foreign trade’s contributions to GDP growth. But Russia is an important importer of Polish foodstuffs (e.g. dairy products, fruit and vegetables). Russian countersanctions, targeting foodstuffs, could be hurting the agro-food sector – which is why the sector has been promised some extra support by the European Commission. Also, Russia is an important supplier of energy carriers. Russian supplies cover about 96% of Poland’s demand for crude oil and about 70% of natural gas.

(for August 2014) showing declines (even if still quite slight) in the volumes of sales of output of the industrial and construction sectors.

Barring extraordinary – and hardly predictable – changes in the external and internal[54] circumstances, Poland's development in 2015-2016 can be expected to be driven, as in 2014, by expanding domestic demand. The investment push which is an essential aspect of this development has been triggered by both external and internal (largely cyclical) economic impulses. These positive impulses were much weaker during the less dynamic years 2012-2013.

Upon his nomination to the post of the next President of the European Council, Prime Minister Tusk designated his successor: Eva Kopacz, until now the Chairperson of the Parliament's lower chamber. Her main merit seems to have been the unconditional loyalty to Mr Tusk. Otherwise, she is widely judged to be rather impulsive. As a Health Minister (2007-2011) she presided over the reform of the public health system. Arguably, that reform is the major failure of Mr Tusk's governments, still awaiting a radical overhaul.

[54] The outcomes of the next parliamentary elections (autumn 2015) are also hardly predictable now. If the elections are decisively won by the Law and Justice party (of former PM Kaczynski), the course of policy (including on economic matters) may change radically. The direction of that change could not be predicted with any certainty.

ROMANIA: Investment slump

GÁBOR HUNYA

In Romania, the growth setback following last year's bumper harvest and export boom seems to be more severe than expected. The decline in investments, both private and public, has accelerated. Alongside exports, the recovery of private consumption, benefiting from fiscal support, has become the new driver of economic growth. The government intends to continue down this track in defiance of IMF recommendations. Improved political stability under a new president to be elected in November may improve the efficiency of the country's administration. Being one of the countries least dependent on trade with Russia, Romania lends full support to EU sanctions.

Economic growth decelerated in the first half of 2014; quarter-to-quarter rates were negative, pointing to a technical recession. The 2.4% GDP growth in the first half of 2014 is sobering after last year's boom. The base effect of strong growth in the second half of 2013 will render even weaker results for the rest of 2014. Beyond net exports, private consumption has become the main driving force of growth this year. The latter contributed 3.3 percentage points to GDP growth and net exports added another 1pp. Gross fixed capital formation plummeted by as much as 11% in the first half of 2014 and had a negative contribution to GDP growth (-2.2pp).

Investments have remained the sour point of the Romanian economy. They have been on the decline for the fifth quarter in a row. Corporate investments shrank while the construction of dwellings started to recover. Public investments, which account for close to 20% of the total investments, plummeted. There are two main reasons for the detrimental development of investments: one is the continuing deleveraging process in the banking sector; credit to the private sector declined further and the share of non-performing loans dwelt around 20%. The other factor is the inability of the government to manage investment programmes and properly utilise EU funds.

It was not fiscal austerity that suppressed public investment outlays. The level of the central government deficit (2.2% of GDP) is well on target but both revenues and expenditures were below the half-year schedule by a wide margin. Revenues were 4.3% lower due to shortfalls in the collection of personal income tax and VAT. This is all the more alarming as both private income and retail sales expanded quite rapidly. Less than half of the scheduled EU funds and co-financing could be disbursed, mirrored by a similar shortfall in expenditures on EU-funded projects. Also the other public capital expenditures declined and fell short of programme by 30%. Government decision-making has become all the more cumbersome as more and more former office-holders have been accused of corruption, making current ministers over-cautious.

Table 15 / Romania: Selected Economic Indicators

	2010	2011	2012	2013 [1)]	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., average [2)]	20,247	20,148	20,058	19,981	.	.	20,000	20,000	20,000
Gross domestic product, RON bn, nom.	523.7	557.3	586.7	628.6	264.7	279.4	660	700	740
annual change in % (real)	-1.1	2.3	0.6	3.5	1.8	2.4	2.2	2.7	3.0
GDP/capita (EUR at exchange rate)	6,100	6,500	6,600	7,100	.	.	.	.	.
GDP/capita (EUR at PPP)	12,400	12,900	13,500	14,400	.	.	.	.	.
Consumption of households, RON bn, nom.	327.2	345.8	363.1	384.3	172.7	183.3	.	.	.
annual change in % (real)	-0.3	1.6	1.1	1.4	0.1	5.1	3.0	2.0	2.5
Gross fixed capital formation, RON bn, nom.	129.4	145.2	154.3	148.2	53.2	47.0	.	.	.
annual change in % (real)	-1.8	7.7	3.8	-3.3	-5.2	-11.0	-2.0	4.0	5.0
Gross industrial production [3)]									
annual change in % (real)	5.5	7.4	2.4	7.8	6.1	9.1	7.0	5.0	5.0
Gross agricultural production									
annual change in % (real)	1.0	8.9	-21.9	27.3	.	.	.	.	.
Construction industry [3)]									
annual change in % (real)	-13.2	2.8	1.2	-0.4	-5.8	-10.2	.	.	.
Employed persons, LFS, th, average [4)]	9,239	9,138	9,263	9,247	.	8,540	8,600	8,690	8,780
annual change in %	0.0	-1.1	1.4	-0.2	.	.	0.6	1.0	1.0
Unemployed persons, LFS, th, average [4)]	725	730	701	730	.	640	.	.	.
Unemployment rate, LFS, in %, average [4)]	7.3	7.4	7.0	7.3	.	7.0	7.0	7.0	6.8
Reg. unemployment rate, in %, end of period	7.0	5.2	5.5	5.7	4.8	4.9	.	.	.
Average monthly gross wages, RON [5)]	1,902	1,980	2,063	2,166	2,208	2,320	.	.	.
annual change in % (real, gross)	-2.8	-1.6	0.8	1.0	0.0	4.0	.	.	.
Average monthly net wages, RON [5)]	1,391	1,444	1,507	1,580	1,599	1,677	.	.	.
annual change in % (real, net)	-3.7	-1.9	1.0	0.8	-0.2	3.8	.	.	.
Consumer prices (HICP), % p.a.	6.1	5.8	3.4	3.2	4.6	1.3	2.0	3.0	3.5
Producer prices in industry, % p.a.	4.4	7.1	5.3	2.0	0.0	-0.3	.	.	.
General governm.budget, EU-def., % of GDP									
Revenues	33.3	33.9	33.7	32.7	.	.	.	.	.
Expenditures	40.1	39.4	36.7	35.0	.	.	.	.	.
Net lending (+) / net borrowing (-)	-6.8	-5.5	-3.0	-2.3	.	.	-2.4	-2.5	-2.7
Public debt, EU-def., % of GDP	30.5	34.7	38.0	38.4	.	.	38.0	39.0	40.0
Central bank policy rate, % p.a., end of period [6)]	6.25	6.00	5.25	4.00	5.25	3.50	.	.	.
Current account, EUR mn	-5,476	-5,921	-5,851	-1,529	123	-877	-3,000	-3,500	-4,000
Current account, % of GDP	-4.4	-4.5	-4.4	-1.1	0.2	-1.4	-2.0	-2.2	-2.4
Exports of goods, BOP, EUR mn	37,333	45,281	45,022	49,579	23,716	25,522	53,000	56,700	60,700
annual change in %	28.3	21.3	-0.6	10.1	5.9	7.6	7.0	7.0	7.0
Imports of goods, BOP, EUR mn	44,901	52,664	52,393	53,005	25,168	27,187	56,700	60,700	64,900
annual change in %	24.9	17.3	-0.5	1.2	-2.8	8.0	7.0	7.0	7.0
Exports of services, BOP, EUR mn	6,622	7,253	8,395	10,792	5,003	5,755	11,900	12,600	13,400
annual change in %	-6.2	9.5	15.7	28.6	30.1	15.0	10.0	6.0	6.0
Imports of services, BOP, EUR mn	6,216	6,911	7,264	8,053	3,766	3,897	8,300	8,800	9,300
annual change in %	-15.5	11.2	5.1	10.9	6.0	3.5	3.0	6.0	6.0
FDI inflow (liabilities), EUR mn	2,227	1,798	2,127	2,730	1,329	1,192	2,500	3,000	3,000
FDI outflow (assets), EUR mn	-12	-25	-88	87	-52	-64	.	.	.
Gross reserves of NB excl. gold, EUR mn	32,606	33,166	31,206	32,525	32,307	30,681	.	.	.
Gross external debt, EUR mn	92,458	98,724	99,681	96,060	99,074	92,958	.	.	.
Gross external debt, % of GDP	74.4	75.1	75.8	67.5	69.7	62.5	.	.	.
Average exchange rate RON/EUR	4.2122	4.2391	4.4593	4.4190	4.3923	4.4641	4.44	4.45	4.50
Purchasing power parity RON/EUR	2.0873	2.1469	2.1575	2.2590	.	.	.	.	.

1) Preliminary. - 2) According to census October 2011. - 3) Enterprises with 4 and more employees. - 4) From 2014 according to census October 2011. - 5) Half-year data refer to enterprises with 4 and more employees. - 6) One-week repo rate.

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

Inflation has subsided but remained positive all through the first half of 2014 and is expected to rise somewhat in the second half of the year. One of the components adding to inflation has been the adjustment of gas prices, and another resulted from the fuel tax increase. The government is, however, trying to postpone the next gas price rise for private consumers, scheduled in the IMF-EU agreement, for social reasons. Cheap domestic production is used as a justification against EU recommendations to introduce a unitary gas market for all consumers.

The current account deteriorated due to a jump in foreign investors' income while the goods trade deficit and the services surplus increased. Services exports, especially transport, revenues continued to increase as Romania attracted the headquarters of some large foreign truck fleets. The average exchange rate for the first half of 2014 (RON 4.46/EUR) was higher than in the pre-year period but firmed in the third quarter. Vehicles, electronic products as well as food products contributed most to the boost in exports. FDI inflow and the number of new greenfield projects were somewhat lower in the first half of 2014 than a year before, still the country maintains a strong position among the NMS in terms of attracting FDI and outsourcing projects.

The impact of the Ukraine-Russia conflict and related sanctions on Romania is limited as economic cooperation with the countries involved is modest. The Ukrainian market accounts for only 1.9% of total Romanian exports and 0.8% of imports (2013). The significance of Russia has been somewhat higher, 2.8% in the case of exports and 4.3% in the case of imports. Close to 90% of Romanian imports from Russia is constituted by mineral products. It is worth noting that Romania has the smallest dependence on trade with Russia among the NMS next to Slovenia. An important reason is the high rate of self-sufficiency of the country in terms of oil and gas. Although Romania is a large exporter of food products, its exposure to Russia (2%) is one of the smallest in the EU. Not unrelated, the Romanian government firmly supports the EU and NATO policy in the conflict and even tries to benefit from its strategic position in the Black Sea region.

In view of the still good growth performance at the beginning of the year, the government delayed structural reforms required under the precautionary IMF stand-by agreement of September 2013. They have even taken action against IMF recommendations by deciding to reduce the social security contribution in accordance with the request of the business community. In turn, the IMF did not conclude its programme review in June and stays in a wait-and-see position until the next supervision due in November this year. If the fiscal target is observed and the external balance is maintained, the government may further extend its freedom of action in relation to the European Commission and the IMF. Shifting the main growth driver from net exports to private consumption will not be drastic and may not require larger amounts of external financing in the coming years. Incumbent socialist Prime Minister Victor Ponta is likely to win the presidential elections in November putting an end to cohabitation with Traian Basescu, who has repeatedly blocked government action and used the anti-corruption agency for political purposes. Regained confidence under a new president and, possibly, prime minister may improve the efficiency of administration and speed up the access to EU funds but it may also result in some loss of checks and balances and in the return of fiscal expansion. The success of investment programmes is in the interest of the EU Commission too and institutional support may increase once the new Commission starts working. Only in this case can one expect a rebound of investments which is badly needed to accelerate GDP growth to 3% in the coming years.

Table 16 / Slovakia: Selected Economic Indicators

	2010	2011	2012	2013 1)	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., average 2)	5,391	5,398	5,408	5,413	5,411	5,417	5,420	5,430	5,440
Gross domestic product, EUR mn, nom.	65,897	68,974	71,096	72,134	34,746	35,403	74,000	77,000	81,000
annual change in % (real)	4.4	3.0	1.8	0.9	0.7	2.5	2.4	2.5	2.6
GDP/capita (EUR at exchange rate)	12,100	12,800	13,100	13,300	.	.	13,700	14,200	14,900
GDP/capita (EUR at PPP)	18,300	18,900	19,400	19,700	.	.	.	.	.
Consumption of households, EUR mn, nom.	37,757	39,025	40,307	40,821	20,145	20,626	.	.	.
annual change in % (real)	-0.7	-0.5	-0.2	0.0	-0.3	3.1	2.0	3.0	3.5
Gross fixed capital form., EUR mn, nom.	13,851	15,957	14,298	13,761	6,050	6,345	.	.	.
annual change in % (real)	6.5	14.3	-10.5	-4.3	-6.2	5.0	3.0	4.0	4.5
Gross industrial production									
annual change in % (real)	8.2	5.3	7.9	4.9	2.1	6.0	4.0	3.0	3.0
Gross agricultural production									
annual change in % (real)	-8.2	8.7	-5.7	2.0	.	.	.	.	.
Construction industry									
annual change in % (real)	-4.6	-1.8	-12.6	-5.2	-11.2	-1.8	.	.	.
Employed persons, LFS, th, average 3)	2,318	2,351	2,329	2,329	2,328	2,343	2350	2390	2430
annual change in %	-2.1	1.5	0.6	0.0	-0.1	0.6	1.0	1.5	1.5
Unemployed persons, LFS, th, average 3)	389	368	378	386	388	370	.	.	.
Unemployment rate, LFS, in %, average 3)	14.4	13.5	14.0	14.2	14.3	13.6	13.5	13.0	12.0
Reg. unemployment rate, in %, end of period	12.5	13.6	14.4	13.5	14.3	12.8	12.5	12.0	11.0
Average monthly gross wages, EUR	769	786	805	824	804	839	.	.	.
annual change in % (real, gross)	2.2	-1.6	-1.2	1.0	1.0	4.5	.	.	.
Consumer prices (HICP), % p.a.	0.7	4.1	3.7	1.5	2.0	-0.1	0.2	1.5	2.5
Producer prices in industry, % p.a.	0.4	4.5	1.9	-1.0	-0.1	-3.5	-3.0	1.0	1.5
General governm.budget, EU-def., % of GDP									
Revenues	32.3	34.1	33.7	35.9	.	.	34.0	.	.
Expenditures	39.8	38.9	38.2	38.7	.	.	36.8	.	.
Net lending (+) / net borrowing (-)	-7.5	-4.8	-4.5	-2.8	.	.	-2.8	-2.7	-2.5
Public debt, EU-def., % of GDP	41.0	43.6	52.7	55.4	.	.	55.2	55.0	54.6
Central bank policy rate, % p.a., end of period 4)	1.00	1.00	0.75	0.25	0.50	0.15	.	.	.
Current account, EUR mn	-2,454	-2,597	1,584	1,547	1,676	917	1,100	800	100
Current account, % of GDP	-3.7	-3.8	2.2	2.1	4.8	2.6	1.5	1.0	0.1
Exports of goods, BOP, EUR mn	48,273	56,783	62,308	64,362	31,844	32,411	65,000	66,000	67,000
annual change in %	21.5	17.6	9.7	3.3	4.5	1.8	1.5	1.5	1.0
Imports of goods, BOP, EUR mn	47,494	55,768	58,730	60,078	28,898	29,838	61,000	62,000	64,000
annual change in %	22.5	17.4	5.3	2.3	1.1	3.3	2.0	2.0	2.5
Exports of services, BOP, EUR mn	4,396	4,749	5,570	5,603	2,584	3,036	6,200	6,600	7,100
annual change in %	1.2	8.0	17.3	0.6	-2.0	17.5	10.0	7.0	7.0
Imports of services, BOP, EUR mn	5,140	5,121	5,263	5,454	2,584	3,064	6,300	6,900	7,400
annual change in %	-4.2	-0.4	2.8	3.6	3.1	18.6	15.0	10.0	7.0
FDI inflow (liabilities), EUR mn	1,336	2,511	2,199	445	-702	-32	.	.	.
FDI outflow (assets), EUR mn	715	513	-58	-319	37	7	.	.	.
Gross reserves of NB excl. gold, EUR mn	541	659	620	670	846	702	.	.	.
Gross external debt, EUR mn	49,262	52,934	53,755	59,684	60,547	64,785	.	.	.
Gross external debt, % of GDP	74.8	76.7	75.6	82.7	83.9	87.5	.	.	.
Purchasing power parity EUR/EUR	0.6691	0.6758	0.6776	0.6794	.	.	.	.	.

1) Preliminary. - 2) According to census May 2011. - 3) From 2012 data according to census May 2011. - 4) Official refinancing operation rates for euro area (ECB).

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

SLOVAKIA: Domestic demand taking over export drive

DORIS HANZL-WEISS

In the course of the current year, domestic demand has been taking over the role of the main engine of growth in Slovakia; it is expected to continue as such over the next two years. Growing household consumption will foster import growth, while global uncertainties will restrain export growth. The contribution of net exports will thus turn negative. For this and the next two years to come, we expect the GDP to grow by about 2.5% annually.

After sluggish growth in 2013, Slovak GDP rose quite dynamically in the first half of 2014, by 2.5%, and growth was also stable over the two quarters. The main growth driver was – in contrast to the former three years – domestic demand. Household consumption increased by 3.1% in the first half of 2014, thanks to improving conditions on the labour market and growing wages. Average real wages surged by 4.5%, the largest increase since 2007. This was due to practically zero inflation. Also public consumption went up by almost 5%. Gross capital formation surged by 13%, of which gross fixed capital formation increased by 5% (here strong growth rates were recorded for intangible fixed assets and 'other machinery and equipment'). On the other hand, the importance of net exports weakened: exports of goods and services rose by 6% but imports by even 8%. While goods exports to Germany (Slovakia's main trading partner) increased by 8% in the first half of 2014, exports to the Czech Republic (the second largest trade partner) declined by 3%. Exports to Russia (ranking 9th and accounting for 4% of goods exports but for 10% of imports) continued declining, by 7%, after a fall of 3% in 2013.

Looking at sectoral developments, industrial production grew by close to 6% in the first seven months of the year. The automotive industry – the largest sector of the Slovak economy – contributed most to the growing manufacturing performance, followed by basic metals and fabricated metal products, the electrical equipment industry as well as other manufacturing. Output of construction continued declining by almost 3% over the first seven months. Conversely, value added of services grew again.

On the labour market, where developments generally lag behind those in the real economy, trends were quite positive: Employment increased by 0.6% in the first half of 2014, the unemployment rate (LFS) dropped from 14.2% to 13.6%. However, this is still substantially higher than in most other EU countries and constitutes one of the major problems in Slovakia. In particular, the large share of long-term unemployed and the high youth unemployment, together with strong regional disparities, are of major concern. The minimum wage may rise by 8% next year (reaching EUR 380), which is a strong increase compared to previous years when it typically rose between 3% and 4%.

In 2013, the budget deficit fell to 2.8% of GDP and thus the EU's excessive deficit procedure against Slovakia was abrogated in June. It had been stipulated that the VAT rate should go down again from 20% to 19% when the budget deficit sinks below 3%, but the government kept the higher rate. For the next years, the deficit targets are set at 2.5% in 2015, 1.6% in 2016 and 0.5% in 2017 (as laid down in the Stability Programme from April 2014). However, further efforts are needed to reach these targets. The public debt level climbed to 55.4% of GDP in 2013, thus surpassing the 55% threshold of the debt-brake law.[55] The minister of finance thus needs to reduce the current year's state budget expenditures by 3% (with specified exemptions). It is expected that the debt level will remain below 57%, as this denotes the next threshold which would imply that the government is to submit a balanced general government budget. After selected changes in the government in July, former independent economy minister Malatiný was replaced by Pavol Pavlis, whose priority task is to seek foreign investment.

The Slovak banking sector, which is largely in foreign ownership, is stable and in good shape. In 2013, profitability increased and the capital adequacy ratio went up to 17.2% (end of 2013). Thus, there is no cause for concern over the forthcoming ECB stress test (results to be released at end of October). With the Single Supervisory Mechanism becoming effective in November this year, about 70% of Slovak banks will come under the direct supervision of the European Central Bank. While loans to households increased strongly in 2013, by 10%, loans to non-financial corporations grew only by 1.7%. In the second quarter of 2014, credit growth accelerated to 11.6% for households and 2.4% for non-financial corporations.

The wiiw forecast for 2014 is quite optimistic: we expect the Slovak GDP to grow by 2.4%, just as in our previous forecast. Domestic demand will be the main growth driver, while the contribution of net exports may turn negative. Growing household consumption will foster import growth, whereas global uncertainties will contain export growth. In general, the economic sentiment indicator showed a stop-and-go pattern in the first half of 2014: While it was stable from January to April, it grew between May and July but remained unchanged again in August. Nevertheless, new orders in main industrial sectors plummeted in July. For the next two years, we have revised our growth forecast downward and now assume GDP to grow by 2.5% in 2015 and 2.6% in 2016. This is because of less dynamic trade developments in the coming years, due to less growth expected globally. Domestic demand will be the main contributor to growth. However, with tensions increasingly growing worldwide and growth remaining sluggish in Europe, risks remain on the downside. Slovakia's links with Russia pose two risks: First, Slovakia imports gas from Russia almost exclusively via Ukraine, thus a possible interruption of gas supplies from Russia would have negative effects. Second, on the export side, possible future Russian counter measures to EU sanctions might hit Slovakia hard. Motor vehicles constitute the most important export products from Slovakia to Russia. Overall, however, Russia is only the 7th largest market for Slovak car exports (6% of total car exports): exports are focused mainly on Germany, the United Kingdom, China and France, which together account for half of Slovakia's car exports, while Italy and the United States take another 6% each, not taking into account indirect effects.

[55] Adopted in 2011, the fiscal responsibility law includes, amongst other things, a debt rule with various thresholds for the debt level and sanctions if surpassed.

SLOVENIA: Unexpectedly high GDP growth

HERMINE VIDOVIC

Increased foreign demand and rising investments supported by EU funds helped Slovenia to return to a growth path, at least temporarily, after the crisis. GDP growth in 2014 could come close to 2%, but will weaken again in the two years thereafter on account of dwindling investment activities and subdued economic growth being registered by its main trading partners. The newly elected government will have to continue its fiscal consolidation policy, including speeding up privatisation. Company deleveraging will also continue in the foreseeable future and remain an impediment to growth.

The economic recovery starting in the last quarter of 2013 continued in 2014. Slovenia's GDP grew by an unexpected 2.5% in the first half of the year, backed primarily by foreign demand and an upswing in gross fixed capital formation (rising by close to 5%). Household consumption remained nearly stagnant, while government consumption continued to fall for the fourth consecutive year. Also the change in inventories contributed negatively to GDP growth. Rising investment translated first of all into a remarkably strong increase in construction activities, municipal infrastructure in particular, co-financed by EU funds at the end of the financial perspective. By contrast, investment in machinery and equipment dropped by 13%. Industrial production recovered after two years of contraction, largely on account of low- and medium-technology industries, while high-tech industries remained slow in picking up again. The labour market situation has somewhat improved: based on Labour Force Survey data, employment increased by 2% in the first half of 2014 (year-on-year), which is mainly due to rising employment of temporary workers; the unemployment rate stood at 10%, slightly lower than in the first half of 2013. In September the consumer confidence indicator reached the highest level since 2008, which was due to a more optimistic outlook on unemployment, the improved financial situation of households and heightened expectations concerning the general economic situation over the next 12 months.

In foreign trade, goods exports rose by 5% and imports by 3% in the first half of 2014, resulting in a significantly higher trade surplus than in the same period of 2013. By contrast, the surplus in services trade fell owing to modest exports growth (1.5%) and rapidly rising imports (14%) particularly in business and technical services and construction services. Also the deficit in factor income has increased because of higher net interest payments on general government debt and debt repayments by the private sector. On the other hand, the net inflow of income from labour increased, because of a rising number of labour migrants abroad. Overall, the current account closed with a surplus of EUR 970 million in the first half of 2014, which was by EUR 140 million less than in the corresponding 2013 period.

Table 17 / Slovenia: Selected Economic Indicators

	2010	2011	2012	2013 1)	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., average 2)	2,049	2,053	2,057	2,060	2,059	2,061	2,058	2,058	2,058
Gross domestic product, EUR mn, nom. 3)	36,220	36,868	36,006	36,144	17,568	18,154	37,050	37,980	38,940
annual change in % (real) 3)	1.2	0.6	-2.6	-1.0	-2.9	2.5	1.8	1.5	1.5
GDP/capita (EUR at exchange rate)	17,700	18,000	17,500	17,500	.	.	18,000	18,500	18,900
GDP/capita (EUR at PPP)	21,000	21,600	21,800	21,800	.	.	.	.	.
Consumption of households, EUR mn, nom. 3)	19,960	20,299	19,981	19,301	9,254	9,366	.	.	.
annual change in % (real) 3)	1.0	0.0	-2.9	-4.0	-4.9	0.6	0.4	0.8	1.0
Gross fixed capital form., EUR mn, nom. 3)	7,694	7,445	6,927	7,127	3,451	3,632	.	.	.
annual change in % (real) 3)	-13.7	-4.6	-8.9	1.9	-0.5	4.9	4.5	2.5	2.0
Gross industrial production									
annual change in % (real)	7.2	1.3	-1.1	-0.9	-2.1	3.5	3.0	2.5	3.0
Gross agricultural production									
annual change in % (real)	0.1	0.3	-10.5	-4.0	.	.	.	.	.
Construction industry 4)									
annual change in % (real)	-16.9	-24.9	-16.9	-2.4	-16.7	37.6	.	.	.
Employed persons, LFS, th, average	966	936	924	906	896	914	920	930	940
annual change in %	-1.5	-3.1	-1.3	-1.9	-3.0	2.0	2.0	1.0	1.0
Unemployed persons, LFS, th, average	75	83	90	102	107	102	.	.	.
Unemployment rate, LFS, in %, average	7.3	8.2	8.9	10.1	10.8	10.1	10.0	9.8	9.6
Reg. unemployment rate, in %, end of period	11.8	12.1	13.0	13.5	12.8	12.8	13.2	13.0	12.9
Average monthly gross wages, EUR	1,495	1,525	1,525	1,523	1,513	1,528	.	.	.
annual change in % (real, gross)	2.1	0.2	-2.4	-2.0	-2.9	0.3	.	.	.
Average monthly net wages, EUR	967	987	991	997	991	999	.	.	.
annual change in % (real, net)	2.1	0.3	-2.1	-1.2	-2.1	0.1	.	.	.
Consumer prices (HICP), % p.a.	2.1	2.1	2.8	1.9	2.2	0.7	0.7	1.0	1.0
Producer prices in industry, % p.a.	2.0	4.6	0.9	0.0	0.5	-1.0	0.0	0.5	1.0
General governm.budget, EU-def., % of GDP									
Revenues	42.7	42.7	43.5	43.6	.	.	.	.	.
Expenditures	48.5	48.9	47.5	58.0	.	.	.	.	.
Net lending (+) / net borrowing (-)	-5.7	-6.3	-3.9	-14.4	.	.	-5.0	-4.0	-3.5
Public debt, EU-def., % of GDP	37.9	46.2	53.3	70.0	.	.	82.0	84.0	85.0
Central bank policy rate, % p.a., end of period 5)	1.00	1.00	0.75	0.25	0.50	0.15	.	.	.
Current account, EUR mn	-50	145	1,026	2,102	1,106	969	1,950	1,800	1,700
Current account, % of GDP	-0.1	0.4	2.8	5.8	6.3	5.3	5.3	4.7	4.4
Exports of goods, BOP, EUR mn	18,973	21,450	21,630	22,025	11,003	11,575	23,100	24,400	25,900
annual change in %	14.4	13.1	0.8	1.8	0.7	5.2	5.0	5.5	6.0
Imports of goods, BOP, EUR mn	19,803	22,406	21,802	21,380	10,632	10,938	22,000	23,100	24,700
annual change in %	16.3	13.1	-2.7	-1.9	-4.9	2.9	3.0	5.0	7.0
Exports of services, BOP, EUR mn	4,593	4,842	5,081	5,367	2,512	2,548	5,500	5,800	6,100
annual change in %	6.0	5.4	4.9	5.6	8.5	1.5	2.0	6.0	6.0
Imports of services, BOP, EUR mn	3,313	3,366	3,360	3,406	1,489	1,702	3,800	4,200	4,500
annual change in %	4.5	1.6	-0.2	1.4	-0.1	14.3	13.0	10.0	7.0
FDI inflow (liabilities), EUR mn	272	718	-59	-786	-843	668	1,000	.	.
FDI outflow (assets), EUR mn	-156	84	-226	-187	-93	78	.	.	.
Gross reserves of NB excl. gold, EUR mn	695	642	593	580	552	767	.	.	.
Gross external debt, EUR mn	40,723	40,100	41,264	39,930	40,867	44,004	.	.	.
Gross external debt, % of GDP	112.4	108.8	114.6	110.5	113.1	118.8	.	.	.
Purchasing power parity EUR/EUR	0.8412	0.8315	0.8030	0.8056	.	.	.	.	.

1) Preliminary. - 2) From 2011 according to register-based census 2011. - 3) According to ESA'10. - 4) Enterprises with 20 and more employees and output of some non-construction enterprises. - 5) Official refinancing operation rates for euro area (ECB).

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

After years of dragging inflows, FDI gained momentum in 2014 owing primarily to the sale of state-owned companies to Austrian and Croatian investors.[56] As for the whole year, the inflow of FDI is expected to rise to EUR 1 billion due to further privatisations. Slovenia's gross foreign debt amounted to EUR 44 billion by the end of June and was by EUR 4.1 billion higher than at the end of 2013. This increase is mainly attributable to government borrowing by selling bonds. Debts of the Bank of Slovenia to the eurosystem and private sector debt decreased.

Thanks to the improved economic situation, growth in general government revenues outpaced growth of expenditures in the first seven months of 2014, resulting in a lowering of the general government deficit. Revenues improved in all categories (taxes and a one-off inflow from concession fees for the mobile telephony radio spectrum), while expenditures rose mainly due to increased interest payments and rising investment outlays. However, despite the reduction, the target deficit for this year has already been exceeded. As a consequence the Minister of Finance announced the adoption of a supplementary budget (spending cuts across several ministries) in the autumn months as well as amendments to the 2015 budget which should be approved at the beginning of 2015. After having injected EUR 3.3 billion in the ailing banking sector in late 2013, the yield on ten-year government bonds fell significantly, from 6.8% in autumn 2013 to 2.7% by the end of September 2014.

At the beginning of May this year Slovenia's Prime Minister Alenka Bratusek resigned after losing the leadership of her party 'Positive Slovenia' to the mayor of Ljubljana, Zoran Jankovic. Early elections were held on 13 July and a new coalition government consisting of the newly founded party SMC of Miro Cerar (a lawyer), the Pensioners Party DeSUS and the Social Democrats took office in mid-September. Most of the new ministers from the SMC party are political newcomers, the only exception being the new Minister of Finance, Dusan Mramor (a professor of economics) who served already as a finance minister between 2002 and 2004. The coalition agreement stipulates that the new government will 'strive to take Slovenia out of the political, social, economic and ethical crisis by securing economic growth, protecting existing jobs and creating new jobs'. Prime Minister Cerar announced that the newly elected government aims to cut the budget deficit from an expected 4.2% of the GDP this year to 3% in 2015 as agreed with the European Commission. Fiscal policy will remain restrictive, public spending is to be reduced and the efficiency of tax collection should be increased. Reforms of the health and pension systems are envisaged as well. Plans for the introduction of a real estate tax were dropped (the attempt to introduce such a tax was rejected by the constitutional court at the beginning of the year). Despite some initial resistance from coalition parties, the privatisation of state-owned enterprises will be continued as planned by the outgoing government. The prime minister announced to draw up a list of additional companies to be sold.

Out of the 15 enterprises earmarked for privatisation in 2013, the coatings maker Helios, the laser producer Fotona and recently also a 75.5% stake in the airport operator Aerodrom Ljubljana have been sold. The latter went to the German airport operator Fraport. In mid-September the privatisation of a 51.1% stake in Žito, one of Slovenia's biggest food companies, has been officially launched. The privatisation process of the biggest company, Telekom Slovenije, which was put on hold prior to the formation of the new government, should be continued and completed by the beginning of 2015. The government expects to receive some EUR 700 million from the sale of the telecom company. Deutsche Telekom and Turkcell were mentioned repeatedly as potential investors.

[56] The Austrian Ring International Holding (RIH) took over the majority of the coating maker Helios in April. Regarding the Croatian investment, part of Agrokor's payment for Mercator was made in the first half of 2014.

Deleveraging of Slovenia's highly indebted companies continued in 2014 at the same pace as in 2013, while household and government deleveraging slowed down. In the first seven months of 2014 loans to the domestic non-banking sector declined by about 15% as compared to the same period a year earlier. It is expected that company deleveraging will continue also in the foreseeable future and remain an impediment to growth.

Based on available results for the first half of 2014, wiiw has revised the forecast for Slovenia's GDP growth for 2014 from minus 0.5% (March forecast) to plus 1.8%, backed by rising exports and stronger than expected investment. The foreign trade performance suggests that the current account will remain in positive territory in 2014 and probably also in 2015. GDP growth will continue in 2015 and 2016, but at a slower pace than in 2014 due to a weakening of investment activities, and it will very much depend on a further rise in exports. Household demand is bound to start slowly recovering due to an improvement of the labour market situation along with growing GDP. Uncertainties remain regarding the policy that will be pursued by the (politically highly inexperienced) new government.

ALBANIA: Economic development under house arrest

MARIO HOLZNER

Albania's GDP growth rates are expected to hover around 1% in the years to come. Weak domestic demand, especially due to fiscal austerity measures, is the main reason for the sluggish development that is a far cry from pre-crisis economic dynamics. The signals emanating from the private sector are contradictory and do not make for a more optimistic outlook at present.

Annualised average consumer price inflation for the first eight months of 2014 is at a record low of 1.8%. This is the result of weak domestic demand and a disinflationary European environment. The Supervisory Board of the Bank of Albania decided in late September 2014 to keep its prime policy interest rate for the next quarters unchanged, at another record low of 2.50%. It was for the first time that the Board convened under the leadership of the acting governor Elisabeta Gjoni. She has replaced long-time governor Ardian Fullani after he was arrested in early September on charges of sloppy management in connection with a cash theft of more than five million euro at the Central Bank. The thief, an employee of the bank, was arrested in July and admitted he had been stealing banknotes for four years. The parliament has sacked Fullani as governor after a decade on the job. He is now under house arrest pending a trial.

Fullani was broadly believed to have conducted quite a pragmatic, growth supporting monetary policy during his mandate, earning him some confidence also on the international scene. However, over the last weeks his and the reputation of the Central Bank were tattered. All the more concerned has been the Supervisory Board of the Bank in the recent weeks to propagate the stability of the Albanian banking sector. Stress tests have shown that the banking sector is overall resilient to macroeconomic shocks. Also capitalisation indicators seem to be at adequate levels. However, the Board mentioned that the banks (which are mostly in foreign ownership) should 'cautiously monitor the possible scenarios for the future developments and their needs for additional capital'. Certainly the credit portfolio quality remains the main concern. The share of non-performing loans stabilised at about 24% in the first half of 2014, though.

Interestingly enough, new loans to the economy increased by some 18% in the first seven months of 2014 as compared to the same period a year earlier. Most of this growth, however, stems from strongly increasing overdraft credits in the business sector, while investment credits for machinery stagnated. Also new loans to households stagnated. This was mostly due to strongly falling credits in foreign currency, whereas especially credits for durable consumer goods in domestic currency experienced a marked increase. Hence the information content of the development on the credit market as an indicator for domestic demand is rather mixed.

Table 18 / Albania: Selected Economic Indicators

	2010	2011	2012	2013 1)	2013	2014	2014	2015	2016
					January-June			Forecast	
Population, th pers., average 2)	2,913	2,905	2,900	2,897	.	.	2,850	2,860	2,870
Gross domestic product, ALL bn, nom. 3)	1,240	1,301	1,335	1,369	684	686	1,400	1,440	1,470
annual change in % (real) 3)	3.7	2.5	1.6	0.5	2.9	0.5	1.3	1.5	0.9
GDP/capita (EUR at exchange rate)	3,100	3,200	3,300	3,400	.	.	.	.	.
GDP/capita (EUR at PPP)	7,100	7,400	7,500	7,600	.	.	.	.	.
Consumption of households, ALL bn, nom. 3)	961.9	1,011.8	1,034.6	1,055.0	.	.	.	.	.
annual change in % (real) 3)	1.7	1.8	0.7	0.5	.	.	2.0	0.5	0.5
Gross fixed capital form., ALL bn, nom. 3)	352.4	381.9	345.0	360.0	.	.	.	.	.
annual change in % (real) 3)	-8.5	5.9	-11.3	-5.0	.	.	1.0	1.5	2.0
Gross industrial production									
annual change in % (real)	37.5	27.1	12.9	23.2	32.2	4.4	5.0	6.0	4.0
Gross agricultural production									
annual change in % (real)	6.2	4.8	5.8	1.0	.	.	4.0	5.0	3.0
Construction output total									
annual change in % (real)	-13.3	-1.1	-11.4	-13.0	-13.2	-6.6	-1.0	1.0	1.0
Employed persons, LFS, th 4)	1,167	1,160	1,117	992	.	.	1,000	1,050	1,050
annual change in %	0.6	.	-3.7	-11.2	.	.	0.8	5.0	0.0
Employment reg. total, th pers., end of period 2)	896	948	962	927	934	910	950	950	950
annual change in %	-1.6	5.8	1.5	-3.7	-1.8	-2.6	2.5	0.0	0.0
Unemployed persons, LFS, th 4)	191	189	173	184	.	.	210	220	230
Unemployment rate, LFS, in % 4)	14.0	14.0	13.4	15.6	15.2	17.7	18.0	18.0	19.0
Reg. unemployment rate, in %, end of period 2)	13.8	13.1	12.8	13.4	13.6	13.5	14.0	14.0	14.5
Average monthly gross wages, ALL	34,767	36,482	37,305	40,860	.	.	.	.	.
annual change in % (real, gross)	-7.0	1.5	0.2	7.4	.	.	1.0	1.0	1.0
Consumer prices, % p.a.	3.6	3.4	2.0	1.9	2.4	1.8	1.0	1.0	1.0
Producer prices in industry, % p.a.	0.3	2.6	1.1	-0.5	.	.	0.0	0.0	0.0
General governm.budget, nat.def., % of GDP									
Revenues	26.2	25.4	24.7	23.9	22.9	25.5	26	26	26
Expenditures	29.3	28.9	28.2	28.8	30.0	28.8	27	27	28
Deficit (-) / surplus (+)	-3.1	-3.5	-3.4	-4.9	-3.5	-1.6	-1.0	-1.0	-2.0
Public debt, nat.def., % of GDP	57.7	59.4	62.0	70.0	.	.	69.4	68.5	69.1
Central bank policy rate, % p.a., end of period 5)	5.00	4.75	4.00	3.00	3.75	2.50	2.50	2.25	2.00
Current account, EUR mn 6)	-1,019	-1,225	-978	-1,035	-508	-618	-1,000	-950	-850
Current account, % of GDP	-11.3	-13.2	-10.2	-10.6	-10.4	-12.6	-10.0	-9.3	-8.3
Exports of goods, BOP, EUR mn 6)	1,172	1,406	1,526	1,756	500	479	1,150	1,200	1,250
annual change in %	56.1	20.0	8.5	15.1	.	-4.2	8.2	4.3	4.2
Imports of goods, BOP, EUR mn 6)	3,254	3,647	3,525	3,476	1,321	1,412	3,050	3,100	3,100
annual change in %	6.5	12.1	-3.4	-1.4	.	6.9	3.2	1.6	0.0
Exports of services, BOP, EUR mn 6)	1,751	1,747	1,673	1,656	971	1,170	2,700	2,750	2,800
annual change in %	-1.2	-0.2	-4.2	-1.0	.	20.5	14.9	1.9	1.8
Imports of services, BOP, EUR mn 6)	1,519	1,612	1,460	1,673	973	1,136	2,450	2,500	2,500
annual change in %	-4.9	6.2	-9.5	14.6	.	16.8	11.8	2.0	0.0
FDI inflow (liabilities), EUR mn 6)	793	630	666	953	410	380	900	800	700
FDI outflow (assets), EUR mn 6)	5	21	18	30	25	46	40	50	40
Gross reserves of NB excl. gold, EUR mn	1,851	1,851	1,909	1,971	1,962	1,964	.	.	.
Gross external debt, EUR mn 6)	4,100	4,958	5,513	6,177	5,854	6,372	.	.	.
Gross external debt, % of GDP	45.6	53.5	57.4	63.3	.	.	.	.	.
Average exchange rate ALL/EUR	137.79	140.33	139.04	140.26	140.19	140.21	140	141	143
Purchasing power parity ALL/EUR	59.94	60.33	61.18	62.30	.	.	.	.	.

1) Preliminary. - 2) According to census October 2011. - 3) According to ESA'10 (FISIM reallocated to industries etc). 2013 estimated by wiiw. Half-year data refer to gross value added. - 4) Until 2011 survey once a year, quarterly thereafter. From 2011 according to census October 2011. - 5) One-week repo rate. - 6) Half-year data and forecasts based on BOP 6th edition.

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

Similarly inconsistent signals come from other indicators relevant for the forecasting of domestic demand. On the one hand, unemployment rates increased by several percentage points to levels of 17% to 18% in the first half of 2014 as compared to a year earlier. On the other hand, we find a 4% real annual increase in the first quarter of 2014 in the turnover of the wholesale, retail trade and repair of motor vehicles sector. This turnover figure is generally considered to be a good indicator regarding the economic expectations of consumers.

Moreover, the Economic Sentiment Indicator (ESI), which quantifies business and consumer confidence, increased in the second quarter of 2014, keeping on the positive developments of the previous two quarters. The ESI is now close to its long-term average. This development is particularly driven by the outstanding advance of the Industry Confidence Index (ICI), which has finally reached pre-crisis levels far above the long-term average. The improved ICI was positively affected by considerable improvements in the production figures and the financial situation of industrial firms. Indeed industrial production figures from the first quarter of 2014 show a real increase of about 15% year on year.

These figures are also confirmed by the customs statistics for the first seven months of 2014. Both, imports as well as exports increased by about 8% on the year. Interestingly, exports increased particularly into Italy, Greece and Turkey. Commodity-wise it is especially exports of textiles, wood but also chemicals that fared well. The largest export group of minerals, fuels and electricity experienced a decline of some 7% in the same period, mainly due to the halved hydro power production in the first half of 2014. This comes a bit as a surprise as precipitation figures appeared to be quite high this year. If autumn continues to be as rainy as the summer was we might expect a reversal in electricity export and import developments and hence a positive contribution of net exports to Albanian GDP.

It is also surprising that the currently published balance of payments figures appear to be quite different from the customs trade figures. In the current account data, goods exports in the first half of 2014 declined by 4% while goods imports increased by 7% on the year. However, this might be related to the adjustments made with the recent implementation of the revised IMF rules published in the sixth edition of the Balance of Payments and International Investment Position Manual. According to these data, services exports have apparently increased by as much as 21% whereas services imports only by 17%, during the same period as above.

Currently the government is rather a drag on aggregate demand. The announced fiscal austerity measures have been indeed realised. From January to July 2014 total revenues increased by 10% and total expenditures decreased by 4% on the year. The cut was especially strong in capital expenditures, which were slashed by as much as 54%. It can be assumed that these trends will continue throughout the whole year. It has to be hoped that private investment replaces public investment as business sentiment improves.

Due to the ambiguous signals from the economic indicators we keep our forecast for GDP growth unchanged as compared to our July 2014 forecast update. Hence we expect economic growth for 2014 at 1.3% and for 2015 at 1.5%. Given a continuous fiscal austerity policy and given that rainfall, which is crucially important for local electricity production, is a mean reverting process, we expect somewhat lower growth for 2016, at 0.9%. Overall these growth rates are only a far cry from pre-crisis growth rates. It will need a substantial boost in domestic demand to get out of the doldrums. A more courageous fiscal policy might be a way to go.

Table 19 / Macedonia: Selected Economic Indicators

	2010	2011	2012	2013 1)	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., mid-year	2,055	2,059	2,061	2,064	.	.	2075	2080	2085
Gross domestic product, MKD mn, nom. 2)	434,112	459,789	458,621	473,019	236,475	256,410	489,600	511,900	537,800
annual change in % (real) 2)	2.9	2.8	-0.4	2.9	0.4	3.9	3.0	3.0	3.0
GDP/capita (EUR at exchange rate)	3,400	3,600	3,600	3,700	.	.	.	.	.
GDP/capita (EUR at PPP)	8,900	9,000	9,000	9,200	.	.	.	.	.
Consumption of households, MKD mn, nom. 2)3)	324096	345262	342809	364665	184,150	188,771	.	.	.
annual change in % (real) 2)	2.1	2.9	-3.0	4.2	5.8	3.1	1.0	1.5	1.5
Gross fixed capital form., MKD mn, nom. 2)	82968	94698	105443	106000	.	.	.	.	.
annual change in % (real) 2)	-2.7	3.2	7.0	2.0	.	.	4.0	4.0	4.0
Gross industrial production 4)									
annual change in % (real)	-4.9	6.9	-2.7	3.2	4.7	4.5	5.0	5.0	5.0
Gross agricultural production									
annual change in % (real)	8.2	-0.4	-5.6	5.0	.	.	3.0	3.0	3.0
Construction output, hours worked									
annual change in % (real)	15.2	28.1	8.3	43.2	57.2	9.1	5.0	5.0	5.0
Employed persons, LFS, th, average	637.9	645.1	650.6	678.8	673.7	686.9	689	699	706
annual change in %	1.3	1.1	0.8	4.3	4.3	2.0	1.5	1.5	1.0
Unemployed persons, LFS, th, average	300.4	295.0	292.5	277.2	279.4	271.2	.	.	.
Unemployment rate, LFS, in %, average	32.0	31.4	31.0	29.0	29.4	28.3	28.0	27.0	27.0
Reg. unemployment rate, in %, end of period	.	.	.	.	.	.	.	.	.
Average monthly gross wages, MKD	30,225	30,602	30,669	31,025	30,987	31,029	.	.	.
annual change in % (real, gross)	-0.6	-2.6	-3.0	-1.6	-2.0	0.3	.	.	.
Average monthly net wages, MKD	20,553	20,847	20,902	21,145	21,128	21,194	.	.	.
annual change in % (real, net)	1.4	-2.4	-2.9	-1.6	-2.0	0.5	.	.	.
Consumer prices, % p.a.	1.6	3.9	3.3	2.8	3.6	-0.2	0.5	1.5	2.0
Producer prices in industry, % p.a. 4)	8.7	11.9	1.4	-1.4	-0.6	-2.2	.	.	.
General governm. budget, nat.def., % of GDP									
Revenues	32.6	32.0	32.6	31.9	.	.	31.0	31.0	31.0
Expenditures	35.0	34.6	36.6	36.1	.	.	35.0	34.0	32.0
Deficit (-) / surplus (+)	-2.4	-2.6	-4.0	-4.2	.	.	-4.0	-3.0	-2.0
Public debt, nat.def., % of GDP	34.8	32.3	39.0	42.7	.	.	42.0	42.0	42.0
Central bank policy rate, %, p.a., end of period 5)	4.11	4.00	3.73	3.25	3.42	3.25	3.25	3.25	3.25
Current account, EUR mn 6)	-144	-189	-226	-147	-224	-220	-320	-330	-350
Current account, % of GDP	-2.0	-2.5	-3.0	-1.9	-2.9	-2.8	-4.0	-4.0	-4.0
Exports of goods, BOP, EUR mn 6)	1,981	2,396	2,304	2,383	1,111	1,275	2,620	2,800	2,970
annual change in %	46.7	21.0	-3.9	3.4	1.6	14.7	10.0	7.0	6.0
Imports of goods, BOP, EUR mn 6)	3,513	4,301	4,312	4,242	2,048	2,197	4,450	4,670	4,900
annual change in %	13.6	22.4	0.2	-1.6	-0.4	7.3	5.0	5.0	5.0
Exports of services, BOP, EUR mn 6)	747	1,045	1,065	1,142	499	574	1,233	1,332	1,412
annual change in %	-5.7	39.8	1.9	7.3	6.8	15.1	8.0	8.0	6.0
Imports of services, BOP, EUR mn 6)	616	686	757	779	364	470	857	900	945
annual change in %	4.8	11.4	10.4	2.9	6.1	29.2	10.0	5.0	5.0
FDI inflow (liabilities), EUR mn 6)	229	370	261	310	118	120	300	300	300
FDI outflow (assets), EUR mn 6)	72.0	25.7	143.7	29.5	0	-21	0	0	0
Gross reserves of NB, excl. gold, EUR mn	1,483	1,802	1,918	1,803	1,838	1,663	.	.	.
Gross external debt, EUR mn 6)	4,106	4,847	5,172	5,220	5,605	5,742	.	.	.
Gross external debt, % of GDP	58.2	64.9	69.4	68.0	67.7	71.7	.	.	.
Average exchange rate MKD/EUR	61.52	61.53	61.53	61.58	61.62	61.65	61.50	61.50	61.50
Purchasing power parity MKD/EUR	23.83	24.84	24.60	25.39	.	.	.	.	.

1) Preliminary. - 2) Annual data according to ESA'95, half-year data according to ESA'10. - 3) Including NPISHs. - 4) Enterprises with 10 and more employees. - 5) Central Bank bills (28-days). - 6) BOP 6th edition.

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

MACEDONIA: Growth versus stability

VLADIMIR GLIGOROV

Macedonia continues to do better than most other Balkan countries. It does so by riding on the back of the country's public investment and export performance. This should continue over the medium term. Political risks are increasing owing to the current government having been so long in office. Moreover, the fact that EU integration has stalled hardly helps. The Russian connection does not play much of a role; hence, the current tensions are mainly inconsequential.

Growth accelerated in the first half of the year and the risks are on the upside of the forecasted rate of 3% for 2014. Practically all elements of demand are contributing positively, with the possible exception of net exports. In particular, private consumption is expanding with continued addition to public investments. There is a positive outlook for the medium term too with the growth rate possibly surpassing 3%. That may depend in part on regional developments as well as on internal political stability.

Macedonia practices what other countries in this region preach. The strategy is to rely on export-led growth with support by domestic demand mainly driven by public investments. The latter are responsible for the strong performance of construction, which is otherwise in the doldrums throughout the Balkans. The government has made an effort to welcome foreign investments, which seems to have paid off, even though the numbers are not too impressive. In any case, these investments seem to have gone into production for exports, which has also provided the necessary stability to the strictly fixed exchange rate to the euro. In turn, monetary policy has been uncharacteristically relaxed, which again has provided space for credit growth, again rather uncharacteristically for a country that has relatively low household and corporate debt. The growth of the former has been supportive of rising private consumption. The constraint to these positive developments may prove to be the external debt, which will restart to increase if imports outpace exports and the current account deficit widens. That may turn out to be a challenge in the medium term.

These positive growth prospects have been associated with rising employment. This is certainly the key policy issue as the unemployment rate continues to be one of the highest anywhere. Still, 28% is lower than 32% or more that was characteristic before the crisis. Indeed, this is one relatively rare case where unemployment declined during the crisis. With growing incomes and credits to households, that has certainly contributed to social stability, which in turn is important for political stability. Since independence, the latter has been the main concern for all the successive governments and this continues to be one risk that is paramount in the mind of the public.

There are two aspects to political stability: the domestic one, which has some new shades, and the external one, which is the issue of EU and NATO integrations and of regional relations. Domestically, the issue is that of a change in government. The currently ruling coalition has been around for too long, which prompts queries of how democratic the system is. The government has been successful in winning the early elections, which has played a stabilising role, but there are also some concerns that the democratic game has been rigged. At some point, change will be needed in order to support the process of democratisation and improve political stability. Otherwise, internal, mostly interethnic political conflicts may grow.

Externally, there is growing realisation that no advance in EU and NATO integration is possible due to the Greek veto. This is not weighing as heavily as it used to because the whole enlargement process for the remains of the Balkans has been rather slow, but this tends to dim the realisation that an external political anchor is fundamental for this small, landlocked and multicultural country. The positive element is improved relations with Serbia, which used to be a problem in the past.

All in all, growth this year may surprise on the upside while it should stay at a relatively elevated level in the medium term too. Given that regional developments play an important role, improvements in Greece and in the other neighbouring countries will be supportive to growth and stability. The emerging trade regime in Europe, with sanctions and countersanctions, are not consequential for Macedonia, which has kept a low profile in the current Europe-wide conflicts, though the country shadows the foreign policy of the EU.

MONTENEGRO: Relying on tourism

VLADIMIR GLIGOROV

In Montenegro, growth will slow down over the current year owing to poor performance in terms of industrial production and investment. In the medium term, public investment and tourism should make for some acceleration of growth. The rift with Russia over the sanctions, which Montenegro introduced in view of its being a candidate country, has not had any appreciable negative impact to date.

Last year's growth will not be repeated this year. The reasons are mostly on the supply side. Industrial production has been declining as have exports of goods. As in the past, almost everything depends on the performance of tourism, which is uncertain due to disappointing weather conditions in the summer. In the end, the modest increase in the first half of the year may get extended for the year as a whole, which would probably be enough to support growth of GDP of around 2%. This result depends also on investments and some increase in private consumption. In the medium run, growth should accelerate to about 3% driven more or less by the same factors.

In the next few years, most of the inherited industrial production will probably disappear altogether. This refers primarily to the aluminium plant and also to the steel mill, which are most probably not going to restart producing. Bankruptcy of the aluminium plant is responsible for the sharp drop in industrial production and in exports of goods in the first half of this year. Chances are that this type of industrial production will not come back. Small and medium-sized industrial firms are yet to make an appearance, so the key sector is that of services and in tourism in particular. Its growth, however, is constrained somewhat by the slow growth or even decline of tourists from the neighbouring countries because those have been doing poorly. Despite all that, there is no doubt that potential investment in tourism is far from being exhausted.

There is some increase in political uncertainty. Internally, the time is running out on the long-time leader of the country, Milo Đukanović, though there is yet to emerge a credible alternative to the largest party. The opposition is divided and without a creditable alternative programme. But, the same could be said for the ruling coalition, especially when it comes to economic policies that would speed up growth and to increased employment.

Externally, some heightened uncertainty is due to the announcement by the incoming president of the EU Commission that there will be no new additions to the EU in the next five years. Montenegro is a frontrunner, having started negotiations a couple of years ago. EU accession has been seen as a major contributor to the country's stability and raising doubts about that is potentially damaging, as are the repeated delays to the membership in NATO. In the latter case also, Montenegro was hoping for speedy accession in order to buttress its stability in a volatile region. Both prospects for membership are not imminent to say the least, which is not helpful.

Table 20 / Montenegro: Selected Economic Indicators

	2010	2011	2012	2013 1)	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., mid-year 2)	619	621	620	622	.	.	623	625	625
Gross domestic product, EUR mn, nom.	3,104	3,234	3,149	3,327	1,409	1,436	3,400	3,500	3,700
annual change in % (real)	2.5	3.2	-2.5	3.3	1.8	0.8	2.1	2.9	3.0
GDP/capita (EUR at exchange rate)	5,000	5,200	5,100	5,300	.	.	.	.	.
GDP/capita (EUR at PPP)	10,200	10,600	10,400	11,200	.	.	.	.	.
Consumption of households, EUR mn, nom.	2,551	2,667	2,632	2,712	.	.	.	.	.
annual change in % (real)	2.0	1.9	-3.2	1.1	.	.	1.0	2.0	2.0
Gross fixed capital form., EUR mn, nom.	655	596	584	639	.	.	.	.	.
annual change in % (real)	-18.5	-10.3	-3.3	8.8	.	.	4.0	5.0	5.0
Gross industrial production 3)									
annual change in % (real)	17.5	-10.3	-7.0	10.7	10.4	-15.3	-1.0	3.0	5.0
Net agricultural production									
annual change in % (real)	-1.7	9.5	-12.7	5.0	.	.	.	.	.
Construction output 4)									
annual change in % (real)	-7.4	15.8	-11.9	1.2	.	.	5.0	5.0	5.0
Employed persons, LFS, th, average 5)	208	195	200	202	200	.	207	210	210
annual change in %	-2.2	.	2.4	1.0	2.6	.	2.5	1.0	1.0
Unemployed persons, LFS, th, average 5)	51	48	49	49	51	.	.	.	.
Unemployment rate, LFS, in %, average 5)	19.6	19.7	19.7	19.5	20.4	.	19.0	19.0	19.0
Reg. unemployment rate, %, average	16.5	15.9	15.3	15.8	14.4	.	15.0	15.0	15.0
Average monthly gross wages, EUR	715	722	727	726	729	724	.	.	.
annual change in % (real, gross)	10.6	-2.1	-3.3	-2.3	-3.8	0.2	.	.	.
Average monthly net wages, EUR	479	484	487	479	482	477	.	.	.
annual change in % (real, net)	2.9	-2.0	-3.3	-3.8	-5.1	-0.1	.	.	.
Consumer prices, % p.a.	0.5	3.5	4.1	2.2	3.2	-0.8	0.0	1.0	2.0
Producer prices in industry, % p.a. 6)	-0.9	3.2	1.9	1.6	3.8	-0.5	.	.	.
General governm.budget, nat.def., % of GDP									
Revenues	40.9	39.7	35.8	37.4	36.5	.	41.0	41.0	41.0
Expenditures	43.9	45.2	42.4	41.0	41.9	.	44.0	43.0	43.0
Deficit (-) / surplus (+)	-3.0	-5.4	-6.6	-3.6	-5.4	.	-3.0	-2.0	-2.0
Public debt, nat.def., % of GDP	40.9	46.0	54.0	56.3	.	.	59.0	58.0	58.0
Central bank policy rate, % p.a., end of period 7)	8.98	9.06	8.83	8.68	8.8	8.6	8.0	8.0	8.0
Current account, EUR mn 8)	-710	-573	-588	-487	-418	-442	-525	-555	-570
Current account, % of GDP	-22.9	-17.7	-18.7	-14.6	-29.7	-30.8	-15.4	-15.9	-15.4
Exports of goods, BOP, EUR mn 8)	357	477	392	403	202	161	360	380	400
annual change in %	20.4	33.6	-17.8	2.8	4.3	-20.1	6.0	6.0	6.0
Imports of goods, BOP, EUR mn 8)	1,624	1,783	1,781	1,733	824	805	1,730	1,800	1,870
annual change in %	0.4	9.8	-0.1	-2.7	-4.9	-2.3	0.0	4.0	4.0
Exports of services, BOP, EUR mn 8)	801	906	998	1,058	260	272	1,160	1,280	1,410
annual change in %	9.5	13.1	10.1	6.0	-4.1	4.8	10.0	10.0	10.0
Imports of services, BOP, EUR mn 8)	337	317	385	411	151	151	430	450	470
annual change in %	1.8	-5.9	21.6	6.6	-10.5	0.0	5.0	5.0	5.0
FDI inflow (liabilities), EUR mn 8)	574	401	482	337	155	166	350	390	430
FDI outflow (assets), EUR mn 8)	22	12	21	13	0	3	20	20	20
Gross reserves of NB, excl. gold, EUR mn 9)	165	171	187	195	187	198	.	.	.
Gross external public debt, EUR mn	912	1,064	1,295	1,433	1,318	1,584	.	.	.
Gross external public debt, % of GDP	29.4	32.9	41.1	43.1	.	.	.	.	.
Purchasing power parity EUR/EUR	0.4927	0.4904	0.4893	0.4993	.	.	.	.	.

1) Preliminary. - 2) According to census April 2011. - 3) Excluding small enterprises in private sector and arms industry. From 2011 NACE Rev. 2. - 4) Gross value added. From 2011 NACE Rev. 2. - 5) From 2011 according to census April 2011. - 6) Domestic output prices. - 7) Average weighted lending interest rate of commercial banks (Montenegro uses the euro as national currency). - 8) Half-year data according to BOP 6th edition. - 9) Data refer to reserve requirements of Central Bank.

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

There has been an improvement in the relationship with the neighbours, in particular with Serbia. This should help the process of democratisation in Montenegro, because the main internal division used to go along ethnic lines, i.e. Montenegrin against Serb, but that rift is bound to ease with the improved relationship between Podgorica and Belgrade. Now the main contentious issues have to do with the internal economic and other policy issues, especially those connected with the rule of law and corruption. Those are also main issues in the ongoing process of negotiations with the EU.

Past the current year, some acceleration of growth should be possible due to investments in infrastructure and tourism and continued, though incremental, growth of private consumption. Policy-makers need to be mindful of widening the current account deficit, which continues to be very large. If foreign investments dry up, the adjustment will be painful. So far, those have held up, though they are well below the peak years before the crisis. So, barring large shocks, growth should rise to about 3% in the medium term.

One such shock could be a significant decline of the number of Russian tourists due to Montenegro introducing sanctions on Russia in solidarity with the EU, a member of which Montenegro is negotiating to become. Similarly, investment in real estate by Russians may abate, though so far there is no indication that either of the two is happening. Russia did not impose sanctions on imports of food from Montenegro, but this is not a very large item. In fact, given the experience with Russian investments, e.g. the one in KAP (the aluminium plant), these investment may not be missed in Montenegro.

Table 21 / Serbia: Selected Economic Indicators

	2010	2011	2012	2013 [1]	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th. pers., mid-year [2]	7,291	7,234	7,199	7,164	.	.	7,070	7,040	7,010
Gross domestic product, RSD bn, nom. [3]	2,882	3,209	3,349	3,618	1,703	1,700	3,700	3,800	4,000
annual change in % (real) [3]	1.0	1.6	-1.5	2.5	0.4	-1.1	-1.0	0.0	1.0
GDP/capita (EUR at exchange rate)	3,800	4,400	4,100	4,500	.	.	.	.	.
GDP/capita (EUR at PPP)	8,500	8,900	9,000	9,200	.	.	.	.	.
Consumption of households, RSD bn, nom. [3]	2,283	2,438	2,544	2,643	.	.	.	.	.
annual change in % (real) [3]	-1.0	-1.2	-1.9	-1.5	.	.	-2.0	-1.0	0.0
Gross fixed capital form., RSD bn, nom. [3]	512	593	717	743	.	.	.	.	.
annual change in % (real) [3]	-5.5	8.4	14.4	-7.7	.	.	0.0	3.0	4.0
Gross industrial production [4]									
annual change in % (real)	1.2	2.5	-2.2	6.3	3.9	-1.1	-3.0	5.0	5.0
Gross agricultural production									
annual change in % (real)	1.0	0.8	-17.3	22.1	.	.	0.0	10.0	8.0
Construction output [5]									
annual change in % (real)	-7.1	10.4	-0.8	-25.7	.	.	3.0	5.0	5.0
Employed persons, LFS, th, average [6]	2,396	2,253	2,228	2,311	2,227	2,408	2,400	2,400	2,400
annual change in %	-8.4	-6.0	-1.1	3.7	3.2	8.1	5.0	1.0	1.0
Unemployed persons, LFS, th, average [6]	569	671	701	656	709	612	.	.	.
Unemployment rate, LFS, in %, average [6]	19.2	23.0	23.9	22.1	24	20	21	23	23
Reg. unemployment rate, in %, end of period	26.7	27.6	28.2	28.2	29	29	28	28	28
Average monthly gross wages, RSD [7]	47,450	52,733	57,430	60,708	59,307	59,865	.	.	.
annual change in % (real, gross)	0.6	0.1	1.0	-1.9	-4.6	-1.3	-1.0	0.0	1.0
Average monthly net wages, RSD [7]	34,142	37,976	41,377	43,932	42,834	43,398	.	.	.
annual change in % (real, net)	0.7	0.2	1.1	-1.5	-4.6	-1.0	-1.0	0.0	1.0
Consumer prices, % p.a.	6.8	11.0	7.8	7.8	11.3	2.3	2.0	4.0	3.0
Producer prices in industry, % p.a.	13.7	12.7	6.8	2.7	4.6	0.6	.	.	.
General governm.budget, nat.def., % of GDP									
Revenues	42.5	40.6	42.0	40.6	.	.	.	.	.
Expenditures	47.3	45.6	48.5	45.6	.	.	.	.	.
Deficit (-) / surplus (+)	-4.8	-5.0	-6.6	-5.0	.	.	-7.0	-5.0	-4.0
Public debt, nat.def., % of GDP	44.5	48.5	59.8	63.7	.	.	72.0	71.0	75.0
Central bank policy rate, % p.a., end of period [8]	11.50	9.75	11.25	9.50	11.0	8.5	8.0	7.0	6.0
Current account, EUR mn [9]	.	.	-3,640	-2,092	-1,055	-866	-1,950	-1,950	-2,100
Current account, % of GDP	.	.	-12.3	-6.5	-6.9	-5.9	-6.2	-6.0	-6.0
Exports of goods, BOP, EUR mn [9]	.	.	8,394	10,540	4,729	5,279	11,200	11,900	12,700
annual change in %	.	.	.	25.6	20.5	11.6	6.0	6.0	7.0
Imports of goods, BOP, EUR mn [9]	.	.	14,028	14,693	6,964	7,131	15,100	15,900	16,700
annual change in %	.	.	.	4.7	1.4	2.4	3.0	5.0	5.0
Exports of services, BOP, EUR mn [9]	.	.	3,104	3,423	1,524	1,680	3,700	3,900	4,100
annual change in %	.	.	.	10.3	7.8	10.2	7.0	5.0	5.0
Imports of services, BOP, EUR mn [9]	.	.	2,965	3,103	1,419	1,540	3,300	3,500	3,700
annual change in %	.	.	.	4.7	1.9	8.5	5.0	5.0	5.0
FDI inflow (liabilities), EUR mn [9]	.	.	926	1,485	333	423	1,000	1,000	1,000
FDI outflow (assets), EUR mn [9]	.	.	257	257	105	87	100	100	100
Gross reserves of NB, excl. gold, EUR mn	9,555	11,497	10,295	10,734	10,206	9,597	.	.	.
Gross external debt, EUR mn	23,786	24,125	25,721	25,842	26,072	25,384	.	.	.
Gross external debt, % of GDP	85.0	76.7	86.9	80.8	.	.	.	.	.
Average exchange rate RSD/EUR	103.04	101.95	113.13	113.14	111.92	115.66	118	120	122
Purchasing power parity RSD/EUR	46.73	49.57	51.46	54.39	.	.	.	.	.

1) Preliminary. - 2) From 2011 according to census October 2011. - 3) According to ESA'95 (FISIM not yet reallocated to industries). - 4) Excluding arms industry. - 5) According to gross value added. - 6) Survey in April and October. - 7) Including wages of employees working for sole proprietors. - 8) Two-week repo rate. - 9) BOP 6th edition.

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

SERBIA: Fiscal dilemma

VLADIMIR GLIGOROV

In Serbia, where fiscal adjustment is urgently required, this year's recession may at best be followed by stagnation or slow growth in the medium term. The risks are on the downside owing to the need to cut public expenditures rather significantly, the sole dilemma being whether fiscal consolidation will have to be frontloaded. Consumption, investment, and employment will depend on that issue. A certain increase in exports to Russia is forecast; this year, however, exports have in fact declined to date. The regime of sanctions currently emerging in Europe is exposing Serbia to growing pressure from Russia, which the country will find difficult to resist.

This year's GDP will shrink by as much as 1%. On the demand side, it is only net exports that might have a positive contribution. Investment may still recover somewhat due to public efforts to deal with the aftermath of the devastating floods. But this is uncertain due to institutional failures. Fiscal consolidation is very much on the agenda, the only open issue being how frontloaded it will be. If indeed it amounts to about 2% of GDP annually in the next three years, stagnant or very slow growth will be a success in the medium term.

After passing some reform legislation dealing with the labour markets and privatisation, the government has turned to fiscal consolidation and public sector reforms, the first elements of which should be incorporated in the revised budget for this year and in the three-year fiscal strategy. Those should also be subjects of intense negotiation with the IMF on a new, most probably three-year standby agreement to be signed before the end of this year. Out of all these intended measures, some elements of the budget cuts have been made public. Those are still not definite, but they are indicative of the direction the government intends to take.

The aim is to stabilise the public debt to GDP ratio at about 75% by the year 2017. After that, the fiscal deficit should be such that this ratio will stop increasing and will start declining towards the legally mandated level of 45%. In order to accomplish this goal, the government intends to cut spending by about 2% of GDP per year. Those savings should come from the elimination of subsidies to loss-making public enterprises, and to a much lesser extent other subsidies, and from cuts in public sector wages and pensions. The latter have received most public attention.

However, it will be easier to cut incomes than subsidies. In the past, inflation was used to reduce real incomes, e.g. compensations and pensions, often speeded up through an exchange rate adjustment. The rising inflation rate would then trigger demands for wage increases and consequentially pensions, which are indexed on the former. In the current circumstances of falling consumption and worsening expectations, which have driven headline inflation down to around zero, a quite significant devaluation would probably be needed to engineer a significant rise in prices; that, however, the central bank would certainly want to avoid. There is scant experience with labour market response to nominal wage cuts, though resistance in some sectors can be expected, while pensioners will have difficulties staging protests given that their party is in the government coalition. There could still be strikes and social protests, but those are unlikely to succeed because the government enjoys high public and electoral support.

Subsidies are a different matter. Those that cover losses would have to be eliminated with price hikes and employment cuts. The needed increases in the price of gas and electricity may have to be quite substantial. In other cases, e.g. the railway company, cuts in employment will also have to be substantial. Other public firms will have to be sold, which besides being unpopular may also lead to more costly services and lay-offs. As for subsidies to agriculture or for investments, these cuts are rather small, but are still not going to be popular with their recipients. It may prove difficult to overcome all the resistance and dissatisfaction that these measures will provoke and mobilise.

Fiscal consolidation, if achieved through expenditure cuts, which is not certain, does little to promote economic growth. In fact, the initial effect will be negative, i.e. recessionary. The economy is already experiencing negative growth of about 1% this year. With some luck, next year and the year after the decline should stop, but not much more can be expected. For things to turn around, a rather significant increase in investment will be needed. In the first half of this year, investment continued to decline as has been the case for most of the crisis years. At the moment, it is not easy to see what would turn this trend around. Without that, however, there will also be no increase of employment, which is sorely needed.

So, after these fiscal consolidation measures, there have to come other reforms that will boost investment, production, and employment. Those would have to include financial consolidation, product market liberalisation, and much more efficient public administration with a complete overhaul of the regulatory system. If these reforms are delayed further, then fiscal consolidation will run into growing resistance and may have a hard time being fully implemented and delivering the desired results.

Prospect for this year are negative and an improvement in the medium term is quite uncertain. Much will depend on the additional policy measures that should be adopted until the end of this year. In any case, practically the whole transition agenda is being faced and risks are significant. That will test the social stability while growing pressure from Russia to take its side is challenging the government's strategy of integration in the EU. Serbia has a trade regime that Russia considers unacceptable in Ukraine, i.e. it has a deep trade agreement with the EU and a free trade agreement with Russia. Currently, that does not present problems, but that may no longer be true once Serbia advances enough towards EU membership and approaches the customs union of the EU, which will require the discontinuation of the free trade agreement with Russia. That may be politically testing.

TURKEY: In the shade of the government's growth targets

SERKAN ÇIÇEK

The Turkish economy performed reasonably well in the first half of 2014 despite the turmoil in the wake of the FED announcing a tapering of its monetary policy. Given both the continuing acceleration in internal demand sparked by the 'dovish' policy stance adopted by the Central Bank to the political pressure and expansionary fiscal policy caused by the elections and the rebalancing of external demand following the depreciation of the Turkish lira, the economy is expected to grow by 3.7% in 2014. Further credit growth will be difficult to forge. Given that constraint and the tensions on Turkey's southern borders, we expect economic growth to decelerate to 2.7% and 2.8% in 2015 and 2016, respectively.

Although the Turkish Central Bank (CBRT) has raised the policy rates in order to stop the decrease in the value of the Turkish lira against the US dollar at the beginning of the year, the Turkish economy has benefited from an impressive adjustment in the first half of 2014 and the growth rate of the economy stood at 3.3% in this period. Three main forces drove the growth in the economy: the dovish policy stance of the CBRT, the expansionary fiscal policy by reason of elections and the current account rebalancing.

The monetary policy settings have loosened since May 2014 by cutting the one-week repo rate by a cumulative 175 bp in order to decrease the tensions with the government. Negative policy rates in real terms have lowered the borrowing costs since May and prevented the growth of private consumption expenditures from turning negative; on the contrary, they increased by 1.8% in the first half of the year. As it is difficult to sustain a negative real interest rate policy for a long time because of the dependence on external financing, there is a possibility of rising demand for foreign exchange in the course of the next couple of months which may again trigger an increase in the policy rates via the CBRT's reaction function. But before the end of the year of 2014, we do not forecast an increase in the policy rates which will preserve a positive but smaller growth of private consumption expenditures. On the other hand, in 2015, we expect the CBRT to loosen inflation targets in order to keep the policy rate at a slightly higher level which may decrease the growth rate of credits and private consumption expenditures.

Table 22 / Turkey: Selected Economic Indicators

	2010	2011	2012	2013 [1]	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., average	73,142	74,224	75,176	76,148	.	.	77,700	78,700	79,600
Gross domestic product, TRY bn, nom.	1,099	1,298	1,417	1,565	742	832	1,760	1,940	2,120
annual change in % (real)	9.2	8.8	2.1	4.1	3.9	3.3	3.7	2.7	2.8
GDP/capita (EUR at exchange rate)	7,500	7,500	8,100	8,100	.	.	7,800	7,800	8,000
GDP/capita (EUR at PPP)	12,200	13,300	13,700	14,100	.	.	.	.	.
Consumption of households, TRY bn, nom.	788	924	994	1,109	537	577	.	.	.
annual change in % (real)	6.7	7.7	-0.5	5.1	4.3	1.8	2.4	1.3	1.8
Gross fixed capital form., TRY bn, nom.	208	283	287	318	158	177	.	.	.
annual change in % (real)	30.5	18.0	-2.7	4.2	1.9	-1.9	1.0	1.5	4.0
Gross industrial production									
annual change in % (real)	12.8	10.0	2.4	3.0	2.2	3.9	3.1	2.5	6.0
Gross agricultural production [2]									
annual change in % (real)	2.4	6.1	3.1	3.1	.	.	.	.	.
Construction industry									
annual change in % (real)	18.6	11.4	0.7	7.5	7.2	4.4	2.0	2.0	5.5
Employed persons, LFS, th, average	22,593	24,100	24,820	25,520	25,338	25,768	26,200	26,600	27,100
annual change in %	6.2	6.7	3.0	2.8	4.2	1.7	2.5	1.7	2.0
Unemployed persons, LFS, th, average	3,048	2,616	2,517	2,750	2,705	.	.	.	.
Unemployment rate, LFS, in %, average	11.9	9.8	9.2	9.7	9.7	.	9.2	9.5	9.1
Reg. unemployment rate, in %, end of period	.	.	.	.	.	.	.	.	.
Average monthly gross wages, TRY	.	.	.	.	.	.	.	.	.
annual change in % (real, gross)	.	.	.	.	.	.	.	.	.
Consumer prices (HICP), % p.a.	8.6	6.5	9.0	7.5	7.1	8.7	8.6	7.4	6.1
Producer prices in industry, % p.a. [3]	6.2	12.3	6.1	5.7	4.0	11.5	8.0	7.1	5.9
General governm. budget, EU-def., % of GDP [4]									
Revenues	37.3	36.6	36.2	37.6	.	.	37.0	36.0	38.0
Expenditures	40.2	37.4	38.6	39.3	.	.	38.5	39.0	39.5
Net lending (+) / net borrowing (-)	-2.9	-0.8	-2.4	-1.7	.	.	-1.5	-3.0	-1.5
Public debt, EU-def., % of GDP	42.4	39.9	36.2	34.6	.	.	36.0	40.0	40.0
Central bank policy rate, % p.a., end of period [5]	6.50	5.75	5.50	4.50	4.50	8.75	8.25	12.00	10.50
Current account, EUR mn	-34,215	-53,891	-37,043	-48,683	-28,234	-17,623	-36,000	-36,000	-39,000
Current account, % of GDP	-6.2	-9.7	-6.0	-7.9	-9.1	-6.3	-6.0	-5.9	-6.2
Exports of goods, BOP, EUR mn	91,292	103,086	127,126	123,036	61,654	63,194	126,000	137,000	148,000
annual change in %	16.1	12.9	23.3	-3.2	1.3	2.5	2.8	9.0	8.0
Imports of goods, BOP, EUR mn	133,962	166,978	178,003	183,236	92,557	84,590	180,000	192,000	206,000
annual change in %	39.3	24.6	6.6	2.9	5.8	-8.6	-2.0	6.6	7.5
Exports of services, BOP, EUR mn	27,776	29,427	34,260	35,674	15,085	15,523	37,000	40,000	43,000
annual change in %	9.1	5.9	16.4	4.1	13.5	2.9	5.0	8.6	8.0
Imports of services, BOP, EUR mn	15,033	15,051	16,280	17,995	8,679	8,739	19,000	21,000	23,000
annual change in %	21.8	0.1	8.2	10.5	17.0	0.7	4.0	8.0	8.0
FDI inflow (liabilities), EUR mn	6,803	11,581	9,708	9,554	4,023	4,935	8,500	10,000	10,000
FDI outflow (assets), EUR mn	1,108	1,710	3,142	2,336	1,085	1,550	2,000	3,000	3,000
Gross reserves of NB excl. gold, EUR mn	60,404	60,531	75,749	80,435	80,709	81,897	.	.	.
Gross external debt, EUR mn	218,415	234,679	255,937	281,444	279,998	280,524	.	.	.
Gross external debt, % of GDP	39.7	42.3	41.8	45.6	42.6	47.3	.	.	.
Average exchange rate TRY/EUR	2.00	2.34	2.31	2.53	2.38	2.97	2.90	3.15	3.35
Purchasing power parity TRY/EUR	1.23	1.31	1.37	1.46	.	.	.	.	.

1) Preliminary. - 2) According to gross value added. - 3) Domestic output prices. - 4) According to ESA'95 excessive deficit procedure. -
5) One-week repo rate.

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

With the local elections and the presidential elections held on 30 March and 10 August 2014, respectively, public spending rose by 5.6% in the first half of the year on average, with both employees' compensation and public spending rising, and hence it became one of the driving forces behind economic growth. Since the government has been eager to sustain economic growth ahead of the parliamentary elections which will be held in the summer of 2015, it is likely that the government consumption expenditures will continue to rise until next summer. A higher interest bill and increases in military expenses due to the tensions at the southern borders of Turkey will also put some pressures on the budget in 2015. We expect a temporary rise in the budget deficit in 2015 by 1.5 percentage points to 3% of GDP but do not see parallels to earlier episodes of excessive budget deficits.

However, the main contribution to GDP growth came from the net export channel in the first two quarters of 2014 which shows that the growth drivers are shifting to the external sector. Turkey's export activity relies on a wide range of enterprises in the interior of the country which produce more traditional, labour-intensive types of products and are catering to regional, non-EU markets. These developments make the Turkish exports more sensitive to exchange rate developments and hence the 8.1% growth in exports which contributed to the economic recovery owed much to the devaluation process earlier this year. But it should be noted that the export volume has slowed over recent months although it started tremendously at the beginning of the year. The ongoing events in Iraq and Syria have greatly affected Turkish exporters. For example, in July 2014, exports to Iraq fell by 45% year on year, subtracting 3.7 percentage points from headline export growth. But the possibility of Russia to boycott imports from Europe as part of the ongoing tensions between Russia and the European Union could mitigate indirect risks on total exports of Turkey via trade diversion effects.

On the other side of the trade balance, we could see a sharp reduction in import growth by 2.1%. The contraction in imports is nourished from two important factors: the relatively high level of the exchange rate plus a legal arrangement imposed by the Banking Regulation and Supervision Agency (BRSA) at the beginning of the year whereby the agency restricted payments with credit cards in instalments. Although the current account deficit narrowed by 38% in the first seven months of the year because of the strong devaluation of the Turkish lira, we expect the current account deficit to drop anchor at around 6% of GDP in 2014. It is quite likely to be of similar size also in 2015 and 2016 because of the high dependency on energy inputs and imported intermediaries.

Unlike in 2013 when gross fixed capital formation was growing at an average rate of 4.2%, it fell by 1.9% in the first half of 2014. Although construction activity financed by both the private and the public sector registered positive growth, the reduction in public and private investment in machinery and equipment dominated the development of gross fixed capital formation in the first two quarters. However, massive government-led infrastructure projects such as a third airport in Istanbul, the Channel Istanbul and a third bridge across the Bosporus will be important drivers of Turkey's construction activities ahead of the parliamentary elections and stimulate future investments of the private sector. But the general economic outlook and changes in the borrowing costs will also have major impacts on future decisions of the private sector.

Meanwhile, also political developments play a crucial role for Turkey's medium- to long-term growth outlook. The clash between Erdogan and the Gulen movement which clearly appeared after the corruption scandal (which saw the sons of three cabinet ministers detained as part of a probe investigation in mid-December 2013) increased the political tensions in the country. For instance, Erdogan is intensifying his attacks against Bank Asya whose shareholders have close relations with the Gulen movement. This has the potential to also deteriorate the financial situation in Turkey.

In a nutshell, we expect internal demand to continue to accelerate through the end of 2014 thanks to the dovish policy stance of the Central Bank against the political pressures and rebalancing in external demand in the wake of the depreciation of the lira, which is the main reason why we have increased our forecast for Turkey's GDP growth in 2014 from 2.2% to 3.7%. On the other hand, we expect a rise in demand for foreign exchange through the end of 2014 because of the negative real interest rate policy that has been followed since May. As it is difficult to sustain such a policy for a longer time because of the dependence on external financing, we expect a slight increase in policy rates at the beginning of 2015 and, immediately thereafter, the CBRT to loosen inflation targets in order to keep the policy rate at a slightly higher level. While this policy will tighten the growth rate of credits and private consumption expenditures, we still expect internal demand to be strong because of the expansionary fiscal policy by reason of elections and net exports to increase as a result of an ongoing devaluation of the exchange rate through 2015. Therefore, we project GDP growth of 2.7% in 2015 and a minimal acceleration of growth in 2016 (2.8%).

BOSNIA AND HERZEGOVINA: Awaiting change

VLADIMIR GLIGOROV

Bosnia and Herzegovina was enjoying respectable growth before being hit by floods in May and June. As a consequence, it is quite likely that no growth will be registered for the current year as a whole. If industrial production and exports hold up, risks may prove to be on the upside. In the medium term, acceleration of growth will hinge on two factors: the efficiency of the reconstruction efforts and the outcome of the crucial parliamentary elections on 12 October. The President of Republika Srpska secured Putin's support, thus making the polls a highly competitive affair. The outcome in that entity proved mixed, with predictable outcomes in the rest of the country, so politics will continue to be a drag on economic recovery.

After a good start in the first quarter, the shock of the floods in May and June dimmed the growth prospects for this year. Some speed-up can be expected in the next couple of years, which could even surprise on the upside. That could happen if reconstruction and recovery efforts prove efficient enough to increase public and, by consequence, private investments too. Otherwise, growth prospects depend on the increase in industrial production and of exports. Public and private consumption will contribute little. That, however, depends on the aftermath of the parliamentary elections, which may still usher in some more meaningful changes.

Economic dynamism comes from foreign investments and exports, mostly in industrial goods. Those may start to recover later in the year and especially next year when the effects of recovery due to reconstruction efforts should be felt. These developments are somewhat more uncertain than before due to the outcome of the parliamentary and presidential elections which were inconclusive. More is also at stake for all political actors. That is in part due to the emergence of new political actors that hope to cash in on the widespread social dissatisfaction expressed forcefully in the social uprising last year and earlier this year. There is a pervasive feeling that the country needs to emerge from almost two decades of post-war stalemate.

In terms of expressing dissatisfaction, it is the Federation where most of the action is. Some of the old parties have fallen in disrepute due to corruption and ineffectiveness. There are a number of new groups and faces that seek to take their country back. Still, the main unknown is the outcome in Republika Srpska. The sense is that this Serbian entity is ready for change, but the ruling party and its leader are not ready to give up. They have turned up the independence and secession rhetoric pointing to the precedents in Crimea and Scotland in recent times. In the past, they argued from the position of strength, as the Serbian entity was arguably doing better than the Federation, but in the current crisis the secessionist call is basically the last resort to stay in power.

Table 23 / Bosnia and Herzegovina: Selected Economic Indicators

	2010	2011	2012	2013 1)	2013	2014	2014	2015	2016
					January-June			Forecast	
Population, th pers., mid-year	3,843	3,840	3,836	3,832	3,832	.	3832	3832	3832
Gross domestic product, BAM mn, nom. 2)	24,879	25,772	25,734	26,259	12,679	.	26,300	26,800	27,900
annual change in % (real) 2)	0.8	1.0	-1.2	2.1	2.6	.	0.0	1.0	2.0
GDP/capita (EUR at exchange rate)	3,300	3,400	3,400	3,500	.	.	3,500	3,600	3,700
GDP/capita (EUR at PPP)	6,700	7,000	7,100	7,300	.	.	.	.	.
Consumption of households, BAM mn, nom. 2)	21,294	21,927	22,338	22,573	.	.	.	.	.
annual change in % (real) 2)	0.1	-0.1	-0.8	0.3	.	.	1.0	2.0	2.0
Gross fixed capital form., BAM mn, nom. 2)	4,299	4,800	4,783	4,703	.	.	.	.	.
annual change in % (real) 2)	-11.1	7.3	1.1	-1.2	.	.	-1.0	3.0	5.0
Gross industrial production									
annual change in % (real)	4.3	2.4	-3.9	5.2	5.2	0.3	1.0	5.0	5.0
Gross agricultural production 3)									
annual change in % (real)	-6.1	1.7	-8.9	5.0	.	.	0.0	5.0	5.0
Construction output total									
annual change in % (real)	-14.3	-5.6	-3.1	-1.1	-0.1	9.3	5.0	5.0	5.0
Employed persons, LFS, th, April	842.8	816.0	813.7	821.6	821.6	812.0	823	831	840
annual change in %	-1.9	-3.2	-0.3	1.0	1.0	-1.2	0.2	1.0	1.1
Employees total, reg., th, average	695.8	691.0	686.9	686.1	684.8	699.8	700	710	720
annual change in %	-0.8	-0.7	-0.6	-0.1	-0.4	2.2	2.0	1.4	1.4
Unemployed persons, LFS, th, April	315.1	310.9	316.6	311.5	311.5	308.0	312	311	310
Unemployment rate, LFS, in %, April	27.2	27.6	28.0	27.5	27.5	27.5	27.0	27.0	27.0
Reg. unemployment rate, in %, end of period	42.8	43.9	44.6	44.5	44.4	43.8	45.0	45.0	45.0
Average monthly gross wages, BAM	1,217	1,271	1,290	1,291	1,285	1,288	.	.	.
annual change in % (real, gross)	-1.0	0.7	-0.5	-0.1	-0.9	1.7	1.0	1.0	1.0
Average monthly net wages, BAM	798	816	826	827	824	830	.	.	.
annual change in % (real, net)	-1.0	-1.4	-0.7	-0.1	-0.8	2.3	2.0	1.0	1.0
Consumer prices, % p.a.	2.1	3.7	2.0	0.2	0.7	-1.5	0.0	1.0	2.0
Producer prices in industry, % p.a.	1.0	5.5	0.3	-1.8	-1.2	-1.4	0.0	1.0	2.0
General governm.budget, nat.def., % of GDP									
Revenues	43.7	44.1	44.5	43.4	.	.	44.0	44.0	44.0
Expenditures	46.1	45.3	46.6	45.6	.	.	46.5	46.0	46.0
Deficit (-) / surplus (+)	-2.5	-1.3	-2.0	-2.2	.	.	-2.5	-2.0	-2.0
Public debt, nat.def., % of GDP 4)	39.1	40.8	44.6	42.5	.	.	44.0	45.0	45.0
Central bank policy rate, % p.a., end of period 5)	.	.	.	.	.	.	.	.	.
Current account, EUR mn 6)	-781	-1,268	-1,213	-794	-367	-506	-1,080	-1,000	-1,200
Current account, % of GDP	-6.1	-9.6	-9.2	-5.9	-5.7	.	-8.0	-7.0	-8.0
Exports of goods, BOP, EUR mn 6)	2,189	2,625	2,575	2,799	1,383	1,449	2,900	3,200	3,500
annual change in %	33.2	19.9	-1.9	8.7	10.6	4.7	5.0	10.0	8.0
Imports of goods, BOP, EUR mn 6)	6,090	6,892	6,893	6,788	3,214	3,457	7,200	7,600	8,000
annual change in %	8.3	13.2	0.0	-1.5	-2.1	7.6	6.0	5.0	5.0
Exports of services, BOP, EUR mn 6)	1,511	1,477	1,484	1,506	713	670	1,500	1,560	1,640
annual change in %	5.9	-2.2	0.5	1.5	5.1	-6.0	-0.5	4.0	5.0
Imports of services, BOP, EUR mn 6)	407	394	380	360	154	156	380	400	420
annual change in %	-10.3	-3.2	-3.6	-5.3	-0.4	1.6	5.0	5.0	5.0
FDI inflow (liabilities), EUR mn 6)	331	340	261	241	277	239	300	400	400
FDI outflow (assets), EUR mn 6)	59	-4	1	16	4.7	-12.6	0	0	0
Gross reserves of NB excl. gold, EUR mn	3,268	3,207	3,246	3,530	3,214	3,559	3,500	3,500	3,300
Gross external public debt, EUR mn	3,215	3,406	3,659	3,788	3,727	3,843	3,900	4,100	4,300
Gross external debt, % of GDP	25.3	25.8	27.8	28.2	27.8	28.6	29.0	29.9	30.1
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.96	1.96	1.96
Purchasing power parity BAM/EUR	0.9686	0.9618	0.9471	0.9464	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (FISIM not yet reallocated to industries). - 3) Based on UN-FAO data, 2013 wiiw estimate. -
4) Based on IMF data. - 5) Bosnia and Herzegovina has a currency board. There is no policy rate and even no money market rate available. -
6) Converted from national currency and based BOP 6th edition.

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

Another change is in the outside support. In the past, the EU was strongly supportive of Bosnia and Herzegovina while the then Serbian government was flirting with secessionist sentiments. In that, Russia was mostly providing implicit support, staying clear of more open interference. This has all changed. The EU seems somewhat uninterested, while the new Serbian government is distancing itself from the secessionist leadership of Republika Srpska and is trying to mend fences with the government in Sarajevo. Russia, by contrast, has come out openly in support of Milorad Dodik, the president of Republika Srpska, and Putin himself has expressed his expectations that the Serbian voters will make the right choice. Promises of financial aid and of investments in the South Stream project, which should branch out into Bosnia and Herzegovina, have been made. That has made the election outcome uncertain.

Depending on that outcome, the policies of the new government and of the new leadership of the entities and the local governments will change or stay the same. Assuming a messy post-electoral process, economic activity may recover rather sluggishly. Otherwise, post-flood recovery could lead to better than expected speed-up of growth. In the medium run, the economy should continue to grow at a pace of up to 3% per year. Rather faster and stronger recovery is feasible with institutional and political changes.

Table 24 / Kosovo: Selected Economic Indicators

	2010	2011	2012	2013 1)	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., average	1,775	1,800	1,816	1,829	.	.	1,845	1,861	1,877
Gross domestic product, EUR mn, nom. 2)	4,402	4,815	5,059	5,327	.	.	5,600	5,900	6,200
annual change in % (real) 2)	3.3	4.4	2.8	3.4	.	.	4.7	3.8	3.7
GDP/capita (EUR at exchange rate)	2,500	2,700	2,800	2,900	.	.	.	.	.
GDP/capita (EUR at PPP)	5,300	5,400	5,600	5,800	.	.	.	.	.
Consumption of households, EUR mn, nom. 2)	3,768	4,142	4,458	4,652	.	.	.	.	.
annual change in % (real) 2)	3.5	3.5	2.9	2.0	.	.	5.0	4.0	3.0
Gross fixed capital form., EUR mn, nom. 2)	1,301	1,476	1,317	1,323	.	.	.	.	.
annual change in % (real) 2)	11.0	8.1	-13.6	-0.2	.	.	0.0	3.0	0.0
Gross industrial production 3)									
annual change in % (real)	-16.6	3.6	32.6	.	.	.	2.0	10.0	5.0
Gross agricultural production 3)									
annual change in % (real)	-9.6	-3.4	5.6	.	.	.	4.0	3.0	4.0
Construction output 3)									
annual change in % (real)	-15.7	-15.3	-24.5	.	.	.	3.0	3.0	4.0
Unemployment rate, LFS, in %, average 4)	45.1	44.8	30.9	30.0	.	.	30.0	29.0	29.0
Reg. unemployed persons, th, end of period	335	325	260	268	266	272	.	.	.
Average monthly net wages, EUR	286	348	354	364	356	399	.	.	.
annual change in % (real, net)	12.7	14.4	-0.8	1.0	-0.7	11.8	10.0	2.0	2.0
Consumer prices, % p.a.	3.5	7.3	2.5	1.8	2.7	0.3	1.0	2.0	2.0
Producer prices in industry, % p.a.	4.7	5.7	1.7	2.5	5.0	-1.0	.	.	.
General governm.budget, nat.def., % of GDP 5)									
Revenues	25.9	27.2	27.3	35.0	.	.	36.0	38.0	37.0
Expenditures	27.7	28.3	28.6	37.0	.	.	38.0	38.0	38.0
Deficit (-) / surplus (+)	-1.8	-1.1	-1.2	-2.0	.	.	-2.0	0.0	-1.0
Public debt, nat.def., % of GDP 5)	5.9	5.3	8.1	8.9	8.6	10.3	10.5	9.9	10.5
Central bank policy rate, % p.a., end of period 6)	14.3	13.9	12.9	11.1	12.0	10.6	.	.	.
Current account, EUR mn	-516	-658	-380	-339	-131	.	-500	-600	-700
Current account, % of GDP	-11.7	-13.7	-7.5	-6.4	.	.	-8.9	-10.2	-11.3
Exports of goods, BOP, EUR mn	305	325	287	305	156	.	300	350	400
annual change in %	72.1	6.5	-11.7	6.3	-8.0		-1.7	16.7	14.3
Imports of goods, BOP, EUR mn	2,057	2,384	2,360	2,297	1,063	.	2,300	2,350	2,450
annual change in %	12.5	15.9	-1.0	-2.7	-0.3	.	0.1	2.2	4.3
Exports of services, BOP, EUR mn	573	618	635	622	252	.	700	750	800
annual change in %	10.7	7.9	2.7	-2.1	-7.5	.	12.5	7.1	6.7
Imports of services, BOP, EUR mn	386	353	289	314	114	.	410	450	500
annual change in %	35.3	-8.6	-18.1	8.6	-19.4	.	30.7	9.8	11.1
FDI inflow (liabilities), EUR mn	366	394	229	259	144	.	250	500	500
FDI outflow (assets), EUR mn	35	16	16	18	6	.	30	40	50
Gross reserves of NB excl. gold, EUR mn	634	575	840	799	846	.	.	.	.
Gross external debt, EUR mn	1,361	1,428	1,517	1,596	1,539	.	.	.	.
Gross external debt, % of GDP	30.9	29.7	30.0	30.0	.	.	.	.	.
Purchasing power parity EUR/EUR	0.463	0.4879	0.4927	0.4999	.	.	.	.	.

1) Preliminary. - 2) According to ESA 2010. - 3) According to gross value added data. - 4) From 2012 new improved sample survey based on census 2011, not comparable with previous years. - 5) National definition based on ESA 2010. - 6) Average weighted lending interest rate (Kosovo uses the euro as national currency).

Source: National statistics and IMF. Forecasts by wiiw.

KOSOVO: Robust growth despite political quarrelling

MARIO HOLZNER

Despite a politically disputatious environment, economic growth in Kosovo is expected to home in on some 4% in both the current year and the two years thereafter. Owing to the marked wage increases in the period leading up to the parliamentary elections in June 2014, growth in the current year is even expected to surpass 4%. Growth prospects depend on developments in Germany and Switzerland, the two top remittance- sending countries for Kosovan migrants.

Five months after the 8 June 2014 general elections in Kosovo the newly elected MPs were not able to nominate the president of the assembly according to the procedure provided by the constitution and interpreted by the constitutional court. As a consequence also no government could be formed so far. The incumbent Prime Minister Hashim Thaci's party, the PDK, has won the relative but not the absolute majority in the parliament. All the major opposition parties (LDK, AAK, Nisma, Vetevendosje) have formed a coalition after the elections and want to take over both the assembly presidency and the government. President Atifete Jahjaga has the duty to solve this political stalemate via intense consultations with the opposing parties. Important legislation and decisions are therefore delayed, such as the planned telecom privatisation.

Despite these political quarrels the economic outlook is still quite stable. The current growth path seems to centre on some 4% of real GDP increase per annum. For the year 2014 we expect a somewhat higher GDP growth rate due to increased government consumption in the run-up to this year's elections. In the first half of 2014 government revenues stagnated while expenditures increased by about 2% as compared to the same period of the previous year. However, the composition of the expenditures has changed markedly. Public capital investment decreased by almost 30% while public expenditures on wages and salaries increased by some 34% over the same period. Average net real monthly wages throughout the economy increased by as much as 12% in the first half of 2014 on the year.

Rising wages together with slightly increasing remittances (+2.4% year on year in the first quarter of 2014) will carry the day via household consumption growth. By contrast, investment will not contribute to GDP growth in 2014 given the strong reduction in public capital spending. Falling public investment as well as less FDI will probably be compensated by rising domestic investment as suggested by the development of new loans. Over the first seven months of 2014 total new loans were increasing by more than 37% year on year. Growth in investment loans to non-financial corporations was particularly strong and stood at 77%. Mortgage loans to households rose by 19%.

Customs statistics for the first half of 2014 reveal a slight drop of about 5% in exports year on year while imports increased by less than a percentage point. Hence we can expect net exports to negatively impact overall GDP growth. Still the external sector is very important for Kosovo. Remittances from migrant workers, living mostly in Germany and Switzerland, make up about 12% of GDP and are constantly fuelling household consumption and providing the means to cover the huge trade deficit. Both the German and the Swiss economy are expected to grow by about 1.3% to 1.8% in 2014. Especially in the case of Germany this is a strong increase when compared to an almost-stagnation in 2013.

However, most recently the 2014 GDP growth forecasts for Germany have been somewhat reduced, e.g. by the European Commission from 1.8% earlier this year to 1.3% in early November 2014. This is also the main reason why, since the last forecast update in July 2014, we had to slightly reduce our forecasts for the GDP growth of Kosovo in 2014 from 5% to 4.7% and similarly from 4% to 3.8% and 3.7% in 2015 and 2016, respectively. Obviously the political stalemate after the June 2014 elections has also negatively influenced the forecast revision.

BELARUS: Economy at a crossroads

RUMEN DOBRINSKY

Growth in Belarus was sluggish in the first half of 2014. It seems, however, that a modest upturn has now set in; it should contribute to an average GDP growth of close to 2% for the year as a whole. At present, policy is focused on preserving a teetering macroeconomic equilibrium, which is being bolstered by mobilising short-term external financial resources. This course is likely to linger on up until the presidential elections scheduled for mid-2015, the outcome of which will play a key role in determining the country's political landscape.

Growth in Belarus was sluggish in the first half of 2014 but a modest upturn seems to be underway. In the course of the year, economic activity has been reviving, albeit at a slow pace: after a sluggish 0.9% year-on-year rate of growth in the first quarter, GDP growth picked up to 1.6% in the second quarter resulting in a 1.2% average rate for the first half of the year. Recent monthly indicators suggest that growth continued to pick up momentum in the third quarter.

On the supply side, good performance in the services sector (apart from construction) contributed to aggregate growth. After a downturn that continued for a year and a half, industrial production also seems about to turn the corner. On the demand side, private consumption provided a modest boost to economic activity, supported by a continued rise in real incomes, while fixed investment experienced a downturn. The current statistics available at the moment of writing do not allow for a detailed assessment, nevertheless, it appears that net exports made the most significant contribution to GDP growth in the first half of 2014 thanks to an ongoing significant reduction in the trade deficit. The observable adjustment in trade flows partly reflects protective policy measures by the authorities seeking to support local producers and exporters and measures seeking to restrain imports. The resumption of production and exports of potassium fertilisers (a key export item) after a disruption in 2013 (due to a dispute with the Russian business partner Uralkali) also contributed to this change.

Since the 2011 balance of payments crisis, the economy of Belarus has been muddling through, seeking new direction. However, policy so far has not addressed the underlying root cause of the crisis – an overvalued real exchange rate which is not consistent with economic fundamentals. The authorities have been reluctant to take any far-reaching corrective policy measures towards a more stable macroeconomic equilibrium as these would imply a painful adjustment. Instead, the key efforts at a high policy level have been focused on attracting additional external financial resources aimed at supporting an unstable macroeconomic equilibrium. However, the sustainability of such a policy course is highly questionable. While preserving it until the upcoming presidential elections in 2015 seems manageable, a major adjustment is probably to be expected in the not too distant future thereafter.

Table 25 / Belarus: Selected Economic Indicators

	2010	2011	2012	2013 [1]	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., average [2]	9,491	9,473	9,465	9,466	.	.	9,475	9,490	9,510
Gross domestic product, BYR bn, nom.	164,476	297,158	530,356	636,784	283,424	337,385	764,900	907,700	1,111,000
annual change in % (real)	7.7	5.5	1.7	0.9	1.4	1.2	1.8	2.3	2.0
GDP/capita (EUR at exchange rate)	4,300	3,900	5,200	5,700	.	.	.	.	.
GDP/capita (EUR at PPP)	10,500	11,100	11,800	11,800	.	.	.	.	.
Consumption of households, BYR bn, nom.	88,470	139,955	244,863	323,927	144,363	177,527	.	.	.
annual change in % (real)	9.5	2.3	10.8	12.2	16.3	5.1	5.0	4.0	2.0
Gross fixed capital form., BYR bn, nom.	64,698	113,230	178,455	235,234	96,163	105,532	.	.	.
annual change in % (real)	17.5	13.9	-11.3	7.5	9.9	-7.5	-2.0	-2.0	0.0
Gross industrial production									
annual change in % (real)	11.7	9.1	5.8	-4.8	-4.2	-1.0	0.0	2.0	4.0
Gross agricultural production									
annual change in % (real)	2.5	6.6	6.6	-4.0	1.5	-4.3	.	.	.
Construction industry									
annual change in % (real)	15.8	17.9	-11.7	7.4	2.8	-6.7	.	.	.
Employed persons, LFS, th, average	4,666	4,655	4,577	4,518	4,534	4,491	4,500	4,550	4,600
annual change in %	0.5	-0.2	-1.7	-1.3	-1.1	-1.0	.	.	.
Unemployed persons, LFS, th, average	.	.	.	.	.	.	.	.	.
Unemployment rate, LFS, in %, average	.	.	.	.	.	.	.	.	.
Reg. unemployment rate, in %, end of period	0.9	0.7	0.6	0.5	0.5	0.5	0.5	0.5	0.5
Average monthly gross wages, ths BYR	1,217	1,900	3,676	5,139	4,771	5,680	.	.	.
annual change in % (real, gross)	15.0	1.9	21.5	18.2	20.5	3.6	.	.	.
Consumer prices (HICP), % p.a.	7.8	53.2	59.2	18.3	21.0	17.2	18.0	16.0	20.0
Producer prices in industry, % p.a.	13.6	71.4	76.0	13.6	16.5	11.3	.	.	.
General governm.budget, nat.-def., % of GDP	-	-	-	-	-	-	-	-	-
Revenues	41.6	38.7	40.5	41.9	45.4	41.6	.	.	.
Expenditures	44.2	35.9	39.8	41.8	43.5	41.4	.	.	.
Net lending (+) / net borrowing (-)	-2.6	2.8	0.7	0.2	1.9	0.1	0.0	-1.0	-2.0
Public debt, IMF-def., % of GDP	41.0	45.9	38.7	35.8	.	.	.	.	.
Central bank policy rate, % p.a., end of period [3]	10.50	43.23	30.00	23.50	25.0	21.5	.	.	.
Current account, EUR mn [4]	-6,187	-3,518	-1,446	-5,804	-2,757	-1,961	-4,000	-4,000	-3,000
Current account, % of GDP	-15.1	-9.5	-2.9	-10.8	-11.1	-7.7	-7.3	-7.1	-5.5
Exports of goods, BOP, EUR mn [4]	18,311	28,499	35,391	27,701	14,275	13,729	27,500	28,000	28,500
annual change in %	26.3	55.6	24.2	-21.7	-26.3	-3.8	-0.7	1.8	1.8
Imports of goods, BOP, EUR mn [4]	25,251	30,913	34,952	31,183	15,260	13,918	28,500	29,000	28,500
annual change in %	29.5	22.4	13.1	-10.8	-12.9	-8.8	-8.6	1.8	-1.7
Exports of services, BOP, EUR mn [4]	3,583	3,906	4,901	5,578	2,625	2,605	5,500	5,600	5,700
annual change in %	37.1	9.0	25.5	13.8	17.6	-0.7	-1.4	1.8	1.8
Imports of services, BOP, EUR mn [4]	2,247	2,334	3,140	3,937	1,766	2,068	3,900	4,000	3,900
annual change in %	43.9	3.9	34.5	25.4	26.8	17.2	-0.9	2.6	-2.5
FDI inflow, EUR mn [4]	1,041	2,787	1,137	1,703	1,275	983	.	.	.
FDI outflow, EUR mn [4]	38	87	121	199	77	8	.	.	.
Gross reserves of NB, excl. gold, EUR mn	2,591	4,648	4,390	3,589	4,874	3,432	.	.	.
Gross external debt, EUR mn [4]	21,449	26,305	25,518	28,807	30,120	29,821	.	.	.
Gross external debt, % of GDP	52.2	71.3	51.9	53.5	56.0	54.6	.	.	.
Average exchange rate BYR/EUR	4,007	8,051	10,778	11,834	11,400	13,296	14,000	16,200	20,300
Purchasing power parity BYR/EUR	1,653	2,814	4,762	5,696	.	.	.	.	.

1) Preliminary. - 2) According to census October 2009. - 3) Refinancing rate of NB. - 4) BOP 6th edtion.

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

During some 15 years preceding the 2011 crisis, Belarus experienced a period of unprecedented, high economic growth which produced impressive outcomes: between 1995 and 2011 real GDP (as reported by the national statistics) tripled. However, what might at the surface appear as an economic miracle did not have sound economic fundamentals. Indeed, one of the core drivers of growth throughout most of the past couple of decades have been the implicit transfers from Russia originating in below market prices charged for the supplied oil and gas and amounting to several billion euro per year. Part of these implicit subsidies was channelled directly to recipient firms (distorting market conditions) and another part generated fiscal revenue and resided in the state coffers.

More generally, the Belarusian economy benefited from close economic ties with Russia and cross-border economic cooperation. Thus during the past decade, strong import demand in Russia supported growing exports of Belarusian engineering products and capital goods (partly thanks to the supply chains preserved from the past) thus contributing to the revival of these sectors of the Belarusian economy.

While this external stimulus supported general economic growth and contributed to relatively balanced public finances, it also produced significant distortions in the Belarusian economy, resulting from populist income policies and activist old-fashioned industrial policy. In particular, during the past decade the government has been pursuing an aggressive investment promotion campaign in the public sphere and in state-owned firms through subsidised directed credit channelled through the banking system. One piece of evidence hinting at overinvestment in this period is the fact that the average rate of gross capital formation (as a percentage of GDP) in the decade up to 2013 was 34%. However, in the absence of proper market-based intermediation through a well-functioning financial system these investment decisions were hardly consistent with efficient resource allocation. In addition, the excessive money supply associated with massive directed credit has been feeding into persistent high inflation in Belarus.

A typical example epitomising the prevailing populist policy stance was the target announced in 2010 to raise average monthly wages in Belarus to the equivalent of USD 1,000 by 2015. This target has been pursued through the two instruments affecting dollar income: nominal wages and the nominal exchange rate. On the one hand, the government encouraged generous increases in nominal wages; these originated in the public sector but then spilled over to the business sector. On the other hand, the National Bank was subverted to pressure by the government to put brakes on the depreciation of the Belarusian rouble which, in principle, follows a floating exchange rate.

While the 2011 currency crunch partly echoed the repercussions of the global economic and financial crisis, it was to a large extent the outcome of the inconsistency of such a policy course which had produced an unsustainable real exchange rate appreciation. The authorities were then forced to accept a more that 200% depreciation of the nominal exchange rate which was a major policy setback, making void the above-mentioned wage target. Concomitantly, the implicit transfers from Russia through subsidised imports of oil and gas have become less reliable and predictable in latest years. The establishment in 2010 of the Customs Union with Russia and Kazakhstan and later of the Eurasian Economic Union, to be formally launched in 2015, played a role in this as it turned out that some of these subsidies were inconsistent with the general economic principles of these integrative economic structures.

The 2011 crisis and the recent changes in the external economic environment prompt the need for a major change in the policy course towards restoring a more stable macroeconomic equilibrium. The decades of unsustainable policies have resulted in the accumulation of significant distortions and structural imbalances in the economy. However, instead of policy reforms, the authorities have sought to attract supplementary short-term external financial resources in an attempt to preserve the status quo, at least in the short run. Consequently, real exchange rate appreciation resumed again after 2012 and by mid-2014, the level of the real exchange rate – which initially had dropped significantly – was approaching its 2011 peaks.

During the past 2-3 years, the authorities have been resorting to all possible sources of balance of payment support, but mostly Russian and Russia-dominated official ones. In June 2011, the Anti-Crisis Fund managed by the Eurasian Development Bank approved a USD 3 billion financial credit to Belarus, of which USD 2.56 billion has been disbursed to date. In addition, in 2013-2014 Belarus raised or negotiated credits from Russia's Sberbank (government guarantee for a USD 1 billion loan that Belarusian potash manufacturer Belaruskali took from Sberbank) and Vnesheconombank (USD 2 billion), as well as sovereign loans from the governments of Russia and China (close to USD 1 billion in total) and a number of smaller official loans. On top of that, in 2014 Belarus negotiated with Russia derogations from Eurasian Economic Union rules on oil export duties, which are equivalent to an up to USD 1.5 billion direct Russia-Belarus government-to-government transfer in 2015. Belarus is also considering a Eurobond issue in 2015 amounting to USD 1 billion (after it made its debut on the Eurobond market in 2010-2011 with two subsequent issues totalling USD 1.8 billion). IMF support has not been negotiated in this period, after some difficulties experienced in the course of the implementation of a 2009 stand-by arrangement and related to strict IMF conditionality.

Thus the underlying policy strategy in recent years appears to have aimed to maintain the status quo – and prevent at any cost an economic collapse accompanied by a plunge in living standards – and buy time, at least until the key presidential elections scheduled for mid-2015. During the past two decades, rising welfare has been one of the declared flagship political achievements and the authorities have been rather cautious about possible reversals. However, in the years after 2008, this has been achieved at the expense of large current account deficits (of the order of 10% of GDP or even higher in much of this period) and, consequently, growing external indebtedness.

The present policy course – implying the need to raise continuously new and ever-increasing balance of payments support – is difficult to sustain in the medium and longer run. Addressing the root causes of the balance of payments crisis would require regaining competitiveness by a combination of lasting real exchange rate depreciation and structural reforms supporting productivity gains. Macroeconomic stabilisation accompanied by sustainable disinflation and contributing to a notable reduction in interest rates is also a key prerequisite for establishing a healthy economic environment. Sooner or later, the authorities will have to face these painful adjustment measures; apart from political considerations, the timing of adjustment will depend on the ability to continue to finance the balance of payments deficit. Thus in a medium-term perspective, the Belarusian economy appears to be at a crossroads between the status quo and a new policy course leading to a more sustainable growth pattern.

In the short term however, the Belarusian economy is likely to get a modest boost resulting from the Russian ban on food and agricultural imports from the EU. Given its geographic location, in the current circumstances the Belarusian food and agricultural exports to Russia will only be limited by production capacity and the capacity to meet Russian quality and phytosanitary regulations. There are also ongoing negotiations with neighbouring EU countries on cooperation in the processing in Belarus of agro products originating in other countries. These developments could provide some support to the economic upturn in the second half of the year.

Given the above, stronger economic activity in the second half could contribute to an average GDP growth for the year as a whole of close to 2%. As regards the macroeconomic environment, no major changes are expected before 2016 and given a continuing favourable push from Russia (both traditional and agro-driven), modest GDP growth should continue in Belarus. The country has also regained some international recognition after mediating between the EU and Russia during the Ukrainian conflict which may ease its access to international financial markets to secure much-needed balance of payments support.

The forecast envisages the start in 2016 of a gradual adjustment process in line with the propositions outlined above. Such an adjustment would impact negatively on domestic demand but could contribute to gradual disinflation and give a further boost to exports.

Table 26 / Kazakhstan: Selected Economic Indicators

	2010	2011	2012	2013 [1]	2013	2014	2014	2015	2016
					January-June		Forecast		
Population, th pers., average [2]	16,322	16,557	16,791	17,035	16,970	17,223	17,150	17,300	17,450
Gross domestic product, KZT bn, nom. [3]	21,816	27,572	30,347	34,140	14,153	15,560	37,500	41,500	46,200
annual change in % (real) [3]	7.3	7.5	5.0	6.0	5.1	3.9	4.5	4.5	5.0
GDP/capita (EUR at exchange rate)	6,800	8,200	9,400	9,900	.	.	9,200	10,400	11,400
GDP/capita (EUR at PPP)	13,700	15,900	16,900	18,300	.	.	.	.	.
Consumption of households, KZT bn, nom. [3]	9,721	11,569	13,623	16,030	6,460	.	18,300	20,300	22,600
annual change in % (real) [3]	11.8	10.9	11.0	10.1	16.8	.	4.5	4.5	5.0
Gross fixed capital form., KZT bn, nom. [3]	5,307	5,772	6,761	7,972	2,407	.	9,400	10,500	11,900
annual change in % (real) [3]	3.8	3.9	9.1	9.9	7.1	.	6.0	7.0	8.0
Gross industrial production									
annual change in % (real)	9.6	3.8	0.7	2.3	1.8	-0.4	2.0	4.0	7.0
Gross agricultural production									
annual change in % (real)	-11.7	26.8	-17.8	11.7	2.9	3.3	-4.0	5.0	5.0
Construction industry									
annual change in % (real)	2.4	2.8	3.1	3.5	0.7	4.2	5.0	8.0	10.0
Employed persons, LFS, th, average [4]	8,114	8,302	8,507	8,571	8,568	8,619	8,660	8,750	8,840
annual change in %	2.7	1.1	1.0	0.7	0.9	0.6	1.0	1.0	1.0
Unemployed persons, LFS, th, average [4]	497	473	475	471	472	463	.	.	.
Unemployment rate, LFS, in %, average [4]	5.8	5.4	5.3	5.2	5.3	5.1	5.1	5.0	5.0
Reg. unemployment rate, in %, end of period	0.4	0.4	0.4	0.3	0.7	0.6	.	.	.
Average monthly gross wages, KZT [5]	77,611	90,028	101,263	109,141	104,712	114,760	.	.	.
annual change in % (real, gross)	7.6	7.1	7.0	1.9	0.5	3.2	.	.	.
Consumer prices (HICP), % p.a.	7.1	8.3	5.2	5.8	6.6	6.2	9.0	6.0	6.0
Producer prices in industry, % p.a.	25.2	27.2	3.5	-0.3	-1.4	10.1	11.0	4.0	5.0
General governm.budget, nat.def., % of GDP									
Revenues	19.7	19.5	19.2	18.7	22.2	24.2	.	.	.
Expenditures	22.1	21.5	22.1	20.7	22.7	25.0	.	.	.
Deficit (-) / surplus (+)	-2.4	-2.1	-2.9	-2.1	-0.4	-0.9	-3.0	-1.5	-1.5
Public debt, nat.def., % of GDP	14.8	12.3	13.0	13.3	11.7	13.2	15.0	14.0	14.0
Central bank policy rate, % p.a., end of period [6]	7.0	7.5	5.5	5.5	5.5	5.5	.	.	.
Current account, EUR mn [7]	1,044	7,325	816	844	2,477	4,803	2,000	-200	-2,500
Current account in % of GDP	0.9	5.4	0.5	0.5	3.5	7.5	1.3	-0.1	-1.3
Exports of goods, BOP, EUR mn [7]	46,231	61,198	67,629	64,435	32,814	30,777	62,900	66,700	69,400
annual growth rate in %	46.8	32.4	10.5	-4.7	-4.0	-6.2	-2.4	6.0	4.0
Imports of goods, BOP, EUR mn [7]	24,769	28,985	37,954	38,244	18,189	14,324	35,800	39,800	43,000
annual growth rate in %	19.4	17.0	30.9	0.8	12.0	-21.2	-6.4	11.2	8.0
Exports of services, BOP, EUR mn [7]	3,102	3,116	3,757	3,854	1,911	1,938	4,200	4,600	4,800
annual growth rate in %	5.4	0.5	20.6	2.6	8.4	1.5	9.0	9.5	4.3
Imports of services, BOP, EUR mn [7]	8,561	7,882	9,941	9,049	4,217	4,108	9,400	10,500	11,600
annual growth rate in %	18.4	-7.9	26.1	-9.0	-6.3	-2.6	3.9	11.7	10.5
FDI inflow (liabilities), EUR mn [7]	5,615	9,885	10,618	7,514	4,338	2,838	7,900	8,200	8,600
FDI outflow (assets), EUR mn [7]	2,855	3,719	1,394	1,437	1,073	-407	1,600	1,800	1,900
Gross reserves of NB excl. gold, EUR mn	19,044	19,477	16,665	13,940	16,157	14,608	.	.	.
Gross external debt, EUR mn [7]	89,259	96,951	103,150	109,037	111,602	114,206	.	.	.
Gross external debt, % of GDP	80.1	71.8	65.1	64.5	64.8	72.8	.	.	.
Average exchange rate KZT/EUR	195.67	204.11	191.67	202.09	198.21	241.83	239	231	232
Purchasing power parity KZT/EUR [8]	98.37	106.61	107.78	114.94	.	.	.	.	.

Note: Gross industrial production and producer prices refer to NACE Rev. 2 (including E - Water supply, sewerage, waste management and remediation activities).

1) Preliminary. - 2) According to census March 2009. - 3) From 2011 according to SNA'08 (SNA'93 before) and FISIM reallocated to industries. - 4) From 3rd quarter 2011 according to census March 2009, wiiw estimates for growth in 2011 and 2012. - 5) Excluding small enterprises, engaged in entrepreneurial activity. - 6) Refinancing rate of NB. - 7) Converted from USD and based on BOP 6th edition. - 8) wiiw estimates based on the 2011 International Comparison Project benchmark.

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

KAZAKHSTAN: Economic growth loses pace

OLGA PINDYUK

Kazakhstan's economic growth will drop to an annual rate of 4.5-5% over the period 2014-2016 owing to the delay in the launch of the Kashagan oil field and weaker external demand. The recent devaluation of the national currency appears to have had a net negative impact on the country's economy, while the improvement in the current account balance will be only temporary. The banking sector in Kazakhstan continues to struggle with an excessive number of non-performing loans.

After a rather strong performance in 2013, Kazakhstan's economy has significantly slowed down its growth in the first half of 2014 – to 3.9% in real terms year-on-year (according to preliminary data) as compared to 6% in 2013. The main culprit of the deteriorating dynamics is the oil sector, which has faced problems both on the production and demand sides. Oil production is expected to remain this year at the 2013 level of 81.8 million tonnes instead of previously planned 83 million tonnes, as the launch of the Kashagan project was postponed until late 2016 because of technical issues.[57] In 2015-2016, oil production will be able to increase only marginally.

In addition to the supply-side issues, demand for oil has started to decline in major exports markets of Kazakhstan: in January-July 2014, oil exports to China fell by 29% year-on-year in USD terms, to the Netherlands by 20%, and to France by 8% – together these countries accounted for 37% of Kazakhstan's oil exports in 2013. Overall, during this period oil exports increased by 1% y-o-y in USD terms as compared with January-July 2013 – primarily on the back of a 13% increase in oil exports to Italy, which accounted for almost a quarter of the country's oil exports in 2013. In 2014-2016, global demand for oil is likely to remain sluggish, but we do not expect world oil prices to fall much below USD 100 per barrel. Thus Kazakhstan's oil exports are forecasted to remain stagnant during this period.

Regardless of slightly positive oil exports dynamics, total merchandise exports decreased during January-June 2014 by 2% y-o-y in USD terms due to a demand-driven fall of exports to the CIS countries (most importantly Russia[58] – by 22% y-o-y) and China[59] (by 21% y-o-y). The sharp devaluation

57 The Kashagan field contains an estimated 13 billion barrels of recoverable oil reserves, which makes it one of the largest oil fields discovered in the last 50 years. Due to numerous technical difficulties the field's launch is already almost a decade behind schedule and the estimated cost of the project has shot up from the original USD 50 billion to USD 135 billion. Kashagan briefly started producing oil in September 2013, only to shut down 13 days later due to a leak in a gas pipeline running from the oilfield to the shore.

58 Main export products sold to Russia are metal ores (25% of exports in 2013), iron and steel (13%), and inorganic chemicals (12%).

59 Main export products sold to China are mineral fuels (62% of exports in 2013), copper (11%), and ores (8%).

of the tenge in February 2014 has not had much positive effect on exports as the largest component of exports – oil and mining products – are priced in USD. At the same time, there was a strong effect of the devaluation on import dynamics: during January-June 2014 goods imports decreased by 15% y-o-y in USD terms. As a result, the current account balance turned positive in the first quarter of 2014 and reached a record high level of USD 6.3 billion. However, the current account surplus will diminish by the year-end, as annual export growth is forecasted to be negative, in part because wheat export is expected to decline after a poor harvest. External demand for commodities is assumed to be weak during the forecasting period, therefore Kazakhstan's exports are forecasted to have a sluggish dynamics. Import growth is expected to recover in 2015-2016, thus the current account balance will gradually decline and turn negative already in 2015.

The devaluation appears to have caused more negative effects to the country's economy than positive ones. First, it was a major blow to confidence of both businesses and consumers. Besides, the devaluation caused higher import prices and eroded the purchasing power. During the first quarter of 2014, real household consumption and gross fixed capital formation remained practically at the level of the first quarter of 2013. Government policies to mitigate the negative effects of the devaluation via a KZT 1 trillion (equivalent to 2.5% of GDP) investment stimulus package to be deployed within two years, wage hikes in the public sector and an increase in social benefits are not likely to fully offset them. Therefore household consumption and investment will grow at a slower pace during the forecasting period than it had been previously assumed. Taking into account also the oil sector problems, we reduce our forecast of Kazakhstan's GDP growth – to 4.5% in 2014 and 2015, and to 5% in 2016 (from 6% in 2014, 6.5% in 2015, and 5.5% in 2016). The negative risks to the forecast are a significant slowdown of economic growth in China and a recession in Russia, and a sustained decline in global oil and other commodities' prices.

The KZT/USD exchange rate is likely to remain stable during the next three years. The risks to the stability of the national currency would be plummeting world oil prices or rapid depreciation of the Russian rouble. The head of the country's National Bank announced that another devaluation of the tenge might take place if the world oil prices fall to 80 USD/barrel or if the Russian rouble depreciates to more than 43 RUB/USD.

The banking sector in Kazakhstan continues to struggle with a high level of non-performing loans (NPLs) – the legacy of the 2007-2008 crisis. In July 2014, the share of NPLs in the loans stock was at 31.6%. About 80% of NPLs belong to corporate clients; the share of NPLs in the portfolio of corporate loans was at 43% in July 2014. By the end of 2015, banks are obliged to decrease the share of NPLs in their loan portfolios to 15% (and by 2016 to 10%), otherwise their licences will be revoked. At the moment, 15 out of 38 banks have NPL shares above 15%, among them 8 out of the 10 largest banks by assets size. BTA and Alliance, the banks that went through restructuring, have NPL shares at 91% and 61% respectively. The National Bank has introduced tax incentives for writing off bad loans, but decreasing NPLs at such a scale might turn out to be rather challenging.

Another issue troubling the banking system is the dollarisation of deposits that has intensified after the February devaluation: the share of foreign exchange deposits reached 45% in July 2014, 5pp higher than in January 2014. Banks rely heavily on deposits as a source of financing, and given that the share of foreign exchange loans is only at about 33%, the currency mismatch is growing, and this limits possibilities for loan increases.

The overall loans dynamics has been positive: the value of newly issued loans during January-July 2014 was 11.5% higher than during the same period in 2013. Growth has been taking place primarily in short-term loans, mostly retail consumer loans and working capital loans. Issued loans for capital expenditures decreased during January-July 2014 by 19% year-on-year, and bank loans accounted only for 9% of total financing of gross fixed capital expenditures during this period. Most likely the recovery of the banking system will be prolonged and loans will not become a significant source of investment financing during the forecasting period.

Table 27 / Russia: Selected Economic Indicators

	2010	2011	2012	2013 [1]	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., average [2]	142,861	142,961	143,202	143,507	143,400	143,800	144,000	144,300	144,500
Gross domestic product, RUB bn, nom.	46,309	55,967	62,218	66,755	30,625	33,689	72,000	77,500	83,000
annual change in % (real)	4.5	4.3	3.4	1.3	0.9	0.8	0.5	1.3	1.9
GDP/capita (EUR at exchange rate)	8,000	9,600	10,900	11,000	.	.	.	.	.
GDP/capita (EUR at PPP)	15,700	17,300	18,200	18,600	.	.	.	.	.
Consumption of households, RUB bn, nom.	23,618	27,193	30,832	34,399	15,957	17,552	.	.	.
annual change in % (real)	5.5	6.8	7.9	4.7	5.0	2.2	1.0	1.0	2.0
Gross fixed capital form., RUB bn, nom.	10,014	11,950	13,605	14,334	5,195	5,214	.	.	.
annual change in % (real)	5.9	9.1	6.5	-0.1	-0.9	-4.6	-5.0	2.0	3.0
Gross industrial production [3]									
annual change in % (real)	7.3	5.0	3.4	0.4	3.4	0.4	1.0	2.0	3.0
Gross agricultural production									
annual change in % (real)	-11.3	23.0	-4.8	6.2	1.0	1.4	.	.	.
Construction output									
annual change in % (real)	5.0	5.1	2.4	-1.5	2.4	-1.5	-1.0	3.0	5.0
Employed persons, LFS, th, average [2]	69,934	70,857	71,545	71,391	71,150	71,135	71,300	71,500	72,000
annual change in %	0.8	1.3	1.0	-0.2	0.2	0.0	-0.1	0.3	0.7
Unemployed persons, LFS, th, average [2]	5,544	4,922	4,131	4,138	4,207	3,968	4,000	4,000	4,000
Unemployment rate, LFS, in %, average [2]	7.3	6.5	5.5	5.5	5.6	5.3	5.3	5.2	5.0
Reg. unemployment rate, in %, end of period [2]	2.1	1.7	1.4	1.2	1.3	1.1	.	.	.
Average monthly gross wages, RUB	20,952	23,369	26,629	29,960	28,614	31,537	.	.	.
annual change in % (real, gross)	5.2	2.8	8.4	5.2	4.7	3.0	.	.	.
Consumer prices, % p.a.	6.9	8.5	5.1	6.8	7.2	7.0	7.5	7.0	6.0
Producer prices in industry, % p.a. [4]	12.2	19.0	6.8	3.4	3.4	6.2	6.0	5.0	4.0
General governm.budget, nat.def., % of GDP									
Revenues	34.6	37.3	37.1	36.6	37.1	37.6	.	.	.
Expenditures	38.0	35.7	36.7	37.9	35.4	34.4	.	.	.
Deficit (-) / surplus (+)	-3.4	1.5	0.4	-1.3	1.7	3.2	-1.0	-1.0	-1.0
Public debt, nat.def., % of GDP [5]	8.4	9.0	10.0	10.4	9.7	9.7	10.0	10.0	11.0
Central bank policy rate, % p.a., end of period [6]	7.75	8.00	8.25	5.50	8.3	7.5	.	.	.
Current account, EUR mn [7]	50,853	69,855	55,452	25,701	20,419	29,797	45,000	50,000	45,000
Current account, % of GDP	4.4	5.1	3.6	1.6	2.7	4.2	3.1	3.4	3.0
Exports of goods, BOP, EUR mn [7]	296,041	370,131	410,300	393,911	192,113	186,242	390,000	400,000	410,000
annual change in %	38.8	25.0	10.9	-4.0	-4.9	-3.1	-1.0	2.6	2.5
Imports of goods, BOP, EUR mn [7]	185,221	228,764	261,202	256,951	122,553	111,477	230,000	230,000	240,000
annual change in %	40.3	23.5	14.2	-1.6	3.1	-9.0	-10.5	0.0	4.3
Exports of services, BOP, EUR mn [7]	37,062	41,680	48,495	52,787	25,210	23,573	50,000	50,000	53,000
annual change in %	12.7	12.5	16.4	8.8	13.3	-6.5	-5.3	0.0	6.0
Imports of services, BOP, EUR mn [7]	56,753	65,706	84,736	96,657	43,567	42,081	90,000	90,000	100,000
annual change in %	24.7	15.8	29.0	14.1	19.4	-3.4	-6.9	0.0	11.1
FDI inflow (liabilities), EUR mn [7]	32,545	39,557	39,353	53,187	32,115	17,347	25,000	30,000	40,000
FDI outflow (assets), EUR mn [7]	39,668	48,008	37,980	65,275	47,640	23,995	60,000	60,000	60,000
Gross reserves of CB, excl. gold, EUR mn	335,251	350,786	367,323	341,787	363,872	316,970	.	.	.
Gross external debt, EUR mn [7]	369,524	416,416	480,440	530,481	541,923	536,557	.	.	.
Gross external debt, % of GDP	32.1	30.4	30.8	33.6	34.3	37.3	.	.	.
Exchange rate RUB/EUR, average	40.3	40.9	39.9	42.3	40.8	48.0	50.0	53.0	55.0
Purchasing power parity RUB/EUR [8]	20.8	23.1	24.1	25.7	.	.	.	.	.

1) Preliminary. - 2) According to census October 2010. - 3) Excluding small enterprises. - 4) Domestic output prices. - 5) wiiw estimate. -
6) From 2013 one-week repo rate, refinancing rate before. - 7) Converted from USD and based on BOP 6th edition. - 8) wiiw estimates based on the 2011 International Comparison Project benchmark.

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

RUSSIAN FEDERATION: Stagnation and isolation ahead

PETER HAVLIK

The Russian economy is languishing in a prolonged slump. The country was already 'stuck in transition and stagnation' before the outbreak of the Ukraine crisis. The current sanctions deter investments, foster capital outflows and boost inflation. Turning inwards and developing import substitution strategies using accumulated domestic resources may prevent an outright recession, but it will not kick-start the requisite modernisation drive. The wiiw baseline scenario – assuming no further escalation of the Ukraine conflict – reckons with a meagre acceleration of GDP growth based on a gradual revival of investment. The above notwithstanding, the conflict over Ukraine will have a lasting impact on trade, investments and integration with Europe.

Russian economic growth is hovering just slightly above zero. The preliminary GDP growth reported for the first half of 2014 – an increase by 0.8% – reflects a modest expansion of industrial production (1.5%), agricultural output (3.5%) and goods transport (1.3%). Household consumption – judged by developments in retail trade turnover, real incomes and wages – weakened compared to the previous year. Fixed capital investment and construction output dropped by 2.5% and 1.5%, respectively, in both cases representing a marked deterioration over the previous year. The collapse of investment growth is particularly worrying, though not surprising given the increased risks and heightened geopolitical tensions resulting from Western sanctions and Russian retaliatory measures.[60] The growth contribution of real net exports became positive with export growth flattening and imports declining, not least due to the weakened rouble. In the first half of 2014, the current account surplus, contrary to previous expectations, widened, exceeding 4% of GDP, while net capital outflows more than doubled, to nearly EUR 60 billion in the first half of the year.

In these circumstances – and with the changed geopolitical situation – the search for a 'new growth model' has become even more urgent. Previous concerns regarding declining export revenues and falling current account surpluses remain though these have been overshadowed by the present tensions: imports declined by more than 5% in the first half of 2014, in particular from Germany, Finland, Italy, Poland and France. Imports from Ukraine were cut by 25%. In this situation of elevated risks and generally worsened conditions of external trade, which is unlikely to change soon, the already existing and broadly acknowledged obstacle to investments – the poor investment climate – will be extremely difficult to overcome. The previously underlined necessity to markedly improve the institutional, administrative and infrastructure prerequisites for investment in order to support growth, restructuring and diversification of the economy has become both more urgent and difficult under the changed geopolitical climate and spiralling sanctions.

60 For a more detailed analysis of the sanctions' impact see the Special Section of this Forecast Report.

All these factors require another downward revision of the GDP growth forecast. As of October 2014 GDP growth is expected to fall to 0.5% this year and stay below 2% in both 2015 and 2016.[61] Consumer spending remains the main – albeit stuttering – engine of GDP growth for the time being, but a further slowdown is around the corner as the growth of incomes is eroded by higher inflation. Investments are expected to drop in 2014 and remain more or less flat thereafter, even under the working assumption that the current financial and trade sanctions will be lifted in the course of 2015. Furthermore, the contribution of net exports to GDP growth will become negative again (as has been the case already for nearly a decade with the exception of the crisis years 2009 and 2014). Given the prospects for stagnating exports in the medium run, and assuming only a one-off downward adjustment of imports in 2014, the present sizeable trade and current account surpluses will gradually diminish.

ESTIMATED DIRECT ECONOMIC COSTS OF THE UKRAINE CONFLICT FOR RUSSIA

The combined effects of higher geopolitical tensions, increased credit risks and financing costs of investments, trade sanctions and other frictions between Russia, Ukraine and the West result in a lower GDP growth in the short and medium term (2014-2016). Estimated annual GDP losses due to lower investments, higher inflation and capital outflows are presented below. A crude estimate of direct costs of the Ukraine conflict for Russia (based on comparing pre-conflict and current GDP growth forecasts) yields around 1 percentage point of foregone Russian GDP annually during 2014-2016 (nearly EUR 20 billion per year at 2013 prices and the exchange rate in 2014). In nominal terms (taking into account forecast changes of GDP growth and exchange rate effects), the estimated cumulated loss of Russian GDP would amount to more than one hundred billion euro over the period 2014-2016.

	2013	2014	2015	2016
wiiw Forecast Report Spring 2014 (March)				
(1) GDP, RUB bn, curr. Prices	66,689	70,000	74,800	80,500
(2) GDP, EUR bn, curr. Prices	1,576	1,555	1,626	1,713
(3) Annual change in % (real)	1.3	1.6	2.3	3.0
(4) Exchange rate, RUB/EUR	42.3	45	46	47
(5) GDP, EUR bn, at 2013 prices and ER	1,576	1,601	1,639	1,688
wiiw Forecast Report Autumn 2014 (November)				
(6) GDP, RUB bn, curr. Prices	66,755	72,000	77,500	83,000
(7) GDP, EUR bn, curr. Prices	1,578	1,440	1,462	1,509
(8) Annual change in % (real)	1.3	0.5	1.3	1.9
(9) Exchange rate, RUB/EUR	42.3	50	53	55
(10) GDP, EUR bn, at 2013 prices and ER	1,578	1,583	1,603	1,634
Costs of the conflict, annual, EUR bn (based on difference between March and November forecasts (5)-(10))	.	18	36	54

Source: Own estimates and projections.

[61] This corresponds more or less to the baseline scenario published by the Central Bank of Russia in September 2014. Alternative scenarios reckon with prolonged sanctions, somewhat higher inflation and somewhat lower GDP growth (see: http://www.cbr.ru, 12 September 2014).

Weaker economic growth notwithstanding, the labour market remains strained with employment nearly flat and unemployment declining (the LFS rate of unemployment was 5% in June 2014). Sectoral and regional labour market shortages persist (e.g. in retail trade and construction), especially in big cities such as Moscow and St. Petersburg. The shadow side of the tight labour market – growing employment of migrant (both legal and illegal) workers and the related social, political, nationalist tensions and even racist sentiments – is posing new challenges to the authorities. According to some estimates there are more than 10 million migrant workers in Russia, the majority of them from the former Soviet republics. The new challenge – though probably less complicated owing to cultural similarity – will be the labour market integration of several hundred thousands of (mostly qualified) Russian-speaking Ukrainian refugees from Donbass who may ease the labour market shortages.

In the changed geopolitical and macroeconomic framework, the earlier plans that the main growth stimulus should come from a revival of investment will hardly materialise. Russia is turning inwards and intends to mobilise domestic investment resources and implement an import substitution strategy instead of FDI. Disputes about new, more expansionary directions of monetary and fiscal policies flared up anew. Officially, the Central Bank of Russia (CBR) monetary policy focuses on inflation targeting with the complete switchover to the free float from the earlier practice of exchange rate targeting to be completed in the course of 2014. As a reaction to increased inflationary pressures, the CBR also revised inflation targets upwards in September 2014.[62] The key policy rate was stepwise increased in the course of the year, most recently to 8% at the end of July 2014. The CBR's restrictive monetary policy is being attacked, most prominently by Sergey Glazyev, who serves as Putin's advisor for regional integration. He also is one of the fiercest critics of the EU-Ukraine Association Agreement (and figures prominently on the Western sanctions list). Mr Glazyev argues that in order to counter external financing restrictions domestic credits must become cheaper, calling for a more expansionary monetary policy and measures to introduce capital controls.[63]

Apart from the worsened investment climate, it is the missing progress in diversification and modernisation that has been the main obstacle to a revival of economic growth. The escalating conflict over Ukraine and ever more assertive domestic and external policies represent another modernisation bottleneck. Nevertheless, Russia succeeded in proceeding with the establishment of the Eurasian Economic Union (EEU) on the basis of the Customs Union with Belarus and Kazakhstan which exists since 2010. The corresponding EEU agreement, imitating the EU and signed in Astana on 29 May 2014, is expected to come in force in January 2015. Besides the free trade area in goods (with some important exceptions such as energy), the agreement envisages also the free movement of labour, capital and services among participating countries (Armenia and Kyrgyzstan are expected to join the EEU in 2015 as well). Coordinated economic policies among EEU members will use 'Maastricht-like' indicators such as limits on budget deficit, government debt, inflation and interest rates.

Summing up, Russian growth prospects have markedly deteriorated as Western sanctions – not largely symbolic ones anymore – result in a further deteriorating investment climate, higher risks, capital

62 Originally, CPI inflation was planned to drop to 5% in 2014, 4.5% in 2015 and 4% in 2016 (within a corridor of +/-1.5 pp). For the new inflation targets see http://www.cbr.ru/today/publications_reports/on_2015(2016-2017)pr.pdf.

63 See www.gazeta.ru, 5 September 2014. Calls for more interventionist policies appeared already early 2013 – see *Vedomosti*, 18 January 2013 and *wiiw Current Analyses and Forecasts*, No. 11 (March 2013), p. 129 for the emerging conservative trends in Russia. For a more comprehensive overview of the recent economic policy discussions in Russia see A. Yakovlev (2013), 'Russian modernisation: Between the need for new players and the fear of losing control of rent sources', *Journal of Eurasian Studies*, Vol. 5, No. 1, pp. 10-20.

outflows, inflation and depreciation of the rouble. Compared to previous forecasts, GDP growth for the coming years was scaled down, largely owing to falling investments. Even barring a further escalation of the conflict, modernisation ambitions will doubtlessly suffer also in the medium and long run due to lower FDI inflows and reduced imports of advanced technologies – despite efforts to mobilise additional domestic resources.[64] Hopes that a more serious damage to relations with the EU and other Russian neighbours could be avoided have unfortunately not materialised so far. Still, the resolution of the conflict at the negotiation table – where topics may include the implementation of the EU's Association Agreements with Georgia, Moldova, and Ukraine – remains preferable to further escalation.[65] In any case, the serious and probably lasting damage to Russian external relations with Ukraine and the West will be very difficult to repair.

[64] The Russian government intends to tap resources accumulated in the National Welfare Fund (RUB 3100 billion or nearly 5% of GDP) in order to compensate effects of Western financial sanctions – see *Vedomosti*, 15 September 2014.

[65] The full implementation of the AA/DCFTA between the EU and Ukraine was delayed until end-2015 according to the trilateral agreement between Russia, Ukraine and the EU from 16 September – see http://europa.eu/rapid/press-release_STATEMENT-14-280_en.htm.

UKRAINE: Military spending offsets IMF-imposed austerity

VASILY ASTROV

In Ukraine, the ongoing military conflict in Donbass, curtailed trade relations with Russia and weakening private consumption are pushing the economy ever deeper into recession. Although the collapse in domestic demand combined with currency depreciation has brought about a marked rebalancing towards net exports, the balance-of-payments pressure remains strong owing to the current capital flight. Under the prevailing circumstances, were the GDP to stagnate next year, it could well be seen as a major achievement. That, however, hinges crucially on the prospects for a lasting peace settlement in Donbass, as well as a revival of trade with Russia.

Available statistics and the more abundant 'soft facts' provide evidence of Ukraine's economy in free fall. In the first quarter of 2014, the GDP decline was at 1.1% (year-on-year) still rather modest. However, it accelerated to 4.6% in the second quarter and 5.1% in the third quarter of 2014 (according to a preliminary estimate). For 2014 as a whole, the recession may reach however 8% given the expected deterioration in the fourth quarter. The main reasons behind are the ongoing war in Donbass, severe cuts in exports to Russia, and the IMF-led austerity package taking its toll on domestic demand.

Apart from the direct war-related damage to the local economy (see Box below), another consequence of the conflict in Donbass are the overall high risk perceptions – not only in the areas where direct fighting takes place. In the first half of 2014, fixed capital investment plunged by some 19% (starting from an already low level),[66] and foreign capital has been leaving Ukraine: in January-August 2014, FDI recorded net *outflows* of some USD 600 million. More recently, capital flight has primarily taken the form of foreign currency purchases, as the war in Donbass showed signs of escalation and depreciation expectations picked up accordingly. As a result, the hryvnia, which had already devalued by 50% in the first months of 2014, got under renewed pressure, prompting the National Bank to react. Although Ukraine has now a formal flexible exchange rate regime, further depreciation has been viewed as unwelcome and jeopardising the stability of both the banking system and the public finances.[67] To counter depreciation pressures, the National Bank resorted to a mix of further monetary policy tightening and administrative measures, including a 100% surrender requirement for the incoming foreign exchange (later reduced to 75%) and several steps aimed at curbing the foreign exchange demand, while the scope of market interventions has been constrained by the low level of reserves. The impact of the implemented measures has been, however, short-lived at best: by the end of September 2014, the hryvnia had depreciated by another 15%, to levels around 14 UAH per USD, accompanied by reports about growing currency shortages and the emergence of a 'shadow' market for foreign exchange.

[66] As a result, by the second quarter of 2014, the investment ratio plunged to a mere 13.9% of GDP.

[67] More than 30% of domestic loans and more than half of the public debt are denominated in foreign currency, mostly US dollars.

Table 28 / Ukraine: Selected Economic Indicators

	2010	2011	2012	2013 1)	2013 January-June	2014 January-June	2014 Forecast	2015 Forecast	2016 Forecast
Population, th pers., average	45,871	45,706	45,593	45,490	43,162	43,031	43,000	42,950	42,920
Gross domestic product, UAH bn, nom. 2)	1,121	1,349	1,459	1,505	654	688	1,540	1,670	1,780
annual change in % (real) 2)	4.1	5.4	0.2	0.0	-1.1	-2.9	-8.0	-1.1	1.8
GDP/capita (EUR at exchange rate)	2,300	2,700	3,100	3,100	.	.	.	.	.
GDP/capita (EUR at PPP)	5,700	6,600	6,800	7,000	.	.	.	.	.
Consumption of households, UAH bn, nom. 2)	718	906	1,002	1,100	476	521	.	.	.
annual change in % (real) 2)	7.0	15.7	8.4	7.7	7.8	2.1	-4.0	-0.5	2.0
Gross fixed capital form., UAH bn, nom. 2)	202	248	283	273	109	97	.	.	.
annual change in % (real) 2)	3.4	6.5	3.3	-6.5	-5.7	-18.4	-20.0	0.0	4.0
Gross industrial production 3)									
annual change in % (real)	11.2	8.0	-0.5	-4.3	-5.0	-4.7	-11.0	0.0	3.5
Gross agricultural production									
annual change in % (real)	-1.5	19.9	-4.5	13.7	16.8	-3.9	.	.	.
Construction output 4)									
annual change in % (real)	-5.4	18.6	-8.3	-14.5	-17.8	-8.9	.	.	.
Employed persons, LFS, th, average	20,266	20,324	20,354	20,404	19,288	18,486	18,300	18,100	18,100
annual change in %	0.4	0.3	0.1	0.2	.	-4.2	-5.0	-1.0	0.0
Unemployed persons, LFS, th, average	1,786	1,733	1,657	1,577	1,576	1,730	.	.	.
Unemployment rate, LFS, in %, average	8.1	7.9	7.5	7.2	7.6	8.6	9.4	10.0	10.0
Reg. unemployment rate, in %, end of period 5)	2.0	1.8	1.8	1.8	1.7	1.7	.	.	.
Average monthly gross wages, UAH 6)	2,239	2,633	3,026	3,265	3,187	3,366	.	.	.
annual change in % (real, gross)	9.7	8.9	14.3	8.2	9.7	-0.3	.	.	.
annual change in % (real, net)	10.2	8.7	14.4	8.2	9.6	-0.4	.	.	.
Consumer prices, % p.a.	9.4	8.0	0.6	-0.3	-0.5	5.8	11.0	9.7	4.5
Producer prices in industry, % p.a. 7)	20.9	19.0	3.7	-0.1	0.0	7.0	12.0	10.0	5.0
General governm.budget, nat.def., % of GDP									
Revenues	28.1	29.5	30.5	29.4	32.3	32.6	.	.	.
Expenditures	33.8	31.2	34.0	33.6	36.6	35.6	.	.	.
Deficit (-) / surplus (+) 8)	-5.8	-1.7	-3.5	-4.2	-4.3	-3.0	-6.5	-5.5	-5.0
Public debt, nat.def., % of GDP	38.6	35.1	35.3	38.8	36.2	53.4	62.0	66.0	64.0
Central bank policy rate, % p.a., end of period 9)	7.75	7.75	7.50	6.50	7.00	9.50	.	.	.
Current account, EUR mn 10)	-2,272	-7,351	-11,153	-12,441	-4,171	-1,758	-3,800	-3,600	-4,500
Current account, % of GDP	-2.1	-6.0	-7.9	-8.8	-6.7	-3.6	-3.8	-3.2	-3.7
Exports of goods, BOP, EUR mn 10)	35,636	44,812	50,127	44,518	21,960	19,577	41,400	42,600	44,700
annual change in %	33.9	25.7	11.9	-11.2	-9.0	-10.9	-7.0	3.0	5.0
Imports of goods, BOP, EUR mn 10)	42,866	57,764	67,124	61,185	28,290	22,393	52,000	53,000	55,700
annual change in %	40.8	34.8	16.2	-8.8	-11.4	-20.8	-15.0	2.0	5.0
Exports of services, BOP, EUR mn 10)	13,808	15,278	17,186	17,032	7,714	5,698	13,600	13,600	14,300
annual change in %	28.9	10.6	12.5	-0.9	-3.7	-26.1	-20.0	0.0	5.0
Imports of services, BOP, EUR mn 10)	9,577	9,613	11,351	12,141	5,541	4,635	10,300	10,300	10,800
annual change in %	15.6	0.4	18.1	7.0	5.3	-16.3	-15.0	0.0	5.0
FDI inflow (liabilities), EUR mn 10)	4,860	5,177	6,360	3,396	1,315	-395	-500	1,000	1,500
FDI outflow (assets), EUR mn 10)	521	138	762	324	113	308	300	300	300
Gross reserves of NB excl. gold, EUR mn	25,096	23,593	17,186	13,592	16,671	11,308	.	.	.
Gross external debt, EUR mn 10)	88,363	97,940	102,120	102,852	102,832	100,536	.	.	.
Gross external debt, % of GDP	83.1	80.5	71.9	72.5	72.5	101.2	.	.	.
Average exchange rate UAH/EUR	10.533	11.092	10.271	10.612	10.5	14.1	15.5	15.0	14.5
Purchasing power parity UAH/EUR 11)	4.328	4.561	4.750	4.925	.	.	.	.	.

Note: Half-year data (population, GDP and its components, industrial production, LFS) and forecasts excluding the occupied territories of Crimea and Sevastopol.

1) Preliminary. - 2) According to SNA'08. - 3) From 2011 according to NACE Rev. 2 including E (water supply, sewerage, waste management, remediation). - 4) From 2011 according to NACE Rev. 2. - 5) In % of working age population. - 6) Enterprises with 10 and more employees. - 7) Domestic output prices. From 2013 according to NACE Rev. 2. - 8) Without transfers to Naftohaz. - 9) Discount rate of NB. - 10) Converted from USD and based on BOP 6th edition. - 11) wiiw estimates based on the 2011 International Comparison Project benchmark.

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

BOX 5 / WAR-RELATED ECONOMIC LOSSES IN THE DONBASS REGION

The Donetsk and Luhansk provinces – commonly referred to as Donbass – are located in the east of Ukraine and have a combined territory of 53 thousand square kilometres and a population of 6.5 million people. Home to coal mining and metallurgy, Donbass has traditionally been Ukraine's industrial heartland, accounting for 16% of GDP and a quarter of the country's exports.

In the first months of the conflict, it was primarily local small and medium-sized businesses which suffered the most. However, as the civil war was gaining momentum, the big industrial enterprises which form the backbone of the Donbass economy, such as those in the metals and chemicals sectors, became increasingly affected as well. In July 2014, statistics reported for the first time huge drops in industrial production: by 28.5% in the Donetsk and 56% in the Luhansk region (year-on-year). In August and September, the drops in industrial production were even bigger: by 59% in Donetsk and 85% in Luhansk, largely accounting for the drops of 21% (in August) and 17% (in September) in Ukraine as a whole (again year-on-year). Apart from shooting, the most important factor behind the halt in production have been damages to infrastructure, notably railway connections and electricity supply. For instance, 70% of coal mines have reportedly ceased operation because of electricity shortages and related flooding, although the lack of crucial inputs such as explosives played a role as well.

Deputy Prime Minister V. Groisman estimated the war-related damage in Donbass at USD 1 billion, with 35 cities and towns (out of 42) and over 11 thousand buildings and infrastructure objects destroyed to various degrees. An arguably more realistic estimate of the size of the damage has been provided by the head of Ukraine's Union of Industrialists and Entrepreneurs A. Kinakh: USD 7-8 billion, or 6% of GDP. The destruction of production capacities means that in the short run, up to 1.8 million people in Donbass may stay unemployed, according to official estimates. In the longer run, however, the problem will likely be the opposite: labour shortages due to the high number of refugees, many of whom may not come back. More than 1 million people have reportedly left Donbass since the outbreak of the military conflict, including 322 thousand to other regions of Ukraine and 875 thousand to Russia.

The exporting sector has been by and large unable to take advantage of the new, much more competitive exchange rate, at least so far. It is indicative that the substantial narrowing of the trade and current account deficits has been solely due to a collapse in imports (by 22% in January-August 2014),[68] while exports declined as well, albeit not as strongly (by 8%). One obvious reason for the export slump are the war-related destructions in Donbass. On top of that, Ukraine has banned the exports of military and dual-use goods to Russia, resulting in a disruption of the extensive value-chain links between the two countries dating back to Soviet times. All in all, exports to Russia – which in previous years was the destination for around a quarter of Ukraine's exports – fell by 24% in the first seven months of 2014. Exports elsewhere have gone up, largely thanks to agricultural products, but not strongly enough to offset the export decline to Russia. In this situation, the decision to put on hold the implementation of the Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU – part of a broader Association

[68] The low import figure is partly due to the assumption of a low price of natural gas imported from Russia in April-June 2014: USD 268 per 1,000 cubic metres (cm). In reality, this is disputed by Russia, which calculates with a much higher price (USD 485 per 1,000 cm), resulting in a much higher value of exports to Ukraine recorded in Russian statistics. Because of the price dispute, Ukraine has not been importing any Russian gas since July 2014 pending a new agreement.

Agreement signed earlier this year – and maintain tariffs on imports from the EU at least until the end of 2015 is good news.[69] It will put a brake on the influx of European goods into Ukraine, while Ukrainian exporters will still be able to benefit from zero import duties unilaterally granted by the EU earlier this year. Of course, the suspension of DCFTA implementation – which represents an important reform 'anchor' – means probably also a delay in the badly needed economic reforms and restructuring. However, the latter would only have a positive impact on economic performance if accompanied by inflows of FDI, and FDI will not be coming as long as the conflict in Donbass and its future status remain unresolved, and the perceived risks of investing in Ukraine are high.

The deepening recession and the ongoing currency depreciation are not only aggravating the already severe balance-of-payments problems (the reason Ukraine obtained an IMF 'rescue package' in May 2014), but also increasingly undermine the sustainability of the public debt which has not been a major concern so far. This makes continuous funding from the IMF even more crucial: Ukraine has already received USD 4.5 billion from the IMF as part of a USD 17 billion agreed package, with another USD 2.6 billion potentially coming before the end of the year. Although the IMF conditionalities attached to the loan officially require budget austerity, in practice the latter has been offset by the ballooning military spending, seemingly tolerated by the IMF. In January-July 2014, budget revenues declined by only 3.5% in real terms, helped in part by a spike in inflation and the hikes in excise and property taxes and royalties implemented as part of the austerity package. State revenues are also benefiting from the 1.5% 'war' payroll tax introduced as of 1 August 2014, which is supposed to bring an estimated USD 240 million until the end of the year. According to official budget statistics, expenditures dropped much more than revenues: by 6.3% in real terms in the first seven months of 2014, with the bulk of cuts falling under the category 'national economy'. Public sector wages and pensions have been cut as well, and the minimum wage has been frozen, meaning a strong decline in real terms. By contrast, defence spending was raised sharply, although budget statistics do not give due account of the true costs of the so-called 'anti-terrorist operation' in Donbass. The USD 640 million budgetary allocations to 'defence' in the first seven months of 2014 represent only a fraction of the total campaign costs, which reached according to official estimations USD 4.9 billion, or 4% of GDP.[70] The expansionary macroeconomic impact of defence spending is confirmed by the strongly positive dynamics (+7%) of the 'collective component' of public consumption in the second quarter of 2014 (after a 12% decline in the 'pre-war' first quarter).

Increased military spending has not only 'crowded out' other essential payments, such as public sector wages and pensions, but has proved ultimately misplaced. As predicted earlier by wiiw, the Kyiv authorities have vastly overestimated their ability to resolve the conflict in Donbass by force, and the defeat of pro-government troops in the battle of Ilovaysk in early September paved the way for negotiations over an overhaul of Ukraine's constitutional set-up. A bill initiated by President Poroshenko after the peace initiative agreed in Minsk and hastily approved by the parliament on 16 September 2014 granted the insurgent Donbass extensive autonomy in a number of areas and is a welcome step to end the war. However, given the degree of polarisation in the Ukrainian society, this compromise may be not accepted both by the rebels, who see Donbass as independent (or ideally as part of Russia), and by Ukrainian nationalists, who view the autonomy preferences granted to Donbass as a defeat. In addition,

69 It also means that Russia will probably not revoke its free trade regime with Ukraine; indeed, the decision to delay the implementation of the DCFTA was taken not least under Russia's pressure.

70 This figure most likely does not include private financing of volunteer regiments which have been fighting on the government side.

many details of the new arrangement remain unclear. Therefore, the current ceasefire continues to be highly fragile.

Given the fragility of the situation in Donbass, the strained trade relations with Russia and the adherence to the IMF-led austerity course, the economic outlook remains rather gloomy. In these circumstances, GDP stagnation next year could already be seen as an achievement. The latter would crucially hinge on a lasting ceasefire and on a revival of trade mending relations with Russia, including most notably the conclusion of a new gas supply contract. These two factors would first of all help Ukraine's exports, while domestic demand is likely to remain depressed for quite some time. In the longer term, a return to economic growth depends not least on the recovery in the euro area and on inflows of FDI, which could finance badly needed domestic reforms and restructuring.

Appendix

Table 29 / GDP per capita at current PPPs (EUR), from 2014 at constant PPPs and population

	1991	1995	2000	2005	2009	2010	2011	2012	2013	2014	2015	2016
											Forecast	
Bulgaria	4,400	4,600	5,400	8,200	10,500	11,000	11,700	12,100	12,000	12,200	12,500	12,800
Croatia	6,700	6,900	9,500	13,400	15,000	14,900	15,400	15,700	15,800	15,700	15,700	15,900
Czech Republic	8,800	11,600	14,100	18,600	20,300	20,600	21,400	21,800	21,600	22,100	22,600	23,200
Estonia	5,400	5,300	8,600	13,800	15,200	16,100	17,700	18,700	19,200	19,500	19,900	20,500
Hungary	6,800	7,600	10,500	14,400	15,600	16,400	17,100	17,300	17,600	18,100	18,500	18,900
Latvia	6,400	5,000	7,000	11,800	12,900	13,400	15,000	16,300	17,200	17,600	18,100	18,600
Lithuania	7,100	5,200	7,500	12,300	13,600	15,100	16,900	18,300	19,100	19,700	20,300	21,000
Poland	4,500	6,200	9,100	11,500	14,200	15,500	16,400	17,100	17,500	18,100	18,700	19,300
Romania	4,000	4,800	5,000	8,000	11,700	12,400	12,900	13,600	13,900	14,200	14,600	15,000
Slovakia	5,800	7,000	9,600	13,600	17,100	18,300	18,900	19,400	19,600	20,100	20,600	21,100
Slovenia	8,500	11,100	15,500	20,000	20,700	21,000	21,600	21,800	21,800	22,200	22,500	22,800
NMS-11	5,400	6,500	8,600	11,900	14,500	15,400	16,100	16,800	17,000	17,400	17,900	18,400
Albania	1,400	2,000	3,500	5,200	7,000	7,100	7,400	7,500	7,600	7,700	7,800	7,900
Macedonia	4,300	4,000	5,100	6,600	8,500	8,900	9,000	9,000	9,000	9,300	9,600	9,900
Montenegro	.	.	5,600	6,900	9,900	10,200	10,600	10,400	10,700	10,900	11,200	11,500
Serbia	.	.	5,000	7,100	8,400	8,500	8,900	9,000	9,300	9,200	9,200	9,300
Turkey	3,700	4,300	7,600	9,100	10,900	12,200	13,300	13,700	14,100	14,600	15,000	15,400
Bosnia & Herzeg.	.	.	3,900	5,200	6,400	6,700	7,000	7,100	7,200	7,200	7,300	7,400
Kosovo	.	.	.	4,400	5,000	5,300	5,400	5,600	5,800	6,100	6,300	6,500
Kazakhstan	5,200	3,800	3,700	7,300	11,300	13,600	15,600	16,800	17,400	18,200	19,000	20,000
Russia	7,100	4,700	5,900	9,900	14,500	15,600	17,000	18,000	18,100	18,200	18,400	18,700
Ukraine	3,700	2,400	3,100	4,700	4,700	5,600	6,500	6,700	6,700	6,200	6,100	6,200
Austria	18,700	19,700	25,100	28,100	29,500	30,900	32,300	33,100	33,200	33,700	34,300	35,000
Germany	18,300	18,800	22,400	26,000	26,900	29,200	30,800	31,500	32,000	32,600	33,300	34,000
Greece	12,200	11,000	16,000	20,400	22,300	21,600	20,300	19,500	19,200	19,300	19,900	20,300
Ireland	12,600	15,200	25,100	32,400	30,100	31,400	32,300	32,900	32,500	33,100	34,100	34,800
Italy	16,900	17,800	22,300	23,600	24,300	25,100	25,500	25,600	25,200	25,400	25,700	26,200
Portugal	10,700	11,300	15,400	17,900	18,800	19,600	19,300	19,400	19,400	19,600	19,900	20,300
Spain	12,900	13,400	18,500	22,900	24,200	24,200	24,300	24,400	24,500	24,800	25,300	25,800
USA	22,000	24,100	31,600	37,000	35,100	36,800	37,400	39,400	39,800	40,900	42,200	43,000
EU-28 average	12,800	14,600	19,000	22,400	23,500	24,400	25,100	25,500	25,700	26,100	26,600	27,100
				European Union (28) average = 100								
	1991	1995	2000	2005	2009	2010	2011	2012	2013	2014	2015	2016
Bulgaria	34	32	28	37	45	45	47	47	47	47	47	47
Croatia	52	47	50	60	64	61	61	62	61	60	59	59
Czech Republic	69	79	74	83	86	84	85	85	84	85	85	86
Estonia	42	36	45	62	65	66	71	73	75	75	75	76
Hungary	53	52	55	64	66	67	68	68	68	69	70	70
Latvia	50	34	37	53	55	55	60	64	67	67	68	69
Lithuania	55	36	39	55	58	62	67	72	74	75	76	77
Poland	35	42	48	51	60	64	65	67	68	69	70	71
Romania	31	33	26	36	50	51	51	53	54	54	55	55
Slovakia	45	48	51	61	73	75	75	76	76	77	77	78
Slovenia	66	76	82	89	88	86	86	85	85	85	85	84
NMS-11	42	45	45	53	62	63	64	66	66	67	67	68
Macedonia	34	27	27	29	36	36	36	35	35	36	36	37
Montenegro	.	.	29	31	42	42	42	41	42	42	42	42
Serbia	.	.	26	32	36	35	35	35	36	35	35	34
Turkey	29	29	40	41	46	50	53	54	55	56	56	57
Albania	11	14	18	23	30	29	29	29	30	30	29	29
Bosnia & Herzeg.	.	.	21	23	27	27	28	28	28	28	27	27
Kosovo	.	.	.	20	21	22	22	22	23	23	24	24
Kazakhstan	.	26	19	33	48	56	62	66	68	70	71	74
Russia	55	32	31	44	62	64	68	71	70	70	69	69
Ukraine	29	16	16	21	20	23	26	26	26	24	23	23
Austria	146	135	132	125	126	127	129	130	129	129	129	129
Germany	143	129	118	116	114	120	123	124	125	125	125	125
Greece	95	75	84	91	95	89	81	76	75	74	75	75
Ireland	98	104	132	145	128	129	129	129	126	127	128	128
Italy	132	122	117	105	103	103	102	100	98	97	97	97
Portugal	84	77	81	80	80	80	77	76	75	75	75	75
Spain	101	92	97	102	103	99	97	96	95	95	95	95
USA	172	165	166	165	149	151	149	155	155	157	159	159
EU-28 average	100	100	100	100	100	100	100	100	100	100	100	100

Note: GDP data still refer to ESA'95. A few countries (HR, CZ, EE, HU, LV, SI, AL, KZ, UA) already report according to ESA'10.
Sources: wiiw Annual Database incorporating national and Eurostat statistics, wiiw estimates, Eurostat, EC - Spring Report 2014.

Table 30 / Indicators of macro-competitiveness, 2009-2016, EUR based, annual averages

	2009	2010	2011	2012	2013	2014	2015	2016
							Forecast	
Bulgaria								
Producer price index, 2010=100	92.2	100.0	109.2	114.0	112.2	111.1	112.2	114.5
Consumer price index, 2010=100	97.1	100.0	103.4	105.9	106.3	105.2	106.3	108.4
GDP deflator, 2010=100	97.3	100.0	104.9	108.1	107.2	106.2	107.2	109.4
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	99.1	100.0	100.3	100.0	98.9	97.0	96.5	97.0
Real ER (PPI-based), 2010=100	94.9	100.0	103.7	105.3	103.8	101.4	100.9	101.4
PPP, NC/EUR	0.8753	0.8680	0.8780	0.8817	0.8982	0.88	0.87	0.88
Price level, EU28 = 100	45	44	45	45	46	45	45	45
Average monthly gross wages, NC	609	648	686	731	808	820	850	890
Average monthly gross wages, EUR (ER)	311	331	351	374	413	420	430	460
Average monthly gross wages, EUR (PPP)	696	747	781	829	899	930	970	1010
GDP nominal, NC mn	68322	70511	75308	78089	78115	78800	81400	85200
Employed persons, LFS, th.,average	3254	3053	2950	2934	2935	2960	2990	3020
GDP per employed person, NC	20999	23097	25532	26615	26600	26600	27200	28200
GDP per empl. person, NC at 2010 ref.pr.	21587	23097	24346	24617	24800	25100	25400	25800
Unit labour costs, NC, 2010=100	100.6	100.0	100.4	105.8	116.0	116.4	119.3	122.9
Unit labour costs, ER adj., 2010=100	100.6	100.0	100.4	105.8	116.0	116.4	119.3	122.9
Unit labour costs, PPP adj., Austria=100	24.7	24.6	24.5	25.2	27.2	26.9	27.1	27.6
Croatia								
Producer price index, 2010=100	95.9	100.0	107.0	112.8	112.5	113.6	114.8	115.9
Consumer price index, 2010=100	98.9	100.0	102.2	105.6	108.1	108.6	109.7	110.8
GDP deflator, 2010=100	99.2	100.0	101.7	103.3	104.2	104.7	105.7	106.8
Exchange rate (ER), NC/EUR	7.340	7.286	7.434	7.517	7.574	7.63	7.64	7.64
ER, nominal, 2010=100	100.7	100.0	102.0	103.2	103.9	104.7	104.9	104.9
Real ER (CPI-based), 2010=100	100.2	100.0	97.2	96.8	96.8	95.7	95.1	94.6
Real ER (PPI-based), 2010=100	98.0	100.0	99.6	101.0	100.1	99.1	98.4	97.9
PPP, NC/EUR	5.126	5.134	5.054	4.917	4.917	4.88	4.85	4.83
Price level, EU28 = 100	70	70	68	65	65	64	64	63
Average gross monthly wages, HRK	7711	7679	7796	7875	7939	7930	7990	8110
Average monthly gross wages, EUR (ER)	1051	1054	1049	1048	1048	1040	1050	1060
Average monthly gross wages, EUR (PPP)	1504	1496	1543	1602	1615	1630	1650	1680
GDP nominal, NC mn	330966	328041	332587	330456	330135	329100	332400	339100
Employed persons, LFS, th., average	1605	1541	1493	1446	1390	1550	1550	1560
GDP per employed person, NC	206171	212847	222839	228547	237473	212300	214500	217400
GDP per empl. person, NC at 2010 ref.pr.	207885	212847	219174	221289	227994	202800	202900	203600
Unit labour costs, NC, 2010=100	102.8	100.0	98.6	98.6	96.5	108.4	109.2	110.4
Unit labour costs, ER adj., 2010=100	102.1	100.0	96.6	95.6	92.9	103.5	104.1	105.3
Unit labour costs, PPP adj., Austria=100	51.1	50.2	48.1	46.4	44.4	48.8	48.2	48.2
Czech Republic								
Producer price index, 2010=100	99.9	100.0	103.7	106.1	106.8	108.1	109.8	111.4
Consumer price index, 2010=100	98.9	100.0	102.2	105.8	107.2	107.8	109.7	111.4
GDP deflator, 2010=100	101.5	100.0	99.8	101.2	102.9	103.9	105.3	106.4
Exchange rate (ER), NC/EUR	26.44	25.28	24.59	25.15	25.98	27.50	26.75	26.00
ER nominal, 2010=100	104.6	100.0	97.3	99.5	102.8	108.8	105.8	102.8
Real ER (CPI-based), 2010=100	96.5	100.0	101.9	100.5	97.2	91.4	94.2	96.9
Real ER (PPI-based), 2010=100	98.4	100.0	101.3	98.6	96.2	90.8	93.3	96.0
PPP, NC/EUR	18.49	18.30	17.90	17.71	17.98	17.9	17.9	17.8
Price level, EU28 = 100	70	72	73	70	69	65	67	68
Average monthly gross wages, NC	23344	23864	24455	25067	25078	25600	26600	27500
Average monthly gross wages, EUR (ER)	883	944	995	997	965	930	990	1060
Average monthly gross wages, EUR (PPP)	1262	1304	1366	1416	1395	1430	1490	1540
GDP nominal, NC bn	3922	3954	4022	4048	4086	4230	4390	4550
Employed persons, LFS, th., average	4934	4885	4904	4890	4937	4950	4960	4970
GDP per employed person, NC	794809	809312	820230	827745	827664	854500	885100	915500
GDP per empl. person, NC at 2010 ref.pr.	783295	809312	822039	817769	804260	822200	840300	860400
Unit labour costs, NC, 2010=100	101.1	100.0	100.9	104.0	105.7	105.6	107.4	108.4
Unit labour costs, ER adj., 2010=100	96.7	100.0	103.7	104.5	102.9	97.1	101.5	105.4
Unit labour costs, PPP adj., Austria=100	40.6	42.1	43.4	42.6	41.3	38.4	39.5	40.5

(Table 30 ctd.)

(Table 30 ctd.)

	2009	2010	2011	2012	2013	2014	2015	2016
							Forecast	
Estonia								
Producer price index, 2010=100	96.9	100.0	104.2	107.0	114.7	115.0	116.9	119.3
Consumer price index, 2010=100	97.3	100.0	105.1	109.5	113.1	113.5	115.2	117.7
GDP deflator, 2010=100	98.5	100.0	103.0	105.8	110.6	110.9	112.7	115.1
Exchange rate (ER), NC/EUR	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Real ER (CPI-based), 2010=100	99.4	100.0	101.9	103.5	105.3	104.7	104.7	105.4
Real ER (PPI-based), 2010=100	99.8	100.0	99.0	98.8	106.1	105.0	105.1	105.7
PPP, NC/EUR	0.6978	0.6871	0.6967	0.7136	0.7398	0.73	0.73	0.74
Price level, EU28 = 100	70	69	70	71	74	73	73	74
Average monthly gross wages, NC	784	792	839	887	949	980	1030	1080
Average monthly gross wages, EUR (ER)	784	792	839	887	949	980	1030	1080
Average monthly gross wages, EUR (PPP)	1123	1153	1204	1243	1283	1340	1410	1470
GDP nominal, NC mn	14138	14708	16404	17637	18739	19100	19800	20800
Employed persons, LFS, th., average	595.8	570.9	609.1	614.9	621.3	615	610	605.0
GDP per employed person, NC	23730	25762	26931	28682	30161	31100	32500	34400
GDP per empl. person, NC at 2010 ref.pr.	24089	25762	26145	27102	27260	28000	28800	29900
Unit labour costs, NC, 2010=100	105.8	100.0	104.3	106.4	113.2	113.8	116.3	117.4
Unit labour costs, ER adj., 2010=100	105.8	100.0	104.3	106.4	113.2	113.8	116.3	117.4
Unit labour costs, PPP adj., Austria=100	44.0	41.7	43.2	43.0	45.0	44.6	44.8	44.7
Hungary								
Producer price index, 2010=100	96.2	100.0	104.1	108.4	109.1	111.4	114.2	117.1
Consumer price index, 2010=100	95.5	100.0	103.9	109.8	111.7	115.0	117.3	120.9
GDP deflator, 2010=100	97.9	100.0	102.2	105.6	108.8	111.1	113.9	116.8
Exchange rate (ER), NC/EUR	280.33	275.48	279.37	289.25	296.87	315	315	315
ER, nominal 2010=100	101.8	100.0	101.4	105.0	107.8	114.3	114.3	114.3
Real ER (CPI-based), 2010=100	95.8	100.0	99.4	98.8	96.5	92.8	93.2	94.6
Real ER (PPI-based), 2010=100	97.4	100.0	97.5	95.4	93.6	88.9	89.8	90.7
PPP, NC/EUR	167.06	164.54	164.39	166.35	171.01	172.4	174.2	175.9
Price level, EU28 = 100	60	60	59	58	58	55	55	56
Average monthly gross wages, NC	199837	202525	213094	223060	230664	243000	252300	263200
Average monthly gross wages, EUR (ER)	713	735	763	771	777	770	800	840
Average monthly gross wages, EUR (PPP)	1196	1231	1296	1341	1349	1410	1450	1500
GDP nominal, NC bn	26175	26946	28035	28549	29846	31400	32900	34400
Employed persons, LFS, th., average	3782	3781	3812	3878	3938	3980	4020	4060
GDP per employed person, NC	6921277	7126317	7354609	7361923	7578270	7889400	8184100	8472900
GDP per empl. person, NC at 2010 ref.pr.	7069400	7126317	7196631	6969596	6967197	7101200	7185200	7256700
Unit labour costs, NC, 2010=100	99.5	100.0	104.2	112.6	116.5	120.4	123.6	127.6
Unit labour costs, ER adj., 2010=100	97.7	100.0	102.7	107.3	108.1	105.3	108.1	111.6
Unit labour costs, PPP adj., Austria=100	32.7	33.5	34.2	34.8	34.5	33.1	33.4	34.1
Latvia								
Producer price index, 2010=100	97.6	100.0	107.7	112.1	114.0	114.5	116.1	118.6
Consumer price index, 2010=100	101.2	100.0	104.2	106.6	106.6	107.3	109.0	111.4
GDP deflator, 2010=100	101.0	100.0	106.4	110.2	111.4	111.9	113.5	115.9
Exchange rate (ER), NC/EUR	1.0041	1.0084	1.0050	0.9922	0.9981	1	1	1
ER, nominal, 2010=100	99.6	100.0	99.7	98.4	99.0	99.2	99.2	99.2
Real ER (CPI-based), 2010=100	103.8	100.0	101.4	102.4	100.3	99.7	99.8	100.5
Real ER (PPI-based), 2010=100	101.0	100.0	102.7	105.3	106.5	105.4	105.3	106.0
PPP, NC/EUR	0.6858	0.6441	0.6566	0.6629	0.6692	0.66	0.66	0.67
Price level, EU28 = 100	68	64	65	67	67	66	66	67
Average monthly gross wages, NC	656	633	660	684	716	740	780	820
Average monthly gross wages, EUR (ER)	653	628	657	690	717	740	780	820
Average monthly gross wages, EUR (PPP)	956	983	1,005	1,032	1,069	1120	1180	1230
GDP nominal, NC mn	18894	18166	20297	22043	23222	23900	24900	26200
Employed persons, LFS, th., average	983	941	971	876	894	895	898	900
GDP per employed person, NC	19218	19307	20914	25175	25978	26700	27700	29100
GDP per empl. person, NC at 2010 ref.pr.	19025	19307	19654	22836	23314	23900	24400	25100
Unit labour costs, NC, 2010=100	105.1	100.0	102.4	91.4	93.6	94.4	97.5	99.6
Unit labour costs, ER adj., 2010=100	105.6	100.0	102.8	92.9	94.6	95.2	98.3	100.5
Unit labour costs, PPP adj., Austria=100	43.5	41.3	42.2	37.2	37.3	37.0	37.5	37.9

(Table 30 ctd.)

(Table 30 ctd.)

	2009	2010	2011	2012	2013	2014	2015	2016
							Forecast	
Lithuania								
Producer price index, 2010=100	90.6	100.0	113.9	119.6	116.7	117.0	118.4	120.5
Consumer price index, 2010=100	98.8	100.0	104.1	107.4	108.7	109.0	110.3	112.3
GDP deflator, 2010=100	97.8	100.0	105.4	108.2	110.0	110.3	111.7	113.7
Exchange rate (ER), NC/EUR	3.453	3.453	3.453	3.453	3.453	3.45	3.45	3.45
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	99.9	99.9	99.9
Real ER (CPI-based), 2010=100	100.9	100.0	101.0	101.5	101.2	100.6	100.3	100.6
Real ER (PPI-based), 2010=100	93.3	100.0	108.2	110.5	107.9	106.9	106.6	106.9
PPP, NC/EUR	2.140	2.042	2.084	2.082	2.117	2.10	2.09	2.10
Price level, EU28 = 100	62	59	60	60	61	61	61	61
Average monthly gross wages, NC	2056	1988	2046	2124	2232	2340	2460	2590
Average monthly gross wages, EUR (ER)	595	576	593	615	646	680	710	750
Average monthly gross wages, EUR (PPP)	961	974	982	1020	1054	1120	1180	1240
GDP nominal, NC mn	92032	95676	106893	113735	119575	123500	129000	135800
Employed persons, LFS, th., average	1416	1344	1371	1276	1293	1308	1320	1328
GDP per employed person, NC	64999	71203	77973	89155	92493	94400	97700	102300
GDP per empl. person, NC at 2010 ref.pr.	66470	71203	73990	82409	84062	85600	87500	90000
Unit labour costs, NC, 2010=100	110.8	100.0	99.0	92.3	95.1	97.9	100.7	103.1
Unit labour costs, ER adj., 2010=100	110.8	100.0	99.0	92.3	95.1	98.0	100.8	103.2
Unit labour costs, PPP adj., Austria=100	36.0	32.6	32.0	29.1	29.5	30.0	30.3	30.7
Poland								
Producer price index, 2010=100	98.2	100.0	107.3	110.8	109.4	108.3	110.0	112.2
Consumer price index, 2010=100	97.4	100.0	103.9	107.7	108.7	109.0	110.6	112.8
GDP deflator, 2010=100	98.5	100.0	103.2	105.7	106.6	107.6	109.2	111.3
Exchange rate (ER), NC/EUR	4.328	3.995	4.121	4.185	4.198	4.20	4.15	4.15
ER, nominal, 2010=100	108.3	100.0	103.2	104.8	105.1	105.1	103.9	103.9
Real ER (CPI-based), 2010=100	91.8	100.0	97.7	97.2	96.3	95.6	96.7	97.2
Real ER (PPI-based), 2010=100	93.4	100.0	98.8	97.7	96.3	94.1	95.2	95.7
PPP, PLN/EUR	2.481	2.387	2.424	2.420	2.429	2.42	2.42	2.43
Price level, EU28 = 100	57	60	59	58	58	58	58	59
Average gross monthly wages, PLN	3102	3224	3404	3530	3650	3770	3940	4140
Average monthly gross wages, EUR (ER)	717	807	826	844	870	900	950	1000
Average monthly gross wages, EUR (PPP)	1250	1351	1404	1459	1503	1560	1630	1700
GDP nominal, NC bn	1345	1417	1528	1596	1636	1690	1770	1860
Employed persons, LFS, th., average	15868	15961	16131	15591	15568	15600	15680	15760
GDP per employed person, NC	84731	88756	94735	102393	105071	108300	112900	118000
GDP per empl. person, NC at 2010 ref.pr.	85988	88756	91837	96874	98547	100700	103400	106000
Unit labour costs, NC, 2010=100	99.3	100.0	102.0	100.3	102.0	103.1	104.9	107.5
Unit labour costs, ER adj., 2010=100	91.7	100.0	98.9	95.8	97.0	98.0	101.0	103.5
Unit labour costs, PPP adj., Austria=100	39.2	42.8	42.0	39.7	39.6	39.4	39.9	40.4
Romania								
Producer price index, 2010=100	95.8	100.0	107.1	112.7	115.0	118.1	122.0	125.2
Consumer price index, 2010=100	94.3	100.0	105.8	109.4	112.9	115.2	118.6	122.8
GDP deflator, 2010=100	94.6	100.0	104.0	108.9	112.7	115.8	119.5	122.7
Exchange rate (ER), NC/EUR	4.240	4.212	4.239	4.459	4.419	4.47	4.45	4.45
ER, nominal, 2010=100	100.7	100.0	100.6	105.9	104.9	106.1	105.6	105.6
Real ER (CPI-based), 2010=100	95.6	100.0	102.0	97.7	100.2	100.1	102.0	104.0
Real ER (PPI-based), 2010=100	98.1	100.0	101.0	98.3	101.3	101.6	103.8	105.0
PPP, NC/EUR	2.108	2.087	2.147	2.158	2.259	2.29	2.33	2.36
Price level, EU28 = 100	50	50	51	48	51	51	52	53
Average monthly grross wages, NC	1845	1902	1980	2063	2166	2280	2400	2550
Average monthly gross wages, EUR (ER)	435	452	467	463	490	510	540	570
Average monthly gross wages, EUR (PPP)	875	911	922	956	959	1000	1030	1080
GDP nominal, NC mn	501139	523693	557348	586750	628581	660000	700000	740000
Employed persons, LFS, th., average	9244	9239	9138	9263	9247	8600	8690	8780
GDP per employed person, NC	54215	56680	60994	63345	67974	76700	80600	84300
GDP per empl. person, NC at 2010 ref.pr.	57312	56680	58647	58174	60328	66300	67400	68700
Unit labour costs, NC, 2010=100	95.9	100.0	100.6	105.7	107.0	102.5	106.1	110.6
Unit labour costs, ER adj., 2010=100	95.3	100.0	100.0	99.8	102.0	96.6	100.4	104.7
Unit labour costs, PPP adj., Austria=100	31.2	32.8	32.6	31.7	31.9	29.8	30.4	31.3

(Table 30 ctd.)

(Table 30 ctd.)

	2009	2010	2011	2012	2013	2014	2015	2016
							Forecast	
Slovakia								
Producer price index, 2010=100	99.6	100.0	104.5	106.5	105.4	102.2	103.3	104.8
Consumer price index, 2010=100	99.3	100.0	104.1	108.0	109.6	109.8	111.4	114.2
GDP deflator, 2010=100	99.5	100.0	101.6	102.9	103.4	103.6	105.2	107.8
Exchange rate (ER), NC/EUR	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Real ER (CPI-based), 2010=100	101.4	100.0	101.0	102.0	102.0	101.2	101.2	102.2
Real ER (PPI-based), 2010=100	102.6	100.0	99.3	98.4	97.5	93.3	92.9	92.9
PPP NC/ EUR	0.6801	0.6691	0.6758	0.6776	0.6794	0.67	0.67	0.68
Price level, EU28 = 100	68	67	68	68	68	67	67	68
Average monthly gross wages, NC	745	769	786	805	824	840	880	930
Average monthly gross wages, EUR (ER)	745	769	786	805	824	840	880	930
Average monthly gross wages, EUR (PPP)	1095	1149	1163	1188	1213	1250	1310	1370
GDP nominal, NC mn	62794	65897	68974	71096	72134	74000	77000	81000
Employed persons, LFS, th., average	2366	2318	2351	2329	2329	2350	2390	2430
GDP per employed person, NC	26537	28435	29333	30526	30969	31500	32200	33300
GDP per empl. person, NC at 2010 ref.pr.	26678	28435	28875	29675	29949	30400	30600	30900
Unit labour costs, NC, 2010=100	103.2	100.0	100.7	100.3	101.7	102.2	106.3	111.3
Unit labour costs, ER adj., 2010=100	103.2	100.0	100.7	100.3	101.7	102.2	106.3	111.3
Unit labour costs, PPP adj., Austria=100	36.8	35.7	35.7	34.7	34.6	34.3	35.1	36.2
Slovenia								
Producer price index, 2010=100	98.1	100.0	104.6	105.5	105.5	105.5	106.0	107.1
Consumer price index, 2010=100	98.0	100.0	102.1	105.0	107.0	107.7	108.8	109.9
GDP deflator, 2010=100	101.1	100.0	101.2	101.5	102.9	103.6	104.6	105.7
Exchange rate (ER), NC/EUR	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Real ER (CPI-based), 2010=100	100.0	100.0	99.0	99.2	99.6	99.3	98.8	98.4
Real ER (PPI-based), 2010=100	101.0	100.0	99.3	97.4	97.5	96.3	95.3	94.9
PPP, NC/EUR	0.8575	0.8412	0.8315	0.8030	0.8056	0.80	0.80	0.79
Price level, EU28 = 100	86	84	83	80	81	80	80	79
Average monthly gross wages, NC	1439	1495	1525	1525	1523	1540	1570	1600
Average monthly gross wages, EUR (ER)	1439	1495	1525	1525	1523	1540	1570	1600
Average monthly gross wages, EUR (PPP)	1678	1777	1834	1900	1891	1920	1970	2020
GDP nominal, NC mn	36166	36220	36868	36006	36144	37050	37980	38940
Employed persons, LFS, th., average	981	966	936	924	906	920	930	940
GDP per employed person, NC	36878	37494	39385	38976	39898	40300	40800	41400
GDP per empl. person, NC at 2010 ref.pr.	36487	37494	38929	38406	38774	38900	39000	39200
Unit labour costs, NC, 2010=100	98.9	100.0	98.2	99.6	98.5	99.3	101.0	102.4
Unit labour costs, ER adj., 2010=100	98.9	100.0	98.2	99.6	98.5	99.3	101.0	102.4
Unit labour costs, PPP adj., Austria=100	65.3	66.2	64.5	63.8	62.2	61.7	61.7	61.8
Albania								
Producer price index, 2010=100	99.8	100.0	102.6	103.8	103.3	103.3	103.3	103.3
Consumer price index, 2010=100	96.6	100.0	103.4	105.5	107.5	108.6	109.7	110.8
GDP deflator, 2010=100	95.7	100.0	102.3	103.4	105.4	106.4	107.9	109.1
Exchange rate (ER), NC/EUR	132.1	137.8	140.3	139.0	140.3	140.0	141.0	143.0
ER, nominal, 2010=100	95.8	100.0	101.8	100.9	101.8	101.6	102.3	103.8
Real ER (CPI-based), 2010=100	102.8	100.0	98.5	98.8	98.4	98.6	97.4	95.6
Real ER (PPI-based), 2010=100	107.2	100.0	95.7	95.0	93.8	92.8	90.8	88.2
PPP, NC/EUR	55.55	59.94	60.33	61.18	62.30	62.1	62.0	61.8
Price level, EU28 = 100	42	44	43	44	44	44	44	43
Average monthly gross wages, NC	36075	34767	36482	37305	40860	42100	42700	43300
Average monthly gross wages, EUR (ER)	273	252	260	268	291	300	300	300
Average monthly gross wages, EUR (PPP)	649	580	605	610	656	680	690	700
GDP nominal, NC bn	1144	1240	1301	1335	1369	1400	1440	1470
Employed persons, LFS, th., Oct	1161	1167	1160	1117	992	1000	1050	1050
GDP per employed person, NC	985727	1061907	1120767	1195454	1379874	1400000	1371400	1400000
GDP per empl. person, NC at 2010 ref.pr.	1030017	1061907	1095411	1156381	1308756	1315200	1271300	1282800
Unit labour costs, NC, 2010=100	107.0	100.0	101.7	98.5	95.4	97.8	102.6	103.1
Unit labour costs, ER adj., 2010=100	111.6	100.0	99.9	97.6	93.7	96.2	100.3	99.3
Unit labour costs, PPP adj., Austria=100	31.3	28.1	27.9	26.6	25.1	25.4	26.0	25.5

(Table 30 ctd.)

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	2009	2010	2011	2012	2013	2014	2015	2016
							Forecast	
Macedonia								
Producer price index, 2010=100	92.0	100.0	111.9	113.5	111.9	112.4	114.1	116.4
Consumer price index, 2010=100	98.4	100.0	103.9	107.3	110.3	110.9	112.6	114.8
GDP deflator, 2010=100	97.4	100.0	103.1	103.2	103.4	103.9	105.5	107.6
Exchange rate (ER), NC/EUR	61.27	61.52	61.53	61.53	61.58	61.5	61.5	61.5
ER, nominal, 2010=100	99.6	100.0	100.0	100.0	100.1	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.9	100.0	100.8	101.4	102.6	102.3	102.3	102.8
Real ER (PPI-based), 2010=100	95.1	100.0	106.2	104.8	103.3	102.7	102.7	103.2
PPP, NC/EUR	23.69	23.83	24.84	24.60	25.39	25.2	25.2	25.3
Price level, EU28 = 100	39	39	40	40	41	41	41	41
Average gross monthly wages, MKD [1)]	29922	30225	30602	30669	31025	31500	32500	33600
Average monthly gross wages, EUR (ER)	488	491	497	498	504	510	530	550
Average monthly gross wages, EUR (PPP)	1263	1268	1232	1246	1222	1250	1290	1330
GDP nominal, NC mn	410734	434112	459789	458621	473019	489600	511900	537800
Employed persons, LFS, th., average	629.9	637.9	645.1	650.6	678.8	689	699	706
GDP per employed person, NC	652061	680581	712757	704970	696807	710600	732300	761800
GDP per empl. person, NC at 2010 ref.pr.	669667	680581	691326	683090	673832	683800	694200	708000
Unit labour costs, NC, 2010=100	100.6	100.0	99.7	101.1	103.7	103.7	105.4	106.9
Unit labour costs, ER adj., 2010=100	101.0	100.0	99.7	101.1	103.6	103.8	105.4	106.9
Unit labour costs, PPP adj., Austria=100	34.2	33.9	33.6	33.2	33.5	33.1	33.1	33.1
Montenegro								
Producer price index, 2010=100	100.9	100.0	103.2	105.1	106.8	106.9	107.0	109.8
Consumer price index, 2010=100	99.5	100.0	103.5	107.7	110.1	110.1	111.2	113.4
GDP deflator, 2010=100	98.4	100.0	100.9	100.8	103.1	103.2	103.2	106.0
Exchange rate (ER), NC/EUR	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Real ER (CPI-based), 2010=100	101.6	100.0	100.4	101.8	102.5	101.5	101.0	101.5
Real ER (PPI-based), 2010=100	103.9	100.0	98.0	97.1	98.8	92.8	91.9	92.5
PPP, NC/EUR	0.4885	0.4927	0.4904	0.4893	0.4993	0.49	0.49	0.49
Price level, EU28 = 100	49	49	49	49	50	49	49	49
Average monthly gross wages, NC	643	715	722	727	726	730	750	780
Average monthly gross wages, EUR (PPP)	1316	1451	1472	1486	1454	1480	1540	1590
GDP nominal, NC mn	2981.0	3103.9	3234.1	3148.9	3327.1	3400	3500	3700
Employed persons, LFS, th., average	212.9	208.2	195.4	200.0	201.9	207	210	210
GDP per employed person, NC	14002	14912	16553	15744	16479	16400	16700	17600
GDP per empl. person, NC at 2010 ref.pr.	14228	14912	16400	15613	15982	15900	16200	16600
Unit labour costs, NC, 2010=100	94.2	100.0	91.8	97.1	94.7	95.8	96.6	98.0
Unit labour costs, ER adj., 2010=100	94.2	100.0	91.8	97.1	94.7	95.8	96.6	98.0
Unit labour costs, PPP adj., Austria=100	43.8	46.6	42.5	43.8	42.1	41.9	41.6	41.7
Serbia								
Producer price index, 2010=100	88.0	100.0	112.7	120.4	123.6	127.7	131.1	136.7
Consumer price index, 2010=100	93.6	100.0	111.0	119.7	129.0	131.6	136.8	140.9
GDP deflator, 2010=100	95.3	100.0	109.6	116.2	122.5	126.5	129.9	135.4
Exchange rate (ER), NC/EUR	93.95	103.04	101.95	113.13	113.14	118	120	122
ER, nominal, 2010=100	91.2	100.0	98.9	109.8	109.8	114.5	116.5	118.4
Real ER (CPI-based), 2010=100	104.8	100.0	108.8	103.0	109.4	106.0	106.8	106.6
Real ER (PPI-based), 2010=100	99.4	100.0	108.2	101.3	104.1	101.8	101.3	102.3
PPP, NC/EUR	44.34	46.73	49.57	51.46	54.39	55.5	56.1	57.6
Price level, EU28 = 100	47	45	49	45	48	47	47	47
Average monthly gross wages, NC	44147	47450	52733	57430	60708	60680	62480	64350
Average monthly gross wages, EUR (ER)	470	460	517	508	537	510	520	530
Average monthly gross wages, EUR (PPP)	996	1015	1064	1116	1116	1090	1110	1120
GDP nominal, NC bn	2720	2882	3209	3349	3618	3700	3800	4000
Employed persons, LFS, th., average	2616	2396	2253	2228	2311	2400	2400	2400
GDP per employed person, NC	1039614	1202670	1424023	1502771	1565819	1541700	1583300	1666700
GDP per empl. person, NC at 2010 ref.pr.	1090478	1202670	1299061	1293552	1278624	1218800	1218700	1231000
Unit labour costs, NC, 2010=100	102.6	100.0	102.9	112.5	120.3	126.2	129.9	132.5
Unit labour costs, ER adj., 2010=100	112.5	100.0	104.0	102.5	109.6	110.2	111.6	111.9
Unit labour costs, PPP adj., Austria=100	39.6	35.3	36.4	35.0	36.9	36.6	36.4	36.0

(Table 30 ctd.)

(Table 30 ctd.)

	2009	2010	2011	2012	2013	2014	2015	2016
							Forecast	
Bosnia and Herzegovina								
Producer price index, 2010=100	99.0	100.0	105.5	105.8	104.0	104.0	105.0	107.1
Consumer price index, 2010=100	97.9	100.0	103.7	105.8	106.0	106.0	107.0	109.2
GDP deflator, 2010=100	98.5	100.0	102.6	103.7	103.6	103.8	104.7	106.9
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	100.0	100.0	100.6	99.9	98.7	97.7	97.3	97.7
Real ER (PPI-based), 2010=100	102.0	100.0	100.2	97.8	96.1	94.9	94.4	94.9
PPP, NC/EUR	0.9871	0.9686	0.9618	0.9471	0.9464	0.94	0.93	0.94
Price level, EU28 = 100	50	50	49	48	48	48	48	48
Average monthly gross wages, NC	1204	1217	1271	1290	1291	1300	1340	1390
Average monthly gross wages, EUR (ER)	615	622	650	660	660	660	690	710
Average monthly gross wages, EUR (PPP)	1219	1256	1321	1362	1364	1390	1440	1490
GDP nominal, NC mn	24307	24879	25772	25734	26259	26300	26800	27900
Employed persons, LFS, th., April	859.2	842.8	816.0	813.7	821.6	823	831	840
GDP per employed person, NC	28290	29518	31582	31627	31961	32000	32300	33200
GDP per empl. person, NC at 2010 ref.pr.	28713	29518	30779	30495	30847	30800	30900	31100
Unit labour costs, NC, 2010=100	101.7	100.0	100.2	102.6	101.5	102.4	105.2	108.4
Unit labour costs, ER adj., 2010=100	101.7	100.0	100.2	102.6	101.5	102.4	105.2	108.4
Unit labour costs, PPP adj., Austria=100	40.9	40.3	40.0	40.0	39.0	38.7	39.1	39.8
Kazakhstan								
Producer price index, 2010=100	79.9	100.0	127.2	131.7	131.3	145.7	151.5	159.1
Consumer price index, 2010=100	93.4	100.0	108.3	113.9	120.5	131.4	139.3	147.6
GDP deflator, 2010=100	83.6	100.0	117.8	123.6	131.2	137.9	146.1	154.9
Exchange rate (ER), NC/EUR	205.68	195.67	204.11	191.67	202.09	239	231	232
ER, nominal, 2010=100	105.1	100.0	104.3	98.0	103.3	122.1	118.1	118.6
Real ER (CPI-based), 2010=100	90.7	100.0	100.7	109.9	108.7	99.2	107.2	111.4
Real ER (PPI-based), 2010=100	78.3	100.0	115.8	124.2	117.5	108.9	115.4	118.9
PPP, NC/EUR	93.5	98.4	106.6	107.8	114.9	120.8	127.9	135.7
Price level, EU28 = 100	45	50	52	56	57	51	55	58
Average monthly gross wages, NC	67333	77611	90028	101263	109141	124320	137710	153270
Average monthly gross wages, EUR (ER)	327	397	441	528	540	520	600	660
Average monthly gross wages, EUR (PPP)	720	789	844	940	950	1030	1080	1130
GDP nominal, NC bn	17008	21816	27572	30347	34140	37500	41500	46200
Employed persons, LFS, th., average	7903	8114	8302	8507	8571	8660	8750	8840
GDP per employed person, NC	2151941	2688560	3321274	3567251	3983390	4330300	4742900	5226200
GDP per empl. person, NC at 2010 ref.pr.	2573662	2688560	2819377	2886766	3035331	3139200	3246700	3374300
Unit labour costs, NC, 2010=100	90.6	100.0	110.6	121.5	124.6	137.2	146.9	157.4
Unit labour costs, ER adj., 2010=100	86.2	100.0	106.0	124.1	120.6	112.3	124.5	132.7
Unit labour costs, PPP adj., Austria=100	24.6	28.6	30.1	34.4	32.9	30.2	32.9	34.7
Russia								
Producer price index, 2010=100	89.2	100.0	119.0	127.1	131.4	139.3	146.2	152.1
Consumer price index, 2010=100	93.5	100.0	108.5	114.0	121.8	130.9	140.1	148.5
GDP deflator, 2010=100	87.6	100.0	115.2	123.8	131.8	141.4	150.3	158.0
Exchange rate (ER), NC/EUR	44.13	40.27	40.87	39.94	42.27	50	53	55
ER, nominal, 2010=100	109.6	100.0	101.5	99.2	105.0	124.2	131.6	136.6
Real ER (CPI-based), 2010=100	87.1	100.0	103.7	108.6	108.0	97.2	96.7	97.3
Real ER (PPI-based), 2010=100	83.8	100.0	111.3	118.4	115.7	102.4	99.9	98.7
PPP, NC/EUR	18.74	20.77	23.07	24.14	25.69	27.2	28.5	29.5
Price level, EU28 = 100	42	52	56	60	61	54	54	54
Average monthly gross wages, NC	18638	20952	23369	26629	29960	32530	35160	38010
Average monthly gross wages, EUR (ER)	422	520	572	667	709	650	660	690
Average monthly gross wages, EUR (PPP)	995	1009	1013	1103	1166	1200	1230	1290
GDP nominal, NC bn	38807	46309	55967	62218	66755	72000	77500	83000
Employed persons, LFS, th., average	69411	69934	70857	71545	71391	71300	71500	72000
GDP per employed person, NC	559097	662178	789866	869635	935062	1009800	1083900	1152800
GDP per empl. person, NC at 2010 ref.pr.	638439	662178	685352	702674	709492	713900	721200	729800
Unit labour costs, NC, 2010=100	92.3	100.0	107.8	119.8	133.5	144.0	154.1	164.6
Unit labour costs, ER adj., 2010=100	84.2	100.0	106.2	120.8	127.1	116.0	117.1	120.5
Unit labour costs, PPP adj., Austria=100	27.0	32.2	33.9	37.7	39.0	35.1	34.8	35.4

(Table 30 ctd.)

(Table 30 ctd.)

	2009	2010	2011	2012	2013	2014	2015	2016
							Forecast	
Ukraine								
Producer price index, 2010=100	82.7	100.0	119.0	123.4	123.3	138.1	151.9	159.5
Consumer price index, 2010=100	91.4	100.0	108.0	108.6	108.3	120.2	131.9	137.8
GDP deflator, 2010=100	88.0	100.0	114.2	123.3	127.2	141.4	155.0	162.3
Exchange rate (ER), NC/EUR	10.868	10.533	11.092	10.271	10.612	15.5	15.0	14.5
ER, nominal, 2010=100	103.2	100.0	105.3	97.5	100.8	147.2	142.4	137.7
Real ER (CPI-based), 2010=100	90.4	100.0	99.5	105.3	100.1	75.4	84.2	89.6
Real ER (PPI-based), 2010=100	82.6	100.0	107.3	116.9	113.1	85.7	95.9	102.7
PPP, NC/EUR	4.1940	4.3280	4.5610	4.7500	4.9250	5.41	5.84	6.02
Price level, EU28 = 100	39	41	41	46	46	35	39	42
Average monthly gross wages, NC	1906	2239	2633	3026	3265	3480	3800	4050
Average monthly gross wages, EUR (ER)	175	213	237	295	308	220	250	280
Average monthly gross wages, EUR (PPP)	454	517	577	637	663	640	650	670
GDP nominal, NC mn	913	1121	1349	1459	1505	1540	1670	1780
Employed persons, LFS, th., average	20192	20266	20324	20354	20404	18300	18100	18100
GDP per employed person, NC	45234	55294	66383	71685	73783	84200	92300	98300
GDP per empl. person, NC at 2010 ref.pr.	51431	55294	58128	58121	58024	59600	59500	60600
Unit labour costs, NC, 2010=100	91.5	100.0	111.9	128.6	139.0	144.2	157.7	165.0
Unit labour costs, ER adj., 2010=100	88.7	100.0	106.2	131.8	137.9	98.0	110.7	119.9
Unit labour costs, PPP adj., Austria=100	29.1	32.8	34.6	41.9	43.2	30.2	33.6	35.9
Austria								
Producer price index, 2010=100	95.2	100.0	108.3	110.9	109.7	111.6	113.7	115.6
Consumer price index, 2010=100	98.1	100.0	103.3	105.8	107.9	109.8	111.8	113.9
GDP deflator, 2010=100	98.6	100.0	102.1	103.9	105.5	107.4	109.4	111.2
Real ER (CPI-based), 2010=100	100.2	100.0	100.2	100.0	100.5	101.3	101.6	102.0
Real ER (PPI-based), 2010=100	98.1	100.0	102.8	102.4	101.4	101.9	102.3	102.4
PPP, NC/EUR	1.1233	1.1036	1.1036	1.0993	1.1143	1.120	1.124	1.125
Price level, EU28 = 100	112	110	110	110	111	112	112	113
Average monthly gross wages, EUR	3162	3196	3272	3352	3424	3490	3580	3660
Average monthly gross wages, EUR (PPP)	2815	2896	2964	3049	3073	3117	3186	3252
GDP nominal, NC mn	276228	285165	299240	307004	313067	323100	334700	346800
Employed persons - LFS, th., average	4078	4096	4144	4184	4175	4210	4250	4290
GDP per employed person, NC	67741	69600	72200	73400	75000	76700	78800	80800
GDP per empl. person, NC at 2010 ref.pr.	68687	69600	70707	70674	71084	71400	72000	72700
Unit labour costs, NC, 2010=100	100.2	100.0	100.8	103.3	104.9	106.4	108.3	109.6
Unit labour costs, PPP 2011 adjusted	0.61	0.61	0.61	0.63	0.64	0.65	0.66	0.67

Notes:

New benchmark PPP results for 2011 were applied (published by Eurostat , OECD and CIS Stat in December 2013). Additionally, we rebased the reference prices to the year 2010 (instead of the previously published 2005 basis).

Employment data and related indicators (e.g. Unit labour costs) may be affected by the new population census data - mostly from 2012 (BG, RO from 2014, AL, ME, KZ from 2011).

Unit labour costs are defined as average gross wages per employee relative to labour productivitiy (real GDP per employed person, LFS) . For level comparisons, labour productivity is converted with the PPP rate 2011 (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.

NC = national currency (including euro-fixed series for euro area countries - EE, LV, SK, SI, AT). 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, 2009-2016, annual changes in %

	2009	2010	2011	2012	2013	2014	2015	2016
							Forecast	
Bulgaria								
GDP deflator	4.3	2.8	4.9	3.1	-0.8	-1.0	1.0	2.0
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	1.5	0.9	0.3	-0.3	-1.1	-1.9	-0.5	0.5
Real ER (PPI-based)	-2.1	5.3	3.7	1.5	-1.4	-2.3	-0.5	0.5
Average gross wages, NC	11.8	6.4	5.8	6.6	10.5	1.5	3.7	4.7
Average gross wages, real (PPI based)	18.8	-1.9	-3.1	2.1	12.2	2.6	2.7	2.6
Average gross wages, real (CPI based)	9.1	3.3	2.3	4.1	10.0	2.6	2.6	2.7
Average gross wages, EUR (ER)	11.8	6.4	5.8	6.6	10.5	1.7	2.4	7.0
Employed persons (LFS)	-3.2	-6.2	-3.4	-1.0	0.0	0.9	1.0	1.0
GDP per empl. person, NC at 2010 ref. pr.	-2.3	7.0	5.4	1.6	0.7	1.2	1.2	1.6
Unit labour costs, NC at 2010 ref. prices	14.5	-0.6	0.4	4.9	9.6	0.3	2.4	3.1
Unit labour costs, ER (EUR) adjusted	14.5	-0.6	0.4	4.9	9.6	0.3	2.4	3.1
Croatia								
GDP deflator	2.8	0.8	1.7	1.6	0.9	0.5	1.0	1.0
Exchange rate (ER), EUR/NC	-1.6	0.7	-2.0	-1.1	-0.7	-0.7	-0.1	0.0
Real ER (CPI-based)	-0.4	-0.2	-2.8	-0.4	0.1	-1.2	-0.6	-0.5
Real ER (PPI-based)	2.0	2.0	-0.4	1.4	-0.9	-1.0	-0.6	-0.5
Average gross wages, NC	2.2	-0.4	1.5	1.0	0.8	-0.1	0.8	1.5
Average gross wages, real (PPI based)	2.7	-4.5	-5.1	-4.2	1.1	-1.1	-0.2	0.5
Average gross wages, real (CPI based)	0.0	-1.5	-0.7	-2.3	-1.5	-0.6	-0.2	0.5
Average gross wages, EUR (ER)	0.6	0.3	-0.5	-0.1	0.1	-0.8	1.0	1.0
Employed persons (LFS)	-1.8	-4.0	-3.2	-3.1	-3.9	2.1	0.0	0.6
GDP per empl. person, NC at 2010 ref. pr.	-5.6	2.4	3.0	1.0	3.0	-2.8	0.0	0.3
Unit labour costs, NC at 2010 ref. prices	8.3	-2.7	-1.4	0.0	-2.2	2.8	0.7	1.2
Unit labour costs, ER (EUR) adjusted	6.6	-2.0	-3.4	-1.1	-2.9	2.0	0.6	1.2
Czech Republic								
GDP deflator	2.6	-1.4	-0.2	1.4	1.7	1.0	1.4	1.0
Exchange rate (ER), EUR/NC	-5.6	4.6	2.8	-2.2	-3.2	-5.5	2.8	2.9
Real ER (CPI-based)	-6.0	3.6	1.9	-1.4	-3.3	-6.0	3.1	2.9
Real ER (PPI-based)	-3.3	1.6	1.3	-2.7	-2.5	-5.6	2.8	2.9
Average gross wages, NC	3.3	2.2	2.5	2.5	0.0	2.1	3.9	3.4
Average gross wages, real (PPI based)	4.9	2.1	-1.2	0.2	-0.6	0.9	2.4	1.9
Average gross wages, real (CPI based)	2.7	1.1	0.3	-1.0	-1.3	1.6	2.1	1.9
Average gross wages, EUR (ER)	-2.5	6.9	5.4	0.2	-3.2	-3.7	6.5	7.1
Employed persons (LFS)	-1.4	-1.0	0.4	0.4	1.0	0.3	0.2	0.2
GDP per empl. person, NC at 2010 ref. pr.	-3.5	3.3	1.6	-1.2	-1.7	2.2	2.2	2.4
Unit labour costs, NC at 2010 ref. prices	7.1	-1.1	0.9	3.7	1.7	-0.1	1.7	1.0
Unit labour costs, ER (EUR) adjusted	1.1	3.4	3.7	1.4	-1.5	-5.7	4.5	3.9
Estonia								
GDP deflator	0.4	1.5	3.0	2.7	4.5	0.2	1.6	2.1
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	-0.8	0.6	1.9	1.5	1.7	-0.5	0.0	0.7
Real ER (PPI-based)	5.1	0.2	-1.0	-0.2	7.4	-1.1	0.1	0.6
Average gross wages, NC	-5.0	1.1	5.9	5.7	7.0	3.3	5.1	4.9
Average gross wages, real (PPI based)	-5.9	-2.0	1.6	3.0	-0.2	3.0	3.4	2.7
Average gross wages, real (CPI based)	-5.2	-1.6	0.8	1.4	3.6	2.9	3.5	2.6
Average gross wages, EUR (ER)	-5.0	1.1	5.9	5.7	7.0	3.3	5.1	4.9
Employed persons (LFS)	-9.2	-4.2	6.7	1.9	1.0	-1.0	-0.8	-0.8
GDP per empl. person, NC at 2010 ref. pr.	-6.1	6.9	1.5	2.7	0.6	2.7	2.9	3.8
Unit labour costs, NC at 2010 ref. prices	1.1	-5.5	4.3	2.9	6.4	0.5	2.2	1.0
Unit labour costs, ER (EUR) adjusted	1.1	-5.5	4.3	2.9	6.4	0.5	2.2	1.0
Hungary								
GDP deflator	3.9	2.1	2.2	3.4	3.0	2.1	2.5	2.5
Exchange rate (ER), EUR/NC	-10.3	1.8	-1.4	-3.4	-2.6	-5.8	0.0	0.0
Real ER (CPI-based)	-7.6	4.4	-0.6	-0.6	-2.4	-3.8	0.5	1.5
Real ER (PPI-based)	-2.5	2.7	-2.5	-2.2	-1.9	-5.0	1.0	1.0
Average gross wages, NC	0.6	1.3	5.2	4.7	3.4	5.3	3.8	4.3
Average gross wages, real (PPI based)	-3.7	-2.5	1.0	0.5	2.8	3.1	1.3	1.8
Average gross wages, real (CPI based)	-3.3	-3.2	1.2	-0.9	1.7	2.3	1.8	1.3
Average gross wages, EUR (ER)	-9.8	3.1	3.8	1.1	0.8	-0.9	3.9	5.0
Employed persons (LFS)	-2.5	0.0	0.8	1.7	1.6	1.1	1.0	1.0
GDP per empl. person, NC at 2010 ref. pr.	-4.1	0.8	1.0	-3.2	0.0	1.9	1.2	1.0
Unit labour costs, NC at 2010 ref. prices	4.9	0.5	4.2	8.1	3.4	3.4	2.6	3.3
Unit labour costs, ER (EUR) adjusted	-5.9	2.3	2.7	4.4	0.8	-2.6	2.6	3.3

Table 31 (ctd.)

Table 31 (ctd.)

	2009	2010	2011	2012	2013	2014	2015	2016
							Forecast	
Latvia								
GDP deflator	-9.8	-1.0	6.4	3.6	1.1	0.4	1.4	2.2
Exchange rate (ER), EUR/NC	-0.4	-0.4	0.3	1.3	-0.6	-0.2	0.0	0.0
Real ER (CPI-based)	1.8	-3.6	1.4	0.9	-2.1	-0.5	0.1	0.7
Real ER (PPI-based)	0.4	-1.0	2.7	2.6	1.2	-1.1	-0.1	0.6
Average gross wages, NC	-3.8	-3.5	4.3	3.7	4.6	3.4	5.4	5.1
Average gross wages, real (PPI based)	-0.7	-5.7	-3.2	-0.4	2.9	3.0	3.9	2.9
Average gross wages, real (CPI based)	-6.8	-2.3	0.0	1.3	4.6	2.8	3.7	2.9
Average gross wages, EUR (ER)	-4.2	-3.9	4.6	5.0	3.9	3.2	5.4	5.1
Employed persons (LFS)	-12.6	-4.3	3.1	1.6	2.1	0.1	0.3	0.2
GDP per empl. person, NC at 2010 ref. pr.	-1.8	1.5	1.8	3.2	2.1	2.5	2.1	2.9
Unit labour costs, NC at 2010 ref. prices	-2.0	-4.9	2.4	0.5	2.4	0.9	3.2	2.2
Unit labour costs, ER (EUR) adjusted	-2.4	-5.3	2.8	1.8	1.8	0.7	3.2	2.2
Lithuania								
GDP deflator	-3.4	2.3	5.4	2.7	1.7	0.3	1.2	1.8
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0
Real ER (CPI-based)	3.1	-0.9	1.0	0.5	-0.3	-0.6	-0.3	0.3
Real ER (PPI-based)	-10.0	7.1	8.2	2.1	-2.3	-0.9	-0.3	0.3
Average gross wages, NC	-4.4	-3.3	2.9	3.8	5.1	4.9	5.1	5.3
Average gross wages, real (PPI based)	10.5	-12.4	-9.7	-1.1	7.7	4.6	3.9	3.4
Average gross wages, real (CPI based)	-8.3	-4.4	-1.2	0.6	3.9	4.5	3.9	3.4
Average gross wages, EUR (ER)	-4.4	-3.3	2.9	3.8	5.1	5.2	4.4	5.6
Employed persons (LFS)	-6.8	-5.1	2.0	1.8	1.3	1.2	0.9	0.6
GDP per empl. person, NC at 2010 ref. pr.	-8.6	7.1	3.9	1.8	2.0	1.8	2.2	2.9
Unit labour costs, NC at 2010 ref. prices	4.5	-9.7	-1.0	2.0	3.0	3.0	2.8	2.4
Unit labour costs, ER (EUR) adjusted	4.5	-9.7	-1.0	2.0	3.0	3.1	2.8	2.4
Poland								
GDP deflator	3.7	1.5	3.2	2.5	0.9	0.9	1.5	1.9
Exchange rate (ER), EUR/NC	-18.8	8.3	-3.1	-1.5	-0.3	-0.1	1.2	0.0
Real ER (CPI-based)	-16.4	9.0	-2.3	-0.6	-0.9	-0.7	1.2	0.5
Real ER (PPI-based)	-12.9	7.1	-1.2	-1.1	-1.4	-2.3	1.2	0.5
Average gross wages, NC	5.4	3.9	5.6	3.7	3.4	3.3	4.5	5.1
Average gross wages, real (PPI based)	2.2	2.1	-1.6	0.4	4.7	4.3	3.0	3.0
Average gross wages, real (CPI based)	1.4	1.2	1.6	0.1	2.5	3.0	3.0	3.0
Average gross wages, EUR (ER)	-14.4	12.6	2.3	2.1	3.1	3.5	5.6	5.3
Employed persons (LFS)	0.4	0.6	1.1	0.2	-0.1	0.2	0.5	0.5
GDP per empl. person, NC at 2010 ref. pr.	1.2	3.2	3.5	1.8	1.7	2.2	2.7	2.5
Unit labour costs, NC at 2010 ref. prices	4.2	0.7	2.0	1.9	1.6	1.1	1.8	2.5
Unit labour costs, ER (EUR) adjusted	-15.4	9.1	-1.1	0.4	1.3	1.0	3.0	2.5
Romania								
GDP deflator	4.2	5.7	4.0	4.7	3.5	2.7	3.3	2.6
Exchange rate (ER), EUR/NC	-13.1	0.7	-0.6	-4.9	0.9	-1.1	0.4	0.0
Real ER (CPI-based)	-9.2	4.6	2.0	-4.3	2.6	-0.1	1.9	2.0
Real ER (PPI-based)	-7.4	2.0	1.0	-2.7	3.0	0.3	2.2	1.1
Average gross wages, NC	4.8	3.1	4.1	4.2	5.0	5.3	5.3	6.3
Average gross wages, real (PPI based)	2.3	-1.2	-2.8	-1.0	2.9	2.5	1.9	3.5
Average gross wages, real (CPI based)	-0.8	-2.8	-1.6	0.8	1.7	3.2	2.2	2.7
Average gross wages, EUR (ER)	-9.0	3.8	3.4	-1.0	6.0	4.0	5.9	5.6
Employed persons (LFS)	-1.3	0.0	-1.1	1.4	-0.2	0.6	1.0	1.0
GDP per empl. person, NC at 2010 ref. pr.	-5.3	-1.1	3.5	-0.8	3.7	1.6	1.7	1.9
Unit labour costs, NC at 2010 ref. prices	10.6	4.2	0.6	5.0	1.2	3.6	3.5	4.2
Unit labour costs, ER (EUR) adjusted	-3.9	4.9	0.0	-0.1	2.2	2.4	4.0	4.2
Slovakia								
GDP deflator	-1.2	0.5	1.6	1.3	0.5	0.2	1.5	2.5
Exchange rate (ER), EUR/NC	3.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	3.7	-1.4	1.0	1.1	0.0	-0.7	0.0	1.0
Real ER (PPI-based)	0.5	-2.5	-0.7	-0.9	-0.9	-4.2	-0.5	0.0
Average gross wages, NC	3.0	3.3	2.2	2.4	2.4	1.9	4.8	5.7
Average gross wages, real (PPI based)	10.6	2.9	-2.2	0.5	3.4	5.1	3.7	4.1
Average gross wages, real (CPI based)	2.0	2.6	-1.8	-1.3	0.9	1.7	3.2	3.1
Average gross wages, EUR (ER)	6.9	3.3	2.2	2.4	2.4	1.9	4.8	5.7
Employed persons (LFS)	-2.8	-2.1	1.5	0.6	0.0	0.9	1.7	1.7
GDP per empl. person, NC at 2010 ref. pr.	-2.2	6.6	1.6	1.2	0.9	1.5	0.7	1.0
Unit labour costs, NC at 2010 ref. prices	5.3	-3.1	0.7	1.2	1.4	0.4	4.1	4.7
Unit labour costs, ER (EUR) adjusted	9.3	-3.1	0.7	1.2	1.4	0.4	4.1	4.7

Table 31 (ctd.)

Table 31 (ctd.)

	2009	2010	2011	2012	2013	2014	2015 Forecast	2016
Slovenia								
GDP deflator	3.4	-1.1	1.2	0.3	1.4	0.7	1.0	1.0
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	-0.1	0.0	-1.0	0.2	0.4	-0.3	-0.5	-0.5
Real ER (PPI-based)	2.6	-1.0	-0.7	-1.9	0.1	-1.3	-1.0	-0.5
Average gross wages, NC	3.4	3.9	2.0	0.1	-0.2	1.1	1.9	1.9
Average gross wages, real (PPI based)	4.9	1.9	-2.5	-0.8	-0.2	1.1	1.4	0.9
Average gross wages, real (CPI based)	2.5	1.8	-0.1	-2.7	-2.0	0.4	0.9	0.9
Average gross wages, EUR (ER)	3.4	3.9	2.0	0.1	-0.2	1.1	1.9	1.9
Employed persons (LFS)	-1.5	-1.5	-3.1	-1.3	-1.9	1.6	1.1	1.1
GDP per empl. person, NC at 2010 ref. pr.	-6.3	2.8	3.8	-1.3	1.0	0.3	0.3	0.5
Unit labour costs, NC at 2010 ref. prices	10.4	1.1	-1.8	1.4	-1.1	0.8	1.7	1.4
Unit labour costs, ER (EUR) adjusted	10.4	1.1	-1.8	1.4	-1.1	0.8	1.7	1.4
Albania								
GDP deflator	2.4	4.5	2.3	1.0	2.0	1.0	1.3	1.2
Exchange rate (ER), EUR/NC	-7.0	-4.2	-1.8	0.9	-0.9	0.2	-0.7	-1.4
Real ER (CPI-based)	-5.8	-2.8	-1.5	0.3	-0.4	0.2	-1.2	-1.9
Real ER (PPI-based)	-4.8	-6.7	-4.3	-0.7	-1.3	-1.1	-2.2	-2.9
Average gross wages, NC	5.2	-3.6	4.9	2.3	9.5	3.0	1.4	1.4
Average gross wages, real (PPI based)	7.0	-3.9	2.2	1.1	10.1	3.0	1.4	1.4
Average gross wages, real (CPI based)	2.9	-7.0	1.5	0.2	7.4	2.0	0.4	0.4
Average gross wages, EUR (ER)	-2.1	-7.6	3.0	3.2	8.6	3.0	0.0	0.0
Employed persons (LFS)	3.3	0.6	-0.6	-3.7	-11.2	0.8	5.0	0.0
GDP per empl. person, NC at 2010 ref. pr.	0.0	3.1	3.2	5.6	13.2	0.5	-3.3	0.9
Unit labour costs, NC at 2010 ref. prices	5.2	-6.5	1.7	-3.1	-3.2	2.5	4.9	0.5
Unit labour costs, ER (EUR) adjusted	-2.2	-10.4	-0.1	-2.2	-4.1	2.7	4.2	-0.9
Macedonia								
GDP deflator	0.7	2.7	3.1	0.1	0.2	0.5	1.5	2.0
Exchange rate (ER), EUR/NC	0.0	-0.4	0.0	0.0	-0.1	0.1	0.0	0.0
Real ER (CPI-based)	-1.8	-0.9	0.8	0.6	1.2	-0.3	0.0	0.5
Real ER (PPI-based)	-3.4	5.1	6.2	-1.4	-1.4	-0.7	0.0	0.5
Average gross wages, NC [1)]	9.0	1.0	1.2	0.2	1.2	1.5	3.2	3.4
Average gross wages, real (PPI based)	17.5	-7.1	-9.5	-1.2	2.6	1.0	1.6	1.4
Average gross wages, real (CPI based)	9.9	-0.6	-2.5	-3.0	-1.6	1.0	1.6	1.4
Average gross wages, EUR (ER)	9.0	0.6	1.2	0.2	1.1	1.2	3.9	3.8
Employed persons (LFS)	3.4	1.3	1.1	0.8	4.3	1.5	1.5	1.0
GDP per empl. person, NC at 2010 ref. pr.	-4.2	1.6	1.6	-1.2	-1.4	1.5	1.5	2.0
Unit labour costs, NC at 2010 ref. prices	13.8	-0.6	-0.3	1.4	2.6	0.1	1.6	1.4
Unit labour costs, ER (EUR) adjusted	13.8	-1.0	-0.3	1.4	2.5	0.2	1.6	1.4
Montenegro								
GDP deflator	2.4	1.6	0.9	-0.1	2.2	0.1	0.0	2.6
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	2.4	-1.5	0.4	1.4	0.7	-0.9	-0.5	0.5
Real ER (PPI-based)	0.0	-3.8	-2.0	-0.9	1.7	-6.1	-1.0	0.6
Average gross wages, NC	5.6	11.2	1.0	0.7	-0.1	0.6	2.7	4.0
Average gross wages, real (PPI based)	9.9	12.2	-2.1	-1.2	-1.7	0.5	2.7	1.3
Average gross wages, real (CPI based)	2.1	10.6	-2.4	-3.3	-2.3	0.6	1.7	2.0
Average gross wages, EUR (ER)	5.6	11.2	1.0	0.7	-0.1	0.6	2.7	4.0
Employed persons (LFS)	-2.7	-2.2	-6.1	2.4	1.0	2.5	1.4	0.0
GDP per empl. person, NC at 2010 ref. pr.	-3.0	4.8	10.0	-4.8	2.4	-0.5	1.9	2.5
Unit labour costs, NC at 2010 ref. prices	8.9	6.1	-8.2	5.8	-2.4	1.1	0.8	1.5
Unit labour costs, ER (EUR) adjusted	8.9	6.1	-8.2	5.8	-2.4	1.1	0.8	1.5
Serbia								
GDP deflator	5.9	4.9	9.6	6.0	5.4	3.3	2.7	4.2
Exchange rate (ER), EUR/NC	-13.3	-8.8	1.1	-9.9	0.0	-4.1	-1.7	-1.6
Real ER (CPI-based)	-6.8	-4.6	8.8	-5.4	6.2	-3.1	0.8	-0.2
Real ER (PPI-based)	-4.8	0.6	8.2	-6.4	2.8	-2.2	-0.5	1.0
Average gross wages, NC	-3.3	7.5	11.1	8.9	5.7	0.0	3.0	3.0
Average gross wages, real (PPI based)	-8.4	-5.5	-1.4	2.0	2.9	-3.2	0.3	-1.2
Average gross wages, real (CPI based)	-11.0	0.6	0.1	1.0	-1.9	-2.0	-1.0	0.0
Average gross wages, EUR (ER)	-16.2	-2.0	12.3	-1.9	5.7	-5.0	2.0	1.9
Employed persons (LFS)	-7.3	-8.4	-6.0	-1.1	3.7	3.9	0.0	0.0
GDP per empl. person, NC at 2010 ref. pr.	4.1	10.3	8.0	-0.4	-1.2	-4.7	0.0	1.0
Unit labour costs, NC at 2010 ref. prices	-7.1	-2.5	2.9	9.4	6.9	4.9	3.0	2.0
Unit labour costs, ER (EUR) adjusted	-19.5	-11.1	4.0	-1.4	6.9	0.5	1.3	0.3

1) In 2009 wiiw estimate (including allowances for food and transport).

Table 31 (ctd.)

Table 31 (ctd.)

	2009	2010	2011	2012	2013	2014	2015	2016
							Forecast	
Bosnia and Herzegovina								
GDP deflator	0.0	1.5	2.6	1.1	-0.1	0.2	0.9	2.1
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	-1.4	0.0	0.6	-0.6	-1.3	-0.9	-0.5	0.5
Real ER (PPI-based)	0.6	-2.0	0.2	-2.4	-1.7	-1.3	-0.5	0.5
Average gross wages, NC	8.1	1.1	4.5	1.5	0.1	0.7	3.1	3.7
Average gross wages, real (PPI based)	11.9	0.1	-1.0	1.2	1.9	0.7	2.1	1.7
Average gross wages, real (CPI based)	8.6	-1.0	0.7	-0.5	-0.1	0.7	2.1	1.7
Average gross wages, EUR (ER)	8.1	1.1	4.5	1.5	0.1	0.7	3.1	3.7
Employed persons (LFS)	-3.5	-1.9	-3.2	-0.3	1.0	0.2	1.0	1.1
GDP per empl. person, NC at 2010 ref. pr.	0.8	2.8	4.3	-0.9	1.2	-0.2	0.3	0.6
Unit labour costs, NC at 2010 ref. prices	7.3	-1.7	0.2	2.4	-1.1	0.9	2.7	3.1
Unit labour costs, ER (EUR) adjusted	7.3	-1.7	0.2	2.4	-1.1	0.9	2.7	3.1
Kazakhstan								
GDP deflator	4.7	19.6	17.8	4.9	6.2	5.1	5.9	6.0
Exchange rate (ER), EUR/NC	-13.9	5.1	-4.1	6.5	-5.2	-15.4	3.5	-0.4
Real ER (CPI-based)	16.2	-4.9	4.3	9.1	-1.1	-8.7	8.1	4.0
Real ER (PPI-based)	-8.5	10.3	0.7	7.2	-5.3	-7.3	6.0	3.0
Average gross wages, NC	10.7	15.3	16.0	12.5	7.8	13.9	10.8	11.3
Average gross wages, real (PPI based)	42.0	-7.9	-8.8	8.7	8.1	2.6	6.5	6.0
Average gross wages, real (CPI based)	3.2	7.6	7.1	6.9	1.9	4.5	4.5	5.0
Average gross wages, EUR (ER)	-4.7	21.2	11.2	19.8	2.2	-3.7	15.4	10.0
Employed persons (LFS)	0.6	2.7	1.1	1.0	0.7	1.0	1.0	1.0
GDP per empl. person, NC	5.3	24.9	25.0	9.0	11.7	8.7	9.5	10.2
GDP per empl. person, NC at 2010 ref. pr.	0.6	4.5	6.1	3.9	5.1	3.4	3.4	3.9
Unit labour costs, NC at 2010 ref. prices	10.1	10.3	9.3	8.3	2.5	10.1	7.1	7.1
Unit labour costs, ER (EUR) adjusted	-5.3	16.0	4.8	15.3	-2.8	-6.9	10.8	6.6
Russia								
GDP deflator	2.0	14.2	15.2	7.4	6.5	7.3	6.3	5.1
Exchange rate (ER), EUR/NC	-17.5	9.6	-1.5	2.3	-5.5	-15.5	-5.7	-3.6
Real ER (CPI-based)	-8.7	14.8	3.7	4.8	-0.6	-10.0	-0.5	0.6
Real ER (PPI-based)	-20.3	19.3	11.3	6.3	-2.2	-11.5	-2.4	-1.3
Average gross wages, NC	7.8	12.4	11.5	13.9	12.5	8.6	8.1	8.1
Average gross wages, real (PPI based)	16.1	0.2	-6.3	6.7	8.8	2.4	2.9	3.9
Average gross wages, real (CPI based)	-3.6	5.2	2.8	8.4	5.3	1.0	1.0	2.0
Average gross wages, EUR (ER)	-11.1	23.2	9.9	16.6	6.3	-8.3	1.5	4.5
Employed persons (LFS)	-2.2	0.8	1.3	1.0	-0.2	-0.1	0.3	0.7
GDP per empl. person, NC at 2010 ref. pr.	-5.7	3.7	3.5	2.5	1.0	0.6	1.0	1.2
Unit labour costs, NC at 2010 ref. prices	14.3	8.4	7.8	11.1	11.4	7.9	7.0	6.8
Unit labour costs, ER (EUR) adjusted	-5.7	18.8	6.2	13.7	5.3	-8.8	0.9	2.9
Ukraine								
GDP deflator	13.0	13.7	14.2	8.0	3.1	11.2	9.6	4.7
Exchange rate (ER), EUR/NC	-29.1	3.2	-5.0	8.0	-3.2	-31.5	3.3	3.4
Real ER (CPI-based)	-18.6	10.6	-0.5	5.8	-4.9	-24.7	11.7	6.5
Real ER (PPI-based)	-21.4	21.1	7.3	8.9	-3.2	-24.3	12.0	7.0
Average gross wages, NC	5.5	20.0	17.6	14.9	7.9	6.6	9.2	6.6
Average gross wages, real (PPI based)	-0.9	-0.7	-1.2	10.8	8.0	-4.8	-0.7	1.5
Average gross wages, real (CPI based)	-9.0	9.7	8.9	14.3	8.2	-4.0	-0.5	2.0
Average gross wages, EUR (ER)	-25.2	16.3	11.7	24.1	4.4	-28.5	13.6	12.0
Employed persons (LFS)	-3.7	0.4	0.3	0.1	0.2	-10.3	-1.1	0.0
GDP per empl. person, NC at 2010 ref. pr.	-11.4	7.5	5.1	0.0	-0.2	2.7	-0.2	1.8
Unit labour costs, NC at 2010 ref. prices	19.2	11.6	11.9	14.9	8.1	3.8	9.4	4.6
Unit labour costs, ER (EUR) adjusted	-15.5	8.2	6.2	24.1	4.6	-29.0	13.0	8.3
Austria								
GDP deflator	1.6	1.4	2.1	1.7	1.6	1.8	1.9	1.7
Real ER (CPI-based)	-0.5	-0.2	0.2	-0.2	0.5	0.8	0.3	0.4
Real ER (PPI-based)	-3.6	1.9	2.8	-0.4	-1.0	0.5	0.4	0.2
Average gross wages, NC	2.4	1.1	2.4	2.5	2.1	1.9	2.6	2.2
Average gross wages, real (PPI based)	10.6	-3.7	-5.5	0.1	3.3	0.2	0.7	0.6
Average gross wages, real (CPI based)	1.9	-0.8	-0.9	0.1	0.1	0.1	0.8	0.3
Employed persons (LFS)	-0.3	0.5	1.2	1.0	-0.2	0.8	1.0	0.9
GDP per empl. person, NC at 2010 ref. pr.	-3.6	1.3	1.6	0.0	0.6	0.4	0.8	1.0
Unit labour costs, NC at 2010 ref. prices	6.2	-0.2	0.8	2.5	1.6	1.5	1.7	1.3
Unit labour costs, ER (EUR) adjusted	6.2	-0.2	0.8	2.5	1.6	1.5	1.7	1.3

NC = national currency (including euro-fixed series for euro area countries - EE, LV, 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 - mostly from 2012 (BG, RO from 2014, AL, ME, KZ from 2011). Where available comparable growth rates are applied.
Sources: wiiw Annual Database incorporating national and Eurostat statistics, WIFO, wiiw estimates. Forecasts by wiiw, Austria by WIFO.

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

ZVR-Zahl: 329995655

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

P.b.b. Verlagspostamt 1060 Wien

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

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ISBN-978-3-85209-039-9