Forecast Report

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Cautious Upturn in CESEE: Haunted by the Spectre of Uncertainty

Economic Analysis and Outlook for Central, East and Southeast Europe

The Vienna Institute for International Economic Studies
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Cautious Upturn in CESEE: Haunted by the Spectre of Uncertainty

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Executive summary

For the economies of Central, Eastern and Southeast Europe, the international economic environment appears generally positive. Over the biennium 2017-2018, GDP growth in the euro area is expected to hover around 1.7%, while imports are expected to expand at an even faster rate: some 4%. This is of vital importance to the CESEE countries, given that the euro area is the most important destination for their exports and their export intensity runs high.

The international financial markets have stabilised and the current economic mood is improving. For quite some time now, the Economic Sentiment Indicator for the EU has been significantly higher than its long-term average. This forward-looking indicator for the EU as a whole is closely shadowed by the same indicator for the average EU-CEE country and, to a certain extent, for most of the EU candidate-countries as well.

Parallel to the global recovery, the US Fed is expected to increase interest rates still further in 2017, while oil prices are likely to go up a bit more. Certainly, this is good news for CESEE oil (products) exporters such as Russia, Kazakhstan, Belarus and Albania. A possibility of the dollar appreciating due to the Fed's interest rate hike is especially bad news for countries indebted in US dollars, such as Turkey.

In the EU, the payments cycle of the European Structural and Investment Funds is only just beginning, bearing with it promise of higher co-financed investments from 2017 onwards. Once a larger number of new projects have been submitted and decided upon, substantial payments, especially to the EU-CEE economies, will be disbursed up until 2022 (and in some cases 2023). Thus, the EU-CEE region can expect EU transfers of some 2-4% of GDP per annum in the years to come, probably peaking at the very end of the disbursement period.

Over recent quarters, GDP growth throughout almost the entire CESEE region has stabilised in positive territory. One exception is Belarus that continues to experience negative growth rates – albeit at lower rates than in 2015. The country is going through a painful adjustment process triggered by accumulated macroeconomic imbalances and its excessive dependence on Russia.

Current wiiw CESEE GDP growth forecasts for the triennium 2017-2019 point to growth of around 3% for most of the region, with a slightly upward trend. The EU-CEE sub-region and the Western Balkan economies in particular should manage to attain average GDP growth rates of up to 3% and in some countries, such as Hungary, Romania, Slovakia, Albania and Kosovo, the levels may be even higher. Also, in Turkey, where growth slowed down markedly in 2016 to below 2% (down from around 6% in prior years) on account of the domestic political turmoil and deterioration in foreign relations, we expect growth to be closer to 3% by the end of the forecast horizon. The CIS-3 economies will record increasing GDP growth rates rising from more than 1% in 2017 to over 2% in 2019, given the higher oil prices. Over the same forecast period, economic growth in Ukraine is projected to accelerate gradually to 3% by 2018-2019 – barring all-out warfare in Donbas and abortion of the IMF programme.

Private consumption and increasing investment will continue to be the main growth drivers over the forecast horizon. After the investment slump in 2016 attributable to the switch from the previous to the current EU (co-) financing period, the EU-CEE economies can expect investment to recover in the years ahead. The mood among household consumers is constantly improving and, given the spending patterns in the EU-CEE sub-region, it should last quite some time.

GDP growth rates of more than 2% together with better opportunities for migration have helped to improve labour market conditions in the EU-CEE countries and in the Western Balkans, in particular. Tightening labour markets are conducive to major wage increases, especially in the EU-CEE economies. Strong wage dynamics in the EU-CEE countries and the Western Balkans have had a healthy impact on headline inflation leaving negative territory.

Most of the countries in the CESEE region have recently witnessed a rise in unit labour costs. At the same time, however, that trend might also be a sign of quality upgrades in local industries. Whereas most of the economies in the EU-CEE sub-region and the Western Balkans display fairly stable exchange rates, currency devaluations in the CIS and Ukraine have reduced exchange-rate-adjusted ULCs.

Despite the general rise in ULCs, competitiveness does not seem to be endangered. Most of the latest industrial production figures for the CESEE countries are encouraging; they point to an ongoing improvement in industry structure and, in several cases, to re-industrialisation. Recently, trade balances of goods and services have for the most part improved throughout the CESEE region, except in the CIS countries and Ukraine. The short-term trends in respect of FDI inflows in the CESEE countries are mostly negative, except for the CIS and Ukraine, yet in the longer term the trend holds particular promise for the Western Balkans. In both Romania and Slovakia, the prospects for future FDI are also quite good, especially in the automotive sector. With the overall labour force in the CESEE countries more or less stagnating, a marked improvement in education structures is evolving as a younger and better educated generation enters the work force, hinting potentially at a general upgrading of quality across the region's economies.

Nevertheless, heightened uncertainties following the UK referendum on Brexit in June 2016 and the US presidential elections in November have cast a cloud over the improved economic conditions noted above. It is only to be hoped that once fully roused, the 'animal spirits' of the economic agents will shrug off the spectre of political uncertainty. Indeed, it is extremely difficult to assess the actual risks. It could very well be this lack of concrete risk-estimates that has prompted the bullish buoyancy of the economic players – be it in the real economy or on the financial markets. That notwithstanding, a number of worrying scenarios are quite conceivable that could ultimately make our forecasts appear upbeat and overoptimistic.

For the EU-CEE sub-region, such a degree of uncertainty constitutes a major challenge, and the consequences could be both material and negative. Thanks to US President Trump, a rise in global protectionism is possible, which would harm industry in the EU-CEE countries, both directly and indirectly via its close integration with Germany. Mr Trump has also questioned post-war European security arrangements, thus causing consternation in some EU-CEE countries. Meanwhile, the growing irritation with the EU-CEE sub-region among some older EU Member States and the fallout from Brexit could possibly pose a threat to west-east fiscal transfers and the free movement of labour in their current forms. In a broader context, evidence of an EU-wide loss of faith in the EU project and its associated values and institutions will all have important consequences. This uncertainty may well act as an impediment to growth in EU-CEE in the near term. More importantly, it could cast doubt on the prospects of longer-term EU-CEE political and economic convergence.

Uncertainties in the Western Balkans are mostly linked to developments in the EU and the USA, as well as, albeit to a lesser extent, to developments in Russia and Turkey. The region is increasingly counting on the EU market and political stability in the EU, with its promise of membership, however distant. In terms of security, the region is not self-governing; NATO plays a vital stabilising role, hence any uncertainty about the US commitment to supporting the region could bear major consequences. Moreover, any confrontational interventions by Russia and uncertainties as to developments in Turkey could prove quite disruptive, were the influence of the EU and USA to decline.

Increasing uncertainties in the CIS region and Ukraine are mostly related to future commodity price developments (most importantly oil prices) and heightened geopolitical tensions. The current mood of uncertainty regarding the future dynamics of oil prices is associated primarily with supply-side factors (viz. the outcome of the OPEC deal and the resilience of shale oil producers). It has been one of the key concerns for the CIS countries dependent on petroleum exports. The election of Donald Trump has added to the uncertainties affecting the CIS region and Ukraine. The possibility of a Trump-Putin deal and a lack of EU unity may result in the West lending less support to Ukraine, which of itself may also lead to political destabilization. At the same time, a potential end to the sanctions would have a mildly positive impact on the Russian economy. The ever-deepening lack of EU unity along with the slow progress towards reforms aggravated by macroeconomic issues and geopolitical strains may jeopardize the implementation of the Association Agreements with the EU in the signatory countries – Georgia, Moldova and Ukraine. The Russian-dominated Eurasian Economic Union (EAEU) has also been facing significant challenges recently on account of the recession in Russia and geopolitical tensions with the West.

However, seen from a currently optimistic perspective, the CESEE region as a whole is back on a convergence track with an average growth differential of 1.2 pp vis-à-vis the euro area over the forecast horizon.

COUNTRY SUMMARIES

ALBANIA

The economy will continue to grow at above 3.6% in the medium term. Investment-driven economic growth will be supported by international capital inflows. A recovery in external demand is expected, in reaction to higher international oil prices and positive signs for the tourism industry. However, the parliamentary elections due in mid-June 2017 have been preceded by political tension, which has jeopardised their fairness, as well as the progress made in the judicial reform initiated last year.

BELARUS

The Belarus economy is undergoing a painful adjustment and a prolonged recession. In 2016, GDP plunged by 2.6%, after falling by 3.8% the previous year. A dispute with Russia over the pricing of gas provoked Russia to reduce its oil supplies, which hit the Belarusian processing industry and exports. At the same time, a change in policy helped lower inflation. The final months of the year brought some positive signs that growth may resume in the coming years.

BOSNIA AND HERZEGOVINA

Growth momentum improved in the second half of 2016, and this should continue in 2017, as a strengthening labour market and rising wages boost private consumption. Industrial output should also post fairly strong growth, helping to underpin an improvement in exports, although this will continue to be held back somewhat by poor infrastructure. The IMF programme will face delays related to political infighting, but should continue to ensure relative fiscal discipline.

BULGARIA

Bulgaria has a new president and is expecting a new government after the early elections in March 2017. The economy is in relatively good shape, with GDP increasing by 3.4% in 2016. Growth was balanced, driven by both private consumption and exports; however, fixed investment became a drag on growth, due to delays in public investment programmes. There are no visible external or domestic imbalances, and the economy seems set to remain on the path of moderate growth in the foreseeable future.

CROATIA

Croatia's economy returned to a stable path of growth in 2016. Prospects are favourable as well, with annual GDP growth of up to 3% until the end of the forecasting period in 2019. The upswing will primarily be driven by a rise in domestic demand, both private consumption and investments. EU funding will play a major role in stimulating investments. Apart from fiscal consolidation, demographic changes will become a major challenge in the future.

CZECH REPUBLIC

Solid external balances and low levels of indebtedness in both the private and the public sector will support moderate growth of above 2% in the period 2017-2019. Some uncertainties persist, however, as to the future course of fiscal policy and the impacts of the expected strengthening of the domestic currency.

ESTONIA

In the next two years, we will see an improvement in the terms of trade with Western markets; meanwhile exports to Russia have already started to recover. Household consumption, backed by a rapid rise in minimum and overall real wages, continues to be the strongest driver of economic activity in Estonia. Moreover, an upswing in public investments should also speed up economic activity in the short run. GDP growth is projected to rise: from 2.2% in 2017 to 2.3% in 2018 and 2.4% in 2019.

HUNGARY

Over the next three years, economic growth is forecast to remain above 3%. In 2016, the expansion of household consumption was the main driver of growth, and that will remain the case, at least until the election year 2018. A deterioration will begin in the external balances; there is expected to be a recovery in investment, largely financed by EU funds.

KAZAKHSTAN

Higher oil prices allowed for faster economic growth and stabilisation of the exchange rate at the end of 2016. Inflation has slowed and will likely stay within the target range of the national bank. GDP has been growing mainly on the back of investment, while consumer demand has been sluggish. Growth of the economy will accelerate during 2017-2019, but the growth rate will be lower than in the pre-2015 years – at 2-3% annually. Investment will continue to be the main driver of growth.

KOSOVO

The economy will remain one of the fastest growing in Europe during the 2017-2019 forecast period, driven by remittances and investment. Domestic demand-driven growth and limited export capacity will mean that the large external deficit will widen further. The IMF programme will be key to maintaining fiscal discipline. Political risks have risen, but should remain contained and are unlikely to significantly derail the economy's momentum.

LATVIA

Our GDP growth forecast for Latvia for 2017 stands at 2.5%. Private and particularly public investment activity will rally. The inflow of EU funds is expected to amount to 2.6% of GDP this year. After a steep decline in recent years, exports to Russia have again started to increase. Household consumption has developed rapidly and will continue, due to rising real wages. In both 2018 and 2019, we expect a further upswing in GDP growth to 2.7% and 2.8%, respectively.

LITHUANIA

Throughout 2017, economic growth in Lithuania will be driven by resurgence in external demand, particularly from the CIS and for oil products. Moreover, an upswing in public investment will be underpinned by fresh funds from the EU this year. The ongoing stable growth in terms of employment and rapid wage rises will result in robust increases in consumer demand. For 2017, we forecast a moderate upswing in the GDP growth rate to 2.7%, followed by 2.8% in 2018 and 3.1% in 2019.

MACEDONIA

The Macedonian economy is expected to return to growth of 3% in 2017 and the medium term. In 2016, growth slowed temporarily, due to the underperformance of investments. The labour market continued to improve, although the unemployment rate remains exceptionally high. Stability was more of a concern than growth, as the country headed towards an electoral resolution to the political crisis. Looking ahead, political stability could push potential growth closer to 4%.

MONTENEGRO

Montenegro's economic growth slowed markedly at the turn of 2016, largely because of a surge in imports. It recovered in the course of the year and is now poised to return to 3% or thereabouts in the medium term. Political risks also contributed to economic volatility, though a degree of stability should have returned following the early elections. The economy will continue to rely even more on services, i.e. on tourism.

POLAND

Under the impact of policies that seek to imbue the national economic and social life with 'law and order', Poland's economy clearly underperformed in 2016. This was epitomised by a dramatic decline in gross fixed capital formation. But the economy is still in pretty good shape. It is expected to grow at a respectable pace, provided the institutional changes imposed consider more carefully the needs of the business sector and the limits to what can be achieved through administrative regulation.

ROMANIA

Economic growth in Romania is expected to hover around 4% in 2017 and beyond. Household demand will remain the main driver, but investments may also play a bigger role. Rising private sector wages may speed up the growth in household consumption; this constitutes an upside risk to the forecast. The capacity to absorb EU funds and political uncertainty constitute downside risks. Currently the government's official GDP forecast for 2017-2019 of annual growth above 5% looks unrealistic.

RUSSIAN FEDERATION

The Russian economy is slowly emerging from recession. With oil prices more or less flat, financial and trade sanctions expected to remain largely in place, and in the absence of any marked institutional reforms, economic growth will stay sluggish – below 2% – even in the medium term.

SERBIA

Growth proved better than expected in 2016, at 2.7%. Looking ahead, it should approach 3% in the medium term. This is mainly because consumption – both private and public – will increase, now that fiscal consolidation is largely at an end; meanwhile investment and exports should continue to grow.

SLOVAKIA

In 2016, a strong decline in gross fixed capital formation depressed GDP growth to 3.3%. For 2017, Slovak growth is forecast to be around 3%, while in 2018 and 2019 an increase in the capacity of the automotive industry should stimulate faster growth close to 4%.

SLOVENIA

Annual GDP growth will reach about 3% during the 2017-2019 forecast period. Exports, the gradual recovery of investments supported by EU funding and continued consumption growth will remain the main drivers of GDP. Household consumption is expected to be boosted by rising wages and a further recovery of the labour market.

TURKEY

During the 2017-2019 forecast period, the Turkish economy will grow at a much slower rate than in recent years. This partly reflects political risks, both domestic and international. In this context, and at a time of monetary tightening by the US Federal Reserve, the financing of Turkey's large current account deficit will be more challenging. Monetary tightening by the Turkish central bank will remain limited, which will exacerbate the weakness of the lira and keep inflation high.

UKRAINE

Economic recovery has progressively gained momentum, but it is entirely driven by domestic demand and is accompanied by widening external imbalances. GDP growth is projected to pick up further to 2.5% in 2017 on account of export stabilisation, and to accelerate to 3% in 2018-2019. However, this scenario crucially hinges on the preservation of the semi-frozen state of the conflict in Donbas and the continuation of the International Monetary Fund programme.

Keywords: CESEE, economic forecast, Europe, Central and Eastern Europe, Southeast Europe, Western Balkans, new EU Member States, CIS, Belarus, Russia, Ukraine, Kazakhstan, Turkey, growth convergence, political uncertainties, external risks, EU funds, investment, consumption-led growth, unemployment, employment, wage growth, inflation, competitiveness, industrial production

JEL classification: E20, O47, O52, O57, P24, P27, P33, P52

Table 1 / OVERVIEW 2015-2016 AND OUTLOOK 2017-2019

	GDP real change in % against prev. year					Consumer prices change in % against prev. year				
			Forecast					Forecast		
	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019
Bulgaria	3.6	3.4	2.9	3.1	3.3	-1.1	-1.3	0.5	1.0	1.5
Croatia	1.6	2.8	2.8	2.9	3.0	-0.3	-0.6	1.3	1.6	1.6
Czech Republic	4.5	2.3	2.4	2.6	2.3	0.3	0.6	2.0	1.8	1.8
Estonia	1.4	1.3	2.2	2.3	2.4	0.1	0.8	2.0	2.5	3.0
Hungary	3.1	2.0	3.3	3.4	3.1	0.1	0.4	2.0	2.5	2.8
Latvia	2.7	1.8	2.5	2.7	2.8	0.2	0.1	1.8	2.1	2.3
Lithuania	1.8	2.2	2.7	2.8	3.1	-0.7	0.7	2.1	2.3	2.7
Poland	3.9	2.8	2.9	3.0	3.1	-0.7	-0.2	1.4	1.9	2.0
Romania	3.9	4.8	4.0	4.0	4.0	-0.4	-1.1	1.5	2.5	2.5
Slovakia	3.8	3.3	3.1	3.6	3.9	-0.3	-0.5	1.2	1.8	1.8
Slovenia	2.3	2.6	2.9	2.9	3.0	-0.8	-0.2	1.3	1.4	1.4
EU-CEE [1)2)]	*3.7*	*3.0*	*3.0*	*3.2*	*3.2*	*-0.4*	*-0.2*	*1.5*	*2.0*	*2.1*
EA-19	*2.0*	*1.7*	*1.6*	*1.8*	*.*	*0.0*	*0.2*	*1.7*	*1.4*	*.*
EU-28	*2.2*	*1.9*	*1.8*	*1.8*	*.*	*0.0*	*0.3*	*1.8*	*1.7*	*.*
Albania	2.6	3.2	3.5	3.9	4.0	1.9	1.3	2.3	2.8	3.0
Bosnia and Herzegovina	3.1	2.3	2.8	3.0	3.1	-1.0	-1.1	1.0	1.4	1.9
Kosovo	4.3	3.6	3.9	3.8	3.7	-0.5	0.3	0.9	1.6	2.3
Macedonia	3.8	2.5	3.1	3.3	3.0	-0.3	-0.2	1.0	1.5	2.0
Montenegro	3.4	2.7	3.1	2.9	3.3	1.4	0.1	1.5	2.0	2.0
Serbia	0.8	2.7	2.8	3.0	3.3	1.9	1.2	2.0	2.0	2.0
WB [1)2)]	*2.2*	*2.7*	*3.0*	*3.2*	*3.4*	*0.9*	*0.5*	*1.6*	*1.9*	*2.1*
Turkey	6.1	1.9	2.1	2.6	3.1	7.7	7.8	8.7	7.5	6.8
Belarus [3)]	-3.8	-2.6	0.5	1.6	2.2	13.5	11.8	10.0	9.0	8.0
Kazakhstan	1.2	1.0	2.0	3.0	3.0	6.6	14.6	7.0	6.0	6.0
Russia	-2.8	-0.2	1.7	1.7	2.0	15.5	7.1	5.0	5.0	5.0
Ukraine	-9.8	2.0	2.5	3.0	3.0	48.7	13.9	10.5	6.1	5.0
CIS + Ukraine [1)2)]	*-3.0*	*0.0*	*1.7*	*1.9*	*2.2*	*17.1*	*8.6*	*5.8*	*5.3*	*5.2*
VIS-4 [1)2)]	*3.9*	*2.6*	*2.9*	*3.0*	*3.0*	*-0.4*	*0.0*	*1.6*	*2.0*	*2.1*
BALT-3 [1)2)]	*2.0*	*1.9*	*2.5*	*2.7*	*2.9*	*-0.3*	*0.5*	*2.0*	*2.3*	*2.7*
SEE-9 [1)2)]	*3.2*	*3.8*	*3.5*	*3.6*	*3.6*	*-0.2*	*-0.7*	*1.4*	*2.0*	*2.2*
NON-EU-11 [1)2)]	*-0.2*	*0.6*	*1.9*	*2.2*	*2.5*	*13.8*	*8.1*	*6.5*	*5.8*	*5.6*
CESEE-22 [1)2)]	*0.9*	*1.3*	*2.2*	*2.5*	*2.7*	*9.7*	*5.6*	*5.0*	*4.7*	*4.6*

(ctd.)

Table 1 / (ctd.)

	Unemployment (LFS) rate in %, annual average					Current account in % of GDP				
			Forecast					Forecast		
	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019
Bulgaria	9.2	7.6	7.0	6.5	6.0	0.4	3.8	3.5	3.2	2.8
Croatia	16.3	13.5	13.0	12.5	12.0	5.1	3.7	2.1	1.5	0.9
Czech Republic	5.1	4.0	3.9	3.8	3.6	0.9	1.6	1.2	0.9	0.8
Estonia	6.2	6.6	6.7	7.0	7.0	2.2	2.7	0.9	0.4	0.0
Hungary	6.8	5.2	4.8	4.5	4.5	3.4	4.3	4.2	3.4	2.5
Latvia	9.9	9.7	9.2	8.8	8.4	-0.8	1.6	0.0	-1.1	-1.7
Lithuania	9.1	8.0	7.2	6.5	6.0	-2.3	0.3	-1.2	-1.4	-1.8
Poland	7.5	6.3	6.2	6.1	6.1	-0.6	-0.5	-0.7	-1.1	-1.4
Romania	6.8	6.0	5.8	5.6	5.5	-1.2	-2.4	-2.5	-2.6	-2.6
Slovakia	11.5	9.7	9.0	8.5	8.0	0.2	-0.6	0.4	0.9	1.5
Slovenia	9.0	8.2	7.8	7.0	6.5	5.2	6.9	5.8	5.0	4.5
EU-CEE [1)2)]	*7.8*	*6.6*	*6.3*	*6.1*	*6.0*	*0.4*	*0.7*	*0.4*	*0.0*	*-0.2*
EA-19	*10.9*	*10.0*	*9.6*	*9.1*	*.*	*3.7*	*3.6*	*3.2*	*3.1*	*.*
EU-28	*9.4*	*8.5*	*8.1*	*7.8*	*.*	*2.2*	*2.1*	*1.9*	*1.9*	*.*
Albania	17.1	15.2	14.8	14.5	14.0	-10.8	-11.5	-11.9	-11.3	-10.7
Bosnia and Herzegovina	27.7	25.4	25.3	25.1	25.0	-5.7	-6.0	-5.8	-5.7	-5.7
Kosovo	32.9	26.5	25.8	25.5	25.2	-8.6	-9.9	-10.4	-11.2	-11.8
Macedonia	26.1	24.0	24.0	23.0	23.0	-2.1	-2.0	-4.0	-4.0	-4.0
Montenegro	17.6	17.5	17.0	16.5	16.5	-13.3	-17.0	-16.4	-20.7	-19.8
Serbia	17.7	16.1	15.0	14.0	14.0	-4.7	-5.0	-4.0	-4.0	-4.0
WB [1)2)]	*21.2*	*19.1*	*18.4*	*17.7*	*17.6*	*-6.1*	*-6.7*	*-6.6*	*-6.7*	*-6.7*
	10.3	10.8	11.0	10.6	10.4 -	-3.8	-3.8	-5.1	-5.4	-5.7
Belarus [3)]	1.0	0.8	1.0	1.0	1.0	-3.7	-3.0	-3.5	-4.4	-4.5
Kazakhstan	5.0	5.0	5.0	5.0	5.0	-3.0	-6.1	-2.4	-1.9	-2.2
Russia	5.6	5.3	5.6	5.6	5.5	5.1	1.7	1.7	1.3	0.9
Ukraine	9.1	9.4	9.2	8.1	7.3	-0.2	-3.6	-4.5	-4.6	-4.8
CIS + Ukraine [1)2)]	*5.9*	*5.9*	*6.0*	*5.8*	*5.6*	*3.6*	*0.6*	*0.8*	*0.5*	*0.2*
VIS-4 [1)2)]	*7.3*	*6.0*	*5.8*	*5.7*	*5.6*	*0.3*	*0.6*	*0.5*	*0.2*	*0.0*
BALT-3 [1)2)]	*8.7*	*8.2*	*7.7*	*7.3*	*7.0*	*-0.7*	*1.3*	*-0.3*	*-0.9*	*-1.3*
SEE-9 [1)2)]	*12.8*	*11.3*	*10.9*	*10.4*	*10.2*	*-1.3*	*-1.7*	*-2.0*	*-2.2*	*-2.3*
NON-EU-11 [1)2)]	*7.6*	*7.6*	*7.7*	*7.4*	*7.2*	*0.9*	*-1.2*	*-1.2*	*-1.5*	*-1.9*
CESEE-22 [1)2)]	*7.6*	*7.3*	*7.3*	*7.1*	*6.9*	*0.9*	*-0.7*	*-0.8*	*-1.3*	*-1.7*

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

Source: wiiw, Eurostat. Forecasts by wiiw (February 2017) and European Commission for EU and euro area (Winter Report, February 2017).

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TABLES AND FIGURES

The statistical data until 2016 presented in this report are as of 20 February 2017, forecasts as of February 2017. Most data are taken from the wiiw Databases. Direct access is available at: http://data.wiiw.ac.at/.

ABBREVIATIONS

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

BALT-3	Baltic countries: Estonia, Latvia, Lithuania
CESEE-22	Central, East and Southeast Europe: EU-CEE + NON-EU-11
CIS	Commonwealth of Independent States covered by wiiw: Belarus, Kazakhstan, Russia
EA-19	euro area 19 countries
EU-28	European Union 28 countries
EU-15	15 original members of the European Union
EU-CEE	European Union – Central and Eastern Europe: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia
NON-EU-11	Non-European Union countries: Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, Serbia, Turkey, Belarus, Kazakhstan, Russia, Ukraine
SEE-9	Southeast Europe: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Macedonia, Montenegro, Romania, Serbia
VIS-4	Visegrád countries: Czech Republic, Hungary, Poland, Slovakia
WB	Western Balkans: Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, Serbia

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

bbl	barrel
BPM5	Balance of Payments Manual Fifth Edition
BPM6	Balance of Payments and International Investment Position Manual Sixth Edition
BOP	balance of payments
CIS-STAT	Interstate Statistical Committee of the Commonwealth of Independent States
CPI	consumer price index
EC	European Commission
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
EFSI	European Fund for Strategic Investments
EIB	European Investment Bank
ER	exchange rate
ESA'95	European system of national and regional accounts, ESA 1995
ESA 2010	European system of accounts, ESA 2010
ESIF	European Structural and Investment Funds
FDI	Foreign Direct Investment
FISIM	Financial Intermediation Services, Indirectly Measured
GFCF	gross fixed capital formation
GDP	Gross Domestic Product
GNI	Gross National Income
ICP	International Comparison Program
IMF	International Monetary Fund
LFS	Labour Force Survey
MFF	Multiannual Financial Framework
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne (Statistical classification of economic activities in the European Community)
NACE Rev. 1	first revision of the original NACE (1970)
NACE Rev. 2	revised classification, introduced in 2008
NB	National Bank
NCU	national currency unit
NPL	Non-performing loans (more than 90 days overdue)

OECD	Organisation for Economic Co-operation and Development
OPEC	Organisation of the Petroleum Exporting Countries
pp	percentage points
PPI	producer price index
PPP	Purchasing Power Parity
SME	small and medium-sized enterprise
SNA	System of National Accounts
SPE	Special Purpose Entity
ULC	unit labour cost
VAT	value added tax
WB	Western Balkans
WIFO	Austrian Institute of Economic Research
wiiw	The Vienna Institute for International Economic Studies

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

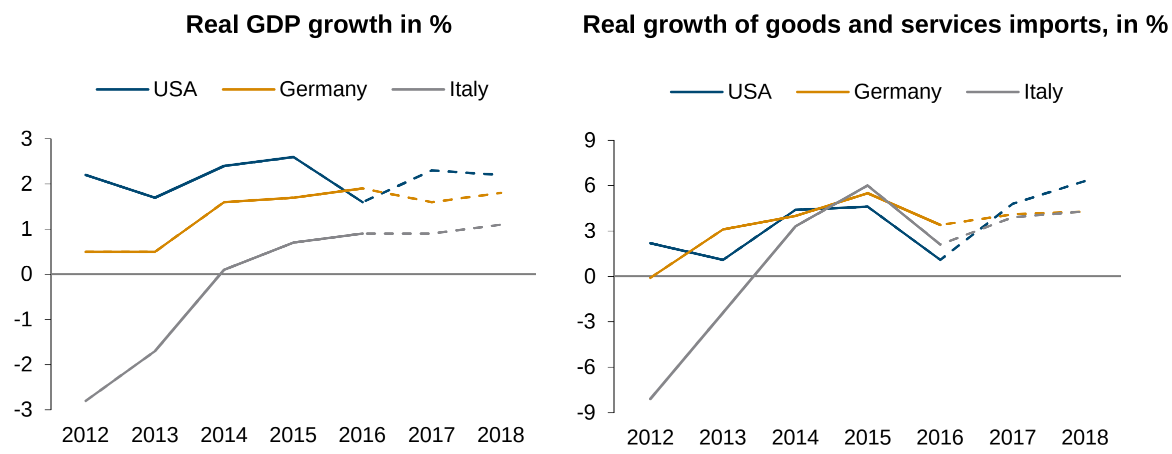
Cautious upturn in CESEE: haunted by the spectre of uncertainty

BY MARIO HOLZNER[1]

INTERNATIONAL ENVIRONMENT: POSITIVE AMID MAJOR UNCERTAINTIES

Over the biennium 2017-2018, GDP growth in the euro area is expected to hover around 1.7%, while imports are expected to expand at an even faster rate: some 4%. Over the past three years, the euro area has been recovering at an average GDP growth rate of 1.6% from the second blow delivered by double-dip recession in the biennium 2012-2013. By way of contrast, the US economy did not experience a second recessional dip[2] and has been growing at a robust rate of 2% over the past five years. It too expects a somewhat higher rate in the near future (Figure 1, left panel). Import dynamics are typically stronger than GDP growth by a factor of around 3 (Figure 1, right panel). This is of vital importance to the countries from Central, East and Southeast Europe (CESEE), given that the euro area is the most important destination for their exports and their export intensity runs high.

Figure 1 / International GDP and import trends



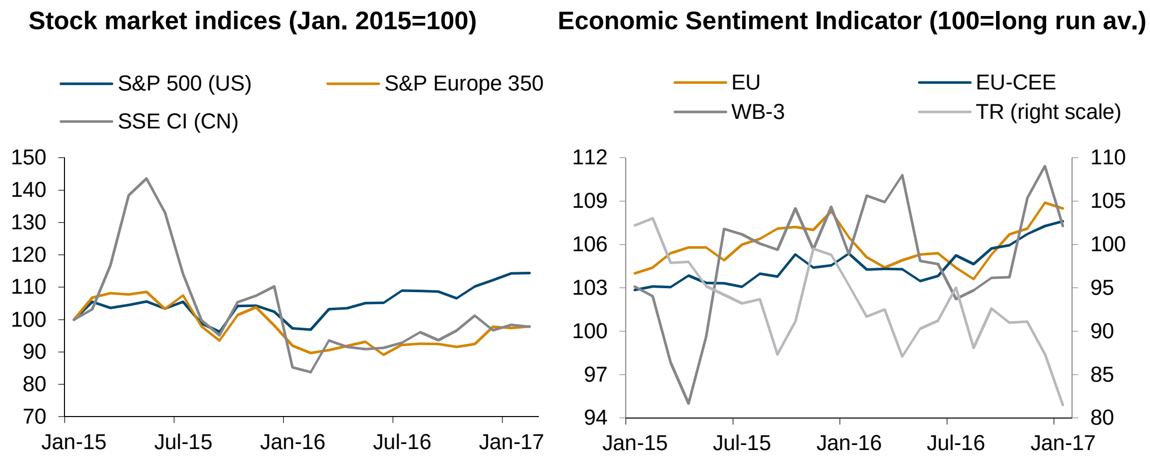
Note: Dashed lines are forecasts.
Source: EC Autumn Forecast 2016 and Winter Forecast 2017.

[1] The author would like to thank Amat Adarov, Vasily Astrov, Vladimir Gligorov, Richard Grieveson, Doris Hanzl, Peter Havlik, Gábor Hunya, Leon Podkaminer, Sándor Richter and Robert Stehrer for valuable comments and suggestions.

[2] For some of the reasons for this difference see Heimberger, P. (2016a), 'Did Fiscal Consolidation Cause the Double-Dip Recession in the Euro Area?', wiiw Working Paper, No. 130; and Heimberger, P. (2016b), 'Warum die Volkswirtschaften der Eurozone den USA und Großbritannien seit der Finanzkrise hinterherhinken: Zur Rolle von Unterschieden in der Geld- und Fiskalpolitik', wiiw Research Report in German language, No. 5.

The international financial markets stabilised towards the end of 2016 and the current economic mood is improving. After the major turbulences in the international financial markets provoked by the extreme volatility of the Chinese stock market throughout 2015 and early 2016 (as indicated by the Shanghai Stock Exchange Composite Index in the left panel of Figure 2), by early 2017 both the European and Chinese stock market indices had returned to the levels of early 2015, while US stocks even rose in value by 14% (they now stand at more than 50% above the level at which they stood prior to the outbreak of the global financial crisis). Improvements in both the real economy and the financial markets have been accompanied by an improvement in the economic agents' mood. For quite some time now, the Economic Sentiment Indicator for the EU has been significantly higher than its long-term average. This forward-looking indicator for the EU as a whole is closely shadowed by the same indicator for the average EU-CEE country and, to a certain extent, for most of the EU candidate-countries as well (Figure 2, right panel). One exception is Turkey where the domestic political turmoil in the wake of the failed coup has had a poisoning effect on expectations as to the future.

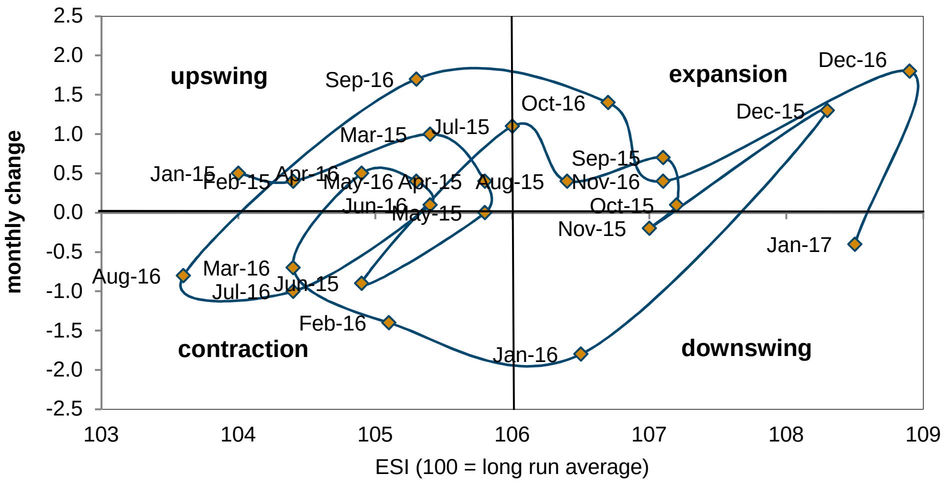
Figure 2 / International stock market and economic sentiment trends



Note: WB-3 comprises MK, ME and RS.
Source: Yahoo! Finance, Eurostat.

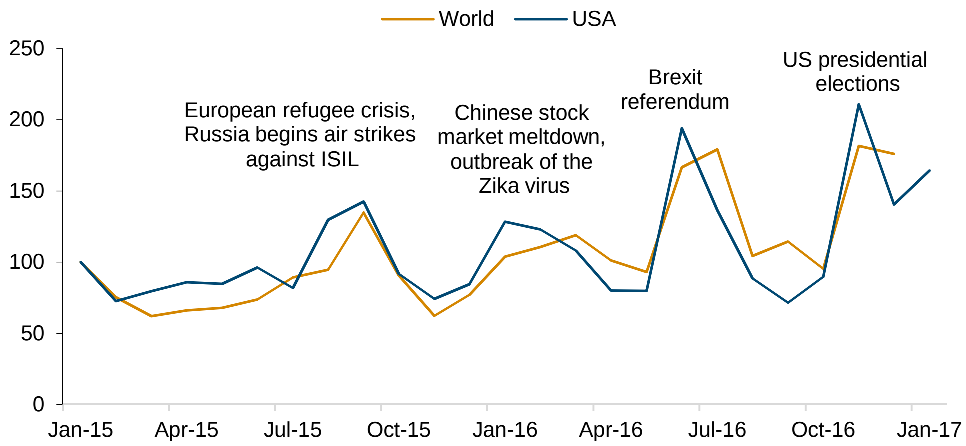
Nevertheless, heightened uncertainties following the UK referendum on Brexit in June 2016 and the US presidential elections in November have cast a cloud over the improved economic conditions noted above. Whereas from early 2015 onwards the EU economic sentiment indicator had taken a turn for the better and entered the upswing and expansion mode, it contracted in the summer of 2016 once it became clear that the United Kingdom would leave the EU. It took a further turn for the worse (downswing mode) when the newly elected US president Donald Trump assumed office in January 2017 (Figure 3). Both events are perceived to have increased economic policy uncertainties on a massive scale (as measured by the news-based economic policy uncertainty index in Figure 4), outstripping the temporary hikes previously associated with, for instance, the refugee crisis in Europe and Russia's involvement in the war in Syria (summer 2015) or the Chinese financial market turbulence, as well as the outbreak of the Zika virus in the Americas in the early months of 2016. Typically, the uncertainty descriptors relevant to the index appeared first in US media only to surface a little later in a global context. Assessments of the possible impact of increased uncertainty on the EU-CEE sub-region, the Western Balkans and the CIS countries are be found in the special topics section of this report.

Figure 3 / EU Economic Sentiment Indicator tracer



Source: Eurostat.

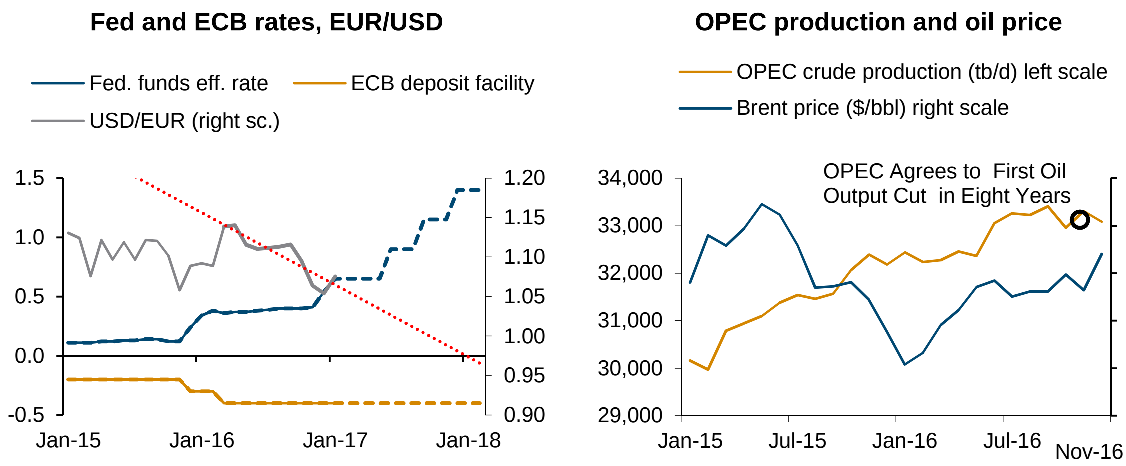
Figure 4 / News-based Economic Policy Uncertainty Index



Source: Economic Policy Uncertainty.

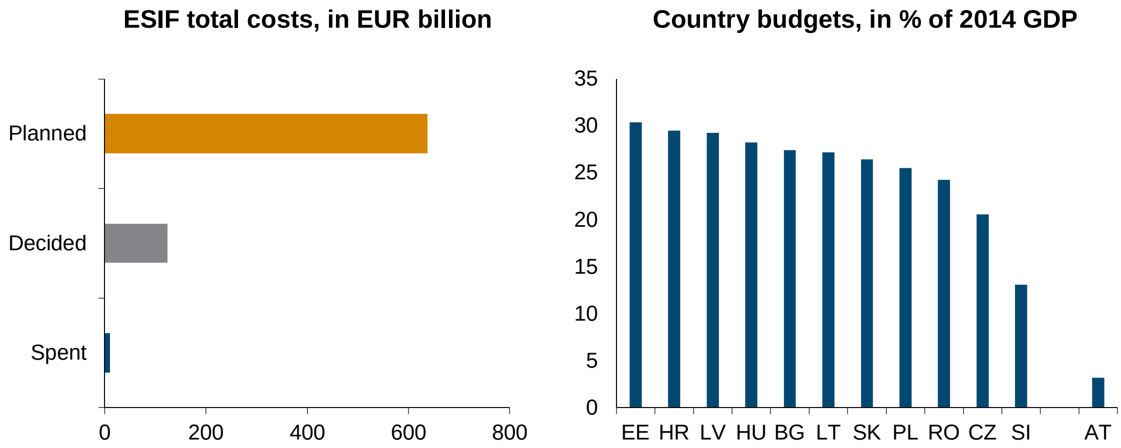
Parallel to the global recovery, the US Fed is expected to increase interest rates still further in 2017, while oil prices are likely to go up a bit more. As the US economy warms up and approaches full employment (the unemployment rate stood at 4.8% in January 2017), market participants, busy interpreting the development of the Fed funds futures prices, generally expect three Federal Funds interest rate hikes (as also forecast by Fed officials in December 2016) by 25 base points each in June, September and December 2017 (although there is every chance that the surge will start even earlier). A rise in US interest rates is also anticipated on account of the infrastructure investments following on the new administration's announcements and the prospects of higher inflation related thereto. On the assumption that the ECB is unlikely to change its monetary stance in the near future, we may well see the dollar appreciating and coming close to parity with the euro (Figure 5, left panel). A possibility of the dollar appreciating is especially bad news for countries indebted in US dollars, such as Turkey. Higher global inflation rates (although still very low by historical standards) will also be bolstered by the increase in oil prices owing to the somewhat higher demand for petroleum, but particularly on account of the cutback in output instigated by OPEC (and some other major oil exporters, including Russia). The deal (the first OPEC cut in eight years) was struck in November 2016 and took effect on 1 January 2017 for a duration of six months. A possibility of it being extended cannot be precluded. This makes it all the more likely that the oil price will go up from current levels of around 55 USD per barrel Brent closer to 60 USD over the next two years (Figure 5, right panel). Certainly, this is good news for CESEE oil (products) exporters such as Russia, Kazakhstan, Belarus and Albania. However, oil prices are not expected to go beyond that as US shale oil producers are once again increasing their number of rigs. A more detailed analysis of oil prices can be found in the special section on uncertainties in the CIS region in this report.

Figure 5 / Determinants of the US dollar/euro exchange rate and the oil price



Note: Dashed lines are own forecasts based on market expectations; the dotted line is the exchange rate trend since March 2016.
Source: Fed, ECB, OPEC, World Bank.

Figure 6 / European Structural and Investment Funds 2014-2020

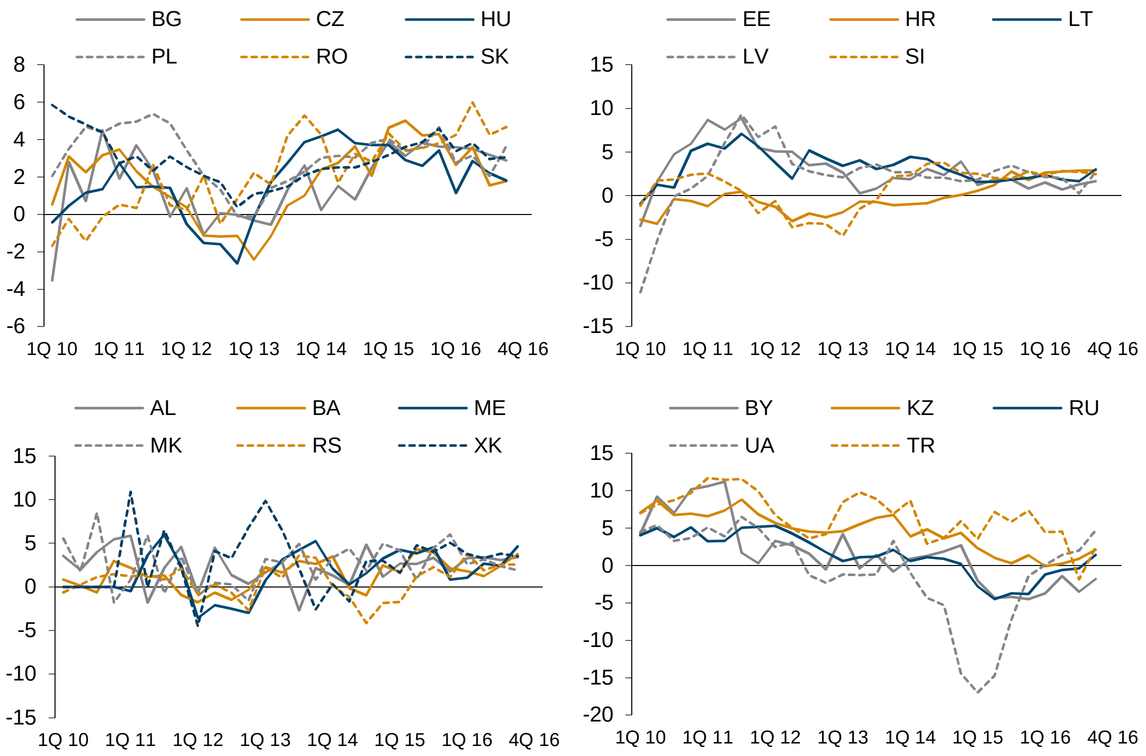


Note: Total budgeted costs include EU and national project costs; information as of November 2016. In the average EU-CEE country the EU share in the budgeted costs makes about 81%.
Source: European Commission.

In the EU, the payments cycle of the European Structural and Investment Funds is only just beginning, bearing with it promise of higher co-financed investments from 2017 onwards. The largest funds in the Multiannual Financial Framework's planning period 2014-2020 are the European Regional Development Fund (EUR 196 billion in terms of EU co-financing), the European Agricultural Fund for Rural Development (EUR 99 billion), the European Social Fund (EUR 86 billion) and the Cohesion Fund (EUR 63 billion). The EU-CEE countries receive substantial transfers predominantly from the first and the last of those funds. However, by November 2016, less than two per cent of the total EU-wide planned project costs of nearly EUR 640 billion had been disbursed (Figure 6, left panel). Once a larger number of new projects have been submitted and decided upon, substantial payments, especially to the EU-CEE economies, will be disbursed up until 2022 (and in some cases 2023). The budgets of the total project costs for this group of countries range typically between 20% and 30% of GDP, of which the EU bears on average some 81% (Figure 6, right panel). Thus, the EU-CEE region can expect EU transfers of some 2-4% of GDP per annum in the years to come, probably peaking at the very end of the disbursement period.

Figure 7 / Quarterly real GDP growth of the CESEE countries

change in % against preceding year



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

CESEE: GROWTH GAINS A BIT OF MOMENTUM

Over recent quarters, GDP growth throughout almost the entire region has stabilised in positive territory. One exception is Belarus that continues to experience negative growth rates – albeit at lower rates than in 2015 (Figure 7, lower right panel). The country is going through a painful adjustment process triggered by accumulated macroeconomic imbalances and its excessive dependence on Russia, which itself has been suffering from low oil prices over the past couple of years and has thus further reduced the support it lends to the Belarusian economy. In fact, Russia likewise registered negative growth throughout most of the previous year, but ultimately left negative territory in the 4th quarter. Turkey experienced a brief interlude when its GDP dropped by 1.8% in the 3rd quarter 2016 (year-on-year), but it should still be in positive territory for the year as a whole. For the first time in years, Ukraine enjoyed positive growth in each quarter of the past year, reaching an amazing 4.7% in the 4th quarter. Most of the other economies stabilised their growth rates around values of some 2-3%. An upwards outlier in 2016 was Romania. It registered an economic growth rate of almost 5%, driven by a surge in demand generated by fiscal loosening in the form of VAT cuts and hikes in the minimum wage.

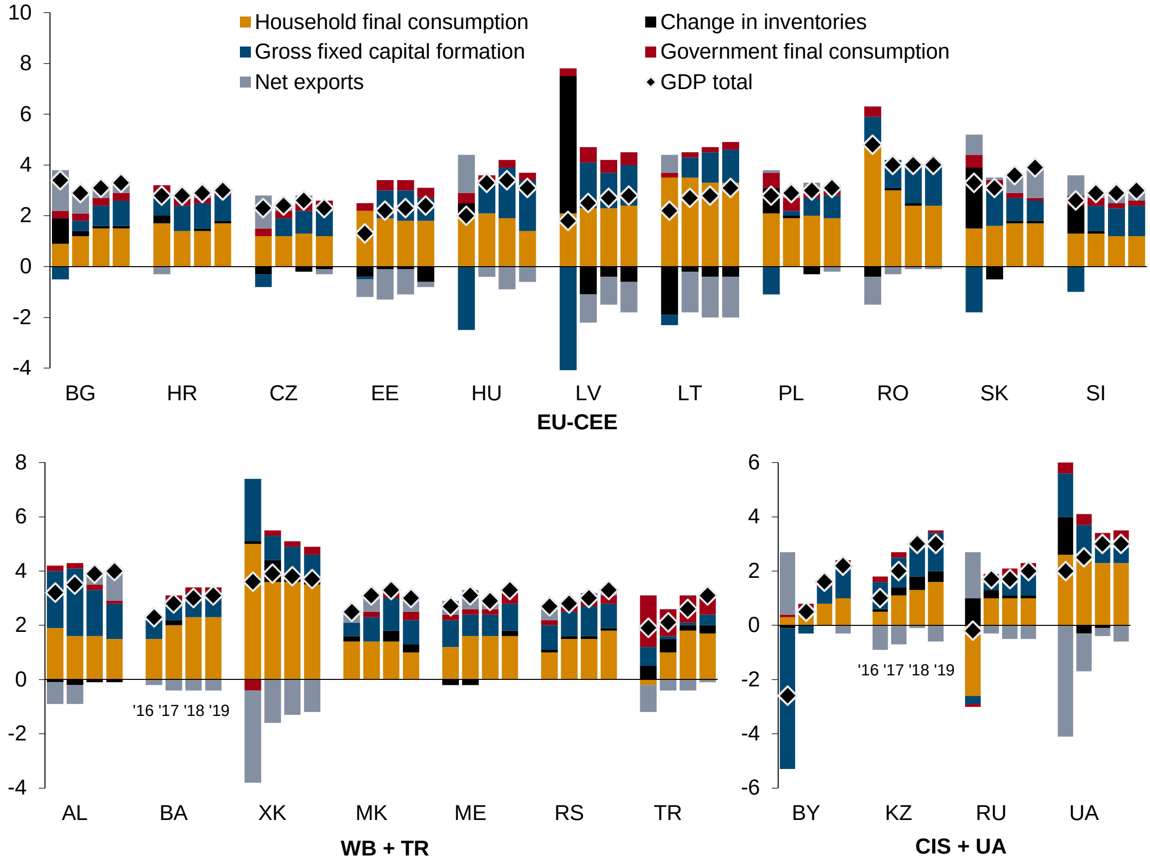
Table 2 / Real GDP growth forecast and revisions

		Forecast, %				Revisions, pp		
		2016	2017	2018	2019	2016	2017	2018
EU-CEE	BG	3.4	2.9	3.1	3.3	0.4	-0.1	0.0
	HR	2.8	2.8	2.9	3.0	0.3	0.1	0.1
	CZ	2.3	2.4	2.6	2.3	0.1	0.0	0.0
	EE	1.3	2.2	2.3	2.4	-0.3	0.0	0.0
	HU	2.0	3.3	3.4	3.1	0.0	0.7	0.5
	LV	1.8	2.5	2.7	2.8	-0.6	-0.1	-0.2
	LT	2.2	2.7	2.8	3.1	-0.1	0.1	-0.2
	PL	2.8	2.9	3.0	3.1	-0.4	-0.6	-0.3
	RO	4.8	4.0	4.0	4.0	0.1	0.5	0.2
	SK	3.3	3.1	3.6	3.9	0.1	0.0	0.2
	SI	2.6	2.9	2.9	3.0	0.2	0.3	0.0
WB	AL	3.2	3.5	3.9	4.0	0.2	0.2	0.3
	BA	2.3	2.8	3.0	3.1	-0.8	-0.5	-0.5
	XK	3.6	3.9	3.8	3.7	1.0	0.9	0.6
	MK	2.5	3.1	3.3	3.0	0.0	0.0	0.0
	ME	2.7	3.1	2.9	3.3	0.0	0.0	0.0
	RS	2.7	2.8	3.0	3.3	0.5	0.3	0.5
Turkey	TR	1.9	2.1	2.6	3.1	-1.4	-0.9	-0.1
CIS +UA	BY	-2.6	0.5	1.6	2.2	0.2	1.4	0.0
	KZ	1.0	2.0	3.0	3.0	0.6	0.0	0.0
	RU	-0.2	1.7	1.7	2.0	0.6	0.9	-0.1
	UA	2.0	2.5	3.0	3.0	1.2	0.6	0.6

Note: Current forecast and revisions relative to the wiiw autumn forecast 2016. Colour scale reflects variation from the minimum (red) to the maximum (green) values.
Source: wiiw forecast.

Current wiiw CESEE GDP growth forecasts for the triennium 2017-2019 point to growth of around 3% for most of the region, with a slightly upward trend. Despite the previously mentioned massive rise in global uncertainty, we are fairly optimistic where our projections are concerned (Table 1). The EU-CEE sub-region and the Western Balkan economies in particular should manage to attain average GDP growth rates of up to 3% and in some countries, such as Hungary, Romania, Slovakia, Albania and Kosovo, the levels may be even higher. In the latter two economies, apart from a low base effect, infrastructure investment will also be pushing growth. In Slovakia, a capacity increase in the automotive industry should stimulate faster growth. Growth in Romania is only slightly decelerating at a high rate and fiscal policy in Hungary is expected to be growth-supportive, given the upcoming elections in spring 2018. In Turkey, where growth slowed down markedly in 2016 to below 2% (down from around 6% in prior years) on account of the domestic political turmoil and deterioration in foreign relations, we expect growth to be closer to 3% by the end of the forecast horizon. This is attributable, inter alia, to the recovery expected in the tourism sector where the number of arrivals from Russia should pick up noticeably, given the recent rapprochement between the two countries. The CIS economies will face increasing GDP growth rates rising from more than 1% in 2017 to over 2% in 2019, given the higher oil prices. Over the same forecast period, economic growth in Ukraine is projected to accelerate gradually to 3% by 2018-2019 – barring all-out warfare in Donbas and abortion of the IMF programme. Apart from the low base effect, growth in this war torn-country will be boosted by a more relaxed fiscal policy stance and recovery of exports thanks to higher commodity prices. Compared to the Autumn 2016 wiiw Forecast Report, the up- and downward revisions of the GDP growth rates forecast will on average cancel each other out. If anything, there will be a minute upward revision (Table 2).

Figure 8 / Real GDP growth in 2016-2019
and contribution of individual demand components in percentage points



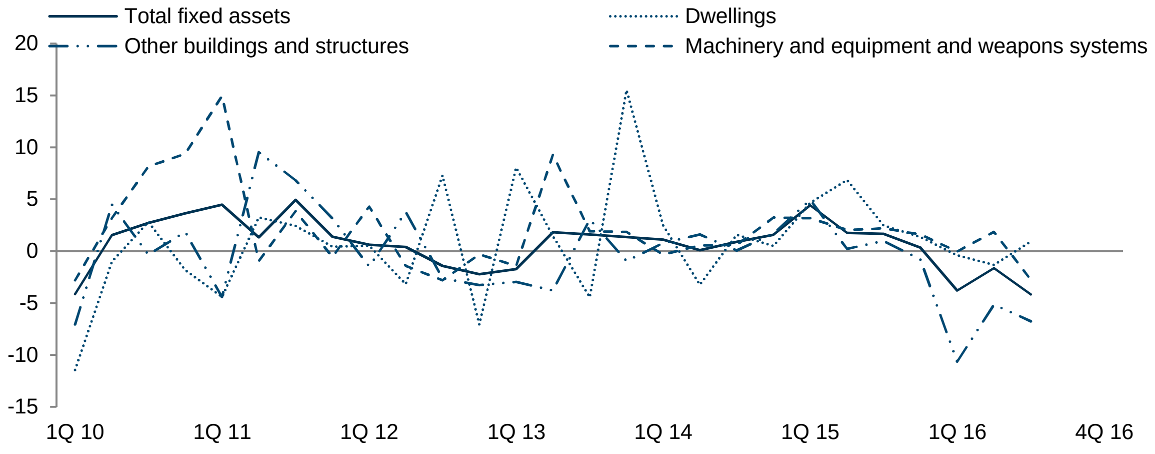
Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Private consumption and increasing investment will continue to be the main growth drivers over the forecast horizon. For the typical EU-CEE and Western Balkans economy, household final consumption is expected to remain the single most important growth driver, contributing on average some 2 pp to GDP growth. After the massive contraction of household consumption in Ukraine in 2014 and 2015, contributions of even more than 2 pp can be expected. For Turkey and the CIS, the negative or close to zero household consumption contributions registered in the previous year will have turned into positive contributions of 1-2 pp by 2019: a reflection of the slow recovery in those countries. The other important growth driver will be gross fixed capital formation. In all the countries in the EU-CEE sub-region, investment contributions will have surged from the mostly negative values recorded over the past year to positive values of about 1 pp by 2019 – mainly on account of the increased absorption of EU co-financed project funds at the end of the current EU Multiannual Financial Framework. In terms of real growth rates, investment grows more rapidly (around 5%) than private consumption (about 3%), implying an increasing investment share in GDP. In the CIS, investment contributions will shift from negative territory in 2016 to positive values of around 1 pp by the end of the forecast horizon on account of the recovery induced by rising oil prices. In Turkey and Ukraine, those contributions will drop to levels significantly below 1 pp owing to the current domestic political uncertainties.

EU-CEE: LASTING CONSUMPTION GROWTH AND INVESTMENT RECOVERY

After the investment slump in 2016 attributable to the switch from the previous to the current EU (co-) financing period, the EU-CEE economies can expect investment to recover in the years ahead. In the first three quarters of 2016 after the closure of the previous EU Multiannual Financial Framework disbursement period, average EU-CEE investment in total fixed assets took a strongly negative turn (Figure 9). The drop was particularly pronounced in certain countries, viz. Estonia and Latvia, where the rate at which EU funds were absorbed was particularly high. The drop was especially pronounced in investments in the sub-category, *other buildings and structures*, most of which comprised EU-supported infrastructure projects such as roads or bridges. Investments in machinery fared far better, although they too followed the general trend over time. It is interesting to note that investments in dwellings partly bucked the overall development trend and even moved slightly upwards in the 3rd quarter 2016. This could be interpreted as an indicator of the unshakeable confidence that households have as to their future.

Figure 9 / Gross fixed capital formation (GFCF) by asset types in EU-CEE
real change in % against preceding year, seasonally and calendar adjusted

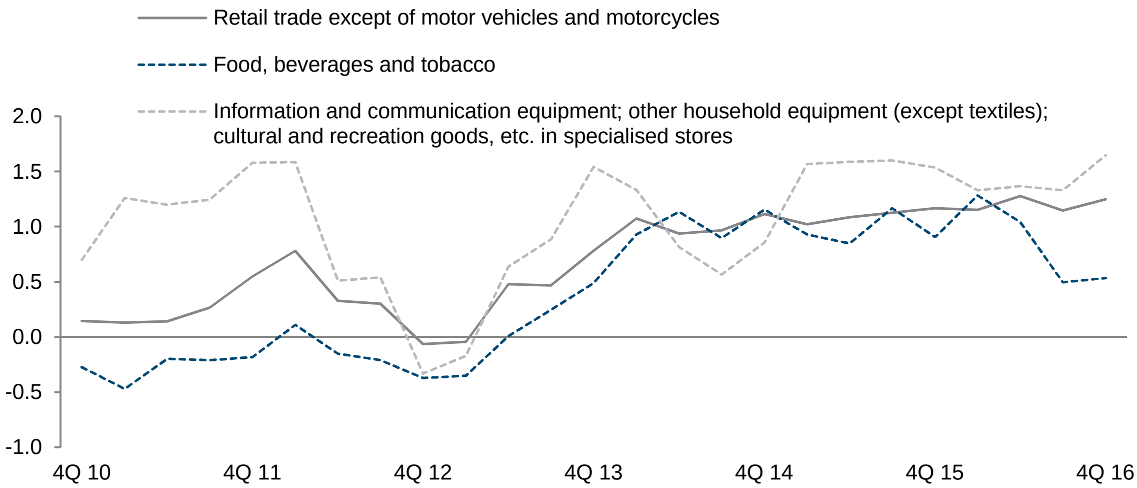


Note: Arithmetic average over 8 EU-CEE countries: BG, CZ, EE, LV, LT, PL, SK, SI.
Source: Eurostat.

The mood among household consumers is constantly improving and, given the spending patterns in the EU-CEE sub-region, it should last quite some time. Ever since the end of 2013, retail trade in the average EU-CEE country has constantly charted an upward course (Figure 10). Since early 2015, one sub-category, sales of computers and mobile phones, household equipment and sports items, has been clearly outperforming the average trend (at least judging from the smaller sample of seven countries for which data relating to that sub-category are available), whereas in the past it had been highly volatile. Moreover, since early 2016 the more basic sub-category, food, which otherwise mirrors the average trend quite closely, has been losing steam. One possible interpretation of this trend is that consumers have since satisfied their basic needs and are now turning to more luxurious items; this also indicates greater trust in the economy's recovery.

Figure 10 / Retail trade turnover in EU-CEE

real change in % against preceding year, seasonally and calendar adjusted data, 4 quarters moving average



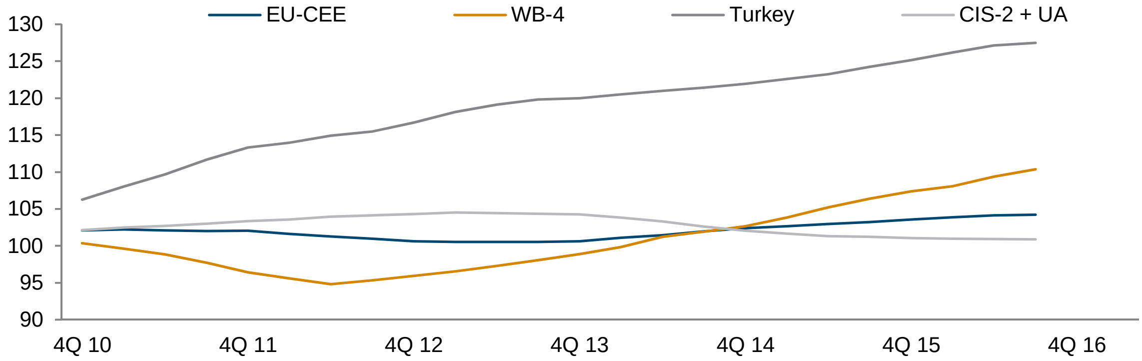
Note: Arithmetic average over countries – for the information and household equipment sub-group only data for 7 countries (BG, CZ, EE, HU, LT, PL, RO) were available.
Source: Eurostat.

LABOUR MARKETS IMPROVING – ESPECIALLY IN THE WESTERN BALKANS

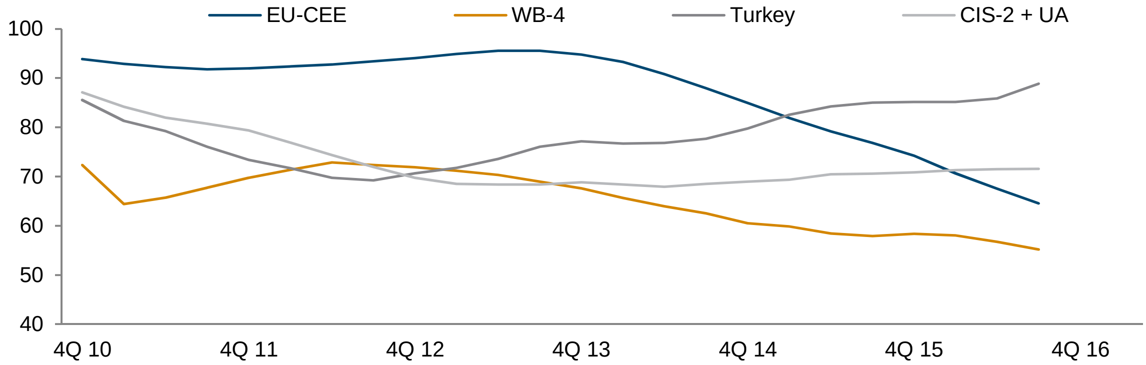
GDP growth rates of more than 2% together with better opportunities for migration have helped to improve labour market conditions in the EU-CEE countries and in the Western Balkans, in particular. In the 3rd quarter 2016 the total number of unemployed persons in EU-CEE sub-region was slashed by 17% compared to the figures for the 3rd quarter 2015 and by a remarkable 36% compared to figures for the 3rd quarter 2013 (Figure 11). However, this was not necessarily due to a substantial increase in the number of employed persons which basically remained constant (+3% over three years); it was mostly due to a decline in the labour force. The reasons for that drop include demographic decline, population ageing, outward migration and cross-border commuting. It is worthwhile noting that the transitional restrictions on Romanian and Bulgarian nationals working in a number of important EU member countries came to an end in January 2014. Interestingly enough, despite similar population statistics, the Western Balkan countries have managed to have the best of both worlds – substantially higher employment and a significant reduction in unemployment. Over the past three years for which data are available, the number of employed persons has increased by 12% and the level of unemployment has dropped by 22% (half of that reduction occurring in the past couple of quarters). It has to be mentioned, however, that the recent marked improvement in the labour markets in the Western Balkans is to be seen against a much lower basis than in the EU-CEE countries: historically their unemployment rates used to be very high. In Kazakhstan and Russia, only little has changed in recent quarters, while in Ukraine the deep recession that befell the country in 2014-2015 has led to both an increase in unemployment and a reduction in employment compounded by massive out-migration. Turkey is an interesting case in that it has experienced a rise in both employment and unemployment. Certainly, the demographics are very different. Compared to most of the other CESEE countries, Turkey has a young and growing population, in addition to the recent massive influx of refugees from Syria.

Figure 11 / Labour market trends

Employed persons, LFS, based on 1Q 2010=100, 4 quarters moving average



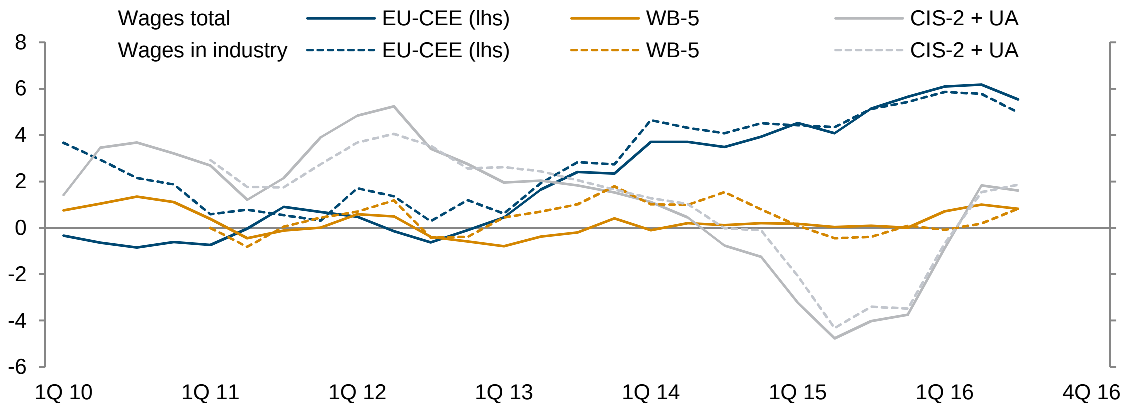
Unemployed persons, LFS, based on 1Q 2010=100, 4 quarters moving average



Note: WB-4 comprises data for BA (employees registered), MK, ME, RS. CIS-2 includes RU and KZ.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

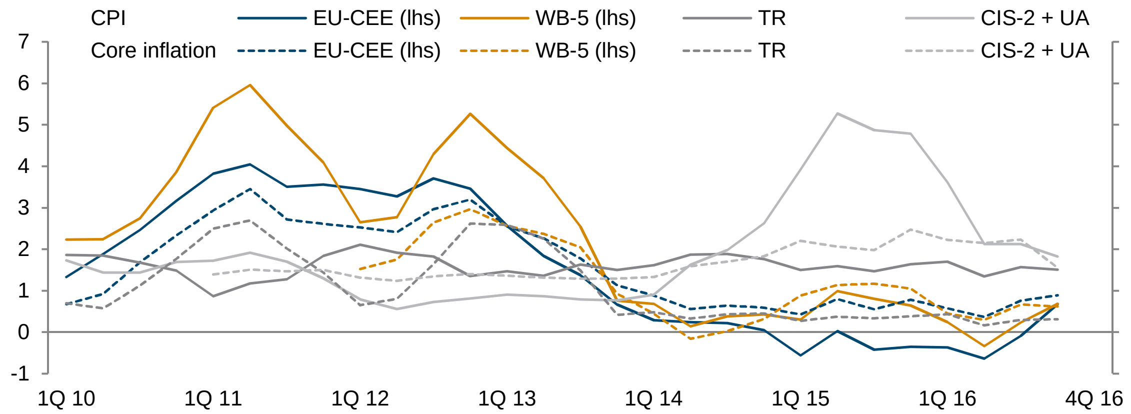
Tightening labour markets are conducive to major wage increases, especially in the EU-CEE economies. In those countries, annual real wage growth rates in the first three quarters of 2016 stood on average at almost 6% (Figure 12). Over the past year, another factor driving overall wage growth was the rise in minimum wages, close to 9% in nominal terms, with Romania being the clear front-runner. Recent wage increases in the Western Balkans and the CIS were more modest. However, in those countries the trend has also been towards growth. It is interesting to note that unlike earlier times, wage increases in CESEE industry over the past few quarters have by and large been either similar to or lower than increases overall – in brief, wages in the more domestically oriented services sector outperformed those more exposed to international competition. This is further indication of domestic demand having increased substantially.

Figure 12 / Average monthly gross wages total and in industry
real change in % against preceding year



Note: Arithmetic average over country groups. WB-5 comprises data for AL, BA, MK, ME, RS. CIS-2 includes RU and KZ.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Figure 13 / CPI and core inflation
change in % against preceding year



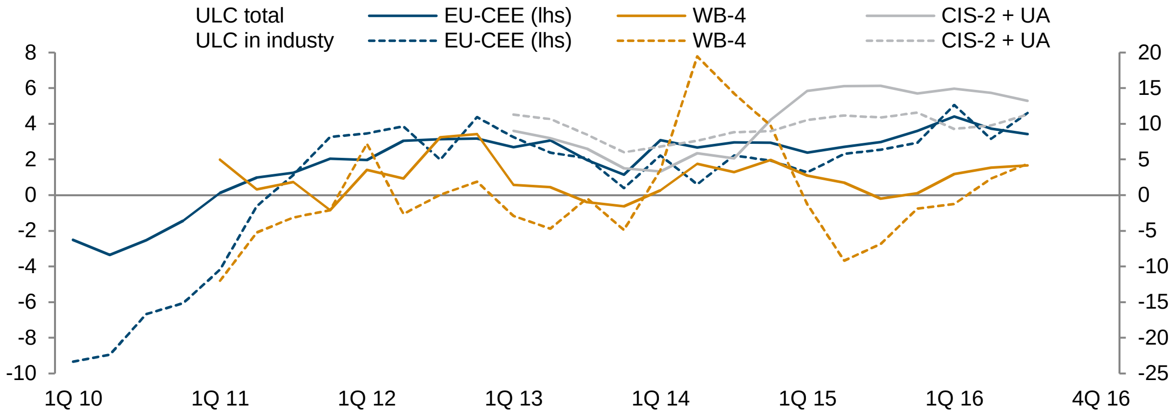
Note: Arithmetic average over country groups. WB-5 comprises data for AL, BA, MK, ME, RS. CIS-2 includes RU and KZ.
Core inflation refers to overall index (HICP) excluding energy.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Strong wage dynamics in the EU-CEE countries and the Western Balkans have had a healthy impact on headline inflation leaving negative territory. In the past and over a number of quarters, wage-influenced core inflation (not including energy prices) in those countries exceeded headline inflation (Figure 13). Given rising oil prices, however, both rates have since converged – albeit at persistently low levels of around 1% or less. Inflation in Turkey, Ukraine and the CIS is still high, owing to constant exchange rate devaluations and subsequent increases in the prices of imported goods.

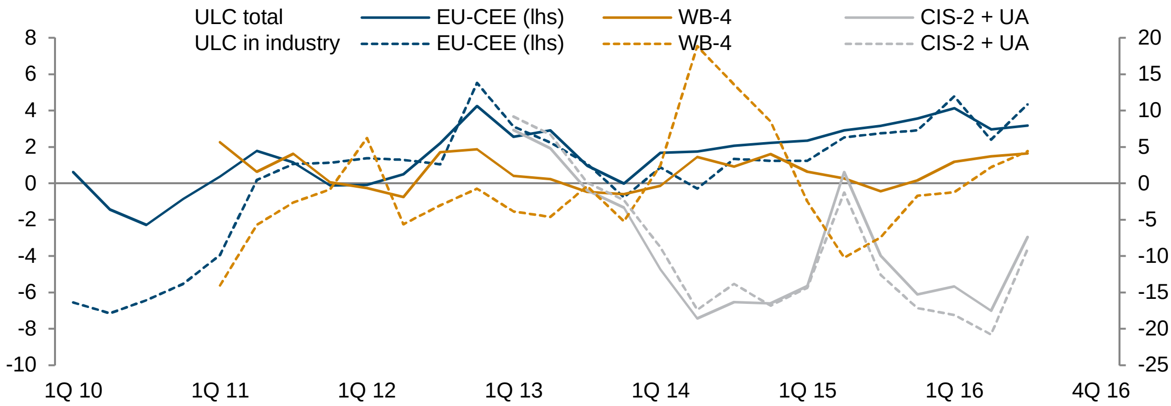
Nevertheless, even in those instances, inflation decelerated recently to rates of 6-12% in the fourth quarter 2016.

Figure 14 / Unit Labour Cost trends economy-wide and in industry at NCU and ER adjusted

ULC total and in industry, real change in % against preceding year



ULC total and in industry ER adjusted, real change in % against preceding year



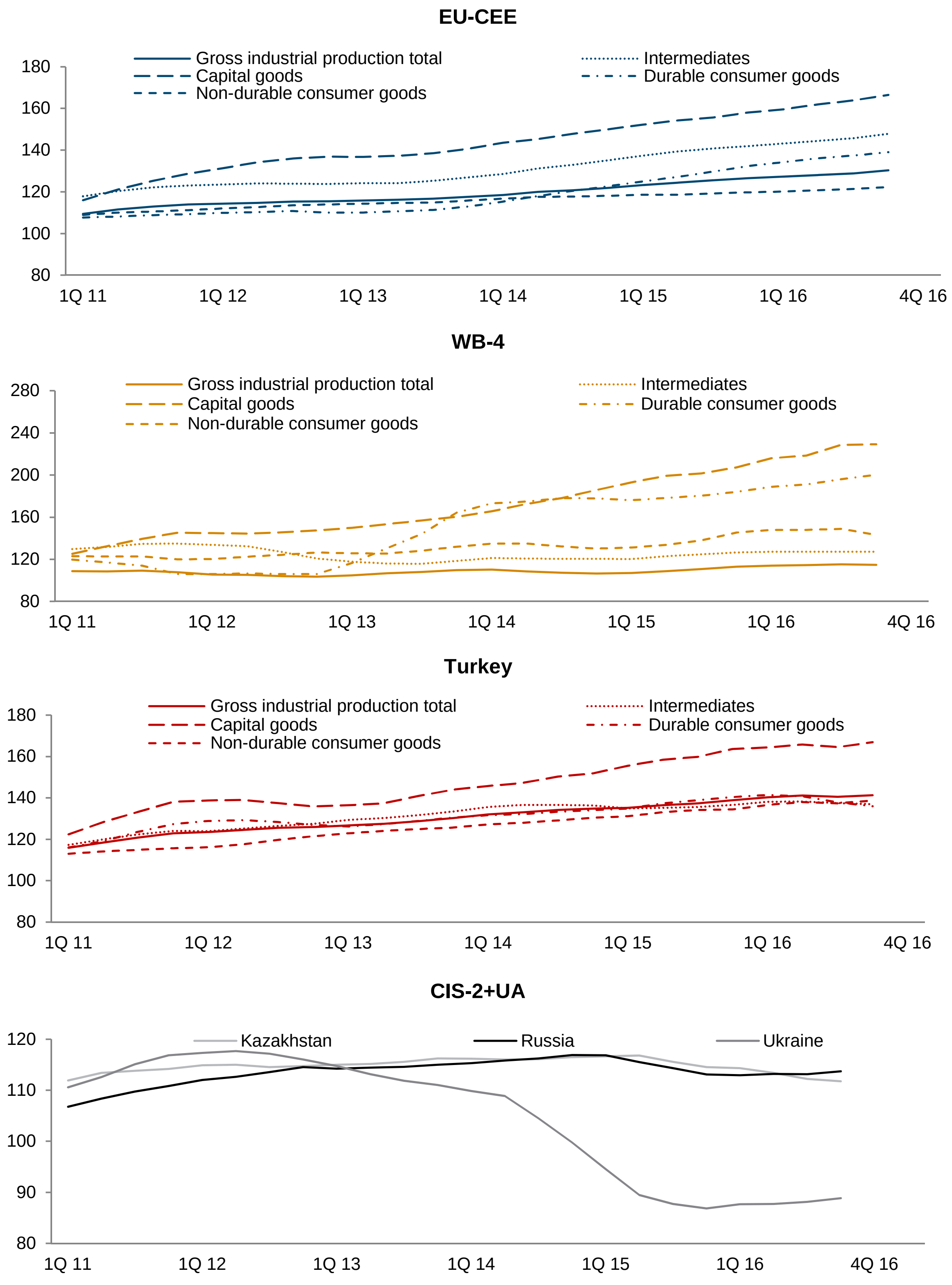
Note: Arithmetic average over country groups. CIS-2 includes RU and KZ. WB-4 comprises data for AL, MK, ME, RS. Unit labour costs are defined as average gross wages per employee relative to labour productivity (ER adjusted: average gross wages in EUR).
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

DEVALUATIONS REDUCE ULCS ONLY IN THE CIS

Most of the countries in the CESEE region have recently witnessed a rise in unit labour costs. Hence, overall wage increases have been outperforming productivity growth. More often than not, ULCs in industry have been rising less than in the overall economy (Figure 14), mostly on account of higher increases in productivity. Whereas most of the economies in the EU-CEE sub-region and the Western Balkans display fairly stable exchange rates, currency devaluations in the CIS and Ukraine have reduced exchange-rate-adjusted ULCs. In the EU-CEE countries and the Western Balkans, increases in ULCs in the 3rd quarter 2016 stood at around 4% – with an upward sloping trend line. If this development continues, it might sooner or later jeopardise international competitiveness. At the same time, however, the trend might also be a sign of quality upgrades in local industries.

Figure 15 / Industrial production Index 1Q 2010=100

calendar adjusted data, not seasonally adjusted data, 4 quarters moving average

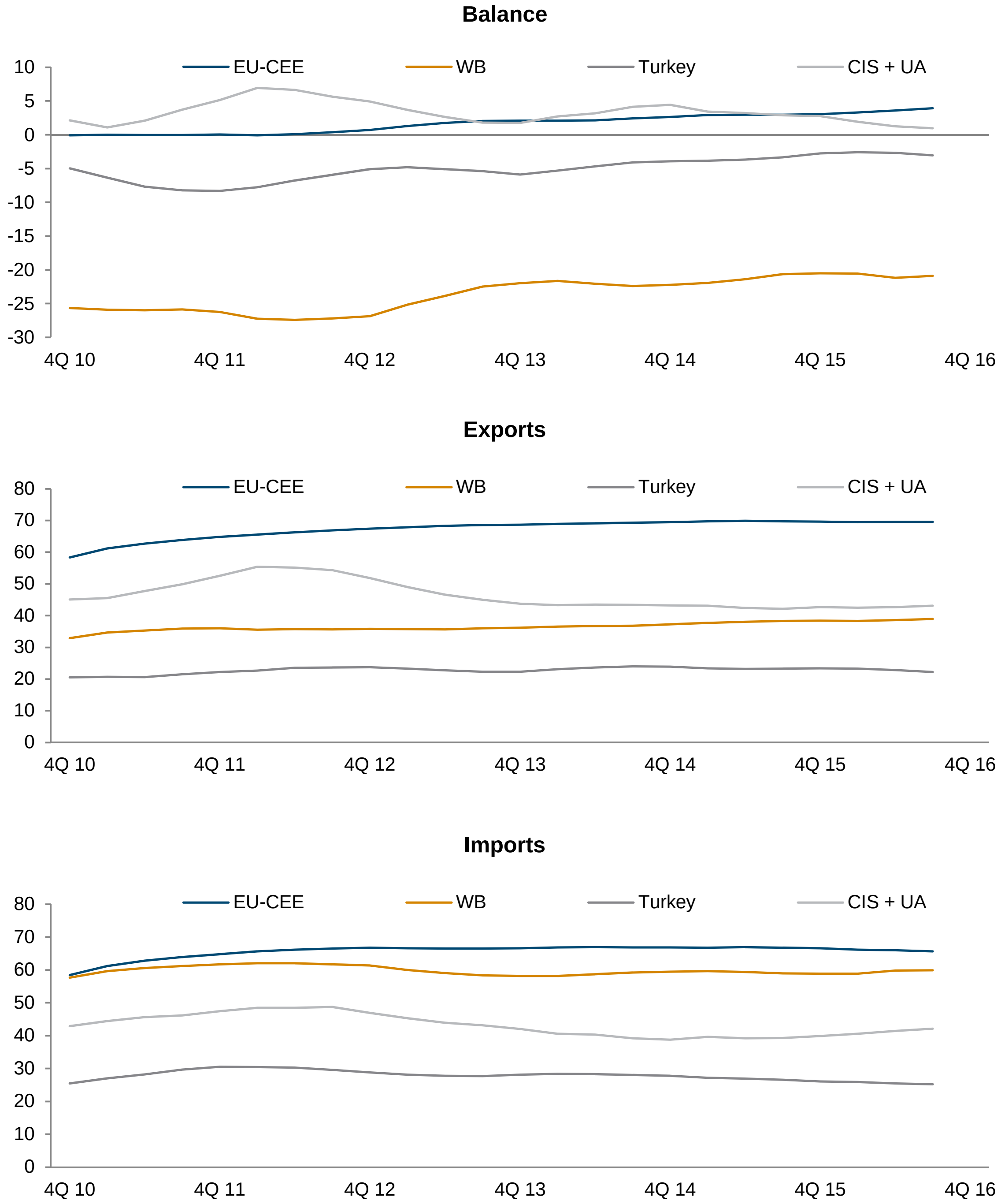


Note: Arithmetic average over country groups. WB-4 comprises data for BA, MK, ME, RS. CIS-2 includes RU and KZ.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Most of the latest industrial production figures for the CESEE countries are encouraging; they point to an ongoing improvement in industry structure and, in several cases, to re-industrialisation. A comparison of 2016 to 2015 or 2013 reveals that (cumulative) industrial production was particularly strong in the EU-CEE countries which recorded real increases of 5% and 12%, respectively (Figure 15). The higher quality sub-categories, *capital goods, intermediates and consumer durables*, noticeably outperformed the average trend. At the same time, the performance of *non-durable consumer goods* was below average. Over the three-year period, the output of *consumer durables* performed best (an increase of more than 21%), whereas over the past year *capital goods* registered the highest growth (6.5%). The first figure reflects the high consumer confidence (as already observed in the detailed retail trade figures) and the second figure is possibly hinting at a pick-up in investment – not only in the EU-CEE sub-region, but also in other European manufacturing core countries (predominantly Germany). Overall industrial production increases were particularly high among the 'laggards' such as Croatia (where the growth reported in 2016 was the highest since 2001), but also among the front-runners such as Slovakia (where massive increases in production capacities in the automotive industry are in the offing). In the Western Balkans, where overall industrial production is rather flat, output in terms of capital goods and durable consumer goods is far outstripping other sub-categories of industrial production. Capital goods fared especially well in Macedonia, as did consumer durables in Serbia. In Turkey, total industrial production is growing at a constant rate, but capital goods production is the sole sector to have moved significantly ahead of the other branches such as the production of consumer goods (an indication that consumer demand is weakening in Turkey). In the CIS and Ukraine (where comparable detailed data are lacking), the overall downturn due to the decline in oil prices, armed conflict and sanctions has lead to stagnation or a drop in total industrial production. However, even then towards the end of 2016, slight improvements were to be observed in both Russia and Ukraine. Obstacles to a greater improvement in the Ukrainian manufacturing sector include: lack of funds, the loss of domestic purchasing power, war damages, Russian trade restrictions and an economy that finds it difficult to take advantage of the Ukraine-EU Deep and Comprehensive Free Trade Agreement, since the vast majority of Ukrainian manufactured goods fail to comply with EU standards and regulations.

Recently, trade balances of goods and services have for the most part improved throughout the CESEE region, except in the CIS countries and Ukraine. It is interesting to note that the trade balances relative to GDP did not necessarily improve (Figure 16) via export growth (despite a long-term positive trend to be observed in most countries in the region), but rather via fewer imports despite the ongoing expansion of household consumption (although, here too, a longer-term increase can be detected); lower energy prices offer a more substantive explanation. Several countries in the Western Balkans proved to be exceptions. Notably in Serbia, the export share in GDP increased quite appreciably. However, even in major EU-CEE economies (Hungary and Poland) the export share widened as well. Recent developments in Turkey contributed to an improvement in the trade balance concurrent with lower export and import ratios. That was attributable to weaknesses in the Turkish tourism industry as well as a reduction in imports on account of lower energy prices and exchange rate depreciation. On average, the trade balance in the CIS and Ukraine deteriorated on account of increased imports. However, developments in that sub-region are comparatively heterogeneous. Overall, trade balances are still significantly positive in most of the EU-CEE and CIS economies, while slightly negative in Turkey. This indicates that over the short-to-medium term, the region will not be lacking in terms of international competitiveness. Even the Western Balkans, which continue to suffer huge double-digit trade deficits in GDP terms, have embarked on a longer-term path towards (slow) improvement.

Figure 16 / Goods and services, in % of GDP, 4 quarters moving average

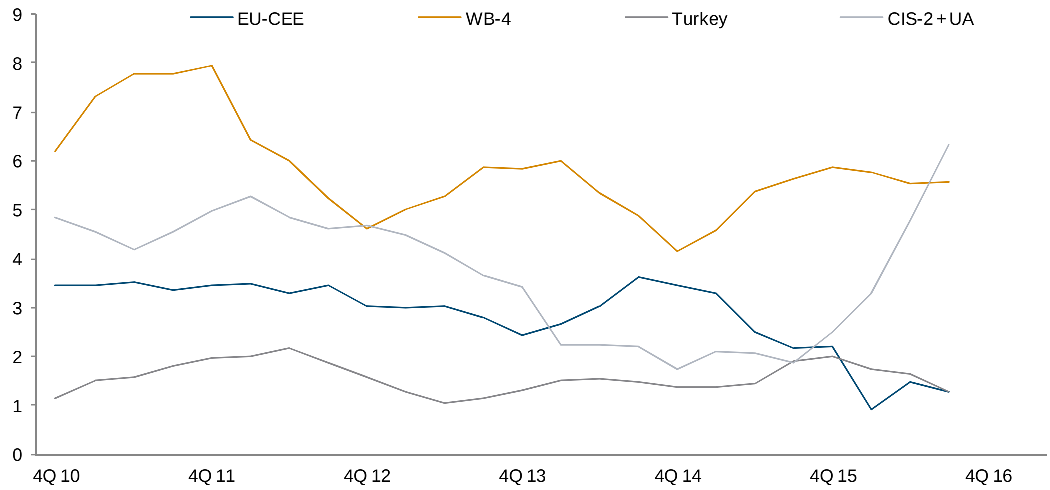


Note: Arithmetic average over country groups. Goods and services according to national accounts, AL and BA according to BOP.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

CESEE COMPETITIVENESS FOSTERED BY FDI AND QUALITY UPGRADE

The short-term trends in respect of FDI inflows in the CESEE countries are mostly negative, except for the CIS and Ukraine, yet in the longer term the trend holds particular promise for the Western Balkans. Over recent quarters, Kazakhstan in particular has registered major inflows of FDI, most of which poured into sectors related to mining. In Russia, the surge in FDI at the end of 2016 stemmed from selling off 20% of the Rosneft oil company for USD 11 billion. to the commodity trader Glencore and Qatar's sovereign wealth fund. The general trend in the EU-CEE countries is, however, on a downward slope. That notwithstanding, some of the latecomers to EU membership have done quite well recently, viz. Croatia and Romania. In the latter country, prospects for future FDI inflows are also quite good, especially in the automotive and shared services sectors. Notably, Slovakia will witness a marked increase in FDI over the years ahead. Jaguar Land Rover is currently building a plant there that is also expected to drag on investments by car suppliers. Minebea, the Japanese manufacturer of electrical equipment, is coming to Slovakia, where PSA Peugeot Citroën is planning to set up an engine production plant. In the Western Balkans (Figure 17), much of the FDI is related to infrastructure, particularly in the transport and energy sectors, examples being the Norwegian Statkraft's Devoll hydropower project or the construction of the Trans Adriatic gas Pipeline (TAP), both of which are located in Albania. All this should offer potential enough to attract future additional FDI to an area that hitherto had not been a prime target for international investors.

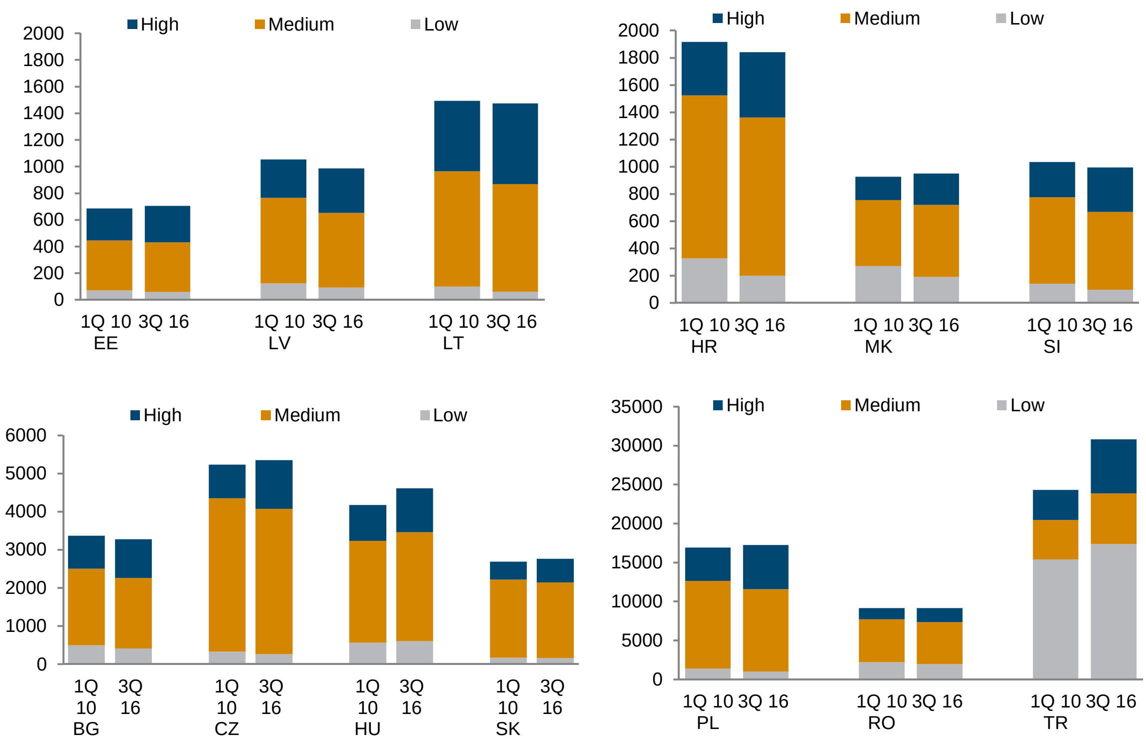
Figure 17 / FDI flows (BOP, liabilities) in % of GDP



Note: Arithmetic average over country groups. CIS-2 includes RU and KZ. WB-4 comprises data for AL, MK, RS, XK.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

With the overall labour force in the CESEE countries more or less stagnating, a marked improvement in education structures is evolving as a younger and better educated generation enters the work force, hinting potentially at a general upgrading of quality across the region's economies. Between the 3rd quarter 2016 and the 1st quarter 2010, the share of a more highly educated workforce (at the tertiary level) increased most in Poland and Slovenia, in the order of 8 pp. That share is now highest in the Baltics (ranging from 34% to 41% in Latvia and Lithuania, respectively). But even in non-EU-CEE economies such as Macedonia and Turkey, the share of the more highly educated has increased greatly over the past seven years, albeit starting from low levels (Figure 18). This is important news for the region. It would appear that constant outward migration to Western Europe has not necessarily resulted in a brain drain, but a brain gain. Those developments take on particular importance for the longer-term competitiveness of the region when it comes to climbing further up the value-added ladder.

Figure 18 / Labour Force by education, thousand persons



Note: Definition of education (ISCED). Low: less than primary, primary and lower secondary education. Medium: upper secondary and post-secondary non-tertiary education. High: tertiary education.
Source: Eurostat.

AN OPTIMISTIC OVERALL OUTLOOK AMID MAJOR GLOBAL UNCERTAINTIES

In summary, the CESEE economies face a cautious upturn, surpassing on average 3% GDP growth by 2019, driven by consumption and increasing investment in a largely supportive international economic environment; competitiveness is not endangered despite the rise in ULCs. It might well be that in the absence of further political friction, recovery in the euro area will evolve more robustly than anticipated. The ‘kick-off’ of EU transfers under the new Multiannual Financial Framework might also prove more dynamic than expected. Generally speaking, the economic sentiment seems to be improving among consumers and producers alike. Labour markets are tightening and wages growing. Finally, after years of depressed economic growth, the CIS economies are also gaining some momentum. Despite wages forging ahead of productivity, competitiveness does not seem to be endangered any time soon. Parts of the region have experienced re-industrialisation, especially in the higher value-added segment of capital goods production. FDI in manufacturing and infrastructure, together with an improvement in the educational structure of the labour force, offer every reason for being fairly optimistic.

At the same time, the CESEE countries and, for that matter, the whole of Europe, together with the rest of the world as well, are haunted by the spectre of political uncertainty; it is only to be hoped that once fully roused, the 'animal spirits' of the economic agents will shrug off the gloom. The largely unexpected outcome of the Brexit referendum and the votes cast in favour of Trump appear to be a form of political backlash in the UK and US. Both outcomes may not necessarily correspond to the current, comparatively favourable, economic trends, but they could be arguably interpreted as a popular reaction to some less pleasant side-effects of globalisation, such as the rising economic inequality. None the less, with its momentary declarative radicalism, the political shifts in the two pillars of the Western post-war economic and security architecture have given rise to widespread uncertainty over the future of such pivotal institutions as the EU and NATO, not to speak of the process of globalisation. However, it is extremely difficult to assess the actual storyline and the related risks. It could very well be this lack of concrete risk-estimates that has prompted the bullish buoyancy of the economic players – be it in the real economy or on the financial markets. That notwithstanding, a number of worrying scenarios are quite conceivable (see special topics on uncertainties in EU-CEE, the Western Balkans and the CIS+UA region attached to this report) that could ultimately make our forecasts appear upbeat and overoptimistic. Authoritarian tendencies in the West are mirrored by similar trends in Eastern Europe. Growing anti-EU populism could bear serious implications for the economies of the EU-CEE countries. The ongoing economic turnaround in the Western Balkans might fall victim to misgivings about the stability of the 'EU carrot' and the 'US stick' that thus far have held the fragile region together. The slow recovery in the CIS and Ukraine might also prove unsustainable as apprehensions about oil prices and geopolitical factors (particularly with regard to the conflict in Ukraine) become more acute. However, seen from a currently optimistic perspective, the CESEE region as a whole is back on a convergence track with an average growth differential of 1.2 pp vis-à-vis the euro area over the forecast horizon.

Special section I: Global and EU political risks driving up uncertainty in EU-CEE

RICHARD GRIEVESON[3]

Brexit, the election of Donald Trump as US president and the 2015 European migration crisis have created a mood of heightened uncertainty about economic policy-making that is likely to last for many years. Given this year's busy election calendar, these developments will compound the severity of the challenges facing the EU in 2017 and beyond. For the EU-CEE sub-region, a potential rise in protectionism and less US support for NATO could prove harmful, while domestic political developments in some older Member States in concert with the fallout from Brexit may well result in lower west-east EU fiscal transfers and a curtailment of the free movement of labour over the medium term. Meanwhile, an apparent loss of faith in the EU project and its associated values and institutions will have major consequences. This uncertainty may well act as an impediment to growth in the EU-CEE countries in the near term. More importantly, it could cast doubt on the longer-term prospects of EU-CEE political and economic convergence.

Economic and political uncertainty has scaled new heights over the past year. The Economic Policy Uncertainty Index[4] provides one indicator of this apparently sudden and dramatic increase in uncertainty. As the chart below shows, the European Economic Policy Uncertainty index has surged higher, with particular spikes in June-July (Brexit) and November (Trump) 2016. Neither event had been widely expected before it happened. At the outset of 2016, bookmakers were quoting the odds on Brexit happening at around 3:1. At the same point in time, Mr Trump was being given around a 7:1 chance of becoming the next US president (he wasn't even ranked favourite for the Republican nomination at that juncture).

The uncertainty generated since, in particular, by the election of Mr Trump, is extremely high. The economic, political, military and cultural might of the US means that it is a matter of concern for everyone, including the EU-CEE countries. On assuming office, Mr Trump followed through on some of his campaign promises, including the large-scale ban on the immigration from seven Muslim-majority countries (only to have it subsequently overturned in a Federal court), thus demolishing the popular thesis that he should be taken seriously, but not literally[5]. Although in some ways, his follow-through on campaign pledges makes Mr Trump more predictable, the vagueness of many his pledges and the

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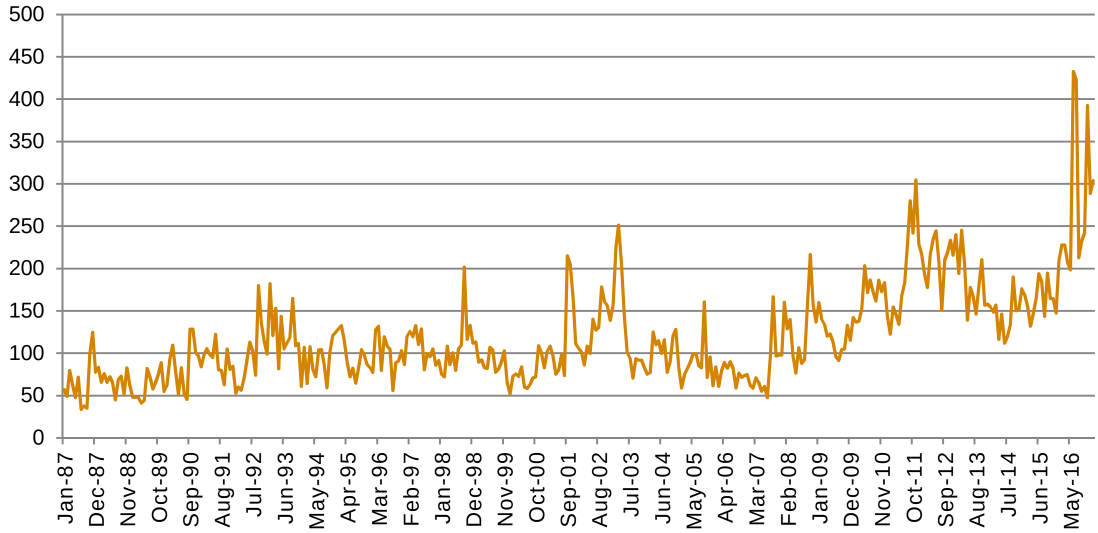
[3] The author would like to thank Vasily Astrov, Peter Havlik, Mario Holzner and Michael Landesmann for valuable comments and suggestions.

[4] The index is compiled using newspaper articles regarding policy uncertainty. The following newspapers are used: Le Monde and Le Figaro for France, Handelsblatt and Frankfurter Allgemeine Zeitung for Germany, Corriere Della Sera and La Repubblica for Italy, El Mundo and El Pais for Spain, and The Times and the Financial Times for the United Kingdom.

[5] https://www.theatlantic.com/politics/archive/2016/09/trump-makes-his-case-in-pittsburgh/501335/

countless unknowns as to what implications those changes will bear, have only served to heighten the degree of serious uncertainty. He has himself said “I want to be unpredictable”. Mr Trump regularly contradicts himself, sometimes in the same interview.

Figure 19 / European Economic Policy Uncertainty Index



Source: Economic Policy Uncertainty.

While both Brexit and the election of Mr Trump came as a shock to most, part of the reason for the concern they have roused is that both events fit in with certain prevalent trends. Mr Trump’s victory and his statement that NATO is ‘obsolete’ have led to greater uncertainty regarding European security, particularly in some EU-CEE countries. However, insecurity had already been on the rise in parts of the EU-CEE sub-region on account of Russia’s annexation of Crimea and its involvement in the conflict in Eastern Ukraine, as well as the impact of the migration crisis in 2015. Meanwhile, for some time now a rise in the number of anti-EU and anti-euro parties has been apparent in many EU Member States that joined the Union prior to 2004 – irrespective of Brexit.

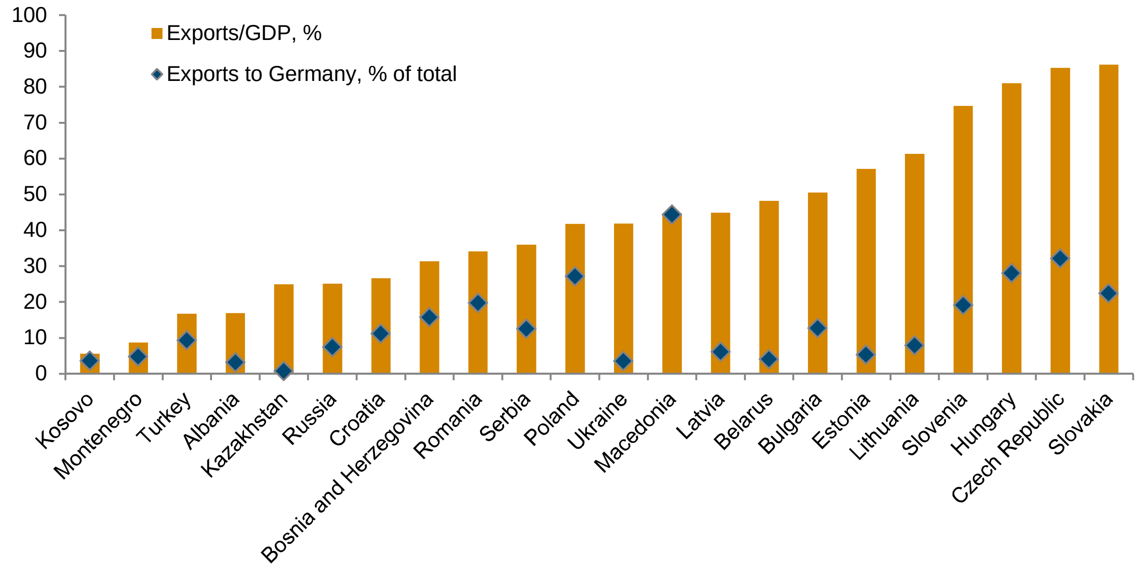
The continuation of the EU and NATO in their current form and the maintenance of the post-war economic and security architecture are being openly questioned. Coming as they have in two of the traditional and most important champions of the current system, Brexit and Mr Trump’s victory have prompted concerns about an end to, or at least a pause in, the post-1990 wave of globalisation, the second of its kind (the first having lasted from 1870-1913).

A RISE IN PROTECTIONISM WOULD HARM INDUSTRY IN THE EU-CEE COUNTRIES

One of the key items on Mr Trump’s agenda is his antipathy to multilateral trade deals. In all likelihood, this means that he will stop all trade negotiations that the previous US administration had initiated (such as the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership). It also means that he may revoke previous agreements, including the North American Free Trade Agreement. This has fuelled fears that the new US president will trigger a rise in global protectionism. Alongside China and Mexico, Mr Trump has singled out Germany as one of the countries that he feels is deliberately and unfairly undermining US industry.

Any US measures against Germany or a more general rise in global protectionism would harm the EU-CEE economies. Mr Trump's apparent antagonism towards Germany[6] is particularly noteworthy from the perspective of the EU-CEE countries. German industry has long supply chains stretching deep into the region, with many EU-CEE countries firmly plugged into the Germany-CEE supply cluster in the automotive and related industrial sectors (that Mr Trump has specifically targeted). Those countries would suffer if German exports were curtailed by the imposition of tariffs. Moreover, many EU-CEE countries have extremely open economies, thus leaving them particularly vulnerable to a downturn in global trade volumes.

Figure 20 / Merchandise exports, 2015



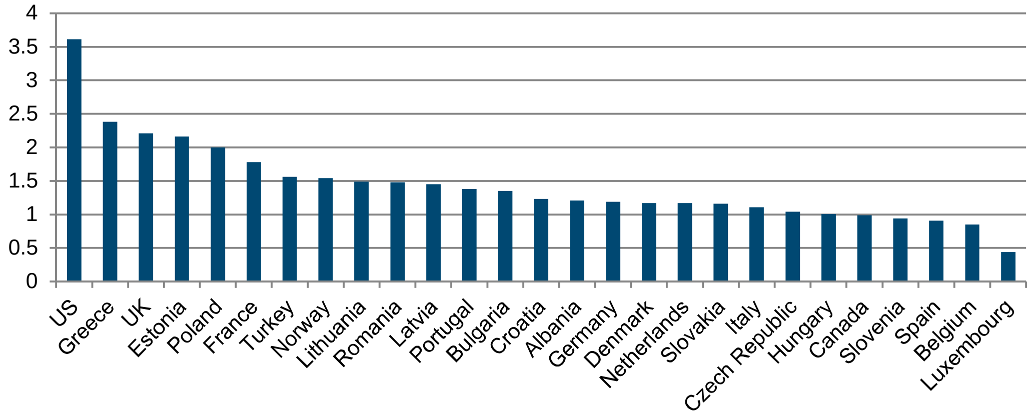
Source: wiiw Annual Database.

QUESTIONING US COMMITMENT TO NATO: WORRIES FOR SOME IN THE EU-CEE SUB-REGION

Mr Trump also appears to want the US to adopt a less active role in policing the world. The US has been integral to maintaining a 'balance of power' in several parts of the world, including Europe. It is much less clear whether this will continue to be the case under Mr Trump. The new US president's commitment to NATO is questionable, further to which he has suggested that the US will not continue to protect 'free-riders'. According to NATO data for 2016, only five NATO members—the US, Greece, the UK, Estonia and Poland—currently meet the alliance's defence spending target: 2% of GDP.

6 https://www.ft.com/content/23d2c622-e706-11e6-893c-082c54a7f539

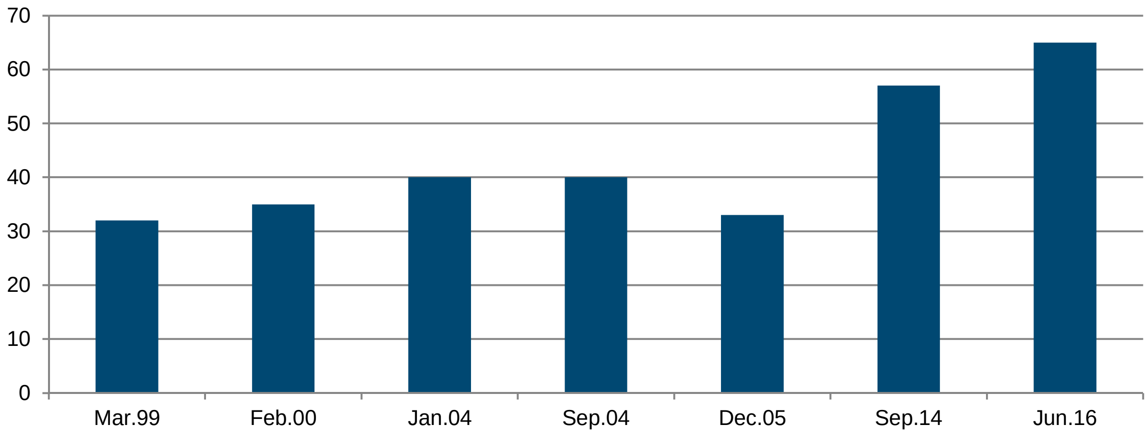
Figure 21 / Defence spending, % of GDP



Source: NATO

This stance has potentially serious security implications for EU-CEE countries. Any questioning of the US role in terms of European security (irrespective of whether any concrete changes actually emerge, which we remain somewhat sceptical about) will evoke a feeling of incertitude and instability, at least in some parts of the EU-CEE sub-region. This will be particularly the case in the Baltic states[7] and Poland, owing to fear of Russia in these countries.

Figure 22 / Share of Polish citizens agreeing that forces of other NATO members should be stationed in Poland



Source: CBOS Public Opinion Research Centre.

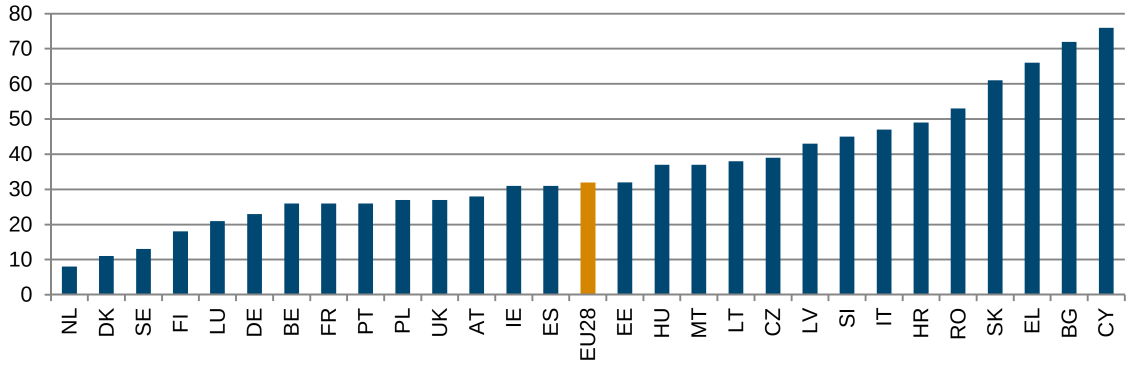
It is highly unlikely that Europeans will step up to fill any security void, particularly in relation to presenting a united front against Russia. 38% of Germans think that their country should use military force in the event of a Russian conflict with a NATO member[8]. Even in parts of the EU-CEE sub-region,

[7] http://cepa.org/index/?id=f3af38a9500cfc72614a7cb788e5a56b

[8] http://www.pewglobal.org/2015/06/10/nato-publics-blame-russia-for-ukrainian-crisis-but-reluctant-to-provide-military-aid/

less than 50% of the population see NATO as a protection[9]. The exit of the UK—along with France one of the EU's two serious military powers—from the bloc makes forging a credible European alternative to NATO even more difficult. Broadly, the EU is decisively split on the subject of Russia; it is quite surprising that a common EU policy on sanctions against Russia has been able to last this long. The share of the population with a positive view of Russia ranges from 76% in Cyprus to a mere 8% in the Netherlands.

Figure 23 / Share of population with positive view of Russia, %



Source: Special Eurobarometer, 'Future of Europe', October 2016.

FISCAL ARRANGEMENTS AND FREE MOVEMENT OF LABOUR UNDER THREAT

In general, Brexit has introduced a high degree of uncertainty into the EU. Negotiations will be inordinately complex[10]; there is almost no chance of them being concluded in the two years following the triggering of Article 50. More than 20,000 laws/bills will need to be scrutinised as part of the negotiating process. Throughout that period, thousands of cross-border businesses and millions of EU-citizens caught on the wrong side of the divide[11], will lack certainty on their futures.

Brexit negotiations could have important implications for both the EU budget and migration flows in and out of CESEE countries. In the near term, Brexit may actually result in stronger cohesion among the remaining 27 members. However, it is clear that some of the issues raised in the Brexit debate, and which were instrumental in the vote to leave, are mirrored across the rest of the EU. These include questions over west-east fiscal transfers and upholding the free movement of labour. Such issues will take on particular importance over the next few years and constitute a key battleground between the old and new Member States.

Brexit could well open a Pandora's box of fiscal questions in the EU. Theresa May, the UK prime minister, has not ruled out the possibility of the UK continuing to contribute to the EU budget. Those

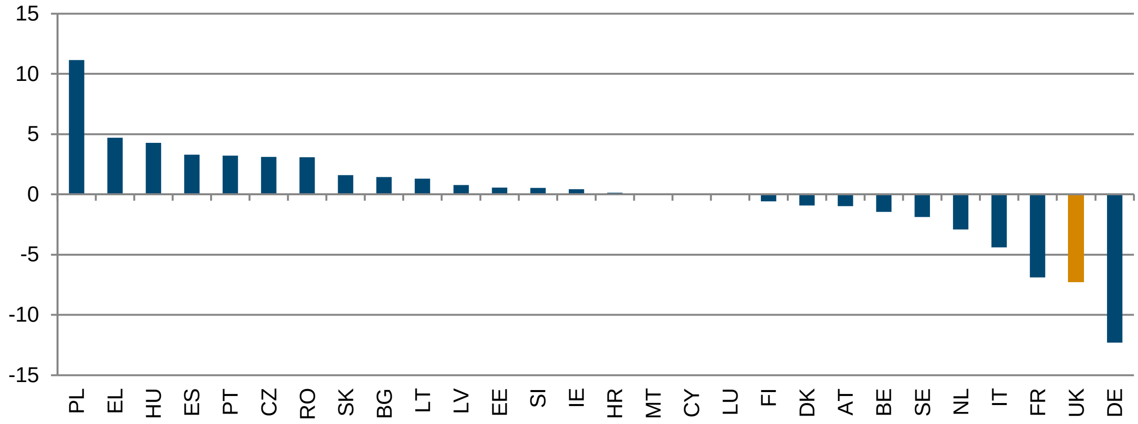
9 http://www.gallup.com/poll/203819/nato-members-eastern-europe-protection.aspx

10 http://www.politico.eu/article/brexit-negotiation-issues-worrying-the-european-parliament/

11 There are around 3.3mn citizens of other EU countries in the UK, and around 1.2mn UK citizens in the rest of the EU.

payments could prove necessary for a number of reasons[12]. However, she has stressed that the contributions will not be 'huge'. In that respect, a tough fight between the UK and the EU-27 is likely[13]. After 2020, however, it is highly probable that UK contributions to the EU budget will shrink. As the UK is currently one of the main net contributors to the EU budget (see chart below), this means that the pool of money available to other Member States will be cut back. As the major recipients of EU funds, the EU-CEE countries will naturally suffer most from this.[14]

Figure 24 / 2010-15 average EU operating budget balance by country, EUR billion



Source: European Commission.

Debates over the recent Monti report[15] offer an early indication of the divisions in this particular area. Some wealthier Member States are opposed to the report's suggestion that the EU be granted greater control over tax revenues. The stance of the major net payers in Western Europe, including Germany, has hardened owing to three factors: infringement of EU law in parts of EU-CEE sub-region, such as Poland and Hungary; a refusal to participate in refugee-sharing schemes; and concerns over corruption.

Meanwhile, despite promises from Angela Merkel, there is no guarantee that EU-wide free movement of labour will endure in its current form. Free movement to and from the UK will certainly be curtailed (although potentially not to the extent that some Brexiteers would like to think[16]). However, there are rumblings in the capitals of other wealthier Member States on this issue. In Austria, for example, Chancellor Christian Kern has sought means of: (i) introducing changes to child-benefit payments for workers from other EU countries whose children are not with them in Austria; (ii) and to find a way for local workers to be favoured when applying for jobs. The German Minister of Finance, Wolfgang Schäuble, is reported to be preparing a bill to halve child-benefit payments for those workers with children in another Member State where such allowances are lower. France, Austria and Germany

12 http://www.cer.org.uk/publications/archive/policy-brief/2017/%E2%82%AC60-billion-brexit-bill-how-disentangle-britain-eu-budget

13 Despite Ms May's desire to play down the amount, a "divorce bill" to be paid by the UK of EUR60bn has been widely quoted.

14 See Richter (2016).

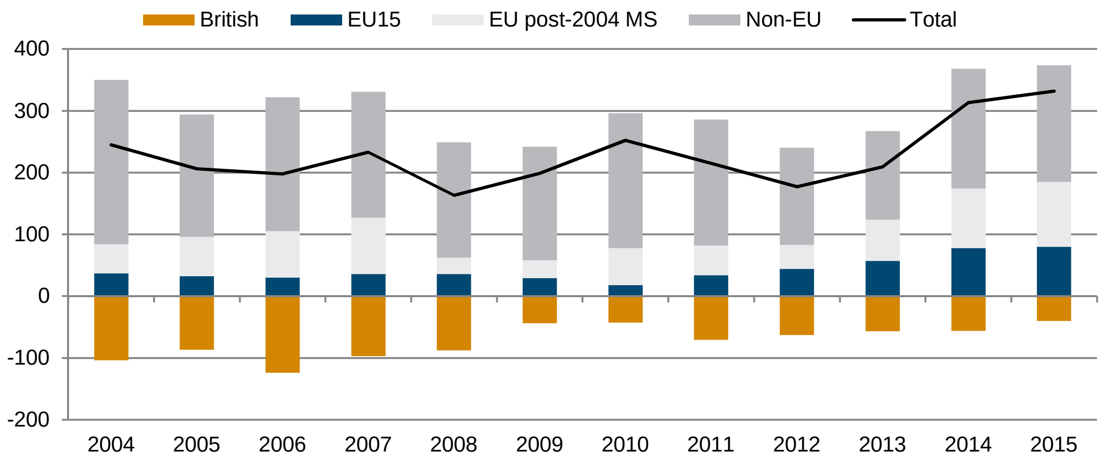
15 http://ec.europa.eu/budget/mff/hlgor/index_en.cfm

16 http://www.spectator.co.uk/2016/12/brexit-is-a-revolution-and-itll-be-decades-before-we-know-its-worked/

have also moved to support rules on so-called 'posted workers', where employees from poorer Member States go to wealthier Member States to work there on a temporary basis. The three countries allege that this constitutes unfair practice, undercuts local labour competitiveness and leads to higher domestic unemployment rates.

The termination of free movement to the UK will have a major impact on the EU-CEE countries. Since 2004 long-term migration to the UK from the EU-12 (EU-CEE plus Malta and Cyprus less Croatia) has averaged almost 100,000 per year (in net terms the figure is around 60,000, but it increased to over 100,000 in the period 2014-15). Any restrictions on free movement in the EU on a broader scale would have an even more significant impact[17]. Although the rise in EU-CEE immigration to Germany started later than the UK (owing to the fact that the UK did not exercise its option to impose transitional controls on migration from the EU-CEE sub-region), by 2015 45% of the 2.1mn immigrants arriving in Germany had EU passports[18] (compared to some 270,000 in the UK in that year).

Figure 25 / Long-term net immigration to the UK by citizenship, thousand persons



Source: UK National Statistics Office.

PRO-EUROPEANS ON THE DEFENSIVE

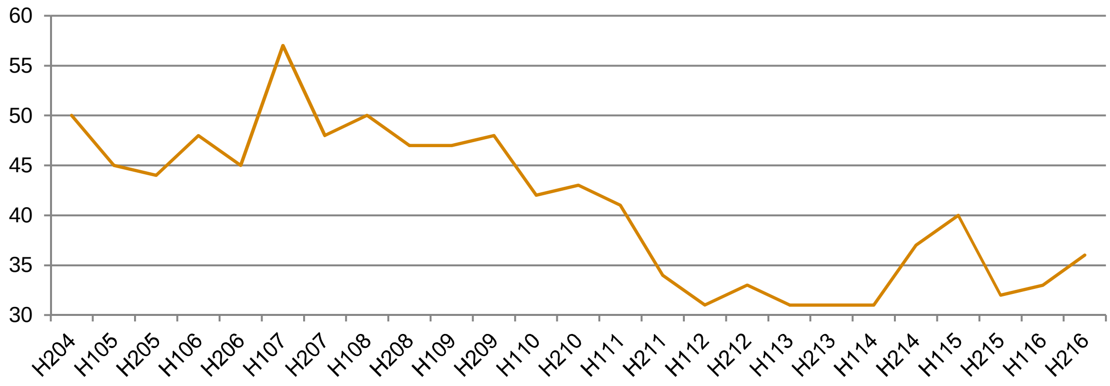
The backdrop described above is daunting enough, even without 2017 being a major election year in the EU. Three important elections will take place in Western Europe in 2017, all of which could (and probably will) have significant implications for the CESEE countries. Germany, France and the Netherlands will all go to the polls this year. Meanwhile, Italy may have an early election. In all of those countries, the EU, the euro zone and migration will feature prominently in the debates and the attitude of voters to the European project may well prove decisive in determining the outcome.

[17] See Mara and Landesmann (2016).

[18] German Federal Statistical Office (Destatis).

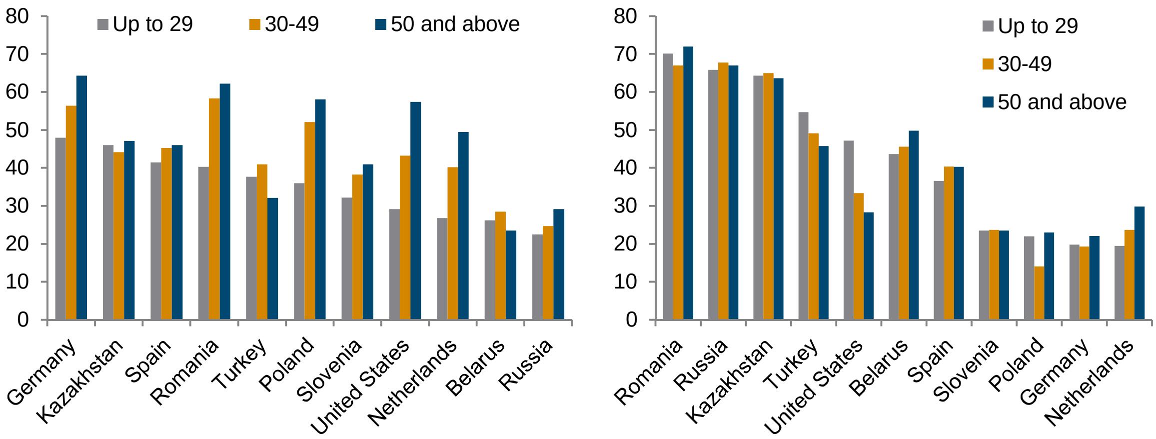
The most likely scenario remains that none of the parties with anti-EU, anti-euro and populist platforms in the Netherlands, Germany and France will be in government after the elections. In Germany, the AfD is still a comparatively small party, while in the Netherlands and France the other parties are likely to join forces to keep the populists out. However, even if the populists are rebuffed in 2017, the threat they pose will not go away. A victory for Marine Le Pen is France is not impossible. If that happens, it is hard to see how the EU and the euro will be able to continue in their current forms.

Figure 26 / Share of respondents expressing trust in the EU, in %



Source: Eurobarometer

Figure 27 / Share of people who think that democracy is 'absolutely important', in %
by age group (left panel), and those who think it is good to have a strong leader unaccountable to parliament and the electorate (right panel)



Source: World Values Survey.

Throughout the EU, voters' faith in mainstream politicians and the wider European project has diminished. Only 36% of citizens say that they trust the EU[19]. A Eurobarometer survey in 2016 showed that only 20% of EU citizens think that their children's lives will be easier than theirs, compared to 56% who think they will be more difficult. Doubts about the EU and its values are often clear, in particular

19 http://ec.europa.eu/COMMFrontOffice/publicopinion/index.cfm/Survey/getSurveyDetail/instruments/STANDARD/surveyKy/2137

among the young, suggesting that it will only become more of an issue over time. According to the World Values Survey, less than 50% of people aged 29 and under in all European countries think it is 'essential' to live in a democracy[20]. Separate surveys show that in France, Marine Le Pen is much more popular among the under-24s than the over-65s[21]. In Romania, a clear majority of the under-30s think that a strong leader unaccountable to parliament and not having to face elections is a good thing. This has had the support of at least one fifth of young people in all European countries surveyed.

IMPLICATIONS FOR CONVERGENCE IN EU-CEE

Apart from the factors already discussed above, the main near-term risks these developments touch on the threats to stability and growth. Uncertainty across a wider number of areas (security, trade openness, the EU budget and migration), all of which matter a great deal to the EU-CEE countries, risk depressing sentiment and, by extension, economic activity in EU-CEE countries. For firms drawing up investment plans, the situation is potentially both difficult and risky.

More broadly, these developments give rise to major questions about economic and political convergence in the EU-CEE sub-region. Some have expressed disappointment with progress achieved over the past quarter of a century; they argue that a new model is needed[22]. However, in a historical context, the developments have been quite significant. A large number of countries have undergone a peaceful transition from totalitarian communism and a planned economy to market capitalism and democracy. Income convergence with Western European levels is a reality, albeit in some cases it has only been taking place slowly and with significant inequality.

However, two things are clear. **Firstly, Western Europe's commitment to the process of transition in EU-CEE is not (and will not be) as strong as it was.** Talk of a 'two-speed' Europe has become increasingly prominent, even in Germany[23]. Many in Western Europe are tired of Poland and Hungary in particular, and what they see as free-riding in the EU-CEE countries in general. Without firm economic, fiscal, political and institutional support from the EU, achieving further convergence in the EU-CEE sub-region will be much more challenging.

Secondly, as developments in Poland and Hungary have shown, there is nothing permanent or fixed in terms of the institutional and political developments in the EU-CEE countries in recent decades. Venezuela provides a particularly interesting example of how an apparent consolidation of democracy and independent institutions can be undone[24]. In the 1980s, Venezuela appeared to be a stable democracy, with clear a track record of free and fair elections; it was widely touted as a model for Latin America. However, all that has gradually eroded, and Venezuela today is very far from being a consolidated democracy. It is not inconceivable that parts of the EU-CEE sub-region, even those countries that in general have made the greatest economic and political strides since the collapse of communism (notably Poland), will go the same way.

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20 World Values Survey, Wave 6 (2010-14).

21 Institut français d'opinion publique.

22 See for example wiiw-Bruegel (2010), EBRD (2013), Podkaminer (2013).

23 https://www.theguardian.com/world/2017/feb/14/plans-for-two-speed-eu-risk-split-with-peripheral-members

24 Foa and Mounk (2017).

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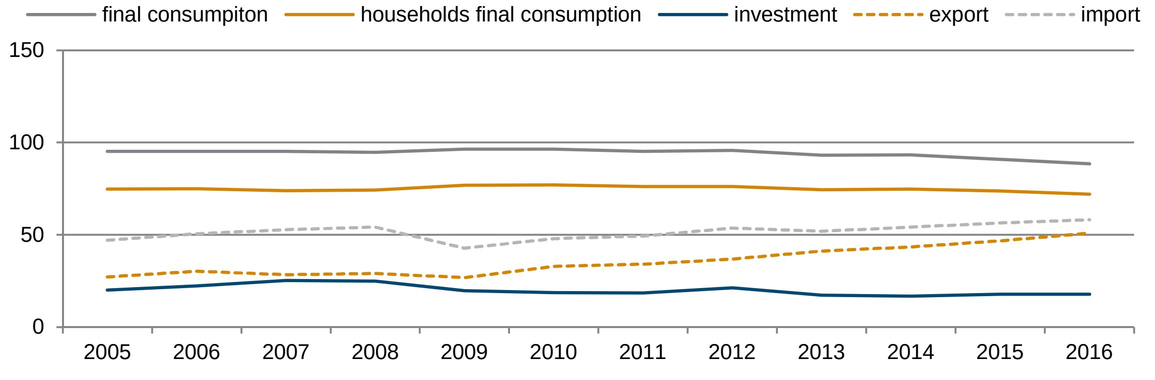
Special section II: Adjustment risk in the face of uncertainty in the Balkans

VLADIMIR GLIGOROV

The region is experiencing an economic transition – more open and investment driven development – which goes very much against historical economic and political inclinations. The risks are that the ongoing macroeconomic adjustment with faster growth and increased employment will not be sustained in part because of European and international uncertainties. External uncertainties have the ability to blow the region up due to the existence of frozen territorial conflicts and constitutional inadequacies in the region.

There is slow adjustment taking place in the Balkans, which is correcting macro imbalances and pushing the potential growth rate up. It comes on the heels of a rather disappointing decade, which is why there are political risks to the sustainability of the process. In addition, there are uncertainties about the external developments in the European Union, Russia, and the USA especially. There are also uncertainties connected with the crisis in the Middle East, which may lead to another refugee crisis. Also, developments in Turkey can influence Balkan politics.

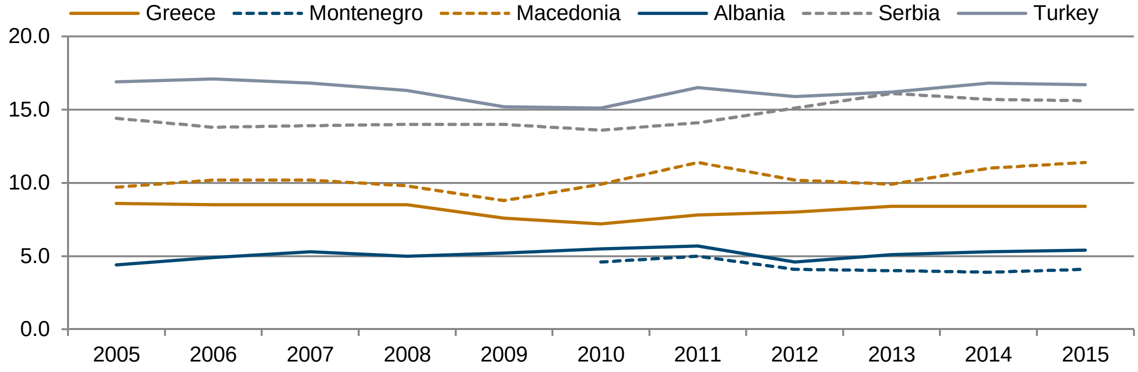
Figure 28 / Serbia, components of the GDP, % of GDP



Sources: Eurostat and national statistics.

The adjustment has three characteristics: openness, external balance, and growth of industry. There is significant increase of openness of Balkan economies. Exports have been growing faster than imports throughout the region since the 2008 crisis. Second change is in investments, which declined in some cases strongly after 2008, now being financed more from domestic savings, which is to say that current account deficit is declining. The process is slow, as can be seen in the case of Serbia in Figure 28. Finally, industrial production is recovering, in a number of cases faster than the GDP. On all the three counts, these are developments that are opposite to those that were observed between e.g. 2000 and 2008 (and in some case in the last several decades).

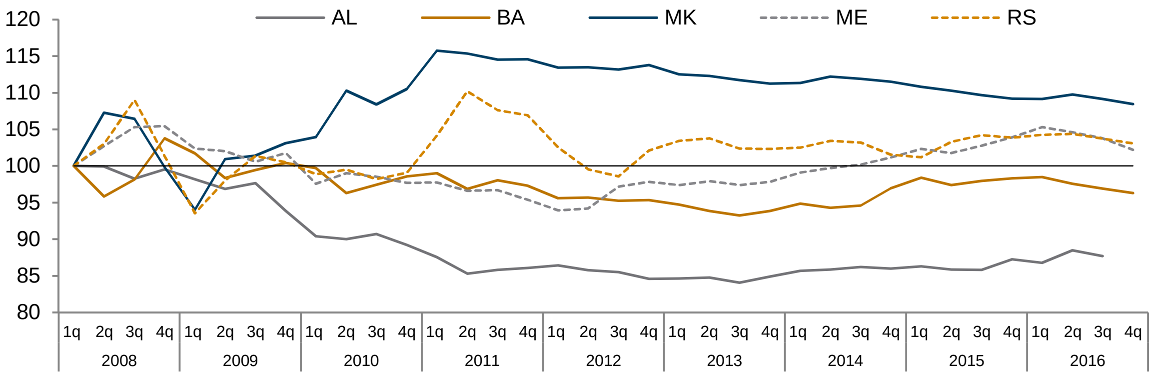
Figure 29 / Manufacturing value added, % of GDP



Source: Eurostat.

The turnaround has been supported by real exchange rate adjustment, by stagnant wages and initially by rising unemployment, as well as mass-migration. By and large, however, real exchange rate has been corrected, wages are starting to increase, and employment is improving. However, there is a long way to go before losses in employment and welfare are erased and improvements start to be felt.

Figure 30 / Real exchange rate, euro per NCU, PPI deflated, quarter over previous quarter

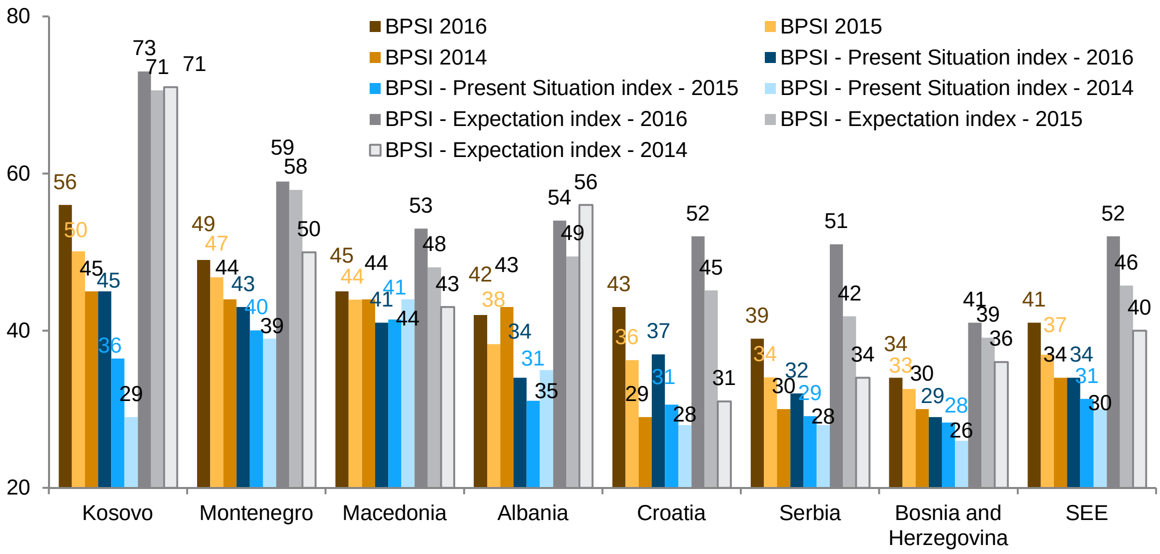


Note: Increasing line indicates real appreciation.
Sources: wiiw database incorporating national and Eurostat statistics.

Real exchange rate depreciation is even more pronounced once unit labour costs are taken account of. Clearly volatility is higher in Albania and Serbia because unlike the rest, theirs are not fixed exchange rate regimes. But, in general, there has been real devaluation throughout the region.

The turnaround is also reflected in the population's sentiments and opinions. This can be seen in the findings of the Balkan Barometer, the regional annual public and business opinion poll, now in its third year. It covers the candidate countries and Croatia (Turkey only in 2017). Overall sentiment index is still below average, and has been improving slowly. Expectation index is improving faster, though it is still hovering around the average in larger countries (with Bosnia and Herzegovina being the most depressed). Business people are more optimistic, especially in the newest 2017 survey. Also, individuals and businesses assess their own prospects better than those of their countries. Indeed, there is a sharp disconnect between society and politics throughout the region along almost all dimensions. This is understandable given the state of the labour markets, where jobs are few and unemployment is a high risk. Close to 50% of the respondents would prefer to live in some other country and outside of the region.

Figure 31 / Sentiment and expectation indices 2014-2016



Source: Balkan barometer 2017.

The risk inherent in this process of adjustment is that it may prove unsustainable because it does not offer significant employment and welfare improvements even in the medium term. On the positive side, populist parties are not in the ascendency, except perhaps in Greece. In part this is due to the fact that access to regional and especially European markets have proved crucial to the post-crisis recovery. So, chances are that recovery will strengthen enough in the medium term, with potential growth rate climbing up to close to 4% at the end of that period, so that the risk of the return to populist and nationalist economic policies may not gain support. Still, the Balkan Barometers suggest that home bias and support for protectionism is still relatively high.

Table 3 / Typology of most important frozen conflicts in the Balkans, resolved but with constitutional consequences, and unresolved

	de jure	*de facto*
secession	Kosovo (2008)	Kosovo 1991-1998
annexation	Croatia (1991),	Republika Srpska
	Bosnia and Herzegovina (1992-1995)	Northern Kosovo

Note: Frozen conflict is an outcome of unsuccessful secession or annexation and may be internationally recognised *de jure* or *de facto*.

More serious risk is that the legitimacy crisis, which has shaken the region in country after country, may indeed lead to authoritarianism or the ascendancy of more aggressive nationalist parties (in political, not necessarily economic terms). The ground is fertile for such developments for two rather fundamental reasons. One is the existence of territorial conflicts, which is to say of a number of frozen conflicts. The other is the demand for constitutional reforms in a number of countries.

This risk can be seen in the distribution of the opinions about regional cooperation, European Union integration, and credibility of the government. When it comes to the latter, governments and policies do not command much credibility and are not seen as transparent and responsive respectively both by the public and the business communities. Regional cooperation is supported, though not enthusiastically. While countries which have territorial or constitutional problems (Serbia, Bosnia and Herzegovina) or have gone through prolonged recession (Croatia) are quite sceptical about integration in the EU, the business community is increasingly positive about EU, which coincides with the growing exports and overall openness to the EU, including the opportunities to work and study there.

So, the key risks to the economic turnaround come from the shaky legitimacy of most governments in the region and persistent political problems, both domestic and cross-border. Those tend to be ameliorated by business interests, which are supportive of stability and growing regional and EU integration.

There is, however, uncertainty about the stability of the two main pillars to the regional set up as it is, the USA and the EU. One is about the commitment of the USA to regional security. The other is about the developments in the EU. Dependent on those are the uncertainties about the Russian policies and about the developments in Turkey. The latter is also connected with the possible renewal of the refugee crisis.

The uncertainty connected with the US policies in the region is also illustrative of the problems that the region has in assessing the external developments. Words coming from the UN and the State Department (and the Senate) suggest that there will be no change in the US commitment to the Balkans and in its policies. That is important for the resolution of the current legitimacy problems in Macedonia, Montenegro, and of course Bosnia and Herzegovina. However, the public, the business people, and the politicians in the region have hard time understanding the direction of the US foreign policy given the repeated statements of criticisms of the EU and the NATO. Initially, there was the opinion that US and Russia will go for a grand bargain, which would have had major consequences for the Balkans. That has had some significant consequences in internal and region politics, but the bets are now off on that possibility.

The importance of this, USA policy, uncertainty cannot be overstated. If US commitment is weakened or changed, territorial and constitutional issues can destabilise the region rather fundamentally. It is unclear how long stability can be maintained with this uncertainty, let alone if there is major change in US foreign policy towards the EU and the Balkans.

The other uncertainty has to do with the stability of the EU. Brexit is not necessarily of major importance in the Balkans, except when it comes to the foreign policy influence of the UK. There has been a major scaling down of that influence after the decision of the UK to leave the EU. Traditionally, in the Balkans (and also in the Middle East), the UK’s political presence and commitment is quite important. However, in economic terms, UK is not of major importance in the region. So, Brexit adds to political uncertainty, but may not prove as destructive as long as NATO remains committed to maintaining regional stability.

Possible break-up of the EU is another matter altogether. Economic development depends on the open EU market and on financial connections with the EU. The region is thoroughly euroised, the financial sector is practically part of the EU one, and there is also significant integration of Balkan and EU labour markets. Finally, regional cooperation, including the regional free trade area, CEFTA, depends on EU encouragement and continued support. Recent CEFTA Barometer makes it clear that the support of regional market integration is closely connected with the integration in the EU markets.

The uncertainty about the stability and durability of the EU is not based on the assessment of possible costs and benefits of an EU break-up or on the expectations from eventual accession to the EU. The later are rather pessimistic in any case, at least within a meaningful time span. The problem is that there is little basis on which to assess the potential effects of EU disintegration. As a consequence, there is political polarisation with mainstream parties and business people keeping the faith in the EU, while nationalist parties increasingly bank on further EU disruptions. This would have been worse had it not been the case that much of the post-2008 recovery had been based on the growing access to the EU markets. And also on the fact that the financial system proved resilient even though the corporate sector accumulated significant levels of non-performing loans and a number of state owned or domestically owned banks collapsed.

Derivative of these major uncertainties are changes in the Russian policy stance in the region as well as the turmoil in Turkey. Russia's presence in the region, in political and security terms, is rather weak and goes mainly via its role in the Security Council of the UN and through its support for nationalistic parties mainly among the Serbian population. Its economic influence has declined with the growing competition in the energy market and after the South Stream pipeline fall through. Recent attempts to exploit the legitimacy crisis in Montenegro and possibly in other countries have been unsuccessful and might backfire. There are political forces in the region that hope that Russia's role may increase dramatically with the decline of the US and EU influences, but those tend not to be matched by significant increase in Russia's commitments to the region. Still, there is that uncertainty.

Developments in Turkey are also contributing to the weakening of its influence in the region. That influences developments in Bosnia and Herzegovina and to a minor extent in Serbia, but are probably consequential when it comes to the refugee crisis primarily. The worry with it has declined in the region, where in any case the refugees are not expected to stay and settle. Still, there is the uncertainty of the possible additional turns in Turkish politics which may prove challenging for the Bosniaks in the Balkans.

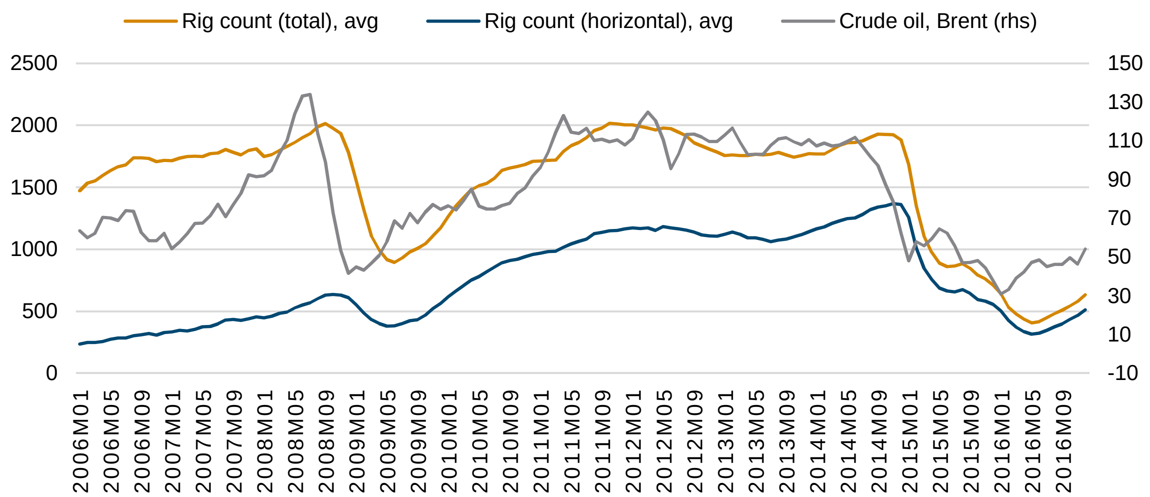
Overall, risks are that the ongoing adjustment will not be sustained in part because of European and international uncertainties. The region is experiencing a transition which goes very much against historical economic and political inclinations. So far, democracy is holding up despite spread of deep legitimacy crises, while businesses are increasingly getting used to open cross-border markets. But the distance between the society and politics is quite stark, where governance is seen as the major impediment to individual and economic development. External uncertainties have the ability to blow the region up due to the existence of frozen territorial conflicts and constitutional inadequacies. The region is not self-governing and change in commitments by the USA and EU are major threats to the in any case shaky regional order.

Special section III:
A marked mood of uncertainty and risks in the CIS region

AMAT ADAROV, VASILY ASTROV AND PETER HAVLIK[25]

Whereas the macroeconomic outlook for the CIS region and Ukraine (CIS+UA) has improved marginally, significant downside risks still cloud the region's future prospects. Risks stem from multiple external and internal factors, yet the most significant pressures are associated with: the uncertainty over future commodity price developments (most importantly oil prices); heightened geopolitical tensions associated with the conflict in Ukraine and the related strained relations between Russia and the West; rising populism in Europe and Brexit; the election of Donald Trump in the United States and the ambiguity regarding the US administration's future foreign policy stance, in general, and with respect to the CIS+UA, in particular.

Figure 32 / Brent Oil Price (USD per barrel) and North America Rotary Average Monthly Rig Count (number of rigs), 2006-2016



Source: World Bank; Baker Hughes.

Persistent uncertainty regarding the future dynamics of oil prices has been among the key concerns in the CIS+UA countries. Increased volatility of oil prices and uncertainty regarding their future developments are among the key fears that countries in the CIS+UA region harbour in terms of their medium- and long-term economic growth prospects. The countries find themselves exposed to global commodity price movements, be it either directly on account of commodities comprising a major

25 The authors would like to thank Mario Holzner, Richard Grieveson and Vladimir Gligorov for valuable comments.

part of their exports (the economies of Russia, Kazakhstan and Belarus are characterised by particularly high exposure to oil prices) and/or indirectly via the strong economic linkages to Russia that have intensified over recent years on account of Eurasian economic integration.

The uncertainty regarding the oil price dynamics is associated primarily with supply-side factors[26]. The price of the benchmark Brent crude oil has increased from below USD 35 per barrel at the beginning of 2016 to above USD 50 per barrel towards the end of the year (Figure 32). The process was accompanied by marked volatility and uncertainty stemming from unclear market expectations regarding the OPEC deal to cut oil production and its de facto implementation, higher-than-expected resilience of shale oil producers to lower oil prices, as well as the proposals advanced by Donald Trump regarding state support for the American energy industry. Towards the end of the year, Brent crude oil price rose on the news of the OPEC deal in November 2016 (agreement between its members and eleven non-OPEC oil producing countries, including Russia and Kazakhstan, to cap production at 32.5 million barrels per day, thereby reducing output by some 1.2 million barrels per day, effective January 2017). The idea behind the deal was to induce upward pressures on global oil prices via coordinated reduction of aggregate oil production, given that the tumble in oil prices in recent years was mainly related to the oversupply of oil due to the expansion of shale extraction technology. While many commentators were originally sceptical about the odds of striking and maintaining a successful deal, compliance was achieved by and large and has since been maintained. The deal, however, is short-lived and whether it will extend beyond its current 6-month horizon is not clear.

Another important related factor, the resilience of shale-oil producers, has most probably been underestimated yet again. As oil prices rose above the 50 USD per barrel mark, the point at which certain shale-oil rigs reach their level of cost-effectiveness, the American oil rig count started to increase significantly, particularly on account of the rigs utilising horizontal drilling techniques associated with shale formations in the US (Figure 32). Apparently, oil price increases help to boost the supply of unconventional oil, thus offsetting the impact of the OPEC deal. As shale extraction technology further improves, the break-even price for the US oil producers will in all likelihood drop still lower. Moreover, Trump has been rather explicit in that he wants the US to become an even more important ‘power player’ on the global energy market. He may well back initiatives to stimulate the US oil industry, including his declared proposal to roll back Obama’s environmental restrictions on energy production activities. As a result, the persistently high supply of global oil and the resultant failure of oil prices to go up despite OPEC efforts jeopardize the growth prospects of the CIS region.

Geopolitical factors, most importantly the election of Donald Trump as US president, have added to the uncertainties afflicting the CIS+UA. One can only speculate about the consequences of some of Trump’s pre-election pronouncements, which to date he seems intent on implementing. Starting from this premise, one could conjecture about the ‘deal’ he would attempt to close with Putin. For instance, the US could withdraw a large volume of the support it lends Ukraine and lift (or at least relax) the sanctions against Russia, while leaving Russia with Crimea and (de facto) Donbas. What could Russia offer in exchange?

[26] The demand for oil is expected to pick up gradually as global growth prospects improve. Uncertainty is associated with supply-side developments and adjustment of the global oil industry to the ‘new normal’ reshaped by the expansion of shale oil technology (for discussion see Adarov, 2016).

› Mr Trump has suggested that Russia could return to the negotiating table on nuclear disarmament, which it left last year. Many security analysts view the chances of such a deal as slim, given the disproportionate nature of the underlying issues, and the Russians have in fact been downplaying them as well.

› In addition, Russia could offer closer cooperation with the US in the battle against Islamic terrorism in Syria and elsewhere. Even though most experts deem this scenario the most likely and there is little doubt that American and Russian interests overlap considerably on this issue , it is hard to see what Russia would actually concede as it has already been actively fighting terrorism for quite some time.

› Given that under President Trump, China is also assuming the status of the United States' main adversary, some commentators (e.g. Inozemtsev, 2017) have suggested that the US may be interested in Russia weakening its ties with China as a concession to the US. It is, however, questionable whether such a move, even if implemented, would really harm or even affect China and thus serve potential US interests.

› Finally, Russia may withdraw its support for Iran: another declared 'enemy' of the United States. Unlike the case of China, this could potentially prove very costly for Iran. However, Russia has already expressed its support for Iran remaining part of the 'anti-terrorist coalition' and, more generally, may be wary of cutting its ties with allies outside the Western world (see e.g. Lieven, 2017).

All in all, while it may not be easy to see what form a potential Russia-US deal could take, the rhetoric from both sides to date has been generally reassuring. Furthermore, commercial interests – such as the potential increased involvement of US companies in Russia, should sanctions be lifted – may play a role as well. In any case, less US external engagement (as proclaimed by Trump) is likely in general terms and that includes Europe. At the same time, the messages transmitted by Mr Trump, who has also gone on record saying that he expects Russia to 'de-escalate violence' in Ukraine and hand back Crimea,[27] have at times been contradictory, thus adding uncertainty to any forthcoming US deal with Russia.

The European Union, already shaken, weakened and divided by a series of crises, is now confronted with a new unprecedented transatlantic rift sparked by the new US presidency. While the elites on both sides of the Atlantic are still reeling from shock following the election of Donald Trump as the 45th US president and the execution of his pre-election pledges, the elated populists and nationalists are applauding with glee. In the lead-up to the Malta Summit, the President of the EU Council, Donald Tusk, penned an open letter to 27 EU heads of state warning them of the dangers emanating from Trump's abrupt change in US policies. The leading figures in the European Parliament (together with Mr Tusk) have since demanded that Ted Malloch, the putative US envoy to the EU who compared the EU to the Soviet Union and favoured EU-disintegration, should be rejected. What impact will this evolving transatlantic split over security (NATO), trade, the new approach to relations with Russia and migration policies have on the future of Europe – and on the CIS+UA region, in particular?

The EU will be unlikely to assume former US strategic and defence commitments. It is obviously premature to infer whether the evolving transatlantic split will help unite the EU or, on the contrary, deepen the current internal differences. Will the EU be ready to pay the Americans' NATO bill and take

[27] See e.g. Reuters, 14 February 2017, http://www.reuters.com/article/us-usa-trump-russia-ukraine-idUSKBN15T2IY

on their commitments, including those in the CIS, Ukraine and beyond? Not necessarily, especially after Brexit and growing disunity within the rest of the EU. The recent open welcome extended to Mr Trump by some EU countries (e.g. by Hungary and the Czech Republic) or the acceptance of at least some of the policies he has announced (e.g. by Austria, Italy and Poland) that contravene the official Brussels line could well be interpreted as signs of growing intra-EU divisiveness. In fact, the divisions may become even more profound in the wake of elections in the Netherlands, France and Germany later this year. Furthermore, at this stage neither the will nor the resources for a more pro-active common EU security and foreign policy are to be discerned.

A potential end to the sanctions would have a mildly positive impact on the Russian economy. Given the increasing number of voices in the EU now arguing in favour of lifting the sanctions against Russia, were the US sanctions to be lifted (or relaxed) later this year and the EU follows suit, the impact on Russia would undoubtedly be positive. It could possibly result in more FDI in Russia and a modest growth stimulus (that notwithstanding, the major problem confronting the Russian economy is related to the collapse in oil prices hence the very fact that oil prices are nudging their way upwards close to USD 60/bbl also helps). At the same time, if the Russians were to respond by lifting their embargo on Western foodstuffs, imports to Russia would almost certainly go up. Those developments could be boosted by an increase in imports of oil-drilling technologies, once Western sanctions are lifted. Needless to say, any acceleration of growth in Russia will also benefit the economies of other CIS countries, especially Belarus which ships around half of its exports to Russia.

At the same time, a potential Trump-Putin deal and the disunity of the EU may result in less support being lent to Ukraine. On the one hand, less diplomatic and military support from the West would leave Ukraine in a weaker position in its battle against the insurgency in the Eastern Donbas region. On the other hand, the changed geopolitical landscape may also bear repercussions in terms of the financial support the country receives. For instance, the IMF may be less willing to continue its loan programme to Ukraine, if conditionality is not met. For more than two years, the programme has fallen behind the original schedule amidst the Ukrainian authorities' failure to introduce the requisite reforms, yet has been kept alive, ostensibly for political reasons. In the EU, 'Ukraine fatigue' is on the increase, as are calls for less support being provided to the country's authorities (see e.g. Kostanyan, 2017). Were Western support to Ukraine, which is still crucial to maintaining macroeconomic stability, to be reduced, it would most likely result in renewed exchange rate depreciation and a spike in inflation, with repercussions in terms of social stability.[28]

Lessening support to Ukraine may also bring about political destabilization. It could put Ukraine's fragile ruling coalition under even more pressure, potentially paving the way for a new government. Should nationalist forces take over, renewed escalation of large-scale combat in Donbas cannot be ruled out; it would almost certainly stall economic recovery in the country as a whole. For that matter, the recent escalation in Avdiivka can be arguably interpreted not least as Ukraine's attempt to draw attention to the need for sanctions against Russia (although there is evidence of the Ukrainian forces having already been on a 'creeping offensive' back in December 2016, and the recent outburst of fighting was merely the separatists' response to the incursion). At the same time, certain nationalist voices in the Ukrainian parliament suggest Kyiv might also decide to abandon Donbas: that, however, is unlikely. Alternatively, the moderately 'pro-Russian' opposition, which is a dominant force in the Russian-

[28] Social stability in Ukraine has been already strongly undermined by harsh austerity measures, notably the implemented energy price hikes – see e.g. Astrov and Podkaminer (2017).

speaking southern and eastern parts of the country, may well take over, riding on a wave of economic difficulties and dismay over the practical results of the pro-Western policy that the country has been pursuing. The possibility of such a scenario can be detected in the recent developments in neighbouring Moldova: a similarly divided country, where a 'pro-Russian' candidate recently won the presidential election.

The deepening EU disunity along with a slow progress in reforms aggravated by macroeconomic issues and geopolitical strains may jeopardize the implementation of the Association Agreements with the EU in the signatory countries – Georgia, Moldova and Ukraine. The three countries pursuing closer integration with the EU by means of the Association Agreements and embedded Deep and Comprehensive Free Trade Area (DCFTA), have encountered multiple difficulties stemming from still inadequate de facto access of domestic producers to the EU market, heavy burden of reform implementation with high risks for the vulnerable segments of the population, such as subsistence farmers, that was exacerbated by rather unfortunate timing of the implementation – the inception period coincided with heightened macroeconomic challenges in the signatory countries and the EU, difficult geopolitical situation, etc.[29] Corruption scandals, lack of visible progress in institutional reforms (except for Georgia), rising euroscepticism and nationalism in Europe have given rise to more populist and/or 'pro-Russian' sentiment in local communities, potentially threatening further progress of reforms or even reversing them.

The Russian-dominated Eurasian Economic Union (EAEU) has also been facing significant challenges recently on account of the recession in Russia and geopolitical tensions with the West (not supported by the other EAEU members). The very future of the EAEU, currently comprising Armenia, Belarus, Kazakhstan, Kyrgyzstan and Russia, is also uncertain. Besides the projected weak economic growth in Russia, the anchor economy of the union (accounting for over 80% of the bloc's aggregate GDP), there are recurrent internal tensions, which escalated recently again between Belarus and Russia (including accusations of goods under embargo being re-exported to Russia, disputes over energy pricing within the bloc and the introduction of border controls for the first time since 1995). All in all, these uncertainties are definitely on the increase; more surprises may well be expected in the months ahead.

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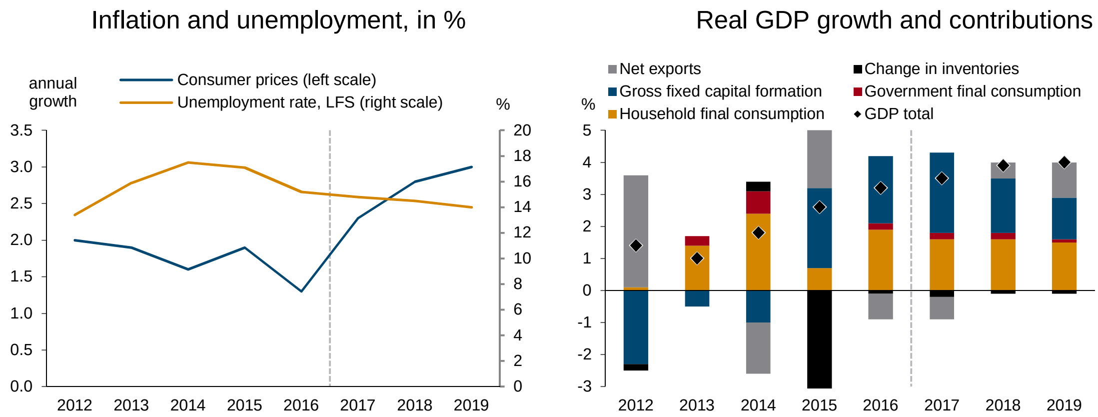
Country reports

ALBANIA: Trans Adriatic Pipeline investment will underpin stronger growth momentum

ISILDA MARA

The economy will continue to grow at above 3.6% in the medium term. Investment-driven economic growth will be supported by international capital inflows. A recovery in external demand is expected, in reaction to higher international oil prices and positive signs for the tourism industry. However, the parliamentary elections due in mid-June 2017 have been preceded by political tension, which has jeopardised their fairness, as well as the progress made in the judicial reform initiated last year.

Figure 33 / Albania: Main macroeconomic indicators



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

In February 2017, the EU Parliament officially approved the start of EU accession talks with Albania, on condition that the implementation of judicial reform is brought forward and that the parliamentary elections due in mid-June 2017 are free and fair. Ahead of the elections, the opposition Democratic Party is staging a protest (ongoing at the time of writing), calling for the government to step down. The party claims that a caretaker government is a prerequisite for free and democratic elections. The opposition is boycotting parliament and is threatening to do the same with the elections if its demands go unheeded. The protests are being led by Lulzim Basha, the new leader of the Democratic Party, although former leader Sali Berisha continues to exercise a strong influence. The current government has affirmed that it will not yield to the demands. The Socialist Movement for Integration, led by Ilir Meta – currently the speaker of parliament – has confirmed its alliance with the

Socialist Party, at least until the upcoming parliamentary elections. Such dynamics and the recent political tension risk impeding the vetting process[30] – the next step in judicial reform, scheduled for February. While the EU accession talks may be a blessing in terms of implementation of judicial reform, the opposition boycott of parliament may prove a curse.

Driven by investment, real GDP growth accelerated to above 3% in 2016. Gross fixed capital formation rose by 8.1% year on year in real terms during the first three quarters of 2016, boosted by international capital inflows. Over the same period, household and government consumption increased by 2.3%. Consumption is expected to continue growing in 2017, owing to better labour market conditions and wage rises. Remittances have recovered only slightly, but continue to smooth consumption. The main sectors of the economy that supported growth in 2016 – and that are expected to continue to do so in the medium term – are services, construction and financial activities. As far as investments are concerned, with 2017 an election year, potential investors – both domestic and foreign – are likely to adopt a wait-and-see attitude until the new government is formed.

Fiscal consolidation was achieved during 2016, but uncertainties loom in 2017. Meanwhile, public debt remains relatively high. In 2016, the general government budget deficit was cut by 2 percentage points (pp) to 2.1% of GDP, and public debt fell by 1.1 pp to 71.6% of GDP. Until November 2016, the general government budget was in surplus, thanks to a 7% year-on-year increase in revenue and a 2% decline in expenditure. Whether the fiscal consolidation achieved during 2016 continues is uncertain for a number of reasons. First, the government has announced an increase in the monthly minimum wage (from Albanian lek 22,000 to 23,000), a public wage rise (between 7% and 36%) and a retirement pension increase of 3% by March 2017. Second, with the parliamentary elections looming, an increase in public investment and capital expenditure is expected. Nevertheless, given the high level of public debt, the government does not have much room for manoeuvre. Third, the agreement with the IMF that began in September 2013 has ended, with no extension envisaged. Thus, a general government budget less committed to fiscal consolidation is likely to be on the cards. Overall, the fiscal stance will depend on the ability of the government to increase the performance of tax revenues at a time of favourable economic conditions and potential political change.

The high level of non-performing loans (around 18% at the end of 2016) continues to impede the demand for credit. Big companies are usually the motors of demand for credit, but in Albania they are responsible for the sluggish overall credit growth (0.6% up until November 2016, year on year). In all, 36 large enterprises are responsible for around two-thirds of non-performing loans. Accordingly, commercial banks have tightened their credit standards for loans to such companies. By contrast, the banks have eased their credit conditions for households and for small and medium-sized enterprises. In particular, the banking sector seems willing to support businesses in the service sector, construction and manufacturing (all expanding sectors). At the same time, consumer and business confidence for the first quarter of 2017 has improved with respect to the last quarter of 2016 and currently stands at above the long-term average. The demand for loans from consumers and small businesses is also increasing. In 2017, credit growth is expected to recover, fuelled mainly by higher demand, as well as by favourable credit conditions for both households and small companies.

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30 The vetting law aims to rid the justice system of corrupt judges and prosecutors, bent politicians and organised crime. The law allows for the screening and subsequent appointment of judges and prosecutors based on their professional qualifications, moral integrity and detachment from organised crime, ‘dodgy dealings’ and corrupt politicians.

The central bank will continue with an easy monetary policy during the first half of 2017, but an upward revision of key interest rates is expected in late 2017, as a result of an increase in domestic and imported inflation. In December 2016, the central bank kept the key interest rate unchanged, at 1.25%. Last year ended with an inflation rate of 1.3%, far below the central bank's target of 3%. January 2017 saw an inflation rate of 2.8% year on year – almost double the rate of 1.5% recorded in January 2016. Domestic inflationary pressure is expected to rise, due to higher capital expenditure and liquidity in the domestic market. The higher international oil prices and rising import prices (e.g. from the EU, the main trading partner of Albania) expected in 2017 are additional sources of inflationary pressure. Therefore, domestic and imported inflation might prompt the central bank to revise the key interest rate upwards in late 2017, and to tighten policy further in the medium term.

The recovery in international oil prices is expected to provide fresh impetus to the export of goods. During 2016, performance of the external sector was quite poor as regards the export of goods, but quite promising as regards the export of services. Almost two-thirds of goods exported during 2016 fell into the category of either the garment or the extraction industry (respectively 43% and 19%). Such an undiversified structure of exports makes them heavily exposed to several external risks. In particular, the extraction industry's exports witnessed a sharp downturn in 2016 (by 10% and 28% in real and nominal terms, respectively, year on year) because of the low international oil prices over the past two years. With the rise in international oil prices, the industry's expectations for the coming years are optimistic. By contrast, labour-intensive products (such as those manufactured by the garment industry) saw significant progress in the course of 2016. The low level of unit labour costs in Albania renders the country still attractive. The performance of services exports has also been positive. Tourism has benefited from the heightened security risks in many competitor markets, notably Turkey. Despite its good performance, the sector has faced the challenge of meeting excess demand. The positive expectations for the coming period will require a long-term tourism strategy to make the sector sustainable over time. On the import side, the increase in both goods and services hints at an increase in consumption, but also an increase in investment.

Exchange rates have been less stable, especially in the last quarter of 2016 and at the beginning of 2017. The dollar has appreciated against the Albanian lek, while the euro has depreciated quite strongly. Usually, the seasonality of the euro depreciation is closely connected to remittances and the return of migrants. The high inflow of capital from big international projects such as the Trans Adriatic Pipeline (TAP) might have been another factor. Last year, the large amount of cannabis produced and traded (and also sequestered) may have generated an excess of euros on the domestic market. Appreciation of the domestic currency makes exports more expensive, but it is expected that further stabilisation of the euro and international oil prices will prevent any dampening effect on exports.

The year 2017 is expected to be a favourable one, as TAP enters its second year of implementation; intensive construction works are planned in this phase. According to estimates by Oxford Economics, the direct and indirect effects of TAP on Albanian GDP will amount to over EUR 500 million in 2016-2017. The neighbouring countries of Italy and Greece – Albania's main trading and foreign direct investment (FDI) partners – will also benefit from the EUR 6.9 billion TAP project. For a small economy such as Albania's, the footprint of a huge international FDI project is large. Late 2016 already saw FDI rising sharply compared to the first half of 2016. The indirect impact is also expected to be great, since many local enterprises will get involved. So far, 1,800 new jobs have been created, and that figure will more than double in 2017. The Albanian government recently renegotiated the terms of the contract, seeking an increase in the positive externalities from the construction of the TAP in Albania. While the positive aspects of the project (such as infrastructure) are regularly emphasised, the negative impact – especially on the environment – is less often addressed.

In a nutshell, we forecast that the economy will grow steadily in the next three years, by 3.6%, 3.9% and 4% in 2017, 2018 and 2019, respectively. Several factors are conducive to rising economic growth. Growth will continue to be driven largely by investments. International capital inflows will play an important role. Growth will further be fuelled by rising external demand – in terms of both the export of goods (extraction industry exports thanks to higher international oil prices) and the export of services (tourism). The favourable economic conditions are expected to boost employment, consumption, savings and demand for credit. It is likely that the higher political risk (on account of the parliamentary elections due in mid-June 2017) will constrain private investment but boost public investment in the early part of the forecast period.

Table 4 / Albania: Selected economic indicators

	2012	2013	2014	2015	2016 [1]	2017	2018 Forecast	2019
Population, th pers., average	2,900	2,897	2,894	2,889	2,886	2,887	2,887	2,886
Gross domestic product, ALL bn, nom.	1,333	1,350	1,394	1,435	1,500	1,600	1,700	1,800
annual change in % (real)	1.4	1.0	1.8	2.6	3.2	3.5	3.9	4.0
GDP/capita (EUR at PPP)	8,000	7,800	8,300	8,600	8,900	.	.	.
Consumption of households, ALL bn, nom.	1,032	1,074	1,130	1,161	1,200	.	.	.
annual change in % (real)	0.1	1.8	3.0	0.9	2.3	2.0	2.0	1.8
Gross fixed capital form., ALL bn, nom.	353	352	343	378	400	.	.	.
annual change in % (real)	-7.9	-2.0	-4.0	10.3	8.0	9.5	6.5	5.0
Gross industrial production								
annual change in % (real)	15.7	28.3	1.6	-5.0	-7.0	1.0	2.0	4.0
Gross agricultural production [2]								
annual change in % (real)	5.7	-3.4	2.0	2.9	0.5	.	.	.
Construction output total								
annual change in % (real)	-11.4	-13.0	5.0	19.3	10.0	.	.	.
Employed persons, LFS, th	1,140	1,024	1,037	1,087	1,160	1,180	1,190	1,195
annual change in %	-1.8	-10.2	1.3	4.8	6.8	1.7	0.8	0.4
Unemployed persons, LFS, th	176	194	220	224	210	200	200	190
Unemployment rate, LFS, in %	13.4	15.9	17.5	17.1	15.2	14.8	14.5	14.0
Reg. unemployment rate, in %, end of period	12.8	13.5	13.0	12.9	12.0	.	.	.
Average monthly gross wages, ALL [3]	37,534	36,332	45,539	46,829	48,800	51,700	54,800	58,400
annual change in % (real, gross)	0.9	-5.0	-0.7	0.9	2.8	3.5	3.2	3.5
Consumer prices, % p.a.	2.0	1.9	1.6	1.9	1.3	2.3	2.8	3.0
Producer prices in industry, % p.a.	1.1	-0.4	-0.5	-2.1	-2.4	-1.0	1.0	0.0
General governm.budget, nat.def., % of GDP								
Revenues	24.8	24.2	26.3	26.4	27.4	28.0	28.5	29.0
Expenditures	28.2	29.2	31.5	30.5	29.5	30.0	31.0	31.0
Deficit (-) / surplus (+)	-3.4	-5.0	-5.2	-4.1	-2.1	-2.0	-2.5	-2.0
Public debt, nat.def., % of GDP	62.1	65.6	70.1	72.7	71.6	69.0	67.0	65.0
Stock of loans of non-fin.private sector, % p.a	2.3	-1.2	2.4	-2.6	-2.5	.	.	.
Non-performing loans (NPL), in %, Dec	22.8	23.2	22.8	18.2	18.2	.	.	.
Central bank policy rate, % p.a., end of period [4]	4.00	3.00	2.25	1.75	1.25	1.5	2.0	2.5
Current account, EUR mn	-978	-1,049	-1,287	-1,105	-1,254	-1,400	-1,400	-1,400
Current account, % of GDP	-10.2	-10.9	-12.9	-10.8	-11.5	-11.9	-11.3	-10.7
Exports of goods, BOP, EUR mn	876	1,051	932	771	609	620	640	670
annual change in %	26.3	19.9	-11.3	-17.2	-21.0	2.0	2.5	4.0
Imports of goods, BOP, EUR mn	3,102	3,030	3,147	3,070	3,438	3,700	3,800	3,900
annual change in %	-3.2	-2.3	3.9	-2.5	12.0	7.0	3.0	3.5
Exports of services, BOP, EUR mn	1,900	1,715	1,881	2,028	2,434	2,500	2,600	2,700
annual change in %	-5.8	-9.7	9.7	7.8	20.0	3.6	4.2	4.5
Imports of services, BOP, EUR mn	1,460	1,489	1,558	1,503	1,639	1,700	1,800	1,900
annual change in %	-9.5	2.0	4.6	-3.5	9.0	6.0	3.0	3.5
FDI liabilities, EUR mn	713	945	869	890	860	.	.	.
FDI assets, EUR mn	65	22	58	72	60	.	.	.
Gross reserves of NB excl. gold, EUR mn	1,909	1,971	2,142	2,831	2,889	.	.	.
Gross external debt, EUR mn	5,513	6,368	6,927	7,686	7,860	8,300	8,600	8,900
Gross external debt, % of GDP	57.5	66.2	69.5	74.9	72.0	71	70	68
Average exchange rate ALL/EUR	139.04	140.26	139.97	139.74	137.36	137	138	138

1) Preliminary and wiiw estimates. - 2) Based on UN-FAO data, from 2014 wiiw estimate. - 3) From 2014 based on data of General Directorate of Taxation, business staistics used before. - 4) One-week repo rate.

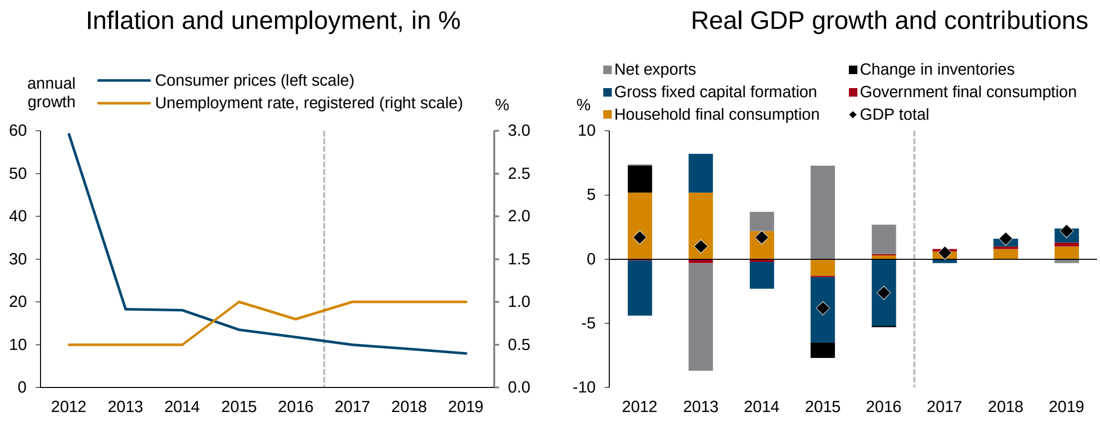
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

BELARUS: Turning the corner?

RUMEN DOBRINSKY

The Belarus economy is undergoing a painful adjustment and a prolonged recession. In 2016, GDP plunged by 2.6%, after falling by 3.8% the previous year. A dispute with Russia over the pricing of gas provoked Russia to reduce its oil supplies, which hit the Belarusian processing industry and exports. At the same time, a change in policy helped lower inflation. The final months of the year brought some positive signs that growth may resume in the coming years.

Figure 34 / Belarus: Main macroeconomic indicators



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

In the last couple of years, the economy of Belarus has undergone a painful adjustment, triggered by accumulated macroeconomic imbalances and balance-of-payments constraints. This has been coupled with a negative external shock due to the recession in Russia, Belarus's main trading partner, and shrinking Russian demand for imports. The collapse in world oil prices added to Belarus's problems, as it exports large quantities of refined oil. In 2016, the situation was aggravated further by a trade dispute with Russia over the pricing of Russian gas deliveries.

These negative factors produced a deep and prolonged recession, something that Belarus had not seen in the last 20 years. GDP dropped by an estimated 2.6% in 2016, after falling by 3.8% in 2015. Total domestic demand weakened further in 2016. Fixed investment was worst affected by the recession and the uncertain prospects for recovery. Real gross fixed capital formation has been declining for three consecutive years since 2014, and the dips were in the double-digits in both 2015 and 2016. Private consumption remained at near stagnation in 2016 as a whole: a drop in the first half was followed by a modest upturn in the second, thanks to some recovery in real incomes in the final months of the year.

In 2016, both the processing industry and exports were negatively affected by the implications of a trade dispute with Russia over the pricing of Russian gas delivered to Belarus. Despite numerous negotiations in the course of the year, the two sides have failed to reach any agreement on the price of Russian gas, with Belarus continuing to pay according to its interpretation. In the meantime, the Russian side has started counting the unpaid price difference as Belarusian debt, which has kept accumulating. According to Russian estimates, by January 2017 this debt stood at around USD 550 million.

Last year, Russia started applying a retaliatory measure – cutting oil supplies to Belarus by an amount corresponding to the value of the estimated debt obligations. As a result, Russia's oil deliveries to Belarus dropped in 2016 by 20.3%, compared to the previous year (from 22.77 million tonnes to 18.15 million). Belarus has only very small domestic oil reserves, and its economy is extremely dependent on deliveries from Russia, which is its only external supplier. Therefore, the cut in Russian oil supply had the effect of another negative external shock.

Belarusian exports of goods in current prices dropped significantly in 2016 for the second year running, also reflecting negative shifts in the terms of trade. The downturn was most visible in the sectors affected by the reduced supply of Russian oil (such as oil refinery and chemical products). But exports of potassium fertilisers (one of Belarus's most important export commodities) also fell significantly in value terms (by some 23%), due to a plunge in world market prices for this commodity.

Importantly, **the last couple of years have also been a period of major macroeconomic policy change by the Belarusian authorities**. In 2015, the Belarusian central bank abandoned the previous policy regime of exchange rate targeting and turned to monetary targeting, while the exchange rate vis-à-vis a currency basket is only used as a reference point. Concomitant with this changeover, the overall macroeconomic policy stance (both monetary and fiscal) was tightened considerably. In 2015-2016 there was also a gradual reduction in government interventions in support of ailing state-owned enterprises (in particular, in the level of directed credit).

These policy changes contributed to a further reduction in inflation and a stabilisation of the nominal exchange rate. Quite remarkably, the exchange rate of the Belarusian rouble vis-à-vis the US dollar in December 2016 was virtually unchanged from January 2016. However, the relative stability of the nominal exchange rate mostly reflects the low level of currency purchases due to the depressed domestic demand. For all practical purposes, the currency redenomination implemented in July (crossing four zeros off the Belarusian rouble) had no effect on the price dynamics in the country.

At the same time, these policy shifts had a negative effect on the financial state of the enterprise sector. In particular, non-performing loans increased considerably in 2016: from 6.8% in December 2015 to 12.8% in December 2016, according to the official statistics. However, according to some experts, the official statistics may underestimate the true level of sub-standard loans on the banks' balance sheets. Overall, a further aggravation of this situation may become a threat to the stability of the financial system. The government also launched an Agency for Asset Management, with the aim of helping to clean up the balance sheets of commercial banks. In 2016, this agency took over non-performing loans amounting to BYN 600 million (about USD 300 million) from the books of 270 corporate entities (first and foremost agricultural firms).

Registered unemployment reportedly fell in 2016, but Belarusian unemployment statistics are highly unreliable in the absence of labour force surveys. At the same time, registered employment continued to decline, a process that has been under way since 2010 and that reflects both the longer-term effects of population ageing and the slack in state-owned companies. According to anecdotal evidence, labour shedding intensified considerably in both 2015 and 2016.

The subdued domestic demand helped to reduce further the current account deficit. Partly, this was also a forced adjustment due to the borrowing constraints that Belarus is facing. In recent years, the country's external debt has increased considerably, and its servicing has been a growing burden on the economy.

Belarus is facing growing difficulties in accessing foreign finance. Borrowing from Russia and Russia-backed financial institutions (such as the Eurasian Development Bank) has also been problematic. In March 2016, Belarus reached an agreement with the Eurasian Fund for Stabilisation and Development (an instrument of the Eurasian Development Bank) on a USD 2 billion loan due to be disbursed over the period 2016-2018. However, in 2016 there were only two disbursements totalling USD 800 million; a third tranche (worth USD 300 million) that was due in 2016 was suspended, due to a reported failure by Belarus to meet some aspects of the loan's conditionality. However, there has been speculation that the true reason for the suspension of funding was the unsettled dispute between Belarus and Russia in the energy sphere.

Faced with a financial squeeze, Belarus approached the IMF in an attempt to negotiate a new funding programme. However, so far the two sides have not been able to come to mutually agreeable terms. Reportedly, the restructuring of the state-owned part of the economy remains the biggest stumbling block in the negotiations. Belarus has also been seeking to re-establish closer economic cooperation with the EU as a way of partly offsetting the shrinking of the Russian market.

While the overall economic picture remained gloomy throughout most of 2016, the final months brought some positive signs. World oil prices started to rise, and this should have both direct (the exports of oil products) and indirect (through Russian imports) positive effects for the Belarus economy. The manufacturing industry was on the road to recovery in the second half of the year, and gross industrial output bottomed out in the fourth quarter, mirroring an upturn in export volumes. Preliminary estimates suggest that the decline in GDP and the value of exports also slowed in the final months of the year.

Apparently, some additional growth impetus has come from a nascent recovery in private consumption. This, in turn, was supported by an upturn in the second half of the year in real wages and personal incomes, thanks to disinflation and the stability of the nominal exchange rate. The recovery in real wages also reflects a lasting (often populist) policy commitment to the preservation of welfare as one of the pillars supporting the Belarusian economic model.

The Belarusian authorities have declared their commitment to preserving the policy course of 2015-2016. The overall macroeconomic stance should thus remain tight and financial interventions are expected to be reduced. Thus, the government announced its intention to reduce the level of newly extended directed credit (implicit subsidies) in 2017 to BYN 1.9 billion from BYN 2.8 billion in 2016. In relative terms, these levels are already far below the highs of previous years, and so their effect on macroeconomic performance is also declining.

If the trends of the most recent months are extended, and if the policy course is maintained, the Belarusian economy may be turning the corner. In a benign scenario, economic growth may resume, albeit modestly, as early as 2017 and continue in the following years. This upward revision of the previous wiiw forecast (which envisaged a continuation of the recession in 2017) reflects the signs of a possible economic revival seen in recent months, driven by an upturn in manufacturing. Further macroeconomic stabilisation and disinflation should support an upturn in private consumption, which, in turn, would provide an impetus to GDP growth. Progress in policy reform may also facilitate negotiations with the IMF and could enable a recovery in private fixed investment.

Much will depend, however, on the settlement of the gas dispute with Russia and on the severity of the balance-of-payments constraints. For the time being, in the absence of an agreement, Russia has announced further cuts in oil supplies to Belarus in 2017. As the servicing of the external debt is a serious burden on the Belarus economy, additional downside risks are associated with a possible failure to secure sufficient new external financing. In an unfavourable scenario, an aggravation of the trade dispute and/or of the restrictions on foreign borrowing could result in new negative shocks to the Belarusian economy. In this case, the continuation of the recession in Belarus cannot be excluded.

Table 5 / Belarus: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018 Forecast	2019
Population, th pers., average	9,465	9,466	9,475	9,490	9,500	9,520	9,540	9,560
Gross domestic product, BYN mn, nom. 2)	54,762	67,069	80,579	89,910	94,321	104,300	115,500	127,500
annual change in % (real)	1.7	1.0	1.7	-3.8	-2.6	0.5	1.6	2.2
GDP/capita (EUR at PPP)	13,400	13,400	13,900	13,700	13,500	.	.	.
Consumption of households, BYN mn, nom. 2)	25,999	33,970	42,082	47,006	50,880	.	.	.
annual change in % (real)	10.8	10.9	4.3	-2.4	0.5	1.2	1.5	2.0
Gross fixed capital form., BYN mn, nom. 2)	18,299	24,941	26,772	25,763	22,750	.	.	.
annual change in % (real)	-11.4	9.0	-5.7	-15.5	-18.0	-1.0	2.0	4.0
Gross industrial production								
annual change in % (real)	5.8	-4.9	2.0	-6.6	-0.4	2.0	3.0	4.0
Gross agricultural production								
annual change in % (real)	6.6	-4.2	2.9	-2.9	3.4	.	.	.
Construction industry								
annual change in % (real)	-8.6	4.6	-5.7	-11.3	-18.4	.	.	.
Reg. employment, th, average	4,612	4,578	4,551	4,496	4,410	4,350	4,350	4,350
annual change in %	-1.7	-0.7	-0.6	-1.2	-1.9	-1.4	0.0	0.0
Reg. unemployed persons, th, end of period	24.9	21.0	24.2	43.3	35.3	40	40	40
Reg. unemployment rate, in %, end of period	0.5	0.5	0.5	1.0	0.8	1.0	1.0	1.0
Average monthly gross wages, BYN	368	506	605	671	722	800	880	960
annual change in % (real, gross)	21.5	16.4	1.3	-2.3	1.5	0.5	1.0	1.5
Consumer prices, % p.a.	59.2	18.3	18.1	13.5	11.8	10.0	9.0	8.0
Producer prices in industry, % p.a. 3)	76.0	13.6	12.8	16.8	12.0	11.0	10.0	9.0
General governm.budget, nat. def., % of GDP								
Revenues	37.3	39.0	37.3	41.3	40.9	39.0	39.0	39.0
Expenditures	36.5	38.8	36.1	39.9	39.8	38.0	38.0	38.0
Deficit (-) / surplus (+)	0.8	0.2	1.3	1.4	1.0	1.0	1.0	1.0
Public debt, EU-def., % of GDP	37.3	36.4	38.4	38.7	39.2	40.0	41.0	42.0
Stock of loans of non-fin.private sector, % p.a	37.0	28.8	21.1	19.4	6.5	.	.	.
Non-performing loans (NPL), in %, Dec	5.5	4.4	4.4	6.8	12.8	.	.	.
Central bank policy rate, % p.a., end of period 4)	30.0	23.5	20.0	25.0	18.0	16.0	15.0	14.0
Current account, EUR mn 5)	-1,446	-5,737	-4,057	-1,857	-1,300	-1,600	-2,100	-2,300
Current account, % of GDP 5)	-2.8	-10.1	-6.7	-3.7	-3.0	-3.5	-4.4	-4.5
Exports of goods, BOP, EUR mn 5)	35,391	27,701	27,492	23,854	20,500	21,700	22,500	23,800
annual change in %	24.2	-21.7	-0.8	-13.2	-14.1	5.9	3.7	5.8
Imports of goods, BOP, EUR mn 5)	34,952	31,183	29,537	25,807	23,000	23,800	24,700	26,000
annual change in %	13.1	-10.8	-5.3	-12.6	-10.9	3.5	3.8	5.3
Exports of services, BOP, EUR mn 5)	4,901	5,690	6,115	6,058	6,000	6,100	6,300	6,500
annual change in %	25.5	16.1	7.5	-0.9	-1.0	1.7	3.3	3.2
Imports of services, BOP, EUR mn 5)	3,140	3,983	4,449	3,985	3,800	4,000	4,100	4,200
annual change in %	34.5	26.8	11.7	-10.4	-4.6	5.3	2.5	2.4
FDI liabilities, EUR mn 5)	1,137	1,703	1,445	1,506	1,100	.	.	.
FDI assets, EUR mn 5)	121	199	57	97	100	.	.	.
Gross reserves of NB excl. gold, EUR mn 5)	4,390	3,589	2,820	2,510	3,071	.	.	.
Gross external debt, EUR mn 5)	25,518	28,807	32,982	34,996	36,400	36,300	36,100	35,700
Gross external debt, % of GDP 5)	50.2	50.8	54.1	69.4	84.9	80.0	75.0	70.0
Average exchange rate BYN/EUR	1.078	1.183	1.322	1.783	2.201	2.3	2.4	2.5

Note: 1 July 2016 denomination of the Belarusian rouble by 10,000. All time series in nominal and real terms as well as the exchange rates and PPP rates have been divided for statistical purposes by 10,000 to achieve the new currency BYN.

1) Preliminary and wiiw estimates. - 2) According to SNA 2008. - 3) Domestic output prices. - 4) Refinancing rate of NB. - 5) Converted from USD.

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

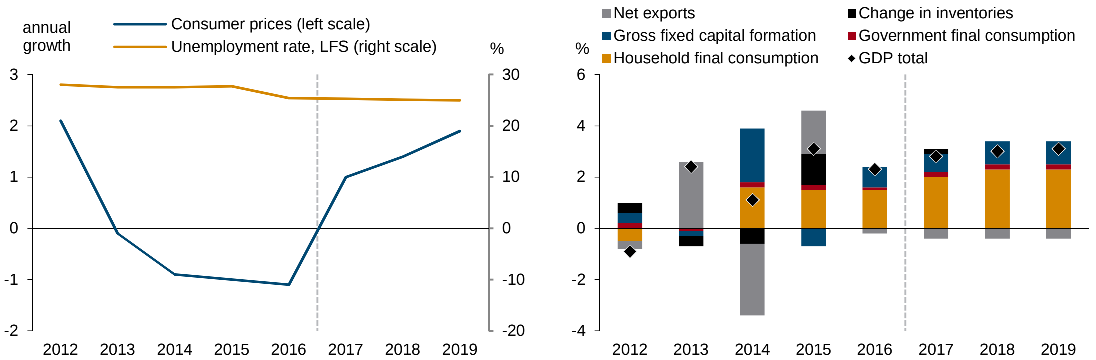
BOSNIA AND HERZEGOVINA: Growth momentum robust amid political risks

RICHARD GRIEVESON

Growth momentum improved in the second half of 2016, and this should continue in 2017, as a strengthening labour market and rising wages boost private consumption. Industrial output should also post fairly strong growth, helping to underpin an improvement in exports, although this will continue to be held back somewhat by poor infrastructure. The IMF programme will face delays related to political infighting, but should continue to ensure relative fiscal discipline.

Figure 35 / Bosnia and Herzegovina: Main macroeconomic indicators

Inflation and unemployment, in % | Real GDP growth and contributions



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

The political situation remains unstable and unconducive to growth. Recent elections, including the municipal polls in October 2016, have seen parties with more strongly ethnic, religious and nationalistic agendas gain ground. In January 2017, the Republika Srpska held celebrations for its National Day (which had previously been ruled unconstitutional by the federal constitutional court). The president of the entity, Milorad Dodik, used the opportunity again to discuss openly the prospect of the Republika Srpska's secession from Bosnia and Herzegovina. He said that he would hold a referendum on the issue by the end of 2018. Parts of the national armed forces took part in the celebrations, increasing doubts about the cohesion of the country.

Mr Dodik has become more assertive in his demands for secession. In January, he was sanctioned by the previous US administration for defying the constitutional court. Americans now cannot do business with him and any assets he has in the US are frozen (the new US administration may undo the measure, but that is unclear at present). The potential for less EU and US focus on the Western Balkans could mean that Bosnia is at increased risk of instability.

Growth slowed in 2016, but should pick up again in 2017 as household consumption and investment rise. After rising by 1.5% in the first half of 2016, growth picked up to 2.4% in the third quarter of the year. It was driven primarily by mining and manufacturing, although in the third quarter agriculture made a significant positive contribution. We estimate full-year growth of 2.3% in 2016, down from 3.1% in the previous year. Growth should rise to 2.8% this year, and around 3% during the rest of the forecast period, primarily driven by household consumption and (to a lesser extent) investment.

The outlook for private consumption appears relatively positive, and this should be the main driver of growth in 2017-2019. After dipping during the first half of 2016, retail trade strengthened, reaching an average of 7.3% year on year in the third quarter and 8.2% in the fourth. The labour market looks strong, with total employment rising by 2.7% year on year in November, the fastest growth since 2014. Average net wages increased by 2.5% year on year in November, the most rapid rise since 2011.

The industrial sector also looks to have good momentum heading into 2017. Industrial output rose by 4.3% in 2016 as a whole, the strongest growth since 2013. Output gains were led in particular by production of durable consumer goods, which increased by an average of 12.7% in working-day adjusted terms. Energy (+7.5%) and capital goods (+4.6%) also grew strongly. Output was much stronger in the Republika Srpska (+8%) than in the Federation (+2.6%) last year. However, infrastructure deficiencies will continue to hold back a more rapid development of the industrial sector and, consequently, export capacity.

The Extended Fund Facility (EFF) with the IMF, approved in September 2016 and due to last for three years, includes an ambitious reform programme. Among the programme's aims are an improvement in the business environment, a shift in the tax burden away from labour, the restructuring and privatisation of state-owned enterprises, an increase in excise taxes on fuel, a reduction in public sector employment and wages, and the construction of the Bosnian section of the Corridor Vc motorway (which will also pass through Hungary and Croatia). Progress on meeting the targets set by the programme is likely to be slow, although incremental improvements can be expected.

Inflation will turn positive in 2017, rising by 1% for the year as a whole, after falling by 1.1% in 2016. Inflationary pressures are generally imported from the eurozone due to Bosnia's currency board arrangement with the single currency. Consumer price inflation remains negative, but moderated to -0.3% year on year in November and December 2016. The transport component of the consumer price basket, which largely reflects local energy prices, rose by 0.6% in December, the first positive outturn since early 2014.

After a surplus in 2015, we expect the budget to fall back into deficit in 2016. The consolidated budget surplus fell to BAM 278 million in the first half of 2016, compared with BAM 296 million in the same period of 2015. Revenue rose by 2.8%, while expenditure was up 2.4% compared to the same period of the previous year. The budget typically posts a large deficit in the fourth quarter of the year.

According to the IMF, fiscal numbers were largely in line with targets up to the end of the third quarter. Over the forecast period, we expect budget shortfalls slightly narrower than 1% of GDP. IMF funding could free up greater resources for capital spending.

The IMF programme is likely to face delays and setbacks. A failure to raise excise taxes on fuel in line with the timeframe stipulated by the IMF EFF caused a delay to the disbursement of the second IMF tranche (worth around EUR 80 million) which had been due in January (and also a delay to a European Bank for Reconstruction and Development loan for Corridor Vc). Press reports in February indicated that a further delay was likely. IMF payments under previous programmes have often been delayed because of a failure to meet stipulated targets.

The banking sector continues to struggle, with non-performing loans (NPLs) still high and credit demand weak. Central bank data show the level of credit to domestic non-financial corporations growing by 2.7% year on year in January-November 2016, while credit to other residents (mainly households) increased by 3.3%. Asset quality has improved somewhat, with NPLs at 8.8% of total gross loans in the third quarter of 2016, down from 10.4% a year earlier.

Bosnia's external shortfall contracted by 22% in the first three quarters of 2016. This was driven in particular by a BAM 245 million reduction in the merchandise goods deficit on the back of lower energy prices. The reduction in the current account deficit was mirrored by a fall in external financing, particularly net foreign direct investment (FDI) inflows, which dropped by BAM 155 million over the period. The current account deficit is a function of the large goods shortfall, which is partly offset by surpluses on the services and secondary income (remittances) accounts. Net FDI inflows covered just 25% of the current account deficit in January-September 2016, the lowest at this stage of the year since 2012. Other investment, chiefly loans, covered 102% of the current account shortfall.

We estimate that the current account deficit narrowed to 4.5% of GDP in 2016, from 6% in the previous year. The external shortfall is expected to widen again to 5.8% in 2017 as oil prices pick up, and to remain at a similar level in 2018-2019. Poor infrastructure will prevent a significant narrowing of the merchandise goods shortfall during the forecast period.

Bosnia will continue to rely primarily on loans to fund the deficit, although risks associated with this are mitigated by the fact that most lending is concessional and of a long-term maturity. Government external debt reached BAM 8.8 billion in the third quarter of 2016 (just over 30% of estimated full-year GDP). We estimate total external debt equivalent to 54.8% of GDP in 2016. Net foreign reserves reached an average of BAM 9.2 billion in the third quarter of 2016, equivalent to over five months of import cover, supporting the stability of the currency board arrangement.

In summary, we expect the recent pick-up in growth momentum to be sustained during the forecast period. We forecast real GDP growth of 2.8% this year, rising to 3% in 2018 and 3.1% in 2019. Growth will still be primarily supported by private consumption, underpinned by rising wages and a strengthening labour market. Investment will also contribute positively. With export capacity likely to be held back by infrastructure weakness, the current account deficit will remain large.

Table 6 / Bosnia and Herzegovina: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018 Forecast	2019
Population, th pers., mid-year 2)	3,836	3,832	3,827	3,819	3,816	3,820	3,818	3,815
Gross domestic product, BAM mn, nom. 3)	26,193	26,743	27,304	28,659	29,000	30,100	31,400	33,000
annual change in % (real)	-0.9	2.4	1.1	3.1	2.3	2.8	3.0	3.1
GDP/capita (EUR at PPP) 3)	7,300	7,500	7,700	8,100	8,300	.	.	.
Consumption of households, BAM mn, nom. 3)	22,334	22,521	22,830	23,143	23,300	.	.	.
annual change in % (real)	-0.7	0.0	1.9	1.7	1.9	2.5	2.8	2.9
Gross fixed capital form., BAM mn, nom. 3)	4,783	4,714	5,234	5,024	5,200	.	.	.
annual change in % (real)	2.2	-1.0	11.7	-3.5	4.5	4.0	5.0	5.0
Gross industrial production								
annual change in % (real)	-3.9	5.2	0.2	3.1	4.4	5.0	5.3	5.1
Gross agricultural production 4)								
annual change in % (real)	-10.0	15.3	0.0	5.0	2.0	.	.	.
Construction output total								
annual change in % (real)	-3.1	-2.4	6.8	-3.2	-0.3	.	.	.
Employed persons, LFS, th, April	813.7	821.6	812.0	822.0	801.0	810	820	830
annual change in %	-0.3	1.0	-1.2	1.2	-2.6	0.8	1.1	1.1
Unemployed persons, LFS, th, April	316.6	311.5	308.0	315.0	273.0	274	275	276
Unemployment rate, LFS, in %, April	28.0	27.5	27.5	27.7	25.4	25.3	25.1	25.0
Reg. unemployment rate, in %, end of period	44.6	44.5	43.6	42.9	41.0	.	.	.
Average monthly gross wages, BAM	1,290	1,291	1,290	1,289	1,301	1,320	1,350	1,390
annual change in % (real, gross)	-0.5	0.2	0.8	1.0	2.0	0.8	1.1	1.1
Average monthly net wages, BAM	826	827	831	830	838	850	870	900
annual change in % (real, net)	-0.8	0.2	1.3	1.0	2.0	1.0	1.0	1.0
Consumer prices, % p.a.	2.1	-0.1	-0.9	-1.0	-1.1	1.0	1.4	1.9
Producer prices in industry, % p.a.	0.3	-1.8	-0.5	0.6	-2.3	1.8	1.9	2.1
General governm.budget, nat.def., % of GDP								
Revenues	43.8	42.7	43.8	43.2	43.5	45.2	45.4	45.4
Expenditures	45.8	44.8	45.8	42.6	44.5	46.0	46.2	46.3
Deficit (-) / surplus (+)	-2.0	-2.2	-2.0	0.7	-1.0	-0.8	-0.8	-0.9
Public debt, nat.def., % of GDP 5)	44.3	43.5	44.0	45.0	45.2	44.9	44.7	44.5
Stock of loans of non-fin.private sector, % p.a.	3.1	2.9	1.7	2.0	2.6	.	.	.
Non-performing loans (NPL), in %, Dec	13.5	15.1	14.2	13.7	12.0	.	.	.
Central bank policy rate, % p.a., end of period 6)	.	.	.	.	.	.	.	.
Current account, EUR mn 7)	-1,160	-723	-1,029	-833	-890	-890	-915	-960
Current account, % of GDP 7)	-8.7	-5.3	-7.4	-5.7	-6.0	-5.8	-5.7	-5.7
Exports of goods, BOP, EUR mn 7)	2,988	3,286	3,385	3,562	3,550	3,720	3,920	4,160
annual change in %	1.2	10.0	3.0	5.3	-0.3	4.9	5.5	6.1
Imports of goods, BOP, EUR mn 7)	7,079	7,027	7,527	7,355	7,400	7,700	8,050	8,470
annual change in %	-0.1	-0.7	7.1	-2.3	0.6	4.0	4.6	5.2
Exports of services, BOP, EUR mn 7)	1,349	1,334	1,365	1,484	1,480	1,560	1,660	1,760
annual change in %	0.4	-1.1	2.3	8.8	-0.3	5.6	6.1	5.9
Imports of services, BOP, EUR mn 7)	404	385	385	423	425	450	480	510
annual change in %	1.2	-4.7	0.1	9.9	0.4	5.0	6.0	6.0
FDI liabilities, EUR mn 7)	305	239	392	264	250	.	.	.
FDI assets, EUR mn 7)	46	64	6	43	50	.	.	.
Gross reserves of NB excl. gold, EUR mn	3,246	3,530	3,908	4,307	4,768	.	.	.
Gross external debt, EUR mn 5)	6,991	7,138	7,245	7,825	8,125	8,250	8,400	8,550
Gross external debt, % of GDP 5)	52.2	52.2	51.9	53.4	54.8	53.6	52.3	50.7
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.96	1.96	1.96

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

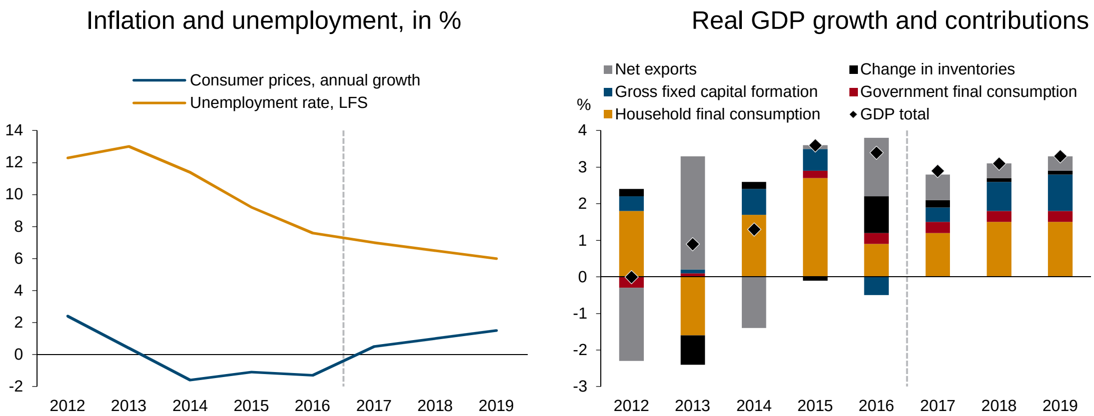
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

BULGARIA: On track for moderate growth

RUMEN DOBRINSKY

Bulgaria has a new president and is expecting a new government after the early elections in March 2017. The economy is in relatively good shape, with GDP increasing by 3.4% in 2016. Growth was balanced, driven by both private consumption and exports; however, fixed investment became a drag on growth, due to delays in public investment programmes. There are no visible external or domestic imbalances, and the economy seems set to remain on the path of moderate growth in the foreseeable future.

Figure 36 / Bulgaria: Main macroeconomic indicators



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

The presidential elections held in November 2016 had some unexpected outcomes. The candidate of the ruling centre-right GERB party lost to the independent candidate Rumen Radev, who was supported by the opposition Bulgarian Socialist Party. This was followed by a major political shake-up and triggered the resignation of the GERB government led by Boyko Borisov. In January, newly elected President Rumen Radev appointed a caretaker government and called early elections for 26 March 2017. The caretaker government is led by Ognyan Gerdzhikov, a respected lawyer who served as chairman of the National Assembly a decade ago, and is composed of non-partisan experts.

The political turbulence had no visible economic consequences. There are signs that the economy has finally overcome the lasting shocks of the 2008-2009 global financial crisis. Revised national accounts data for 2015 indicate higher GDP growth (3.6%) than reported earlier (3.0%). Subsequent revisions of quarterly national accounts for 2016 also point to higher GDP growth than reported by first estimates. The latest statistics suggest a rate of GDP growth of 3.4% for 2016 as a whole.

There was a shift in the main growth drivers in 2016. While domestic demand (both private consumption and gross fixed capital formation) was the main factor behind GDP growth in 2015, in 2016 economic growth was mostly export driven, and net exports made the largest contribution to GDP growth. Domestic factors played a mixed role: private consumption continued to make a positive contribution to GDP growth, but the contribution of gross fixed capital formation was negative. On the supply side, industry (in particular manufacturing) and business services (especially tourism and ICT services) contributed most to preserving the growth momentum. Gross manufacturing continued to expand steadily for the third consecutive year, while 2016 was a record year in terms of the number of tourists and tourism revenue (this reflecting both a one-off surge in Russian tourists in a period when Turkey was closed as a destination, and a continued rise in tourists from other countries). These were also the sectors that contributed most to the export expansion.

Real gross fixed capital formation actually fell year on year in 2016. The main reason for this was the underperformance of public investment programmes in 2016. This was mostly related to the delays in launching new public investment projects supported by the EU 2014-2020 Multiannual Financial Framework (MFF). While bureaucratic reshuffles at the EC did play a part, the main reason for the delays was the slow reorganisation of the local application procedures for funding under the 2014-2020 MFF. Mirroring the downturn in fixed investment, real gross construction output was deep in negative territory.

Export performance varied in the course of 2016, but taken as a whole it was a notable support to output performance. This was mostly thanks to exports to the EU, which grew steadily throughout the year. The EU-directed export expansion could be traced across the board (in terms of destinations and main commodity groups), and so it should be attributed to the general improvement in EU economic performance. Exports to non-EU markets were uneven, but after a weak start in the first months of the year they also resumed robust growth in the second half of 2016.

The labour market also continued recovering in 2016: the number of those employed rose for the fourth consecutive year, while the rate of unemployment dropped to levels not seen since 2009. The tightening of the labour market was matched by a surge in real wages, which continued to rise at a pace exceeding productivity growth. In turn, rising real wages and growing consumer confidence were among the factors that propped up private consumption. Real incomes received an additional boost from the lasting deflationary trends of the past three years.

So far, the seemingly disproportionate rise in real wages has not had any visible negative effects on international competitiveness: in current euro terms, exports of goods have been rising steadily (which was not the case for imports of goods), while the positive balance in the trade in services has actually been improving, thanks to the surge in exports of ICT services and steady tourist inflows. Exports of ICT services have grown strongly in recent years as Bulgaria has come to be recognised as one of the top European destinations for outsourcing.

The current account balance has been positive for the past four years. The level of the surplus in 2016 was surprisingly high, but it mirrors both the above-mentioned trends in the trade in goods and services and the continuing gradual process of deleveraging by Bulgarian firms and banks. Transfers (both private and from the EU budget) have also stayed high over the past few years. While 2016 was probably an exceptional year in terms of tourism revenues, one could still expect these to remain at decent levels. Thus, a current account surplus is probably shaping up as a lasting feature of Bulgaria's economic performance. Gross external debt was little changed in absolute terms and continued to fall in relative terms.

There was also a modest improvement in domestic credit activity after several years of stagnation. With the dramatic fall in interest rates, the preferences of both firms and households notably shifted towards credit denominated in the local currency. Reflecting these changes, the stock of outstanding bank claims denominated in euro has been declining since 2014. By contrast, new deposits are almost evenly split between BGN and euro.

On the negative side, foreign direct investment (FDI) inflows were disappointing in 2016. It is now clear that there is no chance of a return to anything like the levels seen before the global financial crisis, when, for almost a decade, annual inward FDI flows exceeded 20% of GDP. The 'new normal' levels seem to be in the range of 3-4% of GDP per annum; moreover, no large-scale FDI projects are envisaged in the immediate future.

There was an improvement in public finances: for the first time since 2009, the consolidated general government balance reported a cash surplus in 2016. However, the cash surplus was largely a result of poor public investment performance, which (as noted above) fell far below the targets. Nominal public capital expenditure in 2016 dropped by 44% from the 2015 level, while public investment financed from EU funds was a mere 13% of the previous year's level. Overall, while nominal cash revenue in 2016 rose by 5.4% year on year, cash spending dropped by 1.8%. Understandably, the ESA fiscal balance will look different, as most cash savings from committed but deferred projects will still have to be reported as 2016 spending. Moreover, during its last month in office, the outgoing government decided to allocate a large chunk of the 2016 cash surplus to some extraordinary unforeseen spending items, such as a doubling of public financial resources earmarked to support the energy-efficiency renovation of apartment blocks. Still, given the good revenue performance, the ESA fiscal balance (which has not yet been published) probably also improved in 2016.

The 2017 fiscal year may be a transitory one, due to the current political uncertainties. While the outgoing government and parliament did adopt a public budget for the current year, if the new elections bring to power a government backed by a different parliamentary configuration, the new government may be tempted to revise the 2017 budget half-way through. However, the latest opinion polls suggest that parliament may be deeply split after the early elections; this may block both the formation of a new government and the adoption of a different fiscal programme.

By and large, we expect the present path of moderate GDP growth to continue in the short to medium term. The central forecast scenario for 2017 envisages EU-backed public investment programmes gradually being brought back on track, allowing for a reversal in public capital expenditure. Private consumption should also contribute positively to GDP growth in 2017 and in the following years. Strong export performance should continue on the expectation of an ongoing moderate upturn in the key EU markets, but a recovery in domestic demand and imports would lead to a reduction in the growth contribution of net exports. On the other hand, the lingering political uncertainties are not very conducive to the business environment in the country, and this might lead to a slight deceleration in output growth in the current year. Overall, however, the GDP growth rates should remain in the range of 3% per annum in the coming three years. The continued tightening of the labour market and rising real wages suggest that inflationary pressures may reappear, reversing the prolonged deflationary trend. The current account can be expected to remain in positive territory, allowing a further reduction in the gross external debt.

Table 7 / Bulgaria: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018 Forecast	2019
Population, th pers., average	7,306	7,265	7,224	7,178	7,150	7,100	7,050	7,000
Gross domestic product, BGN mn, nom.	82,040	82,166	83,634	88,571	92,196	95,300	99,200	104,000
annual change in % (real)	0.0	0.9	1.3	3.6	3.4	2.9	3.1	3.3
GDP/capita (EUR at PPP)	12,200	12,200	12,800	13,600	14,200	.	.	.
Consumption of households, BGN mn, nom.	53,346	50,660	51,963	54,831	55,700	.	.	.
annual change in % (real)	2.9	-2.5	2.7	4.3	1.5	2.0	2.5	2.5
Gross fixed capital form., BGN mn, nom.	17,443	17,365	17,653	18,612	17,600	.	.	.
annual change in % (real)	1.8	0.3	3.4	2.7	-2.2	2.0	4.0	5.0
Gross industrial production 2)								
annual change in % (real)	-0.3	-0.2	1.8	2.9	2.7	3.0	3.5	4.0
Gross agricultural production								
annual change in % (real)	-10.0	14.2	-0.6	-8.2	-1.2	.	.	.
Construction industry 3)								
annual change in % (real)	-0.8	-3.7	7.0	2.4	-10.0	.	.	.
Employed persons, LFS, th, average	2,934	2,935	2,981	3,032	3,017	3,020	3,020	3,020
annual change in %	-1.1	0.0	1.6	1.7	-0.5	0.0	0.0	0.0
Unemployed persons, LFS, th, average	410	436	385	305	247	230	210	190
Unemployment rate, LFS, in %, average	12.3	13.0	11.4	9.2	7.6	7.0	6.5	6.0
Reg. unemployment rate, in %, end of period	11.4	11.8	10.7	10.0	8.0	.	.	
Average monthly gross wages, BGN	731.1	775.1	821.7	877.9	960.3	1,040	1,120	1,210
annual change in % (real, gross)	3.5	5.1	7.5	7.0	10.3	8.0	7.0	6.0
Consumer prices (HICP), % p.a.	2.4	0.4	-1.6	-1.1	-1.3	0.5	1.0	1.5
Producer prices in industry, % p.a.	4.4	-1.5	-1.2	-1.9	-3.1	0.0	0.5	1.0
General governm.budget, EU-def., % of GDP								
Revenues	34.1	37.1	36.6	39.0	37.0	37.5	38.0	38.0
Expenditures	34.5	37.6	42.1	40.7	38.0	38.0	38.0	38.0
Net lending (+) / net borrowing (-)	-0.3	-0.4	-5.5	-1.7	-1.0	-0.5	0.0	0.0
Public debt, EU-def., % of GDP	16.7	17.0	27.0	26.0	29.0	28.6	27.4	26.2
Stock of loans of non-fin.private sector, % p.a	2.8	0.0	-8.2	-1.6	1.0	.	.	.
Non-performing loans (NPL), in %, Dec	16.6	16.9	16.7	20.4	18.3	.	.	.
Central bank policy rate, % p.a., end of period 4)	0.03	0.02	0.02	0.01	0.00	0.0	0.0	0.0
Current account, EUR mn	-358	536	35	172	1,810	1,700	1,600	1,500
Current account in % of GDP	-0.9	1.3	0.1	0.4	3.8	3.5	3.2	2.8
Exports of goods, BOP, EUR mn	19,675	21,218	21,027	21,920	22,643	23,400	24,200	25,000
annual change in %	3.2	7.8	-0.9	4.2	3.3	3.3	3.4	3.3
Imports of goods, BOP, EUR mn	23,667	24,151	23,803	24,542	24,433	25,300	26,200	27,200
annual change in %	8.8	2.0	-1.4	3.1	-0.4	3.6	3.6	3.8
Exports of services, BOP, EUR mn	5,817	5,889	6,738	7,080	7,567	7,700	7,900	8,200
annual change in %	9.3	1.2	14.4	5.1	6.9	1.8	2.6	3.8
Imports of services, BOP, EUR mn	3,229	3,235	4,224	3,998	4,197	4,300	4,400	4,500
annual change in %	26.0	0.2	30.6	-5.4	5.0	2.5	2.3	2.3
FDI liabilities, EUR mn	1,383	1,509	1,539	1,661	1,088	.	.	.
FDI assets, EUR mn	315	266	657	65	545	.	.	.
Gross reserves of NB excl. gold, EUR mn	13,935	13,303	15,276	19,022	22,475	.	.	.
Gross external debt, EUR mn 5)	37,714	36,936	39,338	34,088	34,200	33,500	33,000	32,500
Gross external debt, % of GDP 5)	89.9	87.9	92.0	75.3	72.6	69.0	65.0	61.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

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

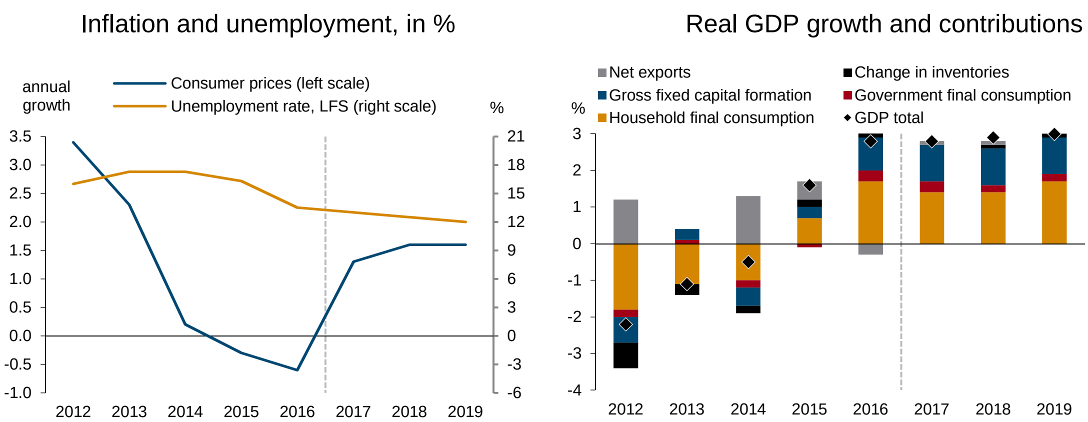
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

CROATIA: Robust growth expectations, at last

HERMINE VIDOVIC

Croatia's economy returned to a stable path of growth in 2016. Prospects are favourable as well, with annual GDP growth of up to 3% until the end of the forecasting period in 2019. The upswing will primarily be driven by a rise in domestic demand, both private consumption and investments. EU funding will play a major role in stimulating investments. Apart from fiscal consolidation, demographic changes will become a major challenge in the future.

Figure 37 / Croatia: Main macroeconomic indicators



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

Croatia's GDP continued its path of recovery, and the economy expanded at an estimated 2.8% in 2016. Growth was backed by domestic demand, both private consumption and rising investments. Private consumption growth was at its highest since the onset of the 2009 crisis, gaining momentum thanks to an improvement in the labour market, combined with real wage increases. Gross fixed capital formation continued growing and translated – after seven years of steady decline – into an increase in construction activities. In 2016, industrial production reported its highest growth (5.4% compared to a year earlier) since 2001. The best performers among the branches of industry were the manufacture of electrical equipment, chemicals and basic pharmaceutical products, while the output of shipbuilding continued to shrink.

The situation in the labour market improved, but challenges remain. According to pension insurance data, employment rose by 2% in the first three quarters of 2016; Labour Force Survey data report an increase of less than 1%, with the unemployment rate falling by 3.8 percentage points to 13.5%, as against a year earlier. Also youth unemployment fell considerably, to an estimated 28% in 2016. However, both the overall and youth unemployment rates are still among the highest in the EU. The reduction in unemployment is only partly a result of rising employment; other factors include increasing inactivity and continued outward migration – mainly to Germany, but to a lesser extent to Austria. For example, since Croatia's EU accession in July 2013, the number of Croatian workers in Germany has risen steadily: from 83,500 to 136,500 in June 2016. In particular, the opening up of the German labour market in 2015 contributed to an increased influx of Croatian citizens to Germany. In Austria, the inflow of Croatian workers has remained fairly limited, with the employment stock increasing by about 6,400 persons in the period 2013-2016. Despite an improved economic environment, combined with rising wages, the out-migration trend continues. The results of a recent survey (conducted across 11 European countries) suggest that 77% of the Croatian respondents would be ready to move abroad for a new job; of these, more than half would go for a better job in the same profession and more than 40% would move for any job. The vast majority of these are young people aged up to 34, and they want to go abroad for more than one year. On the other hand, Croatian employers complain about labour and skills shortages in certain branches, such as shipbuilding, construction, tourism, transport and IT; they are calling for an increase in the number of work permits issued for foreign labour.

External trade in goods performed less dynamically than a year earlier, with exports and imports growing at 4.4% in euro terms in 2016. The trade deficit was about EUR 350 million higher than in 2015, while the surplus in the services trade rose, thanks to increased earnings from tourism. Revenue from tourism reached a record high in 2016, benefiting from political uncertainties in competitor countries like Turkey and Tunisia. Thus, the current account is in surplus again, at an estimated 3.7% of GDP. Foreign debt declined in 2016, owing to higher than expected GDP growth and continued deleveraging, particularly by the government and by banks.

The consolidated general government deficit continued to narrow in 2016, mostly on account of higher than expected (tax) revenue, coupled with lower expenditure, particularly on subsidies, intermediate consumption and spending on employees. The expenditure cut is partly due to provisional budget financing in the first quarter of the year, limiting state expenditure. According to preliminary results, the general government deficit declined to 2.2% of GDP in 2016. The reduction in the deficit has also translated into a reduction in public debt to 84% of GDP. Public debt fell for the first time after six years of steady increase. In view of the favourable results, Croatia hopes to exit the EU's excessive deficit procedure (EDP) this year. The 2017 budget anticipates a further reduction in the general government deficit to 1.9% of GDP, based on a 3.2% increase in GDP and taking into account the effects of the tax reform. At the end of January 2017, the government adopted the Public Debt Management Strategy 2017-2019, with the very ambitious goal of reducing the fiscal deficit to 0.6% of GDP and total public debt to 75.3% of GDP by the end of 2019. The debt reduction strategy consists of three pillars: economic growth, a further reduction in the budget deficit and better use of state assets. Positive economic results and a more stable government are also reflected in an improvement in the credit outlook from negative to stable by Standard & Poor's in December 2016 and by Fitch in January 2017. But despite this upgrading, Croatia's credit rating remains two notches below investment grade rating. In 2017, Croatia will have to repay almost EUR 4 billion of maturing bonds and interest, which should be financed via the issuing of domestic and international bonds. Already at the beginning of February, the Croatian Ministry of Finance issued two Croatian kuna bonds on the domestic market, a HRK 3 billion bond, maturing in 2022, issued at an interest rate of 2.25% and a yield of 2.29%, and a

HRK 5.5 billion bond issued at an interest rate of 2.875% and a yield of 3.09%, maturing in 2028. The issuing of bonds on the international financial markets is envisaged in March.

The introduction of the euro, for several years a major goal of the Croatian National Bank (CNB), is again in the focus of public debate. At the beginning of January, the Croatian press announced that the government and the CNB would develop a common strategy to introduce the euro. Given the current situation, Croatia fulfils three of the four Maastricht criteria (it does not yet fulfil the public debt criterion). According to Boris Vujčić, governor of the CNB, the procedure will take some time, since the procedure to introduce the euro can only start once Croatia leaves the EDP (the date of which is still uncertain). So far there has been no statement on this by the European Central Bank.

Following early elections, a new government came to office in October 2016. In mid-June 2016, the Croatian parliament dismissed Prime Minister Tihomir Orešković in a vote of no confidence. As this action also marked the end of the coalition government formed of the Croatian Democratic Union (HDZ) and its junior partner Most (in office since January 2016), early elections became necessary. HDZ, the winner of the snap elections in September, again formed a coalition with Most and representatives of smaller parties, including the representatives of minorities. The new government is led by Andrej Plenković, the newly elected more liberal head of HDZ and a former Member of the European Parliament. Compared to his predecessor as party head, Tomislav Karamarko, Mr Plenković is more centrist and capable of compromise. He is also better at understanding local politics than Mr Orešković, the former technocratic prime minister, who had spent most of his life abroad. Therefore, the government appears more stable and likely to last longer than the previous one. This also reduces the political risk in Croatia (considered quite high in the past) and should be helpful in reducing borrowing costs and increasing investor confidence. The government has a solid majority in the country's parliament (91 out of 151 seats).

A tax reform was introduced on 1 January 2017. Accordingly, personal income tax now has two tax brackets – 24% and 36% – instead of three (12%, 25% and 40%); 24% is envisaged for all incomes below HRK 17,500 a month. The personal tax allowance was increased from HRK 2,600 to HRK 3,800 a month. In addition, the overall corporate income tax was reduced from 20% to 18%, and for farmers from 20% to 12%. Furthermore, the rate of VAT on certain goods and services (e.g. agricultural raw materials, electricity supply, waste collection) was reduced from 25% to 13%.

Only recently it was announced that Croatia intends to buy back the stake of Hungarian MOL in INA, the country's oil company. Croatia, which owns about 45% of INA, and the energy group MOL, which has almost 50%, have been at odds for years over management rights and investment policy in INA. In order to raise funding for the deal, the government came up with the idea of selling 25% of the Croatian electricity company HEP in an initial public offering. However, the proposal is still at an early stage and requires the approval of the coalition parties.

wiiw expects Croatian GDP to grow by up to 3% a year in the period 2017-2019. Growth will be driven by domestic demand: private consumption will continue to grow at comparatively high levels in 2017, thanks to the impact of the tax reform on wages, along with rising employment. Also government consumption is expected to increase as a result of local elections due to be held in the first half of 2017. Consumption will remain a driver of growth in the 2018-2019 period, as the labour market situation continues to improve. Credit activities may gradually recover. Investment growth should gain momentum in the public and the private sectors alike, supported by EU funding. Given the rise in domestic demand, imports, too, will increase in the forecasting period, while goods exports will remain at a low level owing to the weak competitiveness of the industrial sector. By contrast, exports of services – tourism in particular – will remain at high levels, since security risks in the main competitor markets will continue. As a result, the current account surplus will gradually decrease from an estimated 3.7% in 2016 to 0.9% in 2019. Assuming further reductions in the general government deficit, public debt is expected to continue its downward path in the coming three years. Demographic challenges – ageing of the population, coupled with a steady decline in the working-age population and more emigration – are also becoming increasingly apparent.

Table 8 / Croatia: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018 Forecast	2019
Population, th pers., average	4,269	4,254	4,236	4,208	4,190	4,190	4,190	4,190
Gross domestic product, HRK mn, nom.	330,456	329,571	328,109	333,837	341,200	355,200	371,400	388,500
annual change in % (real)	-2.2	-1.1	-0.5	1.6	2.8	2.8	2.9	3.0
GDP/capita (EUR at PPP)	16,000	15,900	16,100	16,700	17,400	.	.	.
Consumption of households, HRK mn, nom.	195,623	195,623	191,407	192,745	197,300	.	.	.
annual change in % (real)	-3.0	-1.9	-1.6	1.2	3.0	2.5	2.5	3.0
Gross fixed capital form., HRK mn, nom.	64,820	65,257	63,797	65,068	67,600	.	.	.
annual change in % (real)	-3.3	1.4	-2.8	1.6	4.5	5.1	5.2	5.0
Gross industrial production 2)								
annual change in % (real)	-5.6	-1.8	1.2	2.7	5.4	3.5	3.5	3.5
Gross agricultural production								
annual change in % (real)	-9.4	4.2	-7.0	2.9	-2.9	.	.	.
Construction output 2)								
annual change in % (real)	-12.6	-4.6	-7.3	-0.6	3.0	.	.	.
Employed persons, LFS, th, average	1,566	1,524	1,566	1,589	1,600	1,620	1,640	1,660
annual change in %	-3.6	-2.7	2.7	1.5	0.7	1.0	1.5	1.5
Unemployed persons, LFS, th, average	297	318	327	309	250	240	230	230
Unemployment rate, LFS, in %, average	16.0	17.3	17.3	16.3	13.5	13.0	12.5	12.0
Reg. unemployment rate, in %, end of period	21.1	21.6	19.6	17.9	14.8	.	.	.
Average monthly gross wages, HRK 3)	7,875	7,939	7,953	8,055	7,800	8,100	8,400	8,700
annual change in % (real, gross)	-2.3	-1.4	0.4	1.8	3.6	2.0	2.0	2.0
Average monthly net wages, HRK 3)	5,478	5,515	5,533	5,711	5,700	5,900	6,100	6,400
annual change in % (real, net)	-2.6	-1.5	0.5	3.7	3.0	2.5	2.5	2.5
Consumer prices (HICP), % p.a.	3.4	2.3	0.2	-0.3	-0.6	1.3	1.6	1.6
Producer prices in industry, % p.a.	5.0	-0.4	-2.7	-3.9	-4.3	-1.0	2.0	2.0
General governm.budget, EU-def., % of GDP								
Revenues	41.8	43.0	42.9	43.6	44.1	43.6	43.3	43.3
Expenditures	47.1	48.3	48.3	46.9	46.3	45.6	45.1	45.0
Net lending (+) / net borrowing (-)	-5.3	-5.3	-5.4	-3.3	-2.2	-2.0	-1.8	-1.7
Public debt, EU-def., % of GDP	70.7	82.2	86.6	86.7	84.0	82.5	81.0	80.0
Stock of loans of non-fin.private sector, % p.a.	-6.9	-1.5	-2.0	-3.1	-4.0	.	.	.
Non-performing loans (NPL), in %, Dec	13.9	15.7	17.1	16.6	14.7	.	.	.
Central bank policy rate, % p.a., end of period 4)	7.0	7.0	7.0	3.0	3.0	3.0	3.0	3.0
Current account, EUR mn	-22	441	906	2,236	1,670	970	730	460
Current account, % of GDP	-0.1	1.0	2.1	5.1	3.7	2.1	1.5	0.9
Exports of goods, BOP, EUR mn	8,673	8,924	9,761	10,695	11,120	11,700	12,300	13,000
annual change in %	-0.8	2.9	9.4	9.6	4.0	5.0	5.5	5.5
Imports of goods, BOP, EUR mn	14,969	15,511	16,257	17,522	18,290	19,600	21,000	22,500
annual change in %	-1.0	3.6	4.8	7.8	4.4	7.0	7.0	7.0
Exports of services, BOP, EUR mn	9,643	9,841	10,222	11,256	12,160	12,900	13,600	14,300
annual change in %	2.9	2.1	3.9	10.1	8.0	6.0	5.5	5.5
Imports of services, BOP, EUR mn	3,128	3,062	2,857	3,195	3,420	3,600	3,800	4,000
annual change in %	-1.4	-2.1	-6.7	11.8	7.0	6.0	6.0	6.0
FDI liabilities, EUR mn	1,145	728	2,281	187	1,200	.	.	.
FDI assets, EUR mn	-87	-111	1,600	-69	-200	.	.	.
Gross reserves of NB excl. gold, EUR mn	11,236	12,908	12,688	13,707	13,514	.	.	.
Gross external debt, EUR mn	45,297	45,803	46,416	45,384	43,500	44,100	45,100	46,200
Gross external debt, % of GDP	103.1	105.3	108.0	103.5	96.0	94.0	92.0	90.0
Average exchange rate HRK/EUR	7.5217	7.5786	7.6344	7.6137	7.5333	7.57	7.57	7.57

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) Data for 2016 according to new data sources. -
4) Discount rate of NB.

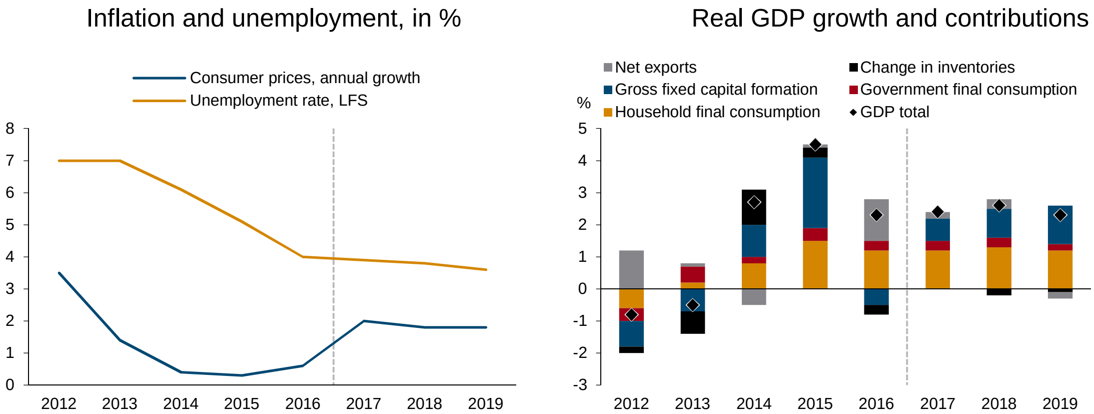
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

CZECH REPUBLIC: Close to full employment, growing moderately

LEON PODKAMINER

Solid external balances and low levels of indebtedness in both the private and the public sector will support moderate growth of above 2% in the period 2017-2019. Some uncertainties persist, however, as to the future course of fiscal policy and the impacts of the expected strengthening of the domestic currency.

Figure 38 / Czech Republic: Main macroeconomic indicators



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

At an estimated 2.4%, GDP growth in 2016 was perceptibly weaker than in the exceptionally good year 2015. Rising consumption (by the household and public sectors) was the main item behind the GDP growth, contributing about 1.7 percentage points (pp) to the overall growth rate. The contribution of foreign trade in goods and non-factor services (1.1 pp) was much higher than in 2013-2015. However, the contribution of gross fixed capital formation was relatively large and negative (-0.6 pp), while that of rising inventories was positive (+0.3 pp).

The strong decline in gross fixed capital formation (by an estimated 2.5% in 2016 vs 2015) is primarily due to the completion by 2015 of infrastructure projects co-financed by EU transfers under the financial package for 2007-2013. This is evidenced by the differential developments within the construction sector. The gross output of the whole construction sector fell, in volume terms, by 7.6% in 2016. However, the volume of civil engineering output – which primarily covers work on various infrastructure projects – fell by as much as 16%. (In 2015 the proportions were different: the whole construction output rose by 7%, but the volume of civil engineering work rose by over 17%.) It is correct to expect infrastructure investment co-financed from EU structural funds to gradually recover in coming years; however, it is less realistic to expect too much in the current year.

The surplus in foreign trade (in goods and services) reached over 8% of GDP in 2016. This exceptional achievement is due not only to the slowdown in the growth of consumption, the recession in investment and the relatively low world market prices for raw materials, but also to the Czech economy's tight integration into the European (mostly German-dominated) manufacturing production networks (concentrated around the automotive industry). The export-oriented and technologically fairly advanced manufacturing sector represents an obvious strength of the Czech economy. But at the same time, it is also a potential risk factor, as it renders the whole national economy quite vulnerable to unforeseeable external developments. A high dependence on the export of mass-consumption goods is not necessarily a very good thing, given the turbulences shaking the global – and European – economy. This was demonstrated by a severe slowdown in the growth of goods' exports and imports in the second half of 2016 (in line with a marked deceleration of demand for personal cars in Western Europe).

With large trade and current account surpluses, the Czech currency has been subject to a nominal appreciation tendency. For several years now (since November 2013), the Czech national bank has been keeping the appreciation pressures in check by intervening (quite frequently in 2016) in the foreign exchange market. The policy of keeping the CZK/EUR exchange rate above the level of 27 (via unsterilised purchases of foreign exchange) has been quite easy to pursue, since inflation was not a threat and it was possible to keep the policy interest rate technically at zero.

Now inflation has returned, rather abruptly, to its 'target' level of 2%. Rising food prices (a sign of growing household incomes) have had a major impact on the current inflation. Inflation is likely to stay close to 2%, primarily on account of rising unit labour costs (with wages climbing by over 4% and close to stagnant labour productivity).

It is likely that control of the exchange rate will be abandoned sometime later in 2017 and inflation targeting reinstated. In consequence, the Czech currency may appreciate in nominal terms, though the precise scale of this remains quite hard to assess. Combined with higher inflation, this may strengthen the real appreciation of the Czech currency, with possibly negative consequences for foreign trade (primarily via higher demand for imports). Control of inflation via hikes in interest rates may not be very productive, at least in the short run, because it is likely to strengthen the exchange rate more (or faster) than it reduces inflation. It will be interesting to see how the Czech monetary authorities cope with the new challenges. In any case, the consequences of real appreciation are unlikely to be dramatic, because the present trade and current account surpluses are very high. The competitive advantages of the economy, derived from the relatively low unit labour costs, will take more time to be seriously eroded.

Emerging labour shortages are felt in many sectors. Demography is an important determinant of the labour market situation. Since 2006, the working-age population has been contracting very rapidly (from about 71% of the total population to about 66% at present). This trend will continue in the near and medium term. The labour shortages induce high inflows of foreign workers. In 2015, foreigners (primarily Ukrainians, Slovaks and Poles) accounted for about 8% of overall employment.

Despite a tight labour market, average wages are expected to increase rather moderately in the near future (despite the 11% rise in the official minimum wage as of 1 January 2017). This will also affect the dynamics of household consumption, which is unlikely to become more buoyant, not least on account of Czech households' saving habits. Under the impact of very low retail interest rates, the growth in loans (primarily mortgages) to the household sector accelerated in 2016. This was paralleled by the growth in households' bank deposits (which has been accelerating since 2014). At about 66%, the ratio of the stock of households' debt to their disposable income is very low by international standards. The share of non-performing loans to households is low (3.4% at the end of September 2016) and falling. Once the increases in interest rates take hold, demand for loans may weaken, negatively affecting household consumption (and investment) demand.

The financial positions of non-financial corporations continued to be quite strong in 2016. The faster rise in unit labour costs experienced in 2016 is likely to continue in 2017-2019. But this is unlikely to impair corporations' ability to expand further, because wages are still quite low by international standards.

The fiscal policy envisaged for 2017-2019 targets surpluses in public finances and further declines in the (already very low) GDP share of public debt. As long as GDP growth continues and the economy nears its 'potential', represented by the stock of available labour force, such a fiscal policy may seem understandable (though neither high inflation nor external deficit is on the horizon). Trouble might arise should the fiscal policy try to respond to unforeseeable developments (e.g. in foreign trade) with a more restrictive stance (as was the case in 2011-2013). Such an instinctive response may then only worsen the situation.

Summing up, private consumption will continue to be the main driver of moderate GDP growth in 2017-2019. A cumulative 'virtuous' cycle of rising domestic demand and rising wages, consumption and investment is expected. All in all, the country's prospects look pretty good, though this might change if the authorities decide to undertake another round of unnecessary fiscal consolidation.

Table 9 / Czech Republic: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018 Forecast	2019
Population, th pers., average	10,511	10,514	10,525	10,546	10,564	10,580	10,590	10,600
Gross domestic product, CZK bn, nom.	4,060	4,098	4,314	4,555	4,700	4,900	5,100	5,300
annual change in % (real)	-0.8	-0.5	2.7	4.5	2.3	2.4	2.6	2.3
GDP/capita (EUR at PPP)	21,900	22,400	23,800	25,200	25,800	.	.	.
Consumption of households, CZK bn, nom.	1,970	1,997	2,044	2,110	2,180	.	.	.
annual change in % (real)	-1.3	0.5	1.7	3.2	2.6	2.6	2.7	2.6
Gross fixed capital form., CZK bn, nom.	1,052	1,027	1,084	1,198	1,180	.	.	.
annual change in % (real)	-3.1	-2.6	4.0	8.9	-1.8	2.8	3.5	4.5
Gross industrial production								
annual change in % (real)	-0.8	-0.1	5.0	4.6	3.0	4.0	4.0	4.0
Gross agricultural production								
annual change in % (real)	-5.8	6.0	10.1	-6.1	4.8	.	.	.
Construction industry								
annual change in % (real)	-7.6	-6.7	4.3	7.0	-7.7	.	.	.
Employed persons, LFS, th, average	4,890	4,937	4,974	5,042	5,135	5,150	5,160	5,160
annual change in %	0.4	1.0	0.8	1.4	1.8	0.2	0.1	0.0
Unemployed persons, LFS, th, average	367	369	324	268	212	210	200	190
Unemployment rate, LFS, in %, average	7.0	7.0	6.1	5.1	4.0	3.9	3.8	3.6
Reg. unemployment rate, in %, end of period 2)	9.4	8.2	7.5	6.2	5.2	.	.	.
Average monthly gross wages, CZK	25,067	25,035	25,768	26,467	27,800	29,500	31,200	32,900
annual change in % (real, gross)	-0.8	-1.5	2.5	2.4	4.3	4.2	4.0	3.5
Consumer prices (HICP), % p.a.	3.5	1.4	0.4	0.3	0.6	2.0	1.8	1.8
Producer prices in industry, % p.a.	2.4	0.7	0.9	-2.4	-3.5	-1.0	1.0	1.5
General governm. budget, EU-def., % of GDP								
Revenues	40.5	41.4	40.3	41.3	41.5	41.6	41.6	41.6
Expenditures	44.5	42.6	42.2	42.0	41.9	42.0	42.0	42.3
Net lending (+) / net borrowing (-)	-3.9	-1.2	-1.9	-0.6	-0.4	-0.4	-0.4	-0.7
Public debt, EU-def., % of GDP	44.5	44.9	42.2	40.3	39.5	38.7	37.5	37.0
Stock of loans of non-fin.private sector, % p.a	2.3	4.1	2.7	6.6	6.7	.	.	.
Non-performing loans (NPL), in %, Dec	6.0	5.9	6.1	5.8	4.8	.	.	.
Central bank policy rate, % p.a., end of period 3)	0.05	0.05	0.05	0.05	0.05	0.3	1.0	1.5
Current account, EUR mn	-2,518	-829	281	1,473	2,720	2,200	1,730	1,600
Current account, % of GDP	-1.6	-0.5	0.2	0.9	1.6	1.2	0.9	0.8
Exports of goods, BOP, EUR mn	104,336	103,184	110,397	118,167	118,100	122,000	127,000	132,000
annual change in %	5.3	-1.1	7.0	7.0	-0.1	3.0	4.0	4.0
Imports of goods, BOP, EUR mn	99,413	96,735	102,417	110,463	108,600	112,000	118,000	123,000
annual change in %	3.5	-2.7	5.9	7.9	-1.7	3.5	5.0	4.0
Exports of services, BOP, EUR mn	18,863	18,059	18,915	20,491	21,100	22,000	23,000	24,000
annual change in %	5.2	-4.3	4.7	8.3	3.0	3.5	4.0	4.5
Imports of services, BOP, EUR mn	15,776	15,346	16,892	17,741	17,500	18,000	19,000	20,000
annual change in %	8.0	-2.7	10.1	5.0	-1.4	4.0	4.5	4.5
FDI liabilities, EUR mn	7,348	5,544	6,101	2,223	5,500	.	.	.
FDI assets, EUR mn	2,531	5,831	3,175	3,211	830	.	.	.
Gross reserves of NB excl. gold, EUR mn	33,560	40,460	44,528	58,903	80,624	.	.	.
Gross external debt, EUR mn	96,826	99,652	106,251	115,877	121,400	130,100	136,600	144,000
Gross external debt, % of GDP	60.0	63.2	67.8	69.4	69.8	71.0	71.0	72.0
Average exchange rate CZK/EUR	25.15	25.98	27.54	27.28	27.03	26.75	26.50	26.50

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

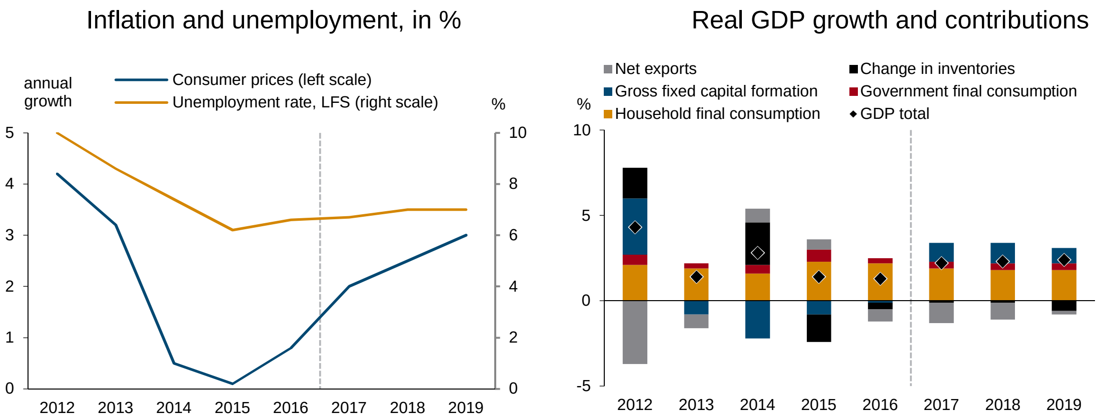
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ESTONIA: Public investment and private consumption will drive growth

SEBASTIAN LEITNER

In the next two years, we will see an improvement in the terms of trade with Western markets; meanwhile exports to Russia have already started to recover. Household consumption, backed by a rapid rise in minimum and overall real wages, continues to be the strongest driver of economic activity in Estonia. Moreover, an upswing in public investments should also speed up economic activity in the short run. GDP growth is projected to rise: from 2.2% in 2017 to 2.3% in 2018 and 2.4% in 2019.

Figure 39 / Estonia: Main macroeconomic indicators



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

Export growth started to accelerate in the final months of 2016, and this trend will continue in 2017. Goods volumes have increased year on year, while producer prices are still on the decline. In particular, goods and services exports to Russia gained strongly in momentum, having dropped by more than a third in 2015 and in the first half of 2016. The economy of neighbouring Sweden is expected to expand at an average of 2.5% per annum, while that of Finland – having emerged from a three-year recession last year – is expected to grow by about 1% both this year and in 2018. Exports to neighbouring Latvia, Estonia's third most important trade partner, continue to struggle, but are similarly expected to strengthen on account of a revival in investment in that country. Low oil prices render the production of shale oil – Estonia's second most important export product – economically inefficient. As a result, mostly shale oil-based electricity production is gradually declining, due to higher electricity imports from Finland. Overall, we expect goods exports to keep on growing at a stronger pace in 2017 and 2018.

In the second half of 2017, Estonia will assume the presidency of the Council of the EU, which is likely to increase income from tourism somewhat. However, we expect imports to grow even more strongly than exports in the next two years.

Investment activity of the enterprise sector will increase in 2017 and 2018. External demand and industrial production have started to strengthen; furthermore, activity in the construction sector has gained momentum. Data on building permits and mortgage loan growth suggest that dwelling construction will continue to expand in 2017. Public investment will increase markedly in 2017. The 2017 state budget of the Estonian government anticipates additional EU funds for public and private investment of 2-3% of GDP. Moreover, the government has enacted various measures to lower the income tax burden, such as a reduction in employer social security contributions of 1 percentage point (to 32%) over the coming two years, and an income tax refund for low-income groups. Overall, we expect the budget to remain slightly in surplus in 2017, while a further reduction in the public debt burden (which already fell below 10% of GDP in 2016) is envisaged. A large part of the rising public expenditure in 2017 will be devoted to defence (2.2% of GDP).

The population is finally growing again, and the activity and unemployment rate are both rising. The recovery in the years following the 2008/2009 bust brought a steady decline in the unemployment rate, to 6.2% in 2015. But this improvement in the labour market situation started to falter in 2016. While employment in the services sectors went on rising, it fell particularly in the shale oil and energy industry. The work ability reform, introduced in July 2016, increased the number of people registered as unemployed. In order to continue to receive benefits, people who hitherto qualified for a work incapacity pension now have to look more actively for jobs and take part in public work activation measures. The outcome is an increase both in activity rates, and in unemployment rates, since only some of those who have to look for a job actually find employment. Demographic statistics show that net emigration, which was substantial in the years after the economic crisis, has finally come to a halt in Estonia and the population of the country is growing again.

Strongly increasing real net wages (8.1% in 2016) are further pushing Estonian household consumption upwards. We expect an increase of 3.7% in real terms in 2017 and a slight deceleration in the years after that. Consumer prices have started to increase slightly in recent months. However, the upward price movement is mostly caused by an increase in excise taxes and, most recently, by rising energy prices. The core inflation rate is still rather low; however, in 2017 consumer prices will again rise more swiftly, pushed up by rising import prices. Forward-looking consumer confidence indicators show an improvement at the beginning of 2017, and the most recent retail trade and credit statistics indicate an increasing propensity to spend. Monthly incomes will continue to grow strongly, not least thanks to another increase in the minimum wage of 10% at the beginning of 2017 (to EUR 470), following a hike of the same magnitude at the beginning of 2016. Nevertheless, the ratio of the minimum wage to the national average wage is still one of the lowest in the European Union.

Moderate GDP growth returns to Estonia. GDP growth of 1.3% in real terms in 2016 was somewhat lower than forecast, due to the unexpectedly poor performance of investment. An upswing in external demand is ongoing, and private investment activity is picking up gradually. A strong upswing in public investments, not only this year, but also in 2018 and 2019, will be facilitated by increasing inflows of EU funds. Rising private income will help household consumption to grow swiftly. Thus, for 2017 and 2018, we maintain our forecast of an upswing to produce real GDP growth of 2.2% and 2.3%, respectively.

Table 10 / Estonia: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018	2019
							Forecast	
Population, th pers., average	1,323	1,318	1,315	1,315	1,315	1,315	1,315	1,315
Gross domestic product, EUR mn, nom.	17,935	18,890	19,758	20,252	20,680	21,560	22,610	23,850
annual change in % (real)	4.3	1.4	2.8	1.4	1.3	2.2	2.3	2.4
GDP/capita (EUR at PPP)	19,600	20,100	20,900	21,600	22,000	.	.	.
Consumption of households, EUR mn, nom.	8,885	9,465	9,818	10,267	10,790	.	.	.
annual change in % (real)	4.3	3.7	3.2	4.6	4.3	3.7	3.6	3.5
Gross fixed capital form., EUR mn, nom.	5,128	5,206	4,814	4,790	4,800	.	.	.
annual change in % (real)	12.7	-2.8	-8.1	-3.3	-0.5	4.5	5.0	4.0
Gross industrial production								
annual change in % (real)	1.1	4.1	3.9	-2.2	2.3	2.5	3.0	3.5
Gross agricultural production								
annual change in % (real)	5.6	4.7	4.6	8.7	-10.2	.	.	.
Construction industry								
annual change in % (real)	16.7	-0.1	-2.1	-5.3	2.5	.	.	.
Employed persons, LFS, th, average	614.9	621.3	624.8	640.9	650.0	655	660	665
annual change in %	1.9	1.0	0.6	2.6	1.4	0.8	0.8	0.8
Unemployed persons, LFS, th, average	68.5	58.7	49.6	42.3	46.0	47	50	50
Unemployment rate, LFS, in %, average	10.0	8.6	7.4	6.2	6.6	6.7	7.0	7.0
Reg. unemployment rate, in %, end of period 2)	6.2	5.3	4.4	4.7	4.5	.	.	.
Average monthly gross wages, EUR	887	949	1,005	1,065	1,150	1,240	1,330	1,450
annual change in % (real, gross)	1.7	4.1	6.0	6.5	7.8	6.0	5.0	6.0
Average monthly net wages, EUR	706	757	799	859	930	1,000	1,070	1,160
annual change in % (real, net)	1.1	4.3	5.7	8.0	8.1	5.0	4.0	5.0
Consumer prices (HICP), % p.a.	4.2	3.2	0.5	0.1	0.8	2.0	2.5	3.0
Producer prices in industry, % p.a.	2.7	7.2	-2.7	-3.0	-1.3	1.0	2.0	3.0
General governm. budget, EU-def., % of GDP								
Revenues	39.0	38.4	39.1	40.5	38.7	38.5	38.6	38.6
Expenditures	39.3	38.5	38.5	40.3	39.0	39.0	39.0	39.0
Net lending (+) / net borrowing (-)	-0.3	-0.2	0.7	0.1	-0.3	-0.5	-0.4	-0.4
Public debt, EU-def., % of GDP	9.7	10.2	10.7	10.1	9.8	9.0	8.0	7.5
Stock of loans of non-fin.private sector, % p.a	0.3	-0.7	2.6	4.7	3.0	.	.	.
Non-performing loans (NPL), in %, Dec	3.0	1.7	1.5	1.1	1.0	.	.	.
Central bank policy rate, % p.a., end of period 3)	0.75	0.25	0.05	0.05	0.00	.	.	.
Current account, EUR mn	-350	-66	182	447	553	200	100	0
Current account, % of GDP	-1.9	-0.4	0.9	2.2	2.7	0.9	0.4	0.0
Exports of goods, BOP, EUR mn	10,750	11,080	11,089	10,853	11,206	11,600	12,100	12,700
annual change in %	3.5	3.1	0.1	-2.1	3.3	3.6	4.3	5.0
Imports of goods, BOP, EUR mn	12,030	12,057	12,092	11,714	12,096	12,700	13,400	14,200
annual change in %	12.1	0.2	0.3	-3.1	3.3	5.0	5.5	6.0
Exports of services, BOP, EUR mn	4,672	4,876	5,322	5,204	5,514	5,800	6,000	6,300
annual change in %	15.7	4.4	9.1	-2.2	6.0	5.5	3.4	5.0
Imports of services, BOP, EUR mn	3,115	3,534	3,623	3,502	3,719	3,900	4,100	4,400
annual change in %	13.9	13.5	2.5	-3.3	6.2	5.4	5.1	6.1
FDI liabilities, EUR mn	1,394	820	1,252	-597	629	.	.	.
FDI assets, EUR mn	996	635	677	-423	491	.	.	.
Gross reserves of NB excl. gold, EUR mn	218	222	352	373	325	.	.	.
Gross external debt, EUR mn	17,957	17,593	19,101	19,208	19,400	19,800	20,800	21,500
Gross external debt, % of GDP	100.1	93.1	96.7	94.8	93.8	92.0	92.0	90.0

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

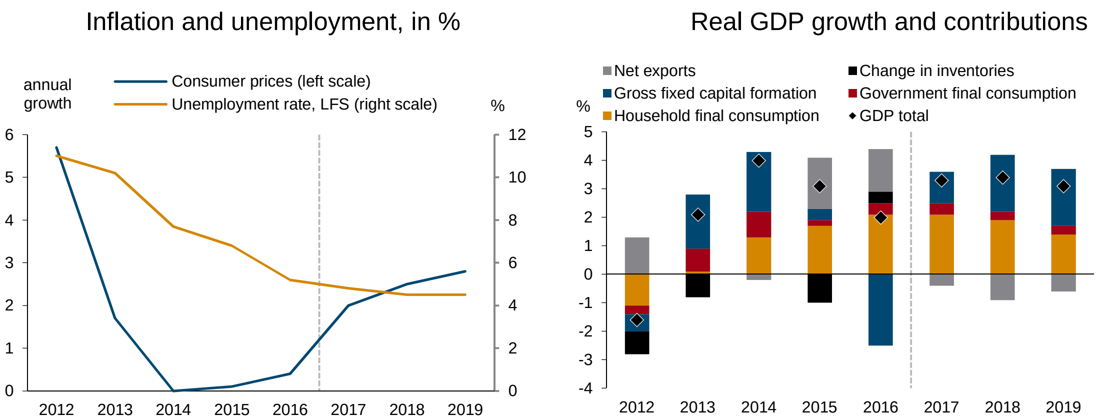
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

HUNGARY: Thriving household consumption pushes the economy onto a higher growth path

SÁNDOR RICHTER

Over the next three years, economic growth is forecast to remain above 3%. In 2016, the expansion of household consumption was the main driver of growth, and that will remain the case, at least until the election year 2018. A deterioration will begin in the external balances; there is expected to be a recovery in investment, largely financed by EU funds.

Figure 40 / Hungary: Main macroeconomic indicators



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

In 2016, economic growth slowed considerably (2%) compared to 2014-2015. The main driver of growth in 2014-2015, the EU co-financed investments, experienced a deep (albeit temporary) decline, as a consequence of a flaw in the construction of the Multiannual Financial Framework (MFF) of the EU, which allowed for considerable fluctuation in the funds disbursed at the interface of the two seven-year planning periods. Last year, household consumption growth replaced investment as the driver of expansion; it will continue to fulfil that function at least until the election year 2018.

Government attempts to counter the EU funds-related temporary investment decline had only limited success. The Hungarian government had promised an early mobilisation of cohesion policy-related EU resources from the 2014-2020 MFF to curb the anticipated decline in investment last year. There was to be an extended advance payment from the budget to the widest possible circle of beneficiary firms and institutions; the respective EU funds would have been collected later. But this plan could be implemented only partially: fixed capital formation generally – and within that, public investment in particular – declined sharply. The main contribution to growth came from consumption and, to a nearly equal extent, from net exports. The former is explained by a rapid rise in net real wages (7-8%); the latter by improved terms of trade and damped import demand due to the low tide of investment.

Wage increases have been accelerating since 2015, with a sudden jump last year. The explanation for this phenomenon is multi-faceted. A considerable push for wage rises resulted from the tightening labour market.

Employment expanded dynamically, while the unemployment rate declined, but the number of persons involved in public works schemes matches the number of those reported unemployed. Outward migration has also reduced the supply of skilled labour in an increasing number of areas of the economy. Some 75% of manufacturing firms already report shortage of labour as an obstacle to production. The figure is over 30% in the services sector with tourism, the retail trade, IT and the health sector affected the most. Both in manufacturing and the services sector the Hungarian indicator for shortage of labour is roughly double that reported by the country's regional peers. All in all, strong wage rises are supported by labour market developments. This push will be further strengthened by a big increase in the statutory minimum wage in 2017: 15% for unskilled and 25% for skilled employees. A change in taxation is trying to counterbalance the negative impact of wage increases on employers: social security contribution payed by employers (as a percentage of gross wages) were reduced from 27% to 22%, and it is envisaged that they will be cut by another 2 percentage points in 2018. There are further employment-fostering taxation changes in the pipeline for 2018 and beyond.

Both market forces and government initiatives will promote wage rises and a corresponding increase in household consumption in the coming years. An important question is how the subsystems of the economy will respond. Increased consumption will, without doubt, induce a surge in imports. In the short run, this should not be a problem because of the huge foreign trade surplus. Wage rises in the public sector will place an increased burden on the budget, but again there is no cause for concern in the short run, as there is room for greater expenditure without danger of the 3% deficit/GDP ratio being surpassed. Strong wage growth may, however, be problematic for firms. Multinational companies (which in any case pay higher wages than Hungarian-owned ones) can adapt more easily to the new situation than domestically owned small and medium-sized firms with a much lower productivity level. This latter group of firms will have to cope with increased labour costs. A positive outcome to this would see efforts being made to improve productivity; a negative outcome would see an increase in illegal employment, the postponement of company expansion – or even bankruptcy.

Fiscal policy is expected to be growth supportive in view of the forthcoming elections. Up until the last few days of 2016, the record of expenditure and revenue meant that the general government deficit for that year could have been very low. But then the government introduced a huge 'last-minute' increase in expenditure across a wide range of areas: e.g. advance payments for EU projects, being under the control of individual ministries, the health sector, etc.). Certainly this expenditure will have an impact on the real economy only this year. The general government deficit may after all have exceeded 2% of GDP. The government will most probably use the room opened up for deficit spending without endangering fiscal stability in the next two years, as prescribed in the Maastricht criteria. As for the fiscal steps to be taken in the run-up to the elections in spring 2018, these are expected to involve mostly 'mood-improving' measures: a reduction in some centrally regulated prices, a cut in tax rates, wage increases in the public sector.

The foreign exposure of Hungarian public finance has decreased considerably in recent years. Purchases of government securities by the banking sector and by households enabled the public sector to refinance the maturing foreign exchange debt without major foreign exchange bond issuance. The share of foreign currency-denominated debt in the government's total external debt dropped to the level observed pre-crisis. As for monetary policy, it remains relaxed and the policy rate is expected to stay relatively low this year and next, despite recurring inflation. The financial sector shows encouraging signs of recovery, with lending starting to grow for both the business and the household sectors.

Over the medium term, the country's massive trade surplus will shrink. The Hungarian current account displayed huge surpluses in 2013-2016, ranging from 2% to more than 4% of GDP. This came from a surplus in trade in goods and services (7-10% of GDP) and the large net inflow of EU transfers (3-5%), while the income balance (4-6% of GDP in the last six years) reduced the current account surplus in the years concerned. The improvement in the terms of trade due to low prices for imported energy has been considerable in the past four years. Meanwhile 2017 is expected to bring about a turn in foreign trade. The improvement in the terms of trade will cease, while a strong rise in household consumption and an upturn in investment will push the growth rate of imports above that of exports. On the forecast horizon, the surpluses in the trade and current account balances will diminish; but because of the huge surpluses, this will not impose any constraint on the new, mainly consumption-driven growth in the short run.

Together with the revival of EU co-financed investment projects, dynamically increasing consumption will be the Hungarian growth driver over the next couple of years. However, these developments will place the Hungarian economy at a crossroads:

› In an *optimistic scenario*, additional demand via a strong expansion in consumption will be met by an appropriate expansion of domestic supply in goods and services, and thus will not generate unsustainable import growth in the medium term. Firms that are domestically owned and that supply the domestic market will start modernising via revived investment activities; export-oriented foreign-owned firms will absorb the increased labour costs. This new dynamism in the economy will be maintained *despite* the current unfavourable political environment, characterised by lack of transparency and extreme centralisation of government decision making; the incalculable, abruptly changing legal regulations; and the widespread cronyism and corruption.

› In a *pessimistic scenario*, the pattern of 2002-2006 will recur: strong consumption growth will lead to a resurgence in unsustainable foreign trade and public finance deficits in just a few years; investment will remain heavily dependent on EU transfers and foreign direct investment; and modernisation across most of the economy will get further bogged down. Rapidly increasing wages will force an increasing number of foreign-owned manufacturing companies to relocate their activities to other countries, and the fact that after 2020 EU transfers will most probably decline substantially will bring the Hungarian economy to near stagnation. Certainly the unfavourable political environment described above will be of no help in avoiding this scenario.

In this and the next two years, economic growth is forecast to remain above 3%, with an expected peak of 3.4% in the election year 2018. A deterioration in the external balances will begin. Investment – carried mainly by EU transfers and supported by a reduction in the corporate income tax rate to 9% (from 19% in general and from 10% in the case of small enterprises) – may recover by 2018.

Meanwhile 2019 may be a year of consolidation, with already less-dynamic wage rises. While consumer price inflation will return to ‘normal’, general government deficit is expected to remain below the 3% of GDP threshold, with public debt slowly shrinking. The fiscal room is available now to improve the financial position of the long-neglected health and education sectors and to ease the extreme poverty of distinct social groups. It remains to be seen, however, whether this will happen or whether further prestige sports investments will steal the show.

Table 11 / Hungary: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018	2019
							Forecast	
Population, th pers., average	9,920	9,893	9,866	9,843	9,810	9,780	9,750	9,720
Gross domestic product, HUF bn, nom.	28,661	30,127	32,400	33,999	35,500	37,700	40,200	42,600
annual change in % (real)	-1.6	2.1	4.0	3.1	2.0	3.3	3.4	3.1
GDP/capita (EUR at PPP)	17,400	17,900	18,700	19,700	20,300	.	.	.
Consumption of households, HUF bn, nom.	14,922	15,207	15,730	16,205	17,300	.	.	.
annual change in % (real)	-2.2	0.2	2.5	3.4	4.5	4.5	4.0	3.0
Gross fixed capital form., HUF bn, nom.	5,548	6,308	7,064	7,367	6,700	.	.	.
annual change in % (real)	-3.0	9.8	9.9	1.9	-11.5	5.0	9.0	9.0
Gross industrial production								
annual change in % (real)	-1.8	1.1	7.7	7.4	1.0	6.0	7.0	6.0
Gross agricultural production								
annual change in % (real)	-10.0	12.5	11.4	-2.3	8.5	.	.	.
Construction industry								
annual change in % (real)	-6.5	8.4	13.5	3.0	-18.8	.	.	.
Employed persons, LFS, th, average	3,827	3,893	4,101	4,211	4,350	4,370	4,390	4,390
annual change in %	1.8	1.7	5.3	2.7	3.3	0.5	0.5	0.0
Unemployed persons, LFS, th, average	473	441	343	308	237	220	210	210
Unemployment rate, LFS, in %, average	11.0	10.2	7.7	6.8	5.2	4.8	4.5	4.5
Reg. unemployment rate, in %, end of period	12.7	9.3	8.9	7.6	6.1	.	.	.
Average monthly gross wages, HUF 2)	223,060	230,714	237,695	247,924	263,600	281,000	299,500	316,800
annual change in % (real, gross)	-0.9	1.7	3.2	4.4	5.9	4.5	4.0	2.9
Average monthly net wages, HUF 2)	144,085	151,118	155,690	162,391	175,300	186,900	199,200	210,700
annual change in % (real, net)	-3.4	3.1	3.2	4.4	7.5	4.5	4.0	2.9
Consumer prices (HICP), % p.a.	5.7	1.7	0.0	0.1	0.4	2.0	2.5	2.8
Producer prices in industry, % p.a.	4.1	0.6	-0.4	-0.9	-1.7	1.0	2.0	2.3
General governm.budget, EU-def., % of GDP								
Revenues	46.2	46.8	46.9	48.5	47.5	47.5	47.5	47.5
Expenditures	48.6	49.3	49.0	50.0	49.8	50.4	50.4	50.4
Net lending (+) / net borrowing (-)	-2.3	-2.6	-2.1	-1.6	-2.3	-2.9	-2.9	-2.9
Public debt, EU-def., % of GDP	78.2	76.6	75.7	74.7	73.9	72.9	71.9	70.9
Stock of loans of non-fin.private sector, % p.a.	-12.8	-4.4	-0.3	-12.3	-1.8	.	.	.
Non-performing loans (NPL), in %, Dec	17.6	18.1	17.4	13.6	11.9	.	.	.
Central bank policy rate, % p.a., end of period 3)	5.75	3.00	2.10	1.35	0.90	1.00	1.30	1.50
Current account, EUR mn 4)	1,752	3,892	2,181	3,714	4,910	5,000	4,300	3,400
Current account, % of GDP 4)	1.8	3.8	2.1	3.4	4.3	4.2	3.4	2.5
Exports of goods, BOP, EUR mn 4)	69,961	70,243	74,423	79,604	82,613	86,700	91,900	98,100
annual change in %	-2.6	0.4	6.0	7.0	3.8	5.0	6.0	6.7
Imports of goods, BOP, EUR mn 4)	67,028	66,912	72,051	75,237	77,632	82,300	88,600	95,900
annual change in %	-2.7	-0.2	7.7	4.4	3.2	6.0	7.7	8.2
Exports of services, BOP, EUR mn 4)	16,060	16,993	18,640	19,957	20,853	22,100	23,600	25,200
annual change in %	0.1	5.8	9.7	7.1	4.5	6.0	6.9	6.7
Imports of services, BOP, EUR mn 4)	12,263	13,232	13,732	14,562	14,789	15,800	17,100	18,500
annual change in %	-3.8	7.9	3.8	6.0	1.6	6.6	8.4	8.2
FDI liabilities, EUR mn 4)	4,405	4,986	6,868	5,964	-8,129	.	.	.
FDI assets, EUR mn 4)	2,310	3,848	4,035	5,565	-12,217	.	.	.
Gross reserves of NB excl. gold, EUR mn	33,757	33,696	34,481	30,226	24,384	.	.	.
Gross external debt, EUR mn 4)	127,667	119,963	120,077	116,937	113,400	112,500	111,200	108,200
Gross external debt, % of GDP 4)	128.8	118.2	114.4	106.6	99.5	93.4	87.1	81.0
Average exchange rate HUF/EUR	289.25	296.87	308.71	310.00	311.44	313	315	319

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

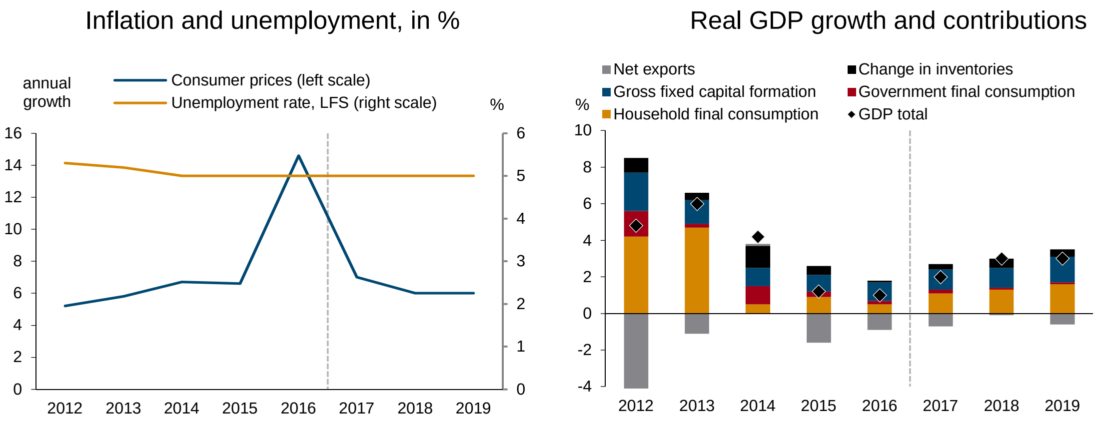
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

KAZAKHSTAN: Benefiting from higher oil prices

OLGA PINDYUK

Higher oil prices allowed for faster economic growth and stabilisation of the exchange rate at the end of 2016. Inflation has slowed and will likely stay within the target range of the national bank. GDP has been growing mainly on the back of investment, while consumer demand has been sluggish. Growth of the economy will accelerate during 2017-2019, but the growth rate will be lower than in the pre-2015 years – at 2-3% annually. Investment will continue to be the main driver of growth.

Figure 41 / Kazakhstan: Main macroeconomic indicators



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

Higher oil prices and the successful launch of the Kashagan oil field caused Kazakhstan's economic growth to accelerate in the last quarter of 2016. According to preliminary data, real GDP increased by 1% last year, while in the first nine months of 2016 growth was only 0.4%, year on year. Industrial production increased in the fourth quarter for the first time in two years, in both the mining and the processing industry. Kazakhstan's agreement with the Organisation of the Petroleum Exporting Countries (OPEC) to reduce its oil output by 20,000 barrels a day should have no significant impact on growth dynamics, as the decrease was calculated from the November 2016 level, when oil production was 8% (or about 120,000 barrels per day) higher than the average volume of oil production in 2016.

GDP has been growing primarily on the back of investment, while consumer demand has been sluggish: during the first nine months of 2016, household consumption increased by only 1% year on year. It appears that households have been using their savings and credit to finance consumption, as real household incomes declined during January-November 2016 by 4.7% year on year, and real wages fell for the second year in a row, down by 2% in 2016 compared with the previous year. In an attempt to address this issue, President Nazarbayev ordered a 20% rise in pensions and child support payments in 2017. However, a significant increase in social expenditure is unlikely in the near future, as the government is committed to the plan for fiscal consolidation, according to which the non-oil deficit will be reduced from about 11% in 2015 to 7% in 2020. Real wages are expected to bounce back and start rising again in 2017 as industrial production recovers, but growth will most likely be modest during the forecast period. Gross fixed capital formation has been much more dynamic than consumption – in the first nine months of 2016, it expanded by 4% year on year. Fiscal policy has been supportive of investment growth, as the counter-cyclical fiscal stimulus package 'Nurly Zhol' (Path to the Future) has helped bolster activity in housing, construction and transport infrastructure. As a result, construction experienced the fastest growth in the economy – up 6.9% year on year during the first nine months of 2016. In addition, foreign direct investment (FDI) picked up significantly in 2016 to account for about one third of investment. The bulk of FDI has traditionally gone into oil extraction and geological exploration (around 56% of total FDI in the first half of 2016); the second biggest recipient was the metal industry (around 13%).

Merchandise exports dropped by about 20% in 2016, due to weak external demand for commodities and sluggish performance by the country's main trading partners. Merchandise imports declined similarly rapidly as a consequence of the sharp depreciation of the tenge and anaemic consumer demand. We forecast that both exports and imports will bounce back in 2017, but export growth will be higher, as the oil price is expected to stay at the level of about USD 55 per barrel, up by more than 20% compared to the average 2016 level. During 2018-2019, the growth of imports will outstrip that of exports on the back of robust investment demand and the recovery of private consumption.

In recent months, higher oil prices have allowed stabilisation of the KZT/USD exchange rate and a gradual restoration of confidence in the domestic currency. The share of forex deposits in total deposits of households decreased to 62% at the end of 2016, down 4.6 percentage points (pp) compared with September 2016. Inflationary pressures have eased as the exchange rate has stabilised. As a result, the year-on-year consumer price index (CPI) fell to 7.8% in January 2017, which is within the limits of the target range of the national bank. We expect the inflation deceleration to ease as the base effect fades, and CPI to remain in the target range of 6-8% during 2017-2019. The policy rate is likely to be adjusted more gradually than in 2016, when it was cut by 5 pp to 12% in just eight months. We forecast that it will be down to 9% by the end of 2019.

The banking system remains a major bottleneck for Kazakhstan's economy. Though banks' liquidity positions have improved as confidence in the tenge has gradually begun to recover, lending remains subdued – in 2016, loan stocks increased by only 1.5% year on year. Banks are cautious in the light of low growth, declining real incomes, risks of continuing depreciation and low quality of existing assets. The officially reported level of non-performing loans (NPL) is relatively low (6.7% at the end of 2016), but it appears that a higher share of assets in the balance sheets could be non-performing. The Kazakh government announced plans to transfer KZT 2 trillion (about USD 6 billion) from the National

Wealth Fund to the Problem Loan Fund to help clean up bad loans from banks' balance sheets. This amounts to more than 15% of the total loan stocks in the country and is a sign that bad assets are much higher than the NPL statistics suggest. According to the latest Moody's report, there was a rise in problem loans in 2016 to 37% of total loans among the rated banks, and Kazakh banks will continue to face solvency risks over the next 12-18 months. The National Bank of Kazakhstan has been supporting banks through the placement of state deposits and subsidised lending programmes, but recognition of loan losses and increase in capital has yet to be accomplished. Consolidation of the banking sector is likely in the next years, as banks will have to come up with additional capital.

Political uncertainty has been growing in Kazakhstan as the exit of President Nazarbayev becomes increasingly likely in the near future. Nazarbayev, who is now 76 years of age, has been in power for more than 25 years, and fears of a power struggle between the political elites are mounting. In order to reduce the chances of political turmoil, the president has proposed changes to the constitution, whereby some of his powers would be delegated to parliament: the president would have to consult parliament before putting forward a prime ministerial candidate for confirmation by parliamentary vote. Currently, Kazakhstan's prime minister is nominated by the president and approved by parliament. However, these changes are regarded as rather cosmetic, as parliament is controlled by the president's party Nur Otan. A greater redistribution of powers between the president, parliament and government would be needed to minimise the risks associated with the political succession.

Poor economic performance has been causing increasing public dissatisfaction with the government. Several protests have taken place across the country during 2016-2017, the most recent being a hunger strike by oil workers in protest against the suppression of the Confederation of Independent Trade Unions. The government has been very aggressive in suppressing the protests, denying permits to protest and jailing peaceful protesters. In addition, the Kazakh authorities have prosecuted independent journalists and activists, and have shut down or blocked access to particular websites in order to limit potential opposition. Given all these measures, the risk of nation-wide protests remains rather low.

Overall, Kazakhstan's economy will slowly recover from the period of low global oil prices, and GDP growth is expected to reach 2% in 2017. In 2018-2019, annual growth is expected to accelerate to 3%. The growth of household consumption will speed up only slightly – to 2-3% annually, a marked slowdown compared to the 10-12% recorded during 2010-2014. Investment will grow much faster – by 5-6% per annum, stimulated by government policies. Major risks to the forecast are a further depreciation of the currency, a crisis of the banking system and a turbulent political succession to the president. Recent sporadic social unrest is unlikely to grow, as the government has been suppressing it quite energetically.

Table 12 / Kazakhstan: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018	2019
							Forecast	
Population, th pers., average	16,791	17,035	17,289	17,544	17,800	18,100	18,350	18,600
Gross domestic product, KZT bn, nom.	31,015	35,999	39,676	40,884	45,732	50,400	55,000	59,500
annual change in % (real)	4.8	6.0	4.2	1.2	1.0	2.0	3.0	3.0
GDP/capita (EUR at PPP)	16,900	17,400	18,200	18,700	18,600	.	.	.
Consumption of households, KZT bn, nom.	13,659	17,617	18,806	21,492	24,900	.	.	.
annual change in % (real)	10.1	10.6	1.1	1.8	1.0	2.0	2.5	3.0
Gross fixed capital form., KZT bn, nom.	7,072	7,877	8,552	9,355	11,400	.	.	.
annual change in % (real)	9.9	5.5	4.4	4.2	4.5	5.0	5.0	6.0
Gross industrial production								
annual change in % (real)	0.7	2.5	0.3	-1.6	-1.1	2.0	3.0	3.0
Gross agricultural production								
annual change in % (real)	-17.8	11.7	1.0	3.4	5.5	.	.	.
Construction industry								
annual change in % (real)	3.1	3.5	4.6	4.4	7.9	.	.	.
Employed persons, LFS, th, average	8,507	8,571	8,510	8,624	8,610	8,650	8,690	8,730
annual change in % 2)	1.0	0.7	-0.7	1.3	-0.2	0.5	0.5	0.5
Unemployed persons, LFS, th, average	475	471	452	451	450	460	460	460
Unemployment rate, LFS, in %, average	5.3	5.2	5.0	5.0	5.0	5.0	5.0	5.0
Reg. unemployment rate, in %, end of period	0.4	0.3	0.4	0.4	0.4	.	.	.
Average monthly gross wages, KZT 3)	101,263	109,141	121,021	126,021	142,351	155,400	169,700	185,300
annual change in % (real, gross)	7.0	1.9	3.9	-2.4	-1.4	2.0	3.0	3.0
Consumer prices (HICP), % p.a.	5.2	5.8	6.7	6.6	14.6	7.0	6.0	6.0
Producer prices in industry, % p.a.	3.5	-0.3	9.5	-20.5	16.8	10.0	5.0	2.0
General governm.budget, nat.def., % of GDP								
Revenues	18.7	17.7	18.5	18.7	20.4	19.0	19.0	18.5
Expenditures	21.6	19.7	21.2	20.9	22.0	20.7	20.6	19.5
Deficit (-) / surplus (+)	-2.9	-1.9	-2.7	-2.2	-1.6	-1.7	-1.6	-1.0
Public debt, nat.def., % of GDP	12.7	12.6	14.6	22.7	25.7	24.0	23.0	22.0
Stock of loans of non-fin.private sector, % p.a.	13.4	13.4	7.2	4.7	1.5	.	.	.
Non-performing loans (NPL), in %, Dec	28.2	31.2	23.5	8.0	7.0	.	.	.
Central bank policy rate, % p.a., end of period 4)	5.5	5.5	5.5	16.0	12.0	11.0	10.0	9.0
Current account, EUR mn 5)	823	894	4,483	-4,929	-7,385	-3,700	-3,100	-4,000
Current account in % of GDP 5)	0.5	0.5	2.7	-3.0	-6.1	-2.4	-1.9	-2.2
Exports of goods, BOP, EUR mn 5)	67,629	64,435	60,440	41,961	33,657	42,800	47,100	50,400
annual change in %	10.5	-4.7	-6.2	-30.6	-19.8	27.0	10.0	7.0
Imports of goods, BOP, EUR mn 5)	37,954	38,244	33,162	30,523	25,123	28,900	30,900	33,700
annual change in %	30.9	0.8	-13.3	-8.0	-17.7	15.0	7.0	9.0
Exports of services, BOP, EUR mn 5)	3,756	3,988	4,981	5,782	5,767	6,800	7,300	7,800
annual change in %	20.5	6.2	24.9	16.1	-0.3	18.0	7.0	7.0
Imports of services, BOP, EUR mn 5)	9,925	9,379	9,721	10,403	10,101	11,600	12,200	13,200
annual change in %	25.9	-5.5	3.6	7.0	-2.9	15.0	5.0	8.0
FDI liabilities, EUR mn 5)	10,618	7,536	5,336	5,940	15,629	.	.	.
FDI assets, EUR mn 5)	1,394	1,488	1,749	2,881	2,680	.	.	.
Gross reserves of NB excl. gold, EUR mn	16,665	13,940	17,920	18,555	18,832	.	.	.
Gross external debt, EUR mn 5)	103,150	109,137	129,328	140,517	141,700	159,900	161,500	163,200
Gross external debt, % of GDP 5)	63.7	61.3	77.6	84.5	117.3	104.7	96.9	90.5
Average exchange rate KZT/EUR	191.67	202.09	238.10	245.80	378.63	330	330	330

1) Preliminary and wiiw estimates. - 2) wiiw estimate in 2012 due to census March 2009. - 3) Excluding small enterprises, engaged in entrepreneurial activity. - 4) From 2015 one day (overnight) repo rate, refinancing rate of NB before. - 5) Converted from USD.

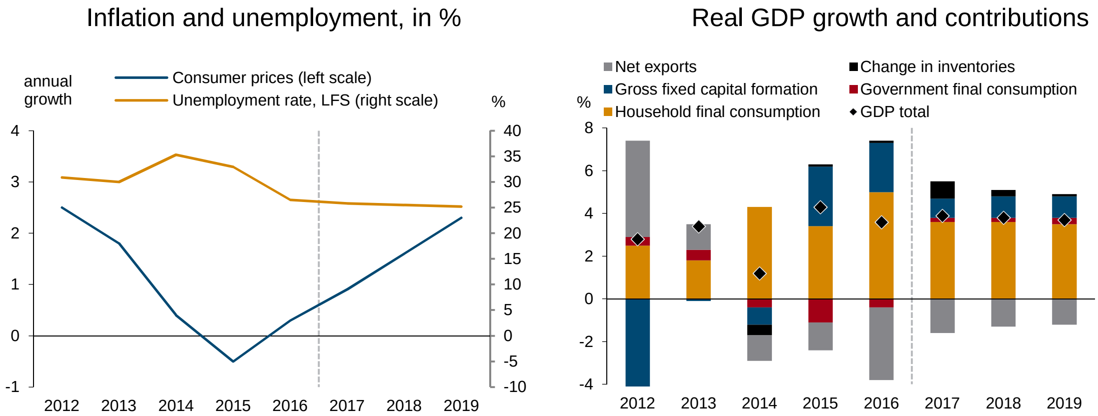
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

KOSOVO: Remittances to continue driving growth

RICHARD GRIEVESON

The economy will remain one of the fastest growing in Europe during the 2017-2019 forecast period, driven by remittances and investment. Domestic demand-driven growth and limited export capacity will mean that the large external deficit will widen further. The IMF programme will be key to maintaining fiscal discipline. Political risks have risen, but should remain contained and are unlikely to significantly derail the economy's momentum.

Figure 42 / Kosovo: Main macroeconomic indicators



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

Political tensions between Kosovo and Serbia have increased. Since the Brussels agreement in 2013, there have been increasing signs of cooperation between the two countries. However, in January 2017, a train left Belgrade to travel to Mitrovica in Kosovo, where the majority of remaining ethnic Serbs in Kosovo live. The train had been painted in Serbian national colours and had 'Kosovo is Serbia' written on it in 21 different languages, including Albanian. The train was stopped before it reached Kosovo. The two sides accused one another of stoking tensions. Serbian President Tomislav Nikolić said that Serbia was ready to enter northern Kosovo militarily to protect Serbs living there. Kosovo President Hashim Thaçi accused Serbia of attempting to replicate a 'Crimea model' to take control of northern Kosovo. The tensions currently look unlikely to go further than heated verbal exchanges. Both sides have a strong incentive not to escalate the situation. However, political risk has clearly risen, in line with a broader rise in tensions across much of the region.

The economy gained momentum in the second half of 2016, and looks quite strong heading into 2017. Real GDP growth reached 3.8% year on year in July-September, up from 2.4% in the second quarter. On the expenditure side, growth was driven exclusively by household consumption in the third quarter, while net exports contributed negatively. After five consecutive quarters of very strong growth, gross capital formation was largely flat. Using a production approach, growth in the third quarter was underpinned by a combination of mining and quarrying, and wholesale and retail trade. We estimate full-year growth of 3.9% in 2016 – lower than 2015 (4.3%), but otherwise the fastest for several years. This is an upward revision from our previous forecast round, reflecting stronger-than-expected consumption.

Private consumption will remain the main driver of growth during the forecast period. Remittances – a key driver of growth – rose by a relatively meagre 2% year on year in the first three quarters of 2016 (compared with an average 9.1% in 2013-2015). However, in general the outlook for remittance inflows appears positive. Around 60% of remittance inflows come from Germany and Switzerland, both of which have strong labour markets. Real disposable incomes are being boosted by low inflation, although the effects of this will wear off gradually during 2017 as price growth picks up. Household lending has risen particularly strongly (see below). The effective interest rate on new loans has continued to fall in line with loose European Central Bank policy, averaging 7.5% in 2016, compared with 8.3% in the previous year.

Investment will also contribute positively to growth, at least in the early part of the forecast period. This will be helped by public infrastructure investment programmes, supported by the IMF, in an attempt to increase the economy's productive potential. However, some large investment projects that have recently been driving growth (including public investment in roads and various private sector projects) will wind down by the end of the forecast period. As detailed in our autumn 2016 report, the failure to agree terms on a major ski resort investment has dealt a blow to the outlook for fixed capital formation growth. Net trade meanwhile should continue to make negative contributions to growth, reflecting the impact of strong remittance- and credit-driven consumption on imports in the context of limited domestic productive capacity.

We think that growth of a little below 4% is achievable during the forecast period. This will be driven in particular by remittances, credit and construction. Although the inflows of remittances look likely to be quite secure (the German and Swiss labour markets should continue to perform well), this remittance- and credit-driven consumption will widen the current account deficit, increasing Kosovo's external vulnerabilities. It may also push up inflation ahead of productivity, preventing the development of a stronger tradable sector and making the economy ever more unbalanced.

Inflation recovered towards the end of 2016, and will rise again this year. The harmonised index of consumer prices rose by 1.3% year on year in December, from 0.9% the previous month. This was the highest rate of inflation since September 2014. Prices were driven higher in December by the transport component (+3.7%), reflecting the rise in global energy prices. Strong growth (+6.1%) was also recorded in the prices of alcoholic beverages and tobacco. Global energy developments will continue to push up inflation this year, although the headline level will drop after the first quarter, as energy base effects become less supportive. We forecast consumer price growth of 0.9% on average in 2017, rising to 1.6% in 2018 and 2.3% in 2019.

The budget deficit will be around 2% of GDP during the forecast period. According to the IMF, the budget performed in line with targets up to the third quarter of 2016. Stronger economic growth benefited tax revenue. We estimate a full-year deficit equivalent to 1.9% of GDP for last year. The 2017 budget targets a rise in capital spending. However, the IMF has warned of the potential for current spending to rise too high. We think that in 2017-2019 the deficit will not rise much over 2%, thanks to the discipline of the IMF stand-by arrangement (SBA). Fiscal reforms (to social payments and pensions) are being undertaken as part of the SBA. Public debt is very low. Total debt reached 14.3% of GDP in the third quarter of 2016. Almost all of the debt is in euros, and almost half is concessional. The average weighted interest rate on public debt was 2.16% in the third quarter of 2016, while the average time to maturity was almost five years.

Credit growth has been rapid, with gross domestic loans rising by 10.4% in 2016, according to the central bank. This was driven primarily by loans to households, which rose by 14.7% last year, while credit to non-financial corporations increased by 8.5%. The level of non-performing loans is currently low, at around 5%. There has been some improvement in legislation around collateral recovery, and the sector overall is well capitalised and profitable. However, such a high level of credit growth creates some potential risks. The authorities are currently working on an improvement in the macro-prudential framework as part of the IMF SBA.

Kosovo runs big external deficits, reflecting a lack of domestic production of physical goods. The external shortfall reflects a huge goods deficit (equivalent to 36% of GDP in 2015, the last year for which full-year data are available). This is partly offset by secondary income inflows (largely remittances). Net secondary income inflows totalled 18% of GDP in 2015. The goods shortfall is otherwise financed by a combination of other income (loans), a surplus on the services account, an unobserved component and relatively small net foreign direct investment (FDI) inflows. The current account deficit reached an estimated 9.9% of GDP in 2016. In the first three quarters of 2016, the external shortfall widened by EUR 105 million to EUR 315 million, driven by a EUR 163 million widening of the goods deficit, reflecting strong domestic demand and a consequent rise in imports. This was partly offset by the EUR 88 million year-on-year increase in the services surplus. Net FDI inflows fell to EUR 158 million, down EUR 90 million compared with the same period of the previous year. The most important sources were China, Turkey, the UK and Albania (around two-thirds of FDI in this period went into real estate, with a further 20% into construction). Meanwhile net inflows of other investment (loans) rose to EUR 204 million, more than double the level of the previous year.

With consumption set to remain the main driver of growth, and domestic production unlikely to rise enough to meet this demand, the current account deficit will widen further during the forecast period. We expect the shortfall to reach 11.8% of GDP by 2019. This will continue to be primarily financed by a combination of remittances, lending and (to a lesser extent) net FDI inflows. There are signs that prolonged regional political instability, plus a lack of progress on sensitive topics (such as the demarcation line with Montenegro), is discouraging FDI. The part reliance on debt-creating inflows to finance the consumption-driven deficit is a potential source of risk. External debt has risen, reaching over EUR 2 billion in the third quarter of 2016. We estimate a full-year external debt level equivalent to 40% of GDP. Over 40% of external debt is inter-company lending, which reduces the risks associated with it. However, both banks and corporates have quite high levels of short-term external debt (representing around 30% of the total external debt level between them).

In summary, the economy should be able to maintain its healthy growth momentum during the forecast period. We forecast growth of 3.9% this year, and 3.8% and 3.7% in 2018 and 2019, respectively. The lack of significant domestic productive capacity is unlikely to change significantly in the coming years, and as a result remittance-financed private consumption, and investment, will be the primary drivers of growth.

Table 13 / Kosovo: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018	20119
							Forecast	
Population, th pers., average	1,807	1,818	1,813	1,788	1,780	1,780	1,790	1,800
Gross domestic product, EUR mn, nom.	5,059	5,327	5,568	5,807	6,000	6,300	6,600	7,000
annual change in % (real)	2.8	3.4	1.2	4.3	3.6	3.9	3.8	3.7
GDP/capita (EUR at PPP)	6500	6500	6700	7400	7800	.	.	.
Consumption of households, EUR mn, nom.	4,458	4,652	4,926	5,045	5,338	.	.	.
annual change in % (real)	2.9	2.0	4.9	3.8	5.8	4.2	4.1	4.0
Gross fixed capital form., EUR mn, nom.	1,317	1,323	1,294	1,499	1,634	.	.	.
annual change in % (real)	-13.6	-0.2	-3.3	12.1	9.0	3.5	4.0	4.0
Gross industrial production 2)								
annual change in % (real)	14.9	6.5	-1.3	5.0	3.5	4.0	5.0	5.0
Gross agricultural production 2)								
annual change in % (real)	-8.5	1.4	0.8	-3.0	-2.8	.	.	.
Construction output 2)								
annual change in % (real)	-8.5	2.6	-6.1	4.0	5.0	.	.	.
Employed persons, LFS, th, average 3)	303	338	324	297	316	330	340	350
annual change in %	.	11.7	-4.4	-8.2	6.5	5.5	4.3	3.1
Unemployed persons, LFS, th, average 3)	136	145	177	146	114	110	120	120
Unemployment rate, LFS, in %, average 3)	30.9	30.0	35.3	32.9	26.5	25.8	25.5	25.2
Reg. unemployment rate, in %, end of period	.	.	.	.		.	.	.
Average monthly net wages, EUR 4)	354	356	416	446	460	470	490	520
annual change in % (real, net)	-0.8	-1.2	16.4	9.0	3.0	2.0	2.5	3.0
Consumer prices, % p.a.	2.5	1.8	0.4	-0.5	0.3	0.9	1.6	2.3
Producer prices, % p.a.	1.9	2.5	1.7	2.7	-0.3	1.5	2.1	2.4
General governm.budget, nat.def., % of GDP								
Revenues	27.3	25.5	24.2	29.4	28.6	28.9	29.8	29.8
Expenditures	28.6	28.0	27.2	27.8	30.5	31.0	32.0	32.0
Deficit (-) / surplus (+)	-1.2	-2.5	-2.9	1.6	-1.9	-2.1	-2.2	-2.2
Public debt, nat.def., % of GDP	8.1	8.9	10.5	12.9	13.2	14.7	16.2	17.5
Stock of loans of non-fin.private sector, % p.a	4.4	2.6	6.2	7.2	9.9	.	.	.
Non-performing loans (NPL), in %, Dec	7.5	8.7	8.3	6.2	4.8	.	.	.
Central bank policy rate, % p.a., end of period 5)	12.24	10.90	9.29	7.69	7.22	7.30	7.30	7.30
Current account, EUR mn	-293	-179	-385	-497	-591	-658	-736	-824
Current account, % of GDP	-5.8	-3.4	-6.9	-8.6	-9.9	-10.4	-11.2	-11.8
Exports of goods, BOP, EUR mn	282	291	324	322	330	340	364	389
annual change in %	-10.9	3.4	11.3	-0.6	2.3	3.0	7.1	6.9
Imports of goods, BOP, EUR mn	2,332	2,287	2,383	2,432	2,647	2,790	2,970	3,175
annual change in %	-1.3	-1.9	4.2	2.1	8.8	5.4	6.5	6.9
Exports of services, BOP, EUR mn	894	875	929	952	955	998	1,053	1,120
annual change in %	9.0	-2.2	6.1	2.5	0.4	4.5	5.5	6.4
Imports of services, BOP, EUR mn	395	355	469	494	509	525	540	557
annual change in %	-7.0	-10.1	32.0	5.5	2.9	3.1	2.9	3.1
FDI liabilities, EUR mn	229	280	151	309	400	.	.	.
FDI assets, EUR mn	16	30	27	37	37	.	.	.
Gross reserves of NB excl. gold, EUR mn	727	694	645	734	830	.	.	.
Gross external debt, EUR mn	1,517	1,608	1,737	1,932	2,400	2,400	2,500	2,700
Gross external debt, % of GDP	30.0	30.2	31.2	33.3	40.0	38.7	38.5	38.5

1) Preliminaryand wiiw estimates. - 2) According to gross value added (manufacturing industry for industrial production). -
3) Population 15-64. - 4) Net wages in state administration. - 5) Average weighted effective lending interest rate (Kosovo uses the euro as national currency).

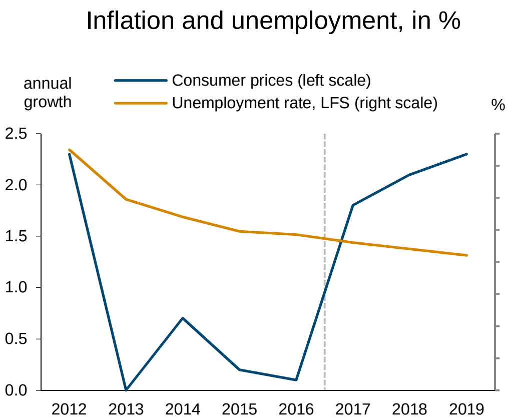
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

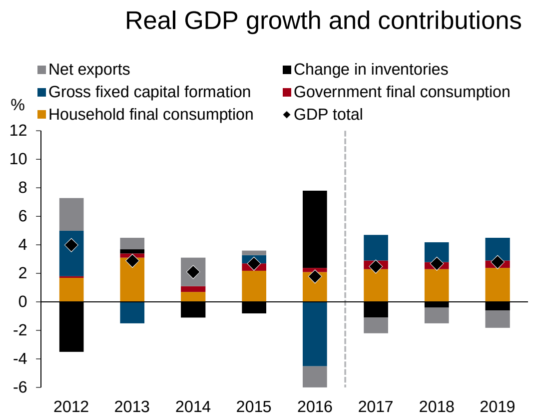
LATVIA: EU funds push up growth rate

SEBASTIAN LEITNER

Our GDP growth forecast for Latvia for 2017 stands at 2.5%. Private and particularly public investment activity will rally. The inflow of EU funds is expected to amount to 2.6% of GDP this year. After a steep decline in recent years, exports to Russia have again started to increase. Household consumption has developed rapidly and will continue, due to rising real wages. In both 2018 and 2019, we expect a further upswing in GDP growth to 2.7% and 2.8%, respectively.

Figure 43 / Latvia: Main macroeconomic indicators





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

After a difficult few years, the outlook for external demand in 2017 is more positive. In the final few months of 2016, Latvian goods exports started to grow again, in both value-added and nominal year-on-year terms. While trade with Western Europe, the Scandinavian countries and the rest of the world has gradually gained momentum, demand from Russia has increased more rapidly. However, exports of fish and fish products are still suffering because of the Russian embargo, and the same is true of mineral products because of low oil prices. Good news comes from the wood sector and electronic products, both of which have reported strong export growth figures. In general, we expect both goods and service exports to revive again this year, and to continue to strengthen in the years to come. Transit trade with Russia, an important sector for Latvia, will remain weak, however, owing to the Russian government's measures to ship the country's exports from its own ports.

In September 2016, Liepājas Metalurgs**, the only steel mill in the Baltic States, was declared insolvent.** The former Ukrainian owner KVV Group is to bring the Latvian government before the European Commission's Anti-Monopoly and Corruption Prevention Committees, claiming to have been treated unfair by the government. In February, the insolvency administrator will start the sale procedure by looking for new investors. However, the rest of the metal sector and downstream production such as machinery and equipment, as well as the electric and electronic sectors, have displayed strongly increased activity.

Gross fixed capital investment is set for strong growth in the forecast period. Investment dropped by close to 20% in real terms in 2016. This was primarily a result of a reduction in capital expenditure of about a third, by both the central state and local governments, and a corresponding drop in construction output. For 2017, however, public investment in infrastructure will rally, with fresh EU funds becoming available. The inflow from Brussels is expected to amount to 2.6% of GDP in 2017. Private residential construction output will, however, remain rather anaemic this year. Slightly declining numbers of building permits, for residential and non-residential buildings alike, are reinforcing the negative prospects in the sector. Overall, after the slump in 2016, we expect total gross fixed investment to increase again by 8% in 2017, and to grow at a rate of 6% in real terms in 2018.

As expected, the significantly lower level of prices for imported goods in 2016, compared to the previous year, kept consumer inflation stagnant. Strong wage growth has raised core inflation slightly. As the effect of falling energy prices abates, so rising prices in the services sector and an upswing in import prices will raise consumer inflation to about 1.8% this year and 2.1% in 2018.

Declining activity in construction has led to lower employment there, while job growth has been recorded in the industrial sectors. Overall employment will start to rise again slightly in 2017 after stagnating in 2016. Demographic developments – including continuing net emigration – will, however, result in a further decline in the working-age population; thus, growth in employment is likely to remain at below 1% in the coming years. Towards the end of 2016, the unemployment rate receded to 9.7%. This year, we expect it to decline gradually to 9.2%. Gross real wages will keep on growing by about 4%, not only in 2017 but also in the years ahead. The government increased the minimum wage slightly to EUR 380 in January 2017 – still rather low as a share of the national average wage, when compared to other EU countries. However, growth in household consumption will increase by close to 4% in real terms in the years to come. The government budget for 2017 foresees expenditure growth – particularly in EU-funded investments – in the field of defence, but also in health and education. The budget deficit is expected to amount to 0.8% of GDP in 2017, after attaining 0.9% of GDP in 2016, due to higher than expected government revenues.

Broad-based and fairly robust economic growth is expected in the years to come. For 2017, we expect external demand to grow again, not only in real, but also in nominal terms. After a sharper than anticipated investment decline in 2016, we expect a strong revival this year. Household demand is continuing to evolve at a good pace, and thus our GDP growth forecast for 2017 remains almost unchanged at 2.5%. However, because of the anticipated speed-up in demand in the EU, and a rise in domestic investment activity driven by the inflow of EU funds, we expect GDP growth to accelerate somewhat in 2018 and 2019, to 2.7% and 2.8%, respectively.

Table 14 / Latvia: Selected economic indicators

	2012	2013	2014	2015	2016 [1)]	2017	2018	2019
							Forecast	
Population, th pers., average	2,034	2,013	1,994	1,978	1,961	1,950	1,945	1,940
Gross domestic product, EUR mn, nom.	21,849	22,774	23,608	24,349	24,800	25,900	27,200	28,600
annual change in % (real)	4.0	2.9	2.1	2.7	1.8	2.5	2.7	2.8
GDP/capita (EUR at PPP)	16,000	16,600	17,500	18,600	19,200	.	.	.
Consumption of households, EUR mn, nom.	13,065	13,780	14,166	14,584	15,100	.	.	.
annual change in % (real)	2.9	5.2	1.1	3.7	3.5	3.8	3.8	4.0
Gross fixed capital form., EUR mn, nom.	5,551	5,291	5,337	5,497	4,400	.	.	.
annual change in % (real)	14.4	-6.0	0.1	2.8	-20.0	8.0	6.0	7.0
Gross industrial production [2)]								
annual change in % (real)	6.2	-0.9	-1.0	3.6	5.4	4.0	5.0	5.0
Gross agricultural production								
annual change in % (real)	17.3	2.3	4.5	14.2	-5.9	.	.	.
Construction industry								
annual change in % (real)	13.7	8.1	7.9	-1.2	-17.9	.	.	.
Employed persons, LFS, th, average	875.6	893.9	884.6	896.1	895.0	900	905	910
annual change in %	1.6	2.1	-1.0	1.3	-0.1	0.6	0.6	0.6
Unemployed persons, LFS, th, average	155.1	120.4	107.6	98.2	96.0	90	90	80
Unemployment rate, LFS, in %, average	15.0	11.9	10.8	9.9	9.7	9.2	8.8	8.4
Reg. unemployment rate, in %, end of period [3)]	10.5	9.5	8.5	8.7	8.4	.	.	
Average monthly gross wages, EUR	684.4	715.7	765.0	818.0	850.0	900	950	1,010
annual change in % (real, gross)	1.4	4.6	6.2	6.7	3.8	4.0	3.8	4.0
Average monthly net wages, EUR	488.0	515.4	560.0	603.0	630.0	660	700	740
annual change in % (real, net)	1.6	5.6	8.0	7.4	4.3	3.5	3.2	4.0
Consumer prices (HICP), % p.a.	2.3	0.0	0.7	0.2	0.1	1.8	2.1	2.3
Producer prices in industry, % p.a.	4.2	1.6	0.4	-1.0	-3.0	1.0	1.5	2.0
General governm.budget, EU-def., % of GDP								
Revenues	36.3	36.1	35.9	35.8	35.8	36.2	36.0	36.0
Expenditures	37.1	37.0	37.5	37.1	36.6	37.0	36.5	36.5
Net lending (+) / net borrowing (-)	-0.8	-0.9	-1.6	-1.3	-0.9	-0.8	-0.5	-0.5
Public debt, EU-def., % of GDP	41.3	39.0	40.7	36.3	40.0	36.0	35.0	34.0
Stock of loans of non-fin.private sector, % p.a	-11.7	-7.0	-8.8	-3.4	0.5	.	.	.
Non-performing loans (NPL), in %, Dec	11.1	8.3	6.9	6.0	5.0	.	.	.
Central bank policy rate, % p.a., end of period [4)]	2.50	0.25	0.05	0.05	0.00	.	.	.
Current account, EUR mn	-794	-621	-463	-189	391	0	-300	-500
Current account, % of GDP	-3.6	-2.7	-2.0	-0.8	1.6	0.0	-1.1	-1.7
Exports of goods, BOP, EUR mn	9,645	9,810	10,214	10,322	10,281	10,700	11,200	11,700
annual change in %	16.2	1.7	4.1	1.1	-0.4	3.9	4.7	4.5
Imports of goods, BOP, EUR mn	12,282	12,431	12,414	12,364	12,008	12,800	13,600	14,400
annual change in %	13.6	1.2	-0.1	-0.4	-2.9	6.7	6.3	5.9
Exports of services, BOP, EUR mn	3,768	3,900	3,853	4,038	4,204	4,400	4,600	4,900
annual change in %	8.6	3.5	-1.2	4.8	4.1	3.6	4.7	5.6
Imports of services, BOP, EUR mn	2,145	2,127	2,101	2,273	2,337	2,400	2,500	2,600
annual change in %	7.7	-0.8	-1.2	8.2	2.8	4.3	4.1	4.7
FDI liabilities, EUR mn	840	743	813	684	354	.	.	.
FDI assets, EUR mn	127	373	441	112	344	.	.	.
Gross reserves of NB excl. gold, EUR mn [5)]	5,373	5,565	2,448	2,957	3,100	.	.	.
Gross external debt, EUR mn	30,254	30,501	33,794	34,505	36,200	36,300	37,500	38,600
Gross external debt, % of GDP	137.4	133.7	143.1	141.7	146.0	140.0	138.0	135.0
Average exchange rate EUR-LVL/EUR	0.9922	0.9981	1.0000	1.0000	1.0000	1	1	1

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

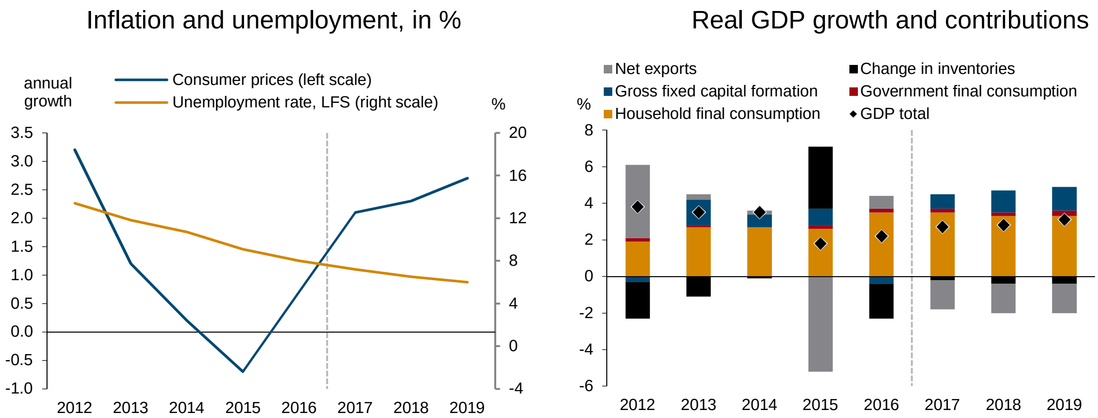
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

LITHUANIA: Still strong outward migration despite high wage growth

SEBASTIAN LEITNER

Throughout 2017, economic growth in Lithuania will be driven by resurgence in external demand, particularly from the CIS and for oil products. Moreover, an upswing in public investment will be underpinned by fresh funds from the EU this year. The ongoing stable growth in terms of employment and rapid wage rises will result in robust increases in consumer demand. For 2017, we forecast a moderate upswing in the GDP growth rate to 2.7%, followed by 2.8% in 2018 and 3.1% in 2019.

Figure 44 / Lithuania: Main macroeconomic indicators



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

Following a revival in the early months of 2016, trade again stagnated towards the end of that year. Exports destined for Russia are still struggling. After a slump in trade with its Eastern neighbour of about 40% in nominal terms in 2015, Lithuanian exports stabilised in the second half of 2016. From now on, a recovery by the Russian economy is to be expected, and with it an upswing in Lithuanian exports. Another reason for recently stagnating exports is the slump in external demand and the fall in prices for refined oil products, which squeezed the profits of the Lithuanian refinery Mažeikių Nafta. These factors will fade in 2017. The transport sector, strongly exposed to Russian transit trade, was affected less badly than expected, and is currently strengthening again. Moreover, tourism exports are also expected to grow at a good pace in 2017: a further 5-10% increase in overnight stays is likely. Since household demand is improving and investment activity is set to revive this year, imports in 2017 will increase – in value-added terms – at above the rate of exports. After a balanced current account in 2016, the deficit is again likely to widen to 1-2% of GDP in the medium term.

After having dropped by about 2% in real terms last year, gross fixed capital investment will revive in 2017. While public capital expenditure declined in 2016, the inflow of fresh EU funds from the 2014-2020 programming period will allow the government to increase capital spending. However, a large part of the rising government outlays will be devoted to defence, with an increase of 25% over 2016. However, for 2017, the budget also envisages a boost in investment in road and railway infrastructure – an ongoing major EU-funded project is Rail Baltica, connecting the Baltics with the European rail network. The construction of dwellings started to increase gradually in 2016, and the rising number of building permits indicates that the upswing will continue in 2017. In addition, the mortgage loan portfolio of households started to grow again at a faster pace towards the end of 2016, after having stagnated since 2008.

The fall in prices for imports, particularly of oil and gas, is still a drag on overall price developments in Lithuania, but the consumer price index (CPI) is going to rise in 2017. Producer prices fell by more than 5% in the last quarter of 2016 year on year, while consumer inflation remained stagnant. This is quite remarkable, as average gross wages continued to increase substantially: in the last quarter of 2016 by about 7% year on year in real terms. Stronger economic stimulus in the rest of the EU and higher investment activity will lead to rising consumer inflation of more than 2% in both 2017 and 2018.

Employment is expected to increase this year by less than 1%. Apart from construction, agriculture and transport (the latter two being hit by the Russian crisis and embargo), job growth is evident in all sectors of the economy, particularly in recreational and business services. Simultaneously, however, net outward migration is continuing and is again likely to exceed 1% of the Lithuanian population in 2017. One reason for the renewed increase in emigration, particularly from 2015 onwards, has been the reintroduction of conscription, which young men prefer to avoid. The employment rate among those aged 15-64 reached 76% in 2016, almost the level of Germany, and the unemployment rate is likely to drop to almost 7% of the labour force in 2017.

In October 2016, the parliament enacted the laws of the 'New social model', a comprehensive reform package of labour and complementary laws covering the social protection and pension system. The package was bitterly contested by unions and opposition groups. At the core of the new laws is the liberalisation of labour contracts: the notice periods for dismissal have been cut, as have severance payments, and the possibility of atypical work and overtime has been expanded. As well as a reduction in employers' social contributions, the reforms also envisage the indexation of public pensions to the average wage. In the parliamentary elections last October, public resistance to the labour market liberalisation package proved disastrous for the then government's coalition partners, and the centre-conservative Farmers and Greens Union won a landslide victory. The programme put forward by the new coalition government – formed by the Farmers and Greens and the Social Democrats – emphasises anti-corruption measures and social and family policies in order to reduce emigration. The newly elected parliament decided to revise the 'New social model' laws and postpone their enforcement by at least six months.

Given the improving situation in the labour market and sharply rising incomes, household consumption will remain the most important driver of growth for the Lithuanian economy in 2017 and the years thereafter. Adjusting our forecast only slightly, we expect GDP to expand by 2.7% in 2017, followed by a minor upswing to 2.8% in 2018 and 3.1% in 2019. The assumed drivers of that growth are economic stabilisation in Russia and growth gaining momentum in the euro area. Moreover, public investment activity should be facilitated by inflows of EU funds. The government plans a budget deficit of 0.8% in 2017. In the years to follow it will drop even further, resulting in a continuously falling public debt to GDP ratio.

Table 15 / Lithuania: Selected economic indicators

	2012	2013	2014	2015	2016 [1]	2017	2018	2019
							Forecast	
Population, th pers., average	2,988	2,958	2,932	2,905	2,880	2,860	2,840	2,820
Gross domestic product, EUR mn, nom.	33,348	35,002	36,590	37,331	38,560	40,400	42,500	45,000
annual change in % (real)	3.8	3.5	3.5	1.8	2.2	2.7	2.8	3.1
GDP/capita (EUR at PPP)	18,600	19,600	20,700	21,600	22,300	.	.	.
Consumption of households, EUR mn, nom.	20,690	21,792	22,762	23,486	24,802	.	.	.
annual change in % (real)	3.1	4.3	4.3	4.1	5.6	5.5	5.3	5.3
Gross fixed capital form., EUR mn, nom.	5,788	6,458	6,770	7,195	7,051	.	.	.
annual change in % (real)	-1.8	8.3	3.7	4.7	-2.0	4.0	6.0	7.0
Gross industrial production (sales)								
annual change in % (real)	3.7	3.4	0.0	4.8	2.3	5.0	4.0	4.5
Gross agricultural production								
annual change in % (real)	14.2	-1.8	8.4	8.6	-3.4	.	.	.
Construction industry								
annual change in % (real)	-7.2	11.3	17.0	-3.5	-9.4	.	.	.
Employed persons, LFS, th, average	1,276	1,293	1,319	1,335	1,360	1,370	1,375	1,380
annual change in %	1.8	1.3	2.0	1.2	1.9	0.7	0.4	0.4
Unemployed persons, LFS, th, average	197	173	158	134	118	106	96	88
Unemployment rate, LFS, in %, average	13.4	11.8	10.7	9.1	8.0	7.2	6.5	6.0
Reg. unemployment rate, in %, end of period [2]	11.4	11.1	9.3	9.0	8.5	.	.	.
Average monthly gross wages, EUR [3]	615	646	677	714	770	840	910	990
annual change in % (real, gross)	0.7	4.0	4.7	6.4	6.9	6.5	5.7	5.5
Average monthly net wages, EUR [3]	478	501	527	554	600	650	700	760
annual change in % (real, net)	0.5	3.8	5.1	6.1	7.4	6.3	5.5	5.3
Consumer prices (HICP), % p.a.	3.2	1.2	0.2	-0.7	0.7	2.1	2.3	2.7
Producer prices in industry, % p.a.	5.0	-2.4	-4.9	-9.7	-4.3	2.5	3.5	4.5
General goverm.budget, EU-def., % of GDP								
Revenues	33.0	32.9	34.0	34.9	34.0	33.4	33.0	34.0
Expenditures	36.1	35.5	34.7	35.1	34.9	34.2	33.6	34.5
Net lending (+) / net borrowing (-)	-3.1	-2.6	-0.7	-0.2	-0.9	-0.8	-0.6	-0.5
Public debt, EU-def., % of GDP	39.8	38.7	40.5	42.7	41.0	40.0	39.0	38.0
Stock of loans of non-fin.private sector, % p.a	-0.8	-2.3	-0.9	4.1	7.6	.	.	.
Non-performing loans (NPL), in %, Dec	13.6	11.0	6.5	5.5	4.2	.	.	.
Central bank policy rate, % p.a., end of period [4]	0.52	0.27	0.12	0.05	0.00	.	.	.
Current account, EUR mn	-393	539	1,317	-872	128	-500	-600	-800
Current account, % of GDP	-1.2	1.5	3.6	-2.3	0.3	-1.2	-1.4	-1.8
Exports of goods, BOP, EUR mn	22,426	23,998	23,750	22,310	21,830	22,700	24,200	25,800
annual change in %	15.5	7.0	-1.0	-6.1	-2.2	4.2	6.7	6.7
Imports of goods, BOP, EUR mn	23,529	24,917	24,686	24,296	23,497	24,500	26,100	27,800
annual change in %	9.5	5.9	-0.9	-1.6	-3.3	4.3	6.6	6.6
Exports of services, BOP, EUR mn	4,793	5,390	5,850	6,011	6,750	7,500	8,400	9,400
annual change in %	18.8	12.5	8.5	2.7	12.3	10.4	12.1	11.8
Imports of services, BOP, EUR mn	3,404	4,033	4,212	4,266	4,550	5,000	5,600	6,300
annual change in %	23.1	18.5	4.4	1.3	6.6	9.0	12.5	12.7
FDI liabilities, EUR mn	454	531	387	873	-95	.	.	.
FDI assets, EUR mn	215	322	382	164	377	.	.	.
Gross reserves of NB excl. gold, EUR mn [5]	6,203	5,705	6,991	1,376	2,263	.	.	.
Gross external debt, EUR mn	26,031	24,596	25,551	28,332	31,500	34,300	37,000	40,500
Gross external debt, % of GDP	78.1	70.3	69.8	75.9	81.7	85.0	87.0	90.0

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

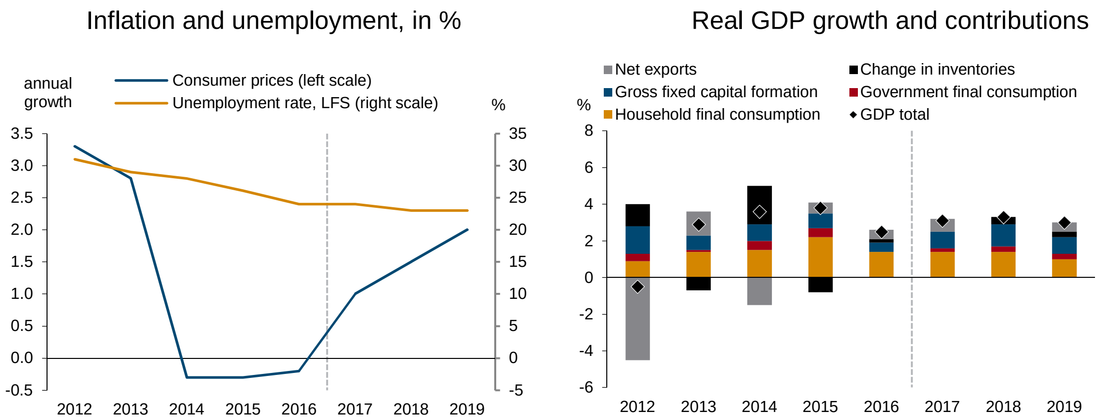
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

MACEDONIA: Temporary slowdown

VLADIMIR GLIGOROV

The Macedonian economy is expected to return to growth of 3% in 2017 and the medium term. In 2016, growth slowed temporarily, due to the underperformance of investments. The labour market continued to improve, although the unemployment rate remains exceptionally high. Stability was more of a concern than growth, as the country headed towards an electoral resolution to the political crisis. Looking ahead, political stability could push potential growth closer to 4%.

Figure 45 / Macedonia: Main macroeconomic indicators



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

The political crisis has exerted a negative influence on economic activity. Throughout 2016, the date for early elections kept being postponed, and the caretaker government remained in office. Finally, elections were held in December. The vote was split across the major parties on both the Macedonian and the Albanian sides of the electorate. As such, the result has been seen as a defeat for the ruling coalition. The chances are that the erstwhile opposition party – the Social Democratic Union – will form a coalition with the Albanian parties, although another round of early elections is likely some time down the road, perhaps in a year or so. As a resolution to the crisis kept being postponed, investments started to be delayed and overall economic activity slowed.

Net exports also deteriorated somewhat. Exports continued to grow, but imports started to catch up. The Macedonian economy is more open than most others in the Balkans. Indeed, economic policy has been geared towards export and investment-led growth since the mid-1990s. After the 2008-2009 crisis, exports improved significantly, and the economy performed better than most others in the region – and indeed in Europe.

Investments are likely to continue. Despite the slowdown in 2016, investments are expected to continue to grow. On the public investment side, infrastructure needs are clear, while private investments rely on relatively low labour costs and supportive economic policy. It is not thought likely that the new government will change investment policies much.

Monetary policy has been supportive. The central bank is mindful of the fixed exchange rate, and so monetary policy tends to be somewhat restrictive. In the past few years, the policy rate was first cut to 3.25%, before being hiked back up to 4%. With inflation around zero, this is still too restrictive. Improved political stability and renewed confidence, plus a quickening of inflation (due in part to growing energy prices), should support some easing of monetary policy (at least in the sense of the policy rate not going up).

Fiscal policy has been under scrutiny. Both the public and international financial institutions have warned that the fiscal policy stance is somewhat risky. The government may choose to heed the warnings and get the fiscal deficit down to around 2% of GDP. However, sustainability is not much of a concern, as public debt is not too high and is not growing any faster than GDP. If there is a country in need of development policies, it is Macedonia, with its huge unemployment.

The overall public sector is small. Public spending, at around 17% of GDP, is relatively low by regional standards. That has consequences for education, health and other social and community services. The new government may choose to strengthen the social safety net and invest more in education and active labour market policies.

Overall macro-balances are stable. Apart from the labour market, which is improving but is still highly distorted, the macro-balances and financial markets are sustainable. This is why growth prospects are favourable in the medium term. Unlike most other economies in the region, Macedonia's is not in any urgent need of adjustment either in terms of its exchange rate or in terms of debt – public, private or foreign. Growth can be supported by both private and public consumption – both of which, indeed, are growing.

Industrial production continues to grow. Manufacturing contributes as much as agriculture to GDP. Both have been growing, and industrial production in particular is expected to continue to improve in the medium term. In addition, just as across most of the region, there is strong growth in service exports, mainly tourism (close to 70%, comparing 2008 and 2016).

Growth prospects are good in the medium run. With political stabilisation, household consumption and renewed investments should push growth back to around 3% in the medium term. Risks are on the up side, given relatively benign macro-balances, with potential for growth in consumption and investment.

Table 16 / Macedonia: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018 Forecast	2019
Population, th pers., mid-year	2,061	2,064	2,067	2,070	2,085	2,090	2,095	2,100
Gross domestic product, MKD mn, nom.	466,703	501,891	527,631	558,240	572,000	596,000	625,000	657,000
annual change in % (real)	-0.5	2.9	3.6	3.8	2.5	3.1	3.3	3.0
GDP/capita (EUR at PPP)	9,000	9,300	10,000	10,500	10,700	.	.	.
Consumption of households, MKD mn, nom.	340,875	355,959	363,629	377,683	384,500	.	.	.
annual change in % (real)	1.2	1.9	2.1	3.1	2.0	2.0	2.0	1.5
Gross fixed capital form., MKD mn, nom.	109,071	119,003	123,549	129,095	127,700	.	.	.
annual change in % (real)	6.5	3.5	4.0	3.6	2.0	4.0	5.0	4.0
Gross industrial production 2)								
annual change in % (real)	-2.7	3.2	4.8	4.9	3.4	5.0	5.0	4.0
Gross agricultural production 3)								
annual change in % (real)	-5.6	6.4	1.7	3.0	6.0	.	.	.
Construction industry								
annual change in % (real)	8.1	43.1	-3.4	40.8	12.0	.	.	.
Employed persons, LFS, th, average	650.6	678.8	690.2	706.0	720.0	730	740	750
annual change in %	0.8	4.3	1.7	2.3	2.0	1.0	1.0	2.0
Unemployed persons, LFS, th, average	292.5	277.2	268.8	248.9	230.0	220	200	220
Unemployment rate, LFS, in %, average	31.0	29.0	28.0	26.1	24.0	24.0	23.0	23.0
Reg. unemployment rate, in %, end of period	25.8	22.8	23.4	22.1	21.0	.	.	.
Average monthly gross wages, MKD	30,670	31,025	31,325	32,171	32,750	33,400	34,200	35,200
annual change in % (real, gross)	-3.0	-1.6	1.3	3.0	2.0	1.0	1.0	1.0
Average monthly net wages, MKD	20,902	21,145	21,394	21,904	22,300	22,700	23,300	24,000
annual change in % (real, net)	-2.9	-1.6	1.5	2.7	2.0	1.0	1.0	1.0
Consumer prices, % p.a.	3.3	2.8	-0.3	-0.3	-0.2	1.0	1.5	2.0
Producer prices in industry, % p.a.	1.4	-1.4	-1.9	-3.9	-2.4	0.0	2.0	2.0
General governm. budget, nat.def., % of GDP								
Revenues	32.1	30.1	29.7	31.0	31.0	31.0	31.0	31.0
Expenditures	36.0	34.1	33.9	34.4	33.0	33.0	33.0	33.0
Deficit (-) / surplus (+)	-3.9	-4.0	-4.2	-3.4	-2.0	-2.0	-2.0	-2.0
Public debt, nat.def., % of GDP	38.3	40.2	45.7	46.6	50.0	50.0	50.0	50.0
Stock of loans of non-fin.private sector, % p.a	5.3	6.4	9.9	9.5	1.0	.	.	.
Non-performing loans (NPL), in %, Dec 4)	10.4	11.3	11.1	10.7	6.5	.	.	.
Central bank policy rate, %, p.a., end of period 5)	3.73	3.25	3.25	3.25	3.75	4.00	4.00	5.00
Current account, EUR mn	-240	-134	-43	-187	-185	-390	-410	-430
Current account, % of GDP	-3.2	-1.6	-0.5	-2.1	-2.0	-4.0	-4.0	-4.0
Exports of goods, BOP, EUR mn	2,307	2,375	2,784	3,041	3,223	3,380	3,550	3,730
annual change in %	-3.7	2.9	17.2	9.2	6.0	5.0	5.0	5.0
Imports of goods, BOP, EUR mn	4,315	4,238	4,640	4,867	5,110	5,370	5,640	5,870
annual change in %	0.3	-1.8	9.5	4.9	5.0	5.0	5.0	4.0
Exports of services, BOP, EUR mn	1,067	1,155	1,304	1,370	1,452	1,520	1,600	1,680
annual change in %	2.1	8.2	12.9	5.1	6.0	5.0	5.0	5.0
Imports of services, BOP, EUR mn	757	780	920	1,028	1,079	1,130	1,190	1,250
annual change in %	10.5	2.9	18.0	11.8	5.0	5.0	5.0	5.0
FDI liabilities, EUR mn	265	302	37	262	400	.	.	.
FDI assets, EUR mn	134	73	-160	59	250	.	.	.
Gross reserves of NB excl. gold, EUR mn	1,918	1,803	2,221	2,049	2,370	.	.	.
Gross external debt, EUR mn	5,172	5,220	5,992	6,291	7,430	7,600	7,700	8,100
Gross external debt, % of GDP	68.2	64.0	70.0	69.4	80.0	78.0	76.0	76.0
Average exchange rate MKD/EUR	61.53	61.58	61.62	61.61	61.60	61.5	61.5	61.5

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) From 2015 wiiw estimate. - 4) The decline in the loans in 2016 was due to the write-off of doubtful and contested claims on loans. - 5) Central Bank bills (28-days).

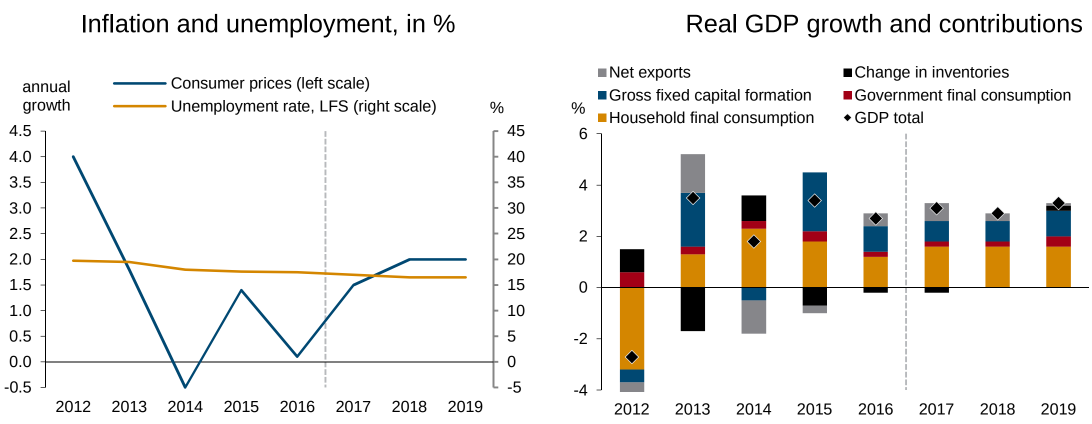
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

MONTENEGRO: Growth returns

VLADIMIR GLIGOROV

Montenegro's economic growth slowed markedly at the turn of 2016, largely because of a surge in imports. It recovered in the course of the year and is now poised to return to 3% or thereabouts in the medium term. Political risks also contributed to economic volatility, though a degree of stability should have returned following the early elections. The economy will continue to rely even more on services, i.e. on tourism.

Figure 46 / Montenegro: Main macroeconomic indicators



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

Growth for the year as a whole declined to below 3%. Though the slowdown occurred at the height of the political crisis over the legitimacy of the government, it was actually deteriorating net exports that were the proximate reason for it. Some of the increased imports went to build up inventories. This was possibly connected both with the coming tourist season, and with planned investment in a highway that is to connect the country along its north–south axis. With that in mind, growth should rebound this year and in the medium term.

The economy is unbalanced. Consumption is over 100% of GDP, and public consumption is a shade above 20% of GDP, more or less as large a share as investment. Net exports are strongly negative, at somewhere around a third of GDP. The question is always posed: is this sustainable? With Montenegro being a microstate (i.e. less than 1 million population) that is largely dependent on real estate and tourism, it is probably not reasonable to look at sustainability through debt-to-income ratios. Foreign debt is probably in excess of 200% of GDP. However, most of the investment is in real estate, which has its price tied to the performance of the tourist industry. So long as tourism grows at a healthy rate, as it has done since 2006 or so, the debt is sustainable.

Public debt is something of a concern. Historically, public debt has tended to be low, but it has been rising due to ambitious infrastructure investments. On the one hand, there is no doubt that those investments are needed if Montenegro is to sustain a growing, services-based economy. On the other hand, misallocated investment could indeed lead to a fiscally unsustainable situation, which would require major adjustments in revenue and expenditure. Montenegro uses the euro and can hardly rely on financial repression or devaluation. The new government has embarked on some measures of expenditure control, but the key will be growth generation from spending in infrastructure and energy, as well as in education and research and development.

The employment and unemployment figures have been stable. There are strong seasonal variations, but the unemployment rate is still not much below 20%. It has been declining somewhat, and in all likelihood will continue to do so rather slowly. In the tourist sector, however, there is a seasonal shortage of employable people.

EU integration is a slow process. Montenegro is ahead of other candidate countries in the process of EU integration. One stumbling block has been the suspicion that rule of law is not enforced and that democracy is deficient. The latter concern was emphasised by the prolonged political crisis, which was partly fuelled by the fact that one party and its leader has been running the country for decades. Changes to the governing coalition and a new head of government should allay those concerns, at least in part. But the polarised nature of Montenegrin politics makes it hard to have a speedier and clearer change in government.

NATO membership is at hand. It is expected that US Congress will ratify the NATO agreement for Montenegro to join the organisation, as will the remaining NATO member states. The government has enough votes to carry the accession motion in parliament. That should prove stabilising for the government. Impending accession to NATO has not led to a decline in the number of Russian tourists, although the Russian government has been very strongly opposed to the move. Russian investments have dried up, but that is related more to the state of the Russian economy. There is continuing litigation over Oleg Deripaska’s investments in the Aluminium Kombinat, which would bankrupt the country if it lost. But that is a distant prospect at the moment.

Growth should speed up this year and continue at a pace of 3% or so in the medium term. It is likely to be driven by investments and continued improvement in the export of services, i.e. tourism. The government has ambitious plans for investment in infrastructure, some with regional reach (so that may be financed within the Berlin Process). This should also boost investments in tourism. High foreign debt is the main risk on the down side, but political stabilisation should mitigate that risk, at least in part.

Table 17 / Montenegro: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018 Forecast	2019
Population, th pers., mid-year	621	621	622	622	625	625	625	625
Gross domestic product, EUR mn, nom.	3,181	3,362	3,458	3,625	3,700	3,900	4,100	4,300
annual change in % (real)	-2.7	3.5	1.8	3.4	2.7	3.1	2.9	3.3
GDP/capita (EUR at PPP)	10,500	10,900	11,300	12,100	12,400	.	.	.
Consumption of households, EUR mn, nom. 2)	2,632	2,724	2,775	2,872	2,915	.	.	.
annual change in % (real)	-3.9	1.6	2.9	2.2	1.5	2.0	2.0	2.0
Gross fixed capital form., EUR mn, nom.	628	678	657	736	773	.	.	.
annual change in % (real)	-2.4	10.7	-2.5	11.9	5.0	4.0	4.0	5.0
Gross industrial production 3)								
annual change in % (real)	-7.1	10.6	-11.4	7.9	-4.4	3.0	5.0	4.0
Net agricultural production								
annual change in % (real)	-12.7	5.0	3.0	3.0	5.0	.	.	.
Construction output 3)								
annual change in % (real)	7.7	41.6	34.1	20.3	47.4	.	.	.
Employed persons, LFS, th, average	200	202	216	222	224	226	228	230
annual change in %	2.4	1.0	7.1	2.5	1.0	1.0	1.0	1.0
Unemployed persons, LFS, th, average	49	49	48	47	48	50	50	50
Unemployment rate, LFS, in %, average	19.7	19.5	18.0	17.6	17.5	17.0	16.5	16.5
Reg. unemployment rate, %, average	15.3	15.8	16.1	16.5	21.9	.	.	.
Average monthly gross wages, EUR	727	726	723	725	751	770	790	810
annual change in % (real, gross)	-3.2	-1.9	0.1	-1.1	3.1	1.0	1.0	1.0
Average monthly net wages, EUR	487	479	477	480	499	510	530	550
annual change in % (real, net)	-3.3	-3.4	0.1	-0.8	3.9	1.0	1.0	1.0
Consumer prices, % p.a.	4.0	1.8	-0.5	1.4	0.1	1.5	2.0	2.0
Producer prices in industry, % p.a. 4)	1.9	1.6	0.1	0.3	-0.1	1.0	2.0	2.0
General governm.budget, nat.def., % of GDP								
Revenues	35.2	37.0	39.1	36.6	40.2	39.0	40.0	40.0
Expenditures	41.4	43.0	42.1	44.6	41.8	42.0	42.0	42.0
Deficit (-) / surplus (+)	-6.1	-6.0	-3.0	-8.0	-1.6	-3.0	-2.0	-2.0
Public debt, nat.def., % of GDP	53.4	55.7	56.2	62.8	61.0	60.0	60.0	60.0
Stock of loans of non-fin.private sector, % p.a	-3.5	5.0	-1.5	2.9	6.3	.	.	.
Non-performing loans (NPL), in %, Dec	17.6	18.4	16.8	13.4	11.0	.	.	.
Central bank policy rate, % p.a., end of period 5)	8.83	8.68	8.41	8.53	7.45	8.00	8.00	8.00
Current account, EUR mn	.	-487	-526	-483	-630	-640	-850	-850
Current account, % of GDP	.	-14.5	-15.2	-13.3	-17.0	-16.4	-20.7	-19.8
Exports of goods, BOP, EUR mn	.	396	357	325	340	350	370	380
annual change in %	.	.	-9.7	-9.0	4.5	4.0	5.0	4.0
Imports of goods, BOP, EUR mn	.	1,724	1,734	1,789	1,970	2,050	2,130	2,220
annual change in %	.	.	0.6	3.2	10.1	4.0	4.0	4.0
Exports of services, BOP, EUR mn	.	994	1,031	1,214	1,270	1,350	1,430	1,520
annual change in %	.	.	3.6	17.8	4.6	6.0	6.0	6.0
Imports of services, BOP, EUR mn	.	341	340	425	470	490	510	530
annual change in %	.	.	-0.3	24.8	10.6	5.0	4.0	4.0
FDI liabilities, EUR mn	.	337	375	630	150	.	.	.
FDI assets, EUR mn	.	13	21	11	-180	.	.	.
Gross reserves of NB excl. gold, EUR mn 6)	348	424	545	674	803	.	.	.
Gross external public debt, EUR mn	1,295	1,433	1,562	1,956	1,960	2,150	2,340	2,540
Gross external public debt, % of GDP	40.7	42.6	45.2	54.0	53.0	55.0	57.0	59.0

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

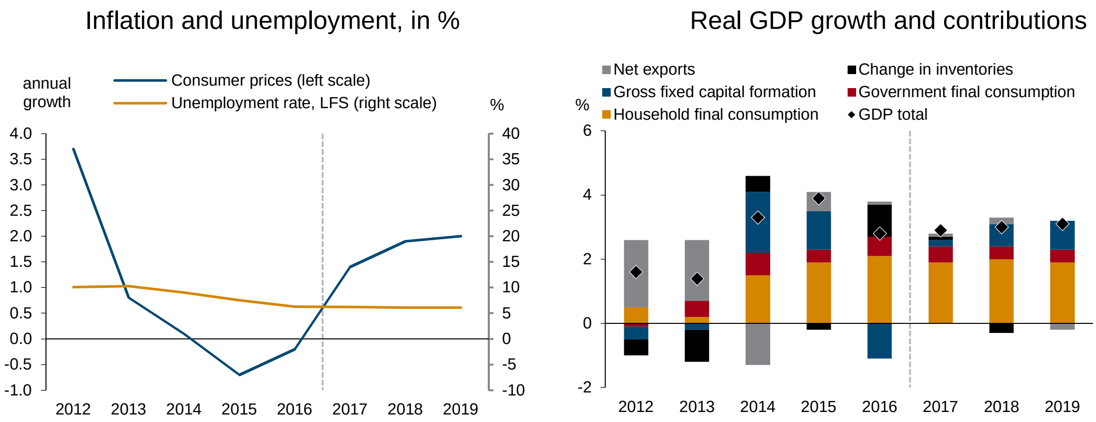
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

POLAND: Not so brilliant anymore

LEON PODKAMINER

Under the impact of policies that seek to imbue the national economic and social life with 'law and order', Poland's economy clearly underperformed in 2016. This was epitomised by a dramatic decline in gross fixed capital formation. But the economy is still in pretty good shape. It is expected to grow at a respectable pace, provided the institutional changes imposed consider more carefully the needs of the business sector and the limits to what can be achieved through administrative regulation.

Figure 47 / Poland: Main macroeconomic indicators



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

At 2.8%, GDP growth in 2016 was perceptibly weaker than had been generally expected and then was the case throughout 2014-2015. Rising consumption (by both the household and the public sector) was the sole item behind the GDP growth. Household consumption contributed 2.1% percentage points (pp) to the overall growth rate, and public consumption another 0.7 pp. The contributions of foreign trade in goods and non-factor services and of gross capital formation were both quantitatively insignificant (+0.1 and -0.1 pp, respectively). However, the contribution of gross fixed capital formation was large and negative (-1.1 pp), while that of rising inventories was large and positive (+1.0 pp).

The dramatic decline in gross fixed capital formation (down 5.5% in 2016) is not entirely due to the completion of infrastructure projects co-financed by EU transfers under the financial package for 2007-2013. As is shown by business climate surveys, the heightened levels of uncertainty over institutional (mainly legal and tax) changes have been very detrimental to propensity to invest: close to 35% of those private firms that do not intend to invest in 2017 quote heightened institutional uncertainty as the reason (and only 13% quote problems with the availability of financial means). The politically motivated official agitation aimed at private business (and its foreign-owned branch in particular) is thus bearing fruit. The draconian penalties proposed (including confiscation of assets) for e.g. faulty corporate tax reporting may well impair private investment (or even production) activities in the future. Interestingly, publicly owned corporations also suffer from the heightened legal uncertainties: 20% of those public corporations that are not undertaking investments in 2017 quote legal uncertainty as the reason. That is not unexpected: for managers of public corporations, inactivity may be safer than activity, as the latter always carries a risk of falling from political grace. Besides, much of the public sector is actually controlled by local government. But local government, predominantly run by the opposition parties, has also become the target for increased 'auditing and surveillance'. No doubt this is also limiting its investment appetite.

The financial standing of the corporate sector is very good. The non-financial corporate sector's net profits rose by 22% in the first three quarters of 2016, reaching PLN 88.9 billion (equivalent to some EUR 20.7 billion). Profitability and liquidity ratios have attained levels not seen since 2010. The commercial banks swallowed the additional 'banking tax' introduced in February 2016 (amounting to 0.44% of banks' assets). In 2016, banks' net profits rose by 24.3%, to reach the equivalent of over EUR 3.2 billion. Corporations' ample financial resources tend to swell their idle bank deposits, whose stocks rose by 8.6% in 2016. (Publicly owned corporations increased the stocks of their deposits by 16.6%; private corporations by 6.9%.) Rather unexpectedly, the stocks of bank deposits of households (including firms and farms run by physical persons) also rose quite strongly, by 9.8%. At the same time, both the corporate and the household sectors have remained reluctant to place themselves in debt. The stocks of their debt to the banking sector rose by 5.4% and 5.2%, respectively. These monetary developments reflect, at least partly, the rather restrictive interest rate policy in the clearly deflationary environment that has prevailed since 2013.

Deflationary tendencies to be overcome. The long spell of deflation seems just to have ended. Under the impact of higher household income and consumer spending, inflation looks set to rise, returning to more normal levels. The interest rates administered by the national bank are likely to stay comparatively high in 2017 and perhaps beyond. Quite possibly, this will reduce the real interest rates on bank loans and deposits, adding more vigour to lending for consumption and investment purposes. On the other hand, the return of inflation (even if quite moderate) may carry a risk of some real appreciation of the Polish currency. As the nominal depreciation of PLN is unlikely to be pronounced, inflation may somewhat weaken foreign trade performance.

The foreign trade performance continues to be satisfactory. Part of the explanation for this is the relatively weak world market prices for raw materials, including oil and natural gas. Also, the contraction in gross fixed capital formation must have reduced demand for imports. If 'normality' returns (with the recovery of prices of energy carriers and the take-off of investment activities), trade may become more of a worry. However, the prospects of trouble emanating from the foreign sector are rather remote. In 2017-2018, trade is likely to be roughly balanced (primarily on account of strong performance in trade in services rather than goods).

The central government budget deficit in 2016 was lower than expected – though higher than in 2015. The general government deficit is likely to have approached 3% of GDP in 2016 and will probably surpass that mark in 2017 and later. Additional social spending programmes initiated in 2016 had a positive impact on consumption and GDP growth in 2016. These impacts will continue in 2017. At the same time, the fiscal costs of these programmes may become a problem for the government, which may be tempted to impose extra taxes and to finish off the still surviving chunk of the second pillar of the pension system.

Falling unemployment and rising wages have not only strengthened the economy (via strong growth in consumption), but they have also helped to stabilise the popularity of the ruling Law and Justice (PiS) party. Otherwise the political developments have been highly disquieting. PiS, which enjoys a parliamentary (though not a constitutional) majority, pays little heed to the Constitution. It continues to subjugate all public institutions, including those in charge of controlling and balancing the powers of the government. The independent judicial system and local government are the current targets for takeover by PiS loyalists. The political system developing in Poland is certainly unlikely to do the country any good in the long – or even the medium – term.

Summing up, Poland's economy *qua* economy is in pretty good shape. The expectation of stable growth in consumption is well grounded, and the maintenance of foreign accounts close to balance will not be a major problem. But politically and – to some extent – also socially, something is rotten in the state of Poland. The ongoing evolution of the political system is also likely to prove harmful economically – primarily in the field of investment, which may remain depressed. This has been demonstrated by developments in 2016. Poland clearly underperformed last year, with much of its potential lying idle amid destructive fears about the legislative whims of the nationalist and populist politics. The likely continuation of current policies does not bode too well for the near future.

Table 18 / Poland: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018 Forecast	2019
Population, th pers., average	38,536	38,514	38,487	38,458	38,450	38,550	38,560	38,575
Gross domestic product, PLN bn, nom.	1,629.4	1,656.8	1,719.7	1,798.3	1,830.0	1,900	1,980	2,060
annual change in % (real)	1.6	1.4	3.3	3.9	2.8	2.9	3.0	3.1
GDP/capita (EUR at PPP)	17,800	17,900	18,600	19,800	20,400	.	.	.
Consumption of households, PLN bn, nom.	988.0	995.3	1,019.4	1,038.2	1,070.0	.	.	.
annual change in % (real)	0.8	0.3	2.6	3.2	3.6	3.3	3.4	3.3
Gross fixed capital form., PLN bn, nom.	322.5	311.7	339.4	360.8	332.0	.	.	.
annual change in % (real)	-1.8	-1.1	10.0	6.1	-5.5	1.0	3.5	4.5
Gross industrial production (sales) 2)								
annual change in % (real)	1.3	2.3	3.4	4.8	2.8	3.6	4.5	4.3
Gross agricultural production								
annual change in % (real)	1.2	0.7	6.9	-2.5	8.6	.	.	.
Construction industry 2)								
annual change in % (real)	-5.2	-10.2	4.3	0.3	-14.5	.	.	.
Employed persons, LFS, th, average	15,591	15,568	15,862	16,084	16,230	16,260	16,280	16,280
annual change in %	0.2	-0.1	1.9	1.4	0.9	0.2	0.1	0.0
Unemployed persons, LFS, th, average	1,749	1,793	1,567	1,304	1,078	1,070	1,060	1,060
Unemployment rate, LFS, in %, average	10.1	10.3	9.0	7.5	6.3	6.2	6.1	6.1
Reg. unemployment rate, in %, end of period	13.4	13.4	11.4	9.7	8.3	.	.	.
Average monthly gross wages, PLN	3,530	3,659	3,777	3,908	4,068	4,300	4,500	4,800
annual change in % (real, gross)	0.1	2.8	3.2	4.5	4.9	4.0	3.5	3.5
Consumer prices (HICP), % p.a.	3.7	0.8	0.1	-0.7	-0.2	1.4	1.9	2.0
Producer prices in industry, % p.a.	3.3	-1.3	-1.3	-2.0	-0.4	0.0	0.8	1.3
General governm.budget, EU-def., % of GDP								
Revenues	39.0	38.4	38.7	38.9	39.5	39.0	39.0	39.5
Expenditures	42.7	42.4	42.1	41.5	42.4	42.5	42.5	43.0
Net lending (+) / net borrowing (-)	-3.7	-4.1	-3.4	-2.6	-2.9	-3.5	-3.5	-3.5
Public debt, EU-def., % of GDP	53.7	55.7	50.2	51.1	53.1	53.0	53.5	55.0
Stock of loans of non-fin.private sector, % p.a	0.6	3.3	5.8	7.1	5.3	.	.	.
Non-performing loans (NPL), in %, Dec	8.8	8.5	8.1	7.5	7.2	.	.	.
Central bank policy rate, % p.a., end of period 3)	4.3	2.5	2.0	1.5	1.5	1.8	2.0	2.5
Current account, EUR mn 4)	-14,458	-5,028	-8,529	-2,654	-2,259	-3,100	-5,100	-6,700
Current account, % of GDP 4)	-3.7	-1.3	-2.1	-0.6	-0.5	-0.7	-1.1	-1.4
Exports of goods, BOP, EUR mn 4)	141,026	149,113	158,657	172,150	176,506	181,400	191,700	203,400
annual change in %	6.5	5.7	6.4	8.5	2.5	2.8	5.7	6.1
Imports of goods, BOP, EUR mn 4)	149,156	149,448	161,911	169,937	174,889	182,800	195,600	211,200
annual change in %	2.4	0.2	8.3	5.0	2.9	4.5	7.0	8.0
Exports of services, BOP, EUR mn 4)	31,949	33,592	36,743	40,663	43,935	46,600	48,900	51,300
annual change in %	8.8	5.1	9.4	10.7	8.0	6.0	5.0	5.0
Imports of services, BOP, EUR mn 4)	25,947	25,948	27,679	29,745	30,608	32,100	33,400	34,700
annual change in %	7.2	0.0	6.7	7.5	2.9	5.0	4.0	4.0
FDI liabilities, EUR mn 4)	5,771	658	14,824	12,631	12,506	.	.	.
FDI assets, EUR mn 4)	1,055	-2,524	5,096	3,790	7,924	.	.	.
Gross reserves of NB excl. gold, EUR mn	78,403	74,257	79,379	83,676	104,439	.	.	.
Gross external debt, EUR mn 4)	279,739	278,948	293,509	302,063	316,660	332,000	352,300	368,900
Gross external debt, % of GDP 4)	71.8	70.7	71.4	70.3	75.5	76.0	76.5	77.0
Average exchange rate PLN/EUR	4.1847	4.1975	4.1843	4.1841	4.3632	4.35	4.30	4.30

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) Reference rate (7-day open market operation rate). - 4) Including SPE.

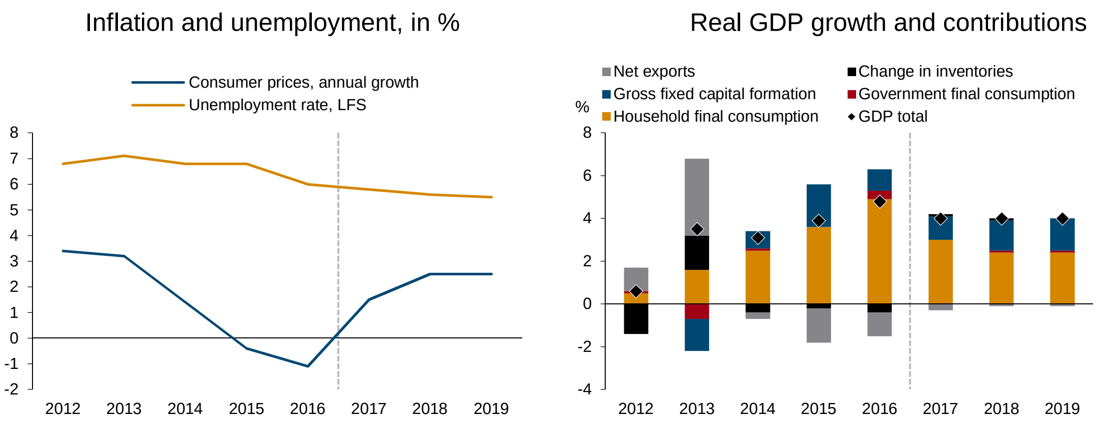
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ROMANIA: Economic deceleration follows the boom

GÁBOR HUNYA

Economic growth in Romania is expected to hover around 4% in 2017 and beyond. Household demand will remain the main driver, but investments may also play a bigger role. Rising private sector wages may speed up the growth in household consumption; this constitutes an upside risk to the forecast. The capacity to absorb EU funds and political uncertainty constitute downside risks. Currently the government's official GDP forecast for 2017-2019 of annual growth above 5% looks unrealistic.

Figure 48 / Romania: Main macroeconomic indicators



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

The fight against corruption is an issue on which the new government could find itself paralysed. The coalition government led by the Social Democratic Party (PSD), which came to power in January 2017, has a comfortable majority in parliament; nevertheless, the battle between the government and the presidency could spark a political crisis at any time. The main controversy centres on the fight against corruption and the status of the National Anticorruption Directorate (DNA) and the domestic intelligence service. The government wants to extend its oversight over these bodies, which have allegedly become states within the state. But they enjoy the unconditional backing of the president and of European institutions.

As one of its first actions, overnight the government softened the penal code with an emergency decree that it soon had to repeal, under popular pressure. The attempt to decriminalise certain corruption offences (such as abuse of office and conflict of interest) triggered massive public protests in early February. The general prosecutor and the chief anticorruption prosecutor both criticised the decree, claiming that it would render the anticorruption fight in Romania ineffective. Criticism also came from several EU institutions and European governments, the Foreign Investors Council and other business organisations. Although the ordinance has been lifted, the PSD has not given up on its goal. The controversy may escalate at any time into a lasting political crisis that could deter investors.

In a wider sense, there is a conflict between the traditional political establishment and a new generation of people, movements and institutions representing 'European', democratic values. The political establishment of almost all parties is based on clientelism and corruption. The promoters of liberal democracy are growing in number and are becoming better organised. But the notion of placing unconditional trust in the DNA is also controversial. The anticorruption prosecutors are by no means blameless and often act arbitrarily, especially in cases of influence peddling or embezzlement. Decision makers know from experience that at any time they could be prosecuted for a decision they take; therefore public procurement, and public investment activity generally, have slowed. Meanwhile the country has received a fillip in its battle against corruption: on 1 February, the World Bank approved a EUR 60 million loan to help Romania improve its judicial services.

Economic growth started to decelerate in the third quarter of 2016; annual growth was still one of the most robust rates in Europe, 4.8%. Soaring household consumption was the main component of growth in 2016, but investments and government consumption contributed positively as well, while the foreign balance was on the negative side. The demand surge was generated by fiscal easing in the form of VAT cuts and minimum-wage hikes. Real wages increased by almost 15% in 2016 also on account of negative inflation.

The government intends to speed up economic growth in 2017 by further generous incomes policy measures. The gross minimum salary was increased from RON 1,250 to RON 1,450 (EUR 322), starting 1 February 2017 benefiting about 2.1 million employees, 300,000 of whom work in the public sector. Also the minimum pensions were increased from RON 400 to, still meagre, RON 520. Wage increases of 20% were introduced for the local and municipal administration. Students also received benefits including free railway transportation and higher public scholarship payments. In exchange for pay rises, the cap of five times the minimum wage, above which social insurance contributions were no longer payable, was lifted. A further benefit to consumers is that the standard rate of VAT was reduced by 1 percentage point and the excise tax on fuel was cut. All in all, there is no economic reason for public dissatisfaction – only political.

Services were the fastest growing economic sector in 2016, most prominently retail trade (up 13.5%), sale and repair of motor vehicles (+18%) and personal services (+9%). Industrial output grew only modestly, mainly on account of declines in the mining sector and the energy sector. Manufacturing production grew by more than 3%, and the production of consumer durables and cars rose especially rapidly. Domestic production of goods and services absorbed most of the surge in household demand, and thus the trade balance did not deteriorate greatly.

Inflation levelled off toward the end of 2016, but over the year as a whole it was negative. It is expected to reach low positive rates in 2017 on account of continuing demand pull and higher international oil prices. A further inflationary factor is that the one-off effects of the previous tax cuts will expire and the new cuts will have only a marginal effect on prices.

The labour market will tighten further in 2017. Unemployment fell to 6.2% on average in 2016 and to below 6% by the end of the year. More sectors report labour shortages, although there are still pools to tap in the eastern regions. The longer-term outlook does not promise more labour force, since the population will fall due to demographic reasons. Emigration may decrease, however, if wages continue to rise and if host countries introduce restrictions. Immigration from Moldova and Ukraine may increase on account of the widening wage gaps between those countries and Romania.

The government's 2017 budget law is based on the unrealistic assumption of 5.2% GDP growth. The National Forecasting Commission revised its figures upwards in January 2017 by 1.5 pp (compared with the October 2016 forecast), without giving any specific reason. The government intends to continue its expansionary fiscal policy by planning deficits of 3% of GDP. The actual figure will most probably be higher, as GDP will be lower, and the fiscal impact of all the social measures introduced at the beginning of 2017 is expected to amount to 0.7% of GDP. Financing of the deficit may not be a problem, given the current abundance of international capital market liquidity.

Monetary policy has been very cautious, with the National Bank keeping the policy rate unchanged throughout 2016. This rate has been relatively high, compared to the consumer price index, and more in line with the producer price index. Some easing has taken place, with a lowering of the reserve requirements. New loans to the economy increased in 2016, albeit modestly. The total loan stock has declined, as non-performing loans (NPLs) are being worked out. The NPL rate fell to 10% at the end of year. Banks have reported robust profits and are increasing their loan portfolios to companies. They are more cautious with lending to the population. Lending interest rates went up recently, reflecting rising demand for consumer loans.

The widening of the current account deficit on account of soaring private consumption is not as severe as expected. Nevertheless, imports did grow ahead of exports, and this trend is expected to continue without any substantial widening of the current account deficit in 2017. The inflow of foreign direct investment (FDI) accelerated in 2016 and may expand further in the future. The largest new projects are in the automotive sector. These include Daimler's EUR 300 million investment in the expansion of its gearbox production in Sebeș, as well as new production units for component suppliers LEONI and Continental. In addition, British American Tobacco announced that it would build one of its largest European factories in Ploiești. Also real estate and retail investments remain buoyant in view of the rising local purchasing power.

Economic growth in Romania is expected to hover around 4% in the coming years. The 2017 deceleration will prove less severe than predicted in earlier wiiw forecasts, due to the government's new demand-generating measures. Household demand will remain the main driver, but investments may also play a bigger role, financed by both EU funds and FDI. Private sector wages, which are rising on account of the labour shortage, may speed up the growth in household demand and may constitute an upside risk to the forecast. The capacity to absorb EU funds and political uncertainty constitute the downside risks. Based on the current level of knowledge the government's official GDP forecast for 2018-2019 of 5.5% and 5.7% looks unrealistic.

Table 19 / Romania: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018 Forecast	2019
Population, th pers., average	20,058	19,984	19,909	19,815	19,830	19,780	19,700	19,650
Gross domestic product, HUF bn, nom.	595	637	668	711	760	810	860	920
annual change in % (real)	0.6	3.5	3.1	3.9	4.8	4.0	4.0	4.0
GDP/capita (EUR at PPP)	14,300	14,600	15,300	16,500	17,300	.	.	.
Consumption of households, RON bn, nom.	366.2	385.5	406.4	433.1	470.0	.	.	.
annual change in % (real)	0.8	2.6	4.2	5.9	8.0	5.0	4.0	4.0
Gross fixed capital form., RON bn, nom.	162.8	157.5	162.4	176.1	190.0	.	.	.
annual change in % (real)	0.1	-5.4	3.2	8.3	4.0	4.5	5.5	6.0
Gross industrial production 2)								
annual change in % (real)	2.4	7.8	6.1	2.8	1.0	2.0	3.0	3.0
Gross agricultural production								
annual change in % (real)	-21.9	24.5	2.9	-6.8	-1.7	.	.	.
Construction industry 2)								
annual change in % (real)	1.4	-0.6	-6.7	10.3	-4.8	.	.	.
Employed persons, LFS, th, average	8,605	8,549	8,614	8,535	8,490	8,490	8,490	8,490
annual change in %	0.9	-0.7	0.8	-0.9	-0.5	0.0	0.0	0.0
Unemployed persons, LFS, th, average	627	653	629	624	541	520	500	490
Unemployment rate, LFS, in %, average	6.8	7.1	6.8	6.8	6.0	5.8	5.6	5.5
Reg. unemployment rate, in %, end of period	5.5	5.7	5.4	5.0	4.8	.	.	.
Average monthly gross wages, RON	2,063	2,163	2,328	2,555	2,900	3,200	3,400	3,700
annual change in % (real, gross)	0.8	0.8	6.5	10.4	15.3	8.0	5.0	5.0
Average monthly net wages, RON	1,507	1,579	1,697	1,859	2,100	2,300	2,500	2,700
annual change in % (real, net)	1.0	0.8	6.4	10.1	14.7	8.0	5.0	5.0
Consumer prices (HICP), % p.a.	3.4	3.2	1.4	-0.4	-1.1	1.5	2.5	2.5
Producer prices in industry, % p.a.	5.2	2.0	-0.2	-2.4	-1.9	2.0	3.0	2.0
General governm.budget, EU-def., % of GDP								
Revenues	33.6	33.3	33.6	35.0	31.0	32.0	33.0	34.0
Expenditures	37.2	35.4	34.4	35.7	33.0	35.2	36.0	37.0
Net lending (+) / net borrowing (-)	-3.7	-2.1	-0.8	-0.8	-2.0	-3.2	-3.0	-3.0
Public debt, EU-def., % of GDP	37.3	37.8	39.4	38.0	38.0	39.0	39.0	39.0
Stock of loans of non-fin.private sector, % p.a.	1.6	-3.4	-3.7	2.5	0.9	.	.	.
Non-performing loans (NPL), in %, Dec	18.2	21.9	13.9	13.5	9.9	.	.	.
Central bank policy rate, % p.a., end of period 3)	5.25	4.00	2.75	1.75	1.75	2.25	3.00	3.00
Current account, EUR mn	-6,394	-1,542	-1,004	-1,928	-4,118	-4,500	-4,900	-5,270
Current account, % of GDP	-4.8	-1.1	-0.7	-1.2	-2.4	-2.5	-2.6	-2.6
Exports of goods, BOP, EUR mn	39,855	43,893	46,839	49,119	52,101	55,200	58,500	62,000
annual change in %	-0.6	10.1	6.7	4.9	6.1	6.0	6.0	6.0
Imports of goods, BOP, EUR mn	49,114	49,709	53,375	56,892	61,399	66,300	70,900	75,900
annual change in %	-0.7	1.2	7.4	6.6	7.9	8.0	7.0	7.0
Exports of services, BOP, EUR mn	9,868	13,434	15,104	16,640	17,630	18,860	20,370	22,000
annual change in %	13.6	36.1	12.4	10.2	6.0	7.0	8.0	8.0
Imports of services, BOP, EUR mn	7,392	8,733	9,236	9,849	10,074	10,580	11,110	11,670
annual change in %	5.1	18.1	5.8	6.6	2.3	5.0	5.0	5.0
FDI liabilities, EUR mn	2,380	2,894	2,931	3,885	4,804	.	.	.
FDI assets, EUR mn	-175	-24	227	930	940	.	.	.
Gross reserves of NB excl. gold, EUR mn	31,206	32,525	32,216	32,238	34,242	.	.	.
Gross external debt, EUR mn	100,857	98,069	94,744	90,434	93,000	96,000	100,000	100,000
Gross external debt, % of GDP	75.5	68.0	63.0	56.5	54.9	53.1	52.1	48.7
Average exchange rate RON/EUR	4.4593	4.4190	4.4437	4.4454	4.4904	4.48	4.48	4.48

1) Preliminary and wiiw estimates. - 2) Enterprises with 4 and more employees. - 3) One-week repo rate.

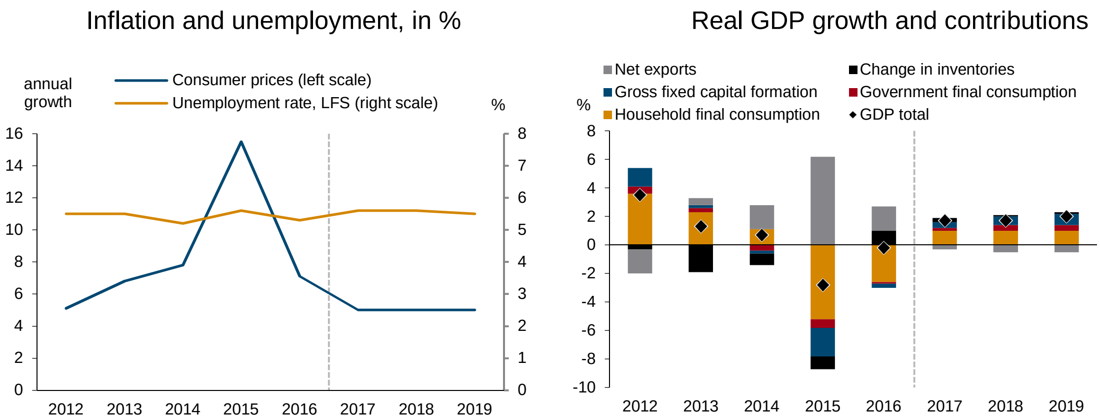
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

RUSSIAN FEDERATION: A shallow recovery, external risks remain elevated

PETER HAVLIK

The Russian economy is slowly emerging from recession. With oil prices more or less flat, financial and trade sanctions expected to remain largely in place, and in the absence of any marked institutional reforms, economic growth will stay sluggish – below 2% – even in the medium term.

Figure 49 / Russian Federation: Main macroeconomic indicators



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

After two years, the Russian economic recession has finally come to an end. The adjustment to the collapse in oil prices and sanctions was, by and large, completed during 2016 (the fourth quarter of 2016 witnessed positive economic growth on an annual basis); the economy has thus now stabilised at a new 'near-stagnation normal'. A preliminary flash official estimate reduced the 2016 GDP decline to just -0.2%, less than previously reported (-0.6%). Both nominal figures and GDP data for 2015 were revised upwards as well. The largest upwards revisions were reported for real estate and trade activities, on the use side for changes of stocks.

The stabilisation relates to both the economy and domestic politics, while the external risks (Trump presidency, aftermath of Brexit, EU disunity, Ukraine conflict, etc.) persist and – in some instances have perhaps even increased (see Special Section on uncertainties in this Report). The speedy and complete lifting of sanctions is not expected, any 'deal' with Trump will be difficult to reach and implement, and the fragile ceasefire in Donbas may not be sustained. The EU's largely hostile stance towards Russia will not change markedly, at least so long as Ms Merkel remains the German chancellor and Russia stays in Crimea and continues to support insurgency in Donbas.

Despite some improvement, the 2016 economic performance was largely disappointing. Apart from agriculture (which reported a 3.5% expansion, largely thanks to Russian counter-sanctions restricting food imports and thus boosting domestic food processing), there are few signs of a sustained recovery, and some indicators continue to point to further contraction. Financial services grew by 2.3% and the manufacturing industry by 1.4%. Even after data revisions, the construction industry, retail trade and catering contracted by nearly 5%. On the demand side, household consumption contracted by 5% in 2016, and gross fixed investment by 1.4%. A shallow investment recovery resulted solely from the accumulation of stocks. The volume of exports grew by 2.3%, while that of imports shrank by 5% in real terms. Trade with the EU and Ukraine contracted more than average; meanwhile trade with China expanded (China strengthened its position as Russia's biggest trading partner). Net exports thus once again contributed positively to GDP growth in 2016 (1.7 percentage points (pp) up in 2016, after more than 6 pp in 2015).

After a huge contraction (exports: -40%, imports: -35%, both in nominal EUR terms) between 2012 and 2016, foreign trade is recovering (helped by oil prices). Also, foreign direct investment (FDI) is no longer falling and the exchange rate is appreciating – even in nominal terms. Russia is again accumulating foreign exchange reserves: the Central Bank of Russia (CBR) is purchasing part of oil export revenues when the price exceeds USD 40 per barrel (forex reserves grew from EUR 302 billion at the end of 2016 to EUR 370 billion as of March 2017). Financial investors seem to be returning slowly to Russia on the back of strengthening oil and metals prices and possibly in the expectation of better prospects for relations with the USA. However, the current account surplus dropped to a record low – below 2% of GDP in 2016 – and will stay there in the coming three years.

No major economic reforms are on the horizon, and a muddling through of sorts is thus to be expected. The CBR is likely to maintain its restrictive monetary policy stance, focusing on disinflation and discouraging credit expansion by maintaining highly positive real interest rates. With oil prices expected to remain flat (yet higher than last year's average of USD 44 per barrel) and given the reluctance of the government to borrow, there will be limited room for manoeuvre in fiscal policy. Despite frequent calls from the domestic expert community for more expansionary measures, in particular for a substantial increase in fixed investments (from the current 21% of GDP to 25-28% of GDP in the medium term), we do not expect such a policy shift – at least not in the next two years (before the presidential elections scheduled for 2018). Even a breakthrough in relations with the West – which we do not see as likely – would not result in a substantial increase in FDI inflows, due to lasting institutional bottlenecks that adversely affect the investment climate.

There seems to be consensus that Russia is facing a prolonged period of (near) stagnation in economic, political and social developments alike. The damaged links with most of the 'near abroad' in both the west and the south – Ukraine in particular (but most recently also Belarus) – will be hard to restore, and conflicts may even escalate. At the same time, Russia managed to resume (at least partly and in relative terms) its role as a global player (Syria, Balkans) and is happily reaping windfall gains from US (Trump) and EU (Brexit) failings and the resulting Western split.

Overall, our current assessment of Russian economic prospects remains broadly unchanged: the mild (milder than expected) recession in 2016 was officially confirmed, and a gradual, yet rather modest, GDP growth acceleration is forecast for the coming three years. Though we have revised our GDP growth forecasts for 2017 slightly upwards, largely thanks to newly available data, we still expect economic growth to stay below 2% and investment to be weak even in the medium term. Inflation will return to low single digits, household consumption will grow again and unemployment will stabilise at close to 5%.

Table 20 / Russian Federation: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018 Forecast	2019
Population, th pers., average	143,202	143,507	146,091	146,406	146,692	146,500	146,500	146,500
Gross domestic product, RUB bn, nom.	66,927	71,017	79,200	83,233	85,881	90,000	95,200	102,000
annual change in % (real)	3.5	1.3	0.7	-2.8	-0.2	1.7	1.7	2.0
GDP/capita (EUR at PPP)	19,100	18,700	18,700	17,700	17,200	.	.	.
Consumption of households, RUB bn, nom.	34,334	38,068	42,037	43,263	43,830	.	.	.
annual change in % (real)	7.4	4.4	2.0	-9.8	-5.0	2.0	2.0	2.0
Gross fixed capital form., RUB bn, nom.	13,522	14,357	16,746	17,261	18,147	.	.	.
annual change in % (real)	6.0	0.9	-1.0	-9.4	-1.4	2.0	3.0	4.0
Gross industrial production 2)								
annual change in % (real)	3.4	0.4	1.7	-3.4	1.1	2.0	3.0	4.0
Gross agricultural production								
annual change in % (real)	-4.8	5.8	3.5	2.6	4.8	.	.	.
Construction output								
annual change in % (real)	2.5	0.1	-2.3	-4.8	-4.3	.	.	.
Employed persons, LFS, th, average	71,545	71,392	71,539	72,324	72,393	72,100	72,300	72,500
annual change in %	1.0	-0.2	0.2	-0.4	0.1	-0.4	0.3	0.3
Unemployed persons, LFS, th, average	4,131	4,137	3,889	4,264	4,243	4,300	4,300	4,200
Unemployment rate, LFS, in %, average	5.5	5.5	5.2	5.6	5.3	5.6	5.6	5.5
Reg. unemployment rate, in %, end of period 3)	1.4	1.2	1.2	1.3	1.2	.	.	.
Average monthly gross wages, RUB	26,629	29,792	32,495	34,030	36,703	39,700	43,400	47,800
annual change in % (real, gross)	8.4	4.8	1.2	-9.3	0.6	3.0	4.0	5.0
Consumer prices, % p.a.	5.1	6.8	7.8	15.5	7.1	5.0	5.0	5.0
Producer prices in industry, % p.a. 4)	6.8	3.3	6.1	12.4	4.0	3.0	4.0	4.0
General governm.budget, nat.def., % of GDP								
Revenues	34.5	34.4	33.8	32.3	32.3	32.0	33.0	33.0
Expenditures	34.1	35.6	34.9	35.7	36.0	35.5	36.0	36.0
Deficit (-) / surplus (+)	0.4	-1.2	-1.1	-3.4	-3.7	-3.5	-3.0	-3.0
Public debt, nat.def., % of GDP	9.7	10.6	13.0	13.2	12.9	13.0	14.0	15.0
Stock of loans of non-fin.private sector, % p.a.	19.1	17.1	25.9	7.6	-6.9	.	.	.
Non-performing loans (NPL), in %, Dec 5)	3.7	3.5	3.8	5.3	5.2	.	.	.
Central bank policy rate, % p.a., end of period 6)	8.25	5.50	17.00	11.00	10.00	8.00	6.00	6.00
Current account, EUR mn 7)	55,452	25,164	43,477	62,052	20,046	23,500	17,900	13,800
Current account, % of GDP 7)	3.3	1.5	2.8	5.1	1.7	1.7	1.3	0.9
Exports of goods, BOP, EUR mn 7)	410,300	392,827	375,561	307,083	252,105	301,500	328,700	351,700
annual change in %	10.9	-4.3	-4.4	-18.2	-17.9	19.6	9.0	7.0
Imports of goods, BOP, EUR mn 7)	261,202	256,901	232,739	173,525	172,826	210,500	231,600	254,800
annual change in %	14.2	-1.6	-9.4	-25.4	-0.4	21.8	10.0	10.0
Exports of services, BOP, EUR mn 7)	48,495	52,787	49,700	46,532	45,148	52,500	55,100	57,900
annual change in %	16.4	8.8	-5.8	-6.4	-3.0	16.3	5.0	5.1
Imports of services, BOP, EUR mn 7)	84,736	96,643	91,487	79,694	67,090	78,000	81,900	86,000
annual change in %	29.0	14.1	-5.3	-12.9	-15.8	16.3	5.0	5.0
FDI liabilities, EUR mn 7)	39,353	52,107	16,655	5,826	27,100	.	.	.
FDI assets, EUR mn 7)	37,980	65,120	43,151	19,954	15,200	.	.	.
Gross reserves of NB excl. gold, EUR mn 8)	367,323	341,787	279,383	292,467	301,871	.	.	.
Gross external debt, EUR mn 7)	480,440	530,481	493,861	474,057	493,057	456,900	426,300	437,100
Gross external debt, % of GDP 7)	28.7	31.6	31.7	38.6	42.6	33.0	30.0	30.0
Average exchange rate RUB/EUR	39.9	42.3	50.8	67.8	74.3	65.0	67.0	70.0

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

1) Preliminary and wiiw estimates. - 2) Excluding small enterprises. - 3) In % of labour force (LFS). - 4) Domestic output prices. - 5) According to Russian Accounting Standards overdue debt is defined as debt service overdue, therefore the data are not fully comparable with other countries. - 6) From 2013 one-week repo rate, refinancing rate before. - 7) Converted from USD. - 8) Including part of resources of the Reserve Fund and the National Wealth Fund of the Russian Federation.

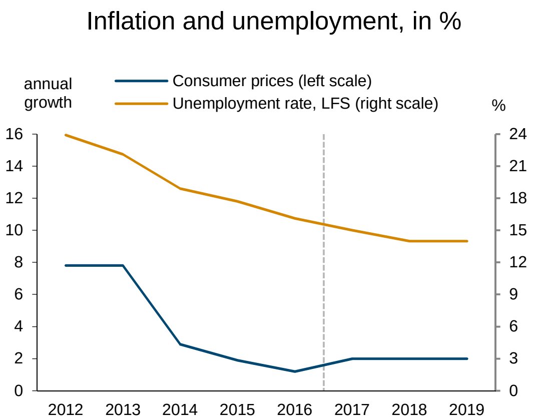
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

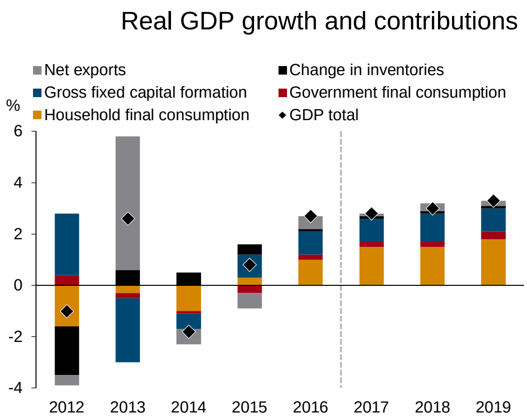
SERBIA: Recovery, finally

VLADIMIR GLIGOROV

Growth proved better than expected in 2016, at 2.7%. Looking ahead, it should approach 3% in the medium term. This is mainly because consumption – both private and public – will increase, now that fiscal consolidation is largely at an end; meanwhile investment and exports should continue to grow.

Figure 50 / Serbia: Main macroeconomic indicators





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

Investments are continuing to drive growth. Investments slumped in the aftermath of the 2008-2009 crisis and started to recover only in the last couple of years. Last year they grew by about 6%. The level of investments is still low – their share of GDP remains below 20% – and so additional recovery is expected in the coming years. Furthermore, the efficiency of public investments is improving, i.e. efficiency of spending is improving.

Exports are continuing to grow. Up until 2008, the economy was rather closed, at least when it came to exports. Since then, exports of both goods and services have grown strongly: by 2016, exports of goods had risen by over 80% in euro terms compared to 2008, and services by over 60%. Exports to the EU have grown particularly strongly; but the Central European Free Trade Agreement (CEFTA), which came into effect in 2006, has also helped, especially with agricultural goods. Thanks to a recovery in the past year or so from the post-2008 stagnation, and also to steady export growth since 2009, the Serbian economy is now much more open, with exports of goods and services above 50% of GDP. Export-led growth is expected to continue.

Industrial production has continued to grow, too. Manufacturing has been doing better: at about 15% of total value added, its share in the economy is somewhat higher than in the region as a whole, and so the improved performance matters. Growth has been more pronounced over the past few years, but overall industry is still recovering from the 2009 slump (and the decline in 2013). It is expected to continue to improve in the medium term, though that will depend a lot on the availability of investment.

Agricultural production has also improved. It is still the case, however, that weather is the main factor in the performance of agriculture. Demand in the region and on other markets is not a constraint, but investments and productivity are. This is one country that has a trade surplus in food products.

Fiscal adjustment is almost over – at least in terms of cutting fiscal deficit. Though the numbers are not entirely transparent, fiscal deficit was down to around 2% of GDP in 2016. With implicit liabilities, the figure is probably a shade higher, but the planned deficit of less than 2% in coming years seems attainable and sustainable. Indeed, public spending recorded real growth in 2016 for the first time since the programme of fiscal consolidation was adopted in 2014. The cost in lost GDP has been borne, and a modest positive contribution is planned for the next few years. It is likely to be more on the side of public investments, while wage and pension growth will probably be rather subdued. Last year there were parliamentary elections, and there are presidential elections this year (in April), and so additional fiscal measures can only be expected later in the year or even next year. Those may prove necessary if public debt does not start to decline due to improved growth: it stands at over 70% of GDP at the moment. The aim is to bring it down to 45%, in accordance with the law on fiscal responsibility.

Inflation is still low. Prolonged economic stagnation or slow recovery has changed the traditional exchange-rate and monetary-policy stance. In the past, a fixed exchange rate with relatively high inflation tended to be disrupted by periodic devaluations. In the last few years, deflationary pressures have been strong, and so the exchange rate has been anchored; the Serbian dinar (RSD) has depreciated only slightly, and prices have been growing ever more slowly. This has induced the central bank to cut its interest rate to levels rarely seen in Serbia. Currently, consumer prices are growing at just above 1%, whereas the inflation target is 3%, plus or minus 1.5 percentage points (reduced from 4%). The central bank expects inflation to return to within the tolerance band this year, but it is not clear when it will be fully on target.

The unemployment rate has declined significantly – to below 14% in the third quarter of 2016. For the year as a whole, it will be around 15%. The employment rate among those aged over 15 has also improved, and now stands at a little below 47% (probably around 45% for the year as a whole). Some of that progress is due to an increase in informal employment; some to outward migration; and some to a decline in productivity (probably supported by a decline in real wages in recent years).

Consumption has started to pick up. Households bore the brunt of fiscal consolidation, and also of the trend for expenditure to switch towards exports. Last year, household consumption started to improve and this is expected to continue in the medium term. Growth in consumption is, however, likely to lag behind growth in investments and exports. An improved current account – needed in part due to relatively high foreign debt and foreign investment position (close to 80% and 100% of GDP, respectively) – will require a further increase in national savings, and thus subdued improvement in consumption. With that, overall recovery cannot be too rapid in the medium term, but should reach around 3%.

Politics continues to generate downside risks. The upcoming presidential elections provide another challenge, in addition to the regional challenges and those that stem from the altered international environment. Serbia still needs to get used to democratic changes in government and to cohabitation, and it also needs to continue the normalisation of its relations within the region. Improved economic prospects and reliance on the regional market should help, but downside risks continue because of dissatisfaction with the government's authoritarian tendencies.

Overall, we can expect an adjustment to export and investment-led growth of 3% by the end of the medium term, with a slow improvement in the labour market and a growing share of manufacturing. Fiscal consolidation is over, in the sense that public consumption is increasing. In addition, household consumption will continue to rise, in part because of growing wages in the public sector and an associated increase in pensions. Investments, public and private, should continue to increase, as should exports, because of the real exchange rate adjustment. Economic risks are on the up side, while political risks are on the down side.

Table 21 / Serbia: Selected economic indicators

	2012	2013	2014	2015	2016 [1)]	2017 Forecast	2018 Forecast	2018 Forecast
Population, th. pers., mid-year	7,201	7,167	7,132	7,095	7,000	7,000	7,000	7,000
Gross domestic product, RSD bn, nom.	3,584	3,876	3,908	4,043	4,200	4,400	4,600	4,800
annual change in % (real)	-1.0	2.6	-1.8	0.8	2.7	2.8	3.0	3.3
GDP/capita (EUR at PPP)	9,900	10,100	10,100	10,500	11,000	.	.	.
Consumption of households, RSD bn, nom.	2,728	2,886	2,922	2,982	3,024	.	.	.
annual change in % (real)	-2.1	-0.4	-1.3	0.4	1.4	2.0	2.0	2.5
Gross fixed capital form., RSD bn, nom.	759	668	652	715	751	.	.	.
annual change in % (real)	13.2	-12.0	-3.6	5.6	5.0	5.0	6.0	5.0
Gross industrial production [2)]								
annual change in % (real)	-2.2	5.5	-6.5	8.3	4.7	5.0	4.0	5.0
Gross agricultural production								
annual change in % (real)	-19.5	21.7	2.1	-8.0	8.1	.	.	.
Construction output								
annual change in % (real)	-0.3	-20.0	2.4	20.9	4.4	.	.	.
Employed persons, LFS, th, average [3)]	2,228	2,311	2,421	2,574	2,600	2,650	2,700	2,750
annual change in %	-1.1	3.7	4.8	0.6	1.0	2.0	2.0	2.0
Unemployed persons, LFS, th, average [3)]	701	656	563	552	500	470	440	450
Unemployment rate, LFS, in %, average [3)]	23.9	22.1	18.9	17.7	16.1	15.0	14.0	14.0
Reg. unemployment rate, in %, end of period [4)]	28.6	29.1	28.4	26.8	.	.	.	.
Average monthly gross wages, RSD	57,430	60,708	61,426	61,145	63,474	66,000	68,700	71,500
annual change in % (real, gross)	1.0	-1.9	-1.7	-2.4	2.6	2.0	2.0	2.0
Average monthly net wages, RSD	41,377	43,932	44,530	44,432	46,097	48,000	49,900	51,900
annual change in % (real, net)	1.1	-1.5	-1.5	-2.1	2.5	2.0	2.0	2.0
Consumer prices, % p.a.	7.8	7.8	2.9	1.9	1.2	2.0	2.0	2.0
Producer prices in industry, % p.a.	6.8	2.7	1.3	1.0	0.0	1.0	1.2	2.0
General governm.budget, nat.def., % of GDP								
Revenues	41.1	39.7	41.5	41.9	44.0	44.0	44.0	44.0
Expenditures	47.9	45.1	48.1	45.6	47.0	46.0	45.0	46.0
Deficit (-) / surplus (+)	-6.8	-5.5	-6.6	-3.7	-3.0	-2.0	-1.0	-2.0
Public debt, nat.def., % of GDP	56.2	59.6	70.4	74.6	74.0	73.0	72.0	72.0
Stock of loans of non-fin.private sector, % p.a	9.4	-4.9	4.5	3.0	2.4	.	.	.
Non-performing loans (NPL), in %, Dec	18.6	21.4	21.5	21.5	19.4	.	.	.
Central bank policy rate, % p.a., end of period [5)]	11.25	9.50	8.00	4.50	4.00	4.00	4.00	4.00
Current account, EUR mn	-3,671	-2,098	-1,985	-1,577	-1,700	-1,500	-1,500	-1,600
Current account, % of GDP	-11.6	-6.1	-6.0	-4.7	-5.0	-4.0	-4.0	-4.0
Exports of goods, BOP, EUR mn	8,376	10,515	10,641	11,357	12,500	13,100	13,800	14,500
annual change in %	3.2	25.5	1.2	6.7	10.1	5.0	5.0	5.0
Imports of goods, BOP, EUR mn	14,011	14,674	14,752	15,350	16,270	16,900	17,700	18,600
annual change in %	2.9	4.7	0.5	4.1	6.0	4.0	5.0	5.0
Exports of services, BOP, EUR mn	3,093	3,422	3,810	4,273	4,530	4,800	5,000	5,300
annual change in %	2.2	10.6	11.3	12.2	6.0	5.0	5.0	5.0
Imports of services, BOP, EUR mn	2,981	3,109	3,344	3,548	3,620	3,800	4,000	4,200
annual change in %	3.8	4.3	7.6	6.1	2.0	5.0	5.0	5.0
FDI liabilities, EUR mn	1,009	1,548	1,500	2,114	1,800	.	.	.
FDI assets, EUR mn	256	250	264	310	150	.	.	.
Gross reserves of NB, excl. gold, EUR mn	10,295	10,734	9,351	9,812	9,543	.	.	.
Gross external debt, EUR mn [6)]	25,645	25,644	25,679	26,374	27,000	28,000	29,000	30,000
Gross external debt, % of GDP [6)]	80.9	74.8	77.1	78.8	79.1	79.0	79.0	79.0
Average exchange rate RSD/EUR	113.13	113.14	117.31	120.76	123.10	124	125	126

1) Preliminary and wiiw estimates. - 2) Excluding arms industry. - 3) Until 2013 survey of April and October, quarterly thereafter. From 2013 census 2011, from 2015 further adjustments according to ILO, Eurostat and EU-LFS. - 4) From 2015 new source for labour force potential. - 5) Two week repo rate. - 6) BOP 5th Edition.

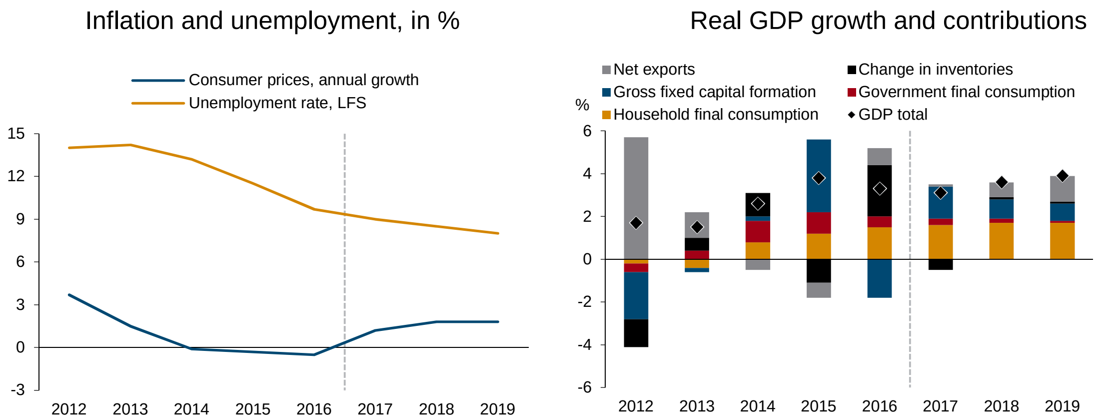
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SLOVAKIA: Moving into the fast lane from 2018 amid rising external risks

DORIS HANZL-WEISS

In 2016, a strong decline in gross fixed capital formation depressed GDP growth to 3.3%. For 2017, Slovak growth is forecast to be around 3%, while in 2018 and 2019 an increase in the capacity of the automotive industry should stimulate faster growth close to 4%.

Figure 51 / Slovakia: Main macroeconomic indicators



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

After a strong GDP increase of 3.8% in 2015, growth slowed in 2016 to about 3.3%. This was due to a sharp drop in gross fixed capital formation: the EU's new programme period is only starting, whereas 2015 was the last year of disbursements under the old EU Multiannual Financial Framework. The construction sector, which finally recovered in 2015 after contracting for six years in a row, again saw a double-digit fall in production in 2016 (-11%). On the other hand, growth was supported by an increase in household consumption (+2.8% in the first three quarters). This, however, was lower than expected, considering the significant improvements on the labour market: employment grew by almost 3% in the first three quarters and the unemployment rate fell to a record low of 9.5%. However, regional disparities are still large and unemployment rates range from 3.3% (in some districts in the west) to 24.6% (in Rimavská Sobota, in the Central region, on the border with Hungary). A shortage of qualified labour is emerging, which is also putting pressure on wages. Real wage growth reached about 4% in 2016, supported by deflation. Consumer prices fell for the third consecutive year (by 0.5%). The minimum wage rose at the beginning of 2017 to EUR 435 (up EUR 30 from last year).

The automotive sector is doing well and capacity will increase from 2018/2019 onward. Looking at sectoral trends, industrial production increased by 3.4% in 2016, with the automotive industry – the largest sector of Slovak manufacturing – the major growth driver. The three main car manufacturers – Volkswagen Bratislava, KIA Motors and PSA Peugeot-Citroën – produced more than 1 million cars in 2016, about the same number as in 2015. Major increases in automotive industry capacity are scheduled for the next two years. Jaguar Land Rover is currently building a plant near Nitra, which should start operating in 2018/2019. Initial annual production capacity will be 150,000 cars (rising eventually to 300,000 cars), and about 2,800 workers will be employed. The investment amounts to more than EUR 1 billion. It is also expected that further investment by car suppliers will follow. In addition, the Japanese producer of car parts Minebea is coming to Košice – a major investment in the less prosperous eastern Slovakia. The investment sum amounts to EUR 60 million. About 1,100 jobs will be created and an R&D centre will probably be built later. Moreover, PSA plans to launch the production of engines from 2018/2019. Aside from the automotive sector, the basic metals and fabricated metal products and the electrical equipment industries both contributed significantly to industrial growth. The major Slovak steel plant US Steel Košice, with more than 10,000 employees, may be sold to the Chinese He Steel, after a memorandum of understanding was signed in January 2017. (He Steel took over the Serbian Smederevo steel mill in 2016, which was abandoned by US Steel in 2012.) There are reportedly fears of production changes and massive lay-offs. Back in 2013, the government offered US Steel some incentives, in return for a promise to stay in the country and maintain existing employment levels until 2018.

The external sector contributed to growth in 2016. Goods exports expanded by 3.6%, while goods imports rose by only 3.1% compared to 2015. Germany is the main export destination for Slovak products, accounting for about 22% of total exports and expanding by 1.3% in 2016 (January to November, compared to the same period the previous year). The Czech Republic is the second major export destination, with 12% of exports (down 1% in 2016). Exports to other important partners, such as Italy, France and the UK, expanded by around 10% each, while those to Austria and Poland declined slightly. The current account moved again into positive territory in 2015, thanks to revisions for that year. The negative primary and secondary income balance was reduced (from EUR -3 billion to about EUR -2 billion), but is still the same amount as the goods trade balance of EUR +2 billion. Trends will be the same for 2016.

No major changes in fiscal policy are envisaged; the thresholds of the Fiscal Responsibility Law will decline from 2018 onwards. The Slovak budget deficit was revised downward for 2015 to -2.7% of GDP (instead of -3%), and the debt level declined to 52.5% of GDP. For 2016, the state budget deficit (part of the general government deficit) reached a low level, while health care and local government expenditure will probably have risen. The 2017 budget, on the revenue side, prolonged (and indeed doubled) the special levy for regulated businesses; while on the expenditure side, the corporate tax rate was reduced by 1 percentage point (to 21%). Deficit targets are set to decrease over the next years (2017: -1.9%, 2018: -0.4%), with a balanced budget expected to be reached in 2019. However, such targets have never yet been met. More effort will have to be made, as the thresholds incorporated into the Fiscal Responsibility Law will decline from the fiscal year 2018 onwards (the five sanction's bands between 50% and 60% will decline steadily by 1 percentage point a year to 40-50% by 2027). Loans to households are still increasing by about 13% a month, constituting a rising risk on the domestic market, due to rapidly increasing household debt levels. Loans to corporations are up again since July 2016, increasing by 5% a month since then. Overall, the banking sector is in good shape and the share of non-performing loans is low (about 5%).

The government is stable, with occasional scandals. From 1 July 2016 to December 2016, Slovakia managed its first ever presidency of the Council of the European Union. Though regarded as an overall success (e.g. a major summit took place in Bratislava on 16 September in response to the Brexit vote, producing the Bratislava declaration and Bratislava roadmap; there was agreement on the EU budget for 2017; and there has been progress in eliminating mobile roaming charges and geo-blocking), the presidency ended with a scandal concerning overpriced events. Speculation that the government would last only until the end of the presidency has proved unfounded. A scandal over high energy prices, however, led to some tension in the coalition at the start of the year.

The forecast is good to excellent, despite rising external risks. For 2017, Slovak growth is forecast to hover around 3%, while in 2018 and 2019 an increase in automotive industry capacity should stimulate growth close to 4%. In 2017, growth will be supported by rising household consumption and a revival in gross fixed capital formation. There will be infrastructure investment – such as the construction of new sections of highway and the Bratislava bypass. Net exports are expected to be balanced, as investment in new plants will spur import needs. From 2018 to 2019, these new capacities will create a surge in exports, thus providing a strong growth impetus. However, external risks are on the rise. Brexit is looming, creating uncertainty about possible (trade) effects. The British market is an important export destination for Slovakia, accounting for about 6% of Slovak exports – and probably more once the Jaguar plant starts production. In addition, the new US presidency might introduce further trade barriers. Increasing protectionism could damage export opportunities to the US (currently the export share is 2.4%), redirect investment from the region to the US, or lure US companies back from Slovakia.

Table 22 / Slovakia: Selected economic indicators

	2012	2013	2014	2015	2016 [1]	2017	2018	2019
							Forecast	
Population, th pers., average	5,408	5,413	5,419	5,424	5,428	5,434	5,439	5,439
Gross domestic product, EUR mn, nom.	72,704	74,170	75,946	78,686	80,900	84,400	89,000	94,100
annual change in % (real)	1.7	1.5	2.6	3.8	3.3	3.1	3.6	3.9
GDP/capita (EUR at PPP)	20,100	20,500	21,300	22,300	23,100	.	.	.
Consumption of households, EUR mn, nom.	40,868	41,084	41,605	42,469	43,400	.	.	.
annual change in % (real)	-0.4	-0.8	1.4	2.2	2.8	3.0	3.1	3.2
Gross fixed capital form., EUR mn, nom.	15,446	15,374	15,495	18,108	16,600	.	.	.
annual change in % (real)	-9.0	-0.9	1.2	16.9	-8.0	6.5	4.0	3.5
Gross industrial production								
annual change in % (real)	8.0	3.8	8.6	7.0	3.3	3.0	5.0	6.0
Gross agricultural production								
annual change in % (real)	-5.7	6.7	7.4	-3.2	7.4	.	.	.
Construction industry								
annual change in % (real)	-12.4	-5.3	-4.1	17.9	-10.6	.	.	.
Employed persons, LFS, th, average	2,329	2,329	2,363	2,424	2,480	2500	2520	2530
annual change in %	0.6	0.0	1.5	2.6	2.3	1.0	0.7	0.5
Unemployed persons, LFS, th, average	378	386	359	314	266	250	230	220
Unemployment rate, LFS, in %, average	14.0	14.2	13.2	11.5	9.7	9.0	8.5	8.0
Reg. unemployment rate, in %, end of period	14.4	13.5	12.3	10.6	8.8	.	.	.
Average monthly gross wages, EUR	805	824	858	883	910	950	990	1030
annual change in % (real, gross)	-1.2	1.0	4.2	3.2	3.8	3.0	2.5	2.5
Consumer prices (HICP), % p.a.	3.7	1.5	-0.1	-0.3	-0.5	1.2	1.8	1.8
Producer prices in industry, % p.a.	1.9	-1.0	-3.5	-2.9	-4.1	1.5	2.0	2.5
General governm.budget, EU-def., % of GDP								
Revenues	36.3	38.7	39.3	42.9	40.8	40.4	40.2	40.5
Expenditures	40.6	41.4	42.0	45.6	43.2	42.6	42.0	41.3
Net lending (+) / net borrowing (-)	-4.3	-2.7	-2.7	-2.7	-2.4	-2.2	-1.8	-0.8
Public debt, EU-def., % of GDP	52.2	54.7	53.6	52.5	52.2	52.0	51.7	51.0
Stock of loans of non-fin.private sector, % p.a.	3.2	5.4	6.7	9.7	9.3	.	.	.
Non-performing loans (NPL), in %, Dec	5.8	5.8	6.0	5.2	4.6	.	.	.
Central bank policy rate, % p.a., end of period [2]	0.75	0.25	0.05	0.05	0.00	.	.	.
Current account, EUR mn	684	1,357	904	168	-489	350	830	1,400
Current account, % of GDP	0.9	1.8	1.2	0.2	-0.6	0.4	0.9	1.5
Exports of goods, BOP, EUR mn	60,159	62,410	62,581	66,089	68,298	71,000	74,900	80,400
annual change in %	10.0	3.7	0.3	5.6	3.3	4.0	5.5	7.3
Imports of goods, BOP, EUR mn	57,653	59,399	59,722	63,974	65,865	68,500	71,900	76,600
annual change in %	5.4	3.0	0.5	7.1	3.0	4.0	5.0	6.6
Exports of services, BOP, EUR mn	6,049	6,928	6,821	7,239	7,492	7,700	8,100	8,300
annual change in %	15.7	14.5	-1.5	6.1	3.5	3.0	5.0	3.0
Imports of services, BOP, EUR mn	5,628	6,570	6,713	7,144	7,158	7,500	7,900	8,300
annual change in %	2.4	16.7	2.2	6.4	0.2	5.0	5.0	5.0
FDI liabilities, EUR mn	1,356	757	-324	1,017	4,278	.	.	.
FDI assets, EUR mn	-958	976	94	1,028	3,994	.	.	.
Gross reserves of NB excl. gold, EUR mn	620	670	1,165	1,648	1,624	.	.	.
Gross external debt, EUR mn	54,882	60,444	67,776	67,225	72,000	74,600	75,000	77,000
Gross external debt, % of GDP	75.5	81.5	89.2	85.4	89.0	88.4	84.3	81.8

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

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

SLOVENIA: Robust growth expectations

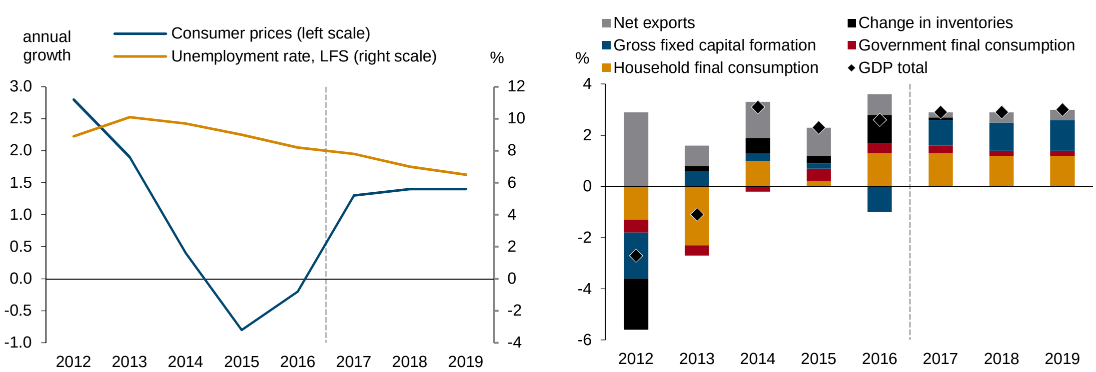
HERMINE VIDOVIC

Annual GDP growth will reach about 3% during the 2017-2019 forecast period. Exports, the gradual recovery of investments supported by EU funding and continued consumption growth will remain the main drivers of GDP. Household consumption is expected to be boosted by rising wages and a further recovery of the labour market.

Figure 52 / Slovenia: Main macroeconomic indicators

Inflation and unemployment, in %

Real GDP growth and contributions



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

Slovenia's GDP increased by 2.6% in 2016, driven by net exports and household consumption. Growth of household consumption accelerated in the wake of rising disposable income, due to more rapidly growing wages and an improvement in the labour market. Gross fixed capital formation contracted again after three years of moderate growth; this was mainly due to a drop in public investment following the end of the last EU financing framework's disbursement period in 2015. The decrease in investments has again affected construction, which had already suffered from a strong contraction in the wake of the economic and financial crisis. By contrast, investments in machinery and equipment continued to grow. Industrial production expanded by 6.3% – the highest growth since 2010 – with the strongest output increases reported for manufacturing of computer and optical products, fabricated metal products and other transport equipment.

The labour market continued to recover, with growing employment and declining unemployment. National account data indicate an employment increase of 1.9% in the first three quarters of 2016, which is confirmed by the labour market statistics provided by the statistical office. By contrast, data obtained from the Labour Force Survey indicate a slight decrease in employment, along with rising inactivity and decreasing unemployment. Overall, the employment expectations of employers for the first months of 2017 are positive, indicating further job increases. As with other EU Central and Eastern European countries, Slovenia is facing a labour shortage: according to a recent survey carried out by the public employment service, about a third of Slovene employers are facing difficulties in recruiting qualified staff. Despite relatively strong wage increases in the public sector (3.5%), average real net wages increased only modestly, by about 2% in 2016. Following a very restrictive wage policy pursued since 2009, public sector wage rises were made possible by paying for promotions agreed in 2014 and through the elimination of some austerity measures (partial release of holiday allowances, somewhat higher basic wages from September 2016).

In external trade, goods exports rose by 3.6% in 2016, as compared to a year earlier, with import growth slightly higher (3.7%), resulting in a slightly higher trade surplus than in 2015. The surplus in services trade widened as well, compared to a year earlier, due to rising exports – of travel, transport and construction services in particular – ahead of much lower import growth. The deficit in the primary income balance has been narrowing, partly on account of the smaller net outflow of direct investment. The deficit in secondary income balance has remained almost unchanged. Thus, the current account surplus increased compared with 2015 and amounted to an estimated 7% of GDP. Foreign direct investment inflows in 2016 were EUR 570 million lower than in 2015. Gross foreign debt stood at EUR 43.3 billion in December 2016, which is EUR 1.7 billion less than in December 2015. The state sector is the biggest debtor, accounting for more than half of foreign debt, while the banking sector's share decreased to 10% – compared to 44% in 2008.

Fiscal consolidation continued in 2016. The general government deficit narrowed to an estimated 2.2% of GDP and the share of the public debt to GDP decreased to 80.2%. The deficit should decline further in the coming years: according to the two-year budget approved by the government in November 2016, the general government deficit is expected to be 1.6% of GDP in 2017 and 0.7% of GDP in 2018. The budget bills for 2017 and 2018 are in compliance with the fiscal rule adopted in 2015, which sets upper limits for expenditure for several years in advance and which has strict rules on how austerity measures can be lifted. The European Commission, however, considered the budget plans to be too optimistic: on the basis of the draft budgetary plan and its autumn report, the Commission judged Slovenia to be among the countries 'at risk of non-compliance' with their obligations under the Stability and Growth Pact, arguing that 'the projected 0.2% of GDP deterioration in the structural balance in 2017 points to a risk of significant deviation from the required 0.6% of GDP adjustment towards the mid-term objective'. Pensions rose by 1.15% from January 2017 – the first regular pension increase since the onset of the crisis. By contrast, disability, parental and children's allowances and unemployment benefits will not increase for another two years. As regards wages, in December 2016 the Slovene government reached an agreement with the public sector trade unions on the abolition of certain austerity measures in 2017 and 2018, as well as an agreement with Fides, the doctors' union.

The performance of Slovenia's banking system improved further in the first ten months of 2016, with pre-tax profits (EUR 362 million) more than double the figure for the same period of 2015. Lending activities are still suppressed: loans to the corporate sector continued to shrink during the first ten months of the year, while loans to the household sector (both housing and consumer loans) grew moderately. Also household deposits increased, despite low interest rates. Compared with 2008, the share of deposits in the bank balance sheets increased from 44% to 70% in 2016. Non-performing loans have been steadily on the decline, accounting for 6.3% of total loans by the end of October 2016: The biggest declines were recorded by construction companies and the retail and real estate activities. Recently Slovene Minister of Finance Vraničar Erman emphasised that the sale of Nova Ljubljanska Banka is going ahead: the government aims to achieve this by the end of 2017. For months, the Slovene media had been speculating that the government might ask the EU Commission for an extension of the deadline for about three years. The sale/privatisation of the country's biggest bank formed part of the restructuring plan submitted to the Commission in December 2013, in order to gain approval for state aid for the bank's bailout.

Economic prospects for the 2017-2019 forecast period look favourable. wiiw expects GDP to grow at about 3% annually, driven by rising domestic demand and slowing net exports. Investments are expected to expand, supported by EU transfers under the new (2014-2020) financial perspective. Household consumption will also remain an important driver, boosted by rising wages and further improvement in the labour market. Unemployment is expected to fall during the forecasting period, not least because of the shrinking working-age population. Current account surpluses will persist, but will narrow once domestic demand strengthens and imports accelerate. Earnings from services will remain at high levels. Given the positive prospects for GDP growth in the next two to three years, it would seem feasible to reduce the budget deficit even further. Thus, public debt is expected to continue its downward path to below 80% of GDP.

Table 23 / Slovenia: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018	2019
						Forecast		
Population, th pers., average	2,057	2,060	2,062	2,064	2,064	2,064	2,064	2,064
Gross domestic product, EUR mn, nom.	36,003	35,917	37,332	38,570	39,500	41,200	43,000	44,900
annual change in % (real)	-2.7	-1.1	3.1	2.3	2.6	2.9	2.9	3.0
GDP/capita (EUR at PPP)	21,800	21,700	22,800	23,900	24,600	.	.	.
Consumption of households, EUR mn, nom.	20,129	19,460	19,827	19,773	20,200	.	.	.
annual change in % (real)	-2.4	-4.1	1.9	0.4	2.5	2.5	2.4	2.4
Gross fixed capital form., EUR mn, nom.	6,934	7,175	7,316	7,525	7,100	.	.	.
annual change in % (real)	-8.8	3.1	1.5	1.0	-5.0	5.0	5.5	6.0
Gross industrial production								
annual change in % (real)	-1.1	-1.0	2.2	5.6	6.3	4.5	4.5	4.0
Gross agricultural production								
annual change in % (real)	-10.7	-1.9	12.5	4.7	-3.8	.	.	.
Construction industry 2)								
annual change in % (real)	-16.8	-2.6	19.5	-8.1	-17.8	.	.	.
Employed persons, LFS, th, average	924	906	917	917	910	920	930	935
annual change in %	-1.3	-1.9	1.2	0.1	-0.8	1.0	1.0	0.5
Unemployed persons, LFS, th, average	90	102	98	90	81	78	70	65
Unemployment rate, LFS, in %, average	8.9	10.1	9.7	9.0	8.2	7.8	7.0	6.5
Reg. unemployment rate, in %, end of period	13.0	13.5	13.0	12.3	10.8	.	.	.
Average monthly gross wages, EUR 3)	1,525	1,523	1,540	1,556	1,585	1,600	1,650	1,710
annual change in % (real, gross)	-2.4	-2.0	0.9	1.2	1.9	1.9	1.9	2.0
Average monthly net wages, EUR 3)	991	997	1,005	1,013	1,030	1,060	1,090	1,120
annual change in % (real, net)	-2.1	-1.2	0.6	0.9	1.8	1.6	1.6	1.4
Consumer prices (HICP), % p.a.	2.8	1.9	0.4	-0.8	-0.2	1.3	1.4	1.4
Producer prices in industry, % p.a.	0.9	0.0	-0.7	-0.3	-1.3	0.5	1.0	1.0
General governm.budget, EU-def., % of GDP								
Revenues	44.5	45.3	45.0	45.1	43.2	43.2	43.0	42.8
Expenditures	48.6	60.3	50.0	47.8	45.4	45.2	44.9	44.3
Net lending (+) / net borrowing (-)	-4.1	-15.0	-5.0	-2.7	-2.2	-2.0	-1.9	-1.5
Public debt, EU-def., % of GDP	53.9	71.0	80.9	83.1	80.2	78.0	77.0	76.5
Stock of loans of non-fin.private sector, % p.a.	-5.2	-16.1	-13.7	-6.4	-4.2	.	.	.
Non-performing loans (NPL), in %, Dec	14.5	13.4	11.9	9.9	6.5	.	.	.
Central bank policy rate, % p.a., end of period 4)	0.75	0.25	0.05	0.05	0.00	0.0	0.0	0.0
Current account, EUR mn	930	1,732	2,325	1,998	2,719	2,400	2,150	2,000
Current account, % of GDP	2.6	4.8	6.2	5.2	6.9	5.8	5.0	4.5
Exports of goods, BOP, EUR mn	21,256	21,692	22,961	24,039	24,913	25,900	27,100	28,300
annual change in %	1.0	2.1	5.9	4.7	3.6	4.0	4.5	4.5
Imports of goods, BOP, EUR mn	21,337	20,984	21,780	22,541	23,375	24,500	25,800	27,300
annual change in %	-3.1	-1.7	3.8	3.5	3.7	5.0	5.5	6.0
Exports of services, BOP, EUR mn	5,107	5,318	5,558	6,025	6,539	6,900	7,300	7,800
annual change in %	4.1	4.1	4.5	8.4	8.5	6.0	6.0	6.5
Imports of services, BOP, EUR mn	3,596	3,586	3,862	4,006	4,235	4,400	4,600	4,800
annual change in %	2.7	-0.3	7.7	3.7	5.7	4.0	4.5	5.0
FDI liabilities, EUR mn	28	71	739	1,516	943	.	.	.
FDI assets, EUR mn	-439	24	155	278	236	.	.	.
Gross reserves of NB excl. gold, EUR mn	593	580	736	687	593	.	.	.
Gross external debt, EUR mn	42,872	41,866	46,514	44,954	43,259	43,300	44,300	44,900
Gross external debt, % of GDP	119.1	116.6	124.6	116.6	109.5	105.0	103.0	100.0

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

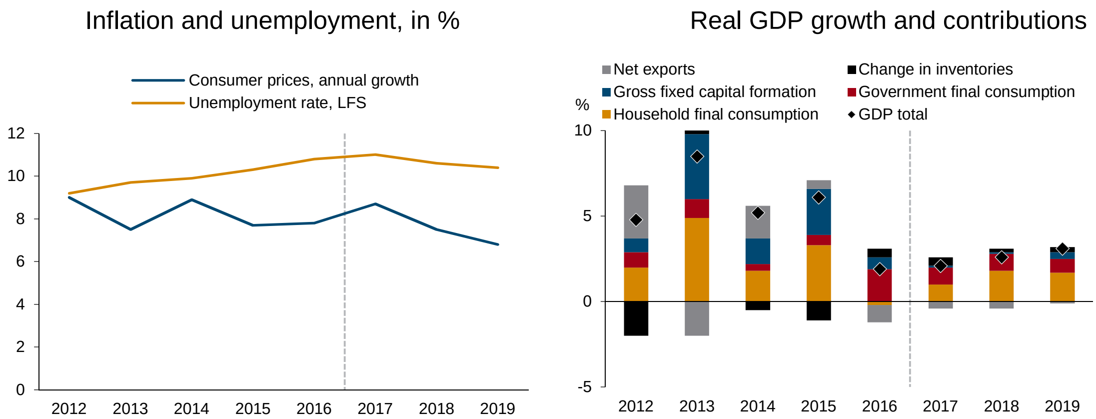
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

TURKEY: Political risk will continue to weigh on growth

RICHARD GRIEVESON

During the 2017-2019 forecast period, the Turkish economy will grow at a much slower rate than in recent years. This partly reflects political risks, both domestic and international. In this context, and at a time of monetary tightening by the US Federal Reserve, the financing of Turkey's large current account deficit will be more challenging. Monetary tightening by the Turkish central bank will remain limited, which will exacerbate the weakness of the lira and keep inflation high.

Figure 53 / Turkey: Main macroeconomic indicators



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

Turkey's political situation is in some ways more volatile than it has been for many years. The failed coup attempt in July 2016 by parts of the military has been followed by a widespread crackdown on suspected 'Gülenists' linked to the exiled preacher Fethullah Gülen. Around 100,000 people from the military, judiciary and public services are reported to have been suspended or sacked. Around 40,000 people are in prison pending trial. Emergency rule, which had been due to end in January 2017, has been extended for another three months. The government argued that this was necessary to continue the purge of suspected 'Gülenists' from state institutions. Under the emergency rule, the government can bypass parliament and suspend certain rights when it deems this necessary.

The president, Recep Tayyip Erdoğan, is pressing ahead with attempts to change the Turkish constitution and to create an executive presidency. The Justice and Development Party (AKP), which Mr Erdoğan founded in 2001 and led until he became president in 2014, together with the nationalist National Movement Party (MHP), voted the constitutional changes through parliament on 20 January (with 339 votes in the 550-seat parliament, passing the 60% threshold required). There is now likely to be a referendum in April. Voters will be asked to decide on a package of 18 constitutional changes, including the introduction of an executive presidency to replace Turkey's current parliamentary system of government. Other amendments include allowing the president to control the budget, appoint more senior judges, and to be the leader of a political party. It would also remove the post of prime minister. Mr Erdoğan has argued that the changes are necessary to rid Turkey of unstable coalition governments.

It is not yet clear which way the population will vote, and either outcome could result in further political instability. Opinion polls to date suggest a very close race. The part of the media that is not in favour of the government has been either shut down or is exercising self-censorship, which could affect the campaign. Mr Erdoğan is campaigning strongly, going to many different parts of the country and emphasising the link between a 'yes' vote and more public spending on infrastructure and health care. The Republican People's Party (CHP), the main opposition group, is against the changes, as are several Kurdish groups. The CHP has argued that the amendments would result in too few checks and balances on the power of the presidency. If the population votes in favour of the changes, they will come into force after parliamentary and presidential elections in 2019. Thereafter, any individual will be able to serve two five-year terms, creating the possibility that Mr Erdoğan could rule until 2029. A 'no' vote would be a serious setback for Mr Erdoğan, and his first significant political defeat since 2002. This would make a general election highly likely, where Mr Erdoğan would hope for the AKP to win a two-thirds majority, allowing the constitutional amendment to be approved by parliament without a referendum.

Other political risks, both domestic and international, remain relevant and could affect investor sentiment and growth. The Kurdish peace process in Turkey's south-east collapsed in 2015. Since then there have been several terrorist attacks linked to Kurdish extremists. Several members of the Kurdish Peoples' Democratic Party (HDP) have been arrested. Terrorist attacks in Istanbul and Ankara have contributed to a huge drop in tourist numbers. Tensions with the EU have increased. However, there was anyway only a very limited prospect of EU accession. There has been a rapprochement with Russia, after Mr Erdoğan apologised for the shooting down of a Russian jet over Turkey. This will be very positive for the economy (see below). Meanwhile, the election of Donald Trump as US president probably means that there will be less US criticism of Turkey. Mr Trump has in the past refrained from speaking negatively about Turkish internal affairs. One potential flashpoint could be over a request from Turkey for the rendition of Mr Gülen, who lives in the US.

The economy slowed markedly in 2016, with year-on-year growth turning negative in the third quarter for the first time since 2009. Turkey's economy contracted by 1.8% year on year in July-September, after having expanded by 4.5% in the first half of the year. The slowdown in growth in the third quarter is likely to have been related to the failed coup of July 2016, and a subsequent negative impact on consumption and investment. Gross fixed capital formation fell by 0.6% in the third quarter, while private consumption declined by 3.2%. Meanwhile, exports fell by 7%, reflecting in part a decline in tourist arrivals owing to security concerns. High-frequency indicators suggest no major bounce-back in economic activity in the fourth quarter.

Overall we estimate full-year growth of 1.9% in 2016, a big slowdown from the average of 6.1% posted in the previous four years. We expect growth to have been held back in particular by private consumption and exports. In the case of the former, uncertainty related to political developments and the impact of higher inflation on real incomes have restrained spending. Meanwhile, exports have been weighed down in particular by the weakness of tourism. Political tensions with Russia and Moscow's cancelling of package tours saw arrivals from Turkey's second most important source of tourists (after Germany) fall by 77.4% in January-November 2016. These negative factors were partly offset by government spending, which rose by an estimated 13.5% in 2016.

We think that a growth rate of 2.6% on average is achievable for the 2017-2019 forecast period. Growth will be more subdued this year, at 2.1%, as the above factors take time to wear off. However, momentum will improve from the levels seen in the second half of 2016. Consumer loan demand appears to have picked up during the final months of 2016 (although this could simply reflect a desire to bring forward purchases of bigger-ticket items before the exchange rate weakness pushes up domestic prices), while external demand for goods exports improved moderately. Private consumption in 2017 will be held back by political uncertainty, although the labour market appears to be coping relatively well. Employment growth slowed in the second half of the year, but remained positive. Although the unemployment rate is rising, this reflects larger numbers of new entrants into the labour force.

The tourism sector should start to recover gradually, beginning this year. In particular, arrivals from Russia will grow strongly, given the rapprochement between the two countries. The plunge in the value of the Turkish lira has significantly improved the cost competitiveness of the Turkish tourism sector (although higher inflation will gradually eat into these gains). Meanwhile merchandise exports will be supported by similar factors, as well as by robust EU demand, which is boosting Turkish automotive output in particular. Investment could be impeded by political uncertainty and weaker economic growth, although government fixed capital formation should be strong. Overall government spending will continue to contribute positively to growth.

Consumer price inflation will remain at high levels, in particular as a result of the weaker lira. The consumer price index (CPI) increased by an average 7.8% in 2016 as compared to a year earlier, and by 8.5% in December. This was the highest level since July, and was driven in particular by the weakness of the lira (see below) and the resulting increase in the cost of imported goods, as well as by hikes in alcohol and tobacco taxes. Meanwhile global energy prices are continuing to rise after bottoming out in the first half of 2016. Inflation rose further to 9.2% in January. We expect inflation to average 8.7% in 2017, with the full extent of the exchange-rate pass-through set to become evident only with a lag. Inflation will then fall to 7.5% in 2018 and 6.8% in 2019, still well above the central bank's 5% target.

Monetary policy has been loose in the context of the weakness of the lira and elevated inflation. The central bank significantly disappointed the market in December by keeping its benchmark one-week repo rate at 8%, the overnight lending rate at 8.5%, and the overnight borrowing rate at 7.5%. This caused a further sell-off of the lira. In January, the central bank again refrained from increasing the one-week repo rate, but did hike the marginal funding rate (+75 basis points) and the late liquidity window lending rate (+100 basis points).

The Turkish lira has weakened considerably. Heightened political risk, monetary tightening by the US Federal Reserve, a relative lack of tightening by the Turkish central bank, and the weakness of the external sector all pushed the lira down to 3.34 TRY/EUR in 2016, from 3.03 TRY/EUR in 2015. The currency has weakened much further since. We forecast an average exchange rate of 3.98 TRY/EUR in 2017. US monetary tightening in particular remains a concern for Turkey. As US rates rise, there is an increased risk of capital outflows from Turkey, which could force the Turkish central bank to tighten policy more sharply. This must be weighed against the slowdown in economic activity.

Despite the weakness of the lira, the Turkish banking sector remains in relatively good shape. Non-performing loans (NPLs) have been rising, but still remain quite low, at 3.3% of total gross loans in the third quarter of 2016. NPL levels for small and medium-sized enterprises (4.5%) and general-purpose retail credits (6.3%) are higher, whereas for housing loans the ratio is just 0.5%. Foreign-exchange (FX) NPLs are lower as a share of the total than for TRY-denominated credits, according to the central bank. This is quite surprising in the context of lira weakness, but historically the link between the exchange rate and NPLs is quite weak, according to central bank research. Total private sector credit growth has slowed since the second half of 2015, primarily reflecting a reduction in private sector FX borrowing. Profitability in the banking sector has risen. There has been little sign of deposit outflows in the wake of the coup attempt and political instability.

There are signs that fiscal policy management will not be as conservative as it has been in the past. The Turkish fiscal position has been generally strong in the last 15 years, with fiscal discipline being maintained by AKP governments over several election cycles. Fiscal deficits have generally been quite small, and public debt is well below 30% of GDP. This allowed the government to initiate a countercyclical increase in spending in 2016, partly in response to the failed coup. According to the Ministry of Finance, the central government budget recorded a deficit of TRY 29.3 billion in 2016, compared with TRY 23.5 billion in 2015. Revenue rose by 14.8%, thanks to non-tax revenue growth (growth in taxation receipts was weaker, owing to the slowdown in economic growth). Meanwhile, expenditure was up 15.3%, despite lower interest payments on public debt. Non-interest expenditure increased by 17.7%.

In 2017, we expect a fiscal deficit equivalent to 2.2% of GDP. The 2017 budget envisages a 30% increase in capital spending, with a focus on the country's poorer eastern and southern regions. Although the shortfall will be wider than in previous years during the forecast period, it will remain well below 3% of GDP, indicating continued relative commitment to fiscal discipline in the face of external risks and a desire not to widen the current account deficit further. Turkey has faced significant extra spending commitments owing to large refugee inflows from the war in neighbouring Syria.

The current account deficit widened to 4.9% of GDP in 2016, and will rise further over the forecast period. In 2016, the deficit was larger owing primarily to developments on the services account and to the collapse of tourism inflows. In US dollar terms, services credits fell by 20% year on year in January-November (data for December are not yet available). This was partly offset by a sharp decline in goods imports (-5.2%), related to the lower cost of energy, which resulted in a 14.8% year-on-year narrowing of the merchandise goods deficit. The latter factor was also supported by a declining trade deficit with the EU, as demand there remained robust. As energy prices pick up (particularly in lira terms), the overall current account deficit is likely to widen further, reaching 5.1% in 2017, 5.4% in 2018 and 5.7% in 2019. The fact that exports are typically priced in euros and imports in US dollars will be a negative factor for the trade balance, as the dollar continues to strengthen. However, a further widening towards the levels of the higher current account deficits of the relatively recent past is unlikely, due to a more subdued trend for domestic demand and much lower oil prices than in 2010-2014.

The fact that most of the financing of Turkey's current account deficit is debt creating remains a potential issue. Turkey has traditionally run quite large current account deficits, financed primarily by a combination of portfolio and other investment (loans), with net foreign direct investment (FDI) inflows contributing a fairly small share of the total (FDI financed 32% of the current account deficit on average in 2003-2015, compared with 55% for other investment). Gross external debt reached an estimated 48.5% of GDP in 2016. So far, the failed coup attempt (and the government's reaction to it) does not appear to have had much of an impact on external financing, but this is not certain to last. Globally, emerging markets have seen capital outflows in the wake of US monetary tightening. All major ratings agencies now rate the Turkish sovereign as junk (following a Fitch downgrade on 27 January).

Short FX positions of corporates have increased, and are a source of risk for the economy. Such positions stood at around 200% of FX reserves, and 100% of annual exports of goods and services in the third quarter of 2016, according to the central bank. However, the central bank has stated that FX borrowers typically have foreign currency revenue streams, and that FX borrowing is generally of an extended maturity. Meanwhile, the bank reports that short-term open FX positions are small.

Overall, the outlook for the Turkish economy is for subdued growth by recent standards throughout the forecast period. We see the economy expanding by 2.1% in 2017, rising to 2.6% in 2018 and 3.1% in 2019. Political risks will continue to weigh on consumer and investor sentiment, irrespective of the referendum result. Meanwhile the lira will remain weak and inflation high. Turkey should still be able to finance its current account deficit, but the risks of financing difficulties have increased, owing to both the heightened political risks and monetary tightening in the US.

Table 24 / Turkey: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018 Forecast	2019
Population, th pers., average	75,176	76,148	77,182	78,218	79,500	80,300	81,100	81,900
Gross domestic product, TRY bn, nom. 2)	1,570	1,810	2,044	2,338	2,600	2,900	3,200	3,500
annual change in % (real)	4.8	8.5	5.2	6.1	1.9	2.1	2.6	3.1
GDP/capita (EUR at PPP) 2)	15,500	16,300	16,900	18,000	18,400	.	.	.
Consumption of households, TRY bn, nom. 2)	979	1,120	1,242	1,412	1,516	.	.	.
annual change in % (real)	3.2	7.9	3.0	5.5	-0.4	1.6	3.0	2.8
Gross fixed capital form., TRY bn, nom. 2)	429	516	591	695	768	.	.	.
annual change in % (real)	2.7	13.8	5.1	9.2	2.5	0.2	0.2	1.5
Gross industrial production								
annual change in % (real)	2.5	3.0	3.6	3.2	1.9	2.2	2.5	3.0
Gross agricultural production 3)								
annual change in % (real)	5.5	2.8	2.0	2.0	2.0	.	.	.
Construction industry								
annual change in % (real)	0.8	7.7	3.0	1.7	3.2	.	.	.
Employed persons, LFS, th, average	24,819	25,520	25,931	26,619	27,240	27,800	28,400	29,000
annual change in %	3.0	2.8	1.6	2.7	2.3	2.0	2.0	2.0
Unemployed persons, LFS, th, average	2,517	2,750	2,854	3,050	3,280	3,440	3,370	3,370
Unemployment rate, LFS, in %, average	9.2	9.7	9.9	10.3	10.8	11.0	10.6	10.4
Reg. unemployment rate, in %, end of period	.	.	.	.	.	.	.	.
Average monthly gross wages, TRY	.	.	.	.	.	.	.	.
annual change in % (real, gross)	.	.	.	.	.	.	.	.
Consumer prices (HICP), % p.a.	9.0	7.5	8.9	7.7	7.8	8.7	7.5	6.8
Producer prices in industry, % p.a. 4)	6.1	5.7	10.1	5.3	4.3	9.5	7.6	6.0
General governm. budget, nat.def., % of GDP								
Revenues	32.2	32.7	31.9	32.0	38.5	37.8	37.5	37.4
Expenditures	34.0	34.0	32.7	32.9	40.1	40.0	39.7	39.5
Deficit (-) / surplus (+)	-1.8	-1.3	-0.8	-1.0	-1.6	-2.2	-2.2	-2.1
Public debt, nat.def., % of GDP 5)	32.6	31.3	28.6	27.5	27.5	28.0	27.9	27.7
Stock of loans of non-fin.private sector, % p.a.	18.6	33.6	19.4	19.4	15.2	.	.	.
Non-performing loans (NPL), in %, Dec	2.9	2.8	2.8	3.1	3.2	.	.	.
Central bank policy rate, % p.a., end of period 6)	5.50	4.50	8.25	7.50	8.00	9.00	8.50	8.00
Current account, EUR mn	-37,208	-47,966	-32,951	-29,074	-29,504	-37,000	-43,000	-48,000
Current account, % of GDP	-5.5	-6.7	-4.7	-3.8	-3.8	-5.1	-5.4	-5.7
Exports of goods, BOP, EUR mn	126,137	121,819	127,237	136,978	135,820	127,000	138,000	150,000
annual change in %	23.2	-3.4	4.4	7.7	-0.8	-6.4	8.5	8.8
Imports of goods, BOP, EUR mn	177,043	182,057	175,312	180,341	172,644	162,000	177,000	194,000
annual change in %	6.5	2.8	-3.7	2.9	-4.3	-6.0	9.0	9.5
Exports of services, BOP, EUR mn	34,078	36,306	39,105	42,129	33,596	32,000	34,000	36,000
annual change in %	15.3	6.5	7.7	7.7	-20.3	-5.0	5.0	6.5
Imports of services, BOP, EUR mn	16,347	18,457	18,915	20,348	19,736	19,000	21,000	23,000
annual change in %	7.6	12.9	2.5	7.6	-3.0	-2.0	11.0	8.5
FDI liabilities, EUR mn	10,305	9,297	9,447	15,371	10,999	.	.	.
FDI assets, EUR mn	3,167	2,716	5,377	4,594	2,828	.	.	.
Gross reserves of NB excl. gold, EUR mn	75,749	80,435	88,058	85,355	87,331	.	.	.
Gross external debt, EUR mn 7)	257,418	282,858	331,195	365,308	377,200	371,600	410,900	439,600
Gross external debt, % of GDP 7)	37.9	39.6	47.1	47.3	48.5	51.0	52.0	51.5
Average exchange rate TRY/EUR	2.31	2.53	2.91	3.03	3.34	3.98	4.05	4.10

1) Preliminary and wiiw estimates. - 2) According to SNA 2010. - 3) Based on UN-FAO data, from 2014 wiiw estimate. - 4) Domestic output prices. - 5) Defined according to EU standards. - 6) One-week repo rate. - 7) BOP 5th Edition.

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

UKRAINE: Investment-led recovery under way

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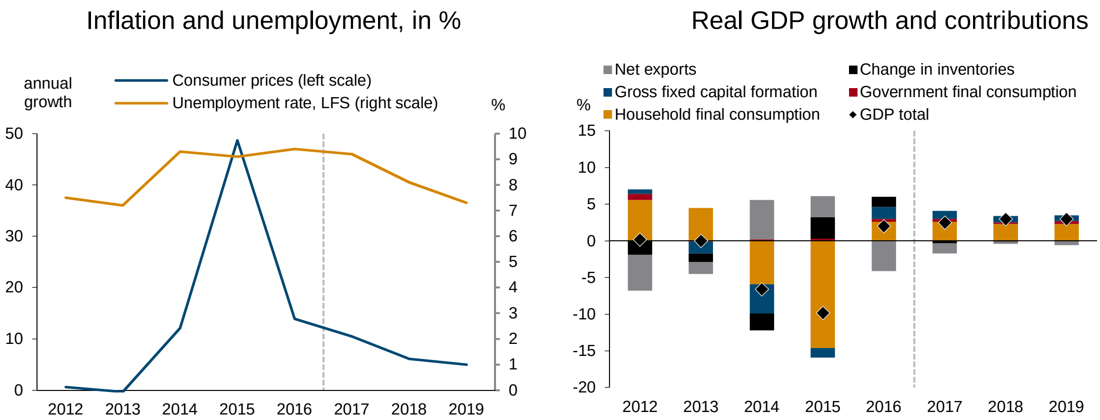
Economic recovery has progressively gained momentum, but it is entirely driven by domestic demand and is accompanied by widening external imbalances. GDP growth is projected to pick up further to 2.5% in 2017 on account of export stabilisation, and to accelerate to 3% in 2018-2019. However, this scenario crucially hinges on the preservation of the semi-frozen state of the conflict in Donbas and the continuation of the International Monetary Fund programme.

Figure 54 / Ukraine: Main macroeconomic indicators



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

The investment-fuelled recovery of Ukraine's economy is progressively gaining momentum. Real GDP growth picked up from 0.1% in the first quarter of 2016 (on an annual basis) to 1.4% in the second quarter, 2% in the third quarter and an impressive 4.7% in the fourth quarter, resulting in GDP growth of some 2% for the year as a whole. This recovery was driven entirely by domestic demand, particularly fixed investments, which surged by an estimated 12% last year. The revival of investments may not come as a big surprise, with businesses making up for years of under-investment in response to economic stabilisation, relative political stability and the largely observed ceasefire in Donbas (at least until recently). Still, the role of foreign direct investment (FDI) remained modest: the bulk of statistically recorded – rather meagre – FDI inflows represented recapitalisation of foreign-owned banks by parent structures. Private consumption performed strongly as well: retail trade turnover – a proxy for private consumption – picked up by 4% last year. However, this increase appears modest against the background of a solid growth in wages (9% in real net terms). This implies that the household saving rate must have been rather high, partly reflecting acute deleveraging needs: the volume of credit to households contracted by 6.6% in nominal (and even more in real) terms.

Construction and agriculture are performing well, but industrial production growth is sluggish. Across sectors, construction output surged by 17.4% and agricultural production by 6% last year, buoyed by a record grain harvest: 66 million tonnes, the highest since the country's independence. This further strengthened the role of agriculture, which has been the main beneficiary of the recent de-industrialisation and whose value-added had reached 14% of Ukraine's GDP the previous year. At the same time, the growth of industrial production (2.8% last year in gross output terms) was constrained by poor export performance. Goods exports declined by 5.2% in US dollar terms, primarily on account of the export slump to Russia (-26%) after it revoked the free trade agreement with Ukraine in response to the Ukraine–EU Deep and Comprehensive Free Trade Agreement (DCFTA).[31] On top of that, Russia imposed an import embargo on Ukrainian food products and restricted the transit of Ukrainian goods destined for third countries (largely Central Asia) across its territory. At the same time, Ukraine's goods exports to the EU grew by a mere 2.4% last year: the vast majority of Ukrainian manufactured goods do not comply with EU standards and regulations, whereas agricultural exports are typically subject to tariff quotas in the EU, which are highly restrictive in many cases. Even so, agriculture and food were the sole commodity group to record positive export growth in 2016 (5.4%).

Investment goods imports are in high demand. Overall goods imports picked up by 3.8% last year (in US dollar terms). Disregarding the sharp decline (-28%) in imported mineral products (essentially oil and gas),[32] import growth was much more impressive: up to 38% in the case of machinery and equipment, the bulk of which were investment goods. On the one hand, increased imports of investment goods are a natural consequence of booming investments and thus represent a welcome development. However, imports rising ahead of exports are a drag on GDP growth and put pressure on the balance of payments. It may be cause for concern that even the rather modest economic recovery observed last year brought with it a marked deterioration in the current account deficit, to 3.6% of GDP (from 0.2% in 2015). With import-fed recovery picking up pace, the external deficits will likely rise further in the years to come.

Fiscal policy has become more expansionary. Unlike in the two previous years, wages and social payments were largely adjusted in line with inflation last year. In addition, the drastic reduction in social security contributions (from 41% to 22%) proved fiscally expansionary as well, as the targeted improvement in tax compliance largely failed to materialise. Nevertheless, the budget deficit widened only moderately (to 2.3% of GDP, from 1.6% in 2015) thanks to over-performing tax revenues. Despite the moderate budget deficit, positive economic dynamics, still high inflation and relative exchange rate stability (70% of public debt is denominated in a foreign currency), Ukraine's public debt as a share of GDP went up last year, to nearly 82% (from 79% in 2015). The main reason for this was the recapitalisation (and nationalisation) of Ukraine's largest bank, Privatbank, in December 2016, largely financed by issuing domestic bonds worth some USD 4 billion.[33] The official reasons for nationalising Privatbank, which had been profitable over the past three years despite the deep economic crisis, were

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[31] DCFTA (which is part of a broader Association Agreement) came into force in January 2016.

[32] The sharp decline in gas imports last year was partly a result of steep (and arguably excessive) domestic tariff hikes, which curbed residential gas consumption (for more on that, see V. Astrov and L. Podkaminer, 'Energy tariff reform in Ukraine: estimated effects and policy options', wiiw Research Report No. 416, February 2017).

[33] On top of that, the recapitalisation of Privatbank also involved a 'bail-in' (i.e. losses) of its bondholders.

the insufficient capital adequacy and the non-transparent nature of its credit portfolio, which largely consisted of 'related lending' (i.e. lending to related parties which often use the borrowed funds to purchase the creditor's equity). Following Privatbank's nationalisation, the state now controls around half of the country's banking system and, although it is planning to re-privatise the bank in the near future, the feasibility of this is questionable (so far, the track record of privatisation in Ukraine has been rather dismal).

Further fiscal relaxation is envisaged for this year, as the minimum wage more than doubled from January 2017, from UAH 1,476 to UAH 3,200 per month. This means that wages and salaries in the public sector, which are indexed to the minimum wage, have increased accordingly. At face value, the magnitude of the hike appears reckless (and it is certainly motivated to a large extent by the authorities' concerns over social stability); but it needs to be seen against the background of the strong decline in the real minimum wage over the past three years – about half of the hike represents a mere correction of this decline. Also, the ratio of the minimum wage to the average wage (around 30% in 2016) was extremely low (e.g. compared to most countries of the Organisation for Economic Co-operation and Development). Even at its new level, the minimum wage is a mere USD 115 per month.

The doubling of the minimum wage will add 0.5 percentage points (pp) to real GDP growth and 1 pp to consumer price index inflation this year, according to the national bank's estimates. The incomes of some 3 million employees who earn less than UAH 3,200 per month will rise accordingly. Given their high propensity to spend, this should boost private consumption. At the same time, for earners of higher wages (which often go partly unreported), the share of their income that is officially declared (and taxed) will go up in line with the higher minimum wage. Indeed, reducing the 'shadow' sector and curbing tax evasion have been the key arguments put forward by the government when advocating the move. The government reckons that additional tax revenues will partly offset the higher wage bill of public sector employees, so that the negative impact of the hike in the minimum wage on the budget should be contained. The 2017 central government budget envisages a deficit of 3% of GDP, thus meeting the IMF target.

All in all, wiiw projects an acceleration of growth to 2.5% this year and around 3% in both 2018 and 2019. The main factor behind this should be the expected stabilisation and recovery of exports, largely thanks to higher global prices for metals and for Ukraine's other key export commodities. Still, the recovery will continue to be driven predominantly by domestic demand. Inflation is projected to gradually subside to single-digit figures on the back of relative exchange-rate stability. Unemployment should gradually recede as well, helped in part by economic recovery, but also by the shrinking labour force – a result of both demographic decline and increased outward migration (to countries such as Poland and the Czech Republic; the latter eased access to its labour market for Ukrainians in February 2017). Recent labour market data are encouraging in this respect: in January 2017, the number of employers looking for labour was 35% higher, and the number of job vacancies was 48% higher, than the year before, while the average number of job applicants per vacancy fell from 16 to 9 over the same period.

The above benign scenario hinges on the preservation of (at least) the semi-frozen status of the conflict in Donbas and the continuation of the IMF loan programme. The former is far from certain, especially given the recent (February 2017) escalation in the fighting, which may be related to the perceived change in the global geopolitical climate following the election of Donald Trump as US president. With Mr Trump in office, Ukraine may potentially receive less support (financial and otherwise) from the US; but this also implies that the US would be less able to influence developments in Ukraine, thus providing the authorities with more room for manoeuvre (for more on that, see Special Topic 'Uncertainty and risks in the CIS region' in this report). As for the IMF programme, its continuation is all the more important, given the widening external imbalances and the increasing risks of another balance-of-payments crisis. Such a crisis is most likely to materialise in 2019, when Ukraine is due to repay USD 7.5 billion in external debt and when the next presidential and parliamentary elections are due. At the same time, the risks that the IMF programme may stall are non-negligible, since implementing some of the IMF requirements – such as introducing unpopular pension reform and lifting the moratorium on the sale of agricultural land – may not be politically feasible in the current circumstances.

Table 25 / Ukraine: Selected economic indicators

	2012	2013	2014	2015	2016 1)	2017	2018 Forecast	2019
Population, th pers., average	45,593	45,490	43,001	42,845	42,673	42,550	42,450	42,380
Gross domestic product, UAH bn, nom.	1,459	1,523	1,587	1,989	2,360	2,700	3,000	3,200
annual change in % (real)	0.2	0.0	-6.6	-9.8	2.0	2.5	3.0	3.0
GDP/capita (EUR at PPP)	6,600	6,600	6,400	5,900	6,100	.	.	.
Consumption of households, UAH bn, nom.	1,002	1,099	1,121	1,317	1,190	.	.	.
annual change in % (real)	8.4	6.5	-8.3	-20.7	4.0	4.0	3.5	3.5
Gross fixed capital form., UAH bn, nom.	283	264	224	263	290	.	.	.
annual change in % (real)	3.3	-8.0	-24.0	-9.2	12.0	8.0	7.0	6.0
Gross industrial production								
annual change in % (real)	-0.5	-4.3	-10.1	-13.0	2.8	3.5	4.0	4.0
Gross agricultural production								
annual change in % (real)	-4.5	13.3	2.2	-4.8	6.1	.	.	.
Construction output								
annual change in % (real)	-8.3	-14.5	-20.4	-12.3	17.4	.	.	.
Employed persons, LFS, th, average	20,354	20,404	18,073	16,443	16,250	16,250	16,350	16,400
annual change in %	0.1	0.2	-6.4	-0.4	-1.2	0.0	0.6	0.3
Unemployed persons, LFS, th, average	1,657	1,577	1,848	1,655	1,700	1,650	1,450	1,300
Unemployment rate, LFS, in %, average	7.5	7.2	9.3	9.1	9.4	9.2	8.1	7.3
Reg. unemployment rate, in %, end of period 2)	1.8	1.8	1.7	1.6	1.5	.	.	.
Average monthly gross wages, UAH 3)	3,026	3,265	3,480	4,195	5,183	6,600	7,300	7,900
annual change in % (real, gross)	14.3	8.2	-5.4	-18.9	8.5	15.0	4.0	3.0
annual change in % (real, net)	14.4	8.2	-6.5	-20.2	9.0	15.0	4.0	3.0
Consumer prices, % p.a.	0.6	-0.3	12.1	48.7	13.9	10.5	6.1	5.0
Producer prices in industry, % p.a. 4)	3.7	-0.1	17.1	36.0	20.5	15.0	8.0	7.0
General governm.budget, nat.def., % of GDP								
Revenues	30.5	29.1	28.7	32.8	33.2	33.9	33.0	32.5
Expenditures	34.0	33.3	33.3	34.3	35.5	36.9	35.5	35.0
Deficit (-) / surplus (+) 5)	-3.5	-4.2	-4.5	-1.6	-2.3	-3.0	-2.5	-2.5
Public debt, nat.def., % of GDP	35.3	38.4	69.4	79.1	81.8	83.0	84.0	83.0
Stock of loans of non-fin.private sector, % p.a.	2.1	11.6	11.8	-2.8	2.4	.	.	.
Non-performing loans (NPL), in %, Dec	16.5	12.9	19.0	28.0	31.0	.	.	.
Central bank policy rate, % p.a., end of period 6)	7.50	6.50	14.00	22.00	14.00	10.0	8.0	8.0
Current account, EUR mn 7)	-11,153	-12,441	-3,476	-170	-3,038	-4,200	-4,300	-4,700
Current account, % of GDP 7)	-7.9	-8.7	-3.4	-0.2	-3.6	-4.5	-4.6	-4.8
Exports of goods, BOP, EUR mn 7)	50,127	44,518	38,235	31,935	30,319	34,200	35,600	37,100
annual change in %	11.9	-11.2	-14.1	-16.5	-5.1	12.8	4.1	4.2
Imports of goods, BOP, EUR mn 7)	67,124	61,185	43,626	35,050	36,454	41,800	43,400	45,500
annual change in %	16.2	-8.8	-28.7	-19.7	4.0	14.7	3.8	4.8
Exports of services, BOP, EUR mn 7)	17,186	17,032	11,257	11,218	11,150	12,600	12,800	13,100
annual change in %	12.5	-0.9	-33.9	-0.4	-0.6	13.0	1.6	2.3
Imports of services, BOP, EUR mn 7)	11,351	12,141	9,350	9,639	10,055	11,700	12,300	12,900
annual change in %	18.1	7.0	-23.0	3.1	4.3	16.4	5.1	4.9
FDI liabilities, EUR mn 7)	6,360	3,396	641	2,750	3,114	.	.	.
FDI assets, EUR mn 7)	762	324	414	34	89	.	.	.
Gross reserves of NB excl. gold, EUR mn	17,186	13,592	5,429	11,320	13,965	.	.	.
Gross external debt, EUR mn 7)	102,120	102,852	103,557	108,666	104,000	108,000	112,000	115,000
Gross external debt, % of GDP 7)	71.9	71.7	102.6	132.4	124.7	116.0	119.5	118.6
Average exchange rate UAH/EUR	10.271	10.612	15.716	24.229	28.292	29.0	32.0	33.0

Note: from 2014 excluding the occupied territories of Crimea and Sevastopol and from 2015 (except for population) parts of the anti-terrorist operation zone.

1) Preliminary and wiiw estimates. - 2) In % of working age population. - 3) Enterprises with 10 and more employees. - 4) Domestic output prices. From 2013 according to NACE Rev. 2. - 5) Without transfers to Naftohaz and other bail-out costs, in 2014 including VAT refund via issued government bonds. - 6) Discount rate of NB. - 7) Converted from USD.

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

Appendix

Table 26 / European Union-Central and Eastern Europe (EU-CEE): an overview of economic fundamentals, 2016

	BG	HR	CZ	EE	HU	LV	LT	PL	RO	SK	SI	*EU-CEE 1)*	*EU-28 2)*
Gross domestic product													
EUR bn, at ER	47.1	45.3	173.9	20.7	114.0	24.8	38.6	419.4	169.2	80.9	39.5	*1,173*	*14,815*
EUR bn, at PPP	101.4	72.7	272.6	28.9	198.7	37.7	64.2	784.8	342.9	125.5	50.7	*2,080*	*14,815*
EU-28=100, at PPP	0.7	0.5	1.8	0.2	1.3	0.3	0.4	5.3	2.3	0.8	0.3	*14.0*	*100.0*
Per capita, EUR, at PPP	14,200	17,400	25,800	22,000	20,300	19,200	22,300	20,400	17,300	23,100	24,600	*20,100*	*29,000*
Per capita, EU-28=100, at PPP	49	60	89	76	70	66	77	70	60	80	85	*69*	*100*
1990=100	151.1	109.6	157.4	155.0	140.4	122.2	136.7	223.6 3)	160.1	193.5	163.1	*183.9*	*156.1*
2007=100	115.5	93.2	110.6	99.2	106.2	96.4	109.0	132.6	118.2	122.5	101.1	*118.8*	*106.1*
Price level													
EU-28=100 (PPP/ER)	46	62	64	72	57	66	60	53	49	64	78	*56*	*100*
Industrial production													
2007=100 4)	95.1	90.9	109.2	116.7	111.4	112.7	117.6	135.2	133.8	148.2	103.3	*124.2*	*97.5*
Population													
in thousand, average	7,150	4,190	10,564	1,315	9,810	1,961	2,880	38,450	19,830	5,428	2,064	*103,642*	*511,369*
Employed persons, LFS													
in thousand, average	3,017	1,600	5,135	650	4,350	895	1,360	16,230	8,490	2,480	910	*45,117*	*223,726*
Unemployment rate, LFS													
in %	7.6	13.5	4.0	6.6	5.2	9.7	8.0	6.3	6.0	9.7	8.2	*6.6*	*8.5*
Compensation per employee, monthly 5)													
EUR	639	1,328	1,310	1,522	1,010	1,219	1,169	1,049	744	1,317	2,126	*1,058*	*3,067*
EU-28=100	20.8	43.3	42.7	49.6	32.9	39.8	38.1	34.2	24.2	42.9	69.3	*34.5*	*100.0*
General government budget, EU-def., % of GDP													
Revenues	37.0	44.1	41.5	38.7	47.5	35.8	34.0	39.5	31.0	40.8	43.2	*39.4*	*44.8*
Expenditures	38.0	46.3	41.9	39.0	49.8	36.6	34.9	42.4	33.0	43.2	45.4	*41.4*	*46.7*
Balance	-1.0	-2.2	-0.4	-0.3	-2.3	-0.9	-0.9	-2.9	-2.0	-2.4	-2.2	*-2.0*	*-1.9*
Public debt, EU def., % of GDP	29.0	84.0	39.5	9.8	73.9	40.0	41.0	53.1	38.0	52.2	80.2	*50.4*	*85.1*
BOP items, % of GDP													
Current account	3.8	3.7	1.6	2.7	4.3	1.6	0.3	-0.5	-2.4	-0.6	6.9	*0.7 6)*	*2.1 6)*
Exports of goods	48.0	24.6	67.9	54.2	72.5	41.5	56.6	42.1	30.8	84.4	63.1	*51.1 6)*	*31.3 6)*
Imports of goods	51.8	40.4	62.5	58.5	68.1	48.4	60.9	41.7	36.3	81.4	59.2	*51.3 6)*	*29.2 6)*
Exports of services	16.1	26.8	12.1	26.7	18.3	17.0	17.5	10.5	10.4	9.3	16.6	*13.1 6)*	*12.4 6)*
Imports of services	8.9	7.6	10.1	18.0	13.0	9.4	11.8	7.3	6.0	8.8	10.7	*8.7 6)*	*10.7 6)*
FDI stock per capita													
EUR, 2015 7)	5,306	5,662	9,840	13,270	7,799	6,880	4,673	4,347	3,261	7,395	5,602	*5,502*	*12,776*

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) 1989=100, which in the Polish case is the appropriate reference year. - 4) EU-28 working-day adjusted. - 5) Gross wages plus indirect labour costs, according to national account concept. - 6) Data for EU-CEE and EU-28 include transactions within the region (sum over individual countries). - 7) Excluding SPE.

Source: wiiw Annual Database, Eurostat, AMECO.

Table 27 / Western Balkans and Turkey, selected CIS countries and Ukraine: an overview of economic fundamentals, 2016

	AL	BA	XK	MK	ME	RS	TR	BY	KZ	RU [1]	UA [2]	*EU-CEE* [3]	*EU-28* [4]
Gross domestic product													
EUR bn, at ER	10.9	14.8	6.0	9.3	3.7	34.1	777.7	42.9	120.8	1,156.5	83.4	*1,173*	*14,815*
EUR bn, at PPP	25.6	31.8	13.9	22.4	7.7	76.9	1,443.5	128.2	331.5	2,529.6	259.5	*2,080*	*14,815*
EU-28=100, at PPP	0.2	0.2	0.1	0.2	0.1	0.5	9.7	0.9	2.2	17.1	1.8	*14.0*	*100.0*
Per capita, EUR, at PPP	8,900	8,300	7,800	10,700	12,400	11,000	18,200	13,500	18,600	17,200	6,100	*20,100*	*29,000*
Per capita, EU-28=100, at PPP	31	29	27	37	43	38	63	47	64	59	21	*69*	*100*
1990=100	223.5	.	.	141.3	.	.	304.5	186.5	195.3	115.0	59.6	*183.9*	*156.1*
2007=100	130.5	112.6	139.3	125.6	116.2	107.4	149.7	122.8	142.5	108.3	82.0	*118.8*	*106.1*
Price level													
EU-28=100 (PPP/ER)	43	47	43	42	48	44	54	33	36	46	32	*56*	*100*
Industrial production													
2007=100 [5]	270.3	120.1	203.4	111.3	66.1	100.4	128.1	125.5	120.8	106.0	67.9	*124.2*	*97.5*
Population													
in thousand, average	2,886	3,816	1,780	2,085	625	7,000	79,500	9,500	17,800	146,692	42,673	*103,642*	*511,369*
Employed persons, LFS in thousand, average	1,160	801	316	720	224	2,600	27,240	4,410	8,610	72,393	16,250	*45,117*	*223,726*
Unemployment rate, LFS in %	15.2	25.4	26.5	24.0	17.5	16.1	10.8	0.8 [6]	5.0	5.3	9.4	*6.6*	*8.5*
Average gross monthly wages													
EUR at ER	355	665	460 [7]	532	751	516	1,172 [8]	328	376	494	183	*1,058* [8]	*3,067* [8]
EU-28=100	11.6	21.7	15.0	17.3	24.5	16.8	38.2 [8]	10.7	12.3	16.1	6.0	*34.5* [8]	*100.0* [8]
General government budget, nat. def., % of GDP													
Revenues	27.4	43.5	28.6	31.0	40.2	44.0	38.5	40.9	20.4	32.3	33.2	*39.4* [9]	*44.8* [9]
Expenditures	29.5	44.5	30.5	33.0	41.8	47.0	40.1	39.8	22.0	36.0	35.5	*41.4* [9]	*46.7* [9]
Balance	-2.1	-1.0	-1.9	-2.0	-1.6	-3.0	-1.6	1.0	-1.6	-3.7	-2.3	*-2.0* [9]	*-1.9* [9]
Public debt, nat. def., % of GDP	71.6	45.2	13.2	50.0	61.0	74.0	27.5	39.2	25.7	12.9	81.8	*50.4* [9]	*85.1* [9]
BOP items, % of GDP													
Current account	-11.5	-6.0	-9.9	-2.0	-17.0	-5.0	-3.8	-3.0	-6.1	1.7	-3.6	*0.7* [10]	*2.1* [10]
Exports of goods	5.6	23.9	5.5	34.7	9.2	36.6	17.5	47.8	27.9	21.8	36.3	*51.1* [10]	*31.3* [10]
Imports of goods	31.5	49.9	44.1	55.0	53.2	47.7	22.2	53.7	20.8	14.9	43.7	*51.3* [10]	*29.2* [10]
Exports of services	22.3	10.0	15.9	15.6	34.3	13.3	4.3	14.0	4.8	3.9	13.4	*13.1* [10]	*12.4* [10]
Imports of services	15.0	2.9	8.5	11.6	12.7	10.6	2.5	8.9	8.4	5.8	12.1	*8.7* [10]	*10.7* [10]
FDI stock per capita													
EUR, 2015 [11]	1,734	1,634	1,837	2,124	6,746	3,742	1,728	1,731	6,218	1,605	1,323	*5,502*	*12,776*

Note: PPP: wiiw estimates for Belarus, Kazakhstan, Russia and Ukraine.

1) Including Crimean Federal District. - 2) Exluding the occupied territories of Crimea and Sevastopol. - 3) wiiw estimates. - 4) wiiw estimates and Eurostat. - 5) EU-28 working-day adjusted. - 6) Unemployment rate by registration. - 7) Average net monthly wages in state administration. - 8) Gross wages plus indirect labour costs, according to national account concept. - 9) EU definition: expenditures and revenues according to ESA 2010, excessive deficit procedure. - 10) Data for EU-CEE and EU-28 include transactions within the region. - 11) Excluding SPE.

Source: wiiw Annual Database, Eurostat, AMECO.

Table 28 / GDP per capita at current PPPs (EUR), from 2016 at constant PPPs and population

	1991	1995	2000	2005	2010	2013	2014	2015	2016	2017	2018 Forecast	2019
Bulgaria	4,300	5,000	5,600	8,700	11,400	12,200	12,800	13,600	14,200	14,600	15,000	15,500
Croatia	6,600	6,900	9,400	13,000	15,100	15,900	16,100	16,700	17,400	17,900	18,400	19,000
Czech Republic	8,800	11,500	14,100	18,600	21,000	22,400	23,800	25,200	25,800	26,400	27,100	27,700
Estonia	5,400	5,300	8,200	14,000	16,500	20,100	20,900	21,600	22,000	22,500	23,000	23,600
Hungary	6,800	7,700	10,400	14,500	16,400	17,900	18,700	19,700	20,300	21,000	21,700	22,400
Latvia	6,000	4,600	7,000	11,800	13,400	16,600	17,500	18,600	19,200	19,700	20,200	20,800
Lithuania	6,900	5,000	7,400	12,300	15,400	19,600	20,700	21,600	22,300	22,900	24,700	25,500
Poland	4,600	6,500	9,300	11,800	15,900	17,900	18,600	19,800	20,400	21,000	21,600	22,300
Romania	3,900	4,600	5,200	8,300	13,100	14,600	15,300	16,500	17,300	18,000	18,700	19,400
Slovakia	6,000	7,300	9,900	14,100	19,000	20,500	21,300	22,300	23,100	23,800	24,600	25,500
Slovenia	8,800	11,400	15,800	20,300	21,200	21,700	22,800	23,900	24,600	25,300	26,000	26,800
EU-CEE	5,400	6,600	8,700	12,100	15,800	17,500	18,300	19,400	20,100	20,700	21,300	22,000
Albania	1,400	1,900	3,300	5,000	7,400	7,800	8,300	8,600	8,900	9,200	9,600	10,000
Bosnia & Herzeg.	.	.	3,900	5,400	6,900	7,500	7,700	8,100	8,300	8,500	8,800	9,100
Kosovo	.	.	.	5,300	6,000	6,500	6,700	7,400	7,800	8,100	8,400	8,700
Macedonia	4,300	4,000	5,400	6,700	8,700	9,300	10,000	10,500	10,700	11,000	11,400	11,700
Montenegro	.	.	5,700	7,100	10,400	10,900	11,300	12,100	12,400	12,800	13,200	13,600
Serbia	.	3,100	5,000	7,400	9,200	10,100	10,100	10,500	11,000	11,300	11,600	12,000
Turkey	5,200	6,000	8,100	10,000	13,200	16,300	16,900	18,000	18,200	18,600	19,100	19,700
Belarus	3,800	3,200	5,100	8,200	12,200	13,400	13,900	13,700	13,500	13,600	13,800	14,100
Kazakhstan	5,000	3,800	3,700	7,400	13,600	17,400	18,200	18,700	18,600	19,000	19,600	20,200
Russia	6,800	4,700	6,000	10,000	15,700	18,700	18,700	17,700	17,200	17,400	17,700	18,100
Ukraine	3,500	2,500	3,100	4,900	5,700	6,600	6,400	5,900	6,100	6,200	6,300	6,500
Austria	18,900	19,900	25,700	29,600	32,000	35,100	35,700	36,900	37,500	38,100	38,700	39,500
Germany	18,800	20,000	24,100	27,500	30,500	33,200	34,600	35,800	36,500	37,100	37,800	38,600
Greece	12,800	13,000	17,100	21,700	21,500	19,200	19,400	19,600	19,700	20,200	20,800	21,200
Ireland	12,800	16,000	26,400	34,400	33,000	35,500	37,700	51,100	53,300	55,100	56,900	58,000
Italy	17,500	18,800	23,700	25,400	26,500	26,400	26,600	27,800	28,100	28,400	28,700	29,300
Portugal	10,800	12,100	16,500	19,300	20,900	20,500	21,100	22,200	22,500	22,900	23,200	23,700
Spain	13,200	13,700	18,900	23,500	24,400	24,000	24,700	25,900	26,700	27,300	27,900	28,500
United States	20,800	24,300	31,900	37,600	36,900	38,700	40,000	41,800	42,500	43,500	44,500	45,400
EU-28 average	14,200	15,200	19,800	23,400	25,500	26,700	27,600	28,900	29,000	29,500	30,000	30,600

European Union (28) average = 100

	1991	1995	2000	2005	2010	2013	2014	2015	2016	2017	2018	2019
Bulgaria	30	33	28	37	45	46	46	47	49	49	50	51
Croatia	46	45	47	56	59	60	58	58	60	61	61	62
Czech Republic	62	76	71	79	82	84	86	87	89	89	90	91
Estonia	38	35	41	60	65	75	76	75	76	76	77	77
Hungary	48	51	53	62	64	67	68	68	70	71	72	73
Latvia	42	30	35	50	53	62	63	64	66	67	67	68
Lithuania	49	33	37	53	60	73	75	75	77	78	82	83
Poland	32	43	47	50	62	67	67	69	70	71	72	73
Romania	27	30	26	35	51	55	55	57	60	61	62	63
Slovakia	42	48	50	60	75	77	77	77	80	81	82	83
Slovenia	62	75	80	87	83	81	83	83	85	86	87	88
EU-CEE	38	43	44	52	62	66	66	67	69	70	71	72
Albania	10	13	17	21	29	29	30	30	31	31	32	33
Bosnia & Herzeg.	.	.	20	23	27	28	28	28	29	29	29	30
Kosovo	.	.	.	23	24	24	24	26	27	27	28	28
Macedonia	30	26	27	29	34	35	36	36	37	37	38	38
Montenegro	.	.	29	30	41	41	41	42	43	43	44	44
Serbia	.	.	25	32	36	38	37	36	38	38	39	39
Turkey	37	39	41	43	52	61	61	62	63	63	64	64
Belarus	.	21	26	35	48	50	50	47	47	46	46	46
Kazakhstan	.	25	19	32	53	65	66	65	64	64	65	66
Russia	48	31	30	43	62	70	68	61	59	59	59	59
Ukraine	25	16	16	21	22	25	23	20	21	21	21	21
Austria	133	131	130	126	125	131	129	128	129	129	129	129
Germany	132	132	122	118	120	124	125	124	126	126	126	126
Greece	90	86	86	93	84	72	70	68	68	68	69	69
Ireland	90	105	133	147	129	133	137	177	184	187	190	190
Italy	123	124	120	109	104	99	96	96	97	96	96	96
Portugal	76	80	83	82	82	77	76	77	78	78	77	77
Spain	93	90	95	100	96	90	89	90	92	93	93	93
USA	146	160	161	161	145	145	145	145	147	147	148	148
EU-28 average	100	100	100	100	100	100	100	100	100	100	100	100

Sources: wiiw Annual Database incorporating national and Eurostat statistics, wiiw estimates, Eurostat, EC - Winter Report 2017.

Table 29 / Indicators of macro-competitiveness, 2012-2019, EUR based, annual averages

	2012	2013	2014	2015	2016	2017	2018	2019
							Forecast	
Bulgaria								
Producer price index, 2010=100	114.0	112.3	110.9	108.8	105.4	105.4	105.9	107.0
Consumer price index, 2010=100	105.9	106.3	104.6	103.5	102.1	102.6	103.6	105.2
GDP deflator, 2010=100	107.7	106.9	107.4	109.8	110.4	110.9	112.0	113.6
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	100.1	99.0	96.9	95.9	94.3	93.1	92.5	92.0
Real ER (PPI-based), 2010=100	105.3	103.8	104.5	105.1	103.5	103.4	102.2	101.2
PPP, NC/EUR	0.9170	0.9259	0.9067	0.9065	0.9088	0.91	0.91	0.90
Price level, EU28 = 100	47	47	46	46	46	47	46	46
Average monthly gross wages, EUR (ER)	374	396	420	449	491	530	570	620
Average monthly gross wages, EUR (PPP)	797	837	906	968	1,057	1,140	1,240	1,340
GDP per employed person, 2010=100	106.0	106.9	106.6	108.6	113.0	116.4	119.6	123.7
Unit labour costs, ER adj., 2010=100	106.4	111.8	118.9	124.7	131.1	137.9	144.5	150.9
Unit labour costs, PPP adj., Austria=100	26.4	27.0	28.2	29.0	30.1	31.1	32.1	33.3
Croatia								
Producer price index, 2010=100	112.4	111.9	108.9	104.7	100.2	99.2	101.2	103.2
Consumer price index, 2010=100	105.7	108.1	108.3	108.0	107.3	108.7	110.5	112.3
GDP deflator, 2010=100	103.3	104.1	104.2	104.3	103.7	105.0	106.7	108.3
Exchange rate (ER), NC/EUR	7.522	7.579	7.634	7.614	7.533	7.57	7.57	7.57
ER, nominal, 2010=100	103.2	104.0	104.7	104.5	103.4	103.9	103.9	103.9
Real ER (CPI-based), 2010=100	96.8	96.8	95.8	95.8	96.0	95.0	94.9	94.6
Real ER (PPI-based), 2010=100	100.6	99.5	98.0	96.8	95.2	93.7	94.0	94.0
PPP, NC/EUR	4.850	4.868	4.801	4.734	4.693	4.75	4.75	4.72
Price level, EU28 = 100	64	64	63	62	62	63	63	62
Average monthly gross wages, EUR (ER) [1)]	1,047	1,048	1,042	1,058	1,035	1,070	1,110	1,150
Average monthly gross wages, EUR (PPP) [1)]	1,624	1,631	1,657	1,701	1,662	1,710	1,770	1,840
GDP per employed person, 2010=100	96.0	97.6	94.5	94.6	96.6	98.1	99.7	101.5
Unit labour costs, ER adj., 2010=100	103.5	101.9	104.6	106.1	101.7	103.5	105.6	107.5
Unit labour costs, PPP adj., Austria=100	53.7	51.6	51.9	51.7	48.8	49.0	49.4	49.6
Czech Republic								
Producer price index, 2010=100	106.2	106.9	107.9	105.3	101.6	100.6	101.6	103.1
Consumer price index, 2010=100	105.8	107.3	107.7	108.0	108.7	110.8	112.8	114.9
GDP deflator, 2010=100	101.5	102.9	105.5	106.6	107.5	109.4	111.0	112.8
Exchange rate (ER), NC/EUR	25.15	25.98	27.54	27.28	27.03	26.75	26.50	26.50
ER nominal, 2010=100	99.5	102.8	108.9	107.9	106.9	105.8	104.8	104.8
Real ER (CPI-based), 2010=100	100.5	97.2	91.6	92.8	93.9	95.1	96.1	95.9
Real ER (PPI-based), 2010=100	98.6	96.2	93.4	94.3	93.3	93.3	93.5	93.0
PPP, NC/EUR	17.60	17.41	17.25	17.15	17.24	17.5	17.5	17.4
Price level, EU28 = 100	70	67	63	63	64	66	66	66
Average monthly gross wages, EUR (ER)	997	964	936	970	1,028	1,100	1,180	1,240
Average monthly gross wages, EUR (PPP)	1,424	1,438	1,494	1,544	1,612	1,680	1,780	1,890
GDP per employed person, 2010=100	101.1	99.6	101.6	104.8	105.2	107.4	110.0	112.5
Unit labour costs, ER adj., 2010=100	104.5	102.5	97.6	98.1	103.5	108.8	113.4	116.9
Unit labour costs, PPP adj., Austria=100	45.1	43.1	40.3	39.7	41.4	42.7	44.2	44.7
Estonia								
Producer price index, 2010=100	107.0	114.7	111.6	108.3	106.9	108.0	110.1	113.4
Consumer price index, 2010=100	109.5	113.0	113.6	113.7	114.6	116.9	119.8	123.4
GDP deflator, 2010=100	108.6	112.8	114.7	115.9	116.8	119.2	122.2	125.9
Real ER (CPI-based), 2010=100	103.5	105.3	105.3	105.4	105.9	106.1	106.9	108.0
Real ER (PPI-based), 2010=100	98.8	106.1	105.2	104.6	104.9	105.9	106.2	107.3
PPP, NC/EUR	0.6897	0.7113	0.7172	0.7125	0.7161	0.73	0.74	0.74
Price level, EU28 = 100	69	71	72	71	72	73	74	74
Average monthly gross wages, EUR (ER)	887	949	1,005	1,065	1,150	1,240	1,330	1,450
Average monthly gross wages, EUR (PPP)	1,286	1,334	1,401	1,495	1,606	1,700	1,810	1,950
GDP per employed person, 2010=100	104.2	104.6	106.9	105.8	105.6	107.1	109.0	110.6
Unit labour costs, ER adj., 2010=100	107.4	114.5	118.6	127.1	137.4	146.2	154.0	165.5
Unit labour costs, PPP adj., Austria=100	45.8	47.6	48.3	50.8	54.2	56.8	59.1	62.6

1) From 2016 lower wages due to new data sources.

(Table 29 / ctd.)

Table 29 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018 Forecast	2019
Hungary								
Producer price index, 2010=100	108.5	109.1	108.7	107.7	105.9	107.0	109.1	111.6
Consumer price index, 2010=100	109.8	111.7	111.7	111.8	112.2	114.5	117.4	120.6
GDP deflator, 2010=100	105.7	108.8	112.5	114.4	117.1	120.4	124.2	127.6
Exchange rate (ER), NC/EUR	289.3	296.9	308.7	310.0	311.4	313	315	319
ER, nominal 2010=100	105.0	107.8	112.1	112.5	113.1	113.6	114.3	115.8
Real ER (CPI-based), 2010=100	98.9	96.5	92.4	92.1	91.7	91.5	91.6	91.2
Real ER (PPI-based), 2010=100	95.5	93.6	91.4	92.4	91.9	92.3	92.0	91.1
PPP, NC/EUR	166.3	170.2	175.4	175.0	178.6	183.5	186.1	187.5
Price level, EU28 = 100	57	57	57	56	57	59	59	59
Average monthly gross wages, EUR (ER)	771	777	770	800	846	900	950	990
Average monthly gross wages, EUR (PPP)	1,342	1,356	1,355	1,416	1,476	1,530	1,610	1,690
GDP per employed person, 2010=100	98.9	99.3	98.1	98.5	97.3	100.0	103.0	106.1
Unit labour costs, ER adj., 2010=100	106.1	106.5	106.8	110.4	118.4	122.1	125.6	127.3
Unit labour costs, PPP adj., Austria=100	37.2	36.5	35.9	36.4	38.5	39.2	39.7	39.6
Latvia								
Producer price index, 2010=100	112.2	114.0	114.5	113.3	109.9	111.0	112.7	114.9
Consumer price index, 2010=100	106.6	106.6	107.3	107.6	107.7	109.6	111.9	114.5
GDP deflator, 2010=100	110.3	111.7	113.4	113.9	113.9	116.1	118.7	121.4
Real ER (CPI-based), 2010=100	102.4	100.3	100.3	100.5	100.3	100.3	100.7	101.0
Real ER (PPI-based), 2010=100	105.3	106.5	108.8	110.3	108.8	109.8	109.6	109.6
PPP, NC/EUR	0.6700	0.6798	0.6758	0.6630	0.6575	0.67	0.67	0.67
Price level, EU28 = 100	68	68	68	66	66	67	67	67
Average monthly gross wages, EUR (ER)	690	717	765	818	850	900	950	1,010
Average monthly gross wages, EUR (PPP)	1,021	1,053	1,132	1,234	1,293	1,340	1,410	1,500
GDP per employed person, 2010=100	118.7	119.6	123.4	125.2	127.6	130.1	133.2	135.9
Unit labour costs, ER adj., 2010=100	92.6	95.5	98.7	104.1	106.1	110.2	113.6	118.4
Unit labour costs, PPP adj., Austria=100	40.2	40.4	41.0	42.4	42.6	43.7	44.4	45.6
Lithuania								
Producer price index, 2010=100	119.6	116.7	111.0	100.2	95.9	98.3	101.7	106.3
Consumer price index, 2010=100	107.4	108.7	108.9	108.2	108.9	111.2	113.8	116.9
GDP deflator, 2010=100	108.1	109.6	110.7	110.9	112.2	114.5	117.2	120.3
Real ER (CPI-based), 2010=100	101.6	101.3	101.0	100.3	100.7	100.9	101.5	102.2
Real ER (PPI-based), 2010=100	110.5	107.9	104.6	96.8	94.1	96.4	98.1	100.5
PPP, NC/EUR	0.5991	0.6037	0.6036	0.5954	0.6006	0.61	0.62	0.62
Price level, EU28 = 100	60	60	60	60	60	61	62	62
Average monthly gross wages, EUR (ER)	615	646	677	714	770	840	910	990
Average monthly gross wages, EUR (PPP)	1,027	1,071	1,122	1,199	1,282	1,370	1,480	1,600
GDP per employed person, 2010=100	116.0	118.5	120.2	120.9	121.1	123.7	126.6	129.9
Unit labour costs, ER adj., 2010=100	92.1	94.8	97.9	102.6	110.4	117.9	124.9	132.3
Unit labour costs, PPP adj., Austria=100	31.0	31.1	31.5	32.4	34.4	36.2	37.9	39.5
Poland								
Producer price index, 2010=100	110.8	109.4	108.0	105.8	105.4	105.4	106.2	107.6
Consumer price index, 2010=100	107.7	108.6	108.7	108.0	107.7	109.2	111.3	113.5
GDP deflator, 2010=100	105.7	106.0	106.5	107.1	106.0	107.0	108.3	109.2
Exchange rate (ER), NC/EUR	4.185	4.198	4.184	4.184	4.363	4.35	4.30	4.30
ER, nominal, 2010=100	104.8	105.1	104.7	104.7	109.2	108.9	107.6	107.6
Real ER (CPI-based), 2010=100	97.2	96.3	96.2	95.5	91.1	91.1	92.3	92.3
Real ER (PPI-based), 2010=100	97.7	96.3	97.2	97.6	94.7	94.9	95.2	94.5
PPP, PLN/EUR	2.377	2.399	2.397	2.363	2.332	2.35	2.34	2.31
Price level, EU28 = 100	57	57	57	56	53	54	54	54
Average monthly gross wages, EUR (ER)	844	872	903	934	932	990	1,050	1,120
Average monthly gross wages, EUR (PPP)	1,485	1,525	1,576	1,654	1,745	1,830	1,920	2,070
GDP per employed person, 2010=100	109.2	110.9	112.4	115.3	117.4	120.6	124.0	127.9
Unit labour costs, ER adj., 2010=100	95.7	97.4	99.5	100.4	98.4	101.6	104.6	108.2
Unit labour costs, PPP adj., Austria=100	41.7	41.4	41.4	41.0	39.6	40.4	41.2	42.0

(Table 29 / ctd.)

Table 29 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018 Forecast	2019
Romania								
Producer price index, 2010=100	112.7	115.0	114.8	112.1	110.0	112.2	115.6	117.9
Consumer price index, 2010=100	109.4	112.9	114.5	114.0	112.8	114.5	117.3	120.3
GDP deflator, 2010=100	109.6	113.4	115.3	118.1	120.4	123.4	126.0	129.6
Exchange rate (ER), NC/EUR	4.459	4.419	4.444	4.445	4.490	4.48	4.48	4.48
ER, nominal, 2010=100	105.9	104.9	105.5	105.5	106.6	106.4	106.4	106.4
Real ER (CPI-based), 2010=100	97.7	100.2	100.6	100.1	97.7	97.7	98.4	98.9
Real ER (PPI-based), 2010=100	98.3	101.4	102.6	102.6	101.3	103.5	104.8	104.8
PPP, NC/EUR	2.070	2.187	2.200	2.180	2.216	2.27	2.28	2.30
Price level, EU28 = 100	46	49	50	49	49	51	51	51
Average monthly gross wages, EUR (ER)	463	489	524	575	646	710	760	830
Average monthly gross wages, EUR (PPP)	997	989	1,058	1,172	1,308	1,410	1,490	1,610
GDP per employed person, 2010=100	109.2	113.8	116.4	122.1	128.7	133.8	139.1	144.9
Unit labour costs, ER adj., 2010=100	93.8	95.3	99.7	104.2	111.2	118.2	120.8	126.3
Unit labour costs, PPP adj., Austria=100	30.5	30.2	31.0	31.8	33.5	34.9	35.5	36.6
Slovakia								
Producer price index, 2010=100	106.5	105.4	101.7	98.7	94.7	96.1	98.0	100.5
Consumer price index, 2010=100	108.0	109.6	109.5	109.1	108.6	109.9	111.9	113.9
GDP deflator, 2010=100	102.9	103.5	103.3	103.1	102.6	103.8	105.6	107.5
Real ER (CPI-based), 2010=100	102.1	102.1	101.4	101.1	100.3	99.7	99.8	99.6
Real ER (PPI-based), 2010=100	98.4	97.5	95.9	95.3	92.9	94.3	94.6	95.0
PPP NC/ EUR	0.6678	0.6687	0.6578	0.6498	0.6448	0.65	0.65	0.65
Price level, EU28 = 100	67	67	66	65	64	65	65	65
Average monthly gross wages, EUR (ER)	805	824	858	883	910	950	990	1,030
Average monthly gross wages, EUR (PPP)	1,205	1,232	1,304	1,359	1,411	1,460	1,520	1,580
GDP per employed person, 2010=100	104.0	105.5	106.7	108.0	109.1	111.8	114.5	118.7
Unit labour costs, ER adj., 2010=100	100.6	101.5	104.6	106.3	108.5	110.5	112.4	112.9
Unit labour costs, PPP adj., Austria=100	36.1	35.5	35.8	35.7	36.0	36.1	36.3	35.9
Slovenia								
Producer price index, 2010=100	105.5	105.5	104.8	104.5	103.1	103.6	104.7	105.7
Consumer price index, 2010=100	105.0	107.0	107.4	106.5	106.3	107.7	109.2	110.7
GDP deflator, 2010=100	101.4	102.3	103.1	104.1	103.9	105.3	106.8	108.3
Real ER (CPI-based), 2010=100	99.2	99.6	99.5	98.7	98.2	97.7	97.5	96.9
Real ER (PPI-based), 2010=100	97.5	97.6	98.8	100.9	101.2	101.6	100.9	99.9
PPP, NC/EUR	0.8031	0.8039	0.7956	0.7833	0.7795	0.79	0.79	0.78
Price level, EU28 = 100	80	80	80	78	78	79	79	78
Average monthly gross wages, EUR (ER)	1,525	1,523	1,540	1,556	1,585	1,600	1,650	1,710
Average monthly gross wages, EUR (PPP)	1,899	1,895	1,936	1,986	2,033	2,030	2,100	2,180
GDP per employed person, 2010=100	102.4	103.3	105.3	107.6	111.3	113.2	115.1	118.0
Unit labour costs, ER adj., 2010=100	99.6	98.6	97.9	96.7	95.2	94.5	95.9	96.9
Unit labour costs, PPP adj., Austria=100	68.5	66.2	64.4	62.4	60.6	59.3	59.4	59.2
Albania								
Producer price index, 2010=100	103.8	103.3	102.9	100.7	98.3	97.3	98.3	98.3
Consumer price index, 2010=100	105.5	107.5	109.2	111.3	112.7	115.3	118.5	122.1
GDP deflator, 2010=100	103.4	103.7	105.2	105.5	106.9	110.1	112.6	114.7
Exchange rate (ER), NC/EUR	139.0	140.3	140.0	139.7	137.4	137.0	138.0	138.0
ER, nominal, 2010=100	100.9	101.8	101.6	101.4	99.7	99.4	100.2	100.2
Real ER (CPI-based), 2010=100	98.8	98.3	99.6	101.7	104.5	105.3	105.6	106.7
Real ER (PPI-based), 2010=100	95.0	93.9	95.4	95.9	96.8	96.0	94.6	92.8
PPP, NC/EUR	57.78	60.07	58.10	58.04	58.57	60.3	60.6	60.5
Price level, EU28 = 100	42	43	42	42	43	44	44	44
Average monthly gross wages, EUR (ER)	270	259	325	335	355	380	400	420
Average monthly gross wages, EUR (PPP)	650	605	784	807	833	860	900	960
GDP per employed person, 2010=100	106.5	119.8	120.4	117.9	114.0	115.9	119.5	123.7
Unit labour costs, ER adj., 2010=100	100.5	85.7	107.1	112.7	123.5	129.0	131.7	135.6
Unit labour costs, PPP adj., Austria=100	28.6	23.8	29.1	30.0	32.5	33.7	34.0	34.0

(Table 29 / ctd.)

Table 29 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018	2019
							Forecast	
Bosnia and Herzegovina								
Producer price index, 2010=100	105.8	104.0	103.4	104.0	101.6	103.5	105.4	107.7
Consumer price index, 2010=100	105.9	105.8	104.8	103.8	102.6	103.7	105.1	107.1
GDP deflator, 2010=100	103.4	103.1	104.1	106.0	104.9	105.9	107.2	109.3
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.1	98.5	97.1	96.2	94.8	94.1	93.8	93.7
Real ER (PPI-based), 2010=100	97.8	96.1	97.5	100.5	99.8	101.5	101.7	101.8
PPP, NC/EUR	0.9344	0.9343	0.9310	0.9253	0.9126	0.92	0.92	0.92
Price level, EU28 = 100	48	48	48	47	47	47	47	47
Average monthly gross wages, EUR (ER)	660	660	659	659	665	670	690	710
Average monthly gross wages, EUR (PPP)	1,381	1,382	1,385	1,393	1,425	1,430	1,470	1,520
GDP per employed person, 2010=100	103.5	105.0	107.4	109.4	114.8	116.7	118.7	121.0
Unit labour costs, ER adj., 2010=100	102.4	101.1	98.7	96.9	93.1	93.0	93.5	94.4
Unit labour costs, PPP adj., Austria=100	42.0	40.4	38.7	37.3	35.3	34.5	34.5	34.3
Kosovo								
Producer price index, 2010=100	106.5	109.2	111.0	114.0	113.7	115.4	117.8	120.6
Consumer price index, 2010=100	110.0	112.0	112.4	111.8	112.2	113.2	115.0	117.6
GDP deflator, 2010=100	107.1	109.0	112.6	112.6	112.3	113.5	114.5	117.1
Real ER (CPI-based), 2010=100	104.0	104.3	104.2	103.7	103.7	102.7	102.6	102.9
Real ER (PPI-based), 2010=100	98.4	100.9	104.6	110.1	111.6	113.2	113.6	114.1
PPP, NC/EUR	0.4340	0.4480	0.4550	0.4410	0.4330	0.44	0.43	0.44
Price level, EU28 = 100	43	45	46	44	43	44	43	44
Average monthly gross wages, EUR (ER) [2]	354	356	416	446	460	470	490	520
Average monthly gross wages, EUR (PPP) [2]	816	795	914	1,011	1,062	1,070	1,130	1,200
GDP per employed person, 2010=100	101.4	93.9	99.4	113.0	109.9	109.2	110.5	111.2
Unit labour costs, ER adj., 2010=100	122.0	132.6	146.3	138.0	146.3	150.4	155.0	163.5
Unit labour costs, PPP adj., Austria=100	19.5	20.7	22.4	20.7	21.7	22.0	22.4	23.3
Macedonia								
Producer price index, 2010=100	113.4	111.8	109.7	105.4	102.9	102.9	104.9	107.0
Consumer price index, 2010=100	107.3	110.3	110.0	109.7	109.5	110.5	112.2	114.5
GDP deflator, 2010=100	104.8	109.5	111.0	113.1	113.1	114.3	116.0	118.4
Exchange rate (ER), NC/EUR	61.53	61.58	61.62	61.61	61.60	61.5	61.5	61.5
ER, nominal, 2010=100	100.0	100.1	100.2	100.2	100.1	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	101.4	102.6	101.8	101.5	101.0	100.4	100.2	100.2
Real ER (PPI-based), 2010=100	104.8	103.3	103.2	101.6	100.8	100.9	101.2	101.2
PPP, NC/EUR	25.15	26.01	25.62	25.67	25.58	25.8	25.8	25.8
Price level, EU28 = 100	41	42	42	42	42	42	42	42
Average monthly gross wages, EUR (ER)	498	504	508	522	532	540	560	570
Average monthly gross wages, EUR (PPP)	1,219	1,193	1,223	1,253	1,280	1,290	1,330	1,360
GDP per employed person, 2010=100	99.9	98.5	100.5	102.0	102.5	104.2	106.2	107.9
Unit labour costs, ER adj., 2010=100	101.6	104.1	103.0	104.2	105.6	106.1	106.6	107.9
Unit labour costs, PPP adj., Austria=100	36.9	36.9	35.8	35.5	35.5	35.0	35.1	34.7
Montenegro								
Producer price index, 2010=100	105.1	106.8	106.9	107.3	107.1	108.2	110.4	112.6
Consumer price index, 2010=100	107.4	109.4	108.8	110.3	110.5	112.1	114.4	116.6
GDP deflator, 2010=100	101.4	103.5	104.6	106.0	105.4	107.7	110.0	111.7
Real ER (CPI-based), 2010=100	101.6	101.9	100.8	102.3	102.1	101.8	102.1	102.1
Real ER (PPI-based), 2010=100	97.1	98.8	100.8	103.6	105.2	103.8	104.0	103.5
PPP, NC/EUR	0.4894	0.4956	0.4920	0.4827	0.4782	0.49	0.49	0.49
Price level, EU28 = 100	49	50	49	48	48	49	49	49
Average monthly gross wages, EUR (ER)	727	726	723	725	751	770	790	810
Average monthly gross wages, EUR (PPP)	1,485	1,465	1,470	1,502	1,570	1,580	1,610	1,660
GDP per employed person, 2010=100	104.5	107.2	101.8	102.7	104.4	107.2	109.2	111.2
Unit labour costs, ER adj., 2010=100	97.3	94.7	99.3	98.7	100.6	100.4	101.1	101.8
Unit labour costs, PPP adj., Austria=100	46.4	44.1	45.3	44.2	44.4	43.7	43.5	43.1

2) Net wages in state administration.

(Table 29 / ctd.)

Table 29 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018	2019
							Forecast	
Serbia								
Producer price index, 2010=100	120.4	123.6	125.2	126.5	126.5	127.8	129.3	131.9
Consumer price index, 2010=100	119.7	129.0	132.7	135.3	136.9	139.6	142.4	145.3
GDP deflator, 2010=100	116.4	122.7	126.1	129.5	130.9	133.4	135.4	136.8
Exchange rate (ER), NC/EUR	113.13	113.14	117.31	120.76	123.10	124	125	126
ER, nominal, 2010=100	109.8	109.8	113.8	117.2	119.5	120.3	121.3	122.3
Real ER (CPI-based), 2010=100	103.0	109.4	108.1	107.0	105.9	105.3	104.8	103.9
Real ER (PPI-based), 2010=100	101.3	104.1	103.7	104.3	103.9	104.1	102.8	102.0
PPP, NC/EUR	50.27	53.54	54.12	54.14	54.59	55.6	55.5	55.0
Price level, EU28 = 100	44	47	46	45	44	45	44	44
Average monthly gross wages, EUR (ER)	508	537	524	506	516	530	550	570
Average monthly gross wages, EUR (PPP)	1,142	1,134	1,135	1,129	1,163	1,190	1,240	1,300
GDP per employed person, 2010=100	107.9	106.8	100.0	94.8	96.4	97.2	98.3	99.7
Unit labour costs, ER adj., 2010=100	102.1	109.1	113.7	116.0	116.2	118.9	121.4	123.6
Unit labour costs, PPP adj., Austria=100	34.6	36.1	36.9	36.9	36.5	36.6	37.2	37.4
Belarus								
Producer price index, 2010=100	301.7	342.7	386.6	451.5	505.7	561.3	617.4	1173.1
Consumer price index, 2010=100	243.9	288.5	340.8	386.8	432.4	475.6	518.4	559.9
GDP deflator, 2010=100	299.4	363.1	428.9	497.5	535.9	589.6	642.6	694.1
Exchange rate (ER), NC/EUR	1.078	1.183	1.322	1.783	2.201	2.3	2.4	2.5
ER, nominal, 2010=100	269.0	295.4	330.0	445.0	549.3	574.0	599.0	624.0
Real ER (CPI-based), 2010=100	85.7	91.0	95.7	80.6	72.7	75.2	77.2	78.5
Real ER (PPI-based), 2010=100	103.6	107.3	110.4	98.0	90.4	95.9	99.4	177.8
PPP, NC/EUR	0.431	0.529	0.613	0.694	0.736	0.81	0.87	0.92
Price level, EU28 = 100	40	45	46	39	33	35	36	37
Average monthly gross wages, EUR (ER)	341	428	458	377	328	350	370	380
Average monthly gross wages, EUR (PPP)	853	958	987	967	981	990	1,010	1,050
GDP per employed person, 2010=100	109.4	111.3	113.9	110.9	110.1	113.1	113.1	115.9
Unit labour costs, ER adj., 2010=100	102.6	126.5	132.3	111.8	98.0	101.2	106.7	109.1
Unit labour costs, PPP adj., Austria=100	26.3	31.6	32.4	26.9	23.2	23.8	24.8	24.5
Kazakhstan								
Producer price index, 2010=100	131.7	131.3	143.7	114.3	133.5	146.8	154.2	157.2
Consumer price index, 2010=100	113.9	120.5	128.6	137.1	157.1	168.1	178.2	188.9
GDP deflator, 2010=100	126.4	138.4	146.4	149.2	165.3	178.6	189.2	198.7
Exchange rate (ER), NC/EUR	191.7	202.1	238.1	245.8	378.6	330	330	330
ER, nominal, 2010=100	98.0	103.3	121.7	125.6	193.5	168.7	168.7	168.7
Real ER (CPI-based), 2010=100	110.0	108.7	98.0	101.1	75.0	90.5	94.3	98.0
Real ER (PPI-based), 2010=100	124.2	117.5	111.3	87.9	67.7	85.4	88.2	88.2
PPP, NC/EUR	109.2	121.2	126.0	124.9	138.0	149.0	155.2	159.8
Price level, EU28 = 100	57	60	53	51	36	45	47	48
Average monthly gross wages, EUR (ER)	528	540	508	513	376	470	510	560
Average monthly gross wages, EUR (PPP)	927	901	961	1,009	1,032	1,040	1,090	1,160
GDP per employed person, 2010=100	107.3	112.9	118.4	118.2	119.5	121.3	124.4	127.6
Unit labour costs, ER adj., 2010=100	124.1	120.6	108.2	109.4	79.3	97.8	104.2	111.0
Unit labour costs, PPP adj., Austria=100	37.2	35.3	31.0	30.8	22.0	26.7	27.9	29.5
Russia 3)								
Producer price index, 2010=100	125.7	129.9	137.8	154.9	161.1	165.9	172.5	179.4
Consumer price index, 2010=100	113.9	121.7	131.2	151.5	162.3	170.4	178.9	187.8
GDP deflator, 2010=100	125.5	131.6	145.7	157.6	163.0	168.0	174.7	183.5
Exchange rate (ER), NC/EUR	39.94	42.27	50.77	67.76	74.26	65	67	70
ER, nominal, 2010=100	99.2	105.0	126.1	168.3	184.4	161.4	166.4	173.8
Real ER (CPI-based), 2010=100	108.6	108.0	96.4	83.4	81.3	95.8	96.0	94.5
Real ER (PPI-based), 2010=100	117.1	114.4	103.0	88.9	85.7	100.8	100.0	97.6
PPP, NC/EUR	24.43	26.47	29.01	32.16	33.95	35.0	35.8	36.8
Price level, EU28 = 100	61	63	57	47	46	54	53	53
Average monthly gross wages, EUR (ER)	667	705	640	502	494	610	650	680
Average monthly gross wages, EUR (PPP)	1,090	1,126	1,120	1,058	1,081	1,140	1,210	1,300
GDP per employed person, 2010=100	112.5	114.2	114.7	110.3	109.9	112.2	113.8	115.8
Unit labour costs, ER adj., 2010=100	113.9	118.6	107.2	87.5	86.4	104.6	109.4	113.4
Unit labour costs, PPP adj., Austria=100	38.4	39.0	34.6	27.7	27.0	32.1	33.3	33.8

3) From 2014 including Crimean Federal District (for LFS employment and wages from 2015).

(Table 29 / ctd.)

Table 29 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018	2019
							Forecast	
Ukraine [4)]								
Producer price index, 2010=100	123.4	123.3	144.4	196.3	236.6	272.1	293.8	314.4
Consumer price index, 2010=100	108.6	108.3	121.4	180.6	205.7	227.3	241.1	253.2
GDP deflator, 2010=100	123.3	128.6	149.1	207.1	241.3	269.3	290.5	300.8
Exchange rate (ER), NC/EUR	10.27	10.61	15.72	24.23	28.29	29.0	32.0	33.0
ER, nominal, 2010=100	97.5	100.8	149.2	230.0	268.6	275.3	303.8	313.3
Real ER (CPI-based), 2010=100	105.3	100.1	75.4	72.7	70.7	74.9	70.8	70.7
Real ER (PPI-based), 2010=100	116.9	113.1	91.2	82.4	86.4	96.9	93.3	94.9
PPP, NC/EUR	4.816	5.088	5.795	7.831	9.096	10.15	10.76	10.93
Price level, EU28 = 100	47	48	37	32	32	35	34	33
Average monthly gross wages, EUR (ER)	295	308	221	173	183	230	230	240
Average monthly gross wages, EUR (PPP)	628	642	601	536	570	650	680	720
GDP per employed person, 2010=100	105.1	104.9	106.5	105.6	108.9	111.6	114.3	117.4
Unit labour costs, ER adj., 2010=100	131.9	137.9	97.8	77.1	79.2	95.9	93.9	95.9
Unit labour costs, PPP adj., Austria=100	45.4	46.3	32.2	24.9	25.2	30.4	29.3	29.4
Austria								
Producer price index, 2010=100	104.9	104.0	102.9	101.4	99.5	100.9	102.5	104.3
Consumer price index, 2010=100	105.8	107.9	109.7	110.7	111.7	113.6	115.5	117.6
GDP deflator, 2010=100	103.9	105.6	107.5	109.5	111.1	112.6	114.4	116.4
Real ER (CPI-based), 2010=100	100.0	100.5	101.7	102.6	103.2	103.1	103.1	102.9
Real ER (PPI-based), 2010=100	96.9	96.2	97.0	97.9	97.7	98.9	98.8	98.6
PPP, NC/EUR	1.077	1.085	1.084	1.067	1.080	1.094	1.093	1.090
Price level, EU28 = 100	108	109	108	107	108	109	109	109
Average monthly gross wages, EUR	3,278	3,346	3,429	3,500	3,550	3,610	3,670	3,740
Average monthly gross wages, EUR (PPP)	3,044	3,083	3,164	3,280	3,290	3,300	3,360	3,430
GDP per employed person, 2010=100	101.9	101.5	101.9	102.0	102.1	102.4	102.8	103.2
Unit labour costs, ER adj., 2010=100	103.6	106.1	108.3	110.4	111.9	113.5	114.9	116.6
Unit labour costs, PPP 2010 adjusted	0.580	0.594	0.606	0.618	0.626	0.635	0.643	0.653

4) From 2014 excluding the occupied territories of Crimea and Sevastopol and from 2015 parts of the anti-terrorist operation zone.

Notes:
Benchmark PPP results for 2011 were applied (published by Eurostat , OECD and CIS Stat in December 2013).
Employment data and related indicators (e.g. Unit labour costs) may be affected by the new population census data.
Unit labour costs are defined as average gross wages per employee relative to labour productivity (real GDP per employed person, LFS). For level comparisons, labour productivity is converted with the PPP rate 2010 (PPP adjusted).
PPP rates have been taken from Eurostat based on the benchmark results 2011. Missing data have been extrapolated by wiiw with GDP deflators. Kazakhstan, Russia and Ukraine are estimated by wiiw using the OECD and CIS PPP benchmark results 2011.
Real exchange rates: Increasing values mean real appreciation.
ER = Exchange Rate, PPP = Purchasing Power Parity, Price level: PPP/ ER.

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

Table 30 / Indicators of macro-competitiveness, 2012-2019, annual changes in %

	2012	2013	2014	2015	2016	2017	2018	2019	2012-16
							Forecast		average
Bulgaria									
GDP deflator	1.6	-0.7	0.5	2.2	0.6	0.5	1.0	1.5	0.8
Real ER (CPI-based)	-0.2	-1.1	-2.1	-1.1	-1.6	-1.3	-0.7	-0.5	-1.2
Real ER (PPI-based)	1.6	-1.4	0.7	0.5	-1.5	-0.1	-1.2	-1.0	0.0
Average gross wages, real (PPI based)	2.1	7.6	7.4	8.9	12.9	8.3	7.2	7.0	7.7
Average gross wages, real (CPI based)	4.1	5.6	7.7	8.0	10.8	7.8	6.6	6.4	7.2
Average gross wages, EUR (ER)	6.6	6.0	6.0	6.8	9.4	7.9	7.5	8.8	7.0
Employed persons (LFS)	-1.1	0.0	1.6	1.7	-0.5	0.1	0.0	0.0	0.3
GDP per empl. person, NC at 2010 ref. pr.	1.1	0.9	-0.3	1.9	4.0	2.9	2.8	3.4	1.5
Unit labour costs, ER (EUR) adjusted	5.4	5.1	6.3	4.9	5.1	5.2	4.8	4.5	5.4
Croatia									
GDP deflator	1.6	0.8	0.0	0.1	-0.6	1.3	1.6	1.6	0.4
Exchange rate (ER), EUR/NC	-1.1	-0.8	-0.7	0.3	1.1	-0.5	0.0	0.0	-0.3
Real ER (CPI-based)	-0.3	0.0	-1.0	0.0	0.2	-1.0	-0.1	-0.4	-0.2
Real ER (PPI-based)	1.1	-1.1	-1.5	-1.2	-1.7	-1.5	0.3	0.0	-0.9
Average gross wages, real (PPI based) [1)]	-3.8	1.3	2.9	5.3	7.1	4.9	1.7	1.5	2.5
Average gross wages, real (CPI based) [1)]	-2.3	-1.5	0.0	1.6	3.1	2.5	2.1	1.9	0.2
Average gross wages, EUR (ER) [1)]	-0.1	0.1	-0.6	1.6	3.6	3.3	3.7	3.6	0.9
Employed persons (LFS)	-3.6	-2.7	2.7	1.5	0.7	1.3	1.2	1.2	-0.3
GDP per empl. person, NC at 2010 ref. pr.	1.5	1.7	-3.1	0.1	2.1	1.6	1.6	1.7	0.4
Unit labour costs, ER (EUR) adjusted	-1.5	-1.6	2.7	1.4	1.5	1.8	2.0	1.8	0.5
Czech Republic									
GDP deflator	1.4	1.4	2.5	1.0	0.9	1.8	1.4	1.6	1.4
Exchange rate (ER), EUR/NC	-2.2	-3.2	-5.7	0.9	0.9	1.1	0.9	0.0	-1.9
Real ER (CPI-based)	-1.4	-3.3	-5.7	1.2	1.2	1.3	1.0	-0.2	-1.6
Real ER (PPI-based)	-2.6	-2.5	-2.9	0.9	-1.1	0.0	0.2	-0.5	-1.6
Average gross wages, real (PPI based)	0.1	-0.8	2.0	5.2	8.9	7.2	4.7	3.9	3.0
Average gross wages, real (CPI based)	-1.0	-1.5	2.5	2.4	4.4	4.0	3.9	3.6	1.3
Average gross wages, EUR (ER)	0.2	-3.3	-2.9	3.7	6.0	7.0	7.3	5.1	0.7
Employed persons (LFS)	0.4	1.0	0.8	1.4	1.8	0.3	0.2	0.0	1.1
GDP per empl. person, NC at 2010 ref. pr.	-1.2	-1.4	1.9	3.1	0.4	2.1	2.4	2.3	0.6
Unit labour costs, ER (EUR) adjusted	1.4	-1.9	-4.7	0.5	5.5	5.0	4.3	3.1	0.1
Estonia									
GDP deflator	3.2	3.9	1.7	1.0	0.8	2.0	2.5	3.0	2.1
Real ER (CPI-based)	1.6	1.7	0.0	0.1	0.5	0.2	0.8	1.0	0.8
Real ER (PPI-based)	-0.1	7.3	-0.8	-0.6	0.3	0.9	0.3	1.0	1.2
Average gross wages, real (PPI based)	3.0	-0.2	8.8	9.2	9.4	6.8	5.2	5.8	6.0
Average gross wages, real (CPI based)	1.5	3.7	5.4	5.9	7.1	5.7	4.6	5.8	4.7
Average gross wages, EUR (ER)	5.7	7.0	5.9	6.0	8.0	7.8	7.3	9.0	6.5
Employed persons (LFS)	1.9	1.0	0.6	2.6	1.4	0.8	0.8	0.8	1.5
GDP per empl. person, NC at 2010 ref. pr.	2.4	0.4	2.2	-1.1	-0.1	1.4	1.8	1.4	0.7
Unit labour costs, ER (EUR) adjusted	3.3	6.6	3.6	7.2	8.1	6.4	5.3	7.5	5.7
Hungary									
GDP deflator	3.4	2.9	3.4	1.7	2.4	2.8	3.1	2.8	2.8
Exchange rate (ER), EUR/NC	-3.4	-2.6	-3.8	-0.4	-0.5	-0.5	-0.6	-1.3	-2.1
Real ER (CPI-based)	-0.5	-2.4	-4.3	-0.3	-0.4	-0.3	0.1	-0.5	-1.6
Real ER (PPI-based)	-2.2	-1.9	-2.3	1.1	-0.5	0.4	-0.3	-1.0	-1.2
Average gross wages, real (PPI based)	0.5	2.9	3.4	5.3	8.1	5.5	4.5	3.4	4.0
Average gross wages, real (CPI based)	-1.0	1.7	3.0	4.2	5.9	4.5	4.0	2.9	2.7
Average gross wages, EUR (ER)	1.1	0.8	-0.9	3.9	5.8	6.3	5.6	4.2	2.1
Employed persons (LFS)	1.8	1.7	5.3	2.7	3.3	0.5	0.5	0.0	3.0
GDP per empl. person, NC at 2010 ref. pr.	-3.3	0.4	-1.2	0.5	-1.3	2.8	2.9	3.1	-1.0
Unit labour costs, ER (EUR) adjusted	4.6	0.4	0.3	3.4	7.2	3.2	2.9	1.3	3.1
Latvia									
GDP deflator	3.6	1.3	1.5	0.4	0.1	1.9	2.3	2.3	1.4
Real ER (CPI-based)	1.0	-2.1	0.0	0.2	-0.2	0.0	0.4	0.3	-0.2
Real ER (PPI-based)	2.6	1.1	2.2	1.4	-1.4	0.9	-0.2	0.0	1.2
Average gross wages, real (PPI based)	-0.5	2.9	6.4	8.1	7.1	4.8	4.0	4.2	4.8
Average gross wages, real (CPI based)	1.3	4.6	6.1	6.7	3.8	4.0	3.4	3.9	4.5
Average gross wages, EUR (ER)	5.0	3.9	6.7	6.9	3.9	5.9	5.6	6.3	5.3
Employed persons (LFS)	1.6	2.1	-1.0	1.3	-0.1	0.6	0.6	0.6	0.8
GDP per empl. person, NC at 2010 ref. pr.	2.4	0.8	3.2	1.4	1.9	2.0	2.4	2.0	1.9
Unit labour costs, ER (EUR) adjusted	2.6	3.1	3.4	5.4	1.9	3.9	3.1	4.3	3.3

1) From 2016 new data sources, growth rates comparable.

(Table 30 / ctd.)

Table 30 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018 Forecast	2019	2012-16 average
Lithuania									
GDP deflator	2.7	1.4	1.0	0.2	1.2	2.0	2.3	2.7	1.3
Real ER (CPI-based)	0.6	-0.3	-0.3	-0.7	0.4	0.3	0.6	0.7	-0.1
Real ER (PPI-based)	2.1	-2.3	-3.0	-7.5	-2.7	2.4	1.8	2.5	-2.7
Average gross wages, real (PPI based)	-1.1	7.7	10.2	16.8	12.7	6.4	4.7	4.1	9.1
Average gross wages, real (CPI based)	0.6	3.8	4.6	6.2	7.1	6.8	5.9	5.9	4.4
Average gross wages, EUR (ER)	3.8	5.1	4.8	5.4	7.8	9.1	8.3	8.8	5.4
Employed persons (LFS)	1.8	1.3	2.0	1.2	1.9	0.7	0.4	0.4	1.7
GDP per empl. person, NC at 2010 ref. pr.	2.0	2.1	1.4	0.6	0.2	2.1	2.3	2.7	1.3
Unit labour costs, ER (EUR) adjusted	1.8	2.9	3.3	4.8	7.6	6.8	5.9	6.0	4.1
Poland									
GDP deflator	2.3	0.3	0.5	0.6	-1.0	0.9	1.2	0.9	0.5
Exchange rate (ER), EUR/NC	-1.5	-0.3	0.3	0.0	-4.1	0.3	1.2	0.0	-1.1
Real ER (CPI-based)	-0.5	-1.0	-0.1	-0.7	-4.6	-0.1	1.4	0.0	-1.4
Real ER (PPI-based)	-1.1	-1.5	0.9	0.4	-2.9	0.2	0.3	-0.7	-0.8
Average gross wages, real (PPI based)	0.5	5.0	4.6	5.6	4.5	5.7	3.8	5.3	4.0
Average gross wages, real (CPI based)	0.0	2.8	3.1	4.2	4.3	4.2	2.7	4.6	2.9
Average gross wages, EUR (ER)	2.1	3.3	3.5	3.5	-0.2	6.2	6.1	6.7	2.5
Employed persons (LFS)	0.2	-0.1	1.9	1.4	0.9	0.2	0.1	0.0	0.8
GDP per empl. person, NC at 2010 ref. pr.	1.4	1.5	1.4	2.5	1.9	2.7	2.8	3.1	1.7
Unit labour costs, ER (EUR) adjusted	0.7	1.8	2.1	0.9	-2.0	3.2	2.9	3.4	0.7
Romania									
GDP deflator	4.7	3.4	1.7	2.4	2.0	2.5	2.1	2.9	2.8
Exchange rate (ER), EUR/NC	-4.9	0.9	-0.6	0.0	-1.0	0.2	0.0	0.0	-1.1
Real ER (CPI-based)	-4.2	2.6	0.3	-0.4	-2.4	-0.1	0.8	0.5	-0.8
Real ER (PPI-based)	-2.7	3.1	1.2	0.0	-1.3	2.2	1.3	0.0	0.0
Average gross wages, real (PPI based)	-1.0	2.8	7.8	12.4	15.7	8.2	3.2	6.7	7.4
Average gross wages, real (CPI based)	0.8	1.6	6.1	10.2	14.8	8.7	3.7	6.2	6.6
Average gross wages, EUR (ER)	-1.0	5.8	7.0	9.7	12.4	9.9	7.0	9.2	6.7
Employed persons (LFS)	0.9	-0.7	0.8	-0.9	-0.5	0.0	0.0	0.0	-0.1
GDP per empl. person, NC at 2010 ref. pr.	-0.3	4.2	2.3	4.9	5.4	4.0	4.0	4.1	3.3
Unit labour costs, ER (EUR) adjusted	-0.7	1.5	4.6	4.6	6.6	6.4	2.2	4.5	3.3
Slovakia									
GDP deflator	1.3	0.5	-0.2	-0.2	-0.5	1.2	1.8	1.8	0.2
Real ER (CPI-based)	1.1	0.0	-0.6	-0.3	-0.8	-0.6	0.1	-0.2	-0.1
Real ER (PPI-based)	-0.9	-0.9	-1.6	-0.6	-2.5	1.4	0.3	0.5	-1.3
Average gross wages, real (PPI based)	0.5	3.4	7.9	6.0	7.4	2.9	2.2	1.5	5.0
Average gross wages, real (CPI based)	-1.2	0.8	4.2	3.2	3.6	3.2	2.4	2.2	2.1
Average gross wages, EUR (ER)	2.4	2.4	4.1	2.9	3.1	4.4	4.2	4.0	3.0
Employed persons (LFS)	0.6	0.0	1.5	2.6	2.3	0.8	0.8	0.4	1.4
GDP per empl. person, NC at 2010 ref. pr.	1.1	1.5	1.1	1.2	1.0	2.5	2.5	3.6	1.2
Unit labour costs, ER (EUR) adjusted	1.4	0.9	3.0	1.7	2.1	1.8	1.7	0.4	1.8
Slovenia									
GDP deflator	0.3	0.9	0.8	1.0	-0.2	1.4	1.4	1.4	0.5
Real ER (CPI-based)	0.2	0.4	-0.1	-0.8	-0.5	-0.5	-0.3	-0.6	-0.2
Real ER (PPI-based)	-1.9	0.1	1.3	2.2	0.3	0.4	-0.7	-1.0	0.4
Average gross wages, real (PPI based)	-0.8	-0.2	1.8	1.0	3.2	0.5	2.1	2.6	1.0
Average gross wages, real (CPI based)	-2.7	-2.0	0.7	1.5	2.1	-0.3	1.7	2.2	-0.1
Average gross wages, EUR (ER)	0.1	-0.2	1.1	0.7	1.8	1.0	3.1	3.6	0.7
Employed persons (LFS)	-1.3	-1.9	1.2	0.1	-0.8	1.1	1.1	0.5	-0.6
GDP per empl. person, NC at 2010 ref. pr.	-1.4	0.9	1.9	2.2	3.4	1.7	1.6	2.5	1.4
Unit labour costs, ER (EUR) adjusted	1.5	-1.0	-0.8	-1.5	-1.5	-0.8	1.5	1.1	-0.7
Albania									
GDP deflator	1.0	0.3	1.4	0.3	1.3	3.1	2.3	1.8	0.9
Exchange rate (ER), EUR/NC	0.9	-0.9	0.2	0.2	1.7	0.3	-0.7	0.0	0.4
Real ER (CPI-based)	0.3	-0.5	1.3	2.1	2.7	0.8	0.3	1.0	1.2
Real ER (PPI-based)	-0.7	-1.2	1.7	0.5	0.9	-0.8	-1.4	-2.0	0.2
Average gross wages, real (PPI based)	1.8	-2.8	1.4	5.0	6.8	7.0	4.9	6.6	2.4
Average gross wages, real (CPI based)	0.9	-5.0	-0.7	0.9	2.9	3.6	3.1	3.5	-0.2
Average gross wages, EUR (ER)	3.8	-4.0	1.1	3.0	6.0	7.0	5.3	5.0	1.9
Employed persons (LFS)	-1.8	-10.2	1.3	4.8	6.8	1.7	0.8	0.4	0.0
GDP per empl. person, NC at 2010 ref. pr.	3.2	12.5	0.5	-2.1	-3.3	1.7	3.0	3.6	2.0
Unit labour costs, ER (EUR) adjusted	0.6	-14.7	0.6	5.2	9.7	4.4	2.1	2.9	-0.1

(Table 30 / ctd.)

Table 30 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018	2019	2012-16
							Forecast		average
Bosnia and Herzegovina									
GDP deflator	0.9	-0.3	1.0	1.8	-1.1	1.0	1.3	1.9	0.5
Real ER (CPI-based)	-0.5	-1.6	-1.4	-1.0	-1.4	-0.8	-0.3	-0.1	-1.2
Real ER (PPI-based)	-2.4	-1.7	1.4	3.1	-0.7	1.7	0.2	0.1	-0.1
Average gross wages, real (PPI based)	1.2	1.9	0.4	-0.6	3.3	-0.3	0.4	0.8	1.2
Average gross wages, real (CPI based)	-0.5	0.2	0.8	1.0	2.0	0.5	0.9	1.0	0.7
Average gross wages, EUR (ER)	1.5	0.1	-0.1	0.0	0.9	0.7	3.0	2.9	0.5
Employed persons (LFS)	-0.3	1.0	-1.2	1.2	-2.6	1.1	1.2	1.2	-0.4
GDP per empl. person, NC at 2010 ref. pr.	-0.6	1.4	2.3	1.8	5.0	1.7	1.7	2.0	2.0
Unit labour costs, ER (EUR) adjusted	2.2	-1.3	-2.4	-1.8	-3.9	-0.2	0.6	1.0	-1.5
Kosovo									
GDP deflator	2.2	1.8	3.3	0.0	-0.3	1.1	0.9	2.3	1.4
Real ER (CPI-based)	-0.1	0.3	-0.1	-0.5	0.0	-0.9	-0.1	0.3	-0.1
Real ER (PPI-based)	-0.9	2.6	3.7	5.2	1.3	1.4	0.4	0.4	2.4
Average net wages, real (PPI based) 2)	-0.2	-1.9	14.9	4.4	3.4	0.7	2.1	3.6	4.0
Average net wages, real (CPI based) 2)	-0.8	-1.2	16.4	7.8	2.8	1.3	2.6	3.7	4.8
Average net wages, EUR (ER) 2)	1.7	0.6	16.9	7.2	3.1	2.2	4.3	6.1	5.7
Employed persons (LFS) 3)	1.4	11.7	-4.4	-8.2	6.5	4.4	3.0	2.9	1.1
GDP per empl. person, NC at 2010 ref. pr.	1.4	-7.4	5.9	13.6	-2.7	-0.6	1.2	0.6	1.9
Unit labour costs, ER (EUR) adjusted	0.3	8.6	10.4	-5.6	6.0	2.8	3.0	5.5	3.8
Macedonia									
GDP deflator	1.0	4.5	1.4	1.9	0.0	1.1	1.5	2.1	1.7
Exchange rate (ER), EUR/NC	0.0	-0.1	-0.1	0.0	0.0	0.2	0.0	0.0	0.0
Real ER (CPI-based)	0.7	1.2	-0.9	-0.3	-0.5	-0.6	-0.2	0.0	0.0
Real ER (PPI-based)	-1.4	-1.4	-0.1	-1.5	-0.8	0.1	0.3	0.0	-1.0
Average gross wages, real (PPI based)	-1.1	2.6	3.0	6.9	4.3	2.0	0.4	0.9	3.1
Average gross wages, real (CPI based)	-3.0	-1.6	1.3	3.0	2.0	1.0	0.9	0.9	0.3
Average gross wages, EUR (ER)	0.2	1.1	0.9	2.7	1.8	1.6	3.7	1.8	1.3
Employed persons (LFS)	0.8	4.3	1.7	2.3	2.0	1.4	1.4	1.4	2.2
GDP per empl. person, NC at 2010 ref. pr.	-1.3	-1.4	2.0	1.5	0.5	1.7	1.9	1.6	0.3
Unit labour costs, ER (EUR) adjusted	1.5	2.5	-1.1	1.2	1.3	0.5	0.5	1.3	1.1
Montenegro									
GDP deflator	0.2	2.1	1.0	1.4	-0.6	2.2	2.2	1.5	0.8
Real ER (CPI-based)	1.4	0.3	-1.0	1.4	-0.2	-0.3	0.3	0.0	0.4
Real ER (PPI-based)	-0.9	1.7	2.0	2.8	1.5	-1.3	0.2	-0.5	1.4
Average gross wages, real (PPI based)	-1.2	-1.7	-0.5	0.0	3.7	1.5	0.6	0.5	0.0
Average gross wages, real (CPI based)	-3.2	-1.9	0.1	-1.1	3.5	1.0	0.6	0.5	-0.5
Average gross wages, EUR (ER)	0.7	-0.1	-0.4	0.3	3.6	2.5	2.6	2.5	0.8
Employed persons (LFS)	2.4	1.0	7.1	2.5	1.0	0.9	0.9	0.9	2.8
GDP per empl. person, NC at 2010 ref. pr.	-5.0	2.6	-5.0	0.9	1.7	2.7	1.9	1.8	-1.0
Unit labour costs, ER (EUR) adjusted	6.0	-2.6	4.8	-0.6	1.9	-0.2	0.7	0.7	1.8
Serbia									
GDP deflator	6.3	5.4	2.7	2.7	1.1	1.9	1.5	1.0	3.6
Exchange rate (ER), EUR/NC	-9.9	0.0	-3.6	-2.9	-1.9	-0.7	-0.8	-0.8	-3.7
Real ER (CPI-based)	-5.3	6.2	-1.3	-1.0	-1.0	-0.5	-0.5	-0.8	-0.5
Real ER (PPI-based)	-6.4	2.8	-0.4	0.6	-0.3	0.2	-1.3	-0.8	-0.8
Average gross wages, real (PPI based)	2.0	2.9	-0.1	-1.5	3.8	3.0	2.9	2.0	1.4
Average gross wages, real (CPI based)	1.0	-1.9	-1.7	-2.3	2.6	1.9	2.0	2.0	-0.5
Average gross wages, EUR (ER)	-1.9	5.7	-2.4	-3.3	1.8	2.8	3.8	3.6	-0.1
Employed persons (LFS)	-1.1	3.7	4.8	0.6	1.0	1.9	1.9	1.9	1.8
GDP per empl. person, NC at 2010 ref. pr.	0.1	-1.1	-6.3	0.2	1.7	0.9	1.1	1.4	-1.1
Unit labour costs, ER (EUR) adjusted	-1.9	6.8	4.2	-3.5	0.1	2.3	2.1	1.8	1.1
Belarus									
GDP deflator	75.3	21.3	18.1	16.0	7.7	10.0	9.0	8.0	25.7
Exchange rate (ER), EUR/NC	-25.3	-8.9	-10.5	-25.8	-19.0	-4.3	-4.2	-4.0	-18.2
Real ER (CPI-based)	15.9	6.2	5.2	-15.8	-9.7	3.4	2.7	1.6	-0.3
Real ER (PPI-based)	27.9	3.6	2.9	-11.3	-7.8	6.2	3.7	78.8	2.2
Average gross wages, real (PPI based)	9.9	21.2	6.0	-5.0	-4.0	-0.2	0.0	-42.6	5.2
Average gross wages, real (CPI based)	21.5	16.4	1.3	-2.2	-3.8	0.7	0.9	1.0	6.1
Average gross wages, EUR (ER)	44.5	25.4	7.0	-17.7	-12.9	6.7	5.7	2.7	6.8
Employment registered	-1.7	-0.7	-0.6	-1.2	-1.9	-1.4	0.0	0.0	-1.2
GDP per empl. person, NC at 2010 ref. pr.	3.4	1.7	2.3	-2.6	-0.7	2.7	0.0	2.4	0.8
Unit labour costs, ER (EUR) adjusted	39.7	23.3	4.6	-15.5	-12.3	3.2	5.4	2.2	6.0

2) Net wages in state administration. - 3) wiiw estimate in 2012 due to improved LFS survey based on EU guidelines.

(Table 30 / ctd.)

Table 30 / ctd.

	2012	2013	2014	2015	2016	2017	2018 Forecast	2019	2012-16 average
Kazakhstan									
GDP deflator	4.8	9.5	5.8	1.9	10.8	8.0	5.9	5.0	6.5
Exchange rate (ER), EUR/NC	6.5	-5.2	-15.1	-3.1	-35.1	14.7	0.0	0.0	-11.6
Real ER (CPI-based)	9.2	-1.1	-9.9	3.3	-25.8	20.6	4.2	3.9	-5.7
Real ER (PPI-based)	7.2	-5.3	-5.3	-21.1	-22.9	26.1	3.2	0.0	-10.2
Average gross wages, real (PPI based)	8.7	8.1	1.3	31.0	-3.3	-0.8	4.0	7.1	8.5
Average gross wages, real (CPI based)	6.9	1.9	3.9	-2.3	-1.4	2.0	3.0	3.0	1.7
Average gross wages, EUR (ER)	19.8	2.2	-5.9	0.9	-26.7	25.0	8.5	9.8	-3.1
Employed persons (LFS)	1.0	0.7	-0.7	1.3	-0.2	0.5	0.5	0.5	0.4
GDP per empl. person, NC at 2010 ref. pr.	3.7	5.2	4.9	-0.2	1.1	1.5	2.5	2.5	2.9
Unit labour costs, ER (EUR) adjusted	15.5	-2.8	-10.3	1.1	-27.5	23.4	6.5	6.5	-5.9
Russia 4)									
GDP deflator	8.3	4.8	10.7	8.2	3.4	3.0	4.0	5.0	7.1
Exchange rate (ER), EUR/NC	2.3	-5.5	-16.7	-25.1	-8.8	14.2	-3.0	-4.3	-11.3
Real ER (CPI-based)	4.8	-0.6	-10.7	-13.5	-2.6	17.8	0.2	-1.5	-4.7
Real ER (PPI-based)	6.3	-2.3	-9.9	-13.7	-3.6	17.6	-0.8	-2.4	-4.9
Average gross wages, real (PPI based)	6.7	8.3	2.8	-6.8	3.7	5.0	5.1	5.9	2.8
Average gross wages, real (CPI based)	8.4	4.8	1.2	-9.3	0.7	3.0	4.1	4.9	1.0
Average gross wages, EUR (ER)	16.6	5.7	-9.2	-21.5	-1.6	23.4	6.6	4.6	-2.9
Employed persons (LFS)	1.0	-0.2	0.2	-0.4	0.1	-0.4	0.3	0.3	0.1
GDP per empl. person, NC at 2010 ref. pr.	2.4	1.5	0.5	-2.4	-0.3	2.1	1.4	1.7	0.3
Unit labour costs, ER (EUR) adjusted	13.9	4.2	-9.6	-19.6	-1.2	21.0	4.6	3.6	-3.2
Ukraine 5)									
GDP deflator	8.0	4.3	15.9	38.9	16.5	11.6	7.9	3.6	16.1
Exchange rate (ER), EUR/NC	8.0	-3.2	-32.5	-35.1	-14.4	-2.4	-9.4	-3.0	-17.1
Real ER (CPI-based)	5.9	-4.9	-24.7	-3.5	-2.7	5.9	-5.5	-0.2	-6.6
Real ER (PPI-based)	8.9	-3.2	-19.4	-9.6	4.9	12.1	-3.8	1.7	-4.2
Average gross wages, real (PPI based)	10.8	8.0	-9.5	-11.4	2.5	10.7	2.4	1.1	-0.3
Average gross wages, real (CPI based)	14.2	8.2	-5.4	-18.9	8.5	15.2	4.2	3.1	0.6
Average gross wages, EUR (ER)	24.1	4.4	-28.4	-21.8	5.8	25.5	0.0	4.3	-5.2
Employed persons (LFS)	0.1	0.2	-6.4	-0.4	-1.2	0.0	0.6	0.3	-1.5
GDP per empl. person, NC at 2010 ref. pr.	0.0	-0.2	-0.2	-9.4	3.1	2.5	2.4	2.7	-1.4
Unit labour costs, ER (EUR) adjusted	24.1	4.6	-28.3	-13.7	2.6	21.2	-2.1	2.2	-3.8
Austria									
GDP deflator	2.0	1.6	1.8	1.9	1.5	1.4	1.6	1.8	1.7
Real ER (CPI-based)	-0.2	0.5	1.2	0.9	0.6	-0.1	0.0	-0.2	0.6
Real ER (PPI-based)	-1.9	-0.8	0.9	1.0	-0.3	1.3	-0.1	-0.2	-0.2
Average gross wages, real (PPI based)	2.2	3.0	3.6	3.6	3.4	0.3	0.1	0.1	3.1
Average gross wages, real (CPI based)	0.7	0.1	0.8	1.2	0.5	0.0	0.0	0.1	0.6
Average gross wages, EUR (ER)	3.1	2.1	2.5	2.1	1.4	1.7	1.7	1.9	2.2
Employed persons (LFS)	0.8	0.5	0.2	0.9	1.5	1.2	0.9	1.2	0.8
GDP per empl. person, NC at 2010 ref. pr.	0.0	-0.4	0.4	0.1	0.1	0.3	0.4	0.4	0.0
Unit labour costs, ER (EUR) adjusted	3.2	2.5	2.0	2.0	1.4	1.4	1.3	1.5	2.2

4) From 2014 including Crimean Federal District (for LFS employment and wages from 2015), growth rates comparable. -
5) From 2014 excluding the occupied territories of Crimea and Sevastopol and from 2015 parts of the anti-terrorist operation zone, growth rates comparable.

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

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

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